

## 8. FISCAL POLICY AND BUDGETARY OPERATIONS

### 8.1 Policy Strategy

Fiscal policy has been formulated within a medium-term budgetary framework with a view to reducing the budget deficit, consistent with macro economic objectives of sustaining economic growth with price stability and external viability. The medium-term budgetary framework which was announced in the 1995 Budget placed emphasis on the correction of structural weaknesses in government fiscal operations. The medium-term fiscal adjustment efforts aim at sustaining buoyant revenue growth, containing operational expenditure and thereby preserving public investment while reducing the overall budget deficit to ease pressure on domestic borrowings. In this context, the 1995 Budget anticipated a significant reduction in the fiscal imbalance - turning the current account from a deficit to a surplus of 0.6 per cent of GDP, reducing the overall deficit from 10 per cent of GDP in 1994 to 7.5 per cent in 1995 and reducing bank financing by Rs.7,405 million or by 1.1 per cent of GDP.

The Government adopted several fiscal measures during 1995 in order to reduce the budget deficit. On the revenue front, the lower rate band of turnover tax, excise tax on petrol and consumer durables, the defence levy and Customs duty on motor vehicles were raised and an excise tax on diesel was introduced. The tax base in respect of Customs duty was strengthened by rationalising ad hoc duty waivers. Revenue collection from the defence levy was streamlined at the point of Customs. A new tax on diesel motor vehicles, other than those used for public transport, was imposed to recover the implicit price subsidy on diesel, while a further levy was imposed on luxury motor vehicles to place a tax burden on the relatively affluent in society. In order to sustain a high non-tax revenue effort, administrative fees and charges were raised. A levy on selected commercial public enterprises was also imposed.

On the expenditure side, in addition to a restraint on operational expenditures of the Government, a 10 per cent cut was imposed on the purchases of goods and services and low priority capital expenditure programmes such as purchases of vehicles and equipment and renovation of buildings. Welfare expenditure was targeted and the administrative price of wheat flour was adjusted in order to contain an emerging large subsidy on wheat flour.

The fiscal policy strategy also incorporated several vital structural reforms in respect of Customs tariffs, excise taxation, public enterprise reform and government welfare

programmes. In addition to a restriction on the use of duty waivers, Customs tariffs were converted to an ad valorem basis, except on crude oil. The highest standard rate of 45 per cent was reduced to 35 per cent and Customs duty on several items was brought down to a standard three band rate structure of 10, 20 and 35 per cent.

A comprehensive reform in respect of excise taxation was introduced towards the end of the year with the removal of a large number of items from such taxation, improving tax administration and reducing the high tax burden on domestic industries. The prohibitive excise tax on beer was reduced with a view to improving investment in the local beer industry. Separate taxes on processed tobacco and cigarettes were unified into a single stage excise on the sale of cigarettes in order to simplify and improve tax administration.

With a view to encouraging capital infusion, revitalising the role of private sector in strategic enterprises and improving the fiscal situation, the Government re-organised the programme of public enterprise reforms covering enterprises in infrastructure, plantations and commercial activity. Institutional arrangements to undertake such reforms in an orderly manner were set in place with the task force on public enterprise reform being converted into a Public Enterprise Reform Commission by statute.

Reform on the fiscal front also concentrated on government welfare programmes. Recognising the importance of having a well targeted programme for poverty alleviation, the Government introduced a new programme, named Samurdhi, in place of the food and kerosene stamp schemes, the school mid-day meal and the Janasaviya programmes. This programme targeted about 1.2 million families outside the Northern and Eastern provinces for direct assistance from the Government.

### 8.2 Budget Out-turn

The fiscal operations in 1995 made significant progress towards fiscal consolidation. The current account deficit dropped to 1.5 per cent of GDP in 1995 from 2.9 per cent in the previous year. The overall budget deficit dropped from 10 per cent of GDP in 1994 to 8.4 per cent of GDP in 1995.

Under the impact of various policy reforms and with a buoyant revenue growth witnessed in personal income tax and taxes on domestic goods and services, together with levies on selected public enterprises, government revenue increased to 20.6 per cent of GDP in 1995 from 19 per cent

**Box 4****Subsidies as a Social Safety Net**

Improving the quality of life through high and sustained economic growth with equity is the ultimate goal of economic policy. The benefits of economic growth are expected to trickle down to all groups including the poorest segments of society. However, there are imperfections in the trickle down process and some segments of the population are sometimes deprived of the benefits. Therefore, governments have a moral responsibility to safeguard the interests of such groups. In Sri Lanka, the provision of assistance to the poor and the weak through subsidies has been high on the agenda of all governments.

People who deserve welfare assistance can be grouped into two categories, namely, (i) the 'permanently poor', i.e., the dependent population including the aged, the chronically ill, the invalid, the disabled, orphans and children deprived of family care and (ii) the 'temporary poor', i.e., people who are economically employable, but are below the poverty line due to various reasons. Social welfare schemes should be targeted to provide the assistance required by these two groups. A permanent welfare programme is necessary for the first category. The poverty of the second group, however, is best addressed by policies and programmes which promote income opportunities for the poor.

Relief measures such as the food subsidy scheme and the rice ration scheme provided by the colonial government during the second world war had a direct impact on the policies of post-Independence governments in Sri Lanka. This role of helping the needy in times of insecurity has been largely misunderstood by society. It was interpreted as a compulsory 'generosity' of the Government and became an integral part of development programmes. This forced post-Independence governments to provide extensive welfare services such as subsidies on essential food items (mainly rice), free education, free health services and subsidised public transport indiscriminately to all groups. However, these policies were effective in enhancing living standards. Sri Lanka has achieved a high rating on most social indicators, particularly in the fields of education and health, superior to most of her Asian neighbours, although the country's economic growth has not been impressive. Meanwhile, ever increasing costs of the indiscriminate provision of welfare services to an ever-growing population imposed a considerable strain on successive government budgets and eroded budgetary resources, thus crowding out investment and growth.

With the shift to open economic policies in the late 1970s, the distortions created by price subsidies were

removed to allow markets to operate efficiently. One major feature of government expenditure policy was to rationalise welfare expenditure while safeguarding the poor through targeted subsidies and income transfer programmes. By 1986, welfare programmes had been streamlined. This included better targeting of food stamps, kerosene stamps, school season tickets, mid-day meals and free text books for school children as well as the infant milk food subsidy. Gradually, however, the safety net was indiscriminately widened again to cover items such as free uniforms to all school children, and recently, wheat flour and bread subsidies to the entire population.

The introduction of a generalised wheat flour subsidy in 1994 reduced the cost of living of low income groups, but led to a number of other complications. It deviated from the concept of targeted subsidy schemes and, once again, transformed the entire population into passive recipients of a subsidy. In fact, the composition of wheat flour consumers indicates that a large share of the subsidy benefits people in high income groups. Moreover, this subsidy distorted relative prices against rice and other food crops. In addition, the sustainability of this scheme has now been threatened due to resource constraints, creating the need for immediate corrective action. The gradual removal of the subsidy began in late 1995 and is now in progress. The direct cost of this subsidy amounted to Rs.5,000 million in 1995.

Poor targeting and resource limitations have threatened the sustainability of many welfare programmes, while their real benefits have eroded over time. Moreover, the open ended nature of some of these welfare schemes distorted resource allocation, while affecting the labour market as well. Therefore, government intervention began to focus more recently on improving the efficiency of welfare programmes through better targeting as well as encouraging the active participation of people in such programmes with the objective of improving their income generating opportunities. This was the theme of the Janasaviya programme launched in late 1989 and the Samurdhi programme introduced in 1996. These schemes were expected to link the poor to the production process by providing enhanced access to basic facilities. Their targeting was also improved through a social screening process. The Janasaviya and Samurdhi programmes have also shown that the impact of pressure groups can be minimised through such a social screening system. These programmes are consistent with the policy of assisting the 'temporary poor' by providing them with income opportunities to rise above the poverty line, the ultimate objective of the social safety net.

in 1994. However, the full impact of several new measures did not reflect in government revenue efforts due to a delay in implementation. In the wake of the escalation of defence and security related expenditure, enhanced cost of salaries and pensions to government employees, higher outlays on food subsidies and a sustained interest burden of domestic debt, the current expenditure remained around 22 per cent of GDP as in the previous year. Consequently, the current account of the budget was in deficit to the value of 1.5 per cent of GDP.

However, even with a current account deficit and public investment of 7.9 per cent of GDP, the Government was able to contain the overall budget deficit at 8.4 per cent of GDP in 1995 due to inflows on account of public enterprise reforms and receipts of past on-lending to commercial enterprises of the Government.

Although both the current account deficit and the overall budget deficit were lower than the previous year's deficits of 2.9 per cent and 10 per cent, respectively, the performance was below expectations. It is important to note that the primary deficit (the deficit net of interest payments) declined from 3.4 per cent of GDP in 1994 to 2.6 per cent of GDP in 1995, while the deficit excluding defence expenditure declined from 5.4 per cent to 3.2 per cent, underscoring the pressure from high domestic debt and defence expenditure on the country's fiscal operations. The deficit excluding the proceeds from public enterprise reforms declined from 10.5 per cent of GDP to 8.9 per cent of GDP.

