

# 6

## *FISCAL POLICY AND GOVERNMENT FINANCE*

*In a challenging environment, the government managed to steer budgetary operations close to envisaged levels during the first six months of 2013 mainly due to committed efforts undertaken to rationalise recurrent expenditure amidst a shortfall in government revenue and channel public investments to priority sectors. Revenue as a percentage of GDP declined to 5.5 per cent during the first six months of 2013 from 6.9 per cent of GDP during the same period of 2012 largely due to a reduction in import related tax collection. Total expenditure and net lending during the first six months of 2013 declined to 9.9 per cent of GDP from 11.1 per cent of GDP during the corresponding period of 2012 largely due to a sharp reduction in recurrent expenditure. Outlays on recurrent expenditure declined to 6.8 per cent of GDP during the first half of 2013 from 7.8 per cent of GDP during the same period 2012. Public investment as a percentage of GDP was maintained at 3.2 per cent with the government limiting capital outlays to those of a priority nature. However, despite the reduction in overall expenditure, the budget deficit increased to 4.3 per cent of GDP during the first six months of 2013 from 4.0 per cent of GDP in the comparable period of the previous year due to lower revenue mobilisation. In financing the overall deficit, the government relied more on domestic sources. The turnaround expected in government revenue during the second half of the year with the recovery of external trade and growth in domestic economic activities, together with strict monitoring of the government's expenditure programme would help the government to meet the fiscal deficit target of 5.8 per cent of GDP in 2013 as envisaged in the budget for 2013.*

## Fiscal Policy Measures

- **The fiscal policy strategy in 2013 has been directed at reducing the budget deficit further to 5.8 per cent of estimated GDP and lowering the government debt / GDP ratio to 75 per cent while maintaining public investments at the required level to support growth objectives.** Towards this, the government took several measures in 2013 to increase revenue and streamline expenditure while encouraging regionally balanced economic growth of the country.
  - **Numerous income tax concessions were granted to encourage foreign investments to the country.** Income tax exemptions were granted for interest income earned from investments made out of foreign currency brought to the country and for the fees earned by a foreign collaborator from a company registered under the Board of Investment (BOI) if the company raises foreign direct investments exceeding US dollars 50 million from foreign sources. Further, the activities of an off-shore business were extended to include the activity of procurement of goods from one country and transportation of the goods to another country other than Sri Lanka, when granting the exemption on profit and income, in order to facilitate off-shore business activities. There were several income tax concessions given to unit trust management companies, and companies listing their shares in the Colombo Stock Exchange.
  - **During the first half of 2013, steps were taken to broaden the Value Added Tax (VAT) base to enhance revenue collection while providing several targeted exemptions to domestic activities.** In order to broaden the tax base, VAT was imposed on wholesale and retail businesses having quarterly turnover/supplies of Rs.500 million. Further, the amendments relevant to the Simplified Value Added Tax (SVAT) scheme were incorporated to the VAT Act and guidelines issued to further simplify the scheme.
- On the other hand, supplies made by the Central Bank of Sri Lanka and public corporations and supply of services by unit trust management companies were exempted from VAT, while locally manufactured products from coconut waste and several other imported items relating to transportation and construction sectors were also exempted to facilitate domestic economic activity. Small and Medium Enterprises (SMEs) with an annual liable turnover not exceeding Rs.12 million were exempted from the VAT and the Nation Building Tax (NBT) enabling them to operate in a viable manner.
- **The Special Commodity Levy (SCL) on selected commodities was used as a mechanism to protect the domestic agriculture sector and stabilise prices in the local market while enhancing government revenue.** Accordingly, SCL on imports of crude palm kernel oil was introduced for a period of 4 months and SCL on potatoes, b' onion and sugar was increased several times during this period.
  - **Several other measures were introduced during the year to enhance tax revenue collection.** Accordingly, stamp duties (considered as provincial council revenue) applicable on affidavits, insurance policy, notary warrant, usage of credit card were revised upwards while periodic licenses for carrying on trade business and sale of liquor were also raised. The tax structure of the betting and gaming industry was rationalised with the introduction of an all-inclusive levy of 5 per cent on gross collections in lieu of indirect taxes levied on these activities. Further, the higher income tax rate of 40 per cent applicable on betting business was maintained while the annual levy payable was increased with a view to enhancing revenue from such businesses.
  - **In the non tax revenue front, budget 2013 introduced several measures to enhance non tax revenue collection of the government.** Accordingly, the embarkation levy and the online visa fee were revised upwards from January 2013. In addition, fees and charges of

the Department of Registrar of Companies, the Registrar General's Department, day book entry registration fees (registration of deeds, issuing a caveat, land registry search, annual notarial registration, charges on case file records by a registered attorney) and the annual revenue licensing fee for motor vehicles were revised upwards. However, the Telecommunication Levy applicable on internet broadband connections was reduced to 10 per cent from 20 per cent in order to reduce the cost of broadband facilities and encourage the use of such services in line with the strategy to develop the 5+1 hubs.<sup>1</sup>

