



THE FINANCE COMMISSION

RECOMMENDATIONS TO H.E. THE PRESIDENT FOR THE YEAR 2021

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

September 2020



මුදල් කොමිෂන් සභාව

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நிதி ஆணைக்குழு

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FINANCE COMMISSION

(Established under Article 154 "R" of the Constitution)

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Your No. }

දිනය } 30.09.2020
திகதி }
Date }

His Excellency Gotabaya Rajapaksa
President of the Democratic Socialist Republic of Sri Lanka
Presidential Secretariat
Colombo 01

Your Excellency,

In terms of Article 154R (4) of the Constitution of the Democratic Socialist Republic of Sri Lanka, the Finance Commission is required to make Recommendations as to "the principles on which such funds are granted annually by the Government for the use of Provinces, should be apportioned between the various Provinces".

I hereby submit the Recommendations of the Finance Commission in respect of the apportionment of the funds to be allocated from the Annual Budget for the use of the Provinces during the year 2021.

Yours respectfully,

Uditha H. Palihakkara
Chairman
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Executive Summary

The Finance Commission was established in 1987 under Article 154 R of the Thirteenth Amendment to the Constitution of the Democratic Socialist Republic of Sri Lanka. In terms of the Constitutional mandate, the Finance Commission makes Recommendations to the Government on allocation of adequate funds from the Annual Budget to meet the needs of the Provinces.

Accordingly, with the guidelines of the Finance Commission, the Provincial Councils prepare the annual needs and submit their fund requirements seeking Government grant to Provincial Councils from National Budget. The Finance Commission had a series of meetings with Provincial Authorities and had consultative discussions with other stakeholders and experts in relevant areas. In addition, the Finance Commission invited the Chief Secretaries and other relevant officials from each Provincial Council to finalize the annual need assessment with the participation of the Department of National Budget and the Department of National Planning.

The Finance Commission having assessed the needs now submits its recommendations to H. E. the President. The recommendations include: the Government Grants to Provinces from the National Budget along with the basis and principles apportioning funds among Provinces in a rational manner, and the Policy Recommendations to achieve balanced regional development and for effective implementation of public investment programmes and service delivery at sub national level.

In this regard, the Finance Commission has taken note of directions given by the new Government, particularly the decision of the Cabinet of Ministers dated 19th February 2020 on the Cabinet Memorandum submitted by H. E. the President along with the Recommendations of the Finance Commission for the year 2020.

The Memorandum stated that the funding requirements of the Provincial Councils have been assessed considering the Government Development Policy Framework, Public Expenditure Management, Provincial Medium-term Development Plan and Performance in relation to the expenditure of the Provincial Councils. And also, the recommendations based on a statistical system in distribution of capital funds among the Provinces. H.E. the President brought the attention of the Cabinet of Ministers, referring the Cabinet Memorandum;

- the disparities and pronounced changes in prosperity in between Provinces,
- very low revenue generation compared with the recurrent expenditure,
- funds allocated to Provincial Councils are not found adequate,
- duplication in fund allocation in respect of the programmes implemented by Provincial Councils whilst allocation of funds has been made through the Line Ministries, as well
- further need assessment to be undertaken for sectors as improvement due to private sector contribution.

Also, H. E. the President indicated in his observations that;

- priority should appropriately be accorded to improve the Quality of Service Delivery rather than raising statistical figures,
- it is desirable the necessary actions to prevent duplication in the allocation of funds, and
- actions to raise the level of Provincial Revenue Generation and focus on developing new avenue of funds generation.

Fiscal Devolution and Balanced Development

The subject contents specified in the three lists as the Provincial Councils List, the Reserved List and the Concurrent List with shared responsibilities in the Ninth schedule to the Constitution. The public investment and service delivery at sub-national levels are performed by spending agencies under the Central Government and Provincial Councils including Local Authorities. The Finance Commission considers the balance regional development in line with the two important principles; the spatial distribution which share the benefit of development intervention to all, and the inclusiveness which considers the all related aspects and sustainable results.

When determining the status of Provinces in Sri Lanka based on socio economic indicators and performance, the Nine Provinces may be differentiated into three categories. The Western Province has always seen a distinct position which compared to all other Provinces in distance. The five Provinces; Uva, Sabaragamuwa, North Central, Eastern and Northern are mostly in the low position far below the national average. The other three Provinces; Central, North Western and Southern are at moderate level, but much below to Western Province.

Provincial Disparities

In spite of various strategies and programmes have been implemented by Government, aiming at balanced regional development, the country is still experiencing disparities, income inequalities at significant levels among the Provinces, as well as lagging areas within the Provinces. Intervention of public investment should have attention to the people in underserved areas within the Provinces to ensure comparable services.

Selected Socio-Economic Indicators of the Provinces

Provinces	Land Area 2018 (Sq.km.)	Mid-year Population 2018 (000)	Provincial Share of GDP 2018 (%)	Median Monthly Per Capita Income 2016 (Rs. Per person per HH)	Provincial Prosperity Index 2018	Human Capital Index (%)	No of University Admissions 2019	Un-employment Rate 2019 (%)	Poverty Head Count Ratio 2016
Western	3,593	6,129	38.5	14,400	1.301	62	8,432	3.1	1.7
Central	5,575	2,750	11.8	9,890	0.490	54	3,232	5.4	5.4
Southern	5,383	2,637	10.0	11,253	0.470	63	4,316	5.7	3.0
Northern	8,290	1,131	04.1	8,434	0.399	52	2,105	5.6	7.7
North Western	7,506	2,536	11.0	11,420	0.456	59	3,308	3.6	2.7
North Central	9,741	1,366	05.7	11,248	0.256	57	1,689	4.5	3.3
Uva	8,335	1,364	05.7	10,139	0.201	55	1,813	5.2	6.5
Sabaragamuwa	4,921	2,047	07.6	9,711	0.341	59	2,866	4.3	6.7
Eastern	9,361	1,710	05.6	8,261	0.168	51	2,340	6.0	7.3

Needs of the Provinces and Assessment

Provincial Councils prepare their annual needs and expenditure requirements of both capital and recurrent nature and submit them to the Finance Commission, seeking 'Government grants to Provincial Councils from the National Budget. The total expenditure requirements submitted by all the nine Provincial Councils are; for Provincial Specific Development Grant (capital) Rs. 133,205 million and for Block Grant (recurrent) Rs. 389,836 million for the year 2021.

The assessment of capital needs of each Province was done jointly by the Finance Commission, the Department of National Budget and the Department of National Planning with the participation of respective

Provincial Authorities considering the Sector Programme, Government directions, Budget constraints and development priorities in each Provincial Programme.

The assessment of recurrent needs of each Provincial Council is also made, jointly by the Finance Commission with the participation of the Department of National Budget and the respective Provincial Authorities considering, mainly the approved cadre and other expenditure required for each Provincial administrative structure.

The requirements of each Provincial Council were assessed giving due attention to the Government budget constraints, and concluded with Rs. 77,950 million under Capital Grant and Rs. 361,692 million under Block Grant (before deduction of estimated devolved revenue and revenue transfers which are not yet available to the Finance Commission).

Recommendations of Grants

The Finance Commission recommend the following Government grants to the Provincial Councils from the National Budget 2021.

- a. **Province Specific Development Grant (PSDG)** to finance capital nature development interventions with special attention to infrastructure and community development in 23 sectors under the devolved subjects in line with the Provincial Annual Development Programmes and the Medium-Term Development Plan of respective Provinces; totally a sum of Rs. 70,400 million.
- b. **Criteria Based Grant** for financing capital nature expenditure for reducing regional disparities to the Provincial Councils for their discretionary spending on development related activities within an agreed financing framework, amounting to a sum of Rs. 7,550 million.
- c. **Revenue Performance Grant** to Provincial Councils in order to improve their revenue performance. This small grant on annual incremental devolved revenue collections with discretionary power to use for capital related development activities amounting to Rs. 3,000 million.
- d. **Block Grant** to meet recurrent expenditure requirements of the Provincial Councils to sustain and improve the public service delivery including transfers to Local Authorities and maintenance of capital assets, amounting to Rs. 340,629 million after deduction of estimated devolved revenue of Rs. 21,062 million (the estimated transfers of Government revenue to Provincial Councils are not included as the relevant information is yet to be finalized by the Department of Fiscal Policy).

Limitations in making Recommendations

The Finance Commission recommends adequate funds to Provinces aiming at balanced regional development in line with the devolution structure. Provincial Councils receive capital funds for their service delivery in the forms of; *a)* grants from the National Budget, *b)* allocations from line Ministries and *c)* allocations of provincial component of special projects. However, it is noted that;

- the Finance Commission has to assess and recommend capital grants to Provincial Councils without the basis of total capital expenditure budget of the Government for ensuing year.
- the service delivery of the Provincial Councils in relation to devolved and concurrent subjects are financed through different sources of funds. The assessment of requirements and recommendations of capital grants to Provincial Councils are not the total needs of the Provincial Councils or the respective Provinces.
- although, the capital needs are assessed in a systematic manner and submitted for financing under capital funds, the Finance Commission could not consider the assessed amount, fully for recommendations in view of the budget constraints.

- a detailed need assessment is required addressing all relevant aspects with integrated planning mechanism including all sources of funds aiming at balanced and inclusive regional development.

Policy Recommendations

The recommendations of the Finance Commission include the policy recommendations to achieve balanced regional development in the country with effective implementation of the Public Investment Programme and service delivery at sub national level. The following recommendations are submitted in view of allocation of funds from the National Budget, need for balanced regional development, inter-agency coordination, devolved revenue generation and private sector participation.

