

BUDGET ALLOCATION CRITERIA STUDY

UNICEF Sri Lanka Working Paper
June 2023



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Contents

ABBREVIATIONS	IV
KEY MESSAGES	V
1. INTRODUCTION	1
2. ALLOCATION TO SECTORS	4
2.1. Legal Framework	6
2.2. Budget Allocation Process and Key Agencies Involved	11
2.3. Special Occasions Requiring Deviations From the Normal Process	13
2.4. Key Channels of Funding	15
2.5. Criteria for Allocation of Funds	17
2.6. Main Challenges	22
2.7. Conclusion	30
3. ALLOCATION TO THE PROVINCIAL COUNCILS	31
3.1. Legal Framework	33
3.2. Budget Allocation Process	35
3.3. Key Channels of Funding	38
3.4. Criteria for the Allocation of Funds	43
3.5. Main Challenges	49
3.6. Conclusion	53
ANNEXURES	55
Annexure 1: Impact of Parliament Debates/Committee Stage Revisions	56
Annexure 2: Key Spending Agencies of the Five Social Sectors	57
Annexure 3: Devolved Sources of Revenue	59
Annexure 4: List of Agencies Interviewed & Interview Guides	60

Abbreviations

ADB	Asian Development Bank	MTMFF	Medium-Term Macro-Fiscal Framework
BG	Block Grant	NBD	National Budget Department
BTT	Business Turnover Tax	NPD	National Planning Department
CBG	Criteria Based Grant	NWSDB	National Water Supply and Drainage Board
CBSL	Central Bank of Sri Lanka	OFID	OPEC Fund for International Development
CF	Consolidated Fund	PBB	Performance Based Budgeting
ERD	External Resources Department	PC	Provincial Council
FPD	Fiscal Policy Department	PSDG	Provincial Specific Development Grant
FR	Financial Regulations	SAs	Spending Agencies
FC	Finance Commission	SDGs	Sustainable Development Goals
FUTA	Federation of University Teachers Association	VoA	Vote on Account
GDP	Gross Domestic Product	WASH	Water, Sanitation and Hygiene
IMF	International Monetary Fund	WB	World Bank
IB	Incremental Budgeting	WBB	Welfare Benefits Board
KPIs	Key Performance Indicators	WBS	Welfare Benefit Scheme
MoF	Ministry of Finance	ZBB	Zero Based Budgeting

Key Messages

- The initial budget allocation decisions by the government are guided by a legal framework (including the Constitution, organic budget laws, Standing Orders of Parliament, and the National Budget Circular), relevant policy frameworks, and historical data such as approved staffing cadres and the capacity to utilise funds.
- Absence of an overarching national Sustainable Development Goals policy and monitoring framework and an integrated national financing framework undermines effective resource allocation toward achievement of the Sustainable Development Goals.
- Actual allocation of funds to sectors and provinces is significantly constrained by the low fiscal capacity of the government, ultimately making budget allocation a supply-driven, rather than demand-driven process. Furthermore, the initial requests by Spending Agencies as well as the initial allocations by the Ministry of Finance are often unrealistic due to the lack of indicative spending ceilings for Spending Agencies; consistently overoptimistic revenue projections; and disregard of fiscal rules.
- The perennial gap between projected and actual revenue that results from overoptimistic revenue projections is typically managed by anticipated under-utilisation of capital allocations by Spending Agencies and the postponement of payments to the following budget year, rather than by reallocation of resources based on objective criteria.
- Lack of firmly defined and adhered to responsibilities across multiple levels of government in relation to resource allocation result in duplication of work, a mismatch of priorities, and inefficient use of resources. For example, there are instances where resources earmarked for projects falling under the purview of the Provincial Councils are being allocated to central government ministries without consulting Provincial Councils.
- IMF program approved in March 2023 recognises the need to address many of the identified constraints such as low revenue, overoptimistic projections, and disregard for fiscal rules. The solutions proposed include introducing a new Public Finance Management law, a new fiscal rule framework and enhancing the analytical capacity of the newly established Macro-Fiscal Unit in the Ministry of Finance. The programme however fails to recognise the importance of addressing weaknesses in the current budget allocation process to sectors as well as to the Provincial Councils.
- Overall, to increase the effectiveness and efficiency of scarce public resource use, there is a need to institute clear criteria to guide budget allocation decisions and improve the overall budget allocation process in the country.

1. INTRODUCTION

A critical “budgeting problem” that any country faces is the need to determine how to best allocate limited public funds to improve the lives of its citizens. This process requires the government to determine how much funding to allocate to different sectors as well as to different sub-regions in the country and on what basis. The lower the amount of funds available compared to the demand for such funds, this decision-making process becomes more challenging and critical.

For decades, government revenue in Sri Lanka has been insufficient to even meet the government’s recurrent expenditure needs. Revenue as a percentage of GDP fell steadily from over 20 per cent in the 1980s to 12.6 per cent in 2019.¹ Revenue plunged further in 2020 and 2021 to historically low levels of less than 10 per cent of GDP due to the economic impact of the global pandemic as well as tax revisions introduced by the government in 2019. The fall in revenue raised the budget deficit to over 10 per cent of GDP in 2021. Under these extreme circumstances, the need to allocate limited public resources in a manner that attains their best economic use is critical.

Faced with an unprecedented economic crisis caused by the sharp fall in government revenue and unable to service the country’s debt, the government reached out to the International Monetary Fund (IMF) for assistance. On 20th March 2023, the IMF Board approved a 48-month Extended Fund Facility (EFF) of about USD 3 billion to help the country recover from the current crisis. The proposed IMF-supported reform programme has identified “*reducing corruption vulnerabilities through improving fiscal transparency and public finance management*” as a key area the country needs to focus on to overcome the current crisis.²

In this context, this report aims to enhance understanding of the criteria that determine the allocation of funds from the national budget to selected sectors and to the Provincial Councils (PCs) in Sri Lanka. The criteria that influence the allocation of resources to different

sectors as well as to the provinces are an important factor affecting the efficient and effective use of limited fiscal resources.

The report examines the decision-making process and the mechanisms that determine the allocation of funds to (1) five selected social sectors: education, health, child protection, social protection and water and sanitation; and (2) sub-national governments (i.e., PCs). The report also endeavours to identify the main constraints that limit the efficient and effective allocation of funds to the sectors and to the PCs.

It is important to note that actual disbursement by the Ministry of Finance (MoF) and the actual utilisation of funds by the respective Spending Agencies (SAs, e.g., ministries, government departments, and the PCs) can be different from the initial funding allocations due to various factors. This report does not go into that level of analysis. Its central focus is on the key criteria and key factors that shape the decisions made on the initial allocation of funds from the national budget to the selected sectors and to the PCs.

The data and information for the analysis were gathered by reviewing the available literature on the subject and through interviews with eleven current and former senior government officials attached to the MoF, the Finance Commission (FC), and respective line-Ministries. During the literature review, documents reviewed included research reports, legislative acts, public regulations, government policy documents, guidelines and circulars issued by the government.

The remainder of the report is divided into two sections. The first section focuses on the allocation of funds from the national budget to the five selected sectors. This section mainly focuses on allocation to the sectors at the national level. It does not provide a detailed analysis of provincial level allocations to sectors due to the dearth of sector level data and information at the provincial level.

1 Central Bank of Sri Lanka. Annual Report 2021. Statistical Appendix. https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/publications/annual_report/2021/en/16_S_Appendix.pdf

2 “IMF Staff Reaches Staff-Level Agreement on an Extended Fund Facility Arrangement with Sri Lanka”. IMF, 1 September 2022. www.imf.org/en/News/Articles/2022/09/01/pr22295-imf-reaches-staff-level-agreement-on-an-extended-fund-facility-arrangement-with-sri-lanka

The second section focuses on allocation of funds to the PCs. Each section provides an overview of (i) the legal framework; (ii) the budget allocation process; (iii) the key agencies involved; (iv) the key channels of funding;

(v) the frameworks and criteria used to allocate funds; and (v) the key constraints decision-makers face in the budget allocation process. The sections then conclude with a summary of the key findings.

2. ALLOCATION TO SECTORS

This section of the report focuses on the allocation of funds from the central government budget to selected social sectors/sub-sectors: health, education, child protection, social protection, and water and sanitation. The study finds that the criteria used to allocate resources to

the five selected sectors are largely similar to the criteria used in general for all sectors. That is, the literature and interviews did not suggest that special factors or additional criteria were considered in allocating funds to the five selected sectors that are the focus in this report.

2.1. Legal Framework

According to an IMF report, the general legal framework that governs the preparation, approval, and execution of the national budget in a country consists of the relevant provisions in the country's constitution, the budget organic law and the country's financial regulations.³ This section provides an overview of the key legislation that forms the legal framework governing national budget

preparation in Sri Lanka. This includes the Constitution of Sri Lanka, the Appropriation Act, the Financial Regulations (FRs), the Fiscal Management (Responsibility) Act (FMRA), the Foreign Loans Act, Standing Orders of Parliament; and circulars issued from time to time by the Ministry of Finance (MoF).

2.1.1. The Constitution of Sri Lanka

In general, a country's constitution can help clarify three important aspects in relation to its public finances: (1) the relative powers of the executive and legislative branches with respect to public finances; (2) the definition of the financial relations between national and sub-national levels of government; and (3) the requirement, for example, in Commonwealth systems (like Sri Lanka), that all public funds be paid into designated accounts and that these funds be spent only under the authority of a law.⁴

Chapter XVII of the Constitution of Sri Lanka clarifies the powers that Parliament has over public finance in the country. Article 148 states that Parliament has full control over public finance in Sri Lanka. Article 149 (1) states that funds of the Republic (such as taxes, duties,

and other revenues) that are not already allocated for a particular purpose are to be credited into one Consolidated Fund (CF).⁵ Article 150(1) states that funds can only be withdrawn from the CF with a warrant from the Minister of Finance.⁶ Article 151 allows Parliament to create a "Contingencies Fund for the purpose of providing for urgent and unforeseen expenditure" that can be drawn on if the Minister of Finance is satisfied that there is a need for such expenditure.

As discussed further in Section 3 of this report, financial relations between the national and sub-national levels of government are defined in Chapter XVII A of the Constitution.

3 Guidelines for Public Expenditure Management. Section 3 - Budget Preparation. International Monetary Fund

4 *Ibid.*

5 Government of Sri Lanka, the Constitution of the Democratic Socialist Republic of Sri Lanka. Revised edition 2021, Article 149 (1). <https://www.parliament.lk/files/pdf/constitution.pdf>. (Last accessed 16 September 2022)

6 A warrant is a document issued by a legal or government official authorising another body to carry out an action relating to administration (in this case, in relation to government finance).

2.1.2. The Appropriation Act

The annual Appropriation Act provides funds to meet the expenses of the government during the financial year and authorises the raising of loans outside Sri Lanka. It makes financial provision for the various activities of the government during the financial year and enables payment for such activities by way of advances out of the CF or any other fund.⁷

Each year, the Appropriation Bill outlines the proposed allocation of funds for government agencies for a given financial year and then goes through three readings in Parliament before it is approved and becomes the Appropriations Act. If a Member of Parliament (MP) wishes to make amendments to the Appropriation Bill, s/he must give notice of these amendments during the debate on the second reading. Such amendments will be approved/rejected during the parliamentary committee stage debates that take place during the third reading of the budget (see Section 2.2 for the key steps in the budget preparation and approval process). As a result of the parliamentary committee stage amendments, the final approved allocations included in the Appropriation Act can be higher or lower than originally proposed in the Appropriation Bill (see Annexure 1 for the

variations between the original allocations proposed in the Appropriation Bill and the final allocations approved in the Appropriation Act for selected ministries).

Under Article 150, paragraph 3 of the Constitution, if the parliament is dissolved by the President before the Appropriation Bill for that financial year has passed into law, and if the parliament has not made any other provisions, then the President can issue funds that are necessary for the functioning of the public service from the CF until a new parliament is summoned in three months.

Under Article 49(2) of the Constitution, rejection of the Appropriation Bill by the parliament is one of the reasons that leads to the dissolution of the Cabinet of Ministers.⁸

The 'Budget Estimates' provides the legislature with a detailed breakdown of the budget and is tabled in Parliament along with the Appropriation Bill during the second reading of the budget. During the third reading, amendments that are accepted are incorporated into the final version of the Appropriation Bill and become part of the approved Budget Estimates.

2.1.3. The Financial Regulations

The FR were developed in 1992 to facilitate the conduct of financial transactions in an orderly manner, and are legally binding on all government departments, statutory boards, and similar institutions. Section 1 of the FR provides guidelines for the preparation, submission, and approval of expenditure estimates for the national budget.⁹

According to Financial Regulation 3 (FR.3) Section 1, all activities of the government should be predetermined and set out in plans and programmes. The expenditure

estimates for a particular financial year are the financial expression of all the government's programmes of activity during the year. Capital projects are to be incorporated into annual expenditure estimates based on the Public Investment Programme (PIP) of the government and allocations are to be made under two categories: ongoing and new projects.

FR.3 also states that planning units of respective ministries are responsible for the *"preparation, revision and implementation of long and medium-term sectoral plans,*

7 Government of Sri Lanka, Parliament of the Democratic Socialist Republic of Sri Lanka. Appropriation Act, No. 30 of 2021. <https://www.parliament.lk/uploads/acts/gbills/english/6232.pdf>. (Last accessed 18 September 2022)

8 Government of Sri Lanka, the Constitution of the Democratic Socialist Republic of Sri Lanka. Revised edition 2021, Article 49 (2). <https://www.parliament.lk/files/pdf/constitution.pdf>. (Last accessed 19 September 2022)

9 Government of Sri Lanka, Department of Public Finance. Financial Regulations (FR) of the Government of the Democratic Socialist Republic of Sri Lanka. 1992. <https://www.treasury.gov.lk/api/file/88bd6063-fe94-40b7-aa3d-d83196eb7f92> (FR.3). (Last accessed 15 September 2022)

the setting of objectives and strategies and coordination with the National Planning Department on sectoral planning.” The planning units of line-ministries are also expected to coordinate and work jointly with the National Budget Department (NBD) in the MoF when preparing their budget estimates, which should be in line with the respective line-ministry’s long and medium-term objectives and the target figures in the PIP.

The FR categorise all government expenditure into two types of expenditure: recurrent expenditure and capital expenditure. Recurrent expenditure includes all current expenditures; while capital expenditure comprises the rehabilitation, improvement, or acquisition of capital assets and the development of resources. This distinction is maintained at every level of budgetary classification and appropriations are made under these two categories.¹⁰

2.1.4. Foreign Loans Act¹¹

The Foreign Loans Act, first passed in 1957 and amended multiple times thereafter (the last amendment being in 1984), governs foreign loans taken by the government as well as guarantees issued by the government to public corporations and public enterprises.¹² Under the Act, the

President, or any person authorised by the President, can sign a loan agreement, guarantee, contract, bond, promissory note, or other document on behalf of the Government of Sri Lanka.

2.1.5. Fiscal Management Responsibility Act

The FMRA was enacted to ensure that the fiscal strategy of the government is based on principles of responsible fiscal management.¹³ To achieve this objective, the FMRA sets limits on budget deficits, total government debt (or total liabilities of the government), and on government guarantees that the government must adhere to when making budgeting decisions.¹⁴ These limits are expected to influence preparation of the government’s Medium-Term Macro Fiscal Framework (MTMFF), which is a key document that outlines the overall revenue and expenditure projections of the government.

year on the day that the second reading of the budget takes place. According to Section 6 of the FMRA, the government’s Medium-Term Fiscal Policy must be specified in this statement and the government’s short-term fiscal objectives for the year are expected to be in line with medium term policy.

The FMRA also provides timelines for the publication of key public finance documents, such as the Budget, Economic and Fiscal Position Report, Mid-Year Fiscal Position Report, Final Budget Position Report, and the Pre-Election Budgetary Position Report.¹⁵

The FMRA requires the government to release a “Fiscal Strategy Statement” to the public and Parliament each

¹⁰ *Ibid.*, (FR.7)

¹¹ Department of External Resources. Foreign Loans Act No.29 of 1957 and subsequent amendments. http://www.erd.gov.lk/index.php?option=com_content&view=article&id=54&Itemid=218&lang=en. (Last accessed 24 October 2022)

¹² *Ibid.*

¹³ Government of Sri Lanka. The Fiscal Management (responsibility) Act (FMRA), No. 3 of 2003. [https://www.srilankalaw.lk/YearWisePdf/2003/FISCAL_MANAGEMENT_\(RESPONSIBILITY\)_ACT,_No._3_OF_2003.pdf](https://www.srilankalaw.lk/YearWisePdf/2003/FISCAL_MANAGEMENT_(RESPONSIBILITY)_ACT,_No._3_OF_2003.pdf) (Last accessed 01 January 2023)

¹⁴ *Ibid.*

¹⁵ Government of Sri Lanka. The Fiscal Management (responsibility) Act (FMRA), No. 3 of 2003. [https://www.srilankalaw.lk/YearWisePdf/2003/FISCAL_MANAGEMENT_\(RESPONSIBILITY\)_ACT,_No._3_OF_2003.pdf](https://www.srilankalaw.lk/YearWisePdf/2003/FISCAL_MANAGEMENT_(RESPONSIBILITY)_ACT,_No._3_OF_2003.pdf) (Last accessed 01 January 2023)

2.1.6. Standing Orders

The Standing Orders of Parliament are rules under the Constitution of Sri Lanka whereby procedure, debate, and the conduct of members in the house are regulated.¹⁶ The main purpose of the Standing Orders is to ensure that Parliament functions in an orderly manner. Article 74(2) of the Constitution states that “*until parliament otherwise provides by law or by resolution, the Standing Orders of the National State Assembly operative immediately prior to the commencement of the constitution, shall, mutatis mutandis, be the Standing Orders of Parliament*”.¹⁷

There are several Standing Orders that apply when Parliament is considering the national budget. For example, under Standing Order 50(1), once the Cabinet publishes the Appropriation Bill in the gazette, the Minister of Finance will place the bill in the Order Paper for the first reading.¹⁸ Under Standing Order 75(5), if a member intends to propose an amendment to the budget, s/he

should give notice of the amendment at the end of the second reading and during the committee stage debate, the government indicates its acceptance or rejection of the amendment.¹⁹ Under the terms of Standing Order 130(9), if there are any amendments made to the Appropriation Bill, such as reduction of the allocation to a particular programme/project, a signed written notice should be given to the Secretary General of Parliament by the minister who intends to give such notice.²⁰

Standing Orders also determine the duration of the debates and discussions in Parliament. For example, a maximum of 26 days is allotted for consideration of the Appropriation Bill; a maximum of seven days is allotted for the second reading of the bill; and a period of 22 days is allocated for the third reading, which begins with the parliamentary committee stage debates.²¹

2.1.7. National Budget Circular ('Budget Call')

A key document that guides the budget-making process of the various government agencies/bodies is the National Budget Circular, or the 'Budget Call', issued by the NBD of the MoF. The circular is issued in July of the year prior to the budget year.²² The circular is addressed to all SAs, i.e., secretaries to the ministries, PCs, heads of departments, and chairpersons of corporations and statutory boards.