- **On the expenditure front, several measures were implemented during the first half of 2013 to ensure prudent management of public expenditure, especially recurrent expenditure.** According to the National Budget Circular No.157, all spending agencies were requested to adhere to the annual provision limits allocated for fuel, electricity, water and transportation, while they were strongly advised to make payments for overtime only when it is absolutely essential. In terms of capital expenditure management, line ministries were not permitted to utilise allocated budgetary provisions for development activities, for procurement of vehicles and furniture and upgrading of office facilities which were not initially identified. In addition, spending agencies were requested to explore the possibility of using unutilised allocations or allocations provided for activities which have not yet commenced, before forwarding requests for additional provisions, with a view to minimising unforeseen overruns in the expenditure programme.
- **Salaries and wages of public sector employees were revised upward, while several benefits were given to pensioners.** Accordingly, a special allowance of 5 per cent of the basic salary was granted to all public servants subject to a minimum of Rs. 750 and a maximum of Rs. 2,500 per month. For non staff grade employees, 50 per cent of the proposed increase was paid from May 2013 and the balance was paid from September 2013. For staff grade employees, 50 per cent of the proposed increase was paid from July 2013 and the balance paid from October 2013. Further, the Cost-of-Living Allowance (COLA) was increased by Rs.750 per month to all public servants. Meanwhile, the COLA paid to all pensioners was increased by Rs. 500 per month. With a view to correcting pension anomalies, a special allowance of Rs.750 per month was granted to pensioners who retired before 2004 while a sum of Rs. 500 per month was granted to those who retired from 2005 to 2006.
- **The public investment programme was aimed at accelerating the implementation of several strategic economic and social infrastructure projects which are necessary to achieve sustained economic growth based on the strategy of developing the 5+1 hubs, while investing in regional infrastructure to ensure more regionally balanced growth.** Accordingly, public investments during the period under consideration mainly focused on expediting the infrastructure development activities in the areas of roads and bridges, power generation, irrigation, water supply, seaport and airport development, along with countrywide education, health and social welfare development programmes. In addition, the government continued to channel resources to rural development initiatives such as "Divi Neguma", "Gama Neguma" and others and urban development initiatives such as the "Pura Neguma" city development programme.
- **Several measures that were urgently required to improve the financial position of state owned enterprises (SOEs) were implemented during the first half of 2013.** The administrated price revisions with respect to petroleum products and the termination of the provision of furnace oil used for thermal power generation at subsidised prices are expected to reduce the operational losses of the Ceylon Petroleum Corporation (CPC)

<sup>1</sup> Aviation, Energy, Maritime, Commercial, Knowledge & Tourism hubs.

in 2013. Meanwhile, the combined outcome of electricity tariff revisions and increased generation of hydropower so far during the year is expected to reduce the operational losses of the Ceylon Electricity Board (CEB). Structural changes were continued in other SOEs as well, with a view to improving their governance and business operations.

- **The government placed greater emphasis on diversifying financing arrangements for urban infrastructure development focusing on leveraging private capital.** The dependence on lease rentals for urban infrastructure financing increased with more prime lands in the city of Colombo being utilised for commercial activities. These new financing avenues are being used to improve the underserved settlements in the city by constructing new apartment units as part of the overall city beautification programme. This programme is implemented by the Urban Settlement Development Authority and the Urban Development Authority in close co-operation with private sector developers. Accordingly, it serves the dual objectives of provisioning housing with modern amenities to urban underserved low income communities, while facilitating private sector real estate development initiatives.
- **In line with the budget proposal for 2013, to provide long term funding for the SME sector, plantations, construction industry and other manufacturing industries, the government facilitated the banking sector to raise long term foreign funds as part of their capital formation.** The National Savings Bank (NSB) issued an international bond amounting to USD 750 million with a maturity of 5 years. The government assisted the issuance by floating domestic bonds (Sri Lanka Development Bonds (SLDBs) and Treasury bonds) enabling the NSB to invest their surplus funds until bond proceeds are fully utilised for SME development activities.