- The expenditure budget allocation should adopt a sound service delivery system and allocate adequate funds to the Provincial Councils to meet the needs on service delivery in line with devolved functions and the shared responsibilities, creating Budget Heads as special expenditure units avoiding duplications in funds allocation.
- The line Ministries should earmark their allocations on development interventions in respect of concurrent subjects, in advance to prepare Provincial/District consolidated implementation programmes for the year, avoiding duplication of work and to maintain a balance. The Department of National Planning should ensure a balance in resource allocation to sub-national level recognizing spatial inequalities through a common framework with an integrated approach.
- A special capital grant to Provincial Councils for service delivery of Local Authorities and an amount for environmental protection activities could be considered from the National Budget.
- Provincial component of the special projects and national projects related to devolved subjects should be implemented through Provincial Councils with the sufficient budget allocations to Provincial Councils.
- Appropriate development interventions to underserved rural areas in lagging regions should be identified by the service delivery agencies for comparable services and for socio economic advancement in line with the balanced regional development within the Provinces.
- Revenue generation and new avenues of fund generation for Provincial Councils and Local Government should be recognized to reduce the dependency and pressures on Government finance by empowering the sub national bodies. The Government should allow the Provincial Councils to generate the income under the devolved revenue sources under the Constitution and transfer adequate amount from the Government collected revenue.
- Allocating funds to the sectors of Provincial Councils under the budget line of “regional development” undermine the service delivery requirements of Provincial Councils. Adequate provisions for health and education sectors should be included to Provincial Councils.
- Resource allocation through public investments should consider the possible private investments in relevant sectors and regions. It would be appropriate to assess possible private sector interventions in each sector and regions, prior to directing public investments.
- National and sub-national level agencies play a significant role in service delivery utilizing public finances received in different forms. A common framework with an integrated approach in planning, budgeting and reporting to be followed. It is imperative that an efficient Inter-Governmental Financial Relations with smooth financial resource flows and sound reporting systems, exist.
- Adoption of norm based budgeting and modern technology in education and health sectors should be strictly considered to reduce the mounting financial pressures of the National Budget, and improving effectiveness of service delivery.

01. Introduction

1.1 Background

The 13th Amendment to the Constitution and the Provincial Councils Act, No. 42 of 1987 provide the Governance Framework for the Provincial Councils. Compliance with the above framework along with other relevant Statutes, Financial Rules, Government Circulars, Guidelines and best practices are important constituents of governance.

The Provincial Councils are responsible for ensuring that their activities are conducted in accordance with the laws, rules and regulations of the Government and that public money is safeguarded and properly accounted for and used economically, efficiently and effectively. The Finance Commission provides the necessary support for the Provincial Councils in making recommendations to the Government for budgetary allocations.

1.2 Mandate of the Finance Commission

The Finance Commission was established by the Thirteenth Amendment to the Constitution of the Democratic Socialist Republic of Sri Lanka in 1987. The mandate of the Finance Commission as specified in Articles 154 R (3), (4) and (5) of the Constitution is as follows.

Article 154R (3) 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.

Article 154R (4) 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.

Article 154R (5) The Commission shall formulate such principles with the objective of achieving balanced regional development in the country, and shall accordingly take into account-

- a) the population of each Province;
- b) the per capita income of each Province;
- c) the need, progressively, to reduce social and economic disparities; and
- d) the need, progressively, to reduce the differences between the per capita income of each Province and the highest per capita income among the Provinces.

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

The main function of the Finance Commission is to make recommendations to the Government on allocation of adequate funds from the annual budget to meet the needs of the Provinces and to recommend the principles to the President as to how such funds should be apportioned between the nine Provinces, with the objective of achieving balanced regional development in the country in terms of the Article 154 R (5). In this process, the Finance Commission provides guidelines to the Provincial Councils for assessing Provincial needs.

Accordingly, the Finance Commission assesses the needs of the Provinces and recommends to the President the principles of apportioning funds between the Provinces.

The recommendations of the Finance Commission include: the budget recommendation with apportionment of funds among Provinces in a rational manner, provision of adequate funds under Government Grants to Provincial Councils and the policy recommendations to achieve balanced regional development in the country for higher socio- economic standards of the people.

As per Article 41 B (6) of the Constitution, the Commission shall be responsible and answerable to Parliament.

1.3 Global Scenario and the Situation of Sri Lanka

The global scenario is unpredictable and experiencing a synchronized slowdown. The International Monetary Fund has projected the global economy to contract by 4.9 % in 2020. The COVID-19 pandemic has led to a severe negative impact on the performance in the first half of 2020 in particular. The projected recovery is likely to be more gradual than the previous forecasts. According to the Asian Development Bank, the economic uncertainty that the COVID-19 pandemic has sparked, could cost the global economy by USD 2 - 4.1 trillion in 2020. Many Governments have stepped up their emergency funding lifelines to protect people, preserve jobs, and prevent bankruptcies.

In Sri Lanka, the slowdown of the economy and developments in the recent past has led to setbacks in many areas and required structural and sector/ institutional reforms. The new government has a vision and commitment in removing the obstacles and progress towards a prosperous economy.

At the beginning of the year, the Central Bank of Sri Lanka expected the Sri Lankan economy to grow by around 4.0 – 4.5% per annum in 2020, and this projection was revised downwards to 1.5% by the time of the publication of the Annual Report in April 2020. However, with the economic impact of the COVID 19 Pandemic, which has resulted in a contraction in the first half of the year, it will be extremely challenging to achieve even this downward revised growth projection. The expected Government spending is also uncertain. The healthcare expenditure and income support measures undertaken to fight the consequences of the pandemic, shutdown of airports and seaports for passenger traffic and movement of goods have affected key economic sectors. The socio-economic impact could be grave with the loss of income and livelihoods for a large segment of the society.

After the Presidential Election 2019, the Ministry of Finance issued directives on tax incentives to enhance economic activities in the country. The Central Bank has also facilitated further, through monetary policy to enhance the economic activities. Nevertheless, underlying structural deficiencies such as debt-repayment risk remains high as a result of drop in revenue and slowdown in economic activity.

The economy requires to be supported with public investments as per the Government policies and priorities to ensure service delivery at a reasonable level, with due regard to the fiscal constraints faced by the Government. In this regard, the Commission had consultations and discussions with the stakeholders at National and Provincial levels including Local Governments and also few experts to obtain their views and suggestions. In addition, a series of discussions were held with the Provincial Councils in assessing the needs of the Provinces. The Commission submits this report for the year 2021 based on the aforesaid situation.

1.4. Balanced Regional Development

In a regional development context of a country, i) the spatial distribution that share the benefit of development intervention, and ii) the inclusiveness in development programmes which consider projects and programmes to bring good and sustainable results, are two important factors.

Balanced regional development focuses the extension of the benefits of economic progress through various means, including widespread transmission of industries to different parts of the country, especially in less developed regions, expansion of the economy and rapid growth to achieve a better balance between national and regional development. As resources are limited, the advantages lie in those locations of the economy where returns are likely to be favorable, i.e., comparative advantage. Development investments and resources are applied over a wider area in a large number of locations, fostering greater spread of benefits. It will be possible to provide directions for a larger scale of development in the less developed regions through a long-term plan. Increase in national income and the balanced regional development are related to one another and the process is cumulative, and each stage determines the shape of socio-economic growth.

In practice, all regions cannot be treated equally for development when regional comparative advantages exist. However, the potential of each region is not identical, and each should be fully developed, rationally. The regional factors and features cannot be easily altered, since there are others which can be influenced by raising levels of education and skill, empowerment, technology on a larger scale. Thus, the national and sub-national level co-ordination (vertical) in planning, and stakeholders' level collaboration (horizontal) in implementation of an integrated development programme is important and essential for effectiveness and success in the regions. A common framework and practices are also required with a sound national policy intervention.

Generally, in determining the status of Provinces in Sri Lanka based on socio-economic indicators and performances, the nine Provinces may be differentiated into three categories. The Western Province has always been in a distinct position compared to all other Provinces in distance. Five Provinces viz. the Uva, North Central, Eastern, Northern and Sabragamuwa are mostly in the low positions far below the national average. The other three Provinces; the Central, North Western and Southern are at moderate levels, but much below the Western Province.

1.5. National Policy and Direction of New Government

a) Vistas of Prosperity and Splendor

This National Policy Framework of the Government, i.e. "Vistas of Prosperity and Splendor" constitutes 10 key policies aimed at achieving the fourfold outcome of a productive citizenry, a contented family, a disciplined and just society and a prosperous nation. The key policies prioritized in the framework gives due consideration to socio- economic, environmental and political dimensions as follows.

- Priority to National Security
- Friendly, Non-aligned Foreign Policy
- An Administration free from corruption
- New Constitution that fulfills the People's wishes
- Productive Citizenry and a vibrant Human Resource
- People Centric Economic Development
- Technology Based Society
- Development of Physical Resources
- Sustainable Environmental Management
- Disciplined, Law Abiding and Value Based Society

The new Government proposed to build a people-centric economy that will be fully owned by the people of the country aiming at strengthening the local economy and increased income.

b) Directions of the New Government

The Vision of the new Government and its recent announcements indicate reforms and restructuring in many areas aiming at better socio-economic performance in the country:

- Take measures to build a production economy protecting local farmers, local entrepreneurs and industrialists.
- Provisions of drinking water to the people across the country.
- Maintain adequate facilities in schools and motivate students to follow science and technical subjects. Also, importance given to pre-schools, education reforms, skills development and technical education.
- Maintain adequate resources and facilities in rural hospitals and eliminate discrepancies in the delivery of free health care services. Preserve and promote Ayurvedic and indigenous medical system.
- Rehabilitate the tanks and develop irrigation system across the country and adequate water during the cultivation.
- Create Job opportunities for youths contributing productively to the country in equal distribution for every Province. Promote self-employment and entrepreneurship in each industry.
- Establish an agriculture-based modern economy, value addition and exports.
- Development of urban and rural infrastructure facilities and housing.
- New approach based on technology in production sectors including methodical development of traditional industries.
- Efficient, speedy and convenient services to the public.