The circular is prepared primarily based on two documents: the policy priorities of the government as outlined in its political manifesto, and the National Policy Framework of the current government; as well as the government's fiscal priorities as outlined in its MTMFF.

The circular broadly outlines the strategies to be followed to achieve the government's medium-term macro-economic goals; defines the areas of priority for the year; and provides guidelines to be followed when preparing budgets. The information provides a signal to SAs about factors that would form the basis on which funds would be allocated to them by the NBD. Although the Budget Call provides a list of priority areas that SAs should consider, it does not provide a breakdown of actual funds earmarked for sectors or identified priority areas.

The circular also outlines the budgeting approach that SAs must follow when preparing their budgets for the year. Interviews with senior officials and available official

16 Government of Sri Lanka, the Constitution of the Democratic Socialist Republic of Sri Lanka. Revised edition 2021, Article 74. <https://www.parliament.lk/files/pdf/constitution.pdf>. (Last accessed 26 October 2022)

17 *Ibid.*, Article 74 (2)

18 An order paper is a list of the subjects that will be discussed in parliament on a particular day.

19 Ministry of Finance and Planning. 2011. A Guide: The Budget Process. Colombo

20 Government of Sri Lanka, Standing Orders of the Parliament of the Democratic Socialist Republic of Sri Lanka. 2018. Standing Order 130 (9). www.parliament.lk/files/pdf/standing-orders-en.pdf. (Last accessed 17 September 2022)

21 *Ibid.*, Standing Order 75 (1),(5),(4)

22 The budget year is the year the particular budget is followed/used.

documents indicate that the government has adopted three different budgeting approaches in the recent past: Incremental-Based Budgeting (IBB); Zero-Based Budgeting (ZBB); and Performance-Based Budgeting (PBB).²³ IBB refers to preparation of a budget based on the current period's budgeted/actual performance as a base and adding incremental amounts for the next budget period (including adjustments for inflation). In the 'Budget Call' for 2016, the government announced a move from IBB to ZBB, which is a budgeting approach that starts from a base of zero and disregards the prior period's budgeted/actual performance.²⁴ The objective of introducing ZBB according to the 'Budget Call' for 2016, was to undertake a comprehensive review of all expenditure categories of

SAs. In 2018, however, the government abandoned ZBB in favour of PBB, where allocation of resources is tied to the achievement of specific measurable outcomes.²⁵ PBB was expected to help identify if an SA was able to utilise all the funds allocated to it.²⁶

Some officials interviewed were of the view that Sri Lanka's budgeting process is designed for programme budgeting and that to date, this approach is largely followed by ministries when formulating their budgets.²⁷ As discussed in an IMF report, program-based budgeting is an element of PBB, where agencies present and justify their budgets based on programs that have been included in their plans for the year.²⁸

23 NBD officials. Key informant interviews. 19 July 2022

24 Government of Sri Lanka, Department of National Budget. Circular No. 03/2015. Dated 29 July 2015. Colombo. 2015. <https://www.treasury.gov.lk/api/file/ab01c50a-5f42-4ba5-a4b5-69dcdaeafdcd> (Last accessed 01 January 2023)

25 Government of Sri Lanka, Department of National Budget. Circular No. 02/2017. Dated 25 July 2017. Colombo. 2017. <https://www.treasury.gov.lk/api/file/2aefff79-3723-4cb9-b0cf-55668d16cc20>. (Last accessed 12 September 2022)

26 Government of Sri Lanka, Department of National Budget. Circular No. 04/2018. Dated 17 July 2018. Colombo. 2018. <https://www.treasury.gov.lk/api/file/4a72742e-45f6-4037-9b01-8ab117ebd0fa>. (Last accessed 20 September 2022)

27 Validation Workshop with Officials. 21 March 2023.

28 IMF. A basic model of performance-based budgeting. Dated September 2009. <https://www.imf.org/external/pubs/ft/tnm/2009/tnm0901.pdf> (Last accessed 06 April 2023)

2.2. Budget Allocation Process and Key Agencies Involved

The preparation of the budget for a particular year commences a year prior to it.²⁹ This section outlines the key steps in the process that the government follows when preparing the annual budget. This process is applicable to all sectors.

Step 1 Apr. – Jun.	SAs (planning units) commence preparation of their annual budgets. The early start enables them to submit estimates to the MoF within the three-week period allocated to submit estimates from the date the NBD issues the National Budget Circular.
Step 2 Jul. – Aug.	Cabinet approves the initial Cabinet memorandum that outlines the MTMFF prepared by the Fiscal Policy Department (FPD) and the government's overall revenue and expenditure position. ³⁰
Step 3 Jul. – Aug.	The NBD issues the National Budget Circular to the SAs that identifies what the government's priorities are and provides guidelines for the preparation of the SAs recurrent and capital expenditure estimates. ³¹
Step 4 Jul. – Aug.	While preparing their budget estimates, SAs send capital expenditure proposals to the National Planning Department (NPD) for approval. ³² If approved by the NPD, they are added into the SAs budget estimates.
Step 5 Jul. – Aug.	The chief accounting officer of each ministry reviews the estimates of each department within the ministry to ensure that they have been prepared in conformity with the Financial Regulations and that the proposed estimates can be achieved during the financial year and then forwards the estimates to the Director General of the NBD.
Step 6 Aug. – Sep.	The MoF issues a public call asking for proposals to be included in the budget from all stakeholders, including the general public. The MoF also conducts ad-hoc consultations with selected stakeholder groups, such as business associations, chambers, and professional associations. ³³
Step 7 Aug. – Sep.	MoF/NBD hold discussions with SAs, revenue departments, and other stakeholders on budget allocations to sectors, ministries, other institutions, and to programs and projects based on priorities within the government's overall development framework.
Step 8 Aug. – Sep.	The NBD finalises its budget estimates and prepares the Appropriation Bill and then submits it to the Cabinet of Ministers for approval. Once approved, the Appropriation Bill is published.
Step 9 Oct.	First reading of the budget: After Cabinet approval and publication of the Appropriation Bill, it is presented to Parliament.

29 NBD officials. Key informant interviews. 19 July 2022

30 Ministry of Finance and Planning. 2011. A Guide: The Budget Process. Colombo

31 *Ibid.*

32 NPD Officials. Validation Workshop. 21 March 2023.

33 Ministry of Finance. 26 September 2018. Ministry of Finance calls for proposals for budget – 2018. <https://www.treasury.gov.lk/api/file/33a110c0-058b-4590-8d6f-f3f1074bb43a> (Last accessed 19th April 2023)

Step 10 Nov.	Second reading of the budget: The detailed Budget Estimates are presented to Parliament and the Minister of Finance delivers the budget speech. Parliamentary debate on the content presented lasts no more than seven days. ³⁴ At the end of the debate the Appropriation Bill is put to a vote.
Step 11 Nov./Dec.	Third reading of the budget: This takes a maximum of 22 days from the end of the second reading debate. The third reading begins with the parliamentary committee stage debates, where budget heads and proposed amendments are debated, voted on, and ultimately included in the final version of the Appropriation Bill. ³⁵
Step 12 Dec.	The budget is passed by Parliament.

34 Standing orders prescribe that not more than seven days should be devoted to the debate on the second reading

35 Asian Development Bank. Public Financial Management Systems. 2018. | Ministry of Finance and Planning. 2011. A Guide: The Budget Process. Colombo | UNICEF. Budget Brief: Budget Cycle and Processes. 2019

2.3. Special Occasions Requiring Deviations From the Normal Process

The general practice outlined above is deviated from in two possible circumstances: (1) when a general election has been called and a new parliament has not yet been elected; or (2) when a new government has just been sworn in and has not yet had time to present its annual budget to the parliament. In these situations, Parliament resorts to passing a Vote on Account (VoA).³⁶

A VoA is a resolution passed in Parliament to allocate funds for government activities in the absence of an approved Appropriation Act. It is a convention adopted by Parliament and is not mentioned in either the Constitution or the Standing Orders. Parliament does not

allocate funds for new projects, but only for those that are in progress. Government departments and public agencies are allocated funds to the extent that essential services for the public can be maintained.³⁷

In 2020, two VoAs were passed by Parliament. A presidential election at the end of 2019 and insufficient time to prepare and present the Appropriation Bill for 2020 were reasons for the VoAs. This was the first time in Sri Lanka's history that the government deviated from the usual process and carried out expenditure activities for a full year without having in place an Appropriation Act approved by Parliament.³⁸

2.3.1. Key government agencies

This section outlines the key government agencies that are involved in the formulation of the budget and allocation of funds from the national budget to different sectors at the central government level.

Ministry of Finance

The responsibility for preparing the annual budget lies mainly with the MoF, with input from line-ministries and other SAs. There are several departments within the MoF that play a critical role in budget formulation.

The Fiscal Policy Department is responsible for formulating the Medium-Term Fiscal Policy Framework (MTFPF) of the government, which is an important document that guides the government's budget allocation decisions.

The National Budget Department is the key agency within the MoF that plays the leading role in the formulation of the national budget.³⁹ The NBD issues the national budget circular to SAs, which is an important guiding document used by SAs in the preparation of their budgets. The NBD is the key agency with whom the SAs negotiate their respective budget allocations. According to an official

36 Parliament of Sri Lanka <https://www.parliament.lk/en/how-parliament-works/appropriation-bill-the-budget?showall=&start=2>

37 *Ibid.*

38 Background on Vote on Account. PublicFinance.lk, <https://publicfinance.lk/en/topics/Background-on-Vote-on-Account-1620670477>

39 Guidelines for Public Expenditure Management. Section 3 - Budget Preparation. International Monetary Fund. <https://www.imf.org/external/pubs/ft/expend/guide3.htm>

from the NBD the consultation with the NBD provides the SAs with an opportunity to make the NBD and MoF aware of sectoral needs and priorities. At the same time, NBD independently prepares a 'shadow budget' based on historical data, such as previously approved staff and past utilization of allocated funds.⁴⁰ The budgets submitted by SAs are then compared to the shadow budget when finalising allocations.

The National Planning Department is responsible for approving capital projects proposed by the SAs. The government's medium-term PIP (discussed in detail in Section 2.4.4) is prepared by the NPD. Although the NPD is not directly involved in budget formulation, given its role in approving capital projects, it is an important decision-maker that influences the allocation of funds for capital projects proposed by the SAs.

The External Resources Department (ERD) is responsible for coordinating and negotiating the mobilisation of external funds and ensuring that these funds are channelled through the national budget. It is also responsible for managing public external debt by maintaining the government's debt portfolio via a debt management system. This is done by recording relevant debt-related data such as loan/grant commitments, disbursements, interest/principal payments, exchange rates, interest rates, and relevant macroeconomic data.

Spending agencies

SAs include ministries, departments, public corporations, statutory boards, and PCs. The role of SAs in the budget process is to formulate and negotiate with the

NBD an annual budget for the SA that is in line with the government's priorities and their own sectoral plans, programmes, and projects. The SAs involved in the budget formulation process for the five selected social sectors are listed in Annexure 2. Sri Lanka has a highly fragmented ministerial structure, where a single sector may fall under multiple ministries in any given year. In 2022, there were 15 line-ministries that covered different aspects of selected sectors of focus of this study; health, education, child protection, social protection, and water and sanitation.

Cabinet of Ministers

The Cabinet of Ministers plays a critical role from the beginning to the end of the budget formulation process. Key documents, such as the MTFPF, must be approved by the Cabinet. The Appropriation Bill prepared by the NBD must also be approved by the Cabinet before it is published and tabled in Parliament.

Parliament

As mentioned in Section 2.1 above, under Article 148 of the Constitution of Sri Lanka, Parliament has full control over the public finances of Sri Lanka. The 24-day-long budget debate in Parliament plays a crucial role in determining the final allocations that are then approved and made into law.⁴¹ As shown in Annexure 1, the final allocations to SAs approved by Parliament can be higher or lower than the original allocations approved by the Cabinet of Ministers. The budget must be approved by a simple majority in Parliament (above 50 per cent, or 113 votes) for it to become effective.

40 Officials of the NBD. Key informant interviews. 23 June 2022

41 The number of days is subject to slight change each year. However, to reiterate, the maximum number of days is 26 as stated in Standing Order 75 (1).

2.4. Key Channels of Funding

The major sources of funding for all five sectors considered in this study fall under two broad categories: (1) domestic funding; and (2) foreign funding.

2.4.1. Domestic funding

The main source of domestic funding is the CF, which consists of government tax and non-tax revenue. The government also borrows from domestic financial institutions to bridge the gap between revenue and expenditure.

In addition, there are a few other sources of non-tax revenue outside the CF that finance expenditure in the five selected sectors, including funding from registered and approved Non-Governmental Organisations (NGOs) and from philanthropists. However, these contributions fall outside national budget allocations.⁴²

2.4.2. Foreign funding

Foreign financing comprises (1) borrowings from external sources and (2) grants from external sources. Borrowings can be foreign loans taken directly by the central government; guarantees issued by the government for foreign loans taken by public entities, such as the National Water Supply and Drainage Board (NWSDB); and borrowings from financial markets through issue of International Sovereign Bonds (ISBs). The main multilateral institutions that provide foreign loans to the five selected social sectors are the World Bank (WB), the Asian Development Bank (ADB), and the OPEC Fund for International Development (OFID). The main bilateral lenders are Japan (through JICA), China, Saudi Arabia, and South Korea (through KOICA). The main providers of grants to the

selected sectors are UNICEF, UNESCO, DFAT Australia, and the World Food Programme.⁴³

As mentioned above, statutory boards such as the NWSDB (which is a key institution in the WASH sector) can borrow directly from domestic and foreign sources. As an example, after 2015, direct borrowing by the NWSDB expanded following the government's issue of Treasury Bonds to strengthen NWSDB's balance sheet and enable autonomous borrowing. In 2017 and 2018, funds raised through Treasury Bonds accounted for 55 per cent and 70 per cent of total WASH expenditures respectively.⁴⁴ This share has since declined, however, with only 37 per cent of expenditures in the WASH sector financed through

42 Due to lack of published data, the percentage contribution of these funds to the sectors cannot be estimated.

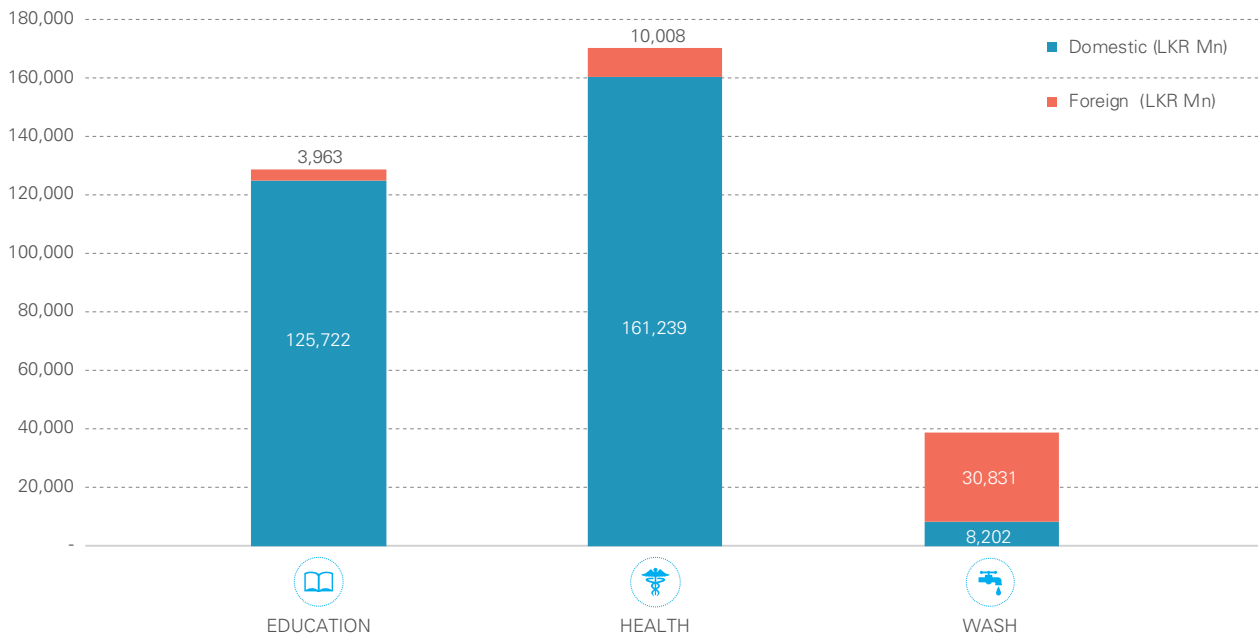
43 Ministry of Women, Child Affairs and Social Empowerment. Key informant interview. 9 August 2022 | UNICEF. Budget Brief: Education sector. 2019 | Study on Educational Planning and Management. National Education Commission. 2016

44 UNICEF. Budget Brief: Water, Sanitation and Hygiene (WASH) sector. 2021

direct borrowings in 2019.⁴⁵ Foreign financing accounted for a significant share of WASH sector expenditure until

2020, with the bulk of foreign financing comprising loans taken by the NWSDB for capital projects.⁴⁶

Exhibit 01: Main Sources of Funding in Selected Social Sectors, 2015-2020 (average annual actual value in LKR million)*



*Note: Data is not available for the social protection and child protection sectors as allocations are split across multiple ministries and the breakdown of funding by source is not available for those line items.

