Annual Report 2005

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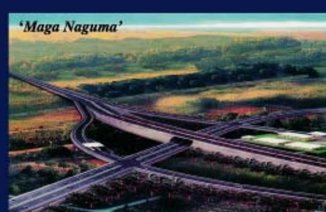
'Nana Sala'


'Maga Naguma'


'Gama Naguma'

Towards a New Sri Lanka...

Ministry of Finance and Planning

ANNUAL REPORT – 2005

MINISTRY OF FINANCE AND PLANNING
(A Report Under the Fiscal Management [Responsibility] Act No. 3 of 2003)

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Chapter I

Fiscal Developments in 2005

Fiscal Consolidation Despite Many Challenges.....

2005 marked a satisfactory progress in the conduct of fiscal policy and Budget management. Revenue increased to 16 percent of GDP, fiscal deficit declined to 7.3 percent, bank financing dropped to 1 percent and more importantly, public debt declined to 94 percent due to the adoption of appropriate fiscal policy measures, favourable fiscal trends, stability in the exchange rate and the sustained high economic growth of over 6 percent.

The Tsunami impact - loss of life of around 35,000 people, displacement of another million people, damaged to private and public properties and economic infrastructure facilities and devastating economic and livelihood disruptions to tourism, fisheries and several service activities - was the biggest and immediate challenge. Total Tsunami related expenditure accounted for 1.4 percent of GDP. The impact of the Tsunami on the Budget was also reflected in the less than expected revenue from import duties and VAT which cost 0.4 percent of GDP. The Government was successful in mobilizing US$ 2.2 Billion of which US$ 1.5 Billion were outright grants. One-year debt relief extended by the Paris Club and other development partners, helped creating a fiscal space for post-Tsunami related expenditure during 2005.

The continuous escalation of oil prices imposed a severe extra burden of around of US $ 400 Million on country's foreign exchange flows and a Rs. 26 Billion subsidy cost on the Budget. This necessitated to continue high taxes and duties on the importation of motor vehicles to curtail demand and increasing the price of fuel by Rs 12/lt to Rs. 80 /ltr for petrol and by Rs8/Ltr.to Rs.50 /lt for diesel. The kerosene subsidy reached an unmanageable level of Rs.28/lt, costing the Government Rs. 6,000 Million for the kerosene subsidy alone.

The compelled attention of the public service administration machinery to the immediate post-Tsunami recovery process, particularly during the first 6 months of 2005 and the Presidential Election process towards the later part of the year, imposed an additional strain on fiscal management. Hence the modernization process of the Inland Revenue Department which commenced in late 2004, further streamlining tax administrative measurers pertaining to the VAT refund mechanism and follow-up measures of the Tax Amnesty legislation, achieved less progress during 2005.

The bumper paddy crop witnessed in both 'Maha' and 'Yala' seasons, blessed by favourable weather conditions, renewed interest on agriculture, development of about 980 minor irrigation projects, provision of the fertilizer subsidy, high tariff on rice imports, the removal of the wheat flour subsidy, necessitated active Government intervention in paddy procurements to safeguard a remunerative producer price for paddy. This required the Treasury to release Rs. 2,000 Million for the purchase of paddy with the assistance of Government Agents. An interest subsidy was provided to state banks to extend credit at low interest rates to the private sector, to facilitate purchase of paddy.

Table I: **Fiscal outturn**

	2004	2005 Bud	2005 Revised	2005 Prov
Total Revenue	**311,473**	**389,492**	**385,722**	**379,746**
Tax Revenue	**281,552**	**351,119**	**345,387**	**336,829**
Income Tax	41,372	55,361	55,911	52,536
Taxes on Goods and Services	191,525	227,165	221,092	223,490
Taxes on External Trade	48,655	68,593	68,384	
Non Tax Revenue	29,921	38,373	40,335	42,917
Total Expenditure	**476,905**	**560,638**	**554,269**	**584,784**
Recurrent	**389,679**	**418,988**	**437,280**	**443,350**
Salaries and Wages	106,187	140,517	140,517	
Interest	119,782	128,001	119,409	120,159
Subsidies and Transfers	105,367	91,534	115,379	
Other Goods and Services	58,343	58,936	61,975	56,257
Public Investments	**97,630**	**144,440**	**118,879**	**148,582**
Other	(10,404)	(2,790)	(1,890)	(7,149)
Revenue surplus/Deficit(-)	(78,206)	(29,496)	(51,558)	(63,604)
Budget Deficit	**(165,432)**	**(171,146)**	**(168,547)**	**(205,037)**
Total Financing	**165,432**	**171,145**	**168,547**	**205,038**
Total Foreign Financing	45,752	58,884	52,463	80,414
Net Foreign Borrowings	37,071	48,684	45,063	47,774
Foreign Borrowings	70,112	91,000	66,379	69,134
Debt Repayments	33,041	42,316	21,316	21,360
Foreign Grants	8,681	10,200	7,400	32,640
Total Domestic Financing	117,243	104,761	115,259	118,304
Non-Bank Borrowings	69,274	104,761	115,259	93,109
Bank Borrowings	43,289			26,195
Non Market borrowing				(1,000)
Other /Deferred Payments	4,680			5,300
Capital Revenue Asset sales	2,437	7,500	825	1,020
Revenue/GDP (%)	15.3	17.1	16.4	16.1
Tax/GDP (%)	13.9	15.4	14.7	14.2
Non Tax/GDP (%)	1.5	1.7	1.7	1.8
Expenditure/GDP (%)	23.5	24.6	23.5	24.7
Current Expenditure/GDP (%)	19.2	18.4	18.5	18.7
Public Investment/GDP (%)	4.8	6.3	5.0	6.3
Revenue Account/GDP (%)	(3.9)	(1.3)	(2.2)	(2.7)
Budget Deficit/GDP (%)	(8.2)	(7.5)	(7.1)	(8.7)
Foreign Aid/GDP (%)	2.3	2.6	2.2	3.4
Bank Financing/GDP (%)	2.1	-	-	1.1
Non Bank Financing/GDP (%)	3.4	4.6	4.9	3.9
Domestic Financing/GDP (%)	5.8	4.6	4.9	5.0
Out of which Tsunami Expenditure			**32,418**	**33,960**
Tsunami related current expenditure			16,692	9,512
Tsunami related capital expenditure			15,726	24,448
Tsunami Expenditure as a% GDP			1.4	1.4
Tsunami related current expenditure			0.7	0.4
Tsunami related capital expenditure			0.7	1.0

Box: 1

Source: Department of Fiscal Policy

IN OIL PRICES IN THE WORLD MARKET

Soaring international oil prices hit the economy with another blow. The rapid price escalation broke all records, with global oil price reaching US$ 70 per barrel in August 2005. This resulted in an increase in the country's import bill and adversely affected the foreign exchange position and increased the cost of living. Sri Lanka's oil importation bill increased to US$ 1,656 million in 2005 from an annual average level of approximately US$ 800 million in during the previous few years. This placed a large burden on both covering the balance of payments and the management of public finance. Although the entire cost could not be passed on to the consumers immediately major price adjustments were made. The diesel price has been revised from Rs. 25 to Rs. 50 per litre. As the international price is expected to remain high, further adjustments in domestic prices cannot be avoided, give that there is an annual subsidy cost around Rs. 20 billion on petroleum products alone.

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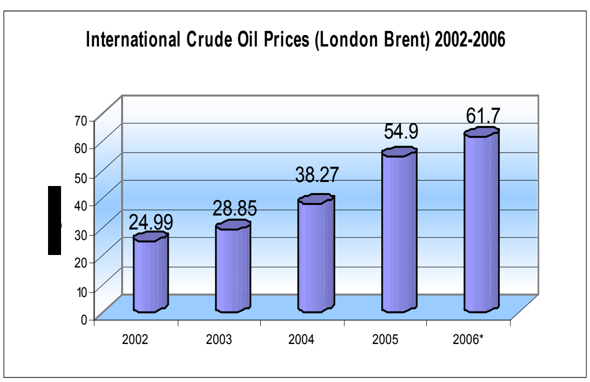
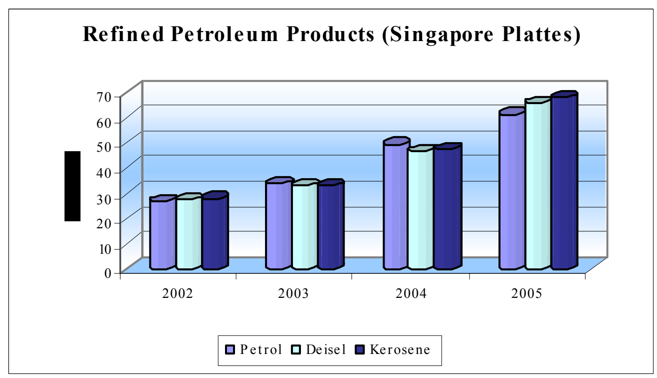


High energy intensity in the country and over dependency on imports together make the economy extremely difficult to absorb external shocks created by the oil price crisis. Further, it has created external and internal macro economic imbalances, widening the trade balance, making adverse affects on the BOP and the GDP growth.

Exchange rate depreciation and external reserves reduction are also some of the consequences to oil price hike.

In this context, the efficient use of energy is essential. The World Bank assisted Renewable Energy Programme will provide an additional $ 40 million for further development of such energies. Improvement in public transport, railways and rapid development of non fuel based electricity generation is required



Salient Features of Oil Imports and Consumption in Sri Lanka

- Imports of Petroleum → 30 million barrels per year
- Average import price of crude oil → US$ 37 per barrel in 2004, US$ 53 in 2005.
- Total import cost → US$ 1,210 million in 2004, US$ 1,700 million in 2005
- Subsidy → Rs. 18 bn in 2004, Rs. 26 bn in 2005
- Sectoral consumption → Transport 50%. Power 25%, Other 25%
- Thermal power generation 69 per cent of total power generation

Source : Department of Fiscal Policy - Research Division

Budget outcome set healthy direction in 2005…..

- Revenue in relation to GDP increased to 16.1 percent and recurrent expenditure reduced to 18.7 percent, compressing the revenue deficit to 2.7 percent in 2005 from 3.9 percent in 2004

- Government investment including post-Tsunami reconstruction expenditure, was raised to 6 .3 percent of GDP.

- Foreign aid utilization increased to 3.4 percent from 2.3 percent of GDP and foreign grants increased to Rs. 32.6 Billion mainly in support of post-Tsunami relief and reconstruction work

- Reduced revenue deficit and enhanced foreign assistance by way of loans and grants and the one year debt relief by the Paris Club and other development partners in favour of the post-Tsunami recovery process enabled the Government to reduce domestic borrowings and more particularly to reduce borrowings from the banking system from 2.1 percent in 2004 to 1.1 percent in 2005

- Budget deficit (excluding Tsunami related expenditure) declined to 7.3 percent of GDP from 8.2 percent in 2004.

A Concerted Effort Towards Reaching the 19 percent Revenue Goal in the Medium -Term ……

- The declining trend in Government revenue, was reversed in 2004 and placed on an upwards trend in 2005 through new revenue measures and improved tax administration measures

- Creation of a three- band VAT structure and restricted refunds in respect of the luxury rate band and no refunds in respect of the concessionary rate band, resulted in monthly VAT refunds being reduced from Rs. 2,000 Million in the first half of 2004 to Rs. 1,000 Million in 2005

- Luxury rate band was raised to 20 percent to partially compensate the loss of revenue from the removal of VAT on diesel, kerosene and gas.

- VAT base at the point of import, was raised to overcome under valuations

- Port and Airport Levy (PAL) was raised to 1.5 percent and non-essential imports were subjected to a specific Cess

- Income taxation was strengthened and restrictions were imposed on various deductions applicable to both corporate and non corporate taxes

- Economic Service Charge (ESC) meant to recover infrastructure costs was extended to be applicable to enterprises coming under the purview of the BOI regime

- The coverage of Excise taxation was expanded, tax applicable to importation of motor vehicles, liquor and tobacco was raised

- A new Social Responsibility Levy (SRL) was introduced to support the National Action Plan for Children

- The overall tax revenue has increased by Rs. 68 Billion , reaching a taxation level of 14.2 percent of GDP. If not for the Tsunami impact and the removal of VAT on petroleum products, the Tax/GDP ratio would have been 14.7 percent in 2005

Timely Tax Legislations passed in 2005, Removed Uncertainties…..

- For the first time ever, enabling legislations for the implementation of Budget proposals were enacted prior to the commencement of the relevant Tax Year. The process was made transparent with a consultative mechanism promoted through the Taxation Cluster of the National Council for Economic Development (NCED) which consists of relevant multidisciplinary expertise, both from the public and private sectors

- Moving towards a new taxation culture, the Inland Revenue Department recognized personal taxpayers through the issuance of Silver and Gold Cards. A Code of Ethics and Conduct and a Tax Charter were published inter alia acknowledging obligations and duties towards promoting a taxpayer friendly culture. Important Tax related information was disseminated through public seminars and Workshops.

A Tax Ombudsman was appointed to resolve taxpayer grievances.

