6

FISCAL POLICY AND GOVERNMENT FINANCE

The fiscal sector showed a mixed performance during the first seven months of 2015. Government revenue as a percentage of estimated GDP increased slightly to 6.4 per cent during the first seven months of 2015, compared to 5.8 per cent of GDP in the corresponding period in 2014, mainly due to an increase in revenue from import related taxes. Total expenditure and net lending as a percentage of estimated GDP increased to 10.8 per cent during the first seven months of 2015, compared to 10.4 per cent of GDP recorded in the same period in 2014 as a combined outcome of the overrun in recurrent expenditure and a decline in public investment. As a result, during the first seven months of 2015, the overall budget deficit is estimated to have declined to 4.5 per cent of estimated GDP from 4.6 per cent of GDP in the corresponding period in 2014. In financing the overall fiscal deficit during the first seven months of the year, the government relied entirely on domestic sources as net foreign financing recorded a repayment during this period, mainly due to comparatively low disbursement of foreign project loans and net outflow of foreign investments in Government securities. In domestic financing, net borrowings from the banking sector increased significantly to Rs. 299.2 billion compared to the annual estimate of Rs. 70.0 billion in the Budget for 2015. In this context, meeting the budget deficit target of 4.4 per cent of GDP in 2015 would be a challenging task.

Fiscal Policy Measures

- **Fiscal policy in 2015 has been directed at supporting growing economic activity while strengthening the fiscal consolidation process to reduce the budget deficit further to 4.4 per cent of GDP and to reduce the government debt to GDP ratio to 72.0 per cent in 2015.** In order to achieve these targets, several policy measures were introduced by the government to enhance government revenue and rationalise recurrent expenditure.

- **Several revenue measures were introduced in the original Budget for 2015 presented in October 2014 and in the Interim Budget presented in January 2015 to address the continued declining trend in revenue to GDP ratio**. In the original Budget, several taxes were streamlined in order to maintain uniformity and simplicity in the tax system. In the Interim Budget, new taxes such as Mansion tax, Migrating tax and Super Gain tax were proposed as revenue enhancing measures. Further, few other measures were also taken to streamline the direct tax collection while improving the compliance and promoting selected sectors. Accordingly, the low income tax rate of 16 per cent on employment income, which was introduced for professionals, was extended to cover other employment categories as well. Moreover, as a relief to Pay-As-You-Earn (PAYE) taxpayers, the present exempted amount of annual employment income of Rs. 600,000 was increased to Rs. 750,000. In addition, a pioneering industry allowance was introduced by applying an income tax deduction by 10 per cent for local manufacturers who have commenced businesses of manufacturing during the 1970s. In addition, a 12 per cent concessionary income tax rate was introduced for the local sugar industry with a view to expand it. Further, the present withholding tax regime applicable for interest income of individuals and charitable institutions was revised by introducing single withholding tax rate of 2.5 per cent of interest income, irrespective of the amount of interest.

- **In the Budget for 2015, the Value Added Tax (VAT) base was expanded and the applicable rate was lowered**. Accordingly, the quarterly turnover applicable for the imposition of VAT on wholesale and retail trade was reduced from Rs. 250 million to Rs. 100 million, while the VAT rate was reduced to 11 per cent from 12 per cent with effect from January 2015. In addition, threshold of liable supplies for the registration for VAT purposes was increased to Rs. 15 million per annum from Rs. 12 million per annum to encourage Small and Medium Enterprises (SMEs). Similarly, the threshold of liable turnover of the Nation Building Tax (NBT) was also increased to Rs. 15 million per annum from Rs. 12 million per annum.

- **Special Commodity Levy (SCL) on importation of several food items was changed periodically in order to adjust the market prices and quantity imported with the view of reducing the cost of living and protecting the income of domestic farmers during the harvesting period**. Accordingly, SCL on several food items was revised downwards as proposed in the Interim Budget with effect from 30 January 2015. SCL on the importation of rice, which was reduced to a lower level to increase the market availability of rice due to low paddy production in 2014, was increased twice during this period to Rs. 40 per kg. Further, in May 2015, a Customs duty of Rs 35 per kg, VAT at a rate of 11 per cent, Ports and Airports Development Levy (PAL) at a rate of 5 per cent and NBT at a rate of 2 per cent was introduced in place of SCL of Rs. 40 per kg of rice. Further, SCL on importation of potatoes and b' onions was changed several times considering the domestic supply conditions.

- **Greater emphasis was placed on expediting the process of automating revenue agencies to improve tax administration and thereby enhance the revenue collection**. The Revenue Administration Management Information

System (RAMIS), which is being introduced with technical assistance from the government of Singapore, is expected to expedite the automation process of the Inland Revenue Department (IRD). This project mainly includes the conversion of taxpayer services in to self-services, the establishment of an integrated system on tax payer information and tax liabilities across the taxes, the creation of a centralised taxpayer database, the implementation of a unique identification number for both individual and corporate taxpayers and the establishment of an integrated system to facilitate exchange of information between IRD and other key stakeholders. In addition, a new web portal has been launched by the IRD from end May 2015, while User Acceptance Testing (UAT) was initiated in October 2015. Meanwhile, Sri Lanka Customs (SLC) was engaged in introducing further improvements and developments to the 24 hour fully automated system, which was started in 2014, as well as the scanning facilities at SLC.

