6

FISCAL POLICY AND GOVERNMENT FINANCE

During the first half of 2014, close monitoring of public expenditure helped the fiscal sector to perform in line with the annual targets. This was mainly achieved from managing recurrent expenditure amidst challenges posed by the shortfall in government revenue compared to the targeted level. Government revenue, as a percentage of estimated GDP declined to 5.4 per cent during the first six months of 2014 compared to 5.6 per cent of GDP recorded in the corresponding period of 2013. This decline was mainly due to the decline in excise tax on petroleum products and cigarettes/tobacco and Economic Service Charge (ESC). Total expenditure and net lending as a percentage of estimated GDP during the first six months of 2014 declined to 9.2 per cent from 10 per cent recorded in the same period in 2013 as a combined outcome of a decline in recurrent expenditure and capital expenditure and net lending. As a result, the overall budget deficit during the first half of 2014 declined to 3.7 per cent of estimated GDP from 4.3 per cent in the same period of 2013. In financing the overall deficit during the first half of the year, the government relied more on foreign sources, which accounted for 65.1 per cent of the total financing requirement. The reliance on domestic banking sector borrowing declined significantly during the first six months of 2014, while borrowings from the non bank sector increased.

Fiscal Policy Measures

- **Fiscal policy in 2014 has been directed at supporting growing economic activity and attaining a more balanced distribution of economic benefits of growth, while continuing fiscal consolidation efforts**. Further, reductions in the budget deficit to 5.2 per cent of GDP and to reduce the government debt to GDP ratio to 74.3 per cent were targeted for 2014. In order to achieve these targets, several policy measures were introduced by the government to enhance revenue and rationalise recurrent expenditure.

- **A number of measures were taken to streamline direct tax collection while improving compliance**. Accordingly, a lower tax rate of 16 per cent was introduced on employment income of professionals. In addition, the formation of corporate entities by professionals to provide high quality professional services to global customers was also encouraged by reducing applicable corporate income tax by 50 per cent for a period of five years. In order to promote exports, the restriction on time period for the applicability of concessional income tax rate of 12 per cent on qualified export profits was removed. However, to maintain uniformity of income tax rates applicable to small and medium industries, the income tax rate on undertakings engaged in manufacturing of goods or providing services with an annual turnover not exceeding Rs. 500 million was revised upwards to 12 per cent from 10 per cent.

- **In order to broaden the Value Added Tax (VAT) base and the Nation Building Tax (NBT) base, several measures were introduced.** The quarterly turnover applicable for the imposition of VAT on wholesale and retail trade was reduced from Rs. 500 million to Rs. 250 million while the VAT exempted amount limited to 25 per cent of total supplies. The removal of the exemption of NBT on banks and financial institutions also supported to expand the tax base while improving the government revenue. However, foreign currency receipts received by any headquarters or regional offices of institutions in the international network relocated in Sri Lanka, were exempted from NBT to further encourage the foreign currency receipts.

- **The Special Commodity Levy (SCL) was used as a mechanism to protect farmers by ensuring remunerative prices and to avoid price fluctuations in the market while enhancing government revenue.** With a view to simplifying the tax structure on imported goods, SCL was introduced for rice, maize and grain sorghum in place of several taxes such as VAT, NBT, Ports and Airports Development Levy (PAL) and Cess. Further, SCL on various commodities such as potatoes, b'onions, red onions and sugar was revised several times depending on domestic market conditions.

- **Emphasis was placed on the development of the technology in tax collecting agencies to improve tax administration and enhance revenue collection**. A unique key number will be introduced to tax payers to link external interfaces with Inland Revenue Department in line with the proposed Revenue Administration Management Information System (RAMIS). In order to further strengthen the recovery of default taxes, provisions such as transfer of immovable property to the government and recover through the remuneration of employees were introduced in addition to filing cases in the high court. Meanwhile, Sri Lanka Customs also introduced a fully automated export documentation process that operates 24 hours daily with the intension to provide efficient service to exporters. Further, a Risk Management Unit (RMU) has been established by Sri Lanka Customs to monitor the compliance of both exporters and importers which would help monitoring international trade related taxes.

- **On the expenditure front, there were several measures introduced in 2014 in order to ensure better management of recurrent and capital expenditure.** According to the National Budget Circular No.1/2014, all spending agencies were instructed to spend within the limits of the provisions in the budget for 2014. In terms of recurrent expenditure, spending agencies were requested to manage expenditure on fuel, electricity, water and transport incurred, adhering to the limits of annual allocation. A special reference was given to the payment of the fuel, electricity and water bills on time, the calculation of the fuel allowance for government officers and usage of vehicles for official travel. Further, the overtime payments were expected to be managed within the allocations for 2014. In terms of capital expenditure management, instructions were issued to limit expenditure to budgetary allocations for 2014.

