THE FINANCE COMMISSION

RECOMMENDATIONS - (2017) TO H.E. THE PRESIDENT

In terms of the Article 154R (4) of the Constitution of Sri Lanka

September 2016

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நிதி ஆணைக்குழு

(அரசியலமைப்பின் 154`எ ஆம்உறுப்புரையின்கீழ் தாபிக்கப்பட்டது)

FINANCE COMMISSION

(Established under Article 154 R of the Constitution)

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Your No FC /3/1/2017

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திகதி:
Date: 20 Sep. 2016

His Excellency Maithripala Sirisena
President of the Democratic Socialist Republic of Sri Lanka
Presidential Secretariat
Colombo 01

Your Excellency,

In terms of the Article 154 R of the 13th Amendment to the Constitution of the Democratic Socialist Republic of Sri Lanka, I hereby submit the Recommendations pertaining to provincial capital and recurrent needs for 2017, including the proposed strategies to achieve balanced regional development in the country.

This Recommendations may be laid before Parliament in terms of 154 R (7) of the Constitution.

Yours respectfully,

Uditha .H.Palihakkara
Chairman,Finance Commission

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Executive Summary

The Finance Commission was established under the Article 154 R (4) of the Thirteenth Amendment to the Constitution in 1987 for the purpose of making recommendation to the government for allocation of adequate funds to meet the needs of the provinces with the objective of achieving balanced regional development in the country. In this context, the Commission is mandated to make recommendations to H.E. the President with regard to the principles on which funds are granted annually by the Government for apportionment of such funds among the provinces and any other matters refer to the Commission by the President relating to provincial finance.

The allocation of funds to the provinces is made in three forms.

i. Criteria Based Grant (CBG) which is used to meet the capital expenditure for improving socio – economic condition for the people in a manner that contribute towards reducing regional disparities.

ii. Province Specific Development Grant (PSDG), allocated mainly for financing development projects meant for infrastructure development under the devolved subjects. Under this, special allocations are made to implement projects which are designed for reducing inter and intra disparities of provinces. For development of underserved villages, some allocations are made with a view to improving the basic facilities of backward villages at divisional level. It also includes flexible allocations for meeting any urgent requirements which are not included in the original Provincial Annual Plans.

iii. Block Grant (BG) is meant for meeting recurrent expenditure needs of the provinces to meet and sustain the service delivery of the provinces.

The major revenue sources of the Provincial Councils are stated in the Provincial Council Act No. 42 of 1987.

The provincial revenue mainly consists of two components viz. transfers of the government revenue and revenue collected from the devolved sources, specified in the Ninth Schedule of the Thirteenth Amendment to the Constitution. The revenue earned by national authorities through Nations Building Tax (NBT) , stamp duty and vehicle registration fees are transferred to the provinces according to a nationally agreed formula.

In the assessment of capital needs of the provinces the Finance Commission adopts a methodology which includes *inter alia*, development policy of the Government, Medium-Term Provincial Development plans, optimum utilization of the provincial level recourses, absorptive capacity of provinces, adoption of Public – Private Partnership (PPP) approach and guidelines and circulars issued by the Finance Commission.

When assessing the provincial recurrent needs, approved cadre, living cadre , vacancies , attachment by line ministries, Local Government transfers and the relevant Government circulars are given due consideration.

For 2017, the total capital needs recommended by the Commission was Rs. 38,432, million and the assessed provincial recurrent needs in the form of Block Grant was Rs. 196,904 million. The total capital needs have been apportioned among the provinces by adopting a revised statistical formula. In the assessment of recurrent needs at provincial level, devolved revenue and transferred revenue from the Government have been deducted from the estimated recurrent needs.

The Commission has recommended some important aspects to be considered by the provinces in identifying these needs and implementation of annual development plans. These aspects include mainly rationalization of provincial expenditure, promotion of private investments, improvement of devolved revenue base, strengthening of monitoring and evaluation mechanism and, minimization of proliferation of provincial agencies.

1. Introduction

The Finance Commission of Sri Lanka (FCSL) established under the Article 154 R (4) of the Thirteenth Amendment to the Constitution in 1987 is mandated to submit recommendations with respect to the principles on which funds are apportioned for the purpose of making recommendation to the government for allocation of funds adequate to meet the needs of the provinces and is also granted annually by the Government for the use of the provinces. Further, Article 154 R (5) requires the Commission to formulate such principles with the objective of achieving balanced regional development in the country.

In keeping with the mandate under the Constitution, the Commission apportions capital funds (PSDG and CBG) among the provinces in a rationale manner to achieve the above objective. In addition, the Commission recommends to the General Treasury, provision of recurrent funds for implementation of provincial development projects and services in the form of Block Grant.

The Commission is making its recommendations to H.E. the President, deviating the practice adopted hitherto i.e. after the annual budget is passed by Parliament. Accordingly, the Finance Commission, in 2016, revised its annual action plan with a view to making arrangements to expedite the whole process of preparation of provincial budgets. This will pave the way for the provinces to obtain their required funds from the General Treasury at the beginning of each financial year and facilitate the adoption of Zero-Based Budgeting Approach (ZBB) effectively.

2. The Role and Major Responsibilities of the Finance Commission

The Article 154 R (3), (4) and (5) of the 13^{th} Amendment to the Constitution provides as follows;

i. The Government shall, on the recommendation of, and in consultation with, the Commission, allocate from the Annual Budget, such funds as are adequate for the purpose of meeting the needs of the provinces.

ii. It shall be the duty of the Commission to make recommendations to the President as to-
   a) The principles on which such funds are granted annually by the Government for the use of provinces should be apportioned between the various provinces; and
   b) Any other matter referred to the Commission by the President relating to provincial finance.

c) The Commission shall formulate such principles with the objective of achieving balanced regional development in the country, and shall accordingly take into account the population, per capita income, the need progressively to reduce social and economic disparities and the need progressively to reduce the differences between the per capita income of each Province and the highest per capita income among the Provinces.Accordingly, the Finance Commission is to apportion such funds between the provinces.

