

# STATE OF THE BUDGET

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Assessment of the Fiscal,  
Financial and Economic  
Assumptions used in the  
Budget Estimates

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Financial and Economic Assumptions  
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March 2024

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State of the Budget- 2024 is a public report compiled by Verité Research, which engages a similar mandate to that of the parliamentary Committee on Public Finance (COPF). The report provides an assessment and analysis of the revenue, expenditure, macro-fiscal and governance outlook on the budget 2024. It aims to inform a wider audience of stakeholders, including the parliament, and COPF. Verité Research anticipates that the contents of this report can improve informed engagement, by the wider public and the parliament, with Sri Lanka's annual budget.

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# SECTION 1: INTRODUCTION TO THE REPORT

# Overview

This *State of the Budget* report compiled by Verité Research assesses the financial, economic and fiscal assumptions, the computation of estimates, and reporting standards applied in the 2024 Budget Speech. The report is compiled using two principal sources of information: the 2024 Budget Speech (delivered in Parliament) and the Approved Budget Estimates for 2024 (provided by the Ministry of Finance).

*State of the Budget* is set out in four main sections. Section one introduces the report, sets out its objectives and provides some background to Sri Lanka's budget formulation process. Section two draws attention to the various deficiencies in the budget. These include missing estimates, injudicious macro-economic assumptions, differences in numbers across different classifications and formats, and fiscal measures with undisclosed consequences.

Section three provides an analysis of the revenue estimates used in Sri Lanka's 2024 Budget. The focus is primarily on tax revenue, and the section is divided into three categories: (1) taxes on income and profits, (2) taxes on domestic goods and services, and (3) taxes on international trade.

Government estimates anticipate increases in certain areas of tax revenue, despite the absence of new tax policies or administrative measures. Section three thus contrasts revenue estimates made by Verité Research, using realistic assumptions, against those in the government budget. The 2024 budget proposes a target of LKR 4,164 billion in total revenue, which is a 42% increase from the revised estimates for 2023. **Verité Research projects a total revenue of LKR 3,570 billion, which is 14% lower than the government's estimate.**

Section four focuses on expenditure allocations. Three key areas highlighted in this section are: (1) expenditure by type, (2) expenditure by ministry, and (3) issues and concerns relating to expenditure allocations. Based on the estimates provided by the government, total expenditure for 2024 is estimated to be LKR 6,558 billion: a 12% increase from the revised estimates for 2023 (excluding bank recapitalisation and public debt amortisation). Total interest payments account for 66% of the increase in expenditure allocations for 2024. For the scope of this report Verité Research does not attempt to project expenditure.

Section four also highlights concerns regarding the 2024 budget, including the rise in allocation of resources to the Defence sector and the discretionary budget, the prioritisation of the Ministry of Transport and Highways in the allocation of capital expenditure, and a high interest-to-revenue ratio.

Through the dissemination of the research findings in this report, Verité Research seeks to encourage and promote public engagement, accountability, and informed decision making in the annual budget process in Sri Lanka.

'State of the Budget 2024' will be hosted on the online platform PublicFinance.lk.

# Background

In March 2023, the International Monetary Fund (IMF) approved a 48-month Extended Arrangement under the Extended Fund Facility (EFF), providing support to Sri Lanka's efforts for fiscal consolidation and debt restructuring. As part of this programme, numerous reforms have been initiated to help the country navigate out of a deep economic and debt crisis.

The 2024 budget was presented to the parliament on November 13, 2023, by President Ranil Wickremesinghe, and outlines the government's proposals to raise public funds through taxation and proposals for expenditure during the year.

The 2024 Budget includes a planned increase in public sector salaries to address the impact of high inflation on real income erosion. Additionally, proposals include increments for pensions, food and lodging allowances, and distress loans. The budget allocates LKR. 205 billion for Social Safety Nets cash transfers through Aswesuma, aligning with the IMF's Indicative Target. The budget also addresses fiscal challenges through the introduction of tax policy revisions and measures to improve tax administration.

The annual budget is the fundamental framework for Public Financial Management (PFM), through which public funds are collected, allocated, spent, and accounted for. Given its critical role, the budget is a matter of public interest. The quality of information, assumptions, and estimates determine the public's ability to engage effectively with the budget. Previous *State of the Budget* reports by Verité Research have consistently highlighted these issues, including poor estimations, a lack of clarity on key macro-fiscal assumptions, differences in numbers across different classifications and formats, and missing estimates of fiscal consequences related to budget proposals. These issues contribute to defective estimates and assumptions, ultimately constraining informed engagement.

Furthermore, Verité Research has been monitoring the progress of high-value budget promises made by the ministers of finance since 2017 through Budget Promises, an online platform hosted under publicfinance.lk. The assessment has revealed that, on average, the government failed to disclose information to assess the progress of 45% of the expenditure proposals between 2017 and 2021, both proactively online and in response to Right to Information (RTI) requests. This opacity has increased significantly in recent years, with the government, on average, failing to disclose information for 70% of the expenditure proposals in both 2022 and 2023. This notable decline in transparency suggests a gap in accountability and raises questions about the effectiveness of budgetary measures.

In light of these developments, it becomes imperative to explore whether the failure to deliver on promises outlined in the budget is rooted in challenges related to economic feasibility, stemming from injudicious assumptions and estimates. An assessment of the financial, economic, and fiscal estimates and assumptions within the budget is provided in this report. Through this analysis, Verité Research aims to improve informed engagement with Sri Lanka's annual budget among a broad audience of stakeholders, including the public, the Committee on Public Finance (COPF), and the parliament.



# SECTION 2: INFORMATIONAL STANDARDS AND DUE DILIGENCE

This section sets out the key informational deficiencies  
in the 2024 Budget under four types of issues

# Injudicious macro-economic assumptions

Macroeconomic and financial assumptions are used to calculate budgetary outcomes. Ensuring the accuracy of these estimates is crucial, as they form the basis for fiscal planning and policy decisions. Consequently, it is important to subject the assumptions and estimations used to arrive at these estimates to objective and robust analysis. Analysis done by Verité Research reveals that the 2024 Budget reports injudicious numbers for the GDP deflator in 2023 and 2024.

The estimated growth of the GDP deflator for 2023, as outlined in the 2024 Budget, is 22.9%. In contrast, the IMF initially projected a growth of 27.4% for the same year, but later revised this estimate to 20.4% in December 2023. Nevertheless, a more accurate estimate by Verité Research suggests that the GDP deflator will increase by 17.2% in 2023. This adjustment is based on extending the trends observed in the GDP deflator index for the third quarter of 2023, resulting in a predicted index value of 235, compared to the IMF's projected end-of-year index value of 261.

Similarly, the budget projects the change in the GDP deflator for 2024 at 9.5%, while the IMF projects it at 10.1%. Meanwhile, Verité Research projects a more conservative estimate of 7.3%. This figure is derived by averaging the budget's estimate of 9.5% and the target inflation for 2024, set at 5% according to a gazette published by the Central Bank of Sri Lanka. The historical average deviation between the GDP deflator and inflation further supports this analysis.

However, the figures provided by the World Bank, IMF, and the 2024 Budget for real GDP growth in 2023 and 2024 closely align with one another. Hence, this report will utilize the same figures.

**Exhibit 2.1 - GDP forecasts for 2023 and 2024 by the IMF, World Bank, and Verité Research.**

	2023					2024				
	IMF - Mar	IMF - Dec	Budget 2024	World Bank	Verité Research	IMF - Mar	IMF - Dec	Budget 2024	World Bank	Verité Research
<b>Nominal GDP - LKR Bn</b>	29,852	28,033	28,609	N/A	27,274	33,533	31,422	31,900	N/A	29,782
<b>% Growth</b>	23.6%	16.1%	18.5%		12.9%	12.3%	12.1%	11.5%		9.2%
<b>GDP Deflator - Index</b>	256	242	247	N/A	235	283	266	270	N/A	253
<b>% Growth</b>	27.4%	20.4%	22.9%		17.2%	10.7%	10.1%	9.5%		7.3%
<b>Real GDP - LKR Bn</b>	11,657	11,585	11,585	11,561	11,585	11,832	11,794	11,794	11,758	11,794
<b>% Growth</b>	(3.0%)	(3.6%)	(3.6%)	(3.8%)	(3.6%)	1.5%	1.8%	1.8%	1.7%	1.8%

Sources: First Review under the Extended Arrangement under the Extended Fund Facility; Budget Speech 2024

# Irreconcilable differences in numbers across different classifications and formats

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The budget information, encompassing proposed annual expenditures, estimated revenues, and other government financial activities for the forthcoming period, is presented annually under various classifications and formats through multiple reports.

On the day of the budget speech, the parliament is provided with three key documents: (1) the budget speech, (2) draft budget estimates, and (3) the fiscal management report. However, the numbers presented across these reports contradict each other. In the past, even the numbers within the same report have contradicted each other.

The total, as well as the breakdown of the revenue and expenditure figures reported in the budget speech, differ from the draft budget estimates. In the 2024 Budget, the total revenue and grants figure disclosed in the budget speech falls short by LKR 54 billion compared to the figure reported in the budget estimates (Exhibit 2.2). Similarly, the total expenditure figure reported in the budget speech is LKR 31 billion lower than the corresponding figure reported in the budget estimates. It is important to note that explanatory information has not been provided on these deviations.

These differences in numbers across reports lead to a situation where the public faces challenges in identifying the most accurate estimate and is unable to reconcile the discrepancies between the reports. This is particularly concerning because, for many external users, the budget documents stand as the most crucial financial statements issued by the government.

**Exhibit 2.2 - Budget speech numbers vs. budget estimate numbers, by classification of revenue and expenditure estimates, Budget 2024 (values in LKR billions)**

Budget Speech		Draft Budget Estimates		
Revenue Component	Value	Revenue Component	Value	Difference
Total revenue and grants	4,127	Total revenue and grants	4,181	(54)
Tax revenue	3,820	Tax revenue	3,820	0
o/w taxes on external trade	505	o/w taxes on external trade	508	(3)
o/w taxes on goods and services	2,235	o/w taxes on domestic goods & services	2,216	3
		o/w license taxes & others	16	
o/w income tax	1,080	o/w taxes on income & profits	1,080	0
Non-tax revenue	287	Non-tax revenue	341	(54)
Grants	20	Foreign grants	20	0
Expenditure Component	Value	Expenditure Component	Value	Difference
Total expenditure	6,528	Total expenditure	6,559	(31)
Recurrent expenditure	5,277	Recurrent expenditure	5,354	(77)
o/w Salaries & wages	1,127	o/w Personal emoluments	666	461
o/w Goods & services	341	o/w Goods & services	721	(380)
o/w Interest	2,651	o/w Interest payments	2,651	0
o/w Transfers	1,158	o/w Transfers	1,316	(158)
Capital expenditure	1,251	Capital expenditure	1,205	46

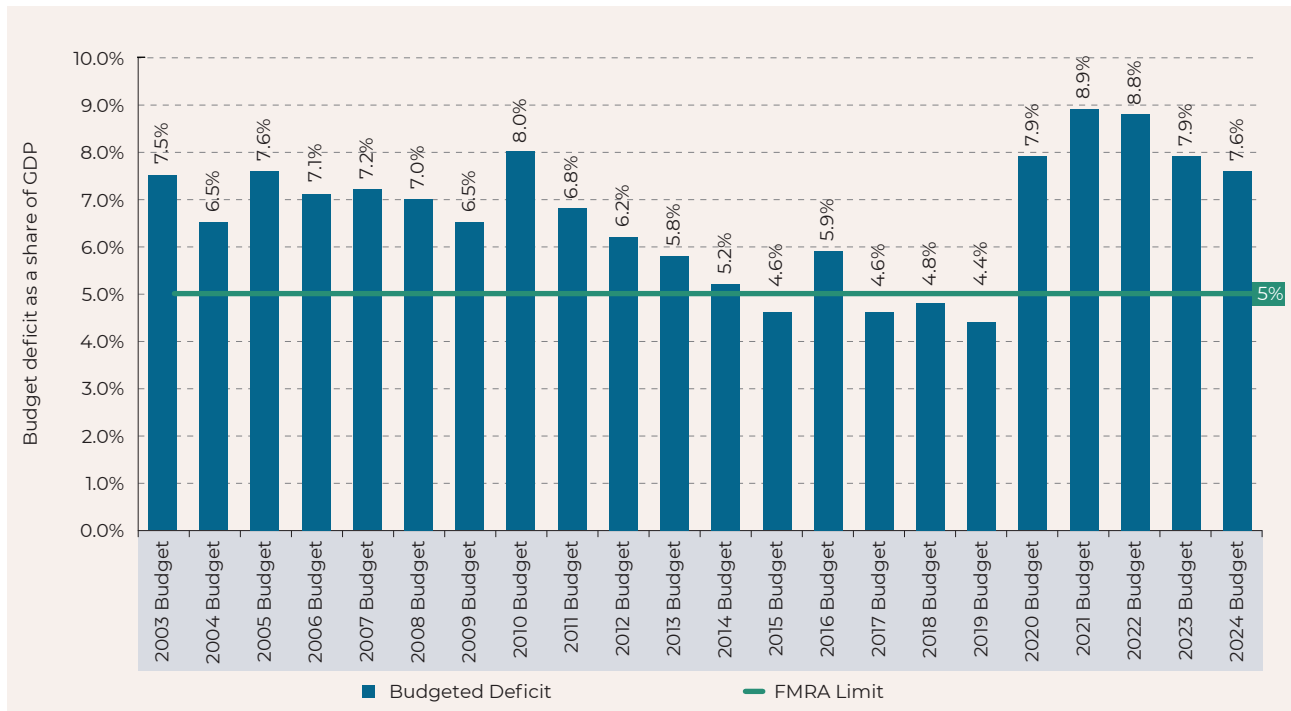
Sources: Budget Speech 2024; Draft Budget Estimates 2024

# Violation of the Fiscal Management Responsibility Act

The Fiscal Management Responsibility Act (FMRA), No. 3 of 2003 is a piece of legislation enacted to ensure that the principles of responsible fiscal management are entrenched within the legislative discipline. The Act also provides for measures to enable the public to actively investigate, scrutinise, and oversee the country's fiscal policy and its performance.

