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நிதி ஆணைக்குழு

Finance Commission

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இலங்கை ஜனநாயக சோசலிசக் குடியரசின் அரசியலமைப்பின் உறுப்புரை 154 R (4) பிரகாரம்

2023 ஆம் ஆண்டிற்கு சமர்ப்பிக்கப்பட்ட கௌரவ ஜனாதிபதிக்கான பரிந்துரைகள் - 2023

RECOMMENDATIONS TO THE HON. PRESIDENT - 2023

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

Democratic Socialist Republic of Sri Lanka

2022 ඔක්තෝබර් මස 07

07 ஒக்ரோபர் 2022

07th October 2022

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(ආණ්ඩුක්‍රම ව්‍යවස්ථාවේ 154 "ඊ" ව්‍යවස්ථාව යටතේ පිහිටුවන ලදී.)
நிதி ஆணைக்குழு
(அரசியலமைப்பின் 154 "ஸ" ஆம் உறுப்புரையின் கீழ் தாபிக்கப்பட்டது)
FINANCE COMMISSION
(Established under Article 154 "R" of the Constitution)

03, සරණ මාවත, රාජගිරිය, ශ්‍රී ලංකාව.
இல. 03, சரண மாவத்தை, ராஜகிரிய, இலங்கை.
03, Sarana Mawatha, Rajagiriya, Sri Lanka.

මගේ අංකය எனது இல. My No.	FC/PRP/08/01/2022	ඔබේ අංකය உமது இல. Your No.		දිනය திகதி Date	2022.10.07

Honorable Ranil Wickremesinghe
President of the Democratic Socialist Republic of Sri Lanka
Presidential Secretariat
Colombo 01

Honorable Sir,

In terms of Article 154R (4) (a) 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 as are granted annually by the Government for the use of Provinces, should be apportioned between the various Provinces"

Accordingly, I am pleased to submit the recommendations of the Finance Commission in respect of the apportionment of the funds that have to be allocated from the Annual Budget to the Provincial Councils for the year 2023 as required under the Article 154R (3) of the Constitution based on the recommendations made by the Commission. Some proposals aimed at enhancing the efficiency of allocation of resources and improving the delivery of services at Provincial level, are also included in this report.

Yours faithfully,

Sumith Abeysinghe
Chairman
Finance Commission

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FINANCE COMMISSION

RECOMMENDATIONS TO THE HON. PRESIDENT FOR THE YEAR 2023

Submitted

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

07th October 2022

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CHAPTER 1

Introduction

1.1 Background

The Finance Commission is pleased to submit its recommendations to the Hon. President on assessed requirement of resources for the Provincial Councils enabling the government to allocate funds in compliance with Article 154R (3) of the Constitution and also on principles on which funds that will be allocated for the ensuing year be apportioned between the various provinces as required by Article 154R (4) (a) of the Constitution with the intention of achieving balanced regional development. Certain proposals aimed at enhancing the efficiency of allocation of resources and improving the delivery of services at provincial level are also included in this report.

1.2 Finance Commission

Along with the establishment of the Provincial Councils by the 13th Amendment to the Constitution of the Democratic Socialist Republic of Sri Lanka which was promulgated in 1987, the Finance Commission was also brought into being. In line with Articles 154 A - 154 Q of the Constitution relating to the establishment of the Provincial Councils, the Provincial Councils Act No. 42 of 1987 was enacted to create a broader governance framework for proper functioning of those entities. With the enactment of their own finance statutes and other statutes by the Provincial Councils on subjects devolved to them, now they have a comprehensive governance framework and an institutional set up which has been evolved during the last 35 years.

Provincial Councils are responsible for service delivery pertaining to devolved subjects referred to in List I of the Ninth Schedule to the Constitution as well as shared responsibilities on subjects referred to in List III (Concurrent List) of the same Schedule. Since their own revenue is now very meagre, the largest chunk of resources needed for the service delivery of Provincial Councils are met from the funds allocated by the National Budget based on the Recommendations of the Finance Commission.

1.3 Mandate of the Finance Commission

Article 154 R of the Constitution of the Democratic Socialist Republic of Sri Lanka provides the provisions for the establishment of the Finance Commission and spells out its functions. 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 154 R (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 154 R (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.

Upon the receipt of the Recommendations of the Finance Commission, the Hon. President submits those to the Cabinet of Ministers seeking approval to implement the recommendations and also to table the same in Parliament. Thereafter, as required under Article 154R (7) of the Constitution the Hon. President causes those Recommendations to be laid before Parliament and to notify parliament as to action taken thereon.

1.4 The Tasks Performed by the Finance Commission

The main function of the Finance Commission is to make Recommendations to the Government on allocation of adequate funds from the Annual National Budget to meet the needs of the Provinces and also on the principles pertaining to the apportionment of such funds between nine Provinces with the objective of achieving balanced regional development in the country in line with the Constitutional provisions referred to in 1.3 above. In this process, the Finance Commission

i. provides Guidelines to the Provincial Councils on the preparation and submission of their needs of resources annually.
ii. assesses the needs of the Provincial Councils after detailed discussions with Provincial Authorities
iii. submits recommendations to the Hon. President on allocation of funds required by the Provincial Councils from the National Budget and on the apportionment of such funds between the Provinces.
iv. apportionment of the funds allocated by the National Budget among various sectors within the province upon the receipt of the approval of the Hon. President/ the Government.
v. issues guidelines pertaining to the formulation Provincial Annual Development Plans with a view to improve the efficiency and effectiveness of use of funds.

vi. reviews the provincial development plans together with relevant stakeholders and grants concurrence to the same.
vii. promotes national and provincial inter-sectoral coordination on development interventions.
viii. provides recommendations to the government on the management of provincial cadre.

1.5 Making Recommendations

The Finance Commission makes its Recommendations on funds needed by the Provincial Councils after a series of elaborate consultative meetings with the Provincial Authorities and with the participation of the officers of the Department of National Budget and Department of National Planning.

The Constitutional provisions, national policy guidelines, relevant cabinet decisions, Sustainable Development Goals (SDGs), critical issues identified through consultation with provincial authorities, socio-economic status of provinces and development priorities identified in the medium-term development plans of the Provincial Councils are generally taken into consideration by the Finance Commission when making recommendations.