The Article 154 R (7) of the Constitution requires that "The President shall cause every recommendation made by the Finance Commission under the above article to be laid before Parliament and shall notify Parliament as to the action taken thereon".

Within the context of the constitutional mandate, the Finance Commission guides the provinces in their development strategies in planning and implementation through the following activities;

- Assessment of the annual needs of provincial recurrent and capital expenditure and cadre requirements,
- Issuing guidelines to facilitate the needs assessment in the provinces,
- Making recommendations to the government on allocation needed for provincial development.
- Informing the provinces on annual grants, allocated by the government,
- Issuing guidelines on the preparation and implementation of provincial annual development plans, and utilization of funds in terms of government policy and budgetary framework,
- Encouraging provinces to achieve balanced regional development through effective utilization of resources.

3. Apportionment of Government Funds among the Provinces

The Article 154 R (3) of the Thirteenth Amendment to the Constitution requires that the Government shall on the recommendation of and, in consultation with the Commission allocate from the National Budget "such funds as are adequate for the purpose of meeting the needs of the provinces". This entails:

a. Estimating the fiscal needs of the provinces based on the analysis of the requests for funds made by the provinces and examining whether such requests are in line with the national policy directives and priorities.

b. Apportioning funds among the provinces with the objective of reducing regional disparities.

3.1 Constituents of Provincial Divisible Pool for Capital Expenditure

At provincial level the main sectors for funding are education, health, roads, agriculture and social welfare. The Commission has clearly identified the key priority areas and the financial resources are distributed among the provinces according to a statistical formula based on needs assessments. The allocation and apportionment of funds to the provinces are made through the following grants.

Criteria Based Grant (CBG) is used to meet the capital expenditure for improving the socio-economic conditions of the people in a manner that contributes towards reducing regional disparities. The funds provided under this grant are available to the provinces for discretionary spending on development oriented projects and programmes. Since 2016, the Finance Commission made arrangements to allocate CBG funds under two categories as below.

i. Development related projects/ activities
   These funds are expected to be utilized for development projects in the provinces supplementing the funds under Province Specific Development Grant (PSDG)
ii. Special projects proposed by provincial council members
   These funds are meant for the projects / activities initiated by the provincial council members.

(Allocations and release of Criteria Based Grants during the period from 2012 to 2016 are given in the **Annex I**)

Province Specific Development Grant (PSDG) is allocated mainly for financing development projects of capital nature paying special attention to infrastructure development under the devolved subjects, among the selected socio-economic sectors.

When provinces submit their development plans, the Commission along with the respective provincial authorities mutually agree on broad outlines to ensure that such plans would address the provincial needs and are in line with the national development policy of the Government. For each project/programme, measurable results (output, outcome and impact) are considered, in the form of pre-defined indicators, and such indicators are used in periodical evaluation on the provincial performance.

All provincial authorities are expected to use the relevant formats introduced by the Finance Commission for Results Based Monitoring (RBM) system. (Allocations and release of Province Specific Development Grants for 2012 – 2016 are given in **Annex II**)

Integrated Projects for Balanced Regional Development - Special allocation is provided under PSDG for projects which would contribute effectively to minimize regional inter and intra socio-economic disparities. In the preparation of project proposals, value addition, employment creation and reduction of poverty are given due attention. These projects should be able to make a considerable impact in the provincial development.

Development of Under-served Villages - The allocations of this category are made under PSDG with the objective of improving the basic facilities of backward villages. Most of the villages lag behind due to lack of social and economic infrastructure facilities, environmental hazards and other social and cultural factors. It is necessary that all such factors be given due attention and an integrated development approach be adopted in identifying projects and programmes. Villages which are in the jurisdiction of Pradeshiya Sabhas are identified under this category.

In selecting the villages, criteria such as, lack of income sources and inadequacy of common facilities are given due consideration. It is expected that projects for village development are selected with the assistance of the Community Based Organizations (CBO). The responsibility of implementation, monitoring and regulating the projects would be assigned to the Department / Unit which is responsible for the subject of rural development.

Flexible Allocation - This category of funds is for ‘gap filling’ and any urgent requirements which are not included in the original plans.

Block Grant is meant for recurrent expenditure needs of the provinces for the purpose of sustaining and improving their service delivery mechanism. Salaries and wages of provincial staff approved by the Department of Management Services (DMS) constitute the major part of recurrent expenditure. Accordingly, the assessment of salaries and wages is determined on actual living cadre within the DMS approved staffing limit subject to any vacancies. This grant also includes transfers to local authorities for meeting the expenditure on reimbursement of the allowances of members, and the salaries and wages of the staff. (Allocations and release of Block Grant during the period from 2012 to 2016 are given in **Annex III**)

4. Provincial Revenue

Provincial revenue originates from two main sources;

i. Transfer of Government Revenue
ii. Revenue collected from Devolved Sources

4.1 Transfer of Government Revenue

As per the Fiscal Policy Circular No. 01/2010, issued by the General Treasury on 29th December 2010, the national revenue authorities, namely the Commissioner General of Inland Revenue, the Director General of Customs, and the Commissioner General of Motor Traffic, have been directed to transfer the collected revenue to the provinces on the following basis,

a. 33 1/3 % of the Nation Building Tax (NBT)
b. 100 % of Stamp Duty
c. 70% (instead of the earlier 60%) of Vehicle Registration Fees

The collected revenue from NBT and Stamp Duty is divided among the provinces according to the percentages given below (Table1)

Table 1: Percentage of NBT and Stamp Duty divided among the provinces.

