

## 8. FISCAL POLICY AND BUDGETARY OPERATIONS

### 8.1 Overview and Policy Strategy

The 1997 budgetary policies were formulated with the objective of making further progress towards firm fiscal consolidation. The primary emphasis was placed on reducing the fiscal deficit in 1997, while correcting existing weaknesses in fiscal management, with a firm commitment to the continuation of the privatisation programme. Accordingly, a cleaning of public accounts, rationalisation of off-budget transactions, strengthening of financial controls and accountability, improving of revenues, reduction of wasteful expenditure, elimination of corruption and consolidation of social expenditures were expected. The budget deficit was expected to be financed through non-inflationary sources. Considerable progress was made in 1997. The growth of expenditure was contained and the privatisation programme proceeded successfully. The overall fiscal deficit was reduced to below the target set for the year, enabling a net reduction in debt to the banking system with a larger reduction in government debt to the Central Bank. These achievements, together with a cautious monetary policy adopted in 1997, helped to maintain a relatively stable domestic financial market in a highly unstable global environment which was triggered by the East Asian financial crisis. The 1998 Budget was presented, within a relatively favourable macroeconomic environment, with a view to further strengthening these achievements and accelerating economic development.

The overall budget deficit (after grants) was brought down to 4.5 per cent of GDP which was a 3.3 percentage point reduction compared to a deficit of 7.8 per cent in 1996. Compared to the original Budget target, the overall budget deficit in 1997 was lower by 1.6 per cent of GDP. This improvement was the outcome of the larger than expected receipts from privatisation (Rs.22,535 million), improved collection of non-tax revenues, improved cash management with strict control over unproductive, wasteful expenditures and supplementary expenditure and interest savings due to retirement of high cost debt. The upward adjustment of wheat flour prices by 12 per cent from Rs.16.95 per kg. to Rs.18.95 per kg. and revision of the fertiliser subsidy targeting it at low-income farmers in the agriculture sector also contributed to contain the growth of recurrent expenditure in 1997. Besides this, project implementation delays, particularly in port development, power, energy and telecommunication, resulted in a shortfall in capital expenditure and affected the utilisation of foreign aid.

The demand for domestic resources by the Government to finance the deficit was significantly curtailed in 1997, reducing the crowding out impact. The proceeds of the Floating Rate Notes (FRN) issue, amounting to US dollars 50 million, were also available to meet infrastructure expenditure. The use of privatisation proceeds to retire high cost public debt and the commitments made to reduce the statutory limit of Treasury bills from Rs.125 billion to Rs.115 billion, enhanced the credibility of fiscal policy. The 1998 Budget expects to make further progress in privatisation and to use such divestiture proceeds for further retirement of public debt. Reflecting the retirement of debt, Treasury bill holdings of the Central Bank declined from Rs.17,100 million at end 1996 to Rs.7,222 million at end 1997. Part of the privatisation proceeds was also placed in a special deposit with the Central Bank. The outcome was a reduction in net credit to the Government from the Central Bank by Rs.13,991 million. However, net credit to government by the entire banking system declined by Rs.2,172 million as commercial bank holdings of Treasury bills increased after the reduction of the statutory reserve requirement. In addition, the Government's stock of administrative borrowings was reduced by Rs.6,654 million in 1997. The 1998 Budget has targetted an overall deficit of 6.5 per cent of GDP (excluding privatisation). This deficit is expected to be reduced to 4 per cent of GDP by the year 2000.

The Government continued with tax policy reforms aiming at a simple, broad based and transparent tax structure. Reforms in the income tax structure continued in order to promote investments and to broaden the base, through improved tax compliance and tax administration. The distortionary dual threshold system of Rs.100,000 for non-employment income and Rs.144,000 for employment income was replaced with a uniform system with a tax threshold of Rs.144,000 for all tax payers. The lower tax slabs, which were subject to concessionary rates, were widened from Rs.35,000 to Rs.100,000. This shifted the annual income level for the highest marginal tax rate from Rs.205,000 for non-employment income earners and Rs.249,000 for employment income earners to over Rs.444,000 for both categories, giving substantial relief to personal income tax payers. The withholding tax on interest income was also reduced from 15 per cent to 10 per cent. The liability to pay PAYE tax was re-imposed on employees in commercially oriented public corporations as this tax liability had been paid by the respective institutions since 1993. Concessions were granted to retirees on their terminal benefits by raising the limit on which concessionary rates were applicable from Rs.1.5 million to Rs.1.8 million and also by widening the bands. In addition, tax administration was improved to

recover PAYE taxes and income tax arrears. To promote foreign investment, tax exemptions were granted on equity income in joint ventures. Tax holidays were granted to firms investing in high technology projects.

The turnover tax structure was revised to facilitate a smooth transition towards a Goods and Services Tax (GST). The 6 per cent and 10 per cent tax rate bands were gradually raised upward to 8 per cent and 12 per cent, respectively, to avoid significant price changes with the introduction of the GST, as the GST was to be a single moderate rate of 12.5 per cent. Petroleum products such as diesel and kerosene were exempted from turnover tax (TT), while the excise tax on diesel was adjusted upwards to prevent revenue loss. All varieties of hard liquor and selected passenger motor vehicles were brought under the Excise (Special Provisions) Act, by imposing a 10 per cent and a 5 per cent tax, respectively.

The proportion of production that had to be exported to make an industry eligible for tax concessions was lowered, to expand the coverage of incentives to the export sector, by way of tax and duty concessions on capital and intermediate goods imports. In order to promote investment, a higher investment tax allowance, an accelerated depreciation allowance on plant, machinery and equipment and a reduction of the national security levy on import of machinery and equipment from 2 per cent to 0.5 per cent, were granted. With a view to promoting capital and share market development, the stamp duty on quoted share transactions was abolished, full imputation credit on dividends distributed by quoted public companies was granted and investors were permitted to set off the depreciation allowance on leased assets against leasing income. Sector specific packages of tax concessions were introduced to encourage investment in priority areas such as advanced technology projects, computer technology and labour intensive projects in remote areas.

A Presidential Tariff Commission was appointed to make recommendations on tariff reforms to rationalise the industrialisation strategy within the context of the emerging international environment. A partial duty waiver of 10 percentage points was given on petroleum products to help contain domestic price increases. In view of the high domestic prices, full and partial duty waivers were granted on some consumer goods such as sugar, rice, potatoes and onions. On imported motor vehicles, the allowable maximum depreciation was reduced to 30 per cent of the FOB value from 90 per cent. As various custom duty exemptions were being abused, a levy equivalent to the 3-month Treasury bill rate was introduced where cases of abuse were detected.

To simplify taxes, stamp duties were made uniform at 2 per cent across a wide range of documents. The dual levy

on diesel motor vehicles was unified at Rs.5,000 per annum. Turnover tax on financial instruments was also unified at 2 per cent.

Administration fees and charges were revised upward on the basis of the 'user pays' principle. Postal rates were increased and the use of free postal facilities was restricted to government institutions and Members of Parliament. Sundays and public holidays were made non-business days for post offices to contain heavy operational losses. An inflation adjusted lease rental scheme was introduced for privatised plantation companies and appropriate levies were imposed on commercially viable public enterprises. In addition, the rate of social security contributions by employees was increased by 1 percentage point to enhance the employees' participation in the Widows and Orphans Pension (W&OP) programme.

On the expenditure side, unproductive or least productive expenditure in selected areas such as travelling, fuel and lubricants, other office equipment, transport, communication utilities and other supplies was cut by 20 per cent, except in the case of expenditure on health and national security. Provision for the purchases of motor vehicles by government institutions was frozen. The debt profile improved with the retirement of high cost public debt comprising Rs.10,000 million of Treasury bills held with the Central Bank and other debt to the two state banks. Wheat and fertiliser subsidy expenditures were contained with an upward adjustment of the wheat flour price and better targeting of the fertiliser subsidy. Public investment was targetted at 6.8 per cent of GDP, but the actual investment was only 5.8 per cent. An Infrastructure Development Fund was established to mobilise resources for private sector infrastructure projects. Private sector participation in infrastructure projects was encouraged under BOO/BOT policies.

The public enterprise reform programme progressed well with privatisation proceeds reaching Rs. 22,535 million against the original budgetary target of Rs. 5,000 million. The privatisation of Sri Lanka Telecom and two salt companies and the sale of convertible debentures of the National Development Bank and plantation company shares were undertaken in 1997. In 1998, further retirement of public debt is expected, using divestiture proceeds.

Improved fiscal performance, together with the reduction of the Statutory Reserve Requirement (SRR), helped to bring down interest rates. The weighted average yield rate on Treasury bills (1 year bills) dropped from 17.11 per cent at the beginning of the year to 10.17 per cent at the end of the year. Interest rates on Rupee Loans were also adjusted downward from 14.5 per cent at the beginning of the year to 11.25 per cent at the end of 1997.

A new medium term marketable debt instrument, i.e. 'Treasury bonds', was introduced in March 1997 and these were issued fortnightly. The coupon rate on these instruments was also adjusted downward from 14.5 per cent in early 1997 to 11.50 per cent by end 1997 in line with changing market interest rates. The benefits of this reduction of the interest structure would largely be seen in the 1998 budgetary outcome. New domestic resources for deficit financing in 1997 came entirely through Rupee Loans and Treasury bonds. The Government announced its intention in the 1998 Budget to reduce the Treasury bill limit from Rs.125 billion to Rs.115 billion and to improve the medium and long-term debt security market. The issue of Floating Rate Notes (FRN) amounting to US dollars 50 million in the international market for financing infrastructure development projects, as well as a benchmarking exercise, was fully subscribed reflecting foreign investor confidence. The underutilisation of foreign resources continued to be a key issue that needs to be addressed effectively.

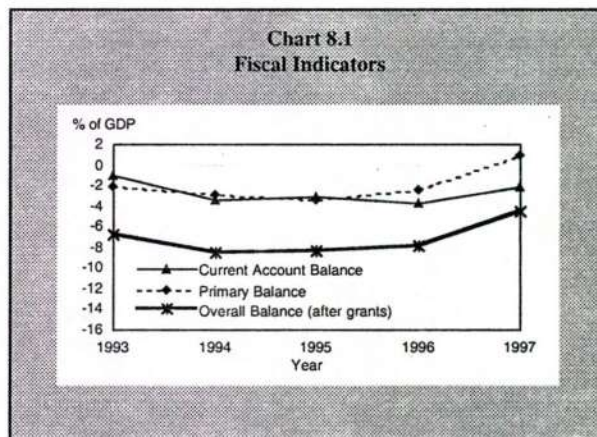
## 8.2 Budget Out-turn

The budgetary operations in 1997 showed significant improvement. The current account deficit declined to 2.2 per cent from 3.8 per cent of GDP in 1996, entirely attributed to the reduction of recurrent expenditure as a ratio of GDP. The overall budget deficit (after grants) declined to 4.5 per cent of GDP from 7.8 per cent of GDP in 1996.

Government revenue collection, as a percentage of GDP, declined from 19.0 per cent in 1996 to 18.5 per cent due to the reduction in tax revenue. Tax revenues from major revenue sources such as income tax, import duty and the national security levy indicated only a slow growth due to increases in the tax exemption thresholds, reduction of tax rates, exemption from taxes and duty waivers granted during the year. Despite the increase in the excise tax rate on liquor and cigarettes, tax revenues did not increase as expected due to the drop in production and sale of these products in 1997. Non-tax revenue recorded a sharp increase owing to timely collection and recovery of arrears in respect of interest, levies, profits and dividends. Non-tax revenue accounted for 2.3 per cent of GDP in 1997 compared to 2.1 per cent in 1996.