The original FMRA, enacted in 2003, limited the budget deficit from exceeding 5% of GDP from 2006 onward. However, budget deficits as a share of GDP have remained above the set limit in 18 out of the 22 years since the introduction of the Act, violating the FMRA. The proposed budget deficit for 2024 at 7.6% of GDP, well above the legally allowed limit of 5% of GDP, yet again marks a violation of the FMRA.

**Exhibit 2.3 – Budget Deficit as a share of GDP, 2003-2024.**



Sources: Central Bank of Sri Lanka Annual Reports 2022; Fiscal Management Responsibility Act, No. 03 of 2003; Fiscal Management (Responsibility)(Amendment) Act, No. 15 of 2013 and No. 13 of 2016.

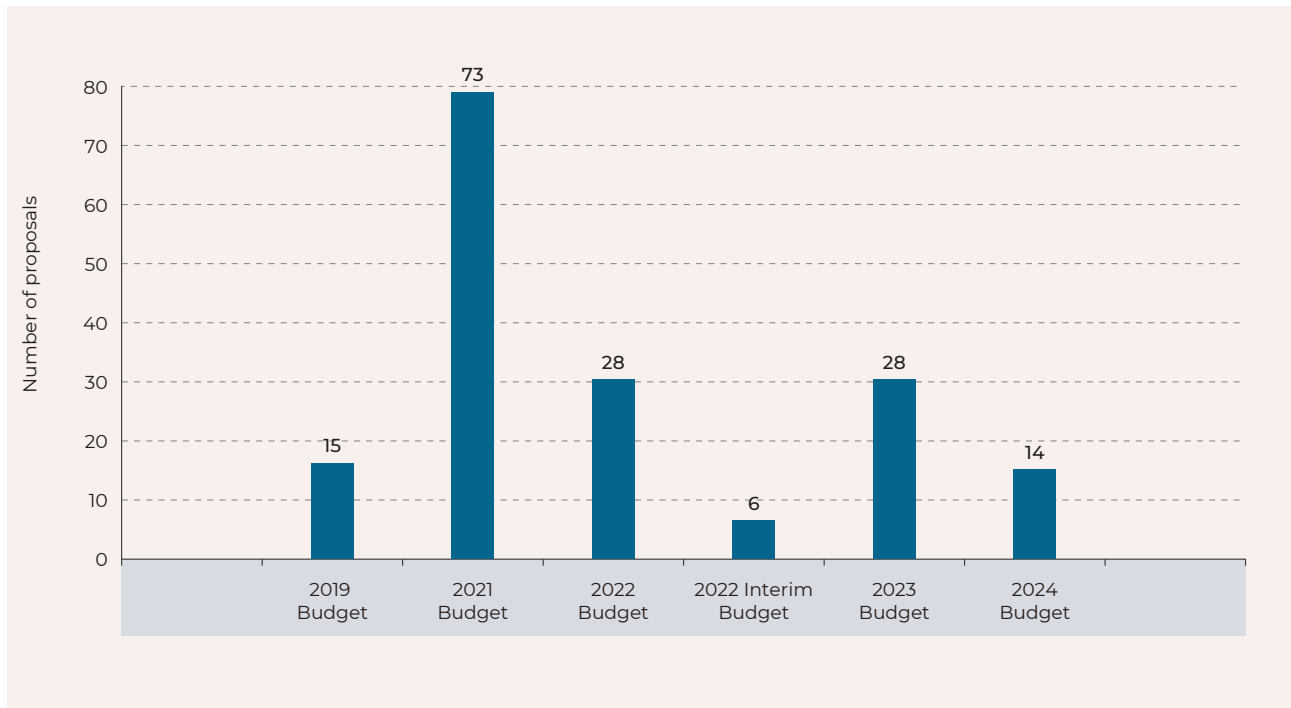
# Missing estimates

Missing estimates refer to instances where the estimates of the fiscal consequences relating to budget proposals are absent or obfuscated in the budget and/or the associated documentation.

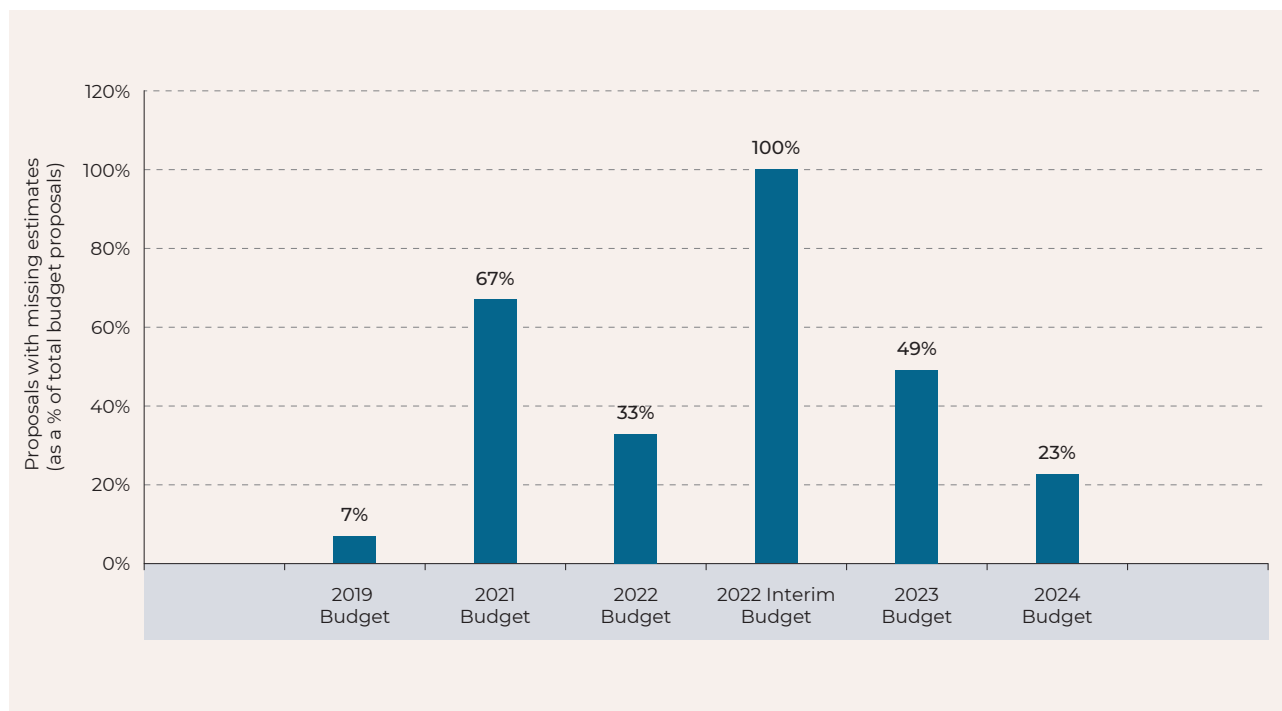
In 2024, the total count of proposals with missing estimates amounted to 14, making it the second lowest since 2019 (Exhibit 2.4). However, when considered as a proportion of the total number of proposals, proposals with missing estimates accounted for 23% above the 2019 levels of 7% (Exhibit 2.5).

The problem of missing estimates is set out in this section in two main parts. The first part sets out examples of negative and positive fiscal measures with missing information. The second part sets out examples of fiscal measures with undisclosed or obfuscated consequences.

**Exhibit 2.4 – Total number of proposals introduced with missing estimates of fiscal consequences, 2019-2024.**



Source: Budget Speech 2019 – 2024

**Exhibit 2.5 – Percentage of proposals introduced with missing estimates of fiscal consequences, 2019-2024.**

Source: Budget Speech 2019 – 2024

## Negative fiscal measures with missing estimations

This section sets out examples of fiscal measures that have a negative fiscal impact, but where estimates on the magnitude of this impact are not provided. It is imperative that every proposal that is set out in the budget speech is evaluated in terms of the estimated fiscal impact in order to provide a holistic understanding of the implications of the proposal.

The 2024 budget speech consisted of one revenue-reducing proposal with no allocation. Notably, the number of expenditure proposals without an allocation decreased from 18 in 2023 to 12 proposals in 2024. While this reduction may indicate an improvement in budget reporting standards, it remains an inadequacy.

**Exhibit 2.6 – Revenue-reducing proposals**

No.	Policy Proposal in the Budget Speech
1	Houses constructed under various urban development programmes have been rented to low-income families. A monthly rent of around LKR 3,000 is obtained from those families. The government proposes to completely stop collecting rent from these families, and for the full ownership of these houses to be given to those families. In 2024, nearly 50,000 families to be given the ownership of houses. By the completion of the programme of providing land and housing rights to the people, about 70% of the people of this country will become the owners of land and houses.

Source: Budget Speech 2024

**Exhibit 2.7 - Expenditure proposals**

No.	Policy Proposal in the Budget Speech
1	The allowance provided to police officers who travel long distances to attend duties does not match with the current situation. Hence, instead of the allowance 152 that is paid at present, a food and lodging allowance with food and lodging allowance with appropriate adjustment for three groups of officers in the Police Department is to be provided.
2	To provide the Distress loan facility for all the public servants effective from January 01, 2024 as previously done.
3	Under the Aswesuma program about 130,000 persons with disabilities and kidney patients are paid a monthly allowance of LKR 5,000. To increase the payment up to LKR 7,500. The present monthly payment of LKR 2,000 for elderly citizens will also be increased to LKR 3,000. Around 530,000 persons will benefit from this. The beneficiaries who were on the waiting list and are already receiving financial assistance will be entered into the list of beneficiaries from 2024. For this purpose, a total of LKR 138 billion will be allocated for this. 153 Some families may face sudden calamities. I will increase the allocation for cash transfers provided through Aswesuma and allowances provided to persons with disabilities, kidney patients and the Elderly to LKR 205 billion in next year. We have identified many shortcomings and weaknesses in the system of providing a monthly allowance of LKR 4,500 to pregnant mothers. LKR 10 billion rupees has been allocated to resolve such issues and make this program more systematic.
4	There are issues with regard to drinking water in all provinces of the country. To prioritize drinking water projects when allocating the decentralized budget and obtaining foreign loans.
5	Steps to establish four new universities considering the current trends for the technical sector. (i) Seethawaka Science and Technology University (Lalith Athulathmudali Post Graduate Institute will be incorporated to this University)(ii) Kurunegala Technology University under the Kothalawala Defence University. (iii) Management and Technology University (iv) International University of Climate Change
6	A new Technology University will be established in Kandy under the guidance of IIT University in Chennai, India.
7	To allow any recognized educational institution in the world to establish universities in Sri Lanka once a set of powerful rules and regulations for the regulation of non-state universities are put in place. This will create opportunities for every student who passes G.C.E (Advanced Level) to obtain university education and earn foreign exchange through the admission of foreign students. Loan facilities will be provided to students studying in these non-state universities. In addition to the existing interest-free student loan scheme, a subsidized student loan scheme through commercial banks is to be established. Arrangements will be made to repay the loan after getting a job.
8	A National Higher Education Commission will be established to integrate the University Grants Commission (UGC) and Tertiary and Vocational Education Commission (TVEC). This Commission will be granted decision-making powers and regulatory for strengthening and expanding higher education.
9	A National Skills Commission will be established which is suitable for the prevailing challenges. Under this Commission, Vocational Training Authority, National Apprenticeship and Industrial Training Authority will be integrated.
10	To reintroduce the Suraksha Student's Insurance Scheme, which was introduced in the year 2016 but is currently not in operation. Accordingly, all school students will be entitled to this insurance coverage.
11	To expedite the arrangements to adopt a promotion scheme that is applicable to both specialists and graded doctors. In addition, we will explore the possibility of paying an allowance for the additional work done by the specialists instead of the existing paying method.
12	The second phase of the Central Expressway, i.e. the section from Kadawatha to Mirigama, will be started jointly with China. The government hopes to get the support of Japan for the construction of the section from Kurunegala to Galagedara. The government is planning to find out whether it is possible to build the highway up to Katugastota.

Source: Budget Speech 2024



## Positive fiscal measures with missing estimations

This section sets out examples of fiscal measures that have a positive fiscal impact but lack estimates on the magnitude of this impact. Budget 2024, similar to Budget 2023, features only one expenditure management proposal.

### Exhibit 2.8 - Expenditure management proposals

No.	Policy Proposal in the Budget Speech
1	To provide only 80% of financing for the payment of salaries to Municipal Councils from 01.01.2024 and gradually allow LGAs to intensify their efforts to increase self-revenue generation. In addition to reduce the amount given to Urban Councils from 01.01.2025 and gradually encourage self-financing within the next 5 years.

Source: Budget Speech 2024

## Policy measures with undisclosed consequences

This section sets out some of the policy measures for which the revenue or expenditure consequences are either undisclosed or obfuscated in the Budget Speech 2024. Exhibit 2.9 provides a table with several examples of this problem.