In recommending the recurrent expenditure needs (including maintenance expenses of each sector) requested by the Provincial Councils, in the backdrop of severe budgetary constraints faced by the government a minimum amount of resources required to carry out the essential service delivery were taken into consideration while limiting the recommendation of capital funds only to acutely felt investment needs.

Accordingly, Chapter 2 of the report contains basic information pertaining to types of funds allocated to the Provincial Councils.

Process and the methodology used in the assessment of the expenditure needs of the Provincial Councils are explained in Chapter 3. In addition, recommendation and apportionment of government grants among Provincial Councils in compliance with Article 154R (4) also are given in Chapter 3.

In the backdrop of unprecedented fiscal crisis faced by the Government, the Commission wishes to put forward certain proposals aimed at enhancing the efficiency in allocation and utilization of resources at national as well as provincial levels which are given in Chapter 4 of the report. Since the Commission observes that bulk of the recommendations made by the Commission in the past, even those ones which can be implemented without incurring additional expenditure has not been implemented, it also wishes to reiterate some salient recommendations previously made in the same Chapter.

CHAPTER 2

Allocation of Resources to Subnational Level

2.1 Three Tiers of the Governance

There are three distinctive tiers of governance in Sri Lanka, i.e., the Government (Centre), Provincial Councils and Local Government Authorities with the clearly demarcated legislative and executive powers and functions to be exercised by each of them. It should be noted that the third tier of governance (the Local Government Authorities) comes under the purview of the Provincial Councils as a devolved subject. The subjects and functions of the Government (Centre) and the Provincial Councils have been specified in the Ninth Schedule to the Constitution in three lists viz. Provincial Councils List (powers devolved to the Provincial Councils), the Reserved List (powers of the Centre), and the Concurrent List (subjects of shared responsibilities).

The public investment and service delivery at sub-national levels are being performed by the spending agencies of the Centre, and by Provincial Authorities including Local Government institution according to the Constitutional arrangements, statutes of the Provincial Councils and bylaws of the local authorities. The Provincial Councils are responsible for the implementation of activities in the Provincial Council List and have shared responsibilities with the Centre under the Concurrent List.

In terms of public service delivery, the subjects assigned to the Provincial Councils are extensive and those include Education, Health, Local Government, Provincial and Local Roads, Agriculture, Irrigation, Social Services, Probation and Childcare, Rural Development and Sports etc. The Provincial Council List specified in the ninth schedule to the Constitution also includes the 20 sources of revenue to be collected by the Provincial Councils. However, those sources do not generate revenue at sufficient levels to fulfill the devolved responsibilities at all. Therefore, it is necessary to provide adequate funds to the Provincial Councils by the Treasury to fulfil these responsibilities.

2.2 Meeting the Expenditure Needs of the Provincial Councils

From the inception, the government had to provide funds to the Provincial Councils to meet their expenditure since their revenue generation from the sources devolved to them under the Constitution was not at all sufficient to meet their expenditure needs. Especially, after the abolition of the business turnover tax (BTT) in 2011 and subsequently doing away with Nation Building Tax (NBT) in 2019, now the situation got worsened.

In addition to the Recurrent Needs for the delivery of services on devolved subjects as well as subjects in the Concurrent List including Health and Education, the Provincial Councils are also required to undertake development activities aiming the balanced regional development through Capital Grants received by them. However, the amount of funds received from the Treasury for Capital Expenditure has been very much less than the amount recommended by the Finance Commission as seen in the table at Annex-1. When look at the amount finally received by them in the form of imprest which is about 62 % of the budgetary allocation (or 26 % of the amount recommended by the Finance Commission) for the last 5 years is awfully inadequate. It is also worthwhile to mention that the amount of capital grants received by all 9 provinces is 3.7 % of the total capital expenditure of the government. Presumably, in recognition of this situation, the previous Commission in its Recommendations submitted to Hon. President last year opined that at least 30% of the total Capital Expenditure be given to the Provincial Councils. When compared with some the other countries with similar level of devolution, even this percentage seems to be low.

Apart from the inadequacy of funds made available to the Provincial Councils, the Finance Commission observes that there are two other anomalies pertaining to this matter. The first one is that the Capital funds received by the Provincial Councils on selected devolved subjects are very much less than the amount received by the Line Ministries/ State Ministries from the national budget for the same subjects. The second anomaly is that the Capital Expenditure as a ratio of Recurrent Expenditure of the Provincial Councils is very much less than the same ratio for the entire Government as seen in the table below.

Table-01: Allocation of Capital and Recurrent Expenditure in National Budget for the Year 2021

Rs. Billion

Expenditure Item	National Agencies	Provincial Councils	Total
Capital Expenditure	1054.51 (30.7%)	40.50 (11.4 %)	1095.01 (28.9 %)
Recurrent Expenditure	2380.15 (69.3%)	314.00 (88.6 %)	2694.15 (71.1 %)
Total	**3434.66 (100%)**	**354.50 (100 %)**	**3789.16 (100 %)**

Even though there are some justifications for the high level of Recurrent Expenditure in the Provincial Councils as the number of public servants serving in the Education and Health sectors are high in the Provincial Councils compared to those in the Centre, this ratio has to be improved in favour of Capital Expenditure if the desired level of regional development is to be achieved.

2.3 Types of Grants Recommended by the Finance Commission to Provincial Councils from National Budget

The Finance Commission has been recommending the transfer of funds to the Provincial Councils in four forms.

a) **Block Grant (BG)** meets Recurrent Expenditure needs of the Provinces for the purpose of sustaining and improving the public service delivery. Personnel Emoluments based on approved cadre is the major component of the Recurrent Expenditure. The assessed Recurrent Needs of the Provincial Councils include the transfers to the Local Government Authorities and the expenditure on maintenance of capital assets. The largest chunk of the Recurrent Expenditure is met from the Block Grant as the amount of revenue collected on devolved revenue sources is very small.

b) **Provincial Specific Development Grant (PSDG)** is for financing capital nature development Programmes with special attention to infrastructure and community development in various sectors under the devolved subjects. The financial provisions under PSDG are made for implementation of the Provincial Annual Development Plans which is formulated by the Provincial Councils in a common integrated planning framework in line with the respective Medium-Term Development Plan and guidelines issued by the Finance Commission.

c) **Criteria Based Grant (CBG)** is also another form of grants recommended for the Provincial Councils for discretionary spending on development related activities (not necessarily within the annual development plan) within an agreed financing framework mainly on decentralized budget for the Provincial Councilors and also on small sectors which could not be accommodated under PSDG and also the development of infrastructure and capacity building of implementing agencies.

d) **Revenue Performance Grant (RPG)** has been recommending to the Provincial Councils in order to encourage them 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. It has not been possible for the Treasury to provide this component presumably due to the resource constraints.

