2024 BUDGET UPDATE | NOVEMBER 2023

AMBEON SECURITIES

13.11.2023

FISCAL PERFORMANCE | 2013-2023

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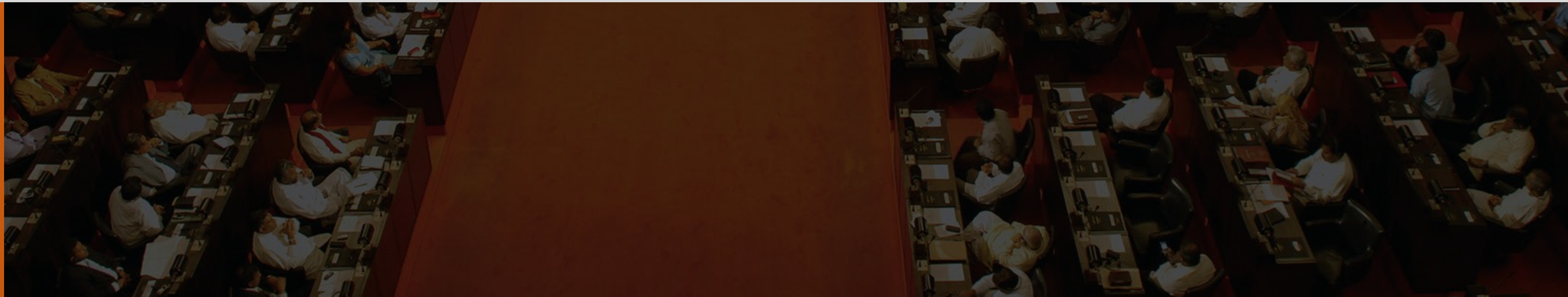

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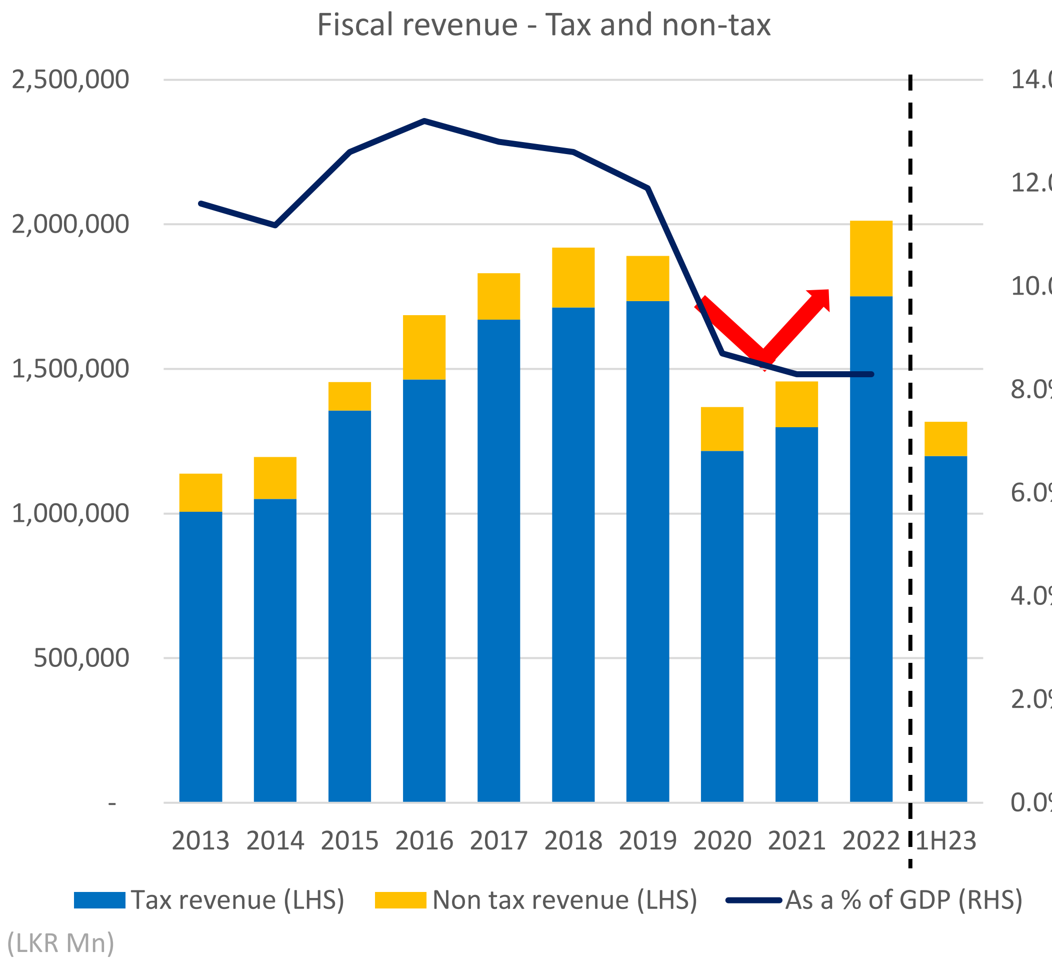
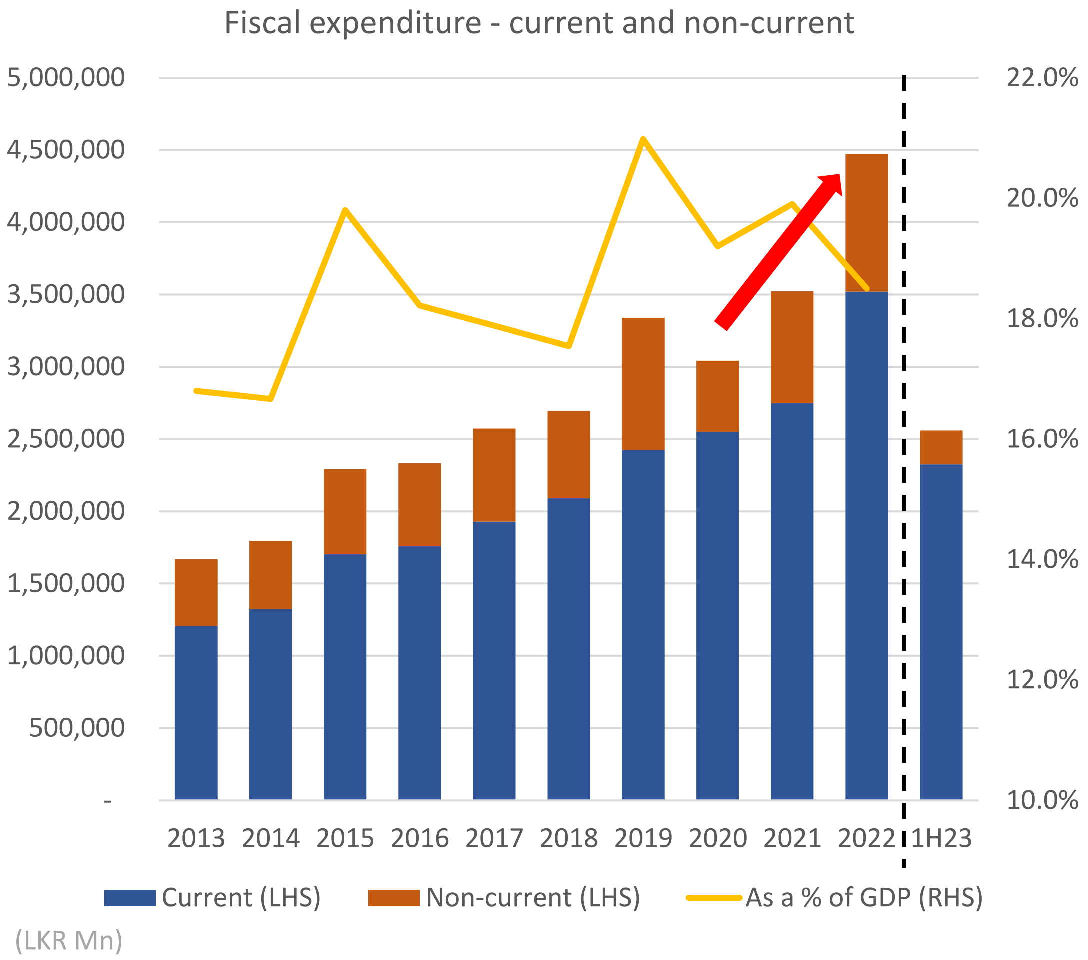
Government revenues and expenditure 2013-2023