The measures taken to rationalise current expenditure, revise wheat flour prices upward and target the development and household welfare programmes for the needy in a better manner, helped to contain the growth of recurrent expenditure at 20.7 per cent of GDP compared to 22.8 per cent of GDP in 1996. Security expenditure as a per cent of GDP also declined from 5.9 per cent in 1996 to 5.1 per cent in 1997. The continuous reduction of current expenditure

during the recent past, from 23.5 per cent of GDP in 1995 to 22.8 per cent of GDP in 1996 and to 20.7 per cent in 1997, reflects the effectiveness of improved cash management and fiscal discipline.



The benefits in the reduction of interest rates and the retirement of public debt on interest payments were partly reflected in 1997. The full benefits will be reflected in 1998. Interest costs as a proportion of GDP, declined marginally to 6.2 per cent of GDP from 6.4 per cent in 1996. Interest costs represented 30 per cent of total current expenditure and absorbed 34 per cent of total revenue and continued to be a large burden on the Government. A surplus in the primary account of 0.9 per cent of GDP in 1997, as against a deficit of 2.4 per cent in 1996, was a notable development in the fiscal front. In addition, a sustainable reduction in the budget deficit is necessary to achieve a further substantial reduction in interest cost.

Public investment (the sum of capital expenditure and on lending) declined to 5.8 per cent of GDP against the expected target of 6.8 per cent of GDP in the 1997 Budget. This was reflected largely in a reduction of on lending. The repayments on account of previous on lending were higher in 1997. Capital expenditure was maintained at the 1996 level. The Government has to maintain capital expenditure in some areas such as roads while permitting the gradual entry of the private sector into areas where they can perform better.

There has been a significant level of underutilisation of available foreign resources, which are almost entirely of a concessionary nature, due to delays in project implementation, disputes at project implementing agencies, lack of domestic funds to absorb foreign resources etc. The amount of foreign grants and loans used in financing the deficit in 1997 was only 1.9 per cent of GDP, indicating a decline from the previous year's level of 2.3 per cent of GDP.

**TABLE 8.1**  
**Summary of Government Fiscal Operations**

	Rs. Million						
	1993	1994	1995	1996	1997 Approved Estimates	1997 Provi- sional	1998 Approved Estimates
<b>Total Revenue and Grants</b>	106,364	118,295	145,286	154,018	180,944	172,365	197,438
<b>Total Revenue</b>	98,339	110,038	136,258	146,279	170,736	164,865	188,438
Tax Revenue	85,891	99,417	118,543	130,202	151,451	144,006	164,049
Non Tax Revenue	12,448	10,621	17,715	16,077	19,285	20,860	24,389
<b>Grants</b>	8,025	8,257	9,028	7,739	10,208	7,500	9,000
<b>Expenditure and Lending minus Repayments</b>	140,460	167,768	200,482	213,932	235,570	212,362	247,085
<b>Current</b>	102,288	127,084	154,159	175,149	183,621	184,746	187,091
Capital	33,662	30,391	41,722	37,638	47,879	44,167	57,338
Lending minus Repayments	4,510	10,293	4,601	1,145	4,070	-16,551	2,656
<b>Current Account Surplus/Deficit(-)</b>	-3,949	-17,046	-17,901	-28,871	-12,885	-19,881	1,347
<b>Budget Deficit (before grants &amp; without privatisation)</b>	-43,321	-60,726	-67,225	-72,382	-69,834	-70,032	-66,647
<b>Budget Deficit (after grants &amp; with privatisation)</b>	-34,096	-49,473	-55,196	-59,914	-54,626	-39,997	-49,647
<b>Financing</b>	34,096	49,473	55,196	59,914	54,626	39,997	49,647
<b>Foreign Borrowings</b>	9,855	11,778	21,224	10,160	14,194	9,722	16,426
<b>Domestic Borrowings</b>	24,241	37,696	33,972	49,754	40,432	30,275	33,221
<b>Market Borrowings</b>	22,229	38,362	33,424	39,391	40,432	39,644	33,221
Non Bank	28,308	37,205	26,359	26,301	40,432	41,816	33,221
Bank	-6,079	1,157	7,065	13,090	-	-2,172	-
Monetary Authority	-13,657	1,764	7,662	9,873	-	-13,991	-
Commercial Banks	7,578	-607	-597	3,218	-	11,820	-
Other Borrowings	2,012	-666	548	10,363	-	-9,369	-
<b>Memorandum item: Budget Deficit (before grants, with privatisation)</b>	-42,121	-57,730	-64,224	-67,653	-64,834	-47,497	-58,647
As a percentage of GDP							
<b>Total Revenue and Grants</b>	21.3	20.4	21.8	20.0	20.3	19.4	19.2
<b>Total Revenue</b>	19.7	19.0	20.4	19.0	19.1	18.5	18.4
Tax Revenue	17.2	17.2	17.8	16.9	17.0	16.2	16.0
Non Tax Revenue	2.5	1.8	2.7	2.1	2.2	2.3	2.4
<b>Grants</b>	1.6	1.4	1.4	1.0	1.1	0.8	0.9
<b>Expenditure and Lending minus Repayments</b>	28.1	29.0	30.0	27.8	26.4	23.8	24.1
<b>Current</b>	20.5	21.9	23.1	22.8	20.6	20.7	18.2
Capital	6.7	5.2	6.2	4.9	5.4	5.0	5.6
Lending minus Repayments	0.9	1.8	0.7	0.1	0.5	-1.9	0.3
<b>Current Account Surplus/Deficit(-)</b>	-0.8	-2.9	-2.7	-3.8	-1.4	-2.2	0.1
<b>Budget Deficit (before grants &amp; without privatisation)</b>	-8.7	-10.5	-10.1	-9.4	-7.8	-7.9	-6.5
<b>Budget Deficit (after grants &amp; with privatisation)</b>	-6.8	-8.5	-8.3	-7.8	-6.1	-4.5	-4.8
<b>Financing</b>	6.8	8.5	8.3	7.8	6.1	4.5	4.8
<b>Foreign Borrowings</b>	2.0	2.0	3.2	1.3	1.6	1.1	1.6
<b>Domestic Borrowings</b>	4.9	6.5	5.1	6.5	4.5	3.4	3.2
<b>Market Borrowings</b>	4.4	6.6	5.0	5.1	4.5	4.5	3.2
Non Bank	5.7	6.4	3.9	3.4	4.5	4.7	3.2
Bank	-1.2	0.2	1.1	1.7	-	-0.2	-
Monetary Authority	-2.7	0.3	1.1	1.3	-	-1.6	-
Commercial Banks	1.5	-0.1	-0.1	0.4	-	1.3	-
Other Borrowings	0.4	-0.1	0.1	1.3	-	-1.1	-
<b>Memorandum item: Budget Deficit (before grants, with privatisation)</b>	-8.4	-10.0	-9.6	-8.8	-7.3	-5.3	-5.7

Source: Central Bank of Sri Lanka

The mobilisation of domestic resources in 1997 was mainly through market-based instruments. The Government has made a firm commitment to reduce the Treasury bill limit by Rs.10,000 million to Rs.115,000 million. This would help improve the medium and long-term securities market. Government securities were shifted towards greater market orientation by a gradual process of replacing traditional non-marketable Rupee Loans by Treasury bonds. In 1997,

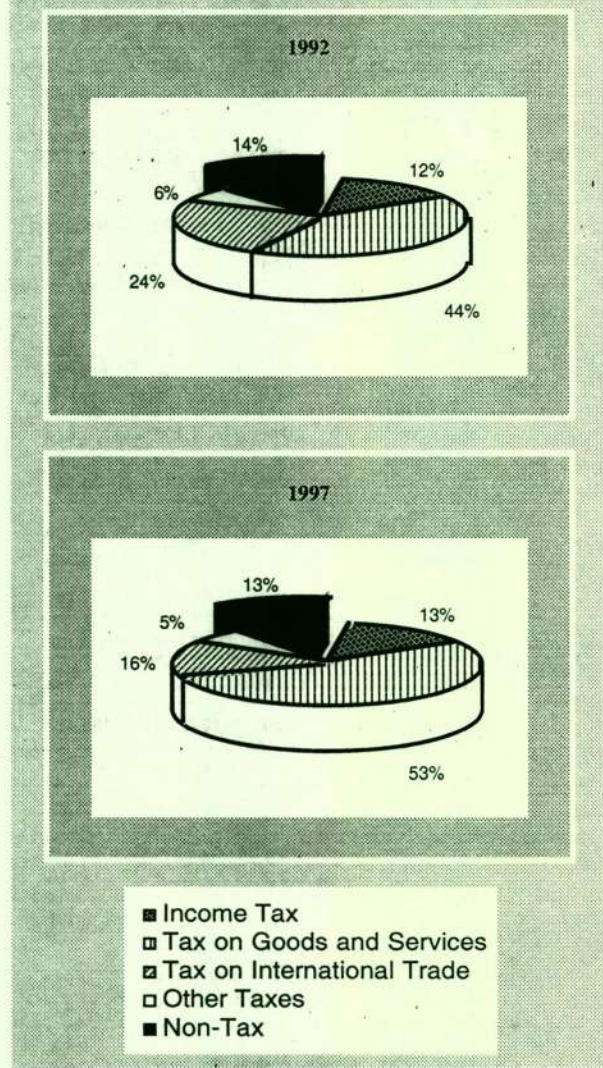
Treasury bonds amounting to Rs.10,000 million were issued. Rupee Loans amounting to Rs.48,500 million were also issued during the year. Of this, Rs.15,000 million was used for repayment of maturing Rupee Loans. All Rupee Loan issues were subscribed by statutory funds and public institutions such as the EPF, NSB, ETF, public sector provident funds (PSPF) and the insurance corporations. The EPF and the NSB invested Rs.42,759 million in Rupee