The domestic resource needs of the Government were largely met through non-bank market borrowings. The balance of payments deficit and sustained high credit demand from the private sector led to a tight liquidity situation and sharp rise in Treasury bill rates and other interest rates towards end 1995. In this context, the Government resorted to increased bank financing through the sale of Treasury bills to the Central Bank. Hence, budgetary operations exerted an expansionary impact on money supply, which remained high during the year.

### 8.3 Revenue and Grants

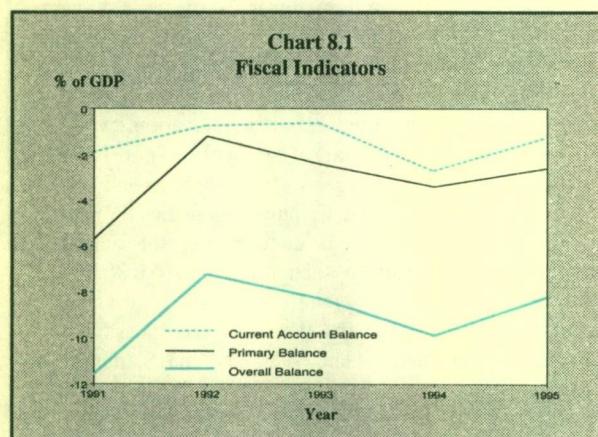
In 1995, government revenue amounted to Rs.136,258 million, recording an increase of 24 per cent compared with the growth of 12 per cent in the previous year. Tax revenue totaling Rs.118,543 million showed an increase of 19 per cent and as a proportion of GDP, increased from 17.2 per cent in 1994 to 17.9 per cent. All major sources of taxes, such as turnover tax on imports, defence levy, excise taxes, import duty and income taxes, contributed to sustain the buoyant growth in tax revenue. Non-tax revenue too marked a substantial increase of 67 per cent, under the impact of levies imposed on selected commercial public enterprises.

#### Tax Revenue

Reflecting an increased reliance on taxes on domestic goods and services such as the defence levy, excise tax and turnover taxes in the tax structure, the share of revenue from taxes on goods and services rose from 57 per cent in 1994 to 60 per cent in 1995. The revenue from this source registered a sharp rise of 25 per cent in comparison to a growth of 18 per cent in the previous year and accounted for 10.7 per cent of GDP.

The defence levy, which is imposed on all goods other than exports and on selected services, generated Rs.14,408 million (2.2 per cent of GDP), recording a 49 per cent increase in 1995. This significant improvement was attributable to an increase in the defence levy from 3.5 per cent to 4.5 per cent in June 1995 and to the imposition of this levy in respect of imports at the point of Customs instead of the previous practice of collecting this levy from banks when Letters of Credit were opened.

Revenue from turnover taxes at Rs.36,429 million sustained a growth of 13 per cent in 1995 largely due to a buoyant revenue growth from turnover tax on imports and an increase in the lowest tax band from 5 per cent to 6 per cent in February 1995. In spite of a slower growth in dutiable imports and a reduction in Customs duties, turnover tax on imports at Rs.19,449 million recorded an increase of 17 per cent compared to a 7 per cent increase in the



The use of foreign grants and concessionary aid decreased from 3.4 per cent of GDP in 1994 to 3.3 per cent in 1995 and net domestic financing of the budget deficit declined from 6.5 per cent of GDP in 1994 to 5.1 per cent in 1995. However, the target of reducing bank financing by Rs. 7,405 million was not achieved. Instead, bank financing increased by Rs. 7,065 million or by 1.1 per cent of GDP.

**TABLE 8.1**  
**Summary of Government Fiscal Operations**

Rs. Million

	1991	1992	1993	1994	1995 Approved Estimates	1995 Prov- isional	1996 Approved Estimates
Total Revenue and Grants	84,049	94,061	106,364	118,295	146,040	145,286	157,207
Total Revenue	76,179	85,781	98,339	110,038	137,110	136,258	148,207
Tax Revenue	68,157	76,353	85,891	99,417	121,324	118,543	132,645
Non Tax Revenue	8,022	9,428	12,448	10,621	15,786	17,715	15,562
Grants	7,870	8,280	8,025	8,257	8,930	9,028	9,000
Expenditure and Lending minus Repayments	119,527	116,973	140,460	167,769	186,595	191,568	208,485
Current	83,756	89,639	102,288	127,085	133,424	146,061	169,781
Capital	25,304	24,948	33,662	30,391	42,668	40,907	43,203
Lending minus Repayments	10,467	2,386	4,510	10,293	10,503	4,600	-4,499
Current Account Surplus/Deficit(-)	-7,577	-3,858	-3,949	-17,047	3,686	-9,803	-21,574
Budget Deficit (before grants)	-43,348	-31,192	-42,121	-57,731	-49,485	-55,310	-60,278
Budget Deficit (after grants)	-35,478	-22,912	-34,096	-49,474	-40,555	-46,282	-51,278
Financing	35,478	22,913	34,096	49,474	40,555	46,282	51,279
Foreign Borrowing	19,329	7,361	9,855	11,778	18,382	12,310	19,078
Domestic Borrowings	16,149	15,552	24,241	37,696	22,173	33,972	32,201
Non Market Borrowings	691	-3,205	2,012	-666	0	548	0
Market Borrowings	15,458	18,757	22,229	38,362	22,173	33,424	32,201
Non Bank	15,423	21,079	28,308	37,205	29,578	26,359	32,201
Bank	35	-2,322	-6,079	1,157	-7,405	7,085	0
As a percentage of GDP							
Total Revenue and Grants	22.6	22.1	21.4	20.4	22.1	21.9	20.3
Total Revenue	20.4	20.2	19.7	19.0	20.8	20.6	19.1
Tax Revenue	18.3	17.9	17.2	17.2	18.4	17.9	17.1
Non Tax Revenue	2.2	2.2	2.5	1.8	2.4	2.7	2.0
Grants	2.1	1.9	1.6	1.4	1.4	1.4	1.2
Expenditure and Lending minus Repayments	32.1	27.5	28.1	29.0	28.3	28.9	26.9
Current	22.5	21.1	20.5	21.9	20.2	22.1	21.9
Capital	6.8	5.9	6.7	5.2	6.5	6.2	5.6
Lending minus Repayments	2.8	0.6	0.9	1.8	1.6	0.7	-0.6
Current Account Surplus/Deficit(-)	-2.0	-0.9	-0.8	-2.9	0.6	-1.5	-2.8
Budget Deficit (before grants)	-11.6	-7.3	-8.4	-10.0	-7.5	-8.4	-7.8
Budget Deficit (after grants)	-9.5	-5.4	-6.8	-8.5	-6.1	-7.0	-6.6
Financing	9.5	5.4	6.8	8.5	6.1	7.0	6.6
Foreign Borrowing	5.2	1.7	2.0	2.0	2.8	1.9	2.5
Domestic Borrowings	4.3	3.7	4.9	6.5	3.4	5.1	4.2
Non Market Borrowings	0.2	-0.8	0.4	-0.1	0.0	0.1	0.0
Market Borrowings	4.1	4.4	4.4	6.6	3.4	5.0	4.2
Non Bank	4.1	5.0	5.7	6.4	4.5	4.0	4.2
Bank	...	-0.5	-1.2	0.2	-1.1	1.1	0.0

Source: Central Bank of Sri Lanka

previous year largely due to the rationalisation of tax exemptions and duty waivers in February 1995. Revenue collection from turnover tax on manufacturing at Rs.9,906 million was an increase of 8 per cent in comparison to a decline of 1 per cent observed in 1994. The revenue on account of turnover tax from the non-manufacturing sector at Rs.7,074 million showed an increase of 10 per cent in comparison to a growth of 34 per cent in the previous year.

Excise taxes yielded Rs.19,436 million, registering an increase of 33 per cent. They accounted for 16 per cent of tax revenue. As a proportion of GDP, they rose from 2.5 per cent in 1994 to 2.9 per cent in 1995. Excise taxes on

liquor at Rs.6,298 million showed an increase of 34 per cent, reflecting the upward revision of excise duty on liquor by Rs.17.80 per proof litre for arrack and Rs.25.90 per proof litre for locally manufactured foreign type spirits in January 1995 and increased liquor production by 9 per cent. Excise taxes on processed tobacco and cigarettes at Rs.8,788 million grew by 11 per cent due to the increase in the excise tax on cigarettes and the increase in the production of tobacco and cigarettes by 3 per cent. Meanwhile, the increase in the excise tax on petrol (from Rs.2 to Rs.7 per litre), the imposition of an excise duty of Re.1 per litre on diesel and the increase of the excise duty rates on selected consumer

durables in February 1995, enhanced the revenue collection by Rs.2,292 million to Rs.4,350 million in 1995. Excise taxes were rationalised in November 1995. In addition, separate excise taxes on processed tobacco and cigarettes were unified, according to international practice.