In addition to the above, the Provincial Councils receive funds through following sources;

a) Funds received from the Line Ministries when implementing their programmes/ Projects through the Provincial Councils.

b) Allocation for implementation of provincial component of special projects which are financed by the donor agencies.

CHAPTER 3

Assessment of Capital and Recurrent Needs and Recommendation on Apportionment of Grants among Provincial Councils for the Year 2023

3.1 Matters Considered in Assessment of Provincial Expenditure Needs

The Finance Commission considered the followings in the Assessment of requirements for making its Recommendations for grants to the Provincial Councils from the National Budget.

a) Constitutional Mandate, Policy Guidelines, and other relevant matters such as cabinet decisions
b) Critical development needs which were highlighted at the interactions with Provincial Authorities most of which are identified in the MediumTerm Development Plans of the provinces.
c) The Capital and Recurrent Expenditure requirements submitted by the Provincial Councils seeking Government grants for the year 2023
d) The Recommendations of the Finance Commission in the recent past and the observations of Hon. President and the Cabinet decisions pertaining to those recommendations
e) Socio-economic status of the Provinces
f) The needs for equitable and balanced regional development
g) The findings of consultative meetings conducted with stakeholders and findings of certain studies

In the view of the inadequacy of funds allocated to the Provincial Councils which are expected to assist the balanced regional development, the Finance Commission in the recent years has recommended that the expenditure budget allocation to the Provincial Councils should be at least 20% of the total estimated capital investment in the National Budget. In allocating such grants, devolution framework, national policies announced by the government as well as SDGs should be taken into consideration. In addition, it was also recommended that the duplications in fund allocation between the Line Ministries and the Provincial Councils should be avoided in the devolved and concurrent subjects and funds should be allocated directly to the Provincial Councils treating these entities as Special Spending Units and designating Chief Secretaries as Chief Accounting Officers.

3.2 Expenditure Requirements of Provincial Councils and Assessment of Grants by the Finance Commission

The Finance Commission issued Guidelines on 28th of January 2022 to the Provincial Councils to identify the Recurrent and Capital Needs separately for the year 2023. Based on the Guidelines, the Provincial Councils have prepared their annual needs of both Capital and Recurrent nature and submitted their Annual Capital and Recurrent Expenditure Requirements seeking Government Grants from the National Budget.

Based document for this exercise has been the comprehensive Medium-term Integrated Development Plan of each Provincial Council which reflects regional specific needs prepared in line with the Government development strategy and SDG framework. The expenditure requirements for Annual Implementation Plan have been identified by taking into consideration the targets and timeframe of the medium-term plans for financing from different sources of funds. Accordingly, the Capital Expenditure requirement of the Provincial

Councils for a particular year has been prepared for the purpose of implementing their development plans utilizing funds received from the National Budget in the form of Provincial Specific Development Grant (PSDG).

The Recurrent Expenditure Requirements of the Provincial Councils have been worked out by respective Provincial Councils taking into consideration the institutional and operational arrangements, approved cadre, maintenance of assets, transfers to Local Government Authorities and Statutory Bodies of the Province and other requirements of recurrent nature in a standard format. The expenditure requirements of each Provincial Council have been reviewed and finalized by the Finance Commission in consultation with Provincial Authorities and relevant authorities at national level. At the same time, the estimated devolved revenue collections of Provincial Councils were also prepared and reviewed. Customarily the total amount of grant for recurrent needs is finalized by deducting the total assessed devolved revenue and the revenue transferred from the Government from the total assessed Recurrent Expenditure.

The Provincial Councils receive funds in the following forms (please see section 2.3) for their service delivery and development activities.

a) Bulk of the funds from the National Budget to meet the capital needs comes in the form of Provincial Specific Development Grant and the lesser amount is in the form of Criteria Based Grant (A small amount has also been recommended in the form of Revenue Performance Grant which also can be used for activities of capital nature).
b) Funds requirements of the Provincial Councils for recurrent expenditure come in the form of Block Grant.
c) Funds received from the Line Ministries when implementing their programmes/ Projects through the Provincial Councils.
d) Allocation for implementation of provincial component of special projects which are financed by the donor agencies.

   The requirements submitted by the Provincial Councils have been assessed by the Finance Commission for recommending the grants referred to in (a) and (b) above.

3.3 Assessment of Expenditure Needs of the Provincial Councils for Government Grants

3.3.1 Assessment of Capital Grants to the Provincial Councils

Assessment of needs for Capital requirement of the Provincial Councils for Capital Grants have been executed based on the information provided by the Provincial Councils as per the formats given by the Finance Commission. The following sectors are common for sectoral allocation within all the Provinces under PSDG and will be incorporated in the Provincial Annual Development Plan. Additional sectors also could be incorporated according to the specific needs of a particular Province with proper justifications.

- Education
- Western Medicine
- Indigenous Medicine
- Provincial Roads
- Land Development
- Irrigation
- Agriculture
- Livestock
- Inland Fisheries
- Small Industries
- Sports
- Probation and Childcare
- Social Services
- Cultural and Religious Affairs
- Co-operative Development
- Early childhood Development
- Estate Infrastructure
- Transport
- Housing
- Rural Electrification
- Local Government
- Tourism
- Rural Development

In addition to above sectors a flexible amount to meet the gaps in the above sectors and a grant for development of villages with special needs will be earmarked when apportioning the grants among various sectors.

