

BRIEFING NOTE

NAVIGATING SRI LANKA'S DEBT

Better reporting can help – a case study on China debt

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Verité Research

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1. Introduction

Sri Lanka has an increasingly negative trajectory of public debt. This challenge invites more focus on better information and better management of the country's debt position and debt dynamics.

However, the initiatives and policies designed to assist Sri Lanka navigate its debt burden face an informational problem – right at the starting block: the available published data does not accurately reflect Sri Lanka's debt burden and its distribution among external lenders. This is because Sri Lanka's regular reporting of debt is limited to a breakdown of external debt held directly by the central government only, and excludes external debt held by other government agencies such as state-owned enterprises (SOEs).

This brief shows that the failure to factor external debt outside central government agencies leads to an underestimation of Sri Lanka's debt. This underlying informational problem is illustrated in three sections. The first section outlines the difference between public external debt and central government external debt. The second section demonstrates the lack of visibility on the composition of external public debt figures using the example of how Sri Lanka reports its external public debt to China as a case study. The analysis exposes a loophole, by which the debt statistics can be manipulated by moving the debt from the books of the central government to the books of SOEs. The final section concludes by highlighting the critical importance of improving the reporting of Sri Lanka's debt position to better reflect its debt dynamics and obligations.

2. Public External Debt is larger than Central Government External Debt

The Central Bank of Sri Lanka (CBSL) publishes a breakdown of the external debt of the central government. However, this is only a subset of the total public debt – that is, the debt owed by the Sri Lankan public sector to external parties, for which the Sri Lankan public is liable.

The standard definition for the calculation for public sector debt includes the debt of (i) the central government; (ii) the central bank; and (iii) public sector corporations (including deposit-taking institutions such as state-owned banks and any other state-owned enterprises).¹

However, in Sri Lanka, government financial reports do not provide ready visibility of the composition of external public debt by indebted institution or by lender. This informational lacuna conceals the full extent of public external debt from the public. Such opacity on the actual debt position can undermine efforts towards understanding and improving Sri Lanka's debt dynamics.

3. Case Study: Underestimating debt to China

The reporting of Sri Lanka's debt to Chinese government entities (referred to here as simply China) serves as an illustration of this debt reporting problem. For instance, those who follow the figures published by the Central Bank are likely to conclude that Sri Lanka's total debt to China is USD 3,387 million (LKR 615 billion) in 2019.² This figure was equivalent to 10% of Sri Lanka's

¹ IMF, 'External Debt Statistics – Guide for compilers and users', 2014, available at: <http://tffs.org/pdf/edsg/ft2014.pdf>, [last accessed 03 April 2020].

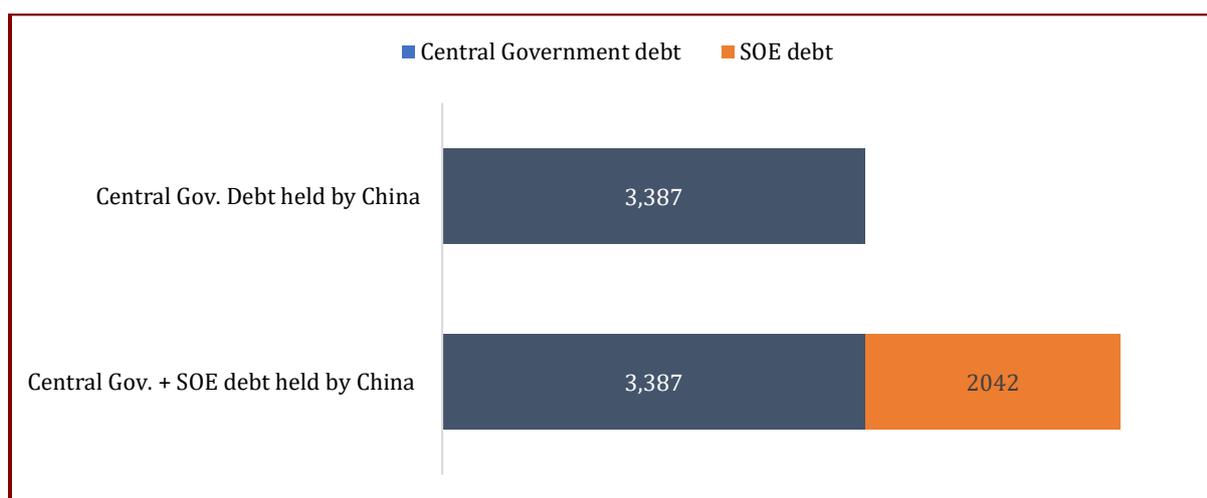
² Converted at 2019 end year exchange rate of LKR 181.63: USD 1

total central government external debt.³ However, these numbers exclude the debt owed to China by Sri Lanka's state-owned enterprises (SOEs).