Source: Author's calculation using Budget Estimates 2015 – 2021

A reduction in foreign financing was seen from 2021 onwards following the onset of the major economic crisis in Sri Lanka. Sri Lanka's credit rating was downgraded by international credit rating agencies from CCC in 2020 to a default rating of RD in 2022, effectively barring the country from accessing foreign sources of finance.⁴⁷

Nonetheless revised budget estimates for 2022 (in the interim budget) suggested a rise in expectations of foreign financing during the year, as foreign financing was expected to account for 70 per cent of total WASH sector expenditures and domestic sources for just 30 per cent during the year.

45 *Ibid.*

46 *Ibid.*

47 Fitch Ratings. Sri Lanka Credit Ratings. <https://www.fitchratings.com/entity/sri-lanka-82576767>

2.5. Criteria for Allocation of Funds

This section outlines the criteria that influence the allocation of funds from the national budget to different sectors. In general, government allocation decisions

are governed by multiple guidelines, documents, and frameworks and as mentioned at the beginning of Section 2, these factors are largely the same across all sectors.

2.5.1. National Policy Framework/Political Manifesto

The political manifesto of the incumbent political party along with the National Policy Framework of the government (which usually aligns with the party's manifesto) are key documents that guide the allocation of funds from the national budget to the sectors. A 2011 publication by the ERD of the MoF entitled "A Guide: The Budget Process" states that the national budget functions as a means of 'materialising' the political mandate of the incumbent government that is outlined in its political manifesto.⁴⁸ The political manifesto, according to the ERD, becomes the foundational document that guides and shapes the government's policy framework and budget allocation decisions.⁴⁹

Following the last presidential election in 2019, the official government policy document, 'National Policy Framework: Vistas of Prosperity and Splendour' (which was also the political manifesto of the elected President) became the key document that was referred to when formulating budgets during the President's tenure.⁵⁰ The national budget circular issued by the NBD for 2022, for example, specifically stated that budget estimates would be prepared "in line with the government policy statement 'Vistas of Prosperity and Splendour', while controlling the pandemic situation."⁵¹

2.5.2. Medium-Term Macro-Fiscal Framework

The MTMFF is the principal document that contains the national level revenue and expenditure estimates that guide NBD's allocation decisions. The MTMFF identifies budget deficit, revenue, and expenditure targets – among other statistics – for a period of five years. Based on the MTMFF, the FPD provides ceilings for capital and recurrent

expenditure for the NBD to consider when deciding on allocations to the respective sectors/SAs.

The National Budget Circular issued by the NBD to all SAs (see Section 2.4.3 for details) outlines the MTMFF and strategies that SAs need to adopt as they prepare

48 Government of Sri Lanka. Ministry of Finance and Planning. A Guide: The Budget Process. 2011

49 Government of Sri Lanka. External Resources Department 'Governance/Institutional Framework of Sri Lanka in National Budget Making Process'. 21 November 2019. http://www.erd.gov.lk/images/governance_framework_in_budget_making.pdf

50 Verité Research. Public Report on the 2021 Budget. Assessment on whether the expenditure allocations and taxation policies are in line with the government's policy. March 2021

51 Government of Sri Lanka. Ministry of Finance. National Budget Circular No. 01/2021. 28 July 2021

their requests for funding to enable the government to achieve its macro-economic goals. For example, the circular issued for Budget 2023, which was prepared under extremely tight fiscal conditions, stated that the common objective for all public institutions in preparing their budgets should be “making a transformative impact via minimum inputs.”⁵² The circular further stated that Budget 2023 should aim to achieve a “2 percent surplus of GDP in the primary account balance at the end of the

2023–2025 medium term.”⁵³ A key strategy for 2023 to achieve this goal was identified as “reducing recurrent expenditure and eliminating unnecessary expenditure”. The circular listed specific activities that the agencies should do to achieve this.⁵⁴ By making these statements, the MoF sent a clear signal to the SAs that achievement of medium-term fiscal targets as outlined in the MTMFF would be a key determinant of the allocation decisions for 2023.

2.5.3. Sectoral policies, plans and programmes

The sectoral policies, plans, and programmes developed by the SAs are expected to guide the preparation of their sectoral budgets. As discussed above, FR.3 states that the planning units of each ministry should prepare long-term and medium-term sectoral plans in coordination with the NPD. According to FR.3 (e), budget estimates for ministries should be prepared in line with sectoral plans and the medium-term and long-term objectives identified. Officials interviewed from the respective line-ministries confirmed that ministry budgets were prepared based on sector priorities identified in the sectoral plans, while taking into consideration the guidelines provided by the government in the National Budget Circular.⁵⁵ The sectoral budgets are then finalised by the NBD after having discussions with the respective SAs.

With respect to the five sectors of focus for this analysis, three of the sectors – education, health, and water and sanitation – usually have a dedicated ministry overlooking the sector. However, for the remaining two sectors – social protection and child protection – there is no dedicated ministry, and expenditure in these sectors falls under multiple ministries. The implications that this has on the preparation of sector level policies and the efficient and effective allocation of funds to meet the needs of these sectors are discussed in detail in Section 2.6.7.

2.5.4. Public Investment Programme

According to FR.3, the PIP of the government forms the basis on which capital investment projects are incorporated into annual expenditure estimates. The NPD prepares the PIP with a four-year, medium-term perspective. The PIP identifies how investible resources available to the government are to be allocated to

different sectors.⁵⁶ The strategic direction for the PIP is derived from the National Policy Framework of the government.⁵⁷

Both ongoing and new programmes and projects approved by the Cabinet are included in the PIP.⁵⁸

52 Government of Sri Lanka, Department of National Budget. Circular No. 05/2022. Dated 2 September 2022. Colombo. 2022. <https://www.treasury.gov.lk/api/file/f23be152-fbb5-472f-b499-789a9b5d091d>. (Last accessed 18 January 2022)

53 *Ibid.*

54 *Ibid.*

55 Line-ministry officials. Key informant interviews. June 2022 – August 2022

56 Government of Sri Lanka. Department of National Planning. Public Investment Programme. [https://www.npd.gov.lk/index.php/en/2017-03-02-07-02-41/publications/38-public-investment-programme.html#:~:text=The%20Public%20Investment%20Programme%20\(PIP,sectors%20and%20various%20government%20agencies](https://www.npd.gov.lk/index.php/en/2017-03-02-07-02-41/publications/38-public-investment-programme.html#:~:text=The%20Public%20Investment%20Programme%20(PIP,sectors%20and%20various%20government%20agencies).

57 Government of Sri Lanka. Department of National Planning. Public Investment Programme (2021 – 2024). 2021. https://www.npd.gov.lk/images/publications/PIP_2021_2024.pdf

58 *Ibid.*

Programmes and projects pending approval are included in the PIP as “new initiatives”.

The PIP is divided into seven broad sectors: (1) social infrastructure; (2) agriculture; (3) commercial infrastructure; (4) governance; (5) environment; (6) social protection; and (7) regional development. The five social sectors of focus in this study fall under three different sectors: education and health fall under social infrastructure; water and sanitation fall under commercial infrastructure; and social protection and some components of child protection fall under social protection.⁵⁹ In 2021–2024, 29 per cent (LKR 892 billion) of total public investment (of LKR 3,050 billion) is programmed to be invested in the five social sectors.⁶⁰ The estimated investment in water and sewerage is LKR 396 billion, in health LKR 258 billion, in education LKR 200 billion, and in social protection (including expenditure on children) LKR 38 billion.⁶¹

The estimated investment in social protection included in the PIP covers three broad areas: (1) social welfare, which includes assistance to individuals and families in need; (2) social security, which provides assistance related to old age, death and permanent disability, and other lifecycle events; and (3) labour market interventions (including income generation activities, public works, grants, and subsidies). The bulk of the estimated annual investment in social protection included in the PIP for 2021–2024 is for social security (70 per cent of the total), including old age retirement incomes such as pensions.⁶²

It is important to note that, for the social protection sector, unlike the other sectors, the programs included in the PIP are not limited to capital projects/expenditure. PIP also includes new or revised recurrent projects/expenditure such as transfer programs which require approval of the NPD.⁶³

2.5.5. Shadow budget prepared by the NBD

As mentioned in Section 2.2.2, prior to receiving budget estimates from the SAs, the NBD prepares a shadow budget that provides it with a basis to evaluate the estimates submitted by the SAs. According to senior NBD officials, the shadow budget is prepared based on the following:⁶⁴

- the MTMFF & the National Policy Framework of the government,
- historical data such as approved cadre, capacity to utilise the funds,

- the core activities of the SAs,
- the cost of rehabilitation/renovation, and
- ongoing development projects along with projects in the pipeline.

According to NBD officials, the shadow budget is not disclosed to the SAs in order to not constrain their planning. When preparing the Appropriation Bill, the NBD then evaluates the budget estimates submitted by the SAs against the shadow budget.

59 Expenses related to children fall under multiple sectors/ministries (e.g., education) and not exclusively included under social protection.

60 *Ibid.*, Table 1.5.2

61 It is important to note that LKR 38 billion is not the entire expenditure on social protection. As mentioned in paragraph 4 of this section, the expenditure included in the PIP consist of only revised or new recurrent projects.

62 Government of Sri Lanka. Department of National Planning. Public Investment Programme (2021 – 2024). 2021. https://www.npd.gov.lk/images/publications/PIP_2021_2024.pdf

63 NPD Officials. Validation Workshop. 21 March 2023

64 NBD Officials. Key Informant Interview. 19 July 2022

2.5.6. Public demand

To some extent, public demand or perceived popularity of certain policies among the public can also influence budget allocation decisions. In general, these may have greater influence over budget decisions when the budget is presented prior to or immediately after an election. For example, in 2015 the country had both a presidential and a parliamentary election. Prior to the elections, organisations such as the Federation of University Teachers' Association (FUTA) as well as university students demanded that the government increase investment in education and there were multiple public forum and march parades held under slogans such as "6 percent of GDP for Education-Save State Education"⁶⁵. It is likely that the subsequent policy statement by the newly elected Prime Minister Ranil Wickremesinghe in November 2015 that stated that improving access to high-quality education and health services would be prioritised in the government's development policy framework⁶⁶ were partly influenced by these actions. When presenting the budget for the year 2016, the newly elected government approved an allocation of LKR 156.5 billion for capital expenditure, which was a 182 per cent increase compared to the actual expenditure in 2015. As a result, total expenditure in education went up to LKR 335.4 billion, an increase of 49 per cent over actual total expenditure in 2015.⁶⁷

A similar example can be observed in social sector expenditure as well. The Samurdhi programme is one of the largest social protection programmes in Sri Lanka and provides direct income transfers to a large number of

beneficiaries. During the 2015 Presidential Election, a number of political parties (including the UNFGG that won the election) promised to expand the Samurdhi benefit programme in order to receive votes during the election.⁶⁸ Further, the budget speech for 2015 presented prior to the election (in October 2014) included an increase in funding for the Samurdhi programme.⁶⁹ In 2015, expenditure on the Samurdhi programme increased by 65.9 per cent from Rs. 15.04 billion in 2014 to Rs. 39.99 billion in 2015.⁷⁰

It is important to note, however, that promised allocations do not always translate into actual expenditure. For example, education and health were considered to be a high government priority in 2016, and the government promised to allocate LKR 156.5 billion for capital expenditure in education and LKR 78.9 billion for capital expenditure in health in 2016. However, actual capital expenditure for education was LKR 58.9 billion (62.3 per cent lower than promised) and LKR 30.7 billion for health (61.1 per cent lower than promised).⁷¹ According to government officials, fiscal constraints prevented the promised allocations being translated into actual expenditure.⁷² Since, bulk of recurrent expenditure is for salaries and wages, reducing recurrent expenditure becomes much more challenging. Hence it is usually the capital expenditure that gets the largest cut.

Furthermore, the budget speech that is read out in Parliament by the Minister of Finance can often include proposals that were not originally included in the budgets

65 Lanka University News. FUTA Huge Protest March-Sri Lanka University Lecturers. 23 September 2012

66 Education and Health in Budget 2016: Grand Promises Don't Bode Well for Governance. publicfinance.lk/en/topics/Education-and-Health-in-Budget-2016-Grand-promises-don't-bode-well-for-governance-1620784730. (Last accessed 9 October 2022) | Economic Policy Statement Made by Hon. Prime Minister Ranil Wickremesinghe in Parliament on 5th November 2015. Government of Sri Lanka. 2015. npd.gov.lk/images/files/Economic_Policy_Stament_05_Nov_2015.pdf, http://npd.gov.lk/images/files/Economic_Policy_Stament_05_Nov_2015.pdf

67 Central Bank of Sri Lanka. 'CBSL 2015 Annual Report: Fiscal Policy and Government Finance. 2015. www.cbsl.gov.lk/sites/default/files/cbslweb_documents/publications/annual_report/2015/en/10_Chapter_06.pdf

68 Deshodaya. UNFGG, UPFA, JVP & TNA Manifestos: Parliamentary Elections 2015 Summary. <https://www.colombotelegraph.com/wp-content/uploads/2015/08/Election-held-LAA.xls-.pdf>. (Last accessed 22 December 2022)

69 Government of Sri Lanka. 2015 Budget Speech. <https://www.treasury.gov.lk/api/file/08ef3734-78af-47f9-a4c7-91c37edca007>. (Last accessed 22 December 2022)

70 Government Expenditure on Samurdhi Payments. publicfinance.lk/en/topics/Government-Expenditure-on-Samurdhi-Payments-1628160503. (Last accessed 9 October 2022)

71 Central Bank of Sri Lanka. 2015 Annual Report: Fiscal Policy and Government Finance. 2015. www.cbsl.gov.lk/sites/default/files/cbslweb_documents/publications/annual_report/2015/en/10_Chapter_06.pdf

72 NBD officials. Key informant interviews. 19 July 2022

submitted by the respective SAs. These often include proposals from different segments of society that the MoF/NBD consults during the budget formulation process. According to senior officials interviewed, the SAs

are unaware of proposals in the budget speech prior to the speech,⁷³ and at times these proposals are not aligned to sectoral priorities.⁷⁴

2.5.7. Sustainable Development Goals (SDGs)

Furthering national goals based on the Sustainable Development Goals (SDGs) of the 2030 Agenda for Sustainable Development also factors into allocation decisions. Under the Sustainable Development Act No. 19 of 2017, Sri Lanka established a Sustainable Development Council that is tasked with – among other things – preparing a National Policy and Strategy on Sustainable Development and issuing guidelines relating to advancing sustainable development objectives to all ministries, PCs, and project approving agencies.⁷⁵ A circular issued by the Presidential Secretariat in 2019 stated it was the duty of all ministries, departments, PCs, and local authorities to comply with the National Policy and Strategy on SDGs and that SDG targets be incorporated to their mandates as relevant.⁷⁶ According to senior ministry officials interviewed, sectoral policies and programmes

take into account the SDGs relevant to their sectors and furthering the SDGs are considered when annual budgets are prepared.

Recent government policies at both the national and sectoral level have made explicit reference to the SDGs. For example, the “National Policy Framework: Vistas of Prosperity and Splendour” stated that one of the government’s priorities was to ensure that the SDGs were met by 2030 and proposed to formulate a systemic plan to achieve the SDGs.⁷⁷ The National Strategic Framework for Development of Health Services 2016–2025 prepared by the Ministry of Health demonstrates how strategies to address various health sector issues contribute to the achievement of relevant sustainable development targets.⁷⁸

73 For example, “SURAKSHA” student insurance scheme introduced by the Government of Sri Lanka was a proposal that appeared in the budget speech of 2017, under the theme “Protect Forever – The Children of the Nation”. According to a retired senior official from the Ministry of Education, the ministry came to know of the proposed scheme only after the budget speech was read. The Ministry of Education implemented the scheme by signing an agreement with Allianz Insurance Lanka Limited in 2018 to provide insurance cover for a year from 1 December 2018 to 30 November 2019, for 24-hour coverage for 365 days of the year

74 Retired official from the Ministry of Education. Key informant interview. July 2022

75 Sustainable Development Act No. 19 of 2017, Section 10 (b) and (d)

76 Government of Sri Lanka, Presidents Office. Circular No. PS/SP/SB/C/22/2019. Dated 3 October 2019. Colombo. 2022. https://www.presidentsoffice.gov.lk/wp-content/uploads/2019/15/PS_SP_SB_C_22_2019%20E.pdf. (Last accessed 18 January 2022)

77 Government of Sri Lanka. Department of Commerce. ‘National Policy Framework: Vistas of Prosperity and Splendour’. <http://www.doc.gov.lk/images/pdf/NationalPolicyframeworkEN/FinalDovVer02-English.pdf>

78 Government of Sri Lanka. Ministry of Health. National Health Strategic Master Plan 2016 – 2025 Vol. II. https://extranet.who.int/countryplanningcycles/sites/default/files/planning_cycle_repository/sri_lanka/national_strategic_framework_.pdf. (Last accessed 18 January 2022)

2.6. Main Challenges

This section outlines the challenges the SAs and MoF face in endeavouring to achieve efficient and effective

resource allocation to meet the needs and desired outcomes in each sector.