3.3.2 Assessment of Capital Expenditure Needs for Year 2023

Provincial Sectoral Capital Expenditure Needs were basically identified by the Provincial sectoral agencies which possess the technical expertise in each sector, with the involvement of the Governors, Chief Secretaries, and other provincial authorities. The Capital Need Assessment has been performed on the basis of the Finance Commission's Guidelines. Further, due attention has been paid to Provincial Five-Year Development Plans/Medium Term Sectoral Results Framework, Sustainable Development Goals and Targets, internal and intra-regional disparities, readiness in project implementation and their feasibility, Special Development Programmes implemented by the Line Ministries at sub-national level and the need for optimum utilization of physical and human resources in the provinces.

Critical development needs for delivering services related to devolved sectors including continuation work, renovation of physical infrastructure, and institutional and beneficiary capacity building are inclusive of the assessment of capital needs. Even though, the government is currently experiencing severe budgetary constraints, the Finance Commission assessed capital expenditure needs which are essential for effective service delivery under devolved subjects (without taking into consideration other constraints) as per the requirement of the Constitution. Furthermore, the Finance Commission is of the view that providing these amounts will not be an extra burden to the government, if it refrains from allocating funds to the Line Ministries under the subjects which are devolved to the Provincial Councils.

Accordingly, the total assessed requirement of capital funds for the 9 provinces for the year 2023 is Rs. 167.0 billion. This consists of Rs. 149.0 billion of Provincial Specific Development Grants, Rs. 15.0 billion of Criteria Based Grants and Rs. 3.0 billion of Revenue Performance Grants. Recommendation on the apportionment of this amount among 9 provinces are given under 3.5.1 of this Chapter.

3.3.3 Assessment of Block Grant for the Year 2023

Recurrent needs of provinces were assessed through scrutinizing the requests submitted by the provinces as per the guidelines issued by the Finance Commission on 28th of January 2022 followed by the budget discussions had with provincial officials.

The assessment of the recurrent needs for 2023 is based on the followings;

01. The total provincial cadre as at 31.03.2022 approved by the Department of Management Services (DMS)
02. The procedural delays in obtaining DMS approval for already deployed / attached cadre to Provincial Councils by the Line Ministries mainly in the Health, Indigenous Medicine, Education etc. However, the Finance Commission has been compelled to accept temporarily the attachment letters issued to Provincial Councils on DMS approvals.
03. Estimated provision for members of PCs to be elected and their personal staff as per the circulars issued by the Presidential Secretariat.
04. Circulars, procedures and instructions issued by the government from time to time.
05. Provision for payment of approved outstanding salary arears
06. Unemployed graduates recruited under the government top priority program and attached to the Provincial Councils who were required to be made permanent in 2021 failing which in 2022. Therefore, provisions have been included for remuneration payable to them.
07. The requirement of the staff of provincial schools which are to be upgraded as National Schools under 1000 schools development program was included under the Provincial Councils until 2024 as requested by the Ministry of Education and agreed.
08. Provincial requests for overtime and holiday pays have been increased dramatically compared to previous years. The requirement for 2023 was assessed considering living cadre and actual expenditure pattern in the recent past.
09. Assessed Local Government Transfers Rs. 35,538,779,000 for the payment of Members Allowance and also for Salary Reimbursements for the cadre approved for local authorities and agreed by the

Department of Management Services at the budget meetings had with Provincial Councils, is shown this time under “Personal Emoluments” (PE) instead of reflecting under “Other Recurrent Expenditure” (ORE) as it was done hitherto, on the request of the Department of National Budget.

10. The Commission decision on 25/04/2018 to provide funds for salaries of only three statutory authorities considering the importance of their assigned functions of Provincial Councils viz. the Provincial Road Development (PRDA), the Provincial Passenger Transport (PPTA) and the Early Childhood Development Authorities (ECDA).
11. Essential and critical needs for repairing and refurbishing provincial assets including Maintenance of Roads, Buildings and Structures, machinery and equipment particularly in the Education, Health, Irrigation Agriculture and other sectors.
12. Other Recurrent Expenditure (ORE) also consist of expenditure assessed for grants to Children Homes, Elders Homes and transfers to households i.e. Cancer, Kidney and TB patients
13. Dwindling provincial revenue due to certain government decisions pertaining to the Provincial revenue and Covid 19 pandemic situation (It has been the policy throughout for the Treasury to reduce the recurrent provision by an amount equivalent to the revenue collected by the Provincial Councils and the amount of revenue transferred to the Provincial Councils by the Treasury).

Accordingly, the provincial recurrent need for the year 2023 has been assessed as Rs. 470,083.63 million.

Table-02: Assessed Amount of Recurrent Needs for the Year 2023

Province	DMS approved cadre of the Province as at 31.03.2022	Assessed Total Recurrent expenditure (Rs. '000)				Request on Advance B Account (Rs.'000)	Assessed Recurrent Need (Rs.'000)
		Personal Emolument	Other Recurrent Expenditure	Request on Contingency Fund	Assessed Total Recurrent Expenditure		
(1)	(2)	(3)	(4)	(5)	(6) = (3+4+5)	(7)	(8) = (6+7)
Western	62,569	61,247,573	24,106,977	200,000	85,554,551	3,654,450	89,209,001
Central	48,256	43,773,433	9,972,195	586,555	54,332,183	1,500,000	55,832,183
Southern	46,835	44,316,698	10,330,809	207,600	54,855,107	4,719,000	59,574,107
Northern	31,575	32,496,733	8,277,472	36,664	40,810,869	650,000	41,460,869
North western	47,818	43,492,472	8,363,618	1,500,000	53,356,090	2,837,000	56,193,090
North Central	29,235	26,055,742	6,908,107	130,000	33,093,849	1,191,934	34,285,783
Uva	32,565	29,462,285	6,642,995	55,000	36,160,280	700,000	36,860,280
Sabaragamuwa	38,711	40,507,978	8,081,043	400,000	48,989,021	2,334,350	51,323,371
Eastern	37,912	36,679,514	7,715,435	200,000	44,594,950	750,000	45,344,950
Total	**375,476**	**358,032,429**	**90,398,651**	**3,315,819**	**451,746,899**	**18,336,734**	**470,083,633**

Note: Column 3 - Includes Personal Emoluments for Living cadre & Vacancies, Line Ministry attachments and salary arrears.

