

# **THE FINANCE COMMISSION**

**RECOMMENDATION- 2014 TO H.E. THE PRESIDENT**

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

**May 2014**

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நதி ஆணைக்குழு

(அரசியலமைப்பின் 154`எ  
ஆம் உறுப்புகளின் கீழ் தாயிக்கப்பட்டது)

FINANCE COMMISSION  
(Established under Article 154 R

of the Constitution)

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දිනය  
திகதி: } 20.05.2014  
Date

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

Your Excellency,

As required by the Article 154 R of the 13<sup>th</sup> Amendment to the Constitution of the Democratic Socialist Republic of Sri Lanka, I hereby submit the Recommendation for 2014 including the proposed strategies to achieve balanced regional development in the country and the apportionment of funds to be allocated from the Annual Budget - 2014 for use in the provinces.

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

Yours respectfully,

Ariyaratne Hewage  
Chairman  
Finance Commission

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## **Preamble**

Recommendation for 2014 is presented to HE the President at a historic moment in the administration of the country. Although certain powers were constitutionally devolved to the provincial councils with the introduction of the 13<sup>th</sup> Amendment to the Constitution in 1987 all provincial councils were not formally established until 2013.

Sri Lanka was governed by the national government as a unitary state with various sub national level authorities performing under the delegated power. Several attempts have been made to decentralize power to the periphery until the 13<sup>th</sup> Amendment to the Constitution introduced the devolution of power to the provincial councils in 1987. The main purpose of devolution was to offer greater political representation to the people at provincial level. Even though the devolution of power existed in constitutional provisions, the Northern and Eastern Provincial Councils were not formally established due to the 30 year long conflict in the country.

Terrorism was eliminated in May 2009, and the country has since been gradually coming back to normalcy. The government launched an accelerated development programme particularly with the objective of building the infrastructure including road network, electricity supply, housing etc. A large number of displaced people was resettled in the East and North in a crash programme. The Eastern Provincial Council was established on 16<sup>th</sup> May 2008 and the Northern Provincial Council was established on 07<sup>th</sup> October 2013. Today Sri Lanka has the full complement of all nine provincial councils in operation.

These provincial councils should pay attention to providing basic facilities to the people in these areas such as health, education, agriculture, irrigation, and roads etc. which are devolved to the provinces along with the comprehensive nation-wide development initiatives launched by the government under Mahinda Chinthana Ten Year Development Framework. Such endeavors would help to maximize the development programmes at national and provincial levels and improve the quality of life of the people in the provinces and to increase the provincial contribution to GDP.

## **1. Role and Responsibility of the Finance Commission**

The constitution of the Democratic Socialist Republic of Sri Lanka, by the 13<sup>th</sup> Amendment to the Constitution introduced in 1987, made provisions for the establishment of provincial councils and the Finance Commission (FC). The Finance Commission was established to facilitate the process of resource transferring to the provinces, and for provincial planning. As indicated in the 13<sup>th</sup> amendment to the Constitution, the main responsibilities of the Commission are to make recommendations to the Government and formulate principles, policies and guidelines on the apportionment of funds between the nine provinces with the objective of achieving a balanced regional development in the country. The mandate of the Finance Commission as indicated in Article 154 R (3), (4) and (5) of the Constitution are as follows;

1. 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.
2. 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”.

### **1.1 Legal base of Devolution**

The devolution of power which introduced a substantial transfer of power in the political and administrative structure in Sri Lanka is based on a number of pillars of legislation. A summary of this legal framework is given below;

#### **1.1.1 The Thirteenth Amendment to the Constitution**

The 13<sup>th</sup> Amendment to the Constitution established devolved governance with a provincial council setup with appropriate legislative, executive and financial authority to be exercised by the provincial councils. The distribution of power between national government and the provinces is included in the three lists given in the 13<sup>th</sup> Amendment as the Reserved List (powers of the national government), the Provincial List (powers devolved to the provinces) and the Concurrent List (areas of shared

responsibilities). The 13<sup>th</sup> Amendment to the Constitution also created three tiers of governance, i.e. the National Government, Provincial Councils and Local Authorities which are interdependent with the national Government superseding the other two tiers.

The 13<sup>th</sup> Amendment to the Constitution provides the legislative basis for the following;

- i. Establishment of Provincial Councils
- ii. Appointment of the Governors of Provinces
- iii. Membership and tenure of Provincial Councils
- iv. Appointment and powers of the Chief Minister and the Board of Ministers
- v. Legislative powers of the Provincial Councils
- vi. Alternative arrangements when failures occur in the administrative machinery
- vii. Establishment of the High Courts of the Provinces
- viii. Establishment of the Finance Commission

#### **1.1.2 The Provincial Councils Act No 42 of 1987**

Provincial Councils Act No. 42 of 1987 provides the detailed procedures to be followed by provincial councils in relation to;

- i. Membership of Provincial Councils
- ii. Meetings and conduct of business in Provincial Councils
- iii. Financial procedures of Provincial Councils
- iv. Establishment of Provincial Public Service Commission
- v. Appointment of Chief Secretary and other officers

#### **1.1.3 The Eighteenth Amendment to the Constitution**

With the introduction of the Eighteenth Amendment to the Constitution of Sri Lanka in 2010 changes were introduced to the system of appointment of the seven commissions. The Chairman and members of the Commissions referred to in Schedule 1 under Article 41 A (1) shall be appointed by the President. In making such appointments, the President shall seek the observations of a Parliamentary Council established under the same Article. The Finance Commission is included in the list of seven Commissions under the Schedule 1.

#### **1.1.4 Provincial Statutes and Financial Rules**

The 13<sup>th</sup> Amendment to the Constitution has made provisions to make statutes applicable to the province for which it is established. Every statute made by a provincial council shall be presented to the Governor for his assent. The Governor shall either assent to the statute or he may return to the provincial council requesting the council to reconsider the statute.

The financial rules framed by the provinces are subject to the overall supervision of the Finance Commission and the procedure of obtaining the support of the Finance Commission for the provincial development planning process. Main functions of the Finance Commission as indicated in the provincial financial rules are;

- Assessment of the requirement of provincial capital expenditure, recurrent expenditure and cadre requirements annually,
- Issuing guidelines and instructions for the needs assessment in the provinces,
- Recommendation of allocations needed for provincial development after engaging in dialogues with provinces,
- Informing the provinces on annual grants allocated by the government,
- Issuing guidelines on the preparation of annual development plans and implementation including utilization of funds within the government policy and budgetary framework,
- Directing provinces to ensure achieving balanced regional development through effective utilization of resources.

### **1.1.5 Legal Base of the Local Authorities**

As the third and lowest tier of the government, local authorities are responsible for providing a variety of public services including roads, sanitation, drains, housing, libraries, public parks and recreational facilities. All local authorities comprise members elected by the people.

Local authorities operate under three legal entities namely Municipal Councils, Urban Councils and Pradeshiya Sabhas. There are 23 Municipal Councils, 41 Urban Councils and 271 Pradeshiya Sabhas operating in the country. The 13<sup>th</sup> Amendment to the Constitution included local government as a devolved subject of the provincial councils. Local authority legislations empower any local authority to establish a local authority fund for its financial purposes such as municipal councils fund, urban councils fund and Pradeshiya Sabhas fund.

## 2. Transfer of Government Funds to the 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 national policy directives and priorities. The Commission informs such needs to the Government with regard to allocation of funds from the Annual Budget which are adequate to meet their needs.
- b. Apportion such funds between the provinces with the objective of reducing regional disparities.

