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STATE OF THE BUDGET 2026

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State of the Budget - 2026 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 of the 2026 budget. 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 I: INTRODUCTION TO THE REPORT

Background

Sri Lanka suffered a severe economic crisis in 2022 with cascading consequences that followed. The recovery plan included suspending repayment and restructuring debt with private creditors and bilateral lenders, while receiving additional budget support loans from multilateral agencies.

The plan for economic recovery was agreed and written into a 48-month program with the International Monetary Fund (IMF), which commenced formally in March 2023. The program focused on improving revenue and financial governance.

Sri Lanka's Fiscal indicators have since improved significantly, even exceeding the expectations set by the IMF.[1] However, this has not translated to real economic recovery as yet. At the end of 2025, the real economic indicators in terms of poverty, employment levels, real wages, and GDP are all still worse than they were prior to the crisis. Poverty especially has increased dramatically. In 2019 poverty was officially assessed on the national poverty line at 14.3%. Though no official measures have yet been published since, using the world bank estimates on a different poverty line and translating them to the national poverty line estimates shows the poverty rate as being around 30% in 2025.

On the governance side of the plan agreed with the IMF there is progress, even while significant parts of the plan remain outstanding. An important reform under the governance side of this recovery plan was the enactment of the Public Financial Management Act No. 44 of 2024 (PFM Act). This legislation improved upon the existing legal framework for transparency, accountability, and discipline in the management of public finances. It defines the roles of the executive and the legislature, sets fiscal targets and mandates the timely publication of budget documents. Crucially, the Act requires the government to disclose its assumptions, estimates, and fiscal risks, enabling both Parliament and the public to assess the budget's credibility and its alignment with national fiscal objectives.

The 2026 Budget, presented on 07 November 2025 by President Anura Kumara Dissanayake, is the first full-year budget under this new public finance management framework. While the 2025 Budget was preceded by a limited vote-on-account, Budget 2026 is expected to fully align with the PFM Act, and to reflect a higher standard of budget formulation and reporting.

The annual budget is the fundamental mechanism for Public Financial Management (PFM), through which public funds are collected, allocated, spent, and accounted for. As such, it is a matter of significant public interest. The public's ability to engage effectively with the budget depends on the quality of its information, assumptions, and estimates. Previous *State of the Budget* reports have consistently noted critical flaws in these areas, including poor estimations, unclear key macro-fiscal assumptions, inconsistent numbers across different documents, and missing cost estimates for new proposals. Many of these shortcomings are evident in the present budget as well and constrain the space for informed reasoned democratic engagement on the budget.

In the past, this democratic deficit has been compounded by the government's poor track record in disclosing information pertaining to the implementation of the budget proposals.

1 Verité Research, Public Finance.lk. Sri Lanka's IMF scorecard: meeting or missing the initial forecasts? (11 July 2025) at https://publicfinance.lk/en/topics/how-has-sri-lanka-performed-against-the-imf-s-initial-forecast-1750332649 [last accessed 20 November 2025]

Through *Budget Promises*,[2] an online platform hosted under publicfinance.lk, Verité Research has been monitoring the progress of high-value budget proposals made by successive finance ministers since 2017. The assessments revealed that, on average, between 2017 and 2021, the government failed to disclose information for 45% of expenditure proposals, even after the information was sought through legally obligated Right to Information (RTI) requests. This opacity has worsened significantly, with the rate of failure-to-disclose rising to an average of 70% in 2022 and 2023. This opacity on implementation, also associated with failure in implementation, raises serious questions about the credibility of budgetary measures.

In this context, a critical question emerges: is the government's failure to deliver on budget promises a result of poor state capacity to deliver, or does it stem from fundamentally flawed assumptions and estimates within the budget itself?

2 Verité Research, Public Finance.lk. Budget Promises: Beyond Parliament. https://dashboards.publicfinance.lk/budget-promises/ [last accessed 20 November 2025]

Overview

This 5th edition of the *State of the Budget* by Verité Research provides a comprehensive analysis of the National Budget for 2026 presented to the Parliament of Sri Lanka on 7 November 2025. It evaluates the budget's financial, economic, and fiscal assumptions; the accuracy and basis of its estimates; its compliance with the Public Financial Management (PFM) Act; and progress on previously raised concerns.

The analysis is based on all budget documents tabled in Parliament, with a particular focus on the 2026 Budget Speech and the Draft Budget Estimates provided alongside to parliament with the relevant details of the budget breakdown. The report is structured in five main sections:

- **Section 1** introduces the report's objectives and the context of Sri Lanka's budget formulation process.
- **Section 2** assesses the quality and coherence of budget information, and identifies any inconsistencies across documents, missing estimates for new proposals, and gaps in adherence to the PFM Act.
- **Section 3** evaluates the budget's macroeconomic assumptions for key indicators and examines their implications for fiscal sustainability and debt dynamics.
- **Section 4** analyses the government's revenue estimates, with a detailed focus on several tax categories.
- **Section 5** reviews selected expenditure components that have posed challenges in previous years.

Through rigorous, evidence-based analysis, this report aims to support informed decision-making and constructive debate on Sri Lanka's budget. Ultimately, it seeks to enhance understanding, strengthen evaluation and support productive engagement in the country's public financial management process.

The complete 'State of the Budget 2026' report will be hosted on the online platform PublicFinance.lk.

Scope and Limitations of the Assessment

1. **Tight time frame:** This assessment was conducted within a compressed timeline. Work began only after the budget speech was delivered to Parliament and aimed to conclude before the end of the parliamentary budget debate. However, natural events, including Cyclone Ditwah, caused further delays to the publication of the report.

2. **Inconsistencies across sources:** The analysis was complicated by discrepancies between official sources. These included notable variations in the data and differences in accounting formats in budget documents.

3. **Limited to data available on budget day:** The assessment drew on information released up to 7 November. As such, developments occurring after this date may not be incorporated in the analysis.

4. **Post-budget revisions excluded:** Some changes to the budget between its presentation and the publication of this report, are not included in the analysis. These included mainly the supplementary allocations submitted to Parliament in response to Cyclone Ditwah and some amendments introduced during the committee stage debate.

SECTION 2: INFORMATIONAL STANDARDS AND DUE DILIGENCE

This section sets out the key informational deficiencies in the 2026 Budget, focusing on three types of issues: (1) irreconcilable differences in numbers across different classifications and formats, (2) missing estimates, and (3) non-compliance with the Public Financial Management Act.

2.1. Irreconcilable Differences Across Core Budget Documents

On the day the budget is presented, Parliament receives three key documents: the *Budget Speech*, the *Annual Budget Estimates*, and the *Budget, Economic and Fiscal Position Report* (previously called the Fiscal Management Report). Verité Research has consistently identified unexplained discrepancies between these documents, a problem that persists in the 2026 Budget. These inconsistencies make it difficult to determine the government's true fiscal goals with regard to the budget, and undermining both comprehension and credibility of the budget.

Two major issues are particularly noteworthy:

1. Mismatch in Revenue Figures

The revenue estimates in the 2026 Budget Speech[3] do not align with those in the Annual Budget Estimates.[4] For instance, while the Budget Speech projects LKR 4,910 billion in tax revenue, the Estimates record only LKR 4,850 billion, a difference of LKR 60 billion. Similarly, taxes on goods and services show a variance of over LKR 118 billion. Despite these differences, the Budget Speech provides only aggregate figures and does not provide a disaggregated breakdown that would allow reconciliation with the detailed estimates. Neither has parliament received any document that explains and enables the reconciliation of these differences (See Exhibit 1 for a full breakdown).

Exhibit 1 : Revenue Estimates: 2026 Budget Speech vs Budget Estimates in LKR billions

	2026 Draft Budget Estimate Data		2026 Budget Speech Data		Difference Between Speech and Estimate	
Item	2025 Revised Estimate	2026 Budget	2025 Revised Estimate	2026 Budget	2025 Revised Estimate	2026 Budget
Total Revenue and Grants	5,159	5,305	5,100	5,300	-59	-5
Total Revenue	5,134	5,275	5,075	5,270	-59	-5
Tax Revenue	4,725	4,850	4,725	4,910	0	60
Income Tax	1,120	1,210	1,120	1,210	0	0
Taxes on Goods and Services	2,890	2,938	2,953	3,056	63	118
Taxes on International Trade	655	649	652	644	-3	-5
License Taxes	60	54	Not Reported	Not Reported		
Non-Tax Revenue	409	425	350	360	-59	-65
Grants	25	30	25	30	0	0

Source: 2026 Draft Budget Estimates and 2026 Budget Speech

3 Ministry of Finance, Planning and Economic Development. Budget Speech 2026 (7 Nov 2025) at https://www.treasury.gov.lk/api/file/6dcc7475-cdf4-4c15-b167-0767ae17330b [last accessed 17 November 2025]

4 Ministry of Finance, Planning and Economic Development. Draft-Detailed Budget Estimate 2026 (7 Nov 2025) at https://www.treasury.gov.lk/api/file/2abcdabf-fd37-48f2-a478-1837cd5b3fdd [last accessed 17 November 2025]

2. Missing and Conflicting Macroeconomic Indicators

The government's key macroeconomic assumptions, including nominal GDP, real GDP growth, and inflation, differ across official documents. The *Medium-Term Fiscal Framework (MTFF)*, published in June 2025 as part of the *Fiscal Strategy Statement*,[5] provides one set of figures, while the *Budget Speech*, delivered in November 2025, implies another, yet omits key indicators such as real GDP growth and inflation. A third, definitive set of figures, used by the Ministry of Finance (MoF), had been provided later to a committee of parliament and thereafter published in the *Committee on Public Finance (COPF) report*.[6] As shown in Exhibit 2, these changes to the MTFF are not reflected in the *Budget*, *Economic and Fiscal Position Report*[7], nor did the Government provide Members of Parliament with a rationale for these changes alongside with budget documents.

Exhibit 2: Classification of Revenue Estimates: 2026 Budget Speech vs. Budget Estimates in LKR billions

	2025			2026		
	Medium Term Fiscal Framework (in FSS)	Budget Speech	COPF report	Medium Term Fiscal Framework (in FSS)	Budget Speech	COPF report
Inflation (GDP Deflator)	3.60%	Not reported	2.40%	5.30%	Not reported	3.20%
Real GDP Growth	3.50%		4.50%	3.10%		4.50%
Nominal GDP Growth	7.10%	6.8% - 7.5% (Calculated)	6.90%	8.40%	7.0 to 8.0% (Calculated)	7.70%
Primary Balance	2.30%	3.80%	3.80%	2.30%	2.50%	2.50%

Source: 2026 Fiscal Strategy Statement (FSS), COPF Report on Budget 2026 and 2026 Budget Speech
Note: The nominal GDP range is provided in the table above because the nominal GDP growth in the Budget speech was determined by dividing the nominal LKR amounts of major fiscal components—such as Revenue, Expenditure, and deficit figures—by the GDP share. However, when calculated, there was no single definitive GDP figure.

This fragmented disclosure is not just poor practice; it probably also constitutes a failure to align with the expectations of the Public Financial Management (PFM) Act, in three ways. First, Section 20 (2)(a) of the PFM Act requires the Budget Speech to serve as a summary of the Annual Budget that is debated in parliament. Section 20 (1) of the PFM Act specifies the Annual Budget Estimates and the Appropriation Bill as the budget documents. Any discrepancies between the two, such as differences in revenue projections, if not explained and updated to parliament, undermine the purpose of the parliamentary process and is not in line with the expectations of the Act.

Second, Section 49 (2)(k) of the Act, mandates that any updates to the MTFF or economic assumptions must be reflected in the Budget and the Economic and Fiscal Position Report. The Government's failure to do so means Parliament is deliberating on future fiscal policy on the basis of information that is no longer accurate and current.

Third, Section 49 (2)(g) of the Act obliges the Government to disclose the "basis, economic or otherwise, which has

5 Ministry of Finance, Planning and Economic Development. Fiscal Strategy Statement 2026 (30 June 2025) at https://www.treasury.gov.lk/api/file/2f704cb4-84a1-45ae-b667-38540a7458fa [last accessed 15 November 2025]

6 Parliament of Sri Lanka, Report of the Committee on Public Finance on Appropriation Bill for the Financial Year 2026 (14 Nov 2025) at https://www.parliament.lk/uploads/comreports/1763095834007786.pdf [last accessed 17 November 2025]

7 Ministry of Finance, Planning and Economic Development. 2026 Budget, Economic and Fiscal Position Report (7 Nov 2025) at https://www.treasury.gov.lk/api/file/1aab9cb7-e765-444f-82a0-9e6159d4048f https:/www.treasury.gov.lk/api/file/1aab9cb7-e765-444f-82a0-9e6159d4048f [last accessed 14 November 2025]

been used in the preparation of such estimates." However, for many policy proposals the Budget Speech does not provide the estimated fiscal impact, which would form part of the basis for evaluating the proposals; and where it does provide estimates, fails to provide the actual informational and assumptive basis (different from what is stated in the documents before Parliament) on which those estimates were prepared.

Verité's Recommendation on Ensuring Informational Standards and Due Diligence

Discrepancies between the Budget Estimates and the Budget Speech can arise where the latter reflects the most recent changes. Nonetheless, Parliament and the public must have access to the most current figures to properly assess the budget.

Verité Research recommends that the government introduce a ***Budget Reconciliation Document*** published alongside the *Budget Speech*. This document should clearly explain any variances between the figures reported in various budget documents. Establishing such a reconciliation mechanism would enhance understanding, strengthen evaluation and support productive engagement in the country's budgetary process, thereby also upholding the spirit of the PFM Act.