Exhibit 1 and 2 shows that the debt owed by SOEs to China amounted to USD 2,042 million (LKR 371 billion) as of 31 December 2019.⁴ When this debt is taken into consideration, Sri Lankan government's total debt to China – that is public debt – increases by 60% to USD 5,429 million (LKR 986 billion).⁵

This example demonstrates that the failure to properly report public debt owed by SOEs can lead to a significant understatement in the reporting of Sri Lanka's actual debt obligations.

Exhibit 1: Estimating Sri Lankan government debt to China (as of 2019) in USD millions



Source: Central Bank Annual Report 2019 and Ministry of Finance (MoF) Annual Report 2019

It also shows that a large quantum of Sri Lanka's external public sector debt lies outside the central government with Sri Lanka's SOEs. The problems and concerns of servicing the (unreported) SOE debt are no different from those of servicing the (reported) central government debt. Therefore, reporting only central government debt provides a misleading picture of Sri Lanka's debt position and dynamics.

3.1 Debt accounting loophole: misleading the debt dynamics

The weakness in reporting also creates a loophole that the government can be exploited to actively conceal the actual debt obligations from the public, and create misleading debt dynamics. Exhibit 2 provides the list of loans held by SOEs. Examples from this list can be used to illustrate the loophole.

³ Central Bank of Sri Lanka, 'Central Bank Annual Report 2019 - Table 115, 2020, available at: <https://www.cbsl.gov.lk/en/publications/economic-and-financial-reports/annual-reports/annual-report-2019>, [last accessed 21 September 2020].

⁴ Converted at 2019 end year exchange rate of LKR 181.63: USD 1

⁵ Converted at 2019 end year exchange rate of LKR 181.63: USD 1

Exhibit 2: Debt owed by SOEs to China

Project loan	Lending agency	Borrowing agency	Outstanding value (in USD millions) ¹
<i>SOE project loans from China EXIM Bank² [Loans which have been transferred from the central government to respective SOEs and are not in the Guarantee list of the MoF]³</i>			
Puttalam Coal Power Project	The Export-Import Bank of China	Ceylon Electricity Board	828
Hambantota Port Development Project	The Export-Import Bank of China	Sri Lanka Ports Authority	951
Mattala Rajapaksa International Airport Project	The Export-Import Bank of China	Airport & Aviation Services (Sri Lanka) Ltd	123
Total			1,902⁴
<i>SOE project loans from China which are guaranteed by the Treasury (Found in the Guarantee list of the MoF)</i>			
Broadlands Hydropower Project	Industrial and Commercial Bank of China Limited	Ceylon Electricity Board	23.1
Colombo Lotus Tower Project	The Export-Import Bank of China	Telecommunications Regulatory Commission of Sri Lanka	40.7
-	China Development Bank Corporation	National Water Supply & Drainage Board	48.8
-	China Development Bank Corporation	National Water Supply & Drainage Board	13.7
-	China National Chemical Engineering No.14 Construction Co. Ltd	Ceylon Petroleum Corporation	13.5
Total			140
Grand Total (Total outstanding SOE loans from China)			2,042

¹ The outstanding debt figures shown here are those as of 31 December 2019.

² Distilled from the Central Bank Annual Report 2019, Chapter 6, table 6.9

³ According to the Ministry of Finance (MoF) Annual Report 2014 - Note - 28 (I) - Statement of Foreign Loan Balances

⁴ Converted at 2019 end year exchange rate of LKR 181.63: USD 1

Source: Central Bank Annual Report 2019 and Ministry of Finance (MoF) Annual Report 2019

The reporting of loans taken for the Puttalam Coal Power Plant, Hambantota Port Development project and the Mattala Rajapaksa International Airport provide instructive illustrations of the informational problems created by shifting debt from central government to SOEs. These loans were originally recognised properly as central government debt. However, in 2014 the outstanding balances of these loans were transferred from the general treasury (central government books) to the books of several SOEs.

The loan taken for Puttalam Coal Power Plant was transferred to the Ceylon Electricity Board; the loan taken for Hambantota Port Development was transferred to the Sri Lanka Ports Authority; the loan taken for Mattala Rajapaksa International Airport to the Airport and Aviation Services (Sri Lanka) Ltd (Refer Annex 1). These movements of debt resulted in restating central

government debt as a lower value, even though the actual amount of public debt was unchanged. It was an accounting sleight of hand that made it appear as if the debt had reduced.⁶

3.2 Debt accounting failures: lost in transition

With respect to the Hambantota Port Development in particular, the National Audit Office (NAO) notes that in 2017 the Hambantota Port Development debt was transferred back into the books of the treasury and taken off the books of the SLPA.⁷ Contradicting the NAO, the Central Bank reports the debt as outstanding and lists it as a liability of the SLPA in its 2019 Annual Report. However, at present, the debt does not appear either in the central government books, nor the SLPA books (Refer Annex 2).⁸

The reports of the Auditor General in Sri Lanka also provide cause for concern. They suggest that the MoF makes serious mistakes with regard to counting and reporting debt correctly, even when that impacts statutory obligations. This particular example shows that debt can also get *miscounted* by simply being *mis-placed* as it is moved around from the books of the central government to that of SOEs and vice-versa.