Province	**Ratio (%)**
Western	48
Central	09
Southern	09
North Western	09
Sabaragamuwa	05
North Central	05
Uva	05
Eastern	05
Northern	05
Total	**100**

Note :These percentages could be re-fixed periodically by the General Treasury with the concurrence of the Finance Commission.

Table 2: Transfers of Government Revenue

(Rs. mn.)

Province	**2015**			**2016**		
	Target	**Transfers**	**%**	**Target**	**Transfers (up to June 2016)**	**%**
Western	18,960	15,785	83%	17,568	9,904	56%
Central	3,555	2,997	84%	3,294	1,845	56%
Southern	3,555	2,883	81%	3,294	1,814	55%
Northern	1,975	1,592	81%	1,830	1,007	55%
North Western.	3,555	3,035	85%	3,294	1,881	57%
North Central	1,975	1,618	82%	1,830	1,048	57%
Uva	1,975	1,645	83%	1,830	1,042	57%
Sabaragamuwa	1,975	1,314	67%	1,830	829	45%
Eastern	1,975	1,643	83%	1,830	1,041	57%
Total	**39,500**	**32,513**		**36,600**	**20,411**	

Source: Provincial Councils

It is observed that in 2015 the revenue share of the provinces transferred by the General Treasury is lower than the target (Table 2). This requires the attention of the General Treasury.

4.2 Revenue Collected from Devolved Sources

Provincial revenue is collected through tax revenue and non-tax revenue as listed in 36.01 to 36.20 in the Ninth Schedule of the Thirteenth Amendment to the Constitution. The main sources of provincial revenue include Motor Vehicle License Fees, Excise Duty, Stamp Duty and Court Fines. The Stamp Duty and Court Fines collected by the provinces are transferred to the Local Authorities. (Amounts collected through the main sources of provincial revenue for 2015 are given in **Annex IV**)

Revenue collected by devolved sources up to June 2016 is given below in Table 3. The Stamp Duty, as a whole constitutes the highest revenue source followed by Motor Vehicle Revenue license Fees.

Table 3: Revenue Collected by Devolved Sources (Up to June) – 2016*

(Rs. '000)

Province	Target Including SD & CF 2016	Revenue Collected by Devolved Source						Total
		BTT*	Motor Vehicle Revenue license Fees	Excise Duty	Other**	Stamp Duty	Court Fines	
Western	18,000,000	11,470	1,770,400	335,140	826,580	7,460,550	325,190	10,729,330
Central	2,750,000	3,100	389,290	162,066	197,448	863,639	39,482	1,655,024
Southern	2,839,700	919	500,223	93,858	157,007	789,962	91,397	1,633,366
Northern	410,300	-	116,318	37,413	90,111	121,741	41,326	406,909
North Western	3,070,000	2,047	560,994	63,441	184,937	832,000	138,345	1,781,763
North Central	1,145,000	597	249,566	40,053	189,508	66,930	95,856	642,510
Uva	855,000	732	177,194	35,665	160,147	151,838	54,977	580,553
Sabaragamuwa	1,390,000	-	245,141	37,477	148,529	396	71,092	502,635
Eastern	940,000	-	190,917	65,629	115,143	208,550	40,698	620,937
Total	**31,400,000**	**18,865**	**4,200,042**	**870,741**	**2,069,410**	**10,495,607**	**898,362**	**18,553,028**

Source: Monthly Revenue Reports of provincial councils – 2016

**** Collection of due BTT up to 2010***

*****Others include rents, interests, examination fees, sale of capital assets, betting tax etc.***

4.3 Revenue Forecast for 2017

Setting revenue targets for the provinces is based on two main sources of revenue viz. transfers of Government revenue and the target for devolved revenue sources. The revenue forecast under the above two sources is deducted from the assessed recurrent needs of the provinces.

The Finance Commission consults the General Treasury and provincial authorities in setting the revenue targets.

4.3.1 Transfer of Government Revenue - 2017

The annual amounts to be transferred to all provinces are decided by the General Treasury in terms of the Fiscal Policy Circular No: 01/2010 of 29.12.2010. Transfers of Government revenue to the provinces for 2017 (Table 4) are based on estimates given by the Department of Fiscal Policy.

Table 4: Estimated Transfers of Government Revenue to the Provinces - 2017

(Rs. '000)

Province	% of Provincial share of FC Forecast	Transfers
Western	48	22,080,000
Central	9	4,140,000
Southern	9	4,140,000
Northern	5	2,300,000
North Western	9	4,140,000
North Central	5	2,300,000
Uva	5	2,300,000
Sabaragamuwa	5	2,300,000
Eastern	5	2,300,000
Total	**100**	**46,000,000***

Source: General Treasury-Dept. of Fiscal Policy

4.3.2. Targets for Devolved Revenue Sources - 2017

The forecast revenue collection for 2017 including stamp duty and court fines is Rs.39, 322 million. The forecast revenue for 2017 excluding stamp duty and court fines is Rs.16, 319 million. Details of revenue forecast for 2017 are given in Table 5.