- **On the expenditure front, several measures were introduced in order to ensure the proper management of public expenditure in 2015**. Under the National Budget Circular No. 02/2015, all spending agencies were instructed to manage the expenditure within provisions allocated for the year 2015 and thus maintain a proper control over the expenditure heads. It was announced that new vehicles would not be provided to government institutions during the year 2015 and vehicles available at present were expected to be managed efficiently. Expenditure on publicity and sponsorship was not allowed in order to prevent misappropriation of public funds. In terms of capital expenditure management, instructions were issued to settle the commitments of the previous year from the provisions allocated for the year 2015 and prioritise the balance provisions by looking at the possibility of implementing less priority projects through the Medium Term Budgetary Framework.

- **Salaries and wages of public sector employees and pension payments were revised upwards during 2015**. The monthly interim allowance of Rs. 3,000 per month granted for the government sector employees with effect from November 2014 was increased by Rs. 7,000, of which Rs. 5,000 was given with effect from February and the balance was granted with effect from June 2015. In addition, a special allowance was introduced for the executive category in the public service with effect from July 2015. The interim allowance of Rs. 2,500 per month granted for pensioners with effect from November 2014 was also increased to Rs. 3,500 per month with effect from April 2015. In addition, pension anomalies of public servants who have retired before the implementation of Public Administration Circular No. 06/2006, were rectified and the adjusted pension was paid with effect from July 2015.

- **Implementation of infrastructure development projects under the public investment programme was slow during the first seven months of 2015 due to lower disbursement of foreign funded project loans, reflecting ongoing Environmental Impact Assessments (EIAs) for some infrastructure development projects and the renegotiation of loan agreements**. However, ongoing irrigation schemes such as Moragahakanda and Kaluganga projects were continued during the year. Meanwhile, development of expressways and widening and improvement of national roads and bridges continued. Accordingly, the Northern Road Connectivity Project (NCP), Hatton-Nuwara Eliya Road Project, Badulla Chenkaladi Road Improvement Project and the construction and improvement of bridges islandwide were continued during the first seven months of 2015. Further, Phase II of the Outer Circular Highway from Kaduwela to Kadawatha was opened on 17 September 2015. Meanwhile, the construction of Phase I of the Central Expressway from Kadawatha to Mirigama commenced in August 2015.

- **The government continued to channel resources to livelihood development initiatives through Samurdhi and Maganeguma**. Accordingly, Samurdhi relief was increased by 100 per cent to Rs. 3,000 per month from Rs. 1,500 per month commencing from January 2015. This was further increased to Rs. 3,500 per month with effect from April 2015. 'Divineguma Diriya Saviya', a special loan scheme that was implemented through Divineguma Community Based Banks was further strengthened to support low income families in order to improve their living standards. Further, allocations were also made for the development of sectors such as agriculture, livestock, fisheries and micro enterprises under the Divineguma programme. In addition, the Maganeguma programme also continued during the first seven months of the year with a view of further developing rural and regional infrastructure facilities.

- **Several reform initiatives were taken to strengthen the operations of major State Owned Business Enterprises (SOBEs) during the first seven months of 2015**. Accordingly, the re-fleeting programme of SriLankan Airlines (SLA) that was initiated in 2014, by replacing the entire wide body fleet with a new fleet in order to improve operational efficiency and to provide modern passenger comforts, was continued during the first seven months of the year. Further, with the approval of the Cabinet of Ministers, SLA prepared a viable and comprehensive restructuring business plan for SLA and Mihin Lanka Ltd., which includes the amalgamation of both airlines.

- **The public debt management strategy continued to focus on ensuring the availability of funding for the government financing needs at the lowest possible cost, while minimising the risks associated with the public debt in an appropriate manner**. During the year, the acceptance of investment in government securities through direct placements was abandoned and replaced with a fully auction based system. Steps were taken to maintain a proper mix of domestic and foreign debt and to reduce maturity mismatches in the debt portfolio. Accordingly, maturing Treasury bills were replaced with medium to long-term Treasury bonds mainly to reduce the debt rollover risk, and to increase the Average Time to Maturity (ATM) of the domestic debt portfolio. Sri Lanka Development Bonds (SLDBs), which is an instrument that makes foreign currency denominated borrowing through the domestic banking system, were also used to reduce the pressure on domestic market interest rates. The government successfully issued US dollars 650 million of International Sovereign Bonds (ISBs) in May 2015 with a maturity period of 10 years at a progressively lower yield rate of 6.125 per cent per annum. In addition, in October 2015, another US dollars 1.5 billion of ISBs was raised at a yield of 6.85 per cent per annum with a maturity period of 10 years.