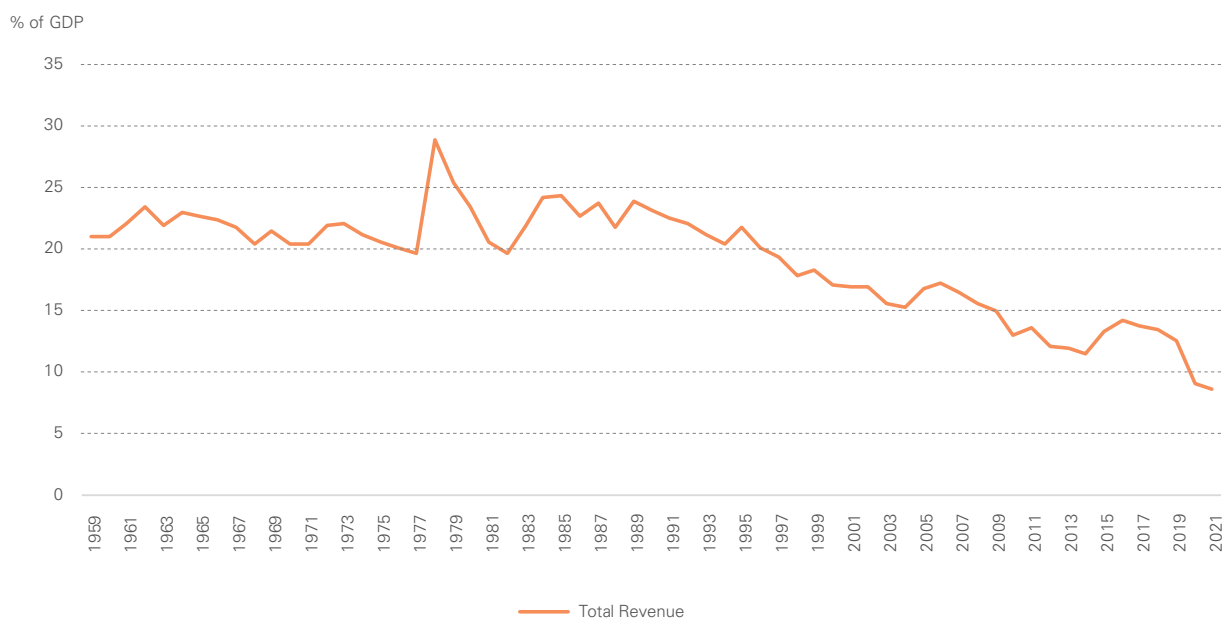
2.6.1. Low government revenue

According to senior officials from the five sectors interviewed, the main factor that contributes to approved estimates being lower than the requested amount, and the actual amount received being lower than the approved amount, is the low fiscal capacity of the government.

In 2021, Sri Lanka's total government revenue was 8.7 per cent of GDP, with tax revenue just 7.3 per cent of GDP.

Government revenue as a percentage of GDP has been on a downward trend since the 1980s when revenue to GDP was above 20 per cent (refer Exhibit 02). Compared to countries with similar income levels, Sri Lanka has one of the lowest revenue to GDP ratios in the world.⁷⁹ According to officials from both the NBD and line-ministries interviewed, this was the most critical constraint faced when allocating funds to different sectors.

Exhibit 02: Total revenue as a percentage of GDP, 1959 – 2021



79 Fixing Sri Lanka's Revenue Problem is a Priority. 2017. Public Finance.lk <https://publicfinance.lk/en/topics/Fixing-Sri-Lanka's-Revenue-Problem-is-a-Priority-1620821022>. (Last accessed 3 November 2022)

Source: PublicFinance.lk <https://publicfinance.lk/en/topics/sri-lanka-s-revenue-to-gdp-ratio-reaches-its-lowest-level-since-1959-1656403809> (Accessed 18 November 2022).

The low revenue base limits the capacity of the government to spend sufficient funds to meet sector needs. According to a senior official from the Ministry of Finance, the low fiscal capacity of the government has made the budget allocation process more of a supply driven process than a demand driven one.

The low tax revenue is the result of low tax rates, a narrow tax base, and low collection efficiency.⁸⁰ The economic

reform programme supported by the IMF facility approved in March 2023 aims to try and address all these problems with wide ranging tax reforms. These include increasing tax rates, removing tax exemptions, introducing new taxes such as a property tax, and reforming the revenue administration.⁸¹ These reforms are expected to help increase government revenue from 8.5 per cent of GDP in 2022 to 15 per cent by 2026.⁸²

2.6.2. Unrealistic macro-economic frameworks based on unrealistic assumptions

Another constraint to efficient and effective resource allocation is the unrealistic and overoptimistic revenue projections made by the government each year that are included in the budget and MTMFF. Weak or erroneous economic assumptions underlying the revenue estimates are largely responsible for this.⁸³ As a result, the initial budget allocations made often become unrealistic and unachievable.

Some of the estimates in the medium-term framework are underpinned by assumptions that lack rigour. In particular, the economic growth and inflation projections of the government – which form the basis for revenue projections – have consistently been overoptimistic. For instance, the 2021 budget forecast GDP growth in 2020 to be 1.5 per cent, which was far more optimistic than the Central Bank's projections of -1.7 per cent, and the IMF and World Bank (WB) projections of -4.6 per cent and -6.7 per cent respectively.⁸⁴ For 2021 and 2022, while the IMF and WB projected real GDP growth to be less than 4 per

cent, the government projected real GDP growth to be 6 per cent in 2021 and 5.2 per cent in 2022.⁸⁵ Actual real GDP growth was -3.6 per cent in 2020 and 3.7 per cent on 2021, which was closer to the WB and IMF projections.

There are multiple other assumptions that lack rigour as well, making the medium-term fiscal framework untenable. For example, the expectation in Budget 2021 was that revenue would increase from an estimated 9.5 per cent of GDP in 2020 to over 14 per cent by 2025, without major revisions to the tax structure. This meant revenue growth was expected to come from nominal growth and administrative reforms, which was unrealistic. When calculating debt, there has been a failure to accurately calculate government interest payments and the impact of currency depreciation on foreign debt in the past.⁸⁶

As a result of the unrealistic revenue projections, allocations made from the national budget to the sectors

80 International Monetary Fund. March 2023. Country Report No. 23/116

81 *Ibid.*

82 *Ibid.*

83 Verité Research. 2021. The Public Report on the 2022 Budget Assessment of the Fiscal, Financial and Economic Assumptions used in the Budget Estimates. https://www.veriteresearch.org/wp-content/uploads/2021/12/VR_ENG_RR_Dec2021_Public-Report-on-the-2022-Budget-Assessments-of-the-Fiscal-Financial-and-Economic-Assumptions-used-in-the-Budget-Estimates.pdf

84 Verité Research. 2020. The Public Report on the 2021 Budget Assessment of the Fiscal, Financial and Economic Assumptions used in the Budget Estimates. https://www.veriteresearch.org/wp-content/uploads/2020/12/Verit%C3%A9Research_Public-Report-on-the-2021-Budget_English_November_2020.pdf

85 Verité Research. 2021. The Public Report on the 2022 Budget Assessment of the Fiscal, Financial and Economic Assumptions used in the Budget Estimates. https://www.veriteresearch.org/wp-content/uploads/2021/12/VR_ENG_RR_Dec2021_Public-Report-on-the-2022-Budget-Assessments-of-the-Fiscal-Financial-and-Economic-Assumptions-used-in-the-Budget-Estimates.pdf

86 Verité Research. 2020. The Public Report on the 2021 Budget Assessment of the Fiscal, Financial and Economic Assumptions used in the Budget Estimates. https://www.veriteresearch.org/wp-content/uploads/2020/12/Verit%C3%A9Research_Public-Report-on-the-2021-Budget_English_November_2020.pdf

become unrealistic as well, compelling the government to borrow more than anticipated as well as disburse less than what was allocated. A 2019 report by the Committee on Public Finance (COPF), which is the parliamentary legislative committee mandated to assess the assumptions used to prepare budget estimates, found that:

“in past years many approved budget proposals have later been shelved or significantly altered because the estimates and assumptions upon which the

proposals were built were later found to have been defective. Such course corrections are costly and are in essence failures of public finance management. Such failures can be minimised if the parliamentary debates during the budget process are more robust and rigorous.⁸⁷

The extent of these unrealistic assumptions is shown in Table 01. The figures show that the government has consistently over-estimated revenue each year.

Table 01: Gap between projected gov. revenue and actual gov. revenue – 2011 – 2020

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Approved estimated revenue (LKR billion)	963.3	1126.1	1277.5	1469.5	1534.7	1838.0	2020.3	2227.2	2357.0	1898.8
Actual revenue (LKR billion)	949.9	1067.5	1153.3	1204.6	1460.9	1693.6	1839.6	1932.5	1898.8	1373.3
Deviation (LKR billion)	(13)	(59)	(124)	(265)	(74)	(144)	(181)	(295)	(458)	(526)
Deviation (%)	-1%	-5%	-10%	-18%	-5%	-8%	-9%	-13%	-19%	-28%

Source: CBSL annual reports (2011 – 2021)

Actual revenue has been less than the approved estimated revenue in every year since 2011. The magnitude of the deviation has increased over the years, moreover. The lack of rigorous analysis and accuracy in determining targets has an adverse effect on the budget, as SAs refer to these targets when deciding on their own budget estimates and these estimates are the basis on which the MoF makes the allocation of funds. Correcting for such errors is costly, time consuming, and has a negative impact on the initial plans and programmes of the SAs, as they then need to alter their plans as well.

The IMF has also recognised these shortcomings in fiscal management as problematic.⁸⁸ It has also noted that government budgets have systematically overestimated revenue and that expenditure management has been

ineffective.⁸⁹ The programme plans to address these shortcomings by “strengthening the core public finance management (PFM) functions of macro-fiscal analysis and forecasting, fiscal data collection and reporting, fiscal management, budget formulation and execution, and public debt management through sequenced reforms”.⁹⁰ The recently established Macro-fiscal Unit (MFU) of the MoF is expected to take a lead on the reforms. The programme aims to provide training to the MFU to strengthen its macro-fiscal analytical, forecasting and reporting capacity. The introduction of the new PFM law and rollout of the Integrated Treasury Management Information System (ITMIS) and a full-fledged IT-based PFM platform that covers 220 national budget execution agencies are also expected to support this effort.

87 Committee on Public Finance. 2019. Report on the Budget 2019: Assessment of the Fiscal, Financial and Economic Assumptions. <https://www.parliament.lk/uploads/comreports/1553835156037838.pdf#page=1>

88 International Monetary Fund. March 2023. Country Report 23/116

89 *Ibid.*

90 International Monetary Fund. March 2023. Country Report 23/116

2.6.3. Absence of systematic means to reallocate funds to meet revenue shortfalls

The persistent revenue shortfall compels the government to reallocate resources during each fiscal year, as shown in Table O2 below. Given greater challenges in reducing

recurrent expenditure, the revenue shortfall is largely met by cutting capital expenditure allocations.

Table O2: Deviations between budgeted allocation and actual expenditure (%)

	Recurrent Expenditure					Capital Expenditure				
	2016*	2017	2018	2019	2020	2016	2017	2018	2019	2020
Health	-18%	-2%	1%	12%	5%	-34%	-31%	-25%	-31%	16%
Education	-61%	1%	-11%	-4%	-2%	-15%	-26%	-42%	-49%	-4%
WASH	20%	3%	-15%	-3%	-2%	-18%	19%	19%	5%	-14%

*Note - the reason for large deviation is a revision to the manner the recurrent expenditure was calculated in 2016

Source: Author's calculation using budget estimates 2016 – 2020

Interviews with officials revealed that at present, there is no systemic means of reallocating or reprioritising funds during the year to meet the revenue shortfall. The gaps in funding that result from overoptimistic revenue forecasts as well as other unforeseen developments are managed in two ways: the first is by using the historical track record of underutilisation of funds for capital projects in any given year; and the second is by postponing payments for work already completed to the following budget year.

According to officials interviewed, initial allocations are often made on the premise that, in any given year, only 60-70 per cent of the funds allocated for capital expenditure would be spent due to procurement delays, land-acquisition delays or other reasons.⁹¹ Hence, in their view, there is usually a 'natural' saving of 30 per cent of the original allocation. The extensive delays in the implementation of large-scale development projects and programmes have been identified as a recurring problem by the Department of Project Management and Monitoring (DPMM) in its annual progress reports,

which find that most of the large-scale project targets are unrealistic.⁹² Yet the problem persists and seems to be exploited during the budget allocation process to manage the shortfall in funds that results from overoptimistic initial revenue projections.

Postponing payments for capital projects to the following budget year is another method used by the MOF to accommodate revenue shortfalls while preventing disruptions to the implementation of ongoing projects. Despite the lack of funds to make payments that year, Spending Agencies continue to implement their projects on the presumption that funds to meet their payment arrears (or bills in hand) will be allocated the following year. According to DPMM reports, outstanding bills as a percentage of actual expenditure for large scale development projects was 10 per cent in 2017, 19 per cent in 2018 and 2019, and 11 per cent in 2020.⁹³

However, senior officials attached to line ministries as well as the PCs found the practice of postponing payment for projects to the following year to be unsatisfactory.

91 NBD Officials. Validation Workshop. 21 March 2023.

92 Department of Project Management and Monitoring. Progress of Development Projects and Programs. Various Years <https://www.treasury.gov.lk/web/dpmm-progress-of-projects/section/2022> (Last accessed 19 April 2023)

93 *Ibid.*

It led to a loss of credibility with contractors as well as resulted in a reduction of the following year's allocation for new capital projects.⁹⁴

Interviews with senior MoF officials also suggested that prioritisation of funding for some projects over others

was not guided by any objective criteria but was instead largely influenced by the proactiveness and persistence of different SAs in seeking funds from the Treasury. The more persistent and proactive agencies were more likely to obtain funding than others.

2.6.4. Non-compliance with fiscal rules framework introduced by the FMRA

Although the objective of the FMRA was to help ensure that the government's fiscal strategy was based on responsible fiscal management principles, this objective has not been achieved to date. Prior analysis by Verité has shown that since 2003 (the year FMRA was introduced), the government has consistently failed to comply with three of the most important fiscal rules outlined in the MNRA.⁹⁵ The first rule is the limit imposed on the budget deficit, which was breached 18 times between 2003–2023. The second rule is the limit imposed on total central government liabilities or debt, which the government revises upwards each time it comes close to breaching it and has also on several occasions failed to meet the revised targets as well. The third fiscal rule sets limit on treasury guarantees, and this has also been subject to frequent upward revision by the government. The IMF's latest country report recognises this problem, stating that the *"fiscal rules framework has not been satisfied since its inception in 2003, resulting in budget overruns and spending arrears."*⁹⁶

A solution to this ongoing problem that has been proposed by some is the introduction of a new Public Finance Management (PFM) law that would include a revamped fiscal rules framework. This proposed solution, however, fails to recognise the core problem with public finance management in Sri Lanka, which is not the absence of rules, but the lack of compliance with them.

Introducing a new law, without addressing the non-compliance issue will likely fail to deliver the expected results.⁹⁷ Poor compliance with FMRA (as well as the proposed PFM law) not only makes the law redundant, but the resulting loss of confidence in the rule of law increases the risk perception of the country, leading to higher costs of borrowing. Stricter penalties/adverse consequences for those who are non-compliant is likely to help increase the accountability of the policy makers to adhere to these laws.⁹⁸

2.6.5. Frequent revisions to budgeting approach

As discussed in Section 2.1.7, the budgeting approach that SAs should follow when formulating their annual budget has been revised multiple times in a relatively short time span. Interviews with MoF officials indicate that there is a lack of clarity on the justification for such frequent revisions among government officials.⁹⁹ Based

on directives received from political authorities, the revised instructions were included in the Budget Circular from time to time. However, the instructions were not accompanied by complementary revisions to the existing structures or capacity building for responsible officials in the SAs.

94 Line Ministry and PC Officials. Validation Workshop. 21 March 2023

95 Verité Research. 2023. Verité Insights. Does Sri Lanka Need More Rules or Better Compliance? https://www.veriteresearch.org/wp-content/uploads/2023/03/VR_EN_Insights_FMRA_March_2023.pdf (Last Accessed 19 April 2023)

96 International Monetary Fund. March 2023. Country Report No.23/116

97 Verité Research. 2023. Verité Insights. Does Sri Lanka Need More Rules or Better Compliance? https://www.veriteresearch.org/wp-content/uploads/2023/03/VR_EN_Insights_FMRA_March_2023.pdf (Last Accessed 19 April 2023)

98 *Ibid.*

99 MOF Officials. Validation Workshop. 21 March 2023

Research suggests that the absence of such complementary initiatives has resulted in SAs treating all budgeting approaches as more or less the same.¹⁰⁰ A study to identify the practical aspects of implementing ZBB found that more than 75 per cent of respondents did not identify any differences between IB and ZBB except for the idea

that cash balances had to be made zero at the end of the year.¹⁰¹ Furthermore, according to a senior MoF official, at present there is no single budgeting method used by the SAs or the NBD. Instead, a mixture of different methods is used by SAs when preparing their budgets and by the NBD when determining the allocations.

2.6.6. Presence of multiple ministries overlooking a single sector

A key challenge arising out of the fragmentation of ministerial portfolios is the difficulty in coordinating policies, programmes and activities of a single sector when they fall under multiple ministries (including both cabinet-level and state ministries). For example, financial allocations for interventions related to child protection and social protection are widely dispersed across multiple ministries (refer Annexure 2 for details). This makes it extremely challenging to track, monitor, and assess resource allocation to the sector. There is no coordination mechanism or a centralised database with information on the activities of multiple agencies and their deployment of resources.¹⁰² The lack of coordination

among institutions/programmes also leads to an overlap in the beneficiaries of these programmes. This affects the accuracy of the budget allocation process as the number of beneficiaries is a criterion used when estimating the budget allocation for certain programmes.

Likewise, in the education sector, there is a lack of an effective coordination mechanism in sub-sectors, which leads to duplication of activities such as capacity development training programmes for teachers for which funds are allocated at both provincial and national levels.¹⁰³

2.6.7. Absence of national level sectoral policies

As discussed in Section 2.4.3, sectoral policies and programmes are a factor that guide budget allocation decisions. These sectoral policies are developed by the planning units of the respective line-ministries. Of the five social sectors, the social protection and the child protection sectors do not have dedicated line-ministries. Expenditure in these sectors fall under the purview of multiple ministries. Medium-term sectoral policies/strategies are periodically prepared for sectors such as education and health. For example, the Ministry of

Education prepares an Education Sector Development Framework and Programme (ESDFP) every five years, following a rolling planning approach.¹⁰⁴ Such sectoral plans are prepared based on assessments of sectoral needs.