- **Salaries and wages of public sector employees and pension payments were revised upwards during 2014.** The Cost of Living Allowance (COLA) paid to public servants was increased by Rs. 1,200 per month from January 2014. Meanwhile, the COLA paid to pensioners retired prior to 2006 was increased by Rs. 500 per month and for others it was increased by Rs. 350 per month. Further, a special agency named National Pay Commission was established at the end of 2013 by abolishing the National Salaries and Cadre Commission in order to advice and assist the government in the formulation of a national wage policy.

- **The public investment programme was aimed at expediting ongoing large infrastructure projects, regional infrastructure and human resource development in order to achieve a sustained and regionally balanced economic growth.** On the development of infrastructure facilities, the government focused on the improvement of the road network with continuous investments in the expressway and highway development in the country. The government also invested in the development of transportation sector as well as power and energy sector with the assistance of development partners to facilitate continued flow of business operations of the private sector. Further, several large scale water supply and sanitation facilities in urban and suburban areas were also initiated. The government continued regional infrastructure development activities such as regional and provincial roads, water supply and irrigation projects. In the human resource development front, the government continued to spend on the improvement of physical infrastructure and delivery of the education and health services and improving the quality of such services. In the education sector, the construction of 1,000 "Mahindodaya Technological Laboratories", the construction of 250 "Mahindodaya Technology Faculties" and the construction and repairing of national schools, national colleges of education and teachers' colleges continued during the first half of 2014. In the health sector, several activities were initiated such as development of infrastructure facilities to combat non-communicable diseases, modernisation of the two national children's hospitals and the modernisation and expansion of the Colombo, Kalubowila and Ragama national hospitals under the Medium Term Expenditure Framework 2014-2016.

- **The government continued to channel resources to livelihood development initiatives such as "Divi Neguma", cottage industry development programme, encourage backyard dairy farm activities, fishery sector and to promote the SME sector.** Funds were allocated to import high quality cows to promote small and medium dairy farms. A special low interest loan scheme was implemented to support the SMEs in the dairy sector and to promote dairy farms, collection centres, equipments, and the development of animal feed while charging higher level of Cess to curtail the importation of dairy products. The Women Micro Enterprise Credit Guarantee Scheme was introduced for Women Enterprise Development to provide working capital assistance through Regional Development Banks and SME Banking Units of Commercial Banks, without requiring security.

- **Several restructuring initiatives were taken to strengthen the balance sheets of major State Owned Business Enterprises (SOBEs) during the first half of 2014**. The balance sheets of SriLankan Airlines (SLA) and Mihin Lanka were strengthened by infusing capital. In addition, the settlement of long outstanding debts of government departments and agencies to SOBEs and buy back of non-performing investments in SOBEs were identified as other measures to improve the financial position of SOBEs. Further, the on-lending loans granted to the Ceylon Electricity Board (CEB) and National Water Supply & Drainage Board (NWS&DB) by the Treasury have been identified to be converted to government equity in order to strengthen the financial position of these entities.

- **Several SOBEs issued international bonds during the first eight months**. The SLA successfully issued a 5 year International Bond of US dollars 175 million in June 2014 at 5.3 per cent with a 100 per cent sovereign guarantee. The funds raised through the bond issue were used mainly for refleeting purposes. Meantime, the National Savings Bank (NSB) issued an international bond of US dollars 250 million during the month of September 2014 with a maturity of five years and an annual coupon rate of 5.15 per cent.

- **The government continued to place diversified financing instruments for regional and urban infrastructure development with a focus on leveraging private capital**. Accordingly, utilisation of lease rentals on urban infrastructure financing was increased with more prime lands in the city of Colombo releasing for commercial activities. A knowledge park for the software industry (TRACE Expert City in Tripoli market, Colombo), a modern shopping complex (Arcade - Independence Square), the floating market project and Colombo Gold Centre are some of these projects implemented under Colombo city development.

- **The public debt management strategy was focused to ensure that the government's financing needs are met at the lowest possible cost while minimising the associated risks**. Under the approved International Sovereign Bond Programme for 2014 amounting to US dollars 1.5 billion, the government successfully issued a US dollar 1 billion Bond in January 2014 with a 5 year maturity at a yield rate of 6 per cent per annum. Subsequently, the balance amounting to US dollars 500 million was issued in April 2014 at a yield of 5.125 per cent per annum, which was the lowest among all offerings by Sri Lanka in the international financial markets. Meanwhile, continued measures were taken to replace a part of maturing Treasury bills with medium to long term Treasury bonds with a view to reducing debt rollover risk, while increasing the Average Time to Maturity (ATM) of the domestic debt portfolio.