- **International sovereign rating agencies affirmed Sri Lanka's existing sovereign credit ratings in 2015**. The Fitch Ratings affirmed its existing rating of 'BB-' and the stable outlook for the Sri Lankan economy, having observed the country's favourable GDP growth, clean external debt servicing record and the level of human development compared to its peers, while citing relatively weak balance of payments and weak public finances as areas of concern. Moody's Investors Service affirmed Sri Lanka's 'B1' sovereign rating with a stable outlook, supported by the high and robust growth over the rating horizon. Similarly, Standard & Poor's Ratings Services affirmed its 'B+' long term and 'B' short term sovereign credit ratings with a stable outlook, citing a relatively low level of wealth, moderately weak external liquidity and higher levels of government debt and interest burden as concerns.

Government Budgetary Operations

Revenue and Grants

Revenue

- **According to the budget for 2015, total government revenue in 2015 is estimated to increase by 25.9 per cent to Rs. 1,504.7 billion.** As a percentage of estimated GDP, the total revenue is expected to increase to 13.3 per cent from 11.6 per cent recorded in 2014. Tax revenue as a percentage of GDP is expected to increase to 11.8 per cent from 10.2 per cent in 2014, while non tax revenue is expected to increase marginally to 1.5 per cent of GDP from 1.4 per cent in 2014.

- **During the first seven months of 2015, government revenue as a percentage of estimated GDP increased to 6.4 per cent from 5.8 per cent in the corresponding period of 2014.** The total revenue collection during this period was 47.9 per cent of the annual estimate of Rs. 1,504.7 billion in comparison to 41.6 per cent in the corresponding period of 2014. Total government revenue in nominal terms increased by 20.7 per cent during this period to Rs. 721.5 billion from Rs. 597.9 billion in the corresponding period of the previous year. This was mainly due to the increase in revenue from excise tax on motor vehicles, liquor, cigarettes and tobacco, import duties and NBT on domestic economic activities. However, a decline in tax revenue was recorded from withholding tax revenue, VAT and NBT revenue on import related activities and from PAL. On the non tax revenue front, profit and dividend transfers from SOBEs as well as fees and charges which showed a considerable increase during the first seven months of 2015 compared to the corresponding period of the previous year also contributed to the increase in revenue.

Table 6.1 Economic Classification of Government Revenue

Rs. billion

Item	2013	2014 (a)	2015 Approved Estimates	2014 Jan - Jul (a)	2015 Jan - Jul (a)
Tax Revenue	**1,005.9**	**1,050.4**	**1,337.0**	**538.1**	**663.3**
Income Taxes	205.7	198.1	310.6	116.0	98.0
VAT	250.8	275.4	296.0	133.3	123.2
Excise Taxes	250.7	256.7	343.4	112.4	256.3
Import Duties	83.1	81.1	85.0	40.4	53.7
PAL	62.0	68.6	81.0	36.2	30.0
NBT	40.9	44.6	50.6	22.7	24.0
SCL	46.7	48.0	65.0	28.9	31.0
Cess	36.1	38.7	48.5	21.3	23.7
Other taxes	30.0	39.2	56.9	26.9	23.3
Non Tax Revenue	**131.6**	**144.8**	**167.7**	**59.7**	**58.2**
Total Revenue	**1,137.4**	**1,195.2**	**1,504.7**	**597.9**	**721.5**

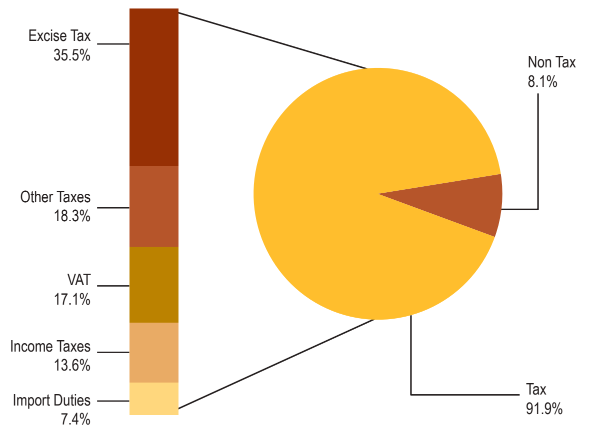
Source: Ministry of Finance

(a) Provisional

- **The revenue from income taxes as a percentage of estimated GDP declined to 0.9 per cent during the first seven months of 2015 from 1.1 per cent in the corresponding period of 2014.** Revenue from income taxes in nominal terms also declined by 15.5 per cent during the first seven months of 2015 mainly due to the decline in revenue from all income tax categories except for PAYE tax. Revenue from PAYE tax increased to Rs. 16.2 billion during the first seven months of 2015 in comparison to Rs. 13.3 billion during the same period of the previous year. However, revenue from corporate and non corporate income tax, Economic Service Charge (ESC) and withholding tax on revenue declined during the first seven month of 2015 in comparison to the corresponding period of 2014. Accordingly, revenue from withholding taxes declined by 36.5 per cent to Rs. 34.7 billion during this period mainly due to the decline in tax on interest as a result of the decline in interest rates in the domestic market. Further, revenue from corporate and non corporate income tax declined by 1.5 per cent to Rs. 43.0 billion while revenue from ESC also declined by 4.4 per cent to Rs. 4.1 billion from Rs. 4.3 billion in the first seven months of 2015.