The Finance Commission adopts these directives in its assessment and recommendations in achieving balance regional development and well-being of the people in the country.

c) Recommendations - 2020 and Approval of the Cabinet of Ministers

On assumption of the new Government, the Recommendations of the Finance Commission - 2020 to H E the President was re-submitted to the Presidential Secretariat with the observations and concurrence of the two new ex-officio members who joined subsequently, and thereupon H. E. the President submitted a Memorandum to the Cabinet of Ministers along with the Recommendations of the Finance Commission on 18.02.2020.

The Memorandum stated that the funding requirements of the Provincial Councils have been assessed considering the Government Development Policy Framework, Public Expenditure Management, Provincial Medium-term Development Plan and Performance of the Provincial Councils in relation to the expenditure incurred by them. And also, the recommendations introduced a statistical system in distribution of capital funds among the Provinces.

H E the President has brought special attention of the Cabinet of Ministers on the Recommendations of the Finance Commission and highlighted the following.

- Though no great disparity is statistically recorded between the Provincial Councils, there are pronounced changes to be seen in the Prosperity Indicator.
- Government revenue generation is very low compared with the recurrent expenditure.
- Funds allocated to the Provincial Councils by the General Treasury are not adequate.

- There has been a duplication in allocating funds to Provincial Councils by the General Treasury in respect of programmes implemented by them, whilst allocation of funds has been made through the Line Ministries, as well.
- Further, the need assessment has to be undertaken for allocating funds for health sector as indicated an improvement due to private sector contribution.
- The highlighted matters in Provincial Audit Reports need attention of the relevant Governors, Chief Secretaries and relevant Authorities in the Provincial level.

Also, H E the President indicated in his observations the following.

- Priority should appropriately be accorded to improve the Quality of Service Delivery rather than raising statistical figures related to development works under way in the Provincial Councils.
- Initiation of necessary actions to prevent duplication in the allocation of funds is desirable.
- Actions to raise the level of Provincial Revenue Generation and that attention is focused on developing new avenue of funds generation.

The Cabinet of Ministers has granted approval for the Memorandum submitted by H.E. the President on 19.02.2020;

- to implement the recommendations submitted by the Finance Commission, and
- to present the said recommendations to Parliament in terms of Article 154 R (7) of the Constitution intimating that action is taken to implement the said recommendations.

02. National Budget and Government Grants to the Provincial Councils

2.1. Constitutional Provision on Fiscal Devolution

After the Thirteenth Amendment to the Constitution, there are three distinctive tiers of governance in Sri Lanka, i.e., the Central Government, Provincial Councils and Local Authorities. Accordingly, a devolved governance was established by demarcating the areas of legislative, executive and financial authority to be exercised by the Provincial Councils. The subject contents of powers are also specified in the three lists given in the Thirteenth Amendment, as the Provincial Councils List (powers devolved to the Provincial Councils), the Reserved List (powers of the Center), and the Concurrent List (subjects of shared responsibilities).

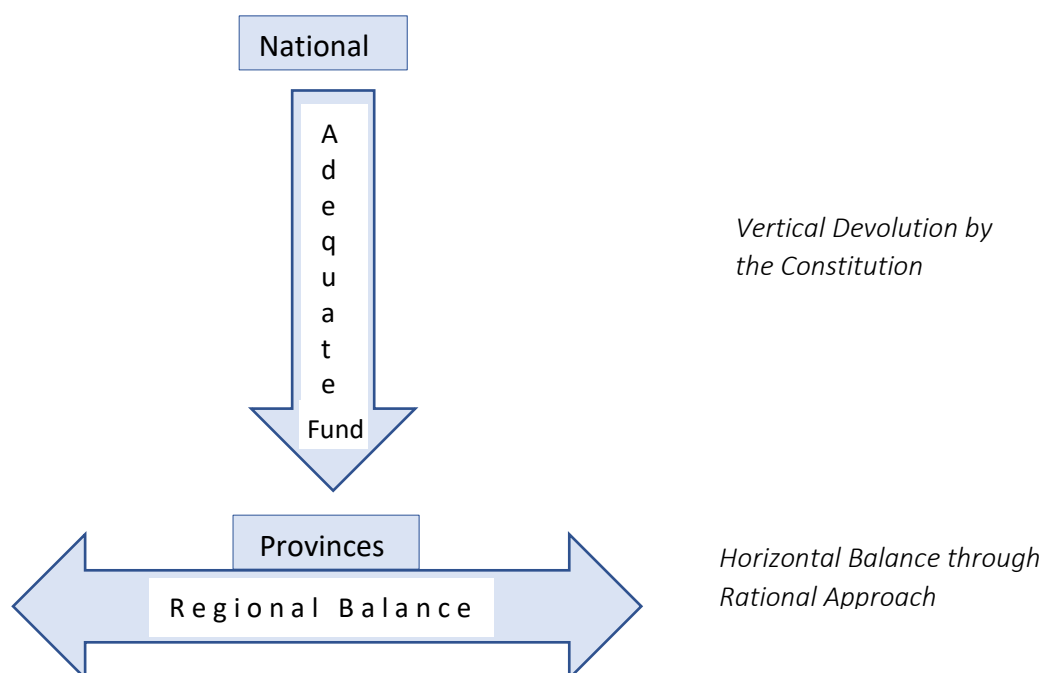
The public investment and service delivery at sub-national levels are performed by, i) the Central Government spending agencies, and ii) Provincial Council spending agencies including Local Authorities.

The Provincial subjects are extensive and include Education, Health, Local Government, Roads, Agriculture, Irrigation, Social Services, Rehabilitation, Rural Development and Sports etc. The Provincial Council List also includes the sources of revenue to be collected by the Provincial Councils. The Provincial Councils are responsible to implement activities in the Provincial Council List and have shared responsibilities under the Concurrent List. However, it is visible that the devolved revenue sources to Provincial Councils do not generate revenue at sufficient levels to fulfill the devolved responsibilities. Therefore, it is necessary to provide adequate funds to the Provincial Councils to meet the gap.

2.2. Vertical Devolution and Horizontal Balance

Article 154 R of the Constitution mandates the Finance Commission to make recommendations to allocate adequate funds for meeting the needs of the Provinces from the annual national budget with the objective of achieving balanced regional development in the country.

The vertical devolution and horizontal balance can effectively be achieved through democratic decentralization inclusive balanced regional development, better commitments at policy level and appropriate design for implementation.



The provision of 'Adequate Funds' sufficient to meet the needs is difficult to achieve under the current budget constraints, as the resources are limited. It can only maintain with a reasonable vertical share to Provinces from the National Budget and horizontal balance with an appropriate weight on an equitable basis.

2.3. Allocation of Funds to meet the Needs of the Provinces

The Constitution requires the Government to allocate adequate funds to meet the needs of the Provinces. In this context, the Finance Commission:

- formulates principles in a rational manner for resource allocation to the nine Provinces under the National Annual Budget with the objective of achieving balanced regional development in the country,
- assesses, determines and recommends the needs of the Provinces based on the requirements submitted by each Provincial Council considering other socio-economic factors, and
- makes apportionment of such funds between the Provincial Councils with the objective of reducing disparities among the Provinces.

2.4. Allocating Adequate Funds to Meet the Needs of the Provinces for Balanced Development

In general, adequate funds for needs of the Provinces mean 'sufficient allocation of resources for Provincial needs or requirements in terms of money'. However, the needs tend to be much more than the available resources. As the Government faces budget constraints and the resources are limited, funds are allocated on priority basis. In this situation, balancing the development and resource allocation become critical.

When discussing about the needs of the Provinces, the role of Provincial Councils should be recognized. Since the needs of the Provinces are fulfilled by the Central and Provincial agencies utilizing funds from national budget, the service delivery under the Reserved, Devolved and Concurrent subjects have to be carefully considered.

The fund requirements based on the needs submitted by the Provincial Councils are only for their devolved functions and the capital budget requirements submitted by them seek Government grants to the Provincial Councils from the National Budget. The Provincial Councils also have opportunities from other sources of funds to meet the capital requirements of the Province through national or special projects.

The Inter-governmental Financial Relations describing the financial flows to sub national level are given in Annexure- 07.

The Finance Commission considers the following in allocating funds to Provincial Councils under the National Budget to meet the requirements.

1. Distribution of available total national capital expenditure budget among the Provinces in an equitable manner based on composite Index /set of principles. The value based on the composite index used for fund distribution among the Provinces in an equitable manner.
2. Allocation of Government grants to the Provincial Councils is also based on the volume of service delivery according to the devolution of power under the Constitution. In this, the amount of grant to the Provincial Councils under national budget may consider the total volume of service delivery under the devolved subjects and a reasonable portion under concurrent subjects as it is a shared responsibility.
3. The Provincial Councils have their own Medium-Term Integrated Development Plans for the respective Provinces prepared in a very comprehensive manner. They submit their annual fund requirements in line with their Medium-Term Plans, considering the annual needs and other sources of funds. The amount of

the Government grants to the Provincial Councils may not be equal or closer to the amount that annual financial requirements estimated by each Provincial Councils in view of the budget constraints.