## Government Budgetary Operations

### Government Revenue and Grants

#### Revenue

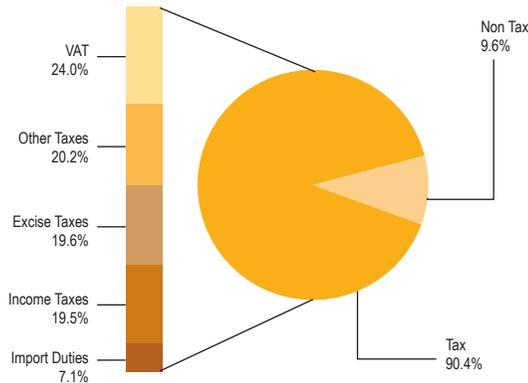
- **According to the budget for 2013, total government revenue in 2013 is estimated to increase by 19.6 per cent to Rs. 1,257.5 billion.** As a percentage of estimated GDP, total revenue is expected to increase to 14.5 per cent from 13.9 per cent in 2012 with tax revenue increasing to 13.0 per cent in 2013 from 12.0 per cent in 2012.
- **Total government revenue as a percentage of estimated GDP, declined to 5.5 per cent during the first half of 2013 from 6.9 per cent in the corresponding period of the previous year.** Total government revenue in nominal terms during the first six months of 2013 declined by 7.6 per cent to Rs.481.7 billion from Rs.521.1 billion in the corresponding period of 2012. The share of tax revenue in total revenue increased to 90.4 per cent in the first half of 2013 from 88.0 per cent in the corresponding period of the previous year while non tax revenue in total revenue declined to 9.6 per cent in the first half of 2013 from 12.0 per cent in the corresponding period of the previous year. The lackluster performance of tax revenue can be largely attributed to the

| Item                   | 2011         | 2012           | Rs. billion             |                |                    |
|------------------------|--------------|----------------|-------------------------|----------------|--------------------|
|                        |              |                | 2013 Approved Estimates | 2012 Jan - Jun | 2013 Jan - Jun (a) |
| <b>Tax revenue</b>     | <b>845.7</b> | <b>908.9</b>   | <b>1,131.0</b>          | <b>458.7</b>   | <b>435.4</b>       |
| Income taxes           | 157.3        | 172.6          | 222.0                   | 80.9           | 94.0               |
| VAT                    | 225.9        | 229.6          | 283.3                   | 115.7          | 115.8              |
| Excise taxes           | 204.8        | 224.0          | 247.3                   | 117.8          | 94.6               |
| Import duties          | 79.8         | 80.2           | 97.3                    | 37.0           | 34.1               |
| PAL                    | 66.0         | 70.1           | 93.1                    | 37.5           | 24.1               |
| NBT                    | 35.7         | 38.7           | 61.7                    | 20.2           | 17.9               |
| SCL                    | 15.6         | 33.7           | 46.7                    | 20.8           | 22.7               |
| Cess                   | 29.7         | 32.7           | 41.1                    | 15.7           | 17.6               |
| Other taxes            | 30.9         | 27.3           | 38.5                    | 13.2           | 14.6               |
| <b>Non tax revenue</b> | <b>122.2</b> | <b>142.5</b>   | <b>126.5</b>            | <b>62.4</b>    | <b>46.3</b>        |
| <b>Total revenue</b>   | <b>967.9</b> | <b>1,051.5</b> | <b>1,257.5</b>          | <b>521.1</b>   | <b>481.7</b>       |

Source: Ministry of Finance and Planning

(a) Provisional

Chart 6.1

Composition of Government Revenue  
(January - June 2013)

decline in import related tax collections due to policy measures implemented to slow down the growth of imports. Lower transfers of profit and dividends from government institutions resulted in a decline in non tax revenue. Total revenue collection during this period was only 38.3 per cent of the annual estimate of Rs.1,257.5 billion.

- **Revenue from income taxes enhanced their share in total tax collection to 21.6 per cent during the first half of 2013 reflecting significant increases in nominal terms for all income related taxes except the Economic Service Charge (ESC).** However, as a percentage of estimated GDP, income tax revenue remained at 1.1 per cent as in the corresponding period of the previous year. Withholding tax revenue from interest income increased significantly by 40.4 per cent to Rs.43.7 billion, due to the substantial increase in issue of government securities with longer maturity. Further, withholding tax collection as a percentage of direct taxes increased to 46 per cent during the first half of 2013 from 38 per cent recorded in the corresponding period of the previous year. Corporate and non corporate tax revenue increased by 19.6 per cent reflecting improved performance in the corporate and non corporate sectors. However, revenue from the ESC declined significantly by 70.2 per cent to

Rs.3.3 billion from Rs.11.1 billion recorded in the comparative period of the previous year due to exemptions granted for selected sectors, and the increase in the quarterly threshold to Rs.50 million from Rs.25 million with effect from April 01, 2012.

