

THE FINANCE COMMISSION

RECOMMENDATIONS - 2016 TO H.E. THE PRESIDENT

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

January 2016

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FINANCE COMMISSION
(Established under Article 154 R
of the Constitution)

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Date

FC/3/1/2016

25.01.2016

His Excellency Maithripala Sirisena

President of the Democratic Socialist Republic of Sri Lanka

Presidential Secretariat

Colombo 01

Your Excellency,

As required by the Article 154 R of the 13th Amendment to the Constitution of the Democratic Socialist Republic of Sri Lanka, I hereby submit the Recommendations for 2017 including the proposed strategies to achieve balanced regional development in the country and the apportionment of funds to be allocated from the Annual Budget - 2016 for use in the provinces.

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

Yours respectfully,

Sgd/ U.H.Palihakkara

Chairman

Finance Commission

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1. The Role of the Finance Commission and Its Major Responsibilities

The Finance Commission was established, under the 154R Article of the 13th Amendment to the Constitution of the Democratic Socialist Republic of Sri Lanka in 1987 with the objective of reducing the regional disparities in the country and facilitating the process of distributing resources to the provinces and provincial development planning. The mandate of the Finance Commission as indicated in Article 154 R (3), (4) and (5) of the 13th Amendment to the Constitution is as follows;

- i. The Government shall, on the recommendation of, and in consultation with, the Commission, allocate from the Annual Budget, such funds as are adequate for the purpose of meeting the needs of the provinces.
- ii. It shall be the duty of the Commission to make recommendation to the President as to-
 - a) 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; and
 - b) Any other matter referred to the Commission by the President relating to provincial finance.
 - c) The Commission shall formulate such principles with the objective of achieving balanced regional development in the country, and shall accordingly take into account the population, per capita income, the need progressively to reduce social and economic disparities and the need progressively to reduce the differences between the per capita income of each Province and the highest per capita income among the Provinces. Accordingly, the Finance Commission is to apportion such funds between the provinces.

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

Within the context of constitutional mandate, the Finance Commission assists the provinces in their planning and implementation by way of engaging mainly in the following activities;

- Assessment of the requirements of provincial capital expenditure, recurrent expenditure and cadre annually,
- Issuing guidelines and instructions in relation to the needs assessment in the provinces,

- Recommendation of allocations to the government needed for provincial development after discussions with the provinces,
- Informing the provinces on annual grants allocated by the government,
- Issuing guidelines on the preparation and implementation of annual development plans including utilization of funds within the government policy and budgetary framework,
- Directing provinces in order to ensure achieving balanced regional development through effective utilization of resources.

1.1 Nineteenth Amendment to the Constitution

According to the 19th Amendment to the Constitution, the Constitutional Council which comprise ten members has been established under the Chairmanship of the Speaker in Parliament. The President shall appoint the Chairman and the members of nine independent Commissions (including the Finance Commission) based on the recommendations of the Constitutional Council. The Finance Commission includes five members and three members out of them are appointed by the President on the recommendation of the Constitutional Council (representing three major communities). The other ex-officio members are namely the Governor of the Central Bank and the Secretary to the General Treasury.

2. Apportionment of Government Funds between Provinces

The Thirteenth Amendment to the Constitution requires that the Government must allocate adequate funds to meet the fiscal needs of the provinces in consultation with the Finance Commission. The work of the Finance Commission involves two main functions in this process;

- a. Estimate the fiscal needs of the provinces based on the analysis of the needs submitted by the provinces and ensure that they are in line with the national policy directives and priorities. The Commission informs the Government with regard to allocation of funds from the Annual Budget.
- b. Apportion funds between the provinces with the objective of reducing regional disparities.

The allocation and apportionment of such funds to the provinces is performed through the following grants.

Block Grants - The Block Grant is to meet recurrent expenditure needs of the provinces for the purpose of sustaining and improving the service delivery system. Salaries and wages of provincial staff approved by the Department of Management Services (DMS) constitute the major part of recurrent expenditure. Accordingly, the assessment of salaries and wages is calculated taking into account the actual living cadre within the approved staffing limit. This grant also includes transfers to local authorities for meeting the expenditure on reimbursement of the allowances of members and salaries and wages of the staff. (Allocation and Release of Block Grant during the period from 2010 to 2014 are given in the Annex I)

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

i. Development Related Projects/ Activities

These funds are expected to be utilized for development projects in the province.

ii. Special Projects proposed by Provincial Council Members

These funds are for the projects initiated by the Provincial Council Members.

(Allocation and Release of Criteria Based during the period from 2010 to 2014 are given in the Annex II)

Province Specific Development Grant (PSDG) - The PSDG is allocated mainly for financing development projects of capital nature, paying special attention to infrastructure development under the devolved subjects. The Finance Commission has allocated PSDG among selected development sectors and sub programmes under major sectors (PSDG Allocations for 2016 are in Annex 3).

When provinces submit their development plans, the Commission and respective provincial authorities discuss and agree to ensure that such plans would address the provincial needs and that they are also in line with national development policy of the Government. For each investment item, measurable results (output, outcome and impact) need to be identified, in the form of pre-defined indicators and periodical monitoring and evaluation on the achievements should be undertaken using such indicators. All provincial authorities are expected to use the relevant formats introduced by the Finance Commission for results based monitoring and evaluation. (Allocation and Release of Province Specific Development Grant 2010 – 2014 are in Annex 3)

Integrated Projects for Balanced Regional Development- A special allocation is provided under PSDG for the projects which can contribute remarkably to minimize inter and intra socio-economic disparities. In the preparation of project proposals under this, increase in the value addition, creation of employment opportunities and reduction of poverty are expected to be given adequate attention.

Development of Under-served Villages - These allocations have been made under PSDG with the objective of investing in improving the basic facilities of the backward villages. Most of the villages are lagging behind due to lack of social and economic infrastructure facilities, environmental hazards and some other social and cultural factors. It is necessary that all such factors be given due attention and an integrated development approach be adopted in identifying projects and programmes. Only villages which are in the jurisdiction of PradeshiyaSabhas should be identified under this funding category. In selecting the villages, criteria like lack of income sources and inadequacy of common facilities need to be given due consideration. Projects for village development should be selected with the assistance of community and village level committees which comprise public officers at rural level, representatives of community organizations, religious leaders and people representing at PradeshiyaSabhas level are suggested to be established, at village level in order to facilitate the implementation of the projects. Depending on the nature of projects, the assistance of the relevant agencies in the province should be obtained in implementation. The responsibility of implementation, monitoring and regulating the projects should be assigned to the Department/ Unit which is responsible for subject of rural development.