### Exhibit 2.9 - Undisclosed consequences: indicative examples

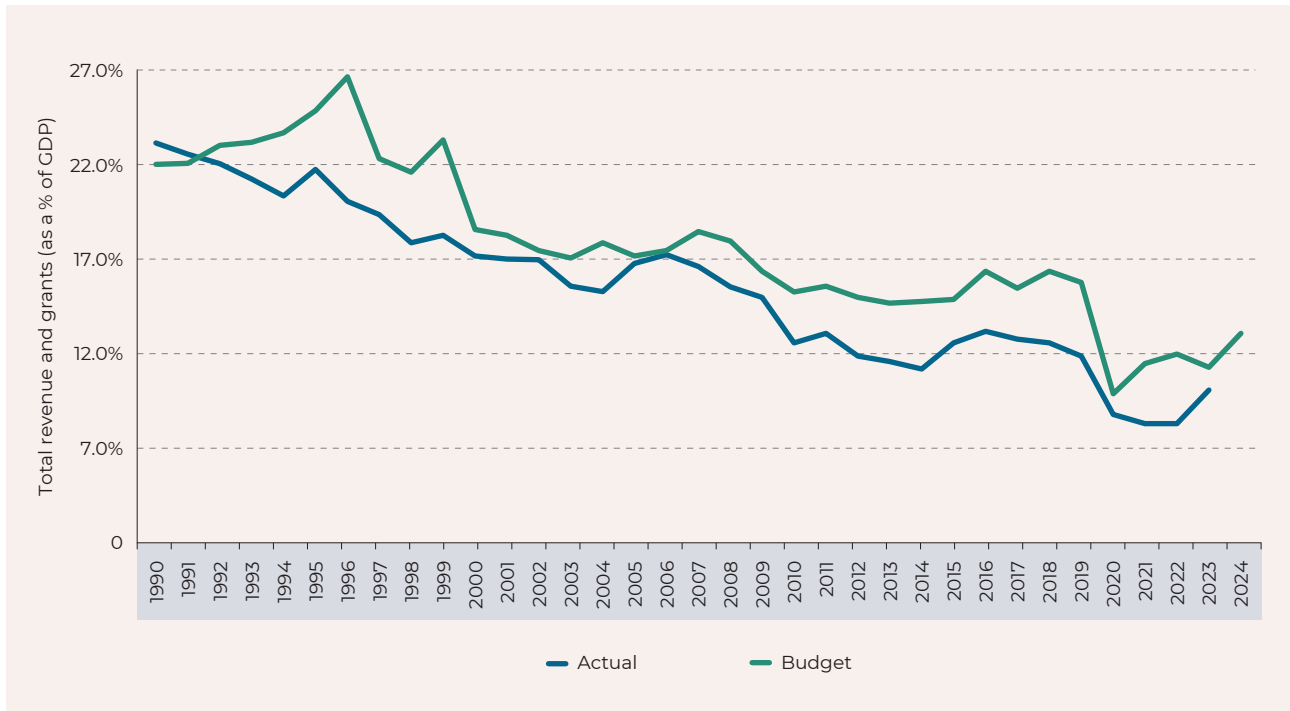
No.	Policy Proposal in the Budget Speech
1	An invitation to relevant stakeholders to take the lead in creating collaboration between creative spaces, industry, and academia in to order to help build the creative economy of Sri Lanka.
2	To introduce a simple policy and regulatory framework to facilitate gig economy and e-commerce transactions, including cross-border transactions. It covers the areas of payment system, fiscal revenue, and employee welfare.
3	The rules and regulations should be adopted to convert the following private higher education institutions that are currently in operation into universities.
4	Steps to be taken on issuing specific guidelines for the procurement of medicines and setting up a separate institution for that purpose.
5	With the aim of upgrading the careers of medical doctors, a proposal to expand the postgraduate opportunities available for doctors under 2023 Budget.
6	To assign the responsibilities of rehabilitating small tanks to the farmer organizations of the respective areas.

Source: Budget Speech 2024

# SECTION 3: REVENUE OUTLOOK

This section outlines several areas of taxation where the revenue estimates provided are likely to overstate the revenue that could be expected to be collected. Inflated revenue estimates can lead Parliament to agree on higher expenditure levels. Consequently, when actual revenue falls short of expectations, it triggers higher budget deficits, elevated debt, higher interest, and ultimately, a problem of sustainability of public finances. Historically, Sri Lanka has failed to meet revenue targets, with actual revenue falling short of revenue targets approved in its budgets since 1991.

**Exhibit 3.1 – Budgeted vs actual revenue and grants as a share of GDP, 1990-2024**



Note: 2022 estimates are from the 2022 Original Budget

Source: Central Bank of Sri Lanka Annual Reports; Budget Speeches (multiple years)

According to the 2024 budget estimates, the government expects to raise LKR 4,164 billion in total revenue in 2024. In nominal terms, this represents a 42% increase over the revised revenue estimate for 2023.<sup>1</sup> And nearly 58% of this projected increase in revenue is expected to come from an increase in VAT collection. Verité Research projects a total revenue of LKR 3,570 billion in 2024, an estimate that is 14% lower than the government's estimate.

<sup>1</sup> All revenue estimates are evaluated by comparing the revised estimates for 2023 with the 2024 estimates.

**Exhibit 3.2 - Revenue estimates as given in the budget estimates (in LKR billions)**

Item	2022 Actual	2023 Revised Estimate	2024 Budget	Y-o-Y Growth	
				2022-2023	2023-2024
Total revenue and grants	2,096	2,926	4,164	40%	42%
Total revenue	2,060	2,914	4,144	41%	42%
Tax revenue	1,751	2,596	3,820	48%	47%
o/w income tax	534	864	1,080	62%	25%
o/w taxes on goods and services	859	1,360	2,216	58%	63%
o/w taxes on external trade	344	360	508	5%	41%
Non-tax revenue	308	318	324	3%	2%
Grants	36	12	20	-67%	67%

Source: Approved Detailed Budget Estimates 2024

# Taxes on income and profit

Income tax is expected to account for 33% of total tax revenue in 2023, based on the government's estimate. Income tax collection is expected to grow by 25% to LKR 1,080 billion in 2024, from the estimated income tax collection of LKR 864 billion in 2023. Verité Research, through the analysis set out below, projects a tax revenue of LKR 940 billion for the same year, which is 13% lower than the government's estimate.

**Exhibit 3.3 - Government's revenue estimates on taxes on incomes and profits in LKR billions**

Tax Type	Revenue Estimates			Increase from 2023		2024
	2022 Actual	2023 Estimate	2024 Budget Estimate	In LKR Billions	Y-o-Y % increase in revenue	Verité Research Estimate
Income tax	534	864	1,080	217	25%	940
o/w corporate tax	455	520	675	156	30%	567
Corporate income tax	454	514	668	155	30%	561
o/w non-corporate tax	50	190	240	50	26%	208
PAYE	26	150	160	10	7%	160
Other	24	40	80	40	100%	48
o/w other tax	29	154	165	11	7%	165
Withholding tax	20	150	160	10	7%	160

Source: Approved Detailed Budget Estimates 2024

## Corporate Income Tax (CIT)

### Observations

Corporate income taxes are expected to grow by 30% (LKR 155 billion) in 2024 to LKR 668 billion from LKR 514 billion in 2023. However, no changes have been proposed to the corporate tax rate or the tax-free threshold for 2024.

### Past experiences

In 2022, CIT collection recorded its highest growth since 2018, growing by 82%. This growth is attributed to the increase in the CIT rate from 24% to 30%, along with the discontinuation of exemptions and concessionary rates of CIT as of October 1, 2022. The impacts of these tax policy measures are expected to contribute to a further estimated 13% increase in CIT for the year 2023, as the effects of the tax policy measures introduced in October 2022 take hold for the entire year.

### Revenue estimates for corporate income tax in 2024

While the government projects a 30% growth in CIT for 2024, Verité Research estimates that CIT will grow in line with nominal GDP (9.2%), reaching LKR 561 billion in 2024, given that new tax policy or administration measures have not been introduced for the year.

Examining the period between 2015 and 2019, when the CIT rate remained unchanged, CIT collection experienced a growth of 13%, slightly surpassing the nominal GDP growth of 10% during the same period. This observation suggests a close alignment between CIT growth and nominal GDP growth. Therefore, it can reasonably be inferred that CIT is likely to continue growing in line with nominal GDP in the absence of new tax policies or administrative measures.

## Non-corporate tax

### Pay-As-You-Earn (PAYE) Tax

#### Observations

The government estimates PAYE to grow by 7% in 2024 to LKR 160 billion from an estimated LKR 150 billion in 2023. However, no changes have been proposed to the tax rate or the tax-free threshold for 2024.

#### Past experiences

In 2020, PAYE tax collection was abolished and replaced with Advanced Personal Income Tax (APIT), resulting in a decline in PAYE revenue for that year and subsequently low levels of collection in 2021 and 2022. However, PAYE tax was reinstated effective January 1, 2023, and made mandatory for all taxpayers exceeding the personal relief of LKR 1.2 million per year of assessment. As a consequence, PAYE is estimated to grow by 487% in 2023, from LKR 26 billion in 2022 to LKR 150 billion in estimated revenue in 2023.

### Revenue estimates for PAYE tax in 2024

Verité Research does not attempt to calculate an alternative estimate for PAYE tax collection in 2024, as PAYE is projected to grow by 7%, a rate lower than the potential growth it could achieve growing in alignment with the nominal GDP growth rate of 9.2%.

### Personal income tax (excluding PAYE)

#### Observations

The government estimates Personal Income Tax (PIT) collection to double in 2024, to LKR 80 billion, from LKR 40 billion in 2023.

The 2024 budget introduces a measure mandating the submission of a Taxpayer Identification Number (TIN) in various transactions, including opening bank accounts, obtaining building plan approvals, registering or renewing motor vehicle licenses, and registering land or titles. This move aims to strengthen the link between taxpayers and their tax identification information in these transactions, contributing to enhanced tax administration and compliance.

#### Past experiences

The approved budget estimates show that PIT revenue was originally projected to rise to LKR 115 billion in 2023. However, revised estimates of PIT revenue project a revenue collection of LKR 40 billion, which is a 65% reduction

from the original revenue estimate. This revision comes despite the implementation of several policy measures in 2023, including the reduction of the tax-free threshold from LKR 3.0 million to LKR 1.2 million annually, the reduction of the tax slab from LKR 3.0 million to LKR 500,000 per annum, and the progressive revision of tax rates from 6% to 36% on each LKR 500,000 exceeding the relief.

### **Revenue estimates for personal income tax (excluding PAYE) in 2024**

In the absence of new tax policy or administration measures for 2024, Verité Research projects that personal income taxes will experience growth in alignment with nominal GDP (9.2%) and an additional 10% due to mandatory tax filing. As a result, the estimated personal income tax collection is anticipated to reach LKR 48 billion in 2024.

### **Withholding Tax (WHT)**

#### **Observations**

The government estimates WHT revenue to grow by 7% in 2024 to LKR 160 billion from an estimated LKR 150 billion in 2023. Importantly, no changes to the WHT rate have been proposed for the year 2024.

#### **Past experiences**

The removal of WHT in 2020 resulted in an 80% decline in collection. Although WHT collection began to recover in 2021 and 2022, the revenue collection remained below the levels observed prior to the removal of WHT in 2020. In 2022, the government announced the reintroduction of non-final withholding taxes on all payments other than dividends and the introduction of final withholding taxes for dividends, effective January 1, 2023. As a result, WHT is estimated to grow by 656% in 2023, from LKR 20 billion in 2022 to LKR 150 billion in estimated revenue in 2023.

### **Revenue estimates for Withholding Tax in 2024**

Verité Research does not attempt to calculate an alternative estimate for WHT collection in 2024, as WHT is projected to grow by 7%, a rate considerably lower than the potential growth it could achieve growing in alignment with the nominal GDP growth rate of 9.2%.

# Taxes on goods and services

Taxes on goods and services are expected to account for 52% of the total tax revenue in 2023, based on the government's estimate. The government anticipates a 63% increase in taxes on goods and services in 2024, growing from LKR 1,360 billion in 2023 to LKR 2,216 billion, increasing the share of taxes on goods and services to 58% of total taxes in 2024. This increase is mainly attributed to a projected rise in VAT collection, resulting from both a VAT rate increase from 15% to 18% and the removal of exemptions.

Verité Research, through the analysis set out below, projects a tax revenue of LKR 1,834 billion through taxes on goods and services for the same year. This estimation is 17% lower than the government's estimate, primarily due to a 26% lower VAT collection in 2024 compared to government estimates.

## Exhibit 3.4 - Government's revenue estimates on taxes on goods and services in LKR billions

Tax Type	Revenue Estimates			Increase from 2023		2024
	2022 Actual	2023 Estimate	2024 Budget Estimate	In LKR billions	Y-o-Y % increase in Revenue	Verité Research Estimate
Taxes on goods and services	859	1,360	2,216	856	63%	1,834
o/w VAT	463	681	1,400	720	106%	1,039
o/w NBT	0.41	-	-	-	-	-
o/w excise duties	343	449	543	94	21%	543
o/w other taxes on goods and services	17	20	23	2	10%	23
o/w Social Security Contribution Levy	36	210	250	40	19%	229

Source: Approved Detailed Budget Estimates 2024

## Value Added Tax (VAT)

### Observations

The government estimates VAT collection to more than double in 2024 to LKR 1,400 billion from an estimated LKR 681 billion in 2023 (2.06 times the revised value). VAT is expected to account for 37% of total tax revenue in 2024. Moreover, it is expected to contribute to 58% of the overall increase in revenue in 2024, underscoring the pivotal role VAT is poised to play in driving revenue growth.

The 2024 Budget introduces key changes to VAT to drive this growth, including an increase in the VAT rate from 15% to 18% effective January 1, 2024. Additionally, the budget proposes the elimination of almost all VAT exemptions other than for products relating to health, education, and a few essential foods. The budget proposes registered persons to use Point of Sale (POS) machines which automate invoicing and sales recording, aimed at supporting VAT collection in the supply of goods or services. Furthermore, as per the IMF's first review under the 48-month



Extended Fund Facility with Sri Lanka, the government plans to reduce the VAT registration threshold from LKR 80 million per annum to LKR 60 million per annum.

### Past experiences

Following a steep decline in VAT collection in 2020 due to a rate reduction and a threshold increase, VAT collection experienced a rebound, with growth rates of 32% and 50% in 2021 and 2022, respectively. The growth in VAT collection in 2021 can be attributed to the normalisation of economic activities.

However, the dynamics of VAT growth in 2022 were influenced by a number of policy adjustments. The VAT rate underwent two increases, from 8% to 12% effective June 1, 2022, and subsequently raised to 15% from September 1, 2022. Additionally, there was a reduction in the VAT registration threshold, lowered to LKR 80 million per annum from LKR 300 million per annum, starting October 1, 2022.

Furthermore, VAT exemptions on condominium housing apartments were removed, effective January 1, 2023, and the zero-rating of tourism-related services ceased as of June 1, 2022. VAT collection is estimated to grow by a further 47% in 2023.

### Revenue estimates for Value Added Tax in 2024

The government expects an increase in VAT revenue from the 2023 estimate of LKR 681 billion to LKR 1,400 billion in 2024. However, Verité Research projects an increase to LKR 1,039 billion, marking a 53% growth, compared to the government's expectation of a 106% surge in 2024.

To achieve a 106% increase in VAT revenue, the year-end inflation rate for 2024, as indicated by the GDP deflator, would need to be 9.6%. If these VAT-related policy measures were not implemented, the inflation rate is projected to be only 5%<sup>2</sup>, implying that these measures would add an extra 4.6% to inflation. Nevertheless, as previously discussed, Verité Research anticipates the GDP deflator to only rise by 7.3%, suggesting that the policy measures will cause a price increase of 2.3%. Consequently, a 53% rise in VAT revenue is deemed feasible, rather than the government's projected 106%.

### Excise duties

#### Observations

The government estimates excise duties to grow by 21% in 2024 to LKR 543 billion from an estimated LKR 449 billion in 2023. Excise duties are expected to account for 14% of total tax revenue in 2024.