- **International rating agencies affirmed Sri Lanka's sovereign credit ratings**. Accordingly, Standard & Poor's Ratings Services affirmed Sri Lanka's 'B+' long-term sovereign credit rating, while the outlook remained stable reflecting the expected growth in per capita real GDP and the improvements in government's fiscal profile. Similarly, Fitch Ratings affirmed Sri Lanka's long-term foreign currency Issuer Default Ratings (IDRs) at 'BB-' with a stable outlook, while Moody's Investors Service, affirmed Sri Lanka's 'B1' sovereign bond rating with a stable outlook.

Government Budgetary Operations

Revenue and Grants

Revenue

- **According to the budget for 2014, total government revenue in 2014 is estimated to increase by 26.4 per cent to Rs. 1,437.5 billion.** As a percentage of estimated GDP, total revenue is expected to increase to 14.5 per cent from 13.1 per cent recorded in 2013. Tax revenue as a percentage of GDP is expected to increase to 12.8 per cent from 11.6 per cent in 2013, while non tax revenue as a percentage of GDP is expected to increase marginally to 1.6 per cent from 1.5 per cent in 2013.

- **During the first half of 2014, government revenue as a percentage of estimated GDP declined to 5.4 per cent from 5.6 per cent of GDP in the corresponding period of 2013.** The total revenue collection during this period was 37.3 per cent of the annual estimate of Rs. 1,437.5 billion in comparison to 38.8 per cent in the corresponding period of 2013. However, total government revenue in nominal terms increased by 10 per cent during the first half of 2014 to Rs. 536.4 billion from Rs. 487.9 billion in the corresponding period of the previous year. This was mainly due to the increase in revenue from corporate and non corporate income tax, VAT revenue generated from both imports and domestic economic activities, excise tax on motor vehicles, PAL and NBT on domestic economic activities. However, a decline in tax revenue was recorded from the collection of excise tax on petroleum products and cigarettes/tobacco and ESC. On the non tax revenue front, profit and dividends transfers from SOBEs, rent and interest showed a considerable increase compared to the corresponding period of the previous year.

- **Revenue from income taxes as a percentage of estimated GDP marginally declined to 1 per cent during the first half of 2014 from 1.1 per cent of GDP in the corresponding period of 2013.** However, revenue from income taxes in nominal terms increased by 5.6 per cent during the first half of 2014 reflecting increases in all income related taxes except for ESC. Further, revenue from income taxes contributed to around one fifth of tax revenue during the first half of 2014. Corporate and non corporate income tax increased by 11.5 per cent in nominal terms reflecting an improvement in economic activity. Revenue from Pay-as-you-earn (PAYE) tax increased to Rs. 11.5 billion during the first half of 2014 in comparison to Rs. 10.5 billion in the first half of the previous year. In addition, revenue from withholding taxes also showed a marginal increase during this period. However, revenue from ESC declined by 4.5 per cent to

Table 6.1 Economic Classification of Government Revenue

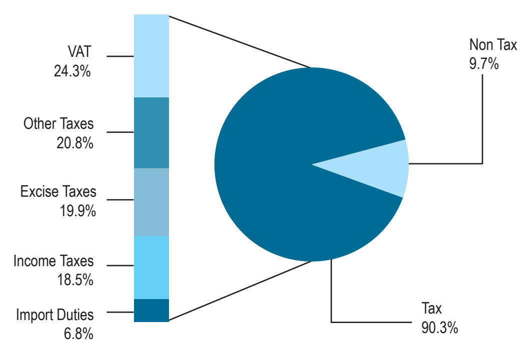
Rs. billion

Item	2012	2013	2014 Approved Estimates	2013 Jan - Jun	2014 Jan - Jun (a)
Tax Revenue	**908.9**	**1,005.9**	**1,274.6**	**441.5**	**484.4**
Income Taxes	172.6	205.7	283.3	94.0	99.3
VAT	229.6	250.8	303.2	118.9	130.2
Excise Taxes	224.0	250.7	266.3	97.3	106.6
Import Duties	80.2	83.1	94.6	34.4	36.4
PAL	70.1	62.0	87.3	24.1	31.0
NBT	38.7	40.9	63.1	17.9	19.5
SCL	33.7	46.7	74.5	22.7	24.9
Cess	32.7	36.1	46.3	17.6	18.1
Other Taxes	27.3	30.0	55.9	14.6	18.4
Non Tax Revenue	**142.5**	**131.6**	**162.9**	**46.3**	**52.0**
Total Revenue	**1,051.5**	**1,137.4**	**1,437.5**	**487.9**	**536.4**

Source: Ministry of Finance and Planning

(a) Provisional

Chart 6.1 Composition of Government Revenue (First Half 2014)



Rs. 3.2 billion from Rs. 3.3 billion in the first half of 2013 reflecting the effect of the increase in the threshold applicable on ESC in 2013.