- **Revenue from VAT increased marginally, in nominal terms mainly due to the decline in VAT on imports, although VAT on domestic goods and services registered a considerable improvement.** VAT on domestic goods and services increased by Rs.5.8 billion due to the broadening of the VAT base with the imposition of VAT on wholesale and retail trade with effect from January 01, 2013. However, VAT revenue on imports declined by Rs.5.7 billion due to the decline in imports during the first half of 2013 compared to the similar period in the previous year. Revenue from VAT as a percentage of estimated GDP declined to 1.3 per cent during the first half of 2013 in comparison to 1.5 per cent recorded in the same period of the previous year, mainly due to lower import related VAT revenues. However, in nominal terms total revenue from VAT increased marginally by 0.1 per cent to Rs.115.7 billion during the first half of 2013 compared to the corresponding period in 2012. VAT revenue during the first half of the year was 40.9 per cent of the annual estimate. The contribution from VAT to total revenue and tax revenue increased to 24.0 per cent and 26.6 per cent during the first half of 2013 from 22.2 per cent and 25.2 per cent, respectively recorded in the corresponding period of 2012.
- **Revenue from the NBT declined by 11.6 per cent to Rs.17.9 billion during the first half of 2013 compared to Rs.20.2 billion in the corresponding period of 2012.** The NBT revenue from both imports and domestic activities recorded a decline during this period. In addition to the decline in imports, the increase

in the NBT threshold to Rs.3 million per quarter from Rs.0.5 million per quarter for businesses carried out by individuals and partnerships and the exemption of selected sectors from the tax in 2013 contributed to the decline in NBT collections during the period.

- **Excise tax revenue from all categories recorded a decline except for liquor during the first half of 2013.** Total excise tax revenue declined by 19.7 per cent to Rs.94.6 billion in comparison to the corresponding period of 2012, mainly due to significant declines in excise tax revenue on imports of motor vehicles, by Rs.18.6 billion (37.1 per cent) and petroleum by Rs.4.9 billion (50.0 per cent). Revenue from excise tax on cigarettes declined by 2.6 per cent to Rs.26.9 billion compared to Rs.27.6 billion recorded in the corresponding period of 2012. However, revenue from excise tax on liquor increased by 3.7 per cent mainly due to an increase in soft liquor production. Consequently, the share of excise taxes in total tax revenue declined to 21.7 per cent in the first half of 2013 from 25.7 per cent in the corresponding period of the previous year.
- **Revenue from other taxes and levies related to imports showed mixed performance.** Revenue from import duties declined by 7.8 per cent to 34.1 billion and Ports and Airports Development Levy (PAL) declined by 35.7 per cent to Rs.24.1 billion during the period under review, in line with the decline in imports. However, during the first half of 2013, revenue from SCL increased by 9.3 per cent to Rs.22.7 billion owing to increases in SCL rates on commodities to protect local producers, especially during the harvesting period. The revenue from Cess increased by 12.5 per cent to Rs.17.6 billion due to the imposition of Cess on a unit basis on several imported items during first half of 2013.
- **Non tax revenue declined by 25.7 per cent to Rs.46.3 billion during the first half of 2013 from Rs.62.4 billion during the corresponding period of the previous year.** This was mainly due

to a decline in profit and dividend transfers from Government institutions by Rs. 20.4 billion. However, non tax revenue from rent, interest, and social security contributions, increased during the period under review compared to the same period in the previous year. Further, revenue from fees and charges increased during the period mainly due to the upward revision of several fees and charges. .

### Grants

- **Foreign grant disbursements recorded a sharp decline of 71.8 per cent in nominal terms during the first half of 2013.** Foreign grants continued to decline during this period as in previous years due to Sri Lanka's progress in to middle income country status. Accordingly, the realised amount of foreign grants in the first half of 2013 amounted to Rs.2.3 billion compared to the annual estimate of Rs.20 billion and Rs.8.3 billion recorded in the same period of 2012.

### Expenditure and Net Lending

- **Total expenditure and net lending as per the budget estimates for 2013, is estimated to remain at 20.5 per cent of GDP as in 2012.** Recurrent expenditure is estimated to decline to 14.6 per cent of GDP from 14.9 per cent in 2012 while capital expenditure and net lending is estimated to increase to 6.0 per cent of GDP in 2013 from the 5.6 per cent recorded in 2012.

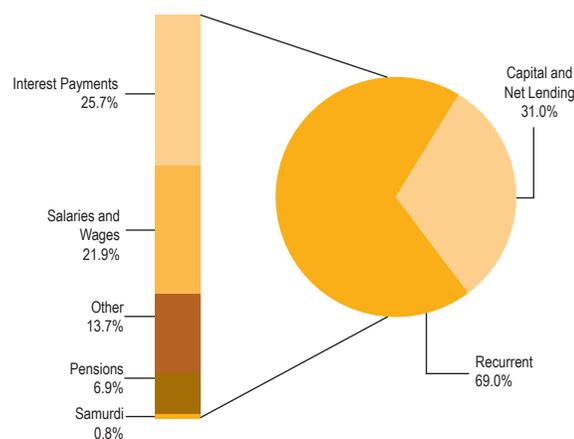
**Table 6.2** Economic Classification of Expenditure