However, such policy frameworks are not regularly prepared and updated for sectors such as social protection or child protection.¹⁰⁵ In 2019, a national policy on child protection was developed by the National Child Protection Authority¹⁰⁶ and an action plan for 2023–2027

100 Fernando, A.J. "Is Zero-Based Budgeting a Reality or a Symbolic Representation of Politics in Public Sector in Sri Lanka?" 2019. University of Sri Jayewardenepura.)

101 *Ibid.*

102 Save the Children. Investing in Children in Sri Lanka: Child Centric Resource Analysis. 2016

103 Retired official from the Ministry of Education. Key informant interview. July 2022

104 A rolling plan is a plan which is designed to continue over a period of time and is subject to regular review and updating at certain time intervals.

105 The World Bank. Sri Lanka Development Update. 2022. <https://thedocs.worldbank.org/en/doc/6c87e47ca3f08a4b13e67f79aec8fa3b-0310062022/original/Sri-Lanka-Development-Update-October-2022-final.pdf> | UNICEF, Sri Lanka. Budget brief: child protection sector in Sri Lanka. 2021. <https://www.unicef.org/srilanka/media/2821/file/BUDGET%20BRIEF:%20CHILD%20PROTECTION%20SECTOR%20SRI%20LANKA%202021.pdf> | UNICEF, Sri Lanka. Budget brief: Social protection sector. 2021. <https://www.unicef.org/srilanka/media/2676/file/BUDGET%20BRIEF:%20SOCIAL%20ASSISTANCE%20SECTOR%202021.pdf>

106 Government of Sri Lanka. National Child Protection Authority. National Policy on Child Protection. 2019. 20221228_WMCA_NationalPolicyOnChildProtectionFinal_2019.pdf

is currently being prepared to implement the policy.¹⁰⁷ The NPD recently conducted a national level social protection assessment and steps are being taken by the government to develop a social protection policy with the help of the WB.¹⁰⁸

The absence of an overarching policy framework for certain sectors along with the absence of a mechanism to regularly update sectoral policies, results in limited coordination and organisation of priorities between ministries with activities in the sector, which ultimately affects the allocation of resources to the sector.

2.6.8. Absence of expenditure ceilings for each spending unit

The National Budget Circular issued by NBD provides macro-level guidance on policy priorities and strategies and the overall budget ceiling for the year. However, it does not provide ceilings on total spending for each spending unit. According to the IMF, it is important for the budget circular to provide instructions to the line Ministries “with the indicative aggregate spending ceiling for each Ministry”.¹⁰⁹ Setting such expenditure ceilings by the NBD may be important to facilitate a meaningful discussion on resource allocation.

The absence of such indicative spending limits for each spending unit as part of the budget guidelines is likely to contribute to more unrealistic SA funding requests.

The requests for funding made by line ministries are not made public. However, requests made by the PCs are made public by the FC. As discussed in Section 3.4.3 below, there is a significant gap between PC requests, FC recommendations, and actual allocations, particularly with respect to capital expenditure. Spending ceilings for SAs will likely help reduce such large gaps, make requests more realistic, and make the planning process more efficient. International experience suggests that such ceilings are likely to have a positive impact in countries such as Sri Lanka, where there is a lack of fiscal discipline (at both technical and political level), a lack of robust processes to determine spending priorities, and a lack of fiscal space for new policies and programmes.¹¹⁰

2.6.9. Lack of a clear, and transparent process to select beneficiaries

The lack of a clear and transparent process to select programme beneficiaries is another problem faced when allocating funds for the social protection and child protection sectors as the number of beneficiaries is a key criterion used by the SAs when formulating budget requests.

In 2016, the government initiated the use of provisions under the Welfare Benefits Act of 2002 to address this problem in the social protection sector. However, this has not been properly implemented to date.¹¹¹ Although the Welfare Benefits Board (WBB) that was established

in 2016 was expected to assume control of beneficiary selection and payment for all the country’s social welfare programs, this had not been effectively implemented until more recently.

The IMF has also recognised this as a critical problem affecting the social protection sector, stating that social safety net programs in Sri Lanka are inadequate and suffer from poor coverage and targeting.¹¹² A key objective of the IMF-supported reform programme is to “implement broader institutional reforms to improve efficiency, coverage, and targeting of the social safety nets”.¹¹³

107 The parliamentary caucus for children focuses on the importance of the coordination of the agencies dealing with child protection. Parliament of Sri Lanka. 15 November 2022. www.parliament.lk/news-en/view/2882

108 NPD officials. Key informant interviews. 21 March 2023

109 International Monetary Fund; Guidelines for Public Expenditure Management. <https://www.imf.org/external/pubs/ft/expend/guide3.htm> (Last accessed January 2023)

110 World Bank. January 2013. GET Note: Setting Expenditure Ceilings within National Budgets “Recently Asked Questions Series”.

111 Ministry of Women, Child Affairs and Social Empowerment. Key informant interview. 9 August 2022

112 International Monetary Fund. March 2023. Country Report No.23/116

113 *Ibid.*

To help advance this objective, the government has made the WBB operational. It will be responsible for the coordination of social safety net (SSN) programs and reforms. The WBB has set up a new social registry and established an electronic database of SSN beneficiaries.¹¹⁴ The registry is expected to contain data on all current and former programme beneficiaries as well as on new applicants. It is expected to facilitate improved targeting of programs by serving as a single source of verified

information on each beneficiary and their household. The government published legal regulations to identify beneficiaries based on verifiable eligibility criteria on 20 October 2022 that received parliamentary approval.¹¹⁵ On 21st April 2023, the government published a gazette announcing the introduction of the new welfare benefits payment scheme (Aswesuma), listing eligible groups, the number of beneficiaries in each group, and the proposed monthly welfare allowance.¹¹⁶

114 *Ibid.*

115 Government of Sri Lanka. Ministry of Finance. Budget Speech 2023

116 The Gazette of the Democratic Socialist Republic of Sri Lanka, Extraordinary. No. 2328/13. April 21, 2023

2.7. Conclusion

The legal framework for budgeting in Sri Lanka is primarily governed by the Constitution of Sri Lanka and supported by organic budget laws, such as the Appropriation Act, the FRs, Fiscal Management (Responsibility) Act, and the Foreign Loans Act. In addition, the Standing Orders of Parliament and the National Budget Circular issued by the NBD play important roles in the budget formulation process. The relevant departments of the MoF (i.e., NBD, NPD, etc.) and the SAs (i.e., ministries, departments, corporations, etc.) take the lead in the budget formulation process. The Cabinet of Ministers approves the Appropriation Bill that outlines the initial allocations, and the Parliament approves the final allocations and makes it into law. The key funding sources of the government comprise tax and non-tax revenue, grants, and borrowings from both domestic and foreign sources.

The budget allocation decisions of the government are governed by policies, plans, and programs developed at the national and sectoral level, along with historical data such as approved staffing cadre; capacity to utilise funds; and the core activities of the SAs, including ongoing projects and projects in the pipeline. The limited fiscal capacity of the government is a key constraint that undermines allocation of sufficient funds to meet the needs identified in the sectors. In addition, the initial funding requests by SAs as well as initial budget allocations are often unachievable due to overoptimistic revenue projections as well as the lack of indicative budget ceilings for SAs. There does not appear to be a systematic means of reallocating resources to manage revenue shortfalls during the budget year and instead, the

MoF appears to rely on under-utilisation of capital funds and postponement of payments to the following budget year. Fragmentation of ministerial portfolios, the absence of national level policies for certain sectors, and failure to update policies at regular intervals further undermine the efficient allocation of scarce public resources. Legislation established in 2003 to institute a responsible fiscal management framework has failed to achieve its objective due to non-compliance with the rules.

The economic reform programme supported by the IMF facility that was approved by the IMF Board in March 2023 recognises the need to address many of the problems identified in this report, including low fiscal capacity, over optimistic revenue projections, poor targeting of social safety nets, and the non-compliance with fiscal rules. The key solutions proposed to address these include introducing a new PFM law, revamping the fiscal rules framework, and enhancing the analytical and forecasting capacity of the MoF by establishing a MFU. Integrating information technology-based solutions such as treasury management systems is also expected to support these endeavours. However, the programme has failed to recognise the importance of addressing the lack of objective and transparent criteria to guide budget allocation decisions, which is critical to ensure efficient utilisation of the increased revenue that is expected to result from tax reforms under the program. Further for the new PFM law to have its desired impact, it is vital to introduce provisions to address the core problem with public finance management in Sri Lanka, which is not the lack of rules, but the lack of compliance with the existing rules.

3. ALLOCATION TO THE PROVINCIAL COUNCILS

Sri Lanka has a devolved budgetary process that was established under the 13th Amendment to the Constitution in 1987. The amendment to the Constitution led to a three-tier administrative structure comprising the central government, PCs, and local authorities. Local government authorities come under the purview of the PCs as a devolved subject.¹¹⁷ The PCs distribute funds to the local authorities that fall under their purview. The powers conferred on the PCs and the central government is outlined in the Constitution in three lists; Provincial Council list, reserved list, and concurrent list and these will be discussed in detail in Section 3.1.1.

Sri Lanka has nine provinces with varying degrees of economic and fiscal capacity (refer Table 03). This section focuses on the allocation of resources from the national budget to the PCs. As in Section 2 above, this section also divided into five sub-sections: the first sub-section provides an overview of the legal framework; the second provides an outline of the budget allocation process and the key agencies involved; the third provides an overview of the key channels of funding; the fourth sub-section looks at the criteria for allocation of funds; and the final section highlights the main constraints that undermine efficient and effective resource allocation.

Table 03: Economic and social indicators for provinces in 2019

Province	Population (000s)	Provincial GDP (Rs Mn)	Provincial GDP per capita (000s)	Provincial contribution to national GDP	Revenue as a percentage of provincial GDP	Expenditure as a percentage of provincial GDP	Poverty headcount ratio
Western	6,149	5,857.83	952.65	39.00%	0.80%	0.90%	5.7
Central	2,766	1,694.64	612.67	11.30%	0.50%	2.10%	18.7
Southern	2,654	1,491.36	561.93	9.90%	0.60%	2.30%	12.6
Northern	1,143	717.62	627.84	4.80%	0.60%	3.60%	23.8
North Western	2,551	1,639.57	642.72	10.90%	0.50%	2.10%	11.8
North Central	1,377	823.31	597.90	5.50%	0.50%	2.50%	11
Uva	1,376	803.47	583.92	5.40%	0.50%	3.10%	28.3
Sabaragamuwa	2,058	1,131.01	549.61	7.50%	0.40%	2.50%	23.1
Eastern	1,729	854.07	493.97	5.70%	0.50%	3.20%	18.6

Sources: Population: CBSL Economic and Social Statistics 2020; provincial GDP: CBSL Annual Report 2020; statistical appendix, revenue and expenditure: FC annual reports, Ministry of Finance budget estimates; poverty head count ratio: Department of Census and Statistics

117 Government of Sri Lanka. FC recommendations. 2022

3.1. Legal Framework

This section provides an overview of the legal framework that governs the allocation of funds to the PCs. The key legislation that is applicable are the provisions in the Constitution that clarify the relationship between the Central Government and the PCs; the provisions related

to provincial allocations in the FRs; the Provincial Councils Act, which lays out relevant operational procedures; and the finance statutes passed by the PCs empowering them to raise revenue from devolved sources.

3.1.1. The Constitution of Sri Lanka

The legal framework for establishing the PCs and making them statutorily eligible to finance their needs via central government funding is outlined in Chapter XVII A of the Constitution.

The FC is established by Article 154 R (1) of the Constitution and comprises the Governor of the Central Bank of Sri Lanka, the Secretary to the Treasury, and three members appointed by the President who represent the three major communities and have held “high office in the fields of law, administration, business, or learning.” Under Article 154 R (3) of the Constitution, the government should allocate adequate funds from the national budget to meet the needs of the PCs, based on the recommendations of and in consultation with the FC. Under Article 154 R (4), the main responsibility of the FC is to recommend to the President the principles on which the funds are to be allocated to the provinces and apportioned between various provinces.

The 13th Amendment outlines the powers conferred on the PCs and the central government in three lists. The

subjects that fall under each list are detailed in the ninth schedule of the Constitution. A brief overview of the three lists is provided below:

List 1: PC list. This includes activities that fall exclusively under the purview of the PCs. The list covers multiple sectors. In some sectors, responsibilities for certain activities fall exclusively under the purview of PCs but others are shared with the central government (included in the concurrent list).¹¹⁸ For example, in education, state schools fall under the purview of PCs, with the exception of certain schools such as national schools, special schools for service personnel, and schools for specified development schemes.¹¹⁹ Supervision and management of all pre-schools and transfer and disciplinary control of all educational personnel fall under the purview of the PCs. In the health sector, the establishment and maintenance of public hospitals, rural hospitals, maternity homes, and dispensaries fall under the PCs, but teaching hospitals and hospitals established for special purposes fall under the central government.¹²⁰

118 List 1 (Provincial Councils List), The Constitution of the Democratic Socialist Republic of Sri Lanka

119 Appendix III, The Constitution of the Democratic Socialist Republic of Sri Lanka

120 List 1 (Provincial Councils List), The Constitution of the Democratic Socialist Republic of Sri Lanka

- List 2: Reserved list. This includes activities that fall exclusively under the purview of the central government, such as defence, national security, and foreign affairs.
- List 3: Concurrent list. This includes activities that are shared by PCs and the central government, such as planning, higher education, national housing and construction, and protection of the environment.

Under the Constitution, the PCs cannot borrow directly from foreign sources, so foreign borrowing/funding has to be channelled through the central government. Foreign borrowing for PCs has to be project specific. The Ministry of Public Administration, Home Affairs, Provincial Councils, and Local Government coordinates the funding from foreign sources for the foreign funded projects of the PCs.¹²¹

3.1.2. The Financial Regulations

Under FR.16(1) any resources provided to other levels of government should be done by way of grants or contributions. In Sri Lanka, the central government transfers funds to the PCs via three main grant types: Block Grants (BG), Provincial Specific Development Grants (PSDG), and the Criteria Based Grants (CBG). These grants are discussed in detail in Section 3.3.2. of this report. FR 16 (1) also states that funds from the national budget to the

PCs are made under the line ministry in charge of the PCs and that the secretary of that ministry is responsible for the formulation of the PC's budgetary proposals, in consultation with the respective chief secretaries of the PCs and the FC.¹²² According to FR.16(2), capital projects that are to be implemented by PCs must be prepared by the respective central-level ministry for the sector involved in consultation with the PCs.

3.1.3. The Provincial Council Act

The Provincial Council Act No. 42 of 1987(PC Act) identifies the operational procedures for the functioning of the PCs. Part III of the PC Act covers finance and Section 19 (1) states that each PC will have a "Provincial Fund" that collects the taxes, grants, and loan advances from the central government's CF. Section 20(1) of the PC Act also provides for the establishment of an "Emergency Fund

for the Province" to meet unforeseen expenditure. All matters connected to both funds are regulated by the rules made by the governor of the province. With respect to foreign financing, Section 22 of the PC Act states that "the foreign aid negotiated by the government for a project or a scheme in a province shall be allocated by the government to such a project or scheme."

3.1.4. PC Statutes

Since 1990, PCs have passed enabling legislation in the form of Financial Statutes that empower them to raise revenue from sources in the provinces (listed in Annex 3).¹²³ Under Section 24 of the Provincial Councils Act No. 42 of 1997, statutes relating to financial matters of

the PCs can only be passed on the recommendation of the Governor. For example, the Finance Statute of the Northern Provincial Council No.01 of 2014 is endorsed by the Governor of the Northern Province and provides for the imposition of and collection of taxes and fees.

121 Asian Development Bank. Public Financial Management Systems. 2018

122 Government of Sri Lanka, Department of Public Finance. Financial Regulations (FR) of the Government of the Democratic Socialist Republic of Sri Lanka. 1992. <https://www.treasury.gov.lk/api/file/88bd6063-fe94-40b7-aa3d-d83196eb7f92>. (Last accessed 18 September 2022)

123 Waidyasekara, D.D.M. 2005. Decentralization and Provincial Financing in Sri Lanka: 2004 – An Update. Institute of Policy Studies

3.2. Budget Allocation Process

This section outlines the steps that the PCs and the FC follow when formulating PC budgets (in addition to the general processes outlined in Section 2.2 above) and the key agencies involved in the process of allocating funds to the PCs.

The PC budget allocation decisions undergo rounds of negotiations and discussions between the PC and the FC and between the NBD and the FC before they are finalised. The budget formulation process starts in January of the year preceding the budget year when the FC issues guidelines and ends with the presentation of the annual financial statement to the provincial assembly by the Chief Minister in December.¹²⁴

The key steps in the budget formulation process are outlined below.

Step 1 Jan. – Feb.	The FC issues guidelines for the preparation of recurrent and capital needs of the PCs.
Step 2 Apr. – May	Heads of provincial departments prepare revenue/expenditure estimates, which are collated by the Deputy Chief Secretary.
Step 3 May – Jun.	Internal review and approval of the estimates by the Chief/Deputy Chief Secretary and Chief Minister.
Step 4 Jun. – Jul.	The FC reviews and finalises the annual needs assessment in consultation with the staff of the PCs.
Step 5 Aug. – Sep.	The FC submits recommendations pertaining to the province’s capital and recurrent expenditure needs to the President and the NBD.
Step 6 Sep. – Oct.	Negotiations take place between the FC and the NBD, and once finalised, the allocations are included in the Appropriation Bill.
Step 7 Nov.	The FC informs the PCs of the final allocations recommended by the MoF and the President.
Step 8 Dec.	Once the national budget is approved by Parliament, the FC apportions funds between the provinces and across sectors within the province as per the recommendations made, in consultation with Chief Ministers and other senior officials of each province.
Step 9 Dec.	The Chief Minister of each province—as the minister in charge of financial matters at the provincial level—submits the final provincial budget to the board of ministers. Subsequently, the Governor presents the annual financial statement to the provincial assembly. ¹²⁵

¹²⁴ Government of Sri Lanka, Eastern Provincial Council. Citizens Budget 2019

¹²⁵ UNICEF, Sri Lanka. Budget Brief: Cycle and Process. Sri Lanka. 2019

3.2.1. Key government agencies involved

In addition to the agencies involved in the national budget making process outlined in Section 3.2, three additional agencies play important roles in the formulation of provincial budgets: the PCs, the FC, and the Ministry in charge of the PCs.