- **Revenue from VAT as a percentage of estimated GDP marginally declined to 1.3 per cent during the first half of 2014 from 1.4 per cent of GDP in the first half of 2013, although in nominal terms it increased by 9.5 per cent to Rs. 130.2 billion from Rs. 119 billion.** This nominal increase in VAT revenue was due to the increase in revenue from both domestic economic activities and imports. Accordingly, revenue from VAT on domestic economic activities increased by 9.5 per cent to Rs. 67.1 billion in comparison to Rs. 61.3 billion recorded in the first half of 2013. The reduction of quarterly turnover threshold applicable for the imposition of VAT on wholesale and retail trade from Rs. 500 million to Rs. 250 million and expansion of economic activity mainly contributed to this increase. During this period, revenue from VAT on imports also increased by 9.5 per cent to Rs. 63.1 billion from Rs. 57.6 billion in the first half of the previous year. During the first half of 2014, VAT revenue as a percentage of total tax revenue remained unchanged at 26.9 per cent from the corresponding period of 2013.

- **During the first half of 2014, revenue from NBT increased by 9.3 per cent to Rs. 19.5 billion from Rs. 17.9 billion in nominal terms, while remaining unchanged at 0.2 per cent of estimated GDP as in the corresponding period of the previous year.** This nominal increase in the revenue collection from NBT was mainly due to the increased revenue collection from domestic economic activities. Accordingly, revenue from NBT on domestic economic activities increased by 13.7 per cent to Rs. 12.3 billion compared to Rs. 10.8 billion in the first half of 2013 mainly due to the removal of the exemption granted to financial services and the improvements in the hotel and restaurant service sector. Meanwhile, revenue from NBT on import related activities also increased slightly by 2.5 per cent to Rs. 7.3 billion in comparison to Rs. 7.1 billion in the first half of 2013.

- **Excise tax revenue increased in nominal terms by 9.6 per cent to Rs. 106.6 billion while as a percentage of estimated GDP it remained unchanged at 1.1 per cent during the first half of 2014 compared to the corresponding period of 2013.** Parallel to the increase in both hard and malt liquor production, revenue from excise tax on liquor increased by 5 per cent to Rs. 32.8 billion. With increased importation of motor vehicles during the first half of 2014, excise tax revenue collection from motor vehicles increased significantly by 33.7 per cent to Rs. 45.8 billion from the Rs. 34.2 billion in the corresponding period of 2013. However, excise tax revenue from petroleum products declined considerably during the first half of 2014 to Rs. 2.3 billion from Rs. 5 billion in line with the decline recorded in the importation of petroleum products. Meanwhile, revenue on tobacco and cigarettes also declined by 4.3 per cent to Rs. 25.7 billion due to lower cigarette sales during the first half of 2014.

- **Revenue from all import related taxes and levies such as import duties, SCL, PAL and Cess increased during the first half of 2014 from the corresponding period of 2013.** Import duties increased by 5.8 per cent to Rs. 36.4 billion from Rs. 34.4 billion recorded in the first half of 2013. Revenue from PAL increased significantly by 28.4 per cent to Rs. 31 billion while revenue from SCL also increased by 9.8 per cent to Rs. 24.9 billion in comparison to the corresponding period of the previous year. The Cess collection also increased during the first half of 2014 to Rs. 18.1 billion.

- **Non tax revenue increased by 12.2 per cent to Rs. 52 billion during the first half of 2014 compared to Rs. 46.3 billion in the corresponding period of 2013.** This was mainly due to increase in profit and dividend transfers from SOBEs, rent and interest. Profit transfers from the Central Bank amounted to Rs. 9 billion during the first half of 2014, while profit and dividend transfers from other SOBEs recorded an increase of 53.2 per cent during the first half of 2014 and amounted to Rs. 12.6 billion, mainly due to the improved performance in state banks and other SOBEs.