Box: 2

ACTIVITY REVIEW – FISCAL MEASURES - 2005

Import Tariff

12.06.2005	- RPO No. 01/2005 to Implement Sri Lanka-Pakistan FTA
29.07.2005	- RPO No. 02/2005 decreased import duty on certain trucks & lorries from28% to 6%
08.11.2005	- RPO No. 03/2005 – Implementing 2005 Budget Proposals
31.12.2005	- Validity period of surcharge was extended upto 31.12.2006

Value Added Tax

01.01.2005 - Three band rate structure for VAT
(5% on essential items, 18% on luxury items and 15% on other goods & services)

- VAT exemption for
  - Supply/Import of agricultural seeds, agricultural plants, animal feed, and shrimp feed.
  - Supply of Electricity through alternative energy sources, Leasing facilities for three-wheelers, locally manufactured goods for duty free shops
    Import of project related capital goods, samples of garments for business purposes by garment buying offices

01.08.2005 ➢ Import or supply of gem, gold

05.08.2005 ➢ Import or supply of diesel, LP Gas & Powdered Milk

16.11.2005 ➢ Import or supply of Computers, Computer Accessories , Yarn , Dye and Machinery for Handloom Industry, for Construction Industry

23.12.2005.1.1 ➢ Import or supply of Rice Milling Machinery

Excise Tax

01.04.2005 -	Revised guidelines and conditions applicable for issuing liquor license
08.11.2005 -	Increased the duty on hard liquor (Rs. 15 per proof lt.) and soft liquor (Rs. 5 per lt.)
08.12.2005 -	Increased the duty on hard liquor (Rs. 15 per proof lt.) and soft liquor (Rs. 5 per lt.)
19.12.2005 -	Increased annual fee of liquor licenses by 50%

Excise (Special Provisions) Tax

29.07.2005 -	Revised duty on, motor vehicles, electrical goods and cigarettes (increased by 14 – 36 cents per cigarettes
08.11.2005 -	Increased duty on cigarettes by 14 – 36 cents per cigarettes
10.11.2005 -	Cellular mobile phones were exempted from Excise (SP) Tax
08.12.2005 -	Increased duty on cigarettes by 14 – 36 cents per cigarettes

Other Tax Measures

01.01.2005 -	Social Responsibility Levy - at the rate of 0.25% on Customs Duty, Excise Duty and on Income Tax (w.e.f.01.04.2005)
01.01.2005 -	Share Transaction Levy - 0.2% from every buyer & seller on share trading transaction
01.01.2005 -	Construction Industry Guarantee Fund Levy
01.01.2005 -	Ports & Airport Development Levy on imports for exports reduced to 0.25%.
01.04.2005 -	Income Tax amendments came into effect implementing 2005 Budget Proposals
01.04.2005 -	Imposed withholding tax on motor vehicles
01.04.2005 -	ESC rate reduced to 0.5% from 1% for wholesale & retail trade
11.05.2005	Fines and penalties were increased

Tariff & Rates

31.03.2005 -	Water tariff has been increased (other than 2 lower slabs)
10.06.2005 -	Bus fare was increased by 13.5%
01.08.2005 -	Railway fare was increased by 40%

Fuel Prices

04.05.2005 -	Increase in prices of petrol (Rs. 4),diesel (Rs.4), kerosene (Rs.3) and furnace oil(Rs. 4)
05.06.2005 -	Increase in prices of petrol (Rs.6),diesel (Rs.4),kerosene (Rs.2.50)and furnace oil (Rs.2)

Source: Department of Fiscal Policy

Box: 3

Tax Ombudsman

Consequent to a proposal in the 2005 Budget an Ombudsman to look into and redress taxpayer grievances arising from mal-administrations on the part of the Inland Revenue officials was appointed from September 2005, in terms of a Cabinet decision. The office of the Ombudsman is an independent one, and forms no part of the Inland Revenue Department or of the Ministry of Finance.

As per the first quarter report of the Ombudsman, following outcome has been achieved.

Number. of complaints received	28
Number of complaints determined and concluded	15
Number of complaints fixed for inquiry *ex-parte* consequent to the failure of the Commissioner General of Inland Revenue to send his observations	02
Instances where recommendations were not complied with by the Commissioner General	NIL

As regards the nature of the complaints, the report records the following –

- Request for general advice on tax issues: It would appear that the Ombudsman is regarded as being independent and more friendly accessible, and accommodative than the Inland Revenue Officials.
- Delay/Failure in issuing refunds
- Mode of searches conducted by the Inland Revenue Officers.
- Seizure of books and other documents not relevant to tax liability, thus disrupting the day to day business affairs.
- Delay in conducting investigations and finalizing liability.
- Failure to issue tax returns and other tax literature in Tamil to Tamil speaking taxpayers.
- Reluctance /delay of the Inland Revenue Officers in the exercise of their discretionary powers when such discretion is favourable to the taxpayer.

The Ombudsman has refrained from making any recommendations in view of the period of operation being short and experience gained being insufficient.

Tax Ombudsman is to be institutionalise by an Act of Parliament once sufficient experience is gathered.

Box: 4

Key Tax Policy Changes in 2005

Value Added Tax (VAT)

- **Change in the rate structure**
  - 5% basic rate on consumer essentials.
  - 15% standard rate
  - 18% rate on luxury goods.

- **Exemptions**
  - Supply/Import of agricultural seeds, agricultural plants, animal feed and shrimp food.
  - Supply of
    - Electricity through alternative energy sources (other than hydro or thermal power)
    - Leasing facilities for three-wheelers
    - Locally manufactured goods for duty free shops
  - Import of
    - Project related capital goods
    - Samples of garments for business purposes by garment buying offices
    - LP Gas, diesel and certain essential food item.

Port & Airport Levy (PAL): Rate increased to 1.5% from 1%. However, the PAL applicable to exports reduced to 0.25% as an incentive for exports.

Economic Service Charge (ESC) : Rate reduced to 0.5% from 1% for whole sale and retail trade.

Personal Income Tax:

- Public servants brought under the PAYE system, but only one half of the salary is taken into account in the tax calculation, the tax so calculated is borne by the employer.
- Income earned in Sri Lanka, by Sri Lankans living abroad and having dual citizenship is exempt
- The first Rs.200,000 of the interest income earned by senior citizens is exempt.

Corporate Income Tax

Following expenses were made non tax-deductible.

- Entertainment expenses and allowances.
- One half of cost of advertisement.
- A certain part of the Head Office expenditure of non-resident Companies.

CESS: Introduced to curtail non essential imports.

Excise Tax on Liquor/Cigarettes: Duty increased on alcohol and tobacco in line with the recommendation of the Presidential Task force on Alcohol, Tobacco and illicit drugs.

Excise (Special Provision) Duty

- Expansion of the coverage of commodities
- Upward revision on excise taxes applicable to Motor vehicles.

Transfer Tax on Land: 100% tax on land transfer to non-citizens.

Customs Tariff: Rationalization of Customs Tariff within a five rate band and strengthening customs administration.

Social Responsibility levy: Imposed on Customs Duty, Excise Duty and income Tax to support the National Action Plan for Children.

Fine/penalty provisions: revision of fine/penalty provisions in some of the statutes which remained unrevised for a very long period.

Income Taxation Remained Buoyant but Warrants Further Expansion…

- Direct taxation which remains low in Sri Lanka in international standards and thus undermines the progressive character of the tax system and also violates equity considerations of taxation, improved during 2005. Income tax on corporate and personal income, taxation on interest income, the new Economic Service Charge (ESC) levied in lieu of provision of free infrastructure facilitates and the Social Responsibility Levy (SRL) earmarked to finance the National Action Plan for Children, raised income tax revenue from Rs. 41,372 million (2 percent of GDP) in 2004 to Rs. 52,536 Million (2.2 percent of GDP) in 2005. The improvements reflect the removal of various exemptions, deductions and loopholes in tax laws as well as expanded tax through the introduction of the ESC

- However, the realized amount was below the target by about Rs 3,500 Million due to continued low compliance, implementation difficulties relating to tax on interest income and inevitable transitional adjustments in relation to the ESC

- In order to concentrate on buoyant service and manufacturing based economic activities and encourage investments in agriculture, taxation on agriculture was exempt in 2005

- The tax-free threshold for personal income tax was raised to Rs. 300,000 and the tax slabs were widened. The lowest tax rate was reduced to 5 percent from 10 percent. Thus the effective tax rate on personal income is below 10 percent in respect of those who are earning around Rs 1 million per annum. Although at income tax liability ought to be applicable to at least 1 million people out of the total population of 19 Million, a concern demanding fact is that only around 300,000 personal income tax files remain operational in the country

TAX ADMINISTRATIVE REFORMS

1. **Award of Gold/Silver cards to good taxpayers in recognition of their compliance with tax requirements.**
   Awards were made at a ceremony at which the Minister of Finance was also present. At a subsequent interactive session at which the card holders were invited to air their views freely, they, expressed their concerns regarding the deficiencies in the general administration of the Inland Revenue Department and ways and means of rectifying such deficiencies.

2. **Appointment of a Tax Ombudsman to look into and provide redress to taxpayers grievances** (see separate box)
   The move is intended to generate a greater a measure of transparency in tax administration.

3. **Setting up of a division dedicated for the settlement of tax appeals.**
   The division was set up in February 2006 and is under the charge of a Commissioner.
   Out of 275 appeals referred to the division up to December 31, 2005, 146 have been settled and 96 referred to the Commissioner General for formal hearings; the number in hand awaiting action was 33.

4. **Codification of a "Taxpayers Charter".**
   The Charter, put out by the inland Revenue sets out the rights and the obligations of tax payers. It also assure fair treatment, courtesy and consideration, to all taxpayers.

5. **Enunciation of a "Code of Ethics and Conduct " for tax officials**
   The Code sets out the "Mission Statement" of the Inland Revenue Department and certain rules of conduct for its employees. The Code being a public document, the tax paying public is now aware of the kind of behavior, the tax officials are required to adhere to. Any deviation from the promised norms of conduct may first be brought to the notice of the Commissioner General for corrective action and thereafter to the Tax Ombudsman where necessary.

6. **Establishment of a consultative process for tax policy formulation.**
   In 2004, the Ministry of Finance took the initiative to invite from the public, proposals relating to tax and other economics issues; the response to such invitation has been encouraging. With the establishment of the National Council for Economic Development - NCED - in the latter part of 2004, a number of clusters, comprising professionals and other experts were set up to assist and advise the Ministry in policy formulations; of the clusters, the Tax Cluster has made a useful contribution in the development of tax policy.

7. **Imposition of a time limit for recovery of tax in default**.
   Prior to 2004, action for the recovery of tax could be initiated irrespective of the time at which such tax went into default. The relevant provisions have since been amended restraining the Department from initiating recovery action after five years from the date on which the relevant assessment becomes final and conclusive.

8. Establishment of five dedicated tax courts in Colombo, Gampaha, Anuradhapura, Galle and Kandy

9. **Reduction of time limit for making assessments to 18 months**.

The time period which was at one time kept at 6 years is now reduced to 18 months; this reduction is intended to serve a dual purpose: firstly it is intended to enable the taxpayers to have their tax liability finalized early and secondly the Department will now be required to process the tax returns without undue delay.

10. **Acknowledgement of un acknowledged appeals**.

An appeal is required to be settled, at the level of the Department, within 2 years from the date on which the receipt of the appeal is acknowledged. In order to avoid any confusion arising from an appeal being not acknowledged the date of acknowledgement is now deemed to be date on which it is delivered.

11. **Acceptance of the returns of certain**

- **new taxpayers**
- **existing taxpayers**

Any individual entering the tax system voluntarily and for the first time is entitled to have his return accepted by the Department even if he does not furnish a statement of accounts if in his return the income disclosed is not less than Rs. 1,000,000/=

Again any individual who is already within the tax system declares for any tax year an income which is not less than 125% of his income for the previous year or pays a tax which is not less than 120% of the tax for the previous year and continuously does so for the next 2 years then he is entitled to have his return for the fourth year accepted by the Department.

12. **10% discount on before- time tax payments**

Currently, a penalty is charged on delayed tax payments. As a compensatory measure, where tax is paid before the due date a discount of 10% of the tax payable will be allowed.

Steady Yield from Taxes on Goods and Services…

- Government revenue from taxes on goods and services primarily through VAT, Excise Duty and Debit Tax, increased from Rs. 191.5 Billion in 2004 to Rs.223.5 Billion in 2005, an increase of 17 percent. Despite reduced imports of motor vehicles, the provision of post-Tsunami relief related exemptions and the removal of VAT on petroleum products, a buoyant growth was visible due to the strengthening of the VAT coverage, a streamlined refund process, the expansion of commodity coverage for Excise taxation and intensified countervailing measures on smuggling of cigarettes

- VAT formed 72 percent of such revenue, reflecting the spiraling growth in the service economy. VAT on various services increased by 16percent. However the setback suffered by the tourism industry has adversely affected revenue growth. The manufacturing sector generated 17percent of revenue growth, primarily from liquor, tobacco and other beverage industries. VAT on imports, net of refunds, marked an increase of 12 percent and exceeded Budget targets by a higher margin reflecting a positive impact of the uplift margin imposed on the computation of the tax base at the point of Customs and also due to the inclusion of the PAL in the tax base. However, due to declined importation of motor vehicles, revenue from such imports did not increase. VAT on financial services that generated Rs.5,463 Million exceeded Budget targets

- Excise taxation which concentrates primarily on liquor, cigarettes, petroleum products, motor vehicles and certain other selected consumer durables increased substantially from Rs. 65,790 Million (3.2 percent of GDP) in 2004 to Rs. 76,978 Million (3.3 percent of GDP) in 2005, thus exceeding Budget target. This outcome is attributable to the combined effects of the upward revision in tax rates, intensified countervailing measures to prevent smuggling and illicit trade and the expansion in the coverage of Excise taxation

External Trade Based Tax Behind Target ……..