Provincial Councils

The role of the PC in the budget allocation process is to develop the medium-term development plan and provincial budget based on the needs of the province. The medium-term development plan, which integrates sector development goals is prepared in line with the national policy goals and SDGs. Based on the medium-term development plan and guidelines issued by the FC, PCs draft the agency results frameworks and needs assessments for the next budgeting year.¹²⁶

When preparing the needs assessments, PCs hold discussions with provincial departments to understand the needs of the provinces. When formulating needs for capital expenditure projects, there are discussions held with the NPD to align projects with overall national policy goals. Once finalised, the PCs submit their need requirements to the FC. Based on the final allocation by the centre, the PCs draft the annual implementation plan for their budgetary allocation.¹²⁷

Finance Commission

As mentioned in Section 3.1.1, the FC was established by Article 154 (R) of the Constitution of Sri Lanka. The FC functions as the negotiator between the central government and the PCs and facilitates the transactions between the two. Under the Constitution, the FC makes recommendations to the President on the allocation

of adequate funds from the annual budget to meet the needs of the provinces and to recommend how such funds should be apportioned between the nine provinces. The recommendations should be provided with the objective of achieving balanced regional development in the country.¹²⁸

The FC makes the following recommendations:¹²⁹

- a. The amount of funds that should be apportioned among provinces in a rational manner.
- b. The amount of funds that should be provided as government grants to PCs.
- c. The policies to achieve balanced regional development in the country.

The PCs submit their fiscal needs to the FC in line with the guidelines provided. The FC then assesses the fiscal requirements based on the needs submitted by the PCs and submits its recommendations to the President and to the NBD. Once the budget for PCs is finalised, the FC apportions the finalised provincial budget across sectors within each province, in consultation with senior officials in each PC.¹³⁰

Ministry in-charge of the PCs

The Ministry in-charge of the PCs acts as the coordinator between the government and the PCs specifically for foreign funded projects. As of now, the Ministry in-charge of the PCs is the Ministry of Public Administration, Home Affairs, Provincial Councils and Local Government (MLG-PC).¹³¹ For projects that are implemented by both the central and provincial governments, the expenditure

126 Former provincial council official. Key informant interview. 23 June 2022

127 FC officials. Key informant interviews. 9 August 2022

128 Government of Sri Lanka, the Constitution of the Democratic Socialist Republic of Sri Lanka. Revised edition 2021, Article 154 (R) Section (4) and 154 (R) Section (5). <https://www.parliament.lk/files/pdf/constitution.pdf>. (Last accessed 16 September 2022)

129 Government of Sri Lanka. FC Annual Report. 2019

130 FC officials. Key informant interviews. 21 March 2023

131 Extraordinary Gazette No. 2289/43. 22 July 2022

allocated to the province is budgeted under the ministry in charge of PCs.¹³²

Since the PCs cannot receive foreign funding directly, the ministry functions as the executive agency for donor-funded development projects implemented by PCs, maintains international relationships, and coordinates

and monitors implementation of foreign funded projects.¹³³ For foreign projects that are implemented by an agency under the PC (e.g., a department), the government employs a local currency sub-grant mechanism where the budget is made part of the central government budget under the MLGPC and project expenditure is included in the PC's local budget.¹³⁴

132 Asian Development Bank. Public Financial Management Systems. 2018

133 Ministry of Local Government and Provincial Councils. Performance Report. 2014

134 Asian Development Bank. Public Financial Management Systems. 2018

3.3. Key Channels of Funding

PCs have two main sources of funding: (1) provincial revenue and (2) grants from the central government. The most important source of financing for PCs is the grants received from the central government. Over the last five years, grants have funded 70 – 85 per cent of the total PC expenditure.

It is important to note that under the Provincial List in the Constitution, PCs have the power to borrow funds to the extent permitted by or under any law made by Parliament.¹³⁵ However, this cannot be considered as a third source as the requisite laws have not been passed to enable the PCs to make use of this provision.

3.3.1. Provincial revenue

In 2015-2020, provincial revenue on average accounted for 0.55 per cent of GDP and 4.5 per cent of central government revenue (refer Table 04). Provincial revenue is sourced from (1) revenue collected by provinces for devolved subjects (refer Annex 3 for details); and (2)

revenue transfers from the central government discussed in detail below. Almost half of provincial revenue is obtained from central government revenue transfers (refer Table 04).

Table 04: Provincial revenue for 2016 – 2021

	2015	2016	2017	2018	2019	2020
LKR million	66,996	79,297	86,404	91,621	91,305	52,245
As a percentage of GDP	0.61%	0.66%	0.65%	0.64%	0.61%	0.35%
PC revenue as a percentage of central government revenue	4.59%	4.68%	4.70%	4.74%	4.81%	3.80%
Devolved revenue as a percentage of total provincial revenue	51.5%	51.7%	50.8%	50.6%	48.4%	78.5%
Central government transfers as a percentage of total provincial revenue	48.5%	48.3%	49.2%	49.4%	51.6%	12.5%

Note: PC revenue includes total devolved revenue (including stamp duty and court fees) and revenue transfers from the central government.

Source: FC annual reports and CBSL annual reports for the years 2015 – 2022

¹³⁵ Government of Sri Lanka, the Constitution of the Democratic Socialist Republic of Sri Lanka. Revised edition 2021, Provincial council list

Revenue collection from devolved sources

Under the Constitution, PCs have the authority to collect revenue from 20 sources devolved to them (refer Annexure 3).¹³⁶ As of 2019, the top three of these devolved sources of revenue were motor vehicle license fees, stamp duty, and court fines. These three sources accounted for 85 per cent of total revenue collected from devolved sources in 2019.

Prior to 2011, Business Turnover Tax (BTT) was the largest contributor to devolved revenue collection. In 2010, BTT alone accounted for 54 per cent of total devolved provincial revenue collection. With effect from 1st January 2011, however, BTT was abolished by Fiscal Policy Circular No. 01/2010. To compensate for the loss of the largest revenue contributor, the circular also established a revenue sharing system, where revenue from certain sources at the central government level is transferred to the provinces.

Table 05: Provincial revenue collection segmented into devolved sources and transfers (2019)

2019	Devolved sources (LKR million)				Provincial revenue sources (LKR million)		Total (LKR million)	Transfers from central government as a percentage of provincial revenue
	Province	Motor vehicle license fees	Stamp duty	Court fines	Other	Revenue collection from devolved sources		
Western	4,319	13,489	1,280	2,899	21,987	22,936	44,923	51%
Central	985	1,540	122	1,026	3,677	4,159	7,836	53%
Southern	1,237	1,950	514	878	4,580	4,175	8,755	48%
Northern	379	789	270	552	1,990	2,387	4,377	55%
North Western	1,441	1,862	405	963	4,678	4,200	8,878	47%
North Central	631	150	313	596	1,691	2,188	3,879	56%
Uva	464	332	162	430	1,389	2,290	3,679	62%
Sabaragamuwa	791	1,213	224	491	2,720	2,336	5,056	46%
Eastern	524	469	223	308	1,523	2,399	3,922	61%
Total	10,771	21,794	3,513	8,143	44,235	47,070	91,305	52%

Note: Other includes rents, interest, examination fees, sale of capital assets, betting tax, excise duty etc. Stamp duty and court fines are transferred to local authorities.

Source: FC recommendations and annual reports from <http://fincom.gov.lk/> (Last Accessed February 2023)

Transfers from the central government

Fiscal Policy Circular No. 01/2010 requires the Commissioner General of Inland Revenue, Director of Customs, and Commissioner General of Motor Traffic to transfer revenue to PCs based on the following ratios:

- Nation Building Tax (NBT): 33.33 per cent
- Stamp duty: 100 per cent
- Vehicle registration: 70 per cent

¹³⁶ Government of Sri Lanka, the Constitution of the Democratic Socialist Republic of Sri Lanka. Revised edition 2021. Ninth Schedule provincial council list item 36

The circular also states how the revenue transfer should be distributed among the provinces. The Western Province receives the largest share of 48 per cent; the Central, Southern and North-Western Provinces receive 9 per cent each; and the remaining provinces receive 5 per cent each. The most important source of the revenue transferred is the NBT (refer Table 06). The share of the

revenue each province receives is decided by the FPD based on the amount collected by each PC through the BTT. Although the circular states that the ratio will be periodically revised and re-fixed in consultation with the FC, to date no such change has taken place since the introduction of the circular.

Table 06: NBT share of total provincial revenue in 2018

2018	Transfer of NBT	NBT as percentage of total provincial revenue
Western	16,274	35%
Central	3,051	39%
Southern	3,051	36%
Northern	1,695	42%
North Western	3,051	36%
North Central	1,717	43%
Uva	1,695	46%
Sabaragamuwa	1,695	42%
Eastern	1,695	44%
Total	33,924	37%

Source: FC annual report

As shown in Table 06, the NBT replaced the BTT as the most important source of revenue for PCs. However, with effect from December 1 of 2019, the NBT was abolished. PC revenue in 2020 and 2021 reflects the impact of the abolishment of the NBT. From 2019 to 2020, provincial revenue dropped by 43 per cent from LKR 91 bn to LKR 52 bn. PC revenue as a percentage of GDP declined from 0.61 per cent in 2019 to 0.35 per cent in 2020 and remained at that level in 2021 (refer Table 04).

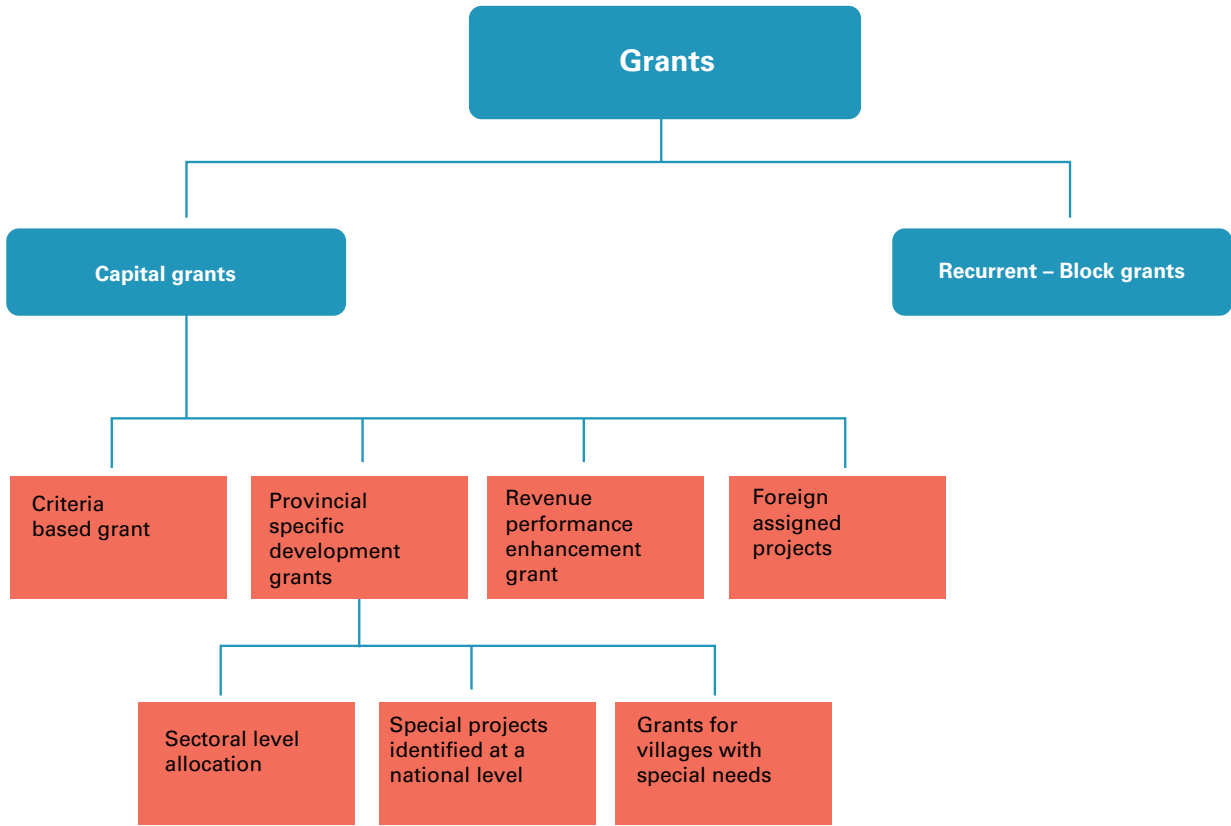
3.3.2. Grants from the central government

PC revenue on average can finance only 25 per cent of PC expenditure. The financing gap is filled by central government transfer of funds in the form of grants.

Exhibit 03 provides an overview of the different types of grants received by the PCs. Grants are given to meet both capital and recurrent expenses. There are four types

of grants PCs receive to meet capital expenditure: (1) CBG, (2) PSDG, (3) revenue performance enhancement grant and (4) foreign assigned projects. Foreign grants for special projects where the PCs have been identified as the implementing agency are obtained via the line-ministries.

Exhibit 03: Types of grants



Source: FC Annual Report 2019

Table 08 provides the purpose each grant is expected to serve and Table 09 provides the value of grants received between 2016 and 2021. Of the grants received, the block grant that is provided to meet recurrent expenditure accounts for the largest share (80 – 90 per cent of the total grant funds received by the PCs). Although the

revenue performance enhancement grant was introduced as a means of incentivising revenue collection at the provincial level, the national budget has never allocated funds to provinces via this grant due to the limited fiscal capacity of the government.

Table 08: Purpose of grants

Grant	Purpose
Block Grant (BG)	This grant is intended to meet the recurrent expenditure of provinces, including personnel emoluments ¹³⁷ and other recurrent expenditure. ¹³⁸ The amount of the grant is assessed based on the gap between recurrent needs and the devolved revenue of the provinces. It is an unconditional grant, where the utilisation of the grant is at the discretion of the provinces.
Criteria Based Grant (CBD)	This grant is intended for capital expenditure. It is intended to help improve socio-economic conditions of the people and contribute to reduced regional disparities. It is an unconditional grant, where the utilisation of the grant is at the discretion of the provinces.
Provincial Specific Development Grant (PSDG)	This grant is intended for capital expenditure. It is intended to finance capital investment projects in sectors devolved to the PCs, including health, education, infrastructure etc. The annual provincial development plan formulated by PCs provides the basis for PSDGs. This is a conditional grant where the utilisation of the funds is segmented based on sectors. ¹³⁹
Revenue performance enhancement grant	This grant was introduced in 2018. Provision of the grant is based on increases in annual devolved revenue collection by the provinces. It is an unconditional grant where the provinces have discretionary power to use the grant for capital related development programmes.

Source: FC recommendations and annual reports

Table 09: Funds received by the PCs in the form of grants: 2016 – 2021

	2016	2017	2018	2019	2020	2021
Central government transfers in the form of grants (LKR million)	196,552	200,859	203,576	218,779	284,761	318,306
Total Grants excluding foreign grants for special projects (LKR million) ¹⁴⁰	184,318	189,834	196,093	213,549	278,349	299,793
BGs (LKR million)	169,106	166,348	180,095	199,968	265,593	284,602
BGs (per cent of total grants)	86%	83%	88%	91%	93%	89%
PSDGs (LKR million)	12,177	20,250	13,536	11,376	11,004	12,632
PSDGs (per cent of total grants)	6%	10%	7%	5%	4%	4%
CBGs (LKR million)	3,035	3,236	2,462	2,205	1,752	2,559
CBGs (as per cent of total grants)	2%	2%	1%	1%	1%	1%
Foreign grants for special projects (LKR million)	12,234	11,025	7,483	5,230	6,412	18,513
Foreign grants for special projects (per cent of total grants)	6%	5%	4%	2%	2%	6%
Proportion of PC expenditure financed by grants	71%	70%	70%	71%	84%	85%

Source: CBSL annual reports of various years

137 Personnel emoluments consist of salaries and wages, overtime and holiday payments and other allowances.

138 Other recurrent expenditure consists of travelling expenses, supplies, maintenance expenditure, contractual services and transfers to local government authorities.

139 The Ministry of Finance budget estimates usually record the PSDGs under the sectors they are allocated for. However, the NBD discontinued this practice in 2022 under the belief that it limits the provinces' flexibility in utilising the funds.

140 Sum of grants excluding foreign grants for special projects.

3.4. Criteria for the Allocation of Funds

This section outlines criteria used by different agencies to allocate funds to the provinces.

3.4.1. Criteria used by the FC when preparing allocation requests

As mentioned in Section 3.2, PC budget formulation commences with PCs undertaking a needs assessment. The PCs then formulate their budget requests based on the needs assessment. The criteria used by the FC to review the budget requests and make final allocation recommendations can be divided into three broad categories: (1) criteria that guide the overall recommendations; (2) criteria to determine recurrent expenditure allocations; and (3) criteria to determine capital allocations, including the apportioning of capital allocation within sectors in each province.

Criteria used to guide the overall recommendations.

When the FC assesses the PC's allocation requests, its recommendations are guided by the following criteria.¹⁴¹

- a. The national capital expenditure budget
- b. The volume of services delivered under subjects devolved to the PCs¹⁴²

- c. The PCs' medium-term development plans
- d. Alignment with the National Policy Framework of the government and the SDGs

Criteria used to determine recurrent expenditure¹⁴³

The FC provides guidelines to PCs when PCs develop their needs assessment. The following factors are taken into consideration when determining recurrent expenditure allocations.