The 2024 budget introduces several tax administration measures for the Excise Department, with a specific proposal aimed at augmenting revenue through the revision of the toddy tender system. This measure seeks to both boost government revenue and discourage illicit practices within the toddy industry.

Furthermore, the budget outlines a plan to introduce the 'Revenue Administration System for Excise Department' (RASED) by the end of October 2024. RASED is designed to enhance the efficiency and productivity of excise revenue management, focusing on minimizing risks associated with wastage and corruption. Additionally, the budget proposes

<sup>2</sup> The target inflation rate is set at 5% according to Gazette No. 2352/20 published by the Central Bank of Sri Lanka

initiatives to strengthen tax collection and enforcement within the beedi industry.

### **Past experiences**

Excise duties are estimated to grow by 31% in 2023, reaching a total of LKR 449 billion in duties collected for the year. This growth is attributed to the policies introduced in 2023, including increased duties on various liquor categories in line with the IMF EFF programme commitment to increase excise taxes on alcohol and tobacco by 20%, effective July 1, 2023. Additionally, the Excise Special Provisions Duty assigned Excise Duty to newly created and amended HS codes, including increased duties on petroleum products and cigarettes, effective January 1, 2023.

### **Revenue estimates for excise duties in 2024**

Verité Research does not attempt to calculate an alternative estimate for excise duty collection in 2024, as excise duties are projected to grow by 21%, which can be attributed to the policy measures introduced during the latter half of 2023, and the administrative measures proposed in the 2024 budget.

### **Social Security Contribution Levy (SSCL)**

#### **Observations**

The government estimates SSCL to grow by 19% to LKR 250 billion in 2024 from an estimated LKR 210 billion in 2023. However, no changes have been proposed to the tax rate or the tax-free threshold for 2024.

#### **Past experiences**

SSCL was introduced with effect from October 1, 2022, under the Social Security Contribution Levy Act, No. 25 of 2022. In 2022, SSCL collection amounted to LKR 36 billion, and is estimated to grow by 482% to LKR 210 billion in 2023.

### **Revenue estimates for Social Security Contribution Levy in 2024**

In the absence of new tax policy or administration measures for 2024, Verité Research projects that SSCL will experience growth in alignment with nominal GDP (9.2%). As a result, the estimated SSCL collection is anticipated to reach LKR 229 billion in 2024.

# Taxes on external trade

Taxes on external trade are expected to account for nearly 14% of the total tax revenue in 2023, based on the government's estimate. The government anticipates a 41% increase in taxes on goods and services in 2024, growing from LKR 360 billion in 2023 to LKR 508 billion. This increase is mainly attributed to a projected rise in customs import duties.

Verité Research, through the analysis set out below, projects a tax revenue of LKR 435 billion in 2024, 14% lower than the government's estimate.

## Exhibit 3.5 - Taxes on external trade in LKR billions

Tax Type	Revenue Estimates			Increase from 2023		2024
	2022 Actual	2023 Estimate	2024 Budget Estimate	In LKR Billions	Y-o-Y % increase in Revenue	Verité Research Estimates
Taxes on external trade	344	360	508	148	41%	435
o/w customs imports duties	50	88	175	87	99%	102
o/w CESS	70	53	60	7	13%	60
o/w PAL and SCL	221	216	270	54	25%	270

Source: Approved Detailed Budget Estimates 2024

## Customs Import Duty (CID)

### Observations

The government estimates customs import duties to grow by 99% in 2024 to LKR 175 billion from an estimated LKR 88 billion in 2023. However, new administrative or policy measures have not been proposed for 2024.

### Past experiences

CID is expected to grow by 76% in 2023 to LKR 88 billion. This notable increase is attributed to the removal of import restrictions on most imported items and the upward revision of CID rates from 0%, 10%, and 15% to 0%, 15%, and 20%, effective March 29, 2023. These adjustments were made to facilitate the proposed phasing out of para-tariffs.

### Revenue estimates for Customs Import Duties in 2024

During the period between 2018 and 2022, revenue estimates for customs import duties have consistently been overestimated. Despite the lack of new administrative or policy measures for 2024, the government expects CID to increase by 99%. However, Verité Research estimates the growth in CID to align with the growth in imports in 2024 amounting to LKR 102 billion, increasing by 16% rather than the government's projected 99%.<sup>3</sup>

<sup>3</sup> The growth for imports for 2024 is calculated at 16% based on the assumption that import volumes reach 2015 levels (excluding motor vehicles). 2015 levels were chosen for import volume calculations for 2024, as GDP is projected to return to 2015 levels in real terms based on IMF estimates.

### Summary of revenue findings

The government estimates revenue collection to increase by 42%, from LKR 2,926 billion in 2023 to LKR 4,164 billion in 2024. Notably, 58% of this expected increase is attributed to a rise in VAT collection. Government estimates also anticipate increases in other areas of tax revenue, despite the absence of new tax policies or administrative measures.

Verité Research, however, projects a revenue collection of LKR 3,570 billion in 2024, 14% lower than the government's estimate, with VAT contributing to 61% of the projected revenue shortfall. Estimates by Verité Research reflect a 22% increase from the 2023 revised estimate, while the government's revenue estimate for 2024 represents a 42% increase from 2023.

The IMF projects a 43% increase in revenue in 2024, closely aligning with government estimates. This estimate anticipates revenue to increase from LKR 2,847 billion in 2023 to LKR 4,081 billion. Therefore the estimate by Verité Research is 13% lower than the IMF estimate for 2024.

#### Exhibit 3.6 - Summary of revenue estimates for 2024 by the Ministry of Finance and Verité Research

	MoF Estimates	Verité Research Estimates	Deviation	
	In LKR Bn	In LKR Bn	In LKR Bn	%
<b>Total revenue and grants</b>	<b>4,164</b>	<b>3,570</b>	<b>(594)</b>	<b>(14%)</b>
Tax revenue	3,820	3,226	(594)	(16%)
o/w income tax	1,080	940	(140)	(13%)
Corporate income tax	668	561	(108)	(16%)
PAYE	160	160	0	0
Personal income tax	80	48	(32)	(40%)
WHT	160	160	0	0
o/w taxes on goods and services	2,216	1,834	(382)	(17%)
VAT	1,400	1,039	(361)	(26%)
Excise duties	543	543	0	0
SSCL	250	229	(21)	(8%)
o/w taxes on external trade	508	435	(73)	(14%)
CID	175	102	(73)	(41%)
CESS	60	60	0	0
PAL and SCL	270	270	0	0
Non-tax revenue	324	324	0	0
Grants	20	20	0	0

Source: Approved Detailed Budget Estimates 2024; Authors' calculations

## Recommendations on revenue

Based on the analysis presented in Section III of this report, Verité Research makes the following recommendations:

- 1.** Corporate income taxes are expected to grow by 30% (LKR 155 billion) in 2024. However, no changes have been proposed to the corporate tax rate or the tax-free threshold. Therefore, it is recommended to revise the estimate down to LKR 561 billion for 2024, accounting for only the growth in nominal GDP (9.2%). This figure reflects a 9% increase from the 2023 revised estimate compared to the government's estimate of a 30% increase.
- 2.** Personal income taxes are expected to grow by 100% (LKR 40 billion) in 2024. However, new tax policies or administration measures have not been introduced for 2024. Therefore, it is recommended to revise the estimate down to LKR 48 billion for 2024. This figure reflects an increase of 20% from the 2023 revised estimate compared to the government's estimate of a 100% increase.
- 3.** VAT is expected to increase by 106% to LKR 1,400 billion in 2024 as a result of the rate increase and the removal of VAT exemptions. However, considering the inflation target of a maximum of 7% in 2024 and, thus a VAT-induced inflation of 2.3%, the VAT revenue estimates in the 2024 budget have been overestimated. It is recommended to revise the estimate down to LKR 1,039 billion. This figure reflects an increase of 53% from the 2023 revised estimate compared to the government's estimate of a 106% increase.
- 4.** SSCL is expected to increase by 19% (LKR 40 billion) in 2024. However, no changes have been proposed to the tax rate or the tax-free threshold for 2024. Therefore, it is recommended to revise the estimate down to LKR 229 billion for 2024. This figure reflects a 9% increase from the 2023 revised estimate compared to the government's estimate of a 19% increase.
- 5.** Customs import duty is expected to grow by 99% in 2024. Considering that no administrative or policy measures related to CID have been introduced for 2024, it is advisable to revise the estimate down to LKR 102 billion. This figure reflects an increase of 16% from the 2023 revised estimate compared to the government's estimate of a 99% increase.

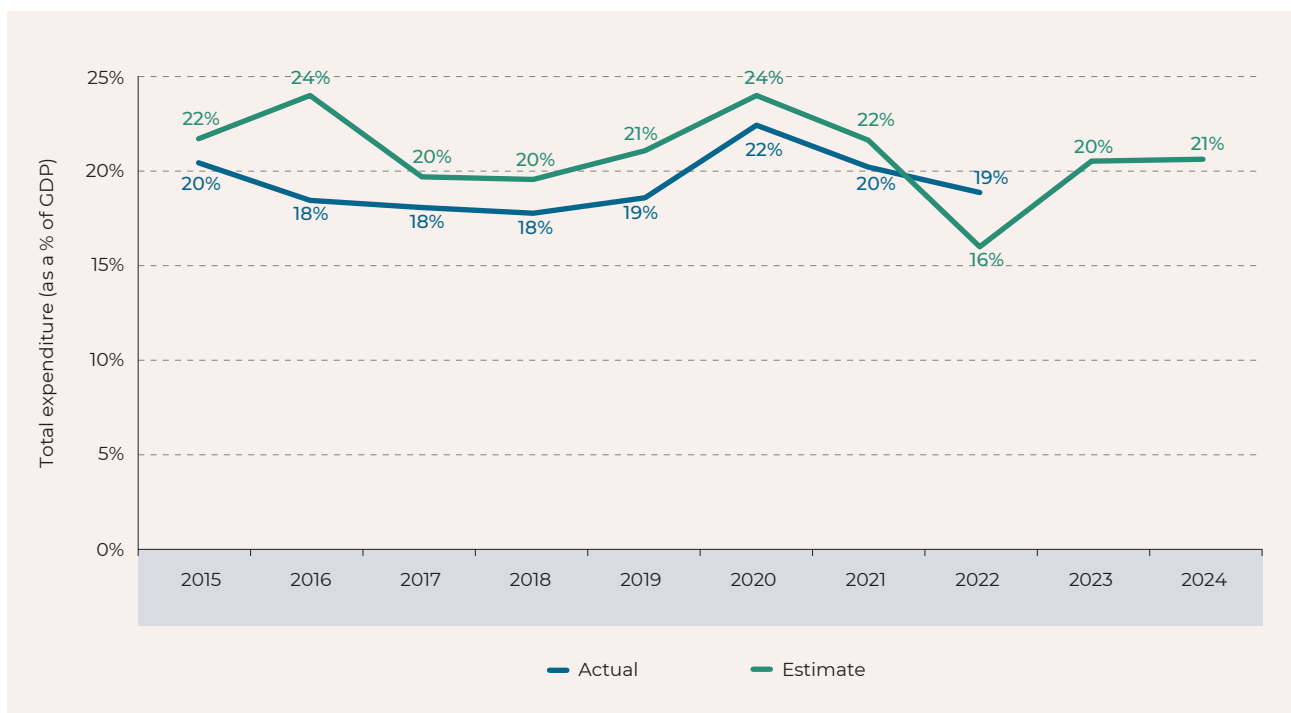
# SECTION 4: **EXPENDITURE OUTLOOK**

This section focuses on the expenditure decisions of the government in the 2024 Budget. According to the 2024 budget estimates, the government anticipates expenditure (excluding public debt amortisation and bank recapitalisation) to increase by 12%, from LKR 5,854 billion in 2023 to LKR 6,558 billion in 2024. This marks the first time that expenditure has exceeded LKR 6 trillion in Sri Lanka. Recurrent expenditure accounts for 81% of expenditure, while capital expenditure (excluding bank recapitalisation) accounts for the remaining 19%.

The increase in recurrent expenditure is estimated to account for 94% of the increase in total expenditure (LKR 704 billion) in 2024. Within recurrent expenditure, interest payments contribute to 66% of the increase in total expenditure. Capital expenditure accounts for the remaining 6% of the increase in total expenditure, where the allocation for the acquisition of capital assets has tripled to LKR 567 billion. However, other line items under capital expenditure record a reduction in their allocation for 2024.

Between 2015 and 2022, actual expenditure has consistently fallen short of budgeted expenditure, with the exception of 2022 when actual expenditure exceeded budgeted expenditure for the first time during this period.

**Exhibit 4.1 – Budgeted vs actual expenditure as a share of GDP, 2015-2024**



Note: 2024 estimate excludes bank recapitalization

Sources: Budget estimates (multiple years); Approved Detailed Budget Estimates 2024

# Expenditure by type

In 2024, recurrent expenditure is projected to grow by 14% to LKR 5,299 billion from LKR 4,634 billion in 2023. This report looks at three key recurrent expenditure items: personal emoluments, interest payments, and subsidies and transfers. Among these, interest payments record the largest increase in allocation for 2024, growing by 21%.

Personal emoluments are expected to grow by 15% in 2024, surpassing the historical annual average growth rate of 10% between 2018 and 2022. In contrast, subsidies and transfers are expected to grow by 3%, lower than their historical average of 14%. This can be attributed to the expected 26% reduction in expenditure for development subsidies in 2024.

Meanwhile, capital expenditure is expected to grow by 3% in 2024. However, this increase is notably lower than the historical average annual growth rate of 13% observed between 2018 and 2022, signaling constraints on expanding capital expenditure in the current fiscal environment. Historically, there has been a shortfall in actual capital expenditure costs compared to initial budget estimates, with capital expenditure, on average, being overestimated by 18% between 2018 and 2022.

