8. FISCAL POLICY AND BUDGETARY OPERATIONS

8.1 Overview and Policy Strategy

The fiscal performance showed a marked improvement in 1999. The overall deficit declined to 7.5 per cent of GDP from 9.2 per cent in 1998 while the deficit on current operations was reduced to 1.0 per cent of GDP from 2.4 per cent in 1998. This indicates the success of the government in re-establishing the fiscal consolidation path achieved during the period 1995 to 1997. The improvement in the fiscal sector was mainly due to the containment of current expenditures to 18.7 per cent of GDP from 19.6 per cent in 1998. There was also an improvement in the tax collection to 14.9 per cent of GDP from 14.5 per cent in 1998. This outcome was achieved in a difficult domestic and external environment. There has been a steady containment of non-interest expenditures since 1995. This achievement buttresses the government's commitment to maintain fiscal discipline with the objective of supporting non- inflationary growth led by the private sector. While the reduction was largely in the current expenditures, public investment also declined marginally. In 1999, 90 per cent of the deficit was financed from domestic sources. High domestic resource needs resulted in an increase of borrowings from the banking sector to 2.3 per cent of GDP in 1999 from 1.9 per cent of GDP in 1998. As private sector credit growth was relatively sluggish and net foreign assets of the banking system declined in 1999, the higher domestic financing needs in 1999 were met through the banking system without exerting a serious expansionary impact on money supply.

The reduction in dissavings of the government together with the lower overall deficit and high public investment was an improvement in fiscal performance. The medium-term fiscal policy strategy announced by the government in the 2000 Budget and in 'Vision 2010' aims at a further reduction of the overall budget deficit to 5 per cent of GDP in 2002 and to 3 per cent of GDP in 2010. Government savings are expected to rise to 4 per cent of GDP in 2002. The improvement in the medium-term fiscal outlook is expected through fiscal adjustment measures aimed at raising revenue elasticity, containing the growth of current expenditure and prudent cash management. Meanwhile, public investment is expected to be maintained above 8 per cent of GDP in order to create an environment conducive to private sector led economic growth.

The government's taxation strategy in 1999 addressed the medium-term structural constraints while adopting measures to maintain the short-term revenue objectives of the government. The major structural reform implemented in 1999 with regard to taxation was the further rationalisation of the tariff structure. Taxes such as the National Security Levy (NSL) and excise taxes were mobilised to maintain a higher revenue effort. Meanwhile, tax administration was strengthened with a view to improving revenue buoyancy over the medium- term. At the same time, taxes were further rationalised to promote investments in selected priority sectors in the economy.

The rationalisation of the tariff structure consisted of a downward revision of the three-band rate structure of 10, 20, and 35 per cent to 5, 10 and 30 per cent. Raw materials and machinery not manufactured in Sri Lanka were made subject to a tariff rate of 5 per cent while the 10 per cent rate was applicable to food items. Crude oil and petroleum imports were categorised under the 30 per cent rate, while the import duty on vehicles was unified at 30 per cent. Excise taxes on petrol driven motor vehicles were introduced in 1999 making the overall tax incidence on such vehicles 73 per cent. The excise tax on diesel driven motor vehicles excluding utility vehicles, was increased by 10 per cent, raising the overall tax incidence on such vehicles to 172 per cent. Medical, communication and transport goods were brought under a zero tariff rate. Agricultural products were afforded higher protection, keeping the import duty rate for these commodities at 35 per cent.

Tax measures such as the increase in the National Security Levy (NSL) to 5.5 per cent from 4.5 per cent, upward revision of excise taxes on cigarettes and hard liquor and the imposition of an additional excise tax of 10 per cent on all imported motor vehicles to rationalise the impact of tariff adjustments on motor vehicles contributed towards maintaining the buoyancy of the tax system. Excise tax on malt liquor was rationalised with the introduction of a universally accepted strength based tax.

The administration of the Goods and Service Tax (GST) was further strengthened in 1999 with a major change effected to the GST refund system. Exporters who import raw materials for export processing are given a deferred payment facility to settle the GST liability and a refund on account of tax paid on imported inputs used in the export production process. Under the earlier refund system, exporters were given a refund by way of a cheque drawn in their favour upon the submission of customs documents to the Inland Revenue Department (IRD). As the operational procedure of this refund scheme was subject to misuse, the refund scheme was streamlined in 1999. Accordingly, a voucher system was introduced whereby the refund from the Inland Revenue Department was made with a voucher drawn in favour of the Customs Department with the refund payment netted against the GST liability. In addition, tax administration was strengthened by increasing field audits during the year. Audit investigations were carried out on the largest 150 tax payers and the largest 100 refund cases. The IRD intends to expand the coverage of field audits to the largest 1,500 tax payers and 1,000 tax refund cases from the year 2000.

Meanwhile, a separate committee of experts was appointed to review tax laws pertaining to the Inland Revenue Department.

With a view to developing the capital and debt markets, further fiscal incentives were granted in 1999. These were the removal of the 10 per cent withholding tax levied on interest paid on listed debentures and debt securities, the abolition of stamp duty on issues of listed debt instruments such as debentures, promissory notes and repurchase agreements relating to Treasury bills and the removal of capital gains tax on share warrants and derivative instruments. The capital gains waiver given in 1998, to unquoted companies which seek a listing on the CSE, was further extended till March 2000.

The government's strategy for developing information technology and the industrial and construction sectors was further strengthened in 1999. Information technology has been one of the major thrust areas showing rapid expansion in recent years. There is also high employment growth potential in this sector. A special fiscal incentive package was granted to those involved in the training of software specialists. Further, steps are being taken to upgrade the existing network of technical and vocational training centres and also to set up an Institute of Information Technology. Meanwhile, fiscal incentive packages granted for regional industrialization and for advanced technology development, scheduled to terminate in early 1999, were extended considering the need for further support for these sectors. In order to encourage private sector participation in the provision of training facilities, institutes which conduct training in priority sectors (garments, gems, jewellery, electronic and computer software) and engage in productivity improvement were granted 5 year tax holidays. Imports of machinery and equipment for the construction industry were made duty free, while income tax on local contractors was reduced from 35 per cent to 15 per cent, in line with the tax concessions enjoyed by foreign contractors. The government in 1999 established a Construction Industry Guarantee Fund with a view to reducing the cost of securities such as bid bonds and performance bonds required to be furnished by contractors.

The agriculture sector was accorded high priority during the year with a view to improving productivity and the production base. As non-availability of quality seed was identified as a constraint to increasing agricultural productivity, the government continued its efforts to strengthen existing seed production centres. Meanwhile, with a view to expanding the agricultural production base, the government established farming villages to modernise rural agriculture. Basic infrastructure was developed to set up four farming villages in the electorates of Gampola, Dambulla, Vavuniya and Kalawewa and further four locations have been identified in Hambantota, Bulathsinghala, Ampara and Kurunegala for this purpose. Further, priority has been given to setting up dedicated trading centres to improve the marketing of agricultural products. The fertiliser subsidy programme, reintroduced in 1994, continued in 1999 for urea. In addition to keeping the tariff on agricultural goods at 35 per cent, agricultural products were included in the negative list of the Indo-Lanka Free Trade Agreement to provide protection under the liberalised trade policy setting in Sri Lanka. The commercialization process of the agriculture sector also continued in 1999 with a view to further reducing the burden on the budget. After the successful divestiture of the Hingurakgoda farm, the Pelvehera seed paddy farm and two livestock farms at Ambewela and Pattipola were also prepared for divestiture in 1999.

The poverty reduction programmes of the government continued, focusing mainly on vulnerable groups in society. The Samurdhi programme, the core poverty reduction programme, covered about 2 million families (including 450,000 families shifted from the former Janasaviya programme). The cost of the programme was little over Rs.8 billion in 1999. Displaced families in the North and East numbering 154,932 were covered under the dry ration programme. A special nutrition supplement programme was introduced in the 1999 Budget for children and mothers in backward areas. Families receiving nutrition cards through the programme totalled 80,718. In addition, universal type welfare programmes such as school uniforms, text books and season tickets also continued in 1999. The increase in the number of families receiving Samurdhi benefits by about 15,000 and dry ration benefits by about 30,000 during 1999 was a worrisome feature indicating the necessity of introducing an effective screening process for beneficiaries under these core welfare programmes. Further rationalisation of non-targetted welfare programmes such as school text books and uniforms would minimise undue pressures on public funds.

Fiscal consolidation measures enabled the government in 1999 to contain current expenditures. A two per cent cut was imposed on recurrent expenditure other than salaries, pensions and interest payments. The cut in current expenses was imposed on all government entities including institutions and corporations. In addition, 3 per cent under-expenditure was expected in the public investment programme while past experience shows about 10 per cent under expenditure in capital expenditures. Cash flow management at the Treasury was further strengthened in

1999 by minimising cash balances at public spending units and restricting the bank overdraft facilities especially to defence services. The revenue generation of most government departments and agencies through the sale of their goods and services has not been sufficient due to low prices. Therefore, the government decided to increase all government fees and charges on public services by 20 per cent, while postal charges were increased by 40 per cent. Revisions in postal rates in the recent past have contributed towards lowering the operational loss of the Postal Department. Although Sri Lanka Railways incurs a similar loss on its current operations, the envisaged upward revision of fares could not be made. An unchanged fare structure since 1996, operational shortcomings and high recurrent expenditure are the main causes hampering an improvement in the railway service. However, fare increases alone would not solve the multifaceted problems in the Railways Department. A comprehensive reform programme should be initiated to improve the rail service in the country.

The year 1999 witnessed a further market orientation of government debt securities and an improvement in the medium and long-term market for government debt. This was largely due to the reliance placed on Treasury bonds in the government debt management strategy. Accordingly, about 70 per cent of total net domestic borrowings was through Treasury bonds in 1999. The maturity structure of bonds was increased to 6 years from 4 years in 1998. Technical difficulties have constrained the issue of Treasury bonds with a maturity period of over 6 years. The planned scripless securities system is expected to eliminate this constraint.

Several measures were introduced in 1999 to develop the government securities market. The electronic bidding system, which was introduced on a trial basis in 1998, commenced operations in 1999. This system was also used to release results of primary auctions to primary dealers. In line with international practice, a day count basis was introduced for Treasury bills to improve primary issues and trading in the secondary market. Accordingly, Treasury bills were issued with maturities of 91 days, 182 days and 364 days in place of 3 months, 6 months and 12 months respectively. Preparatory work has been completed to introduce a scripless system - a long-felt need to activate secondary market operations for government debt securities. Another major step taken to improve domestic debt management and open market operations was the reform of the Monetary Operations Unit (MOU). The MOU was replaced by three committees; the Liquidity Assessment Committee (LAC), the Open Market Operations Committee (OMOC) and the Domestic Debt Management Committee (DDMC) in 1999. The main responsibilities assigned to these committees include the assessment of liquidity in the market, assessing the need for Central Bank intervention in the market and determining the value, composition and the maturity structure of domestic market borrowings raised through Treasury bonds, Rupee loans and Treasury bills. Preliminary work has also been completed in setting up the dedicated primary dealer network. Dealers are required to dedicate a capital of Rs.150 million solely for this purpose. The number of primary dealers are expected to decline to about half from the current 18 after the new system is in place. There is still room for improvement in debt market activities in areas such as regionalisation of activities, moving towards a fully scripless system, trading of government securities at the stock exchange, introducing a system for the surveillance of public debt and allowing foreign investors to enter the government securities market. These measures would help improve secondary market activities, leading to sound debt management.

Transparency in fiscal operations has been improved in the recent past with the issue of several publications. The 'Budget at a Glance', as its name suggests, provides a succinct summary of the budget presented in terms of the budget proposals, public investment and development programmes and incentives for targeted groups and sectors. In addition, the publication also provides a medium-term fiscal policy direction and sectoral development programmes. 'Trends in Public Finance', published mid year, in addition to providing information on fiscal developments, gives the broad policy direction of economic reforms and an opportunity to revise fiscal targets for the year when necessary. The 'Path to Development' shows an improved presentation of the government's medium-term investment plan. The presentation of the government's 'Budget Estimates' has been restructured to improve transparency in providing budgetary information to the general public. New features of the publication include explanatory notes on the method of estimation, incorporating economic and other assumptions used in preparing budget estimates. Further, it includes information in summary form in respect of government ministries, institutions and corporations in a simplified manner.

