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FISCAL POLICY AND GOVERNMENT FINANCE

6.1 Overview

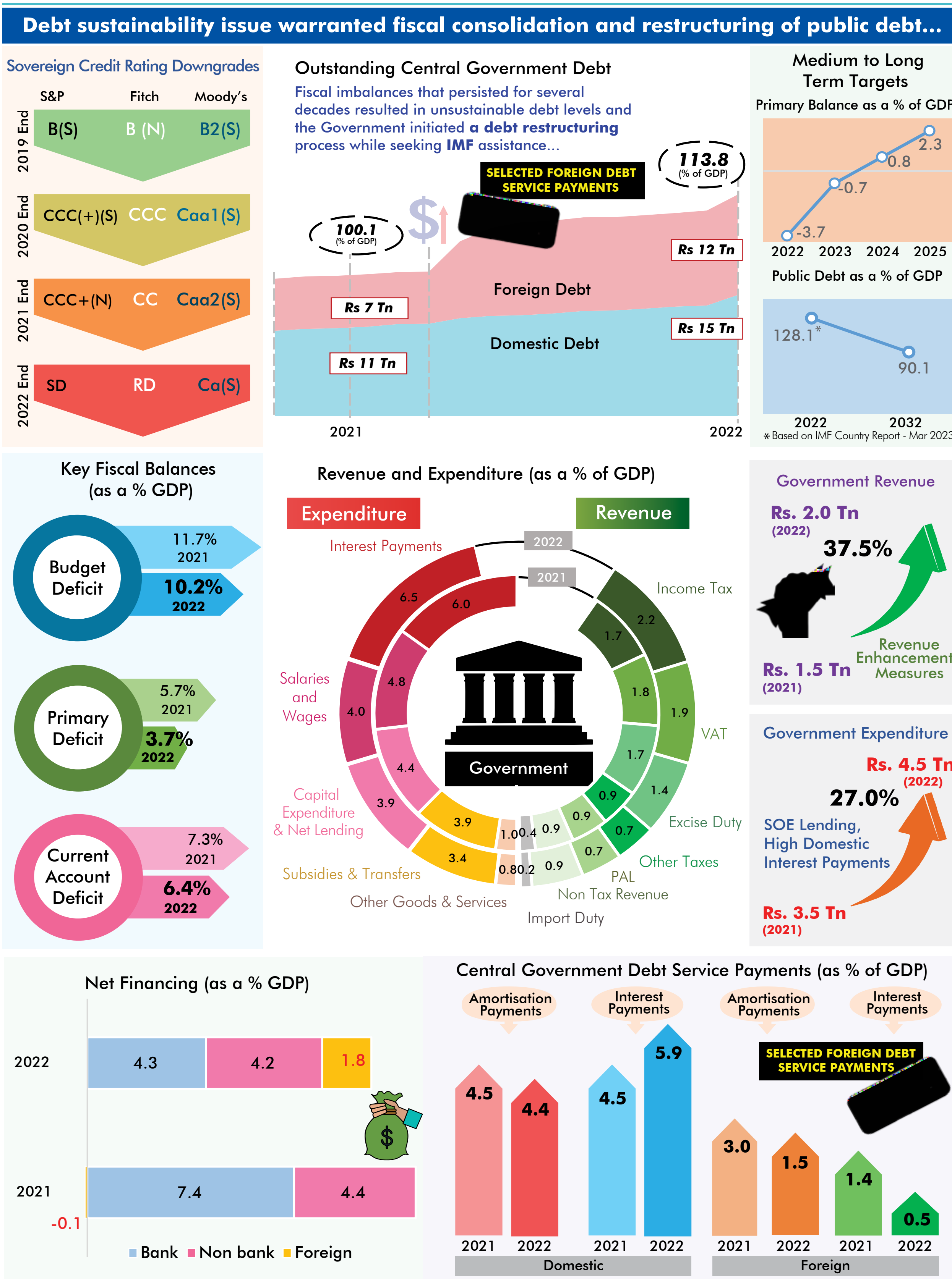
Fiscal sector imbalances that persisted for several decades reached a tipping point in 2022, resulting in a myriad of socio-economic stresses with unprecedented political ramifications. The public debt reached an unsustainable level, due to perpetual budget deficits and significant fiscal slippages in recent years amidst the COVID-19 pandemic and policy missteps, despite limitations enshrined in the Fiscal Management (Responsibility) Act, No. 3 of 2003 and its amendments as well as the Active Liability Management Act, No. 8 of 2018. Falling government revenue and rising debt service obligations over the years heightened the country's vulnerabilities to domestic and global economic shocks. A series of sovereign credit rating downgrades by international rating agencies that started in January 2020 and intensified during the second half of 2021 through early 2022 posed a formidable challenge for the Government in mobilising foreign financing required for servicing foreign debt. Lack of access to foreign financing and the depletion of usable official reserves to near-zero levels in early 2022 constrained foreign debt servicing by the Government. Consequently, the Government announced a temporary suspension of selected foreign debt service payments, on 12 April 2022. The Government had already sought assistance from the International Monetary Fund (IMF) for an Extended Fund Facility (EFF) in March 2022. However, no progress was made on negotiating an EFF as Sri Lanka's public debt has reached unsustainable level, warranting measures to initiate debt restructuring, following the announcement of the debt standstill. Subsequently, a staff level agreement was reached in early September 2022, and upon securing the financing assurances from the bilateral creditors, the Executive Board of the IMF approved the EFF budget support programme in March 2023. In the recent years, the Government was compelled to rely on domestic sources for deficit financing, and for a large part, monetary financing, which surged during 2021 and persisted through 2022, resulting in significant inflationary pressures. This warranted significant monetary policy tightening in early 2022 to stem burgeoning inflation, resulting in an upward adjustment of yields on government securities, which were heavily affected subsequently by rising uncertainties about the restructuring of domestic debt of the Government. As fiscal sector pressures mounted during 2022, the Government was compelled to frontload unparalleled fiscal reforms and policy measures aimed at regaining confidence and stability with significant adjustment costs in the near term. The Government embarked on a strong fiscal consolidation path, primarily revenue based, along with the commissioning of cost reflective pricing strategies for utilities provided by major State Owned Business Enterprises (SOBEs). However, government expenditure continued to rise despite some expenditure rationalisation measures implemented during 2022. This increase of government expenditure in nominal terms mainly reflected the large interest payments on ballooning domestic debt, and the significant increase of lending to State Owned Enterprises (SOEs) and expenditure on subsidies and transfers. Nevertheless, the *fiscal consolidation measures, along with the expansion of nominal GDP with a high deflator helped the Government to contain the deficits in main fiscal balances, in GDP terms, during 2022. The primary deficit narrowed, both in nominal terms as well as in GDP terms, compared to 2021, and a further improvement in the primary balance is warranted in the period ahead to ensure public debt sustainability. Government revenue is expected to increase in 2023, reflecting the full benefit of measures introduced in late 2022, including the expansion of Value Added Tax (VAT) and personal income tax bases and the increase of personal and corporate income tax rates. Sri Lanka is expected to complete the debt restructuring process in 2023 and bring the trajectory of public debt in line with the debt sustainability targets under the IMF-EFF arrangement over the medium to long term. With the continued efforts on revenue enhancement and expenditure rationalisation, a surplus in the primary balance is projected from 2024, thereby ensuring medium to long term public debt sustainability. In particular, expenditure cuts by the Government on non-essential and non-urgent activities would be an absolute necessity for successful completion of the IMF-EFF budget support programme. Concerted efforts of all stakeholders and the support of the public are imperative in the forthcoming period in order to ensure that the envisaged fiscal consolidation path is realised by committing to an expeditious implementation of reforms, including those of SOBEs. The realisation of fiscal consolidation is vital to ensure sustained recovery and stability of the economy and protect the vulnerable groups of society in the period ahead.*

6.2 Fiscal Policy Measures

The Government initiated significant reforms in 2022 aimed at fiscal consolidation and debt sustainability, assisted mainly by the IMF-EFF budget support programme, among others. The Budget 2022 proposed ambitious targets for government revenue and expenditure, as a percentage of GDP, of 12.0 per cent and 20.8 per cent, respectively. However, these targets became challenging due to lacklustre revenue collection in the first half of the year reflecting the impact of disruption to economic activity and expenditure overruns amidst large domestic interest payments caused by the substantial increase in domestic borrowing at elevated interest rates, which were affected by the high risk premia due to debt restructuring concerns. The Government announced expenditure rationalisation measures in March and April 2022, while the Cabinet of Ministers approved several revenue enhancement measures in May 2022. In September 2022, the Parliament approved the Interim Budget 2022, which was aimed at reinforcing revenue enhancement measures, providing further budgetary allocations on essential activities for which initial allocations remained inadequate, and making budgetary allocations in line with the changes to the structure of Ministries. As per the Interim Budget 2022, the government revenue to GDP target for the year was revised to 8.8 per cent, while envisaging lower expenditure and overall fiscal deficit of 18.6 per cent and 9.8 per cent of GDP, respectively. Accordingly, the primary deficit target for 2022 was revised to 4.0 per cent of GDP.

Several revenue enhancement measures were introduced in 2022 with the aim of reversing the declining trend in tax revenue of the Government and addressing structural weaknesses in government revenue collection. As per the Budget 2022, the Government imposed a retrospective one-off surcharge tax of 25 per cent on individuals, companies, and partnerships whose taxable income for the 2020/2021 tax assessment year exceeded Rs. 2.0 billion. Meanwhile, VAT on financial services was increased from 15 per cent to 18 per cent with effect from January 2022. Meanwhile, the VAT rate was increased from

Figure 6.1
Performance of the Fiscal Sector



8 per cent to 12 per cent and the Telecommunication Levy was raised from 11.25 per cent to 15 per cent with effect from June 2022. The general VAT rate was further increased from 12 per cent to 15 per cent effective from 01 September 2022, as proposed by the Interim Budget 2022. With the enactment of Value Added Tax (Amendment) Act, No. 44 of 2022 on 15 December 2022, the threshold turnover per annum for VAT registration was brought down to Rs. 80.0 million from Rs. 300.0 million with effect from 01 October 2022, thereby broadening the tax base. In addition, effective from 01 October 2022, a Social Security Contribution Levy of 2.5 per cent on turnover was imposed on importers, manufacturers, service providers, wholesalers, and retailers, whose annual turnover exceeds Rs. 120.0 million. Moreover, the Government introduced a surcharge on selected imported items for a period of six months with effect from 01 June 2022 in consideration of sparse liquidity in the domestic foreign exchange market and the issues related to granting import licenses. Although legislative amendments were made to the income tax structure, including measures in the Inland Revenue (Amendment) Bill to amend the Inland Revenue Act, No. 24 of 2017, these amendments were effective from January 2023. Since a majority of the revenue enhancement measures that were introduced in 2022 became effective from the second half of 2022 and beginning of 2023, the full impact on government revenue from such measures is expected from 2023 onwards.