4. Earmarking the capital allocation for sectors and sub-sectors from the grants available for each Provincial Council after the approval of the National Budget will be made in close consultation between the Finance Commission and the Provincial Councils in a rational manner and on a priority basis.

2.5. Government Grants to the Provincial Councils from the National Budget

The Government transfers funds in the form of grants to the Provincial Councils as follows.

- a) **Block Grant** meets recurrent expenditure needs of the Provinces for the purpose of sustaining and improving the public service delivery. Personnel Emoluments on approved cadre by the Department of Management Services is the major portion of Provincial Councils' recurrent expenditure. This grant includes the transfers to Local Authorities to meet their expenditure on salaries to staff and allowances to Members, and the expenditure on maintenance of capital assets. The Block Grant is calculated as the amount needed to fill the gap between the recurrent expenditure of the Province and the devolved revenue collected by such Province.
- b) **Provincial Specific Development Grant (PSDG)** is meant for financing capital nature development programmes with special attention to infrastructure and community development in various sectors under the devolved subjects. The Medium-Term Development Plan for the Provinces and the Provincial Annual Development Plan are formulated by the Provincial Councils in a common integrated framework aligned with the Guidelines provided by the Finance Commission.

The financing arrangements for the Provincial Annual Development Plans are made under different sectors. The following sectors are common for all the Provinces and incorporated in the Provincial Annual Development Programme, considering specific requirements of the Provinces, and the major part of PSDG among the selected sectors. Additional sectors could be incorporated according to the needs of the particular Province with proper justifications.

* Education	* Provincial Roads	* Land Development
* Western Medicine	* Estate Infrastructure	* Irrigation
* Indigenous Medicine	* Transport	* Agriculture
* Sports	* Housing	* Livestock
* Probation and Childcare	* Rural Electrification	* Inland Fisheries
* Social Services	* Local Government	* Small Industries
* Cultural and Religious Affairs	- Local Authority Roads	* Tourism
* Co-operative Development	- Community Water Supply	* Rural Development
* Early Childhood Development	- Waste Management	
	- Others Services	

A flexible amount of funds are earmarked for each Province to address the identified gaps in the Provincial Investment Programme and, also an amount to cater for villages with special needs. In addition to the recommended PSDG amount by the Finance Commission, the allocations for special projects of Provinces identified at national level are also recognized PSDG.

The formulated Annual Development Plans with financial allocations of each Provincial Council under PSDG are jointly reviewed by the Finance Commission and the respective Provincial Councils, and agree for implementation of the projects in the Provinces every year.

- c) **Criteria Based Grant (CBG)** is also for financing capital nature expenditure for improving the socio-economic conditions of the people, contributing towards reducing regional disparities. The CBG funds are available to the Provincial Councils for discretionary spending on development related activities within an agreed financing framework, following the Guidelines of the Finance Commission.
- d) **Revenue Performance Grant** is recommended to Provincial Councils in order to improve their revenue performance. This is a development oriented small grant pivoted on annual incremental devolved revenue collections. The Provincial Councils have discretionary power to use this grant for capital related development programmes.

03. Socio-Economic Status and Service Delivery of the Provinces

Despite implementation of various strategies and programme, aiming at balanced regional development, the country still experiences disparities and income inequalities at significant levels among the Provinces, as well as lagging areas within the Provinces. It is noted that economic development, physical and social infrastructure are unevenly spread in the geographical space and most of the economic activities such as industry, trade, commerce and services take place within the Western Province making it the core region in the country.

3.1. Socio Economic Conditions of the Provinces

The demographic and economic situation and the resources of Provinces in Sri Lanka show a significant variation between and among the nine Provinces. The land extent of these nine Provinces varies from 5.73 % to 15.5 % of total area and population from 1.1 million to 6.1 million. Though the Western Province is the smallest Province, it contains the largest portion of population in the country, having 28.28 % of the total population. The highest portion of the national GDP is also recorded in the Western Province. The Northern Province represents the lowest. It was noted that the GDP gap among Provinces remains 4.1 % - 38.5 % in 2018. Four Provinces, namely, Northern, North Western, Uva and Eastern contributed, each, less than 06 % to the national economy.

Table - 01: Selected Socio-Economic Indicators of Provinces

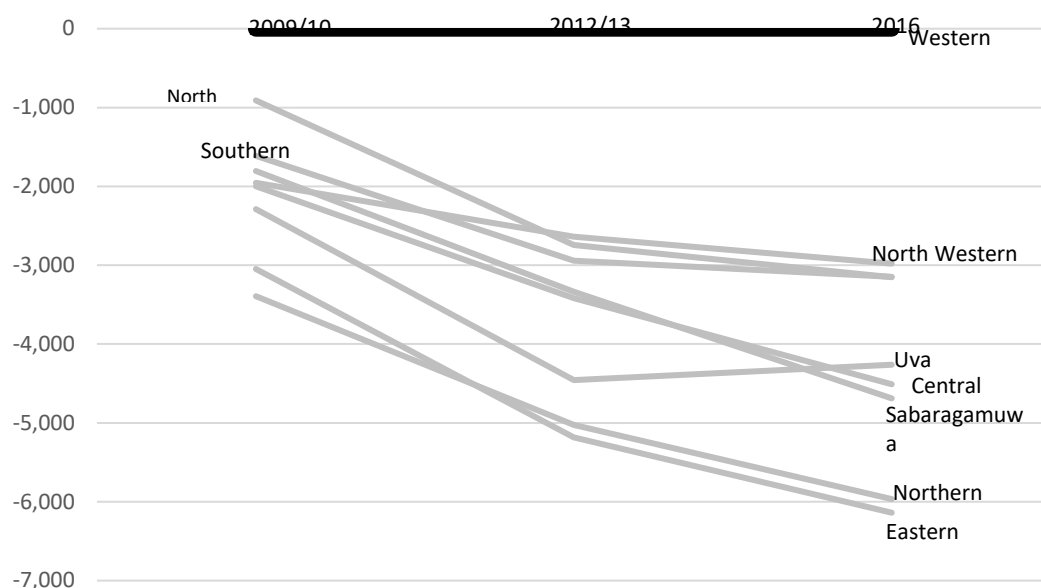
Provinces	Land Area 2018 (Sq.km.)	Mid-year Population 2018 (000)	Provincial GDP 2018 (Rs. Bn)	Provincial Share of GDP 2018 (%)	Median Monthly Per Capita Income 2016 (Rs. Per person per household)	Un-employment Rate 2019 (%)	Poverty Head Count Ratio 2016
Western	3,593	6,129	5,526	38.5	14,400	4.0	1.7
Central	5,575	2,750	1,700	11.8	9,890	6.0	5.4
Southern	5,383	2,637	1,432	10.0	11,253	6.7	3.0
Northern	8,290	1,131	584	4.1	8,434	5.0	7.7
North Western	7,506	2,536	1,584	11.0	11,420	4.1	2.7
North Central	9,741	1,366	816	5.7	11,248	3.3	3.3
Uva	8,335	1,364	824	5.7	10,139	4.0	6.5
Sabaragamuwa	4,921	2,047	1,090	7.6	9,711	4.4	6.7
Eastern	9,361	1,710	810	5.6	8,261	6.4	7.3
Sri Lanka	62,705	21,670	14,366	100	11,307	4.8	4.1

Source: Central Bank of Sri Lanka, Department of Census and Statistics

The Gross Domestic Product and the Provincial Gross Domestic Product are the key macro-economic indicators form the basis for many other ratios, parameters of growth and comparable measures of the regions. Annexure-08 gives the Nominal Provincial Gross Domestic Product during the period 2012 – 2018. The Income Distance of Provincial Per Capita Income is an important indicator and progressive criteria on

equalizing. The income distance indicator clearly shows the regional variation of economic condition among the Provinces in Figure -1.

Figure 1: Income Distance - Median Monthly Per Capita Income of Provinces



Source: Central Bank of Sri Lanka

3.1.1. The Provincial Prosperity Index and Human Capital Index

The Provincial Prosperity Indexes as a composite index with 43 variables computed by the CBSL will be a meaningful measure reflecting the economic and social wellbeing of the Provinces as the level of prosperity across the Provinces. The three sub-indices, Economy and Business Climate, Well-being of the People, Socio-Economic Infrastructure in the Provincial Prosperity Index are also giving status of the Provinces in specific areas. The Provincial Prosperity Index also shows a significant distance between Western Province and other Provinces.

The Human Capital Index looks at both education attainment and health outcomes of the Provinces and the variation among the Provinces varies from lowest 51 in the Eastern Province to highest 63 in the Southern Province.

Table - 02: Provincial Prosperity Index and Human Capital Index – 2018

Province	Sub-Indices of Prosperity Index			Prosperity Index	Human Capital Index (%)
	Economy & Business Climate	Well-being of the People	Socio-Economic Infrastructure		
Western	1.734	1.125	1.043	1.301	62
Central	0.586	0.274	0.61	0.49	54
Southern	0.680	0.552	0.179	0.47	63
Northern	0.473	0.397	0.328	0.399	52
North Western	0.672	0.39	0.305	0.456	59
North Central	0.495	0.318	-0.044	0.256	57
Uva	0.345	0.078	0.179	0.201	55
Sabaragamuwa	0.568	0.406	0.05	0.341	59
Eastern	0.302	0.075	0.127	0.168	51
Sri Lanka	1.034	0.764	0.55	0.783	58

Source: Central Bank of Sri Lanka, World Bank

The assessed need of the Provinces is an important criterion for Provincial public investment for comparable service delivery to the people in all parts of the country. The availability of infrastructure facilities and the requirement for further improvement and expansion are considered in the process.