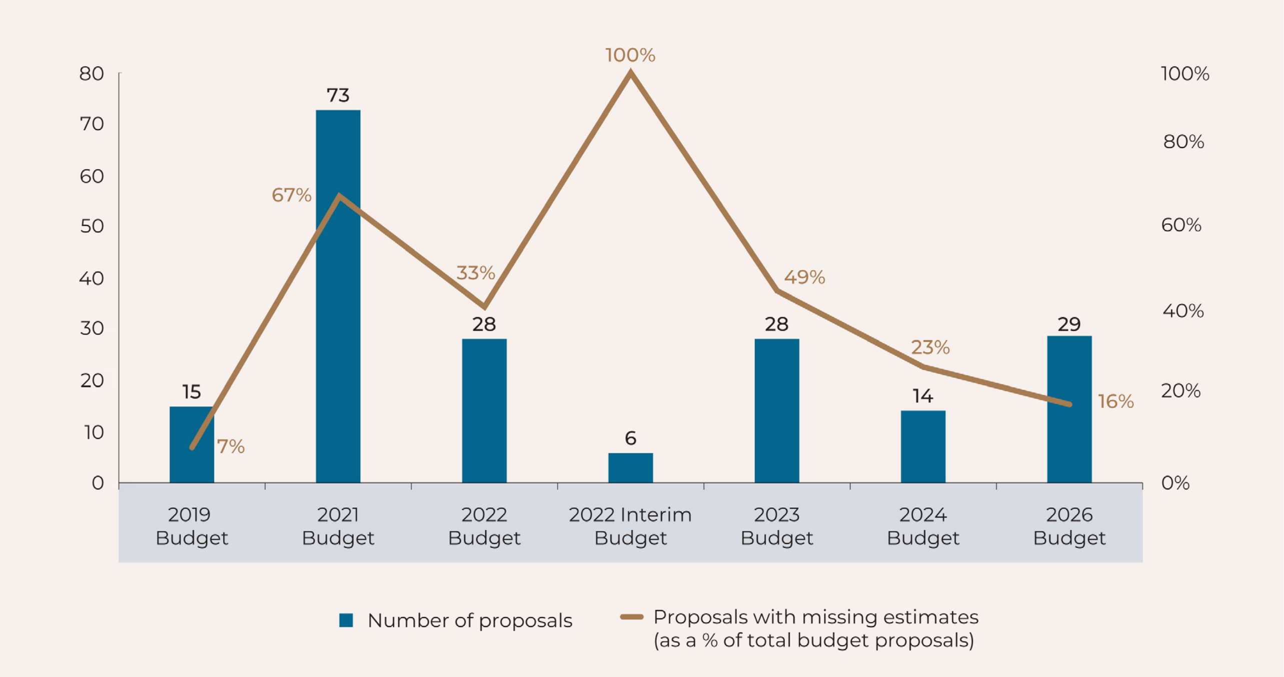
2.2 Missing Estimates

A reasonable understanding of the budget requires that each proposal include a clear estimate of its fiscal impact. This expectation is underscored in Section 49 (2) of the PFM Act, which mandates that the *(e) estimates relating to revenue and expenditure and (g) the basis, economic or otherwise which has been used in the preparation of the estimates specified in paragraphs (a) to (f)* should be contained in the Economic and Fiscal Position report tabled in parliament.

Despite the legal mandate through the PFM Act, the "missing estimates" problem is that numerous proposals in the 2026 Budget omit or obscure information on their fiscal impact.

The 2026 budget contained 29 proposals without estimates, the highest count since 2021 (Exhibit 3). However, in proportional terms, this accounted for 16% of all proposals, a lower share than in previous years.

Exhibit 3: Total Number of Proposals With Missing Estimates of Fiscal Consequences, and as a Percentage of Total Budget Proposals



2.2.1 Negative Fiscal Measures With Missing Estimations

This section sets out examples of fiscal measures that have a negative fiscal impact, through measures that increase expenditure or reduce revenue, but where estimates are not provided on the magnitude of that budgetary impact.

The 2026 budget shows a notable expansion of such proposals, including 4 revenue-reducing measures (up from one in 2024) and 18 new expenditure initiatives.

Exhibit 4: Revenue-Reducing proposals

1	With the aim of expanding new investments and encouraging new investments in small and medium-sized enterprises, it is proposed to reduce the investment threshold eligible for the existing enhanced capital allowances from USD 3 million to USD 250,000.
2	Accordingly, effective from January 1, 2026, all service fees for electronic payments to Government institutions are permitted to be waived. Further, to promote payments using the QR code system, we propose to provide the necessary provisions through the expenditure head of the Ministry of Digital Economy to enable QR code payments worth less than Rs. 5,000 to be made free of charge.
3	To accelerate the spread of digital technology, a simpler and faster unique approval process will be established for the construction of digital infrastructure facilities such as communication towers. It is proposed to suspend the tax applicable to new towers constructed under this digital technology expansion programme for a period of 5 years.
4	Locally manufactured fabric is subjected to VAT and the imported fabric, although exempted from VAT, is subjected CESS of Rs. 100 per kilo gram. To ensure a level playing field, it is proposed to remove CESS and impose VAT on the imported fabric. This will be implemented effective from April 01, 2026.

Source: Budget Speech 2026

Note: The revenue-reducing proposals listed below were identified as such in the Budget Speech.

Exhibit 5: Expenditure Proposals With Missing Estimates

1	Two more (technology) parks are planned to be established under the Board of Investment of Sri Lanka, centered in the cities of Digana and Nuwara Eliya.
2	It is planned to make the Haputale area another major tourist destination in Sri Lanka by improving the infrastructure facilities and providing necessary publicity in the tourist attractions located in the areas of Haputale, Beragala and Idalgashinna, which already have a large local and foreign tourist attraction in the Uva Province.
3	To make this vision a reality, we must invest in state-of-the-art airport facilities and develop our own airline with an adequate fleet of aircraft. To this end, we will resume the stalled project to expand the Bandaranaike International Airport in the first quarter of next year.
4	An awareness program on a Unique Digital Identity will be launched in Sri Lanka in early 2026. The first digital identity card will be issued in the 3rd quarter of 2026.
5	In order to expand access to digital technology for all citizens, it is envisaged to provide broadband vouchers for education-related access to children from disadvantaged and other low-income families. The aim is to further enable online education and participation in the digital economy. This will ensure the creation of a digital future that benefits all.
6	It is proposed to establish 10 voluntary rehabilitation centers under the Rehabilitation Bureau in 10 locations including Polonnaruwa, Welikanda-Senapura, to rehabilitate people addicted to toxic drugs.
7	Provisions have also been made in this year's budget for the renovation of hostels that have not been properly maintained due to the financial crisis in the country.
8	It is proposed to construct a new administrative complex for the second phase of the Uva Provincial Council, a long-standing requirement.
9	In 2026, we expect to enhance the Thriposha programme and the Monthly Nutrition Assistance Programme for Pregnant and Lactating Mothers, and ensuring wider coverage and improved delivery of these programmes through strengthened community health networks.
10	Approval has been granted to procure 294 essential vehicles and modern communication equipment to enhance the efficiency of the Department of Wildlife Conservation.
11	Therefore, in the 2026 budget, Government support will be provided for the operations and essential capital expenditures of the Sri Lanka Broadcasting Corporation, Sri Lanka Rupavahini Corporation and Independent Television Network.
12	Furthermore, the necessary feasibility studies for the widening of the Katugastota-Galagedara road section are scheduled to commence next year.
13	In parallel with the construction of the Kandy Multi-Modal Transport Centre, provisions have been made in this budget to widen and upgrade several access roads leading into Kandy city.
14	In the next year, we expect to enhance the capacity of the Colombo Port and enhance operational efficiency through major development initiatives, including the Western Container Terminal Phase II project with the support of the Asian Development Bank, feasibility studies for the proposed Ports Logistics Centres with the support of the World Bank, and the proposed Colombo North Port Development Project.
15	In addition, the Kerawalapitiya Customs Verification Centre and Trade Facilitation Centres in the Bloemendal area will be established.
16	In addition to developing the necessary infrastructure to positioning the ports in Sri Lanka as a leading logistics hub in the region, digitalization and automation of port operations are being enhanced to ensure seamless and efficient port operations, including the implementation of the Port Community System as an integrated data management system.
17	In order to reduce the current congestion at the entrance to Matale city, necessary measures will be taken to expand the number of lanes to 4 lanes, acquire the necessary land for this purpose, and prepare a city plan.
18	It is proposed to increase the interest-free festive advance of Rs. 10,000 provided to government employees to Rs. 15,000.

Source: Budget Speech 2026

2.2.2 Positive Fiscal Measures With Missing Estimations

This section sets out examples of fiscal measures that have a positive fiscal impact, through measures that control expenditure or increase revenue, but where estimates are not provided on the magnitude of that budgetary impact.

The 2026 Budget presents 5 proposals to raise revenue without an estimated fiscal impact. The revenue proposals include specific tax adjustments and enhanced administration and compliance efforts to expand the tax base and reduce leakages.

Exhibit 6: Revenue Increasing Proposals

1	**Reduction of registration threshold of Value Added Tax and Social Security Contribution Levy:** With the view of broadening the tax base, we propose to reduce the annual turnover threshold for the registration from Rs. 60 million to Rs. 36 million Value Added Tax and Social Security Contribution Levy effective from April 01, 2026.
2	**Imposition of Social Security Contribution Levy on Vehicles** It is observed that the social security contribution levy on the sale of vehicles is not being collected properly. Therefore, the social security contribution levy is proposed to be charged at the time of import or manufacture and sale of vehicles, and exempt this tax at the time of after-sales. This is expected to be implement-ed effective from April 2026.
3	**Improving the Tax Audit Process** To enhance the integrity, efficiency and fairness of tax administration, the Government will introduce a modern tax audit framework effective on the returns filed from January 2026. These reforms will streamline audit procedures and reduce the illegal connections between taxpayers and officials, thereby minimizing opportunities for discretion and corruption. Under the new system, the selection of audit cases will be based on transparent risk assessments conducted by the Risk Management Unit and, when necessary, reviewed by a committee appointed by the Commissioner General of Inland Revenue.
4	**Amendments to the Telecommunications Tax Act and Strengthening the Government's Programme Against Money Laundering and the Financing of Terrorism** Any bad debt incurred by the telecommunications service provider should be included in the payment of the Telecommunications Levy on the provision of telecommunications services. Similarly, any bad debt recovered should be included in the payment of the relevant tax. It is proposed to amend the Telecommunications Tax Act, No. 21 of 2011, to introduce the relevant amendments and to reflect the changes made from time to time in relation to telecommunications taxes.
5	**Development of the National Electronic Invoicing System** To initiate a national e-invoicing system, Sri Lanka has introduced an API-based integrated framework to enable seamless connectivity between taxpayers' Enterprise Resource Planning (ERP) systems and the Revenue Administration Management Information System (RAMIS).

Source: Budget Speech 2026

2.2.3 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 2026. Exhibit 7 provides a table with 2 such measures.

Exhibit 7: Proposals with undisclosed consequences

1	Locally produced coconut oil and palm oil are subjected to Value Added Tax and Social Security Contribution Levy, while imported coconut oil and palm oil are sub-jected to Special Commodity Levy at Rs. 150 per kilogram and Rs. 275 per kilogram, respectively. To ensure a level playing field, it is proposed to remove the Special Commodity Levy on imported coconut oil and palm oil and instead implement the general tax structure including Value Added Tax. It is also proposed to implement this proposal from April 2026.
2	Implementation of the National Tariff Policy: We propose to revise the current Customs Import Duty rates of 0%, 15%, 20%, in line with the National Tariff Policy, to 0%, 10%, 20%, 30%, effective from April 2026. Also, with the aim of boosting economic growth by increasing the competitiveness of external trade, we expect the gradual phase out of para-tariffs through the pro-posed revisions in Customs Import Duty rates. We propose to prepare and implement a plan according to a time frame for the phaseout of para-tariff with a minimal impact on government revenue.

2.3 Compliance with the Public Financial Management Act

The Public Financial Management Act No. 44 of 2024 (PFM Act) establishes a legal framework to ensure the national budgetary process is managed with transparency, accountability and financial discipline. This section assesses the government's adherence to these principles by reviewing the completeness of mandated budget disclosures and compliance with key fiscal limits.

2.3.1 Compliance Related to Budget Transparency

The PFM Act mandates specific transparency requirements for the submission of the national budget to Parliament. This includes releasing a complete set of documents specified in Section 20, and ensuring the Budget, Fiscal and Economic Report meets the content requirements of Section 49 (2).

A review of compliance with Sections 20 and 49 (2), detailed in Exhibit 8 below, reveals that while several core budget documents have been published, significant gaps remain in both completeness and accuracy. Key deficiencies include a lack of up-to-date information in the annual budget estimates and public investment projects report and incomplete information disclosures in several other additional budget documents.

Under Section 49 (2), several essential macroeconomic estimates are either partially available, entirely absent, or not up-to-date. Furthermore, the underlying assumptions are poorly explained, and no formal sensitivity analysis of the fiscal projections has been provided. These are detailed in Exhibit 9.