Table 5: Devolved Revenue Forecast for 2017

(Rs'000)

Province	Revenue Forecast Excluding Stamp Duty and Court Fines			Revenue Forecast including Stamp Duty and Court Fines		
	Provincial Estimates	Finance Commission Forecast	% of Provincial share of Finance Commission Forecast	Provincial Estimates	Finance Commission Forecast	% of Provincial share of Finance Commission Forecast
Western	6,444,320	7,500,000	46	19,782,320	22,800,000	58
Central	1,615,000	1,629,000	10	2,965,000	3,314,000	8
Southern	1,305,000	1,500,000	9	2,838,000	3,175,000	8
Northern	484,000	545,000	3	1,002,000	1,068,000	3
North western	1,685,500	1,698,500	10	3,535,500	3,648,500	9
North Central	932,550	936,000	6	1,242,550	1,251,000	3
Uva	669,350	760,000	5	849,350	1,140,000	3
Sab.	1,045,900	1,050,000	6	1,687,900	1,750,000	4
Eastern	569,000	700,000	4	950,000	1,175,000	3
Total	**14,750,620**	**16,318,500**	**100**	**34,852,620**	**39,321,500**	**100**

Source: Provincial Budget Estimates 2017 and Finance Commission

The forecast amount of stamp duty and court fines to be transferred to the local authorities from the total revenue for 2017 is Rs 23,003 million. The provincial breakdown of revenue transfers to local authorities is given in **Annex V.**

5. Assessment of Provincial Capital and Recurrent Needs

The Finance Commission adopts a comprehensive process of assessment of provincial expenditure needs using criteria included in the budget guidelines.

5.1 Assessment of Capital Needs

The Finance Commission issued guidelines in relation to provincial capital and recurrent expenditure for 2017 in March 2016. To strengthen the process, the Commission prepared a check list to be used in the preparation of provincial capital needs. With regard to annual capital needs, due attention was paid to the following matters,

- Development policy of the Government.
- The impact of special development programmes at sub-national level implemented by the Government.
- Achievement of the Sustainable Development Goals (SDGs)
- Optimum utilization of physical and human recourses in the provinces.
- Adoption of PPP approach for commercially viable projects.
- Reduction of inter and intra-regional disparities in development.
- Readiness in project implementation and their feasibility.
- Circulars issued by the Finance Commission.

The new arrangements of assessing capital needs, unlike previously, has enabled the Finance Commission to determine the provincial funds in a more effective and rational manner. As and when the capital needs of the provinces for 2017 are received, the Commission reviewed submissions made by each province, with due reference to the Provincial Medium-Term Development Plans, past performance, capacity of provinces, identified priority sectors, the Budget Call – 2017 etc., and forwarded the assessments of the Commission on provincial needs-2017 to the General Treasury.

5.2 Assessment of Recurrent Needs

In order to facilitate the developmental process of the provinces, the Commission recommends the required provisions under recurrent budget by way of a Block Grant.

The recurrent expenditure mainly consists of Personal Emoluments (PE) and Other Recurrent Expenditure (ORE). The PE includes salaries and wages, overtime, holiday payments and other allowances. The ORE comprises travelling expenses, supplies, maintenance, contractual services, transfers to other agencies, grants, subsidies, interest payments etc. In the assessment of provincial PE, approved cadre by the Department of Management Services, living cadre, vacancies , attachment by line ministries, local government transfers and the relevant government circulars are given due attention. In assessing the ORE, expansion of the cadre and services, salary revisions, fluctuation of prices and relevant circulars are given required consideration.

5.3 Capital and Recurrent Needs submitted by the Provinces for 2017

In response to the letter dated 21.03.2016 of the Finance Commission addressed all Chief Secretaries of the provinces on Annual Provincial Capital and Recurrent Needs – 2017; provincial requests have been submitted to the Commission. The details are given in Table 6.

Table 6: Provincial Requests on Capital and Recurrent Needs - 2017

(Rs. mn.)

Province	Capital	Recurrent *	Total
Western	7,076	43,553	50,629
Central	17,753	33,604	51,357
Southern	11,088	29,066	40,154
Northern	10,672	23,198	33,870
North Western	8,606	30,167	38,773
North Central	10,381	20,088	30,469
Uva	3,420	21,247	24,667
Sabaragamuwa	6,007	25,341	31,348
Eastern	10,240	23,037	33,277
Total	**85,243**	**249,301**	**334,544**

Source: Provincial Request - 2017

Note: * This amount has been calculated by deducting the devolved revenue transfers.

The total capital and recurrent needs requested by the provinces is Rs 85,243 million and Rs. 249, 301 million respectively. Therefore the total request of funds for 2017 Rs. 334,544 million.

5.4 Apportionment of Provincial Capital and Recurrent Funds.

The fund distribution among provinces has never proved to be simple. Generally, based on the provincial needs on capital and recurrent expenditure, a series of discussions are held between the General Treasury and the Finance Commission to arrive at a common agreement on bulk amount to be apportioned among the provinces. The distribution of "Allocable Amount" amongst provinces has been made on the basis of recognized criteria.

An improved statistical formula has been used by the Commission in apportioning capital funds among the provinces in 2017 in a rational manner. The Department of Census and Statistics has given technical assistance to develop the formula at the request of the Finance Commission.

The methodology to be used for apportioning capital funds among the provinces under PSDG and CBG is based on a Multivariate Statistical Technique called "Principal Component Analysis". In the formula, the following socio – economic indicators and variables have been taken into account.

- Population
- Provincial GDP
- Poverty Head Count Ratio

- Median per-capita income
- Persons per medical officer
- Number of candidates qualified for universities in Science Stream

According to the formula the following province-wise percentages have been used to allocate capital funds (PSDG and CBG) among the provinces in 2017 **(**Table 7).