- **The revenue from VAT declined to 1.1 per cent of estimated GDP in the first seven months of 2015 from 1.3 per cent of GDP during the**

Chart 6.1 Composition of Government Revenue (Jan - Jul 2015)



corresponding period of the previous year. In nominal terms also, it declined by 7.6 per cent to Rs. 123.2 billion during this period from Rs. 133.3 billion recorded during the corresponding period of the previous year. Decline in VAT revenue was mainly due to the reduction of VAT rate from 12 per cent to 11 per cent with effect from January 2015 and the imposition of excise tax as a composite tax on motor vehicles, cigarettes and liquor instead of VAT and other taxes. Accordingly, during this period, revenue from VAT on import related activities declined significantly by 18.1 per cent to Rs. 46.8 billion from Rs. 57.1 billion in the first seven months of the previous year, although revenue from VAT on domestic economic activities increased marginally by 0.3 per cent to Rs. 76.4 billion in comparison to Rs. 76.2 billion recorded in the first seven months of 2014. During this period, VAT revenue as a percentage of total tax revenue declined significantly to 17.1 per cent from 22.3 per cent recorded during the corresponding period of 2014.

- **Excise tax revenue as a percentage of estimated GDP increased significantly to 2.3 per cent during the first seven months of 2015 in comparison to 1.1 per cent of GDP recorded in the corresponding period of 2014 mainly reflecting the impact of composite excise tax on motor vehicles, liquor and cigarettes.** In nominal terms also, revenue from excise tax increased significantly by 128.1 per cent to Rs. 256.3 billion compared to the same period in 2014. Excise tax revenue on motor vehicles largely supported this increase, while excise tax revenue on tobacco, cigarettes and liquor also recorded a considerable growth during this period. With the increased importation of motor vehicles during the first seven months of 2015 due to the reduction of taxes on selected motor vehicles and the charge of the excise tax in lieu of VAT, NBT, Cess, Customs duty and PAL on motor vehicles from the latter part of 2014, excise tax revenue collection from motor vehicles increased significantly by 256.0 per cent to Rs. 143.1 billion compared to Rs. 40.2 billion recorded in the corresponding period of 2014. The revenue from excise tax on liquor increased by 51.4 per cent to Rs. 57.2 billion during the first seven months of 2015 mainly due to the duty imposed on the manufacture of liquor in place of VAT and NBT and the increase in liquor production during the first seven months of 2015. Meanwhile, revenue from tobacco and cigarettes also increased by 51.2 per cent to Rs. 46.9 billion in the first seven months of 2015 due to the increase in tax rates and increase in demand mainly with the increased salaries and wages. However, excise tax revenue from petroleum products declined to Rs. 2.4 billion from Rs. 3.4 billion recorded during the first seven months of 2014.

- **Revenue from NBT increased by 5.6 per cent to Rs. 24.0 billion from Rs. 22.7 billion in nominal terms during the first seven months of 2015, though it remained unchanged at 0.2 per cent of estimated GDP as in the corresponding period of the previous year.** This nominal increase in revenue collection from NBT was mainly due to the increased revenue collection from domestic economic activities by 60.1 per cent to Rs. 15.3 billion compared to Rs. 9.6 billion during the first seven months of 2014 mainly due to improvements in the domestic economic activities. Meanwhile, revenue from NBT on import related activities declined by 34.3 per cent to Rs. 8.6 billion in comparison to Rs. 13.1 billion in the first seven months of 2014 due to the removal of the NBT from motor vehicles, liquor and cigarettes.

- **The revenue from all other import related taxes and levies such as import duties, SCL, and Cess except revenue collection from PAL, increased during the first seven months of 2015 compared to the corresponding period of 2014**. The revenue from import duties increased by 32.8 per cent to Rs. 53.7 billion from Rs. 40.4 billion recorded in the first seven months of 2014. The revenue from Cess increased by 11.4 per cent to Rs. 23.7 billion while the revenue from SCL also increased by 7.3 per cent to Rs. 31.0 billion in comparison to the corresponding period of the previous year. The revenue collection from PAL declined during the first seven months of 2015 by 17.2 per cent to Rs. 30.0 billion mainly due to imposition of excise tax as a composite tax on motor vehicles instead of PAL and other taxes.