**TABLE 8.2**  
**Summary of Revenue by Component**

Item	Rs. Million						
	1993	1994	1995	1996	1997 Approved Estimates	1997 Provi- sional	1998 Approved Estimates
<b>Tax Revenue</b>	<b>85,891</b>	<b>99,417</b>	<b>118,543</b>	<b>130,202</b>	<b>151,451</b>	<b>144,006</b>	<b>164,049</b>
Income Taxes	12,543	15,277	17,161	20,751	21,345	20,847	24,064
Personal	5,235	5,621	7,358	7,315	7,825	7,958	8,639
Corporate	7,308	9,656	9,803	13,311	13,120	12,563	14,850
Save the Nation Contributions	-	-	-	125	400	326	575
Taxes on Property	3,493	4,386	5,162	5,279	6,788	7,754	8,056
Tax on Treasury Bills held by Central Bank	1,073	471	1,050	1,604	350	1,080	-
Taxes on Domestic Goods and Services	47,963	56,695	70,797	77,105	92,883	87,699	100,968
General Sales and Turnover Tax	29,663	32,300	36,429	37,631	43,478	43,257	47,130
Manufacturing	9,231	9,171	9,906	8,874	12,023	9,509	10,255
Non-Manufacturing	4,825	6,445	7,074	9,711	8,922	13,362	10,800
Imports	15,607	16,684	19,449	19,046	22,532	20,386	23,975
Excise Tax	11,655	14,632	19,436	22,067	28,936	26,050	31,464
Liquor	4,063	4,686	6,298	5,839	7,780	6,187	8,369
Tobacco	6,866	7,868	8,788	12,833	15,175	14,804	16,295
Other	726	2,058	4,350	3,395	5,981	5,059	6,800
Defence Levy	6,589	9,693	14,408	16,441	18,426	17,274	20,500
Licence Fees	56	60	524	966	2,043	1,118	1,874
Taxes on International Trade	20,819	22,598	24,373	25,464	30,085	26,626	30,961
Imports	20,762	22,598	24,365	25,459	30,085	26,626	30,961
Exports	57	-	8	5	-	-	-
<b>Non-Tax Revenue</b>	<b>12,448</b>	<b>10,621</b>	<b>17,715</b>	<b>16,077</b>	<b>19,453</b>	<b>20,690</b>	<b>24,389</b>
Property Income	8,154	7,360	12,011	10,059	12,271	14,690	15,178
of which: Central Bank Profits	1,000	1,200	1,200	1,700	1,500	1,500	2,650
Interest Income	4,390	4,560	6,991	5,222	6,496	7,752	7,108
Fees and Charges	1,303	988	1,751	2,827	3,009	2,248	2,858
Other Non-Tax Revenue	2,991	2,273	3,953	3,191	4,173	4,022	6,353
<b>Total Revenue</b>	<b>98,339</b>	<b>110,038</b>	<b>136,258</b>	<b>146,279</b>	<b>170,904</b>	<b>164,696</b>	<b>188,438</b>
As a percentage of GDP							
<b>Tax Revenue</b>	<b>17.2</b>	<b>17.2</b>	<b>17.8</b>	<b>16.9</b>	<b>17.0</b>	<b>16.2</b>	<b>16.0</b>
Income Taxes	2.5	2.6	2.6	2.7	2.4	2.3	2.3
Personal	1.0	1.0	1.1	1.0	0.9	0.9	0.8
Corporate	1.5	1.7	1.5	1.7	1.5	1.4	1.4
Save the Nation Contributions	-	-	-	....	....	....	0.1
Taxes on Property	0.7	0.8	0.8	0.7	0.8	0.9	0.8
Tax on Treasury Bills held by Central Bank	0.2	0.1	0.2	0.2	....	0.1	-
Taxes on Domestic Goods and Services	9.6	9.8	10.6	10.0	10.4	9.8	9.8
General Sales and Turnover Tax	5.9	5.6	5.5	4.9	4.9	4.9	4.6
Manufacturing	1.8	1.6	1.5	1.2	1.3	1.1	1.0
Non-Manufacturing	1.0	1.1	1.1	1.3	1.0	1.5	1.1
Imports	3.1	2.9	2.9	2.5	2.5	2.3	2.3
Excise tax	2.3	2.5	2.9	2.9	3.2	2.9	3.1
Liquor	0.8	0.8	0.9	0.8	0.9	0.7	0.8
Tobacco	1.4	1.4	1.3	1.7	1.7	1.7	1.6
Other	0.1	0.4	0.7	0.4	0.7	0.6	0.7
Defence Levy	1.3	1.7	2.2	2.1	2.1	1.9	2.0
Licence Fees	....	....	0.1	0.1	0.2	0.1	0.2
Taxes on International Trade	4.2	3.9	3.6	3.3	3.4	3.0	3.0
Imports	4.2	3.9	3.6	3.3	3.4	3.0	3.0
Exports	....	-	....	....	-	-	-
<b>Non-Tax Revenue</b>	<b>2.5</b>	<b>1.8</b>	<b>2.7</b>	<b>2.1</b>	<b>2.2</b>	<b>2.3</b>	<b>2.4</b>
Property Income	1.6	1.3	1.8	1.3	1.4	1.6	1.5
of which: Central Bank Profits	0.2	0.2	0.2	0.2	0.2	0.2	0.3
Interest Income	0.9	0.8	1.0	0.7	0.7	0.9	0.7
Fees and charges	0.3	0.2	0.3	0.4	0.3	0.3	0.3
Other Non-Tax Revenue	0.6	0.4	0.6	0.4	0.5	0.5	0.6
<b>Total Revenue</b>	<b>19.7</b>	<b>19.0</b>	<b>20.4</b>	<b>19.0</b>	<b>19.2</b>	<b>18.5</b>	<b>18.4</b>

Source: Central Bank of Sri Lanka

**Chart 8.2**  
**Composition of Revenue – 1990 and 1995**



Loans. They also invested Rs.4,792 million in Treasury bonds, thus accounting for 81 per cent of the gross borrowings of the Government in 1997. Net credit to the government from the banking system was a net repayment of Rs.2,172 million in 1997. The contractionary impact of budgetary operations was, however, much larger, as there was a Rs.13,991 million repayment of net credit to the Government by the Central Bank.

### 8.3 Revenue and Grants

In 1997, revenue increased by 13 per cent to reach Rs.164,865 million. Tax revenue, at Rs.144,006 million, recorded a growth of 11 per cent as in the previous year. Non-tax revenue showed a substantial increase of 30 per

cent, owing to the increase in property income and the levies imposed on selected public enterprises (such as Bank of Ceylon, Ports Authority etc.) during 1997. Foreign grants utilised for budgetary purposes were estimated at Rs.7,500 million compared to Rs.7,739 million in 1996.

### Tax Revenue

Most of the tax revenues in Sri Lanka are in the forms of indirect taxes as many sectors have been exempted from income taxes. Indirect taxes account for 86 per cent of total tax revenue. However, in order to reduce the regressivity of the tax structure, many essential consumer goods including most food items have been exempted from taxation. However, this has made the tax structure less transparent. The Goods and Services Tax is expected to correct some of these weaknesses.

Tax revenue as a ratio of GDP declined from 16.9 per cent in 1996 to 16.2 per cent in 1997. As a share of total revenue too, tax revenues declined to 87 per cent from 89 per cent in 1996. This was due to the slow growth of revenues from import duty, the national security levy (NSL), income tax, excise tax on cigarettes and excise duty on liquor. Tax revenues from domestic goods and services such as the turnover taxes, NSL, excise tax and licence fees increased by 14 per cent and their share in total tax revenue increased to 61 per cent from 59 per cent in 1996. These amounted to 9.8 per cent of GDP.

The NSL, which was applicable to all goods other than exports and on selected services, generated Rs.17,274 million (1.9 per cent of GDP) recording a 5 per cent increase. Revenue from this source accounted for 12 per cent of total tax collections. Despite the reduction of the NSL on imports of machinery and equipment from 2 per cent to 0.5 per cent, collections from imports recorded a 13 per cent increase in 1997, reflecting the higher import growth in 1997.

Revenue from turnover taxes, at Rs.43,257 million, increased by 15 per cent, mainly due to increased collection from the non-manufacturing sector and the realisation of the full impact of an increase in the tax rate bands from 6 per cent and 10 per cent to 7 per cent and 11 per cent, respectively. To facilitate the move to GST these rates were further revised (the 7 per cent and 11 per cent tax bands to 8 per cent and 12 per cent and the 20 per cent tax band to 18 per cent) from November 1997. This had a positive impact on revenues. Turnover taxes accounted for 30 per cent of total taxes in 1997. Turnover tax collections from the manufacturing sector increased by 7 per cent in 1997. Turnover-tax collections from the non-manufacturing sector increased by 38 per cent, reflecting the rapid expansion of

## Box 7

## Tax Compliance

Realised tax revenue depends on the tax base, tax rate and the tax compliance rate. The tax base (the value of all items subject to taxation) varies with the growth of the economy and with the changes in tax policies. Tax rates have been revised downward recently with the long-term objective of simplifying the tax system, leading to a uniform tax. Tax rates have also been lowered with a view to increasing tax compliance and offering incentives to investors. In the context of simplifying the tax structure and reduction of the tax rate, the increase of tax revenue has become increasingly dependent on the rate of tax compliance and the supply response to tax reductions.

Tax compliance is the voluntary adherence to tax laws relating to filing compliance, payment compliance and reporting compliance. Filing compliance is the submission of duly completed tax returns on the due date. The date of filing tax returns varies according to the type of tax. For example, income tax is calculated on an annual basis and is paid quarterly. Tax returns are filed annually. Payment compliance is the payment of tax or tax instalment on or before the due date without falling into arrears. Reporting compliance is reporting the taxable income and other details and the tax payable accurately in the tax returns without under-reporting to evade tax. Achieving 100 per cent tax compliance in all these areas is the ideal situation. Where voluntary compliance levels are low and unsatisfactory, the tax administration will be compelled to apply enforcement measures that are accompanied by additional costs incurred in deploying its limited human and financial resources. In addition, in enforcing these measures, bottlenecks are bound to arise affecting effectiveness of the tax administration system.

Filing compliance in Sri Lanka has been low, that

is, it has remained around 50 - 60 per cent even after one month of the due date. This phenomenon is particularly evident in respect of income tax. The table below gives the filing compliance rates during the past few years. It has increased to around 90 per cent only after 13 months from the due date.

The tax filing compliance rate in Sri Lanka compares poorly with developed countries where 96 per cent of known tax payers file their returns on the due date, 98 per cent one month later and 100 per cent within two months.

Payment compliance of taxes in Sri Lanka has also not been encouraging, particularly in respect of payment of income tax by non-salary earners where a greater degree of self assessment is involved. Income tax arrears have remained at more than 1/3 of the total collection.

Even though reliable data on the extent of under-reporting of taxes are not available, under-reporting is known to be extensive. Tax evasion is believed to be prevailing widely among those persons whose incomes do not enter into proper records. These categories mainly include professionals who provide services on payment and traders who do not issue proper receipts.

The relatively low tax compliance in Sri Lanka is attributed to the following factors.

*Complicated tax structure:* If the tax system is complicated and revised often, taxpayers will not understand it and they will have difficulties in self-assessment. The taxpayer should be able to calculate his tax liability without much difficulty.

TABLE 1  
Compliance in Filing Returns

	Percentages					
	1991	1992	1993	1994	1995	1996
Income Tax						
1 month after the filing date	51	55	58	59	53	53
13 months after the filing date	81	90	90	87	90	89
Turnover Tax						
3 months after the filing date	68-70	75-78	78-80	77-81	77-81	77-80

Source: Department of Inland Revenue

Box 7 (contd.)

TABLE 2  
Default in Tax Payment

Type of Tax	Percentages				
	1993	1990	1994	1995	1996
Total Default as % of Total Tax Revenue	37.03	31.53	12.04	11.53	13.79
Total Income Tax Default as % of Total Income Tax Collection	67.11	73.60	31.00	35.49	37.66
Total Turnover Default as % of Total Turnover Tax Collection	4.95	12.70	5.82	5.27	4.90

Source: Department of Inland Revenue

*High marginal tax rates:* A high marginal tax rate makes tax compliance more expensive and leads to corruption in the tax administration.

*Lack of knowledge of the taxpayers about their obligations:* The taxpayer should understand the importance of paying taxes and the cost of not paying the taxes on the due dates.

*Social attitude towards tax evasion:* In Sri Lanka, tax evasion, non-filing and delay in payments are not considered anti-social. Having to pay the penalties is not regarded as a serious offence by society.