- Revenue from Import Duty at Rs.45,390 Million marked only a increase of 10 percent and reflected a 9 Billion shortfall over Budget estimates. This was largely due to the decline in the value of imports consequent to the short-term impact of the high Import Duty imposed in 2004 and the exchange rate appreciation during the year. The entry of duty free imports in the post-Tsunami phase together with seemingly large under valuation and leakages has also resulted in the suppression of revenue from this source

- In 2005, Sri Lanka Customs adopted a transaction based valuation system in accordance with World Trade Organization (WTO) requirements. It was confronted with a large inflow of low value imports. In addition, the Government deepened bilateral liberal trade movements with India, Pakistan and the European Union (EU) to facilitate trade without tariff barriers. Further, more than 60 percent of tariff line items were placed at lower rates of Customs tariff, including zero rate. The combined effect of these developments resulted in a continued decline of the average tariff from 6 percent in 2004 to 4 percent in 2005

- Revenue from PAL improved to Rs.10,969 Million due to the increase of this levy from 1 percent in 2004 to 1.5 percent in 2005

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Table II: **Variance Analysis of Government Revenue**

	2004	2005 Bud	2005 Revised	2005 Prov	Reasons
Tax Revenue	**281,552**	**351,119**	**345,387**	**336,829**	
Income Tax	**41,372**	**55,361**	**55,911**	**52,536**	
Personal Income Tax	13,435	17,710	17,910	15,252	less than expected expansion in the base, more than expected loss in rate reduction and expected administration measures could not be put in place
Corporate Income Tax	12,628	15,874	16,224	17,719	improvement reflects the removal of various tax deductions and loopholes in tax laws
Economic Service Charge	4,035	8,000	8,000	7,283	Administrative delays in disputed areas
Tax on Interest Income	11,274	13,777	13,777	12,282	Non issuance of anticipated longer maturity treasury bonds
Taxes on Goods & Services	**191,525**	**227,165**	**221,092**	**223,490**	
TT/GST/VAT	120,622	142,690	138,232	138,660	
Manufacturing	23,106	29,864	27,489	27,278	Removal of VAT on diesel, L P Gas, powdered milk, gem and jewellery.
Non Manufacturing	28,690	36,640	36,240	32,559	Due to negative growth in tourism and related services due to Tsunami
Imports	64,859	70,933	69,250	73,360	Imposition of a margin coupled with the inclusion of PAL in VAT calculation
VAT/ TT on Banking & Financing	3,967	5,253	5,253	5,463	Due to high profits
Excise Taxation	65,790	76,865	74,515	76,978	
Liquor	13,512	17,082	17,082	16,085	Expected volume growths especially in the malt liquor was not achieved
Tobacco/cigarettes	23,457	27,301	26,301	26,692	Despite the volume growth less than the estimated(2.5% vs est. 4%) the rate revisions and intensified countervailing measures helped to the over performance
Petroluem Products	14,817	21,982	18,000	18,041	
Other	14,004	10,500	13,132	16,160	Although the motor vehicle imports declined with the full year impact of the rate revision coupled with the expansion of the base helped the performance
Other Taxes and Levies	5,113	7,610	8,345	7,852	
Stamp duty				9	
Licence Fee/Motor Vehicle Tax	624	2,357	2,900	2,142	Enforcement delays
Debit Tax	4,489	5,253	5,445	5,701	Higher growth in banking transactions
Tax on External Trade	48,655	68,593	68,384	60,803	
Imports	41,096	54,815	53,171	45,390	Tsunami related duty free imports in the 1st quarter coupled with continuation of duty waivers on certain food items accounted for the variation. Also less than expected growth in consumable and motor vehicle imports, investment goods which carry lower rates accounting for the growth in the imports and lower rates due to bilateral trade agreements resulting a decline in the average tariff rate and appreciation of the exchange rate contributed for the decline
Port devt Levy	7559	11428	11613	10969	
Cess		2350	3600	4444	introduction of specific rates enhanced the collection
Non Tax Revenue	**29,921**	**38,373**	**40,335**	**42,917**	
Property Income	15,193	19,109	20,571	20,724	
CB Profits	1,000	4,000	5,000	5,000	
Interest	8,673	6,761	7,631	8,641	Lower original estimates
Profits and Dividends	4,357	6,765	6,357	5,928	Anticipated dividends payments from Air Lanka, Ports Authority and levies from state banks mainly caused the deviation
Rent	1,163	1,583	1,583	1,155	Revenue shortfalls crown forest and lease rental from plantation companies
Fees and Charges	6,447	6,454	6,454	8,364	Increases in passport, visa fee and motor vehicle transfer collections mainly contributed for the revenue enhancement
. Other	8,281	12,810	13,310	13,829	
Social security contribution	3,444	6,678	6,678	4,910	More than expected allowances in public servants salaries
Non industrial sales	1,564	3,078	3,428	3,813	
Fines and forfeitures	1,148	1,328	1,328	1,715	Reformulating of penalty provisions coupled with improved compliance helped to enhance the revenue
Other	2,125	1,726	1,876	3,391	Classification errors which will have an impact on certain non tax items
Total Revenue	**311,473**	**389,492**	**385,722**	**379,746**	

Non- Tax Revenue Remained [illegible]e….

Source: The Department of Fiscal Policy

- Higher non-tax revenue is targeted through cost recovery of various Government services, social security contributions, recovery of interest income from Government lending and increased profits and dividend from public enterprises

- Reformulation of penalty provisions in various statutes in 2005, raised revenue from such sources from Rs. 1,148 Million in 2004 to Rs. 1,715 Million. in 2005, in addition to improved compliance

Fuel Subsidy Cost the Budget over Rs. 25,000 Million and Needs Targeting to make it effective

- The 2005 Budget suffered heavily from the subsidy on petroleum products in addition to the removal of VAT on kerosene, diesel and gas costing Rs. 7,000 million , the subsidy on petrol, kerosene, diesel and other petroleum products increased to Rs. 26,000 million. Such subsidies cost the Budget Rs. 18,000 Million in 2004.

- High fuel prices increased the operational losses of transport, electricity and railways necessitating a fare revision to minimize losses. Electricity tariff was raised and railway and bus fares were equally raised in keeping with cost escalations. In spite of such revisions the Budget absorbed Rs.6,035 million by way of Government subsidies and transfers.

- Escalation in oil prices from US $ 40 /bl in 2002/2003 to around US$ 60/bl in 2005 and the rise in demand for Petroleum products cost the country US$ 1,600 Million (Rs.160 Billion) for the importation of such products for local consumption. This is around 20 percent of total import cost in 2005.

- With the price increase of Rs. 12/lt on petrol and Rs. 8/ltr. on diesel, targeted subsidy schemes for three wheeler operators and for fishing boats were implemented. Three-wheeler operators were required to open separate Savings Accounts with the People's Bank in order to be eligible to claim the subsidy. Around 5,000 three-wheeler operators have entered this scheme as of end March 2006. Fuel subsidy of Rs. 300 per month is provided for such registered three-wheeler operators at a cost of Rs. 20 million. The Ministry of Fisheries fuel subsidy scheme for fishermen cost Rs101million.

- Implementation of such schemes for the needy groups of the society together with the removal of the general fuel subsidy could make it a pro-poor subsidy programme as well as a powerful instrument of income transfer from those who can afford to those who cannot while reducing excessive burden on the budget.

Assistance to Agriculture Doubled….

- Expenditure channeled to agriculture by way of fertilizer subsidy, interest subsidy for agriculture credit, restructuring credit for paddy mills and for the provision of agricultural seed, increased to Rs.6,846 million in 2005 from Rs. 3,572 million in 2004

- Annual advances provided for the purchase of paddy though the Government Agents increased from Rs. 600 Million in 2004 to Rs. 2,100 Million in 2005.The total paddy stock purchased during 2005 was 1,060 MT. Paddy production during 2005 increased to 3,246,000MT from 2,628,000MT.

- Recovery from advances released from paddy procurement is to be channeled to a Revolving Fund, to ensure that a dedicated fund is available for paddy procurements without pressurizing the Budget in the future as proposed in 2006 Budget.

Public Expenditure Directed Towards Pro Poor - Pro Growth Development Programs…..

- Rs 1,436 Million was spent on 'Maga Neguma' (rural road rebuilding program, 'Dahasak Maha Wav'(small irrigation rehabilitation program) 'Pubudamu Wellassa' and 'Rajarata Navodaya'(provincial specific infrastructure development initiatives), all three infrastructure initiatives launched through the 2005 Budget

- Rs. 130 million was utilized for the further expansion of dedicated provincial economic centres - the infrastructure development initiatives to promote market network facilities for agricultural produce

- Rs. 156 million was directed towards Empowering selected industrial villages

- Rs. 16,657 million. was channeled for the development of schools and health facilities, housing, livelihood development programs and small infrastructure development initiatives in the northern and eastern districts

- Rs. 4,361 million was spent on the redevelopment of the hosing and basic facilities in the Tsunami affected coastal belt.

- Rs. 3,266 million was channeled to 'Jana Pubuduwa','Gami Pubuduwa', 'Gami Diriya' to restore community infrastructure, livelihood development and micro enterprise development among 98,230 'Samurdhi' beneficiaries

Welfare expenditure is protected in the Budget ......

- The Government Budget provided a wide range of welfare assistance aiming at poorer segment of the population, displaced persons, disable soldiers and other vulnerable groups. The total expenditure spent on these categories of people increase from Rs. 16,796 million in 2004 to Rs. 17,618 million. in 2005.

Table III: **Development Assistance, Welfare Payments and Subsidies**

Rs Million.

Description	*2004*	*2005*
Children	***3,298***	***3,484***
Infant Milk Food subsidy	127	143
Child and Mother Nutrition Programme	39	166
Triposha Programme	805	504
Free Text Books	788	863
School Uniforms	1100	1,200
School season tickets	258	261
Handicapped Students	28	40
Dharma school Text books	61	150
Bursaries and Scholerships	92	157
Agriculture	***3,660***	***7,028***
Interest subsidy for Agri Loans	48	136
Fertiliser Subsidy	3,572	6846
Development Subsidy	40	46
Welfare payments	***16,796***	***17,618***
Samurdhi relief	8497	9,103
Assistance to Disable Solders	3840	4,749
Assistance to Internally Displaced Persons	2340	1,591
WFP food Assistance	1150	1,258
Public Assistance through Provin. Councils	659	640
Flood and Drought relief	310	277
Fuel subsidies	***18,511***	***26,312***
Petrol	1,702	650
Diesel	12,275	13,672
Kerosene	2,574	5,642
L P Gas	237	0
Fuel Oil	1,723	6,348
Other	***744***	***788***
Street lighting	700	743
Water subsidy for religious places	44	45
Losses of Departmental Enterprises	***6,262***	***9,060***
Sri Lanka Railways	2070	3,554
Sri Lanka Transport Board	3221	3,854
Postal Department	971	1,652
Total	**49,271**	**64,290**

Source: The Department of National Budget

- Government provided Rs. 2,873 million targeting children through various programmes including the provision of free text books, uniforms, nutritional meal and school season tickets. A 5 year national action plan for children which was implemented in late 2004 was incorporated into 2005 Budget. The total expenditure as per this programme amounted to Rs. 177 million. The new social responsibility levy introduced in 2005 to year mark financing this program raised Rs. 295 million

- Total expenditure of Rs. 108,408 million (4.6 percent of GDP) consisting of Rs. 84,810 million (3.6 percent of GDP) of current expenditure and Rs. 23,598 million (1.0 percent of GDP) of capital expenditure for the provision of services, furniture, equipment, machinery, buildings, and other infrastructure facilities was directed for health, education and skills development

- Sri Lanka's human resource development index stood at 0.751 in 2005 in comparison with the average of 0.694 in developing countries

- Sri Lanka launched its Millennium Development Goals strategy in 2005 and incorporated those goals in the 2006 Budget presented to Parliament in November/December 2006. Although Sri Lanka outperformed in relation to many Millennium Development Goals, selected districts and provinces continued to lag behind national performance standards

Sri Lanka Millennium Development Goals

Eradicate extreme poverty and hunger..........

Proportion of population below the national poverty line has reduced to 22 in 2004. The target to be achieved in 2015 is 13. Though Sri Lanka has achieved a considerable success in the improvement of non income poverty, the success of reducing income poverty is not appreciable. The Government's policy on reducing poverty is based on pro-poor and pro-growth approach and strategy of reducing sharp regional disparities in poverty and wealth creation. Special poverty reduction projects are being implemented in rural areas focusing on creating income opportunities.

Achieve universal primary education...........

The net enrolment rate in primary education was 97% in 2004, which was much higher than the South Asian regional average. The literacy rate of 15-24 year old, records a high achievement of 95%. Government's education policy is to provide equitable quality education for all. Major emphasis will be placed on improving the quality of primary and secondary education and expansion of non formal education among non-school going children and elders.

Promote gender equality and empower women........

Sri Lankan women have a comparatively better status than women in many other developing countries. The gender disparity in primary and secondary education and literacy is not and serious issue. However, major challenges with respect to promoting gender quality and empowerment of women are ensuring the legal rights of women, reducing gender imbalances in skills development, reducing poverty of war and tsunami affected women and increase in the political participation of women.

Reduce child mortality............

The infant mortality and under 5 child mortality rate were relatively low compared to South East Asian Region due to wide sprat system of maternal and child health clinics and island-wide family health programmes Under 5 child mortality rate has decrease from 22.2 in 1991 to 13.5 in 2002. The infant mortality rate also shows a remarkable decline from 17.7 in 1991 to 11.2 in 2002. The Government will pay particular attention on provision of quality care and services to pregnant mothers and infants in the North East and other lagging behind districts.

Improve maternal health..........

The Government maternal and child care system currently provides domiciliary and clinic services to nearly 80% of pregnant women and infants. Throughout the country there is an access to family planning and counseling service on birth control. The maternal mortality rate has declined by 1/3, 42.3 in 1991 to 27.5 in 2002. The ratio has been planned to reduce to 20 by 2015 through further improvement of health delivery system in relation to obstetric care and programmes on maternal under nutrition.

Combat HIV/AIDS, Malaria and other diseases.........

Sri Lanka is not a vulnerable country in terms of HIV infection. However, it has been estimated that 3,500 persons were living with HIV in the country by end of 2003. Although Sri Lanka is branded as a country of low level HIV epidemic, the Government is launching an island-wide awareness campaign on HIV infection and possible protective measures. The percentage of prevalence of HIV in the age group of 15-24 was 0.05 in 2001. It has been planned to reduce this to 0.01 by 2015 through expanding prevention programmes for highly vulnerable groups and strengthening the facilities at hospital on HIV epidemic.

Ensure environment sustainability.........