Exhibit 8: Compliance Status of Mandated Budget Documents (Section 20 of the PFM Act)

Sub Section 20 of the Act		Documents Mandated to be Released	Status of Document(s)	Latest Version (Base/ Publication Dates)
1	a	The estimates of revenue and expenditure (in this Act referred to as the "**annual budget estimates**") in the forms as may be prescribed;	**Document Available With Deficiencies** The aggregates set out in the Budget Speech differs from those in the formal Budget Estimates. No supporting documents are released reconciling the deviations or providing the disaggregated data for the Budget Speech, as provided in the Budget Estimates. (refer section 2.1 for details)	07.11.2025
	b	The **Appropriation Bill** that includes, inter-alia, the estimates of expenditure, and borrowing ceilings	**Document Available** The Appropriation Bill for 2026 sets government expenditure and borrowing limits.	17.09.2025
2	a	**Budget speech** summarising the contents of the annual budget and the overall thrust of the Government's fiscal policy;	**Document Available With Deficiencies** 16% of all budget proposals do not mention a financial allocation (refer section 2.3 for details). The Budget Speech presented to the parliament contains the budget proposals, overall fiscal policy, the summary of the Budget Estimates and financing. However, the fiscal summary presented in the Budget Speech does not tally with the Budget Estimates; hence, not a summary.	07.11.2025
	b	A **public-friendly version of the annual budget** containing easy-to-understand summary of the main features of the annual budget;	**Document Available** The document, "The National Budget 2026 Citizens Budget: A Public-Friendly Version of the Annual Budget," provides a summary of the budget process, its basis of preparation, and revenue and expenditure figures.	07.11.2025
	c	The **fiscal strategy statement** and the **budget, economic and fiscal position report;**	**Document Available With Deficiencies** The Fiscal Strategy Statement, released on 30 June 2025, sets the government's medium-term fiscal plan. However, the Budget, Economic and Fiscal Position Report, does not follow the assumptions set in the fiscal strategy neither does it provide an update (Refer section 2.1 for details).	Fiscal Strategy Statement - 30.06.2025 Budget, economic, and fiscal position report - 07.11.2025
	d	**Medium-term debt management strategy** and **annual borrowing plan;**	**Document Available With Deficiencies** Medium Term Debt Management Strategy presents a rolling 5-year strategy for managing government debt from 2026-2030, but it lacks a forecasted debt pathway. The Annual Borrowing Plan provides an actionable framework for financing government borrowing in 2026 only.	07.11.2025

Sub Section 20 of the Act		Documents Mandated to be Released	Status of Document(s)	Latest Version (Base/ Publication Dates)
	e	The list of ongoing and newly approved **public investment projects,** including public-private partnership projects in accordance with subsection (1) of section 45;	**Document Available With Deficiencies** The Major Public Investment Project 2026/2028 report includes a list of ongoing and newly approved projects, broken down by ministry. It outlines each project's duration, total estimated cost, cumulative expenditure as of 31 December 2024, and budgetary allocations for 2025 (revised), 2026 (estimated), and 2027–2028 (projected). However, the reported cumulative expenditure figures have not been updated to include costs incurred during 2025. The figures remain identical to those published in the previous year's report, ending 31 December 2024. As a result, the document does not reflect the most recent financial progress of these projects, rendering the publication outdated. This approach falls short of the expectations set out in Section 45(2) of the PFM Act, which states that the "Secretary to the Treasury shall be responsible for maintaining an updated data repository on public investment projects, including public-private partnership projects." The apparent absence of updated information is a failure to meet the obligations of the Act.	07.11.2025
	f	The list of **outstanding loans and outstanding guarantees** provided by the Government and other contingent liabilities of the Government including those related to public-private partnership projects	**Document Available With Deficiencies** Annex 1 of the Budget, Economic and Fiscal Position Report – 2026 details a list of outstanding treasury guarantees and letters of comfort issued by the General Treasury up to 31 August 2025. But do not provide a list of outstanding loans.	07.11.2025
	g	Summary of **public service employment** across budgetary entities;	**Document Available** Cadre Information of Public Sector report provides a summary of public sector employment across budgetary entities, including the number of employees in state-owned enterprises.	07.11.2025
	h	A **statement of tax expenditures** including the total cost of existing tax expenditures, the disclosure of new tax expenditures	**Document Available** Tax Expenditure Statement 2024/2025 includes a statement of tax expenditures that details the cost of existing measures and discloses new ones, providing an overview and analysis across tax types.	07.11.2025

Exhibit 9: Status of Mandated Disclosures in the Budget, Economic and Fiscal Position Report (Section 49 (2) of the PFM Act)

Sub Section of 49 (2) of the Act	Information to be Released Under Section 49 (2) of PFM Act	Status
a	Estimates relating to the gross domestic product	**Partially Available** The GDP growth rate is given as a range (between 4% and 5%) in 2026. However, all calculations and projections in the budget and medium-term framework require the government to use an exact figure, which has not been transparently declared.
b	Estimates relating to consumer prices	**Not Available** This normally means at least a projection of annual inflation either point to point, or average up to the point etc. But the report neither states which inflation measure is used, nor does it go beyond 6 months: it merely states that “inflation is expected to reach the 5% target by mid-2026”
c	Estimates relating to employment and unemployment	**Partially Available** The report mentions the unemployment rate is expected to be below 5% in 2026 but provides no specific quantified figure.
d	Estimates relating to the current account position of the balance of payments	**Not Available** The report provides the current account balance up to Q2 2025 but offers no projections for the future.
e	Estimates relating to revenue and expenditure	**Available** This report projects 2026 revenue and expenditure at 15.4% and 20.5% of GDP, respectively. And provides the details in the budget estimates.
f	Estimates relating to Government borrowing	**Available** Government gross borrowing requirements are projected at LKR 3,800 billion for 2026.
g	The basis, economic or otherwise which has been used in the preparation of the estimates specified in paragraphs (a) to (f)	**Partially Available** While some basis is provided for expenditure estimates and broader macroeconomic assumptions, the methodology for deriving revenue estimates is not explained. For example, the Excise duty on motor vehicles is expected to decrease by 32.8% despite a stable duty rate, with no justification provided for this calculation.
h	A statement relating to the sensitivity of the estimates specified in paragraphs (a) to (f) and the changes which may occur in connection with the economic or other basis used in the preparation of such estimates	**Partially Available** The report identifies fiscal risks but provides no sensitivity analysis quantifying their effects on the estimates in (a) to (f).
i	A statement, quantified as far as practicable, the risks that may have a material effect on the fiscal position such as contingent liabilities including guarantees and indemnities granted by the Government under any written law;	**Partially Available** Risks are mentioned qualitatively but not quantified.
j	Public announcements relating to proposals of the Government in connection with Government spending not included in the estimates referred to in paragraph (e);	**Not Available** Proposals are announced in the Budget Speech but are not mentioned in the Budget, Economic and Fiscal Position Report. Even the Budget Speech does not contain the value of all the government spending beyond the Estimates.

Sub Section of 49 (2) of the Act	Information to be Released Under Section 49 (2) of PFM Act	Status
k	Ongoing negotiations of the Government which have not been finalised, updates to the fiscal strategy statement and the medium-term fiscal framework since the publication of the original statement	**Not Available** No updates have been provided on the Nominal GDP figures in the Fiscal Strategy Statement, which are inconsistent with the Budget Speech implied figures.

2.2.2 Compliance Related to PFM Limits

Compliance with the Primary Expenditure Limit

Section 15 (1) the PFM Act defines a ceiling for primary expenditure (total expenditure excluding interest payments) at 13% of nominal GDP. According to the 2026 Budget Speech, the government has complied with this limit in 2024 and 2025 and projects compliance for 2026.

Exhibit 10:Primary Expenditure as a Share of GDP

In LKR Billions	2024	2025	2026
Primary Expenditure	3,441	3,898	4,440
GDP in Market Prices	29,899	32,036	34,584
Primary Expenditure as a % of GDP	11.5%	12.2%	12.8%

Source: 2026 Budget speech

Compliance with Government Guarantees Limit

Under section 43 (1) (b) of the PFM Act, the total value of government guarantees outstanding at the end of the year must not exceed 7.5% of that year's GDP. In the Budget, Economic and Fiscal Position Report – 2026, the total value of Guarantees Issued by the general treasury up to 31.08.2025 was LKR 1,384,765.32 million. With the GDP at market price estimated at LKR 32,036,00 million in 2025, the government has kept this guarantee at 4.32%, well within the limit.

Compliance on Annual Budget Reserve Limit

Under section 25 (2) of the PFM Act, the budget allocation amounts to LKR 87.6 billion, which is just below the legal ceiling of 2% of the proposed primary expenditure estimate. Refer to section 5.3 for more details.

SECTION 3: ASSESSMENT OF MACROECONOMIC ASSUMPTIONS USED IN THE BUDGET

This section assesses the macroeconomic assumptions underpinning the 2026 Budget, focusing on real GDP growth, inflation, interest rates and the exchange rate, and highlighting their implications for debt dynamics.

The macroeconomic assumptions underlying the 2026 Budget are set out in the Medium-Term Fiscal Framework (MTFF) for 2025–2030, published in the Fiscal Strategy Statement (FSS) on 30 June 2025.

However, significant inconsistencies have since emerged between the MTFF and the more recent Budget Speech and the *Budget, Economic and Fiscal Position Report 2026* (published 7 November 2025). The Public Finance Management (PFM) Act anticipates explanation or formal updates to be provided when numbers estimated with the budget undergo significant revision.

This assessment of the budget, therefore, prioritises the most recent official projections: the Budget Speech serves as the primary source. Where indicators are not provided in the speech, it is supplemented by the *Budget, Economic and Fiscal Position Report* where needed. The original MTFF is used only when data is absent from both later documents.

Sound macroeconomic indicators, particularly for real GDP growth, inflation, the exchange rate, and interest rates, are critical for two main reasons.

First, key fiscal targets, including government revenue, the primary surplus, and the primary expenditure ceiling, are often expressed as percentages of GDP. Revenue and primary surplus targets are part of the medium-term framework aimed at ensuring debt sustainability, while the ceiling on primary expenditure is a (misconceived)[8] legal obligation under the PFM Act.

Second, inaccurate projections can undermine the entire budget's reliability. While Parliament approves spending in nominal rupee terms, many fiscal rules and performance metrics are tied to nominal GDP. If GDP is overestimated, the government may be forced to cut spending to comply with legal limits. Historically, these cuts have predominantly been to capital expenditure (refer Section 5.5 for details). Furthermore, interest rate assumptions directly impact interest payment forecasts. Recent years have seen significant deviations in actual interest costs. When interest costs exceed projections, the government has often compensated by reducing capital expenditure, further distorting fiscal priorities.

8 Verité Research, 13% primary expenditure rule proposed for Sri Lanka departs from economic theory and practice (Vol. 12, No. 2)(July 2024) at https://www.veriteresearch.org/wp-content/uploads/2025/11/ExpenditureLimit_F.pdf [last accessed 15 November 2025]

3.1 Real GDP Growth

The *Budget, Economic, and Fiscal Position Report 2026* projects real GDP growth in the range of 4–5% for 2026, a figure notably higher than the 3-3.5% forecast made by major international institutions.

This official projection also represents a significant upward revision from the government's own initial estimate of 3.1% for 2026, published in the Medium-Term Fiscal Framework (MTFF) in June 2025. The government justifies this revision by citing the stronger-than-expected 4.8% growth recorded in the first half of 2025.

Exhibit 11: Real GDP Growth Projections From Various Institutions

International Institution	Date of Release	Projections for 2025	Projections for 2026
World Bank	**Oct-25**	**4.6%**	**3.5%**
IMF	**Jul-25**	**3.5%**	**3.1%**
ADB	**Sep-25**	**3.9%**	**3.3%**
CBSL / GoSL	**Aug-25**	**4.5%**	

Source: World Bank, Sri Lanka Development Update, October 2025 Sri Lanka's Economic Recovery Remains Incomplete as Key Challenges Remain, *International Monetary Fund IMF Country Report No. 25/162, Asian Development Bank* Sri Lanka: Economy | Asian Development Bank, *Government of Sri Lanka Budget Speech 2026, CBSL Monetary Policy Review September No. 05*

3.2 Inflation

The 2026 Budget, Economic, and Fiscal Position Report states that "inflation will rise gradually toward the 5% target by mid-2026", attributing this increase to improved domestic demand, the normalisation of administered prices and prudent monetary and fiscal policies. The MTFF projects inflation, as measured by the GDP Deflator at 5.3% in 2026. However, the Ministry of Finance has also later reported to the Parliament Committee on Public Finance (COPF) that the Inflation (deflator) is assumed to be 3.2% for 2026.[9] This contradiction is a puzzle that needs to be resolved.

Since the new Central Bank Act was passed, there is a track record of inflation consistently falling significantly short of the agreed mandate and the official projections. Even in the 2025 Budget inflation expectations were set at 6.7%, but the actual annual average Colombo Consumer Price Index (CCPI) stood negative, at -1.2% as of October 2025.[10] That means that inflation will be at most close to zero by the end of the year.

The present inflation dynamics also run counter to the expectations set out by the Central Bank of Sri Lanka (CBSL) in December 2024 where, in-keeping with the inflation target agreed with the government, it was projected to reach the 5% by mid-2025.[11] The CBSL has since revised its estimates multiple times; but each time the estimates have been far off the mark from what transpired.