| Item                                     | 2011           | 2012           | Rs. billion                   |                   |                          |
|--|----------------|----------------|-------------------------------|-------------------|--------------------------|
|  |                |                | 2013<br>Approved<br>Estimates | 2012<br>Jan - Jun | 2013<br>Jan - Jun<br>(a) |
| <b>Current expenditure</b>               | <b>1,024.9</b> | <b>1,131.0</b> | <b>1,267.4</b>                | <b>589.1</b>      | <b>595.2</b>             |
| o/w Salaries and wages                   | 319.6          | 347.7          | 414.4                         | 170.0             | 188.6                    |
| Interest payments                        | 356.7          | 408.5          | 444.8                         | 204.1             | 221.8                    |
| Foreign                                  | 68.6           | 90.8           | 85.0                          | 30.0              | 31.8                     |
| Domestic                                 | 288.1          | 317.7          | 359.8                         | 174.0             | 190.0                    |
| Samurdhi                                 | 9.0            | 10.6           | 14.2                          | 5.5               | 7.0                      |
| Pensions                                 | 100.0          | 111.7          | 129.1                         | 55.4              | 59.7                     |
| Fertiliser subsidy                       | 29.8           | 36.5           | 37.8                          | 17.6              | 12.3                     |
| <b>Capital and Net lending</b>           | <b>408.3</b>   | <b>425.5</b>   | <b>517.6</b>                  | <b>244.0</b>      | <b>267.2</b>             |
| <b>Total expenditure and net lending</b> | <b>1,433.2</b> | <b>1,556.5</b> | <b>1,784.9</b>                | <b>833.0</b>      | <b>862.4</b>             |

Source: Ministry of Finance and Planning

(a) Provisional

**Chart 6.2** Composition of Government Expenditure (January - June 2013)



In nominal terms, total expenditure and net lending in 2013 is estimated to increase by Rs. 228.4 billion to Rs.1,784.9 billion compared to Rs.1,556.5 billion recorded in 2012. Recurrent expenditure is expected to increase by Rs. 136.4 billion to Rs.1,267.4 billion in 2013, while capital expenditure and net lending is expected to increase by Rs. 92.1 billion to Rs.517.6 billion.

- **Total expenditure and net lending during the first half of 2013 declined to 9.9 per cent of estimated GDP from 11.1 per cent of GDP during the same period in 2012 due to a decline in both recurrent expenditure and capital expenditure and net lending.** In nominal terms, government expenditure and net lending increased by 3.5 per cent to Rs. 862.4 billion during the first six months of 2013 compared to Rs. 833.0 billion during the corresponding period in 2012. Further, total expenditure and net lending in the first half of 2013 accounted for 48.3 per cent of the annual estimate for 2013. This was mainly due to the committed effort made by the government in rationalising recurrent expenditure in the midst of low government revenue performance.
- **Despite a moderate increase in salaries and wages, interest payments and pension payments, recurrent expenditure during the**

first six months of 2013 declined to 6.8 per cent of estimated GDP from 7.8 per cent of GDP recorded in the same period in 2012, due to a considerable decline in expenditure on other goods and services. In nominal terms, recurrent expenditure increased by 1.0 per cent to Rs. 595.2 billion during the first half of 2013. Expenditure on salaries and wages increased by 11.0 per cent mainly due to the special allowance given to all public servants which was equivalent to 5 per cent of the basic salary from May 2013, and an increase in the monthly COLA of public sector employees in the non staff grade category by Rs.750 with effect from January 2013. Pension payments rose by 7.7 per cent due to the increase in the monthly COLA for pensioners by Rs.500 per month with effect from January 2013, measures taken to correct pension anomalies and the net increase in the number of pensioners by 8,435 during the first half of 2013. Expenditure on interest payments increased by 8.7 per cent, compared to the increase of 22.9 per cent recorded in the first six months of 2012. Despite increased borrowings of the government during the first six months of the year, relatively low interest rates prevailing in the domestic market coupled with measures taken to reduce the share of short term debt in the total domestic debt stock, resulted in this moderate increase in interest payments. Expenditure on the Samurdhi programme increased by 27.6 per cent during the first half of 2013, while expenditure on the fertiliser subsidy declined by 30.1 per cent during the period under review due to fertiliser stocks being carried forward from the previous year.

- **Capital expenditure and net lending increased by 9.5 per cent to Rs. 267.2 billion during the first half of 2013, reflecting the government's commitment to expediting infrastructure development projects.** As a percentage of estimated GDP, capital expenditure and net lending declined marginally to 3.1 per cent during this period from 3.3 per cent in the corresponding period of 2012. Public investments focused mainly on road development and other key

strategic areas such as ports, power and energy, irrigation and water supply and sanitation. In addition, the implementation of many infrastructure development projects around the country under initiatives such as "Gama Neguma", "Maga Neguma", "Pura Neguma" and Northern and Eastern Provinces development initiatives under "Uthuru Wasanthaya" and "Nagenahira Navodaya" contributed to the increase in capital expenditure. The realised capital expenditure and net lending in the first half of 2013 accounted for 51.6 per cent of the annual estimate for the year.