Rapid decline of forest coverage, diminishing biological diversity and emission of carbon dioxide, prevalent of unhygienic underserved settlement, particularly in the city of Colombo have been major environmental challenges. Per capita emission of carbon dioxide (metric tones per person) has increased from 0.2 in 1990 to 0.5 in 2000. However, the other environment related indicators such as proportion of population with access to safe drinking water and proportion of housing units with access to secured tenure in urban sector have improved considerably during the past decade. The Government has already taken initiatives to control the emissions from vehicles and to improve urban infrastructure facilities coupled with relocation of slum and shanty dwellers.

Develop a global partnership for development........

This goal prescribes the necessity of a partnership development between developed and developing countries. This partnership is to be built through aid, debt relief, fair trade and transfer of technology.

Table IV: Variance Analysis of Government Expenditure

	2004	2005 Bud	2005 Revised	2005 Prov	2006 Proj	Reasons
Total Current expenditure	**389,679**	**418,988**	**437,280**	**443,350**	**506,856**	
Goods & Services	164,530	199,453	202,492	194,860	238,359	.
Central Government	55,187	69,822	71,111	66,416	80,725	
Salaries	30,246	44,042	44,042	44,950	49,504	Impact of graduate recruitments to permanent positions
Other	24941	25,780	27,069	21,466	31,221	Compressed expenditure through budget controls
Defence	56,341	62,129	62,050	61,498	71,663	
Salaries	30,850	37,479	36,247	38,040	42,033	Impact of salary increase
Other	25,491	24,650	25,803	23,458	29,630	Compressed expenditure through budget controls
Police and Public Security	17,111	20,495	20,842	20,467	23,101	
Salaries	10,636	13,553	13,553	10,993	15,836	Over estimation of budget estimates
Other	6,475	6,942	7,289	9,474	7,265	
Provincial Councils	35,891	47,007	48,489	46,479	62,870	
Salaries	34,455	45,443	46,675	44,620	61,197	Recruitment of graduates to Provincial Services
Other	1,436	1,564	1,814	1,859	1,673	
.Interest payments	119,782	128,001	119,409	120,159	151,259	
Domestic	99,790	103,549	105,562	107,096	126,138	Due to increase in interest rates - to control money supply
Restructuring bonds	6,068	6,068	6,068	6,068	6,068	
Foreign	13,924	18,384	7,779	6,995	19,053	Moratorium on debt services
Subsidies and Transfers	105,367	91,534	115,379	128,331	117,238	
Public Corporations	8,405	4,639	7,096	10,412	13,579	Increase of losses in Railway and Postal coupled with
(o/w Railways & Postal)	3,524	3,043	3,500	5,205	6,366	transfers to CTB to cover the operational losses
Public Institutions	13,019	15,258	15,500	16,084	19,374	inputs of salary increase
Payments to local Authorities	358	450	450	233	250	
Pensions	36,444	45,328	44,416	46,782	48,361	Increase allowances of Pensions due to correction of anomalies
Payments- disabled soldiers	3,860	3,850	4,150	4,749	4,850	Increase in allowance
School Uniform /Nutritional food/season tickets and text books	1,988	2,038	2,100	2,229	2,751	
Samurdhi	8,498	9,635	8,800	9,161	12,200	expansion in the programme coverage.
Fertiliser Subsidy/ Farmer Incentives/	3,572	4,200	6,800	6,846	9,000	Due to escalation of world prices.
Assistance for IDPs	2,532	1,682	2,200	1,591	1,480	Compensated by Tsunami relief assistance in North & East
Other	26,691	4,454	23,867	30,244	5,393	Continuation of Fuel subsidy and part of tsunami expenses
Capital Expenditure	**83,807**	**129,111**	**107,144**	**140,154**	**164,740**	
Acq. of fixed assets	40,449	72,291	59,804	88,190	75,071	Post-Tsunami rehabilitation and reconstruction expenditure
Transfers to Public Corporations	19,068	13,575	13,582	19,919	26,858	Increase of transfers to Air port aviation ,SME Bank, Water board.
Transfers to Public Institution	19,306	27,316	25,650	20,701	36,618	Delayed implementation of projects such as Southern high way, Katunayake Express way.
Transfers to Provincial councils	4,812	12,641	7,885	11,141	25,900	Increase in foreign funded projects
Other	173	3,288	223	203	293	
Net lending	**3,420**	**12,539**	**9,845**	**1,280**	**10,046**	
On Lending - Govt. Corporations	13,823	15,329	11,735	8,428	13,555	Delayed implementation of Upper Kotmale Hydropower projects.
Advance Account net lending	1,950	2,500	1,900	1,850	3,000	
Restructuring Costs	3,567	3,950	5,450	1,365	1,750	
Repayment of on lending	(15,920)	(9,240)	(9,240)	(10,364)	(8,259)	Repayment of revolving funds of Rs. 1.5 billion
IV. Total Expenditure (including Tsunami Expenditure)	**476,905**	**560,638**	**554,269**	**584,784**	**681,642**	

Source: Department of National Budget

Public Servants Better Remunerated now Needs to put in Higher Commitment.….

- In the 2005 Budget, the salaries of public servants, including service personnel were increased by a 20 percent subject to a minimum of Rs. 2,500 per month. The monthly pensions were raised by 15 percent subject to a minimum of Rs. 750 and a maximum of Rs. 1,500 per month

- 42,000 graduates were recruited and 12,000 other appointments were made in nursing, clerical and other fields

- Salary expenditure of Government servants increased from Rs. 30,246 Million in 2004 in Rs. 44, 950 in 2005, while the salary expenditure of Provincial Councils met by the Government increased from Rs. 34,455 Million to Rs. 44,620 Million

- Increased allowances for pensions, on account of correction of anomalies and higher retirements, contributed to raise budgetary expenditure on pensions from Rs. 36,444 Million (11.7 percent of Government revenue) in 2004 to Rs 46,782 Million (12.3 percent of Government revenue) in 2005

- Social Security Contribution deducted from public servants generated Rs. 4,910 Million in comparison with Rs. 3, 444 in 2004.

Table V: **Government Employees and Pensioners**

Description	2004	2005
Employees:		
General Education	**201,081**	**205,089**
Teachers	187,338	187,339
Other Staff	13,743	17,750
Students	3,870,628	3,875,050
Teachers/Students ratio	21	21
Health	**84,500**	**89,000**
Doctors	11,600	13,500
Nurses	24,700	28,000
Population for Physician	1,638	1,444
population for Nurse	769	696
Government Enterprises	**38,434**	**40,882**
Railway	16,203	17,556
Postal	22,231	23,326
Other Government Employees	**260,511**	**273,817**
Population / Govt Servent ratio	***29***	***29***
Total Government Employees	**584,526**	**608,788**
Pensioners:		
Civil	246,246	246,762
Widows and Orphans	103,895	107,605
Armed Forces	33,789	32,886
Pirivenas and other schools	1,767	1,581
Foreign Pensioners	3,900	4,574
Local Governments	14,792	14,695
Other	7,038	7,584
Total Pensioners	**411,427**	**415,687**
per month - Rupees	***7,382***	***9,623***

Source; Compiled by department of National Budget

Interest Expenditure Crowd-Outs Government Revenue…

- With the benefits of debt relief, along with moderate borrowings and prudent practices of Treasury Operations, the interest payments on Government debt in 2005 at Rs. 120 Million remained virtually at the same cost incurred in 2004

- Intensified monetary policy actions to curb demand pressures led to a rise in interest rates and imposed additional cost of Rs. 4,000 Million over Budget estimates on domestic interest payments. Debt relief reduced the interest payment on foreign debt to Rs.6,995 Million from the Budgeted provision of Rs18,384 Million

- Interest payments in relation to Government revenue declined from 36.9 percent in 2004 to 30.4 percent in 2005, reflecting a buoyant growth in Government revenue, a better managed debt profile through Treasury cash operations and debt relief benefits

Table VI: **Consolidated Budget**

	2004 **Rs Bn**	**2005 Prov** **Rs Bn**	**2004** **% GDP**	**2005 Prov** **% GDP**
Total Revenue	**325.0**	**395.8**	**16.0**	**16.7**
Central Government	311.5	379.7	15.3	16.0
Tax	281.6	336.8	13.9	14.2
Non Tax	29.9	42.9	1.5	1.8
Provincial councils	13.5	16.1	0.7	0.7
Tax	11.5	13.8	0.6	0.6
Non Tax	2.0	2.3	0.1	0.1
Total Expenditure (including tsunami expenditure)	**488.0**	**598.1**	**24.0**	**25.3**
Central Government (including transfers to provincial councils)	476.9	584.8	23.5	24.7
Current	389.7	443.4	19.2	18.7
Capital	87.2	141.4	4.3	6.0
Provincial councils (using own resources)	11.1	13.3	0.5	0.6
Current	10.4	12.0	0.5	0.5
Capital		.3		.1
Budget Deficit(including tsunami expenditure)	**163.0**	**202.3**	**8.0**	**8.6**
Budget Deficit excluding tsunami expenditure)		**168.3**		**7.2**

Source: Department of Fiscal Policy

Public Enterprises Continued to Strain the Budget…..

- Budgetary transfers to state enterprises, including Railways and Postal, the two Departmental enterprises, to meet their operational expenditure amounted to Rs18,218 Million in 2005 in comparison with Rs. 8,405 Million in 2004.The losses on Railways and Postal operations alone amounted to Rs.5,205 Million. The other state enterprises, which depended on Treasury assistance, include Sri Lanka Transport Board, Sri Lanka Electricity Board.

- Capital expenditure provided for the railways , postal and Transport Board amounted to Rs 4,878 million.

- Profits and dividend received from profitable state enterprises increased from Rs. 4,357 Million in 2004 to Rs. 5,928 Million in 2005. These enterprises consist of the three state banks Airport Aviation Ltd. etc.

- Dividend income on the Government's stake in Sri Lanka Telecom and such other enterprises totaled to Rs 2,834

- The Treasury has highlighted uneconomical transactions, absence of realistic pricing strategies, lack of Corporate strategies, managerial skills and exceptionally high overhead cost and inefficiencies and lack of business focus as the major weaknesses in many state run enterprises

- Common deficiencies highlighted by the Auditor General in respect of state enterprises include the lack of professionalism in management, absence of Corporate Plans and Budgets, delayed submissions of Annual Accounts, weak system managements and controls, uneconomical transactions and inadequate compliance towards Good Governance

A Trust Fund to Manage Temporary Surpluses of State Institutions…

- As proposed in the 2005 Budget, a new Trust Fund was setup under the Trust Ordinance to manage all temporary surplus balances of individual Government institutions in a professional manner. The Treasury has identified 20 such entities with total resources of Rs11.4 Billion , but only 11 enterprises out of them with Rs. 6.5 Billion have complied with this requirement as of March 2006

- The operation of the Trust Fund with a total value of Rs. 6.5 billion from these 11 enterprises. The beneficiary agencies are given cash requirement from the fund on a regular basis for their operation.

- The operation of such Trust Fund not only provides the benefit of been able to use managerial expertise in fund management at least cost but has also been able to raise capital and improve overall public financial management and stability in interest rates and liquidity management

Treasury Operations Improved Budget Management…

- The newly created Department of Treasury Operations, improved cash releases, helped daily liquidity management in monitory operations. This helped reducing the borrowing cost of the Treasury. Thus, the average cost of borrowing remained at 6.0 percent in 2005 as compared with 6.1 percent in 2004. The cost of borrowing through Treasury Bills and Treasury Bonds increased to 10.7 percent from 8.3 percent, due to tightening of monetary policy during the year to contain inflation. This resulted in an additional cost of Rs.4, 000 Million on interest payment on domestic debt to the Budget

- Daily working balances of the Treasury in the Bank of Ceylon and the People's Bank was kept under close surveillance. Monthly average working balance kept below Rs. 10,000 Million Large variations were observed during November and early December due to payment leads and revenue lags that occurred due to advance payments made on Tsunami related relief , payments for paddy procurement and bunching of payment of salaries and pensions during festival seasons. The uneven pattern of salaries and pensions during March, April and May is a matter of concern for Treasury operations

- Delayed payments associated with Treasury cash operations were reduced. The outstanding undisputed claims, particularly in respect of the fertilizer subsidy and VAT refunds were reduced from Rs1,800Million in beginning of 2005 to Rs.450Million at end March 2006 by the end of the year

- Treasury operations continued to engage in the refinancing of high-cost rupee loans, with low-cost debt instruments in order to reduce debt-servicing costs

- Composition of the borrowing profile between domestic and foreign currency was guided on the basis of interest rate differentials, exchange risks and market liquidity conditions, while adhering with approved ceilings and prudent debt management requirements. The mobilization of Foreign Currency Denominated loans to the tune of US$ 580 Million helped reducing the overall debt servicing in the Budget. The annual cost of these three-year debt is below 6 percent in foreign currency terms

A Marked Reduction in Public Debt…...

- Government debt declined to 94 percent of GDP from 105.5 percent in 2004. During the past 5 years, the Debt to GDP ratio remained over 100 percent

- Domestic debt consisting of Central Bank Advances, Treasury Bills, Treasury Bonds and Rupee Loans declined to 53.5 percent from 56.4 percent reflecting lower borrowings and a higher growth in GDP

- Foreign debt reduced to 40.4 percent from 49.1 percent reflecting stability in the exchange rate and lower debt financing of the Budget and high economic growth

Table VII: **Debt Indicators**

Indicator	2004	2005 Prov
Public Debt/GDP	105.5	93.9
Domestic Debt/GDP	56.4	53.5
Foreign Debt/GDP	49.1	40.4
Foreign Debt/Export earnings and foreign remittances	109.1	96.2
Debt Service/GDP	14.8	14.6
Debt Service/ Revenue	92.5	87.1
Foreign Debt service/Export earnings and foreign remittances	5.1	2.9
Interest/ Current Expenditure	29.9	20.1
Interest/Government Revenue	36.9	30.4

Source: compiled by the Department of Fiscal Policy

Debt Management........