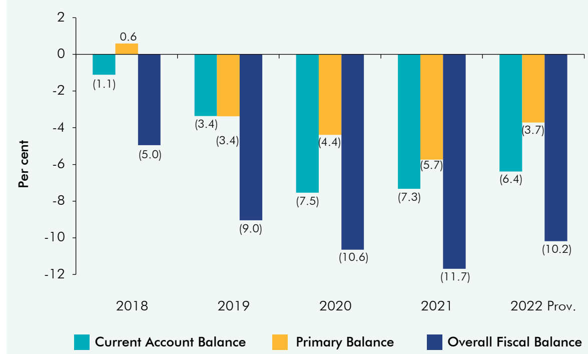
Despite the limited fiscal space, the Government initiated measures to help the vulnerable segments of the society amidst significant socio-economic stresses. In January 2022, the Government announced a relief package to support public sector employees, pensioners, and low income earners to ease the immediate financial strain caused by the economic crisis. Accordingly, public sector employees and pensioners were paid a monthly allowance of Rs. 5,000, and the monthly allowance for Samurdhi beneficiaries was raised by Rs. 1,000 per family. Considering the escalation of government expenditure over the budgetary allocations, the Parliament approved a supplementary allocation of Rs. 695.0 billion in June 2022 (2.9 per cent of GDP) to carry on the relief package introduced in January 2022 and to allocate funds for other expenditure. In view of unprecedented hardships caused by the economic crisis, the World Bank and Asian Development Bank (ADB) repurposed some of their existing project funding to the Government to support affected communities. These funds were used for numerous activities, including the provisioning of cash grants to poor and vulnerable groups, provisioning of fertiliser for agricultural activities, purchasing of essential medicines, and purchasing of Liquified Petroleum (LP) gas and distributing LP gas cylinders in urban and semi urban areas.

In view of the widening budget deficit and limited budgetary financing avenues for the Government, several expenditure rationalisation measures were introduced since March 2022. Accordingly, the Ministry of Finance, Economic Stabilisation and National Policies (MOF) issued a circular instructing government institutions to suspend non-essential, non-urgent capital expenditure, restrict recurrent expenditure on overtime payments, loans granted to public sector employees, and stationery and printing costs, etc., while freezing new recruitments to the public sector. Moreover, a similar circular was issued in August 2022, instructing to curtail expenditure of commercial corporations, statutory boards, and government owned companies. In consideration of the energy crisis faced by the country and increasing government expenditure, in March 2022, the Ministry of Public Services, Provincial Councils, and Local Government issued a circular instructing to reduce expenditure on fuel and electricity of these institutions.

After a long hiatus in regular electricity tariff and fuel price adjustments, the Government revised retail petroleum prices and end consumer electricity tariffs to a cost recovery level several times, in view of persistent financial losses of Ceylon Petroleum Corporation (CPC) and Ceylon Electricity Board (CEB). The Government adjusted retail fuel prices from June 2022 onwards on a monthly basis and the Cabinet of Ministers approved the use of 2018 fuel pricing formula to determine retail prices. Meanwhile, the electricity tariffs were upwardly adjusted in August 2022 and February 2023. Further, in November 2022, the Cabinet of Ministers approved to adjust electricity tariffs to cost recovery levels in January and July every year. In future, Bulk Supply Transaction Account (BSTA) would be improved to determine cost recovery based electricity tariffs, electricity subsidy and budget transfers to the CEB in relation to the electricity subsidy. Cost reflective price adjustments are expected to strengthen the financial performance of the CEB and CPC, thereby minimising the potential fiscal burden that arises from contingent liabilities.

The gross borrowing limit for 2022 was revised several times in consideration of the large budget deficit and gross financing needs in nominal terms, thereby creating additional space for domestic financing amidst limited foreign financing. A gross borrowing limit of Rs. 3,200 billion for the year 2022 was approved under the Appropriation Act, No. 30 of 2021. In early September 2022, this limit was revised upward to Rs. 3,844 billion by the Appropriation

Figure 6.2
Key Fiscal Balances (a)
(as a percentage of GDP)



(a) According to the Ministry of Finance, the fiscal sector statistics of 2019 have been restated as announced in the Budget Speech for 2020.

Source: Ministry of Finance, Economic Stabilisation and National Policies

(Amendment) Act, No. 21 of 2022 in view of the increased expenses on essential activities, over the existing allocations provided in the Budget 2022 as well as increased domestic debt service payments. Moreover, in November 2022, the Parliament granted approval to further raise the gross borrowing limit for 2022 by another Rs. 663 billion to Rs. 4,507 billion in order to meet the Government's soaring funding requirement amidst elevated interest rates. Meanwhile, the Parliament approved an increase in the limit of outstanding Treasury bills from Rs. 3,000 billion to Rs. 4,000 billion in June 2022. This limit was further raised to Rs. 5,000 billion in November 2022, with a Parliamentary approval, in consideration of the rising borrowing requirement in face value terms due to high market interest rates.

Given the limited access to foreign financing amidst the debt standstill and the series of sovereign credit rating downgrades, the Government opted for a reverse graduation for Sri Lanka for a limited time period in relation to funding from International Development Association (IDA), with the aim of accessing concessional foreign financing. Sri Lanka no longer qualified for loans granted by the International Bank for Reconstruction and

Development (IBRD) owing to the lower sovereign credit ratings. Therefore, in October 2022, the Cabinet of Ministers approved a request to be made to the World Bank for funding from the IDA, which provides concessional financing to highly vulnerable countries through its 'Gap' facility. Accordingly, the World Bank approved Sri Lanka's request for IDA funding in December 2022, enabling the country to implement a macroeconomic stabilisation programme while protecting the vulnerable groups.

On 12 April 2022, the Government announced a debt standstill, as an interim measure, for identified categories of external public debt, in view of impending large foreign debt service payments of the Government with depleted gross official reserves and limited foreign exchange inflows to the country. Simultaneously, the Government announced its intention to restructure its foreign bilateral and commercial debt. The Government sought assistance from the IMF for an EFF arrangement, which required efforts to ensure debt sustainability through a debt restructuring process. Accordingly, the Lazard Frères SAS and Clifford Chance LLP were appointed as the financial and legal advisors, respectively, to facilitate the debt restructuring process of the Government. In tandem with the EFF supported programme and debt restructuring efforts, a comprehensive macroeconomic reform agenda was implemented to ensure debt and fiscal sector sustainability in the near to long term. This macroeconomic programme encompasses a strong fiscal consolidation process besides the institutional reforms to SOEs including establishing of cost reflective pricing mechanisms for the provisioning of utilities. In this regard, the Sri Lankan Government and the IMF entered into a Staff Level Agreement in early September 2022 for a budget support EFF arrangement. All key bilateral creditors, including Paris Club member countries, India and China, gave their financing assurances for the debt restructuring process to a level accepted by the IMF. Subsequently, the Executive Board of the IMF approved SDR 2.286 billion (around US dollars 3 billion) under the EFF for Sri Lanka on 20 March 2023. With the approval of the EFF, the debt restructuring negotiations with the bilateral and commercial creditors are expected to be completed during 2023.

Sri Lanka's sovereign credit ratings, which had been downgraded in recent years, were subjected to further downgrade in 2022 following the preemptive default of selected foreign debt service payments. Accordingly, S&P Global Ratings downgraded Sri Lanka's sovereign credit rating from 'CCC (Negative)' to 'CC (Negative)' on 13 April 2022, and 'SD' (Selective Default) on 25 April 2022 owing to the non-payment of International Sovereign Bond (ISB) coupons in April 2022. Further, on 18 April 2022, Moody's Investor Service downgraded Sri Lanka's sovereign credit rating to 'Ca (Stable)' from 'Caa2 (Stable)'. Fitch Ratings downgraded the country's long term foreign currency Issuer Default Rating (IDR) from 'C' to 'RD' (Restricted Default) on 19 May 2022. Moreover, on 01 December 2022, long term local currency IDR was downgraded from 'CCC' to 'CC' by Fitch Ratings in view of the probable 'local currency debt default'.

Several debt obligations of SOBEs were reclassified as central government debt by end 2022, resulting in an escalation in central government debt. In January 2023, the Cabinet of Ministers approved the absorption of eight loans to the central government debt that were obtained from the Export-Import Bank of China (EXIM Bank of China) and were recorded as SOBE loans. These loans, which were previously classified under the Sri Lanka Ports Authority (SLPA), CEB, and Airport and Aviation Services Ltd. (AASL),

Table 6.1
Key Fiscal Policy Measures Implemented during 2022 and early 2023 and Forthcoming over the Near to Medium Term

Date	Measure
01 Jan 2022	VAT rate on financial services provided by the financial institutions was revised from 15 per cent to 18 per cent with effect from 01 January 2022.
13 Jan 2022	A monthly allowance of Rs. 5,000 which is not taken into account for the calculation of pension, was granted to public officers and pensioners with effect from 01 January 2022.
08 Mar 2022	Guidelines were issued to the public sector to minimise the usage of electricity and fuel.
08 Apr 2022	Surcharge Tax Act, No. 14 of 2022 was enacted to impose a retrospective one-time surcharge tax of 25 per cent on individuals, partnerships, and companies, whose taxable income is calculated in accordance with the provisions of the Inland Revenue Act, No. 24 of 2017, and their taxable income exceeding Rs. 2 billion for the tax assessment year, commencing from 01 April 2020.
12 Apr 2022	Interim Policy regarding the suspension of servicing of selected external public debt was announced.
26 Apr 2022	Guidelines were issued to the public sector to restrict non-urgent/non-essential expenses.
31 May 2022	Cabinet approval was granted for several revenue enhancement measures in line with the IMF-EFF supported programme parameters.
01 Jun 2022	VAT rate on the supply of goods and services was increased to 12 per cent from 8 per cent.
04 Jun 2022	The Telecommunication Levy was increased to 15 per cent from 11.25 per cent.
07 Jun 2022	The limit on Treasury bills was increased to Rs. 4,000 billion from the previous limit of Rs. 3,000 billion.
08 Aug 2022	Guidelines were issued to Commercial Corporations, Statutory Boards, and Government Owned Companies to restrict non-urgent/non-essential expenses.
01 Sep 2022	VAT rate on the supply of goods and services was increased to 15 per cent from 12 per cent.
09 Sep 2022	The Appropriation (Amendment) Act, No. 21 of 2022 was approved by the Parliament. Gross borrowing limit was increased to Rs. 3,844 billion from Rs. 3,200 billion.
13 Sep 2022	The Cabinet approval was granted for the establishment of the State Owned Enterprises Restructuring Unit.
01 Oct 2022	The Social Security Contribution Levy Act, No. 25 of 2022 was enacted with effect from 01 October 2022 to impose a Social Security Contribution Levy at the rate of 2.5 per cent on turnover, for the importers, manufacturers, service providers, wholesalers, and retailers, who have an annual turnover exceeding Rs. 120 million.
18 Oct 2022	Appropriation Bill – 2023 was submitted to the Parliament.
21 Nov 2022	Cabinet approval was granted to automate fuel price adjustments based on the 2018 fuel pricing formula, with the aim of achieving cost recovery, as a prior action of the IMF-EFF supported programme.
21 Nov 2022	Cabinet approval was granted to automate electricity tariff adjustments on a cost recovery and semi annual basis as a prior action of the IMF-EFF supported programme.
30 Nov 2022	The gross borrowing limit was increased to Rs. 4,507 billion from Rs. 3,844 billion.
30 Nov 2022	The limit on issuance of Treasury bills was increased from Rs. 4,000 billion to Rs. 5,000 billion.
08 Dec 2022	The Appropriation Act, No. 43 of 2022 was approved by the Parliament.
14 Dec 2022	Value Added Tax (Amendment) Act, No. 44 of 2022 was enacted to bring the legal effect for the increase in VAT rate, expand the tax base and remove VAT exemptions.
19 Dec 2022	Inland Revenue (Amendment) Act, No. 45 of 2022 was enacted amending the tax structure for corporate and personal income tax and reintroducing withholding tax.
01 Jan 2023	Excise duties on petrol and diesel, and cigarettes were revised.
03 Jan 2023	Excise duty on liquor was revised.
04 Apr 2023	A bill to amend the Betting and Gaming Levy Act, No. 40 of 1988 was submitted to the Parliament.
Forthcoming Policy Measures	
End-May 2023	Parliamentary approval of the welfare benefit payment scheme and the application of the new eligibility criteria to identify low-income families for receiving welfare benefit payments.
End-June 2023	Cabinet approval for a comprehensive strategy, highlighting the timelines and modalities, to restructure the balance sheets of the CEB, CPC, SriLankan Airlines, and the Road Development Authority.
End-Sep 2023	Completion of the rollout of the Integrated Treasury Management Information System (ITMIS), expanding its coverage.
End-Oct 2023	Submission to the Parliament for the first reading of the 2024 Appropriation Bill that is in line with IMF-EFF supported programme parameters.
End-Dec 2023	Parliamentary approval of the 2024 Appropriation Act and the spending allocations in line with IMF-EFF supported programme parameters.
End-Dec 2023	Submission to Parliament of a new Public Financial Management Bill that will authorise the budget formulation process, roles and responsibilities of relevant agencies, and information and accountability requirements.
End-Dec 2023	Improve the Bulk Supply Transaction Account (BSTA) to accurately measure the electricity subsidy and start using the same to determine the cost recovery based electricity tariff and government transfer requirement.
01 Jan 2024	Start estimating and publishing the direct costs imposed by tax incentives granted under the Strategic Development Projects and Board of Investment Acts.
01 Jan 2024	Revamp the VAT system by abolishing the vast majority of exemptions.
01 Jan 2024	Take measures to significantly speed up valid VAT refunds and abolish the SVAT system.
01 Jan 2024	Introduce automatic indexation of excise duties to inflation.
01 Jan 2025	Introduce a nationwide real property tax.
01 Jan 2025	Introduce a gift and inheritance tax with a tax-free allowance and minimal exemptions.