Flexible Amount

These funds allocated under PSDG should only be used to make adjustments in relation to sectors/ agencies which are in short of funds and to incorporate essential activities which are not included in the approved plan.

3. Methodology of Apportionment of Capital Funds between Provinces

The Finance Commission is responsible for formulating principles towards achieving balanced regional development in the country. In keeping with this objective, the Commission apportions capital funds (PSDG and CBG) between the provinces in a rationale manner. In this regard, the Finance Commission uses a statistical methodology.

The Finance Commission has taken steps to allocate capital funds between the provinces on district basis in 2016 with the objective of ensuring fair distribution of funds for development in the province.

At the request of the Finance Commission, the Director General of Department of Census and Statistics provided technical assistance to develop a statistical methodology for this purpose. Accordingly, the Department of Census and Statistics has appointed a team on this matter and they have developed a statistical formula. In developing the formula, the following socio-economic variables have been considered.

Factor	Variable (Indicator)	
Economic	X1 -	Poverty Head Count Ratio (%)
Health	X2 -	No. of Hospital Beds per 1000 people
Education	X3 -	Computer Literacy Rate (%)
	X4 -	Percentage of difficult schools out of total provincial schools (%)
Infrastructure	X5 -	Percentage of the length of roads to be developed out of total provincial road length (%)
Agriculture	X6 -	Paddy cultivated extent per square kilometer (Acer/Km2)
	X7 -	Average paddy yield (Bushels per acre)

3.1 Methodology of Developing the Statistical Formula

- Identifying suitable proportions using the considered variables.
- A multivariate statistical technique i.e. “Principal Component Analysis” (PCA) has been used to obtain a common score for the considered variable.
- The coefficients of Principle Components (PCs) should not be multiplied by standardized form of variables owing to the above reasons. But, the variable per se cannot be used as they are in different scales.
- All the variables have been adjusted by dividing them from their “means” and the variance of them is converted as coefficient of variance (CV).
- Using the coefficients of first PC, the score (Value of first PC) for each district has been calculated based on the adjusted values of variables, divided by their mean. (CV approach)

$$PC1 = a_1 * X_1 + a_2 * X_2 + \dots + a_7 * X_3$$

- Since the beneficiaries of the fund allocation are the people of the districts, the calculated scores above have been given weight according to the population of each district.
- Finally, the weighted score of a district has been divided by the total weighted score and the proportion for each district has been calculated.

It is expected to improve the formula further, identifying new variables which represent the development levels of provinces in 2017. Further, provinces have been allowed to adjust the district-wise allocations made in 2016, if necessary

The PSDG funds allocated by the General Treasury for 2016 have been apportioned between the provinces and districts based on the above formula. The apportionment of funds at provincial and district levels have been basically done on the basis of the above proportions. However, considering some practical aspects like benefits of foreign and locally funded projects implemented at national level, sector priorities of districts, policy directions of the government and the revenue generated by each province, few adjustments have been made in this exercise.

The CBG funds allocated by the General Treasury have also been apportioned between the provinces using the above formula and these funds have not been apportioned on district basis. Considering the number of council members in each province, separate amount of CBG has been apportioned to each province for use of them for development purposes. The rest has been allocated for development projects of the province in general.

4. Provincial Revenue

Provincial revenue originates from two main sources;

- i. Transfer of Government Revenue
- ii. Revenue Collected from Devolved Sources

4.1 Transfer of Government Revenue

According to the Fiscal Policy Circular No: 01/2010, the national authorities, namely the Commissioner General of Inland Revenue, Director General of Customs and Commissioner General of Motor Traffic have been directed to transfer the collected revenue to the provinces on the following basis;

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

According to the Circular, collected NBT and stamp duty should be shared between the provinces fortnightly, using dedicated bank accounts according to the following percentages, subject to re-fixing them periodically by the General Treasury, with the concurrence of the Finance Commission.

Province	Ratio
Western	48%
Central	9%
Southern	9%
North Western	9%
Sabaragamuwa	5%
North Central	5%
Uva	5%
Eastern	5%
Northern	5%
Total	100%

Table 1: Transfer of Government Revenue - 2014 and 2015

Rs. mn

Province	2014		2015	
	Target	Transfer	Target	Transfer up to June *
Western	16,800	14,999	18,960	7,532
Central	3,150	2,837	3,555	1,426
Southern	3,150	2,755	3,555	1,369
Northern	1,750	1,532	1,975	764
North Western	3,150	2,884	3,555	1,439
North Central	1,750	1,538	1,975	642
Uva	1,750	1,554	1,975	731
Sabaragamuwa	1,750	1,453	1,975	706
Eastern	1,750	1,425	1,975	783
Total	35,000	30,977	39,500	15,391

Source: Monthly Revenue Reports of provincial councils 2014,2015

*Provisional

The figures in Table 01 show that lesser amounts have been transferred to the provinces, against the targeted amounts. It is observed that the target on transfer of government revenue decided by the General Treasury needs to be re-visited, since there is a gap between the targets and actual transfers.

4.2 Revenue Collected from Devolved Sources

Provincial revenue is collected through tax revenues and non-tax revenues as listed from 36.01 to 36.20 in the Ninth Schedule of the Thirteenth Amendment to the Constitution and some main sources of provincial revenue are, Motor Vehicle License Fees, Excise Duty, Stamp Duty and Court Fines. Stamp Duty and Court Fines collected by provinces are annually transferred to the Local Authorities. Stamp Duty constitutes the highest contribution of all the revenue sources. Amounts collected through the main sources of provincial revenue in 2014 and 2015 (up to June) are given in Tables 2 and 3.