Table - 03: Basic Needs and Infrastructure Facilities in Provinces

Province	Road Density 2018 (km)	Safe Drinking Water 2016 (HH%)	Electricity for Lighting (HH %)	Toilets facilities (HH%)	No of Hospitals*	Schools 2018	No of University** Admissions 2017/18
Western	1.02	98.2	98.7	93.0	158	1,356	8,432
Central	0.72	77.7	96.8	91.5	169	1,517	3,232
Southern	0.60	92.7	98.6	92.8	125	1,110	4,346
Northern	0.41	92.3	92.4	89.1	116	987	2,105
North Western	0.55	92.7	95.9	90.3	153	1,250	3,308
North Central	0.32	71.2	97.3	88.7	90	815	1,699
Uva	0.42	79.4	96.0	92.4	95	898	1,813
Sabaragamuwa	0.78	76.0	96.4	91.8	112	1,128	2,866
Eastern	0.24	97.7	93.2	90.6	130	1,114	2,340
Sri Lanka	0.50	88.80	96.90	91.70	1,148	10,175	30,141

Source: Central Bank of Sri Lanka, Department of Census and Statistics, Ministry of Education, Ministry of Health.

Note: Road Density is road length per Sq.km.,

* Number of Hospitals including prisons hospitals. ** exclude Special Additional Intake

3.2. Service Delivery of Provincial Councils

The Provincial subjects are extensive, and include major sectors such as Education, Health, Local Government, Roads, Agriculture, Irrigation etc. As per the Constitutional provisions, the Provincial Councils perform service delivery functions with public investments at sub-national levels, and necessary institutional arrangements are made with required cadre for Provincial Councils and Local Authorities to perform their mandatory services.

Table- 04: Service Delivery by Provincial Councils - Assets, Institutions and Employees

Province	Roads Length -Km 2018		Agricultural Land (Acres)2014	No of Schools 2018	No of Hospitals 2018	No of Local Authoraties-2019	Approved cadre of Provincial Councils as at 2020.03.31
	Provincial	Rural					
Western	1,952	11,180	458,360	1,284	130	49	63,874
Central	2,244	13,216	665,949	1,463	163	47	50,128
Southern	1,630	10,491	653,428	1,044	119	49	46,433
Northern	2,120	11,668	298,847	965	113	34	35,999
North Western	2,745	20,571	928,422	1,215	150	33	47,973
North Central	1,948	12,709	745,671	805	88	27	29,992
Uva	2,371	10,923	615,669	862	93	28	33,181
Sabaragamuwa	2,623	7,871	625,947	1,100	110	29	37,879
Eastern	1,121	12,171	411,038	1,084	123	45	37,715
Total	18,754	110,800	5,403,331	9,822	1,089	341	383,174

Source: Department of Census and Statistics, Ministry of Provincial Council and Local Government, Ministry of Education, Ministry of Health.

In this context, adequate funds for development are necessary for the Provincial Councils to deliver public services in the respective Provinces in line with their mandatory functions based on Provincial Medium-Term and Annual Development Plans.

04. Provincial Medium-Term Development Plan and Expenditure Requirements of Provincial Councils

The Finance Commission issues guidelines to the Provincial Councils, separately for preparation of recurrent and capital needs. Provincial Councils prepare the annual needs of both capital and recurrent nature and submit their annual capital and recurrent budget requirements of the Provincial Councils, seeking Government grants to Provincial Councils from the National Budget.

4.1. Provincial Medium Development Plan and Capital Budgeting

With the objective of reducing regional disparities, balanced and integrated regional development, optimizing potential resources, the Provincial Councils have formulated Medium-Term Development Plans for the respective Provinces. These plans follow a multi-sector integrated results-based approach. The sector and sub-sector performance targets and sectoral programmes to achieve the goals are well defined and all included in the plans, with tentative annual financial requirements.

In line with the Medium-Term Integrated Plan of the Provinces and expected service delivery, each Provincial Council has developed an Agency Results Framework which incorporates the results framework for every development sector. Based on the Medium-Term Development Plan of the Provinces and the Agency Result Framework of the Provincial Councils, the annual Provincial needs are determined by the Provincial Councils for funding from Government grants under the National Budget to the Provincial Councils.

After the intimation of the approved amount of capital grant to each Provincial Council by the General Treasury, the Provincial Councils prepare an Annual Development Programme for implementation.

4.2. Capital and Recurrent Expenditure Requirements of Provincial Councils

All Provincial Councils have submitted their requirements of capital and recurrent budget needs under the Government grants for the year 2021.

The capital requirements of Provincial Councils were submitted in detail incorporating all the sectors under the purview of Provincial Councils in a structured format, in line with the Medium-Term Development Plan and the guidelines. Similarly, the recurrent requirements of Provincial Councils were submitted by them in detail with Personal Emoluments (PE) based on the approved cadre and Other Recurrent Expenditure (ORE) including maintenance of capital assets.

Table - 05: Requests of Capital and Recurrent Budget Needs Submitted by Provincial Councils in 2021

Provincial Councils	Capital Needs	Recurrent Needs			Total Needs
	PSDG	PE	ORE	Sub-Total	
Western	13,530	49,160	32,018	81,178	94,708
Central	17,894	37,341	12,338	49,679	67,573
Southern	9,564	33,903	11,366	45,269	54,833
Northern	21,422	25,639	8,837	34,476	55,898
North Western	12,181	34,371	10,063	44,434	56,615
North Central	10,255	20,968	6,939	27,907	38,162
Uva	11,101	23,638	7,029	30,667	41,768
Sabaragamuwa	14,287	30,155	7,480	37,635	51,922
Eastern	22,971	29,408	9,183	38,591	61,562
Total	133,205	284,583	105,253	389,836	523,041

Rs. Mn.

05. Assessment of Capital and Recurrent Needs for Grants to Provincial Councils

The Provincial Councils receive funds in the following forms for their service delivery in the respective Provinces.

- a) Government Grants from the National Budget for capital and recurrent expenditure needs based on the Recommendations of the Finance Commission
- b) Allocation from Line Ministries for implementation of development activities by Provincial Councils through national / special projects
- c) Allocation for Implementation of Provincial Component of Special Foreign funded Projects

5.1. Assessment of Needs for Grants - Capital

The Provincial capital needs for each sector have been identified by Provincial sector agencies and compiled into the Annual Capital Needs of the respective Provincial Councils for financing under Provincial Specific Development Grant (PSDG) in line with the National Policy Framework, development potentials and Provincial Medium- Term Development Plan and Priorities in line with the FC Guidelines.

The Annual Capital needs were studied by the Finance Commission and assessment of the needs of each Provincial Council was done by the Finance Commission, jointly with officials from the Department of National Budget and the Department of National Planning with the participation of Provincial Authorities. During the assessment, attention was paid on undertaking continuation works, excluding the construction of new buildings and prioritizing the capital expenditure items in the requirements submitted by Provincial Councils. Finally, the total amount Rs. 77,950 Million for all Provincial Councils have been determined.

5.2. Assessment of Needs for Grant - Recurrent

The Provincial recurrent needs for Provincial agencies are prepared in line with the guidelines and the budget discussions with Provincial authorities. The officials from Department of National Budget also participated at the review discussion on recurrent needs of each Provincial Council. The expenditure on Personal Emoluments in the recurrent needs was assessed on the basis of total cadre approved by the Department of Management Services to the Provincial Councils. In this exercise, approved cadre of the Provincial Road Development Authorities, Provincial Passenger Transport Authorities and Early Childhood Development Authorities are also considered as eligible.

In addition, essential needs for other recurrent expenditure including maintenance cost, arrears payments and loans to public officers were considered during the assessment of recurrent needs of Provincial Councils. The assessment of total recurrent expenditure was Rs. 361,692 Million for all Provincial Councils.

Provincial Revenue Sources

Revenue for Provincial Councils are generated mainly from the following two sources.

- i) Transfer of Government Revenue
- ii) Revenue collection from Devolved Sources

In terms of the Fiscal Policy Circular No. 01/2010 issued by the General Treasury, the major source of devolved revenue viz the Business Turnover Tax (BTT) was abolished and was it supplemented by a special revenue sharing system which was introduced to transfer the collected revenue to the Provincial Councils according to the following percentages.

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

Although 20 devolved revenue sources were made through tax revenue and non-tax revenue that are 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 only 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.

Revenue Estimates for the Year 2021

The revenue estimates for the Provincial Councils include; i) devolved revenue targets of the Provincial Councils, and ii) estimated transfers of Government revenue to Provincial Councils. The assessment for Block Grant to Provincial Councils was calculated with the deduction of devolved revenue targets of Provincial Councils from the assessed amount of Provincial recurrent expenditure needs. The transfers of Government Revenue to Provincial Councils is to be estimated by the Department of Fiscal Policy and such amounts are not included, as the Department of Fiscal policy has not yet made available these figures to the Finance Commission so far.

Table - 06: Assessed Amount of Capital and Recurrent Grants to Provincial Councils for 2021

Rs. Mn.