8.2 Budget Outturn

Budgetary operations improved in 1999 consequent upon a conscious effort taken towards fiscal consolidation after the slippage experienced in the preceding year. The overall budget deficit before grants declined from Rs.93,147 million in 1998 to Rs.82,961 million in 1999. As a percentage of GDP, the overall deficit declined to 7.5 percent in 1999 from 9.2 per cent in the previous year. The higher revenue effort, together with lower government expenditure, enabled the government to contain the budget deficit in 1999. Total revenue, at Rs.195,905 million in 1999, rose in GDP terms to 17.6 per cent in 1999 from 17.2 per cent in 1998 due to a higher mobilisation of taxes. Tax revenue increased from 14.5 per cent of GDP in 1998 to 14.9 per cent of GDP in 1999. Total expenditure and net lending at

TABLE 8.1
Summary of Government Fiscal Operations

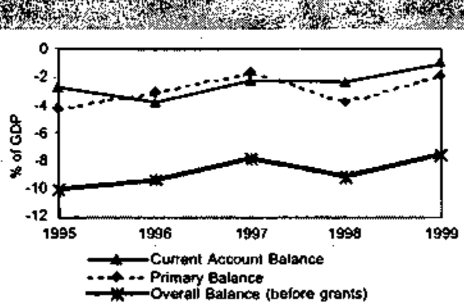
Rs. Million

	1995	1996	1997	1998	1999 Approved Estimates	1999 Provi-sional	2000 Approved Estimates
Total Revenue	136,258	146,279	165,036	175,032	214,320	195,905	233,974
Tax Revenue	118,543	130,202	142,512	147,368	185,410	166,029	201,766
Non Tax Revenue	17,715	16,077	22,524	27,664	28,910	29,877	32,208
Expenditure and Lending minus Repayments	203,483	218,659	235,097	268,179	283,263	278,865	329,831
Current	154,159	175,148	184,749	199,648	199,205	207,271	226,751
Capital and Net Lending	49,324	43,511	50,348	68,532	84,058	71,594	103,080
Public Investment	52,809	45,973	51,260	68,278	84,556	71,142	102,261
Other Capital	-3,486	-2,463	-912	253	-498	452	819
Current Account Surplus/Deficit(-)	-17,901	-28,869	-19,714	-24,616	15,115	-11,365	7,223
Primary Account Surplus/Deficit(-)	-29,000	-23,457	-14,815	-38,250	-9,163	-20,837	-26,809
Overall Deficit (before grants)	-67,225	-72,380	-70,061	-93,147	-68,943	-82,961	-95,857
Financing	67,225	72,380	70,061	93,147	68,943	82,961	95,857
Foreign Financing	30,252	17,898	17,287	17,397	20,283	7,951	22,166
Net Borrowings	21,224	10,160	9,958	10,197	12,283	1,190	14,166
Grants	9,028	7,739	7,329	7,200	8,000	6,761	8,000
Domestic Financing	33,972	49,754	30,275	71,362	40,660	74,876	43,691
Market Borrowings	33,424	39,391	39,644	72,292	40,660	75,718	43,691
Non Bank	26,359	26,301	41,816	53,338	40,660	49,723	43,691
Bank	7,065	13,090	-2,171	18,954	-	25,995	-
Monetary Authority	7,662	9,873	-13,991	5,609	-	20,807	-
Commercial Banks	-597	3,217	11,820	13,346	-	5,188	-
Other Borrowings	548	10,363	-9,369	-930	-	-842	-
Privatisation Proceeds	3,001	4,728	22,499	4,389	8,000	134	30,000
As a percentage of GDP							
Total Revenue	20.4	19.0	18.5	17.2	18.5	17.6	18.7
Tax Revenue	17.8	17.0	16.0	14.5	16.0	14.9	16.1
Non Tax Revenue	2.7	2.1	2.5	2.7	2.5	2.7	2.6
Expenditure and Lending minus Repayments	30.5	28.5	26.4	26.3	24.5	25.1	26.3
Current	23.1	22.8	20.8	19.6	17.2	18.7	18.1
Capital and Net Lending	7.4	5.7	5.7	6.7	7.3	6.4	8.2
Public Investment	7.9	6.0	5.8	6.7	7.3	6.4	8.2
Other Capital	-0.5	-0.3	-0.1	-	-	-	0.1
Current Account Surplus/Deficit(-)	-2.7	-3.8	-2.2	-2.4	1.3	-1.0	0.6
Primary Account Surplus/Deficit(-)	-4.3	-3.1	-1.7	-3.8	-0.8	-1.9	-2.1
Overall Deficit (before grants)	-10.1	-9.4	-7.9	-9.2	-6.0	-7.5	-7.6
Financing	10.1	9.4	7.9	9.2	6.0	7.5	7.6
Foreign Financing	4.5	2.3	1.9	1.7	1.8	0.7	1.8
Net Borrowings	3.2	1.3	1.1	1.0	1.1	0.1	1.1
Grants	1.4	1.0	0.8	0.7	0.7	0.6	0.6
Domestic Financing	5.1	6.5	3.4	7.0	3.5	6.7	3.5
Market Borrowings	5.0	5.1	4.5	7.1	3.5	6.8	3.5
Non Bank	3.9	3.4	4.7	5.2	3.5	4.5	3.5
Bank	1.1	1.7	-0.2	1.9	-	2.3	-
Monetary Authority	1.1	1.3	-1.6	0.6	-	1.9	-
Commercial Banks	-0.1	0.4	1.3	1.3	-	0.5	-
Other Borrowings	0.1	1.3	-1.1	-0.1	-	-0.1	-
Privatisation Proceeds	0.4	0.6	2.5	0.4	0.7	-	2.4

Source: Central Bank of Sri Lanka

Rs.278,865 million declined as a percentage of GDP from 26.3 per cent in 1998 to 25.1 per cent in 1999. The reduction in total expenditure and net lending was largely due to a slow down in current expenditure, which decreased from 19.6 per cent of GDP in 1998 to 18.7 per cent of GDP in 1999. Cuts imposed on current expenditure in the 1999 Budget and strict monitoring of such expenses and improved cash management helped constrain current expenditure. The higher revenue effort and the slowdown in current expenditures lowered the deficit in the current account of the budget from Rs.24,616 million in 1998 to Rs.11,365 million in 1999. As a percentage of GDP, the dissavings of the government declined from 2.4 per cent in 1998 to 1 per cent in 1999 contributing to domestic savings in the economy. Meanwhile, public investment, which consists of capital expenditure and on-lending to

Chart 8.1
Fiscal Indicators



commercial public enterprises, rose by Rs.2,864 million to Rs.71,142 million in 1999, although as a percentage of GDP, public investment declined to 6.4 per cent from 6.7 per cent in 1998. The 1999 budget target for public investment was 7.3 per cent of GDP.

In financing the deficit, a sum of Rs.7,951 million was utilised from foreign sources as compared to Rs.17,397 million used by way of foreign grants and loans in 1998. In GDP terms, foreign financing declined to 0.7 per cent in 1999 from 1.7 per cent in 1998. The budgeted amount for 1999 was Rs. 20,283 million or 1.8 per cent of GDP. Proceeds from privatisation brought in Rs. 134 million in 1999 as compared to a sum of Rs. 8,000 million envisaged in the budget. Consequently, recourse to domestic borrowing was Rs.3,514 million higher in 1999 than the Rs.71,362 million obtained in 1998. The domestic borrowing target was Rs.40,660 million in 1999. Borrowings from non-bank sources totalled Rs.49,723 million, a reduction of Rs.3,615 million over 1998. Non-bank borrowings as a percentage of GDP declined to 4.5 per cent during 1999 from 5.2 per cent in the preceding year. Consequently, bank financing rose by Rs.7,041 million to Rs.25,995 million registering an increase in its GDP ratio from 1.9 per cent in 1998 to 2.3 per cent in 1999. Financing from the Central Bank rose from Rs.5,609 million in 1998 to Rs.20,807 million in 1999. This partly reflected the shift in the composition of holding of government debt securities from commercial banks to the Central Bank due to additional liquidity needs of banks towards the end of 1999 in anticipation of Y2K uncertainty.

8.3 Revenue

The declining trend observed in the revenue/GDP ratio in the recent past was arrested in 1999 with a higher mobilisation of tax revenue. Revenue as a percentage of GDP increased from 17.2 per cent in 1998 to 17.6 per cent in 1999. In absolute terms, government revenue totalled Rs.195,905 million in 1999 registering an increase of 12 per cent in comparison to a moderate growth of 6 per cent recorded in 1998. Although few new tax measures were introduced in 1999, the impact of the tax changes adopted in the 1998 Budget along with improved tax administration especially targetted at the GST, increased the tax revenue/GDP ratio to 14.9 per cent in 1999 from 14.5 per cent in 1998. Meanwhile, non-tax revenue as a percentage of GDP was sustained at 2.7 per cent as in 1998. In order to maintain the revenue effort and improve elasticity in the tax system, steps should be taken to further expand the tax base while strengthening tax administration simultaneously. The rationalisation of Board of Investment (BOI) concessions and the establishment of a Revenue Protection Unit (RPU) in the year 2000 Budget with a view to expanding the tax base and strengthening tax enforcement are steps taken in the right direction.

Tax Revenue

The share of tax collection in total revenue increased to 85 per cent from 84 per cent in 1998 reflecting marked improvements in revenue from income taxes, excise taxes, GST and the National Security Levy. Tax revenue in 1999 grew by 13 per cent in comparison to a marginal increase of 3 per cent in 1998. Revisions made to the National Security Levy and excise taxes to maintain tax buoyancy are some of the measures that contributed to enhance the tax collection in 1999. The GST showed signs of becoming an important tax instrument with an increase in its GDP ratio by nearly one percentage point to 3.2 per cent in 1999. However, taxes collected under import duties recorded marginal reductions in comparison to 1998.

The share of income tax revenue in total tax revenue rose to 17 per cent in 1999 from 14 per cent in 1998, while as a percentage of GDP income taxes increased to 2.5 per cent from 2 per cent in the previous year. Income tax revenue, which has been virtually stagnant in the recent past, increased by 38 per cent to Rs.28,228 million in 1999. Personal income taxes increased by 13 per cent to Rs.9,169 million, while corporate taxes increased sharply by 56 per cent to Rs.18,362 million. Despite the slower growth in the economy in 1999 compared to 1998, the reduction of the corporate tax rate on sectors such as agriculture, fisheries, tourism and construction to 15 per cent in the 1999 Budget and the continuation of the investment tax allowance and other tax incentives announced in earlier budgets, the corporate tax revenue increased sharply mainly due to higher income tax payments by the Sri Lanka Ports Authority (Rs. 3,405 million) and the Ceylon Petroleum Corporation (Rs 3,410 million). Meanwhile, improved tax administration brought a collection of Rs.3,895 million as additional assessments on account of income taxes. Maintaining the tax threshold at the same level throughout the year under review contributed to increase the revenue from taxes on employment income. Meanwhile, the Save

TABLE 8.2
Summary of Revenue by Component

Rs. Million

	1995	1996	1997	1998	1999 Approved Estimates	1999 Provi-sional	2000 Approved Estimates
Tax Revenue	**118,543**	**130,202**	**142,512**	**147,368**	**185,410**	**166,029**	**201,766**
Income Taxes	17,161	20,751	21,548	20,429	24,192	28,228	29,230
Personal	7,358	7,315	8,183	8,099	9,934	9,169	11,438
Corporate	9,803	13,311	13,038	11,788	13,544	18,362	16,945
Save the Nation Contribution	-	125	327	542	714	697	847
Taxes on Property	5,162	5,279	6,392	7,079	9,293	7,690	9,325
Tax on Treasury Bills held by Central Bank	1,050	1,604	1,080	-	-	-	-
Taxes on Domestic Goods and Services	70,797	77,105	86,750	91,706	120,798	102,391	136,337
Turnover Tax	36,429	37,631	43,492	16,166	550	1,799	2,759
Manufacturing	9,906	8,874	9,475	3,727	50	161	-
Non Manufacturing	7,074	9,712	13,329	7,312	500	1,635	2,759
Imports	19,449	19,046	20,689	5,127	-	3	-
Goods and Services Tax	-	-	-	23,177	57,561	35,540	50,536
Manufacturing	-	-	-	5,533	11,943	10,552	12,674
Non Manufacturing	-	-	-	5,437	17,240	9,192	15,688
Imports	-	-	-	12,207	28,378	15,796	22,174
Excise Tax	19,436	22,067	24,775	30,293	34,544	35,928	46,552
Liquor	6,298	5,839	6,181	7,665	9,192	8,745	10,700
Tobacco	8,788	12,833	14,139	15,051	17,002	17,205	18,750
Other	4,350	3,395	4,455	7,577	8,350	9,978	17,102
National Security Levy	14,408	16,441	17,338	21,079	26,700	28,127	35,340
Licence Fees	524	966	1,145	991	1,443	997	1,150
Taxes on International Trade	24,373	25,464	26,743	28,154	31,127	27,720	26,874
Imports	24,365	25,459	26,739	28,154	31,127	27,720	26,874
Exports	8	5	4	-	-	-	-
Non Tax Revenue	**17,715**	**16,077**	**22,524**	**27,664**	**28,910**	**29,877**	**32,208**
Property Income	12,011	10,059	15,022	18,462	18,895	18,988	20,760
of which: Central Bank Profits	1,200	1,700	1,500	2,650	3,000	3,000	3,200
Interest Income	6,991	5,222	8,002	7,786	7,050	7,056	7,100
Fees and Charges	1,751	2,827	2,800	2,890	3,329	3,375	4,361
Other Non-tax Revenue	3,953	3,191	4,702	6,312	6,686	7,514	7,087
Total Revenue	**136,258**	**146,279**	**165,036**	**175,032**	**214,320**	**195,905**	**233,974**