Table 2: Provincial Revenue Collected by Devolved Source – 2014

(Rs. '000)

Province	Target (Including Stamp Duty & Court Fines)	BTT	Motor Vehicle license Fees	Excise Duty	Stamp Duty	Court Fines	Others**	Total
WP	13,900,000	2,186,050	2,573,020	263,620	6,354,370	571,370	1,936,320	13,884,750
CP	2,075,000	417,388	492,551	184,817	607,923	67,754	211,875	1,982,308
SP	2,340,000	381,374	428,622	63,420	828,365	166,487	291,542	2,159,810
NP	400,000	-	-	-	-	-	80,983	80,983
NWP	2,555,000	193,607	551,466	69,136	899,307	309,164	247,035	2,269,715
NCP	955,000	116,525	284,387	24,110	50,150	193,097	239,840	908,109
Uva	630,000	115,311	143,481	53,750	125,550	96,156	129,357	663,605
SGP	1,210,000	129,659	351,105	44,037	304,804	112,351	178,506	1,120,462
EP	760,000	112,216	215,508	28,684	133,313	74,127	128,011	691,859
Total	24,825,000	3,652,130	5,040,140	731,574	9,303,782	1,590,506	3,443,469	23,761,601

Source: Monthly Revenue Reports of provincial councils - 2014

*Collection of due BTT up to 2010

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

Table 3: Provincial Revenue Collected by Devolved Source (up to June) – 2015***(Rs. '000)**

Province	Target (Including Stamp Duty & Court Fines)	BTT**	Motor Vehicle license Fees	Excise Duty	Stamp Duty	Court Fines	Other***	Total
WP	13,675,000	21,270	1,777,800	319,390	5,245,170	315,160	728,780	8,407,570
CP	2,090,000	3,191	378,056	189,154	582,621	30,887	119,390	1,303,299
SP	2,372,000	1,541	445,582	86,184	626,047	104,771	132,752	1,396,877
NP	348,000	-	117,389	-	4,690	-	56,541	178,620
NWP	2,620,000	198	534,187	83,431	604,578	148,300	153,078	1,523,772
NCP	960,000	3,763	226,974	38,445	38,820	107,521	99,635	515,158
Uva	630,000	819	161,479	55,212	80,590	21,342	98,210	417,652
SGP	1,065,000	-	249,904	47,578	-	47,294	88,647	433,423
EP	740,000	-	134,562	38,802	141,785	-	144,611	459,760
Total	24,500,000	30,782	4,025,933	858,196	7,324,301	775,275	1,621,644	14,636,132

Source: Monthly Revenue Reports of Provincial Councils – 2015

* Provisional

**Collection of due BTT up to 2010

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

4.3 Revenue Forecast for 2016

Setting of revenue targets for the provinces is based on two main sources of revenue, Transfers of Government Revenue and Target for Devolved Revenue Sources. The total amount of forecast revenue under the above two sources is deducted from the assessed recurrent needs. The Finance Commission engages in a consultative process with the General Treasury and provincial authorities in setting the revenue targets.

4.3.1. Transfer of Government Revenue

The annual amounts to be transferred to all provinces are decided by the General Treasury in terms of the Fiscal Policy Circular No: 01/2010 of 29.12.2010. The General Treasury has allocated Rs. 36,600 million from the nationally collected revenue to the provinces for the year 2016. Transfers of Government Revenue to the provinces for 2016 have been forecast, based on the following percentages, agreed between the Finance Commission and the General Treasury.

Province	Ratio
Western	48%
Central /Southern / North Western	9%
Sabaragamuwa / North Central / Uva / Eastern / Northern	5%

Table 4: Estimated Transfers of Government Revenue to the Provinces – 2016
(Rs'000)

Province	Transfers	% of Provincial Share
Western	17,568,000	48
Central	3,294,000	9
Southern	3,294,000	9
Northern	1,830,000	5
North Western	3,294,000	9
North Central	1,830,000	5
Uva	1,830,000	5
Sabaragamuwa	1,830,000	5
Eastern	1,830,000	5
Total	36,600,000	100

Source: Budget Division, Finance Commission

4.3.2. Targets for Devolved Revenue Sources

The targets for devolved revenue have been fixed based on the revenue assessments submitted by the provincial authorities and the past performance of actual revenue collected by the provinces for the previous years and the first six months of 2015.

The forecast revenue collection for 2016 including stamp duty and court fines is Rs. 31,400 million. The forecast revenue for 2016 excluding stamp duty and court fines is Rs. 14,700 million. Details on revenue forecast for 2016 are given in the table 5.

Table 5: Revenue Forecast for 2016

(Rs'000)

Province	Revenue Forecast Including Stamp Duty & Court Fines			Revenue Forecast Excluding Stamp Duty & Court Fines		
	Provincial Estimate	FC Forecast	% of Provincial share of FC Forecast	Provincial Estimate	FC Forecast	% of Provincial share of FC Forecast
Western	15,439,260	18,000,000	57	4,974,260	7,000,000	48
Central	2,283,000	2,750,000	9	1,273,000	1,450,000	10
Southern	2,441,500	2,839,700	9	1,160,500	1,400,000	10
Northern	344,500	410,300	1	341,800	400,000	3
North Western	2,599,700	3,070,000	10	1,349,700	1,550,000	11
North Central	1,093,550	1,145,000	4	829,550	850,000	6
Uva	520,951	855,000	3	315,951	600,000	4
Sabaragamuwa	1,321,555	1,390,000	4	791,555	900,000	6
Eastern	775,000	940,000	3	465,000	550,000	4
Total	26,819,016	31,400,000	100	11,501,316	14,700,000	100

Source: Provincial budget estimates 2016 and Budget Division, Finance Commission

The forecast amount of stamp duty and court fines to be transferred to the local authorities from total revenue for 2016 is Rs 16,700 million. The provincial breakdown of revenue transfers to local authorities is given in table 6.

Table 6: Stamp Duty and Court Fines to be transferred to the Local Authorities for 2016

(Rs'000)				
Province	Stamp Duty	Court Fines	Total	% Provincial Share
Western	10,300,000	700,000	11,000,000	65.87
Central	1,200,000	100,000	1,300,000	7.78
Southern	1,219,700	220,000	1,439,700	8.62
Northern	10,000	300	10,300	0.06
North Western	1,200,000	320,000	1,520,000	9.10
North Central	110,000	185,000	295,000	1.77
Uva	170,000	85,000	255,000	1.53
Sabaragamuwa	400,000	90,000	490,000	2.93
Eastern	300,000	90,000	390,000	2.34
Total	14,909,700	1,790,300	16,700,000	100

Source: Budget Division, Finance Commission

5. Assessment and Apportionment of Funds to the Provinces - 2016

The Finance Commission engages in a comprehensive process of assessment of provincial expenditure needs and analyze of them, using criteria included in the budget guidelines. Basic principles of this process are as follows:

- A series of consultative meetings are held with the relevant provincial officers and a wide range of data and information on provincial development priorities, required service delivery and actual cadre are given due consideration.
- The Finance Commission submits its assessment of provincial fund requirements to the General Treasury.
- After consultation with the Finance Commission, the General Treasury agrees upon the bulk amount to be allocated for the provinces.
- The bulk amount is apportioned between the provinces, based on set of criteria developed by the Commission.
- The constitutional provisions require the Finance Commission to submit its recommendations to H.E. the President with regard to principles of apportioning funds from the annual budget between provinces.