Grants

- **Foreign grant disbursements increased in nominal terms during the first half of 2014.** Accordingly, the realised amount of foreign grants in the first half of 2014 was Rs. 7.2 billion compared to the annual estimate of Rs. 32 billion and Rs. 2.3 billion recorded in the same period of 2013.

Expenditure and Net Lending

- **As per the budget estimates for 2014, total expenditure and net lending is expected to increase to 20 per cent of GDP compared to 19.2 per cent of GDP in 2013.** Recurrent expenditure is estimated to decline to 13.4 per cent of GDP from 13.9 per cent in 2013 while capital expenditure and net lending is estimated to increase to 6.6 per cent of GDP in 2014 from 5.4 per cent recorded in 2013. In nominal terms, total expenditure and net lending in 2014 is estimated to increase by Rs. 316.2 billion to Rs. 1,985.6 billion compared to Rs. 1,669.4 billion recorded in 2013. Current expenditure is expected to increase by Rs. 123.1 billion to Rs. 1,328.3 billion in 2014, while capital expenditure and net lending is expected to increase by Rs. 193.1 billion to Rs. 657.3 billion.

- **Total expenditure and net lending during the first half of 2014 declined to 9.2 per cent of estimated GDP from 10 per cent of GDP during the same period in 2013 due to government public expenditure management with revenue shortfall.** In nominal terms, government expenditure and net lending increased by 5.4 per cent to Rs. 915.4 billion during the first half of 2014 compared to Rs. 868.5 billion during the corresponding period in 2013.

Table 6.2 Economic Classification of Expenditure

Rs. billion

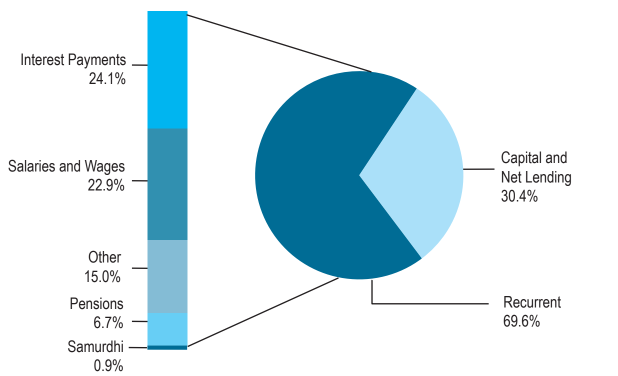
Item	2012	2013	2014 Approved Estimates	2013 Jan - Jun	2014 Jan - Jun (a)
Current Expenditure	**1,131.0**	**1,205.2**	**1,328.3**	**600.1**	**637.2**
o/w Salaries and Wages	347.7	393.2	410.6	188.6	210.1
Interest Payments	408.5	444.0	441.0	221.8	220.3
Foreign	90.8	101.0	76.0	31.8	32.0
Domestic	317.7	343.0	365.0	190.0	188.3
Samurdhi	10.6	15.3	15.0	7.0	8.2
Pensions	111.7	122.8	136.2	59.7	63.3
Fertiliser Subsidy	36.5	19.7	38.0	12.3	24.3
Capital and Net Lending	**425.5**	**464.2**	**657.3**	**268.4**	**278.2**
Total Expenditure and Net Lending	**1,556.5**	**1,669.4**	**1,985.6**	**868.5**	**915.4**

Source: Ministry of Finance and Planning

(a) Provisional

- **During the first half of 2014, current expenditure declined significantly to 6.4 per cent of estimated GDP from 6.9 per cent of GDP recorded in the same period in 2013, mainly due to decline in the expenditure on interest payments in real terms.** In nominal terms, recurrent expenditure increased moderately by 6.2 per cent to Rs. 637.2 billion during the first half of 2014 compared to Rs. 600.1 billion during the corresponding period in 2013. Expenditure on salaries and wages increased by 11.4 per cent to Rs. 210.1 billion mainly due to the increase in COLA by Rs. 1,200 per month paid to government employees from January 2014. Pension payments rose moderately by 6.1 per cent with the increase in the monthly COLA for pensioners. Further, the net increase in the number of pensioners by 6,057 during the first six months of 2014 also contributed to the increase in pension payments. Expenditure on interest payments declined marginally by 0.6 per cent to Rs. 220.3 billion during the first half of 2014 compared to Rs. 221.8 billion during the corresponding