*Equity and fairness of the tax system:* A tax system should be recognised and accepted by the public as fair and equitable for better tax compliance. If some important sectors and persons evade payment of tax and delay payments for excessively long periods through exemptions etc., there is a genuine cause for non-compliance by others. Granting of tax amnesties at regular intervals affects tax compliance. It contributes to inequality, which discourages the voluntary genuine taxpayers. Similarly, discriminatory treatment to taxpayers in the same category also lowers tax compliance.

*Level of efficiency of the tax administration:* Tax personnel have to be courteous and efficient in the administration of tax laws. Compliance and enforcement measures complement each other and, if they are effective, the delinquent as well as law-abiding taxpayers would have no better option than to comply with tax laws.

Some measures have been taken to improve tax compliance. They include certain simplifications to the tax structure by reducing the number of tax brackets,

an increase of the tax threshold, computerisation of tax collection procedures etc. Yet, further measures can be taken to improve tax compliance. Among these would be:

Tax laws should be simplified further and the tax authorities should issue clear guidelines to the taxpayers in simple language.

Errant taxpayers should be dealt with appropriately. They should be identified effectively to keep the good taxpayers honest and deterrent penalties should be imposed on defaulters.

The tax administrators should be given a training to maintain good relations with taxpayers and taxpayers must be kept alert by tax inspectors.

There should be an efficient system of accounting and tax audit. Measures should be developed to prevent backlogging of uncollected taxes.

Exemptions and waivers that make it difficult to track down tax evaders and tax frauds should be minimised.

Taxpayers should be educated about the various taxes and the importance of abiding by tax laws and the consequences of non-compliance. The media and public seminars etc. can be used for these public awareness programmes. These educational programmes and taxpayer assistance programmes could reach even the level of secondary schools.



certain activities in the sector such as electricity, telecommunication, air travel and hotel services. The unification of the turnover tax on banking and financial institutions at 2 per cent from November 1996 and further reduction to 1 per cent from November 1997 had a negative impact on revenue. The revenue from turnover tax on imports registered a moderate growth of 7 per cent in spite of the increase in the total value of imports by 15 per cent in 1997. A moderate growth in dutiable imports (7 per cent) due to the duty waivers and turnover tax exemptions granted for certain imports such as machines used for packing milk, tea bags and meat, yarn, colour separators used in the tea industry, tankers, bowsers and trucks, and the reduction of the mark-up from 25 per cent to 10 per cent from November 1997 were mainly responsible for this slow growth.

Excise taxes increased by 18 per cent and accounted for 18 per cent of tax revenue. The excise tax collection from cigarettes increased by 15 per cent in 1997 compared to a 46 per cent growth in the previous year. This slowing of tax collections from cigarettes despite an upward revision of the excise tax by 7 per cent, was due to a 6 per cent drop in sales of cigarettes. The reduction of legal sales of cigarettes indicates that high taxes have dampened the consumption of cigarettes, as the tax level on cigarettes has already reached a prohibitive level. This has led to an expansion of illegal cigarette sales. Despite the total production of all the major varieties of hard liquor, except blended arrack, declining by 18 per cent, the upward revision of excise duty on hard liquor and the increase in the production of beer by 19 per cent contributed to increase the excise tax collections from liquor by 6 per cent. The revenue obtained under the Excise (Special Provision) Act showed a marked increase of 49 per cent, mainly due to the replacement of a specific type of excise duty on selected petroleum products by an ad valorem duty at a higher tax rate and the introduction of a 10 per cent excise tax on hard liquor and 5 per cent excise tax on the import of selected passenger motor vehicles. Excise duty rates on cigarettes, liquor and selected consumer durables were increased from November 1997 to compensate for the revenue loss due to the reduction in turnover tax from 20 per cent to 18 per cent on such products. Since November 1997, taxation under the Excise (Special Provision) Act has been confined to cigarettes, liquor, motor vehicles and selected petroleum products in order to simplify the tax structure.

Duty collection from imports increased only by 5 per cent in 1997, in spite of a 15 per cent increase in the value of imports, as the share of dutiable imports in total imports declined to 37.1 per cent in 1997 from 39.6 per cent in 1996. A partial duty waiver of 10 per cent on imports of petroleum products from mid January 1997, full and partial duty waivers on imports of mass consumption items such as

sugar, rice, potatoes and onions and the downward revision of tariff rates for bus chassis, timber, agricultural equipment, books etc. were the major factors that slowed down the duty on imports. The average duty rate on total imports had declined from 8.5 per cent in 1996 to 7.4 per cent in 1997, while the effective duty rate on imports dropped from 20.6 per cent to 19.3 per cent. Accordingly, import duty collection as a percentage of GDP declined from 3.3 per cent in 1996 to 3.0 per cent in 1997.

Revenue from income taxes increased marginally in 1997. This was a net outcome of personal taxes increasing by 9 per cent, collection from Save the Nation Contribution (SNC) increasing from Rs.125 million to Rs.326 million and corporate taxes decreasing by 6 per cent. As a percentage of GDP income tax revenue dropped from 2.7 per cent in 1996 to 2.3 per cent in 1997. The increases in the investment tax allowance and the depreciation allowance, together with the other tax concessions granted to the corporate sector, and the upward adjustments of income slabs for personal taxes appear to have slowed down income tax collections.

Stamp duties increased by 47 per cent as a result of adopting a sliding scale stamp duty system, the introduction of a uniform stamp duty rate of 2 per cent across a wide range of documents and the growth of imports. The full impact of the reduction of stamp duty on pro-notes, repurchase agreements relating to Treasury bills, mortgage backed securities and mortgage bonds on lease agreements, which came into effect from November 1997, will be felt in 1998. Despite the unification of the dual type levy on diesel vehicles at the lower level of Rs.5,000 from April 1997, revenue collected from the diesel and luxury tax and other revenues under the Motor Traffic Act increased by 16 per cent due to the increase in the tax liable vehicle stock. Taxes on Treasury bills purchased by the Central Bank declined to Rs. 1,080 million in 1997 as against Rs. 1,604 million collected in 1996, reflecting the reduction in the amount of Treasury bills purchased by the Central Bank and lower interest rates on Treasury bills in 1997.

### Non-Tax Revenue

Non tax revenue showed a sharp increase of 30 per cent and accounted for 13 per cent of total revenue in 1997. This helped to cover up part of the decline in tax revenues from their expected levels. Non-tax revenue increased to 2.3 per cent of GDP from 2.0 per cent in 1996. Increases were seen in interest receipts, profits, dividends and levies. Interest receipts, at Rs.7,752 million, registered an increase of 48 per cent due to the timely payment of interest by institutions such as the CEB (Rs.2,227 million), Sri Lanka Telecom (Rs.2,470 million) and the NDB (Rs.1,229 million). The receipts from profits, dividends and levies amounted to

Rs.4,189 million in 1997 against Rs.2,321 million in 1996. Bank of Ceylon transferred Rs.1,000 million, being collections of repayments of part of the loans for which restructuring bonds were issued in 1993 and part of the interest on these bonds (Rs.636 million). Levies collected under the Finance Act from Bank of Ceylon (Rs.400 million) and the Sri Lanka Ports Authority (Rs.400 million) also contributed to the increase of this revenue in 1997. The upward revision of charges on government publications, registration fees and other administrative fees and the increase in passport fees also helped to increase non-tax revenues. The increase in the employees' contribution to the W&OP by 1 percentage point and revenue sources such as rent and national lotteries contributed to the substantial increase in other non-tax revenue in 1997.

### Foreign Grants

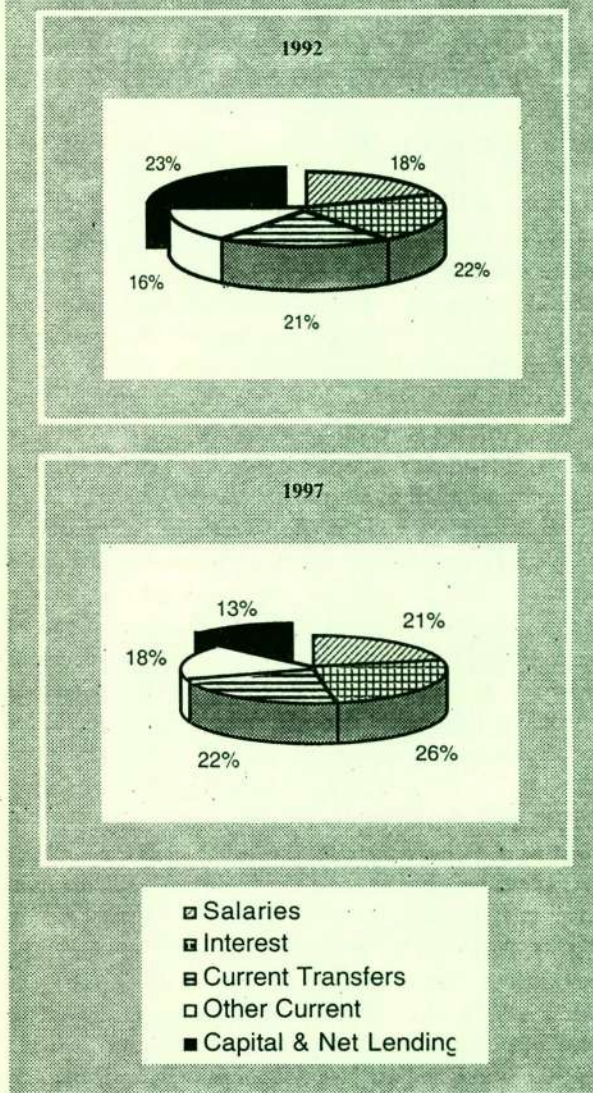
Total foreign grants received for budgetary purposes during 1997 amounted to Rs.7,500 million, a 3 per cent decrease compared to 1996. Grants as a percentage of GDP have been declining and in 1997 these amounted to 0.8 per cent of GDP. Receipts on account of project grants totalled Rs.4,635 million and accounted for 62 per cent of the total grants. Japan has been the largest donor of grants, accounting for 32 per cent of the total grants in 1997.

### 8.4 Expenditure

Total government expenditure and net lending in 1997 at Rs.212,362 million, declined by 0.7 per cent compared to a 7 per cent increase in the previous year. Total expenditure as a percentage of GDP continued to decline in 1997 recording 23.8 per cent compared to 30 per cent in 1995 and to 27.8 in 1996. This was entirely due to the reduction in net lending reflecting the higher privatisation proceeds (Rs.22,535 million) which appear as a negative net lending. Excluding privatisation proceeds, expenditure as a ratio of GDP declined from 28.4 per cent in 1996 to 26.4 per cent in 1997. The outcome of advance account operations was an outpayment of Rs.1,226 million in 1997.

Due to the shortfall which occurred in the on lending programme, public investment declined to 5.8 per cent of GDP from 6.0 per cent in 1996. The growth of current expenditure was contained at 5.5 per cent compared to 13.6 per cent in 1996. This was made possible due to the stricter current expenditure controls including better management of welfare expenditure. Transfers to public corporations declined, reflecting lower expenditures on account of the flour subsidy.

Chart 8.3  
Composition of Expenditure



### Current Expenditure

Current expenditure increased by 5.5 per cent, compared to 13.6 per cent in 1996. As a percentage of GDP, current expenditure declined by 2.1 percentage points in 1997 to 20.7 per cent. Defence expenditure remained virtually at the same level accounting to Rs. 44,971 million and accounted for 21 per cent of the total expenditure. However, as a percentage of GDP, it declined from 5.8 per cent in 1996 to 5.1 per cent in 1997. The expenditure on defence, salaries, pensions and interest on public debt, inclusive of interest payments on long term bonds issued to the two state banks and the National Savings Bank (NSB), accounted for 79 per cent of total current expenditure in 1997.