## Exhibit 4.2 - Total expenditure breakdown in LKR billions

Expenditure	Expenditure Estimates			Increase from 2023	
	2022 Actual	2023 Revised Estimate	2024 Budget Estimate	Total change from 2023	Y-o-Y % increase in Expenditure
<b>Recurrent Expenditure</b>	<b>3,539</b>	<b>4,634</b>	<b>5,299</b>	<b>665</b>	<b>14%</b>
Personal emoluments	713	694	799	105	15%
Travelling expenses	16	25	27	2	6%
Supplies	159	293	378	86	29%
Maintenance expenditure	8	15	17	2	10%
Services	56	94	99	6	6%
Transfers	1,021	1,278	1,322	44	3%
Interest payments and discounts	1,565	2,189	2,651	462	21%
Other recurrent expenditure	0.2	47	6	(41)	(87%)
<b>Capital Expenditure</b>	<b>1,014</b>	<b>1,220</b>	<b>1,260</b>	<b>40</b>	<b>3.3%</b>
Rehabilitation and improvement of capital assets	19	67	82	15	23%
Acquisition of capital assets	75	168	567	400	239%
Capital transfers	121	183	98	(85)	(46%)
Acquisition of financial assets	439	160	122	(38)	(24%)
Capacity building	6	7	7	(1)	(8%)



	Expenditure Estimates			Increase from 2023	
	2023	2024	2025	2024	2025
Other capital expenditure	355	635	383	(252)	(40%)
<b>Total</b>	<b>4,554</b>	<b>5,854</b>	<b>6,558</b>	<b>704</b>	<b>12%</b>

Note: Excludes bank recapitalisation and public debt amortisation

Source: Approved Detailed Budget Estimates 2024

## Recurrent expenditure

### Observations

Recurrent expenditure is projected to grow by 14% in 2024, increasing from LKR 4,634 billion in 2023 to a record high of LKR 5,299 billion. Interest payments and discounts have historically constituted the majority of recurrent expenditure and this trend will continue in 2024, accounting for 50% of recurrent spending.

### Past experiences

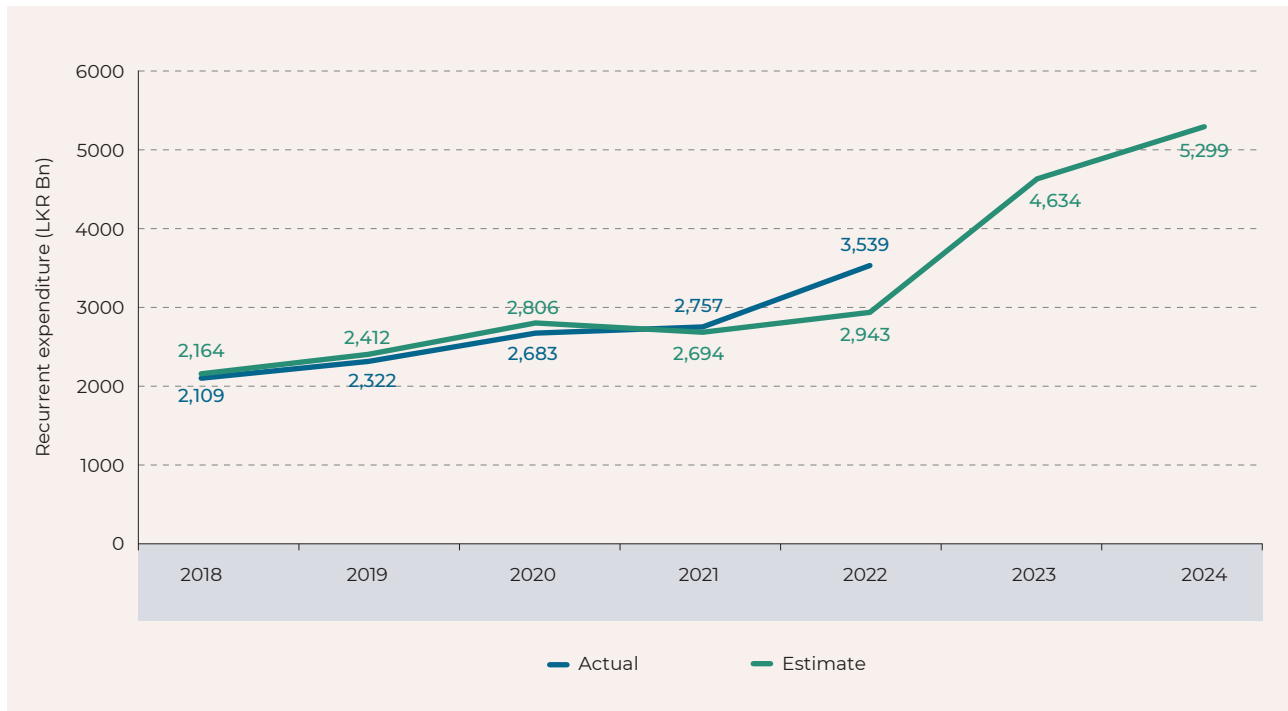
The 14% growth in recurrent expenditure projected for 2024 aligns with the average annual growth rate of 14% observed during the period from 2018 to 2022. Notably, in 2022, actual recurrent expenditure increased by 28%, marking the highest growth since 2018.

#### Exhibit 4.3 - Average annual growth rate and average over-shoot, 2018-2022

	Average annual growth rate	Average over-shoot from approved budget estimations (Estimate vs Actual)
Recurrent expenditure	14%	3%

Sources: Budget estimates (multiple years); Approved Detailed Budget Estimates 2024

On average, between 2018 – 2022, the government has underestimated the cost of recurrent expenditure by 3%. During the period from 2018 to 2021, government estimates for recurrent expenditure have, on average, closely aligned with actual expenditures. However, in 2022, actual recurrent expenditure exceeded budget estimates by LKR 597 billion primarily due to actual interest cost expenditure being underestimated by LKR 449 billion. The underestimation of interest payments thus accounted for 75% of the increase in actual recurrent expenditure compared to the estimate.

**Exhibit 4.4 - Estimates versus actual figures for recurrent expenditure in LKR billions, 2018-2024**

Sources: Budget estimates (multiple years); Approved Detailed Budget Estimates 2024

## Personal emoluments

### Observations

A discrepancy exists between the personal emolument figures presented in the budget speech and those in the approved budget estimates, with no explanation provided for the disparity. As the approved budget estimates are prepared and published after the budget speech, the following analysis will consider the personal emoluments figure from the approved budget estimate.

Personal emoluments are projected to increase by LKR 105 billion from 2023, to LKR 799 billion in 2024. The 2024 budget proposes a salary hike for public sector employees, intending to raise the cost-of-living allowance by LKR 10,000, effective January 2024. This increase, from LKR 7,800 to LKR 17,800, will be added to the monthly salary starting in April, with the accumulated balance from January to March 2024 paid in installments over a six-month period, commencing in October 2024.

According to calculations by Verité Research, this proposal's allocation amounts to LKR 13 billion. <sup>4</sup>Adjusting the 2023 allocation of personal emoluments for nominal GDP growth and factoring in the additional increase due to the proposal to raise the cost-of-living allowances, the expected allocation for personal emoluments in 2024 amounts to LKR 771 billion. This figure closely aligns with the government's estimation for personal emoluments in 2024.

<sup>4</sup> This figure has been calculated based on the number of public sector employees (1.3 million) provided in the 2024 Budget Speech.

**Exhibit 4.5 - Personal emoluments in LKR billions**

	Expenditure estimates			Increase from 2023	
	2022 Actual	2023 Revised Estimate	2024 Budget Estimate	Total Change from 2023	Y-o-Y % Increase in Expenditure
<b>Personal emoluments as per 2024 Budget estimates</b>	<b>713</b>	<b>694</b>	<b>799</b>	<b>105</b>	<b>15%</b>
Salaries and wages	399	373	378	5	1%
Overtime and holiday	45	44	48	4	9%
Other allowances	269	277	373	96	35%

Sources: Budget Speech 2024; Approved Detailed Budget Estimate 2024

**Past experiences**

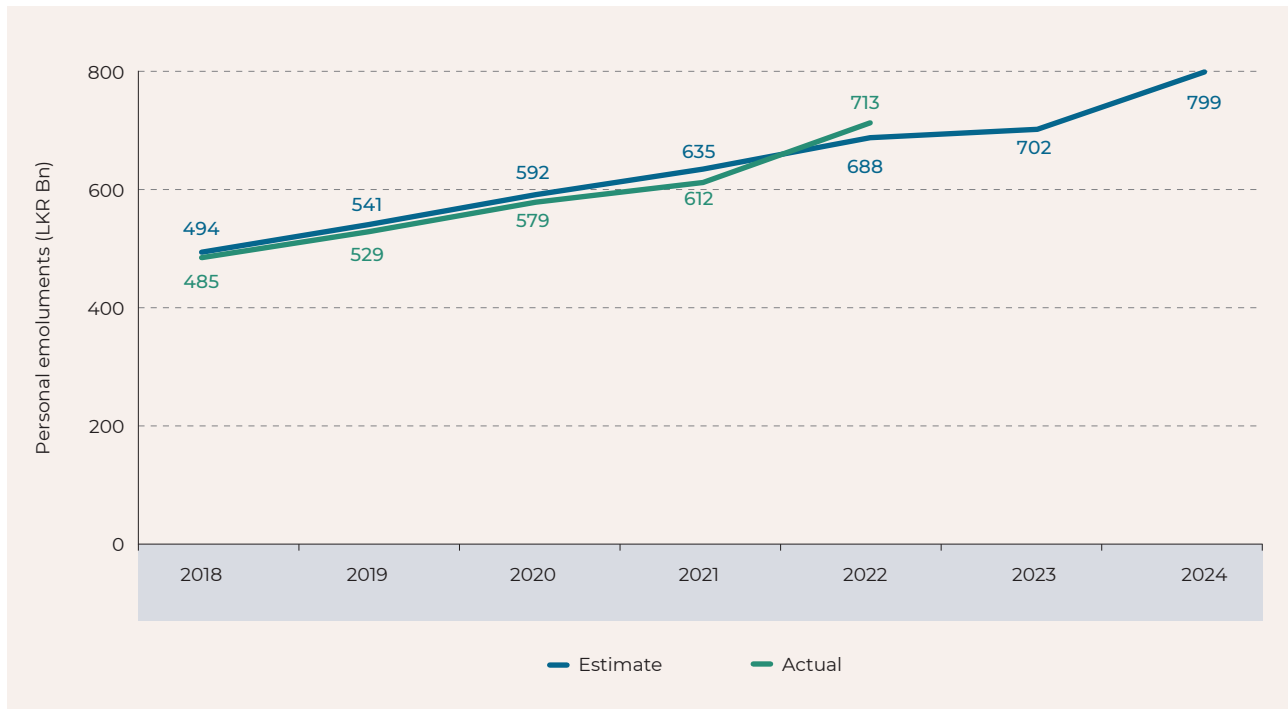
On average, personal emoluments grew by 10% over the period between 2018 and 2022. However, personal emoluments are projected to increase by 15% in 2024, exceeding the historical annual average.

**Exhibit 4.6 - Average annual growth rate and average over-shoot, 2018-2022**

	Average annual growth rate	Average over-shoot from approved budget estimations (Estimate vs Actual)
Personal emoluments	10%	(1%)

Sources: Budget estimates (multiple years); Approved Detailed Budget Estimates 2024

During the period between 2018 and 2022, the government has on average, overestimated the cost of personal emolument expenditure by 1%. Overall, government estimates for personal emoluments have closely aligned with actual expenditures. Therefore, for reasons stated above, Verité Research uses the personal emoluments allocation in the budget estimate.

**Exhibit 4.7 - Estimates versus actual figures for Personal Emoluments in LKR billions, 2018-2024**

Sources: Budget estimates (multiple years); Approved Detailed Budget Estimates 2024

## Interest payments

### Observations

Interest payments are projected to increase by 21% to LKR 2,651 billion in 2024, accounting for 40% of the estimated total expenditure.

Domestic interest payments are expected to increase by 58% in 2023, compared to 2022. Additionally, the estimate for 2024 anticipates a further increase in domestic interest payments, growing by 28% compared to 2023. Meanwhile, foreign interest payments are expected to increase by 47% in 2023, compared to 2022, and are projected to rise by a further 58% in 2024.

**Exhibit 4.8 - Interest payment in LKR billions**

	2022	2023 Re-vised Estimate	2024 Budget Estimate	Total Change from 2023	Y-o-Y % Increase in Expenditure
<b>Total interest payments</b>	<b>1,565</b>	<b>2,189</b>	<b>2,651</b>	<b>462</b>	<b>21%</b>
Interest payment for domestic debt	838	1,325	1,692	367	28%
Interest payment for foreign debt	129	189	299	110	58%
Discounts on treasury bills and treasury bonds	599	675	660	(15)	(2%)

Source: Approved Detailed Budget Estimates 2024

### Past experiences

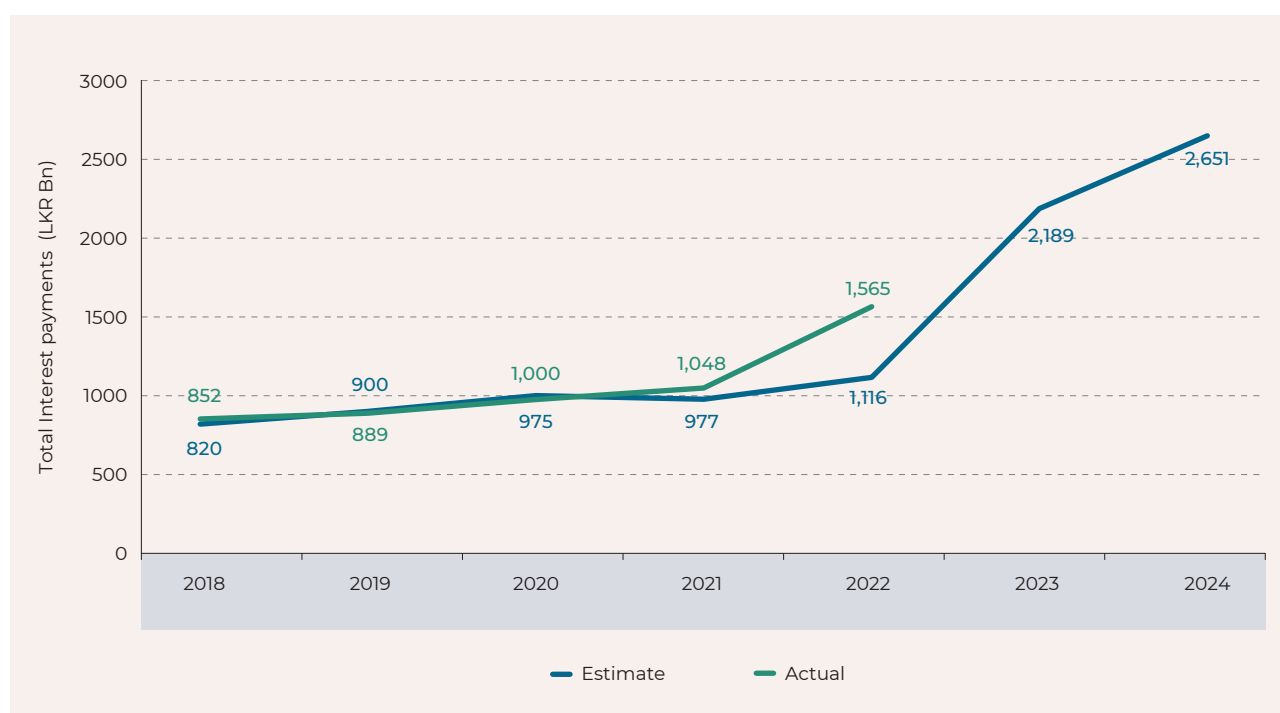
On average, interest payments grew by 16% over the period between 2018 and 2022.