As a percentage of GDP

	1995	1996	1997	1998	1999 Approved Estimates	1999 Provi-sional	2000 Approved Estimates
Tax Revenue	**17.8**	**17.0**	**16.0**	**14.5**	**16.0**	**14.9**	**16.1**
Income Taxes	2.6	2.7	2.4	2.0	2.1	2.5	2.3
Personal	1.1	1.0	0.9	0.8	0.9	0.8	0.9
Corporate	1.5	1.7	1.5	1.2	1.2	1.7	1.4
Save the Nation Contribution	-	-	-	0.1	0.1	-	-
Taxes on Property	0.8	0.7	0.7	0.7	0.8	0.7	0.7
Tax on Treasury Bills held by Central Bank	0.2	0.2	0.1	-	-	-	-
Taxes on Domestic Goods and Services	10.6	10.0	9.7	9.0	10.4	9.2	10.9
Turnover Tax	5.5	4.9	4.9	1.6	-	0.2	0.2
Manufacturing	1.5	1.2	1.1	0.4	-	0.0	0.0
Non Manufacturing	1.1	1.3	1.5	0.7	-	0.1	0.2
Imports	2.9	2.5	2.3	0.5	-	-	-
Goods and Services Tax	-	-	-	2.3	5.0	3.2	4.0
Manufacturing	-	-	-	0.5	1.0	1.0	1.0
Non Manufacturing	-	-	-	0.5	1.5	0.8	1.3
Imports	-	-	-	1.2	2.5	1.4	1.8
Excise Tax	2.9	2.9	2.8	3.0	3.0	3.2	3.7
Liquor	0.9	0.8	0.7	0.8	0.8	0.8	0.9
Tobacco	1.3	1.7	1.6	1.5	1.5	1.5	1.5
Other	0.7	0.4	0.5	0.7	0.7	0.9	1.4
National Security Levy	2.2	2.1	1.9	2.1	2.3	2.5	2.8
Licence Fees	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Taxes on International Trade	3.6	3.3	3.0	2.8	2.7	2.5	2.1
Imports	3.6	3.3	3.0	2.8	2.7	2.5	2.1
Exports	-	-	-	-	-	-	-
Non Tax Revenue	**2.7**	**2.1**	**2.5**	**2.7**	**2.5**	**2.7**	**2.6**
Property Income	1.8	1.3	1.7	1.8	1.6	1.7	1.7
of which: Central Bank Profits	0.2	0.2	0.2	0.3	0.3	0.3	0.3
Interest Income	1.0	0.7	0.9	0.8	0.6	0.6	0.6
Fees and Charges	0.3	0.4	0.3	0.3	0.3	0.3	0.3
Other Non-tax Revenue	0.6	0.4	0.5	0.6	0.6	0.7	0.6
Total Revenue	**20.4**	**19.0**	**18.5**	**17.2**	**18.5**	**17.6**	**18.7**

Source: Central Bank of Sri Lanka

the Nation Contribution (SNC) increased from Rs.542 million in 1998 to Rs.697 million in 1999.

Excise taxes remained a buoyant source of revenue in 1999, increasing its share in tax revenue from 20 to 22 per cent in 1999 and its GDP percentage from 3 to 3.2 in 1999. The revenue mobilised from excise taxes at Rs.35,928 million recorded an increase of 19 per cent in 1999.

Excise tax revenue on cigarettes amounted to Rs.17,205 million, accounting for 48 per cent of the total excise duty collected. Despite the decline in cigarette sales by 3 per cent, the excise tax revenue from cigarettes rose by 14 per cent in 1999 in comparison to a 6 per cent growth in 1998. The full impact of upward revisions made to the excise tax in 1998 and a further increase in the excise tax in October 1999, together with the shift in the consumption towards cigarette brands subject to higher taxes contributed to enhance the revenue collection from the excise tax on cigarettes.

Revenue generated from the excise tax on liquor, at Rs.8,745 million, increased by a lower rate of 14 per cent in 1999 compared to the 24 per cent growth observed in 1998. This was largely due to two factors, which impacted on the revenue collection in opposite directions. Firstly, the production of hard liquor declined by 5 per cent and that of malt liquor increased by 5 per cent in 1999. In 1998 production had increased by 12 per cent and 45 per cent, respectively. Secondly, it reflects the combined outcome of the full impact of the revision of excise tax (under the Excise Ordinance) on malt liquor on a strength basis, together with the imposition of an excise tax on malt liquor under the Excise (Special Provisions) Act and the upward revision of tax rates on hard liquor.

The share of revenue under the Excise (Special Provisions) Act, excluding cigarettes and liquor, in the total excise duty collection increased from 25 per cent to 28 per cent. The revenue mobilised from this category in 1999 was Rs.9,978 million, which is a significant growth of 32 per cent. The increase in petrol and diesel sales by 4 and 15 per cent, respectively, and the full impact of the upward adjustment made to excise tax on petrol as a revenue neutralising measure with the introduction of the GST contributed towards enhancing tax revenue from this source. Further, the full impact of an additional excise duty of 10 per cent imposed under the Special Provisions Act on imported motor vehicles resulted in a growth of 56 per cent in revenue from excise taxes on vehicles.

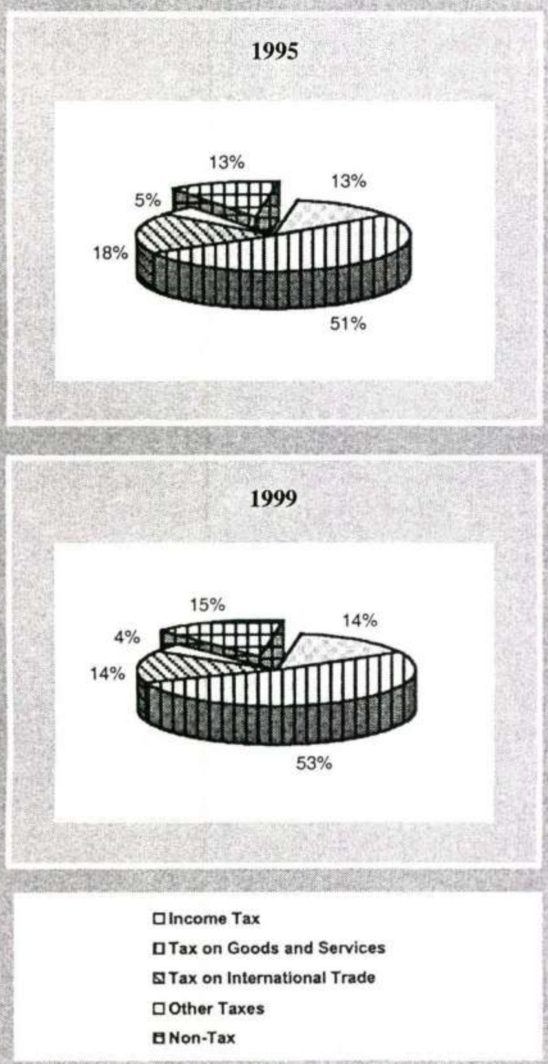
The upward revision of the National Security Levy (NSL) helped generate a sum of Rs.28,127 million in 1999, further enhancing its GDP ratio and tax share to 2.5 per cent and 17 per cent, respectively. The NSL, which in 1998 accounted for 14 per cent of tax revenue and amounted to 2.1 per cent of GDP, recorded a significant growth of 33 per cent in 1999. The full impact of the upward revision of the NSL rate from 4.5 per cent to 5.5 per cent in 1998, combined with the expansion of the service sector and the rise in prices of taxable services such as telecommunication, contributed towards enhancing revenue from this source. Revenue from the NSL on domestic activities increased by 39 per cent, while that on imports registered a growth of 30 per cent. Consequently, the share of the NSL from imports declined marginally to 62 per cent of the total NSL collection from 63 per cent in 1998.

Revenue from import duties decreased by 2 per cent to Rs.27,720 million in 1999 largely due to a reduction in dutiable imports, lower CIF values and the downward revision of the tariff structure to 5,10 and 30 per cent. Thus, in spite of a 4 per cent growth in the value of imports, the share of dutiable imports in total imports declined to 35.6 per cent in 1999 from 36.4 per cent in 1998. Consequently, the average effective duty rate decreased to 20.5 per cent in 1999 from 20.9 per cent in 1998. Further, the average duty rate also decreased to 7 per cent in 1999 from 7.4 per cent in the previous year. Despite the increase in import duty on petroleum products from 25 to 30 per cent and the increase in the CIF value of petroleum products by 40 per cent, the rationalisation of the tariff structure which brought about a downward revision of tariff rates together with lower international prices for Sri Lanka's major dutiable imports, contributed to the decline in the import duty collection.

The Goods and Services Tax (GST) introduced in April 1998 showed an improved performance in 1999 reflecting partly the full year's impact of this tax in 1999, the growth in specific sectors of the economy and measures adopted to overcome the initial teething problems encountered in the administration of this tax. Thus, the GST in 1999 mobilised Rs.35,540 million from domestic sources and imports as compared to Rs.23,177 million collected over the nine month period in 1998. As a percentage of GDP, GST revenue increased from 2.3 per cent in 1998 to 3.2 per cent in 1999.

Revenue from GST on domestically produced goods and services totalled Rs.19,744 million in 1999. When a comparison is made for a similar period during both years (May - December), GST from domestic sources recorded a significant increase of 30 per cent over 1998. While GST revenue from the manufacturing sector brought in Rs.10,552 million, collections from non-manufacturing sources amounted to Rs.9,192 million. The bulk of GST revenue on manufactures was derived from the food, beverage and tobacco sub-sector. Major contributors to this sub-sector were the tobacco and liquor industries. The chemical and petroleum sector also contributed to GST revenue from manufacturing sources. GST revenue from the non-manufacturing sector was obtained mainly from services such as construction, electricity and insurance, reflecting the higher growth in these sectors in the economy.

Chart 8.2
Composition of Revenue



GST on imports netted a sum of Rs.15,796 million in 1999 with a new refund mechanism put in place to reduce leakages from this tax. A major problem encountered in the collection of GST on imports was the high expenditure incurred on account of refund payments. Refunds for 1999 amounted to Rs.11,137 million in comparison to a total of Rs.7,826 million expended for a nine month period in 1998. In an effort to stem the outflow arising from the GST refunds on imports, the authorities in 1999 effected changes to the refund mechanism while simultaneously strengthening other tax administration measures to improve the collection from this source.

The refund system for GST imports enables exporters to claim refunds of taxes paid on imported inputs used in the production of exports. Initially, refunds were made directly to the importer by way of a cheque issued by the Inland Revenue Department drawn in favour of the importer for the full value of the tax on imported inputs. However, during the latter part of 1999 cheques issued by the Inland Revenue Department were replaced by a voucher system, whereby the Inland Revenue Department remitted direct to the Customs Department, a credit voucher drawn in favour of the Customs for the GST payment netted against the refund due to the importer. The change in the refund mechanism enhanced the import GST revenue collection in net terms by reducing leakages through this mechanism. Thus, GST refunds as a percentage of gross receipts averaged at 16.7 per cent during the latter half of 1999 as compared to an average of 30.2 per cent witnessed for the first six months of 1999. In addition, audit checks were also intensified during the latter part of 1999 in order to improve GST compliance. Therefore, GST revenue in net terms on account of imports during the second half of 1999 increased by 14 per cent to Rs.8,921 million in comparison to Rs.7,841 million during the comparable period in 1998.