**TABLE 8.3**  
**Economic Classification of Expenditure and Lending minus Repayment**

Item	Rs. Million						
	1993	1994	1995	1996	1997 Approved Estimates	1997 Provi- sional	1996 Approved Estimates
<b>Current Expenditure</b>	<b>102,288</b>	<b>127,084</b>	<b>154,159</b>	<b>175,148</b>	<b>183,621</b>	<b>184,746</b>	<b>187,091</b>
Expenditure on Goods and Services	44,895	54,700	75,447	80,003	83,086	83,830	85,605
Salaries and Wages	26,332	29,309	34,909	38,332	44,603	44,676	47,855
Other Goods and Services	18,563	25,391	40,538	41,671	38,483	39,154	37,749
Interest payments	30,203	38,031	38,225	48,923	55,492	55,246	55,367
Foreign	5,102	5,511	6,162	6,739	8,338	6,692	7,418
Domestic	25,101	32,520	32,063	42,184	47,154	48,554	47,949
Current transfers and subsidies	27,190	34,180	40,487	46,223	44,044	45,670	45,419
To public corporations	1,571	2,634	7,841	8,232	2,239	2,693	2,374
To public institutions	2,031	1,976	2,182	2,284	3,931	2,657	5,381
To other levels of government	896	1,307	1,157	1,592	1,464	1,941	1,524
To households and other sectors	22,692	28,263	29,307	34,114	35,410	38,379	36,140
Food stamps, food subsidy etc.	4,580	4,654	1,799	591	395	182	375
Janasaviya / Samurdhi	3,685	5,369	5,130	8,591	8,692	8,718	9,670
Pensions	10,516	13,271	14,549	15,465	18,075	17,916	18,285
Fertiliser subsidy	-	630	1,345	1,500	1,500	1,695	1,500
Other	3,911	4,339	6,484	7,967	6,758	9,666	6,310
Provision for under expenditure/Contingency	-	-	-	-	1,000	-	700
<b>Capital Expenditure</b>	<b>33,662</b>	<b>30,391</b>	<b>41,722</b>	<b>37,638</b>	<b>47,879</b>	<b>44,167</b>	<b>57,338</b>
Acquisition of real assets	19,719	16,747	22,589	20,938	28,726	25,653	35,185
Capital transfers	13,943	13,644	19,134	16,701	19,153	18,515	22,153
To public corporations	4,311	4,246	7,614	6,017	6,371	5,890	6,396
To public institutions	8,551	8,433	10,446	9,603	11,532	11,041	13,980
To other levels of government	1,036	914	1,057	1,042	1,200	1,511	1,745
Other	45	51	17	39	50	83	32
Provision for under expenditure	-	-	-	-	-	-	-
<b>Lending minus Repayment</b>	<b>4,510</b>	<b>10,293</b>	<b>4,601</b>	<b>1,145</b>	<b>4,070</b>	<b>-16,551</b>	<b>2,656</b>
Advance accounts	410	2,482	-1,580	630	500	1,226	500
On lending	6,265	10,064	11,087	8,335	12,665	7,278	13,658
Restructuring cost	1,465	3,739	3,191	90	801	2,153	1,500
Privatisation proceeds	-1,200	-2,996	-3,001	-4,728	-5,000	-22,535	-8,000
Loan repayments	-2,430	-2,976	-5,097	-3,182	-4,896	-4,713	-5,002
<b>Total Expenditure and Net Lending</b>	<b>140,460</b>	<b>167,768</b>	<b>200,482</b>	<b>213,931</b>	<b>235,570</b>	<b>212,262</b>	<b>247,085</b>
	As a percentage of GDP						
<b>Current Expenditure</b>	<b>20.5</b>	<b>21.9</b>	<b>23.1</b>	<b>22.8</b>	<b>20.6</b>	<b>20.7</b>	<b>18.2</b>
Expenditure on goods and services	9.0	9.4	11.3	10.4	9.3	9.4	8.3
Salaries and wages	5.3	5.1	5.2	5.0	5.0	5.0	4.7
Other goods and services	3.7	4.4	6.1	5.4	4.3	4.4	3.7
Interest payments	6.0	6.6	5.7	6.4	6.2	6.2	5.4
Foreign	1.0	1.0	0.9	0.9	0.9	0.8	0.7
Domestic	5.0	5.6	4.8	5.5	5.3	5.5	4.7
Current transfers and subsidies	5.4	5.9	6.1	6.0	4.9	5.1	4.4
To public corporations	0.3	0.5	1.2	1.1	0.3	0.3	0.2
To public institutions	0.4	0.3	0.3	0.3	0.4	0.3	0.5
To other levels of government	0.2	0.2	0.2	0.2	0.2	0.2	0.1
To households and other sectors	4.5	4.9	4.4	4.4	4.0	4.3	3.5
Food stamps, food subsidy etc.	0.9	0.8	0.3	0.1	....	....	....
Janasaviya / Samurdhi	0.7	0.9	0.8	1.1	1.0	1.0	0.9
Pensions	2.1	2.3	2.2	2.0	2.0	2.0	1.8
Fertiliser subsidy	-	0.1	0.2	0.2	0.2	0.2	0.1
Other	0.8	0.7	1.0	1.0	0.8	1.1	0.6
Provision for under expenditure/Contingency	-	-	-	-	0.1	-	0.1
<b>Capital Expenditure</b>	<b>6.7</b>	<b>5.2</b>	<b>6.2</b>	<b>4.9</b>	<b>5.4</b>	<b>5.0</b>	<b>5.8</b>
Acquisition of real assets	3.9	2.9	3.4	2.7	3.2	2.9	3.4
Capital transfers	2.8	2.4	2.9	2.2	2.1	2.1	2.2
To public corporations	0.9	0.7	1.1	0.8	0.7	0.7	0.6
To public institutions	1.7	1.5	1.6	1.2	1.3	1.2	1.4
To other levels of government	0.2	0.2	0.2	0.1	0.1	0.2	0.2
Other	....	....	....	....	....	....	....
Provision for under expenditure	-	-	-	-	-	-	-
<b>Lending minus Repayment</b>	<b>0.9</b>	<b>1.8</b>	<b>0.7</b>	<b>0.1</b>	<b>0.5</b>	<b>-1.9</b>	<b>0.3</b>
of which Advance accounts	0.1	0.4	-0.2	0.1	0.1	0.1	....
On Lending	1.3	1.7	1.7	1.1	1.4	0.8	1.3
Restructuring Cost	0.3	0.6	0.5	....	0.1	0.2	0.1
Privatisation Proceeds	-0.2	-0.5	-0.4	-0.6	-0.6	-2.5	-0.8
Loan Repayments	-0.5	-0.5	-0.8	-0.4	-0.5	-0.5	-0.5
<b>Total Expenditure and Net Lending</b>	<b>28.1</b>	<b>29.0</b>	<b>30.0</b>	<b>27.8</b>	<b>26.4</b>	<b>23.8</b>	<b>24.1</b>

Source: Central Bank of Sri Lanka

(a) From 1996 onwards includes interest payments on long-term bonds issued to the two state banks and the NSB.

The Government recognised the need to eliminate anomalies and accepted most of the recommendations of the Salaries Commission. The new salary scales were made effective in 1997, allowing for 40 per cent of the increase to take place in 1997. Thus the salary bill rose by 17 per cent in 1997 and accounted for 24 per cent of the total recurrent expenditure in 1997, compared to 22 per cent in the previous two years.

Interest payments increased by 13 per cent in 1997 and accounted for 30 per cent of current expenditure. Of the total interest payments of Rs.55,246 million, Rs.6,227 million was on account of the long-term bonds issued to the two banks and the NSB. The value of the bonds issued during the second half of 1996 to the two state banks and the NSB amounted to Rs. 23,872 million at an interest rate of 14 per cent per annum.

Interest on Rupee Loans in 1997 was Rs.30,021 million, compared to Rs.23,201 million in 1996. Rupee Loans obtained in 1997 amounted to Rs.48,500 million and carried an average interest rate of 12.93 per cent compared to 14.14 per cent in 1996. The maturity period of the new loans decreased to 4.5 years from 5 years in 1996. The interest rates on Treasury bonds ranged between 11.50 and 14.00 per cent. The maturity periods were between 2 and 4 years. The weighted average interest rate on these bonds was 12.50 per cent. Interest on these bonds is paid half yearly and Rs.327 million was paid in 1997. During 1997, 12-month Treasury bill interest rates ranged between 17.11 and 10.17 per cent compared to 19.05 and 14.40 per cent in 1996. Interest payments on account of Treasury bills increased marginally to Rs.18,174 million. The increase was partly due to the payment of Rs.325 million as interest on the Rs.10,000 million worth of Treasury bills retired in August 1997 for which interest was otherwise due in 1998. Interest payments

TABLE 8.4  
Functional Classification of Expenditure

Item	Rs. Million						
	1993	1994	1995	1996	1997 Approved Estimates	1997 Provi- sional	1998 Approved Estimates
<b>Current Expenditure</b>							
<b>General Public Services</b>	27,564	30,444	47,888	53,916	54,955	58,926	56,948
Civil administration	7,405	4,637	6,562	10,207	13,431	13,956	12,577
Defence	15,413	19,415	35,186	38,117	33,528	37,062	36,457
Public order and safety	4,746	6,392	6,140	5,591	7,997	7,908	7,914
<b>Social Services</b>	37,476	47,656	57,648	59,294	58,740	59,742	64,356
Education	11,225	14,836	15,784	16,018	13,407	17,757	21,920
Health	5,711	7,666	8,818	9,260	12,054	9,581	10,269
Welfare	20,255	24,560	32,106	32,824	31,824	31,251	30,858
Housing	-	-	-	-	-	-	-
Community services	285	593	941	1,191	1,455	1,154	1,309
<b>Economic Services</b>	4,328	6,195	8,078	8,807	8,532	7,419	10,756
Agriculture and irrigation	1,483	2,506	3,826	3,894	4,175	3,723	4,969
Fisheries	107	99	105	148	199	156	350
Manufacturing and mining	403	351	252	282	650	599	767
Energy and water supply	93	518	990	590	728	486	874
Transport and communication	1,346	2,024	2,014	2,423	1,822	1,674	2,672
Trade and commerce	203	72	172	891	241	159	243
Other	693	625	719	580	718	622	880
<b>Other</b>	32,920	42,789	40,546	53,132	60,394	58,859	54,332
of which: Interest	30,203	38,031	38,687	48,923	55,492	55,246	55,368
<b>Provision for Under Expenditure</b>	-	-	-	-	1,000	-	700
<b>Total Current Expenditure</b>	102,288	127,084	154,158	175,149	183,821	184,746	187,091
<b>Capital Expenditure and Lending</b>							
<b>General Public Services</b>	4,085	2,390	5,776	3,161	3,810	3,627	7,527
Civil administration	3,463	1,753	3,962	1,935	3,810	3,627	7,527
Public order and safety	622	637	1,814	1,226	-	-	-
<b>Social Services</b>	6,075	7,677	9,854	10,322	13,675	11,562	16,059
Education	2,845	2,877	3,124	4,384	4,552	4,592	5,957
Health	1,353	1,519	2,134	2,538	3,965	2,554	4,308
Welfare	1,084	1,681	1,690	868	852	751	396
Housing	604	802	1,610	1,174	1,526	792	1,647
Community services	189	798	1,297	1,359	2,782	2,863	2,751
<b>Economic Services</b>	29,600	29,304	36,106	31,409	41,808	32,479	46,833
Agriculture and irrigation	5,682	5,179	6,060	4,718	6,233	37,80	6,730
of which: Mahaweli Project	2,810	2,598	3,090	1,940	1,655	1,626	1,265
Fisheries	124	368	361	311	525	480	773
Manufacturing and mining	1,471	22	250	356	1,256	1,442	2,167
Energy and water supply	4,728	5,518	5,003	6,035	7,949	6,816	10,203
Transport and communication	10,165	14,522	18,888	12,636	18,468	12,948	20,536
Trade and commerce	364	182	20	105	321	182	909
Other	7,068	3,513	5,524	7,247	7,056	6,835	5,316
<b>Other</b>	1,081	1,084	1,074	1,081	1,250	3,787	1,778
<b>Total Capital Expenditure and Lending</b>	40,841	40,455	52,810	45,973	60,544	51,445	70,996

Source: Central Bank of Sri Lanka

on foreign loans declined marginally and amounted to Rs.6,265 million. The decline was partly a result of the appreciation of the rupee against the Japanese yen. The average rate of interest on the foreign debt stock in 1997 was 1.7 per cent compared to 1.8 per cent in 1996.