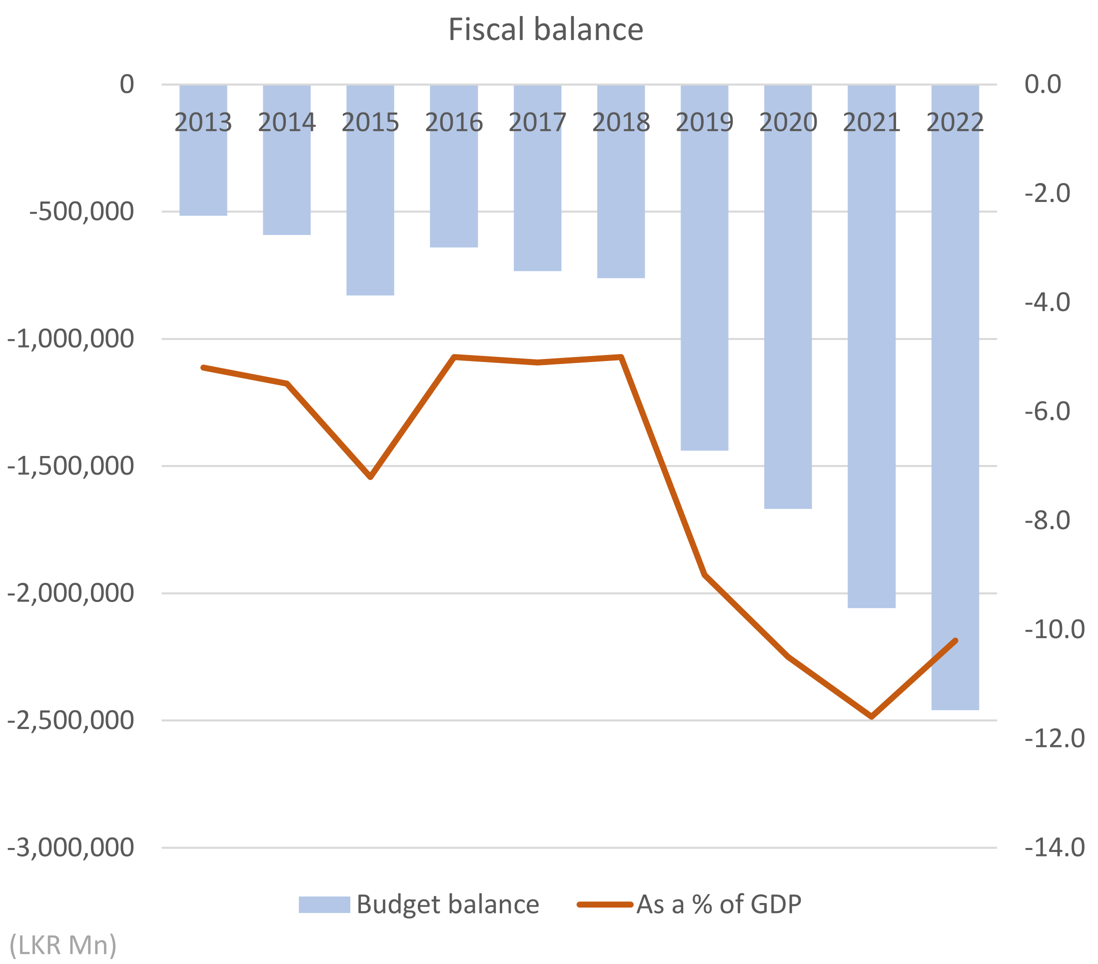


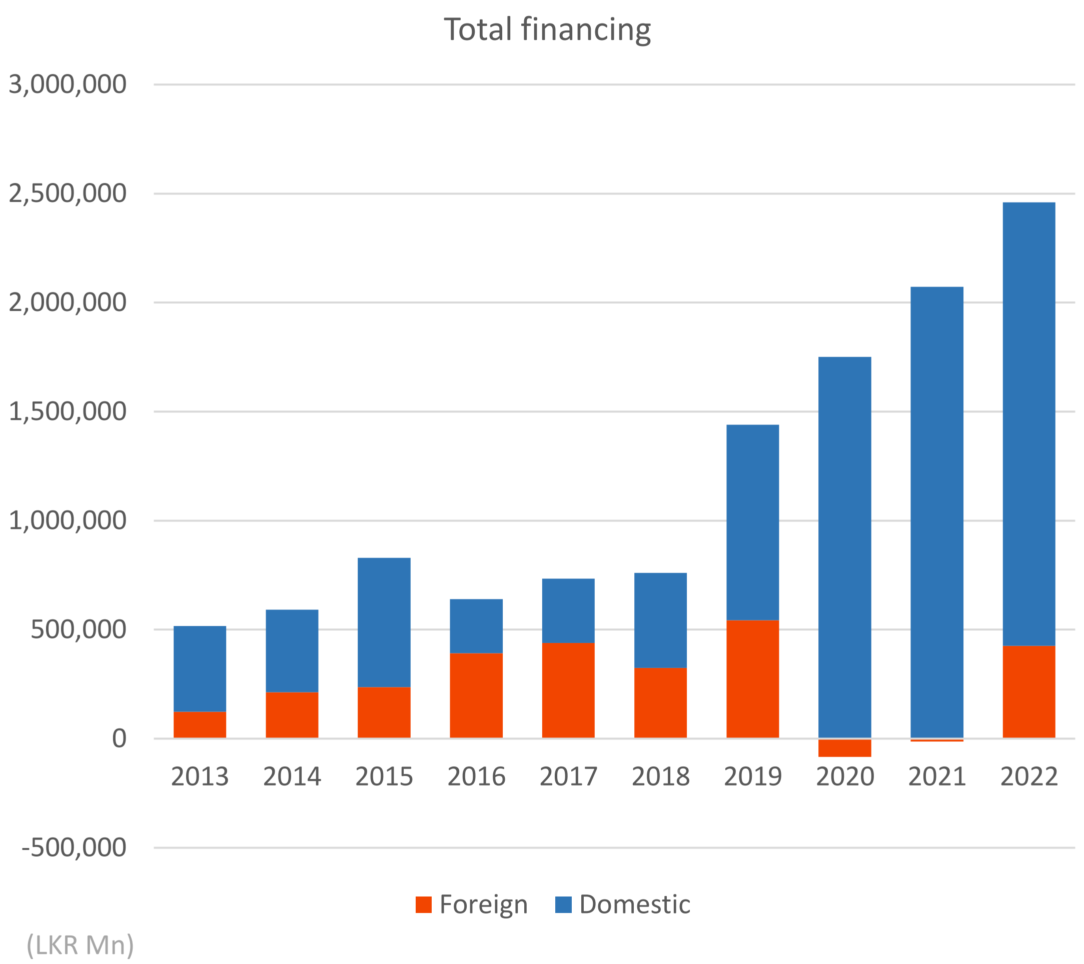


Note: Major tax cuts in 2020 resulted in lower tax revenues in 2020 and 2021

Source: CBSL

Budget deficit and financing 2013 - 2023





Note: External shocks such as covid-19 pandemic and poor policy choices have resulted in a rapid deterioration in fiscal balance post-2019

Source: CBSL

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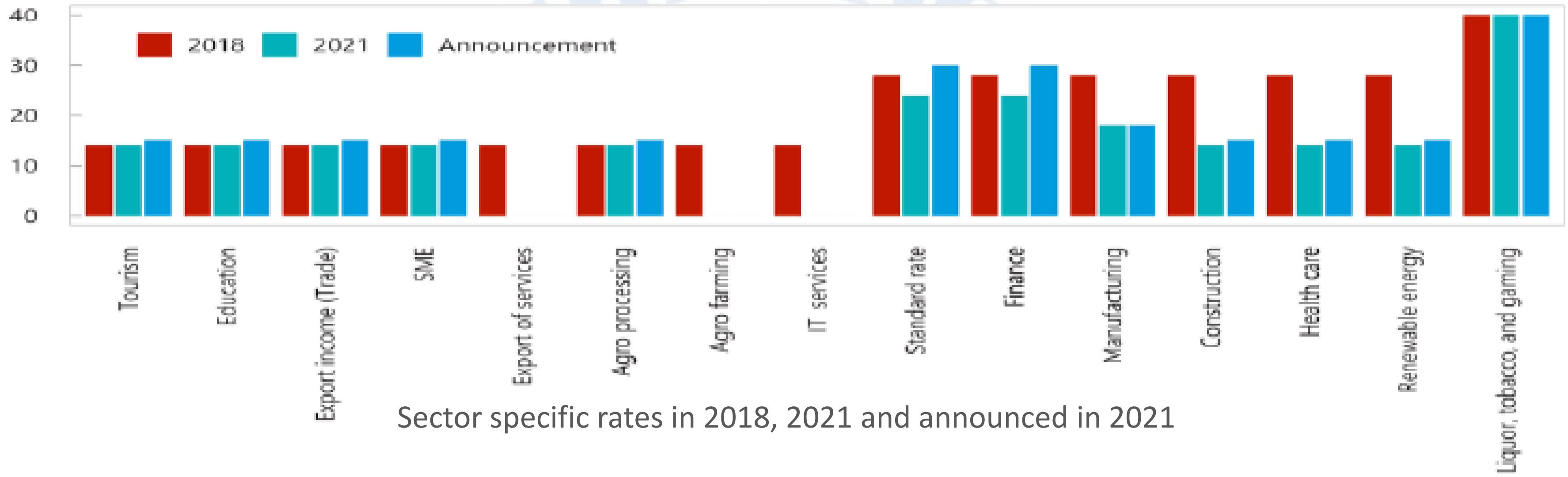
IMF highlights on tax policy

- Constant changes in the tax policy has deteriorated policy focus. The discretionary policy changes in the special commodity levy, exemplified by the reduction in the levy on goods like sugar in October 2020, have resulted in significant revenue losses.



Sector specific rates in 2018, 2021 and announced in 2021

- Complex tax systems with multiple taxes, unclear rationale, and widespread tax incentives create opportunities for rent-seeking and abuse of power. Such systems lead to unpredictable policy interventions, erode tax certainty, and undermine investor confidence.
- Lack of centralization and fragmentation in decision-making poses a significant challenge to implementing a principle-based taxation system.
- The selection of Strategic Development Projects handled by the Board of Investment (BoI) which are tax exempted lacks clear criteria for determining strategic relevance
- IMF recommended that the budgetary impact of all tax expenditures be consistently quantified and publicly disclosed on a government website.