- **Non tax revenue declined by 2.6 per cent to Rs. 58.2 billion during the first seven months of 2015 compared to Rs. 59.7 billion in the corresponding period of 2014.** This nominal decline was mainly due to the non availability of Central Bank profit transfers and decline in rent and interest income. However, the revenue from fees and charges increased by 33.1 per cent to Rs. 23.9 billion from Rs. 18.0 billion recorded in the first seven months of 2014. Profit and dividend transfers from SOBEs during this period recorded a 44.3 per cent increase to Rs. 21.3 billion compared to the same period in 2014 mainly due to the improved performance in state banks and other SOBEs.

Grants

- **Foreign grant disbursements declined in nominal terms during the first seven months of 2015**. Accordingly, the realised amount of foreign grants in the first seven months of 2015 was Rs. 0.2 billion compared to the annual estimate of Rs. 30.0 billion and Rs. 3.5 billion recorded in the same period of 2014.

Expenditure and Net Lending

- **As per the Budget for 2015, total expenditure and net lending is estimated to increase to 18.0 per cent of GDP compared to 17.4 per cent of GDP in 2014.** Recurrent expenditure is estimated to increase to 13.7 per cent of GDP from 12.9 per cent in 2014 while capital expenditure and net lending is estimated to decrease to 4.3 per cent of GDP in 2015 from 4.6 per cent recorded in 2014. In nominal terms, total expenditure and net lending in 2015 is estimated to increase by Rs. 238.2 billion to Rs. 2,034.0 billion in comparison to Rs. 1,795.9 billion recorded in 2014. Recurrent expenditure is expected to increase by Rs. 229.1 billion to Rs. 1,552.0 billion in 2015, while capital expenditure and net lending is expected to increase by Rs. 9.1 billion to Rs. 482.0 billion.

- **Total expenditure and net lending during the first seven months of 2015 increased to 10.8 per cent of estimated GDP from 10.4 per cent of GDP during the same period in 2014 due to increased recurrent expenditure.** In nominal terms, government expenditure and net lending increased by 14.2 per cent to Rs. 1,226.5 billion during this period compared to Rs. 1,073.9 billion recorded during the corresponding period in 2014.

- **During the first seven months of 2015, recurrent expenditure increased significantly to 8.7 per cent of estimated GDP from 7.5 per cent of GDP recorded during the same**

Table 6.2 Economic Classification of Expenditure

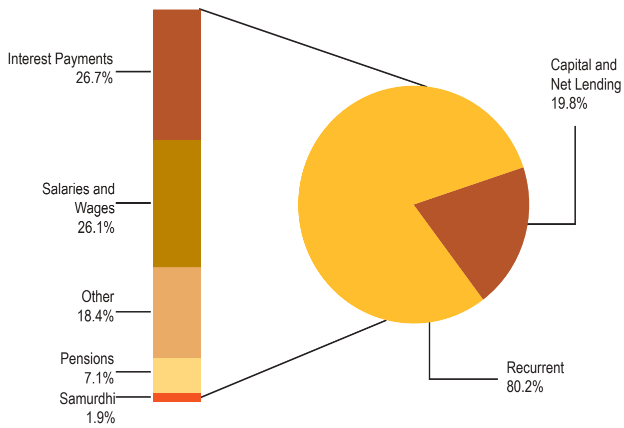
Rs. billion

Item	2013	2014 (a)	2015 Approved Estimates	2014 Jan - Jul (a)	2015 Jan - Jul (a)
Recurrent Expenditure	**1,205.2**	**1,322.9**	**1,552.0**	**767.0**	**983.6**
o/w Salaries and Wages	393.2	441.0	570.0	245.6	319.6
Interest Payments	444.0	436.4	425.0	298.8	326.9
Foreign	101.0	108.5	76.0	52.3	75.1
Domestic	343.0	327.9	349.0	246.6	251.8
Samurdhi	15.3	15.0	41.0	9.2	23.1
Pensions	122.8	126.1	159.9	71.6	87.0
Fertiliser Subsidy	19.7	31.8	35.0	18.4	18.3
Capital and Net Lending	**464.2**	**473.0**	**482.0**	**306.9**	**242.8**
Total Expenditure and Net Lending	**1,669.4**	**1,795.9**	**2,034.1**	**1,073.9**	**1,226.5**

Source: Ministry of Finance

(a) Provisional

Chart 6.2 Composition of Government Expenditure (Jan - Jul 2015)