Table 7: Percentages of allocation for Capital Funds (PSDG and CBG) among the provinces for the year of 2017.

Province	Index	Allocation %
Western	0.58631	**6.36**
Central	0.89621	**9.72**
Southern	0.89543	**9.71**
Northern	1.27113	**13.78**
North Western	0.94187	**10.21**
North Central	1.10997	**12.04**
Uva	1.29017	**13.99**
Sabaragamuwa	1.0471	**11.35**
Eastern	1.18388	**12.84**

Source: Finance Commission

Selected variables for the fund allocating formula are given in the **Annex VI.**

After assessing the capital needs requested by the provinces, the Finance Commission determined respective needs of the provinces on a fair and rational manner using the provincial percentages of allocation given in the Table 7.

The break- down of assessed provincial capital needs for 2017 is given in Table 8.

Table 8: Assessed Provincial Capital Needs Assessment –2017

(Rs. mn.)

Province	Needs Assessment – 2017	
	PSDG	CBG
Western	2,126.28	318.00
Central	3,249.59	486.00
Southern	3,246.25	485.50
Northern	4,606.93	689.00
North Western	3,413.41	510.50
North Central	4,025.21	602.00
Uva	4,677.14	699.50
Sabaragamuwa	3,794.53	567.50
Eastern	4,292.67	642.00
Total	**33,432.00**	**5000.00**

Source: Finance Commission

The assessment of the provincial recurrent needs made by the Finance Commission is given in the Table 9. In the assessment of Block Grant, estimated revenue of the provinces was deducted from the total provincial recurrent expenditure.

Table 9: Assessed Provincial Block Grant for 2017

(Rs.'000)

Province	Total Recurrent Expenditure	Rev. Target Excluding Stamp Duty and Court Fines by Prov. Councils	Estimated Transfers of Government Revenue to the Provinces	Total Block Grant Assessed
Western	49,000,167	7,500,000	22,080,000	19,420,167
Central	33,020,053	1,629,000	4,140,000	27,251,053
Southern	30,026,668	1,500,000	4,140,000	24,386,668
Northern	22,439,232	545,000	2,300,000	19,594,232
North Western	32,494,204	1,698,500	4,140,000	26,655,704
North Central	20,517,475	936,000	2,300,000	17,281,475
Uva	21,764,448	760,000	2,300,000	18,704,448
Sabaragamuwa	25,901,712	1,050,000	2,300,000	22,551,712
Eastern	24,059,421	700,000	2,300,000	21,059,421
Total	**259,223,380**	**16,318,500**	**46,000,000**	**196,904,880**

Source: Finance Commission

6. Issues Ahead

Though the Finance Commission has adopted an improved allocation formula in 2016, the Commission was of the view that there still remains room for further improving and refinement of the formula. So that the apportionment of funds for the year 2017 can be made more realistic, futuristic and adoptable to the growing needs of the provinces. Currently, there is a dearth of information on provinces and districts. However, with the establishment of a sound needs assessment and a Management Information System (MIS), the issues of fiscal decentralization will be addressed in a more pragmatic manner. The Finance Commission is already working with the provinces for exploring ways and means of acquiring more data on actual expenditures, receipts, revenue potential, development indictors and other indicators for determining critical aspects of fiscal needs of provinces in order that future allocations would encompass all appropriate indicators of expenditures of the provinces. In the wake of the significant developments in the country, there is also need for a thorough study on exploring data for determining bench marks such as tax collection, backwardness, and adequate information for district based allocation. Recently, the Finance Commission has conducted training sessions and workshops for guiding the provincial officers on preparation of their budgets under ZBB.

6.1 Internal Revenue Generation

In the recent past, there has been no systematic approach to encourage and capacitate the provinces and the local government institutions for effective generation of their potential revenue and this has led to creating a severe dependency syndrome. The provinces and local authorities need to lessen the grants-dependency syndrome and ensure that they make efforts to generate potential revenue to the maximum possible extent. The Finance Commission has taken some initiatives to encourage revenue generation by re-introducing the Matching Grant.

6.2 Overstretching

The state coffers have been overstretching for a considerable period due to excessive and unmet demands of the provinces and local authorities. This has heightened further by the Government's deliberate policy of undertaking projects and programs which are purely provincial in nature under the provincial list in the 13th Amendment to the Constitution.

6.3 Prevention of Duplication

It is observed that, duplication of some of the activities occurs due to allocation of resources by national level institutions without consulting the relevant provincial authorities. There is a need for proper co-ordination in this regard to avoid duplication and improve financial discipline.

6.4 Frequent Requests for Changes

It is observed that all provinces have the practice of revising projects and activities contained in their annual development plan throughout the financial year. This indicates that the provinces do not make proper needs assessment in preparation their annual plans. Sometimes political factors are also attributable for such changes. This practice should be avoided by the provinces since they are obliged to adopt ZBB approach which is geared to monitoring activities of each project since the beginning of each financial year.

6.5 Need to improve Governance and Accountability

The Commission has identified the need for improving of Governance and Accountability and has emphasized the importance of exercising economy, efficiency and effectiveness in using scares resources.

Every effort should be made at provincial level to introduce financial discipline for effective utilization of funds. The Finance Commission has already taken some initiatives in this regard by advocating the importance of assets management and improving governance and accountability.