The process of 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 provinces for the purpose of sustaining and improving the service delivery system. Salaries and wages of provincial staff constitute the major part of recurrent expenditure to be paid to the provincial cadre approved by the Management Services Department (MSD). 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 aimed at meeting the expenditure on reimbursement of allowances of members and salaries and wages of staff. (Allocation and Release of Block Grant 2009 – 2013 are in Annex 1)

**Criteria Based Grant (CBG)** - This is a grant meant 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. However, the provinces are required to utilize this grant, adhering to the guidelines issued by the Commission Circular No. FC/PSDG&CBG/CIRCULAR/2011/1 dated 26<sup>th</sup> July 2011 as amended in 2012 and 2013. These amendments introduced the increase in the ceilings of contracts to be awarded to the registered community organizations and the provision of more opportunities for generation of self-employment. (Allocation and Release of Criteria Based Grant 2009 – 2013 are in Annex 2)

**Province Specific Development Grant (PSDG)** - The PSDG is allocated mainly for financing development projects of a capital nature, paying special attention to infrastructure development under different devolved subjects with a view to improving the quality of life of people. 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 within the National Development Policy Framework of the Government. For each investment, measurable results (output, outcome and impact) need to be identified, in the form of pre-defined indicators and periodical monitoring and evaluation of achievements should be undertaken on the basis of 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 2009 – 2013 are in Annex 3)

**Special Projects for Balanced Regional Development** - A specific amount is provided for the projects under balanced regional development for implementing medium scale projects, identified and formulated by provinces, and aimed at reducing regional disparities. Prior concurrence of the Commission should be obtained for such projects which are required to be formulated and implemented, during a period of one to three years. It is expected to bring about positive impacts including value addition, poverty reduction and employment generation through these projects in respective areas.

**Projects for Backward and Isolated Village Development** - These projects are to provide necessary infrastructure for the identified rural villages which have been isolated and neglected due to lack of essential basic infrastructure. In designing these projects, an integrated approach has to be adopted considering all requirements in different sectors for the development of such villages. Construction of small scale bridges, culverts and access roads, providing electricity, drinking water, agricultural technology, facilitation for small scale industry, and development with technical knowhow should be priority areas under these projects.

### 3. Criteria used for Apportionment of Resources 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 funds between the provinces considering the main criteria of total population and per capita income of each province and the need for reducing socio-economic disparities between the provinces.

The Commission engages in an extensive review exercise to ensure reducing the regional socio-economic disparities between provinces. The main macro indicators of Provincial Gross Domestic Product (GDP), Poverty Headcount Index, Provincial Per Capita Income, Provincial Share of GDP, Average Share of Economic Sectors in Provinces, Annual Provincial Growth Rate and Population Share of the Provinces are used in this exercise.

#### 3.1 Methodology Used for Apportionment of Resources

The Commission has introduced an updated formula for the apportionment of funds under the Province Specific Development Grant (PSDG) and the Criteria Based Grant (CBG).

A multivariate statistical technique called “Principal Components Analysis” (PCA) was used to calculate the composite indices for all provinces using the variables closely associated with the living standards of the people. The following four categories have been taken into account for the resource allocation formula with assigning of weights ( $a_i$ ) for categories was determined by the Commission taking into account the factors relating to the regional development priorities of the Government.

- i. Income and poverty; Variables - Mean per capita income, Poverty head count index and Unemployment rate – PSDG weight 40%
- ii. Health ; Variables – Neo-natal Mortality Rate and Low weight births– PSDG weight 15%
- iii. Education; Variables - Student enrollment and Learning achievements at grades 4,5,9,O/L and A/L exams– PSDG weight 15%
- iv. Infrastructure facilities; Variables - Number of houses without electricity and Length of C, D roads– PSDG weight 30%.

The above four categories were assigned with weights by population share of each province. The allocation formula can be expressed as:

$$x_i = a_1V_{1i}\bar{B} + a_2V_{2i}\bar{B} + \dots + a_nV_{ni}\bar{B}, \quad \sum_{i=1}^n a_i = 1$$

Where  $x_i$  is the allocation for province  $i$ ,

$V_{ni}$  is the score value of variable category  $n$  for province  $i$ ,

$a_n$  is the weight for variable category  $V_n$

In the case of the CBG weights were assigned on the basis of Population 35%, Per Capita Income 20%, and Poverty Head Count Index 20% and Unemployment Rate 25%.

**Table 1: Composite Indices for Apportionment of Funds – 2014**

| <b>Province</b> | <b>CI Scores for PSDG</b> | <b>CI Scores for CBG</b> |
|-----------------|---------------------------|--------------------------|
| Western         | 0.141776                  | 0.215716                 |
| Southern        | 0.119078                  | 0.120791                 |
| Sabaragamuwa    | 0.119396                  | 0.105867                 |
| Central         | 0.125506                  | 0.125938                 |
| Uva             | 0.105193                  | 0.083533                 |
| Eastern         | 0.105971                  | 0.091885                 |
| North Western   | 0.105490                  | 0.110560                 |
| North Central   | 0.085104                  | 0.072859                 |
| Northern        | 0.092487                  | 0.072850                 |

*Source: Finance Commission*

The funds allocated by the Treasury were apportioned between the provinces based on the above formula. The provincial apportionment of capital funds (PSDG and CGB) was basically done on the basis of the above composite indices. However, considering some practical aspects like funds allocated under foreign and locally funded projects at national level and the revenue generated by each province, some adjustments were made in this exercise.

Once the capital funds are apportioned between the provinces, the bulk amount that each province receives, need to be allocated among sectors/agencies so that provinces may be able to develop sector/agency based development plans for the next financial year.

In order to allocate capital grants among sectors for the year 2014, the Finance Commission adopted a realistic and rational approach taking into consideration the following aspects.

- i. Adherence to the policy directions and strategies spelt out in the Development Policy Framework of the Government.
- ii. Compliance with the goals and thrust areas identified in the Medium-Term Agency Results Framework of the provinces.
- iii. The existing intra provincial disparities with respect to major socio-economic sectors particularly health, education and social services.
- iv. Need for improved physical infrastructure in provinces to attract private investment mainly in income generating activities.
- v. Need for formulating specially designed projects which have forward and backward linkages in provincial economies.
- vi. Investing in selected projects which have a direct impact on isolated geographical pockets in provinces, with a view to improving connectivity with other parts of the province.

The provincial recurrent expenditure has contributed tremendously to the achievement of better results in human development especially in the field of Education and Health. The major proportion of recurrent expenditure is incurred on delivering the services of Health and Education. It should also be noted that provincial recurrent expenditure in other sectors meets the cost of required human resources to implement various development programmes of line ministries. Hence, provincial recurrent expenditure supports not only the provincial development investment but also the development investments of national agencies.

## 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 Nationally Collected Revenue to Provinces

According to a policy decision made by the government, the BTT was abolished and a new system of sharing nationally collected revenue was introduced with effect from 2011. 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 according to the Fiscal Policy Circular No: 01/2010 i.e. 33 1/3% of the Nation Building Tax (NBT), 100% of Stamp Duty and 70% of Vehicle Registration Fees.