**Exhibit 4.9 - Average annual growth rate and average over-shoot, 2018-2022**

	Average annual growth rate	Average over-shoot from approved budget estimations (Estimate vs Actual)
Total interest payments	16%	11%

Sources: Budget estimates (multiple years), Approved Detailed Budget Estimates 2024

During the period between 2018 and 2021, government estimates for interest costs have, on average, closely aligned with actual expenditures. However, in 2022, actual interest cost expenditure was underestimated by LKR 449 billion.

**Exhibit 4.10 - Estimates versus actual interest payment expenditure in LKR billions, 2018-2024**

Sources: Budget estimates (multiple years); Approved Detailed Budget Estimates 2024

**Subsidies and transfers****Observations**

Allocations to subsidies and transfers are projected to increase by 3% to LKR 1,322 billion in 2024. However, this increase is notably lower than the historical average annual growth rate of 14% observed between 2018 and 2022. The slower growth in 2024 is attributed to the 26% decrease in expenditure for development subsidies during the same period.

**Past experiences**

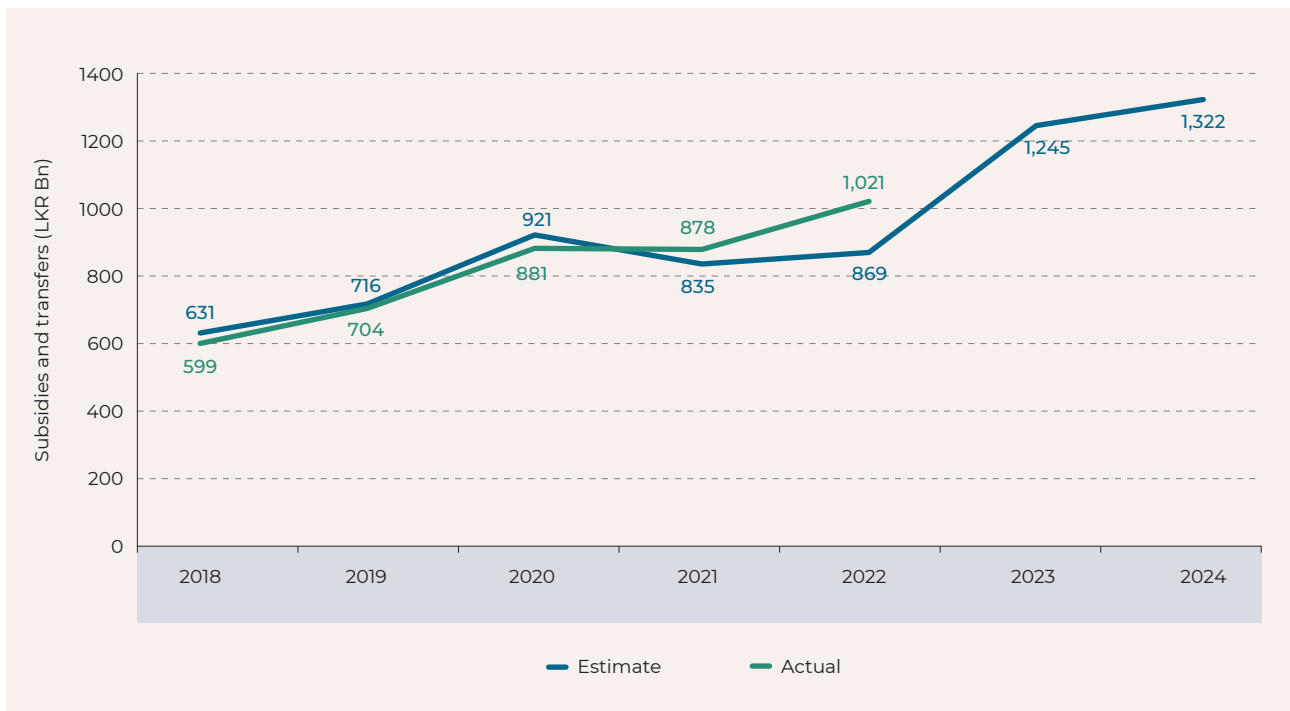
On average, subsidies and transfers grew by 14% during the period between 2018 and 2022.

**Exhibit 4.11 - Average annual growth rate and average over-shoot, 2018-2022**

	Average annual growth rate	Average over-shoot from approved budget estimations (Estimate vs Actual)
Subsidies and transfers	14%	3%

Sources: Budget estimates (multiple years), Approved Detailed Budget Estimates 2024

On average, the government has overestimated the cost of subsidies and transfers by 3%. However, between 2018 and 2022, actual government spending exceeded the projected costs for subsidies and transfers in 2021 and 2022.

**Exhibit 4.12 - Estimates versus subsidies and transfers payment expenditure in LKR billions, 2018-2024**

Sources: Budget estimates (multiple years); Approved Detailed Budget Estimates 2024

**Capital expenditure****Observations**

Capital expenditure is projected to grow by 3% in 2024, increasing to LKR 1,260 billion from LKR 1,220 billion in 2023. This increase is mainly attributed to an increase in the acquisition of capital assets, such as buildings and structures (502%) and land and land improvements (378%).

**Past experiences**

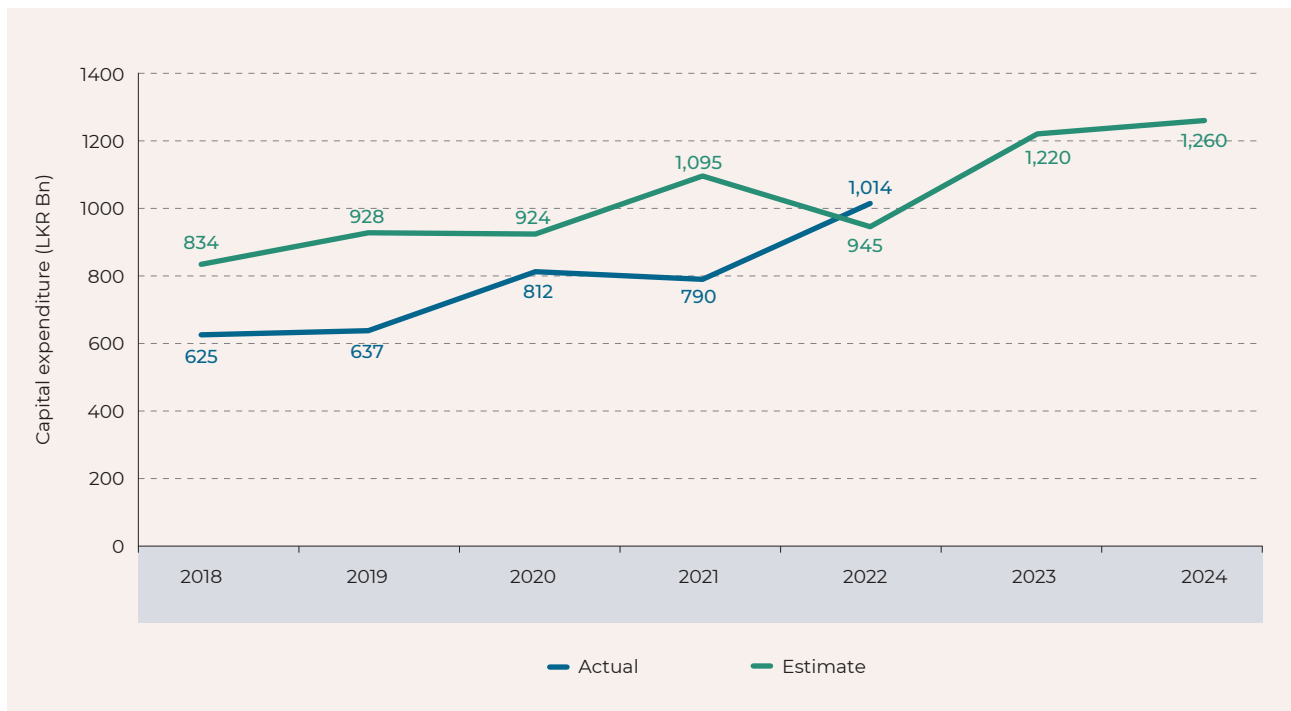
During the period from 2018 to 2022, capital expenditure grew by an average annual growth rate of 13%. Notably, in 2022, there was a substantial growth of 28%, driven by an increase in the acquisition of financial and capital assets.

**Exhibit 4.13 - Average annual growth rate and average over-shoot, 2018-2022**

	Average Annual Growth Rate	Average overshoot from approved budget estimations (Estimate vs Actual)
Capital expenditure	13%	(18%)

Sources: Budget estimates (multiple years), Approved Detailed Budget Estimates 2024

Between 2018 and 2022, capital expenditure has, on average, been overestimated by 18%. However, in 2022, there was a notable deviation from this trend as actual capital expenditure surpassed budget estimates for the first time since 2018.

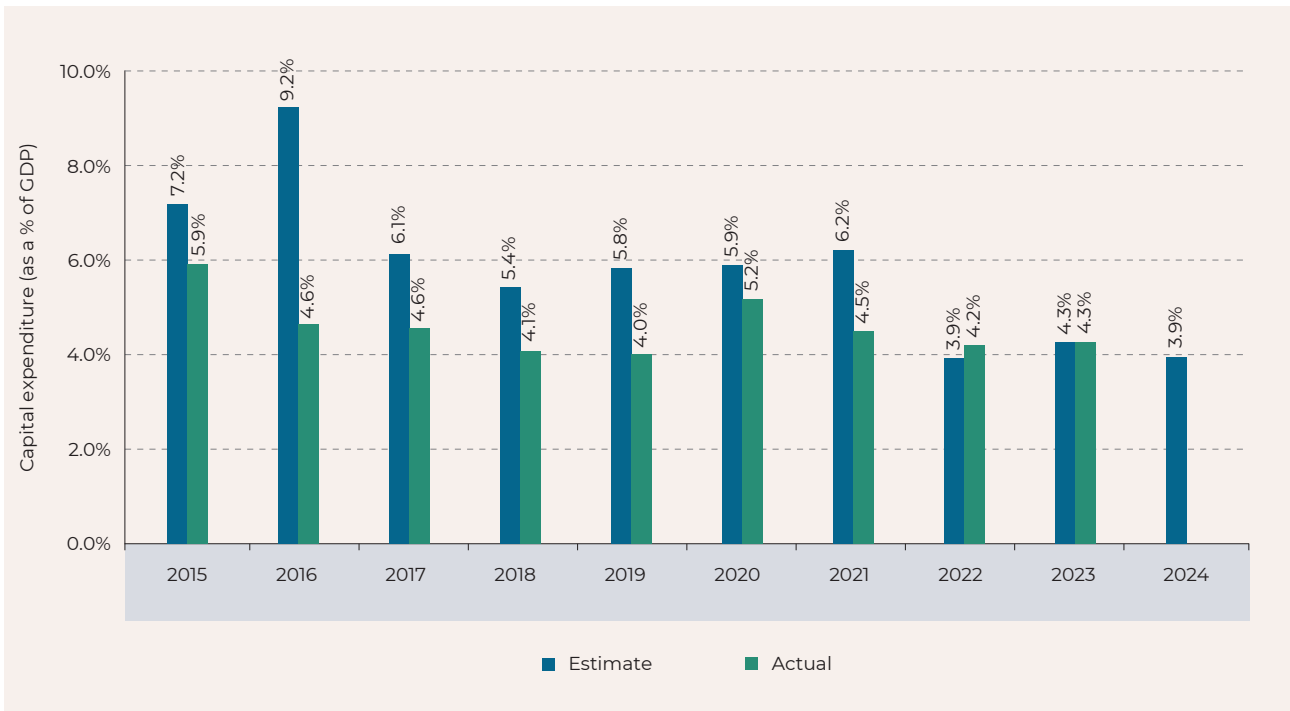
**Exhibit 4.14 - Estimates versus actual capital expenditure, in LKR billions, 2018-2024**

Note: 2024 estimate excludes bank recapitalisation

Sources: Budget estimates (multiple years); Approved Detailed Budget Estimates 2024

Historically, capital expenditure has been overestimated in annual budgets, with actual expenditure falling short of budgeted expenditure. This recurring trend has been attributed to the government's strategy of mitigating revenue shortfalls by reducing capital expenditure. However, in 2022 and 2023, the gap between estimated and actual expenditure has notably decreased, indicating that the government is now budgeting capital expenditure allocations closer to actual expenditure. Furthermore, capital expenditure is projected to grow by 3% in 2024, well below historical rates, indicating constraints on expanding capital expenditure in the current fiscal environment.

**Exhibit 4.15 – Estimates versus Actual Capital Expenditure, as a share of GDP, 2015-2024**



Note: Revised estimates have been utilised instead of actual values for 2023

Note: 2024 estimate excludes bank recapitalisation

Sources: Budget estimates (multiple years), Approved Detailed Budget Estimates 2024



# Ministerial spending

This section focuses on the allocation to ministries in the 2024 budget. To gain a clearer understanding of the government's fiscal priorities and policy decisions, interest payments and public debt amortisation are excluded in the following analysis.

## Observations

In 2024, total expenditure, excluding both interest payments and bank recapitalisation, increased by LKR 242 billion. The Ministry of Finance (MoF) was the primary contributor to this increase, accounting for 94% of the total rise. The increase in the MoF's expenditure was mainly driven by an increase of LKR 132 billion (14 times the 2023 revised value) in personal emoluments, primarily through other allowances (LKR 133 billion, 32 times the 2023 revised value), and an increase in allocation to welfare programmes (LKR 155 billion, 4 times the 2023 revised value).