It is noteworthy that current transfers and subsidies declined by 1 per cent in 1997 to Rs. 45,670 million, compared to an increase of 14 per cent in 1996. The main reason for this decrease was the reduction of wheat flour subsidy payments to Rs.1,000 million, compared to Rs.5,515 million in 1996, as the price of wheat flour was adjusted to a non-subsidised price level of Rs.18.95 per kg. in 1997 from Rs.16.95 per kg. This was done in a situation when international wheat prices were declining. The average import price of wheat to the Co-operative Wholesale Establishment (CWE) had declined to US dollars 166.98 per metric ton, compared to US dollars 225.31 in 1996. With the price adjustments, consumption declined by 11 per cent to 616,799 metric tons.

The railway operations continued to incur losses. The operational loss was estimated at Rs.712 million in 1997, a decline from Rs.888 million in 1996. The Postal Department, too made an operational loss of Rs.255 million in 1997, compared to a loss of Rs.344 million in 1996. Payments to other levels of government increased by 22 per cent to Rs.1,941 million due to the new work programmes started by the newly elected local bodies. Transfers to other public institutions at Rs.2,657 million recorded an increase of 16 per cent in 1997. Transfers to public institutions set up to deliver economic services recorded an increase of 19 per cent compared to the 14 per cent increase recorded in the transfers to institutions which deliver social services.

Pension payments increased by 16 per cent to Rs.17,916 million. This was mainly a result of the 5 per cent increase in pensions as announced in the Budget and the impact of the early retirement scheme.

Samurdhi payments increased by 2 per cent to Rs.8,718 million. There were 1.9 million Samurdhi/Janasaviya welfare recipient families and 31,369 Samurdhi animators in 1997.

The fertiliser subsidy payments increased to Rs.1,895 million from Rs.1,500 million in 1996 due to the increased subsidy component of urea under the new scheme announced in October, 1997 to ensure that benefits are accrued to the majority of small farmers. The price of urea was reduced from Rs. 590 to Rs.350 per 50 kg.

Other transfers to households amounted to Rs.7,631 million, out of which, expenditure on refugees and drought relief payments amounted to Rs.3,357 million and Rs.548 million respectively.

Expenditure on other goods and services which represent day-to-day operational expenditures, declined by 6 per cent, an achievement due to the 20 per cent cut in non-priority expenditures as announced in the 1997 Budget.

According to the functional classification, current expenditure on social services, which includes expenditure on education, health, welfare and community services declined to 6.7 per cent of GDP from 7.7 per cent in 1996. These expenditures accounted for 32 per cent of total current expenditure. Expenditure on education and health accounted for 46 per cent of the total expenditure on social services, an increase from 43 per cent in 1996.

Current expenditure on economic services declined by 16 per cent in 1997 to Rs.7,418 million. Expenditure on transport and communication, trade and commerce, agriculture and irrigation facilities, and energy and water supply indicated a decline.

Current expenditure on general public services increased by 9 per cent to Rs.58,926 million. The expenditure on defence and public order and safety accounted for 76 per cent of the expenditure on general public services compared to 81 per cent in 1996. As a percentage of GDP, the expenditure on defence and public order and safety decreased from 5.7 per cent in 1996 to 5.1 per cent in 1997.

### Public Investment

Public investment, which includes capital expenditure and on lending to public enterprises, increased by 12 per cent to Rs.51,445 million. However, the expenditure was lower, by 15 per cent, compared to budgeted expenditure. This was due to implementation and procedural delays which led to under utilisation of highly concessional foreign funds.

The Ceylon Electricity Board (CEB) utilised Rs.3,479 million on account of on-going projects out of Rs.4,441 million allocated in the 1997 Budget. The Sri Lanka Ports Authority and Sri Lanka Telecom received Rs.984 million and Rs.1,367 million, respectively. The Sri Lanka Ports Authority utilised only 19 per cent of the on-lending allocation of Rs. 5,300 million. Sri Lanka Telecom utilised 66 per cent of the total allocation of Rs. 2,081 million. The Ceylon Petroleum Corporation (CPC) and other projects such as agro based commercial projects received Rs.692 million as against the expected Rs.493 million in 1997. In addition, the Government released Rs.750 million to the household sector through loan schemes such as 'Surathura Diriya' and self-employment credit schemes.

Capital transfers to corporations amounted to Rs.5,880 million (National Water Supply and Drainage Board - Rs.2,513 million; CEB -Rs.811 million; The Sri Lanka Land

Reclamation and Development Corporation -Rs.1,746 million; National Housing Development Authority -Rs.454 million) compared to Rs.6,017 million in 1996.

Capital transfers to other public institutions increased by 15 per cent to Rs. 11,041 million. Of this total, 79 per cent was for economic services such as transport, communication, agriculture and irrigation. Transfers to the Road Development Authority (RDA) increased by 32 per cent to Rs.5,826 million. The Mahaweli Authority of Sri Lanka received Rs.1,626 million. The Urban Development Authority also received a sum of Rs.511 million in 1997. Capital transfers for social services increased by 65 per cent to Rs. 1,836 million. The Samurrdhi Authority received Rs.936 million, and the National Development Trust Fund received Rs.453 million.

The Government also spent Rs. 2,193 million as cost of restructuring. Reflow of funds to the Government as repayments on account of past on lending amounted to Rs.4,713 million.

## 8.5 Provincial Councils

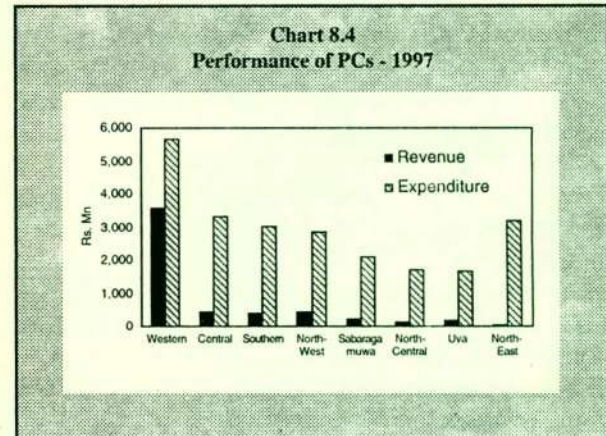
The revenue collections of Provincial Councils (PCs) increased by 10 per cent to Rs.5,395 million. These were sufficient to meet 23 per cent of their resource requirement, as in the previous year. Their expenditure increased by 6 per cent to Rs.23,455 million. This resulted in an overall deficit of Rs.18,348 million in 1997, compared to Rs.16,873 million in 1996. The entire deficit was financed through Central Government transfers, of which block grants or current transfers accounted for 92 per cent. The balance was in the form of criteria based grants and matching grants for capital projects.

### Revenue

Taxes on production and expenditure increased by 10 per cent to Rs.3,743 million and accounted for 69 per cent of the total revenue. Most of these revenues were in the form of turnover taxes and licence fees. Turnover tax at rates ranging from 1 per cent to 5 per cent were collected on wholesale and retail businesses. Turnover tax collections increased by 11 per cent compared to a 6 per cent increase in 1996, reflecting the growth of wholesale and retail businesses in 1997. Licence fee collections increased by 5 per cent compared to 17 per cent in 1996, reflecting the slow growth in the registrations of vehicles and new issues of liquor licences in 1997. As the tax rate structure on production and expenditure remained as in 1996, expansion of the tax base led to the increase in revenue.

The collection of stamp duty, which was the second largest revenue source for PCs, increased marginally by 1

per cent, owing to the slowing down of property transactions. Revenues from fees and charges, consisting of court fees and fees and charges under the Motor Traffic Act, increased by 15 per cent mainly due to improvements in collection procedures and increases in rates.



The Western, Central, Southern and North-Western PCs accounted for about 90 per cent of total revenue, while the North-East Province accounted for less than 1 per cent.

### Expenditure

Most of the expenditure (94 per cent) by PCs was current expenditure. Current expenditure increased by 6 per cent, while capital expenditure showed a larger increase of 19 per cent.

### Current Expenditure

The expenditure on account of personal emoluments (salaries, wages, overtime and holiday payments, cost of living allowance and other allowances) rose by 5 per cent, reflecting the increase in salaries of government employees from January 1997. Payments to those in education (Rs.12,094 million), health (Rs.3,054 million) and divisional administration (Rs.545 million) accounted for 92 per cent of total personal emoluments in 1997. The growth of other recurrent expenses (such as travelling, supplies, contractual services and current transfers) was contained at 6 per cent compared to an increase of 24 per cent in 1996. This was the result of strict discipline enforced by the Treasury in cash management.

Recurrent expenditure on social services (education, health and other social activities) rose by 5 per cent and accounted for 87 per cent of the total current expenditure in 1997. Recurrent expenditure on economic services increased by 4 per cent, while expenditure on administration increased by 9 per cent in 1997.

**TABLE 8.5**  
**Budget Out-turn for Provincial Councils**

	Rs Million		
	1995	1996	1997(a)
<b>1 Total Revenue</b>	<b>4,440</b>	<b>4,884</b>	<b>5,395</b>
1.1 Tax on Production and Expenditure	3,181	3,416	3,744
Turnover Taxes	2,335	2,464	2,734
Licence Fees	840	946	1,000
Other Taxes	6	6	10
1.2 Profits and Dividends	68	67	175
1.3 Sales and Charges	317	355	408
1.4 Stamp Duty	867	1,036	1,051
1.5 Other	7	10	17
<b>2. Total Expenditure</b>	<b>20,652</b>	<b>22,128</b>	<b>23,455</b>
2.1 Current Expenditure	19,795	20,941	22,055
Functional Basis	19,795	20,941	22,055
Provincial Administration	2,067	1,942	1,941
Economic Services	755	834	939
Social Services	16,973	18,166	19,175
Economic Basis	19,795	20,941	22,055
Personal Emoluments	16,031	16,263	17,067
Other	3,765	4,679	4,988
2.2 Capital Expenditure	1,057	1,187	1,400
Acquisition of Capital Goods	594	757	729
Capital Transfers	66	53	55
Other	397	377	616
<b>3 Financing</b>	<b>15,288</b>	<b>16,873</b>	<b>18,348</b>
3.1 Block Grants	14,066	15,831	16,855
3.2 Criteria Based Grants	897	800	1,168
3.3 Matching Grants	325	242	325

(a) Provisional

Source: Ministry of Provincial Councils &amp; Local Governments

The total current expenditure of the Western PC, at Rs.5,307 million, accounted for 24 per cent of total current expenditure of all PCs, followed by the Central PC (14 per cent), the North East PC (14 per cent), the Southern PC (13 per cent), North West PC (12 per cent), the Sabaragamuwa PC (9 per cent), the North Central PC (7 per cent) and the Uva PC (7 per cent).