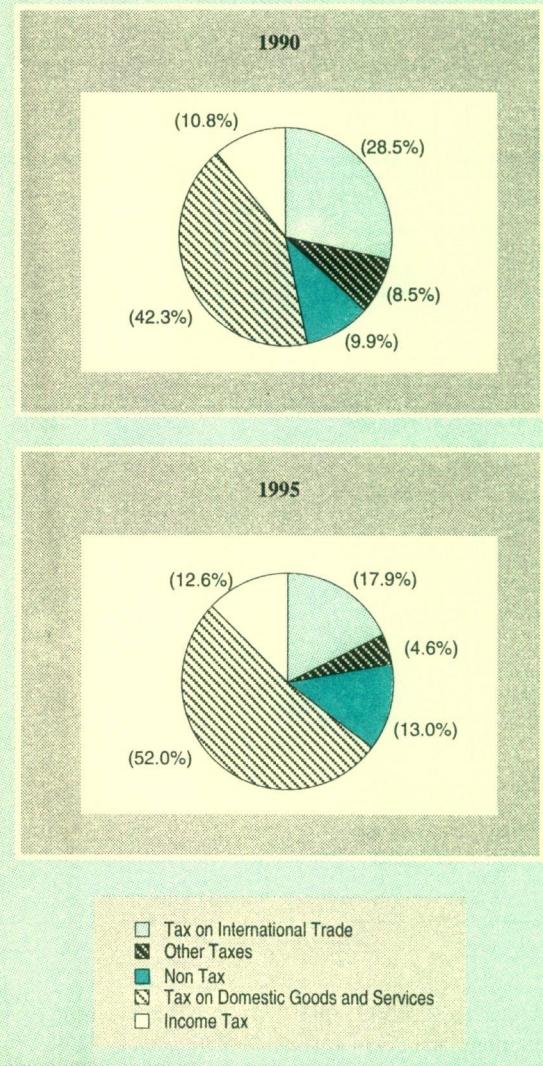
In spite of the lowering of the maximum tariff from 45 per cent to 35 per cent, the exemption of essential food items such as lentils and dried fish, the continuation of concessionary rates in respect of milk powder, sugar, cement and yarn and a slower growth of imports, the revenue from import duties at Rs. 24,365 million recorded an increase of 8 per cent. However, in relation to GDP, it declined from 3.9 per cent in 1994 to 3.7 per cent in 1995. The tariffs on imports were rationalised within a three band rate structure consisting of 10, 20 and 35 per cent. However, liquor, tobacco, passenger cars and certain luxury items were excluded from this revision on social and equity grounds. The import tariff reform together with a slower growth of imports, resulted in the import duties applicable to a wide range of commodities such as textile fabrics, agricultural machinery, implements and tools, vehicles used for public transportation, bicycles, parts and accessories of motor vehicles, which were earlier liable for higher rates of 35-45 per cent, being classified under the lower rates of 20-35 per cent.

Revenue from taxes on personal and corporate income at Rs.17,161 million accounted for 14 per cent of tax revenue. The income tax to GDP ratio remained unchanged at 2.6 per cent as in the previous year. In spite of an increase of the tax free income threshold to Rs.60,000 and a higher provision of Rs.15,700 tax credit for employment income as against a threshold income of Rs.42,000 and employment tax credit of Rs.6,000 in 1994, personal income tax collection in 1995, at Rs.7,358 million, witnessed an increase of 31 per cent. Revenue from corporate income taxes rose to Rs.9,803 million reflecting a marginal increase of 2 per cent.

Stamp duties at Rs.5,162 million showed an increase of 18 per cent in 1995. With a view to generating a buoyant revenue growth, stamp duties on receipts were placed on a sliding scale based on the value of transactions from November 1995. As a result of the increased stock of Treasury bill holdings by the Central Bank, taxes on the interest on Treasury bills held by the Central Bank generated a revenue of Rs.1,050 million. Meanwhile, license fees increased from Rs.60 million in 1994 to Rs.524 million in 1995, a sum of Rs.167 million being collected through the luxury motor vehicle and private diesel vehicle taxes which came into effect from April 1995, but were implemented in September 1995. Therefore, the full impact of this revenue measure was not felt in the 1995 budgetary out-turn. Under

this new tax on motor vehicles, an annual tax of Rs.25,000-Rs.50,000 per vehicle was levied on luxury vehicles while an annual tax of Rs.5,000 - Rs.10,000 was imposed on diesel vehicles other than lorries and those used for public transport and agriculture.

**Chart 8.2**  
**Composition of Revenue – 1990 and 1995**



### Non-Tax Revenue

Non-tax revenue at Rs.17,715 million was an increase of 67 per cent over that of the previous year. The non-tax revenue accounted for 13 per cent of total revenue in 1995. A levy of Rs.1,500 million on the Ceylon Electricity Board (CEB), Rs.1,000 million on Sri Lanka Telecom and Rs.250 million on the Ceylon Petroleum Corporation (CPC)

**TABLE 8.2**  
**Summary of Revenue by Component**

Item	1991	1992	1993	1994	1995 Approved Estimates	1995 Provi- -sional	Rs. Million 1996 Approved Estimates
<b>Tax Revenue</b>	<b>68,157</b>	<b>76,353</b>	<b>85,891</b>	<b>99,417</b>	<b>121,324</b>	<b>118,543</b>	<b>132,645</b>
Income taxes	9,722	10,967	12,543	15,277	15,420	17,161	17,299
Personal	3,539	4,067	5,235	5,621	5,270	7,358	5,537
Corporate	6,183	6,900	7,308	9,656	10,150	9,803	11,762
Taxes on property	3,541	3,597	3,493	4,386	4,667	5,162	5,839
Tax on Treasury bills held by Central Bank	3,033	1,991	1,073	471	-	1,050	-
Taxes on domestic goods and services	32,107	38,158	47,963	56,685	72,495	70,797	80,807
General sales and turnover tax	21,430	24,095	29,663	32,300	39,005	36,429	40,695
Manufacturing	7,945	8,262	9,231	9,171	11,380	9,906	9,699
Non-Manufacturing	2,974	3,546	4,825	6,445	8,180	7,074	8,772
Imports	10,511	12,287	15,607	16,684	19,445	19,449	22,224
Excise tax	10,597	10,232	11,655	14,632	20,339	19,436	21,775
Liquor	3,126	3,434	4,063	4,686	5,410	6,298	5,950
Tobacco	6,884	5,573	6,866	7,888	10,232	8,788	11,195
Other	587	1,225	726	2,058	4,697	4,350	4,630
Defence levy	-	3,764	6,589	9,693	10,887	14,408	16,090
Licence fees	80	67	56	60	2,264	524	2,247
Taxes on international trade	19,754	21,640	20,819	22,598	28,742	24,373	28,700
Imports	18,617	20,819	20,762	22,598	28,742	24,365	28,700
Exports	1,137	821	57	-	-	8	-
Tea	492	360	23	-	-	-	-
of which: ad valorem tax	298	226	-	-	-	-	-
Rubber	476	318	16	-	-	-	-
Coconut	125	117	4	-	-	-	-
Other exports	44	26	14	-	-	8	-
<b>Non-Tax Revenue</b>	<b>8,022</b>	<b>9,428</b>	<b>12,448</b>	<b>10,621</b>	<b>15,786</b>	<b>17,715</b>	<b>15,562</b>
Property income	5,964	6,262	8,154	7,360	10,140	12,856	10,082
of which: Central Bank profits	500	1,150	1,000	1,200	1,200	1,200	1,200
Interest income	2,617	3,596	4,390	4,560	5,635	6,946	6,006
Surplus of trading enterprises	2,612	1,179	-	-	-482	-	-
Fees and charges	917	1,225	1,303	988	2,613	1,751	2,650
Other non-tax revenue	1,141	1,941	2,991	2,273	3,033	3,108	2,830
<b>Total Revenue</b>	<b>76,179</b>	<b>85,781</b>	<b>98,339</b>	<b>110,038</b>	<b>137,110</b>	<b>136,258</b>	<b>148,207</b>