5.1 Request for Provincial Capital and Recurrent Needs

The provincial authorities were requested to submit their recurrent needs for 2016, in accordance with the “Guidelines on Request of Funds” issued by Finance Commission on 21st March, 2015.

Recurrent expenditure consists mainly of two components viz. personal emoluments and other recurrent expenditure. The personal emoluments include salaries and wages, overtime and holiday pay and other allowances. The other recurrent expenditure consists of traveling expenses, supplies, maintenance, contractual services, transfers to other agencies, grants, subsidies and interest payments etc. The provincial recurrent needs are submitted by provinces using the specimen formats attached to the guidelines of the Finance Commission. The recurrent needs requested by the provinces are given below.

**Table 7: Provincial Requests on Recurrent Expenditure – 2016
(Including Local Government Transfers, Stamp Duty and Court Fines)**

(Rs'000)

No.	Province	Personal Emoluments *	% of Provincial Share	Other Recurrent Expenditure	% of Provincial Share	Total Recurrent Expenditure
1	Western	34,870,566	62	21,776,560	38	56,647,126
2	Central	24,231,918	77	7,413,688	23	31,645,606
3	Southern	20,577,436	74	7,233,899	26	27,811,335
4	Northern	14,730,806	73	5,486,567	27	20,217,373
5	North Western	22,146,626	77	6,687,207	23	28,833,833
6	North Central	12,698,545	78	3,646,067	22	16,344,612
7	Uva	15,953,123	76	4,996,146	24	20,949,269
8	Sabaragamuwa	17,868,554	77	5,253,843	23	23,122,397
9	Eastern	16,062,386	79	4,240,524	21	20,302,910
	Total	179,139,960	73	66,734,501	27	245,874,461

Source: Provincial Budget Estimates – 2016
Excluding Vacant Cadre

**Table 8: Provincial Requests on Other Recurrent Expenditure – 2016
(Excluding Local Government Transfers, Stamp Duty and Court Fines)**

(Rs'000)

Province	Other Recurrent Expenditure
Western	6,238,525
Central	3,658,825
Southern	4,007,401
Northern	3,838,367
North Western	3,731,392
North Central	2,411,373
Uva	3,812,434
Sabaragamuwa	3,297,095
Eastern	2,840,524
Total	33,835,936

Source: Provincial budget estimates – 2016

The provincial authorities were requested to submit their capital expenditure needs for 2016 in accordance with the “Guidelines on Capital Expenditure Needs of Provinces for 2016” issued by Finance Commission on 12.05.2015. Provinces were instructed to use Form 2 attached to the guideline which was introduced under Results Based Management Approach, when submitting their annual capital needs.

Table 9: Provincial Requests on Capital Needs (PSDG) -2016

Rs. mn

Province	Need of the Province	% of Provincial Share
Western	7,413	12
Central	10,081	16
Southern	5,412	9
Northern	7,978	13
North Western	5,951	9
North Central	6,684	11
Uva	7,681	12
Sabaragamuwa	3,883	6
Eastern	7,302	12
Total	62,384	100

Source: Need Request Form (Form 2) sent by Provinces

Note: Excluding nationally agreed Foreign and locally funded Projects and CBG

5.2 Assessment of Provincial Needs

Requests for capital and recurrent needs, submitted by the provinces are carefully examined and assessed by the Finance Commission before making recommendations to the Government. In assessing the provincial needs, alignment with the Government development policies, guidelines issued by the Finance Commission, Medium-Term Development Plans of the provinces, Circulars issued by the General Treasury and the Ministry of Public Administration and past performance on spending public funds in the provinces are taken into consideration.

When assessing the recurrent needs submitted by the provinces, the Finance Commission takes into account the cadre approved by the Department of Management Services, actual living cadre and vacancies, new appointments agreed to provincial councils agreed by the line ministries, personal emoluments, salary arrears and staff loans, estimates of other recurrent expenditure including maintenance of capital assets, allowances for elected members and transfers to local authorities and other agencies.

Table 10: Assessed Personal Emoluments of the Provincial Living Cadre - 2016

No.	Province	Living Cadre	%	Personal Emoluments (Rs'000)							
				Salaries & wages	%	Overtime & Holiday pay	%	Other Allowances	%	Total (PE)	%
1	Western	57,494	18	15,731,000	20	1,813,000	19	17,000,000	19	34,544,000	19
2	Central	42,280	13	10,301,676	13	1,652,186	17	12,278,056	13	24,231,918	14
3	Southern	37,346	12	9,208,897	12	970,385	10	10,398,154	11	20,577,436	11
4	Northern	27,777	9	5,924,334	8	925,192	10	7,881,280	9	14,730,806	8
5	North Western	39,881	12	9,774,341	13	1,020,290	11	11,351,995	12	22,146,626	12
6	North Central	23,168	7	5,298,545	7	900,000	9	6,500,000	7	12,698,545	7
7	Uva	29,461	9	6,932,643	9	866,791	9	8,153,689	9	15,953,123	9
8	Sabaragamuwa	31,933	10	7,885,395	10	923,223	10	9,327,936	10	18,136,554	10
9	Eastern	30,807	10	7,106,714	9	625,178	6	8,330,494	9	16,062,386	9
Total		320,147	100	78,163,545	100	9,696,245	100	91,221,604	100	179,081,394	100

Source : Provincial budget estimate 2016 and Finance Commission

Note : Excluding vacant cadre

**Table 11: Assessed Other Recurrent Expenditure for the Provinces - 2016
(Excluding Stamp Duty and Court Fines)**

(Rs.'000)

No.	Province	Other Recurrent Expenditure without Local Government Transfer	% of Provincial Share	Local Government Transfer	% of Provincial Share	Total Other Recurrent Expenditure with Local Government Transfer	%
1	Western	4,721,000	15	8,038,035	39	12,759,035	25
2	Central	3,363,729	11	2,731,527	13	6,095,256	12
3	Southern	3,729,101	12	2,283,662	11	6,012,763	12
4	Northern	3,712,064	12	1,646,200	8	5,358,264	10
5	North Western	3,271,392	11	1,531,558	7	4,802,950	9
6	North Central	2,437,188	8	889,566	4	3,326,754	6
7	Uva	3,620,221	12	1,003,712	5	4,623,933	9
8	Sabaragamuwa	3,612,736	12	1,216,772	6	4,829,508	9
9	Eastern	2,652,795	9	1,095,000	5	3,747,795	7
Total		31,120,226	100	20,436,032	100	51,556,258	100

Source: Finance Commission

In assessing the provincial capital needs, the Commission undertakes a comprehensive analysis considering the contents of the Development Policy of the Government and Provincial Medium-Term Plans. Maintenance of services, improvement of service efficiency, achievement of planned results effectively, avoidance of duplication of work and wastage of resources, priority needs, implementation capacity of provincial agencies have also been given due consideration.