Provincial Councils	Capital Needs	Recurrent		
		Assessed Expenditure	Devolved Revenue Target	Block Grant
Western	7,900	68,531	8,050	60,481
Central	10,153	46,793	2,275	44,518
Southern	7,248	42,440	2,131	40,309
Northern	11,674	32,585	1,035	31,550
North Western	6,272	41,798	2,560	39,238
North Central	6,316	27,292	1,451	25,841
Uva	7,942	30,287	1,050	29,237
Sabaragamuwa	6,894	35,775	1,480	34,294
Eastern	13,551	36,191	1,030	35,161
Total	77,950	361,692	21,062	340,629

Note: The deduction of the revenue is not included the transfers of government revenues to Provincial Councils.

06. Recommendations and Apportionment of Grants to Provincial Councils from National Budget 2021

6.1. Recommendation and Apportionment of Capital Grant 2021

The recommendation of capital grant to Provincial Councils takes into account the regional disparities, Provincial and sector specific matters. The Commission has also taken into account the principles based on; needs, equity and performance in allocating resources among the Provinces.

The needs of the Provinces and fund requirements are the basis for recommendation of resource allocation. Each Provincial Council estimated the needs and submitted the budgetary requirements, seeking funds for capital expenditure from the National Budget based on the medium-term strategic plan and sectoral analysis. The Finance Commission is of the view of that the entire fund allocation from the National Budget relates to the devolved subjects to be allocated to the Provincial Councils. For apportionment of capital fund, the Finance Commission studied socio economic differentials and applied equity principles through a composite index.

The capital budget requirements under PSDG were submitted by each Provincial Council based on the Provincial needs and other sources of funds to the Provinces in a systematic manner. The Finance Commission has to make recommendation for capital grant to Provincial Councils to meet the needs of the Provinces, without the knowledge of the size of Government's capital budget for next year. In this regard, we are of the view that the capital grant to the Provincial Councils should consider at least 30 % of the total capital expenditure budget of the Government for the service delivery.

The apportionment of PSDG among the Provinces should be based on the current needs of the Provinces and on the basis of equity, using composite index in appropriate proportion. In addition, the total amount for Criteria Based Grant and Revenue Based Grant are assessed, separately and apportioned to Provincial Councils.

The needs submitted by Provincial Councils were assessed by the Finance Commission, jointly with the Department of National Budget and Department of National Planning, and the aggregate amount for PSDG to all Provincial Councils from the National Budget - 2021 determined with due consideration of budget constraints. The Finance Commission made apportionment of the determined Capital Needs among the nine Provinces as horizontal share on equity basis, using a composite index.

Composite Index and Apportionment of Capital Expenditure Funds

The Finance Commission in collaboration with the Department of Census and Statistics developed an improved statistical formula for the apportionment of capital funds among the Provinces. A Composite Index adopting a multivariate statistical technique called "Factor Analysis" is used by the Commission to apportion capital funds among the Provinces in a rational manner. The following Provincial level variables were incorporated to construct the index.

- Mid-year Population
- Provincial GDP
- Number of Persons under Poverty
- Median Monthly Per-capita Income
- Persons per Medical Officer
- University entrance in Science stream

Table – 07: Composite Index and the Percentages for Apportionment for the Year 2021

Provinces	Composite Index	Provincial Share (In Percentage)
Western	0.71179	07.83 %
Central	1.01822	11.21 %
Southern	0.93367	10.28 %
Northern	1.17468	12.93 %
North Western	0.92328	10.16 %
North Central	1.03606	11.40 %
Uva	1.05958	11.66 %
Sabaragamuwa	1.08216	11.91 %
Eastern	1.14696	12.62 %

6.2. Recommendation and Apportionment of Recurrent Grants

After a detail review by the Finance Commission officials on recurrent expenditure needs submitted by each Provincial Council, the Finance Commission organized a series of discussions with each Provincial Council to assess the required recurrent expenditure with the participation of the Department of National Budget. Having assessed amounts of funds for recurrent expenditure of the Provincial Councils and the estimated revenue of Provincial Councils, the Finance Commission recommends the Block Grant to Provincial Councils the assessed Expenditure minus estimated revenue of respective Provincial Councils.

6.3. Recommendation of Grants to Provincial Councils from the National Budget

The capital and recurrent budget needs of the Provincial Councils have been assessed by the Finance Commission, jointly with the Department of National Budget and the Department of National Planning. The economic situation and the fiscal position of the country, and the budget constraints faced the government were taken in to the serious consideration during the assessment.

The amount of funds for Criteria Based Grant to the Provincial Councils is recommended within the total amount assessed for Provincial Specific Development Grant after considering the budget constraints. Finally, the Finance Commission had made recommendation and apportionment of Government Grant to the Provincial Councils and the details are given below.

Table – 08: Recommended Amount of Capital and Recurrent Grants to Provincial Councils for 2021

Rs. Mn.

Provincial Councils	Capital			Recurrent	Total	%
	PSDG	CBG	RPG	Block Grant		
Western	5,512	591	849	60,481	67,433	16 %
Central	7,892	847	282	44,518	53,539	13 %
Southern	7,237	776	468	40,308	48,789	12 %
Northern	9,103	976	396	31,550	42,025	10 %
North Western	7,153	767	333	39,238	47,491	11 %
North Central	8,025	861	132	25,841	34,859	08 %
Uva	8,209	880	141	29,237	38,467	09 %
Sabaragamuwa	8,385	899	177	34,295	43,756	10 %
Eastern	8,884	953	222	35,161	45,220	11 %
Total	70,400	7,550	3,000	340,629	421,579	100 %

07. Limitations in Recommendations for Balanced Regional Development

Regional development by supporting wealth-generating economic activities is an effort to reduce regional disparities. However, the inequalities are a serious issue when parts of the country are highly developed and others are severely affected by lack of resources and facilities. Although few Provinces are endowed with rich natural resources, they are poor, as they are unable to utilize the existing resources. Some urban areas experience good access to services, strong social institutions to high quality living environments but there are many disadvantaged sections within the Provinces. This contextual complexity leads to serious policy dilemmas, especially social capital, demography, lifestyle preferences, technologies and polity.

The responsibilities for balanced regional development are spread across numerous agencies from all tiers of Government. Constitutionally, the Provinces and the Local Authorities are mainly responsible for the development of their geographical areas in the developed and less developed regions. Economic overheads are very important for particular regions and the inadequacy in some regions remained backward compared to other regions of the country.

Although the balanced growth has been accepted in economic planning in Sri Lanka, it had not made much headway in this objective. In a real sense, the mechanisms have not yielded the expectations of few Provinces. Sufficient investments are also needed for growth without ignoring their potential and comparative advantages. The new investments in the private sector concentrate much on those regions having basic infrastructural facilities.

Limitations

1. The Finance Commission is expected to recommend adequate funds to Provinces aiming at Balanced Regional Development in line with fiscal devolution without knowing the size of the budget with sectoral breakdown.
2. The service delivery of the Provincial Councils in relation to devolved subjects and shared responsibility under concurrent subjects are financed through different sources of funds.
3. The request submitted by Provincial Councils or assessed and recommended for grants by the Finance Commission is not the total needs of the Provincial Councils or Provinces as the other parts of financing are expected from various other sources.
4. The assessment and recommendation of the Finance Commission do not take into the account the private sector investment and operations in the Provinces and the line ministry programmes in the Provinces.
5. The capital needs are assessed by Provincial Councils in a systematic manner and submitted for financing under Capital Funds. Although the capital needs have been assessed in a systematic manner, the Finance Commission could not consider them, fully in view of the budget constraints. In addition, the recommendation of Criteria Based Grant to Provincial Councils also has to be included in the total assessed amount for PSDG.
6. The shortfall of expenditure in Provincial Councils in the past years are not taken into account during the process of the assessment and recommendations of capital grant.

08. Policy Recommendations

In addition to the recommendation of Government grants to Provincial Councils along with the basis and principles for apportioning funds among Provinces, the Finance Commission makes policy recommendations to achieve balanced regional development in the country with effective implementation of the Public Investments and service delivery at sub national level.

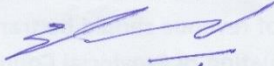
The following recommendations are submitted for giving due consideration for: allocation of funds from the National Budget, Balanced Regional Development, inter-agency coordination, devolved revenue generation and private sector participation.