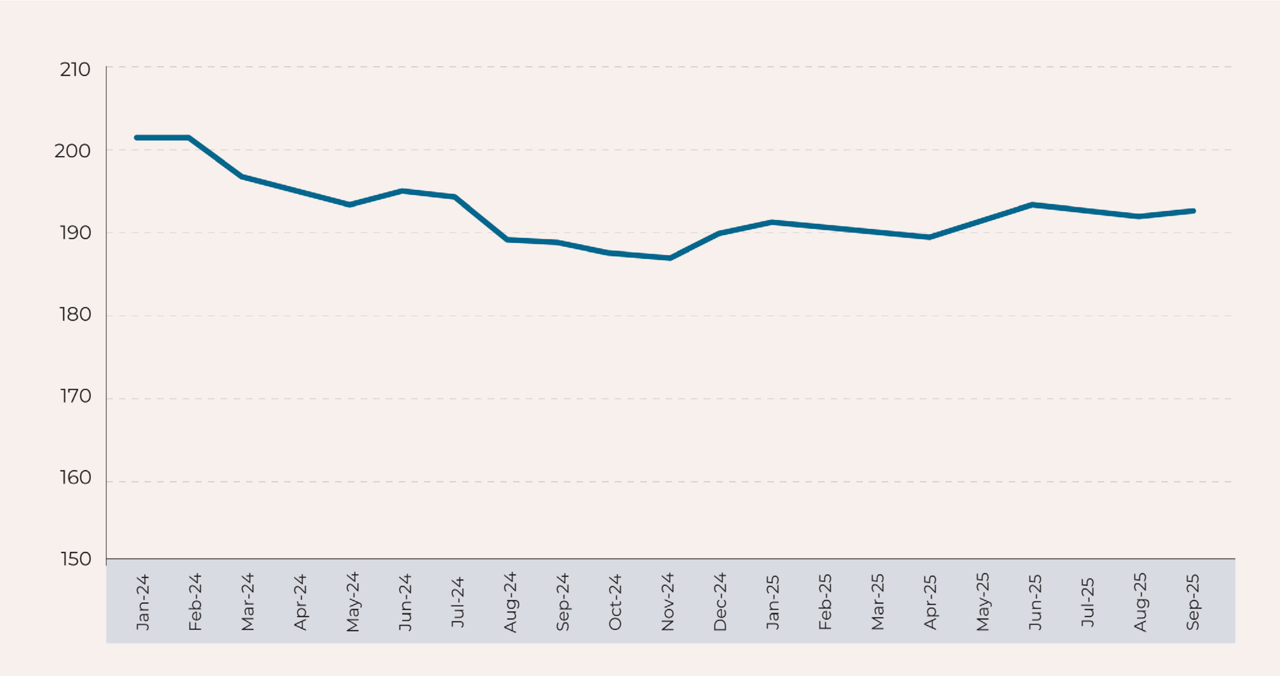
9 Parliament of Sri Lanka, Report of the Committee on Public Finance on Appropriation Bill for the Financial Year 2026 (14 Nov 2025) at https://www.parliament.lk/uploads/comreports/1763095834007786.pdf [last accessed 17 November 2025]

10 Central Bank of Sri Lanka. Inflation in October 2025 – CCPI (31 October 2025) at https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/press/pr/press_20251031_inflation_in_october_2025_ccpi_e.pdf [last accessed 27 November 2025]

11 Central Bank of Sri Lanka, Monetary Policy Review: No. 06 (26 Nov 2024) at https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/press/pr/press_20251126_Monetary_Policy_Review_No_6_2025_e_Ey8g7.pdf [last accessed 27 November 2025]

Presently, CBSL states that inflation is expected to reach the agreed 5% by mid-2026, which is the position that is also stated in the budget. Yet, the basis for this revised forecast remains unclear. For inflation to reach the 5% quarterly target in the second quarter of 2026, the headline price index must average 202.45—up 4.5% from 193.8 in October 2025.

Exhibit 12: Price Index of the CCPI (2021=100)



Source: Department of Census and Statistics

The 2026 inflation forecasts by international institutions (Refer Exhibit 13) also vary, and their projections for 2025 did not align closely with the actual outcomes.

Exhibit 13: Inflation Projections of International Institutions

International Institution	Date of Release	Projection for 2025	Projection for 2026
World Bank	October 2025 (Annual Average)	-0.2%	3.7%
IMF	July 2025 (Annual Average)	3.3%	5.2%
	July 2025 (YoY Change Dec)	8.9%	5.2%
ADB	September 2025 (Annual Average)	0.5%	4.5%

Source: World Bank, Sri Lanka Development Update. Sri Lanka's Economic Recovery Remains Incomplete as Key Challenges Remain, International Monetary Fund IMF Country Report No. 25/162, Asian Development Bank Sri Lanka: Economy | Asian Development Bank*, CBSL Monetary Policy Review September No. 05, Budget, Economic, and Fiscal Position report 2026.*

3.3 Interest Rates

The *Budget, Economic and Fiscal Position 2026* report fails to disclose the projected interest rates for 2026 and beyond.

3.4 Exchange Rate

Since January to October 2025, despite an improved current account position the rupee depreciated significantly against major global currencies: by 16% against the Euro, 10.2% against the Pound sterling, 6.6% against the Japanese yen, and 6.2% against the Chinese yuan. However, due to the US dollar also depreciated against major global currencies, the LKR depreciation against the USD was only about 3.3%. The only exceptions were marginal appreciations against the Indian rupee both around 0.4%.[12]

The *Budget, Economic and Fiscal Position 2026* report says the "exchange rate is expected to be stable in 2026", but gives no specific rate. Given the observed dynamics in 2025, particularly given the expected resumption of external debt repayments, which will create additional pressure on foreign exchange flows, it is important for macroeconomic planning to have a clear analytical outlook on exchange rate movements in 2026.

Based on historical exchange rate parity trends between the two currencies and the expected pressures from the country's external financing requirements, Verité Research expects that the rupee will depreciate by at least 4% against the US dollar in 2026.

12 Central Bank of Sri Lanka, Indicative Exchange Rates at https://www.cbsl.gov.lk/en/rates-and-indicators/exchange-rates/daily-indicative-exchange-rates [last accessed at 25 November 2025]

Box Article: Importance of Macro Variables in Assessing the Outlook for Sri Lanka's Debt Dynamics

With the 2025 Budget now published, an updated view of Sri Lanka's debt trajectory is essential. At the end of 2024, central government debt stood at 96.1% of GDP, which is a significant decrease from the peak reached during the crisis. It is, nevertheless, a high level of debt that constrains fiscal space. How this debt to GDP ratio might evolve over 2025 and 2026, in light of the most recent macroeconomic assumptions, is a matter of interest that needs evaluation.

Shifts in the Baseline Assumptions

The fiscal framework published in the June 2025 Fiscal Strategy Statement (FSS), on which the previous projections were made, are no longer valid; as a new report made available to the Committee on Public Finance (COPF) shows that current expectations of the Ministry of Finance (MoF) on growth, inflation, and the primary balance diverge significantly from the parameters underpinning the FSS.

Exhibit 13 sets out these differences, showing that each of the core variables—real GDP growth, the GDP deflator, and the primary balance—has been revised.

Exhibit 14: Revisions to Key Fiscal and Macroeconomic Assumptions

	2025		2026	
	Fiscal Strategy Statement	COPF report	Fiscal Strategy Statement	COPF report
Inflation (GDP Deflator)	3.6%	2.4%	5.3%	3.2%
Real GDP Growth	3.5%	4.5%	3.1%	4.5%
Primary Balance	2.3%	3.8%	2.3%	2.5%

These revisions substantially alter the debt path, making it necessary to reconstruct the debt dynamics using the updated MoF assumptions. The key inputs used for this exercise are summarised in Exhibit 14.

Exhibit 15: Baseline Assumptions Used

	2025	2026	Source
Inflation (GDP Deflator)	2.4%	3.2%	COPF report
Real GDP Growth	4.5%	4.5%	COPF report
Primary Balance	3.8%	2.5%	Budget, Economic and Fiscal Position Report
Exchange Rate Depreciation	4.0%	4.0%	Verité Research Assumption

Growth Outturns and the Role of the GDP Deflator

A striking feature of the current projections is the stronger-than-expected recovery in real activity. Real GDP growth, initially expected to be around 3.1%, has outperformed in both 2024 and 2025, with outturns and forecasts now at 4.5%. The updated MoF projections assume real growth of 4.5% in both 2025 and 2026, signalling a more robust recovery than previously projected.

However, with regard to reducing the debt to GDP ratio, this improvement in real GDP is largely offset by weaker inflation dynamics. The original expectation of a GDP deflator of around 5% has been revised down to 2.4% in 2025 and 3.2% in 2026. This downward adjustment brings nominal GDP down closer to the levels previously expected, even with real growth being higher. That is, in terms of reducing the level of debt, the gains from stronger real output are partially neutralised by inflation levels being lower than planned.

Implications for the Debt Path

Based on the updated assumptions (COPF Assumptions), Sri Lanka is now projected to achieve only a 0.2 percentage point reduction in the central government debt-to-GDP ratio by 2026 relative to 2024. If real GDP growth were to fall by just 0.1 % point, from 4.5% to 4.4% in both 2025 and 2026, the debt-to-GDP ratio would begin to rise again. This highlights how sensitive the debt path remains to small deviations in the macroeconomic variables such as growth and inflation.

To illustrate the significance of the inflation shortfall, Exhibit 16 compares the projected debt outcomes under two scenarios under current real GDP growth expectations:

1. The revised projected deflator, and

2. The counterfactual where the deflator is at 5% as planned in 2025 and 2026.

Had the deflator remained at 5% as planned, Sri Lanka would have had a 4 percentage point more in reduction of the debt to GDP ratio by 2026. Instead, due to the analysis demonstrates the significant impact of missing inflation targets, in terms of the debt sustainability dynamics.

Exhibit 16:Projected Debt Outcomes Under Two Scenarios

Scenarios	Change in Debt to GDP (2025 - 2026)
GDP deflator: Baseline Assumption Real GDP Growth: Baseline Assumption	(-) 0.2 percentage points
GDP deflator: at 5% for both years Real GDP Growth: Baseline Assumption	(-) 4.2 percentage points

SECTION 4: ASSESSMENT OF GOVERNMENT REVENUE

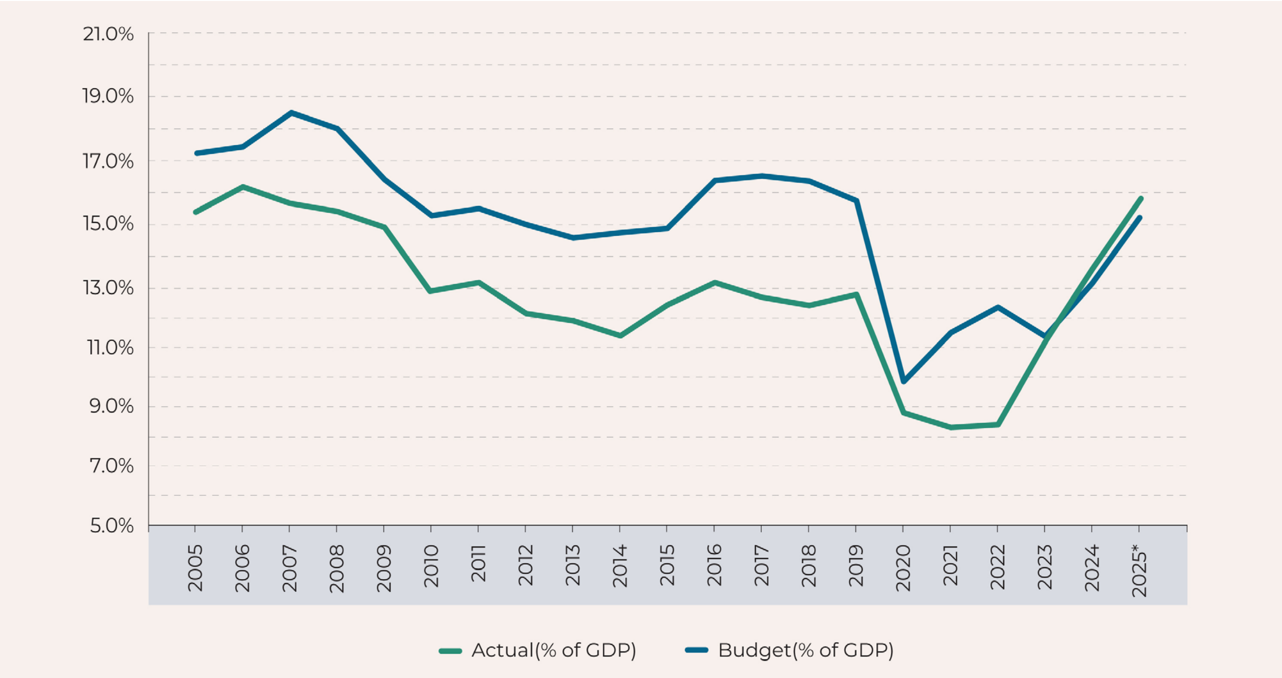
This section assesses revenue projections presented in the 2026 budget. The analysis of the projected figures takes into consideration underlying assumptions, past experiences, and the impact of announced policy changes, as applicable.

With reference to Section 2.1, there are discrepancies between the revenue and grants figures presented in the Draft Budget Estimates and those cited in the Budget Speech. As the Budget Speech does not provide a detailed breakdown of revenue and grants required for substantive analysis, this section relies on the revenue figures from the 2026 Draft Budget Estimates.

Looking at data from 2005, 2024 is the first year in which Sri Lanka's revenue and grants, as a share of GDP (the measure used for the revenue target), are estimated to exceed the ratio set out in the Budget Speech for the respective years. This is expected to remain the case in 2025 as well.

However, in nominal terms, 2025 is projected to be the first year (since 2000, the earliest year for which comparable data are available) in which revenue and grants exceed the original Budget estimate. According to the revised figures for 2025 from the Draft Budget Estimates in 2026, revenue and grants in 2025 are now projected to be 2.3% (LKR 116 billion) above the budgeted target.

Exhibit 17: Budgeted vs Actual Revenue and Grants as a Share of GDP, 2000-2025



Source: Budgeted revenue and grants as a share of GDP is taken from relevant Budget Speeches and Draft Budget Estimates. Actual revenue figures are from the Central Bank of Sri Lanka Annual Reports and expressed as a share of GDP as reported by CBSL.
Note: The 2025 figure is a revised estimate.

Expected Revenue for 2026: According to the 2026 Draft Budget Estimates, the government expects to raise LKR 5,305 billion in total revenue and grants in 2026, representing a 2.8% increase over the revised estimate for 2025. Given that tax policy remains broadly unchanged for 2026, this represents a relatively modest rise. Excluding the sharp declines in 2019 and 2020, the 2026 projection marks the smallest year-on-year increase in total revenue and grants since 2000.