### Key Fiscal Balances

- The overall fiscal deficit as per the budget for 2013, is expected to decline to 5.8 per cent of GDP from 6.4 per cent of GDP in 2012. In nominal terms, the overall deficit is estimated to increase to Rs. 507.4 billion from Rs. 489.0 billion in 2012. The current account deficit and primary deficit (overall deficit net of interest payments) are also expected to improve in 2013. Accordingly, the current account deficit is expected to decline to 0.1 per cent of GDP from 1.0 per cent in 2012 and the primary deficit is expected to decline to 0.7 per cent of GDP from 1.1 per cent in 2012.
- The three key fiscal balances deteriorated during the first half of 2013, due to lower than expected performance in government revenue.

Accordingly, the overall budget deficit as a percentage of GDP increased to 4.3 per cent during this period from 4.0 per cent in the same period in 2012. In nominal terms, the overall budget deficit increased to Rs. 378.3 billion during the first half of 2013 from Rs. 303.7 billion during the first half of 2012. Further, the current account deficit as a percentage of GDP increased to 1.3 per cent in the first half of 2013 from 0.9 per cent in the corresponding period of the previous year reflecting an increase in government dissaving due to the revenue shortfall. In line with the increase in the overall budget deficit, the primary deficit also increased to 1.8 per cent of GDP in the first half of 2013 from 1.3 per cent of GDP during the same period of 2012.

### Financing the Deficit

- In financing the overall deficit of Rs. 378.3 billion during the first half of 2013, domestic financing contributed to 61.3 per cent of the total while foreign financing accounted for the balance 38.7 per cent. Net domestic financing increased by 25.1 per cent to Rs.232.0 billion and net foreign financing increased by 23.8 per cent to Rs.146.3 billion compared to the corresponding period in 2012. The share of banking sector borrowings in total domestic financing increased to 90.7 per cent in the first half of 2013 from 57.9 per cent during the same period of 2012.

Chart 6.3 Major Fiscal Indicators

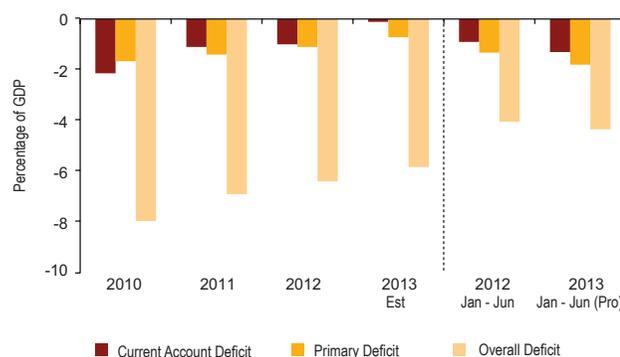
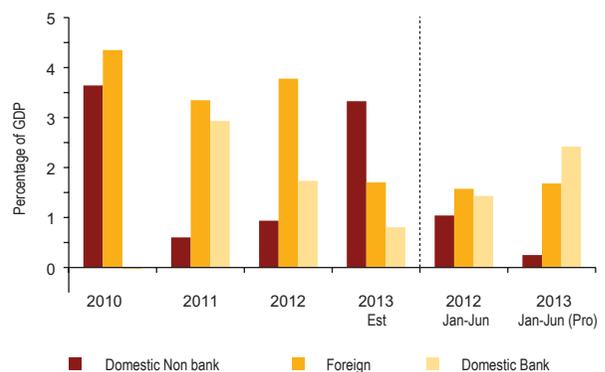


Chart 6.4 Deficit Financing



**Table 6.3** Sources of Financing

| Item                                       | Rs. billion  |              |                 |                          |
|--|--------------|--------------|-----------------|--------------------------|
|  | 2011         | 2012         | 2012<br>Jan-Jun | 2013<br>Jan - Jun<br>(a) |
| <b>Domestic financing</b>                  | <b>231.2</b> | <b>202.5</b> | <b>185.5</b>    | <b>232.0</b>             |
| Bank                                       | 191.9        | 131.5        | 107.4           | 210.4                    |
| Non bank                                   | 39.4         | 71.0         | 78.1            | 21.6                     |
| <b>Foreign financing</b>                   | <b>219.0</b> | <b>286.5</b> | <b>118.1</b>    | <b>146.3</b>             |
| Loans                                      | 193.9        | 180.8        | 70.1            | 72.9                     |
| Non resident investments in Treasury bonds | 12.4         | 99.7         | 31.7            | 78.5                     |
| Non resident investments in Treasury bills | 12.6         | 6.0          | 16.3            | -5.2                     |
| <b>Total</b>                               | <b>450.2</b> | <b>489.0</b> | <b>303.7</b>    | <b>378.3</b>             |