1. The expenditure budget and allocation of funds should adopt a sound service delivery system and allocate adequate funds from the national budget to the Provincial Councils to meet the needs and expenditure on service delivery in line with devolved functions and the shared responsibilities under concurrent subjects. The national budget should itself comprise the dimensions of devolution framework (reserved, devolved, concurrent), as well as SDG framework. To avoid duplication of fund allocation between the Line Ministries and Provincial Councils, the budget allocation for devolved subjects has to be made, directly to the Provincial Councils creating Budget Heads as special expenditure units, ensuring that the Provincial Councils are, directly responsible to Parliament.
2. To ensure balanced regional development in the country, the line ministries should earmark the allocations to Provinces and Districts from their budgets on development interventions in respect of concurrent subjects together with the Provincial Councils and District Secretariats, enabling them to prepare their consolidated annual implementation plan for the year avoiding duplication of work, and to maintain a balance within the Provinces. The relevant national level coordinating agencies in consultation with the Department of National Planning should ensure a balance in resource allocation to sub-national level for comparable services and equal opportunities, and to reduce regional disparities. The Public Investment Programme and the National Budgets have focused much on sectors without recognizing spatial inequalities. Therefore, due attention should be given on regional balance as well.
3. A large volume of works at community level such as rural infrastructure, community development and other local authority services are implemented by Local Authorities that come under their purview. However, budget allocations for these areas are with other agencies and this need to be stopped. The Provincial Councils and Local Authorities are much engaged in disaster response and mitigation activities at the local level and in community-based interventions. A special capital grant to the Provincial Councils for service delivery of Local Authorities and an amount for environmental protection activities could be considered from the national budget based on selected criteria.
4. The Provincial component of special projects and national programme on devolved subjects should be implemented through the Provincial Councils with sufficient budget allocations to the Provincial Councils. Such projected needs could be identified in consultation with the Provincial Councils and the Finance Commission as the line ministries do not have resources to assess the needs and implement them at sub-national level.
5. An efficient and effective provision of public services and availability of sufficient infrastructure to maintain quality and accessibility, value addition, market development and better responding mechanisms for emerging needs are important. Appropriate development interventions to underserved rural areas in lagging regions should be identified by the service delivery agencies for comparable services and for socio economic advancement in line with the balanced regional

development within the Provinces. While giving priority to major performing sectors, a minimum level of expenditure should be ensured on critical small sectors which may assist human development and providing basic needs to the community,

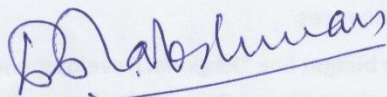
6. Revenue generation and new avenues of fund generation for Provincial Councils and Local Authorities should be recognized and encouraged through incentives, proper studies and raising awareness for efficient revenue management. In this regard, active involvement of the Department of Fiscal Policy is expected. The Government should allow the Provincial Councils to generate incomes under the devolved revenue sources listed in the Constitution. And also, adequate share of revenue should be transferred to the Provincial Councils from national revenue. The dependency situation of Provincial Councils and Local Authorities on receiving government grants should be gradually reduced by empowering the sub national bodies for high income generation in terms of own high revenue generation. This would assist the Government to reduce the pressures on Government finances.
7. Currently, Provincial Councils are provided funds under the budget line “Regional Development” without adequate allocations for Provincial sectors. Allocating funds to the sectors of the Provincial Councils under the budget line of regional development undermine the service delivery requirements of the Provincial Councils, specially, in the education and health sectors. Particularly, in the education sector around 90% of students are at Provincial schools. This applies to health sector as well. Therefore, adequate provisions for health and education sectors should be granted to the Provincial Councils.
8. A common framework with an integrated approach to be followed in planning, budgeting and reporting by all public sector agencies in a streamlined process with regard to public investments, aiming good results, avoiding delays and duplications. For this purpose, an independent planning system is desirable. It is imperative that an efficient Inter-Governmental Financial Relations with smooth financial resources flows and sound reporting systems exist.
9. Adoption of Norm Based Budgeting and modern technology, especially in teaching and other related services should be strictly considered in education and health sectors to reduce the mounting financial pressures of the National Budget, and improving effectiveness of service delivery.
10. A clear understanding of inter-linkages between national and sub-national level spending and its nexus to economic growth will assist the Government to make better decisions for the country. In this regard, the investments by the private sector cannot be ignored. The public investments should consider the possible private investments in relevant sectors and regions in an inclusive manner to ensure quality service delivery and better outcomes to ensure balanced development and sector performance.

Our assessments and recommendations considered the features of public finance, the needs of the Provinces focusing on balanced regional development and the budget constraints. We have also highlighted the limitations in making recommendations for budget allocations and the policy recommendations for effective implementation. We submit these recommendations for your highest consideration.



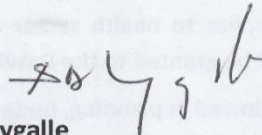
U. H. Paliyakkara

Chairman



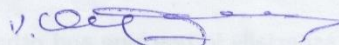
Deshamanya Prof. W. D. Laksman

Member (Ex-officio) and the Governor of the Central Bank of Sri Lanka



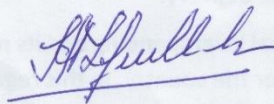
S. R. Attygalle

Member (Ex-officio) and the Secretary to the Treasury/Ministry of Finance



V. Kanagasabapathy

Member (Appointed)



H. M. Zafrullah

Member (Appointed)

Request for Grants submitted by the Provincial Councils in 2020 and 2021

Rs. Mn.

Province	2020	2021
Western		
Capital	6,172	13,530
Recurrent	82,547	81,178
Total	88,719	94,708
Central		
Capital	14,475	17,894
Recurrent	48,912	49,679
Total	63,387	67,573
Southern		
Capital	12,780	9,564
Recurrent	42,433	45,269
Total	55,213	54,833
Northern		
Capital	14,640	21,422
Recurrent	33,233	34,476
Total	47,873	55,898
North Western		
Capital	9,126	12,181
Recurrent	44,444	44,434
Total	53,570	56,615
North Central		
Capital	6,968	10,255
Recurrent	28,033	27,906
Total	35,001	38,161
Uva		
Capital	12,029	11,101
Recurrent	30,298	30,667
Total	42,327	41,768
Sabaragamuwa		
Capital	7,328	14,287
Recurrent	39,107	37,636
Total	46,435	51,923
Eastern		
Capital	18,619	22,971
Recurrent	36,149	38,591
Total	54,768	61,562

Source: Finance Commission

The Fund Apportioning Formula, Methodology and Variables for Capital Grant-2021

The Funds Apportionment to the Provinces are determined based on different principles and criteria. In order to design a statistical methodology to distribute capital funds among Provinces, a composite index using selected variables were formulated. The compound indicators with multi dimension are very popular tools for assessing and ranking countries, regions or institutions in terms of status, performance and other complex concepts that are not directly measurable by an indicator.

With the support of the Department of Census and Statistics, the Finance Commission use a composite index for apportionment of capital grant among the Provinces. The following six variables were selected to incorporate in the Fund apportioning formula, considering experts' view in line with Constitution.

- Mid-Year Population
- Provincial Gross Domestic Product
- Number of Poor Population of Province
- Median per-capita income of Province
- Number of Persons per Medical Officer in Province
- percentage of students qualified for universities in Science Stream of Province

Provincial data was obtained for variables from the Department of Census and Statistics, Central Bank of Sri Lanka and Department of Examinations.

In order to construct a composite index, a Multivariate Statistical technique called Factor Analysis (FA) was used. FA is a useful tool for investigating variable relationships for complex concepts such as socioeconomic status, dietary patterns, or psychological scales. It allows to investigate concepts that are not easily measured directly by collapsing a large number of variables into a few interpretable underlying factors.

Some variables were adjusted taking reciprocal or subtracting it by 100 to convert the variables in to one direction keeping the need of giving higher attention for higher values of the variables. Those adjustments are as follows

Variable Adjustments

Variable	Variable Adjustment
Mid – Year Population of Province	Same
Provincial Gross Domestic Product	1 / Provincial GDP
Number of Poor Population of Province	Same
Median per capita income of Province	1 / Median per capita income
No. of Persons per Medical Officer in Province	1 / Persons per Medical Officer
percentage of candidates qualified for universities in Science Stream of Province	100 - (Percentage of candidates qualified for universities in Science Stream)

Under this factor analysis, it was resulted that more than 75 percent of actual situation was explained by one factor. Under that factor an index was calculated for each Province. It is known as 'factor score'. But those values were in the form of 'plus's and 'minus's. The index should not be with minus values since the total score is needed without affecting minuses.

In order to get non-negative values, Composite Index (CI) for each Province was obtained using the following mathematical manipulation.

$$CI = \left\{ n \left(\frac{1}{n} \right) \right\}^{fs}$$

Where,

CI : Composite Index

n : Sample size, that number of Provinces (09)

fs : factor score

Finally, the CI value of a Province was divided by the summation of CI values of Nine provinces and the proportion for each Province was calculated. Calculated method for Provincial allocation shown below;

Province	Factor Score	CI (Without minuses)	Percentage for Allocation
Western	-1.39256	0.71179	7.83
Central	0.07397	1.01822	11.21
Southern	-0.28111	0.93367	10.28
Northern	0.65946	1.17468	12.93
North Western	-0.32696	0.92328	10.16
North Central	0.14509	1.03606	11.40
Uva	0.23704	1.05958	11.66
Sabaragamuwa	0.32342	1.08216	11.91
Eastern	0.56164	1.14696	12.62
		9.1	100.00

Source: Finance Commission

The Recommendation of Grants of the Finance Commission for the year 2020 and 2021

RS.Mn.