The Appropriation law passed by the Parliament for the financial year 2005 authorized a gross borrowing limit of Rs. 457.2 billion. Even after accommodating for urgent Tsunami expenditure the Government was able to execute the 2005 budget within the approved borrowing limit. The table below gives the summary of transaction during the year 2005 for domestic and external debt of the government, and the total debt stock.

Table VIII: **Government Debt**

Item	End Dec 2004	End Dec 2005
		Rs Billion
Total Domestic Debt	**1,143.4**	**1,266.5**
Short - Term	269.8	267.5
Treasury bills	243.9	234.2
Provisional advances from the Central Bank	34.8	39.7
Other	-8.9	-6.5
Medium and Long -term	873.6	999.0
Rupee securities (b)	164.8	140.6
Treasury bonds	643.3	751.6
Treasury certificates of deposit	0.0	0.0
Sri Lanka Development Bonds	26.1	25.5
Other (c)	39.4	81.3
Total Foreign Debt	**997.1**	**956.6**
By Institution	997.1	956.6
Concessional Loans	970.3	919.0
Multilateral	475.2	486.5
Bilateral	495.1	432.6
Non-Concessional Loans	25.8	37.6
Multilateral	1.8	0.3
Bilateral	0.6	0.8
Commercial Loans	23.5	36.4
Total Outstanding Government Debt	**2,140.5**	**2,223.1**

(a) Provisional

(b) Include long-term bonds of Rs.24,088 million and Rs.23,873 million issued in 1993 and 1996 respectively to BOC, PB and NSB .

(c) Includes the outstanding balance to FCBUs

Source: Department of Fiscal Policy

The gross borrowings of the Government for 2005 stood at Rs. 404.2 Billion (net of Treasury Bill one year rollovers) as against the authorized borrowing limits of Rs. 457.2 Billion. This was possible due to one year debt moratorium extended by the donor countries to manage the Tsunami disaster. The net borrowing for the year recorded as Rs. 182.8 Billion.

Government Debt Securities Market

Interest rates, both on short term and medium term domestic borrowings increased by 2–3 percentage points during the year. This was mainly due to tight monitary policy adapted by the Central Bank of Sri Lanka (CBSL). However the interest rates were stabilized towards the end of the year with the easing of inflow pressure into economy. The following table shows the movement of yield rates during the year. The CBSL raised policy rates four times in 2005, increasing the policy rate from 7.50% at the beginning of the year to 8.75% at the end of the year.

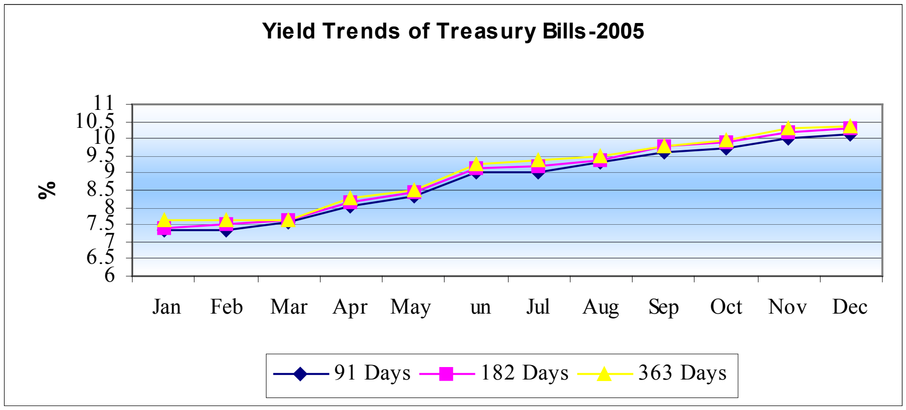
Table IX: **Behaviour of Yield Rates - 2005**

Year	Treasury Bills			Treasury Bond			
	91 Days	182 Days	364 Days	2 Year	3 Year	4 Year	5 Year
Dec. 2004	7.25	7.40	7.65	8.25	8.60	8.75	10.10
March 2005	7.55	7.64	7.75	8.25	8.35	8.45	-
June 2005	9.00	9.15	9.20	-	10.70	10.70	-
Sept. 2005	9.62	9.76	9.80	10.65	10.98	11.08	11.10
Dec. 2005	10.10	10.32	10.37	10.69	11.19	10.85	11.10
Change	**2.85**	**2.92**	**2.72**	**2.44**	**2.59**	**2.10**	**1.00**
April 2006 (1st week)	10.05	10.30	10.36	-	11.04	11.15	10.83

Source: Department of Treasury Operations

Maturity in yield rates for both treasury bills and bonds reflected a greater preference for short term Government securities. Yield rates for 91 days Treasury Bills in the primary market increased from 7.25 percent in December 2004 and ended at 10.10 percent by December 2005, while the 3 year Treasury Bond Rates increased from 8.60 percent to 11.19 percent by the end of the year. Outright transactions and Repo transactions in Treasury Bills in the secondary market increased by around 7.2 percent and 52.6 percent respectively, compared with the first nine months of 2004. Outright transactions of Treasury Bonds in the secondary market declined by 11.8 percent and 26.9 percent respectively during this period.

Figure 1:



Equity Market........

The share market performance during the year was mixed and volatile. The total turnover for the year was Rs. 96.1 billion, an increase of 62.8 percent from 2004. The All Share Price Index and the Milaka price Index increased by 46.5 percent and 52.4 percent respectively between January and October 2005 but decreased between the months November and December. This trend was visible during the presidential elections and the presentation of the National budget for 2006 in November/December. Market capitalization increased from Rs. 422.1 billion to Rs. 584.0 billion by December 2005. Market activities further expanded with three IPOs during 2005.

Table X: **Stock Market Performance**

	2000	2001	2002	2003	2004	2005
All Share Price Index(Rs.Million)	447.6	621.0	815.0	1,062.1	1,506.9	1,368.9
Milanka Price Index	698.5	1,031.0	1,374.6	1,897.8	2,073.7	2,691.9
Average Daily Turn Over(Rs.Million)	44.0	58.0	127.0	307.0	246.0	480.0

Source: Colombo Stock Exchange

Sri Lanka obtained a Sovereign Rating…….

- Resilience of the economy to external shocks, sustained growth in exports in excess of 10 percent, diversified economic activities and the risk profile, a stable economic outlook to generate over 6 percent growth, a buoyant private enterprise economy, a strong financial market and regulatory framework, sound corporate governance and accounting standards and a sound debt servicing record, contributed towards establishing a BB-/B+

Sovereign Rating in 2005, for the first time. This rating is comparable with countries such as countries such as Philippines, Indonesia and Pakistan The Government has maintained an outstanding debt servicing record. All Government debts are managed and serviced by the Central Bank of Sri Lanka. The Government has also honoured all Government guaranteed debt. Such debt servicing in respect of the Hilton Hotel alone amounted to Rs. 225Million in 2005.

- Sri Lanka's total foreign debt service, as a percentage of total export of goods, services and earnings from overseas remittances is around 10 percent

- Sri Lanka's external debt is characterized with heavy concessionary elements with longer maturity and reasonably diversified currency compositions. Total commercial foreign debt is less than 10 percent

- The Government is committed to maintain low-cost of debt through refinancing of high-cost debt, which have been raised during high interest rate regimes and due to exchange rate variations. Refinancing of such debt by low-cost , long maturing and in stable foreign currency denominations, is conducive to reduce debt servicing costs, while maintaining the same level of debt stock

'Mahinda Chinthana' - A Vision for the Future ....

- As articulated in the Prsidential Policy Statement to the Parliament and in Budget 2006, 'Mahinda Chinthana' economic policy framework is a consolidation of the Pro- Poor growth Strategies based on private and public sector participation in economic and social development. It is developed on a market friendly, export oriented and competitive economic policy framework to sustain an 8 percent growth in GDP

- Government is to be proactive in promoting socioeconomic development in particular social development, environment protection, education and health and infrastructure development to ensure a balanced regional development and employment creation

- Building on the 'Mahinda Chinthana'- A Vision for the Future, encompasses five themes as the core of the strategies

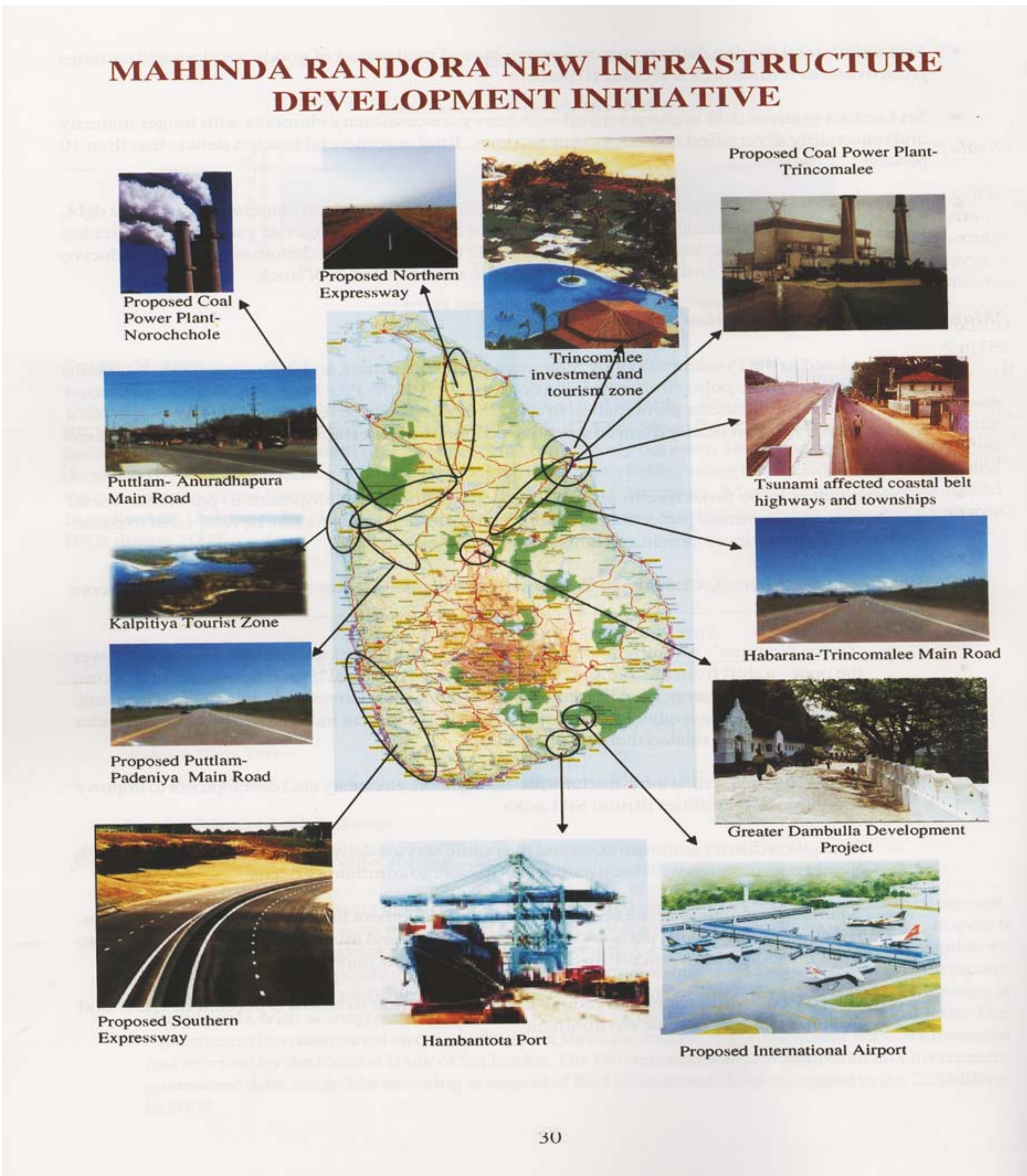
    - 'Gama Neguma'- a community based integrated rural development initiative to empower the poor - a shift from the traditional welfare approach to rural level empowerment as a core poverty reduction strategy. All livelihood development initiatives including micro- financing, 'Samurdhi' and such other low income focused development initiatives to be clustered under this program

    - 'Maga Neguma' - rural infrastructure (roads, irrigation, electricity etc.) development to improve economic opportunities in rural Sri Lanka

- Strengthen district administration and the public service delivery mechanism together with greater coordination with local authorities to cater to community needs

- 'Mahinda Randora' – a national infrastructure development initiative (electricity, highways, irrigation, water supply, ports and air ports, townships and investments and tourist zones) to provide modern infrastructure to promote nation wide economic developement.

- Macro Economic strategy to reduce the Budget deficit to below 5 percent of GDP and provide a stable economic environment.


MAHINDA RANDORA NEW INFRASTRUCTURE DEVELOPMENT INITIATIVE
Proposed Coal Power Plant-Norochchole
Proposed Northern Expressway
Trincomalee investment and tourism zone
Proposed Coal Power Plant-Trincomalee
Puttlam- Anuradhapura Main Road
Tsunami affected coastal belt highways and townships
Kalpitiya Tourist Zone
Habarana-Trincomalee Main Road
Proposed Puttlam-Padeniya Main Road
Greater Dambulla Development Project
Proposed Southern Expressway
Hambantota Port
Proposed International Airport
30

The Economy in 2005

Displayed Strong Resilience……

Over a 6 percent growth, easing off the inflation to below 10 percent, sustained increase in industrial exports by 10 percent, buoyant growth in private remittances to generate US$1,700 million foreign inflows, reduced fiscal imbalances to compress bank financing to 1.1 percent of GDP, a build up of official international reserves to US$ 2,735 Million and declining national debt to 94 percent of GDP are the salient development outcomes in 2005.

The country sustained for the third successive year, over US$ 1,000 per capita income by reaching US$ 1, 250 in 2005. The Government obtained its first international sovereign debt rating with 'Fitch' assigning a BB- and 'Standard and Poors' assigning a B+.

These developments have taken place against the backdrop of the Tsunami disaster of 26th December 2004, rising oil prices that increased country's oil import costs to US$ 1,600 Million and intensified international competition for garment exports following the abolition of Multi Fiber Agreements (MFAs).