Chart 6.2 **Composition of Government Expenditure (First Half 2014)**



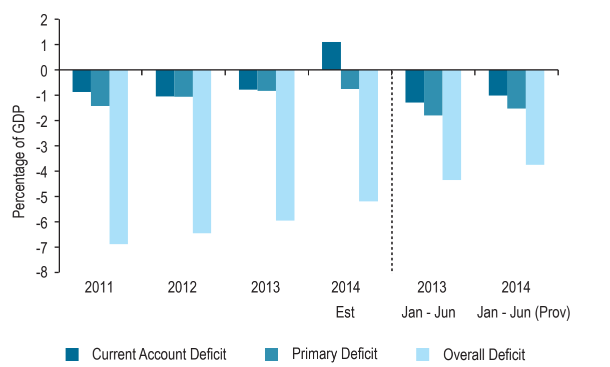
period in 2013. Despite increased borrowings of the government during the first half of the year, relatively low interest rates that prevailed in the domestic market coupled with measures taken to reduce the share of short term debt in total domestic debt stock, resulted in this decline in interest payments. Meanwhile, expenditure on the Samurdhi programme increased by 18.1 per cent to Rs. 8.2 billion during the first half of 2014 compared to Rs. 7 billion during the corresponding period in 2013. Expenditure on the fertiliser subsidy during this period increased by 97.5 per cent to Rs. 24.3 billion over the corresponding period of the previous year mainly due to the settlement of arrears of the last quarter of 2013.

- **Capital expenditure and net lending in nominal terms increased by 3.7 per cent to Rs. 278.2 billion during the first half of 2014, reflecting the government's commitment to continue with the public investment programme amidst the shortfall in government revenue during this period.** However, as a percentage of GDP, it declined to 2.8 per cent during this period from 3.1 per cent in the corresponding period in 2013. The government focused on a threefold approach to public investment in the country which included the development of infrastructure, regional development and development of human capital. Under infrastructure development, the government focused mainly on road development and other key strategic sectors such as ports, airports, power and energy, irrigation, water supply and sanitation and several mega projects were continued during the period. In addition, the government expedited the implementation of many regional and rural infrastructure development projects under initiatives such as "Gama Neguma", "Maga Neguma" and "Pura Neguma" to reduce the rural-urban disparities, which had contributed to the increase in capital expenditure.

Key Fiscal Balances

- **Continuing the fiscal consolidation process, the three key fiscal balances improved during the first half of 2014 despite a lower than expected performance in government revenue, reflecting government's efforts on public expenditure management.** Accordingly, the overall budget deficit as a percentage of GDP declined to 3.7 per cent during the first half of 2014 from 4.3 per cent in the same period of 2013. Even in nominal terms, the overall budget deficit declined to Rs. 371.8 billion during the period under consideration from Rs. 378.3 billion during the first half of 2013. Similarly, the current account deficit recorded a decline to 1 per cent of GDP in the first half of 2014 from 1.3 per cent of GDP in the corresponding

Chart 6.3 **Major Fiscal Indicators**



period of 2013. In line with the improvement in the overall budget deficit, the primary deficit (overall deficit net of interest payments) also declined to 1.5 per cent of GDP in the first half of 2014 from 1.8 per cent of GDP during the corresponding period in 2013.

Financing the Budget Deficit

- **In financing the overall deficit of Rs. 371.8 billion during the first six months of 2014, foreign sources contributed 65.1 per cent, while domestic sources contributed the balance 34.9 per cent.** Accordingly, net foreign financing increased significantly by 65.5 per cent to Rs. 242.1 billion during the period under consideration, whereas net domestic financing decreased considerably by 44.1 per cent to Rs. 129.7 billion compared to the corresponding period in 2013.

- **The reliance placed on borrowings from the domestic banking sector declined during the first six months of 2014, while borrowings from the non bank sector increased compared to the same period of 2013**. Accordingly, borrowings from the banking sector declined significantly to Rs. 53.6 billion during the first half of the year, from Rs. 210.4 billion during the same period in the previous year. Of the total domestic financing, bank financing contributed 41.3 per cent during the first six months of 2014 in comparison to the 90.7 per cent recorded during the same period of 2013. Even though financing from the Central Bank increased to Rs. 28.8 billion from a net repayment of Rs. 45.7 billion in the corresponding period of the previous year, a decline in financing from the commercial banking sector from Rs. 256.1 billion in the first half of 2013 to Rs. 24.8 billion in the corresponding period of 2014 helped to reduce financing from the banking sector. Meanwhile, borrowings from the non bank sector increased to Rs. 89.4 billion during the first six months of 2014, from Rs. 21.6 billion during the same period in the previous year.