Total GST revenue for 1999 at Rs.35,540 million however, fell short of the budgetary target of Rs.57,561 million (5 per cent of GDP). Moreover, in comparison to the turnover tax system which the GST replaced, the revenue yield of the new tax has been lower. The introduction of GST at a lower rate of 12.5 per cent as opposed to a tax structure of 8,12 and 18 per cent levied under turnover taxes prior to its abolition can be cited as a major reason for the reduced collection of GST vis-a-vis turnover taxes. However, new measures announced in the year 2000 Budget such as the removal of GST exemptions on cement and timber will lead to an expansion in the tax base of the GST adding further impetus to the revenue mobilisation effort of this tax in the future.

Revenue from stamp duties, at Rs.7,690 million in 1999, showed a deceleration in growth from 11 per cent in 1998 to 9 per cent in 1999 mainly due to lower imports and the removal of such duties on financial instruments. The removal of stamp duties on listed debt instruments such as debentures, promissory notes and repurchase agreements on Treasury bills, together with the slower growth of imports, could be cited as contributory factors for the deceleration in stamp duty collection.

Non-Tax Revenue

Non-tax revenue, at Rs.29,877 million in 1999, remained a buoyant source of revenue maintaining its share of GDP at 2.7 per cent as in 1998 mainly on account of higher property income. The growth in non-tax revenue was 8 per cent over 1998, with such revenue accounting for 15 per cent of the total revenue in 1999. Property income consisting of profits and dividends, interest, rent etc., increased by 3 per cent to Rs.18,988 million accounting for 64 per cent of the non-tax revenue in 1999. Interest income in 1999 was Rs.7,056 million. The main contributors were the Ceylon Electricity Board (CEB - Rs. 2,411 million), SL Telecom (Rs. 1,394 million), National Development Bank (NDB - Rs. 899 million) and Development Finance Corporation Bank (Rs. 565 million). Sums of Rs. 688 million and Rs. 572 million were collected from the Bank of Ceylon and the People's Bank, respectively, in accordance with the revenue sharing agreements made with these institutions regarding interest accruing to restructuring bonds. Profits, dividends and levies (excluding Central Bank profit transfers) increased from Rs. 6,200 million in 1998 to Rs. 7,707 million in 1999 reflecting an increase of 24 per cent during the year. Enterprises such as the Ports Authority (Rs. 3,750 million) and CEB (Rs. 600 million) helped to expand this sub-category of property income. Central Bank profit transfers increased from Rs. 2,650 million in 1998 to Rs. 3,000 million in 1999. Other non-tax revenue sources, which consist largely of fees and charges, rent and non-industrial sales, increased by 19 per cent. The upward revision of administration fees and charges mainly contributed to this increase.

8.4 Expenditure

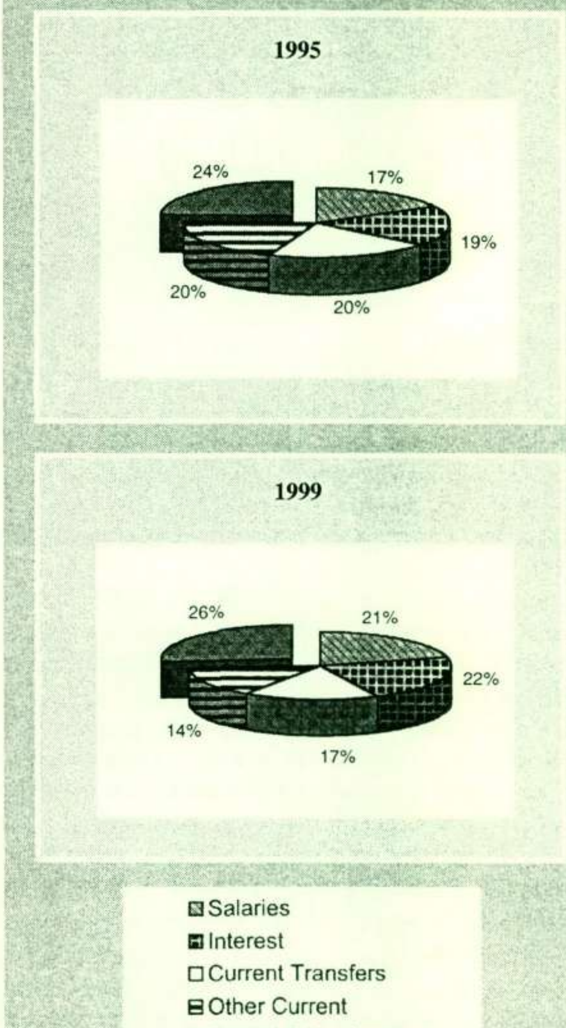
Reflecting the fiscal consolidation effort made during the past few years, particularly with regard to budgetary expenditures, the year 1999 witnessed a further reduction in total expenditure and net lending largely due to a slowdown in recurrent expenditures. Total expenditure as a percentage of GDP dropped from 26.3 per cent in 1998 to 25.1 per cent in 1999 reflecting largely a decline in the current expenditure/GDP ratio from 19.6 per cent to 18.7 per cent in 1999. In absolute terms, total expenditure and lending minus repayments amounted to Rs.278,865 million, an increase of 4 per cent over 1998. Current outlays amounted to Rs.207,271 million accounting for 74 per cent of total expenditure. The two per cent cut in recurrent expenditure enforced through the 1999 Budget and improved expenditure control and monitoring enabled the government to maintain current expenses at a lower level. Meanwhile, capital expenditure and net lending totalled Rs.71,594 million, an increase of 4 per cent over the previous year. Public investment, which consists of capital expenditure and on-lending, increased from Rs.68,278 million in 1998 to Rs 71,142 million in 1999. However, as percentage of GDP, Public investment declined to 6.4 per cent in 1999 from 6.7 per cent in 1998. Public investment was expected to reach 7.3 per cent of GDP in the 1999 Budget.

Current Expenditure

Expenditure rationalisation measures and strict control of recurrent expenses decelerated the growth in current expenditure to 4 per cent in 1999 from 8 per cent in 1998. Prudent cash management through the maintenance of minimal idle cash balances and the close monitoring of the government's cash flow position resulted in improved expenditure management. In addition, the economising of public expenditures with a cut imposed on all recurrent expenses other than salaries, pensions and interest payments contributed towards containing current outlays. Moreover, the resort to supplementary estimates only for essential purposes during the year constrained the growth in current expenditure. While supplementaries for current expenditures amounted to Rs. 7,096 million in 1999, the comparable figure for 1998 was Rs. 14,408 million.

The drop in current expenditure was largely reflected in the purchase of goods and services of the government. Expenses incurred by the government for the purchase of goods for civil and defence purposes dropped sharply from 22 per cent of total current expenditure in 1998 to 19 per

Chart 8.3
Composition of Expenditure



cent in 1999. Subsidies and transfers, which showed a decline in absolute as well as GDP terms, continued to account for 23 per cent of total current expenditure as in 1998. Meanwhile, interest expenditure, which accounted for 27 per cent of current expenditure in 1998, increased its share to 30 per cent in 1999. The share of salaries and wages also increased marginally from 27 per cent in 1998 to 28 per cent in 1999.

Salaries and wages, at Rs.58,532 million, recorded a lower growth of 9 per cent in 1999 in comparison to a much higher increase of 21 per cent witnessed in 1998. As a percentage of GDP, expenditure on salaries and wages was maintained at 5.3 per cent as in 1998. Central government salaries rose by 13 per cent to Rs.14,473 million in 1999. The full year impact of the salary increase given during the second half of 1998 to public servants drawing a salary in excess of Rs.7,500 per month, and the recruitment of 10,000 graduates into the public sector which cost the government Rs.500 million, largely contributed to the higher salary bill. In addition, the payment of salaries to Govi Niyamakas employed under the Agrarian Services Department whose salaries were earlier paid through the Samurdhi Authority also raised the salaries and wages bill of the central government. The salaries and wages bill of the provincial councils, which show the personal emoluments of public servants attached to provincial councils, increased from Rs.17,902 million in 1998 to Rs.19,200 million in 1999 reflecting the normal increment observed in salaries each year. Meanwhile, defence salaries rose by 8 per cent to Rs.24,859 million in 1999 due to new recruits to the defence services during the year. However, defence salaries marginally declined from 2.3 per cent of GDP in 1998 to 2.2 per cent of GDP in 1999.

Outlays on account of other goods and services decreased by 9 per cent to Rs.39,690 million in 1999 reflecting cuts in such expenditure for civil as well as defence sectors. Consequently, expenditure on goods and services as a percentage of GDP fell substantially from 4.3 per cent in 1998 to 3.6 per cent in 1999. The significant decline in outlays for the purchase of defence goods and services by 14 per cent enabled this category of expenditure to show a substantial reduction. Thus, purchases of defence goods and services, which in 1998 amounted to Rs.27,958 million, decreased to Rs.23,848 million in 1999, consequently lowering the share of such outlays in GDP terms to 2.1 per cent in 1999 from 2.8 per cent in the preceding year. A tight control on cash releases to defence services, whereby Treasury approval had to be sought for withdrawals made from the banking sector, and lower imports for defence purposes contributed largely towards curtailing expenditure from this source. Similarly, outlays for the purchase of goods and services for ministries and departments at Rs.13,730 million registered a marginal decline, in turn reducing its GDP ratio from 1.4 per cent in 1998 to 1.2 per cent in 1999. Although the purchase of goods and services by provincial councils increased by 14 per cent during the year, the impact of this on the overall goods and services expenditure was negligible.

Interest expenditure, at Rs.62,123 million in 1999, rose by 13 per cent reflecting higher borrowings from domestic sources, the impact of the exchange rate variation and the generally higher interest rates observed for government securities in 1999. Total interest payments as a percentage of GDP rose from 5.4 per cent in 1998 to 5.6 per cent in 1999. Interest outlays on account of domestic borrowings amounted to Rs.47,302 million in 1999 as compared to Rs.41,529 million in the preceding year, increasing its GDP ratio from 4.1 per cent in 1998 to 4.3 per cent in 1999. In addition, the government incurred an expenditure of Rs.6,069 million as in the previous year on account of interest paid to the Bank of Ceylon, People's Bank and the National Savings Bank for bonds issued for restructuring purposes. Similarly, interest expenses on account of foreign loans rose by Rs.1,452 million to Rs.8,752 million although in GDP terms, the share of such expenses amounted to only 0.8 per cent.

The increase in domestic borrowings in 1998 and 1999 raised the domestic interest bill further. Moreover, the gradual increase in the interest rate structure towards the end of 1998 and maintenance of such rates during 1999 added to the interest cost of the budget. While the interest rates for Rupee loans and Treasury bonds hovered around 12-12.50 and 12.65-14.02 per cent per annum, respectively, in 1999, the comparable rates for the preceding year were 11-11.50 per cent and 10.81-13.94 per cent. Meanwhile, the 12-month Treasury bill rate, which rose from 10.24 per cent in January 1998 to around 13.00 per cent at the end of 1998, contributed to the higher interest cost of Treasury bills in 1999.

Interest payments on account of Rupee loans amounted to Rs.32,803 million reflecting a reduction in outlays arising from these expenses by Rs.283 million in 1999. Accordingly, interest payments on rupee securities as a ratio of the debt outstanding as at end December 1999 declined from 13.2 per cent in 1998 to 12.5 per cent in 1999. Although the outstanding stock of Rupee loans increased in 1999, the re-issue of maturing loans amounting to Rs. 53 billion in 1998 and 1999 at lower rates of interest, helped significantly reduce the interest cost.