Exhibit 18: Revenue Estimates as Provided in the Budget Estimates in LKR billions

Item	2024 Actual	2025 Revised Budget	2026 Budget	Y-o-Y Growth	
				2024-2025	2025-2026
Total Revenue and Grants	4,150	5,159	5,305	24.3%	2.8%
Total Revenue	4,090	5,134	5,275	25.5%	2.8%
Tax Revenue	3,705	4,725	4,850	27.5%	2.6%
Income Tax	1,026	1,120	1,210	9.1%	8.0%
Taxes on External Trade	481	655	649	36.2%	-1.0%
Taxes on Goods and Services	2,178	2,890	2,938	32.7%	1.7%
Non-tax Revenue	386	409	425	6.0%	4.0%
Grants	60	25	30	-58.3%	20.0%

Source: Draft Budget Estimates 2026

4.1 Taxes on Income and Profit

Income tax collection is expected to grow by 8.0% to LKR 1,210 billion, up from an estimated LKR 1,120 billion in 2025.

Exhibit 19: Government's Revenue Estimates on Taxes on Incomes and Profits in LKR billions

	Revenue Estimates			Increase from 2025		Increase from 2025 (%)	
Tax Type	2024 Actual	2025 Revised Budget	2026 Budget Estimate	In LKR Billion	Y-o-Y % increase in Revenue	Nominal GDP	Policy and Admin
Income Tax	1,026	1,120	1,210	90	8.0%	8.0%	0.1%
o/w Corporate tax	582	647	708	61	9.4%	8.0%	1.5%
Corporate Income tax	579	646	707	61	9.4%	8.0%	1.5%
o/w non-corporate tax	278	294	315	21	7.1%	8.0%	-0.8%
PAYE	198	198	215	17	8.6%	8.0%	0.6%
Other	80	96	100	4	4.2%	8.0%	-3.8%
o/w Withholding tax	164	175	185	10	5.7%	8.0%	-2.2%
On interest	66	69	70	1	1.4%	8.0%	-6.5%
On Fees and Charge	98	106	115	9	8.5%	8.0%	0.5%
o/w Capital Gain tax	1.9	4.4	2.5	-2	-43.2%	8.0%	-51.1%

Source: Draft Budget Estimates 2026

Policy changes announced in the 2026 Budget
The budget did not introduce any rate or threshold changes for any category of income tax. However, broader administrative measures were introduced in the Budget Speech. These included:

- Establishing the Inland Revenue Department (IRD) under a unified administrative structure
- Strengthening the tax audit process, and
- Developing a national electronic invoicing system

Corporate Income Tax (CIT)

Observations
CIT revenue is projected to increase by 9.4% to LKR 708 billion in 2026, rising from an estimated LKR 647 billion in 2025. The analysis finds this to be reasonable.

The revised estimates for 2025 projected that CIT collection would increase by 11.0% in 2025. This can be attributed to policy measures announced in the 2025 Budget, including: (1) Increasing the corporate tax rate for betting, gaming, and tobacco companies from 40% to 45%, and (2) Removing the tax exemption on export services and applying a standard 15% rate on income from such services.

Revenue estimates for Corporate Income Tax in 2026
The government projects CIT revenue to grow by 9.4% in 2026, which can be read as the net result of an 8.0% boost from nominal GDP growth and a 1.5% boost from policy, administrative and other measures.

Historical precedent provides a useful benchmark. Between 2016 and 2019, when the standard CIT rate and threshold were unchanged, CIT collections grew by an average of 17% per year, compared with nominal GDP growth of 8.4%during the same period. The introduction of the Inland Revenue Act, No. 24 of 2017, within this timeframe suggests that a substantial share of this above-trend growth was driven by improvements introduced under the new Act.

Given that the 2026 Budget proposes more modest administrative reforms, without rate or threshold changes, it is plausible that a 1.5 % point gain above nominal GDP growth could be achieved. Verité therefore considers the 9.4% CIT growth projection reasonable.

Non-corporate Tax

Pay-As-You-Earn (PAYE) Tax

Observations
PAYE revenue is projected to increase by 8.6% to LKR 215 billion in 2026, rising from an estimated LKR 198 billion in 2025. The analysis finds this to be reasonable.

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 1 January 2023 and made mandatory for all taxpayers exceeding the personal relief of LKR 1.2 million per year of assessment.

From 1 April 2025, the personal income tax relief was increased to LKR 1.8 million per year, alongside adjustments to tax slabs. With this higher tax-free threshold, the increase in revenue is expected to be marginal, with collection from PAYE expected to rise by only 0.2% from 2024 to 2025.

Revenue estimates for PAYE tax in 2026

The government projects PAYE revenue to grow by 8.6%. Nominal GDP can account for 8.0% of the expected increase. The small increase beyond that is justified with overall administrative measures introduced in the 2026 Budget. Therefore, Verité Research considers the 8.6% growth rate in PAYE tax collections to be reasonable within the current policy scope.

Personal Income Tax (Excluding PAYE)

Observations

Personal Income Tax (PIT) collection is projected to increase by 4.2% to LKR 100 billion in 2026, rising from an estimated LKR 96 billion in 2025. The analysis finds this to be reasonable.

Revenue estimates for Personal Income Tax (excluding PAYE) in 2026

The 4.2% projected increase in PIT can be read as the net result of an 8.0% boost from nominal GDP growth, partially offset by a 3.8% reduction from policy, administrative and other measures.

This negative policy effect likely reflects the larger impact in 2026 from an increase in the personal income tax threshold from LKR 1.2 million to LKR 1.8 million, as the negative revenue consequences came into effect only on 1 April 2025. That is, for 2025, the policy effect applied only for nine months, but for 2026, it will apply for the whole year. Therefore, the budgeted increase of 4.2% growth of PIT (excluding PAYE), being less than the growth of nominal GDP, is reasonable.

Withholding Tax (WHT)

Observations

WHT revenue is projected to increase by 5.7% to LKR 185 billion in 2026, rising from an estimated LKR 175 billion in 2025. The analysis does not find this to be reasonable.

WHT was abolished in 2020, resulting in an 80% decline in collection that year. Although collections began to recover in 2021 and 2022, they remained substantially below pre-2020 levels.

A reversal occurred in 2022 with the reintroduction of non-final WHT on most payments (excluding dividends) and the introduction of a final WHT on dividends, effective 1 January 2023. This policy shift triggered a 696% surge in revenue, from LKR 20 billion in 2022 to LKR 158 billion in 2023.

The government has continued to leverage this revenue stream, increasing the WHT rate from 5% to 10% effective 1 April 2025.

Revenue estimates for Withholding Tax in 2026

Revenue from WHT arises from two sources: interest income and fees and other charges. WHT collections from interest income are projected to be LKR 69 billion in 2025, while fees and other charges are projected to be LKR 106 billion. For 2026, the corresponding projections are LKR 70 billion and LKR 115 billion. As WHT on fees and other charges is assumed to grow broadly in line with nominal GDP, these projections appear reasonable. The concern relates to WHT on interest income.

For 2025, Verité Research projects WHT on interest income based on three factors: (i) the increase in the WHT rate, (ii) the reduction in interest rates compared to 2024, and (iii) the growth in time and savings deposits. WHT on interest income of LKR 66 billion was collected in 2024.

The WHT rate increase took effect on 1 April 2025 and therefore does not apply to Q1 2025. Up to September 2025, the Average Weighted Deposit Rate (AWDR) was 23.9% lower than the corresponding period of 2024. Adjusting the baseline quarterly revenue of LKR 16.5 billion in 2024 for the interest rate reduction yields WHT revenue of LKR 14.9 billion for Q1 2025. From Q2 2025 onwards, with the higher rate in effect, Verité Research assumes WHT revenue for the remaining three quarters doubles relative to 2024. After adjusting this amount for the lower interest rates, WHT revenue for the remainder of 2025 is estimated at LKR 66.3 billion. As such, WHT revenue from interest income adjusted for rate and interest rate changes amounts to LKR 81.2 billion in 2025. According to data up to Q2 2025, time and savings deposits increased by 12.9% relative to the same period in the previous year. Assuming this growth applies for 2025 as a whole, and applying it to the above WHT estimate, raises projected WHT revenue from interest income in 2025 to LKR 91.6 billion. On this basis, the Government appears to have underestimated WHT revenue from interest income in 2025 by LKR 22.6 billion.

For 2026, Verité assumes that, in the absence of any further WHT rate increases, WHT revenue on interest income will grow in line with nominal GDP, resulting in an estimated collection of LKR 98.9 billion. Assuming WHT on interest income in 2026 is LKR 98.9 billion and WHT on fees and other payments is LKR 115 billion (as estimated by the Government), the total WHT collection would be LKR 213.9 billion. This is LKR 28.9 billion higher than the Government's estimate of LKR 185 billion for 2026.

Capital Gains Tax (CGT)

Observations

CGT revenue is projected to decline by 43.2% to LKR 2.5 billion in 2026, down from an estimated LKR 4.4 billion in 2025. The analysis finds this to be reasonable.

Effective from 1 April 2025. The rate rose from 10% to 15% for individuals and partnerships, and to 30% for other entities (companies and trusts, etc.). Consequently, the CGT collection is estimated to have grown 137% in 2025, reaching LKR 4.4 billion, up from LKR 1.9 billion in 2024.

Revenue estimates for CGT 2025

The decline projected for CGT revenue for 2026 follows from an exceptional year in 2025, where collections were boosted by falling yields on government securities, which generated, on their sale, very large capital gains. Sales to realise capital gains would also have occurred just prior to the increased rate taking effect – causing a one-time spike in the realisation of capital gains.

For 2026, with yields stabilised, and no repeat of the one-time spike, realised gains can be expected to reduce significantly. Comparing to the LKR 1.9 billion in capital gains in 2024 (without the policy induced realisation spike in 2025).

The expected increase in capital gains over the two years is 34.9%. This captures two countervailing dynamics. One, the increase in rates for individuals and corporates respectively (increasing the revenue); and two is the stabilisation of interest rates and thereby the reduced accrual of capital gains on government securities (reducing revenue).

The revenue increase from 2024 that is projected from the above countervailing dynamics, is significant. It is, therefore, reasonable that the collection is expected decline hugely from 2025, in which there was a one-off spike due to the incentive to realise capital gains before the rate increase took effect.

4.2 Taxes on External Trade

The government anticipates a 1.0% decline in these collections to LKR 649 billion, down from an estimated LKR 655 billion in 2025. This decrease is mainly attributed to an expected reduction of vehicle imports following a surge in 2025.

Exhibit 20: Taxes on External Trade in LKR billions

	Revenue Estimates			Increase from 2025		Increase from 2025 attributable to	
Tax Type	2024 Actual	2025 Revised Estimate	2026 Budget Estimate	In LKR Billion	Y-o-Y % increase in Revenue	Nominal GDP	Policy and Admin Changes
Taxes on External Trade	481	655	649	-7	-1.0%	8.0%	-9.0%
o/w Customs Import Duties	111	240	210	-30	-12.5%	8.0%	-20.5%
o/w Ports & Airports Development Levy	170	177	190	13	7.3%	8.0%	-0.6%
o/w CESS	81	90	95	5	5.6%	8.0%	-2.4%
o/w Special Commodity Levy	115	145	150	5	3.4%	8.0%	-4.5%
Other	4	3	4	0	7.3%	8.0%	-0.7%

Source: Draft Budget Estimates 2026

Policy changes announced in the Budget 2026

- Implementation of the National Tariff Policy, that will revise the current CID bands from 0%, 15%, and 20% to 0%, 10%, 20%, and 30%, effective from April 2026.
- The phased removal of the para tariffs. However, the budget does not specify a time frame for this removal.
- Replacing the Special Commodity Levy (SCL) on imported coconut and palm oil with Value-Added Tax (VAT) and the Social Security Contribution Levy (SSCL).
- Replacing CESS on imported fabric with VAT.

Customs Import Duty (CID)

Observations

CID revenue is projected to decline by 12.5% to LKR 210 billion, down from an estimated LKR 240 billion in 2025. The analysis finds this to be reasonable.

In 2025, CID revenue is estimated to have grown by 115.9%. This increase was likely driven by the lifting of vehicle-import restrictions together with the imposition of a 20% customs import duty on motor vehicles and an additional 50 % surcharge applied to that duty, bringing the effective duty on motor vehicle imports to 30%

Revenue estimates for Customs Import Duties in 2026

The CID revenue in 2026 is projected to decline by 12.5%. This net decline reflects an 8.0% positive contribution from expected nominal GDP growth, offset by a 20.5% reduction from policy, administrative, and other measures. The latter is largely attributed to the anticipated drop in motor vehicle imports following the surge in demand in 2025.

Vehicle imports exhibit a boom-bust cycle; in the years following the boom from 2015 to 2019, vehicle import volumes have fallen by an average of 30.8% after a boom year. Given that 2025 vehicle imports surged by an exceptional amount, it is assumed that 2026 will be a bust year. As such, Verité Research projects motor vehicle imports in 2026 to decline by around 30% in 2026. Growth in other imports is expected to cushion the reduction in motor vehicle imports. As such, an overall 20.5% reduction from policy, admin, and other measures is reasonable. Within this analytical framework, the government's CID revenue estimate for 2026 can be considered reasonable.

PAL, CESS, and SCL

Revenue Estimates for PAL, CESS, and SCL in 2026

Projections for all three para-tariffs show growth at rates below nominal GDP, indicating an overall negative policy effect consistent with the phase-out of para-tariffs.

The scale of the negative policy effect varies across PAL, CESS and SCL, with SCL showing the largest reduction. This is likely due to SCL's history of frequent discretionary adjustments, making it more susceptible to policy changes. The government has provided no information about how these tariffs will be reduced. However, as the projected growth rates are consistent with the intended policy direction (of a rate reduction with a small revenue impact), the government's revenue estimates for these para-tariffs are evaluated as reasonable.

4.3 Taxes on Goods and Services

The government anticipates a 1.7% increase in this category, reaching LKR 2,938 billion, up from the estimated LKR 2,890 billion in 2025.