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

(a) Provisional

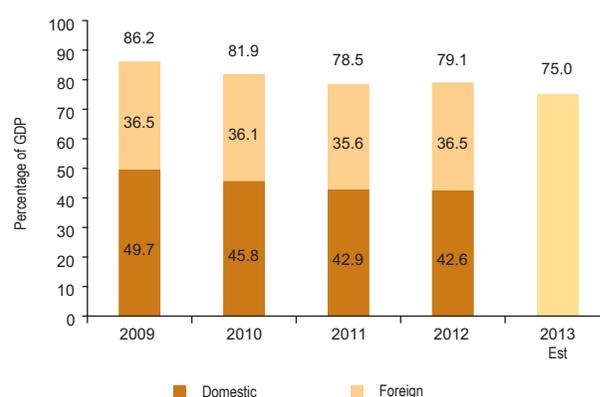
- During the first six months of the year Financing from the banking sector exceeded the budgetary target for 2013, while financing from the non bank sector remained considerably low compared to the budgetary estimate for the year. Despite the net repayment of Rs.45.7 billion to the Central Bank, financing from the banking sector increased to Rs.210.4 billion compared to Rs.107.5 billion in the corresponding period in 2012 and the budgetary target of Rs.70 billion for 2013, reflecting substantial borrowings from the commercial banking sector. Even though the budget for 2013 expected borrowings from the non bank sector to increase substantially by Rs. 218.4 billion over 2012 to Rs.289.4 billion, net borrowings from the non bank sector during the first half of 2013 declined to Rs.21.6 billion from Rs.78.1 billion during the same period in the previous year.
- Total net foreign financing during the first half of 2013 amounted to Rs.146.3 billion, almost reaching the annual estimate of Rs.148 billion, mainly due to an increase in foreign investments in rupee denominated securities over the expected level. Foreign financing in the first half of 2013 was significantly higher than the Rs.118.1 billion recorded in the corresponding period of 2012. A significant increase in foreign investments in Treasury bonds (by around 148 per cent), which amounted to Rs.78.5 billion, contributed to the higher foreign financing in the

first half of 2013 compared to the same period of 2012. However, foreign investments in Treasury bills recorded a net repayment of Rs.5.2 billion compared to net borrowing of Rs.16.3 billion in the corresponding period of 2012. Gross foreign project financing during the period under consideration amounted to Rs. 122.3 billion compared to Rs. 115.3 billion recorded in the same period in 2012. Accordingly, foreign financing amounted to 38.7 per cent of the total net borrowing requirement during the first half of the year compared to 38.9 per cent recorded in the same period of 2012.

## Government Debt and Debt Service Payments

### Government Debt

- The total outstanding government debt stock increased by Rs. 518.4 billion to Rs. 6,518.5 billion as at end June 2013 from Rs. 6,000.1 billion as at end December 2012. Domestic debt increased by Rs. 403.7 billion to Rs. 3,636.5 billion, while foreign debt increased by Rs.114.7 billion to Rs. 2,882 billion.
- The short term domestic debt stock increased by 15.9 per cent, while the medium and long term domestic debt stock increased by 11.4 per cent from end December 2012 to end June 2013.

**Chart 6.5** Outstanding Government Debt

**Table 6.4** Outstanding Government Debt.

| Item                         | 2011           | 2012           | Rs. billion     |                        |
|------------------------------|----------------|----------------|-----------------|------------------------|
|                              |                |                | 2012<br>Jan-Jun | 2013<br>Jan-Jun<br>(a) |
| <b>Domestic Debt (b)</b>     | <b>2,804.1</b> | <b>3,232.8</b> | <b>3,155.3</b>  | <b>3,636.5</b>         |
| By maturity period           |                |                |                 |                        |
| Short term                   | 698.2          | 813.3          | 792.1           | 942.3                  |
| Medium and long term         | 2,105.9        | 2,419.5        | 2,363.2         | 2,694.2                |
| By institution               |                |                |                 |                        |
| Banks (c)                    | 886.2          | 1,060.3        | 1,059.7         | 1,309.1                |
| Non bank sector              | 1,917.9        | 2,172.5        | 2,095.6         | 2,327.4                |
| <b>Foreign debt</b>          | <b>2,329.3</b> | <b>2,767.3</b> | <b>2,796.3</b>  | <b>2,882.0</b>         |
| Concessional                 | 1,328.8        | 1,369.6        | 1,534.8         | 1,395.4                |
| Non concessional             | 1,000.5        | 1,397.7        | 1,261.5         | 1,486.6                |
| <b>Total Government Debt</b> | <b>5,133.4</b> | <b>6,000.1</b> | <b>5,951.6</b>  | <b>6,518.5</b>         |

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

(a) Provisional

(b) Excludes government bonds of Rs. 4,397 million issued to CWE in November 2003, Rs.78,447 million issued to CPC in January 2012 and rupee denominated Treasury bonds held by foreign investors from 2007 and the Sri Lankan diaspora and migrant workers from 2009.