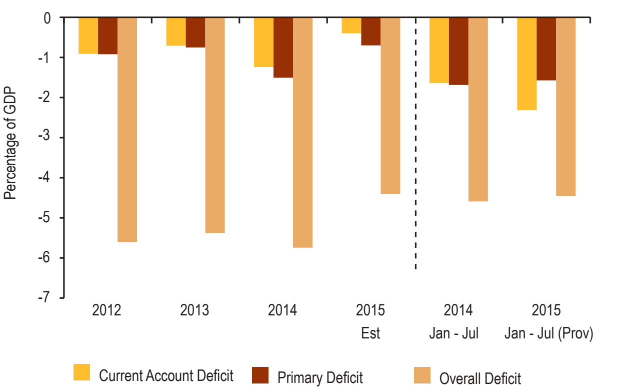
period in 2014. In nominal terms, recurrent expenditure increased by 28.3 per cent to Rs. 983.6 billion compared to Rs. 767.0 billion during the corresponding period in 2014. Expenditure on salaries and wages increased by 30.2 per cent to Rs. 319.6 billion mainly due to the grant of an interim allowance of Rs. 3,000 per month with effect from November 2014 and its' increase by Rs. 5,000 per month with effect from February 2015 and by Rs. 2,000 per month with effect from June 2015. Pension payments also increased significantly by 21.5 per cent with the increase in monthly allowance for pensioners by Rs. 2,500 with effect from November 2014 and Rs. 1,000 per month with effect from April 2015 compared to the corresponding period of 2014. Further, the rectification of pension anomalies of public servants who have retired before the implementation of Public Administration Circular No. 06/2006, with effect from July 2015, also contributed to the increase in the pension bill. Expenditure on interest payments increased by 9.4 per cent to Rs. 326.9 billion during the first seven months of 2015 compared to Rs. 298.8 billion during the corresponding period in 2014. Meanwhile, expenditure on the Samurdhi programme increased significantly by 152.4 per cent to Rs. 23.1 billion during the first seven months of 2015 compared to Rs. 9.2 billion during the corresponding period in 2014. This was mainly due to the 100 per cent increase in Samurdhi allowance to Rs. 3,000 per month from Rs. 1,500 per month commencing from January 2015 and the further increase of Rs. 500 to Rs. 3,500 per month with effect from April 2015. Meanwhile, the expenditure on the fertiliser subsidy during this period declined marginally by 1.0 per cent to Rs. 18.2 billion in comparison the corresponding period of the previous year.

- **Capital expenditure and net lending as a percentage of GDP declined to 2.1 per cent during the first seven months of 2015 from 3.0 per cent recorded in the corresponding period in 2014.** In nominal terms, it declined by 20.9 per cent during this period to Rs. 242.8 billion from Rs. 306.9 billion recorded in the same period in 2014. This was mainly a result of the slow progress in the implementation of the infrastructure projects due to the renegotiation of selected loan agreements and ongoing EIAs, which in turn reflect a lower disbursement of foreign funds related to projects. The realised capital expenditure and net lending in the first seven months of 2015 accounted for 60.2 per cent of the annual estimate for the year.

Key Fiscal Balances

- **The overall budget deficit and primary deficit as a percentage of GDP improved slightly, while the current account deficit deteriorated during**

Chart 6.3 Major Fiscal Indicators



the first seven months of 2015 compared to the levels recorded during the corresponding period of 2014. Accordingly, the overall budget deficit declined to 4.5 per cent of GDP during the first seven months of 2015 from 4.6 per cent in the same period of 2014. However, in nominal terms, the overall budget deficit increased to Rs. 504.8 billion during the period under consideration from Rs. 472.5 billion in the corresponding period of 2014. The current account deficit increased to 2.3 per cent of GDP in the first seven months of 2015 from 1.6 per cent of GDP during the same period of 2014 due to a higher increase in recurrent expenditure rather than the increase in government revenue. The primary deficit (overall deficit net of interest payments) declined slightly to 1.6 per cent of GDP in the first seven months of 2015 from 1.7 per cent of GDP recorded during the same period in 2014.

Financing the Budget Deficit

- **The government relied entirely on domestic sources for financing the overall budget deficit of Rs. 504.8 billion during the first seven months of 2015 as net foreign financing recorded a repayment during this period.** Net domestic financing increased significantly by 195.6 per cent to Rs. 559.7 billion compared to the corresponding period in 2014. Net foreign financing recorded a repayment of Rs. 54.9 billion during the period under consideration in comparison to Rs. 283.2 billion of net financing recorded during the first seven months of 2014.

- **The reliance on borrowings from both the domestic banking sector and the non bank sector increased significantly during the first seven months of 2015 compared to the same period of 2014 mainly due to the non realisation of foreign disbursements as expected.** Accordingly, borrowings from the banking sector increased significantly to Rs. 299.2 billion during the first seven months of the year from Rs. 86.4 billion during the same period in the previous year. Substantial increase in financing from the commercial banking sector to Rs. 230.1 billion in the first seven months of 2015 from Rs. 59.0 billion in the same period of 2014 and the notable increase in financing from the Central Bank by 152.6 per cent to Rs. 69.1 billion contributed to the significant increase in financing from the banking sector. Of the total domestic financing, net bank financing contributed to 53.5 per cent during the first seven months of 2015, which was 45.6 per cent in the same period of 2014. Meanwhile, borrowings