### Capital Expenditure

Capital outlays on equipment, structural and land improvement, at Rs.729 million, accounted for 52 per cent of total capital expenditure, down from 64 per cent in the previous year due to a sharp increase of capital outlays on other programmes implemented on the directives of Provincial Council Members in 1997. PCs have taken over some capital projects from the respective line ministries. The total value of these projects amounts to Rs.3,047 million, of which health (Rs.711 million), highways (Rs.707 million), education (Rs.661 million) and contribution to the Integrated

Rural Development Programme (IRDP) (Rs.888 million) represented 97 per cent of the total. Of this the Southern PC, at Rs. 917 million, accounted for 30 per cent of the total expenditure while the shares of other PCs ranged between 4 - 13 per cent of the total. Funds for these capital projects were provided through the Medium Term Investment Programme (MTIP) of the respective ministries.

### 8.6 Public Enterprise Reforms

The Public Enterprise Reform Programme generated Rs.22,535 million, contributing to 12 per cent of total receipts of the Government in 1997, enabling the government to retire part of the public debt and restructure its debt portfolio. This helped to reduce the interest cost but the full effect on interest cost will be felt in 1998 and beyond.

A major step forward in the public enterprise reform programme was the sale of a 35 per cent stake in Sri Lanka Telecom Limited to Nippon Telegraph and Telephone

Corporation (NTT) of Japan for Rs.13,274 million (US dollars 225 million). The accompanying management contract with NTT was another vital step towards improving the operational efficiency of Sri Lanka Telecom. The Government also earmarked 3.5 per cent of shares of Sri Lanka Telecom for its employees.

The sale of convertible debentures of the National Development Bank (NDB) held by the Government generated Rs.4,500 million. The transaction was the largest single public offering made through the Colombo Stock Exchange. Convertible debentures of NDB amounting to Rs. 275 million, which had been issued to the Government in January 1993, were divested. The convertible debentures, which were to mature in 1999, 2000 and 2001 were converted into 18.33 million ordinary shares at a par value of Rs. 10 per share and offered to the market through the Colombo Stock Exchange. As the issue was too large to be absorbed by the domestic market, 16.5 million shares were offered abroad, while 916,667 shares were offered to domestic investors. The remaining 916,666 shares were purchased by the NDB for its employee Stock Ownership Plan. The international issue was priced at Rs. 260 per share and the domestic issue was priced at Rs. 250 per share.

The divestiture of 51 per cent of shares each of seven plantation companies (Nemunukula Plantations Limited, Maturata Plantations Limited, Malwatte Valley Plantations Limited, Kahawatte Plantations Limited, Elpitiya Plantations Limited, Talawakelle Plantations Limited, and Pussellawa Plantations Limited) were completed. Proceeds realised from this amounted to Rs.2,914 million. Public share issues for the divestiture of 19 per cent of each of five plantation companies, namely, Bogawantalawa Plantations Limited, Kegalle Plantations Limited, Agalawatte Plantations Limited, Horana Plantations Limited and Kelani Valley Plantations Limited, contributed Rs. 635 million. Public share issues for the divestiture of 20 per cent each of Watawala Plantations Limited and Maskeliya Plantations Limited added Rs. 111 million to Government revenue in 1997.

The sale of 90 per cent of shares of Lanka Salt Limited and Puttalam Salt Limited generated Rs. 575 million, while the public share issue of 17.33 per cent of shares of Lanka Ceramic Limited generated Rs. 206 million in 1997.

Mattegama Textile Mill Limited was acquired by the Government as a failed privatised public enterprise. This was re-divested through the sale of the entire ownership for

TABLE 8.6  
Realisation of Privatisation Proceeds in 1997

Name of the Enterprise	Sale of Majority Share holding			Public Share Issue		Total Amount Realised Rs. Million
	% Divested	Local Rs. Million	Foreign Rs. Million	% Divested	Amount Realised Rs. Million	
<b>Plantation Companies</b>						
Namunukula Plantations Limited	51	408	-	-	-	408
Maturata Plantations Limited	51	467	-	-	-	467
Malwatte Valley Plantations Limited	51	622	-	-	-	622
Kahawatte Plantations Limited	51	308	-	-	-	308
Elpitiya Plantations Limited	51	308	-	-	-	308
Bogawantalawa Plantations Limited	-	-	-	19	141	141
Kegalle Plantations Limited	-	-	-	19	118	118
Agalawatte Plantations Limited	-	-	-	19	133	133
Horana Plantations Limited	-	-	-	19	120	120
Kelani Valley Plantations Limited	-	-	-	19	123	123
Watawala Plantations Limited	-	-	-	20	60	60
Maskeliya Plantations Limited	-	-	-	20	60	60
Talawakelle Plantations Limited	51	408	-	-	-	408
Pussellawa Plantations Limited	51	398	-	-	-	398
<b>Other Enterprises</b>						
Lanka Salt Ltd	90	453	-	-	-	453
Puttalam Salt Ltd	90	123	-	-	-	123
Lanka Ceramic Ltd	-	-	-	17	206	206
Mattegama Textile Mills Ltd	100	-	30	-	-	30
Sri Lanka Telecom Ltd	35	-	13,380	-	-	13,380
National Development Bank Sale of Convertible Debentures	-	-	-	51	4,500	4,500
<b>Total</b>		<b>3,494</b>	<b>13,410</b>		<b>5,462</b>	<b>22,365</b>

Source: Public Enterprise Reform Commission

(a) The Government accounts show net receipts from divestiture proceeds after payment of commission to Colombo Stock Exchange, other service charges etc. The table shows only the proceeds received through the Public Enterprise Reform Commission. In addition to this, instalment payments are received directly by the Treasury.



Rs.29.5 million to Kabool Lanka Ltd. The enterprise was restructured and rehabilitated with the injection of a new investment of about Rs.1,000 million by the investor, thus ensuring employment for about 900 persons.

## 8.7 Financing the Budget Deficit

The budget deficit (after grants) was estimated at Rs. 39,997 million in 1997, compared to Rs.59,914 million in 1996. Net borrowings from domestic sources (Rs. 30,275 million) financed 76 per cent of the budget deficit compared with 83 per cent in 1996. Net domestic financing as a percentage of GDP declined from 6.5 per cent in 1996 to 3.4 per cent in 1997 with a net repayment to the domestic banking system, as compared to bank financing amounting to 1.7 per cent of GDP in 1996.

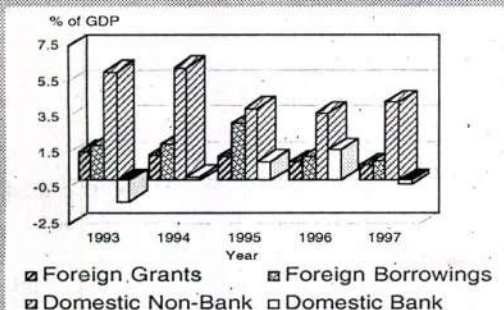
Gross foreign borrowings, at Rs.22,973 million, showed an increase of 11 per cent in 1997. Gross disbursement on foreign borrowings, excluding borrowings raised through the Floating Rate Notes (FRN) issue of US dollars 50 million (equivalent to Rs.2,901 million), were 27 per cent below the amount budgeted for 1997. The major reasons for the reduction of aid utilisation were delays in project implementation particularly in the areas of ports, power and energy sectors etc. and lack of domestic resources to absorb foreign funds. Repayments on account of foreign loans increased by 26 per cent to Rs.13,251 million. Net foreign borrowings amounting to 1.1 per cent of GDP were available for deficit financing in 1997 compared to 1.4 per cent in the previous year. Net foreign borrowings from bilateral and multi-lateral sources amounted to Rs.9,784 million, while other sources including the FRN issue reported a net repayment of Rs.62 million. Out of the total project aid loans, the Asian Development Bank (Rs. 4,499 million), International Development Association (Rs.3,676 million) and Government of Japan (Rs.3,629 million) provided 71 per cent in 1997.

Net borrowing through Rupee Loans amounted to Rs.33,500 million, compared to Rs.24,154 million in the previous year. The Employees' Provident Fund (EPF) and the National Savings Bank (NSB) have contributed to 84 per cent of total Rupee Loans. Net investment by the EPF on Rupee Securities grew by 6 per cent to Rs.17,588 million in 1997 in addition to the new investments in Treasury bonds. Net investments by the NSB in Rupee Loans rose from Rs.4,919 million in 1996 to Rs.10,655 million in 1997. The NSB has shifted its investment in government securities towards Rupee Securities.

The new, market based Treasury bonds introduced to the market in March 1997 became popular. The Government raised Rs.10,000 million during the period from March to December 1997 through Treasury bonds. With the improvement in the fiscal situation and the changing market conditions, the interest rate on Treasury bonds declined. Accordingly, the coupon rate on Treasury bonds was gradually revised downward from 14.0 per cent to 11.5 per cent. The EPF (Rs.3,100 million) and the NSB (Rs.1,609 million) contributed to 47 per cent of Treasury bonds while the balance was purchased by other investors. Commercial banks purchased Rs. 1,788 million or 18 per cent of the Treasury bonds.

The marked improvement on the fiscal front that narrowed the resource gap in 1997, mainly due to large inflows of privatisation proceeds, enabled the Government to retire part of its high cost debt held with the banking system. The retirement of Treasury bills held with the Central Bank amounted to Rs.10,000 million (face value). In addition, the settlements were made to the two state banks. The net impact of these operations resulted in an overall repayment of Rs.2,172 million to the banking system in 1997 compared to net borrowings of Rs.13,090 million from the banking system in the previous year. The financing of the deficit through the Central Bank declined by Rs.13,991 million, which was a larger reduction than the initial retirement of Treasury bills. Net credit to Government from commercial banks amounted to Rs.11,618 million due to banks investing most of the funds released through the reduction of statutory reserve requirements, in Treasury bills. Government deposits held with the banking system at end 1997 totalled Rs.20,206 million, consisting of Rs.6,467 million with the Central Bank and Rs.13,739 million with commercial banks.

Chart 8.5  
Deficit Financing



## 8.8 Government Debt

Government debt at the end of 1997 stood at Rs.758,714 million, recording an increase of 7 per cent. The total debt/GDP ratio declined to 85 per cent in 1997 compared to 92 per cent in 1996. This is a favourable trend observed since 1993. The total domestic debt accounted for

50 per cent of the total government debt. The level of domestic debt and foreign debt increased by 10 per cent and 5 per cent in 1997 respectively.