(c) Includes outstanding balance to OBUs.

The increase in short term debt was mainly due to the increase in borrowings through Treasury bills. However, the share of Treasury bills in total domestic debt as at end June 2013 marginally increased to 20.1 per cent from 19.5 per cent at end 2012, but it was lower than the end June 2012 position of 21.6 per cent. Out of the total domestic debt stock, the share of medium and long term debt marginally declined to 74.1 per cent from 74.8 per cent at end 2012 and 74.9 per cent at end June 2012. Treasury bonds which dominated the outstanding domestic debt portfolio accounted for 64.3 per cent as at end June 2013. In line with the policy of reducing non marketable debt, outstanding rupee securities reduced to 1.5 per cent of total domestic debt at end June 2013 from 1.8 per cent at end 2012.

- Outstanding foreign currency denominated domestic debt as at end June 2013 increased by Rs. 32.7 billion to Rs. 277.7 billion (US dollars 2,183.8 million) from Rs. 242.1 billion (US dollars 1,862.6 million) as at end December 2012. This was mainly due to an increase in net borrowings from SLDBs by US dollars 233.1 million. The share of foreign currency denominated domestic debt to total domestic debt increased marginally to 7.6 per cent as at end June 2013 from 7.5 per cent at end December 2012. The total debt stock increased by around

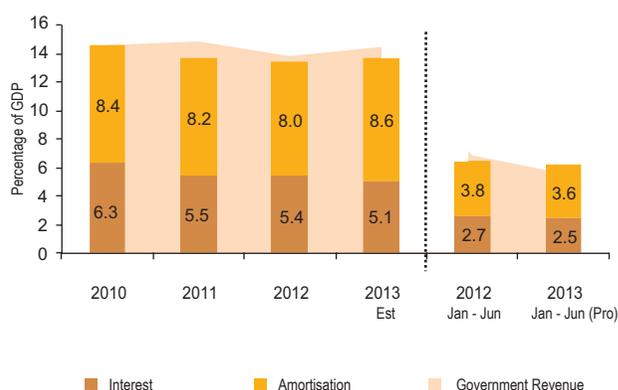
Rs. 14.0 billion due to the depreciation of the Sri Lankan rupee against several major foreign currencies. Foreign currency denominated outstanding debt stock mainly consisted of US dollars, SDR, Japanese yen and Euros. The Sri Lanka rupee depreciated against the US dollar, the SDR and the Euro by 2.2 per cent, 0.1 per cent and 1.0 per cent respectively, while it appreciated against the Japanese yen by 12.7 per cent during the first six months of 2013.

- The reliance on foreign commercial borrowings increased during the first half of 2013 mainly due to substantial increases in foreign investments of rupee denominated Treasury Bonds. The share of non concessional debt of the total foreign debt stock increased to 51.6 per cent by end June 2013 from 50.5 per cent at end 2012. Meanwhile, the share of concessional loans of the total foreign debt stock declined to 48.4 per cent by end June 2013 from 49.5 per cent as at end 2012 reflecting the reduction of concessional loans with the country graduating to lower middle income status.

### Debt Service Payments

- According to the 2013 budget, total debt service payments are estimated at Rs.1,191.8 billion. This consists of amortisation payments of Rs. 747 billion and interest payments of Rs.444.8 billion. Amortisation payments on

**Chart 6.6** Government Debt Service Payments vs Revenue



domestic debt and foreign debt in budget 2013 are estimated to be Rs.604 billion and Rs.143 billion respectively. Interest payments on domestic debt are estimated at Rs.359.8 billion while interest payments on foreign debt are estimated at Rs.85 billion in 2013.

- **During the first half of 2013, total domestic and foreign debt service payments amounted to Rs. 536.4 billion.** This consisted of amortisation payments of Rs. 314.7 billion (58.7 per cent) and interest payments of Rs. 221.8 billion (41.3

per cent). Further, debt service payments to domestic and foreign sources amounted to Rs. 455.3 billion and Rs.81.2 billion, respectively. Up to June 2013, total debt service payments amounted to 45.0 per cent of the annual target with amortisation payments accounting for 42.1 per cent of the annual target and interest payments accounting for 49.9 per cent of the annual target. Accordingly, the latest estimates indicate that total debt service payments in 2013 would be lower than the level estimated in the annual budget mainly due to variations in the exchange rate.