Exhibit 21: Taxes on Goods and Services in LKR billions

	Revenue Estimates			Increase from 2025		Increase from 2025 (%)	
Tax Type	2024 Actual	2025 Revised Budget	2026 Budget Estimate	In LKR Billion	Y-o-Y % increase in Revenue	Nominal GDP	Policy and Admin
Taxes on Goods and Services	2,178	2,890	2,938	48	1.7%	8.0%	-6.3%
o/w VAT	1,310	1,670	1,769	99	5.9%	8.0%	-2.0%
Domestic*	712	850	933	83	9.8%	8.0%	1.8%
Imports	597	820	836	16	2.0%	8.0%	-6.0%
o/w Excise Duty	597	914	832	-82	-9.0%		
o/w Social Security Contribution Levy	251	287	315	28	9.8%	8.0%	1.8%
Other	20	19	22	3	14.9%	8.0%	6.9%

Source: Draft Budget Estimates 2026
**VAT from Financial Services, Manufacturing and Other Services.*

Policy changes announced in the 2026 Budget

- Effective from 1 April 2026, the Value Added Tax (VAT) and Social Security Contribution Levy (SSCL) thresholds are proposed to be reduced to LKR 36 million per annum from LKR 60 million per annum.
- Replacing the Special Commodity Levy (SCL) on imported coconut and palm oil with Value-Added Tax (VAT) and the Social Security Contribution Levy (SSCL).
- Replacing CESS on imported fabric with VAT.
- Changing the point of collection for SSCL to be at the time of import, manufacture, or first sale of vehicles, and will be exempt at the after-sales stage.
- Introducing bad debt/ bad debt recovery adjustments in computing the telecommunication levy. This amendment will be incorporated into the Telecommunications Levy Act.

Value Added Tax (VAT)

Observations

VAT collection is projected to increase by 5.9% to LKR 1,769 billion in 2026, up from an estimated LKR 1,670 billion in 2025. The analysis finds this to be reasonable.

Revenue estimates for Value Added Tax in 2026

In order to assess the 5.9% VAT revenue projection for 2026, Verité Research analysed its domestic and import VAT components separately.

For domestic VAT, nominal GDP growth is expected to account for 8.0% of the expected increase, and policy, administrative and other measures are expected to account for 1.8% of the increase, resulting in a net increase of 9.8%. The 1.8% is expected to include the expansion of the VAT base arising from the reduction in the registration threshold, which is considered to be reasonable.

For import VAT, a lower growth of 2.0% is projected. This reflects an 8.0% boost from nominal GDP growth offset by a reduction of 6.0% from policy, administration and other measures. Verité Research identifies the main driver of this negative impact to stem from the projected reduction of around 30% in motor vehicle imports. This reduction in motor vehicle imports would reduce VAT collection from motor vehicles by about LKR 50 billion, which is consistent with the 6% reduction in import VAT attributed to policy, administrative and other measures.

This LKR 50 billion estimate is obtained as follows. Considering the CID collection in 2024 amounts to LKR 111 billion, and assuming this would grow in line with nominal GDP in 2025, the baseline CID revenue for 2025 would be approximately LKR 120 billion. However, the projected CID revenue for 2025 is LKR 240 billion, implying that the additional LKR 120 billion is generated by motor vehicle imports. With a CID rate of 30% on motor vehicles, this implies the value of vehicles taxed under CID to be approximately LKR 400 billion.

To estimate the associated VAT, assuming a value of LKR 100 billion for a vehicle. Before VAT, border taxes (CID, PAL, and excise) together amounted to around LKR 140 billion. VAT is levied on the value of the imports plus all other taxes; this implies a VAT base of LKR 240 billion.[13] Applying the 18% VAT rate to this base yields a VAT of LKR 43.2 billion for vehicle imports, which amount to a value of LKR 100 billion. Given that the value of taxed motor vehicles is around LKR 400 billion, the implied VAT collected on these vehicles is around LKR 172.7 billion. Assuming VAT on motor vehicles falls in line with the expected 30% decline in vehicle imports, VAT revenue would fall by about LKR 50 billion. This is consistent with the projected decline in import VAT arising from policy, administrative and other measures in 2026.

As such, overall VAT collection is considered to be reasonable.

13 Sri Lanka Customs, Computation Formulae For Imported Goods. 15 July 2021 at https://www.customs.gov.lk/wp-content/uploads/2021/07/15.formula_2011.pdf [last accessed 25 November 2025].

Excise Tax

Excise duties are projected to decline by 9.0% to LKR 832 billion in 2026, down from an estimated LKR 914 billion in 2025. The analysis finds this to be reasonable.

Exhibit 22: Government's Revenue Estimates on Taxes on Excise Duties in LKR billions

	Revenue Estimates (in LKR Bn)			Increase from 2025	
Tax Type	2024 Actual	2025 Revised Budget	2026 Budget Estimate	In LKR Billion	Y-o-Y % increase in Revenue
Excise Duties	597.3	914.0	832.0	-82.0	-9.0%
o/w Liquor	213.4	226.0	243.0	17.0	7.5%
o/w Cigarettes	117.1	100.0	105.0	5.0	5.0%
o/w Petroleum Products	200.2	180.0	205.0	25.0	13.9%
o/w Motor Vehicles	58.6	396.0	266.0	-130.0	-32.8%
o/w Other	8.0	12.0	13.0	1.0	8.3%

Source: Draft Budget Estimates 2026

Policy changes announced in the 2026 Budget

The 2026 Budget Speech did not announce any policies related to excise duties.

Excise duties on Liquor

Observations

Excise duty revenue from liquor is projected to rise by 7.5% to LKR 243 billion in 2026, despite no proposed adjustments to tax rates. The analysis finds this to be reasonable.

Historical data shows a direct link between tax rates and revenue from liquor excise duties. In 2025, both revenue and tax rates increased by 5.9%. The previous year, revenue rose by 25.3%, against a 30.7% rate increase. In both instances, revenue growth was either lower than or equal to the increase in rates, indicating that changes in revenue were primarily driven by tax policy.

Revenue estimates for excise duties on liquor in 2026

The government projects a 7.5% increase in liquor excise revenue for 2026. Since no rate changes have been proposed, this growth cannot be attributed to tax policy. The projection must therefore be based on an anticipated increase in consumption volumes.

Excise duties on Cigarettes

Observations

Excise duty revenue from cigarettes is projected to increase by 5.0% to LKR 105 billion in 2026, despite no proposed adjustments to tax rates. The analysis finds this to be reasonable.

In 2025, excise revenue from cigarettes is expected to fall by 14.6%. This decline is primarily driven by "bottom trading", where consumers shift from longer, higher-priced cigarettes to shorter, cheaper sticks as tax and price levels rise. Previous analysis by Verité Research showed that between 2018 and 2024, the market share of shorter cigarettes (under 67 mm) increased by more than 50 percentage points. Had the 2018 market structure persisted, the sticks sold in 2024 would have generated an additional LKR 40.9 billion in government revenue. The trend is evidently intensified further in 2025, reinforcing Verité Research's recommendation to eliminate cigarette bands and consolidate them into a single tax structure.

Revenue estimates for excise duties on cigarettes in 2026

With no tax rate adjustments announced, achieving the projected 5.0% revenue increase in 2026 would require an equivalent rise in cigarette consumption. This projection appears optimistic given the historical trend of a 4.6% average annual decline in consumption over the past two decades. Consumption has only risen by more than 5.0% in only three instances during this period.

Excise duties on Petroleum products

Observations

Excise duty revenue from petroleum products is projected to increase by 13.9% to LKR 205 billion in 2026, despite no proposed adjustments to tax rates. The analysis finds this to be reasonable.

In 2025, excise revenue from petroleum products is estimated to have fallen by 10.1%, a decline directly attributable to reductions in excise tax rates during the year: petrol by 6.5%, auto diesel by 10.7%, and super diesel by 9.5%. These cuts lowered the average tax collected per litre sold.

Revenue estimates for excise duties on petroleum products in 2026

With no tax rate revisions planned, the projected 13.9% increase in excise revenue can be explained by a higher expected fuel consumption. The surge in vehicle imports following the 2025 lifting of import restrictions and the expansion of the transportation sector is likely to increase demand for fuel, providing a basis for the projected revenue growth.

Excise duties on Motor Vehicles

Observations

Excise duty revenue from motor vehicles is projected to contract by 32.8% to LKR 266 billion in 2026. No adjustments to tax rates have been proposed for 2026.

In 2025, excise revenue from motor vehicles surged, increasing 6.8 fold following the removal of import restrictions. This growth was driven by the release of pent-up demand, which elevated import volumes and excise collections to exceptional levels.

Revenue estimates for excise duties on motor vehicles in 2026

The projected contraction in 2026 likely reflects the anticipated "normalisation" of vehicle imports after the extraordinary spike of 2025. As discussed in the section on customs import duties and VAT. Verité Research expects motor vehicle imports to decline by around 30% in 2026, and the government's projected revenue are in line with this expected reduction.

Social Security Contribution Levy (SSCL)

Observations

SSCL revenue is projected to rise by 9.8% to LKR 315 billion in 2026, up from an estimated LKR 287 billion in 2025. The analysis considers this to be reasonable, taking into account the revision to the SSCL threshold proposed in the budget and the proposed amendments to the Social Security Contribution Levy Act set out in the Gazette published on 1 October 2025, pending its second reading in Parliament at the time of writing. The bill proposes an exemption of SSCL for financial services with effect from 1 January 2026 and revisions to other existing exemptions.[14]

Revenue estimates for SSCL in 2026

Verité Research estimates SSCL revenue in 2026 by first deriving an implied VAT-equivalent rate for the levy and then adjusting for the expansion of the tax base. In 2025, domestic VAT is projected to raise LKR 850 billion at a rate of 18%, implying that each one percentage point of VAT yields approximately LKR 47.2 billion. Over the same period, SSCL is expected to raise LKR 287 billion. Expressed in VAT-equivalent terms, this SSCL yield corresponds to an increase of around 6.08 percentage points on the VAT. This 6.08 % point increase can be considered as the required increase in the current VAT rate to collect the expected revenue of SSCL in 2025 (implied VAT-equivalent rate).

However, the current SSCL rate is only 2.5%. Given that a 2.5% levy produces revenue equivalent to 6.08 percentage points of VAT implies that the SSCL base is substantially broader than the VAT base. This reflects how the two taxes operate. VAT is charged at each stage of the value chain, but firms claim input VAT credits, so the net burden falls only on final value added. SSCL, by contrast, does not allow input credits or refunds and is effectively applied on gross turnover at each stage. This cascading structure means the same underlying value is taxed multiple times, and the 2025 figures imply that SSCL-taxable transactions are about 2.43 times VAT-taxable transactions.

Verité Research assumes that the reduction of the SSCL threshold will increase the number of SSCL-taxable transactions by 10% in 2026. Under this assumption, the ratio of SSCL-taxable to VAT-taxable transactions rises from 2.43 to about 2.67. Applying the 2.5% SSCL rate to this expanded base is then equivalent to an effective VAT increase of around 6.69 percentage points.

Applying this to the projected 2026 domestic VAT revenue of LKR 933 billion and considering the VAT rate of 18% provides a SSCL collection of LKR 347 billion for 2026. By contrast, the government projects SSCL revenue of LKR 315 billion in 2026. This lower figure likely reflects the expected impact of the amendments to the SSCL Act as proposed by the bill published on 1 October 2025. If the changes proposed in the bill do not materialise, Verité Research's estimate of LKR 347 billion is more likely to be realised, which is around LKR 31.5 billion above the government's projection.

14 The Gazette Of The Democratic Socialist Republic Of Sri Lanka, Social Security Contribution Levy (Amendment). Issued On 01.10.2025. at - https://www.documents.gov.lk/view/bills/2025/10/638-2025_E.pdf. [last accessed 25 November 2025].

4.4 Summary on Revenue Outlook

Overall, based on the Draft Budget Estimates for 2026 the government projects total revenue and grants to grow by 2.8% in 2026. Excluding years in which revenue and grants contracted, this is one of the lowest annual increases since 2000.

In 2026, VAT is the main driver of the increase, accounting for almost two-thirds (67.6%) of the projected growth in total revenue and grants. By contrast, revenue from excise duty, customs import duties, and licence taxes are projected to record the largest falls. These taxes are heavily affected by the expected reduction in motor vehicle imports. As such the slower growth in total revenue and grants in 2026 is e largely driven by the projected fall in motor vehicle imports.

However, Verité Research's analysis indicates that the government has underestimated revenue from WHT by LKR 28.9 billion, implying that total revenue and grants in 2026 are understated by the same amount.