Expenditure on account of Treasury bill interest payments rose from Rs.12,398 million in 1998 to Rs.13,085 million in 1999. Consequently, interest payments as a ratio of the end year outstanding Treasury bill stock increased marginally from 10.3 per cent in 1998 to 10.5 per cent in 1999. New issues of Treasury bills to the value of Rs. 5,000 million raised the debt outstanding on account of

TABLE 8.3
Economic Classification of Expenditure and Lending minus Repayment

Rs. Million

	1995	1996	1997	1998	1999 Approved Estimates	1999 Provi-sional	2000 Approved Estimates
Current Expenditure	**154,159**	**175,148**	**184,749**	**199,648**	**199,205**	**207,271**	**226,751**
Expenditure on Goods and Services	75,446	80,003	83,831	97,768	91,976	98,223	107,103
Salaries and Wages	34,909	38,332	44,677	53,880	54,292	58,532	62,948
Other Goods and Services	40,538	41,671	39,154	43,888	37,684	39,690	44,155
Interest Payments	38,225	48,923	55,246	54,897	59,780	62,123	69,048
Foreign	6,162	6,739	6,692	7,300	8,060	8,752	9,812
Domestic (a)	32,063	42,184	48,554	47,598	51,720	53,371	59,236
Current Transfers and Subsidies	40,487	46,223	45,672	46,982	47,749	46,925	49,600
To Public Corporations	7,841	8,232	2,693	2,967	2,486	3,277	2,721
To Public Institutions	2,182	2,284	2,657	4,320	6,033	4,834	6,222
To Other Levels of Government	1,157	1,592	1,941	1,977	2,103	1,629	1,625
To Households and Other Sectors	29,307	34,114	38,381	37,719	37,127	37,185	39,031
Food Stamps, Food Subsidy etc.	1,799	591	-	-	-	334	455
Samurdhi/Janasaviya	5,130	8,591	8,718	8,652	8,374	8,020	8,000
Pensions	14,549	15,465	17,916	19,477	19,321	19,056	21,228
Fertiliser Subsidy	1,345	1,500	1,895	2,152	1,500	1,390	1,500
Other	6,484	7,967	9,852	7,438	7,932	8,385	7,848
o/w School uniforms, text books & season tickets	1,171	1,839	1,798	1,989	1,500	1,803	2,230
Refugees	2,325	2,278	3,357	2,307	2,437	2,667	3,049
Provision for Under Expenditure / Contingency	-	-	-	-	-300		1,000
Capital Expenditure	**41,722**	**37,638**	**43,982**	**54,160**	**68,736**	**60,046**	**80,542**
Acquisition of Real Assets	22,589	20,938	25,468	32,246	37,734	32,639	43,512
Capital Transfers	19,134	16,700	18,514	21,915	33,597	27,407	46,054
To Public Corporations	7,614	6,017	5,880	6,801	9,828	9,075	13,150
To Public Institutions	10,446	9,602	11,041	13,285	19,261	15,968	22,310
To Other Levels of Government	1,057	1,042	1,511	1,764	1,975	2,297	10,477
Other	17	39	83	65	2,533	67	117
Provision for Under Expenditure	-	-	-	-	-2,595		-9,023
Lending minus Repayment	**7,602**	**5,873**	**6,366**	**14,370**	**15,322**	**11,548**	**22,537**
Advance Accounts	-1,580	630	1,226	2,784	500	1,585	1,500
On Lending	11,087	8,335	7,278	14,117	15,820	11,096	21,718
Restructuring Cost	3,191	90	2,193	3,688	3,980	4,556	5,219
Loan Repayments	-5,096	-3,182	-4,331	-6,218	-4,978	-5,689	-5,900
Total Expenditure and Net Lending	**203,483**	**218,659**	**235,097**	**268,179**	**283,263**	**278,865**	**329,831**
		As a percentage of GDP					
Current Expenditure	**23.1**	**22.8**	**20.8**	**19.6**	**17.2**	**18.7**	**18.1**
Expenditure on Goods and Services	11.3	10.4	9.4	9.6	8.0	8.8	8.5
Salaries and Wages	5.2	5.0	5.0	5.3	4.7	5.3	5.0
Other Goods and Services	6.1	5.4	4.4	4.3	3.3	3.6	3.5
Interest Payments	5.7	6.4	6.2	5.4	5.2	5.6	5.5
Foreign	0.9	0.9	0.8	0.7	0.7	0.8	0.8
Domestic (a)	4.8	5.5	5.5	4.7	4.5	4.8	4.7
Current Transfers and Subsidies	6.1	6.0	5.1	4.6	4.1	4.2	4.0
To Public Corporations	1.2	1.1	0.3	0.3	0.2	0.3	0.2
To Public Institutions	0.3	0.3	0.3	0.4	0.5	0.4	0.5
To Other Levels of Government	0.2	0.2	0.2	0.2	0.2	0.1	0.1
To Households and Other Sectors	4.4	4.4	4.3	3.7	3.2	3.3	3.1
Food Stamps, Food Subsidy etc.	0.3	0.1	-	-	-	-	-
Samurdhi/Janasaviya	0.8	1.1	1.0	0.8	0.7	0.7	0.6
Pensions	2.2	2.0	2.0	1.9	1.7	1.7	1.7
Fertiliser Subsidy	0.2	0.2	0.2	0.2	0.1	0.1	0.1
Other	1.0	1.0	1.1	0.7	0.7	0.8	0.6
o/w School uniforms, text books & season tickets	0.2	0.2	0.2	0.2	0.1	0.2	0.2
Refugees	0.3	0.3	0.4	0.2	0.2	0.2	0.2
Provision for Under Expenditure /Contingency	-	-	-	-	-	-	0.1
Capital Expenditure	**6.2**	**4.9**	**4.9**	**5.3**	**5.9**	**5.4**	**6.4**
Acquisition of Real Assets	3.4	2.7	2.9	3.2	3.3	2.9	3.5
Capital Transfers	2.9	2.2	2.1	2.2	2.9	2.6	3.7
To Public Corporations	1.1	0.8	0.7	0.7	0.9	0.8	1.0
To Public Institutions	1.6	1.3	1.2	1.3	1.7	1.4	1.8
To Other Levels of Government	0.2	0.1	0.2	0.2	0.2	0.2	0.8
Other	-	-	-	-	0.2	-	-
Provision for Under Expenditure	-	-	-	-	-0.2	-	-0.7
Lending minus Repayment	**1.1**	**0.8**	**0.7**	**1.4**	**1.3**	**1.0**	**1.8**
Advance Accounts	-0.2	0.1	0.1	0.3	-	0.1	0.1
On Lending	1.7	1.1	0.8	1.4	1.4	1.0	1.7
Restructuring Cost	0.5	-	0.2	0.4	0.3	0.4	0.4
Loan Repayments	-0.8	-0.4	-0.5	-0.6	-0.4	-0.5	-0.5
Total Expenditure and Net Lending	**30.5**	**28.5**	**26.4**	**26.3**	**24.5**	**25.1**	**26.3**

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.

Treasury bills to Rs. 124,996 million contributing to the higher interest cost. Moreover, the slightly higher interest rates prevailing for such securities towards the end of 1998 and the maintenance of such rates in 1999 added to the higher interest expenditure.

The market orientation of government securities continued in 1999 with budgetary expenditure reflecting higher interest payments on Treasury bonds. The interest cost of Treasury bonds increased sharply from Rs.2,101 million in 1998 to Rs.7,487 million in 1999. This is the combined outcome of a larger amount of funds being mobilised through Treasury bonds (Rs.55,952 million in 1999 as against Rs.38,915 million in 1998) and the higher interest rates prevailing for these securities during the latter period of 1998 and in 1999.

Interest expenditure on foreign loans increased by 20 per cent to Rs.8,752 million. The increase in the rupee value of the outstanding external debt stock on account of exchange rate variations by Rs. 105 billion over a two year period and the increase in borrowings from bilateral as opposed to multilateral sources for which interest rates were relatively higher, contributed to higher expenditure on foreign loans. Thus, foreign interest payments as a ratio of foreign debt increased to 1.7 per cent in 1999 from 1.6 per cent in 1998.

Current transfers and subsidies, at Rs.46,925 million in 1999, were maintained at more or less the same level in nominal terms as in 1998. As a result, transfers and subsidies as a percentage of GDP declined to 4.2 per cent in 1999 from 4.6 per cent in the previous year. This was largely due to a reduction in pension expenditures, which decreased from 1.9 per cent of GDP in 1998 to 1.7 per cent in 1999. Pension expenses account for 41 per cent of total subsidies and transfers.

Expenses on account of pension payments amounted to Rs.19,056 million in comparison to Rs.19,477 million in 1998. While the number of pensioners increased by about 14,000 in 1999, the actual cost incurred on pensions was lower compared to 1998 due to the payment of arrears made on account of the Cost of Living (COL) allowance in the previous year.

Expenditure incurred on Samurdhi, the government' s core welfare programme, declined from Rs.8,652 million in 1998 to Rs.8,020 million in 1999. In nominal terms, outlays on account of Samurdhi registered a decline of 7 per cent while as a percentage of GDP, Samurdhi payments dropped to 0.7 per cent from 0.8 per cent in the previous year. The lower Samurdhi expenditure was due to the transfer of 10,000 Samurdhi animators from the Samurdhi programme to the Agrarian Services Department as Govi Niyamakas whose salaries were paid through the central government in 1999. Despite an increase in the number of families by about 15,000 to 2 million in 1999, the decline in the number of beneficiaries coming under the Rs 1,000 category helped to contain the expenditure on Samurdhi in 1999.

Expenditure incurred on the fertiliser subsidy declined by Rs.762 million and amounted to Rs.1,390 million in 1999. The reduction in the international price of urea from US dollars 133 per metric ton in 1998 to US dollars 110 per metric ton in 1999 largely contributed to this decrease.

Transfers to corporations and institutions rose by Rs.824 million to Rs.8,111 million in 1999, although in GDP terms it was maintained at around 0.7 percent during both years. While transfers to corporations amounted to Rs.3,277 million, an increase of 10 per cent, public institutions obtained a sum of Rs.4,834 million, an increase of 12 per cent over 1998. As a share of total transfers and subsidies, transfers to public corporations and institutions rose to 17 per cent in 1999 from 15 per cent in the previous year. Major users of such public funds continued to be the Samurdhi Authority (Rs.938 million) and the Sri Jayawardenapura Hospital (Rs.328 million). While operational losses of the Postal Department decreased to Rs.212 million as a result of the 40 per cent increase in postal rates in November 1998, operational losses of Sri Lanka Railways rose to Rs.1,848 million in 1999. Of this, Rs.326 million was incurred to clear arrears to the CPC and Rs 150 million to settle salary arrears. The continuation of such losses in the postal and railway departments points to the urgent need for price revisions and the adoption of a comprehensive reform plan to improve the efficiency of these enterprises.

Public Investment

Public investment, consisting of government capital expenditure and on-lending to public enterprises, grew by 4 per cent to Rs.71,142 million in 1999. However, as a percentage of GDP, public investment declined from 6.7 per cent in 1998 to 6.4 per cent in 1999. In nominal terms, higher public investment was observed largely in government institutions, corporations and provincial councils while investments made by ministries and departments grew at a slower pace. Accordingly, government direct transfers to institutions, corporations and other levels of government registered a sharp increase of 25 per cent, while transfers to ministries and departments rose only by 1 per cent in 1999. While the 1999 Budget expected to maintain public investment at 7.3 per cent of GDP, delays in project implementation and administrative constraints restricted the government from reaching the investment target.

Expenditure incurred by central government ministries and departments under the Public Investment Programme (PIP) for construction and development of fixed assets increased by 1 per cent to Rs.32,639 million in 1999. These investments were mostly concentrated in areas such as education, health, agriculture and irrigation. Total capital transfers to public corporations, institutions and other levels of government rose by 25 per cent to Rs. 27,407 million in 1999. Capital transfers to commercially oriented public corporations and boards showed a substantial increase of 33 per cent to Rs.9,075 million. The National Water Supply and Drainage Board (Rs. 4,770 million), Land Reclamation and Development Corporation (Rs1,112 million), Ceylon Electricity Board (Rs 934 million) and National Housing Development Authority (Rs. 1,032 million) accounted for over 86 per cent of these transfers in 1999. Capital transfers to non-commercial public institutions rose by 20 per cent to Rs.15,968 million in 1999. The Road Development Authority (Rs. 6,896 million), Mahaweli Development Authority (Rs. 1,357 million), Urban Development Authority (Rs. 735 million), Board of Investment (Rs. 1,375 million) and Reconstruction and Rehabilitation Authority of the North (Rs. 1,045 million) continued to be major users of these funds accounting for over 71 per cent of total capital transfers to institutions in 1999. Meanwhile, capital transfers to provincial councils and local governments increased by 13 per cent to Rs.2,297 million.