Source: IMF Governance Diagnostic Assessment, Sep 2023

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IMF highlights on revenue administration

- Revenue administration is highly prone to corruption. Corruption vulnerabilities in revenue collection are heightened at points where officials interact with the public, especially when exercising discretion without adequate safeguards. Enhancing online tax return filing can effectively reduce human interactions between taxpayers and officials, thereby minimizing corruption vulnerabilities.
- Both Customs and Inland Revenue Department (IRD) officials acknowledge widespread corruption within their institutions, characterized by a low risk of exposure and minimal consequences for wrongdoings.
- Effective digitization, exemplified by the Automated System for Customs Data (ASYCUDA) in import clearance processes, has demonstrated a reduction in corruption vulnerabilities.
- The management of tax expenditures, including exemptions, tax holidays, and concessions, is characterized by fragmentation, potential misuse, and insufficient oversight. There is a lack of clarity and a defined process for communication between the Inland Revenue Department (IRD) and the Ministry of Finance (MoF) regarding approved exemptions.
- The working relationship between the Fiscal Policy Department and the Inland Revenue Department (IRD) is dysfunctional and has broken down. The IRD has been unwilling to share crucial tax data with the Ministry of Finance (MoF), hindering effective collaboration.
- IMF recommends minimizing interactions between taxpayers/traders and revenue officials aim to reduce discretionary opportunities and corruption vulnerabilities
- IMF recommends implementing short-term anti-corruption measures within each revenue department
- IMF further recommends strengthening Revenue Department oversight and inputs to revenue forecasting and tax policy, emphasizing transparency and collaboration

Source: IMF Governance Diagnostic Assessment, Sep 2023

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IMF highlights on public financial management

- Sri Lanka is facing significant fiscal challenges resulting from a combination of external shocks, questionable policy choices in 2019, and the impact of the COVID-19 pandemic.
- The government has struggled to maintain fiscal discipline due to optimistic revenue forecasts and challenges in controlling spending, further exacerbated by weak accountability for fiscal rule adherence. Budget coverage and commitment controls weaknesses have led to cash rationing, often executed opaquely with minimal oversight.
- A significant concern regarding fiscal governance in Sri Lanka is the government's consistent failure to meet revenue projections and adhere to expenditure limits outlined in its annual budget. This trend has resulted in breaches of existing fiscal rules and undermined the budget's credibility.
- Corruption risks are heightened when the budget lacks credibility, allowing the executive arm of the government to exceed budget limits. This creates an environment where projects and activities can be funded without proper consideration of costs and benefits, escaping external scrutiny by Parliament.
- Projects funded in the budget often deviate from those proposed in the plan, allowing for the misuse of scarce resources on non-priority projects and fostering non-transparent manipulations to secure project funding. The Department of Management Audit highlights that implementing investment projects without feasibility studies is a common internal audit finding.
- Poor planning and project preparation contribute significantly to implementation issues in major projects. According to the Progress of the Mega Scale Development Projects Report (Fourth Quarter - Year 2022), only 22 out of 261 ongoing projects (10 percent) were completed by the end of 2022. Furthermore, 29 projects were halted due to unresolved issues, while 129 were classified as poorly performing, requiring serious attention.
- The inconsistent treatment of unsolicited capital investment proposals poses a threat to effective governance and significantly increases corruption risks.