Column 4 - Includes Local Government Transfers (LGT), PE for Provincial Council Authorities (without taking into consideration Stamp Duty & Court Fines receivable to Local Government Authorities).

3.4 Provincial Revenue

The revenue sources devolved on Provincial Councils under the 13th amendment to the Constitution are contained in item 36.1 to 36.20 of list 1 of the ninth schedule.

Motor vehicle Revenue License Fees, License tax on liquor sale, Stamp Duty, Court Fines and Business Turnover Tax (BTT) were the main revenue sources of Provincial Councils. Out of these sources, stamp Duty and Court Fines legally have to be transferred to the Local Authorities.

BTT, the most important turnover tax on wholesale and retail sales was abolished with effect from 1st January 2011 by the Fiscal Policy Circular No:01/2010. With the abolition of the turnover the tax base of provincial revenue has been narrowed transferring of revenue collected (centrally) by the government on certain revenue items which are specified in the devolved list and part of Nation Building Levy became important.

This transfer mechanism was effected through the above mentioned Fiscal Policy Circular. Accordingly, 100% of Stamp Duty, 70% of Vehicle Registration Fees and 33 1/3% of Nation Building Tax (NBT) have to be transferred. However, the NBT was abolished with effect from 01.12.2019.

Even though, there was a noticeable increase in the revenue as a percentage of the provincial expenditure pursuant to the introduction of the above transfer mechanism, the abolition of NBT in 2019 resulted a significant decrease in those percentages as shown in the table below.

Table-03: Provincial Expenditures and Revenue Receipts (Rs. Mn)

Year	Total Expenditure	Total Revenue Collection including Treasury Transfers	Provincial Revenue as a percentage of Provincial Total Expenditures
2008	120,195	30,561	**25**
2009	133,175	29,333	**22**
2010	143,491	36,506	**25**
2011	149,750	46,505	**31**
2018	281,543	46,354	**33**
2019	303,740	44,235	**30**
2020	335,418	41,005	**16**
2021	342,023	53,004	**19**

The decline in the revenue collection of the Provincial Councils as a percentage of the total expenditure will compel the government to increase the amount of funds provided to these entities.

3.5 Recommendation on Apportionment of Government Grants Among Provincial Councils-2023

3.5.1 Recommendation on Apportionment of Capital Grants

Following the forgoing Need Assessment process and making Recommendations of funds for the Provincial Councils based on the criteria referred to in 3.1 in this Chapter and also taking into consideration the need for alleviating social and economic disparities among the Provinces, the Commission also has to make Recommendations on apportionment of such funds among various Provinces as required by Article 154 R (4)(a) of the Constitution. To facilitate this process, the Finance Commission in collaboration with the Department of Census and Statistics developed a statistical formula adopting a multivariate statistical technique called “Factor Analysis” for the apportionment of Capital funds among the Provinces in a rational manner. The following Provincial level variables have been incorporated to construct the index.

- Mid-Year Population of the Province
- The Land Area of the Province
- Provincial Gross Domestic Product
- Number of poor population of the Province
- Median per capita income of the Province
- No. of Persons per Medical Officer (allopathic doctor) in the Province
- Percentage of students qualified for university entrance in Science Stream in the Province

Provincial data were obtained on the above-mentioned variables from the Department of Census and Statistics, Central Bank of Sri Lanka and Department of Examination.

The table 4 shows latest available data of the selected Socio – economic indicators of the provinces. The Finance Commission has taken into consideration socio economic situation of each province with the aim of ensuring fair distribution of government funds specially among the Provinces which are comparatively lagging behind.

Table-04: Selected Physical, Demographic and Socio-Economic Indicators of Provinces

Province	Land Area 2020 (Sq.km.)	Mid-year Population 2020 (000)	Provincial GDP 2020 (Rs. Bn)	Median Monthly Per Capita Income 2019 (Rs. Per one income receiver)	Number of poor people -2019	Percentage of students qualified for university entrance in Science Stream -2020	Persons per Medical officer 2019
Western	3,684	6,165	5694	35,171	342,200	29.1	768
Central	5,674	2,781	1692	25,067	503,500	10.8	1080
Southern	5,544	2,669	1518	26,267	327,100	17.3	1291
Northern	8,884	1,152	689	24,629	267,200	5.8	1016
North Western	7,888	2,563	1653	28,800	294,400	11.0	1488
North Central	10,472	1,386	876	26,323	144,900	4.5	1338
Uva	8,500	1,387	812	22,343	378,500	5.5	1517
Sabaragamuwa	4,968	2,070	1188	23,517	468,100	9.5	1463
Eastern	9,996	1,746	849	25,000	316,300	6.5	1095
Sri Lanka	**65,610**	**21,919**	**14973**	**28,465**	**3,042,300**	**100.0**	**1070**

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

The Commission recommends that the percentages shown in the Table 5 to be used for the apportionment of Capital Fund among the Provinces, which were calculated using the Composite Index.

Table-05: Composite Index Values and Percentages of each Province for Capital Fund Allocation

Province	Composite Index (CI) Value	Percentage Value of CI value
Western	0.67633	7.42
Central	1.01174	11.11
Southern	0.92192	10.12
Northern	1.17369	12.88
North Western	0.91576	10.05
North Central	1.04349	11.45
Uva	1.12125	12.31
Sabaragamuwa	1.09137	11.98
Eastern	1.15499	12.68
		100.00

Accordingly, the Finance Commission recommends the following amounts as capital grants to Provincial Councils for the year 2023.