Table 6.3 Sources of Financing

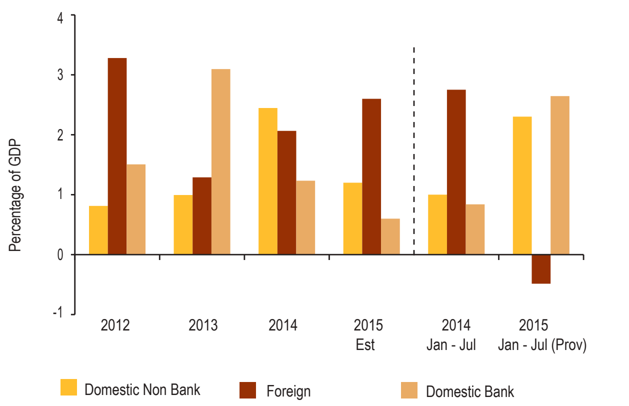
Rs. billion

Item	2013	2014 (a)	2014 Jan-Jul (a)	2015 Jan-Jul (a)
Domestic Financing (b)	**392.4**	**378.7**	**189.3**	**559.7**
Bank	297.0	126.9	86.4	299.2
Non Bank	95.4	251.8	103.0	260.4
Foreign Financing	**123.7**	**212.5**	**283.2**	**-54.9**
Loans	67.9	211.7	249.6	-10.6
Non Resident Investments in Treasury Bonds	62.5	15.0	21.2	-11.4
Non Resident Investments in Treasury Bills	-6.7	-14.2	12.4	-32.9
Total	**516.1**	**591.2**	**472.5**	**504.8**

Sources: Ministry of Finance
Central Bank of Sri Lanka

(a) Provisional
(b) Excludes funds raised through Treasury bonds issued for restructuring of SOBEs in 2014 and 2015.

Chart 6.4 Deficit Financing



from the non bank sector also increased to Rs. 260.4 billion during the first seven months of 2015, from Rs. 103.0 billion recorded during the same period in the previous year.

- **Net foreign financing during the first seven months of 2015 recorded a repayment of Rs.** 54.9 billion compared to net borrowings of Rs. 283.2 billion recorded in the corresponding period of 2014. This was mainly due to the comparatively lower disbursement of foreign project loans, net outflow of foreign holding of rupee denominated Treasury bills and bonds, repayment of the matured International Sovereign Bond in the early part of the year and lower utilisation of the proceeds from the International Sovereign Bond during the period under review. Net foreign financing comprised Rs. 12.0 billion of project loans, Rs. 44.3 billion net repayment of Treasury bills and bonds, and Rs. 22.6 billion net repayment of International Sovereign Bonds which is the difference between US dollars 500 million repayment (Rs. 65.8 billion) and the lower utilisation of US dollars 323 million (Rs. 43.2 billion) out of the International Sovereign Bond of US dollars 650 million (Rs. 87.0 billion) issued in May 2015.

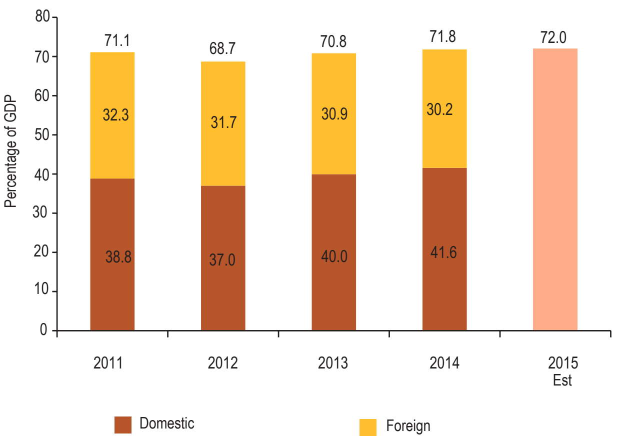
Government Debt and Debt Service Payments

Government Debt

- **The total outstanding central government debt stock increased by Rs. 599.9 billion to Rs. 7,990.8 billion as at end July 2015 from Rs. 7,390.9 billion as at end 2014.** The decline in the total debt stock due to exchange rate variation amounted to Rs. 2.9 billion as the Sri Lankan rupee appreciated against Japanese Yen and euro although it depreciated against US dollar and other major foreign currencies during the first seven months of 2015. However, the discount factor (which is the net difference in the book value and the face value of issues and maturities of Treasury Bills and Treasury Bonds) contributed to a decline in the debt stock by Rs. 6.5 billion due to the issuance of government securities at a premium during the period under review. Domestic debt increased by Rs. 573.2 billion to Rs. 4,851.0 billion, while foreign debt increased by Rs. 26.8 billion to Rs. 3,139.9 billion.

- **Of the total domestic debt, short term debt as at end July 2015 increased by 16.2 per cent, while medium and long term debt also increased by 12.6 per cent from the end 2014.** The share of short term debt in the total domestic debt stock increased marginally to 22.5 per cent at the end of July 2015 from 22.0 per cent at the end of 2014. The share of medium and long term debt in the total domestic debt stock declined slightly to 77.5 per cent at the end of July 2015 compared to 78.0 per cent as at end 2014. The share of Treasury bills in the total domestic debt as at end July 2015 increased slightly to 16.3 per cent from 16.2 per cent at the end of 2014. Treasury bonds, which dominated the outstanding domestic debt portfolio, declined to 64.3 per cent of the total domestic debt as at end July 2015 compared to

Chart 6.5 Outstanding Government Debt



66.5 per cent as at end 2014. However, the share of SLDBs in the total domestic debt as at end July 2015 increased to 11.7 per cent from 9.1 per cent at end 2014 due to a higher reliance on SLDBs to finance the budget deficit.