Sustained Buoyant Growth in Excess of 6 percent…….

- GDP increased by 6.2 percent in 2005-a further acceleration from 5.5 achieved in 2004. Despite the dip in growth during the first quarter of 2005 consequent to the Tsunami, the economy bounced back to record over 6 percent growth in the three successive quarters, reaching near 6.5 percent growth in the second half of the year.

- The GDP expansion in 2005 was wide spread. Agriculture recorded 1.2 percent increase a marked improvement from the negative growth of 0.5 percent witnessed in 2004. The urban based industrial sector witnessed 7.9 percent growth while services increased by 6.7 percent. While agriculture and services sector suffered from the setback to Fisheries and Tourism due to the Tsunami the industry sector faced sever competition from international trade and high oil prices.

- The value added in paddy increased by 23.4 percent. rubber by 10.2 percent, minor agricultural exports by 16 percent and other food crops including fruits and vegetable and other highland crops increased by 4.7 percent. Livestock increased by 2.3 percent. Fishing industry however suffered a negative growth of 40.7 percent reflecting the devastating impact of Tsunami. Wide spread development in agriculture was due to favourable weather conditions, attractive prices for export crops as well as for fruits and vegetables, new incentives for paddy, expansion in irrigation facilities and reorientation of trade policies towards promoting domestic agriculture for food security.

- Industrial sector expansion benefited from the high growth of manufacturing industries at 6.4 percent and SMEs by 5.8 percent despite high competition. The expansion in construction industry particularly in urban property development and housing including Tsunami related reconstruction work as well as rapid recovery in power generation and water supply were favourable development in 2005.

- Despite a slower growth in external trade contribution from domestic trade, cargo handling, telecommunication, banking and finance, government services as well as private services contributed to a sustain growth in fast diversifying service sector during 2005.

Improved investment and buoyant savings.......

- The investment to GDP increased from 25 to 26.8 percent largely due to the expansion in public investment which increased from 4.8 percent to 6.6 percent. Private investment improved to 20.2 percent of GDP. Domestic demand for consumption was met largely from domestically produced goods while the buoyant external demand was conducive for export growth. Export trade increased by 6.8 percent while domestic trade expanded by 8.3 percent in 2005.

- Domestic saving to GDP rose from 15.9 percent in 2004 to 17.2 percent to 2005. As reflected in the government fiscal operations, the reduction in revenue deficit contributed positively to domestic savings.

Table XI: **GROSS DOMESTIC PRODUCT - SECTORAL COMPOSITION (1998 CONSTANT**

	2003 Rs. million	**2004** Rs. million	**2005** Rs. million.
Agriculture,Forestry and Fishing	189,990	189,057	191,300
Agriculture	159,054	157,410	167,709
Tea	23,793	24,172	24,706
Rubber	3,655	3,766	4,148
Coconut	18,622	18,612	18,787
Minor Agricultural export crops	5,267	5,139	5,975
Paddy	27,058	23,182	28,605
Highland crops	21,170	20,664	21,735
Fruits	1,066	1,161	1,206
Vegetable	34,796	36,954	38,574
Livestocks	11,224	11,284	11,539
Other Agriculture	12,403	12,476	12,434
Forestry	9,526	10,097	10,803
Fishing	21,410	21,550	12,788
Industry	345,017	364,000	394,016
Mining and Quarrying	16,527	16,363	20,447
Manufacturing	217,845	230,371	244,329
Processing Industries	10,657	11,136	11,223
Factory Industries	191,878	202,638	215,554
Small Industries	15,310	16,597	17,552
Electricity, water and Gas	26,676	28,312	32,257
Electricity	23,347	24,841	28,740
Water	1,094	1,129	1,178
Gas	2,235	2,342	2,339
Construction	83,969	88,954	96,983
Services	720,250	769,365	820,673
Trade hotels and restaurants	316,633	340,447	362,147
Imports	113,243	123,292	128,522
Exports	61,958	66,445	70,984
Domestic trade	135,350	143,335	155,272
Hotels and restaurants	6,082	7,375	7,369
Transport, storage & communication	139,394	153,365	168,287
Cargo, Storagrs and Wearhousing	2,868	4,245	7,365
Postal and Telecommunication	8,774	10,366	12,974
Transport	127,752	138,754	147,948
Financial Services, Real Estate and Business Ser	139,262	145,559	153,598
Banking and insurance	101,472	107,357	114,823
Real estates, renting and business services	37,790	38,202	38,775
Government and other services	124,961	129,994	136,641
Public Administration & Defence	95,392	99,335	104,678
Community and other services	29,569	30,659	31,963
GDP	1,255,257	1,322,422	1,405,989

Source: Department of Census and Statistics

Inflation moved on a downward trend......

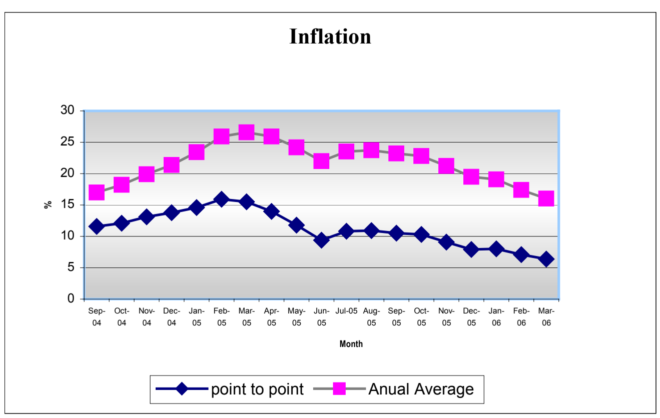
- The average inflation as reflected in the Colombo Consumer Price Index (CCPI) declined to 9.6 percent in March 2006 from the peak level of 12.8 percent in August 2005. The average inflation measured by the Sri Lanka Consumer Price Index (SLCPI) decelerated below 8 percent from 14.5 percent in July 2005. On a year on year basis CCPI declined to 6.4 percent in March 2006 from 16 percent an year a ago. The same trend was shown in SLCPI which declined to 3 percent from 17 percent an year ago.

- The moderate inflation was achieved by high level of domestic production which adequately met the domestic demand. The sharp decline in rice and vegetable prices due to favourable supply conditions were conducive for this development despite the supply destructions caused by Tsunami particularly on fish production and also due to high cost escalation owing to rising fuel prices.

- Government fiscal policy actions to compress fiscal imbalances particularly to reduce borrowing from the banking system and the Central Bank monetary policy action by raising policy rates by 125 basis points on open market operations to contain demand pressure were conducive to moderate inflation in the economy in 2005.

- Despite a high interest rate by 2 to 3 percent in 2005 than 2004 and higher taxes particularly on motor vehicles and consumer durables, private sector credit continued to expand at around 20 percent reflecting a high investment spending associated with economic expansion.

Figure 2:



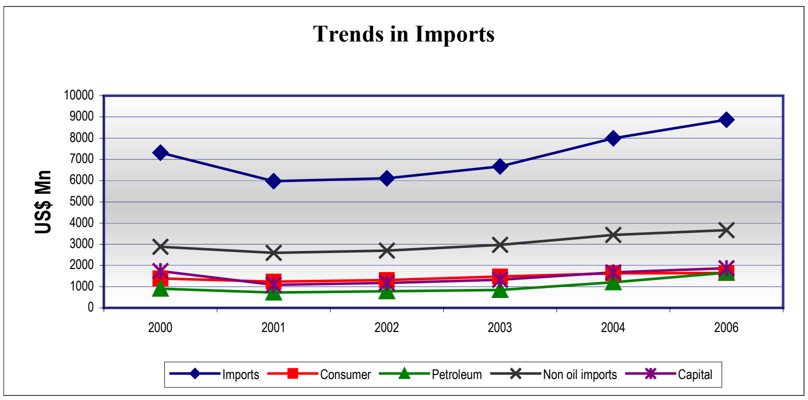
Trade deficit declined and remain favorable for investment.........

- Value of export reach US$6,344 million recording 10.2 percent increase in 2005. Industrial exports increased by 9.8 percent to US$ 4,946million despite stiff competition for export of textile and garment particularly after the removal of the Multi-Fiber

Agreement. Agricultural exports totaled to US$ 1,184 million witnessing a 8.4 percent growth reflecting high volume growth as well as favourable commodity prices for Sri Lanka's agricultural exports.

- Sri Lanka's total imports in 2005 amounted to US$ 8,863 million in comparison to US$ 7,999million in 2004. Consumer goods imports which totaled at US$ 1,644 million recorded only a moderate increase of 1 percent largely reflecting the compressed demand for motor vehicle imports. Non oil intermediate imports increased to US$ 6,662 million - a growth of 6.6 percent and capital goods imports increased to US$ 1,860 million recording 12 percent increase. The trend in growth in such imports made the import structure growth conducive.

Figure 3:



- The cost of petroleum imports reached US$ 1,655 million which was an increase of US$ 446 million which is 37 percent increase. The cost of oil imports in 2005 was virtually doubled the amount spent in 2003. Consequently the petroleum imports account for 19 percent in 2005 as compared to 12.9 percent in 2003.

Figure 4:

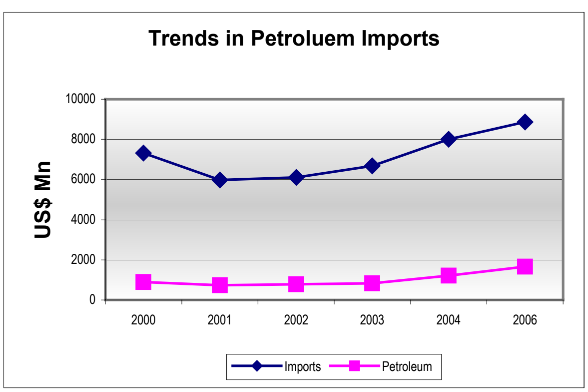
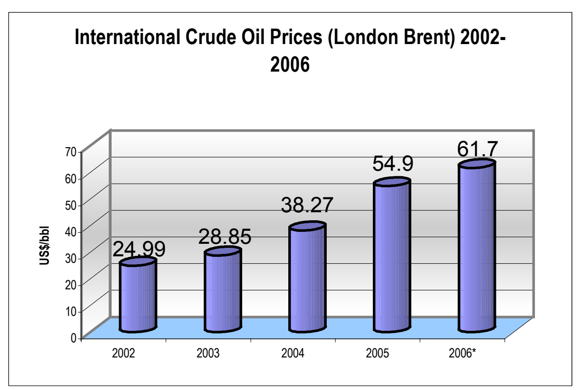


Figure 5



- Trade deficit in relation to GDP decline to 10.8 percent in 2005 from 11.4 percent despite the escalation cost of oil imports largely due to the moderation in consumer goods imports and sustained growth in exports and high economic growth during 2005.

Table XII: **Trade Performance**

	2000	2001	2002	2003	2004	2005
Exports (US$ million)	**5,522**	**4,817**	**4,699**	**5,133**	**5,757**	**6,344**
Agriculture	1,005	932	938	965	1,065	1,154
Industrial	4,283	3,710	3,631	3,977	4,506	4,946
Other	234	175	130	191	186	245
Imports (US$ million)	**7,320**	**5,974**	**6,105**	**6,672**	**7,999**	**8,863**
Consumer	1,388	1,235	1,319	1,481	1,623	1,644
Intermediate	3,789	3,321	3,492	3,811	4,645	5,317
Petroleum	901	731	789	838	1,209	1,655
Non oil imports	2,888	2,590	2,703	2,973	3,436	3,662
Capital	1,737	1,081	1,170	1,320	1,670	1,869
Tourism						
Arrivals	400,414	336,794	393,171	500,642	566,202	549,308
Earnings (US$ million)	252.9	211.1	253.0	339.9	412.2	327.6
Trade Deficit/GDP(US$million)	-10.8	-7.4	-8.5	-8.4	-11.4	-10.7

Source: Central Bank of Sri Lanka

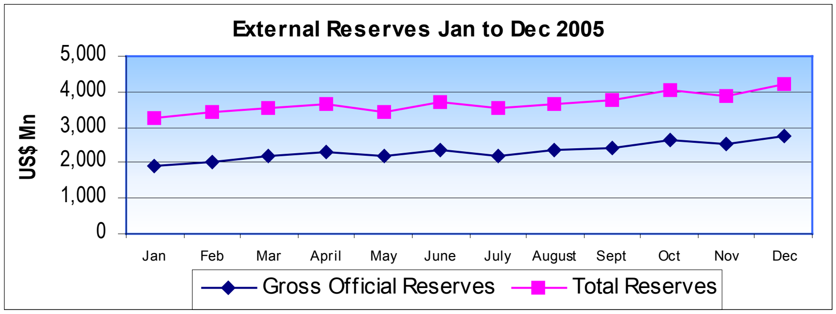
Strengthened Foreign assets ....

- The balance of payments (BOP) generated a surplus of US$ 501 million as opposed to a deficit of US$ 205 million in 2004 in spite of the winding of trade deficit to US$2,519 million in 2005 from US$ 2,242 in 2004

- A sharp increase of 28 percent in private remittances to US$ 1,734 million, increase foreign aid disbursement to US$ 737 million, debt relief of US$ 263 million contributed for this improvement.