Table 12: Provincial Capital Needs for 2016 Assessed by the Finance Commission

Rs.mn

Province	PSDG		CBG	
	FC Recommendation	% of Provincial Share	FC Recommendation	% of Provincial Share
Western	6,200	13.8	1,500	13.6
Central	5,600	12.4	1,300	11.8
Southern	5,300	11.8	1,300	11.8
Northern	4,500	10.0	1100	10.0
North Western	4,700	10.4	1100	10.0
North Central	4,100	9.1	1100	10.0
Uva	4,700	10.4	1200	10.9
Sabaragamuwa	5,300	11.8	1,200	10.9
Eastern	4,600	10.2	1200	10.9
Total	45,000	100	11,000	100.0

Source: Finance Commission

5.3 Apportionment of Funds between Provinces

Apportionment of funds between the provinces is a major function performed by the Finance Commission, as a mandatory requirement of the Constitution. After agreeing with the General Treasury on the bulk amount to be allocated from the annual budget, apportion between provinces are made. Since all provincial agencies prepare their annual budgets and submit them for the approval of the provincial councils, the Commission considers the assessed needs of the provinces thoroughly in the apportionment exercise.

Apportionment of Block Grant among the provinces in 2016 is as follows.

**Table 13: Apportionment of Block Grant - 2016
(Rs'000)**

No.	Province	Block Grant
1	Western	21,743,756
2	Central	23,374,837
3	Southern	20,507,815
4	Northern	16,174,230
5	North Western	20,797,869
6	North Central	12,838,965
7	Uva	16,249,837
8	Sabaragamuwa	18,219,198
9	Eastern	16,511,493
Total		166,418,000

Source: Finance Commission

The apportionment of capital funds (PSDG and CBG) between the provinces for 2016 using a statistical methodology mentioned in Chapter 3 with the concurrence of the General Treasury is depicted in the table below. This table includes development projects funded by foreign and local sources at national level as well.

Table 14: Apportionment of Capital Funds – 2016**Rs. mn**

Province	CBG	PSDG	Sub Total	% of Provincial Share	Special Projects	Foreign Assisted Projects	Total	% of Provincial Share
Western	460.00	2,894.10	3,354.10	10.81	-	746.10	4,100.20	9.11
Central	423.00	3,684.30	4,107.30	13.24	-	1,067.04	5,174.34	11.50
Southern	413.00	2,246.30	2,659.30	8.57	1,000.00	730.00	4,389.30	9.75
Northern	475.00	3,199.30	3,674.30	11.84	150.00	4,993.70	8,818.00	19.59
North Western	375.00	3,216.30	3,591.30	11.58	-	1,118.10	4,709.40	10.46
North Central	400.00	2,838.30	3,238.30	10.44	-	1,226.92	4,465.22	9.92
Uva	475.00	2,736.30	3,211.30	10.35	-	833.66	4,044.96	8.99
sabaragamuwa	514.00	2,913.30	3,427.30	11.05	-	1,148.00	4,575.30	10.17
Eastern	465.00	3,297.30	3,762.30	12.13	-	969.75	4,732.05	10.51
Total	4,000.00	27,025.50	31,025.50	100.00	1,150.00	12,833.27	45,008.77	100.00

Source: Budget Estimates 2016

5.4 Financing Local Authorities

Transfer of funds from provinces to local authorities for payment of salaries and allowances to approved living cadre and members is a major element of recurrent expenditure of local authorities. At present, the total amount paid for salaries of the staff is reimbursed from the funds provided under the Block Grant. Although, some contract and casual cadre were previously paid by the collected revenue of the local authorities, recently they were absorbed into the approved cadre. Hence, the total salary bill is paid by the funds transferred under the Block Grant. It is recommended that the collected revenue by local authorities to be utilized for the improvement of the service delivery to the public. In addition, stamp duties and court fines transferred to local authorities by the provincial councils should be invested in development activities in the respective local authority areas.

Table 15: Allocation of Allowances to Members and Reimbursement of Staff Salaries of Local Authorities - 2016

Province	MC	UC	PC	Total LG	Member's Allowance		Reimbursement of Staff Salaries		Grand Total (Rs.'000)
					No. of Members	Allowance (Rs.'000)	Living	Amount (Rs.'000)	
Western	7	14	27	48	884	179,940	17,859	7,858,095	8,038,035
Central	4	6	33	43	634	125,580	6,104	2,605,947	2,731,527
Southern	3	4	42	49	585	116,880	4,271	2,166,782	2,283,662
Northern	1	5	28	34	398	79,140	3,686	1,567,060	1,646,200
North Western	1	3	29	33	501	96,840	3,404	1,434,718	1,531,558
North Central	1	0	25	26	283	58,020	1703	831,546	889,566
Uva	2	1	25	28	319	61,929	2,257	941,783	1,003,712
Sabaragamuwa	1	3	25	29	424	78870	2,643	1,137,902	1,216,772
Eastern	3	5	37	45	413	91,195	3,020	1,003,805	1,095,000
Total	23	41	271	335	4441	888,394	44,947	19,547,638	20,436,032

Source: Provincial budget estimates and Finance Commission-2016

6. Aligning with National Policy

The major objective of the development policy of the Government is to continue the progress achieved by the country, as a nation of the “middle income category” and maintain 7% -8% of annual growth rate. Under the national policy titled “Five Fold Policy”, the Government has targeted to make a socio-economic revolution. The five fold policy includes five themes namely developing the economy, eradicating corruption, ensuring freedom, investing in infrastructure and improving education. In this context, more attention has been paid in the government policy on increasing per-capita income, reducing income disparities between different income groups, minimizing socio-economic disparities at regional level and ensuring free education system through adopting the concept of “social-market economy”. In this policy, particular attention has been paid to the contents included in the policy statements delivered by H.E. the President and Hon. Prime Minister before Parliament.

The Finance Commission has provided directives through guidelines to the provinces that they should prepare their Annual Development Plans in line with the above strategies at macro level.

6.1 Developing the Economy

Developing the economy is one objective of the new development strategy of the Government. As a measurement of the development, Sri Lanka has shown a higher level of achievement with regard to MDGs. In future, Sri Lanka has agreed to work towards sustainable development under 17 Goals and 169 Targets declared by the United Nations at the Sustainable Development Summit. Among the goals to be achieved by 2030, the followings are related to development of provinces.