1. Approved cadre by the Department of Management Services, including actual current cadre and vacancies in the PCs
2. New recruitments by the line-ministries attached to the PCs
3. Estimates of personnel emoluments, salary arrears, and staff loans

141 Government of Sri Lanka. FC recommendations. 2019 – 2022

142 The volume of services varies across provinces due to variations in economic conditions of each province. Example of factors taken into consideration by the FC under this include the number of schools established within the province and the number of health staff within the province.

143 Government of Sri Lanka. FC guidelines for annual provincial recurrent needs. [Guideline for annual provincial recurrent needs.pdf](#) | Government of Sri Lanka. FC Annual Report 2019

4. Estimates of other recurrent expenditure, including maintenance of capital assets¹⁴⁴
5. Allowances for elected members of provincial and local governments
6. Transfers to local authorities
7. Government circulars issued relating to the budget and allocations to provinces
2. Availability of financial resources through various credit schemes managed by formal and semi-formal financial sector institutions.
3. Adoption of Public Private Partnership (PPP) approaches and promotion of private sector investments in commercially viable projects
4. Special development programmes and projects identified and implemented by the public and private sectors and their effect/impact on socio-economic development, and any gaps that need filling

Criteria used to determine capital expenditure¹⁴⁵

In addition to alignment with the government's development policies and contribution to furthering the SDGs, other factors taken into consideration are the following:

1. Socio-economic indicators and inter/intra-provincial disparities in development¹⁴⁶
5. Project feasibility and readiness for implementation
6. Guidelines and circulars on capital expenditure issued by relevant ministries; and any other relevant government rules and regulations.

3.4.2. Criteria used by the NBD to finalise allocations¹⁴⁷

The NBD bases its assessment on the following:¹⁴⁸

- a. The alignment of the projects with the national policy document
- b. Fiscal capacity at the central government level
- c. Historical data such as the approved cadre (when determining recurrent expenditure)
- d. Projects in the pipeline and the capabilities of the provinces to utilise funds based on past experience (when determining capital expenditure)

3.4.3. Criteria used when apportioning funds across provinces

The FC is also tasked with making recommendation on apportioning funds between the nine provinces with the objective of achieving balanced regional growth.

Block Grant

The key criterion the FC uses when deciding on the BG is the province's actual needs. First, the needs of the provinces are prioritised and assessed through a needs-based assessment. Thereafter the FC will carry out a

¹⁴⁴ Other recurrent expenditure consists of travelling expenses, supplies, maintenance expenditure, contractual services and transfers to local government authorities

¹⁴⁵ Government of Sri Lanka. FC guidelines for annual provincial capital needs. [Guideline for annual provincial recurrent needs.pdf](#) 03.03.2020 | Government of Sri Lanka. FC Annual Report 2019

¹⁴⁶ Examples of socio-economic indicators considered by the FC are mentioned in section 3.4.3

¹⁴⁷ NBD officials. Key informant interviews. 19 July 2022

¹⁴⁸ NBD officials. Key informant interviews. 19 July 2022

separate assessment to identify the revenue target of each province. The final BG recommendation is calculated by taking the difference between the recurrent expenditure needs and the devolved revenue target of the provinces (refer Table 09).¹⁴⁹

As shown in Table 10, the total recommended block grant for PCs tends to be on average 30 per cent less than the requested amount. It is evident that the FC

recommendations attempt to distribute the BG in an equitable manner. For example, the Western Province (WP) requests tend to be significantly higher compared to other provinces. However, the FC recommendations for the WP are significantly lower compared to the request. The FC recommendation reduces the large difference between the distribution of the block grant to the WP and other provinces.

Table 10: Distribution of BGs across provinces

	Total block grant allocation (LKR million)	Distribution across provinces as a percentage of total block grant								
		WP	CP	SP	NP	NWP	NCP	UP	SGP	EP
2011	94,602	9.5%	14.5%	12.4%	9.8%	13.8%	8.0%	9.5%	10.9%	11.6%
2012	94,877	9.5%	14.5%	12.4%	9.0%	13.3%	7.4%	10.0%	11.9%	12.0%
2013	100,800	8.4%	14.7%	10.8%	10.0%	14.0%	7.3%	10.2%	13.0%	11.5%
2014	126,143	9.3%	14.2%	12.5%	10.0%	13.0%	8.4%	9.9%	11.7%	10.9%
2015	167,554	11.2%	14.1%	12.8%	9.7%	13.0%	8.1%	9.7%	11.0%	10.4%
2016	169,194	12.9%	13.8%	12.1%	9.9%	12.3%	8.4%	9.7%	10.8%	10.1%
2017	166,350	9.1%	14.0%	12.6%	10.3%	13.1%	8.3%	9.7%	11.6%	11.2%
2018	180,094	8.3%	14.4%	13.2%	10.6%	12.5%	8.5%	9.0%	12.1%	11.4%
2019	199,470	8.9%	14.9%	12.4%	10.7%	12.6%	8.4%	9.5%	11.6%	10.8%

Source: Author's own calculation based on FC Annual Report 2019

Table 11: Comparison of the distribution of Block Grants – PC requests and FC recommendations

Province	2016		2017		2018		2019	
	PC Request	FC Recommendation	PC Request	FC Recommendation	PC Request	FC Recommendation	PC Request	FC Recommendation
WP	23%	13%	17%	9%	19%	9%	22%	9%
CP	13%	14%	13%	14%	15%	14%	13%	15%
SP	11%	12%	12%	12%	11%	13%	11%	12%
NP	8%	10%	9%	11%	9%	11%	9%	11%

¹⁴⁹ Based on the FC recommendations, the figures for transfers from the central government are provided by the FPD. However, at the time that the FC assesses the needs, the figures are not available, and therefore are not considered.

NWP	12%	12%	12%	13%	12%	13%	12%	13%
NCP	7%	8%	8%	8%	8%	9%	7%	8%
UP	9%	10%	9%	10%	8%	9%	8%	10%
SGP	9%	11%	10%	11%	10%	12%	10%	11%
EP	8%	10%	9%	11%	9%	12%	8%	11%
Total (LKR Million)	245,874	167,802	249,301	171,390	279,439	201,885	333,281	234,454

Source: Author's own calculation based on FC Annual Report 2019

Capital Grant

Under Article 154 R(5) of the Constitution of Sri Lanka, the FC is expected to take into account the following factors when apportioning funds across the provinces: (a) the population of each province; (b) the per capita income of each province; (c) the need to progressively reduce social and economic disparities between the provinces; and (d) the need to progressively reduce per capita income differences between the provinces.

Notable disparities exist across Sri Lanka's nine provinces (refer Table 03 for details). Hence, to ensure that capital expenditure funds are apportioned across provinces in an appropriate manner, the FC utilises a statistical method called factor analysis to apportion capital grants.

The analysis makes use of recent key statistical indicators to formulate a composite index based on which funds are apportioned across the provinces. For example, the apportionment of funds in 2022 developed an index using the following indicators with equal weights:¹⁵⁰

- Mid-year population – 2019
- Provincial GDP – 2019
- Poverty headcount ratio – 2016
- Land area of the province
- Median monthly per capita income – 2016
- Persons per medical officer – 2019
- University entrance: Science stream – 2020

Given that education and health are the most significant sectors devolved to the PCs, two key indicators from the sectors are taken into consideration when apportioning capital grants.¹⁵¹

Table 12: Distribution of capital grants across provinces

	Total capital grant (LKR million)	Distribution across provinces (as a percentage of total capital grant)								
		WP	CP	SP	NP	NWP	NCP	UP	SGP	EP
2011	14,269	14%	13%	12%	10%	12%	11%	10%	10%	7%
2012	15,900	14%	13%	13%	10%	12%	11%	10%	10%	7%

¹⁵⁰ Government of Sri Lanka. FC recommendations. 2022

¹⁵¹ According to the School Census Statistics (2020) by the Department of Census and Statistics, 96 percent of schools are provincial schools and 80 percent of students study in provincial schools

2013	12,570	13%	12%	12%	10%	11%	10%	11%	11%	10%
2014	15,601	11%	11%	10%	8%	18%	9%	14%	10%	9%
2015	15,792	13%	12%	11%	12%	11%	10%	11%	11%	10%
2016	31,909	11%	13%	9%	12%	11%	11%	10%	11%	12%
2017	34,234	9%	12%	11%	15%	10%	11%	11%	11%	10%
2018	25,789	6%	9%	9%	14%	10%	11%	14%	13%	12%
2019	27,334	6%	10%	10%	14%	10%	12%	15%	11%	13%

Source: Calculations based on FC annual reports

3.4.4. Criteria used to apportion funds across sectors within a province

As mentioned in section 3.2.1, once the final allocation to a province is decided on, the FC apportions the allocated funds across sectors within the province.

The FC decides on the sectoral allocation within a province through a weighting system done in collaboration with the planning division of the relevant PC. The PC

planning divisions are requested to weight each sector based on its importance. PCs consider the national level policy framework and their existing needs assessments when weighting each sector. The FC will then apportion the funds based on the weights for each sector agreed with the PCs for each province.¹⁵²

3.4.5. Criteria used to allocate foreign grants for special funded projects.

Allocations for foreign funded projects are determined based on the needs of the provinces and discussions with the ERD and the NPD to ensure that the projects are aligned with the government's PIP.¹⁵³ The PIP for 2021 – 2024 has estimated investing LKR 170 billion (5 per cent of total estimated investment) in regional development. The proposed projects are prioritised and approved by the NPD based on economic and financial analyses, such as cost-benefit analysis, financial analysis methods, and cost-effectiveness analysis.¹⁵⁴

According to a senior official attached to a PC, the central government consults the PCs when developing proposals for foreign funding in areas that fall under the purview of the PCs. In some cases, the central government reaches out to specific provinces for project proposals based on how relevant the foreign funding available is to that province. As discussed in Section 3.5.2, there is room for improvement in the consultations on and coordination of foreign funded projects between PCs and the central government line ministries.

3.4.6. Supplementary allocation criteria

Provinces make requests for supplementary allocations when their actual expenditure exceeds their initial allocations. For recurrent expenditure, which is partly financed

by the BG, supplementary allocations are requested based on the following reasons:¹⁵⁵

¹⁵² FC officials. Key informant interviews. 21 March 2023

¹⁵³ NPD officials (inquired via telephone)

¹⁵⁴ Government of Sri Lanka. Department of National Planning. Project Submission Format. Operation manual. 2019. https://www.npd.gov.lk/images/circulars/attachment_to_annex_1_operational_manual.pdf

¹⁵⁵ Government of Sri Lanka. FC Annual Report 2019

1. New recruitment, filling cadre vacancies, and payment of allowances
2. Releasing/attaching staff from/to line-ministries without transfer of adequate funds to meet the recurrent costs
3. Unbudgeted financial commitments due to the issue of new circulars or the implementation of new policy decisions
4. Inter-provincial transfers of officers without transfer of adequate funds

For capital expenditure, PCs prepare an annual implementation plan and initiate projects based on their final allocation. There are some instances where projects are fast-tracked even before obtaining the funding allocation due to political influence or pressure from the local community.¹⁵⁶ In such cases, the required funds can exceed the allocated funds (especially when completion of the

project is envisaged in the coming financial year), compelling the PCs to request additional funds.¹⁵⁷ According to officials interviewed, there are also instances where local politicians endeavour to use their influence with the central government to obtain additional funds for projects and these requests may not necessarily be aligned to the needs identified by the provinces.

Interviews with officials also suggest that the need for supplementary allocations can arise due to miscommunication between government agencies. For example, in certain instances when PCs formulate their initial needs assessments, the MoF notifies the PCs to not take into account previous bills in hand as they would receive the allocation for that separately. However, when the allocation comes from the MoF, this is not accounted for, creating financing issues for the PCs. In 2017, 56 per cent of the allocation for capital grants (LKR 20,344 million) was provided as a supplementary estimate for the settlement of bills in hand from the previous year.

156 Former provincial council officer. Key informant interview. 19 July 2022

157 PC, FC officials. Key informant interviews. 9 August 2022

3.5. Main Challenges

This section outlines some key constraints that impede the government from efficiently and effectively allocating resources from the national budget to the provinces

to adequately meet their needs and ensure balanced regional growth.

3.5.1. Low government revenue

As discussed in detail in Section 2.5.1, low government revenue is a key constraint faced when allocating funds from the national budget to different sectors in the economy. The same constraint is faced when allocating funds from the national budget to the provinces. The FC – as per the Constitution – is expected to make recommendations to the President based on the needs of the provinces. However, actual allocations have been significantly lower than recommended allocations (refer Table 11). This gap is largely attributed to the low fiscal capacity of the central government. The most notable difference can be

observed in relation to capital expenditure, where the gap in some years has been over 70 per cent.

In 2021, the FC had requested that at least 30 per cent of the national capital expenditure budget be allocated to the PCs.¹⁵⁸ This was subsequently reduced to 20 per cent in 2022 due to the severe fiscal constraints faced by the central government.¹⁵⁹ In reality, however, over the past five years, capital grants to the PCs have amounted to a maximum of only 3 per cent of the national capital expenditure budget.

Table 13: Gap between FC recommendations and actual funds received

Year	Capital allocation				Recurrent allocation			
	FC recommendation (LKR Mn) (1)	Budgeted allocation (LKR Mn) (2)	Actual received (LKR Mn) (3)	Percentage gap between (3) and (1)	FC recommendation (LKR Mn) (1)	Budgeted allocation (LKR Mn) (2)	Actual received (LKR Mn) (3)	Percentage gap between (3) and (1)
2015	52,500	15,792	17,597	-66.5%	159,387	167,554	167,483	5.1%
2016	56,000	33,061	15,537	-72.3%	167,802	169,194	168,382	0.3%

158 Government of Sri Lanka. FC recommendations. 2021

159 Government of Sri Lanka. FC recommendations. 2022

2017	38,432	35,809	23,769	-38.2%	171,390	166,350	165,496	-3.4%
2018	57,000	25,788	16,148	-71.7%	201,885	180,094	180,094	-10.8%
2019	40,000	27,334	13,581	-66.0%	234,454	199,970	199,970	-14.7%
2020	99,000	15,376	12,756	-87.1%	342,504	N/A	N/A	N/A

Note: The recurrent expenditure includes BGs, and the capital expenditure includes PSDGs and CBGs. The estimated transfers of Government revenue to the PCs are excluded in FC recommendations as the figures are not available to the FC when they make their recommendations.

Source: FC annual reports and recommendations from 2019 to 2022

According to officials from the NBD, the variation between the FC's recommendations and the budgeted allocations of recurrent expenditure results largely from the inclusion of personal emoluments of vacant cadre by FC in its recommendation and exclusion of the same by NBD when making the final allocation.¹⁶⁰

According to some officials interviewed, at times, the large shortfall between recommended and actual funds from the central government has made the needs assessments conducted by PCs redundant in determining the allocations from the national budget to the provinces.¹⁶¹

This has also compelled the PCs and the FC to request a higher amount of funds than what may be required, with the hope of obtaining at least half the amount of funds requested.¹⁶²

The fiscal constraints faced by the central government have also led to delays in releasing funds to the PCs.¹⁶³ This is problematic as the PCs base their implementation plan on the final allocation. The delay between the allocation and actual release of funds results in implementation issues for PCs and can cause some projects to be abandoned.

3.5.2. Lack of a streamlined consultation process between line-ministries and PCs

Although it was noted by an official from a PC that the central government consults PCs when developing project proposals, the FC has consistently noted that there is duplication of work and a mismatch in priorities due to the lack of a streamlined consultation process between line-ministries and the PCs.¹⁶⁴ This mainly occurs due to funding for provincial-level projects that fall under the Provincial List as well as the Concurrent List being provided to central government ministries with little or no consultation with the PCs on how these funds will be spent. According to the FC, when earmarking such allocations, it is important to engage PCs to enable the PCs to prepare their consolidated annual implementation plan

for the year avoiding duplication of work.¹⁶⁵ The NPD has also recognised that poor coordination among national level ministries/institutions and local government institutions in implementing development projects in rural areas is a shortcoming that undermines regional development.¹⁶⁶

According to a senior official, the bulk of capital funds for sectors devolved to the PCs is allocated to line ministries and only a small portion is allocated directly to the provinces. The FC has consistently recommended to the central government that this trend be reversed and that funds for subjects devolved to the PCs be directly

160 NBD officials. Key informant interview. 21 March 2023

161 Former provincial council officer. Key informant interview. 17 July 2022

162 Provincial council officials. Key informant interviews. 5 July 2022, 17 July 2022

163 Welikala, A. A New Devolution Settlement for Sri Lanka: Proceedings and Outcomes. Conference of provincial councils. Publisher: Centre for Policy Alternatives (Guarantee) Ltd. 2016

164 Government of Sri Lanka. FC recommendations. 2021 | FC recommendations. 2020 | FC recommendations. 2022

165 *Ibid.*

166 National Planning Department. November 2021. Public Investment Program 2021 - 2024

allocated to the PCs and that PCs be directly responsible to parliament.¹⁶⁷

As discussed in section 3.2.1., under the Constitution, the budget allocation recommendations of the FC should aim to achieve balanced regional development in the country. To fulfil this responsibility, the FC is guided by objective criteria (which is discussed in detail in subsection 3.4.3.). In contrast, FC officials interviewed stated that the national level line ministries do not use any systematic, rational methodology or objective criteria when they apportion capital funds allocated to them for subjects devolved to the PCs.¹⁶⁸ The absence of such a rational methodology to guide line ministries in apportioning funds to PCs leaves room for over-allocation or under-allocation of funds from line ministries to PCs and also makes FC recommendations redundant as they are unable to ensure that there is balanced regional development across provinces.¹⁶⁹

The same problem occurs in relation to foreign funded projects as well, since foreign funding is channelled to the provinces through the respective line-ministry or the ministry in charge of the PCs. The FC has consistently recommended that the government avoid setting up national level project offices to execute donor funded

projects that fall under devolved subjects for three reasons:¹⁷⁰ First, there is a large pool of resources, including skilled human resources, available in the PC level project offices that are underutilised due to the insufficiency of capital grants. Second, the national level project offices are often staffed with either staff from outside the public service or provincial level staff on a secondment basis that are paid additional remuneration, both of which reflect additional costs to the government. Third, when project offices that are not at the PC level are used, after project completion, it is difficult to hold the project staff responsible for any shortcomings in project implementation.