4. Conclusion

This *brief* highlights the need for improving the reporting framework on Sri Lanka's debt. It does this by evaluating Sri Lanka's debt position with China, where a considerable proportion of the overall debt is accounted for by SOEs, which is currently undisclosed in the regular reporting of public debt.

As Sri Lanka prepares to navigate the most challenging period the country has faced in terms of debt management, improving the reporting of debt to better reflect the actual debt position and dynamics is an important first step in the path to a solution.

⁶ Ministry of Finance Sri Lanka (MoF), 'Annual Report 2014', Page 146, 276 and 302, available at: <http://treasury.gov.lk/documents/10181/12870/2014/a9d95930-b101-40dc-9b1b-cd1ebb2a82ba> [last accessed 13 October 2020].

⁷ According to the NAO this transfer is as per the Cabinet Memorandum No. MPS/SEC/2017/32 dated 20 July 2017 named "Hambantota Port Relief Agreement" the cabinet approval of which was granted on 04 August 2017.

⁸ Ministry of Finance Sri Lanka (MoF), 'Annual Report 2019: Report of the Auditor General on the Financial Statements of the Government for the year ended 31st December 2019', Section 1.6.2.1 (a) (ii), available at: <http://treasury.gov.lk/documents/10181/12870/Annual+Report+2019-20200625-rev2-eng/5952fd01-ba62-4186-a270-fe87fd87fd5c> [last accessed 13 October 2020].

Annex 1: Loan transfers from the central government to the SOEs as per the Annual Report 2014.

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Explanatory Notes

Note 10 - Vehicles on Lease

In terms of the Budget Circular No 150, the Department of National Budget has procured 2,519 motor vehicles and 21,498 Motorcycles on Lease in 2014 and a sum of Rs. 1,839,590,000 has been paid as lease installments during the year which included under the Object code No 2101-Acquisition of Vehicles.

Note 30.1 - Disposal of Movable Assets

Disposal of Movable Assets in the reporting period is disclosed in the Financial Statements of the following year.

Schedule I - Expenditure Committed in 2013 and Paid in 2014

The total expenditure incurred during the year 2014, represents recurrent expenditure of Rs. 27,478 million and Capital expenditure of Rs. 44,922 million, related to the reporting period of 2013.

Schedule II - Total Revenue and Expenditure of Provincial Councils

Total Revenue of Rs. 59,979,015,473 and Total Expenditure of Rs. 195,782,311,048 were reported for 9 Provincial Councils. (Provincial amounts)

Investment in Physical Assets

The detailed information on public investment in physical assets, both in terms of foreign and local funds, for the period from 2005 - 2014, amounts to Rs. 2,576,199 million, which covers around 75% of the same being a significant capital formation, is provided in a separate report.

Loans Transferred from Debt Stock

Following loan balances have been transferred from debt stock to relevant public enterprises:

Loan key No.	Institution	Project	Amount (Rs.)
2005045	Ceylon Electricity Board	Puttalam Coal Power Project	32,762,150,000
2007044	Sri Lanka Ports Authority	Hambantota Port Development Project	31,206,345,802
Total			63,968,495,802