- Eradicate poverty in all its forms
- End all forms of hunger and malnutrition
- Ensure health and well-being for all including commitment to end the epidemics of AIDS, Tuberculosis, Malaria and other communicable diseases.
- Make sure that all girls and boys complete free primary and secondary schooling.
- Invest in adequate infrastructure for providing sanitation facilities to ensure universal access to safe and affordable drinking water.
- Invest in clean energy sources such as solar, wind and thermal to ensure universal access to affordable electricity.
- Empower the bottom percentile of income earners.
- Conserve and restore the terrestrial ecosystems.

Further, in order to develop the economy at provincial level, the following activities will be undertaken by the government.

- Generate one million jobs.
- Promote foreign investment aimed at manufacturing industries, agriculture, tourism and service delivery by establishing economic development Mega Zones.
- Encourage new manufacturing industries by establishing Industry and Technology Development Mega Zones throughout the country.
- Establish Tourism Development Mega Zones to improve tourist industry.
- To make agricultural products globally competitive by establishing Agricultural Development Mega Zones.
- Promote large and small scale fishermen through establishing Economic Development Mega Zones for fisheries covering coastal belt.
- Establish 2500 Cluster Villages throughout the country to accelerate development programmes aimed at village level.

The Finance Commission has already issued guidelines to the provinces in line with the above national strategies enabling them to prepare Annual Development Plans of provincial agencies. The Finance Commission approves the projects of all provincial plans with a view to contributing to the development process of country after careful evaluation. The Commission follows the following steps to increase the economic growth and achieve regional development in the country.

- Allocation of resources on district basis for minimizing the socio-economic disparities within the province. Therefore, district-wise allocations will be made under PSDG from 2016.
- Directing provinces to identify projects with community participation so as to minimize the development disparities based on the principles of ‘demand driven approach’ to minimize the intra-provincial disparities.
- Promoting provincial authorities to undertake follow-up action with regard to implementation of projects and programmes contained in annual development plans.

6.2 Eradication of Corruption

One of the main government policies is to eradicate corruption. The government expects to introduce legislation which will cover all forms of anti-corruption and anti-bribery and pay attention on expenditure management. The Finance Commission has brought attention of the provinces to the following aspects.

- Take measures to prevent pollution and adopt proper public expenditure management.
- Adopt proper procurement procedures in the construction of buildings and use of buildings, vehicles, machinery and equipment in productive and optimal manner.

6.3 Establishing a Strong Middle Class with Higher Income

Current practice in the country makes the rich richer and the poor poorer. Therefore, the government has given priority for the following key matters in order to change this situation and thereby enabling the country to graduate towards higher income stage.

- i. Promote self-employment and small scale entrepreneurs with the objective of creating jobs and generating income.

- ii. Make the middle class committed to economic development through empowerment of them.
- iii. Ensure food security through increasing food production at national level, based on homestead and village.
- iv. Provide adequate assistance to vulnerable social groups and empower them.
- v. Determine salaries and wages taking into account the cost of living, in order to ensure higher living standards.

The programmes on tourism, small and medium enterprises, agriculture and farming and women's development are suggested to be implemented to ensure having benefits for the people at provincial level. Further, the Finance Commission has taken measures to promote self-employment and small scale entrepreneurs, after considering the contribution of informal sector to the national economy.

6.4 Improving Education

Human resource is the most valuable resource in a country. Therefore, the government has paid due attention on human resource development with a view to improving the labour force of the country to meet the demand in national and international labour markets. In this context, the government has identified the following policies.

- Provide more facilities and incentives to all schools without discrimination
- Implement a special programme to provide safe drinking water and sanitary facilities to all schools where such facilities are not available
- Introduce a new School Education Act
- Establish National E – Libraries
- Increase investments in education to 6% of GDP gradually

Finance Commission has allocated funds for education sector in line with the above policies and issued guidelines on implementation of projects and programmes at provincial level.

- i. Completion of partially constructed school buildings and maintaining capital assets.
- ii. Provide common facilities including teacher quarters to solve the problem of shortage of teachers
- iii. Transforming teacher education / professionalization a educational services
- iv. Improving drinking water and sanitation facilities
- v. Provide Guidance and facilities to dropout students to engage in vocational training

6.5 Investment in Infrastructure Facilities

Priority has been given to invest in infrastructure facilities in line with the government policy on fivefold strategy. Therefore, much attention has been paid to the sectors of health, social welfare, transport, roads and housing.

The Finance Commission has issued guidelines to implement provincial development projects relating to these sectors adhering to the government policy. The required provisions have also been made. In the identification of projects, the provincial authorities are expected to pay attention in the following matter.

- Complete partially constructed hospital buildings and maintain of capital assets
- Construct quarters for doctors and para-medical staff so as to improve service delivery of hospitals in difficult areas
- Procure and maintain medical equipment / machinery
- Prevent and control of diseases
- Improve primary health care in MOH areas
- Improve OPD / ETU / Dental and Other Clinics in divisional and base hospitals
- Conserve and promote traditional systems of medicine
- Develop herbal gardens and local drug production
- Provide assistance to poor families to fulfill their housing needs.
- Provide grants for needy families for improvement of their shelters based on Aided Self-Help Approach.
- Carpet and improve provincial (C and D) roads
- Rehabilitate and maintain road related infrastructure
- Maintain bus stands including sanitary facilities

6.6 Enhancing the Revenue and New and Alternative Sources of Revenue for the Provincial Councils

Transfer of revenue collected by the government and the revenue collected by the provincial councils from assigned sources of revenue are the two main sources of revenue in the provinces. The Provincial Revenue List given in the 13th Amendment to the Constitution includes 21 sources of revenue to be collected by the provincial authorities. The proportion of estimated revenue stands at 14.5% of the total estimated expenditure of all provinces in 2016, excluding the Western Province.

The proportion of estimated revenue is 51.9% of the total estimated expenditure of the Western Province, in 2016.

There is a high potential in the provinces to improve their revenue from the devolved sources, within the legal framework. The new revenues should be earned from the assigned revenue sources which are not used so far. For this purpose, the provinces should take measures to utilize their human and physical resources optimally. Further, it is necessary to encourage the local authorities to enhance their revenue capacity. Collection of revenue by local authorities is comparatively very low due to the failure of updating of statutes. Therefore, updating the relevant statutes is important because it has directly resulted in low income of the local authorities. Provincial councils also transfer stamp duty and court fines to local authorities annually. However, there should be a proper system to utilize them, since how they are spend them is not so clear.