Exhibit 23: Summary of Total Revenue and Grants in LKR billion

	Revenue Estimates			Increase from 2025	
Revenue Source	2024 Actual	2025 Revised Estimate	2026 Budget Estimate	In LKR Billion	Y-o-Y % increase in Revenue
Tax on Income and Profits	**1,026**	**1,120**	**1,210**	**90**	**8.0%**
o/w Corporate tax	582	647	708	61	9.4%
Corporate income tax	579	646	707	61	9.4%
o/w non-corporate tax	278	294	315	21	7.1%
PAYE	198	198	215	17	8.6%
Other	80	96	100	4	4.2%
o/w Withholding tax	164	175	185	10	5.7%
o/w Capital Gain tax	2	4	3	(2)	-43.2%
Taxes on External Trade	**481**	**655**	**649**	**(7)**	**-1.0%**
o/w Customs Import Duties	111	240	210	(30)	-12.5%
o/w Ports & Airports Development Levy	170	177	190	13	7.3%
o/w CESS	81	90	95	5	5.6%
o/w Special Commodity Levy	115	145	150	5	3.4%
Other	4	3	4	0	7.3%
Taxes on Goods and Services	**2,178**	**2,890**	**2,938**	**48**	**1.7%**
o/w VAT	1,310	1,670	1,769	99	5.9%

	Revenue Estimates			Increase from 2025	
Revenue Source	2024 Actual	2025 Revised Estimate	2026 Budget Estimate	In LKR Billion	Y-o-Y % increase in Revenue
o/w Excise Duty	597	914	832	(82)	-9.0%
o/w Social Security Contribution Levy	251	287	315	28	9.8%
Other	20	19	22	3	14.9%
License taxes	**20**	**60**	**54**	**(6)**	**-10.1%**
Non-Tax Revenue	**386**	**409**	**425**	**17**	**4.0%**
Grants	**60**	**25**	**30**	**5**	**20.0%**
Total Revenue and Grants	**4,150**	**5,159**	**5,305**	**147**	**2.8%**

Source: Draft Budget Estimates 2026

SECTION 5: ASSESSMENT OF GOVERNMENT EXPENDITURE

This section reviews selected expenditure estimates presented in the 2026 Budget. It does not provide a comprehensive evaluation of all government spending. Instead, Verité Research focuses on expenditure components that have posed challenges in the past and continue to warrant scrutiny. These include interest payments, elevated outlays on vehicle procurement, discretionary spending under the Ministry of Finance, allocations to the defence sector, uniform-related expenditure, and the persistent under-utilisation of capital expenditure allocations.

5.1. Interest Payments

Exhibit 24: Government Expenditure on Interest Payment in LKR Billions

	Estimates			Increase from 2025	
Tax Type	2024 Actual	2025 Revised Estimate	2026 Budget Estimate	In LKR Billion	Y-o-Y % increase in Revenue
Interest Payments	2,690	2,950	2,617	(333)	-11.3%
Interest Payment for Domestic Debt	1,686	1,650	1,782	132	8.0%
Interest Payment for Foreign Debt	400	600	331	(269)	-44.8%
Discounts on Treasury Bills & Bonds	603	700	504	(196)	-28.0%

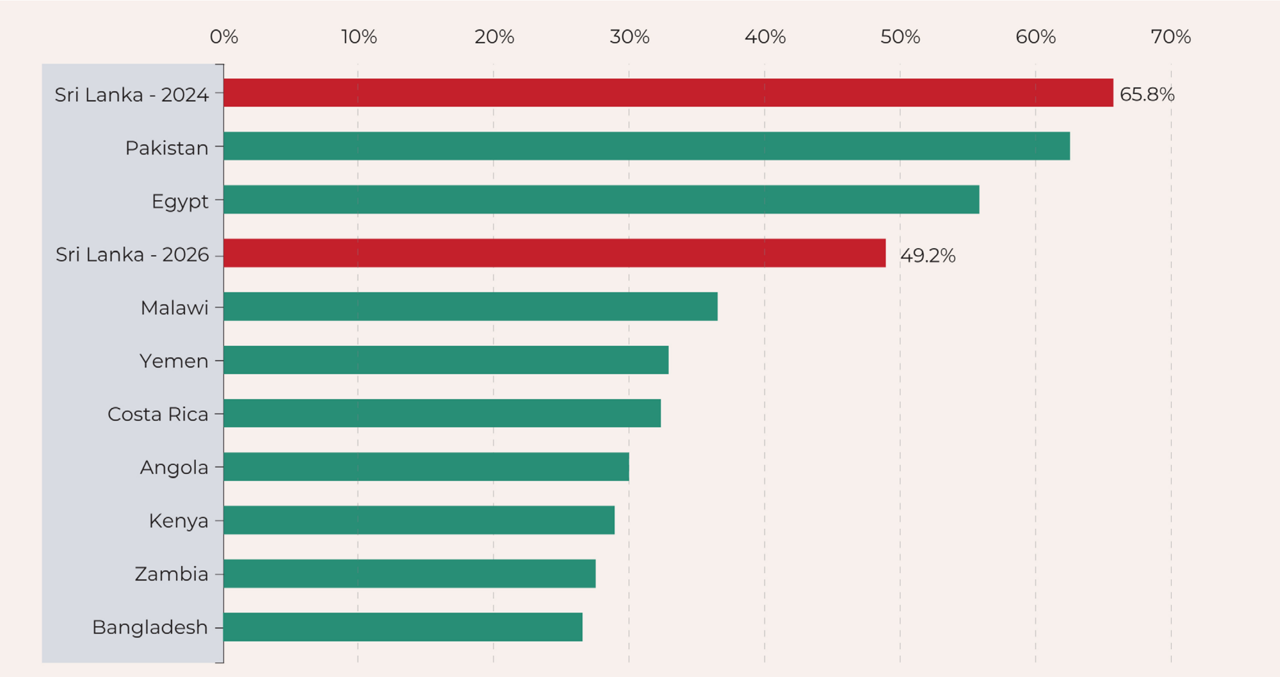
Source: Draft Budget Estimate

Interest payments are a key expenditure item for the Sri Lankan government. Total interest expenditure for 2026 is projected at LKR 2,617 billion. This consists of LKR 2,286 billion for domestic interest payments (including both coupon payments and discounts on Treasury bills and bonds) and LKR 331 billion in foreign interest payments.

The interest-to-revenue ratio is projected to be 49.2% in 2026, meaning nearly half of all government revenue will be used solely to service interest payments. This marks a significant improvement from 65.8% in 2024; yet, it severely constrains fiscal space for essential public spending (see Exhibit 24).

As a share of GDP, interest costs are projected to be 7.6% in 2026. This keeps Sri Lanka's interest cost to GDP as one of the highest in the world.

Exhibit 25: Interest cost as a share of the Government Revenue in 2024 and 2026 (for Sri Lanka)



Source: IMF World Economic Outlook Database – April 2025
Note: Interest Cost is calculated as the difference between the primary and budget balance

To assess the credibility of the government's interest payment projections, Verité Research conducted separate analyses of the domestic and foreign interest components.

Domestic Interest: the estimate is based on applying the following assumptions on the outstanding stock of Treasury bills and bonds as of end-September 2025:

- Treasury bills due in 2026 are rolled over for one year at the current yield of approximately 8%.
- Maturing Treasury bonds are refinanced over five years at the current yield of approximately 9.75%.
- Standard discounts applied to Treasury instruments are included in the calculation.
- All coupon (interest) payments on existing Treasury securities are financed through the issuance of new Treasury bills.

The calculations, based on the above assumptions, yield an estimate that aligns closely with the government's figure for domestic interest cost.

Foreign Interest: the calculations of Verité Research on foreign interest cost for 2026, are broadly in line with those of the government. The estimate applies an average interest rate of 2–3% per annum to the existing stock of bilateral and multilateral loans and assumes a 4% currency depreciation for both 2025 and 2026, using the December 2024 exchange rate as a baseline.

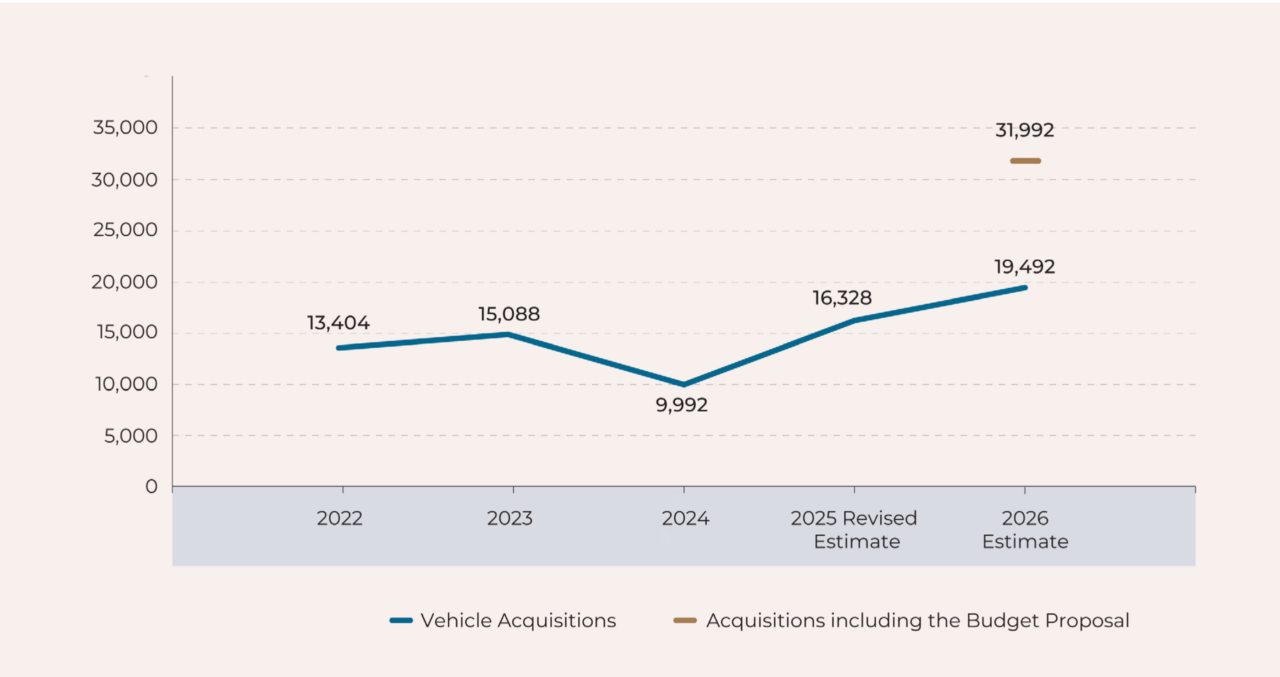
The numbers reported show foreign interest costs as declining by c. 45% from 2025 to 2026. However, Verité Research calculations show this to be resulting from a grossly overstated revised estimate for 2025, rather than any change in the profile of foreign debt and interest payments.

5.2 Elevated Outlay on Vehicle Procurement

Verité Research, alongside the Committee on Public Finance (COPF), has consistently raised concerns over the rising costs associated with vehicle procurement for the use of the government. The COPF's previous reports noted that capital expenditure on vehicle acquisition rose sharply, from approximately LKR 1.4 billion in 2015–2016 to over LKR 16 billion in 2017. The frequent use of supplementary estimates to conceal such spending has raised red flags over potential wastage and financial leakages. COPF has recommended that Parliament strengthen oversight and introduce better expenditure controls in this area.

Against this backdrop, the 2026 Budget's allocations are notable. It projects LKR 19.4 billion for the "Acquisition of Vehicles" and introduces a new proposal titled "Providing vehicles/machineries required for Government Institutions and Provincial Councils", with a further LKR 12.5 billion allocation. Combined, these raise the expected outlay to LKR 32 billion, marking a 96% increase over the revised 2025 estimate of LKR 16.3 billion.

Exhibit 26: : Government Expenditure on Vehicle Acquisition (LKR Millions)



Source: 2026 Budget speech and Budget Estimates

Evidence of this planned spending is already emerging. In October 2025, the Ministry of Finance issued a tender (Bid No: MOF/NCB/23/76/2025) for the procurement of 1,775 brand-new, automatic four-wheel-drive diesel double cabs.[15] With each vehicle estimated to cost between LKR 21–25 million, the total implied cost of over LKR 37 billion exceeds the total budget allocation for this purpose.

15 Ministry of Finance, Planning and Economic Development Procurement of 1775 Nos. Brand New Auto Transmission Four-wheel Drive Diesel Double Cabs, at https://www.treasury.gov.lk/api/file/39701e17-28ee-4abd-8f0a-dda41d46b91a [last accessed 27 November 2025].

This surge in procurement coincides with government auctions of some state-owned luxury vehicles. For instance, on 15 May 2025, 17 vehicles were sold for a total of LKR 200 million, averaging LKR 11 million per vehicle.[16] While the President's Media Division claimed these auctions were transparent and exceeded government valuations, the low base values applied to relatively new vehicles raised questions about the process.[17]

Overall, transport, vehicle procurement, and travel continue to impose a heavy burden on public finances. Spending in this area has now stabilised at a significantly higher post-crisis level, suggesting entrenched inefficiencies. Corrective measures are needed to improve transparency, tighten valuation standards, and enhance decision-making processes to curb wastage and leakage.

5.3 Discretionary Spending of the Government

Previous State of the Budget reports have raised concerns regarding the large share of government expenditure that is regularly channeled through a discretionary budget line-item.

Funds allocated to this line-item can be redirected by the treasury without prior parliamentary approval, thereby weakening Parliament's control over public finances. Prior to 2018, over 20% of total expenditure was budgeted under this category, whereas Verité Research recommends capping such spending at 5% of total expenditure.

It is Section 6 (1) of the Appropriation Act No. 30 of 2021 that provides the legal basis for such discretionary allocations. It permits funds allocated for what is termed "the development activities of the Department of National Budget (NBD)" to be transferred to any other budget head at the discretion of senior Treasury officials. These transfers bypass prior parliamentary scrutiny, requiring only post-facto reporting within a two month period. This enables spending to diverge significantly from originally approved allocations.

The Committee on Public Finance (COPF) has also highlighted this issue, identifying misuse of discretionary funds in its 2018 and 2019 reports. As a result, two key reforms were recommended: (1) limiting the "Supplementary Support Services and Contingent Liabilities" category to 5% of total expenditure, and (2) introducing a separate budget head for "Proposals of the Finance Minister" to improve transparency. While this new head was introduced in 2019, it remains part of the discretionary budget. Consequently, both it and the annual budget reserve continue to permit spending without line ministry scrutiny. The 2024 PFM Act sought to address this problem. Section 25 limits the "annual budget reserve" — the renamed Supplementary Support Services category — to 2% of proposed primary expenditure. These funds intended for urgent or unforeseen needs, or to top up insufficient allocations, now require approval through the Appropriation Act and must be reported to Parliament within two months.