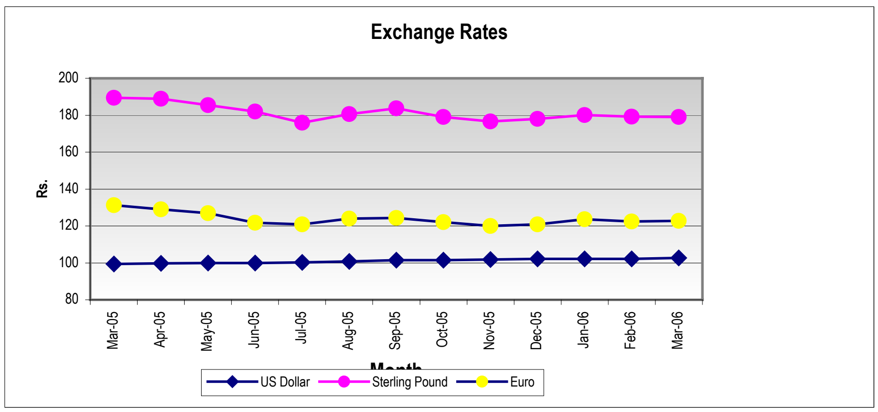
- Underpinning the strength of the Balance of payments gross official reserves increased to US$ 2,735 million and total foreign reserves of the country to US$ 4,200 million.

Figure 6:



- Sri Lanka Rupee maintained a stable value during 2005 with the exchange rates moving within a narrow margin.

Figure 7



Financial markets ....

- Deposits mobilization by the banking system increased by 19 percent sustaining the recent momentum generated by financial institution to mobilize savings. The annul growth of deposits mobilization has successively increased form 10.5 percent in 2001 to 19 percent in 2005

- Parallel with the revival of private sector investment, and economic activities, credit to private sector which increase only by 0.9 percent in 2004 increased by 21.5 percent in 2005. This credit expansion is associated with the credit facilities for housing, real estates and wide range of service activities and import financing pertaining to intermediate and capital good and exports.

- Reflecting high private sector credit growth in the presence of still high Government borrowings and a rise in external assets resulted in a money supply growth of 19.1 percent during 2005.

State banks consolidated rapidly.............

- Strengthening in the financial sector performance the state banks improved their performance during 2005. Non-performing loans of the People's Bank and the Bank of Ceylon declined from 14 and 9.8 percent respectively in 2004 to 12.2 and 7.3 percent respectively in 2005. While Bank of Ceylon maintaining AA(Sri) rating standard for two successive years, peoples' Bank succeed in upgrading its grading BBB+(Sri) in 2004 to A-(Sri) in 2005. The national Saving Bank which maintain AAA(Sri) rating status during 2004 and 2005 succeeded in reducing non-perforating loan from 4.9 percent to 2.4 percent.

- While several regional development banks consolidated their financial positions State Mortgage and Invest bank slightly lost its rating status from A+ (Sri) to A(Sri), its non-performing loans increased form 34.3 percent in 2004 to 36.3 percent in 2005.

Table XIII: **Performance of State Banks**

Institution	**Total Revenue Rs.million**		**Net Profit Rs. million**			
	2004	**2005**	**2004**		**2004**	**2005**
Bank of Ceylon	23.96	26.96	2.56	3.06	AA	AA
National Savings Bank	19.40	21.23	4.15	3.35	AAA	AAA
People's Bank	22.60	27.20	2.57	3.84	BBB+	BBB+;
State Mortgage & Investment Bank	1.26	1.25	0.38	0.42	A	A
Rajarata Development Bank	205.00	0.30	38.02	0.06	BBB+	not rated
Ruhunu Development Bank	436.70	0.58	43.89	0.15	BBB+	not rated
Sabaragamuwa Development Bank	398.23	0.50	53.90	0.12	BBB-	not rated
Kandurata Development Bank	274.37	0.36	44.25	0.07	BBB	not rated
Uva Development Bank	259.29	0.06	58.04	0.09	BBB	BBB
Wayamba Development Bank	592.87	0.81	172.87	0.26	BBB+	not rated

Source: Department of Public Enterprises

Chapter III

Private Sector Development

The present government policy is geared towards encouraging private sector participation in the economy. Several financial incentives have been provided to enhance the availability of resources and promote private sector development with particular emphasis on SME sector development.

Fiscal incentives for private sector development

Sector	Key Fiscal Initiatives
Agriculture	▪ Provision of all varieties of fertilizer at Rs. 350/50 Kg per bag for the cultivation of paddy and vegetables. ▪ Financial assistance for organic fertilizer users particularly in fruits and vegetable cultivation. ▪ Provision of quality seeds and planting material through government seed farms. ▪ Exemption of tax on agriculture and agricultural processing ▪ Removal of 15% tax on income from exporting agricultural products such as fruits, vegetables, rice, cut flowers, foliage plants and organic agricultural products. ▪ Restructuring the existing loans obtained by small and medium paddy mills/ sharing a part of the non performing loans. ▪ Initiation of paddy purchasing, with an initial capital of Rs. 2000 million. ▪ A guaranteed price for paddy has been raised to a range of Rs. 16.50, Rs. 17.50 /Kg. ▪ Amendments made to the legislation to incorporate mandatory provisions where the credit extended to agriculture sector to be increased to 10 percent of the total credit during next 3 year. ▪ VAT rate on locally manufactured medicated soft drinks (Ginger beer, Nelli etc) reduced from 20% to 15% to promote usage of local agricultural products.
Plantations	▪ Setting up of Rs. 10 Billion revolving fund in support of development activities in tea, rubber and coconut cultivation. ▪ Increment of re-planting and new-planting subsidies for tea, rubber and coconut cultivation by 25 percent. Rubber replanting subsidy was increased last year up to Rs. 100,000/hectar. ▪ Reduction of Economic Service Charge from 1 percent to 0.5 percent for tea, rubber and coconut processing factories. ▪ Introduction of new incentives, high yield seed clone gardens to encourage cashew cultivation (in Mahaoya, Ampara and Monaragala).
Organic Product Exports	▪ Implementation of National Organic Standard and certification programme to promote organic agriculture. ▪ Formation of a separate fund to share the cost incurred in certificates of exports such as tea, spices, herbs etc.
Livestock	▪ Exemption of milk processing machinery from import duty and VAT. ▪ Implementation of concessional credit scheme to assist diary farmers to purchase high yield cows. ▪ Animal feed exempted from VAT ▪ Additional funds allocated for development of diary industry in rural areas. ▪ Increment of the producer price of milk up to Rs. 25-30/ltr. to provide remunerative prices to the farmers.

Sector	Key Fiscal Initiatives
	▪ Government is planning to phase out the existing duty waiver on imported milk powder.
Prawn Farming	▪ Allocation of funds to infrastructure rehabilitation work and environment protection and shrimp project. ▪ Removal of VAT on Shrimp feed.
Mahaweli	▪ Implementation of a special SME credit scheme for 500 SMEs in the Mahaweli area to promote agro processing industries including high quality rice milling. ▪ Identified lands for model farms for fruits and vegetables.
Floriculture	▪ Allocation of Rs. 20 million, to provide necessary technical know-how and extension services to small and medium growers. ▪ Exemption of Agricultural seeds and plants from VAT.
Fisheries	▪ Setting up of a Fishing Promotion Fund with Rs. 700 million to promote the manufacturing of the multi-day boats and the fishing vessels, purchase of mother vessels and training facility for fishing for export markets. ▪ Development of the Ocean University to train required skills. ▪ Allocation of Rs. 100 million for the promotion of prawn farming in Puttalam and Batticoloa districts. ▪ Allocation of Rs. 50 million to set up an ornamental fish exchange in order to promote ornamental fish projects
Textile/ Handloom Industry	▪ Writing off of the non-paid debt of the local textile manufacturers that have registered for textile industry restructuring. ▪ Setting up of dedicated textile zones at Thulhiriya and Horana to start large scale factories with BOI incentives. ▪ Setting up of a college of textile and clothing in Thulhiriya with Rs. 250 Million in 2006, to train professional managers, qualified service providers and skilled workers. ▪ Exemption of the required machinery, yarn dyes and technology that need for handloom industry, from custom duty and VAT.
Printing and packaging industry	▪ Reduction of duty on all categories imported paper, in order to reduce high cost of local printing and packaging services. ▪ Reduction of the duty on packing material.
Transport	▪ Introduction of concessional credit scheme to assist private bus operators to replace their own buses. ▪ Removal of excise duty of 5-15 percent for motor bicycles to assist field level officers, Samurdhi Development Officials, media personnel, etc to purchase a motor bicycle at a affordable price. ▪ Reduction of import duty from 25 percent to 15 percent, on tyres used in three wheelers to provide relief for three wheeler operators.
Construction industry	▪ Implementation of credit guarantee scheme for construction companies to import modern machinery and equipment on concessionary financial terms. ▪ Exemption of construction machinery and equipment, from custom duty and VAT, in order to reduce upfront cost. ▪ Establishment of Lanka Putra – reconstruction and development bank, to promote the domestic construction industry. ▪ Removal of VAT on unprocessed logs to help local saw mill operators, construction industry and furniture manufacturers.
All sectors	▪ Tax Incentives, holidays exemption for industries setting up/ relocation in districts

Sector	Key Fiscal Initiatives
	other than Colombo and Gampaha. ▪ Incentives for Advanced Technology Based Industries ▪ This scheme has been introduced particularly to support SME sector development. In order to attract a large number of small SMEs to the scheme, applicable investment limit has been reduced to Rs. 2 million.

Chapter IV

Reform Initiatives

Pro-poor Development Focus.......

Development strategies have been focused towards pro-poor and more regionally balanced growth. Strategies and policies implemented in the past generated GDP growth rates of about 4.5% per year, but the benefits of that growth did not spill over to many rural areas. The development that took place was largely urban-centred and many rural areas lagged behind in term of the availability of basic facilities including infrastructure and public utilities. The evidence showed that while 23% of the population lives below the poverty line, there are large variations in poverty across regions.

To address these weaknesses, a New Development Strategy was envisaged. The "Mahinda Chinthana" presented a further consolidated vision and strategy for a more comprehensive and participatory, economic and social development in Sri Lanka for future years. The ultimate objective is to uplift the overall development while raising the income of the poor who constitute around 50 % of the country's population. Empowering people at grass root level through community development projects is considered a way forward. The Government has launched a multi-prong initiative to develop the rural economy. Greater emphasis has been placed on:

- Education, health, skills development to sustain the country's traditional advantage on human recourse development for economic growth

- Revitalizing production sectors such as agriculture, construction, industry in addition to developing a buoyant service sector

- SME sector and micro enterprises for economic development and employment creation

- Rural infrastructure development to create wider access to economic activities. This includes. Irrigation, rural road, housing, provincial specific development initiatives, rural electrification and telecommunications

- Rehabilitation and reconstruction of basic infrastructure facilities, devising programmes for speedy settlements and through the development of livelihood support programmes in the North and East Districts and the tsunami affected coastal belt.

- Rapid development of infrastructure such as electricity, roads, transport, ports, airports, water supply and urban development

The improvement of the socio- economic conditions of people in the estate sector has also become a national priority. The poverty ratio in this sector is estimated at 30 percent, which is higher than the national average. Access to basic services such as health, education, housing, electricity, water and sanitation is poor. It is in this light that the government has initiated the Jana Sevana development programme to construct 50,000 houses, provision of basic facilities such as electricity, road development, schools, training facilities in order development the living conditions of the estate community.

Fiscal Reforms....

The Fiscal Management Reform Program (FMRP) which is a 3 year reforms strategy assisted by the ADB for the implementation of a reforms program embraces the three revenue departments; IRD, Customs and excise and other agencies under the Ministry of Finance & Planning and has the following reform components:

- Policy based loan entitled 'Fiscal Management Reform Program' (FMRP) of US$ 45 million supports the strengthening of public finances by improving public resource and expenditure management and control systems, promoting fiscal discipline and fiscal co-ordination, improving budget frame work and improving effectiveness of tax and customs administration.

- Project Loan entitled 'Strengthening of Fiscal Management Institution Project' (SFMIP) of US$ 10 million in support of institutional development and the development of skills and know-how

- Project Loan entitled Modernization of Revenue Administration Project (MRAP) of US$ 15 million to support institutional strengthening focusing primarily on the procurement of equipment for the modernization of revenue administration and to infuse modern technology

Towards the modernization of the Department of Inland Revenue

- A series of measures which consist of the following was implemented:

    - New organizational structure providing a modern management framework was approved by the Cabinet

    - Appointment of Revenue Board consisting of heads of IRD, Customs, Excise Departments, BOI and the Treasury to coordinate revenue performances of all the revenue collecting agencies

    - Appointment of Steering Committee of 11 members to facilitate a consultative process within agencies

    - Setting up of a dedicated project office for the execution of the FMRP

    -

- Tax Ombudsman was appointed in September 2005 to look into tax payer grievances

- Taxpayer's Charter was introduced by the tax administration, which stipulates important rights of tax payers and their obligations under the tax system

Sector Based Budgeting and Medium Term Expenditure Framework

The preparation of the government budget is guided within a Medium Term Expenditure Framework (MTEF) consistent with the overall medium-term macro-economic framework for the country. The MTEF presents its financial plans towards specific targets within the context of sectoral policy strategies and is designed to improve the management of public finances at all levels. Since it is formulated as a rolling plan for a period of 3-5 years, the implementing agencies have sufficient time to revise their work plans well in advance as and when required with proper sequencing of priorities.

The Strategy of the 2006 budget is a further consolidation of an broad policy framework of the 2005 budget with greater emphasis on pro-poor growth strategies articulated in the Mahinda Chintana –a vision for the future. Within the sectoral budget classification, relevant ministries and their specific functions were identified and were listed under each sector policy priorities in order to avoid duplication and to ensure that all ministries, department and spending agencies work in coordination to ensure expenditure management, control and to imp[rove efficiency. In the overall budget, special emphasis was placed on:

  - Investing in people to build a productive, efficient and skilled human recourse base
  - Building a nation wide modern, high value, efficient rural and urban infrastructure network
  - Promotion of information technology for dissemination of technological know-how
  - Modernizing agriculture by focusing on increased productivity, high value addition and diversified exports
  - Poverty alleviation through community based development initiatives
  - Linking development strategies of the Millennium Development Goals to the Medium Term Budgetary Framework
  - Improving the socio economic conditions of those affected by the conflict, the estate sector, and those affected by the tsunami

- The budgetary allocations for 2006 and for the Medium Term of 2006-2008 were based on 8 sectoral classifications. These consist of :
  - Pro-poor growth and rural development – community based development initiatives

- Human resources development- towards a knowledge based economy
- Infrastructure development
- Production and services
- Science, technology, research and development
- Livelihood development and social protection
- Art, Culture and religion
- Governance , public order and safety

Financial Sector Reforms Concludes Several Legislations….