amounted to US dollars 1,427.3 million at end 2022, and had been obtained in relation to Hambantota port, Norochcholai coal powerplant, and Mattala airport. In addition, several foreign currency debt obligations of the CPC amounting to US dollars 2,434.8 million were also reclassified under central government debt.

As part of the comprehensive economic reform programme to address macroeconomic imbalances and restore public debt sustainability, the Government undertook several bold measures to reinforce its commitment towards the fiscal consolidation path. The Cabinet of Ministers granted approval to reduce 6 per cent of the approved recurrent expenditure estimates of all government institutions for 2023. Accordingly, the MOF issued a circular to all ministries, departments, provincial councils, district secretariats, state corporations, statutory boards, and government owned companies to cutdown 6 per cent of their recurrent expenditure, other than essential expenses, such as salaries, retirement benefits, medicines, rents and local taxes, interest payments, and mandatory welfare benefit payments. Moreover, with the aim of enhancing the progressivity of the tax structure by raising the direct tax to overall tax ratio, the Inland Revenue (Amendment) Act, No. 45 of 2022 was approved by the Parliament in December 2022 revising the income tax structures for both individuals and corporates. These legislative amendments, inter alia, included revision of the tax-free threshold for personal income taxes to Rs.1.2 million per annum from Rs. 3.0 million; removal of expenditure relief of Rs. 1.2 million granted for expenditure incurred on account of education, health, interest paid on housing loans, contributions to pension scheme, etc.; increase in personal income tax rates upward to 6 per cent, 12 per cent, 18 per cent, 24 per cent, 30 per cent, and 36 per cent compared to previous 6 per cent, 12 per cent, and 18 per cent; revision of tax brackets to Rs. 0.5 million for the income above Rs. 1.2 million tax free threshold; reintroduction of the mandatory Pay As You Earn (PAYE) system; and upward revision of corporate income tax rate to 30 per cent, while removing sector specific corporate income tax exemptions and concessionary rates granted for companies. Meanwhile, the Government increased the excise duty on cigarettes, alcoholic and petroleum products, effective from January 2023. Moreover, the Government revised the Ports and Airports Development Levy (PAL) for several imported items. Although efforts have been made thus far to expand the tax base, the Government needs to focus on improving the tax administration to further expand the tax base by minimising tax evasions, enabling the Government to raise revenue without imposing a substantial burden on those who are already in the tax net. Given the reduction of earned incomes due to economic downturn and the high rate of migration of the potential taxpayers, achieving the expected personal and corporate income tax revenue targets by the Inland Revenue Department (IRD) would be challenging in the near term. The IRD, with the support of the judiciary, should therefore expedite settlements on pending tax cases as well as conclude legal action on tax fraudsters and tax evaders to fill in these revenue gaps.

The Government needs to remain committed to implementing fiscal consolidation measures and implementing reforms under the IMF-EFF supported programme with the aim of ensuring long term fiscal sustainability to promote sustainable economic growth and enhance the country's economic resilience. While demonstrating the Government's commitment to addressing economic imbalances and paving the way for the successful implementation of the IMF programme, the Government met all prior actions before the approval of the EFF arrangement by the IMF Executive Board. These actions included the approval of the Cabinet of Ministers for revenue enhancement measures, Parliamentary approval for the Interim Budget 2022, submission of the Appropriation Bill for 2023 to the Parliament in accordance with the EFF supported programme parameters, the approval of the Cabinet of Ministers to automate monthly retail fuel price adjustments on cost recovery basis, and to automate semi annual electricity price adjustment on cost recovery basis. In addition, several quantitative performance criteria, indicative targets and structural benchmarks are stipulated under the IMF-EFF arrangement to be achieved within a specific timeline. The quantitative performance criteria include targets on primary balance and stock of expenditure arrears of the Government, for which the country's performance will be measured against the target at each biannual review of the programme by the IMF. Accordingly, the primary deficit target of 0.7 per cent of GDP is to be achieved for 2023, while expenditure arrears should be fully settled by June 2023 without accruing any arrears afterwards. In addition, the IMF-EFF supported programme has also set indicative targets in terms of government revenue, social spending by the central government, cost of non commercial obligations for fuel and electricity and a ceiling for treasury guarantees. Meanwhile, structural benchmarks, inter alia, include retail fuel price revisions to the cost recovery level on a monthly basis, electricity tariff revisions to cost recovery levels on a biannual basis, improvement of the bulk supply transaction account to determine cost recovery based electricity tariffs, Parliamentary approval for the welfare benefit payment scheme and the use of new eligibility criteria to identify beneficiaries of these schemes, approval of the Cabinet of Ministers for a comprehensive strategy to restructure the balance sheets of CEB, CPC, SriLankan Airlines (SLA), and Road Development Authority, completion of the rollout of the Integrated Treasury Management Information System (ITMIS) and expansion of its coverage, approval of the Cabinet of Ministers for the revenue enhancement measures for 2024, submission of the Appropriation Act and approval of Budget 2024 by the Parliament in line with the programme parameters, and submission of a new Public Financial Management Bill to the Parliament. Meeting these structural benchmarks within the stipulated timeline will be crucial for the continuation of the IMF-EFF supported programme. Implemention of these structural reforms would be paramount to achieve fiscal sustainability in the period ahead, while addressing longstanding issues of the SOEs that emanated economic vulnerabilities.

Table 6.2
Summary of Government Fiscal Operations

Item	2021	2022 (a)
Rs. million		
Total Revenue and Grants	**1,463 ,810**	**2,012,589**
Total Revenue	1,457,071	1,979,184
Tax Revenue	1,298,019	1,751,132
Non Tax Revenue	159,052	228,052
Grants	6,740	33,405
Expenditure and Net Lending	**3,521,735**	**4,472,556**
Recurrent	2,747,512	3,519,633
Capital and Net Lending	774,223	952,923
o/w Public Investment	789,636	1,014,293
Current Account Balance	**-1,290,441**	**-1,540,448**
Primary Balance	**-1,009,542**	**-894,777**
Overall Fiscal Balance	**-2,057,925**	**-2,459,967**
Total Financing	**2,057,925**	**2,459,967**
Foreign Financing	-13,901	424,822
Domestic Financing	2,071,826	2,035,145
As a Percentage of GDP (b)		
Total Revenue and Grants	**8.3**	**8.3**
Total Revenue	8.3	8.2
Tax Revenue	7.4	7.3
Non Tax Revenue	0.9	0.9
Grants	0.04	0.1
Expenditure and Net Lending	**20.0**	**18.5**
Recurrent	15.6	14.6
Capital and Net Lending	4.4	3.9
o/w Public Investment	4.5	4.2
Current Account Balance	**-7.3**	**-6.4**
Primary Balance	**-5.7**	**-3.7**
Overall Fiscal Balance	**-11.7**	**-10.2**
Total Financing	**11.7**	**10.2**
Foreign Financing	-0.1	1.8
Domestic Financing	11.8	8.4

(a) Provisional
(b) GDP estimates (base year 2015) released by the Department of Census and Statistics on 15 March 2023 have been used.

Source: Ministry of Finance, Economic Stabilisation and National Policies

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6.3 Government Budgetary Operations

Revenue and Grants

Revenue

Government revenue and grants improved in 2022 in nominal terms, owing to the revenue based fiscal consolidation measures implemented during the year along with the sharp increase in the price level. In nominal terms, government revenue grew by 35.8 per cent in 2022, compared to 2021, reflecting higher tax and non tax revenue collections. Tax revenue increased by 34.9 per cent in 2022 benefitting from the increased revenue mobilisation from income taxes, VAT, PAL, and the excise duties on liquor and cigarettes. Meanwhile, the rise in revenue collection from all the subcategories of non tax revenue, except profit and dividend, resulted in an increase of 43.4 per cent in non tax revenue during the year. Most revenue enhancing measures initiated during the year were implemented in the second half of 2022 and early 2023. As a result, the government revenue, as a percentage of GDP, recorded a marginal decline due to the notable growth in nominal GDP. Grants grew by 395.7 per cent to Rs. 33.4 billion in 2022, compared to 2021. Accordingly, government revenue and grants, as a percentage of GDP, remained unchanged in 2022, compared to the preceding year.