Source: IMF Governance Diagnostic Assessment, Sep 2023

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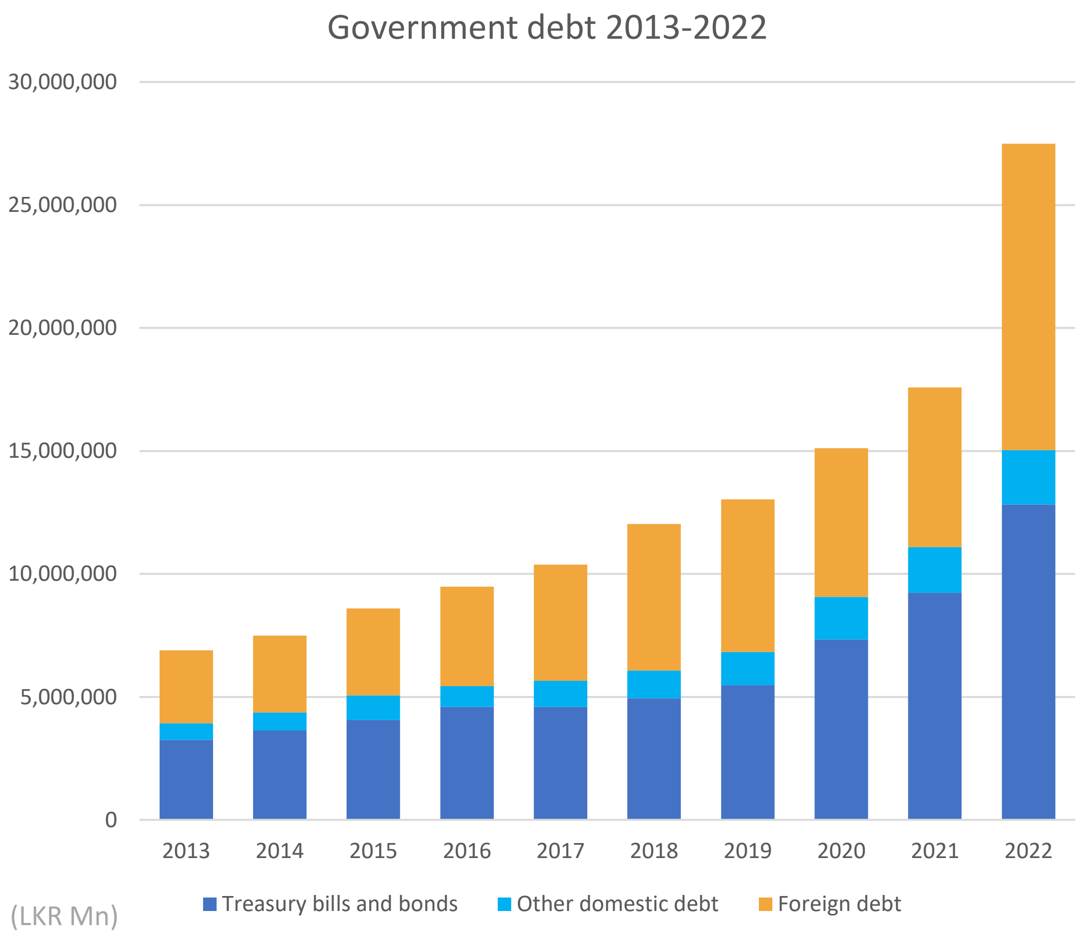
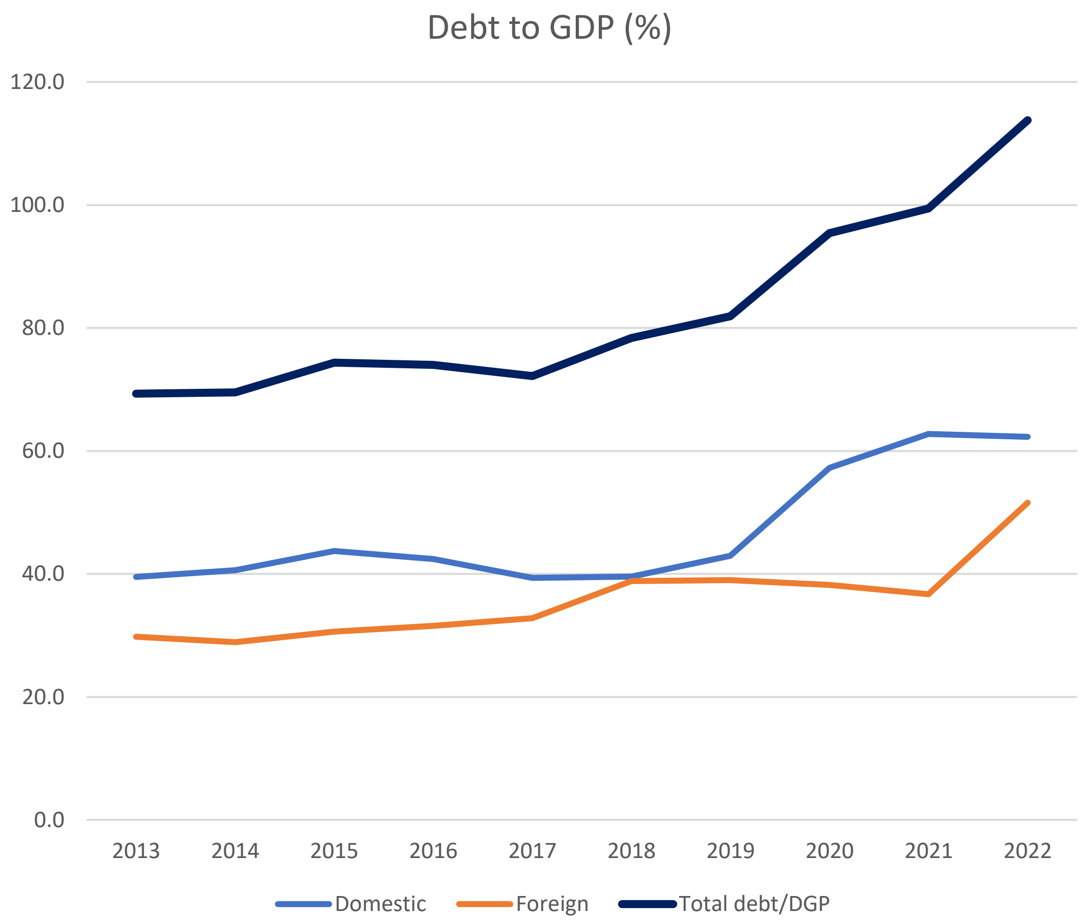
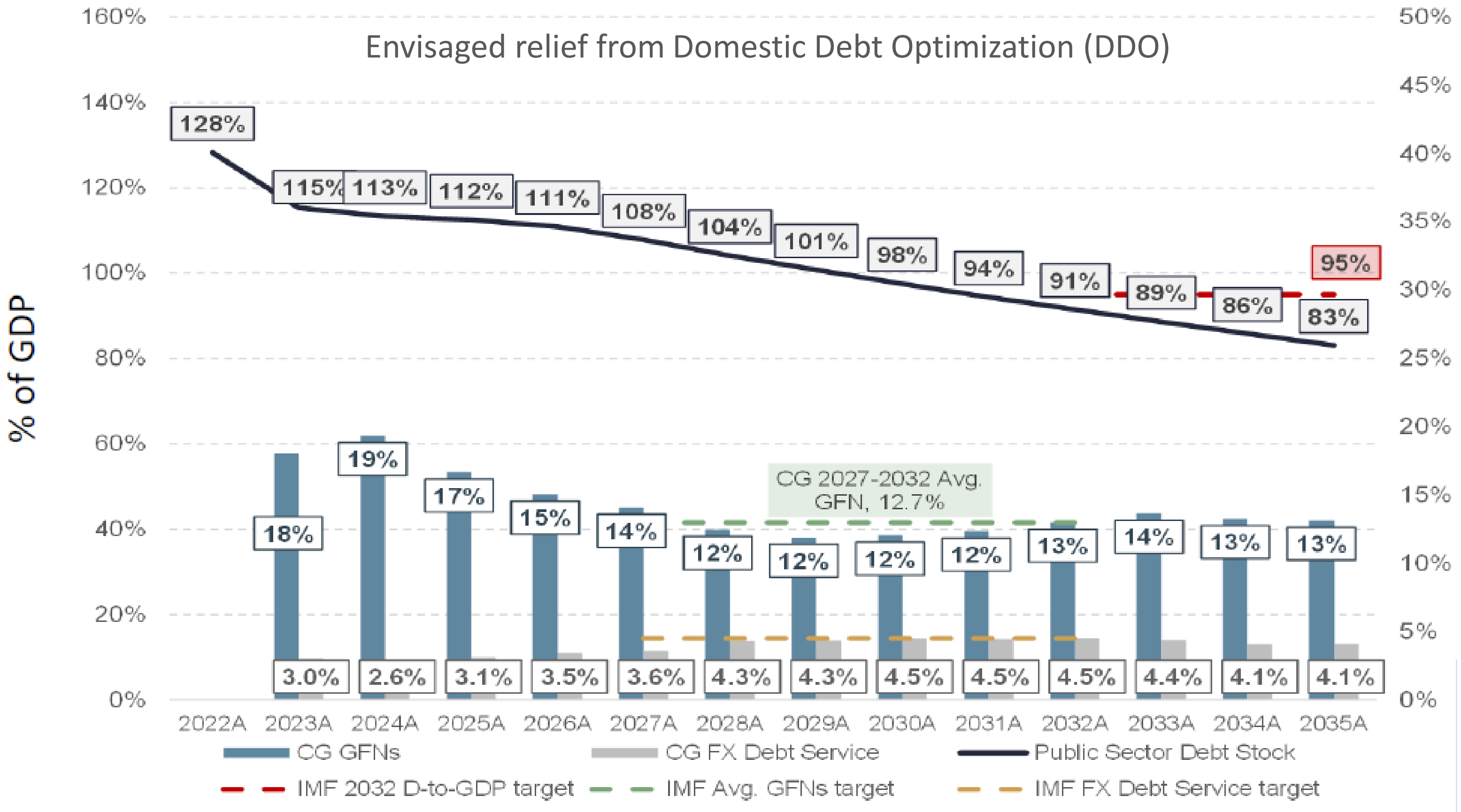
National debt 2013-2022