As a percentage of GDP

<b>Tax Revenue</b>	<b>18.3</b>	<b>17.9</b>	<b>17.2</b>	<b>17.2</b>	<b>18.4</b>	<b>17.9</b>	<b>17.1</b>
Income taxes	2.6	2.6	2.5	2.6	2.3	2.6	2.2
Personal	0.9	1.0	1.0	1.0	0.8	1.1	0.7
Corporate	1.7	1.6	1.5	1.7	1.5	1.5	1.5
Taxes on property	1.0	0.8	0.7	0.8	0.7	0.8	0.8
Tax on Treasury bills held by Central Bank	0.8	0.5	0.2	0.1	0.0	0.2	0.0
Taxes on domestic goods and services	8.6	9.0	9.6	9.8	11.0	10.7	10.4
General sales and turnover tax	5.8	5.7	5.9	5.6	5.9	5.5	5.2
Manufacturing	2.1	1.9	1.8	1.6	1.7	1.5	1.3
Non-Manufacturing	0.8	0.8	1.0	1.1	1.2	1.1	1.1
Imports	2.8	2.9	3.1	2.9	2.9	2.9	2.9
Excise tax	2.8	2.4	2.3	2.5	3.1	2.9	2.8
Liquor	0.8	0.8	0.8	0.8	0.8	1.0	0.8
Tobacco	1.8	1.3	1.4	1.4	1.6	1.3	1.4
Other	0.2	0.3	0.1	0.4	0.7	0.7	0.6
Defence levy	-	0.9	1.3	1.7	1.7	2.2	2.1
Licence fees	...	...	...	...	0.3	0.1	0.3
Taxes on international trade	5.3	5.1	4.2	3.9	4.4	3.7	3.7
Imports	5.0	4.9	4.2	3.9	4.4	3.7	3.7
Exports	0.3	0.2	-	-	-	-	-
Tea	0.1	0.1	...	-	-	-	-
of which: ad valorem tax	0.1	0.1	...	-	-	-	-
Rubber	0.1	0.1	...	-	-	-	-
Coconut	...	...	...	-	-	-	-
Other exports	...	...	...	-	-	-	-
<b>Non-Tax Revenue</b>	<b>2.2</b>	<b>2.2</b>	<b>2.5</b>	<b>1.8</b>	<b>2.4</b>	<b>2.7</b>	<b>2.0</b>
Property income	1.6	1.5	1.6	1.3	1.5	1.9	1.3
of which: Central Bank profits	0.1	0.3	0.2	0.2	0.2	0.2	0.2
Interest income	0.7	0.8	0.7	0.8	0.9	1.0	0.8
Surplus of trading enterprises	0.7	0.3	-	-	-0.1	-	-
Fees and charges	0.2	0.3	0.3	0.2	0.4	0.3	0.3
Other non-tax revenue	0.3	0.5	0.6	0.3	0.5	0.5	0.4
<b>Total Revenue</b>	<b>20.4</b>	<b>20.2</b>	<b>19.7</b>	<b>19.0</b>	<b>20.8</b>	<b>20.6</b>	<b>19.1</b>

Source: Central Bank of Sri Lanka

contributed to sustaining high non-tax revenue in 1995. Revenue from fees and charges increased from Rs.988 million in 1994 to Rs.1,751 million in 1995 following the increase of fees and charges on services rendered by Government departments by 20 per cent with effect from January 1995. Fees and charges in respect of resident visas and passports were also raised in November 1995. Interest receipts were Rs.6,946 million in 1995 as against Rs.4,560 million in 1994. Other sub-income categories such as rent, fines and forfeitures indicated marginal improvements over the previous year. In relation to GDP non-tax revenue increased to 2.7 per cent from 1.8 per cent in 1994.

## Foreign Grants

The utilisation of foreign grants for budgetary purposes during 1995 at Rs.9,028 million registered an increase of 9 per cent. Consequently, total foreign grants in relation to GDP remained at 1.4 per cent in 1995 as in the previous year. Japan and the USA continued to be the largest donors providing 64 per cent of total grants to Sri Lanka. Out of total grants, Rs.5,980 million were on account of the Public Investment Programme.

## 8.4 Expenditure

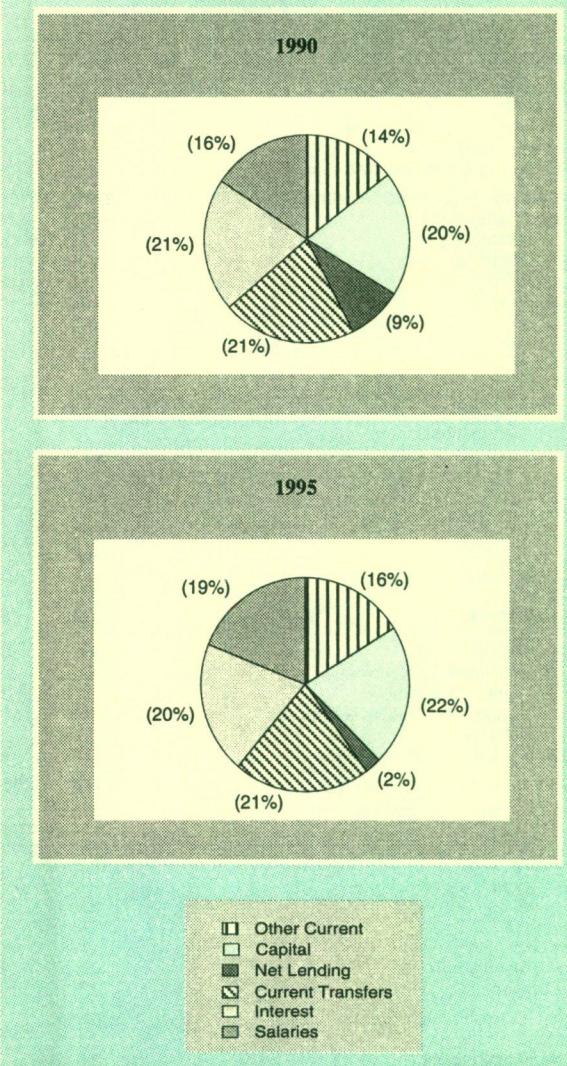
Total government expenditure and net lending at Rs.191,568 million in 1995 showed an increase of 14 per cent. However, total expenditure as a proportion of GDP declined marginally from 29 per cent in 1994 to 28.9 per cent in 1995. Current expenditure at Rs.146,061 million accounted for 76 per cent of total government expenditure while the balance 24 per cent was capital expenditure and net lending. Meanwhile, public investment, which consisted of capital expenditure and on-lending to public enterprises funded through the government budget, stood at Rs.51,994 million, accounting for 7.9 per cent of GDP in 1995.

### Current Expenditure

Current expenditure in 1995 at Rs.146,061 million was an increase of 15 per cent. As a percentage of GDP it rose marginally from 22 per cent in 1994 to 22.1 per cent in 1995.

The level of current expenditure of the Government underscored the serious short-term constraints in fiscal adjustments. Personnel emoluments and pension payments to government employees accounted for more than one third of current expenditure and absorbed nearly 38 per cent of government revenue in 1995. Following successive high budget deficits in recent years, public debt has risen to 95 per cent of GDP and interest payments accounted for a

**Chart 8.3**  
**Composition of Expenditure – 1990 and 1995**



fourth of current expenditure and used nearly 28 per cent of government revenue. In the context of high outlays on personnel emoluments, pensions and interest payments on public debt, the burden of fiscal adjustments towards a lower budget deficit falls on important public expenditure programmes such as maintenance of public assets and public investment. In addition it calls for a higher revenue effort.

In the wake of a spillover impact of ad hoc wage increases granted during 1994 and the establishment of a teachers' service with new salary scales in 1995, the wage bill of the Government at Rs.36,346 million, showed an increase of Rs.7,037 million during the year. The impact of the implementation of the new salary scale for the teachers' service amounted to about Rs.3,000 million. Moreover, the correction of salary anomalies of selected categories of public

servants on an ad hoc basis, the recruitment of around 650 graduate trainees and the grant of permanent status to casual employees in various government departments effected during 1994 also contributed to an enhanced wage bill in 1995. Expenditure on salaries and wages accounted for one fourth of current expenditure and stood at around 5.5 per cent of GDP in 1995.

Pension payments, which rose by 13 per cent in 1995, amounted to Rs.15,057 million. This increase was partly due to the grant of an overdue cost of living allowance of Rs.260 for pensioners. The total number of pensioners also continued to grow, from about 330,000 in 1994 to 342,000 in 1995.

Expenditure incurred by the Government in procuring various goods and services including electricity, communication, travelling, supplies of office requisites and defence requirements rose to Rs.31,002 million indicating an increase of 22 per cent over that of 1994. The enhancement on account of these outlays was mainly due to increased defence expenditure, following the resumption of hostilities in April 1995. The share of defence related expenditure in this category accounted for Rs.22,460 million or 72 per cent and reflected the heavy burden of defence expenditure on fiscal operations. However, due to stringent measures taken to contain operational expenditure, costs of non-defence expenditure on other goods and services declined from Rs.10,172 million in 1994 to Rs.8,542 million in 1995.

Interest payments on public debt amounted to Rs.38,226 million or 5.8 per cent of GDP in 1995. Domestic interest payments dropped marginally from Rs. 32,520 million in 1994 to Rs.32,064 million in 1995. Interest on Treasury bills dropped by 25 per cent due to the lagged effect of lower Treasury bill rates experienced in 1994 and the first four months of 1995 as against the high rates that prevailed in 1993. In contrast, interest payments on Rupee loans rose from Rs.13,808 million in 1994 to Rs.18,117 million in 1995 reflecting the impact of large borrowings made during the period July 1994 to June 1995, totaling Rs.40,168 million. The interest on foreign debt increased from Rs.5,511 million in 1994 to Rs.6,162 million in 1995. However, the average interest rate on foreign loans was around 1.8 per cent in 1995, as in the previous year, reflecting the concessional nature of foreign debt.

