IPE Institute for Political Economy

Rewarding Work over Wealth

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Public Finance Management Act 2024:

Shifting deficit financing towards commercial sources.

The underlying premise of the Bill is that Sri Lanka's debt issues primarily stem from the budget deficit, with particular emphasis on the primary deficit (i.e., the budget deficit excluding interest payments on existing government debt). The Bill posits that reducing the public debt requires first reducing the **primary deficit**, and ultimately achieving a primary surplus. To accomplish this, the Bill advocates for capping **primary expenditures** and adhering strictly to **budget deficit targets**.

KEY PROBLEMS:

The PFM Bill should have distinguished between domestic and foreign debt. Combining them creates the false impression that they are interconnected, despite requiring different management strategies.

What is being ignored in the Bill is that even as the budget deficit has been falling over the last 40 years from 15.5% of GDP to 6.7% of GDP (see column 1 table 1) **the interest burden as a percentage of GDP has been rising** (see chart 1). Currently expenditure on interest is the highest component of government current expenditure (see chart 2).

What is also ignored is the fact that current government expenditure is not excessively high by international standards according to the IMF. Since, however, **interest payments as a percentage of GDP are high by international standards**, this would suggest non-interest expenditure levels (on salaries and welfare) are correspondingly low by international standards.

The main reason why government interest payments have been rising even though the budget deficit has been falling is that there has been a massive 81% fall in central bank financing of the budget deficit (see column 2 table 1) and a corresponding massive increase in domestic and foreign commercial borrowing by the government. It is the shift in foreign borrowings towards foreign commercial borrowings that is largely responsible for the surge in the foreign debt servicing burden since 2015 culminating in the foreign debt crisis of 2022 (see chart 3).

This begs the question why the PFB is focusing on the primary deficit and in particular primary expenditure. Why is it that **the PFM Bill has no discussion of the problem of interest payments by government** and suggestions for how this could be brought down? The answer is more likely than not because it contradicts the attempt by government in the form of the Central Bank Act to further shift deficit financing towards commercial sources.

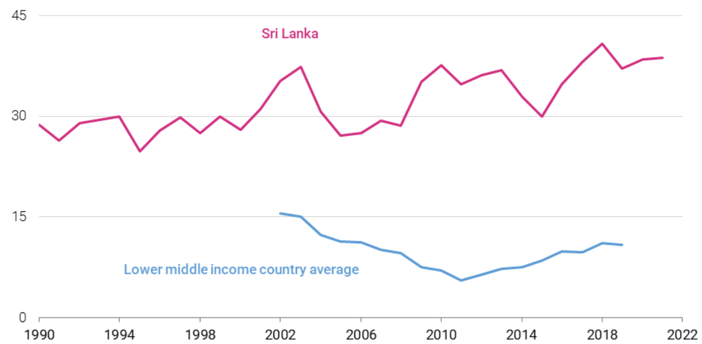
TABLE 1

Administrations		Budget deficit as % of GDP	% of government debt owned by Central Bank	Trade deficit as % of GDP
J.R. Jayewardene	1978-1988	15.5	13.6	12.6
R. Premadasa	1989-1993	7.9	10.7	10.4
C. Kumaratunga	1994-2005	8.2	5.0	8.9
M. Rajapaksa	2006-2014	6.7	2.8	11.3
M. Sirisena	2015-2019	6.7	2.6	10.7

Chart 1

The government's interest payment burden

Interest payments, as % of total current expenditure



Source: Central Bank of Sri Lanka, World Bank

Chart 2

Sri Lanka's government current expenditure by category

Sri Lanka government current expenditure by category in 2021, as % of total

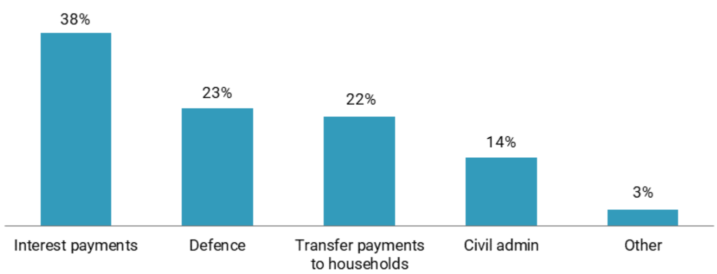
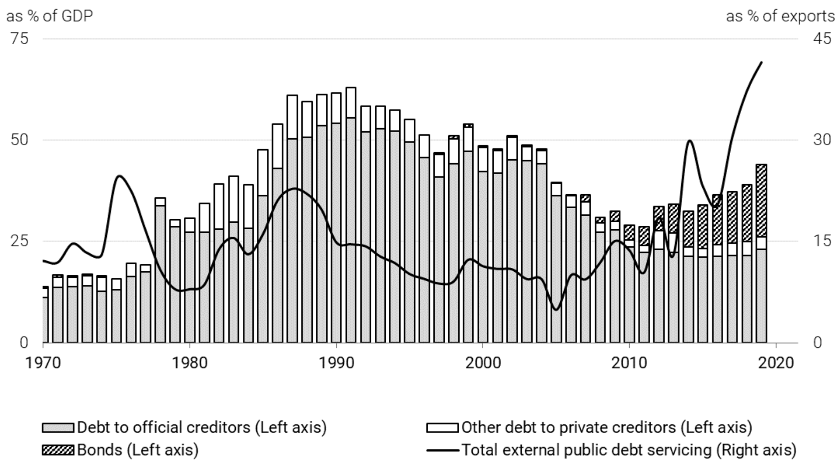


Chart 3

Source: Central Bank of Sri Lanka



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Advisory Board
July 2024