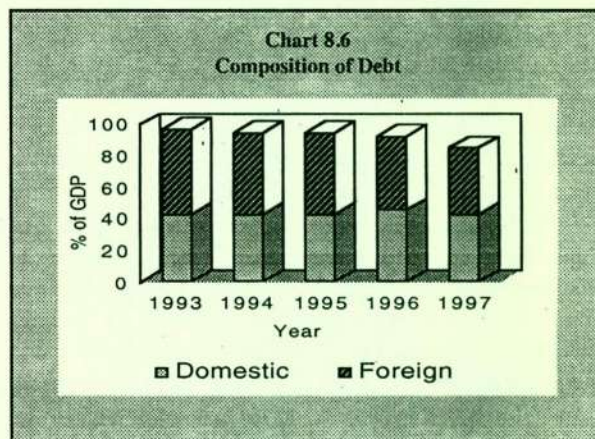
### Domestic Debt

The debt structure improved significantly with the issue of Treasury bonds, issue of Rupee Loans with options of early retirement, and a reduction in the level of short-term debt. This made the debt structure more flexible and yield determination more market oriented. Of the total domestic debt, short-term debt, at Rs. 133,303 million, declined to 35 per cent at the end of 1997 from 41 per cent at the end of 1996. Treasury bills accounted for 86 per cent of the short-term debt. Interest rates on Treasury bills declined sharply in 1997. At the beginning of the year, the weighted average yield rates on 3, 6, and 12 month Treasury bills were 17.14, 17.03 and 17.11 per cent, while at the end of the year these rates had dropped to 9.97, 10.09 and 10.21 per cent, respectively. Central Bank provisional advances, which accounted for the balance 14 per cent of short-term debt, increased by 3 per cent to Rs. 18,307 million at the end of 1997.

Medium and long-term debt (including long-term restructuring bonds) increased by 21 per cent and accounted for 65 per cent of the total domestic debt in 1997. Treasury bonds accounted for 4 per cent of the total outstanding medium and long-term debt. Commercial banks, the EPF and savings institutions have purchased 33 per cent, 32 per cent and 18 per cent, respectively, of the total Treasury bond issues, leaving 17 per cent for all other investors. The balance of the medium and long-term debt stock consisted almost entirely of Rupee Loans. The bulk of the domestic resource requirement of the Government was met through the Rupee Loans, which mobilized Rs. 48,500 million. There were 17 series of Rupee Loans floated in 1997, with the maturity periods varying from 2-8 years. The interest rate on Rupee Loans was adjusted downward in line with the anticipated decline in inflation, while a relatively higher rate of interest was offered for Rupee Loans with longer maturity, giving them a slight edge over short-term instruments. Accordingly, Rupee Loans issued during the first quarter of the year carried an annual interest rate of 14.5 per cent. The rates were gradually reduced to 11.25 per cent by the end of the year. Over 35 per cent of the Rupee Loans were floated with optional maturities of 6-7 years, while about 53 per cent of the issues were with maturities of 2-4 years. The EPF and the NSB continued to be the two main subscribers to the Rupee Loan programme. These two institutions contributed 64 per cent and 24 per cent, respectively. Total investments in Rupee Loans by others amounted to Rs. 5,741 million, consisting of ETF (Rs. 2,454 million), insurance corporations (Rs. 1,500 million), the Ports Authority (Rs. 750

million), PSPF (Rs. 923 million) and other public institutions (Rs. 114 million).

The outstanding liability on account of Treasury Certificates of Deposits (TCD), decreased from Rs. 212 million at end 1996 to Rs.83 million at end 1997 and became relatively insignificant in the Government's debt portfolio. In 1997, TCDs were issued with a maturity period of 12 months and yield rate of 18.06 per cent, of which 3 per cent was charged as stamp duty. The liability on Tax Reserve Certificates (TRC) remained very small at Rs.7 million at the end of 1997.



### Foreign Debt

The outstanding foreign debt increased by 5 per cent to Rs.375,752 million at the end of 1997. Gross borrowings amounted to Rs.24,406 million. The expenditure on debt repayment amounted to Rs.10,004 million. The outstanding liability also increased by Rs. 1,959 million due to exchange rate variations.

The total level of concessional loans increased by 4 per cent to Rs.361,430 million. The share of concessional debt in total foreign debt recorded a marginal reduction to 96 per cent compared with 97 per cent at the end of 1996. Bilateral debt, at Rs.188,165 million, accounted for 52 per cent of concessional loans, while the balance Rs.173,265 million or 48 per cent were liabilities to multilateral agencies. The issue of Floating Rate Notes added to the stock of non-concessional debt.

The outstanding stock of project and programme loans stood at Rs.320,547 million at the end of 1997, showing an increase of 6 per cent. Approximately 80 per cent of the project and programme loans were obtained from bilateral and multilateral sources. The outstanding liability on commodity loans recorded a decrease of Rs.1,427 million to

**TABLE 8.7**  
**Outstanding Central Government Debt (at end year)**

Rs. Million

	1993	1994	1995	1996	1997 Provisional
<b>Total Domestic Debt (a)</b>	<b>213,685</b>	<b>249,119</b>	<b>285,759</b>	<b>349,007</b>	<b>382,962</b>
Short-term	101,845	108,725	127,470	142,689	133,303
Medium and Long-term	111,840	140,394	158,289	206,318	249,659
<b>By Debt Instrument</b>	<b>213,685</b>	<b>249,119</b>	<b>285,759</b>	<b>349,007</b>	<b>382,962</b>
Rupee Securities	105,707	137,554	157,928	205,975	239,475
Treasury Bills	97,196	98,896	113,771	124,996	114,996
Treasury Bonds					10,000
Other	10,782	12,669	14,060	18,036	18,491
<b>By Institutions</b>	<b>213,685</b>	<b>249,119</b>	<b>285,759</b>	<b>349,007</b>	<b>382,962</b>
Banks	90,135	100,043	113,355	103,553	101,966
Central Bank	16,480	21,345	28,684	34,807	24,999
Commercial Banks	73,655	78,698	84,671	68,746	76,967
Sinking Fund	239	137	100	100	100
Non-Bank Sector	123,311	148,939	172,304	245,354	280,896
National Savings Bank	37,767	46,407	48,406	47,794	62,498
Employees' Provident Fund	65,645	79,745	95,000	113,236	134,667
Other	19,899	22,786	28,898	84,324	83,531
<b>Total Foreign Debt</b>	<b>270,224</b>	<b>301,812</b>	<b>346,286</b>	<b>359,390</b>	<b>375,752</b>
Project Loans	216,355	246,075	286,848	302,666	320,547
Non-Project Loans	53,869	55,737	59,438	56,724	55,205
<b>By Institutions</b>	<b>270,224</b>	<b>301,812</b>	<b>346,286</b>	<b>359,390</b>	<b>375,752</b>
Concessional Loans	260,557	292,462	335,656	348,936	361,430
Commercial Loans	9,667	9,350	10,630	10,454	14,322
<b>By Currency</b>	<b>270,224</b>	<b>301,812</b>	<b>346,286</b>	<b>359,390</b>	<b>375,752</b>
SDR	81,467	95,340	115,537	130,818	142,733
US Dollar	66,614	67,546	72,488	74,623	83,107
Yen	73,946	89,291	101,537	99,668	96,736
Deutsche Mark	23,865	25,009	29,114	27,313	25,746
Other	24,332	24,626	27,610	26,768	25,428
<b>External Supplier's Credit</b>	<b>1,065</b>	<b>950</b>	<b>1,020</b>	<b>923</b>	<b>499</b>
<b>Total Outstanding Government Debt</b>	<b>483,909</b>	<b>550,931</b>	<b>632,045</b>	<b>708,397</b>	<b>758,714</b>
<b>Total Outstanding Government Debt Net of Sinking Fund</b>	<b>483,589</b>	<b>550,794</b>	<b>631,945</b>	<b>708,297</b>	<b>758,614</b>

Source: Central Bank of Sri Lanka

(a) Inclusive of Rs. 24,088 million and Rs. 23,873 million of long term bonds issued in 1993 and 1996, respectively.

**TABLE 8.8**  
**Effect of Exchange Rate Variation on Foreign Loans**

Rs. Million

Item	1993	1994	1995	1996	1997(b)
Gross receipts	16,839	19,384	24,359	23,992	24,406
Repayments	6,984	7,606	8,477	8,939	10,004
Net receipts	9,855	11,778	15,882	15,053	14,402
Change in liability due to exchange rate variations	24,831	19,810	28,592	-1,949	1,959
Liability at end period	270,224	301,812	346,286	359,390	375,752

Source: Central Bank of Sri Lanka

(a) Data are based on value date recording system provided by the Public Debt Department of the Central Bank of Sri Lanka

(b) Provisional

Rs.53,816 million in 1997. In addition to new borrowings and repayment, exchange rate variations reduced the debt stock by Rs.765 million. All commodity loans were from bilateral sources (USA, Japan, Netherlands, Germany, Canada etc.) and were received on concessionary terms.

### Government Debt Service Payments

The debt service payments of the Government, at Rs.92,519 million, consisting of Rs. 37,272 million of amortisation payments and Rs.55,247 million of interest payments, registered an increase of Rs.11,256 million or 14 per cent in 1997. This was the total outcome of an increase in amortisation payments by Rs.4,032 million and an increase in interest payments by Rs.7,224 million. However, debt service payments as a ratio of GDP declined from 10.6 per cent in 1996 to 10.4 per cent in 1997. The amortisation payments of domestic and foreign loans in 1997 amounted to Rs.24,021 million and Rs.13,251 million, respectively.

Interest payments on domestic debt rose by 15 per cent to Rs.48,555 million in 1997. Interest payments on Rupee Loans increased by 29 per cent to Rs.30,021 million, reflecting a heavy dependency on the Rupee Loan programme for financing the budget deficit, and the cost of restructuring bonds issued during the second half of 1996. Interest on Treasury bonds was only Rs.327 million. Interest payments on medium and long-term debt rose by 29 per cent in 1997, indicating the higher reliance on medium-term borrowings at higher interest for deficit financing in recent years. Interest payments on short-term debt, at Rs.18,174 million, increased marginally by 1 per cent. Despite the significant reduction in interest rates on Treasury bills, the interest cost increased due to the large issues of more 3-month and 6-month Treasury bills in 1997 in addition to the early interest payment on retired Treasury bill stock. Interest payments on foreign debt declined by Rs. 47 million to Rs. 6,692 million.

TABLE 8.9  
Government Debt Service Payments

Item	Rs.Million				
	1993	1994	1995	1996	1997(a)
Debt Service Payments	58,938	63,593	77,663	81,263	92,519
Amortisation Payments	27,290	22,671	36,546	33,240	37,272
Domestic	20,327	15,065	28,069	22,749	24,021
Foreign	6,963	7,606	8,477	10,491	13,251
Interest Payments	31,648	40,922	41,117	48,023	55,247
Domestic	26,546	35,411	34,955	41,284	48,555
Short-term	13,351	18,712	13,947	18,053	18,174
Medium & Long-term	13,195	16,699	21,008	23,231	30,381
Foreign	5,102	5,511	6,162	6,739	6,692
Interest/Current Expenditure (%)	30.94	32.20	26.67	27.42	29.90
Debt Service/GDP (%)	11.79	10.98	11.63	10.57	10.39

(a) Provisional

Source: Central Bank of Sri Lanka