The on-lending programme which provides foreign funds to commercially oriented public enterprises declined in 1999 due to implementation delays in some planned projects. While the 1999 Budget envisaged a target of Rs. 15,820 million for on-lending purposes, the actual utilisation of on-lent funds amounted to Rs.11,096 million. In 1998, the comparable amount was Rs. 14,117 million. The Ceylon Electricity Board (Rs.4,576 million), Sri Lanka Telecom (Rs.3,420 million), Tree Crop Rehabilitation Project (Rs. 2,060 million) and Sri Lanka Ports Authority (Rs.360 million) were the main users of these funds, accounting for 94 per cent of the on-lending programme. Project implementation delays by the Sri Lanka Ports Authority resulted in a 87 per cent under utilisation of foreign funds in 1999.

TABLE 8.4
Functional Classification of Expenditure

Rs. Million

Item	1995	1996	1997	1998	1999 Approved Estimates	1999 Provi-sional	2000 Approved Estimates
Current Expenditure							
General Public Services	**47,888**	**53,915**	**58,926**	**66,158**	**58,070**	**63,220**	**70,762**
Civil Administration	6,562	10,207	13,956	15,196	14,721	14,513	20,234
Defence	35,186	38,117	37,062	42,496	35,619	40,071	38,442
Public Order and Safety	6,140	5,591	7,908	8,466	7,730	8,636	12,086
Social Services	**57,648**	**59,293**	**59,742**	**63,595**	**66,763**	**66,319**	**73,614**
Education	15,784	16,018	17,757	20,582	22,231	21,642	22,985
Health	8,818	9,260	9,581	10,089	10,651	11,215	15,133
Welfare	32,106	32,824	31,251	31,472	31,168	31,164	33,195
Community Services	941	1,191	1,154	1,451	2,713	2,298	2,301
Economic Services	**8,078**	**8,807**	**7,418**	**10,547**	**9,862**	**10,075**	**11,113**
Agriculture & Irrigation	3,826	3,894	3,723	5,444	4,963	5,012	5,622
Fisheries	105	148	156	175	184	180	178
Manufacturing and Mining	252	282	599	325	436	346	552
Energy and Water Supply	990	590	486	757	876	884	830
Transport & Communucation	2,014	2,423	1,674	2,934	2,060	2,770	2,598
Trade & Commerce	172	891	159	167	306	167	418
Other	719	580	622	745	1,037	716	915
Other	**40,546**	**53,132**	**58,662**	**59,349**	**64,811**	**67,657**	**70,261**
of which; Interest	38,225	48,923	55,246	54,897	59,780	62,123	69,048
Provision for Under Expenditure	-	-		-	-300		1,000
Total Current Expenditure	**154,159**	**175,149**	**184,749**	**199,648**	**199,206**	**207,271**	**226,751**
Capital Expenditure and Lending							
General Public Services	**5,776**	**3,161**	**3,442**	**6,243**	**8,149**	**6,345**	**8,234**
Civil Administration	3,962	1,935	3,442	6,243	8,149	6,345	7,614
Public Order and Safety	1,814	1,226	-	-	-		620
Social Services	**9,854**	**10,323**	**11,552**	**15,528**	**16,969**	**17,493**	**20,210**
Education	3,124	4,384	4,592	6,112	7,304	7,652	8,198
Health	2,134	2,538	2,554	4,330	4,774	4,456	7,109
Welfare	1,690	868	751	967	141	375	1,210
Housing	1,610	1,174	792	1,314	1,514	1,647	2,029
Community Services	1,297	1,359	2,863	2,804	3,236	3,364	1,665
Economic Services	**36,106**	**31,409**	**32,479**	**44,677**	**57,526**	**44,940**	**79,723**
Agriculture & Irrigation	6,060	4,718	3,780	6,018	9,726	6,211	10,875
o/w Mahaweli Project	3,090	1,940	1,626	1,049	2,127	1,357	2,989
Fisheries	361	311	480	562	876	694	1,478
Manufacturing and Mining	250	356	1,442	2,191	836	882	777
Energy and Water Supply	5,003	6,035	6,816	8,804	12,627	10,702	15,890
Transport & Communication	18,888	12,636	12,946	18,908	23,013	16,892	35,826
Trade & Commerce	20	105	182	230	394	302	1,254
Other	5,524	7,247	6,835	7,965	10,055	9,258	13,623
Other	**1,074**	**1,079**	**3,788**	**1,829**	**4,508**	**2,365**	**3,117**
Provision for Under Expenditure	-	-	-	-	-2,595	-	-9,023
Total Capital Expenditure and Lending	**52,810**	**45,973**	**51,260**	**68,277**	**84,556**	**71,142**	**102,261**

Source: Central Bank of Sri Lanka

On a functional basis, public investment in economic services amounted to Rs. 44,940 million (4 per cent of GDP), its growth rate decelerating to 1 per cent from 38 per cent in the previous year. These investments were mainly concentrated in the areas of transport and communication (Rs.16,892 million), energy and water supply (Rs.10,702 million) and agriculture and irrigation (Rs. 6,211 million) accounting for 75 per cent of total investments in economic services in 1999. The Road Development Authority (RDA) incurred a sum of Rs.6,896 million to develop the national road network while investments made by Sri Lanka Railways amounted to Rs. 2,886 million. However, the under utilisation of funds earmarked for investment purposes in these two institutions amounted to 10 per cent and 48 per cent respectively. At the same time, Rs.1,128 million was transferred to the Sri Lanka Central Transport Board (SLCTB) to purchase buses and engines in 1999. The SLCTB was however unable to reach the investment target of Rs.1,500 million as funds allocated for capital investment were being used to meet additional current expenses. Public investment in the communication sector was channelled mainly to the development of the telecommunication sector with the provision of a sum of Rs. 3,420 million in 1999. In the energy sector, investments amounting to Rs.5,559 million were used to improve electricity generation, transmission and the distribution network. The National Water Supply and Drainage Board (NWSDB) spent Rs.4,770 million on development activities, as envisaged in the annual investment programme.

Public investment in social services rose by 13 per cent to Rs.17,493 million (1.6 per cent of GDP) in 1999. These investments were mainly concentrated in education (Rs.7,652 million), health (Rs.4,456 million), community services (Rs.3,364 million) and housing (Rs.1,647 million). In the education sector, the construction and improvement of buildings for schools and teacher training colleges and the purchase of capital assets continued to be the major investments in 1999. In the health sector, the construction of hospital buildings, acquisition of equipment for patient health care services and the improvement of provincial health care services were the major projects undertaken in 1999. Major community service programmes implemented in 1999 included the rehabilitation programme in the Northern and Eastern provinces, implementation of the Metropolitan Environment Project and projects introduced under the Samurdhi programme.

The public enterprise restructuring programme continued in 1999 at a cost of Rs.4,556 million in comparison to Rs. 3,688 million in 1998. Major restructuring programmes implemented were in respect of retrenchment of employees, reform in the textile sector and failed privatised enterprises. Reflow of funds on account of loan repayments by public enterprises amounted to Rs.5,689 million in 1999. Ceylon Electricity Board (Rs.1,635 million), Sri Lanka Telecom (Rs.1,542 million), Ports Authority (Rs.569 million), National Development Bank (Rs.1,016 million) and DFCC Bank (Rs.565 million) accounted for 76 per cent of total repayments. Meanwhile, operations on advance account activities resulted in a net outflow of Rs.1,585 million in comparison to Rs.2,784 million in 1998. As in previous years, net outflows on account of public officers' loans and advances accounted for almost the entire outflow in 1999.

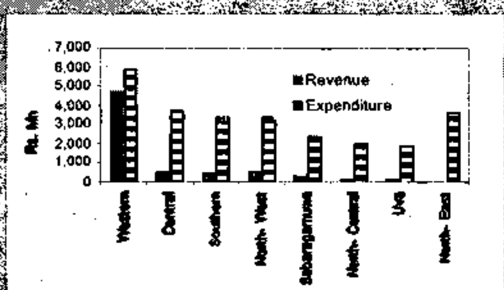
8.5 Provincial Councils

Revenue collection and resource utilisation by Provincial Councils (PCs) recorded a marked improvement in 1999. Total PC revenue, at Rs.6,993 million, increased by 17 per cent in 1999 as compared to 11 per cent in 1998. Strict controls on recurrent expenditure enabled PCs to contain total expenditure at Rs.28,717 million, an increase of 7 per cent in comparison to 14 per cent in the previous year. PC revenues however were sufficient to cover only one fourth of their total expenditure indicating the heavy dependence on the central government for resources. The central government continued to fill the gap and transferred funds through current and capital grants. Total central government grants, at Rs.22,787 million, consisted of a block grant of Rs.21,122 million for recurrent expenses and Rs.1,665 million of capital grants (criteria based grant and matching grant) for investment activities of PCs in 1999. PCs continued their function as implementing agencies of line ministries for capital projects assigned to them by the central government. The major issues identified at the PC level are limited scope for resource allocation, inadequate powers for resource mobilisation and the dominance of the central government as a source of funds. The government has recognised the necessity of reforming the current PC system to reduce the dependency on the central government as well as to permit them to implement their own investment programmes within a co-ordinated national plan.

Revenue

The revenue collection of PCs increased by 17 per cent in 1999. Sharp increases were seen in both tax as well as non-tax revenue. Turnover taxes, licence fees on motor vehicles and stamp duties continued to be the three major revenue sources accounting for 85 per cent the of total revenue collection. Turnover taxes levied by PCs on wholesale and retail trade grew by 13 per cent to Rs.3,361 million in 1999 over the 9 per cent increase in 1998 reflecting the rate of expansion of such business activities during this period. However, the relative importance of turnover taxes has gradually declined in the recent past. The turnover tax collection in 1999 accounted for 48 per cent of the total revenue in comparison to 50 per cent in 1998. This proportion was 54 per cent in 1995. Revenue from licence fees increased by 9 per cent to Rs.1,223 million, of which licence fees on motor vehicles amounted to Rs.1,000 million. An increase in the registration of motor vehicles by 25 per cent in 1998 was mainly responsible for the growth in revenue from licence fees in 1999. The rate of growth of stamp duty declined to 8 per cent in 1999 as compared to 21 per cent in the previous year due to the gradual downward revision of stamp duty rates in the recent past. Meanwhile, revenue collected under sales and charges showed a sharp increase of 52 per cent. This increase was a result of the high revenue collected as court fees and fees under the Motor Traffic Act in 1999.

Chart 8.4
Performance of PCs - 1999



PCs continued their involvement in Local Government (LG) activities as LGs are a fully devolved subject under the 13th Amendment to the Constitution. PCs have been given the responsibility of collecting revenue on behalf of LGs and transferring them to the respective LGs. Total revenue collected for LGs by PCs in 1999 amounted to Rs.1,939 million. The main revenue sources devolved for LGs are stamp duties, court fines and interest income.

Revenue collected by the Western Provincial Council amounted to Rs.4,683 million and accounted for 67 per cent of the total revenue of PCs. The revenue share of the Central, Southern and North Western PCs was about 8 per cent each followed by Sabaragamuwa (4 per cent), North Central (3 per cent) and Uva (3 per cent). The revenue collection in the Northern and Eastern provinces continued to be a function of the central government.