7. Conclusion

The Vision of the National Government of Consensus is to graduate the Sri Lankan economy towards "Upper Middle Income" states by 2020. In achieving this vision, the Government adopts an economic strategy based on "Social Competitive Market", under which the economic benefits of competition to promote efficiency in the use of resources are combined with action to promote social equity. This whole approach focuses on five goals, namely;

- Generating one million jobs
- Enhancing income levels of the people
- Developing rural economies
- Empowering middle class
- Ensuring land ownership in rural areas

Achieving balanced regional development in the country is one of the policy objectives of the Government. In this regard, several regional development initiatives have been identified by the Government for improving regional economies. Megapolis Development, specific economic zones, village development programmes and urban renewal programmes are salient among them. At the same time, measures have been taken to double the capital funds allocated to provinces in 2016, giving particular attention to education and health sectors.

In spite of the fact that "achieving balanced regional development in the country" is the main mandate of the Finance Commission, it is observed that a considerable progress in this direction has not been made the major reason being the capital funds allocated to the provinces constitute only 10% of the total development oriented budget of the country. However, it is noteworthy that even with limited funds available, the provincial contribution to GDP at national level has changed somewhat in favour of lagging provinces, namely Northern, Eastern, North Central and Uva over the past two decades. During the last fifteen year period, the contribution of the Western Province to the national GDP has decreased from 49% to 41%, and thereby some lagging provinces have been able to increase their respective shares in the range of 2% to 4%. **(Annex VII)**

As far as the variations of socio-economic development are concerned, all provinces have shown a slight progress despite the fact that some isolated geographical pockets suffer from severe drawbacks in relation to living standards of the people. Other indicators like poverty head count ratio, expenditure on non-food items, pass rates of students at GCE O/L and A/L examinations, low-birth weight, availability of safe drinking water and improved provincial road network, in all provinces have registered a sizeable progress during the recent past. In terms of the Prosperity Index and the Millennium Development Goals, almost all provinces have shown positive results even though there are inter and intra-provincial disparities in living standards of the people.

The government's financial and socio-economic policy is based on carefully determined interconnected pillars, such as sustainable growth, fair distribution of income, achieving the Upper-Middle Income Status of the country and together they will maintain the country's prosperity and wellbeing.

It can be concluded that in realizing the Vision of the Government, provinces are required to play a vital role in improving their respective economies to be on par with the national level. In this effort, provincial authorities should be committed to innovative solutions in designing their development strategies and encourage the private sector to be an active partner of the provincial development process. With regard to the latter, the role of the provincial councils is mainly to facilitate the process through creating a conducive environment for private sector investment. In this context, provinces, among other matters, should encourage PPP and make use of the incentives granted by the Government and their own infrastructure with respect to promoting investment expenditure in small and medium sectors.

8. Recommendations for Better Performance of the Provinces

A devolved system of Government with the establishment of Provincial Councils in 1987 envisaged decentralization of decision making process to the periphery and minimize regional variations in development. The expenditure pattern of the provinces shows that almost 80% of the total provincial budget is in respect of recurrent needs and the remainder is for capital needs. At national level this ratio is 75:25. However, it is worthwhile to recognize that a major portion of the recurrent expenditure is for maintenance of the education and health sectors, and the overtime bill in the health sector seems excessive. This needs to be controlled. On the other hand, the capital expenditure of the provinces represents around 10 % of the total capital budget of the country excluding the sectors of defence and general administration expenses.

Public expenditure of Sri Lanka substantially grows faster than the economy in recent years, while tax revenue, like economic growth, has consistently been lower than the multiyear projections. The other notable factor is that the required funds for development needs of the Government sector are mainly obtained through external sources by way of loans and other assistance provided by funding agencies and development bonds issued in the market. All these sources have a funding cost. Therefore all spending units should pay serious attention to the effective use of budgetary allocations, giving due attention on the concepts of "value for money" and "cost effectiveness", and there should be a proper co-ordination and integration of all resources made available to provinces, avoiding duplication and wastage.

In this context, the provincial authorities are required to give due consideration to the following in identifying the needs and preparing plans with respect to both capital and recurrent expenditure.

i. To carry out a resource mapping exercise in each province.
ii. To rationalize provincial expenditure with a view to achieving optimum result using Key Performance Indicators
iii. To upgrading the infrastructure which facilitates the private investors
iv. To the extent possible, private investments need to be promoted for the projects which are commercially and economically feasible
v. To direct Local Authorities to improve their service delivery using novel approaches like PPP and joint ventures.
vi. To channel public funds to improve human recourses development, ensuring better service delivery, based on a sound human resource development plan.
vii. To tap the advantages from anchor projects implemented by the Government, in close proximity.
viii. To pay due attention to the incentives introduced by the Budget - 2016, and measures be taken to promote SME sector.
ix. To improve devolved revenue base to expand the provincial revenues and to reduce the burden on national budget.
x. To adopt the ZBB Approach at the outset of the budgetary process, to ensure effective utilization of funds avoiding possible duplication and overlapping.
xi. To allocate adequate funds to productive sectors with great potential of increasing value addition and creating employment opportunities.

xii. To strengthen monitoring mechanism at sub-national level to ensure productive utilization of all resources, financial, physical and human.

xiii. To minimize the proliferation of provincial level agencies avoiding the overlapping and duplication of activities.

xiv. To enhance potential revenue capacity, particularly at Local Authority level

xv. To rationalize the reimbursement of salaries of the local authorities taking into account their revenue potential and any savings thereby be channelled for developmental work.

The government should pay due attention to the above matters and make necessary policy and regulatory changes within a definitive action plan. This will facilitate the development efforts of the provinces. It is also required to give recognition for clear demarcation of the subjects between the Provincial List and Concurrent List to ensure horizontal and vertical coordination among the institutions at national and sub-national levels, with respect to planning and implementation.