The collected NBT and Stamp Duty should be shared between the provinces fortnightly using dedicated bank accounts on the following percentages, subject to their being re-fixed periodically by the 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%    |

Table 2: Transfer of Government Revenue – 2012 and 2013

| Province      | 2012          |               | 2013          |                       |
|---------------|---------------|---------------|---------------|-----------------------|
|               | Target        | Transfer      | Target        | Transfer up to June * |
| Western       | 15,360        | 13,043        | 18,240        | 5,879                 |
| Central       | 2,880         | 2,458         | 3,420         | 1,090                 |
| Southern      | 2,880         | 2,456         | 3,420         | 1,041                 |
| Northern      | 1,600         | 1,257         | 1,900         | 601                   |
| North Western | 2,880         | 2,579         | 3,420         | 1,049                 |
| North Central | 1,600         | 1,416         | 1,900         | 597                   |
| Uva           | 1,600         | 1,377         | 1,900         | 611                   |
| Sabaragamuwa  | 1,600         | 1,356         | 1,900         | 536                   |
| Eastern       | 1,600         | 1,290         | 1,900         | 603                   |
| <b>Total</b>  | <b>32,000</b> | <b>27,232</b> | <b>38,000</b> | <b>12,006</b>         |

Source: Provincial Councils

\*Provisional

## 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 of the Ninth Schedule of the 13<sup>th</sup> Amendment to the Constitution and some main sources of provincial revenue are, Motor Vehicle License Fees, Excise Duty, Stamp Duty and Court Fines.

The mechanism of sharing the nationally collected revenue between the provinces has helped the backward provinces to improve their revenue with an increased contribution to the total provincial revenue.

**Table 3: Provincial Revenue Collection by Source (Up to June ) – 2013**

(Rs. '000)

| Province      | BTT**         | Motor Vehicle license Fees | Excise Duty    | Stamp Duty       | Court Fines    | Other***         | Total             |
|---------------|---------------|----------------------------|----------------|------------------|----------------|------------------|-------------------|
| Western       | 34,960        | 1,631,470                  | -              | 3,342,970        | 285,030        | 1,023,900        | 6,318,330         |
| Central       | 7,500         | 368,934                    | 68,714         | 422,738          | 47,107         | 108,346          | 1,023,339         |
| Southern      | 7,769         | 293,000                    | 29,174         | 431,321          | 88,419         | 135,270          | 984,953           |
| Northern****  | -             | 106,293                    | -              | -                | -              | 52,772           | 159,065           |
| North Western | 656           | 398,895                    | 34,224         | 433,917          | 121,638        | 166,098          | 1,155,428         |
| North Central | 1,608         | 198,874                    | 13,652         | 32,546           | 38,443         | 58,400           | 343,523           |
| Uva           | 4,780         | 112,479                    | 18,202         | 50,297           | 25,163         | 81,758           | 292,679           |
| Sabaragamuwa  | -             | 226,687                    | 16,936         | 94,293           | 31,305         | 94,394           | 463,615           |
| Eastern       | -             | 128,369                    | 15,974         | 119,378          | 39,120         | 71,102           | 373,943           |
| <b>Total</b>  | <b>57,273</b> | <b>3,465,001</b>           | <b>196,876</b> | <b>4,927,460</b> | <b>676,226</b> | <b>1,792,040</b> | <b>11,114,876</b> |

Source: Monthly Revenue Reports of provincial councils – 2013 (Provisional)

\*\*Collection of due BTT up to 2010 \*\*\*Others include rents, interests, examination fees, sale of capital assets, betting tax etc.

\*\*\*\*No provincial revenue collection mechanism available since a statute has not been passed by the Council

The statutes passed by the respective provincial councils in terms of the provisions of the 13<sup>th</sup> Amendment to the Constitution require that the revenue collected by the provinces by way of stamp duty and court fines be transferred annually to the respective local authorities. Revenue collected through stamp duty is higher than that of the court fines.

## 4.3 Setting Provincial Revenue Targets

The system of setting revenue targets for the provinces is based on two main sources of provincial revenue.

1. The annual amount to be transferred to all provinces decided by the General Treasury in terms of the Fiscal Policy Circular No: 01/2010 of 29.12.2010. Transfers of Government Revenue to the provinces for 2013 have been forecast based on the following percentages agreed by the Finance Commission and the General Treasury.

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

2. The targets for the devolved revenue set by the Finance Commission are based on the assessment of revenue collection submitted by the provincial authorities and the past performance of provincial revenue collection.

The total amount of revenue targets set under the above two systems is deducted from the assessed recurrent expenditure needs under the Block Grant to the provinces. When setting the revenue targets for the provinces, the Finance Commission engages in a consultative process with the General Treasury and provincial authorities.

#### 4.4 Revenue Forecast for 2014

The Finance Commission analyzed the performance of actual revenue collected by the provinces for the previous years and the first six months of 2013 as a basis of the forecast for 2014. The Finance Commission's forecast for devolved revenue sources of all provinces for 2014 including stamp duty and court fines is Rs. 24,825 million. The revenue forecast of the Finance Commission for 2014 excluding stamp duty and court fines is Rs. 12,000 million.

**Table 4: Revenue Forecast for 2014**

(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                                 | FCe Forecast      | % of Provincial share of FC Forecast |
| Western       | 9,385,550                                           | 13,900,000        | 56                                   | 3,730,550                                           | 6,000,000         | 50                                   |
| Central       | 2,044,000                                           | 2,075,000         | 8                                    | 1,019,000                                           | 1,050,000         | 9                                    |
| Southern      | 2,167,500                                           | 2,340,000         | 9                                    | 1,067,500                                           | 1,150,000         | 10                                   |
| Northern      | 363,095                                             | 400,000           | 2                                    | 363,095                                             | 400,000           | 3                                    |
| North Western | 2,271,100                                           | 2,555,000         | 10                                   | 1,151,100                                           | 1,200,000         | 10                                   |
| North Central | 1,122,405                                           | 955,000           | 4                                    | 876,405                                             | 700,000           | 6                                    |
| Uva           | 527,366                                             | 630,000           | 3                                    | 347,844                                             | 400,000           | 3                                    |
| Sabaragamuwa  | 1,083,550                                           | 1,210,000         | 5                                    | 618,550                                             | 700,000           | 6                                    |
| Eastern       | 697,000                                             | 760,000           | 3                                    | 342,000                                             | 400,000           | 3                                    |
| <b>Total</b>  | <b>19,661,566</b>                                   | <b>24,825,000</b> | <b>100</b>                           | <b>9,516,044</b>                                    | <b>12,000,000</b> | <b>100</b>                           |

Source: Provincial budget estimates 2014 and Finance Commission

The forecast amount of stamp duty and court fines to be transferred to the local authorities from the total devolved revenue for 2014 is Rs 12,825.

**Table 5: Stamp Duty and Court Fines to be transferred to the Local Authorities for 2014**

(Rs'000)

| Province      | Stamp Duty        | Court Fines      | Total             | % of Provincial Share |
|---------------|-------------------|------------------|-------------------|-----------------------|
| Western       | 7,200,000         | 700,000          | 7,900,000         | 62                    |
| Central       | 885,000           | 140,000          | 1,025,000         | 8                     |
| Southern      | 920,000           | 270,000          | 1,190,000         | 9                     |
| Northern*     | -                 | -                | -                 | -                     |
| North Western | 950,000           | 405,000          | 1,355,000         | 11                    |
| North Central | 65,000            | 190,000          | 255,000           | 2                     |
| Uva           | 120,000           | 110,000          | 230,000           | 2                     |
| Sabaragamuwa  | 380,000           | 130,000          | 510,000           | 4                     |
| Eastern       | 280,000           | 80,000           | 360,000           | 3                     |
| <b>Total</b>  | <b>10,800,000</b> | <b>2,025,000</b> | <b>12,825,000</b> | <b>100</b>            |

Source: Finance Commission

\* No provincial revenue collection mechanism available since a statute has not been passed by the Council

In terms of the Fiscal Policy Circular No: 01/2010, it is expected to transfer Rs. 35,000 million from the nationally collected revenue to provinces in 2014.