In contrast, the Ministry of Women, Child Affairs and Social Empowerment (MWCS) recorded the largest decrease, at LKR 100 billion. The majority of this decrease is attributed to a 66% reduction in transfers, mainly due to a decline in the ministerial allocation for welfare programmes. This suggests a redirection of funds for welfare programmes from the MWCA to the MoF in 2024.

**Exhibit 4.16 - Ministerial allocation, in LKR billions**

Ministry	2023 Revised	2024 Budget Estimate	Total Change from 2023	Y-o-Y % Increase in Expenditure
<b>Ministry</b>	<b>3,665</b>	<b>3,907</b>	<b>242</b>	<b>6%</b>
Ministry of Finance, Economic Stabilisation and National Policies	400	627	227	36%
Ministry of Health	368	411	42	10%
Ministry of Defence	412	424	12	3%
Ministry of Tourism and Lands	11	21	9	44%
Ministry of Public Administration, Home Affairs, Provincial Councils and Local Government	519	527	8	2%
Ministry of Trade, Commerce and Food Security	6	3	(4)	(137%)
Ministry of Water Supply and Estate Infrastructure Development	76	73	(4)	(5%)
Ministry of Transport and Highways	424	417	(7)	(2%)
Ministry of Agriculture and Plantation Industries	121	113	(9)	(8%)
Ministry of Women, Child Affairs and Social Empowerment	174	75	(100)	(134%)
Others	1,152	1,218	65	5%

Note: The ministries exhibiting the top 5 largest deviations and those with the 5 smallest deviations between 2024 and 2023 have been identified and selected.

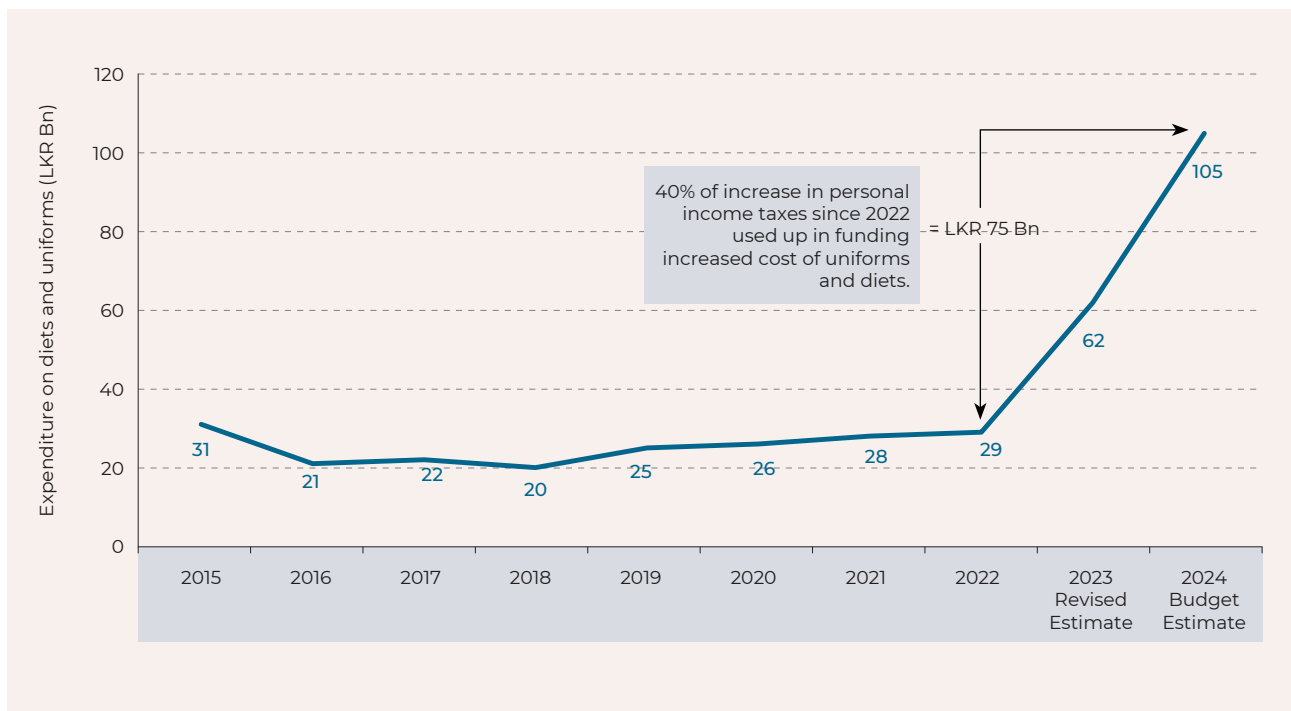
Source: Approved Detailed Budget Estimates 2024

# Concerns on government expenditure allocations

## Issue 1: Unprecedented increase in the allocation for diets and uniforms in the Defence sector

In 2023, total expenditure on diets and uniforms is expected to rise by 107%, compared to 2022. This allocation is projected to increase further in 2024, growing by 62% to LKR 119 billion. In 2024, 88% of the total expenditure on diets and uniforms will be allocated to the Ministry of Defence (MOD). This allocation, amounting to LKR 105 billion in 2024, is equivalent to 40% of the increase in personal income taxes. The majority of this expenditure under the MoD is attributed to the Sri Lankan army.

**Exhibit 4.17 - Defence sector diets and uniform allocation, in LKR billions, 2015-2024**



Note: Defence sector includes Ministry of Defence and Ministry of Public Security

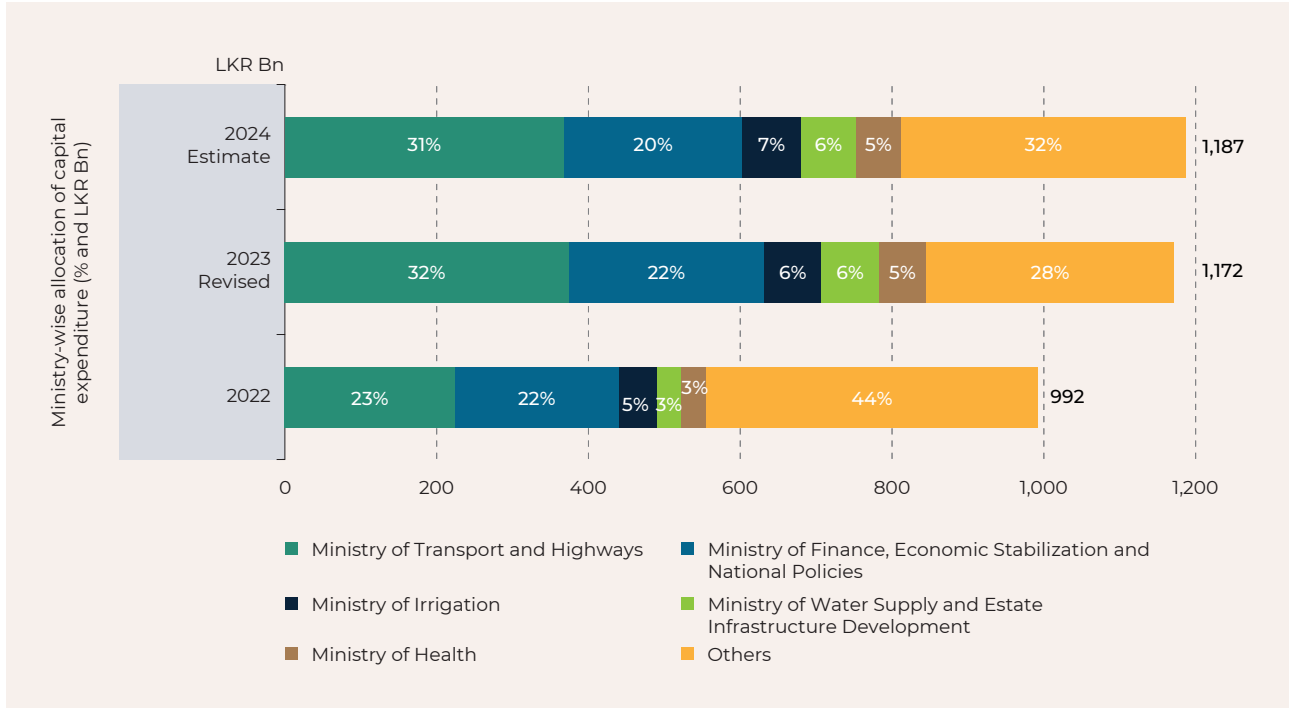
Sources: Budget estimates (multiple years); Approved Detailed Budget Estimates 2024

## Issue 2: Prioritisation of the Ministry of Transport and Highways in the allocation of capital expenditure in the 2024 budget

In 2023 and 2024, the Ministry of Transport and Highways received the highest capital allocation among all ministries, accounting for 32% and 31% of the allocations respectively. Despite a 2% decrease in allocations in 2024 compared to 2023, the capital expenditure allocation to the Ministry of Transport and Highways remains the highest in absolute terms relative to other ministries.

The Ministry of Health, which accounted for just 5% of the capital allocation in 2023, experienced a 3% decrease in its allocation for 2024 compared to 2023, indicating a reduction in funding for health-related initiatives. The Ministry of Water Supply and Estate Infrastructure Development also recorded a decline (5%) in capital allocation in 2024.

**Exhibit 4.18 – Allocation by ministry, of capital expenditure allocation, as a proportion of total allocation and LKR billions, 2022-2024**



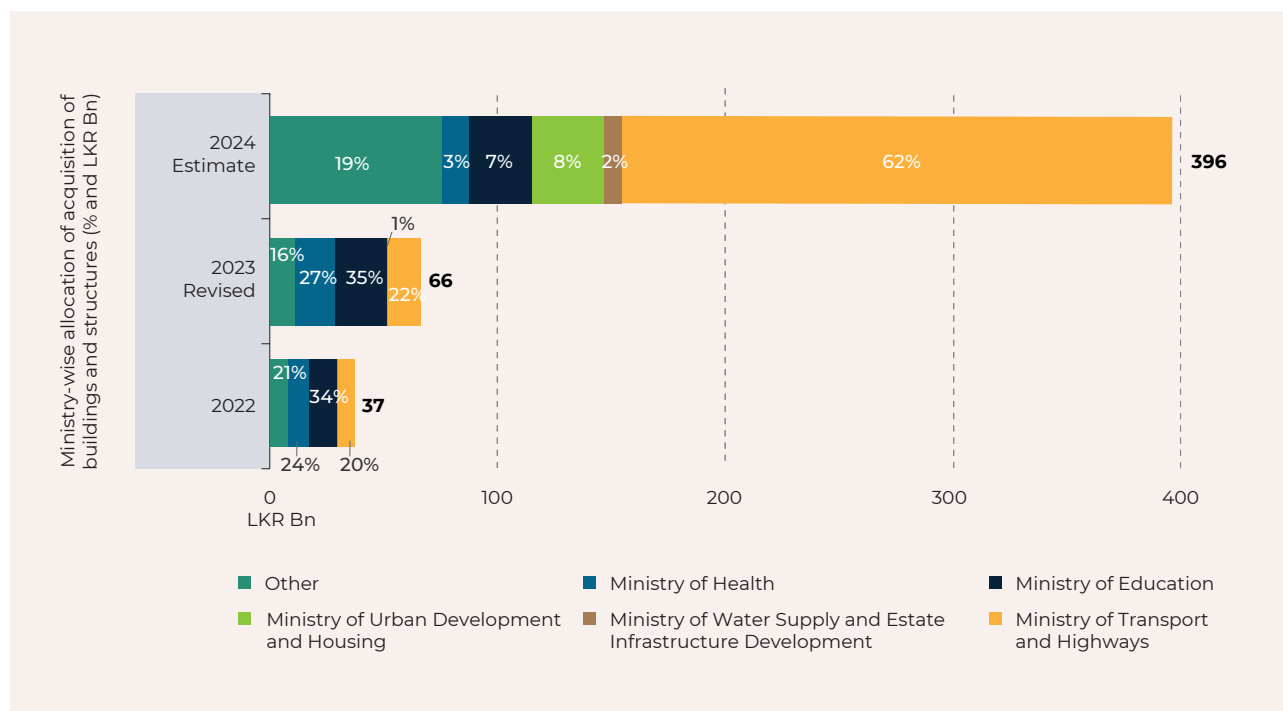
Note: 2024 excludes bank recapitalization, non-cabinet ministry allocation, Provincial council and Discontinued spending heads

Sources: Approved Detailed Budget Estimates 2024

In 2024, the allocation for the acquisition of buildings and structures emerged as the highest capital expenditure allocation item in the budget, increasing from LKR 66 billion in 2023 to LKR 396 billion in 2024 (6 times the 2023 revised value). The Ministry of Transport and Highways accounted for 62% of the allocation for acquisition of buildings and structures in 2024 (exhibit 4.19), with its allocation increasing from LKR 14 billion in 2023 to LKR 247 billion in 2024 (17 times the 2023 revised value). Consequently, the ministry recorded a rise in allocations both in relative and absolute terms.

Meanwhile, the allocation for the acquisition of buildings and structures to the Ministry of Health declined by 31% in 2024, decreasing from LKR 18 billion in 2023 to LKR 12 billion in 2024. As a result, the proportion of the allocation towards the Ministry of Health decreased from 27% in 2023 to just 3% in 2024, reflecting a decline in allocations both in relative and absolute terms. It is important to note that in 2022 and 2023, the allocation of funds for the acquisition of buildings and structures was more evenly distributed among ministries, including the Ministry of Transport, the Ministry of Health, and the Ministry of Education.

The data presented above highlights a notable concentration of capital expenditure on the Ministry of Transport and Highways in annual budgets, while simultaneously reducing allocations to other ministries, especially those crucial for improved social outcomes, such as the Ministry of Health, both in relative and absolute terms.

**Exhibit 4.19 – Allocation by ministry, of the acquisition of buildings and structures as a proportion of total allocation and LKR billions, 2022-2024**

Note: There is no allocation for ministry of water supply and estate infrastructure development in 2022/23 and Ministry of Urban Development and Housing in 2022.