Table-06: Recommended Amounts of Capital Grants to the Provincial Councils for the Year 2023

Provincial Council	Capital Grants (Rs. Million)				%
	PSDG	CBG	RPG	Total	
Western	11,055	1,113	223	12,391	7.42
Central	16,554	1,666	333	18,553	11.11
Southern	15,079	1,518	304	16,901	10.12
Northern	19,191	1,932	386	21,509	12.88
North Western	14,975	1,507	302	16,784	10.05
North Central	17,061	1,718	344	19,123	11.45
Uva	18,342	1,847	369	20,558	12.31
Sabaragamuwa	17,850	1,797	359	20,006	11.98
Eastern	18,893	1,902	380	21,175	12.68
Total	**149,000**	**15,000**	**3,000**	**167,000**	**100.00**

The Finance Commission will issue a set of Guidelines to formulate the Annual Development Plans by the Provincial Councils for the Grants to be provided under PSDG enabling to maintain a uniform planning framework among nine Provincial Councils. As customarily done, after the consultative process with the participation of relevant stakeholders, the Commission will grant its concurrence for Annual Development Plans that will be prepared by the Provincial Councils.

3.5.2 Recommendation of Block Grant to the Provincial Councils

The grant for needs of recurrent nature to the Provincial Councils totally depends on the assessed final amount of Recurrent Expenditure requirements, the estimated revenue of the respective Provincial Council and the revenue transferred from the Treasury. The expenditure requirements and the devolved revenue targets of the Provincial Councils were assessed by the Finance Commission through review discussions with the participation of respective Provincial authorities, the officials of the Department of National Budget and the Department of Management Services.

The Finance Commission recommends the Block Grant for the Provincial Councils to fill the gap between the assessed recurrent expenditure and expected total revenue of those entities. The estimated transfers of Government revenue to the Provincial Councils which is a small component of total estimated revenue of Provincial Councils has not been included in revenue estimates shown in the 3rd column in table 7 as these figures are not yet made available by the Department of Fiscal Policy.

Accordingly, the Recommended amount for Block Grant for the year 2023 by the Commission is given below.

Table-07: The Block Grant Recommended by the Finance Commission for the Year 2023

(Rs.'000)

Province	** Total Recurrent Expenditure	** Devolved Revenue Target	Total Block Grant Recommended by FC (without Revenue Transfers)
'(1)	'(2)	'(3)	(4)= (2) -(3)
Western	89,209,001	6,555,809	82,653,192
Central	55,832,183	2,100,000	53,732,183
Southern	59,574,107	1,782,891	57,791,216
Northern	41,460,869	1,148,500	40,312,369
North Western	56,193,090	2,564,800	53,628,290
North Central	34,285,783	1,355,000	32,930,783
Uva	36,860,280	830,000	36,030,280
Sabaragamuwa	51,323,371	1,360,000	49,963,371
Eastern	45,344,950	850,000	44,494,950
Total	**470,083,633**	**18,547,000**	**451,536,633**

Note: ** Excluding Stamp Duty and Court Fines

Total Recurrent Expenditure (TRE) – includes PE for Authorities, Personal Emoluments for Line Ministry attachments & Salary Arrears.

When determining the size of the block grant the Treasury has been throughout used to deduct the total revenue from the total estimated recurrent expenditure. Assuming that this practice is followed by the Treasury for the year 2023 the value of the block grant has to be estimated by deducting the estimated amount of revenue from Rs. 451,536.633 million for the year as shown in the last column of the above table (please see our recommendation pertaining to this situation at item 7 of Chapter 4 of this report)

Alternatively, it is also proposed that Provincial Councils be allowed to use 40% of their revenue to meet the huge gap in advance B account and for other critical needs.

Accordingly, total amount of grants (Capital and Recurrent) recommended by the Finance Commission for Provincial Councils for the year 2023 will be Rs. 618,536.6 million.

Chapter 04

Some Proposals for Improving the Efficiency of Resource Allocation and Service Delivery at Provincial Level

While submitting its Recommendations to the Hon. President pertaining to the year 2022 in compliance with the Article 154R (4) (a) of the Constitution the Finance Commission submitted certain proposals for the rational allocation and effective utilization of scarce resources at provincial level. There was an acutely felt need for submitting those proposals as the country was experiencing serious fiscal constraints primarily due to COVID 19 pandemic. Those proposals which were along with the other recommendations included therein were accepted by the Hon. President, approved by the Cabinet of Ministers and subsequently tabled in Parliament. However out of those proposals even those ones which do not entail incurring of additional expenditure but that might have far-reaching impact have not been implemented. Therefore, in addition to our forgoing recommendations submitted in compliance with the Constitutional requirement, we also wish to make certain new proposals in this chapter in place of customarily submitted policy recommendations as there should be a concerted effort to spend scarce resources very judiciously with fiscal prudence. In this chapter we also will be reiterating certain previous proposals submitted which were not implemented, where applicable.

1. **Rational allocation of resources for Balanced Regional Development within the existing resource envelope:**

The primary responsibility assigned to the Finance Commission by the Constitution is to assist in achieving the Balanced Regional Development, through rational allocation of resources.

Since the Commission was convinced that the resources allocated to the Provincial Councils were very much inadequate throughout, it was proposed that adequate funds be provided for those entities on devolved subjects. The Commission is inclined to repeat this recommendation as a matter of policy as it believes that this can be implemented within the existing resource envelope by refraining from allocating resources to Line Ministries on devolved subjects and by channeling same to the Provincial Councils. Therefore, Finance Commission wishes to recommend the government in future that whatever the amount of funds that will be allocated for devolved subjects be allocated to the Provincial Councils, directly taking in to consideration the fact that constitutionally the Provincial Councils are entitled to receive them.

2. **Setting up of powerful agency to be in charge with the rational allocation of resources both at National and Provincial level:**

In our previous recommendations we stated that the expected Balanced Regional Development which was emphatically mentioned in Article 154 R (5) of the Constitution cannot be achieved through the Provincial Councils alone due to the following reasons.

(a) The amount of resources that the Provincial Councils receive on devolved subjects are very much less than the amount the Line Ministries/agencies in the center receive on same devolved subjects

(b) Line ministries/agencies in the center implement projects and programs aiming at regional development in geographical areas which extend beyond provincial boundaries

(c) In channeling resources to regions as per (a) and (b) above, those Line Ministries/agencies in the center rarely adopt criteria reflecting regional inequalities as the Finance Commission does

(d) Non availability of integrated planning mechanism in both national and provincial level to avoid duplication and overlapping of activities and also to ensure funds are diverted to the most deserving areas/sectors

In addition to the above, the need to undertake independent and rigorous appraisal of investment proposals to ensure that only the projects with higher economic returns are implemented is acutely felt pursuant to the present debt crisis. This situation underscores the lack of such appraisals which resulted in heavy investment of funds borrowed at commercial rate of interest for projects with very long gestation period usually at the expense of projects with higher economic returns.