The increase in government revenue can be primarily attributed to the growth in income tax collection, which was driven by the retrospective one-off surcharge tax collection. Revenue from income taxes recorded a year-on-year growth of 76.8 per cent, in nominal terms, mainly due to the surcharge tax, which accounted for more than one fifth of total income tax mobilised during the year. Accordingly, revenue from income taxes, as a percentage of GDP, increased from 1.7 per cent in 2021 to 2.2 per cent in 2022. Consequently, the share of direct tax revenue in the total tax revenue collection improved to 30.5 per cent in 2022 over 23.3 per cent recorded in 2021. Revenue from corporate and non corporate income taxes, which includes the surcharge tax, increased significantly by 78.5 per cent to Rs. 488.4 billion in 2022 in comparison to Rs. 273.6 billion recorded in 2021. Revenue from surcharge tax, which was collected in two instalments in April and July 2022, amounted to Rs. 120.7 billion. Meanwhile, revenue from Advance Personal Income Tax (APIT) and Withholding Tax (WHT) also increased in 2022 by Rs. 10.2 billion and Rs. 7.4 billion, respectively, to Rs. 25.5 billion and Rs. 19.8 billion, respectively, compared to 2021, due to improved tax administration in 2022, compared to 2021 when revenue collection activities were hampered by

Table 6.3
Summary of Government Revenue

Item	2021	2022 (a)
Rs. million		
Tax Revenue	**1,298,019**	**1,751,132**
Income Taxes	302,115	534,021
VAT	308,213	463,072
Excise Taxes	306,861	342,523
PAL	154,125	180,595
Import Duties	64,339	50,009
Other Taxes	162,365	180,912
Non Tax Revenue	**159,052**	**228,052**
Total Revenue	**1,457,071**	**1,979,184**
As a Percentage of GDP (b)		
Tax Revenue	**7.4**	**7.3**
Income Taxes	1.7	2.2
VAT	1.8	1.9
Excise Taxes	1.7	1.4
PAL	0.9	0.7
Import Duties	0.4	0.2
Other Taxes	0.9	0.7
Non Tax Revenue	**0. 9**	**0.9**
Total Revenue	**8.3**	**8.2**

(a) Provisional
(b) GDP estimates (base year 2015) released by the Department of Census and Statistics on 15 March 2023 have been used.

Source: Ministry of Finance, Economic Stabilisation and National Policies

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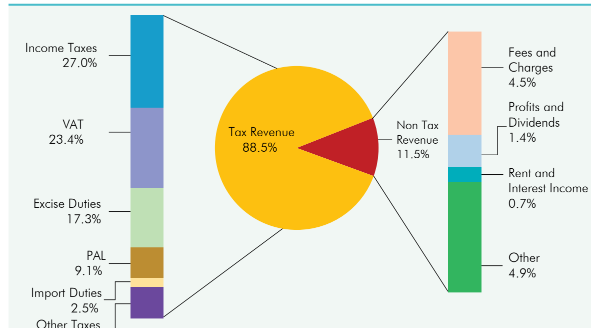
the pandemic. The arrears collected on Economic Service Charge (ESC), which was abolished in early 2020, recorded at Rs. 0.2 billion in 2022.

Revenue from VAT increased by 50.2 per cent, in nominal terms, during 2022, mainly reflecting the impact of the rise in price levels and upward revisions made to the VAT rate from June and September 2022. Since revisions to the general VAT rate were effective during the second half of 2022, revenue from VAT, as a percentage of GDP, recorded only a marginal increase from 1.8 per cent of GDP in 2021 to 1.9 per cent of GDP in 2022. Revenue from VAT on domestic services increased to Rs. 291.6 billion in 2022, compared to Rs. 185.5 billion in 2021, while revenue from VAT on import related activities increased to Rs. 171.5 billion in 2022 in comparison to Rs. 122.8 billion in the previous year. Reflecting the nominal growth in VAT revenue, the share of revenue from VAT on total revenue and total tax revenue increased to 23.4 per cent and 26.4 per cent, respectively, compared to 21.2 per cent and 23.7 per cent, respectively, recorded in 2021.

Revenue from excise duties grew by 11.6 per cent in 2022, in nominal terms, over the preceding year, benefitting from the increased collection of excise duties on liquor and cigarettes. Accordingly, revenue from excise duties on liquor increased by 19.2 per cent to Rs. 165.2 billion in 2022, while revenue from excise duty on cigarettes and tobacco increased by 17.6 per cent to Rs. 104.2 billion, which could be mainly attributable to the upward revisions made to the excise duty structure on liquor and cigarettes effective from November 2021. In addition to the increase in excise duties, growth in cigarette sales contributed to higher revenue collection from cigarettes. Revenue from excise duty on motor vehicles further declined by 19.9 per cent to Rs. 14.5 billion in 2022 with the continuation of restrictions on motor vehicle imports. Moreover, revenue

Figure 6.3
Composition of Government Revenue - 2022



Source: Ministry of Finance, Economic Stabilisation and National Policies

from excise duty on petroleum products declined to Rs. 53.1 billion in 2022, compared to Rs. 55.3 billion in 2021 due to the reduction in importation of petroleum products during 2022 amidst the foreign exchange liquidity shortage in the country. Similarly, revenue from excise duty, as a percentage of GDP, declined from 1.7 per cent in 2021 to 1.4 per cent in 2022, reflecting the necessity of implementing the inflation indexed excise duty structure for liquor and cigarettes. With the aim of adjusting the excise duties for inflation, the Government increased the excise duty on cigarettes, alcoholic beverages, and petroleum products, effective from January 2023.

Revenue from all international trade related taxes except PAL declined during the period under review reflecting the partial impact of import control measures implemented considering the balance of payments pressures. Due to the imposition of import control measures, including the introduction of a license system for non-essential goods, and lower demand for imports amidst depreciated exchange rate and tight financial conditions, the revenue from import duties declined by 22.3 per cent to Rs. 50.0 billion in 2022 in comparison to Rs. 64.3 billion recorded in 2021. Meanwhile, revenue collection from the Special Commodity Levy (SCL) declined significantly to Rs. 40.2 billion in 2022 from Rs. 55.8 billion in 2021. Moreover, revenue from CESS declined to Rs. 70.3 billion in 2022 from Rs. 75.5 billion recorded in 2021. However, revenue collection from PAL increased to Rs. 180.6 billion in 2022, compared to Rs. 154.1 billion in 2021. Increase in international prices on several items, such as petroleum products, cement clinker, steel, raw materials, and other consumable commodities, along with the impact of the depreciation of the Sri Lanka rupee, contributed to the increased collection from PAL.

Non tax revenue collection increased by 43.4 per cent, mainly due to the improved revenue collection from fees and charges and profits transferred by the Central Bank based on the financial statements of 2021. Accordingly, revenue from fees and charges increased by Rs. 47.4 billion to Rs. 90.1 billion in 2022 mainly due to the revision of fees and charges of postal and railway departments. The profits transferred by the Central Bank increased to Rs. 30.0 billion in 2022 in comparison to Rs. 15.0 billion recorded in 2021. In addition, social security contributions also increased by 8.1 per cent to Rs. 37.4 billion in 2022 over 2021. Meanwhile, revenue from rent and interest income increased during the year by 14.1 per cent to Rs. 13.2 billion, even though profit and dividend transfers declined by 8.2 per cent to Rs. 28.1 billion, respectively.

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Grants

Total foreign grants received from bilateral and multilateral sources increased to Rs. 33.4 billion in 2022 from Rs. 6.7 billion in 2021. Foreign grants from bilateral sources increased to Rs. 18.9 billion in 2022 from Rs. 3.3 billion recorded in 2021, while foreign grants from multilateral sources increased to Rs. 14.5 billion in 2022 from Rs. 3.5 billion in 2021.

Expenditure and Net Lending

Government expenditure and net lending increased, in nominal terms, while declining as a percentage of GDP, reflecting the significant growth in nominal GDP in 2022. Despite the expenditure rationalisation measures introduced in 2022, recurrent expenditure increased by 28.1 per cent in 2022 over 2021, whereas capital expenditure and net lending increased by 23.1 per cent during the same period, in nominal terms. Accordingly, total expenditure and net lending grew by 27.0 per cent, in nominal terms,

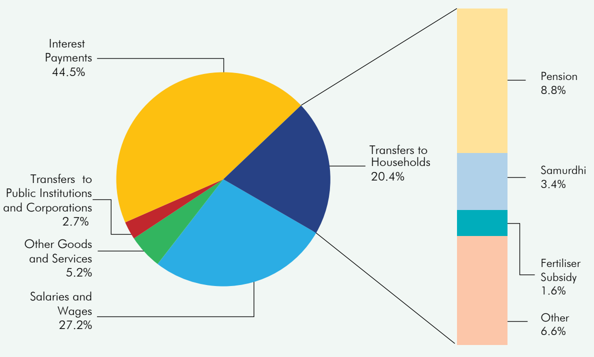
Table 6.4
Economic Classification of Expenditure and Lending Minus Repayments

Item	2021	2022 (a)
Rs. million		
Recurrent Expenditure	**2,747,512**	**3,519,633**
Expenditure on Goods and Services	1,014,612	1,139,066
o/w Salaries and Wages	845,680	956,210
Interest Payments	1,048,382	1,565,190
Foreign	253,750	128,621
Domestic	794,633	1,436,569
Current Transfers and Subsidies	684,518	815,376
o/w Households and Other Sectors	595,696	719,467
Samurdhi Recipients	55,400	120,988
Pensions	269,827	309,067
Fertiliser Subsidy	21,235	56,810
Other	249,233	232,602
Capital Expenditure	**767,606**	**715,429**
Acquisition of Real Assets	438,753	445,521
Capital Transfers	326,578	268,601
Other	2,275	1,307
Net Lending	**6,617**	**237,495**
Capital Expenditure and Net Lending	**774,223**	**952,924**
Total Expenditure and Net Lending	**3,521,735**	**4,472,556**
As a Percentage of GDP (b)		
Recurrent Expenditure	**15.6**	**14.6**
Expenditure on Goods and Services	5.8	4.7
o/w Salaries and Wages	4.8	4.0
Interest Payments	6.0	6.5
Foreign	1.4	0.5
Domestic	4.5	5.9
Current Transfers and Subsidies	3.9	3.4
o/w Households and Other Sectors	3.4	3.0
Samurdhi Recipients	0.3	0.5
Pensions	1.5	1.3
Fertiliser Subsidy	0.1	0.2
Other	1.4	1.0
Capital Expenditure	**4.4**	**3.0**
Acquisition of Real Assets	2.5	1.8
Capital Transfers	1.9	1.1
Other	0.0	0.0
Net Lending	**0.0**	**1.0**
Capital Expenditure and Net Lending	**4.4**	**3.9**
Total Expenditure and Net Lending	**20.0**	**18.5**

(a) Provisional
(b) GDP estimates (base year 2015) released by the Department of Census and Statistics on 15 March 2023 have been used.

Source: Ministry of Finance, Economic Stabilisation and National Policies

Figure 6.4
Composition of Government Recurrent Expenditure - 2022

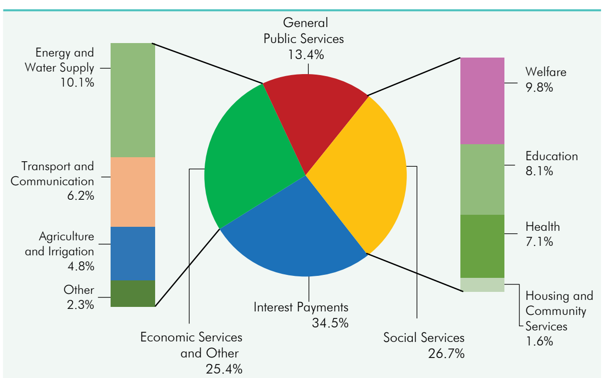


Source: Ministry of Finance, Economic Stabilisation and National Policies

during 2022, compared to 2021. However, with the sharp rise in nominal GDP, total expenditure and net lending, as a percentage of GDP, declined to 18.5 per cent in 2022, in comparison to 20.0 per cent recorded in the preceding year.