**Table 6: Estimated Transfers of Government Revenue to the Provinces – 2014**

(Rs'000)

| Province      | Transfers         | % of Provincial Share |
|---------------|-------------------|-----------------------|
| Western       | 16,800,000        | 48                    |
| Central       | 3,150,000         | 9                     |
| Southern      | 3,150,000         | 9                     |
| Northern      | 1,750,000         | 5                     |
| North Western | 3,150,000         | 9                     |
| North Central | 1,750,000         | 5                     |
| Uva           | 1,750,000         | 5                     |
| Sabaragamuwa  | 1,750,000         | 5                     |
| Eastern       | 1,750,000         | 5                     |
| <b>Total</b>  | <b>35,000,000</b> | <b>100</b>            |

Source: Finance Commission

## 5. Assessment and Apportionment of Funds to Provinces - 2014

The Finance Commission engages in a comprehensive process in calling for required provincial needs and analyzing them using the criteria included in the budget guidelines. In this process –

- 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.
- The General Treasury agrees in consultation of the Finance Commission, upon the bulk amount to be allocated between the provinces.
- The bulk amount is apportioned between provinces based on the set of criteria developed by the Commission.
- The Chief Minister as the minister in-charge of the subject of finance submits the Provincial Budget at the Board of Ministers and subsequently the approved budget is submitted to the Governor who will cause it to be submitted to the Provincial Council for its approval.
- The constitutional provisions require the Finance Commission to submit its recommendations with regard to principles of apportioning funds from the annual budget between provinces to H.E. the President.

### 5.1 Request for Provincial Capital and Recurrent Needs

The provincial authorities were requested to submit their estimates of financial needs for the financial year of 2014 in accordance with the “Guidelines on Presentation of Request for Finances” issued by Finance Commission on 21<sup>st</sup> March, 2013. Provinces were instructed to use Form 2 attached to the guideline when submitting their annual capital needs.

**Table 7: Provincial Requests on Capital Needs (PSDG) -2014**

Rs. Mn

| Province      | Total Estimates | % of Provincial Share |
|---------------|-----------------|-----------------------|
| Western       | 10,776          | 17.25                 |
| Central       | 4,487           | 7.18                  |
| Southern      | 16,038          | 25.68                 |
| Northern      | 5,375           | 8.60                  |
| North Western | 5,279           | 8.45                  |
| North Central | 4,066           | 6.51                  |
| Uva           | 7,942           | 12.71                 |
| Sabaragamuwa  | 3,047           | 4.88                  |
| Eastern       | 5,454           | 8.73                  |
| <b>Total</b>  | <b>62,464</b>   | <b>100</b>            |

Source: Provincial budget estimates-2014

Note: Excluding nationally agreed Foreign and locally funded Projects

Recurrent expenditure consists mainly of two components viz. personal emoluments and other recurrent expenditure. The personal emoluments include salaries and wages, overtime and holiday payments and allowances for the employees. 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.

**Table 8: Provincial Requests on Recurrent Expenditure – 2014**  
**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       | 26,689,728          | 65                    | 14,610,998                  | 35                    | 41,300,726                  |
| 2   | Central       | 17,788,698          | 72                    | 7,011,146                   | 28                    | 24,799,844                  |
| 3   | Southern      | 16,430,701          | 75                    | 5,493,863                   | 25                    | 21,924,564                  |
| 4   | Northern      | 11,318,696          | 76                    | 3,544,744                   | 24                    | 14,863,440                  |
| 5   | North Western | 17,470,734          | 77                    | 5,313,160                   | 23                    | 22,783,894                  |
| 6   | North Central | 10,845,225          | 77                    | 3,221,068                   | 23                    | 14,066,293                  |
| 7   | Uva           | 12,318,027          | 76                    | 3,963,477                   | 24                    | 16,281,504                  |
| 8   | Sabaragamuwa  | 15,761,454          | 77                    | 4,623,102                   | 23                    | 20,384,556                  |
| 9   | Eastern       | 12,757,386          | 71                    | 5,103,347                   | 29                    | 17,860,733                  |
|     | <b>Total</b>  | <b>141,380,649</b>  | <b>73</b>             | <b>52,884,905</b>           | <b>27</b>             | <b>194,265,554</b>          |

Source: Provincial budget estimates – 2014

## 5.2 Assessment of Provincial Needs

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

In assessing the provincial capital needs, the Commission undertakes a comprehensive analysis, within the National Policy Framework 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, special attention to priority needs, implementation capacity of provincial agencies have been given due consideration.

**Table 9: Provincial Requests on Other Recurrent Expenditure – 2014**  
**Excluding Local Government Transfers, Stamp Duty and Court Fines**  
**(Rs'000)**

| Province      | Other Recurrent Expenditure |
|---------------|-----------------------------|
| Western       | 5,800,731                   |
| Central       | 4,542,740                   |
| Southern      | 3,983,342                   |
| Northern      | 2,532,592                   |
| North Western | 3,271,468                   |
| North Central | 2,617,319                   |
| Uva           | 3,288,836                   |
| Sabaragamuwa  | 3,180,102                   |
| Eastern       | 3,849,162                   |
| <b>Total</b>  | <b>33,066,292</b>           |

Source: Provincial budget estimates – 2014

**Table 10: Capital Needs for 2014 Assessed by the Finance Commission**  
**(Rs. Mn)**

| Province      | PSDG              |                       | CBG               |                       |
|---------------|-------------------|-----------------------|-------------------|-----------------------|
|               | FC Recommendation | % of Provincial Share | FC Recommendation | % of Provincial Share |
| Western       | 5,955             | 14.2                  | 1,222             | 13.6                  |
| Central       | 5,271             | 12.6                  | 1,104             | 12.3                  |
| Southern      | 5,001             | 11.9                  | 1,100             | 12.2                  |
| Northern      | 3,885             | 9.3                   | 886               | 9.8                   |
| North Western | 4,431             | 10.6                  | 916               | 10.2                  |
| North Central | 3,574             | 8.5                   | 800               | 8.9                   |
| Uva           | 4,418             | 10.5                  | 954               | 10.6                  |
| Sabaragamuwa  | 5,015             | 11.9                  | 1,048             | 11.6                  |
| Eastern       | 4,450             | 10.6                  | 970               | 10.8                  |
| <b>Total</b>  | <b>42,000</b>     | <b>100</b>            | <b>9,000</b>      | <b>100.0</b>          |