Transfers to public corporations and institutions increased from Rs.4,610 million to Rs.10,023 million, mainly due to a payment of Rs.5,000 million to the Co-operative Wholesale Establishment (CWE) to meet the cost of the flour subsidy. The high level of expenditure on the flour subsidy resulted from increased consumption of flour together with a sharp rise in the average price (C & F price) of wheat grain from US dollars 136 per metric ton in 1994 to US

dollars 185 per metric ton in 1995. The wheat flour subsidy, which was Rs.0.22 per kg in August 1994, rose drastically in 1995 in spite of an increase in the administrative price of wheat flour from Rs.6.65 per kg to Rs.11.15 per kg. On average, the wheat flour subsidy remained at Rs.9.02 per kg during the year. Reflecting the effect of the large price subsidy, flour issues by the Food Commissioner's Department rose by 10 per cent while total wheat imports increased by 22 per cent between these two years.

Transfer payments on account of the operational losses of the Government Railways remained virtually unchanged while those of the Postal Department dropped due to the increase in postal rates during 1995. The operational losses of railways continued to remain due to non-adjustment in fares. Welfare expenditure on multiple programmes such as food and kerosene stamps, the Janasaviya and Samurdhi Programmes, free school uniforms, free mid-day meal, season tickets, free text books, infant milk food subsidy and Thripasha care totalled Rs.10,580 million or 1.6 per cent of GDP. The expenditure for providing emergency relief to affected families and rehabilitation of displaced persons in the Northern and Eastern provinces was Rs.2,106 million. The fertiliser subsidy, which was reintroduced in October 1994, amounted to Rs.1,345 million. However, the three main welfare programmes namely, Janasaviya, food and kerosene stamps and school mid-day meal programme, were consolidated with the introduction of the Samurdhi Programme.

On a functional basis, current expenditure on social services, which includes education, health, welfare and community services, increased by 21 per cent to Rs.57,648 million in 1995, accounting for nearly 40 per cent of total current expenditure. As a share of GDP it increased from 8.2 per cent in 1994 to 8.7 per cent in 1995. Expenditure on education increased by 6 per cent over that of the previous year, due largely to the teachers' salary revisions in 1995, while expenditure on health increased to Rs.8,818 million in 1995 in comparison to Rs.7,666 million in 1994.

Current expenditure on economic services, which included operational expenditure incurred by government institutions mainly on agriculture and irrigation, fisheries, manufacturing and mining, energy and water supply, transport and communications and trade and commerce amounted to Rs.8,078 million - an increase of 30 per cent over the amount utilised in 1994. This was largely due to the full year impact of the fertiliser subsidy.

Current outlays on public administration and defence at Rs.39,986 million, showed an increase of 31 per cent over the previous year. This was mainly reflected in the increased expenditure on defence related activities, which grew from

**TABLE 8.3**  
**Economic Classification of Expenditure and Lending minus Repayment**

Rs. Million

Item	1991	1992	1993	1994	1995 Approved Estimates	1995 Provi- sional	1996 Approved Estimates
<b>Current Expenditure</b>	<b>83,756</b>	<b>89,638</b>	<b>102,288</b>	<b>127,084</b>	<b>133,424</b>	<b>146,061</b>	<b>169,781</b>
Expenditure on goods and services	35,848	39,692	44,895	54,700	55,223	67,348	82,521
Salaries and wages	17,985	20,793	26,332	29,309	32,900	36,946	39,978
Other goods and services	17,863	18,898	18,563	25,391	22,323	31,002	42,543
Interest payments	22,073	25,940	30,203	38,031	37,203	38,226	44,057
Foreign	4,113	4,739	5,102	5,511	6,361	6,162	7,351
Domestic	17,960	21,201	25,101	32,520	30,842	32,064	36,706
Current transfers and subsidies	25,835	24,007	27,190	34,353	41,480	40,487	48,103
To public corporations	1,743	1,428	1,571	2,634	7,793	7,841	6,308
To public institutions	1,405	1,649	2,031	1,976	2,343	2,182	2,739
To other levels of government	1,050	1,111	896	1,307	1,250	1,157	1,512
To households and other sectors	21,637	19,819	22,335	28,263	30,093	29,307	37,545
Food stamps, food subsidy etc.	4,023	4,466	4,580	4,654	4,750	3,343	1,081
Janasaviya / Samurdhi	3,407	3,098	3,685	5,369	4,600	5,759	11,794
Pensions	8,832	8,099	10,516	13,271	14,894	15,057	17,359
Fertiliser subsidy	-	-	-	630	1,500	1,345	1,500
Other	5,375	4,156	3,554	4,339	4,349	3,803	5,811
Provision for under expenditure	-	-	-	-	-482	-	-4,900
<b>Capital Expenditure</b>	<b>25,305</b>	<b>24,949</b>	<b>33,662</b>	<b>30,391</b>	<b>43,623</b>	<b>40,907</b>	<b>43,203</b>
Acquisition of real assets	14,072	12,604	19,719	16,747	25,428	21,908	27,313
Capital transfers	11,233	12,345	13,943	13,644	18,194	18,998	18,290
To public corporations	2,993	4,610	4,311	4,246	5,230	7,614 (a)	5,123
To public institutions	6,990	6,663	8,551	8,433	11,803	10,446	12,119
To other levels of government	950	1,028	1,036	914	1,112	921	1,000
Other	300	44	45	51	49	17	49
<b>Lending minus Repayment</b>	<b>10,467</b>	<b>2,386</b>	<b>4,510</b>	<b>10,293</b>	<b>10,503</b>	<b>4,601</b>	<b>-4,499</b>
Advance accounts	1,819	-150	410	2,462	500	-1,580	500
On lending	7,286	6,246	6,265	10,064	13,761	11,087	15,313
Restructuring cost	3,335	1,750	1,465	3,739	3,392	3,191	4,792
Privatisation proceeds	-841	-2,850	-1,200	-2,996	-4,500	-3,001	-21,000
Loan repayments	-1,132	-2,610	-2,430	-2,976	-2,650	-5,097 (b)	-4,104
<b>Total Expenditure and Net Lending</b>	<b>119,528</b>	<b>116,973</b>	<b>140,460</b>	<b>167,768</b>	<b>187,549</b>	<b>191,568</b>	<b>208,485</b>

As a percentage of GDP

<b>Current Expenditure</b>	<b>22.5</b>	<b>21.1</b>	<b>20.5</b>	<b>22.0</b>	<b>20.2</b>	<b>22.1</b>	<b>21.9</b>
Expenditure on goods and services	9.6	9.3	9.0	9.5	8.4	10.2	10.6
Salaries and wages	4.8	4.9	5.3	5.1	5.0	5.5	5.2
Other goods and services	4.8	4.4	3.7	4.4	3.4	4.7	5.5
Interest payments	5.9	6.1	6.0	6.6	5.6	5.8	5.7
Foreign	1.1	1.1	1.0	1.0	1.0	0.9	0.9
Domestic	4.8	5.0	5.0	5.6	4.7	4.8	4.7
Current transfers and subsidies	6.9	5.6	5.4	5.9	6.3	6.1	6.2
To public corporations	0.5	0.3	0.3	0.5	1.2	1.2	0.8
To public institutions	0.4	0.4	0.4	0.3	0.4	0.3	0.4
To other levels of government	0.3	0.3	0.2	0.2	0.2	0.2	0.2
To households and other sectors	5.8	4.7	4.5	4.9	4.6	4.4	4.8
Food stamps, food subsidy etc.	1.1	1.0	0.9	0.8	0.7	0.5	0.1
Janasaviya / Samurdhi	0.9	0.7	0.7	0.9	0.7	0.9	1.5
Pensions	2.4	1.9	2.1	2.3	2.3	2.3	2.2
Fertiliser subsidy	-	-	-	0.1	0.2	0.2	0.2
Other	1.4	1.0	0.8	0.8	0.7	0.6	0.7
Provision for under expenditure	-	-	-	-	-0.1	-	-0.6
<b>Capital Expenditure</b>	<b>6.8</b>	<b>5.9</b>	<b>6.7</b>	<b>5.3</b>	<b>6.6</b>	<b>6.2</b>	<b>5.6</b>
Acquisition of real assets	3.8	3.0	3.9	2.9	3.9	3.3	3.5
Capital transfers	3.0	2.9	2.8	2.4	2.8	2.9	2.4
To public corporations	0.8	1.1	0.9	0.7	0.8	1.2	0.7
To public Institutions	1.9	1.6	1.7	1.5	1.8	1.6	1.6
To other levels of government	0.3	0.2	0.2	0.2	0.2	0.1	0.1
Other	0.1	-	-	-	-	-	-
<b>Lending minus Repayment</b>	<b>2.8</b>	<b>0.6</b>	<b>0.9</b>	<b>1.8</b>	<b>1.6</b>	<b>0.7</b>	<b>-0.6</b>
of which Advance accounts	0.5	....	0.1	....	....	....	....
<b>Total Expenditure and Net Lending</b>	<b>32.1</b>	<b>27.5</b>	<b>28.1</b>	<b>29.0</b>	<b>28.4</b>	<b>28.9</b>	<b>26.9</b>

Source: Central Bank of Sri Lanka

(a) Includes Rs. 2,395 million transferred to the Shipping Corporation to clear the loan balance appearing in Treasury books.

(b) Includes loan repayments of Rs.2,395 million by the Shipping Corporation.