Government recurrent expenditure grew significantly in 2022, mainly due to the increased domestic interest payments owing to large borrowing requirements and elevated interest rates, along with the rise in expenditure on salaries and wages, and subsidies and transfers. The yields on government securities soared due to the risk premia associated with concerns about domestic debt restructuring. Such rise in yields was well beyond the impact of the increase in policy interest rates due to inflationary pressures.

Figure 6.5
Total Expenditure and Lending by Function - 2022



Source: Ministry of Finance, Economi Stabilisation and National Policies

Limited access to foreign financing amidst the debt standstill, and the resultant large borrowing requirement from domestic sources exerted further pressures on the yields on government securities. Accordingly, the expenditure on interest payments, which accounted for 44.5 per cent of total recurrent expenditure, grew by 49.3 per cent during 2022, while domestic interest payments rose by 80.8 per cent in 2022, compared to 2021. Expenditure on interest payments accounted for 79.1 per cent of government revenue in 2022.

Table 6.5
Functional Classification of Expenditure

Item	2021	2022 (a)
Rs. million		
Recurrent Expenditure	**2,747,512**	**3,519,633**
General Public Services	499,629	570,918
Civil Administration	134,930	170,303
Defence	257,918	281,643
Public Order and Safety	106,782	118,971
Social Services	974,821	1,092,615
Education	261,716	328,969
Health	275,165	279,803
Welfare	397,343	445,635
Community Services	40,597	38,208
Economic Services	164,590	203,491
Agriculture and Irrigation	68,206	109,330
Energy and Water Supply	1,385	1,259
Transport and Communication	47,255	45,935
Other	47,744	46,967
Other	1,108,472	1,652,609
o/w Interest Payment	1,048,382	1,565,190
Capital Expenditure and Lending	**789,636**	**1,014,293**
General Public Services	61,675	36,100
Civil Administration	54,624	30,271
Public Order and Safety	7,051	5,829
Social Services	189,733	116,818
Education	48,897	38,522
Health	111,956	43,734
Housing	18,333	25,434
Community Services	10,547	9,128
Economic Services	537,370	859,835
Agriculture and Irrigation	79,463	108,697
Energy and Water Supply	96,520	458,295
Transport and Communication	263,042	234,408
Other	98,346	58,434
Other	858	1,540
Total Expenditure and Lending	**3,537,148**	**4,533,926**
As a Percentage of GDP (b)		
General Public Services	3.2	2.5
Social Services	6.6	5.0
Economic Services	4.0	4.4
Other	6.3	6.9
o/w Interest Payment	6.0	6.5
Total Expenditure and Lending	**20.1**	**18.8**

(a) Provisional
(b) GDP estimates (base year 2015) released by the Department of Census and Statistics on 15 March 2023 have been used.

Source: Ministry of Finance, Economic Stabilisation and National Policies

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However, interest payments on foreign debt decreased notably by 49.3 per cent during 2022 due to the temporary suspension of external debt service payments on bilateral and commercial debt for an interim period. Expenditure on goods and services increased by 12.3 per cent in 2022, compared to 2021. Salaries and wages, which accounted for 27.2 per cent of the total recurrent expenditure in 2022, increased by 13.1 per cent during the year, owing to the additional monthly allowance paid to public sector workers based on the relief package introduced in January 2022 as well as the impact of general annual increments. Similarly, expenditure on other goods and services grew by 8.2 per cent in 2022, in comparison to the preceding year. Meanwhile, expenditure on subsidies and transfers recorded a year-on-year growth of 19.1 per cent in 2022, mainly due to the additional monthly allowance paid to pensioners and Samurdhi recipients and increased expenses on fertiliser subsidy. However, expenditure on supply of free medicine decreased marginally by 0.8 per cent with the easing of the COVID-19 pandemic.

Capital expenditure and net lending increased notably in nominal terms, mainly due to higher lending to SOBEs. Accordingly, capital expenditure and net lending, in nominal terms, increased by 23.1 per cent in 2022, compared to 2021. Following the decision of the Government to suspend non-urgent capital expenditure, capital transfers to public institutions, provincial councils and public corporations declined by 17.8 per cent in 2022. However, net lending by the Government increased substantially in 2022, compared to the previous year, primarily due to lending to CPC by the Government via the Indian line of credit to import fuel and lending to SOEs using funds received from the World Bank to purchase LP gas and fertiliser. Meanwhile, public investment also grew by 28.5 per cent to Rs. 1,014.3 billion in 2022. Capital expenditure on social services declined by 38.4 per cent during the period under review, mainly due to the reduction in capital expenditure on the health sector in 2022, compared to 2021, reflecting the impact of reduction in pandemic related expenditure. Meanwhile, capital expenditure on economic services increased by 60.0 per cent due to lending to CPC and capital transfers to SOBEs, such as CEB, National Water Supply and Drainage Board, and Bank of Ceylon.

Key Fiscal Balances and Financing the Budget Deficit

All key fiscal balances as a percentage of GDP improved in 2022, benefiting from the substantial growth in nominal GDP as well as the efforts towards fiscal consolidations. Accordingly, the overall budget deficit declined to 10.2 per cent of GDP in 2022, in comparison to 11.7 per cent of GDP in 2021. However, the budget deficit, in nominal terms, increased to Rs. 2,460.0 billion in 2022, compared to Rs. 2,057.9 billion recorded in 2021. Similarly, the current account deficit in GDP terms declined to 6.4 per cent (Rs. 1,540.4 billion) in 2022, compared to

Table 6.6
Sources of Domestic Financing (Net)

Rs. million

Item	2021	2022 (a)
By Instrument	**2,071,826**	**2,035,145**
Treasury bonds	1,301,543	1,440,190
Treasury bills	635,098	1,608,211
Sri Lanka Development Bonds	-68,324	-380,069
Central Bank Provisional Advances	-2,950	85,510
Borrowings from OBUs	-103,547	-52,236
Others	310,006	-666,461
By Source	**2,071,826**	**2,035,145**
Bank	1,304,287	1,027,721
Non-Bank	767,539	1,007,424

(a) Provisional

Source: Ministry of Finance, Economic Stabilisation and National Policies
Central Bank of Sri Lanka

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7.3 per cent of GDP (Rs. 1,290.4 billion) in 2021. Reflecting the discretionary fiscal policy component of the Government, the primary deficit, which excludes interest payments from the overall deficit, declined both in nominal terms and as a percentage of GDP. Accordingly, the primary deficit declined to 3.7 per cent of GDP (Rs. 894.8 billion) in 2022 from 5.7 per cent (Rs. 1,009.5 billion) recorded in 2021, mainly reflecting the impact of fiscal consolidation, primarily through revenue enhancement measures during 2022.

The Government relied predominantly on domestic sources to finance the budget deficit in 2022 amidst limited access to foreign financing. Net domestic financing[1] contributed 82.7 per cent (Rs. 2,035.1 billion) of the total financing in 2022, compared to 100.7 per cent (Rs. 2,071.8 billion) in 2021. Net domestic financing, as a percentage of GDP, amounted to 8.4 per cent in 2022, in comparison to 11.8 per cent in 2021. Meanwhile, the share of net financing through foreign sources increased to 17.3 per cent (Rs. 424.8 billion) in 2022, compared to the net repayment of 0.7 per cent (Rs. 13.9 billion) in 2021. Accordingly, net foreign financing stood at 1.8 per cent of GDP in 2022, in comparison to the net repayment for foreign sources of 0.1 per cent of GDP in 2021.

Net domestic financing from expansionary sources remained significant in 2022, although the relative contribution from such sources to net domestic financing declined notably, compared to the preceding year. Accordingly, the share of net financing from the banking sector within the domestic financing, declined to 50.5 per cent in 2022 (4.3 per cent of GDP), compared to 63.0 per cent (7.4 per cent of GDP) in 2021. Net financing from the Central Bank rose to Rs. 1,338.4 billion in 2022, compared to the net financing of Rs. 1,225.2 billion in 2021. Such monetary financing reflects the impact of direct subscription to Treasury bills by the Central Bank amidst subdued market appetite for government securities, and administrative issuances of Treasury bills to the Central Bank to meet large gross financing needs of the Government and to meet the cashflow requirements of the General Treasury, under extremely challenging circumstances. However, monetary financing in the second half of the year was relatively low compared to the first half of 2022 due to improved government revenue collection during this period and the receipt of financing from multilateral and bilateral foreign sources, primarily IDA and IBRD under the World Bank, ADB and Indian credit lines. The Central Bank financing includes provisional advances, which increased to Rs. 85.5 billion in 2022, compared to the net repayment of Rs. 3.0 billion recorded in the previous year. Meanwhile, a net repayment of Rs. 310.7 billion was registered in relation to financing from Licenced Commercial Banks in 2022, compared to a net financing of Rs. 79.1 billion in 2021. Net financing from the non bank sector increased to Rs. 1,007.4 billion in 2022, compared to Rs. 767.5 billion in 2021, whereas the share of non bank sector financing accounted for 49.5 per cent of total net domestic financing in 2022, compared to 37.0 per cent in the preceding year. Net financing from the non bank sector, as a percentage of GDP, declined to 4.2 per cent in 2022, compared to 4.4 per cent in 2021.

Net financing through Treasury bills increased substantially during 2022, reflecting the market appetite for short tenure instruments amidst uncertainties about domestic debt restructuring. Instrument based net domestic borrowings increased to Rs. 2,668.3 billion in 2022 from Rs. 1,868.3 billion in 2021. Net borrowings through Treasury bills increased significantly to Rs. 1,608.2

1 Includes all net borrowings through Treasury bonds, Treasury bills, Offshore Banking Units (OBUs), and Sri Lanka Development Bonds (SLDBs)

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billion in 2022, compared to Rs. 635.1 billion in 2021, while net borrowings through Treasury bonds increased to Rs. 1,440.2 billion in 2022, compared to Rs. 1,301.5 billion in 2021. However, borrowings through SLDBs recorded a net repayment of Rs. 380.1 billion in 2022, compared to a net repayment of Rs. 68.3 billion in 2021. Meanwhile, net domestic borrowings from non marketable instruments recorded a net repayment of Rs. 633.2 billion in 2022, mainly due to the settlement of Government overdraft balances during the year, compared to the net borrowing of Rs. 203.5 billion in 2021. Net repayment to OBUs during 2022 stood at Rs. 52.2 billion.

Net financing from foreign sources increased in 2022, compared to 2021, mainly reflecting the impact of funding from multilateral and bilateral sources amidst the unprecedented economic crisis. Owing to the repayment of a matured ISB in January 2022 prior to the announcement of the debt standstill, the net repayments in relation to ISBs amounted to Rs. 100.5 billion (US dollars 500 million) in 2022, compared to a net repayment of Rs. 199.9 billion (US dollars 1.0 billion) in 2021. However, net financing through foreign project and programme loans, which include financing from several multilateral and bilateral sources, amounted to Rs. 525.3 billion during the period under review, compared to a net financing of Rs. 39.3 billion recorded in 2021. The World Bank and ADB repurposed funding from their existing projects to meet pressing needs of the people amidst the crisis, such as for the importation of medicine, fertiliser, and LP gas and providing cash transfers to vulnerable groups. Meanwhile, the Government of India provided credit lines to Sri Lanka for the importation of fuel, fertiliser, medical items, food etc. during 2022. The State Bank of India provided a credit line up to US dollars 1.0 billion for the importation of essential items, while the EXIM Bank of India offered short term credit lines of US dollars 500 million and US dollars 55 million to import fuel and fertiliser, respectively. Approximately, US dollars 200 million was drawn from the credit line of the State Bank of India for the importation of fuel.