- **Net foreign financing during the first six months of 2014 increased to Rs. 242.1 billion from Rs. 146.3 billion recorded in the corresponding period of 2013.** The issuance of International Sovereign Bonds early on during the year contributed to the increase in net foreign financing during the first half of 2014. Under the approved International Sovereign Bond Programme for 2014 amounting to US dollars 1.5 billion, the government issued a US dollar 1 billion Bond in January 2014, while the balance amounting to US dollars 500 million was issued in April 2014. The full amount of the first issuance and a part of the proceeds from the balance has been utilised for debt

Table 6.3 Sources of Financing

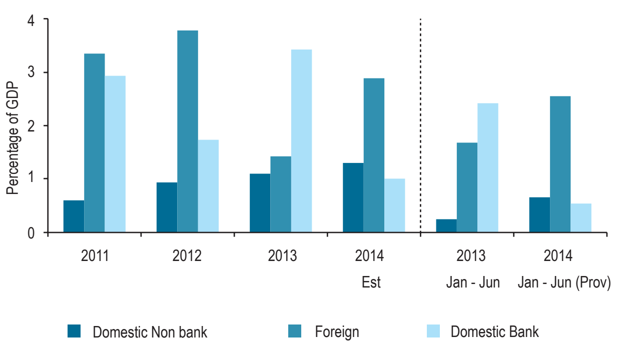
Rs. billion

Item	2012	2013	2013 Jan-Jun	2014 Jan- Jun (a)
Domestic Financing	**202.5**	**392.4**	**232.0**	**129.7**
Bank	131.5	297.0	210.4	53.6
Non Bank	71.0	95.4	21.6	76.1
Foreign Financing	**286.5**	**123.7**	**146.3**	**242.1**
Loans	180.8	67.9	72.9	210.4
Non Resident Investments in Treasury Bonds	99.7	62.5	78.5	20.8
Non Resident Investments in Treasury Bills	6.0	-6.7	-5.2	11.0
Total	**489.0**	**516.1**	**378.3**	**371.8**

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

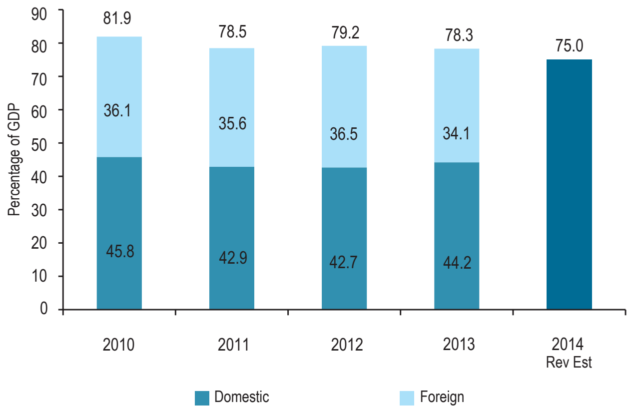
(a) Provisional

Chart 6.4 Deficit Financing



repayments. The proceeds of the International Sovereign Bonds accounted for 65.3 per cent of net foreign financing during the period under consideration. However, foreign loan disbursements declined to Rs. 52.3 billion on a net basis during the first half of 2014 from Rs. 72.9 billion in the same period of 2013. In addition, during this period financing from foreign investments in government securities declined to Rs. 31.7 billion from Rs. 73.3 billion in the previous year.

Chart 6.5 Outstanding Government Debt



Government Debt and Debt Service Payments

Government Debt

- **The total outstanding government debt stock increased by Rs. 548 billion to Rs. 7,341.3 billion as at end June 2014from Rs. 6,793.2 billion as at end December 2013.** Domestic debt increased by Rs. 235.7 billion to Rs.4,068.6 billion, while foreign debt increased by Rs. 312.3 billion to Rs. 3,272.7 billion. The increase in the total debt stock due to exchange rate variation amounted to Rs. 38.8 billion as the Sri Lanka rupee depreciated against several major foreign currencies except the US dollar and the euro during the first half of 2014. However, unlike in the previous years, the discount factor contributed a decline in the debt stock by Rs. 12 billion due to the issuance of government securities at a premium during the period under consideration. The latest estimates expects the debt to GDP ratio to be 75 per cent by the end of 2014.

- **Of the total domestic debt, short term debt as at end June 2014 declined marginally by 0.1 per cent, whereas medium and long term debt increased by 8.1 per cent from end 2013.** The replacement of a part of maturing Treasury bills with medium to long term Treasury bonds and the retirement of administrative borrowings contributed to a decline in short term debt amidst an increase in provisional advances from the Central Bank. Accordingly, the share of Treasury bills in the total domestic debt as at end June 2014 declined to 16.4 per cent from 18.3 per cent at end 2013. On the contrary, the share of medium and long term debt in the total domestic debt stock increased to 77.7 per cent from 76.3 per cent at end 2013. Treasury bonds, which dominates the outstanding domestic debt portfolio, accounted for 65.7 per cent as at end June 2014 compared to 64 per cent as at end December 2013.