- **The outstanding foreign currency denominated domestic debt as at end July 2015 increased by Rs. 178.9 billion to Rs. 589.6 billion (US dollars 4,413.5 million) from Rs. 410.7 billion (US dollars 3,134 million) as at end 2014.** This was entirely due to the increase in SLDBs amounting to US dollars 978 million on a net basis. Meanwhile, the share of foreign currency denominated domestic debt to total domestic debt increased to 12.2 per cent as at end July 2015 from 9.6 per cent by end 2014.

- **The share of non concessional debt in the total foreign debt stock declined to 50.9 per cent by end July 2015 from 52.1 per cent at end 2014.** In contrast, the share of concessional loans in the total foreign debt stock increased to 49.1 per cent by end July 2015 from 47.9 per cent at end 2014. The decline in the non concessional debt by 1.4 per cent to Rs. 1,599.3 billion was mainly on account of a decline in foreign investments in government securities.

Table 6.4 Outstanding Government Debt

Rs. billion

Item	2013	2014 (a)	2014 End Jul (a)	2015 End Jul (a)
Domestic Debt (b)	**3,832.8**	**4,277.8**	**4,128.1**	**4,851.0**
By Maturity Period				
Short Term	909.2	941.2	936.6	1,093.6
Medium and Long Term	2,923.7	3,336.6	3,191.5	3,757.4
By Institution				
Banks (c)	1,433.8	1,669.9	1,563.2	1,864.3
Non Bank Sector	2,399.1	2,607.9	2,564.9	2,986.7
Foreign Debt	**2,960.4**	**3,113.1**	**3,259.8**	**3,139.9**
Concessional	1,492.8	1,491.0	1,546.2	1,540.6
Non Concessional	1,467.6	1,622.1	1,713.6	1,599.3
Total Government Debt	**6,793.2**	**7,390.9**	**7,387.9**	**7,990.8**

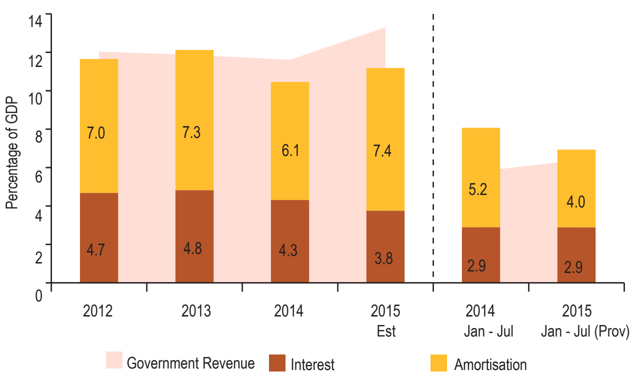
Sources: Ministry of Finance
Central Bank of Sri Lanka

(a) Provisional
(b) Excludes Rs. 4,397 million of Treasury bonds issued to CWE in November 2003, Rs. 78,447 million of Treasury bonds issued to settle dues to CPC in January 2012, Rs. 13,125 million of Treasury bonds issued to capitalise SriLankan Airlines in March 2013 and rupee denominated Treasury bonds held by foreign investors from 2007and the Sri Lankan diaspora and migrant workers from 2009.
(c) Includes outstanding balance to OBUs of LCBs.

Debt Service Payments

- **As per the original estimates, total debt service payments in 2015 amounted to Rs. 1,265.0 billion, which is considerably higher than Rs. 1,076.3 billion recorded in 2014.** This consists of amortisation payments of Rs. 840.0 billion and interest payments of Rs. 425.0 billion. Amortisation payments on domestic debt is estimated to be Rs. 635.9 billion, while amortisation payments on foreign debt is estimated to be Rs. 204.1 billion in 2015. Interest

Chart 6.6 Government Debt Service Payments vs Revenue



payments in 2015 on domestic and foreign debt are estimated to be Rs. 349.0 billion and Rs. 76.0 billion, respectively.

- **Total domestic and foreign debt service payments amounted to Rs. 784.3 billion during the first seven months of 2015.** This consisted of amortisation payments of Rs. 457.5 billion (58.3 per cent) and interest payments of Rs. 326.9 billion (41.7 per cent). Further, debt service payments to domestic and foreign sources amounted to Rs. 578.6 billion and Rs. 205.8 billion, respectively. During the first seven months of 2015, total debt service payments amounted to 62.0 per cent of the annual estimate, comprising of amortisation payments accounting for 54.5 per cent of the annual estimate and interest payments accounting for 76.9 per cent of the annual estimate.