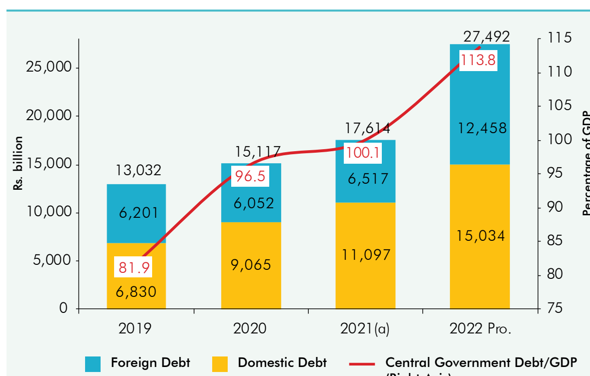
6.4 Government Debt and Debt Service Payments

Central Government Debt[2]

Central government debt, which gradually moved towards unsustainable levels, particularly over the recent years, reached a decisive moment in early 2022, resulting in an announcement of a debt standstill by the Government. The limited access to foreign financing amidst Sri Lanka's sovereign credit rating downgrades caused a severe drain on gross official reserves due to continued debt servicing by drawing down the gross official reserves. With

2 The compilation of debt statistics became challenging with the ongoing debt structuring process and arrears in payments. The outstanding central government debt statistics at end 2022 are provisional, as these debt statistics exclude several overdue debt service payments, including overdue interest payments of affected debt, which are deemed to be capitalised as per the interim policy decision on debt standstill and several overdue interest payments in relation to SLDBs. The details of such payment arrears were published on the website of the Ministry of Finance, as part of data dissemination efforts under the ongoing debt restructuring process. However, such information is still being incorporated into the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS), which is the data source generally used for reporting debt statistics by the Central Bank.

Figure 6.6
Outstanding Central Government Debt



(a) Revised

Sources: Ministry of Finance, Economic Stabilisation and National Policies
Central Bank of Sri Lanka

Table 6.7
Outstanding Central Government Debt (as at end year) (a)

Rs. million

Item	2019	2020	2021 (b)	2022 (c) (d)
Total Government Debt	**13,031,543**	**15,117,247**	**17,614,181**	**27,492,031**
Domestic Debt (e)	**6,830,260**	**9,065,068**	**11,097,223**	**15,033,876**
By Maturity Period				
Short Term (f)	1,270,374	2,197,594	3,139,794	4,267,724
Medium and Long Term (e)(g)	5,559,887	6,867,473	7,957,430	9,882,058
Other Domestic (h)	n.a	n.a	n.a	884,093
By Institution (i)				
Bank (i)	2,737,223	4,542,155	5,247,919	8,525,718
Non Bank (i)	3,825,703	4,210,099	4,822,098	6,164,063
Repurchase Transaction Allocations (j) (k)	267,334	312,814	1,027,207	344,096
Foreign Debt (l) (m)	**6,201,283**	**6,052,179**	**6,516,958**	**12,458,155**
Multilateral	1,469,867	1,601,482	1,895,340	3,611,552
Bilateral and Commercial	4,731,415	4,450,697	4,621,618	8,846,603
Of which;				
International Sovereign Bonds	2,531,493	2,203,279	2,243,049	3,921,587
Foreign Currency Term Financing Facility	242,191	279,612	445,521	797,589
Non Resident Investment in Treasury Bills	23,727	670	204	12,476
Non Resident Investment in Treasury Bonds	80,294	6,204	1,710	13,078
By Currency				
SDR	927,372	970,714	989,442	1,604,694
US Dollars	4,076,588	3,875,950	4,295,194	8,716,938
Japanese Yen	624,956	664,291	623,206	979,567
Euro	228,713	251,406	240,974	417,406
Other	343,653	289,818	368,142	739,550
Central Government Debt/GDP (n)	**81.9**	**96.5**	**100.1**	**113.8**
Memorandum Items				
Total Exchange Rate Variation	12,401	355,663	499,681	5,617,220
On Foreign Debt	16,857	329,895	473,796	5,262,420
On Foreign Currency Denominated Domestic Debt	-4,456	25,767	25,884	354,800

(a) As per the guidelines of compiling government debt statistics in the Manual of Government Finance Statistics published by the IMF in 2014, non resident holdings of outstanding SLDBs have been classified under foreign debt and resident holdings of outstanding ISBs of the Sri Lankan Government have been classified under domestic debt.
(b) Revised
(c) Provisional
(d) The outstanding central government debt excludes several debt service payments that became overdue after 12 April 2022, the date of which the Interim Policy regarding the servicing of Sri Lanka's external public debt was announced by the Ministry of Finance, Economic Stabilisation and National Policies. These debt service payments comprise of overdue interest payments of affected debt which deemed to be capitalised as per the Interim Policy, and several overdue interest payments in relation to SLDBs.
(e) Includes Government Treasury bonds of Rs. 78,441 million issued for CPC in January 2012 of which Rs. 21,778 million matured on 01 January 2017 and Rs. 25,217 million matured on 01 January 2022 and the current outstanding is Rs. 31,446 million
(f) Excludes Treasury bills held by non resident investors
(g) Excludes Treasury bonds held by non resident investors
(h) Includes outstanding balance of the government guaranteed foreign currency debt of the Ceylon Petroleum Corporation that was absorbed into central government debt w.e.f. December 2022, which amounted to Rs. 884,093.4 million
(i) Institution wise classification was revised in the Annual report 2022 based on the records of the Central Depository System and the data for 2019-2021 have been revised accordingly.
(j) Includes security holdings under Repurchase agreements for which absolute ownership could not be established
(k) Holdings under repurchase transactions with respect to Open Market Operations, have been allocated to the respective Licensed Commercial Bank or Standalone Primary Dealer only in the year 2022.
(l) Foreign loan debt statistics and classification of foreign debt for 2021 and 2022 are prepared based on the data sourced from the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS) maintained by the Ministry of Finance, Economic Stabilisation and National Policies, and extracted on 09 and 10 March 2023
(m) From December 2022 onwards, several outstanding project loans which were previously classified under Ceylon Electricity Board, Airport and Aviation Services Ltd. and Sri Lanka Ports Authority were absorbed into central government debt.
(n) GDP estimates (base year 2015) released by the Department of Census and Statistics on 15 March 2023 have been used.

Sources: Ministry of Finance, Economic stabilisation and National Policies
Central Bank of Sri Lanka

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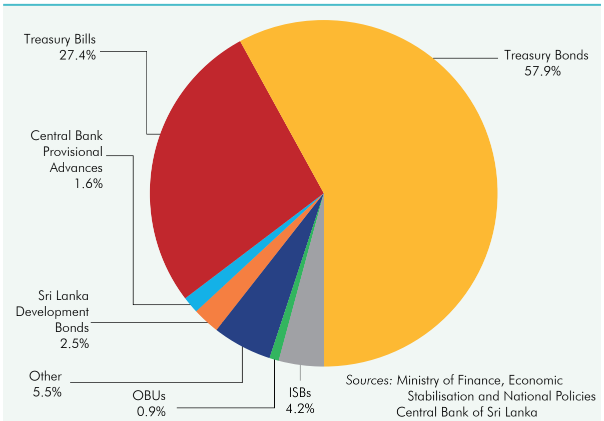
mounting foreign currency debt servicing and almost exhausted usable reserves of the Central Bank by early April 2022, the Government had to announce a debt standstill as an interim measure, while seeking assistance from the IMF for an EFF supported programme and subsequent efforts to initiate a debt restructuring process aimed at ensuring debt sustainability in the period ahead.

Central government outstanding debt increased significantly at end 2022, compared to end 2021, reflecting the impact of large financing needs of the Government, sharp depreciation of the exchange rate, as well as the absorption of selected SOE debt to the Central Government. The total outstanding central government debt

Figure 6.7
Composition of Outstanding Central Government Domestic Debt - as at end 2022



Sources: Ministry of Finance, Economic Stabilisation and National Policies
Central Bank of Sri Lanka

stock,[3] in nominal terms, increased by 56.1 per cent to Rs. 27,492.0 billion by end 2022 from Rs. 17,614.2 billion by end 2021. As a percentage of GDP, central government debt rose to 113.8 per cent by end 2022 in comparison to 100.1 per cent at end 2021. Meanwhile, outstanding foreign debt of the Central Government, valued in domestic currency, increased from 37.0 per cent of GDP at end 2021 to 51.6 per cent of GDP by end 2022, mainly reflecting the sharp depreciation of the Sri Lanka rupee against major currencies during 2022.

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With the significant depreciation of exchange rate, the relative share of foreign debt rose by end 2022, while the relative share of domestic debt declined from 63.0 per cent in end 2021 to 54.7 per cent by end 2022. Outstanding short term domestic debt increased by 35.9 per cent by end 2022 from end 2021, mainly reflecting the increase in the outstanding stock of Treasury bills, which increased to Rs. 4,113.9 billion by end 2022, from Rs. 2,270.5 billion at the end of 2021. Consequently, the share of Treasury bills in total domestic debt stock as at end 2022 increased to 27.4 per cent from 20.5 per cent at end 2021. The outstanding debt stock on account of provisional advances to the Government by the Central Bank increased from Rs. 150.1 billion at end 2021 to Rs. 235.6 billion at end 2022. Meanwhile, other remaining short term debt, net of bank deposits, recorded a negative balance of Rs 81.8 billion at end 2022 as the Government settled a part of its overdraft balance during 2022. However, the medium and long term domestic debt stock increased by 24.2 per cent by end 2022, from Rs. 7,957.4 billion by end 2021. Treasury bonds, continued to dominate the outstanding domestic debt portfolio, accounting for 57.9 per cent of the total outstanding domestic debt stock (Rs. 8,709.1 billion) at end 2022 in comparison to 62.8 per cent (Rs. 6,966.2 billion) recorded as at end 2021. Meanwhile, the resident holdings of SLDBs declined to Rs. 382.1 billion[4] (US dollars 1,052.3 million) from Rs 455.2 billion (US dollars 2,271.1 million) reported at end 2021, owing to settlements made during the year. Resident holdings of ISBs, in domestic currency terms, increased from Rs. 372.6 billion at end 2021 to Rs. 635.4 billion[5] by end 2022 due to the sharp exchange rate depreciation, while the foreign currency value of the same declined from US dollars 1,859.0 million at end 2021 to US dollars 1,750.0 million at end 2022, due to settling of a matured ISBs amounting to US dollars 500 million. Outstanding debt from OBUs decreased by Rs. 7.9 billion from end 2021 to Rs. 131.4 billion (US dollars 361.8 million) by the end of the period under review. Moreover, the share of the banking sector debt in total domestic debt increased to 56.7 per cent by end 2022 from 47.3 per cent at end 2021. A significant increase in central government debt held by the Central Bank was recorded in 2022, due to the notable rise in Treasury bills holding to Rs. 2,575.7 billion by end 2022 from Rs. 1,391.3 billion held at the end of 2021. This increase was attributable to the

3 As per the records retrieved on 09 and 10 March 2023 from CS-DRMS of the Ministry of Finance and the records of the Public Debt Department of the Central Bank and the monetary survey of the Central Bank.