Source: Finance Commission

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

**Table 11: Assessed Personal Emoluments of the Provincial Living Cadre – 2014**

| NO           | Province      | Living Cadre   | %          | Personal Emoluments (Rs'000) |            |                        |            |                   |            |                    |            |
|--------------|---------------|----------------|------------|------------------------------|------------|------------------------|------------|-------------------|------------|--------------------|------------|
|              |               |                |            | Salaries & wages             | %          | Overtime & Holiday pay | %          | Other Allowances  | %          | Total (PE)         | %          |
| 1            | Western       | 54,074         | 18         | 14,983,558                   | 20         | 1,609,633              | 16         | 8,271,852         | 19         | 24,865,043         | 19         |
| 2            | Central       | 39,775         | 13         | 9,188,673                    | 12         | 1,129,436              | 11         | 5,575,102         | 13         | 15,893,211         | 12         |
| 3            | Southern      | 35,950         | 12         | 8,509,453                    | 11         | 991,957                | 10         | 5,022,957         | 11         | 14,524,367         | 11         |
| 4            | Northern      | 27,061         | 9          | 5,617,964                    | 8          | 843,991                | 8          | 3,824,510         | 9          | 10,286,465         | 8          |
| 5            | North Western | 38,740         | 13         | 9,267,598                    | 13         | 1,236,145              | 12         | 5,499,883         | 12         | 16,003,626         | 12         |
| 6            | North Central | 21,316         | 7          | 4,856,843                    | 7          | 876,784                | 9          | 3,030,645         | 7          | 8,764,272          | 7          |
| 7            | Uva           | 27,133         | 9          | 6,219,599                    | 8          | 971,143                | 10         | 3,973,545         | 9          | 11,164,287         | 9          |
| 8            | Sabaragamuwa  | 31,239         | 10         | 8,840,326                    | 12         | 1,630,156              | 16         | 4,697,609         | 11         | 15,168,091         | 12         |
| 9            | Eastern       | 28,884         | 9          | 6,625,537                    | 9          | 682,190                | 7          | 4,478,538         | 10         | 11,786,265         | 9          |
| <b>Total</b> |               | <b>304,172</b> | <b>100</b> | <b>74,109,551</b>            | <b>100</b> | <b>9,971,435</b>       | <b>100</b> | <b>44,374,641</b> | <b>100</b> | <b>128,455,627</b> | <b>100</b> |

Source : Provincial budget estimate 2014 and Finance Commission

Note : Excluding vacant cadre

**Table 12: Assessed Other Recurrent Expenditure for the Provinces – 2014**  
**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       | 5,792,231                                                     | 20                    | 5,058,767                 | 45                    | 10,850,998                                                       |
| 2            | Central       | 3,499,940                                                     | 12                    | 1,378,126                 | 12                    | 4,878,066                                                        |
| 3            | Southern      | 2,985,272                                                     | 10                    | 934,087                   | 8                     | 3,919,359                                                        |
| 4            | Northern      | 2,514,598                                                     | 9                     | 1,012,152                 | 9                     | 3,526,750                                                        |
| 5            | North Western | 3,271,468                                                     | 11                    | 782,738                   | 7                     | 4,054,206                                                        |
| 6            | North Central | 2,280,320                                                     | 8                     | 322,095                   | 3                     | 2,602,415                                                        |
| 7            | Uva           | 3,288,836                                                     | 11                    | 484,641                   | 4                     | 3,773,477                                                        |
| 8            | Sabaragamuwa  | 3,180,102                                                     | 11                    | 571,575                   | 5                     | 3,751,677                                                        |
| 9            | Eastern       | 2,204,102                                                     | 8                     | 652,686                   | 6                     | 2,856,788                                                        |
| <b>Total</b> |               | <b>29,016,869</b>                                             | <b>100</b>            | <b>11,196,867</b>         | <b>100</b>            | <b>40,213,736</b>                                                |

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 Treasury on the bulk amount to be allocated from the annual budget. 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. The apportionment of capital funds (PSDG and CBG) between the provinces for 2014 with the concurrence of the Treasury is depicted in the following table. This Table includes development projects funded by foreign and local sources at national level as well.

**Table 13: Apportionment of Capital Funds – 2014**

Rs. Mn

| Province      | CBG          | PSDG          | Sub Total     | % of Provincial Share | Development Projects * | Total         | % of Provincial Share |
|---------------|--------------|---------------|---------------|-----------------------|------------------------|---------------|-----------------------|
| Western       | 475          | 1,270         | 1,745         | 12.95                 | 1,510                  | 3,255         | 9.87                  |
| Central       | 430          | 1,230         | 1,660         | 12.32                 | 2,267                  | 3,927         | 11.91                 |
| Southern      | 380          | 1,230         | 1,610         | 11.95                 | 485                    | 2,095         | 6.35                  |
| Northern      | 280          | 1,035         | 1,315         | 9.76                  | 4,516                  | 5,831         | 17.69                 |
| North Western | 350          | 1,140         | 1,490         | 11.06                 | 980                    | 2,470         | 7.49                  |
| North Central | 350          | 1,000         | 1,350         | 10.02                 | 2,043                  | 3,393         | 10.29                 |
| Uva           | 330          | 1,150         | 1,480         | 10.98                 | 2,393                  | 3,873         | 11.75                 |
| sabaragamuwa  | 335          | 1,150         | 1,485         | 11.02                 | 3,095                  | 4,580         | 13.89                 |
| Eastern       | 340          | 1,000         | 1,340         | 9.94                  | 2,206                  | 3,546         | 10.76                 |
| <b>Total</b>  | <b>3,270</b> | <b>10,205</b> | <b>13,475</b> | <b>100</b>            | <b>19,495</b>          | <b>32,970</b> | <b>100</b>            |

Source: Finance Commission

\* Nationally agreed foreign and locally funded projects.

### 5.4 Planning and Approval Procedure of Provincial plans

Constitutional provisions require that the governor of a province shall, in respect of every financial year, and at least three months before the commencement of such financial year, cause to be laid before the provincial council of that province, a statement of the estimated receipts and expenditure of the province for that year. This is called the Annual Financial Statement. Detailed financial rules have been framed by all nine provincial councils which govern the planning and budgeting process of the respective provincial councils. According to the approved rules, all activities of the provincial council shall be pre-determined and set out in their Plans and Programmes.

The Annual Financial Statement for a particular financial year is the financial expression of a provincial council's policies and programmes of activity during that year. The formulation of the Annual Financial Statement is therefore, a matter of crucial importance requiring sound co-ordination and attention.

**Table 14: Apportionment of Block Grant – 2014**  
(Rs'000)

| No. | Province      | Block Grant        |
|-----|---------------|--------------------|
| 1   | Western       | 9,000,000          |
| 2   | Central       | 15,600,000         |
| 3   | Southern      | 13,800,000         |
| 4   | Northern      | 11,500,000         |
| 5   | North Western | 15,000,000         |
| 6   | North Central | 9,000,000          |
| 7   | Uva           | 11,000,000         |
| 8   | Sabaragamuwa  | 14,000,000         |
| 9   | Eastern       | 12,500,000         |
|     | <b>Total</b>  | <b>111,400,000</b> |

*Source: Finance Commission*

The Provincial Treasury having regard to the revenue, the grant from the Government, provincial and other receipts estimated to be available, will provide indicative allocations to the different ministries. The departments under these ministries prepare the draft financial statements within the limits of the indicative allocations provided. The financial needs of the province are prepared in accordance with the Finance Commission's guidelines.

## **5.5 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. 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, later 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 be utilized for the improvement of the service delivery to the public.