Rs.25,807 million in 1994 to Rs.33,424 million in 1995. This source of expenditure itself accounted for more than one fifth of total current expenditure and was 5.0 per cent of GDP.

## Public Investment

Public investment, which consisted of Rs.40,907 million on account of capital expenditure and Rs.11,087 million on account of on lending to public corporations, amounted to Rs.51,994 million or 7.9 per cent of GDP. Capital expenditure directly incurred by ministries and departments under the Public Investment Programme (PIP) for construction and development of fixed assets stood at Rs.21,908 million in 1995 in comparison to Rs.16,747 million in 1994. Public investment projects undertaken by public corporations and statutory bodies used Rs.29,147 million - an increase of 28 per cent over the previous year. Of these funds, Rs. 19,476 million was utilised by the Sri

Lanka Ports Authority (Rs.5,943 million), Road Development Authority (Rs.4,927 million), National Water Supply and Drainage Board (Rs.3,156 million), Mahaweli Authority of Sri Lanka (Rs.3,090 million) and Sri Lanka Telecom (Rs.2,360 million).

Capital expenditure incurred by public corporations and institutions by way of resources mobilised through on lending, was at Rs.11,087 million, lower than the budget estimate of Rs.13,761 million for 1995. Of the budgetary provision of Rs.4,335 million to be fully funded by foreign aid for the power distribution and transmission project of the Ceylon Electricity Board, only Rs.1,482 million was utilised. Similarly, of Rs.3,501 million provided for the Telecommunication Development Project, Sri Lanka Telecom utilised only Rs. 2,360 million. These shortfalls were mainly due to implementation and procedural delays. However, Sri Lanka Ports Authority utilised Rs.5,943 million - more than

**TABLE 8.4**  
**Functional Classification of Expenditure**

Item	1991	1992	1993	1994	1995 Approved Estimates	1995 Provi- sional	1996 Approved Estimates
<b>Current Expenditure</b>							
<b>General Public Services</b>	<b>19,811</b>	<b>24,453</b>	<b>27,564</b>	<b>30,444</b>	<b>31,049</b>	<b>39,986</b>	<b>48,400</b>
Civil administration	5,612	7,099	7,405	4,637	8,182	6,562	16,202
Defence	10,317	12,876	15,413	19,415	16,750	27,284	25,180
Public order and safety	3,882	4,478	4,746	6,392	6,118	6,140	7,018
<b>Social Services</b>	<b>31,594</b>	<b>32,700</b>	<b>37,477</b>	<b>47,656</b>	<b>54,932</b>	<b>57,648</b>	<b>63,194</b>
Education	7,951	10,533	11,225	14,836	14,732	15,784	13,231
Health	4,110	4,518	5,711	7,666	8,627	8,818	10,566
Welfare	19,266	17,378	20,255	24,560	30,826	32,106	38,550
Housing	-	-	-	-	-	-	-
Community services	267	271	285	593	747	941	847
<b>Economic Services</b>	<b>3,925</b>	<b>3,834</b>	<b>4,328</b>	<b>6,195</b>	<b>7,241</b>	<b>8,078</b>	<b>8,169</b>
Agriculture and irrigation	912	1,398	1,483	2,506	2,968	3,326	3,448
Fisheries	98	68	107	99	133	105	178
Manufacturing and mining	231	349	403	351	651	252	702
Energy and water supply	659	133	93	518	997	990	810
Transport and communication	1,308	1,208	1,346	2,024	1,602	2,014	1,974
Trade and commerce	137	232	203	72	105	172	287
Other	580	446	693	625	785	719	771
<b>Other</b>	<b>28,425</b>	<b>28,652</b>	<b>32,920</b>	<b>42,789</b>	<b>40,684</b>	<b>40,350</b>	<b>54,918</b>
of which: Interest	22,073	25,940	30,203	38,031	37,203	38,226	44,057
<b>Provision for Under Expenditure</b>	-	-	-	-	-482	-	-4,900
<b>Total Current Expenditure</b>	<b>83,756</b>	<b>89,639</b>	<b>102,288</b>	<b>127,084</b>	<b>133,424</b>	<b>146,061</b>	<b>169,781</b>
<b>Capital Expenditure and Lending</b>							
<b>General Public Services</b>	<b>2,422</b>	<b>1,970</b>	<b>4,085</b>	<b>2,390</b>	<b>5,006</b>	<b>5,096</b>	<b>4,335</b>
Civil administration	1,680	1,256	3,463	1,753	3,626	3,962	3,226
Public order and safety	742	714	622	637	1,380	1,134	1,109
<b>Social Services</b>	<b>2,964</b>	<b>6,137</b>	<b>6,075</b>	<b>7,677</b>	<b>11,140</b>	<b>9,854</b>	<b>12,363</b>
Education	1,178	2,008	2,845	2,877	4,126	3,124	4,418
Health	1,119	2,023	1,353	1,519	3,075	2,134	3,661
Welfare	15	1,191	1,084	1,681	289	1,690	1,145
Housing	535	767	604	802	2,099	1,610	1,256
Community services	117	148	189	798	1,551	1,297	1,882
<b>Economic Services</b>	<b>26,022</b>	<b>20,444</b>	<b>29,600</b>	<b>29,304</b>	<b>40,424</b>	<b>36,106</b>	<b>43,170</b>
Agriculture and irrigation	6,071	5,890	5,682	5,179	6,171	6,060	6,525
of which: Mahaweli Project	2,410	2,670	2,810	2,598	2,764	3,090	2,133
Fisheries	181	175	124	368	189	361	542
Manufacturing and mining	171	184	1,471	22	273	250	1,019
Energy and water supply	6,181	5,527	4,728	5,518	7,884	5,003	6,914
Transport and communication	10,921	4,363	10,165	14,522	18,639	18,888	19,696
Trade and commerce	218	365	364	182	427	20	353
Other	2,279	3,940	7,066	3,513	6,841	5,524	8,121
Other	1,250	1,072	1,081	1,084	1,161	939	1,049
<b>Total Capital Expenditure and Lending</b>	<b>32,658</b>	<b>29,622</b>	<b>40,841</b>	<b>40,455</b>	<b>57,731</b>	<b>51,884</b>	<b>58,516</b>

Source: Central Bank of Sri Lanka

the budgetary allocation, which was largely foreign funded, for the development of port facilities.

In terms of functional classification, public investment for development of economic services amounted to Rs.36,106 million (5.5 per cent of GDP). Of this amount, Rs.18,888 million or 52 per cent was on account of the transport and communications sector of which, Rs.4,927 million was utilised for the development of the road network. The Sri Lanka Port Authority and Sri Lanka Telecom used Rs.5,943 million and Rs.2,360 million. Out of Rs.6,060 million spent on agriculture and irrigation, 51 per cent was utilised by the Mahaweli Authority of Sri Lanka. Public investment in energy and water supply stood at Rs.5,003 million, which was 37 per cent lower than the original resource allocation for the development of this sector. This reduction was mainly due to the under-utilisation of funds allocated for the CEB under the on lending programme. Capital expenditure on account of social services increased by 28 per cent to Rs.9,854 million in 1995. Out of the five sectors in social services, four sectors, namely, education, health, housing and community services experienced substantial increases in public investment. Welfare services witnessed only a marginal increase. As a proportion of GDP, public investment in social services rose from 1.3 per cent in 1994 to 1.5 per cent in 1995. Total capital investment in general administration, at Rs.5,096 million, represented 0.8 per cent of GDP.

## 8.5 Public Enterprise Reforms

The Public Enterprise Reform Programme generated Rs.3,001 million. The Government completed the divestiture of a few key commercial enterprises such as Colombo Gas Company, attracting foreign capital and technology. Total revenue raised from the Colombo Gas Company transaction amounted to US dollars 37 million (Rs. 1,998 million). In addition, Capital Development Investment Company Ltd. and several plantation companies were also divested during the year. The Public Enterprise Reform Commission also initiated restructuring of Air Lanka, Sri Lanka Telecom, Orient Lanka Limited, Sevanagala Sugar, Lanka Electric Company and several other small enterprises. Recoveries from past on - lending by the Government totalled Rs.5,097 million of which Rs. 1,420 million was paid by the CEB. Annual interest payments on Government bonds held by the two state banks in respect of their restructuring programme amounted to Rs. 2,891 million.

## 8.6 Financing the Budget Deficit

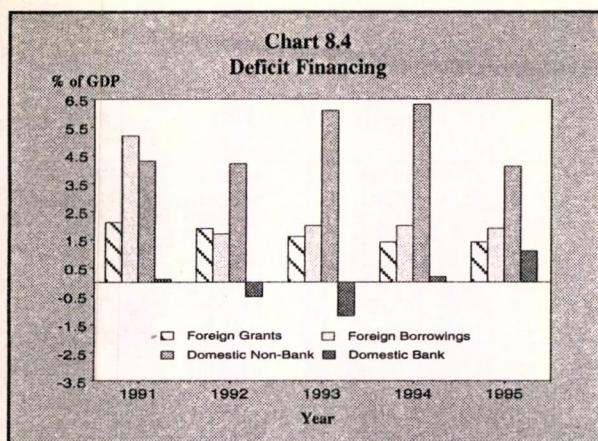
The budget deficit (after grants), at Rs. 46,282 million in 1995, marked a decline of 6 per cent or Rs.3,191 million

over that of 1994. Gross foreign resources available for financing the deficit amounted to Rs.20,787 million, an increase of 7 per cent. However, net borrowings from foreign sources amounted to Rs.12,310 million due to a repayment of Rs. 8,477 million. Moreover, it is notable that gross foreign borrowings were 21 per cent below the level expected in the budget due to project implementation delays, particularly in the case of the power and telecommunication projects which were foreign funded. Net foreign borrowings as a proportion of GDP stood at 1.9 per cent in 1995.