4 This excludes some of the arrears in interest payments that became overdue after the announcement of the debt standstill in April 2022.

5 This excludes arrears interest payments that became overdue after the announcement of the debt standstill.

direct subscription of Treasury bills by the Central Bank amidst subdued market subscription, and the administrative issuance of Treasury bills to the Central Bank.

Outstanding foreign debt[6] of the Central Government, in nominal terms, increased from Rs. 6,517.0 billion at end 2021 to Rs. 12,458.2 billion by end 2022. The significant depreciation of the Sri Lanka rupee against major currencies during 2022 primarily contributed to the increase in the share of foreign debt stock within the total outstanding debt stock to 45.3 per cent at end 2022 from 37.0 per cent witnessed at end 2021. Within the foreign debt portfolio, multilateral debt increased to Rs. 3,611.6 billion by end 2022, from Rs. 1,895.3 billion registered at end 2021 due to the domestic currency depreciation impact as well as the receipt of multilateral funding for targeted support during the economic crisis. Moreover, bilateral and commercial debt, which stood at Rs. 4,621.6 billion at the end of 2021, increased notably in 2022 to Rs. 8,846.6 billion[7] by end 2022, primarily due to the absorption of several debts, held by the CPC, AASL, CEB and SLPA, into central government debt, new loans received from India for humanitarian assistance, such as the Indian credit line as well as currency depreciation. Amongst the commercial debt, the rupee value of ISBs held by non residents increased by Rs. 1,678.5 billion by end 2022 due to the depreciation of the Sri Lanka rupee against the US dollar. The non resident holding of Treasury bills and Treasury bonds increased to Rs. 12.5 billion and Rs. 13.1 billion, respectively, by end 2022 from Rs. 0.2 billion and Rs. 1.7 billion, respectively, recorded at the end of 2021. Due to the parity variation caused by the sharp depreciation of the Sri Lanka rupee against major currencies during 2022, the rupee amount of the foreign currency debt increased by around Rs. 5,617.2 billion (23.3 per cent of GDP) at end 2022.

The restructuring of identified public debt is expected to be completed during 2023. Accordingly, the Government is in the process of evaluating debt restructuring options that could reduce the outstanding debt levels to a manageable level, while meeting the debt sustainability targets as per the Debt Sustainability Analysis conducted by the IMF. With the restructuring of public debt, the outstanding public debt is expected to reduce to a level below 95 per cent of GDP by 2032, the average central government gross financing needs are to be kept below 13 per cent of GDP during 2027 to 2032, and foreign currency debt service payments of the Central Government are to be maintained below 4.5 per cent of GDP in any year during 2027 to 2032 period.

Central Government Debt Service Payments

The Government suspended selected debt service payments on bilateral and commercial foreign debt from 12 April 2022 as an interim measure. Suspension of these debt service

Table 6.8
Central Government Debt Service Payments

Rs. million

Item	2019	2020	2021 (a)	2022 (b)
Debt Service Payments	**2,022,507**	**1,941,373**	**2,380,599**	**2,997,645**
Domestic	1,213,698	1,169,522	1,594,328	2,510,281
Foreign	808,809	771,851	786,271	487,364
Amortisation Payments	**1,121,155**	**961,071**	**1,332,216**	**1,432,455**
Domestic	546,315	455,899	799,695	1,073,712
Foreign	574,839	505,172	532,521	358,743
Interest Payments	**901,352**	**980,302**	**1,048,383**	**1,565,190**
Domestic	667,383	713,623	794,633	1,436,569
Short Term	81,029	77,965	98,668	555,171
Medium and Long Term	586,354	635,658	695,965	881,398
Foreign	233,970	266,679	253,750	128,621

(a) Revised
(b) Provisional

Sources: Ministry of Finance, Economic Stabilisation and National Policies
Central Bank of Sri Lanka

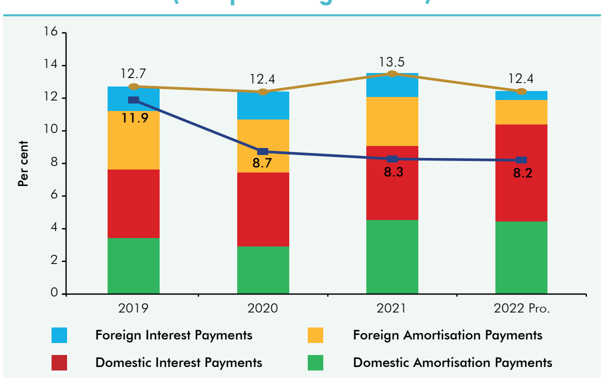
6 As per the Manual of Government Finance Statistics published by the IMF in 2014, the non resident holdings of central government debt are classified as foreign debt.

7 This outstanding balance excludes arrears in interest payments of bilateral and commercial debt that were overdue after the announcement of the debt standstill since recording of these overdue payments as capitalised interest in the CS-DRMS is still ongoing.

payments enabled the Government to save a considerable amount of foreign currency outflows providing a temporary reprieve amidst the balance of payments crisis. The estimated saving of foreign currency outflows through the suspension of bilateral and commercial debt during April to December 2022 amounted to US dollars 2.8 billion. Due to the debt standstill, the ISB which was due to mature in July 2022 of US dollars 1.0 billion was not repaid. In addition, several debt service payments related to SLDBs were not made during the debt standstill period. Part of these SLDB debt service payments were settled in rupee terms. Meanwhile, multilateral debt, new credit facilities, and any amounts disbursed under existing credit facilities after 12 April 2022 were not subjected to the interim policy.

The total debt service payments in 2022 recorded a notable increase in nominal terms of 25.9 per cent, compared to 2021, owing to the significant increase in debt amortisation and interest payments related to domestic debt. Domestic debt service payments increased by 57.5 per cent in 2022 over the preceding year, reflecting the increased yields on government securities and greater dependency on domestic sources in deficit financing due to restrained

Figure 6.8
Central Government Debt Service Payments (as a percentage of GDP)



Sources: Ministry of Finance, Economic Stabilisation and National Policies
Central Bank of Sri Lanka

access to foreign financing sources. However, with the Government's announcement of interim policy on the suspension of selected foreign debt service payments since April 2022, foreign debt service payments declined by 38.0 per cent in 2022, in comparison to 2021.

The total amortisation payments, which accounted for 47.8 per cent of the total debt service payments, increased by 7.5 per cent in 2022, compared to the preceding year. Domestic debt repayments increased by 34.3 per cent in 2022, mainly due to the increased maturities of Treasury bonds and SLDBs. Nevertheless, foreign

Table 6.9
Central Government Debt Indicators (a)

Per cent

Indicator	2019	2020	2021	2022 (b)
Central Government Debt/GDP	81.9	96.5	100.1	113.8
Domestic Debt/GDP (c)	42.9	57.8	63.1	62.3
Foreign Debt/GDP	39.0	38.6	37.0	51.6
Domestic Debt/Central Government Debt	52.4	60.0	63.0	54.7
Foreign Debt/Central Government Debt	47.6	40.0	37.0	45.3
Foreign Debt/Exports (d)	178.6	250.2	218.7	240.1
Debt Service/GDP	12.7	12.4	13.5	12.4
Debt Service/Government Revenue	107.0	141.9	163.4	151.5
o/w Domestic Debt Service/ Government Revenue	64.2	85.5	109.4	126.8
Debt Service/Government Expenditure (e)	45.4	48.5	49.0	50.8
o/w Domestic Debt Service/ Government Expenditure (e)	27.2	29.2	32.8	42.5
Foreign Debt Service/Exports (d)	23.3	31.9	26.4	9.4
Interest Payments/GDP	5.7	6.3	6.0	6.5
Interest Payments/Government Expenditure (e)	20.2	24.5	21.6	26.5
Domestic Interest Payments/GDP	4.2	4.6	4.5	5.9
Foreign Interest Payments/GDP	1.5	1.7	1.4	0.5
Interest Payments/Government Recurrent Expenditure	37.2	38.5	38.2	44.5
Foreign Interest Payments/Exports (d)	6.7	11.0	8.5	2.5

(a) GDP estimates (base year 2015) released by the Department of Census and Statistics on 15 March 2023 were used.
(b) The outstanding central government debt excludes several debt service payments that became overdue after 12 April 2022, the date of which the Interim Policy regarding the servicing of Sri Lanka's external public debt was announced by the Ministry of Finance, Economic Stabilisation and National Policies. These debt service payments comprise of overdue interest payments of affected debt which deemed to be capitalised as per the Interim Policy, and several overdue interest payments in relation to SLDBs.
(c) Includes Government Treasury bonds of Rs. 78,441 million issued for CPC in January 2012 (of which Rs. 21,778 million matured on 01 January 2017 and Rs. 25,217 million matured on 01 January 2022) and the current outstanding is Rs. 31,446 million.
(d) Export of goods and services
(e) Government expenditure includes amortisation payments.

Sources: Ministry of Finance, Economic Stabilisation and National Policies
Department of Census and Statistics
Central Bank of Sri Lanka

debt repayments decreased by 32.6 per cent to Rs. 358.7 billion in 2022 as a result of the debt standstill of the Government. Foreign debt service payments in 2022 included repayment of an ISB that matured in January 2022, equivalent to Rs. 100.5 billion (US dollars 500 million), compared to Rs. 199.9 billion (US dollars 1.0 billion) of ISB maturity payments in 2021. Amortisation payments on domestic debt, as a percentage of GDP, slightly declined to 4.4 per cent in 2022 from 4.5 per cent in 2021, while amortisation payments for foreign debt to GDP declined to 1.5 per cent in 2022 from 3.0 per cent in 2021.

Interest payments on central government debt recorded a year-on-year growth of 49.3 per cent in 2022 with a notable rise in the yields on government securities and domestic borrowings. The rise in yields on government securities surpassed the policy rate adjustment, due to the elevated risk premia owing to the concerns about possible restructuring of domestic debt. Heightened pressures on domestic sources for deficit financing amidst limited foreign financing also contributed to the rise in government securities yields. Consequently, interest payment on central government domestic debt increased by 80.8 per cent in 2022, compared to the previous year, particularly on account of Treasury bills and Treasury bonds. With the suspension of interest payments on foreign bilateral and commercial debt pursuant to the debt standstill, interest payments on foreign debt declined by 49.3 per cent to Rs. 128.6 billion in 2022, compared to the corresponding payments in 2021. Accordingly, as a percentage of GDP, interest payments on domestic debt increased to 5.9 per cent in 2022 from 4.5 per cent in 2021, while interest payments on foreign debt decreased to 0.5 per cent of GDP in 2022 from 1.4 per cent of GDP in the previous year.