Source: CBSL, Ministry of Finance

Debt restructuring and IMF Debt Sustainability Analysis (DSA) targets



Debt stock target

95% of GDP by 2032

Gross Financing Need

Avg. 13% of GDP in 2027-2032

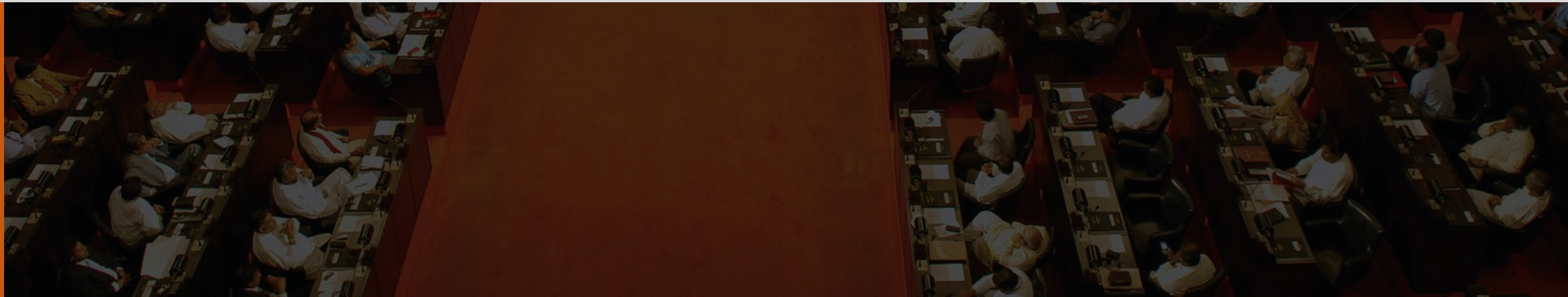
FX debt service target

Max 4.5% of GDP in 2027-2032

Fiscal adjustments and domestic and external debt restructuring are expected to help achieve the DSA targets

Source: CBSL

BUDGET HIGHLIGHTS | 2024



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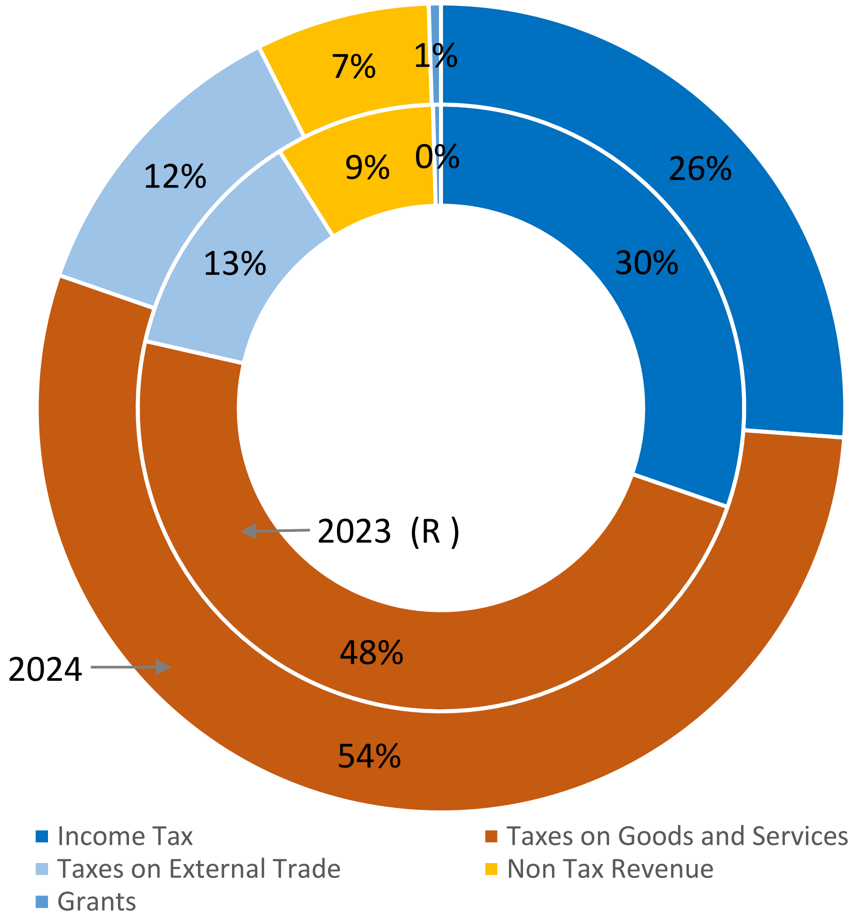
Revenue highlights

Revenue composition



(LKR Bn)	2022	2023 (R) estiamtes	2024 Budget
Total Revenue and Grants	**2,013**	**2,851**	**4,127**
Growth YoY		*42%*	*45%*
Total Revenue	1,979	2,839	4,107
Tax Revenue	1,751	2,596	3,820
Growth YoY		*48%*	*47%*
Income Tax	534	864	1,080
Growth YoY		*62%*	*25%*
Taxes on Goods and Services	876	1,376	2,235
Growth YoY		*57%*	*62%*
Taxes on External Trade	341	357	505
Growth YoY		*5%*	*41%*
Non Tax Revenue	228	243	287
Grants	33	12	20

- Taxes on goods and services comprise the largest portion (54%) of total fiscal revenue
- Although indirect taxes are effective in terms of collection, they do not foster fairness, as the burden of taxation fall disproportionately on lower-income categories.