Table 6.4 Outstanding Government Debt

Rs. billion

Item	2012	2013	2013 End Jun	2014 End Jun (a)
Domestic Debt (b)	**3,232.8**	**3,832.8**	**3,637.7**	**4,068.6**
By Maturity Period				
Short Term	813.3	909.2	942.3	908.6
Medium and Long Term	2,419.5	2,923.7	2,695.4	3,160.0
By institution				
Banks (c)	1,060.3	1,433.8	1,309.1	1,510.3
Non Bank Sector	2,172.5	2,399.1	2,328.6	2,558.3
Foreign Debt	**2,767.3**	**2,960.4**	**2,882.0**	**3,272.7**
Concessional	1,369.6	1,492.8	1,395.4	1,552.1
Non Concessional	1,397.7	1,467.6	1,486.6	1,720.6
Total Government Debt	**6,000.1**	**6,793.2**	**6,519.7**	**7,341.3**

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 settle dues to CPC in January 2012, Rs.13,125 million issued to capitalise SriLankan Airlines in March 2013 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 of LCBs

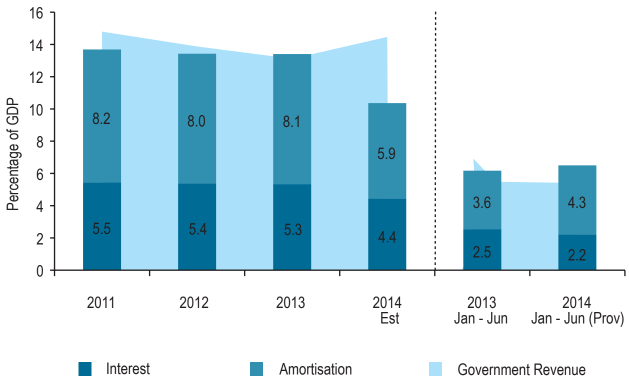
- **The outstanding foreign currency denominated domestic debt as at end June 2014 increased by Rs. 17.1 billion to Rs. 405.9 billion (US dollars 3,115 million) from Rs. 388.8 billion (US dollars 2,974 million) as at end December 2013.** This was entirely due to an increase in Sri Lanka Development Bonds (SLDBs) amounting to US dollars 141.5 million on a net basis. Meanwhile, the share of foreign currency denominated domestic debt to total domestic debt declined marginally to 10 per cent as at end June 2014 from 10.1 per cent in end 2013.

- **The reliance on foreign commercial borrowings increased during the first half of 2014 mainly with the issuance of International Sovereign Bonds.** Accordingly, commercial borrowings which include Sovereign Bond proceeds and investment in government securities, increased by 21.9 per cent to Rs. 1,228.2 billion and the share of non concessional debt in the total foreign debt stock increased to 52.6 per cent by end June 2014 from 49.6 per cent at end 2013. Correspondingly, the share of concessional loans in the total foreign debt stock declined to 47.4 per cent by end June 2014 from 50.4 per cent at end 2013.

Debt Service Payments

- **As per the original budget estimates, total debt service payments in 2014 are expected to be Rs. 1,029.9 billion, which is considerably lower than Rs. 1,162.9 billion recorded in 2013.** This comprises amortisation payments of Rs. 588.9 billion and interest payments of Rs. 441 billion. Amortisation payments on domestic debt is estimated to be Rs. 492.9 billion, while amortisation payments on foreign debt is estimated to be Rs. 96 billion in 2014. Interest payments on domestic and foreign debt are estimated to be Rs. 365 billion and Rs. 76 billion, respectively, in 2014.

Chart 6.6 Government Debt Service Payments vs Revenue



- **During the first six months of 2014, total domestic and foreign debt service payments amounted to Rs. 644.4 billion.** This consisted of amortisation payments of Rs. 424.1 billion (65.8 per cent) and interest payments of Rs. 220.3 billion (34.2 per cent). Further, debt service payments to domestic and foreign sources amounted to Rs. 559.7 billion and Rs. 84.7 billion, respectively. Up to June 2014, total debt service payments amounted to 62.6 per cent of the annual estimate, comprising amortisation payments accounting for 72 per cent of the annual estimate and interest payments accounting for 50 per cent of the annual estimate.