Provincial Councils should adopt a novel approach to improve this revenue base while encouraging private sector to invest in commercial ventures. Following actions are very important in increasing the provincial income base.

i. Facilitate private sector to invest at provincial level -

In this effort, reducing bottlenecks on acquiring public and private lands, providing environmental and legal clearance in time, and providing skill development training to workers are of vital importance.

ii. Need for an innovative approach to utilization of revenue –

Most of the provinces depend heavily on limited public funds provided by the General Treasury, based on the recommendations of the Finance Commission. Instead, it is important to enhance the provincial revenue from the devolved sources and utilize them in productive investments. Particularly, provincial authorities must take action not to limit revenue for recurrent expenditure but invest them in capital projects as well.

iii. Identifying development potentials at provincial level –

All provinces have their own resource potentials which could be harnessed for development. Therefore, provinces have to identify such resource potentials which have comparative advantages, and take measures to use them by paving the way for increased value addition and improved revenue in provinces.

It is expected to enhance the provincial contribution to the GDP by implementing the above programs. The Finance Commission will coordinate with the Board of Investment, other relevant national agencies and the provincial authorities for realizing the objectives.

6.7 Adopting the Agency Results Framework Approach

The Finance Commission introduced the Agency Results Framework in the preparation of Medium-Term Plans for the provinces, based on Result Based Management Approach in 2013. Accordingly, all provinces have prepared Medium-Term Agency Results Framework for a period of five years from 2013 to 2017, and Annual Development Plans are implemented accordingly.

With the objective of ensuring investing public funds effectively and efficiently, the Zero Based Budgeting Approach has been introduced from 2016 onwards through Budget Circular No.3/2015 dated 29/07/2015, issued by the Secretary to the Treasury. Hence, all provinces are requested to prepare a new Agency Results Framework for a period of three years from 2016 to 2018 in 2016, based on the Zero Based Budgeting Approach taking into account, government policies and budget proposals. A Three Year Medium-Term Agency Results Framework should be prepared giving due consideration to experiences gathered during the past few years, Zero Based Budgeting concept and provincial development priorities. The required forms will be provided with the guidelines for 2016 by the Finance Commission.

6.8 Establishment of an Effective Monitoring and Evaluation Mechanism

It is expected to evaluate the results of investments in terms of the Key Performance Indicators that have been developed in provincial Agency Results Frameworks. The provinces have already been informed in this regard and the officers of the Commission will make field visits to provinces to carry out monitoring and follow-up actions.

6.9 Provincial Cadre and Its Deployment Based on Institutional Roles and the Workload

The Department of Management Services, the National Pay Commission, relevant line Ministries and the Finance Commission have jointly prepared reports pertaining to optimum cadre of each spending agency of the provinces. The optimum cadre required for delivering the service of each agency in efficient and effective manner has been determined accordingly.

Even though, provinces have adequate cadre in general, it is evident that there is an excess cadre in the urban areas and a deficit in rural areas. Therefore, it is important to enforce the existing rules and regulations and manage the provincial cadre on a rational basis to avoid difficulties. It is observed that the ratio of supporting staff is in an increasing trend compared with the staff grade positions in the entire cadre. Therefore, proper systems and norms should be introduced to overcome this unfavorable situation.

7. Conclusion

According to the policy statements of H.E. the President and Hon. Prime Minister, mid-term annual growth rate has been targeted between 7% - 8%. In the achievement of this growth rate at macro level, the contribution made by the provinces is vital. As far as the provincial contribution to GDP is concerned, the impact of the Western Province is around 43%. However, during the past five year period, this contribution has decreased from 45% to 43% showing a positive trend. The least contributed Northern Province has shown an increasing trend of its share of GDP from 2.4% to 4%, the reason being the special development activities undertaken in the area in the recent past.

When the indices like Poverty Ratio, Unemployment Rate, Prosperity Index, Infant Mortality Rate, Computer Literacy Rate Student and Drop-out Ratio are considered, a positive change can be observed in all the provinces. In addition, the criteria such as the use of durable house hold items, quality of houses, safe drinking water and supply of electricity are taken into consideration, an appreciable favorable trend is observable. However, it is worthwhile to mention that implementation of special programmes and projects focused on minimizing intra-provincial socio-economic disparities should be paid further attention. It is also necessary to give due consideration on achievement of Sustainable Development Indices, declared by the United Nations in carrying out future planning.

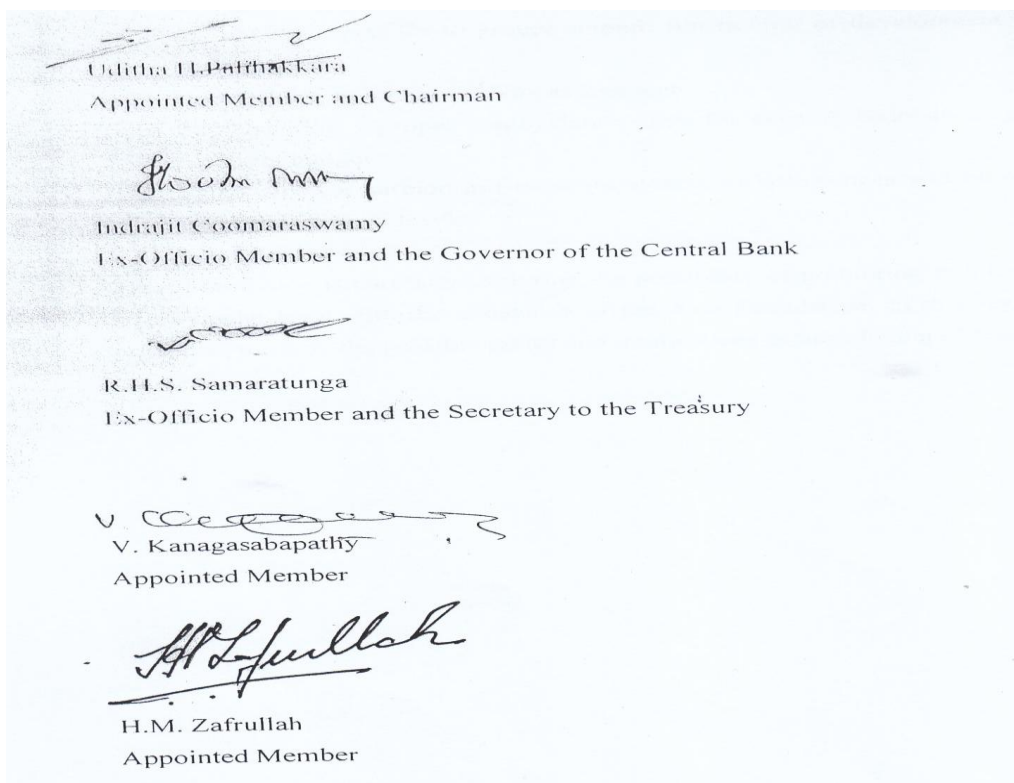
The Finance Commission has already taken measures to fulfill the constitutional mandate of achieving balanced regional development in the country, and special allocations have been made towards realizing this objective. Guidelines have been given to the provinces with regard to implementation of special projects with the assistance of private sector, aiming at reduction of intra-provincial socio-economic disparities. These projects should be capable of improving value addition and generating income avenues in the respective project areas. The Finance Commission has also taken steps to ensure utilization of resources effectively but adopting Results Based Management approach and Zero-Based Budgeting.