TABLE 8.5

Budget Out-turn for Provincial Councils

Rs Million

	1995	1996	1997	1998	1999(a)
1 Total Revenue	4,440	4,864	5,395	6,002	6,993
Tax on Production and Expenditure	3,181	3,416	3,744	4,114	4,593
Turnover Taxes	2,335	2,464	2,734	2,980	3,361
Licence Fees	840	946	1,000	1,127	1,223
Other Taxes	6	6	10	8	9
Interest ,Profits and Dividends	68	67	175	129	282
Sales and Charges	317	355	408	481	731
Stamp Duty	867	1,036	1,051	1,267	1,372
Other	7	10	17	11	15
2. Total Expenditure	20,852	22,128	23,455	26,736	28,717
2.1 Current Expenditure	19,795	20,941	22,055	25,230	26,284
Functional Basis	19,795	20,941	22,055	25,230	26,284
Provincial Administration	2,067	1,942	1,941	2,377	2,524
Economic Services	755	834	939	1,067	1,154
Social Services	16,973	18,166	19,175	21,787	22,605
Economic Basis	19,795	20,941	22,055	25,230	26,284
Personal Emoluments	16,031	16,263	17,067	19,744	20,431
Other	3,765	4,679	4,988	5,486	5,853
2.2 Capital Expenditure	1,057	1,187	1,400	1,506	2,433
Acqusition of Capital Goods	594	757	729	773	1,140
Capital Transfers	66	53	55	75	102
Other	397	377	616	658	1,191
3 Financing	15,288	16,873	18,348	20,594	22,787
Block Grants	14,066	15,831	16,855	19,194	21,122
Criteria Based Grants	897	800	1,168	1,163	1,236
Matching Grants	325	242	325	237	429

(a) Provisional

Source: Ministry of Provincial Councils & Local Governments

Expenditure

Total PC expenditure increased by 7 per cent to Rs.28,717 million in 1999 from Rs.26,736 million in 1998. However, as a percentage of GDP, PC expenditure remained at 2.6 per cent as in 1998. Current expenditure, at Rs.26,284 million, increased by 4 per cent and accounted for 92 per cent of the total expenditure of PCs. The corresponding performance in 1998 was 14 per cent and 94 per cent respectively. As a ratio of GDP, current expenditure in 1999 declined marginally to 2.4 per cent from 2.5 per cent in the previous year, indicating the improvement of current expenditure management at PCs during 1999. Current expenditure of PCs is concentrated on two major functions, education (Rs.14,445 million) and health (Rs.4,825 million), which together account for over 73 per cent of total current expenses. This reflects the limited devolved powers extended to the PC system in resource allocation. The expenditure on personal emoluments at Rs.20,431 million, rose by 3 per cent to accommodate annual salary increments. On a functional basis, personal emoluments on education (Rs.13,642 million) and health (Rs.2,977 million) continued to comprise the bulk of such expenditure, accounting for 81 per cent of total personal emolument expenditure in 1999. Other current expenses such as travel, supplies, contractual services and transfers reported a decline in the rate of growth to 7 per cent from 10 per cent in 1998.

The composition of current expenditure showed little change in 1999. Total recurrent expenditure on social services consisting of education, health and other social services, rose by 4 per cent to Rs.22,605 million and accounted for 86 per cent of total current expenditure as in previous years. Meanwhile, outlays on provincial administration and economic services grew by 6 per cent and 8 per cent to Rs.2,524 million and Rs. 1,154 million, respectively.

The Western Provincial Council continued to be the largest expenditure unit among PCs in 1999. The current expenditure of the Western Provincial Council at Rs.5,869 million accounted for 22 per cent of the current expenditure of all PCs, followed by the North East PC and Central PC whose share amounted to 14 per cent each in 1999. Meanwhile, other PCs accounted for 7 - 10 per cent each of total current expenditure in 1999.

Capital Expenditure

Investment expenditure by PCs increased significantly in 1999. Total capital expenditure increased by 62 per cent to Rs.2,433 million in comparison to an 8 per cent growth in 1998. The capital expenditure undertaken by PCs include acquisition of capital assets, land and property improvement, capital transfers to LGs and maintenance of capital assets. The Western PC and the North Central PC have been the main subscribers to the capital programme accounting for 30 per cent and 21 per cent of the total capital programme, respectively. The participation of other PCs in the capital expenditure programme ranged between 5 - 10 per cent of the total in 1999.

PCs continued their function as implementing agencies for investment programmes assigned by line ministries of the central government under the Medium-Term Investment Programme (MTIP). Total MTIP projects implemented through PCs amounted to Rs.3,355 million in 1999. These investments, which were largely concentrated in areas such as roads (Rs.1,256 million), health (Rs.1,160 million) and education (Rs.783 million), accounted for about 95 per cent of the total MTIP investment. The distribution of MTIPs among PCs shows that the Southern PC with Rs.780 million of MTIP expenditure accounted for about 23 per cent of the total. This was mainly due to outlays on road projects (Rs.505 million) implemented by the Southern PC which accounted for over 40 per cent of the total MTIP programme on roads undertaken by all PCs in 1999. Meanwhile, implementation of MTIPs by other PCs ranged between 6-14 per cent of total MTIP expenditure in 1999.

Investment undertaken by PCs is a small fraction of the total public investment. Further, there was no proper mechanism to integrate provincial investment needs into the overall public investment programme of the central government. In view of this problem, the Budget 2000 announced some measures to enhance the participation of PCs in national investment largely by transferring the entire responsibility of the operation of the MTIPs from the central government to PCs.

Central Government Transfers

Grants from the central government to PCs increased significantly in 1999. Central government transfers to PCs consist of block grants for current expenses and criteria based grants and matching grants for capital expenses. Total block grants amounted to Rs.21,122 million in comparison to Rs.19,194 million in 1998. Central government transfers through criteria based and matching grants increased by about 20 per cent to Rs.1,665 million in order to assist PCs to implement the identified provincial investment programmes in 1999.

8.6 Public Enterprise Reforms

The continuous uncertainty in the global environment and the sluggish performance at the domestic stock market did not permit the government to implement the scheduled privatisation programme in 1999. The divestiture programme brought in only Rs.134 million in 1999, although the budget expected Rs. 8,000 from privatisation proceeds. The divestiture of the balance 20 per cent shares of Namunukula Plantations Ltd. and Talawakele Plantations Ltd. generated

Rs.55 million and Rs.33 million, respectively, in 1999. In addition, the sale of 7.8 per cent of shares of Ceylon Glass Co. Ltd. raised Rs.45 million in 1999. The shortfall in privatisation proceeds necessitated recourse to higher domestic borrowings during the year. Nevertheless, the government was able to complete the preparatory work for the corporatisation and divestiture of selected public enterprises during the reviewed period.

The preparatory work for the reform of selected public enterprises in the services, industrial and agricultural sectors continued in 1999. The main emphasis was on enterprises in the service sector such as the Postal Department, Ceylon Electricity Board (CEB), National Insurance Corporation (NIC) and Ceylon Shipping Corporation (CSC). The reform process of the Postal Department was in progress and the draft Bill for the conversion of the department to a corporation was completed in 1999. Meanwhile, several studies were carried out with a view to restructuring enterprises in the service sector such as the NIC, CEB, and CSC during the year. Steps were also taken to select international banks to advise on the listing of Sri Lanka Telecom shares in international and local markets. In the industrial sector, re-divestiture of failed privatised enterprises such as Hingurana Sugar Co. and Pugoda Textile Ltd. was in progress in 1999. The liberalisation of the lubricant market was one of the key events in 1999, under which five companies were selected to sell lubricants in the local market. Meanwhile, commercialisation of the agricultural sector continued in 1999. Accordingly, basic preparatory work for the divestiture of the Pelvehera seed paddy farm was finalised in 1999. Two livestock farms in Ambewela and Pattipola are also listed for divestiture in 1999. These divestiture programmes are scheduled to be completed in 2000.

8.7 Financing of the Deficit

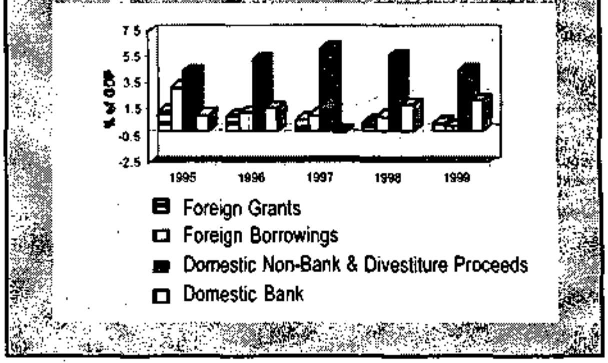
A larger part of the budget deficit was domestically financed as privatisation was delayed and utilisation of foreign financing was lower than in the previous year. Gross foreign borrowings utilised for budgetary purposes amounted to Rs. 22,630 million while loan repayments to the external sector totalled Rs. 21,440 million. Accordingly, net foreign borrowings available for financing the deficit were Rs. 1,190 million compared with Rs. 10,196 million in 1998. Foreign grants received for financing the budget declined to Rs. 6,761 million from Rs.7,200 million in 1998. Meanwhile, the privatisation programme generated only Rs. 134 million as against the expected target of Rs.8,000 million in the 1999 Budget. Consequently, net domestic borrowings increased to Rs. 74,876 million in comparison to Rs. 71,362 million in 1998. However, as a percentage of GDP, domestic financing declined to 6.7 per cent in 1999 from 7 per cent in 1998. Due to the limited availability of resources from domestic non-bank sources, borrowing from the banking system increased to Rs. 25,995 million (2.3 per cent of GDP) in 1999 in comparison to Rs.18,954 million (1.9 per cent of GDP) in 1998.

Gross borrowings from domestic sources, at Rs.96,039 million, consisted of Rs.68,748 million from domestic non-bank sources and Rs.27,291 million from bank sources. Treasury bonds, Rupee loans and Treasury bills continued to be the major debt instruments for resource mobilisation from domestic sources.

The market orientation of government securities was further enhanced by increasing the share of borrowing through Treasury bonds to 63 per cent of total domestic borrowings in comparison to 46 per cent in the previous year. On a cash basis, the Treasury bond programme raised Rs.60,880 million from domestic sources as compared to a sum of Rs.34,741 million in 1998 and Rs.10,000 million in 1997. Borrowing from non-bank sources amounted to Rs. 58,500 million in 1999 while the balance sum of Rs. 2,380 million has taken up by the banking sector. With a view to creating a long-term domestic debt market, Treasury bonds with maturities of 5 years and 6 years were introduced in 1999 in addition to the existing 2, 3 and 4 year bonds. While the coupon rates on Treasury bonds with a maturity of 2 - 6 years were fixed at a range of 11.00 - 12.00 per cent, the weighted average yield rates determined in the market for these securities were in the range of 12.64 - 14.02 per cent in 1999. While institutional investors such as the EPF and the NSB played a major role in the Treasury bond market, subscriptions from other non-bank investors also increased to 59 per cent of total issues in comparison to 47 per cent in 1998. This reflects the increasing popularity of Treasury bonds among non-captive investors in the market.

Mobilisation of domestic resources for deficit financing through Rupee loans indicated a significant decline. Gross borrowing through Rupee loans declined sharply to Rs 22,986 million in 1999 from Rs. 52,300 million in 1998. However, net borrowing through Rupee loans, at Rs. 11,486 million, was around the same level as in 1998. The interest

Chart 8.5
Deficit Financing



rates on Rupee loans were in a range of 12.00-12.50 per cent for issues with maturities of 2 - 10 years. As in previous years, the EPF continued to be the principal subscriber to the Rupee loan programme in 1999 with a gross investment of Rs.12,132 million followed by the ETF and NSB with investments of Rs.5,802 million and Rs.4,000 million, respectively. The balance subscriptions were mainly received from the Sri Lanka Insurance Corporation (SLIC) and the Public Sector Provident Fund (PSPF).

The outstanding Treasury bill stock reached the statutory limit of Rs 125 billion with the issue of an additional Rs 5,000 million of Treasury bills in 1999. With these and Treasury bonds with less than one year left to maturity now being in the market, the amount of maturing government debt securities that is available for portfolio management increased in 1999. In 1999, Central Bank intervention in the primary Treasury bill market was significantly higher than in 1998, as the Central Bank bought more bills towards the latter half of the year to ease the pressure on interest rates due to additional demand for liquidity as a result of Y2K uncertainty. Holdings of Treasury bills by the banking sector increased to Rs 40,155 million while more than half of these were held by the Central Bank. As a percentage of the total Treasury bills stock, the banking sector holdings increased to 32 per cent from 20 per cent in 1998.

Net credit extended to the government by the banking system in 1999 increased to Rs.25,995 million (after adjusting for a settlement of US dollars 18 million on FCBU borrowings) as compared to Rs.18,954 million (including US dollars 100 million borrowed from FCBUs) in the previous year. Net credit to government by the Central Bank amounted to Rs. 20,807 million in 1999. This was mainly reflected in the use of Central Bank provisional advances (Rs. 2,777 million), an increase in Central Bank holdings of Treasury bills (Rs. 16,933 million) and a drawing down of deposits (Rs. 645 million) in 1999.

Net credit to the government from commercial banks totalled Rs. 6,484 million in 1999. This was the combined outcome of an increased utilisation of the overdraft facility (Rs. 5,542 million), increase in liability on account of import bills (Rs. 1,324 million), higher government security holdings (Rs. 571 million), build up of deposits (Rs.1,021 million) and an increase in other government liabilities (Rs.68 million).