The economic programme proposed by the government to the IMF states that the government intends to “adjust the system of transfers between the central and provincial governments” as part of the tax reform programme. However, it does not provide any further information on how this is to be done or what the desired impact is.¹⁷¹ Beyond this statement, the IMF-supported programme makes no reference to the PCs and the need to address the resource constraints faced by them that undermine the achievement of balanced regional development in the country.

3.5.3. Lack of a plan and monitoring for goals such as SDGs by PCs and the FC

The FC and the PCs state that the SDGs are considered when PCs make their budget estimates. However, according to officials interviewed, in practice there is no strategic plan that is followed to reach SDG targets and to monitor progress and outcomes at the provincial level. Instead, only after a programme has been decided will the PCs and FC consider to which SDG it relates.¹⁷²

Officials at the SDG Council acknowledge that the absence of an overarching national SDG policy framework is a serious limitation to efficient budget allocation

to SDG-related programs. The officials also suggested that a key shortcoming to achieving progress toward the SDGs was the absence of an integrated national financing framework (INFF) that would seek to deploy resources beyond public spending, including private investment.

According to SDG Council officials, the government is taking steps to improve the synergies between government agencies, given the integrated and interconnected nature of SDGs. A new initiative is being implemented to encourage line ministries to propose national-level

167 The Finance Commission. September 2020. Recommendations to H.E. the President for the year 2021

168 FC Officials. Validation Workshop. 21 March 2023

169 *Ibid.*

170 Government of Sri Lanka. FC recommendations. 2023 | FC recommendations. 2022

171 International Monetary Fund. March 2023. Country Report No. 23/116

172 PC, FC officials. Key informant interviews. 9 August 2022

SDG targets. To date, 20 out of the 21 ministries selected have identified various national-level SDG targets that will be integrated into a national-level Monitoring and Evaluation framework.

According to PC and FC officials interviewed, the lack a systemic approach to ensuring progress toward the

SDGs at the sub national level is a major constraint. In their view, it is important to monitor progress toward SDG goals at the PC level to ensure that no province is left behind. The United Nations Sustainable Development Framework for Sri Lanka for 2023-2027 also recognises the importance of the PCs in achieving balanced regional development.¹⁷³

173 United Nations Sri Lanka. June 2022. United Nations Sustainable Development Cooperation Framework for Sri Lanka 2023-2027. Government approved draft.

3.6. Conclusion

Along with the Constitution of Sri Lanka that clarifies the relationship between the central government and the PCs in relation to public finances, the FRs, the Provincial Councils Act, and financial statutes passed by the PCs comprise the legal framework governing provincial level budget formulation. The key agency at the centre of PC budget formulation is the FC, established by Article 154 (R) of the Constitution that functions as the negotiator between the central government and the PCs. Under the Constitution, the FC makes recommendations to the President on the allocation of funds from the annual budget to the provinces and on how such funds are to be apportioned across the provinces. The other key agencies involved in the budget formulation process are the PCs and the Ministry in charge of the PCs.

The two main sources of funding for PCs are provincial revenue and grants from the central government. PCs are heavily dependent on grants from the central government, which account for 70 – 85 per cent of the total annual expenditure of the PCs. Although under the Constitution PCs have the power to borrow funds, to date the requisite laws to enable the PCs to make use of this provision have not been passed.

Formulation of PC budgets are guided by the Ninth schedule of the Constitution, which lays out the activities that fall under the purview of the PCs vis-à-vis the central government. Activities falling exclusively under the PCs are in the PC list; activities exclusively under the central government are in the Reserved list; and shared activities are in the Concurrent list. In addition, the needs

assessments and medium-term development plans prepared by the PCs guide FC allocation recommendations. The FC's recommendations to apportion funds among provinces are guided by a composite index based on selected socio-economic indicators and the need to progressively reduce social and economic disparities across provinces.

Low government revenue is the main constraint that undermines the ability of the PCs to receive sufficient funds to meet their needs. Another key constraint is the allocation of funds to central government ministries for provincial-level projects in areas that fall under the Provincial List and the Concurrence List, with little or no consultation with the PCs on how these funds are to be spent. This leads to duplication of work, a mismatch of priorities, and a wastage of scarce public resources. Further, the absence of a rational system to allocate funds from line ministries to PCs undermines the achievement of balanced regional development across provinces. Although the SDGs are incorporated into national, sectoral, and provincial plans, realisation of the SDGs is undermined by the absence of an overarching national SDG policy; the absence of a monitoring framework, particularly at the PC level; and the absence of an integrated financing framework.

The IMF country report for the facility for Sri Lanka approved in March 2023 makes no reference to the importance of introducing a better system of resource allocation from the central government to the provinces, which is critical for the country to achieve balanced

regional development. The government's proposed Economic Programme that is annexed to the country report published by the IMF states that the government plans to

adjust the system of transfers between the central government and the provinces but does not provide details of how this is to be done or what its desired impact is.¹⁷⁴

174 International Monetary Fund. March 2023. Country Report No. 23/116

ANNEXURES

Annexure 1: Impact of Parliament Debates/Committee Stage Revisions

Difference between the proposed allocation (Appropriation Bill) and the final approved allocation (Appropriation Act)¹⁷⁵ (Figures in LKR Billion)

	2019		2021		2022	
	Appropriation Bill	Appropriation Act	Appropriation Bill	Appropriation Act	Appropriation Bill	Appropriation Act
Ministry of Health	187.5	185.5	159.6	159.5	153.5	158.5
Ministry of Education	105.0	105.0	121.2	126.5	127.6	162.9
Ministry of Water Supply	126.5	126.5	75.8	101.3	32.5	47.5
State Ministry of Women and Child Development, Preschools and Primary Education, School Infrastructure and Education Services	9.1	9.1	33.0	30.5	22.8	23.8
State Ministry of Samurdhi, Household Economy, Micro-finance, Self-employment and Business Development	64.9	64.9	113.8	84.7	75.0	75.0

Source: Parliament of Sri Lanka, 2019, 2021, 2022 Appropriation Bills and Acts

Annexure 2: Key Spending Agencies of the Five Social Sectors

1. Health sector

- Ministry of Health

2. Child protection

- State Ministry of Production, Supply and Regulation of Pharmaceuticals and Community Health
- State Ministry of Women and Child Development, Preschools and Primary Education, School Infrastructure and Education Services
- Ministry of Justice
- Ministry of Education

3. Social protection

- State Ministry of Samurdhi, Household Economy, Micro-finance, Self-employment and Business Development
- Department of Samurdhi Development
- Ministry of Health
- State Ministry of Women and Child Development, Preschools and Primary Education, School Infrastructure and Education Services
- Ministry of Finance

4. Water and sanitation

- Ministry of Water Supply
- State Ministry of Rural and Divisional Drinking Water Supply Projects Development
- State Ministry of Backward Rural Areas Development and Promotion of Domestic Animal Husbandry and Minor Economic Crop Cultivation

5. Education

- Ministry of Education
- State Ministry of Women and Child Development, Preschools and Primary Education, School Infrastructure and Education Services
- State Ministry of Education Reforms, Open Universities and Distance Learning Promotion
- State Ministry of Skills Development, Vocational Education, Research and Innovation
- National Education Commission
- Minister of City Planning, Water Supply and Higher Education
- University grants commissison
- Ministry of Higher education and highways
- Ministry of National Policies, Economic Affairs, Resettlement & Rehabilitation, Northern Province
- Ministry of Buddhasasana Religious and Cultural Affairs
- National Budget Department
- State Ministry of Dhamma Schools, Pirivenas and Bhikkhu Education
- Development, Vocational Training & Skills Development and Youth Affairs

Annexure 3: Devolved Sources of Revenue

The Constitution of the Democratic Socialist Republic of Sri Lanka, ninth schedule item no.36 of list 1 (provincial council list)

36.01	Turnover taxes on wholesale and retail sales within such limits, and subject to such exemptions as may be prescribed by law made by parliament
36.02	Betting taxes and taxes on prize competitions and lotteries, other than national lotteries and lotteries organised by the Government of Sri Lanka
36.03	License taxes, arrack, toddy rents, tapping license fees and liquor license fees
36.04	Motor vehicle license fees within such limits, and subject to such exemptions as may be prescribed by law made by parliament
36.05	Dealership license taxes on drugs and other chemicals
36.06	Stamp duties on transfer of properties such as lands and motor cars
36.07	Toll collections
36.08	Fees imposed by courts
36.09	Fees charged under the Medical Ordinance
36.10	Fees charged under the Motor Traffic Act
36.11	Department fees in respect of any of the matters specified in this list
36.12	Fees under the Fauna and Flora Protection Ordinance
36.13	Fees on lands alienated under the Land Development Ordinance and Crown Lands Ordinance
36.14	Court fees, including stamp fees, on documents produced in court
36.15	Regulatory charges under the Weights and Measures Ordinance
36.16	Land revenue, including assessment and collection of revenue, and survey and maintenance of land records for revenue purposes
36.17	Taxes on land and buildings, including the property of the state, to the extent permitted by law made by parliament
36.18	Taxes on mineral rights within such limits, and subject to such exemptions as may be prescribed by law made by parliament
36.19	Licensing fees on the possession, transport, purchase and sale of intoxicating liquors
36.20	Other taxation within the province in order to raise revenue for provincial purposes to the extent permitted by or under law made by parliament

Annexure 4: List of Agencies Interviewed & Interview Guides

List of Agencies interviewed

1	Finance Commission
2	Ministry of Health
3	Department of National Budget
4	Western Provincial Council
5	Ministry of Education ¹⁷⁶
6	Ministry of Water Supply
7	National Water Supply and Drainage Board
8	Department of Social Services
9	Ministry of Women, Child Affairs and Social Empowerment

Discussion Guide for Sectors

Key research question	Questions
Basis of fund allocation	<ol style="list-style-type: none"> 1. What are the key sources of funding for the sector? 2. What are the key criteria considered when drafting the medium-term plans and annual financial plans? How do these documents influence the allocation received by the ministry? 3. Are any national policy goals referred to when deciding budgetary requirements? How do the above documents influence the allocation received by the ministry? 4. When submitting recurrent and capital expenditures in response to the Nation Budget Department's (NBD) 'Budget Call', on what basis are these figures decided? Examples for recurrent and capital expenditure? 5. The 'Budget Call' in 2018 (Circular No. 2/2017) specified to stick to the performance-based budgeting system. Was this relevant only for 2018 or is it still based on the performance-based budgeting system?

	<ol style="list-style-type: none"> 6. Does the budgeting methodology influence the allocation obtained by the ministry? If so, how? 7. What is needs assessment and how is it carried out? 8. When submitting spending requirements for new projects, in your experience are there any factors that will increase the likelihood of getting the Treasury's approval? E.g., regional/ political bias. Please provide some examples. 9. Does the ministry ever obtain the entire amount that is requested in response to the 'Budget Call'? 10. If there is a shortfall – on what basis are projects prioritized? 11. When formulating annual financial plans, what are the key factors considered? 12. Does the Treasury disburse funds on a timely basis? If there is a delay what happens? 13. Is the political economy influential in determining the budget? If so, how significant is the influence? Are there any examples that can be shared with us?
Key agencies	<ol style="list-style-type: none"> 14. During the consultations with the NBD, who are the representatives that take part from the ministries? 15. During these consultations are there any significant changes made in requested allocations?
Legal framework	<ol style="list-style-type: none"> 16. As per the 'Budget Call', ministries are supposed to submit all annexes by mid-August of the preceding budget year. Is this timeline met? 17. If not, please provide reasons as to why there are difficulties in meeting the timeline? 18. Any legal aspects that we are missing out on? 19. What are the bottlenecks that are faced when deciding the allocation or getting funds from the Treasury?
Additional question (additional questions relevant to the sector and budget allocation, if any, were asked in this section)	<ol style="list-style-type: none"> 20. Do you think there is room for improvement in the way the national budget can be allocated?

Discussion Guide for Provinces

Key research question	Questions
Basis of fund allocation to the provincial councils	<ol style="list-style-type: none"> 1. What are the key sources of funding for a PC? 2. What are the key criteria considered when drafting the medium-term plans and annual financial plans? 3. How do the above documents influence the allocation received by PCs? 4. Are there any national policy goals that are considered when making funding requests to the Financial Commission (FC)? If so, please provide certain examples of such goals and the alignment with the said policy? 5. Are there any factors that increase the likelihood of obtaining funding for new projects?

	<ol style="list-style-type: none"> 6. Is there a duplication of funds received from the FC and respective line-ministries? 7. If such a duplication exists, does it disrupt the fund allocations to the provinces? What is the best way suggested to limit the duplication of funds? 8. Do you think that the PSDG and CBG allocated by the FC address the regional inequalities? 9. Is the final allocation provided from the national budget sufficient to meet the requirements of the PCs?
Key agencies	<ol style="list-style-type: none"> 10. Who are the key agencies consulted when drafting the funding requests submitted to the FC? 11. What are the roles played by the NBD and NPD when assessing the fund requirement? 12. Given that the two largest devolved sectors are education and health, are there any consultations with the Ministry of Health and Ministry of Education when deciding fund requirements?
Additional questions	<ol style="list-style-type: none"> 13. Are there challenges that disrupt the channel through which the national budget reaches the PCs? 14. Do you think there is room for improvement in the way the national budget is allocated to the PCs?

Discussion Guide for the Finance Commission

Key research question	Questions
Basis of Fund allocation to Provincial Councils	<ol style="list-style-type: none"> 1. Are any national policy goals taken into consideration when assessing the requests for funding from PCs? If so, please provide certain examples. 2. When recommending grants, are the historical allocations and utilisation of grants by PCs taken into consideration? 3. Are the medium-term plans and annual development plans drafted by the provinces considered when determining the funds for provinces? 4. The capital grant (PSDG, CBG) recommendations are based on the government's estimate for the capital expenditure estimates. Do you see any issues in basing the grant recommendation on these estimates? 5. The 2022 Finance Commission (FC) recommendations suggest that 20 per cent of total capital expenditure of the government be allocated to PCs and the 2021 recommendations suggest that the figure be 30 per cent. How does the FC decide on such a percentage? 6. Based on the FC recommendations, capital funds are apportioned among the provinces based on factor analysis. Does this still take place? 7. If so, please provide insight on how this works? 8. The factor analysis is based on seven key indicators as per the FC recommendation documents. On what basis were these indicators selected? 9. Are there any practical challenges involved in conducting this analysis? 10. Is there up to date data available to conduct the analysis? 11. We noticed that for certain devolved activities (particularly education and health) the PCs receive funding from the PSDG and line-ministries. Do you think this is an efficient method of fund allocation?

	<p>12. Does this lead to a duplication of funds? If so, what can be done to limit this?</p> <p>13. When there is a shortfall in obtaining funds, how are the provincial financial needs prioritised?</p> <p>14. Are there any factors that increase the likelihood of a certain province obtaining more funds as opposed to another province?</p> <p>15. In the 2022 recommendations, the FC provided recommendations under two options. Why was there such a distinction made?</p>
Key agencies	<p>16. What is the role played by the NBD and the NPD when assessing the fund allocation for PCs?</p> <p>17. During these consultations with the NBD and NPD, are there any significant changes made in requested allocations?</p> <p>18. Are there any other key stakeholders involved in the budget allocation process?</p>
Legal framework	<p>19. Article 154 (R) of the constitution notes that the central government shall provide funds from the annual budget to satisfy the needs of the Provincial Councils (PCs). What is categorised as these needs?</p> <p>20. The constitution also notes that the FC should ensure balanced regional development. What activities does the FC undertake to meet this objective? Does the concurrent list in the PC Act limit the fiscal autonomy of the PCs? If so, how?</p>
Additional questions	<p>21. Are there any challenges that disrupt the channels through which the national budget is allocated to the PCs?</p> <p>22. Do you think there is room for improvement in the way the national budget can be allocated to the PCs?</p>

Discussion Guide for Department of National Budget

Key research questions
<ol style="list-style-type: none"> 1. We noticed that the macro-fiscal framework is the initial document created in the budgetary process. How does this document influence sectors when deciding their allocations? 2. The annual 'Budget Call' (those prior to 2019) specifies that spending agencies should use a performance-based methodology. How does this methodology impact the allocation of funds to provinces and sectors? 3. Is this methodology still recommended? If so, why? If it was discontinued, what is the reason? 4. In the initial stages of consultation with the line-ministries and Finance Commission (FC), what are the evaluation criteria used by the NBD to assess the requests made by the spending agencies? 5. Are the medium-term plans and annual development plans drafted by the ministries considered when deciding the allocations? 6. During the consultations with the ministries, does the NBD meet with each ministry separately? 7. Who usually part takes in these discussions? 8. What factors determine the ability of a spending agency to secure the funding that they requested? 9. If a certain request has more public focus (e.g., welfare programme etc.), is the NBD more likely to allocate funds for such proposals? 10. In your experience, when finalising allocations are certain spending agencies prioritised over others? If so, please provide examples of such agencies.

11. Does the NBD consider the utilisation of funds by ministries in previous years when assessing recommendations and providing allocations?
12. It is noted that the NBD specifies an expenditure ceiling for all spending agencies. Is this ceiling for both recurrent and capital expenditure?
13. On what basis is the ceiling determined? Why is the ceiling not mentioned in the 'Budget Call'?
14. Is the budget decision making process more demand (need based) or supply based (available fiscal capacity)?
15. In relation to Provincial Council (PC) finances, we note that the funds given by the Treasury to the FC are significantly lower than the PCs' requests and FC's initial recommendations. What is the reason for this discrepancy?
16. Despite this consistent gap between the FC requests and funds allocated, the FC consistently requests for a higher amount. Why does this happen?
17. In the budget estimates, as there is no separate budget head for PCs, under which budget heads are the grants given to the PCs recorded?
18. What are the challenges faced when allocating the national budget? What are the challenges faced when deciding the national budget? (allocation)
19. Do you think there is room for improvement in the way the national budget can be allocated?