Although recurrent expenditure of the provinces constitutes a very high rate of 80%, the expenditure in the sectors education, health and agriculture can be viewed as investments in the promotion of human capital. The other notable factor in this regard is that the provinces provide manpower required for implementation of programmes and projects by most of the agencies at national level.

8. Way Forward

In the preparation of future provincial development plans, it is necessary to adhere to development policies and strategies of the Government which are mainly characterized by improvement of the productivity of agro economy, promotion of small and medium scale entrepreneurs, development of local industries, improvement of tourist industry, management of environment, empowerment of middle-class, popularization of healthy food, continuation of free health and education policy and establishment of a skilled labour force. The guidelines and circulars in this regard will be issued to provinces by the Commission. Further, measures will be taken to allocate financial provisions on district basis in order to strengthen the mandate of reducing intra-provincial development disparities. In the allocation of funds between the districts and sectors, a statistical methodology taking into account socio-economic indicators reflecting the regional disparities will be adopted. Further, in this exercise the practical aspects like specific potentials at provincial level and benefits according to the provinces from foreign funded projects will be paid required attention. Through these measures, it is expected to create an environment which will lead to utilize the allocated funds to provinces in an optimal manner, thus enabling the public to fulfill their aspirations.

It is also imperative to maintain an optimal cadre to suit the provincial needs. There is a pre-requisite to manage recurrent expenditure in proper manner. Therefore, the Commission will assist the provinces to undertake assessments on realistic cadre requirements with the technical support of the Department of Management Services and the National Pay Commission.



Annex 1

Allocation and Release of Block Grant 2010 – 2014

(Rs.mn)

Province	2010		2011		2012		2013		2014	
	Allo.	Release	Allo.	Release	Allo.	Release	Allo.	Release	Allo.	Release
Western	6,100	6,100	7,170	8,979	9,011.25	8,893.77	8,501.76	9,690.75	11,699	11,699
Central	13,000	13,000	13,270	13,697	13,762.75	13,048.62	14,863.83	15,686.83	17,917	17,917
Southern	10,500	10,500	11,172	11,760	11,802.99	11,906.59	12,908.47	13,586.47	15,785	15,785
Northern	8,400	8,700	9,153	9,318	8,556.79	8,500.30	10,075.30	10,795.30	12,642	12,642
Eastern	10,100	10,100	10,473	10,952	11,385.07	10,737.26	11,635.26	12,066.26	13,784	13,784
North Western	12,300	12,299	12,656	13,018	12,651.07	11,920.59	14,118.11	14,846.11	16,413	16,413
North Central	7,300	7,300	7,386	7,596	7,005.42	6,776.02	7,345.62	7,764.62	10,594	10,594
Uva	8,300	8,300	8,897	8,948	9,458.83	9,031.70	10,263.21	10,758.21	12,500	12,500
Sabaragam uwa	9,000	9,000	9,823	10,335	11,243.32	10,736.94	13,088.46	13,606.46	14,809	14,809
Total	85,000	85,299	90,000	94,602	94,877.48	91,551.79	102,800.00	108,801	126,143	126,143

Source: Finance Commission and General Treasury

Annex 2

Allocation and Release of Criteria Based Grant 2010 – 2014

(Rs.mn)

Province	2010		2011		2012		2013		2014	
	Allo.	Release	Allo.	Release	Allo.	Release	Allo.	Release	Allo.	Release
Western	450	383	400	660	427	180.41	370	370	475	292.5
Central	410	308	375	337	400	218.40	321	192.6	430	129
Southern	350	298	325	292	347	189.46	295	177	380	255
Northern	300	255	275	247	294	160.52	195	195	280	280
Eastern	325	276	250	230	267	145.78	217	130.2	340	227
North Western	300	255	300	270	320	174.72	270	162	350	290
North Central	260	260	275	1,277	293	1420.0	230	742	350	192.5
Uva	300	255	300	240	320	174.72	240	144	330	179
Sabaraga muwa	380	323	335	301	357	194.92	252	151.2	335	335
Total	3,075	2,612	2,835	3,855	3,025	2,858.93	2,390	2,264	3,270	2,180

Source: Finance Commission and General Treasury

Annex 3

Allocation and Release of Province Specific Development Grant 2010 – 2014

(Rs.mn)

Province	2010		2011		2012		2013		2014	
	Allo.	Release	Allo.	Release	Allo.	Release	Allo.	Release	Allo.	Release
Western	1,755	1,737	1,736	1,380	1,990	491	1,701	1,062	2,280	1,078
Central	2,145	1,895	2,490	1,369	3,013	856.88	3,254	889	3,497	1,264
Southern	1,773	1,656	1,535	1,283	1,818	813.85	1,634	785	1,715	1,049
Northern	2,807	2,365	3,068	1,306	3,568	947.37	3,692.7	836	5,551	1,328
Eastern	3,273	1,730	5,079	1,135	3,917	1,108.25	4,915	1,062	3,206	1,595
North Western	1,633	1,613	1,542	1,265	1,836	816.85	1,867	765	2,120	1,933
North Central	2,350	1,956	2,808	1,141	2,806.5	717.72	2,139.5	741	3,043	1,054
Uva	2,007	1,888	3,169	1,210	3,117	805.81	2,596	838	3,543	2,282
Sabaragamuwa	1,737	1,564	2,028	1,110	2,648	709.66	2,765	795	4,245	1,684
Total	19,480	16,403	23,455	11,199	24,713.5	7,267.39	24,564.2	7,773	29,200	13,267

Source: Finance Commission and General Treasury

Note: Including Development Projects