**Table 15: Allocation of Allowances to Members and Reimbursement of Staff Salaries of Local Authorities – 2014**

| Province      | MC        | UC        | PS         | Tot LG     | Members' Allowance |                    | Reimbursement of Staff Salaries |                   |
|---------------|-----------|-----------|------------|------------|--------------------|--------------------|---------------------------------|-------------------|
|               |           |           |            |            | No of Members      | Allowance (Rs'000) | Living                          | Amount (Rs'000)   |
| Western       | 7         | 14        | 27         | 48         | 884                | 62,034             | 16,334                          | 4,996,733         |
| Central       | 4         | 6         | 33         | 43         | 634                | 43,098             | 4,411                           | 1,335,028         |
| Southern      | 3         | 4         | 42         | 49         | 582                | 40,188             | 3,054                           | 893,890           |
| Northern      | 1         | 5         | 28         | 34         | 398                | 27,030             | 3,524                           | 985,122           |
| North Western | 1         | 3         | 29         | 33         | 498                | 33,954             | 2,449                           | 782,738           |
| North Central | 1         | 0         | 25         | 26         | 294                | 20,034             | 1034                            | 302,061           |
| Uva           | 2         | 1         | 25         | 28         | 327                | 22,428             | 1,585                           | 385,659           |
| Sabaragamuwa  | 1         | 3         | 25         | 29         | 424                | 28476              | 1,742                           | 543,099           |
| Eastern       | 3         | 5         | 37         | 45         | 447                | 31,499             | 2,094                           | 621,187           |
| <b>TOTAL</b>  | <b>23</b> | <b>41</b> | <b>271</b> | <b>335</b> | <b>4488</b>        | <b>308,741</b>     | <b>36,227</b>                   | <b>10,845,517</b> |

Source: Provincial budget estimates and Finance Commission-2014

## **6. Aligning with National Development Policy**

The major objective of the Development Policy Framework of the Government is to lift the entire country to the level of a middle income economy status with per capita income of US \$ 4,470 by 2016. As highlighted in the Public Investment Strategy (2014-2016), per capita income is expected to improve up to US \$ 8,500 by 2020. In the achievement of this objective, development strategies at macro level have been formulated based on the concept of Five Hubs, Naval, Aviation, Commercial, Energy and Knowledge. In addition, it is expected to achieve a rapid economic growth over 8% per annum by introducing structural changes in the economy. It is also expected to reduce the Poverty Headcount Ratio to the level of 2% by 2020, bringing the country's overall Happiness Index to the first place in Asia. In keeping with these macro targets of the government, the Finance Commission pays attention to the following matters in directing the provinces to map out and implement their policies, plans and projects.

The Finance Commission issued guidelines to the provinces in line with the above national strategies enabling them to prepare and implement Medium-Term Agency Results Frameworks and Annual Development Plans of provincial agencies. The following are the main approaches under this strategy;

### **6.1 Reduction of Regional Variations to ensure Minimum Wellbeing for Every Citizen**

It is worthy to mention that some macro level socio-economic fundamentals and Millennium Development Goals (MDGs) have surpassed the targeted indicators, particularly in the areas of poverty, employment, health standards and educational attainment. Surveys and studies have found that there were some isolated and backward villages in most of the provinces and they were not given due attention in the process of fund utilization. Therefore, the Finance Commission has decided to include a separate allocation for such backward geographical areas under Backward and Isolated Village Development. In 2014, Rs.500mn has been allocated for this purpose and it is hoped to continue this allocation in the coming years depending on the progress achieved.

However, there are comprehensive education, health and social development programme implemented with greater inclusiveness of Provincial Councils. In deploying more resources in education and health by Provincial Councils, the priority should be given to improve quality of education and health achieving remaining gaps in terms of poverty and MDGs. So far, Sri Lanka has made a significant and substantial progress in meeting many of the MDG related targets, including halving the number of people living in extreme poverty and the proportion of people without sustainable access to improved sources of drinking water and sanitation facilities well before the target year. The country's experience is most compelling in achieving the best indicators for child and maternal health and access to primary health care where all provinces have made a significant contribution. Education attainment levels are also high with regard to literacy, access to primary education and education completion rate and MDG targets for universal primary education and gender equality in primary education have been almost achieved. Remarkable gains have been made in the fight against HIV, Malaria and other communicable diseases.

Outstanding health indices also have been recorded in terms of low infant mortality rate, under five mortality rate, maternal mortality rate and high level of life expectancy because of effective policies and programmes implemented by the Government. The foundation of these achievements are the

policies of free health and free education covering the entire nation and committed by all levels of medical and other related professional personnel and the existence of a strong preventive and curative health infrastructure.

## **6.2 Creation of More Income Opportunities for Rural Communities**

It is important to acquire maximum benefits from the growing tourism industry for the benefit of the people living in the provinces. Introducing community based tourism could enhance employment opportunities and small and medium enterprises for rural communities. It is necessary to train the young generation of such communities in tourism related activities to enable them to acquire gainful employment. Further, local authorities could be effectively utilized as facilitators in providing market facilities for agricultural and small industrial products.

## **6.3 Provincial and Rural Road Infrastructure for Sustainable Development**

Since provincial authorities play a significant role in developing the road infrastructure at the provincial level, the following thrust areas have been established considering the importance of developing the road network for achieving socio-economic development in the country;

- i. Maintenance of Roads – Strong need for maintaining GIS and computer based road inventory with the information on the current condition of the roads, maintenance time scheduled and suggested future improvements for sustainable maintenance of the road network. Sufficient service corridors have to be established to avoid damage.
- ii. To ensure sufficient resource allocation for road improvements and maintenance, establishment of road maintenance trust funds at provincial level is needed to complete the asphalt laying of all C & D classes road by 2017.
- iii. Making available required technical officers for road sector development is essential. Capacity development of road sector employees and contractors is required.
- iv. Improving research on the road sector is vital for the introduction of economical road designs, material and construction technologies.
- v. Establishment of better co-ordination with other development sectors (water, electricity, telecommunication etc.) is mandatory for sustainable maintenance of the constructed roads.
- vi. Provision of new equipment for road construction and maintenance is needed for sustainable maintenance of the road network.
- vii. Development of proper policies and guidelines for the road sector development and acquisition of land for road construction and improvement will lead to efficient and sustainable deliverables in the road sector.

## **6.4 New and Alternative Sources of Revenue for the Provincial Councils**

The major portion of provincial revenue depends on the funds allocated from the General Treasury. About 80 percent of the treasury allocation is spent on recurrent expenditure to pay salaries and allowances. Although capital allocation is meant to be invested in projects aimed at economic development and employment generation with a view to improving the living standards of people and to implement National Development Initiatives at Provincial and District level by line Ministries and agencies, it is observed that a considerable part of such funds is spent on constructing large office buildings and other urban-based projects.

The Provincial Revenue List given in the 13<sup>th</sup> Amendment to the Constitution includes 21 sources of revenue to be collected by the provincial authorities. However, the proportion of estimated revenue stands at 18% of the total estimated expenditure of all provinces in 2014 excluding the Western Province. The proportion of estimated revenue in the Western Province is 71.5% of the total estimated expenditure of Western Province in 2014.

Therefore Provincial councils need to adopt novel approaches to promoting investment and strengthening the revenue base as well as encouraging private sector role in the economy by providing enabling environment to expand the economic base at the Provincial level.

- **Facilitate private sector participation in provincial development activities** - The provincial councils need to facilitate private sector participation in development activities carried out at Provincial level. In this effort, avoiding legal barriers, reducing bottlenecks in relation to acquiring both public and private lands, and providing environmental and legal clearance in an effective manner, and introducing effective regulatory mechanisms, are of vital importance.
- **Need for an innovative approach to utilization of revenue at Provincial level** - It is required to enhance the provincial revenue from devolved sources and utilize it for more productive investments, instead of depending heavily on limited public funds provided by the Treasury/ Finance Commission. Authorities must be mindful not to limit revenue for recurrent items, since there is a resource gap in the implementation of capital projects.
- **Identifying development potential at Provincial level** - All provinces have their own resource potential which could be harnessed for development. Provinces have to identify such resource potential which have comparative advantages, and take measures to use them by paving the way to increased value addition and improved revenue in provinces.