The Provincial Councils, should, on their part, make every effort to improve their governance mechanism to strengthen their Financial Management and Accountability through Capacity Building. A better co-ordination and co-operation between the Finance Commission and the Ministry of Provincial Councils and Local Government is also important and this will bring about more meaningful results.

9. The Way Forward

The constitutional mandate given to the Finance Commission is to facilitate achieving balanced regional development in the country within the devolved system of Government introduced in 1987. The experiences during the last three decades, has shown that the Finance Commission alone would not be in a position to realize the mandatory objective effectively without a meaningful support of stakeholders, namely the Government, Provincial Councils, Local Authorities, private sector and the civil society.

Against this background it is imperative that sound policy directives be considered. This will entail:

(i) Entrusting the responsibility of implementation of the projects and programs under the Provincial List to the provinces, as appropriate.

(ii) Revising the subjects under the Concurrence List for reducing the duplication and overlapping at provincial level.

(iii) Increasing the financial allocations to the Provinces under devolved subjects paving the way for optimal use of regional resources.

(iv) Promoting private investments to lagging regions through appropriate incentives.

(v) Formulating sound development plans to addressing the real needs of the people by considering the resource availability at provincial level.

(vi) Strengthening the horizontal and vertical coordination among the Government institutions and sub-national agencies to ensure smooth functioning of development process at three tiers of governance.

(vii) Undertaking an optimum cadre assessment

(viii) Implementing a proper deployment policy for existing cadre to reduce the heavy burden on recurrent budget.

(ix) Establishing a harmonized payment system on allowances and other payments at provincial level and national level.

The Commission is currently exploring the possibility of promoting Public-Private Partnership (PPP) at provincial level with the assistance of the Asia Foundation. In this regard, workshops are being organized to study the possible issues and implications in introducing PPP scheme.

Uditha H.Palihakkara

Appointed Member and Chairman

Indrajit Coomaraswamy

Ex-Officio Member and the Governor of the Central Bank

R.H.S. Samaratunga

Ex-Officio Member and the Secretary to the Treasury

V. Kanagasabapathy

Appointed Member

H.M. Zafrullah

Appointed Member

Annex I -Allocation and Release of Criteria Based Grant 2012 – 2016

(Rs.mn.)

Province	2012		2013		2014		2015		2016	
	Allo.	Release	Allo.	Release	Allo.	Release	Allo	Release *	Allo.	Release up to August
Western	427	180	370	370	475	292.5	525	2641	460	50
Central	400	218	321	192.6	430	129	500	2575	423	26
Southern	347	189	295	177	380	255	385	2211	413	69
Northern	294	161	195	195	280	280	400	2399	475	40
North Western	320	175	270	162	350	290	425	2151	375	10
North Central	293	1420	230	742	350	192.5	375	2658	400	100
Uva	320	175	240	144	330	179	375	2229	475	115
Sabaragamuwa	357	195	252	151	335	335	400	2966	514	124
Eastern	267	146	217	130	340	227	400	1830	465	45
Total	**3,025**	**2,858**	**2,390**	**2,264**	**3,270**	**2,180**	**3785**	**21660**	**4000**	**579**

Source: Finance Commission and General Treasury
****Including both PSDG and CBG***

Annex II -Allocation and Release of Province Specific Development Grant 2012 - 2016

(Rs.mn.)

Province	2012		2013		2014		2015		2016	
	Allo.	Release	Allo.	Release	Allo.	Release	Allo.	Release *	Allo.	Release up to August
Western	1,990	491	1,701	1,062	2,280	1,078	2,598	2641	3640	300
Central	3,013	856.88	3,254	889	3,497	1,264	3,879	2575	4751	303
Southern	1,818	813.85	1,634	785	1,715	1,049	3,997	2211	3976	374
Northern	3,568	947.37	3,692.7	836	5,551	1,328	5,038	2399	8343	400
North Western	1,836	816.85	1,867	765	2,120	1,933	2,500	2151	4334	305
North Central	2,806.5	717.72	2,139.5	741	3,043	1,054	2,230	2658	4065	100
Uva	3,117	805.81	2,596	838	3,543	2,282	3,361	2229	3570	200
Sabaragamuwa	2,648	709.66	2,765	795	4,245	1,684	4,360	2966	4061	367
Eastern	3,917	1,108.25	4,915	1,062	3,206	1,595	2,469	1830	4267	160
Total	**24,713.5**	**7,267.39**	**24,564.2**	**7,773**	**29,200**	**13,267**	**30,432**	**21660**	**41007**	**2509**

Source: Finance Commission and General Treasury
Note: Including Development Projects
****Including both PSDG and CBG***

Annex III -Allocation and Release of Block Grant 2012– 2016

(Rs.mn.)

Province	2012		2013		2014		2015		2016	
	Allo.	**Release**	**Allo.**	**Release**	**Allo.**	**Release**	**Allo.**	**Release**	**Allo.**	**Release up to July 2016**
Western	9,011	8,894	8,502	9,691	11,699	11,699	18,842	18,842	21,744	9,240
Central	13,76	13,049	14,864	15,687	17,917	17,917	23,542	23,542	23,375	12,033
Southern	11,803	11,907	12,908	13,586	15,785	15,785	21,459	21,459	20,508	13,483
Northern	8,557	8,500	10,075	10,795	12,642	12,642	16,768	16,268	16,174	10,052
North Western	12,651	11,921	14,118	14,846	16,413	16,413	21,705	21,634	20,798	12,796
North Central	7,005	6,776	7,346	7,765	10,594	10,594	13,616	13,616	12,839	8,008
Uva	9,459	9,032	10,263	10,758	12,500	12,500	16,482	16,237	16,250	9,863
Sabaragamuwa	11,243	10,737	13,088	13,606	14,809	14,809	18,410	18,410	18,219	10,689
Eastern	11,385	10,737	11,635	12,066	13,784	13,784	17,530	17,475	16,511	10,633
Total	**81,114**	**91,552**	**102,800**	**108,801**	**126,143**	**126,143**	**168,354**	**167,483**	**166,418**	**96,797**