Province	Recurrent	Capital			Total
	Block Grant	PSDG	CBG	RPG	
Western					
Recommendation 2020	58,533	7,047	704.70	849	67,134
Recommendation 2021	60,481	5,512	591.00	849	67,433
Central					
Recommendation 2020	45,455	10,089	1,008.90	282	56,835
Recommendation 2021	44,518	7,892	847.00	282	53,539
Southern					
Recommendation 2020	38,324	9,252	925.20	468	48,969
Recommendation 2021	40,308	7,237	776.00	468	48,789
Northern					
Recommendation 2020	32,383	11,637	1,163.70	396	45,580
Recommendation 2021	31,550	9,103	976.00	396	42,025
North Western					
Recommendation 2020	40,448	9,144	914.40	333	50,839
Recommendation 2021	39,238	7,153	767.00	333	47,491
North Central					
Recommendation 2020	26,473	10,260	1,026.00	132	37,891
Recommendation 2021	25,841	8,025	861.00	132	34,859
Uva					
Recommendation 2020	30,423	10,494	1,049.40	141	42,107
Recommendation 2021	29,237	8,209	880.00	141	38,467
Sabaragamuwa					
Recommendation 2020	35,786	10,719	1,071.90	177	47,754
Recommendation 2021	34,295	8,385	899.00	177	43,756
Eastern					
Recommendation 2020	34,680	11,358	1,135.80	222	47,396
Recommendation 2021	35,161	8,884	953.00	222	45,220
Total					
Recommendation 2020	342,505	90,000	9,000	3,000	444,505
Recommendation 2021	340,629	70,400	7,550	3,000	421,579

Source: Finance Commission

Assessed Distribution among the Sectors of PSDG in 2020 and 2021

No.	Sector	Share of Provincial Capital Grant %	
		2020	2021
1	Education	16.35	13.63
2	Western Medicine	14.90	18.65
3	Indigenous Medicine	3.64	2.82
4	Sports	1.56	0.76
5	Probation and Childcare	2.18	0.86
6	Social Services	1.42	0.92
8	Cultural and Religious Affairs	0.88	0.66
7	Early Childhood Development	0.50	0.45
9	Housing	1.01	0.79
10	Cooperatives	0.46	0.75
11	Provincial Roads	13.94	18.24
12	Estate Infrastructure	0.79	0.81
13	Transport	1.21	0.93
14	Land	0.49	0.19
15	Agriculture	5.72	3.74
16	Livestock	3.53	2.26
17	Inland Fisheries	1.37	0.71
18	Irrigation	4.34	4.40
19	Rural Development	1.64	1.26
20	Small Industries	1.93	1.10
21	Rural Electrification	0.61	0.38
22	Tourism	2.57	1.89
23	Local Government	8.96	13.80
	Grant for Village Development and Flexible Amount	10.00	10.00
	Total	100.00	100.00

Source: Finance Commission

* The distribution in fund allocation is subject to revision based on total grant and priorities

Total Approved Cadre of Provincial Councils and Recommended Block Grant 2020 and 2021

Province	DMS Approved Cadre		Recommended Block Grant RS.Mn.	
	2020	2021	2020	2021
Western	63,111	63,874	58,533	60,481
Central	50,744	50,128	45,455	44,518
Southern	46,551	46,433	38,324	40,308
Northern	36,148	35,999	32,383	31,550
North Western	47,541	47,973	40,448	39,238
North Central	29,887	29,992	26,473	25,841
Uva	33,054	33,181	30,423	29,237
Sabaragamuwa	37,703	37,879	35,786	34,295
Eastern	37,900	37,715	34,680	35,161
Total	382,639	383,174	342,505	340,629

Source: Finance Commission

Provincial Revenue Collection by Sources in 2018 and 2019

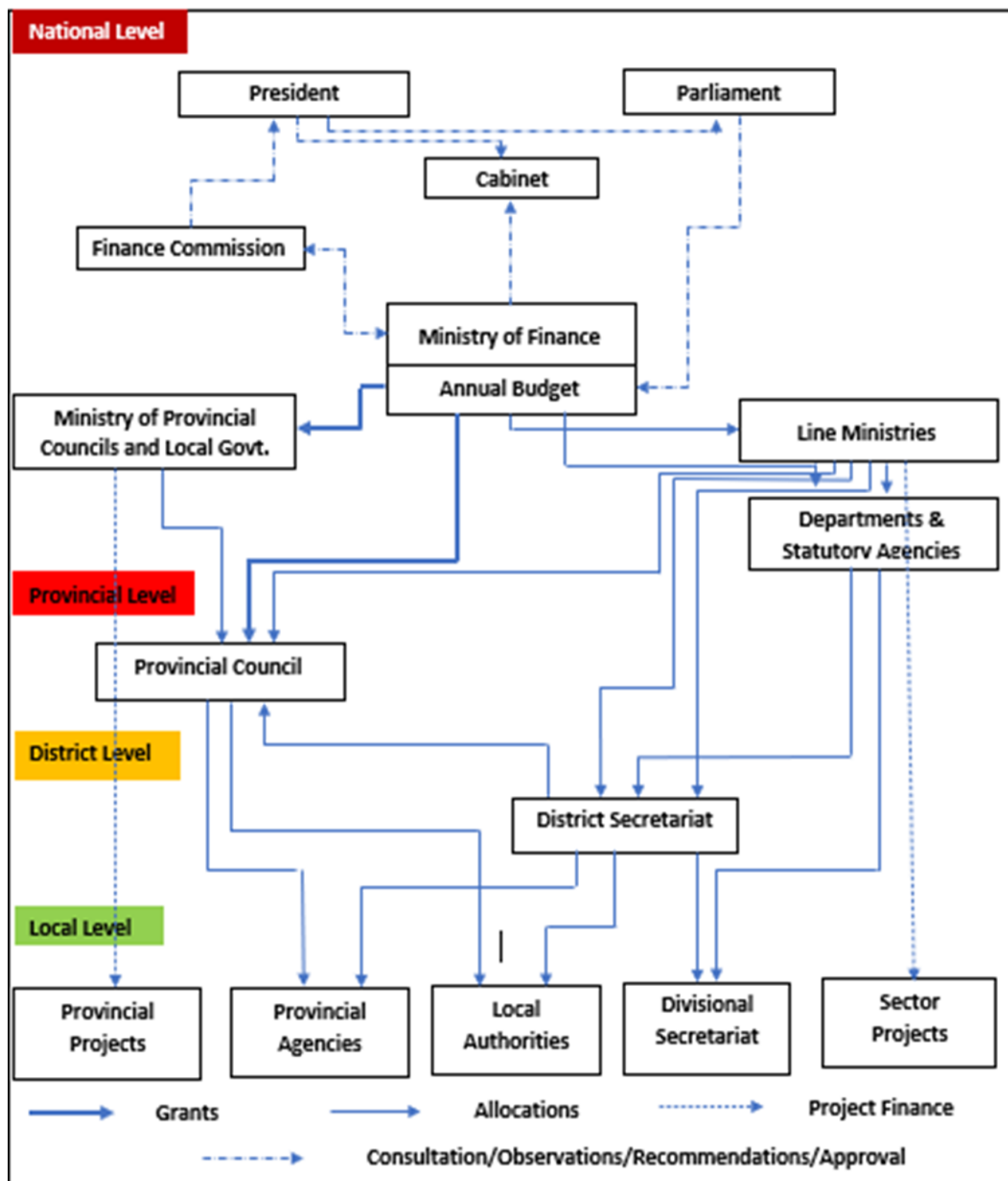
Province	Revenue Collection from Developed Sources ('000)						
	BTT*	Motor Vehicle License Fees	Excise Duty	Stamp Duty	Court Fines	Other**	Total
Western							
2018	846	4,244,750	649,350	17,284,580	955,860	2,313,894	25,449,280
2019	572	4,318,610	672,570	13,488,510	1,280,040	2,226,398	21,986,700
Central							
2018	1,636	963,025	424,991	1,845,477	97,068	527,808	3,860,005
2019	3,740	985,086	409,601	1,540,246	122,319	616,116	3,677,108
Southern							
2018	985	1,251,751	132,947	2,003,469	472,295	517,982	4,379,429
2019	1,588	1,236,625	131,688	1,949,820	514,140	745,895	4,579,756
Northern							
2018	-	378,372	35,255	798,260	177,033	394,602	1,783,522
2019	-	378,712	35,077	789,388	270,282	516,783	1,990,242
North Western							
2018	7,804	1,396,531	151,058	1,913,484	444,571	503,591	4,417,039
2019	6,606	1,441,034	142,629	1,862,417	404,902	820,394	4,677,982
North Central							
2018	792	604,011	64,313	167,162	237,681	600,336	1,674,295
2019	941	631,364	60,775	149,577	312,784	535,263	1,690,704
Uva							
2018	1,060	451,897	97,824	349,821	213,478	357,462	1,471,542
2019	202	464,110	113,380	331,998	162,484	317,266	1,389,440
Sabaragamuwa							
2018	-	768,347	119,509	320,364	192,348	333,878	1,734,446
2019	861	791,176	114,417	1,212,826	223,940	377,192	2,720,412
Eastern							
2018	-	495,604	124,822	526,221	154,374	283,790	1,584,811
2019	-	523,795	83,580	469,163	222,495	223,799	1,522,832
Total							
2018	13,123	10,554,288	1,800,069	25,208,838	2,944,708	5,833,343	46,354,369
2019	14,510	10,770,512	1,763,717	21,793,945	3,513,386	6,379,106	44,235,176

Source: Monthly Revenue Reports of Provincial Councils – 2018

* Collection of due BTT up to 2010,

**Others Include Rents, Interests, Examination Fees, Sale of Capital Assets, Betting Tax etc.

FINANCIAL FLOWS TO THE SUBNATIONAL LEVEL



Source: Mr. Ashoka S. Gunawardhana

Nominal Provincial Gross Domestic Product 2012-2018 (Rupees in Billions)

Province /Year	2012	2013	2014	2015	2016	2017	2018
Western	3,244	4049	4295	4365	4541	5,086	5,526
Central	776	1,004	1,089	1,161	1,278	1,622	1,700
Southern	834	968	1,033	1,105	1,188	1,348	1,432
Northern	278	324	407	453	541	550	584
North Western	760	1,046	1,112	1,163	1,280	1,478	1,584
North Central	379	490	561	645	706	755	817
Uva	362	500	563	610	856	776	824
Sabaragamuwa	467	667	732	825	973	1,054	1,090
Eastern	478	544	568	624	633	749	810
Sri Lanka	7,579	9,592	10,361	10,951	11,996	13,418	14,366

Source: Central Bank of Sri Lanka