Therefore, while emphasizing our recommendations made last year regarding the adoption of integrated planning mechanism, the Commission wishes to propose that a powerful independent entity similar to the former Planning Commission of India be established to be in charged with overall resource allocation and prioritization of projects. Initially this can be created by amalgamating the National Planning Department and the Finance Commission and also by co-opting the services of related other agencies. If the government agrees, the Finance Commission together with the National Planning Department can develop a concept paper to initiate required Constitutional Amendments.

3. Proper management of provincial cadre:

The Commission feels that the undertaking of the cadre review proposed in the revised Budget for this year is a long overdue. However, it is doubtful whether the desired outcome can be achieved by focusing it on primary level of the public service. Present cadre which was approved long ago does not reflect the true requirement at present as the adoption of new technology and outsourcing of certain services previously carried out by the in house staff was not foreseen. If the country is to be put on high growth trajectory re-engineering of the public service is a must. Therefore, the Commission strongly recommends that the proposed cadre review should be a comprehensive one covering entire spectrum of the public service. The Commission also proposes that Management Information System (MIS) for the effective deployment of entire cadre be developed and maintained by the Department of Management Services.

4. Refraining from setting up of project offices in executing donor funded projects:

In our recommendations submitted last year, we strongly recommended that staff of the Provincial Councils be used when implementing projects instead of establishing project offices for that purpose. Our contention was that a well-developed organizational structure at provincial level with capable human resources of diverse disciplines and their capacity is not being fully utilized mainly due to the insufficiency of capital grants given to the Provincial Councils. In fact, what the Line Ministries do when setting up of project offices is either to hire the staff from outside of the public service or obtain the services of provincial staff on secondment basis by paying additional remuneration in addition to their salaries. In addition to the cost involved in the project administration, the Commission came across numerous problematic situations especially after the completion of the project when a project is implemented through a project office. The main problem is that the difficulty in holding the project staff responsible for any shortcoming in the project implementation. It is customary for the donor agencies to propose setting up of project offices when committing financial assistance to a particular project presumably due to the lack of understanding of the ground situation. While welcoming the inclination of the government to restrict the number of project offices set up for project implementation, we wish to recommend that a firm policy decision be taken by the government in this regard so that the Department of External Resources can persuade donor agencies not to propose setting up of project offices but to use the existing staff of the Provincial Councils as much as possible when committing assistance to various projects.

5. Making Chief Secretaries directly answerable to Parliament:

In two earlier occasions it was proposed that the Provincial Councils be made Special Spending Agencies in the Appropriation Act and thereby the Chief Secretaries to be directly held answerable to Parliament. The proposal to designate Chief Secretaries as Chief Accounting Officers can be further justified on the ground that they are responsible for managing the provincial budget as well as the provincial public service. It would be also pertinent to mention that Chief Secretaries are also appointed by the Hon. President in terms of Constitutional provision as in the case of Secretaries to the Line ministries. It would be pertinent to mention that one can also question the propriety of the present practice of the inclusion of Provincial Councils in the Annual Appropriation Act as spending units which come under the Line Ministry, when those entities are not listed under that Ministry in the gazette notification issued under Article 44 (1) (a) of the Constitution presumably due to legal implications. In view of the above the Commission wishes to re-iterate this proposal in this year’s recommendation too.

6. The need to revisit the policy of locating/expanding health care institutions:

Health authorities have pointed out that there is a heavy pressure on hospitals in major cities while the health care institutions at the periphery are grossly underutilized. In the meantime, there is a pressure for the government to equip the latter category also with modern equipment and man with trained health care professionals for whom heavy recurrent expenditure has to be incurred in the form of additional remuneration applicable to their counterparts in the major hospitals. Heavy investments made in the last two decades in infrastructure development have created a modern road network connecting the most parts of the country. This has enabled patients in many peripheral areas to have fairly easy access to the hospitals in the main cities. On top of that, 'Suwasariya" mobile ambulance service which proved its efficiency especially during the COVID epidemic, improved this situation further. It is not very clear that these aspects have been taken in to consideration in locating/expanding health care institutions either by the Line Ministry or Provincial Councils. Therefore, the Commission wishes to recommend that a comprehensive and independent study be undertaken by the government to formulate a policy for locating/expanding Hospitals and other health care institutions of public sector.

7. Linking the revenue generation of Provinces to the development objectives of the devolution:

The rational of devolution of certain sources of revenue to the Provinces is to meet at least part of the expenditure needed for Balanced Regional Development. However, the practice adopted by the Treasury from the inception has been to set off the entirety of provincial revenue to meet part of recurrent expenditure of the province. Bulk of the recurrent expenditure of the Province (approximately 80%) is spent on maintaining free education and free health system which is implemented uniformly throughout the country based on rules and regulations issued by the Centre. This practice does not incentivize the provincial authorities to adopt any innovative approaches to address even the regional specific issues of the Province. On the other hand, when the national schools (most of those are located in the cities) are maintained at the expense of general tax revenue, it looks anomalous for the Provincial Councils to use their revenue to maintain provincial schools and rural health care institutions. Since the provision of free health and free education is a national policy implemented universally across the country it is suggested that the provincial element of that cost also be borne by the government and leave the provincial revenue with the Provincial Councils to facilitate the development of other devolved sectors through revenue earned by those entities. Even though the net impact to the government will be the same even under proposed mechanism, it will provide some incentives for the provincial authorities to intensify their revenue effort in order to develop other sectors (other than education and health) which are also linked to the upliftment of the livelihood of the rural community.

Since there is no sufficient fiscal space for the Treasury to accommodate our recommendation made in last year to meet the huge gap in the Advanced Account B, the Commission as an alternative, wishes to recommend that the Provincial Councils be allowed to utilize 40% of their revenue to meet that gap. This will alleviate glaring anomaly that the provincial public servants experience vis a vis their counterparts in the government.