Source: Finance Commission and General Treasury

Annex IV -Provincial Revenue Collection by Sources – 2015

(Rs. '000)

Province	Target Including Stamp Duty & Court Fines 2015	Revenue Collected form Devolved Sources						Total
		BTT *	**Motor Vehicle Revenue license Fees**	**Excise Duty**	**Other ****	**Stamp Duty**	**Court Fines**	
Western	13,675,000	41,700	3,752,050	722,640	1,588,410	12,172,360	746,520	19,023,680
Central	2,090,000	8,061	806,045	415,940	368,788	1,357,856	73,144	3,029,834
Southern	2,372,000	2,538	945,366	170,811	391,080	1,499,959	21,284	3,031,038
Northern	348,000	-	282,581	-	140,119	192,375	24,307	639,382
North Western	2,620,000	766	1,131,128	163,545	293,502	1,401,741	358,065	3,348,746
North Central	960,000	8,522	487,358	57,934	337,837	116,773	192,131	1,200,556
Uva	630,000	2,335	346,774	126,013	310,180	225,518	71,165	1,081,985
Sabaragamuwa	1,065,000	384,333	625,786	112,730	248,254	568,507	127,300	2,066,909
Eastern	740,000	-	334,776	50,244	194,769	318,743	163,415	1,061,947
Total	**24,500,000**	**448,255**	**8,711,865**	**1,819,857**	**3,872,939**	**17,853,832**	**1,777,330**	**34,484,078**

Source: Monthly Revenue Reports of provincial councils – 2015
****Collection of due BTT up to 2010***
*****Others include rents, interests, examination fees, sale of capital assets, betting tax etc.***

Annex V -Stamp Duty and Court Fines to be transferred to the Local Authorities for 2017

Province	Stamp Duty (*Rs'000*)	Court Fines (*Rs'000*)	Total (*Rs'000*)	% of Provincial share of FC Forecast
Western	14,500,000	800,000	15,300,000	39
Central	1,600,000	85,000	1,685,000	4
Southern	1,450,000	225,000	1,675,000	11
Northern	458,000	65,000	523,000	3
North Western	1,600,000	350,000	1,950,000	17
North Central	125,000	190,000	315,000	9
Uva	280,000	100,000	380,000	5
Sabaragamuwa	570,000	130,000	700,000	6
Eastern	375,000	100,000	475,000	5
Total	**20,958,000**	**2,045,000**	**23,003,000**	**100**

Source: Finance Commission

Annex VI - Selected variables for the fund allocating formula – 2017

Province	Population - 2015 (*'000*)	Provincial GDP -2014 (*Rs. mn.*)	Poverty Head Count Ratio 2012/13	Median Per Capita Income 2012/13 (*Rs.*)	Persons per Medical Officer 2013	Candidates Qualified for Universities - Science Stream - Province Wise % -2015
Western	5,979	4,320	2.0	10,567	797.0	29.6
Central	2,658	1,073	6.6	7,150	953.8	11.6
Southern	2,556	1,112	7.7	7,624	1271.9	17.9
Northern	1,094	367	10.9	5,540	1102.8	5.2
North Western	2,448	1,100	6.0	7,927	1510.7	10.4
North Central	1,312	523	7.3	7,824	1532.9	4.6
Uva	1,316	511	15.4	6,110	1470.3	5.4
Sabaragamuwa	1,988	689	8.8	7,229	1476.9	9.8
Eastern	1,615	597	11.0	5,385	1178.0	5.6
Sri Lanka	**20,966**	**10,292**	**6.7**	**7,881**	**1,081**	**100**

Source: Department of Census and Statistics, Central Bank, Ministry of Health , Nutrition and Indigenous Medicine

Annex VII - Provincial share to the GDP at Current Prices , 2006- 2015

(Rs.mn)

Province	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Western	1,472,060	1,732,279	2,003,055	2,216,346	2,512,908	2,905,159	3,243,854	3,643,180	4,358,000	4,611,000
Central	259,829	319,095	430,579	473,416	562,744	644,159	775,580	959,694	1,076,000	1,152,000
Southern	292,498	374,105	464,723	509,053	598,976	726,996	834,287	954,568	1,097,000	1,160,000
Nothern	81,978	104,202	139,001	155,828	189,740	241,200	277,828	311,468	349,000	391,000
North Western	267,102	342,653	438,606	466,041	534,831	652,136	760,148	542,845	1,155,000	1,224,000
North Central	117,848	140,391	206,749	221,294	266,954	300,042	379,243	886,819	542,000	607,000
Uva	125,410	160,747	200,102	219,293	253,177	292,463	361,975	438,862	557,000	587,000
Sabaragamuwa	178,411	226,106	281,431	294,659	350,806	406,566	467,238	409,979	711,000	781,000
Eastern	143,523	177,863	246,436	279,363	333,969	375,288	478,401	526,185	605,000	671,000
Total	**2,938,659**	**3,577,441**	**4,410,682**	**4,835,293**	**5,604,104**	**6,544,009**	**7,578,554**	**8,673,600**	**10,450,000**	**11,184,015**

Source: Central Bank of Sri Lanka