Source: Ministry of Finance

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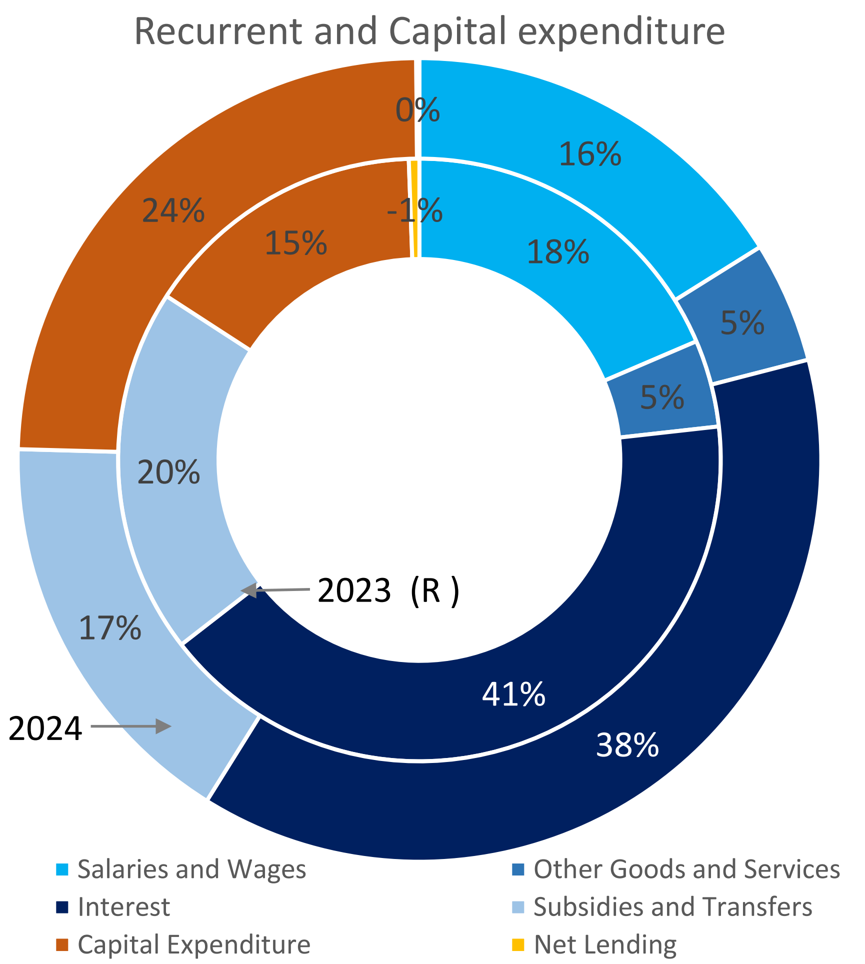
Expenditure highlights



Note: 2024 estimates include LKR 450Bn for bank recapitalization

Source: Ministry of Finance

(LKR Bn)	2022	2023 (R) estiamtes	2024 Budget
Total Expenditure	**4,473**	**5,253**	**6,978**
Growth YoY		*17%*	*33%*
Recurrent	3,520	4,471	5,277
Growth YoY		*27%*	*18%*
Salaries and Wages	956	986	1,127
Growth YoY		*3%*	*14%*
Other Goods and Services	183	248	341
Growth YoY		*36%*	*38%*
Interest	1,565	2,193	2,651
Growth YoY		*40%*	*21%*
Subsidies and Transfers	815	1,044	1,158
Growth YoY		*28%*	*11%*
Capital Expenditure and Net Lending	953	782	1,701
Growth YoY		*-18%*	*118%*
Capital Expenditure	715	812	1,260
Growth YoY		*14%*	*55%*
Bank Recapitalization	-	-	450
Net Lending	238	-30	-9

- Interest expenses comprise the largest portion (38%) of total fiscal expenditure despite indicating a proportionate reduction from 2023 (41%)
- Recurrent expenditure reflect 76% of the total fiscal expenditure

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Budget deficit and financing

(LKR Bn)	2022	2023 (R) estiamtes	2024 Budget
Revenue Surplus (+)/Deficit(-)	-1,540	-1,632	-1,170
Primary Surplus (+)/Deficit(-)			
Without bank recapitalization	-895	-209	250
With bank recapitalization	N/A	N/A	-200
Budget Surplus (+)/Deficit(-)			
Without bank recapitalization	-2,460	-2,402	**-2,401**
With bank recapitalization	N/A	N/A	**-2,851**

(LKR Bn)	2022	2023 (R) estiamtes	2024 Budget
Total Financing	2,460	2,402	2,851
Total Foreign Financing	425	340	726
Foreign Borrowings-Gross	783	780	1,000
Debt Repayment	-359	-440	-274
Total Domestic Financing	2,035	2,062	2,125
Non - Bank Borrowings	3,610	4,002	2,205
Sri Lanka Development Bond	-380	-461	-80
Bank Borrowings and Other	-1,195	-1,479	-

As a % of GDP	2022	2023 (R) estiamtes	2024 Budget
Revenue Surplus (+)/Deficit (-) GDP (%)	-6	-6	-4
Primary Surplus (+)/Deficit (-) GDP(%)			
Without bank recapitalization	-4	-1	1
With bank recapitalization	N/A	N/A	-1
Budget Surplus (+)/Deficit (-) GDP(%)			
Without bank recapitalization	-10	-9	**-8**
With bank recapitalization	N/A	N/A	**-9**