Foreign loans disbursements for budgetary purposes amounted to Rs.22,630 million compared to Rs.28,547 million in 1998. A delay in implementing foreign funded projects in the areas of port development and energy largely contributed to the reduction in foreign resource utilisation in 1999. In net terms, foreign borrowings available for financing the deficit amounted to Rs. 1,190 million (0.1 per cent of GDP) and were sufficient to finance only 1 per cent of the overall deficit in 1999. In 1998, net borrowings amounted to Rs.10,196 million (1 per cent of GDP) and financed 11 per cent of the total deficit. Meanwhile, resources available through foreign grants were estimated at Rs.6,721 million in 1999 as compared to Rs.7,200 million in 1998. The financing trends indicate the need to reduce delays in project implementation while minimising the overall budget deficit to release resources for private sector investment and to ease pressure on interest rates.

8.8 Government Debt

Total government debt at end 1999 stood at Rs.1,051 billion, registering an increase of 14 per cent over the debt stock at end 1998. Higher domestic borrowings and exchange rate variations were the main reasons for this increase. Domestic debt accounted for 52 per cent of total debt in 1999. The stock of government debt as a percentage of GDP increased to 95 per cent in 1999 from 91 per cent in 1998.

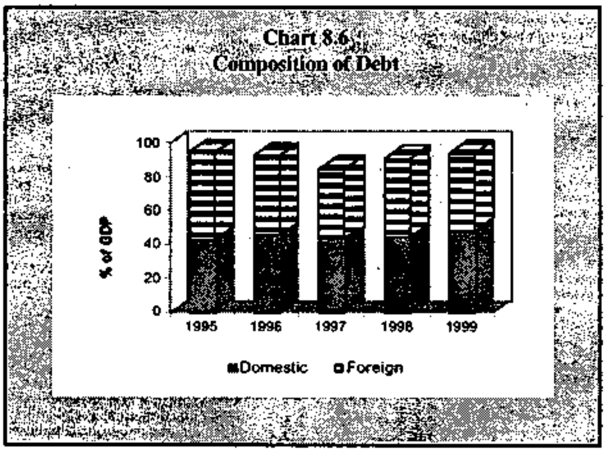
Domestic Debt

Reflecting the increased resort to domestic financing, the domestic debt stock of the government increased by 17 per cent to Rs.543,465 million in 1999. As a percentage of GDP, it increased to 49 per cent in 1999 from 46 per cent in 1998. Of the total debt stock, a sum of Rs. 48 billion was on account of the bank restructuring bonds issued in 1993 and 1996. In line with the government's policy towards developing a medium and long-term debt market for government securities, the higher mobilisation of funds through such securities raised medium and long-term debt by 22 per cent to Rs.367,579 million in 1999. Short-term debt registered a slow growth of 8 per cent due to constraints imposed by the authorised Treasury bills programme for 1999 to limit total Treasury bill issues to Rs 125 billion. Consequently, the share of medium and long-term debt in the total domestic debt further increased to 68 per cent in 1999 from 65 per cent in 1998. This ratio was 55 per cent in 1995.

The debt stock raised through Rupee securities as at end 1999 stood at Rs.262,056 million. Major subscribers to the Rupee loan programme have been the Employees' Provident Fund (EPF) and the National Savings Bank (NSB), accounting for 70 per cent of total investments in 1999.

The stock of Treasury bonds increased to Rs.104,867 million as at end 1999 from Rs.48,915 million in the previous year. As a share of medium and long-term debt, Treasury bonds rose to 29 per cent in 1999 from 16 per cent and 4 per cent in 1998 and 1997, respectively.

The share of short-term debt in domestic debt declined to 32 per cent in 1999 from 35 per cent in the previous year. The stock of short-term debt at Rs.175,886 million



consisted of Rs.124,996 million on account of Treasury bills, a sum of Rs. 22,969 million for Central Bank provisional advances and a debt of Rs. 27,921 million on account of other liabilities to domestic sources.

Reflecting high borrowings from the banking sector, the share of the banking sector debt in total domestic debt rose by 2 percentage points to 26 per cent in 1999. The debt held by the banking sector increased by Rs.26,617 million to Rs.139,671 million in 1999. This debt comprised Rs.48,867 million of debt held by the Central Bank and Rs.90,804 million of debt held by commercial banks including long-term restructuring bonds amounting to Rs.43,481 million. The debt held by the Central Bank increased by 80 per cent during the year mainly due to the sharp increase in holdings of Treasury bills by Rs.16,933 million and provisional advances by

TABLE 8.6

Outstanding Central Government Debt (at end year)

Rs. Million

	1995	1996	1997	1998	1999 Provisional
Total Domestic Debt(a)	**289,410**	**356,702**	**387,740**	**463,426**	**543,465**
Short Term	130,535	149,798	137,494	163,253	175,886
Medium and Long term	158,875	206,904	250,246	300,173	367,579
By Debt Instruments	289,410	356,702	387,740	463,426	543,465
Rupee Securities	157,928	205,975	239,475	250,570	262,056
Treasury Bills	113,771	124,996	114,996	119,996	124,996
Treasury Bonds	-	-	10,000	48,915	104,867
Other	17,711	25,731	23,269	43,945	51,546
By Institutions	289,410	356,702	387,740	463,426	543,465
Banks	111,025	101,764	100,536	113,054	139,671
Central Bank	26,878	34,303	19,770	27,179	48,867
Commercial Banks(b)	84,147	67,461	80,766	85,875	90,804
Sinking Fund	100	100	100	100	100
Non-Bank Sector	178,286	254,839	287,104	350,272	403,694
National Savings Bank	48,406	47,794	62,498	67,260	79,555
Employees' Provident Fund	95,000	113,236	134,867	157,711	181,581
Other	34,880	93,809	89,739	125,301	142,558
Total Foreign Debt	**346,286**	**359,685**	**376,331**	**461,273**	**507,866**
Project Loans	286,848	302,960	320,867	400,284	444,423
Non-Project Loans	59,438	56,725	55,464	60,989	63,443
By Type	346,286	359,685	376,331	461,273	507,866
Concessional Loans	336,795	350,319	362,435	446,331	497,672
Non- Concessional Loans	9,491	9,366	13,896	14,942	10,194
By Currency	346,286	359,685	376,331	461,273	507,866
SDR	115,537	130,818	142,733	179,124	195,799
US Dollars	72,488	74,918	83,111	89,877	91,282
Yen	101,537	99,868	98,738	132,371	164,800
Deutsche Mark	29,114	27,313	25,746	29,747	27,375
Other	27,610	26,768	26,003	30,154	28,610
External Supplier's Credits	1,020	923	499	575	530
Total Outstanding Govt. Debt	**635,696**	**716,387**	**764,071**	**924,699**	**1,051,331**
Total Outstanding Govt. Debt Net of Sinking Fund	635,596	716,287	763,971	924,599	1,051,231
Memorandum Item: Debt/GDP(%)					
Domestic Debt	43.3	46.4	43.5	45.5	48.9
Foreign Debt	51.9	46.8	42.3	45.3	45.7
Total Debt	95.2	93.3	85.8	90.8	94.7

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

(b) Inclusive of Rs. 6,773 million (US$ 100 million) and 5,913 million (US$ 82 million) outstanding borrowings from FCBUs in 1998 and 1999 respecively.

Rs.2,777 million. Debt held by commercial banks increased by 6 per cent due to an enhanced holding of Treasury bonds by Rs. 2,145 million and debt held on account of other liabilities by Rs.2,784 million.

Foreign Debt

The stock of government foreign debt increased by 10 per cent to Rs.507,866 million in 1999, largely due to an additional liability of Rs.37,989 million on account of exchange rate variations. As a ratio of GDP, the foreign debt stock increased marginally to 46 per cent. The appreciation of the Japanese yen against the rupee by 20 per cent in 1999 largely contributed to the increase in the external debt stock. Project loans increased by 11 per cent to Rs.444,423 million while non-project loans increased by 4 per cent to Rs. 63,443 million. Japan, with gross disbursements of Rs.10,424 million, continued to be the largest bilateral source for project loans followed by multilateral sources such as the ADB and IDA with gross disbursements of Rs.6,695 million and Rs.3,579 million, respectively, in 1999. The outstanding stock of non-project loans in the form of cash, commodity and other types increased only due to exchange rate variations.

The entire increase in foreign debt in 1999 was on account of concessional loans which rose by 12 per cent to Rs. 497,672 million. The ratio of concessional debt to total foreign debt increased to 98 per cent at end 1999 from 97 per cent at end 1998. Bilateral sources accounted for over 50 per cent of concessional debt. Meanwhile, the stock of non-concessional loans declined by 32 per cent to Rs.10,194 million mainly due to the partial settlement (US dollars 34 million out of a total of US dollars 50 million) of the Floating Rate Notes (FRN) under the put option in 1999.

The currency composition of foreign debt has shown significant changes in the recent past. The ratio of yen denominated debt to total foreign debt increased to 32 per cent in 1999 from 29 per cent in 1998 while US dollar denominated loans declined from 19 per cent to 18 per cent. The SDR denominated debt remained at around 38 per cent of the total foreign debt stock. Loans denominated in these three currencies represent about 90 per cent of the total foreign debt stock. The volatility of the yen in the international market has exerted a significant impact on the country's foreign debt due to the high share of yen denominated debt.

TABLE 8.7

Effect of Exchange Rate Variation on Foreign Loans (a)

Rs.Million

	1995	1996	1997	1998	1999(b)
Gross receipts	24,359	23,992	24,642	30,996	24,741
Repayments	8,477	8,939	10,004	11,576	16,137
Net receipts	15,882	15,053	14,638	19,420	8,604
Change in liability due to exchange rate variations	28,592	-1,654	2,008	65,522	37,989
Liability as at end of period	346,286	359,685	376,331	461,273	507,866

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

TABLE 8.8

Government Debt Service Payments

Rs.Million

	1995	1996	1997	1998	1999(a)
Debt Service Payments	77,675	82,163	83,729	114,866	103,885
Amortization Payments	36,546	33,240	28,483	59,968	41,762
Domestic	28,069	22,749	15,232	41,617	20,322
Foreign	8,477	10,491	13,251	18,351	21,440
Interest Payments	41,129	48,923	55,246	54,898	62,123
Domestic	34,967	42,184	48,554	47,598	53,371
Short Term	13,947	18,053	18,174	12,398	13,085
Medium & Long- Term	21,020	23,231	30,381	35,200	40,837
Foreign	6,162	6,739	6,692	7,300	8,752
Interest /Current Expenditure(%)	26.68	27.93	29.90	27.50	29.97
Debt Service/GDP(%)	11.63	10.69	9.40	11.28	9.35
Foreign Debt Service/Exports(%)	7.50	7.60	7.27	8.37	9.29

(a) Provisional

Source: Central Bank of Sri Lanka

Debt Service Payments

Debt service payments declined by 10 per cent to Rs.103,885 million in 1999 reflecting a reduction in amortisation payments to the domestic sector due to the early retirement of Rupee loans in 1998 under the optional retirement facility. As a ratio of GDP, debt service payments declined to 9.3 per cent in 1999 from 11.3 per cent in 1998. Total interest payments as a ratio of current expenditure of the government increased to 30 per cent as compared to 28 per cent in the previous year, while foreign debt service payments in relation to exports increased to 9 per cent from the previous years level of 8 per cent.

Total amortisation payments, at Rs.41,762 million, consisted of a sum of Rs.20,322 million on account of domestic debt and Rs.21,440 million on account of foreign debt. Domestic amortisation payments declined by 52 per cent as, Rupee loans worth Rs.16,000 million to be settled in 1999, were retired in 1998 under the early retirement option. Amortisation payments to the foreign sector (including a deferred payment of Rs.5,303 million on purchases for defence services and the partial settlement of the FRN of amounting to US dollars 34 million) rose to Rs.21,440 million from Rs.18,351 million in 1998.

Total interest payments, at Rs.62,123 million, consisted of Rs.53,371 million on account of domestic debt and Rs.8,752 million on foreign debt. Despite the increase in the domestic debt stock by 17 per cent in 1999, interest payments to the domestic sector grew at a lower rate of 12 per cent indicating the cumulative effect of the decline in interest rates on government securities in recent years. The growth of the outstanding medium-term debt stock by Rs.67,406 million in 1999 largely contributed to the increase in the interest cost on domestic debt. Interest payments on foreign debt rose by 20 per cent to Rs.8, 752 million in comparison to a growth of 9 per cent in 1998.