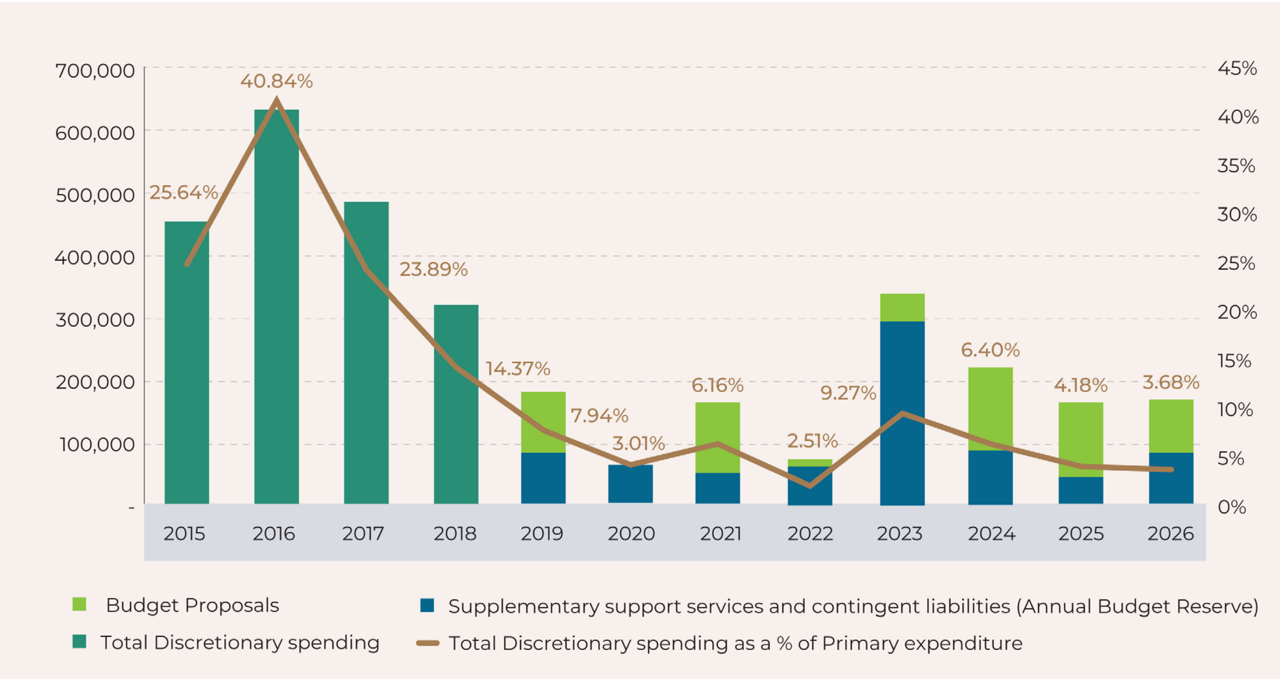
However, discretionary spending extends beyond the annual budget reserve. It includes funds held under the budget proposals head within the NBD's development budget. In 2026, with primary expenditure estimated at LKR 4,440 billion, the annual budget reserve has a legal ceiling of LKR 88.8 billion. The budget allocates LKR 87.6 billion to this reserve, which is just under the limit at 1.97% of primary expenditure. An additional LKR 76 billion is allocated to budget proposals, bringing total discretionary spending to LKR 163.6 billion, or 3.68% of primary expenditure.

16 Presidential Media Division 'Clarification on misleading reports concerning the tender sale of vehicles owned by the Presidential Secretariat' Presidential Media Division 17 May 2025 at https://pmd.gov.lk/news/clarification-on-misleading-reports-concerning-the-tender-sale-of-vehicles-owned-by-the-presidential-secretariat/ [last accessed 27 November 2025].

17 *Daily Mirror*, Yohan Perera, 'Govt. loses over Rs. 200Mn in NCP vehicle sales: MP Jayasekera' 2 June 2025 at https://www.dailymirror.lk/breaking-news/Govt-loses-over-Rs-200Mn-in-NCP-vehicle-sales-MP-Jayasekera/108-310458 [last accessed 27 November 2025].

This marks a modest improvement. Overall discretionary spending has declined from 4.18% in 2025 and is now well below the 5% threshold proposed by Verité Research. While the total amount has remained broadly unchanged, its composition has shifted significantly: the annual budget reserve has more than doubled and now constitutes over half of discretionary spending, while the share allocated to budget proposals has fallen substantially.

Exhibit 27: Discretionary Budget Balance, in LKR millions, 2015-2026



Source: 2026 Budget Estimates

Since 2022, changes in the reporting format have allowed some proposals to be reflected directly under line ministries, while others remain in the discretionary budget. The "budget proposals" head effectively functions as a holding area during budget debates, with funds transferred to relevant ministries once decisions are finalised and the budget is approved. The 2025 budget corroborates this process: between the draft and approved Estimates, the annual budget reserve fell by 54% and budget proposals by 23%. Over the same period, ministerial allocations saw only minor adjustments, while the Ministry of Finance's total allocation declined by nearly 9%, demonstrating a clear reallocation of resources from discretionary heads to ministries.

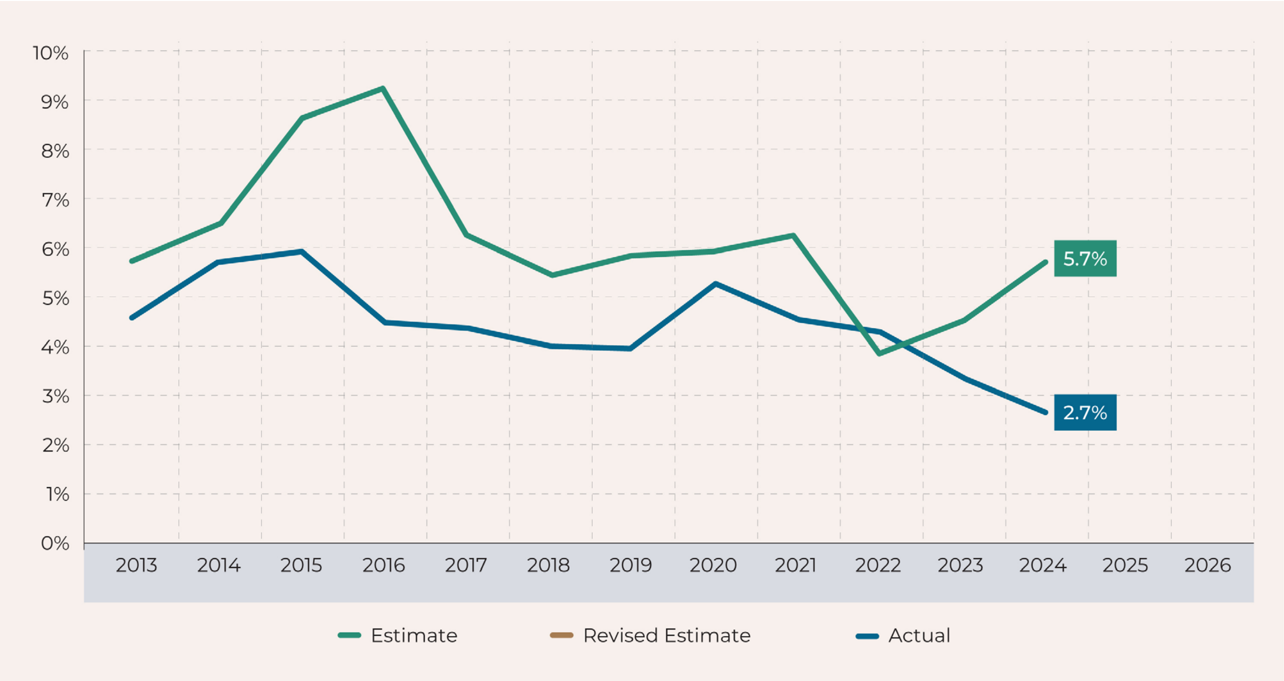
A concrete example of this is the 2025 proposal to allocate LKR 20 billion to settle Sri Lankan Airlines' legacy debts. This was absent from the draft Estimates but appeared in the final version under Head 241 as recurrent and capital allocations for loan repayments, illustrating how discretionary funds are redirected to specific ministries during the budget's finalisation.

In conclusion, the current discretionary budget represents a positive development, remaining well under the 5% expenditure limit—in fact, it is under 5% of primary expenditure itself. The annual budget reserve also complies with its 2% legal ceiling. Based on the 2025 precedent, it is expected that a significant portion of the current budget proposals allocation will be reassigned to line ministries after approval, further reducing the discretionary total.

5.4 Persistent Under-Utilisation of Capital Expenditure Allocations

Capital expenditure is projected to rise by 4.9% in 2026, increasing from a revised estimate of LKR 1,315 billion in 2025 to LKR 1,380 billion.

Exhibit 28: Government Capital Expenditure Utilisation as a Share of GDP



Source: Budget Estimates (multiple years)
Note: Actual GDP values were taken for each year from the Department of Census and Statistics National Accounts estimates under the base year 2015.

Historical trends show that actual capital expenditure has consistently fallen short of both original and revised budget estimates. Since 2018, this gap has persisted each year, with the sole exception of 2022. In 2024, for instance, actual capital spending was just 2.7% of GDP, less than half of the 5.4% projected in the original 2024 Budget Estimates.

This persistent under-execution can be explained by fiscal constraints. In practice, capital spending functions as a residual category: once interest payments are met, and the government seeks to comply with primary balance targets, capital expenditure is often the first area to be cut when revenues fall short or interest costs rise. In effect, rising interest obligations are crowding out public investment.

Beyond fiscal limitations, structural and project-level challenges further constrain capital spending. These include procurement delays, poor contractor performance, changes in project design and scope, land acquisition issues, and delays in Treasury releases.[18] Many large projects are stalled or extended beyond their original timelines, pushing both implementation and associated payments beyond the budget year.

Together, these factors have limited the government's ability to realise its capital investment plans, undermining the credibility of capital expenditure estimates and constraining long-term growth prospects.

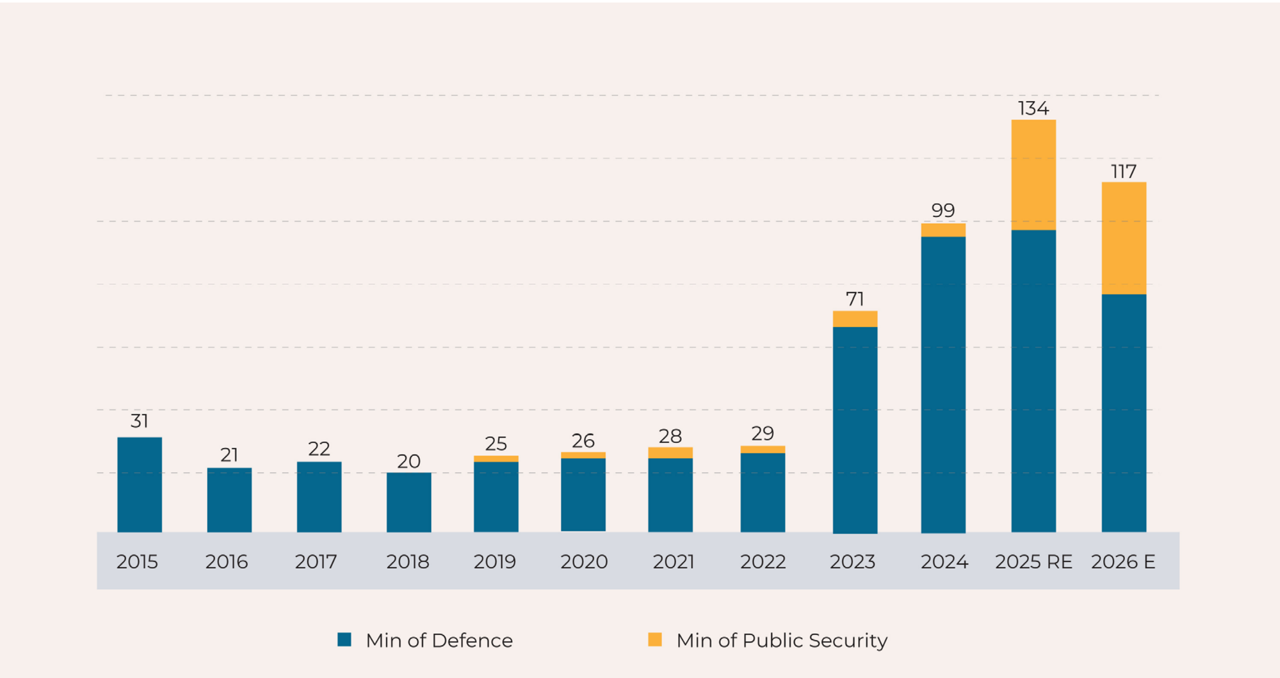
18 Department of Project Management and Monitoring, Progress of Mega Scale Development Projects Second Quarter – Year 2025 at https://www.treasury.gov.lk/api/file/8e22d73e-32dd-450f-b6ac-c8bc527e0358 [last accessed 25 November 2025]

5.5 Concern on the Defence Sector Allocation for Diets and Uniforms

In recent years, spending on diets and uniforms within the defence sector has followed an alarming trajectory. Verité Research previously raised this concern in 2024, when expenditure on this within the Ministry of Defence tripled. While the ministry's total budget remained stable in 2025, the problem shifted rather than being resolved. The provision for diets and uniforms under the Ministry of Public Security has increased 17-fold.

In 2026, the cost of diets and uniforms across the defence sector is expected to decline by 12.7%. However, this does not negate the overarching trend. Over the period from 2022 to 2026, total spending on diets and uniforms across the defence sector is projected to rise by 299%. This increase is profoundly disproportionate, far outstripping cumulative inflation of approximately 80% over the same period and indicating a significant real-term expansion in expenditure.

Exhibit 29: Defence Sector Spending on Diets and Uniform (LKR billions)



Source: Budget Estimates (multiple years)

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