Source: Ministry of Finance

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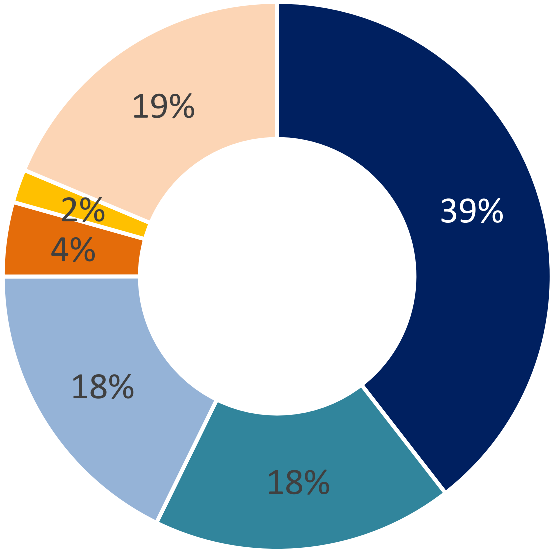
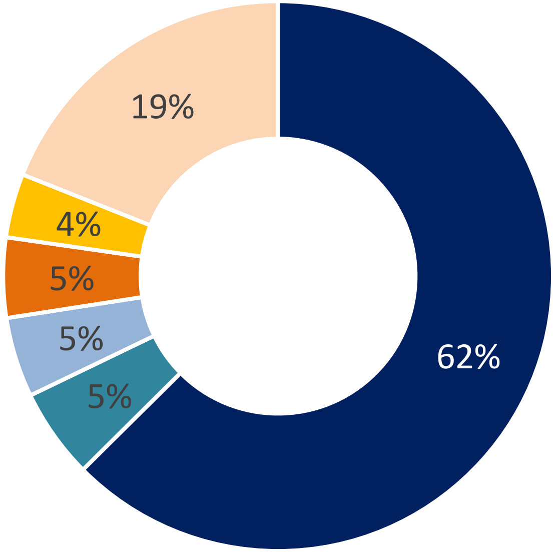
Key budget allocations

Key Welfare and Subsidy Programmes - 2024



	(LKR Mn)
Pension payments	401,458
Aswasuma	180,500
Medical supplies for hospitals	180,300
Service compensation for death and injured soldiers	44,500
Interest subsidy for senior citizen’s accounts	20,000
Other	189,763

Key expenditure proposals - 2024



	(LKR Mn)
Increase Monthly Cost of Living Allowance of Public Sector employees and Pensioners	133,000
Decentralized Budget	11,250
Kadurata Dashakaya Integrated Village Development Program	10,000
Rural Road Maintenance and Management	10,000
Preparing Institutional Structure for Research and Development Activities	8,000
Other	40,340

Source: Ministry of Finance

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Key budget proposals

Budget proposal	Sector	Impact
Establish new investment zones centered in Hambantota, Jaffna, Trincomalee, Bingiriya, and Kandy	Investments	Increased economic activities, improved infrastructure, and a more balanced regional development can result in overall economic expansion.
National Economic Commission that oversees the institutional framework that integrates the functions of the Investment Development Board, Export Development Board, Industrial Development Board, and National Enterprises Development Authority.	Investments	Improved efficiency in economic planning and execution, potentially attracting more foreign and domestic investments
LKR3,000Bn will be allocated for the implementation of foreign debt restructuring and settlement of International Sovereign Bonds under foreign debt restructuring	National debt	Helps in managing the country's external debt, potentially improving credit ratings and fostering investor confidence.
Borrowing limit to be increased from LKR3,900Bn to LKR7,350Bn. This is an increase of LKR3,450Bn	National debt	Enables the government to undertake more significant infrastructure projects, invest in public services, and navigate economic downturns more effectively. However, it also raises concerns about debt sustainability.

Source: Ministry of Finance

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Key budget proposals

Budget proposal	Sector	Impact
20% of the shares of the two large state-owned banks should be given to strategic investors or the public	Banking	Potentially strengthens the banking sector, improves financial services.
LKR450Bn to support the capital improvement process in the banking system	Banking	Ensures the resilience of the banking system, which is essential for economic stability. It instills confidence in depositors and investors. Banking counters are positively affected
Eliminate non-tariff import taxes, including import CESS, Port, and Airport Levy. Easing of these taxes will be phased out through 3 to 5 years.	Imports	Stimulates international trade, reducing the cost of imported goods. Positively affect counters that are import dependent.
After external debt restructuring is complete, the second phase of the Central Expressway from Kadawatha to Mirigama will commence, jointly with China. Government to obtain support of Japan for the construction of the section from Kurunegala to Galagedara.	Infrastructure	Reduces transportation costs, and fosters economic activities.

Source: Ministry of Finance

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Key budget proposals

Budget proposal	Sector	Impact
LKR 2Bn will allocated in 2024 for the preliminary activities related to the construction of the Hingurakgoda International Airport	Infrastructure	Positively affect tourism sector as well.
Utilize Colombo Port to meet the supply needs of South West India and Trincomalee Port to meet the supply needs of South East India.	Infrastructure	Positive sentiment for logistics, shipping, and related sectors.
Free land by government where construction companies can construct buildings as per the plans of respective government agencies	Infrastructure	Encourages construction, infrastructure development, and economic growth. Positively affect the construction sector.
LKR 1.5Bn for Kandy multi transport center project which will be started in January 2024	Infrastructure	Improves regional transportation, stimulating economic activities in and around Kandy. Positively affects tourism in the area.
LKR 10Bn to renovate rural roads and LKR 2Bn to renovate roads and bridges destroyed by natural disasters	Infrastructure	Positively affect construction and material sectors.
LKR 50Bn allocation for SMEs including a concessionary loan scheme of around LKR 30Bn with the support of the Asian Development Bank	SME	Boosts SMEs, supporting entrepreneurship and economic diversification.

Source: Ministry of Finance

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Key budget proposals

Budget proposal	Sector	Impact
LKR 3Bn in 2024 to establish a National Center for Artificial Intelligence to ensure an economic and social transformation	Technology	Promotes technological advancement, innovation, and economic transformation.
Increase milk production by 53% in 5 years with the contribution of the private sector	Agriculture	Supports agriculture, food security, and economic self-sufficiency.
LKR 2.5Bn for Provincial Agricultural and Fisheries Modernization Boards focused on increasing paddy production to 8 MT per hectare from current 3.5MT per hectare	Agriculture	Increases agricultural productivity, positively impacting rural economies.
LKR 500Mn for developing Northern sea fishing and LKR 200 Mn to develop fresh water fishing	Agriculture	Contributes to food security and economic growth.
LKR 100Mn to establish Ayurvedic wellness centers in tourist hotels	Tourism	Positively affect tourism sector, boosting tourism, contributing to foreign exchange earnings and economic growth.
From 2024, bring at least 5 Mn tourist every year to Sri Lanka.	Tourism	Positively affect tourism sector, boosting tourism, contributing to foreign exchange earnings and economic growth.
Pinnawala- Kithulgala Tourism Corridor to be developed over 3 years	Tourism	Positively affect tourism sector, boosting tourism, contributing to foreign exchange earnings and economic growth.
Establish 4 new universities, convert private higher educational institutes to universities, and enhance facilities in state universities	Education	Strengthens education, improving human capital and innovation.

Source: Ministry of Finance

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