Gross borrowings for budgetary purposes from non-bank domestic sources through the issue of Rupee loans, Treasury bills and administrative arrangements amounted to Rs.55,075 million as compared to Rs.52,051 million in the previous year. The Government mobilised gross borrowings of Rs.46,715 million through the issue of Rupee securities. The borrowings through this source in 1994 were Rs.46,878 million. However, due to repayments of Rs. 26,329 million, net borrowing through the Rupee Loan Programme amounted to Rs.20,386 million as against Rs. 31,922 million in 1994.

As in the previous year, the Employees' Provident Fund (EPF) continued to be the major subscriber to the Rupee loan programme. Subscriptions from this source to Rupee loans in 1995, at Rs.31,420 million, showed an increase of 24 per cent or Rs.6,068 million. In contrast, total subscriptions by the National Savings Bank (NSB) to the Rupee loan programme declined from Rs.19,595 million in 1994 to Rs.14,429 million in 1995, as a result of a shift from Rupee loans to Treasury bills due to the higher yield on the latter. However, during 1995 the NSB accounted for more than 30 per cent of the total subscriptions to the Rupee loans programme. During 1995, the interest rate on Rupee loans remained at 14 per cent, while the yield on Treasury bills with one year maturity fluctuated between 13.68 and 20.54 per cent. Resources utilised through Treasury bills amounted to Rs.9,755 million. In financing the budget deficit, the Government also utilised Rs.53 million through Treasury Certificates of Deposits (TCD) and Rs.548 million through administrative arrangements.

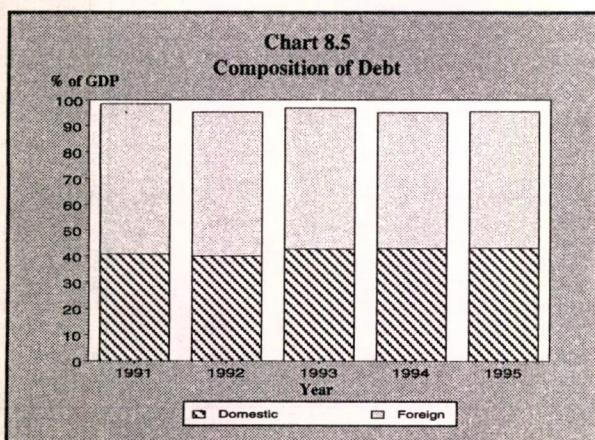
With a repayment of Rs.28,069 million, net domestic borrowings from non-bank domestic sources amounted to Rs.26,359 million in 1995 in comparison to Rs.37,205 million in 1994. Consequently, domestic non-bank financing in relation to GDP declined from 6.3 per cent in 1994 to 4.1 per cent in 1995. Thus, the budget deficit (after grants), which was 7 per cent of GDP, was financed by foreign financing - 1.9 per cent of GDP and domestic non-bank sources - 4.1 per cent of GDP, leaving a balance to be financed through the banking system. Hence, bank financing in relation to GDP increased from 0.2 per cent in 1994 to 1.1 per cent in 1995, exerting pressure on money supply.



The Government borrowed Rs. 8,760 million from the Central Bank. This consisted of Rs. 7,426 million mobilised through Treasury bills and Rs. 1,334 million on account of provisional advances. When the buildup of government cash balances with the Central Bank at Rs. 227 million and the reduction in the cash items in the process of collection by Rs.871 million were taken into account, net credit to the Government by the Central Bank amounted to Rs.7,662 million in 1995, contributing to an expansion of reserve money (high powered money) in the economy. In spite of increased holdings of government import bills (Rs.2,548 million), overdrafts to the Government (Rs. 379 million) and cash items in the process of collection (Rs. 856 million), net credit to the Government by commercial banks declined by Rs.597 million due to the reduction in holdings of Treasury bills and government securities in commercial bank portfolios (Rs.4,186 million) and a deposit build up (Rs. 194 million). Therefore, overall fiscal operations during 1995 resulted in an increase in net credit to the Government from the banking system by Rs.7,065 million.

## 8.7 Government Debt

Government debt at the end of 1995 at Rs.631,593 million increased by 15 per cent. Accordingly, the



government debt to GDP ratio continued to remain at the previous year's level of 95 cent. Domestic debt accounted for 45 per cent of total debt while the balance 55 per cent was on account of foreign debt.

### Domestic Debt

The domestic debt, which accounted for 45 per cent of the total outstanding debt, increased by 15 per cent to Rs.285,759 million at end 1995. In 1994, the domestic debt stock increased by 17 per cent over that of the previous year. Of the total domestic debt Rs.127,471 million or 45 per cent was short-term debt with maturities of one year or less. During the year under review, short-term debt increased by 17 per cent in comparison to the growth rate of 7 per cent observed in 1994. The higher increase in 1995 was attributable to increased borrowing through Treasury bills to finance the shortfall in the government cash flow. The outstanding liability on account of Treasury bills accounted for 89 per cent of the total short-term debt. The total value of Treasury bills outstanding rose from Rs.98,896 million at the end of 1994 to Rs.113,771 million at end 1995. This was the net outcome of new issues of Treasury bills amounting to Rs.16,475 million and repayments at Rs.1,600 million during 1995. In 1994, the Government raised only Rs.1,700 million through new issues of Treasury bills for budgetary purposes. The authorised limit of Treasury bills remained unchanged at Rs.125,000 million since 16 December 1992. Central Bank provisional advances, which accounted for the balance 11 per cent of the short-term debt of the Government, increased by Rs.1,334 million to Rs.13,700 million at end 1995.

Medium and long-term debt, at Rs.158,289 million, increased by 13 per cent in comparison to a rate of increase of 26 per cent in 1994. In value terms, the increase in medium and long-term debt was Rs.17,896 million. However, the Government domestic debt stock indicated a shift towards short-term debt, as the share of medium and long-term debt decreased from 56 per cent in 1994 to 55 per cent in 1995. This was a reversal of a trend observed since 1993 as the proportions of medium and long-term debt increased from 42 per cent in 1992 to 52 per cent in 1993 and further to 56 per cent in 1994. With the repayment of medium-term Treasury bill holdings of Rs.2,536 million which were in the domestic debt portfolio in 1994, almost the entirety of medium and long-term debt in 1995 consisted of Rupee loans.

As the bulk of the domestic debt was mobilised through the issue of Rupee loans, the outstanding liability on account of this debt instrument increased by 15 per cent over Rs.137,554 million, the amount outstanding at the end of the previous year. Under the Rupee Loan Programme for 1995,