Debt service indicators, which include debt and debt service ratios and debt service coverage ratios, showed mixed performances in 2022. Total debt service payments, as a percentage of government revenue, declined notably in 2022, mainly due to the notable nominal growth in revenue collection as well as the impact of debt standstill on debt servicing. However, the significant rise in domestic debt service payments posed notable pressures on the government budget during 2022, as evident by the sharp rise in domestic debt service payments relative to both government revenue and government expenditure. The foreign debt service burden eased temporarily in 2022 under the debt standstill, as reflected in the ratio of foreign debt service payments to exports and the ratio of foreign debt service payments to GDP. The ongoing debt restructuring negotiations are expected to provide a sizeable relief on account of reducing gross foreign financing needs in the medium term, before the resumption of foreign debt service payments in the period ahead. The Government needs to ensure that the gross financing needs and foreign currency debt servicing are maintained at the levels envisaged under the IMF-EFF arrangement during 2027-2032.

Outstanding Public Debt

The outstanding public debt, which includes debt of the central government, foreign project loans received by SOBEs, and public guaranteed debt,[8] increased to 118.7 per cent of GDP at end 2022 from 110.4 per cent of GDP at end 2021. This was mainly due to an increase in central government debt and the depreciation of the Sri Lanka rupee against major currencies during 2022. In absolute terms, the total outstanding public debt increased to Rs. 28,672.7 billion at end 2022 from Rs. 19,432.1 billion at end 2021. The outstanding

8 Compilation of public guaranteed debt is based on data received from Ministry of Finance, Economic Stabilisation and National Policies as of 10 March 2023.

Table 6.10
Outstanding Public Debt (as at end year)

	2019	2020	2021	2022 (a)
Rs. million				
Total Outstanding Central Government Debt (b) (c) (d)	**13,031,543**	**15,117,247**	**17,614,181**	**27,492,031**
Outstanding Balance of Foreign Project Loans Received by SOBEs without Public Guarantee (c)	**345,453**	**323,510**	**311,191**	**-**
Airport & Aviation Services (Sri Lanka) Ltd.	22,317	22,189	21,833	-
Ceylon Electricity Board	150,418	136,720	128,026	-
Sri Lanka Ports Authority	172,717	164,602	161,332	-
Public Guaranteed Debt (e)	**778,305**	**986,391**	**1,506,743**	**1,180,701**
Airport & Aviation Services (Sri Lanka) Ltd.	16,532	34,801	115,332	59,756
Bank of Ceylon & People's Bank	n.a.	n.a.	36,540	66,889
Ceylon Electricity Board	25,212	70,559	89,311	139,593
Ceylon Petroleum Corporation (d)	297,220	345,500	561,267	100,969
Ceylon Shipping Corporation Ltd.	12,613	12,505	12,263	19,959
General Sir John Kotelawala Defence University	35,311	35,562	35,738	35,670
Lanka Coal Company (Pvt.) Ltd.	5,398	9,692	13,899	2,080
National Water Supply & Drainage Board	102,339	138,180	200,851	291,526
Paddy Marketing Board	11,420	2,023	1,313	759
Road Development Authority	206,563	262,015	349,895	341,736
SriLankan Airlines Ltd. (f)	32,083	43,530	60,336	72,598
Other Corporations	33,615	32,023	29,998	49,164
Public Debt	**14,155,301**	**16,427,148**	**19,432,115**	**28,672,731**
As a percentage of GDP (g)				
Total Outstanding Central Government Debt (b) (c) (d)	81.9	96.5	100.1	113.8
Outstanding Balance of Foreign Project Loans Received by SOBEs without Public Guarantee (c)	2.2	2.1	1.8	-
Public Guaranteed Debt (e) (f)	4.9	6.3	8.6	4.9
Public Debt	**89.0**	**104.8**	**110.4**	**118.7**

(a) Provisional
(b) Includes Government Treasury bonds of Rs. 78,441 million issued for CPC in January 2012 of which Rs. 21,778 million matured on 01 January 2017 and Rs. 25,217 million matured on 01 January 2022 and the current outstanding is Rs. 31,446 million.
(c) From December 2022 onwards, several outstanding project loans which were previously classified under the Ceylon Electricity Board, Airport and Aviation Services Ltd. and Sri Lanka Ports Authority were absorbed into central government debt.
(d) Outstanding balance of the government guaranteed foreign currency debt of the Ceylon Petroleum Corporation was absorbed into central government debt by end December 2022.
(e) Compilation of public guaranteed debt is based on data received from Ministry of Finance, Economic Stabilisation and National Policies as of 10 March 2023
(f) Includes an international bond amounting to US dollars 175 million issued by the SriLankan Airlines in June 2014. This was matured in June 2019 and re-issued for a period of 5 years.
(g) GDP estimates (base year 2015) released by the Department of Census and Statistics on 15 March 2023 have been used.

Sources: Ministry of Finance, Economic Stabilisation and National Policies
Central Bank of Sri Lanka

central government debt, which is the largest share of public debt, increased by 56.1 per cent to Rs. 27,492.0 billion at end 2022, accounting for 95.9 per cent of the total public debt. Public guaranteed debt declined by 21.6 per cent to Rs. 1,180.7 billion at end 2022 from Rs. 1,506.7 billion at end 2021, accounting for 4.1 per cent of the total outstanding public debt, mainly due to absorption of government guaranteed foreign currency debt of CPC into central government debt by end 2022. A selected set of foreign project loans of CEB, SLPA and AASL were included in central government debt, as proposed by the National Budget 2022 and approved by the Cabinet of Ministers in 30 January 2023.

6.5 Budgetary Operations in Sub National Governments

Policy Directions and Measures taken by Sub National Governments

The Ministry of Provincial Councils and Local Government (MPCLG) continued to play a pivotal role in providing policy advice to sub national governments[9] in 2022 in order to identify the development needs at the sub national level and to facilitate investments with a view to achieving balanced regional development. Despite budgetary constraints, priority was given to economic and

9 The sub national governments comprised nine Provincial Councils and 341 local governments that include 24 Municipal Councils, 41 Urban Councils, and 276 Pradeshiya Sabhas.

social infrastructure development projects, including the upgrading of education and health sectors to improve living standards of the people. Accordingly, the Ministry continued the Primary Health Care System Strengthening Project and the General Education Modernisation Programme in regional areas during 2022. Further, several infrastructure development projects were continued during 2022, including the Local Government Enhancement Sector Project (Pura Neguma programme), the Rural Infrastructure Development Project in Emerging Regions (RIDEP Project), and the Greater Colombo Wastewater Management Project, in view of improving physical infrastructure in urban as well as other regional areas.

The Finance Commission (FC) recommended several policy measures during the year with the objective of ensuring balanced and equitable socio-economic development in all provinces. Accordingly, the FC recommended the establishment of a powerful agency responsible for the rational allocation of resources at both national and provincial levels. This agency would ensure effective utilisation of resources, while undertaking independent and rigorous appraisal of investment proposals to prioritise the projects with higher economic returns. The FC recommended that the Government to carry out a comprehensive and independent study to formulate a policy for locating/expanding hospitals and other health care institutions to improve health care services at provincial level. Further, the FC highlighted the need to explore new avenues to empower Provincial Councils (PCs) and local authorities with higher revenue generation to reduce the dependency on the central government budget. Many taxes and fees, including motor vehicle license fees and license fees on liquor sales outlets collected by PCs, have not been revised in line with market conditions. Since the revision of these fees and taxes falls under the purview of respective line Ministries, the FC recommended that the line Ministries revise such fees and tax rates to increase revenue mobilisation at provincial levels.

Table 6.11
Budget Outturn of Provincial Councils

Rs. million

Item	2019	2020	2021 (a)	2022 (b)
Total Revenue	**91,344**	**52,245**	**63,942**	**73,793**
Tax Revenue	81,499	43,096	55,165	59,894
Non Tax Revenue	9,845	9,149	8,777	13,899
Total Expenditure	**310,124**	**337,006**	**382,248**	**392,512**
Recurrent Expenditure	286,884	289,667	323,762	382,792
o/w Personal Emoluments	219,698	228,561	252,582	300,073
Capital Expenditure	23,240	47,339	58,486	9,720
Central Government Transfers	**218,780**	**284,761**	**318,306**	**318,719**
Block Grants	199,968	265,593	284,602	298,737
Criteria Based Grants	2,205	1,752	2,559	745
Province Specific Development Grants	11,376	11,004	12,632	5,102
Foreign Grants for Special Projects	5,230	6,412	18,513	14,135

(a) Revised
(b) Provisional

Sources: Ministry of Finance, Economic Stabilisation and National Policies
Ministry of Public Administration, Home Affairs, Provincial Councils and Local Government

Budgetary Operations in Provincial Councils

The revenue collection of PCs continued its positive momentum in 2022, with the increase in both tax and non tax revenue collection of PCs. Accordingly, in nominal terms, total revenue of PCs increased by 15.4 per cent in 2022, compared to the previous year. Tax revenue increased by 8.6 per cent in 2022, mainly benefitting from the increased revenue collection from stamp duty, which grew by 9.4 per cent to Rs. 45.1 billion in 2022 from Rs. 41.2 billion recorded in the preceding year. Stamp duty, which continued to be the major source of revenue of PCs, accounted to 75.3 per cent of the total tax revenue in 2022, compared to the share of 74.7 per cent recorded in 2021. Meanwhile, non tax revenue increased significantly by

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58.4 per cent in 2022, primarily due to the higher revenue collection from interest income, profits, and dividends, which increased to Rs. 6.5 billion in 2022 from Rs. 2.2 billion recorded in the preceding year. Meanwhile, the share of revenue from the Western Provincial Council in the total revenue collection of PCs increased to 54.2 per cent in 2022 from 52.1 per cent in 2021. Amongst other PCs, the North-Western and Southern Provinces accounted for 9.6 per cent and 9.3 per cent of the total revenue, respectively.

In line with the expenditure rationalisation measures of the Government, the growth in total expenditure of PCs moderated to 2.7 per cent in 2022, compared to the previous year, owing to the significant reduction in capital expenditure. Recurrent expenditure increased by 18.2 per cent in 2022, reflecting the rise in expenditure on personal emoluments, which remained the largest component of recurrent expenditure with a share of 78.4 per cent in the total recurrent expenditure of PCs. Meanwhile, 87.5 per cent of personal emoluments of PCs were accounted by the education and health sectors. During the year, in terms of total recurrent expenditure of PCs, the Western, Central and Southern PCs recorded the highest spending, accounting for 21.7 per cent, 12.9 per cent, and 12.7 per cent of total recurrent expenditure of PCs, respectively. With the commitment of the Government to reduce expenditure by curtailing non-essential and non-urgent capital expenditure, capital expenditure of PCs declined significantly by 83.4 per cent during the year over the preceding year.

Transfers from the Central Government to PCs increased marginally by 0.1 per cent to Rs. 318.7 billion in 2022, compared to the previous year. An increase in transfers was observed only in the category of block grants, while transfers under all other categories declined during the year. Accordingly, block grants to PCs, which represent 93.7 per cent of the total transfers, increased by 5.0 per cent in 2022. During the year, transfers under Criteria Based Grants (CBG), Province Specific Development Grants (PSDGs), and grants for special projects declined by 70.9 per cent, 59.6 per cent, and 23.6 per cent, respectively, reflecting the impact of fiscal consolidation measures of the Government. Meanwhile, transfers from the Central Government declined to 1.4 per cent of GDP in 2022 from 1.8 per cent of GDP in 2021. Moreover, central government transfers, as a percentage of total expenditure of the PCs, declined to 81.2 per cent in 2022, compared to 83.3 per cent recorded in the previous year.