Source: Ministry of Finance Sri Lanka (MoF), Annual Report 2014

NOTE - 28 (j) - STATEMENT OF FOREIGN LOAN BALANCES							(Rs.)
Name	Loan Key	Balance as at 01.01.2014 (8343)	Accounted during the year	Repayments	Parity	Closing Balance as at 2014.12.31 (8343)	
Danske Bank							-
Towns South of Kandy Water Supply Project	2006072	4,466,660,694		750,559,787	(446,783,142)	3,269,317,785	
Exp. Development Bank of Iran							-
Uma Oya Hydro Electric and Irrigation Project	2008027	6,618,625,856			14,963,066	6,633,588,922	
Implementation of Rural Electrification Project 8	2010005	5,726,897,959			(667,466,659)	5,059,431,300	
Exp. Imp. Bank of China							-
Muthurajawela Oil Tank Farm Project	2001079	2,206,265,577		733,575,327	1,478,684	1,474,168,934	
Hambantota Port Development Project	2007044	32,073,358,419				(967,012,617)	
Bunkering Facility & Tank Farm Project at Hambantota	2009009	7,739,139,898	770,609,177	385,201,189	18,244,263	8,142,792,149	
Colombo - Katunayake Expressway (CKE) Section A2	2009010	8,312,466,974		690,966,308	15,487,111	7,636,987,778	
Colombo - Katunayake Expressway (CKE) Section A1	2009011	9,158,139,838		761,262,101	17,062,701	8,413,940,438	
Colombo - Katunayake Expressway (CKE) Section A3	2009012	6,249,602,639		519,539,661	11,644,807	5,741,707,785	
Colombo - Katunayake Expressway (CKE) Section A4	2009013	8,732,118,688		725,849,476	16,268,971	8,022,538,182	
Puttalam Coal Power Project Phase II	2009027	2,601,274,669				(2,601,274,669)	
Mattala Hambantota International Airport Project	2010006	1,356,473,947				(1,356,473,947)	
Supply of 13 Nos. Diesel Multiple Units to Sri Lanka Railway Project	2010007	8,495,630,292	5,405,023,262	-	(277,046,405)	13,623,607,149	
Supply of 2 Nos. MA60 Aircraft Project	2010029	5,698,868,345			(113,581,062)	5,585,287,283	
Procurement of Material for the Northern Province Power Sector Development Programme	2010030	2,842,893,240	1,170,009,027	199,937,051	10,994,582	3,823,959,798	
Northern Road Rehabilitation Project (A009) from Galkulama to 230 km post	2010031	8,534,908,185	746,054,417	385,031,708	18,441,387	8,914,372,280	
Northern Road Rehabilitation Project - 11B	2010032	4,186,985,235	1,370,408,895	-	13,442,542	5,570,836,672	
Northern Road Rehabilitation Project - (Mulatiyu - Kokkila) 11A	2010033	4,248,401,550	1,342,234,679	231,990,596	12,471,829	5,371,117,463	
Northern Road Rehabilitation Project - (AB020) (AB032) (AB016) (AB018)	2010034	6,964,423,102	2,805,628,933	405,521,212	24,505,735	9,389,036,557	
Northern Road Rehabilitation Project A009 (from 230km to Jaffna)	2010035	8,857,598,463	361,676,950	382,480,730	18,516,539	8,855,311,222	
Highway Section Pinnaduwa to Kodagoda (30km to 45km)	2011005	4,191,146,977	847,396,829	-	13,001,562	5,051,545,358	
Highway Section Kodagoda to Godagama (45km to 61km)	2011006	4,758,223,239	1,146,614,596	-	14,379,931	5,919,217,786	
Rehabilitation & Improvement of 67 km Length of Navatkuli, Karaitivu, Mannar Road	2011008	2,565,715,677	2,996,716,473	-	15,179,057	5,577,611,207	
Rehabilitation & Improvement of 113 km Length of Puttalam Marichchikade, Mannar Road	2011009	2,153,260,884	3,278,813,431		13,883,360	5,445,957,675	
Finance Material Required for Lighting Sri Lanka Eastern Province Project	2012001	1,818,136,179	2,088,051,287		12,893,778	3,919,081,244	
Hambantota Port Development Project Phase II	2012033	757,875,668				(757,875,668)	
Matara - Bellaitta Section of Matara - Kataragama Railway Line Extension	2013005	3,200,000,000	10,162,395,550		34,697,751	13,397,093,301	
Hambantota Port Development Project Phase I for Ancillary Work and Supply of Equipment Project	2013014						
Greater Kurunegala Water Supply and Sewerage Project	2013041		762,863,668		(53,517,058)	709,346,610	

Source: Ministry of Finance Sri Lanka (MoF), Annual Report 2014

Annex 2: Auditor General's Report on the Hambantota Port Loan

- (ii) Out of the borrowings made by the Government for the construction of Hambantota Port, a sum of Rs.172,717 million represents the balance payable as at 31 December 2019. The approval of the Cabinet of Ministers for the Cabinet Memorandum No. MPS/SEC/2017/32 dated 20 July 2017 named "Hambantota Port Relief Agreement" presented by the Ministry of Port and Naval Affairs in this connection, had been granted on 04 August 2017. Accordingly, the General Treasury had undertaken the responsibility for the settlement of remaining balance of the debts made by the Sri Lanka Government for the construction of Hambantota Port so as to be effective from the date of enforcement of the said Relief

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Agreement, whereas that debt balance had not been included in the financial statements of the Government. Moreover, the above balance had also been eliminated from the financial statements of the Sri Lanka Ports Authority as at 31 December 2019.

Source: Ministry of Finance Sri Lanka (MoF), Annual Report 2019