Source: Approved Detailed Budget Estimates 2024

### Issue 3: Elevated allocation of funds to the discretionary budget

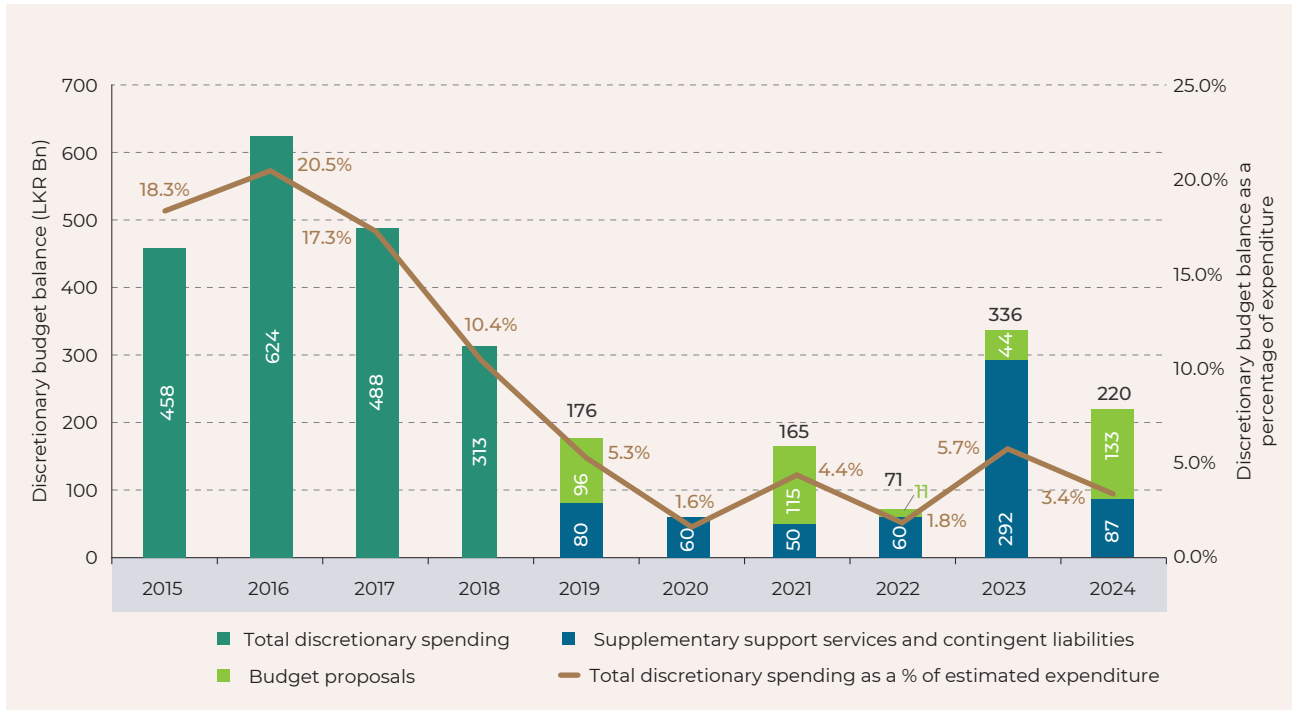
Section 6(1) of the Appropriation Act No.30 of 2021 allows for funds allocated to the development activities of the Department of the National Budget (NBD) to be shifted to any other head in the schedule, subject to the discretion of the Secretary to the Treasury, Deputy Secretary to the Treasury, or the Director General of the NBD. Such transfers do not require Parliamentary approval, and Parliament will only be notified via the submission of a report within two months of such a transfer. Consequently, the law allows for discretionary expenditure of funds allocated to the NBD's development activities by the government.

The allocation to the discretionary budget is projected to decline by LKR 116 billion (34%) to LKR 220 billion in 2024, compared to the initial estimate of 2023. However, the allocation remains relatively high compared to previous years. As a percentage of the total estimated expenditure, the discretionary budget accounted for 5.7% in 2023, decreasing to 3.4% in 2024. Despite this decrease, concerns persist regarding the discretionary budget, as highlighted by two key issues.

The 2018 and 2019 Budget reports by COPF identified instances of misuse within the discretionary budget and emphasised the diversion of funds from their intended purposes. Recommendations from the Committee put forth to address this concern include limiting the Supplementary Support Services and Contingent Liabilities category in the National Budget Document (NBD) to a maximum of 5% of total expenditure and creating a new budget head titled "Proposals of the Finance Minister" to prevent the misappropriation of funds. Although this was implemented by the Ministry of Finance in 2019, the budget head falls under the discretionary budget due to challenges in allocating certain proposals to specific ministries during the committee stage. Consequently, this allows the utilisation of funds from budget proposals for purposes without parliamentary approval.

Since 2022, changes in the reporting format have resulted in some budget proposals being categorized under specific ministries, while others are placed in the discretionary budget. This lack of clarity in distinguishing proposals in the discretionary budget from those under ministries in budget estimates complicates fund tracking. In 2024, out of the total expenditure proposals worth LKR 212.6 billion, 63% were placed in the discretionary budget, with the remaining 37% allocated to respective ministries.

**Exhibit 4.20 - Discretionary budget balance, in LKR billions, 2015-2024**



Note: Estimates are used for all years

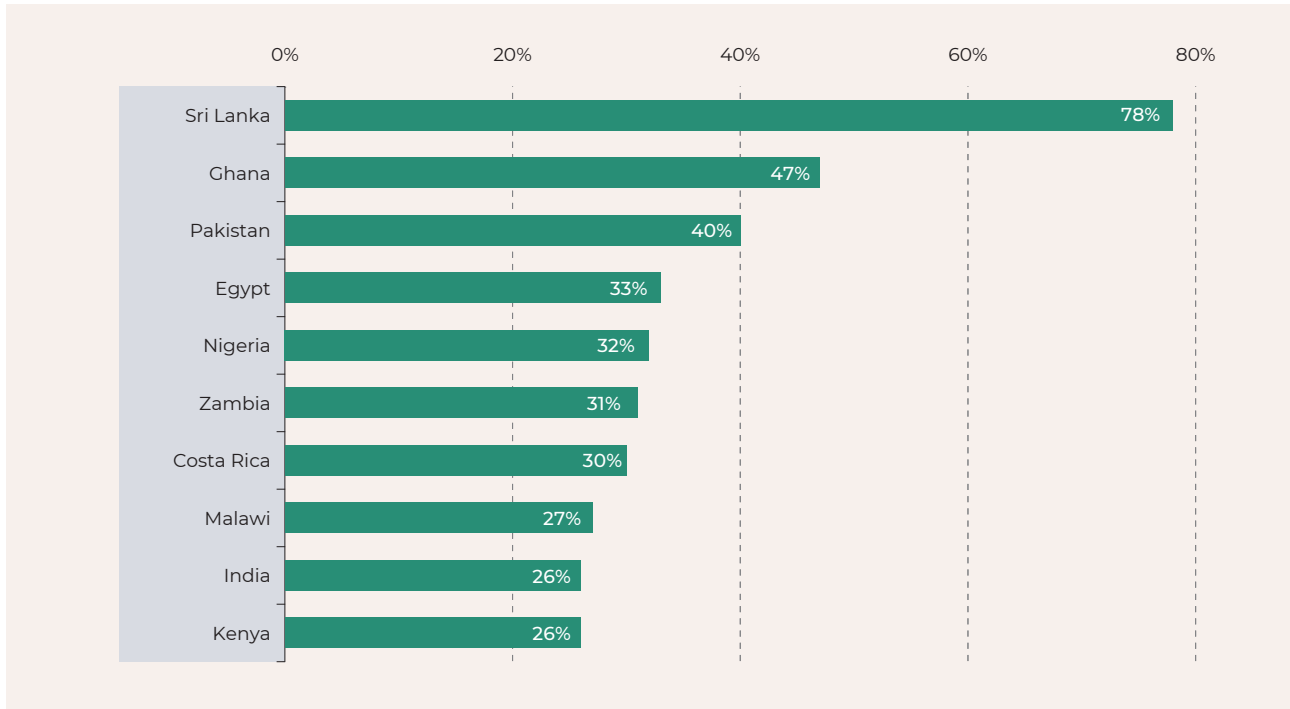
Note: The 2020 Budget estimates did not include the budget proposal figure.

Sources: Budget estimates (multiple years); Approved Detailed Budget Estimates 2024

## Issue 4: Elevated interest cost to revenue

In 2022, Sri Lanka recorded the highest interest-to-revenue ratio globally, reaching 78%, well above Ghana with the second-highest ratio at 47% (Exhibit 4.20).

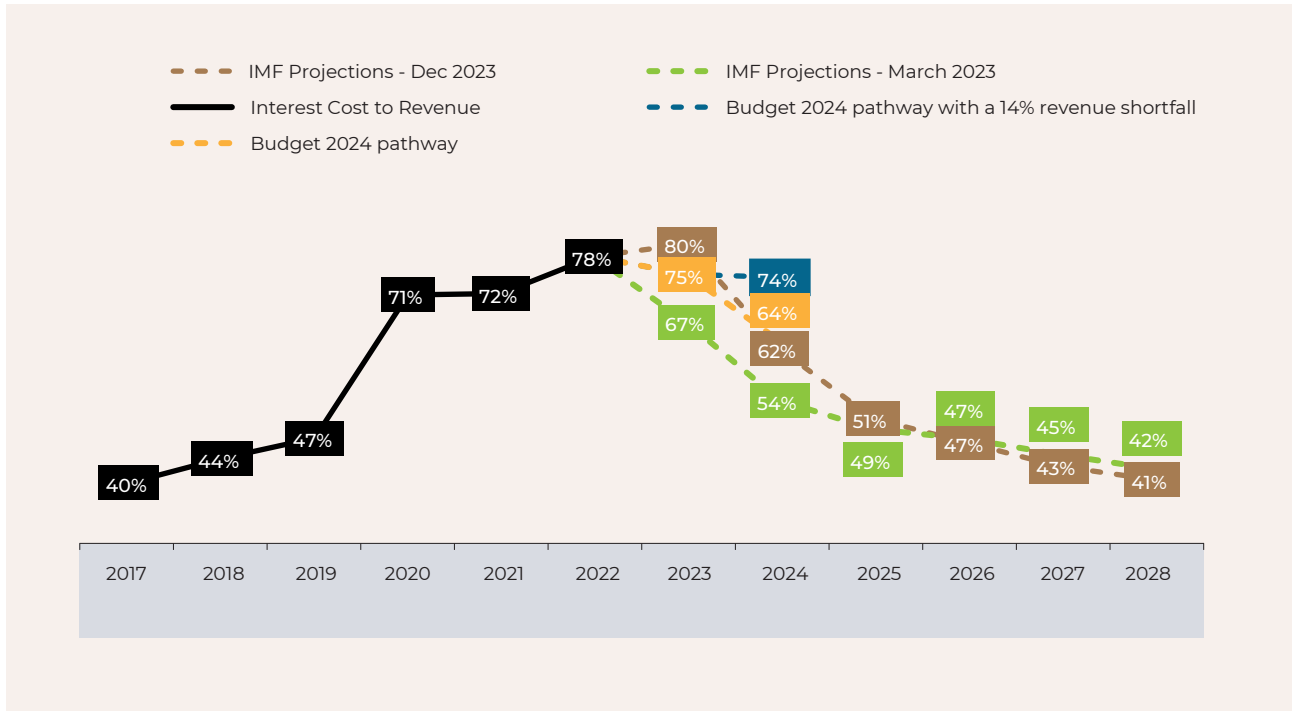
**Exhibit 4.21 - Countries with the highest ratio of interest payments to total government revenue in 2022**



Source: IMF, World Economic Outlook Database January 2024

According to the IMF's revised projections, this ratio is expected to reach a record 80% in 2023, as shown in Exhibit 4.22. This figure is higher than the initial projection of 67%, which would have indicated a decrease from 2022. Meanwhile, the 2024 Budget projects a 75% interest-to-revenue ratio in 2023, slightly below the IMF's projection of 80%.

**Exhibit 4.22 - Interest cost to revenue ratio (2017 - 2027)**



Source: First Review under the Extended Arrangement under the Extended Fund Facility; Budget Speech 2024; Central Bank of Sri Lanka Annual Reports

However, concerns arise for 2024, where both the IMF and the budget forecast an interest-to-revenue ratio in the mid-60s. This projection hinges on optimistic revenue expectations. Yet, if revenue falls short of government expectations and aligns with the revenue estimates by Verité Research outlined in Section 3, the interest-to-revenue ratio would be 74%, exceeding the budget target by 10%.

Reducing this ratio is critical for debt sustainability. Even under the revised IMF pathway, Sri Lanka only achieves Zambia’s ratio in 2026, and that too based on high revenue targets, which historically Sri Lanka has failed to meet. Therefore, despite interest rates falling from their historical peak of 30.5% at the end of August 2022, the interest burden on the economy remains sticky in the medium term.

# Summary of expenditure findings and recommendations

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The principal drivers of the LKR 704 billion increase in expenditure for 2024 are interest payments, discounts, and the acquisition of buildings and structures. In terms of recurrent expenditure, various sectors have experienced growth, with noteworthy increases in interest payments. Personal emoluments also continue to grow, surpassing historical averages. Interest expenses remain notably high, exceeding the IMF's projections for 2023, and are expected to further increase in 2024.

Capital expenditure is expected to grow by 3% in 2024, primarily driven by a tripling of the allocation for the acquisition of capital assets. However, other line items under capital expenditure have recorded a reduction in their allocation for 2024.

In terms of ministry-wise allocations, the Ministry of Finance (MoF) plays a pivotal role in the LKR 242 billion increase in expenditure,<sup>5</sup> driven by a rise in personal emoluments and welfare programme transfers. Conversely, the Ministry of Women, Child Affairs, and Social Empowerment (MWCS) sees a decrease in contributions, suggesting a potential redirection of welfare funds from the MWCS to the MoF.

Concerns regarding the 2024 budget include the rise in allocation of resources to the Defence sector and the discretionary budget, the prioritisation of the Ministry of Transport and Highways in the allocation of capital expenditure, and a high interest-to-revenue ratio.

## Recommendations on expenditure

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- Reassess and reallocate funds from the Defence sector into critical areas such as health, education, and social welfare to address current crises and promote social well-being.
- Enhance transparency and clarity in discretionary spending to prevent the misallocation of funds, ensuring that resources are allocated efficiently and effectively.

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<sup>5</sup> Excluding interest payments and bank recapitalisation