8. **Avoiding the inclusion of activities pertaining to the devolved subjects in the portfolios of National Ministries:**

By the 13th Amendment to the Constitution certain powers and responsibilities were devolved to the Provincial Councils while retaining the power of policy making also on those devolved subjects with the Centre (in addition to subjects in the concurrent list and the reserved list). Accordingly, the Provincial Councils over the time have developed strong institutional framework comprising of required human and physical resources to undertake activities pertaining to the development of those devolved sectors. However, the Finance Commission observes that many Line Ministries used to implement projects on regional basis pertaining to the subjects devolved to Provincial Councils. Since the Line Ministries in many instances do not have their own mechanism to implement those projects/activities they have to rely on administrative set up of Provincial Councils or District Administration or a specially set up project office as explained in paragraph 4 above. This has resulted in duplication and overlapping of activities leading to wastage and inefficiency. The Line Ministries get the legitimacy to undertake such activities by virtue of powers vested with them in terms of the notification issued under Article 44 (1) (a) of the Constitution which also contain inter-alia the subjects which are devolved to the Provincial Councils. Therefore, it is recommended that the Line Ministries be entrusted with the responsibility of policy development and macro level strategic planning pertaining to devolved subjects, leaving the implementation of those activities with the Provincial Councils, making the devolution more meaningful.

9. **Consultation with the Provincial Councils in the identification of location for projects implemented by the Line Ministries:**

When implementing projects/activities by the Line Ministries pertaining either to the Concurrent list or to the Provincial list (if the present practice continues despite our foregoing recommendations), it is suggested that provincial authorities be consulted in locating such projects within the Province. This will avoid the inclusion of the same activity in the Annual Development Plan of the Provincial Council, and the resultant duplication and overlapping. The proposed consultation will be mutually beneficial to both the Line Ministry and the Provincial Council as the maximum benefits out of the projects can be derived by locating them in the most suitable location. Similar consultation should take place when implementing donor funded projects too.

10. **Having a dialogue with the Provincial Councils in issuing circulars by the Line Ministries that affects the provincial public service:**

The provincial authorities have brought to our knowledge that they encountered difficulties in implementing certain circulars issued by the Line Ministries without proper consultation with Provincial Councils. These include budgetary constraints and administrative issues. It is not correct to assume that the Provincial Councils can meet the additional expenditure needed to implement such circulars, out of their "own funds" as those entities do not have such surplus funds which are not allocated to a particular activity. It is suggested that the Treasury also be consulted to ascertain whether it is in a position to allocate required additional resources to the Provincial Councils in implementing such circulars

11. Disregarding the provincial hierarchy in implementing projects through provincial cadre:

Certain Governors and provincial authorities have expressed their concerns on some Line Ministries directly dealing with the lower and middle level staff of the provincial set up bypassing the higher provincial authorities when implementing projects. Even though there is a possibility of expediting the execution of projects by dealing directly with the middle and lower level staff in the provincial set up, problematic situations arise when this is done without the knowledge of the higher authorities in the Provincial set up. This situation can be avoided if the Line Ministries can have preliminary discussions with the Governors, Chief Secretaries and the relevant provincial authorities prior to the commencement of the project and reach an agreement regarding the mobilizing of the provincial cadre for a particular project.

12. Removal of constraints in provincial revenue mobilization:

Twenty sources of revenue of Provincial Councils (19 specific sources and 1 miscellaneous source) are specified in item 36.01 to 36.19 in the List 1 of the 9th schedule to the Constitution. Out of those sources taxes relating to turnover, motor vehicle license fee, taxes on lands and buildings and betting taxes can be levied by the Provincial Councils subject to the limitations imposed by Parliament. There is a need to revisit this list and expand it while relaxing restrictions where possible. Since this has to be done through an Amendment to the Constitution in consultation with relevant stake holders, it may be difficult to implement this proposal in the short term.

Even though the Provincial Councils have the power to collect those taxes and levies, the rates of many taxes and fees have to be specified under the provisions of relevant legislation by respective Ministers of the Cabinet. Therefore, amending rates in keeping with changing situations is beyond the control of the Provincial Councils. For an example motor vehicle license fees presently in force have been determined in 2013 and the license fees on liquor sales outlets have been specified in 2017.Therefore, the Commission wishes to recommend that similar taxes and levies be revised by the Line Ministries in keeping with other developments.

We submit the foregoing recommendations for your highest consideration.

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Sumith Abeysinghe

Chairman

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கலாநிதி பி.நந்தலால் வீரசிங்கபதவிவழி அங்கத்தவரும்

(இலங்கை மத்திய வங்கியின் ஆளுநரும்)

Dr. P. Nandalal Weerasinghe

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

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கே.எம். மகிந்த சிறிவர்தன

பதவி வழி அங்கத்தவர் (திறைசேறி செயலாளர்/நிதி அமைச்சு)

K.M. Mahinda Siriwardana

Member (Ex-officio) (Secretary to the Treasury)

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நியமன அங்கத்தவர்

Sinnathamby Samithamby

Member (Appointed)

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ரஸீக் சரூக்

நியமன அங்கத்தவர்

Razik Zarook

Member- (Appointed) and President's Counsel

Annexure-1

Provincial Capital Need Request, Recommendation, Budgetary Allocation & Imprest Released (2017 - 2021)

(Rs.Mn)

Year (1)	Amounts Requested by PCs (2)	Amounts Recommended by FC (3)	Budgetary Allocation (4)	Imprest Released (5)	Imprest Released as a % of Budgetary Allocation (6) =5/4*100	Imprest Released as a % of Recommended Amount by FC (7) = 5/3*100
2021	133,205	77,950	26,944	15,191	56.38	19.49
2020	102,137	99,000	15,376	12,756	82.96	12.88
2019	98,854	40,000	27,334	13,581	49.69	33.95
2018	82,588	57,000	25,788	16,148	62.62	28.33
2017	85,243	38,432	35,809	23,769	66.38	61.85
Total	**502,027**	**312,382**	**131,251**	**81,445**	**62.05**	**26.07**

Source: Finance Commission, Dept. Of National Budget