The Finance Commission expects to coordinate with the Board of Investment, other relevant National Agencies and the Provincial Authorities to promote private investment at provincial levels with a view to transforming this concept into practice. Provincial Authorities should facilitate this process and think of new ways and means to improve their revenue base and to support employment generation in their Provinces towards increased contribution to the GDP. Foreign private investment shall come in only through the National Government. The facilitation for much investment at Provincial level should be streamlined.

## **6.5 Enhancing the Revenue Base at Provincial Level**

In terms of the legal provisions, there is a great potential in the provinces to improve revenue from the devolved sources and also to support the local authorities to enhance their revenue capacity. The revenue base of the provinces and the local authorities can be identified as tax revenue and non tax revenue. Some proposed key strategies for revenue enhancement are given below;

- Proper valuation of property will help increase the revenue of LAs as valuation available at present is not updated. It is observed that in many instances, administrative cost of revenue collection is higher than the value of the amount expected to be collected. Updating the present valuation has become a serious issue since the required personnel for valuation is in short supply on the one hand and non-adoption of alternative avenues of valuation on the other. It is therefore suggested that LAs should use the available legal provisions to obtain property valuations from other recognized institutions.

- It has been reported that proper assessment of property has not been done when transferring land and buildings and as a result, the actual amounts of stamp fees also has not been paid by the parties involved in transferring property. Although some provincial revenue officers have taken remedial actions to address this issue, still the real amounts payable as stamp fees have not been collected. It is necessary to educate the public with regard to the payment of stamp fees due, based on the real value of the property.
- There are various income generating institutions operating in provinces without paying taxes to the provincial authorities. Introduction of regulatory mechanism to bring in such income generating institutions as tutorials, health service providers, eateries, beauty salons, fitness centres and tourism related institutions which are operated as private entities, is an essential function which requires immediate attention of the provincial authorities. Provincial authorities should introduce innovative mechanisms to collect revenue from these income generating entities.
- Provincial authorities should promote private sector collaboration in the establishment of commercially viable business ventures on the basis of sharing capital and revenue.
- LAs are empowered to collect their own revenue by different acts and regulations. However, the capacity for collecting revenue differs from LA to LA due to socio-economic factors which do not come under their purview. Even low revenue generating LAs are expected to provide basic facilities to the public within their jurisdiction. It may be prudent to consider providing additional financial support for such LAs to enable them to provide similar services to all.
- After introducing revenue sharing arrangement by the government by amalgamating NBT at National level and BTT at Provincial level to simplify and broad-base the tax system, the services of the provincial revenue officers have become partially redundant. Against this backdrop, it is necessary to take suitable actions to utilize the services of provincial revenue officers in an effective manner by harmonizing their work with the Department of Inland Revenue. In addition, the services of provincial revenue officers could also be obtained for enhancing the revenue of LAs by way of supporting property valuation, collection of revenue and developing skills of LA cadre.

## **6.6 Adopting the Agency Results Framework Approach**

The Finance Commission introduced the Agency Results Framework approach for provinces in 2013 and they prepared a Medium-Term Agency Results Framework for provinces (2013-2017) incorporating the Agency Results Framework compiled by each agency. Based on this Agency Results Framework, Annual Development Plans for 2013 and 2014 were prepared and now they are at the implementation stage.

Under this approach, provincial agencies are expected to identify results in the form of outputs and outcomes with respect to each Thrust Area with Key Performance Indicators and targets for a period of five years. With the introduction of this approach, it is expected to utilize resources to achieve intended results effectively rather than depending on the conventional practice based on mere input-output relations. All provinces have been requested to prepare their Annual Development Plans for 2014 based on the above Medium-Term Agency Results Framework while adhering to the Development Policy Framework of the Government and guidelines of the Finance Commission.

In addition, the practice of monitoring and evaluation is also expected to be carried out using this approach. To facilitate the monitoring and evaluation process, specimen formats have been introduced by the Finance Commission. More details on planning and monitoring under this approach were provided to provinces through guidelines for 2014.

## **6.7 Establishment of an effective Monitoring and Evaluation Mechanism**

Finance Commission took measures to introduce the Results Based Monitoring and Evaluation (RBME) approach in 2013 at provincial level in order to ensure that authorities are focused on achieving the results of investments, in terms of the Key Performance Indicators that have been developed in their Agency Results Frameworks.

Based on this Agency Results Framework, Annual Development Plans for 2013 and 2014 were prepared and now they are at the implementation stage. With the introduction of this approach, it is expected to utilize resources to achieve intended results effectively rather than depending on the conventional practice based on mere input-output relations. All provinces have been requested to prepare their Annual Development Plans for 2014 based on the above Medium-Term Agency Results Framework while adhering to the Development Policy Framework of the Government and guidelines of the Finance Commission.

## **6.8 Provincial cadre based on institutional roles and the workload**

A proper assessment of cadre requirements is essential to deliver effective services assigned to the different institutions. The role of an institution in service delivery and its workload has to be properly assessed in this exercise to avoid creation of unnecessary cadre which may become unproductive on the one hand, and a burden on the budget, on the other. For this purpose, joint exercise is undertaken in collaboration with the Department of Management Services, the Salaries and Cadres Commission, relevant national ministries and the Finance Commission, to decide on the optimum cadre requirement. The workload of the institution and the timeframe for performing the assigned tasks will be taken into account in this exercise.

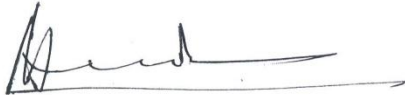
## **7. Conclusion**

Development results achieved in the provinces during the last few years can be considered remarkable when the trend of key socio-economic indicators is observed. During the last five year period, the provincial contribution to GDP has changed remarkably and this is evident from the fact that, the contribution of the Western Province has dropped from 45% to 43%. As far as the achievement of MDGs Target 1 is concerned, in every province the Poverty Headcount Index has shown a remarkable decline during the period from 2002 to 2010. The achievement of the education sector in terms of increasing the pass rate of Grade Five Scholarship Examination, GCE (O/L) and GCE (A/L) Examinations can be attributed to the results of expenditure incurred by provinces. In the health sector also a remarkable achievements can be observed when analyzing health related indicators at provincial level.

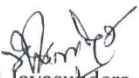
It is noteworthy to mention that Northern and Eastern Provinces have been able to achieve remarkable progress particularly in the development of infrastructure including roads, electricity supply, housing and livelihood activities. Government will continue to provide funding for development projects in these provinces under the post-war rehabilitation programmes.

Recurrent expenditure which accounts for 80% of the total expenditure consists mainly of two components i.e, personal emoluments and other recurrent expenditure. As there is a common conviction that the recurrent component of the provinces is relatively higher, the members of the Finance Commission directed to undertake a study on the effectiveness of the recurrent expenditure. The study covering major sectors namely health, education, roads, agriculture, irrigation and social welfare revealed that the expenditure incurred on recurrent items is productive in terms of achievements under each sector. These investments have also contributed to the intended results of capital projects implemented by national agencies since the required manpower particularly in the education and health sectors was provided by provinces using recurrent expenditure. Further, it was found that in the achievement of macroeconomic targets and MDGs, the provincial staff has made a greater contribution since they have engaged in day to day activities performed by national agencies as well.

The Budget Speech - 2014 has introduced several proposals that could be linked with provincial development programmes in order to obtain better results. These proposals are related to the sectors of agriculture, irrigation, fisheries, livestock, rural development, small industries, health, education and local government. When developing and implementing projects and programmes at sub national level, it is necessary to maintain a close dialogue with the ministries and agencies at national level for the purpose of avoiding possible duplication of work, and to harness the potential of these proposals for provincial development.