**TABLE 8.5**  
**Outstanding Central Government Debt (a)**

Rs. Million

	1991	1992	1993	1994	1995 Provisional
<b>Total Domestic Debt</b>	<b>152,119</b>	<b>170,020</b>	<b>213,685</b>	<b>249,118</b>	<b>285,759</b>
Short-term	84,412	97,924	101,845	108,725	127,471
Treasury Bills	72,968	84,996	91,343	96,360	113,771
Rupee Securities	4,000	4,000	-	0	0
Provisional Advances	7,444	8,928	10,502	12,366	13,700
Medium and Long-term	67,707	72,096	111,840	140,393	158,289
Rupee Securities (b)	62,823	65,180	105,707	137,554	157,928
Treasury Bills	-	2,100	5,853	2,536	0
National Defence Bonds	4,532	4,532	-	0	0
Treasury Certificates of deposit	153	102	114	145	200
Tax Reserve Certificates	9	8	8	7	7
Administrative Borrowings	190	174	158	151	153
By Debt Instruments	152,120	170,020	213,685	249,118	285,759
Rupee Securities	66,823	69,180	105,707	137,554	157,928
Treasury Bills	72,968	87,096	97,196	98,896	113,771
National Defence Bonds	4,532	4,532	-	0	0
Treasury Certificates of Deposit	153	102	114	145	200
Tax Reserve Certificates	9	8	8	7	7
Provisional Advances	7,444	8,928	10,502	12,366	13,700
Other	191	174	158	151	153
By Institutions	152,120	170,020	213,684	249,119	285,760
Banks	52,145	58,111	90,134	100,043	113,355
Central Bank					
By Debt Instruments	42,486	34,932	16,480	21,345	28,684
Rupee Loans	10	6	-	0	0
Treasury Bills	35,032	25,998	5,978	8,979	14,984
Provisional Advances	7,444	8,928	10,502	12,366	13,700
Commercial Banks					
By Debt Instruments	9,659	23,179	73,654	78,698	84,671
Rupee Loans	414	413	24,088	24,840	24,928
Treasury Bills	9,239	22,760	49,566	53,858	59,742
National Defence Bonds	5	5	-	0	0
Other	1	1	-	1	1
By Institutions	9,659	23,179	73,653	78,698	84,671
Bank of Ceylon	6,791	15,753	40,333	39,468	42,298
People's Bank	2,182	2,938	15,690	18,363	17,802
Other	686	4,488	17,630	20,867	24,571
Sinking Fund	840	359	239	137	100
Rupee Loans	840	359	239	137	100
Non-Bank Sector					
By Debt Instruments	99,135	111,550	123,311	148,939	172,304
Rupee Loans	65,559	68,402	81,379	112,577	132,900
Treasury Bills	28,697	38,338	41,652	36,059	39,044
National Defence Bonds	4,527	4,527	-		
Treasury Certificates of Deposit	153	102	114	145	200
Tax Reserve Certificates	9	8	8	7	7
Other	190	173	158	151	153
By Institutions	99,134	111,550	123,311	148,938	172,304
National Savings Bank	26,558	30,782	37,767	46,407	48,406
Savings Institutions & Individuals	13,031	14,981	13,165	15,811	19,349
Employees' Provident Fund	45,862	54,563	65,645	79,745	96,000
Insurance Institutions	4,074	4,035	244	312	303
Finance Companies	2,427	3,131	5,868	5,942	8,420
Other	7,182	4,058	622	721	826
Departmental & Official Funds	34	428	453	556	662
Foreign Administrative Borrowings	190	174	158	151	153
Other	-	-	-	14	11
<b>Total Foreign Debt</b>	<b>214,579</b>	<b>235,539</b>	<b>270,224</b>	<b>301,812</b>	<b>345,834</b>
By Type	214,579	235,539	270,224	301,812	345,834
Project Loans	166,149	185,003	216,355	246,075	286,515
Non-Project Loans	48,430	50,536	53,869	55,737	59,320
Commodity	46,037	48,550	52,120	54,147	57,715
Other	2,393	1,986	1,749	1,590	1,604
By Institutions	214,579	235,539	270,224	301,812	345,834
Concessional Loans	202,554	225,132	260,557	292,463	335,595
Multilateral	78,084	91,067	109,284	123,016	144,636
Bilateral	124,470	134,065	151,273	169,447	190,960
Commercial Loans	12,025	10,407	9,667	9,350	10,239
External Supplier's Credit	1,260	1,094	1,065	950	1,020
<b>Total Outstanding Government Debt</b>	<b>366,698</b>	<b>405,559</b>	<b>483,909</b>	<b>550,930</b>	<b>631,593</b>
Total Outstanding Government Debt Net of Sinking Fund	365,858	405,199	483,589	550,884	631,593

(a) Values at end year.

(b) Inclusive of Rs. 24,088 million of long term bonds in 1993.

Source: Central Bank of Sri Lanka

which commenced in January 1995, Rs.46,715 million was raised through the flotation of 10 series of loans. These loans carried an interest rate of 14 per cent per annum and optional maturity periods of 5-6 years and 5-7 years. Furthermore, Rupee loans amounting to Rs.26,329 million were repaid during the year. As a result, net resources mobilised through the Rupee Loan Programme amounted to Rs.20,386 million, resulting in an outstanding Rupee loan liability of Rs.157,928 million at end 1995. This included Rs.24,088 million of long-term bonds (30 year maturity) issued under the restructuring programme of Bank of Ceylon and People's Bank. The EPF and NSB continued to be the two main subscribers to the Rupee loan programme, accounting for 81 per cent of the total outstanding Rupee loans at end 1995. During the year under review, almost the entirety of the outstanding Rupee securities, excluding long-term bonds amounting to Rs. 24,088 million, was held by the non-bank sector.

The outstanding liability on account of Treasury Certificates of Deposits (TCD), although relatively insignificant in the debt portfolio of the Government, increased from Rs. 145 million at end 1994 to Rs. 200 million at end 1995. The TCDs were issued for maturity periods of 6 and 12 months at yield rates of 17.15 and 18.06 per cent, respectively. The total rupee liability on account of foreign administrative borrowings amounted to Rs. 153 million while the liability on Tax Reserve Certificates (TRC) remained negligible at Rs. 7 million, as at end 1995.

### Foreign Debt

The total foreign debt outstanding at end 1995 amounted to Rs. 345,834 million, representing an increase of Rs.44,022 million or 15 per cent over the previous year. The increase in foreign debt was inclusive of net borrowing of Rs. 15,335 million and an additional liability of Rs.28,687 million arising from the movements of exchange rates. Foreign debt accounted for 55 per cent of total government debt as in the previous year.

The outstanding liability on account of concessional loans amounted to Rs.335,595 million - an increase of Rs.43,132 million over the previous year. This increase resulted from foreign assistance of Rs.22,634 million received on concessional terms, repayment of Rs.7,161 million and an additional liability of Rs.27,660 million on account of exchange rate variations. However, the share of concessional loans in foreign debt remained at 97 per cent as in 1994. Bilateral loans constituted Rs.190,960 million or 57 per cent of concessional loans, while the balance Rs.144,635 million had been obtained through multilateral agreements. The outstanding liability in respect of foreign loans obtained on a commercial basis amounted to Rs.10,239 million.

Liability on account of project and programme loans, at Rs.286,515 million, was an increase of Rs. 40,440 million over the level recorded in 1994. This was the net outcome of inflows of Rs. 22,246 million, repayment of Rs. 5,552 million and increase in the outstanding liability by Rs. 23,745 due to exchange rate variations. The outstanding liability on account of commodity loans rose to Rs.57,715 million, resulting from a net repayment of Rs.1,251 million and a liability of Rs.4,819 million caused by fluctuations in the exchange rates. Approximately 95 per cent of the project and programme loans were obtained from bilateral and multilateral sources while the entirety of commodity loans was from bilateral sources.

### Government Debt Service Payments

The debt service payments of the Government, at Rs. 74,772 million, which consisted of Rs.36,546 million of amortisation payments and Rs.38,226 million of interest payments, increased by 23 per cent over the previous year. Debt service payment as a ratio of GDP increased from 10.5 per cent in 1994 to 11.3 per cent in 1995, largely due to a high volume of maturing of domestic debt on account of Rupee loans, totaling Rs.26,329 million. Total domestic debt repayment, which included retirement of Treasury bills

**TABLE 8.6**  
**Effect of Exchange Rate Variation on Foreign Loans 1991 – 1995 (a)**

Item	1991	1992	1993	1994	1995*
Gross receipts	25,969	15,316	16,839	19,384	23,812
Repayments	4,881	7,955	6,984	7,606	8,477
Net receipts	21,088	7,361	9,855	11,778	15,335
Change in liability due to exchange rate variations	16,607	13,599	24,831	19,810	28,687
Liability at end period	214,578	235,538	270,224	301,812	345,834

(a) Data are based on value date recording system.  
\* Provisional

Source: Central Bank of Sri Lanka

**TABLE 8.7**  
**Government Debt Service Payments 1991 – 1995**

Item	1991	1992	1993	1994	Rs.Million 1995*
Debt Service Payments	39,855	52,018	57,493	60,702	74,772
Amortisation Payments	17,782	26,078	27,290	22,671	36,546
Domestic	12,901	18,123	20,327	15,065	28,069
Foreign	4,881	7,955	6,963	7,606	8,477
Interest Payments	22,073	25,940	30,203	38,031	38,226
Domestic	17,960	21,201	25,101	32,520	32,064
Short-Term	10,410	11,923	13,351	18,712	13,947
Medium & Long-Term	7,550	9,278	11,750	13,808	18,117
Foreign	4,113	4,739	5,102	5,511	6,162
Interest/Current Expenditure (%)	26.35	28.94	29.53	29.93	26.17
Debt Service/GDP (%)	10.70	12.23	11.50	10.48	11.30

\* Provisional

Source: Central Bank of Sri Lanka

amounting to Rs.1,600 million, stood at Rs.28,069 million in 1995. The repayment of foreign loans in 1995 amounted to Rs. 8,477 million. Of this, repayment of Rs.5,552 million was on account of project and programme loans, while Rs.2,781 million was on account of commodity loans .

Interest payments on domestic and foreign debt accounted for 26 per cent of current expenditure and 28 per cent of government revenue, imposing a heavy burden on government budgetary operations. Interest payments on Rupee securities, at Rs.18,117 million, increased by 31 per cent owing to the enhancement of outstanding Rupee loans

which resulted from a heavy dependence on the Rupee Loan Programme for financing the budget deficit in 1994 and 1995. The interest cost of Rupee loans which were raised during the second half of 1994 and first half of 1995 was reflected in 1995, as interest payments on Rupee loans are paid bi-annually. In spite of a growth in the outstanding stock of Treasury bills, interest payments on account of this instrument declined by 25 per cent to Rs.13,947 million, compared to an increase of 40 per cent witnessed in 1994 due to relatively lower yield rates experienced in 1994 and the first four months of 1995. Interest payments on foreign loans increased by 12 per cent to Rs.6,162 million in 1995.