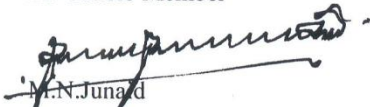
Ariyaratne Hewage  
Appointed Member & Chairman



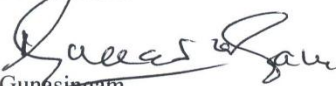
P.B. Jayasundera  
Ex-Officio Member



Ajith Nivard Cabraal  
Ex-Officio Member



M.N. Junaid  
Appointed Member



C.P.E. Gunasingam  
Appointed Member

## Annex 1

### Allocation and Release of Block Grant 2009 – 2013

Rs. Mn

| Province      | 2009          |               | 2010          |               | 2011          |               | 2012             |                  | 2013              |                          |
|---------------|---------------|---------------|---------------|---------------|---------------|---------------|------------------|------------------|-------------------|--------------------------|
|               | Allo.         | Release       | Allo.         | Release       | Allo.         | Release       | Allo.            | Release          | Allo.             | Release Up to 30.06.2013 |
| Western       | 1,923         | 2,749         | 6,100         | 6,100         | 7,170         | 8,979         | 9,011.25         | 8,893.77         | 8,501.76          | 3,250                    |
| Central       | 12,176        | 12,487        | 13,000        | 13,000        | 13,270        | 13,697        | 13,762.75        | 13,048.62        | 14,863.83         | 5,887                    |
| Southern      | 10,298        | 10,085        | 10,500        | 10,500        | 11,172        | 11,760        | 11,802.99        | 11,906.59        | 12,908.47         | 5,459                    |
| Northern      | 8,349         | 7,963         | 8,400         | 8,700         | 9,153         | 9,318         | 8,556.79         | 8,500.30         | 10,075.30         | 4,261                    |
| Eastern       | 9,891         | 9,421         | 10,100        | 10,100        | 10,473        | 10,952        | 11,385.07        | 10,737.26        | 11,635.26         | 4,671                    |
| North Western | 12,294        | 11,868        | 12,300        | 12,299        | 12,656        | 13,018        | 12,651.07        | 11,920.59        | 14,118.11         | 5,720                    |
| North Central | 6,270         | 6,513         | 7,300         | 7,300         | 7,386         | 7,596         | 7,005.42         | 6,776.02         | 7,345.62          | 3,031                    |
| Uva           | 7,907         | 7,807         | 8,300         | 8,300         | 8,897         | 8,948         | 9,458.83         | 9,031.70         | 10,263.21         | 4,274                    |
| Sabaragamuwa  | 8,893         | 8,493         | 9,000         | 9,000         | 9,823         | 10,335        | 11,243.32        | 10,736.94        | 13,088.46         | 4,978                    |
| <b>Total</b>  | <b>77,999</b> | <b>77,386</b> | <b>85,000</b> | <b>85,299</b> | <b>90,000</b> | <b>94,602</b> | <b>94,877.48</b> | <b>91,551.79</b> | <b>102,800.00</b> | <b>41,531.00</b>         |

Source: Finance Commission and General Treasury

## Annex 2

### Allocation and Release of Criteria Based Grant 2009 – 2013

Rs.Mn

| Province      | 2009         |              | 2010         |              | 2011         |              | 2012            |                 | 2013         |                          |
|---------------|--------------|--------------|--------------|--------------|--------------|--------------|-----------------|-----------------|--------------|--------------------------|
|               | Allo.        | Release      | Allo.        | Release      | Allo.        | Release      | Allo.           | Release         | Allo.        | Release Up to 30.06.2013 |
| Western       | 510          | 375          | 450          | 383          | 400          | 660          | 427             | 180.41          | 370          | 370                      |
| Central       | 446          | 306          | 410          | 308          | 375          | 337          | 400             | 218.40          | 321          | 160.5                    |
| Southern      | 426          | 230          | 350          | 298          | 325          | 292          | 347             | 189.46          | 295          | 147.5                    |
| Northern      | 332          | 241          | 300          | 255          | 275          | 247          | 294             | 160.52          | 195          | 97.5                     |
| Eastern       | 382          | 197          | 325          | 276          | 250          | 230          | 267             | 145.78          | 217          | 108.5                    |
| North Western | 370          | 272          | 300          | 255          | 300          | 270          | 320             | 174.72          | 270          | 135                      |
| North Central | 297          | 137          | 260          | 260          | 275          | 1,277        | *1,616.63       | 1420.0          | *1,005       | 742                      |
| Uva           | 373          | 206          | 300          | 255          | 300          | 240          | 320             | 174.72          | 240          | 120                      |
| Sabaragamuwa  | 416          | 311          | 380          | 323          | 335          | 301          | 357             | 194.92          | 252          | 126                      |
| <b>Total</b>  | <b>3,550</b> | <b>2,276</b> | <b>3,075</b> | <b>2,612</b> | <b>2,835</b> | <b>3,855</b> | <b>4,348.63</b> | <b>2,858.93</b> | <b>3,165</b> | <b>2,007</b>             |

Source: Finance Commission and General Treasury

\*with supplementary allocation

### Annex 3

#### Allocation and Release of Province Specific Development Grant 2009 – 2013 *Rs.Mn*

| Province      | 2009          |               | 2010          |               | 2011          |               | 2012            |                 | 2013            |                          |
|---------------|---------------|---------------|---------------|---------------|---------------|---------------|-----------------|-----------------|-----------------|--------------------------|
|               | Allo.         | Release       | Allo.         | Release       | Allo.         | Release       | Allo.           | Release         | Allo.           | Release Up to 30.06.2013 |
| Western       | 1,726         | 1,567         | 1,755         | 1,737         | 1,736         | 1,380         | 1,990           | 491             | 1,701           | 990                      |
| Central       | 2,572         | 1,606         | 2,145         | 1,895         | 2,490         | 1,369         | 3,013           | 856.88          | 3,254           | 797.27                   |
| Southern      | 1,727         | 1,102         | 1,773         | 1,656         | 1,535         | 1,283         | 1,818           | 813.85          | 1,634           | 555.83                   |
| Northern      | 1,877         | 1,946         | 2,807         | 2,365         | 3,068         | 1,306         | 3,568           | 947.37          | 3,692.7         | 518.46                   |
| Eastern       | 4,702         | 1,202         | 3,273         | 1,730         | 5,079         | 1,135         | 3,917           | 1,108.25        | 4,915           | 725.8                    |
| North Western | 1,530         | 1,056         | 1,633         | 1,613         | 1,542         | 1,265         | 1,836           | 816.85          | 1,867           | 478                      |
| North Central | 1,701         | 1,202         | 2,350         | 1,956         | 2,808         | 1,141         | 2,806.5         | 717.72          | 2,139.5         | 534                      |
| Uva           | 2,338         | 1,173         | 2,007         | 1,888         | 3,169         | 1,210         | 3,117           | 805.81          | 2,596           | 769.82                   |
| Sabaragamuwa  | 2,259         | 1,143         | 1,737         | 1,564         | 2,028         | 1,110         | 2,648           | 709.66          | 2,765           | 652.1                    |
| <b>Total</b>  | <b>20,431</b> | <b>11,998</b> | <b>19,480</b> | <b>16,403</b> | <b>23,455</b> | <b>11,199</b> | <b>24,713.5</b> | <b>7,267.39</b> | <b>24,564.2</b> | <b>6,021.28</b>          |

Source: Finance Commission and General Treasury

Note: Including Development Projects