- The financial sector strategy of the government is directed towards achieving financial system stability and promoting access to finance. The Central Bank of Sri Lanka will continue to play a lead role, including the setting up of an independent Financial Intelligence Unit (FIU) and a regulatory framework for micro financing agencies.

- Reforms undertaken to improve the efficiency and the soundness of the financial system:

    - Amendments to the Banking Act which were required to further strengthen the supervisory and regulatory powers of CBSL and to deal with pyramid type schemes. The amendments to the act were passed as Act No.2 of 2005.

    - Amendments to the Finance Leasing Act was completed as Act No 24 of 2005 in order to facilitating securitization of Lease receivables, housing mortgages etc to improve cash flows of lending institutions

    - The payments and Settlement Systems Act was passed in parliament in September 2005 to create a safe, secure and efficient payment and settlement system. This act facilitates the regulation of payments, clearing and settlement systems, regulation of providers of money services and the electronic presentment of cheques.

    - To enhance capital to maintain financial system stability and in the interest of a strong and sound banking system policy measures where adopted to enhance the minimum capital funds requirement of an LCB to Rs.2,500 million and LSB to Rs.1,500 million.

- Legislation on Prevention of Money Laundering, the Suppression of Terrorist Financing Act; was enacted to avoid Sri Lanka's financial system being used for money laundering activities & to reduce potential reputational risk. The Convention to give effect to Suppression of Terrorist Financing was enacted as Act No 25 of 2005.

- All Licensed banks and finance companies were mandated to obtain a credit rating by a reputed rating agency to enable investors and depositors to make informed decisions. All 22 Licensed Commercial Banks, 13 Licensed Specialised Banks out of 14 and 8 finance company out of 28 have obtained credit ratings to date.

- Setting up of the SME Bank as a Licensed Specialized Bank with Government Capital to enhance access to finance by small and medium entrepreneurs. The bank was declared opened on 29th June 2005. The objective is to open 93 representative officers in NSB Branches out of which 3 have been established in Matara, Anuradapura and Kegalle.

- Establishment of the "Susahana" refinance facility to SME and micro enterprises affected by tsunami disaster. The terms and conditions of the scheme are as follows: loans are provided at the rate of interest for end borrower at 6%, while the rate of interest for refinance loans is 3%. The extent of refinance is 100% of the loan while the repayment period is 3-8 years. The Central Bank announced that it financed 8,278 loans amounting to Rs 3.8 billion for micro enterprises and SMEs affected by Tsunami.

- Setting up of Lanka Clear Ltd. for retail cheque clearing of commercial banks, establishment of real time gross settlements system for large value payments through banks and scripless securities settlements system for government securities trading are three major systems which were implemented during the year

- Financial legislations in progress
  - Amendments to the Regulation of the Insurance Industry Act No. 43 of 2000
  - Amendments to the Finance Companies Act No. 78 of 1988
  - Credit Information Bureau Act
  - Amendments to the Banking Act No.30 of 1988

Reforms in the State Banks Make Good Progress……

In 2005 the Strategic Enterprise Management Agency was created to strengthen the management of strategic state enterprises and to improve their performance. The performance of the State Banking Institutions has been positive with many obtaining favourable ratings. The introduction of good management practices has resulted in the successful performance of the two state banks in 2005. The Bank of Ceylon demonstrated a relatively sound financial profile with the ongoing measures to resolve bad loans and improvement in its profitability while Fitch Ratings Lanka Ltd (FRL) affirms the rating for the Bank's long-term unsecured Senior Debt at AA(Sri). The rating denotes a very low expectation of credit risk.

The performance of the Peoples Bank also has improved during the year resulting in of the bank's National Long Term Rating upgrading to A- (Sri) from BBB+ (Sri) in March 2006. The rating reflects an improved financial performance, particularly in terms of the bank's capital position. The equity position has improved considerably through healthy internal capital formation over the last few years and due to an infusion of new capital of LKR 2bn in Dec 2005. The rating also reflects its state ownership and systemic importance. The government's capital infusion in Dec 2005 is the first tranche of an ADB assisted re capitalisation programme.

FRL affirmed National Savings Bank's national long term rating at 'AAA(sri)' during the year 2005. NSB is the third largest bank in Sri Lanka in terms of assets and commands a strong customer franchise in the deposit mobilization market.

The rating for the State Mortgage & Investment Bank's (SMIB) Long-term unsecured Senior Debt of State Mortgage & Investment Bank (SMIB) was lowered to A (sri) denoting a low expectation of credit risk**.** In mid 2005, SMIB has moved to broaden its deposits base and increase its mortgage loan portfolio through new products reflecting moderate results.

Legal and Judicial Reforms Invests Heavily in Human Capital…….

The Legal and Judicial Reforms which were launched in 2000 under a Credit Agreement with the World Bank earmarking US$ 21 Million to make the legal and judicial framework in Sri Lanka more efficient, transparent and responsive to the public at large achieved a committed disbursement rate of around 90 per cent in 2005 as compared to the 35 per cent disbursement level in 2004. Reform emphasis was placed on much needed human resource and institutional capacity building and automation.

- Human resource and institutional capacity building was given priority through further training of members of the judiciary and the Attorney General's Department. International training, focused on subject specific tailor-made courses aimed at enhancing specialized knowledge were conducted with the assistance of reputed academic institutions in Hong Kong, Rome, Malaysia and India. Emphasis was on non-traditional subject areas which demand attention in a global context such as law and economics, law and development, law relating to anti money laundering, cost of litigation and effective case flow management, alternate dispute resolution, law relating to financial instruments, World Trade Organization relations, Mediation and Arbitration, International Sales Contracts, Corporate Criminality and Securities Regulation.

- Members of the Legal Draftsman's Department were given extensive local and foreign training on legislative drafting skills. They were given subject specific training so that such knowledge would enable them to draft statutes in diverse areas with a proper understanding of the subject.

- 150 Judges, 89 Officers of the Attorney Generals Department, 19 officers of the Legal Draftsman's Department have so far benefited through such training. A further batch of 15 judges are earmarked to be sent to the City University of Hong Kong, on subject specific training in relation to provisions of the proposed new Companies Act. Members of the judiciary and the legal profession were given 11 local and 64 foreign scholarships to follow LLM and PhD programmes to gain specialized knowledge. Further, 15 members from the judiciary and the legal profession were sponsored to follow the local LLM Program conducted by the Sri Lanka Law College in collaboration with the University of Wales. 21 Labour Tribunal Presidents attended foreign training in India, being the first ever foreign training exposure given to Labour Tribunal Presidents. The foreign training component alone cost around Rs.103 Million in 2005.

- Commercial law area was given an impetus by facilitating the amendment of outdated legislation and finalizing new legislation, which includes the new Companies Act, Payment and Settlements Systems Act, Anti-Money Laundering Act and the Financial Transactions Reporting Act. In addition, outdated fines and penalties provisions contained in 80 statutes, some of which have not been revised for decades, were updated with the enactment of the Fines and Penalties Act, thus improving compliance and enhancing governance.

- Law books were provided to judge's libraries, the Attorney General's Department, law schools as well as outstation courthouses and bar associations to ensure ready and greater access to knowledge. New course manuals were developed through local and foreign consultancies, with assistance from universities of repute such as the City University of Hong Kong, to be used for continuous local training for members of the judiciary, conducted by the Judges Training Institute. Rs 14 Million has been spent in 2005 in these respects.

- Legal and Judicial infrastructure was improved with the construction and redevelopment of 28 selected court complexes scattered across the country. A brand new Court Complex built in Trincomalee at a cost of Rs. 85 Million has commenced operation and is a landmark building in the Northeast. The Jaffna Court Complex, which was designed to blend with the unique architecture of the area, was built at a cost of Rs 180 Million and is to be opened shortly. The historic Judicial Services Commission building, which has been built in 1903 was redeveloped and refurbished at a cost of Rs. 35 Million. The total spent on court construction and redevelopment in 2005 is around Rs. 210 Million.

- All required furniture, computers and office equipment were provided to these premises aimed at improving service infrastructure facilities to the judiciary to be able to give an efficient and better service to the public. Labour Tribunals were provided with 80 computers, to upgrade their service standard. The cost of furniture, computers and equipment provided in 2005 is around Rs. 101 Million.

- To promote Alternate Dispute Resolution, a Commercial Mediation Center was setup in the premises of the Ceylon Chamber of Commerce and mediators were given specialized training in commercial mediation. Awareness campaigns were conducted to popularize mediation as a means of alternate dispute resolution, aimed at reducing laws delays and reducing cost of litigation. This center is now operating virtually independently.

- Work in relation to the Automation of courthouses under a pilot project, where 8 selected courthouses in Colombo and Kandy would be automated commenced in 2005. The aim is to reduce laws delays and human intervention, to make the judicial system more efficient and to minimize corruption and is aimed at a future move towards an electronic filing system for the benefit of the public. The pilot phase was structured after studying automated systems in several countries in the region including Hong Kong, Singapore and New Zealand, which follow the common-law system and is expected to cost around Rs. 170 Million

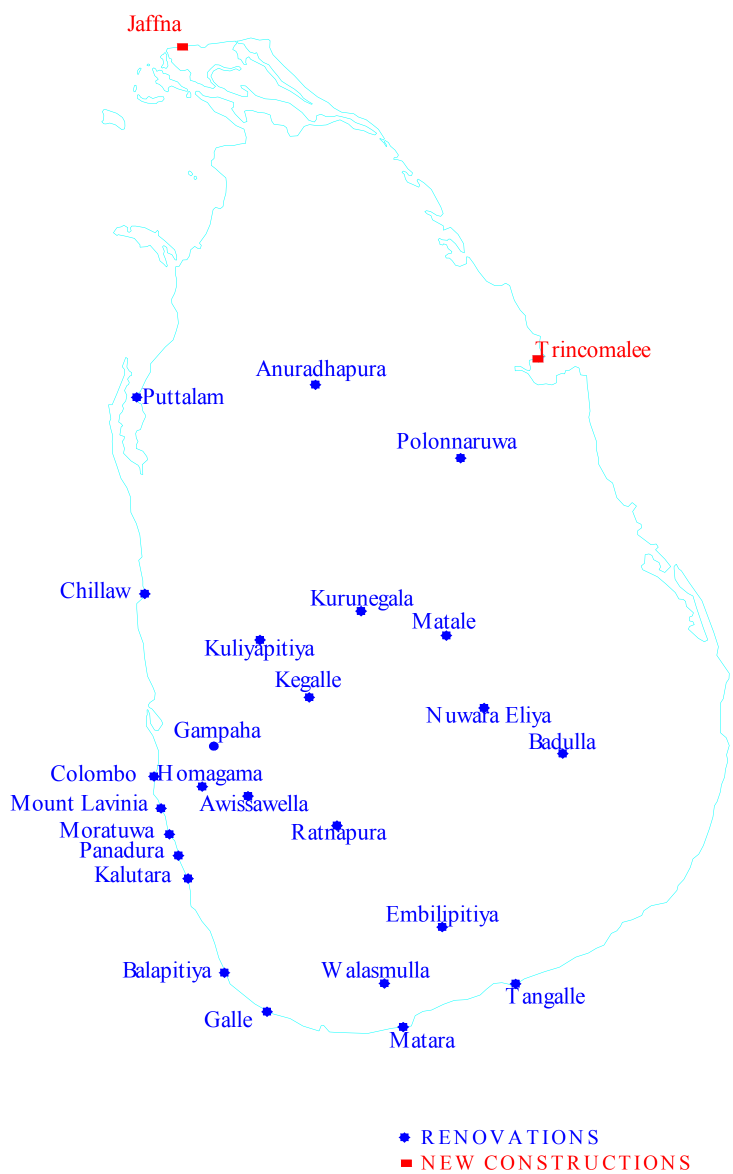
- Installation process of Phase II of the LawNet also commenced in 2005 aimed at making Sri Lanka's law database, web based, updated and user friendly. All updated statutes , by-laws, regulations, important judicial decisions etc. will be available through the worldwide web, paving faster and greater access to legal information both locally and internationally and is expected to cost around. Rs 100 Million.

- Work in relation to the introduction of a Local Area Network for the Attorney General's Department commenced in 2005. The Attorney General's Department will be fully automated enabling greater coordination among officers, thus improving efficiency and the quality of work and is expected to cost around. Rs. 74 Million.

- A new Legal Cluster was set up under the National Council for Economic Development (NCED) with the participation of a multidisciplinary group of specialists including members of the judiciary, the Attorney General's Department, Legal Draftsman's Department, Ministry of Finance, Ministry of Justice, Central Bank of Sri Lanka, private bar, law schools, trade chambers, the banking and the business community. The legal cluster has created an enabling environment for such members to engage in a dialogue on legal and regulatory policy issues of current interest in order to pave way for required reforms.

COURT COMPLEX DEVELOPMENT PROGRAMME

COMPLETED BY LEGAL AND JUDICIAL REFORMS PROJECT 2000-2006



	PROJECT	COST / Rs. million
	PILOT PROJECT	
	Mount Lavinia	9.8
	RENOVATIONS	
	Package	
PHASE 01	01 Colombo	40.2
PHASE 01	02 Moratuwa Panadura Kalutara	30.2
PHASE 01	03 Galle Matara Tangalle Walasmulla Embilipitiya Ratnapura	90.5
PHASE 02	04 Nuwara Eliya Badulla	15.4
PHASE 02	05 Homagama Awissawella	12.5
PHASE 02	06 Gampaha Kegalla	18.5
PHASE 03	07 Chillaw Puttalam	46.9
PHASE 03	08 Anuradhapura Polonnaruwa	61.8
PHASE 03	09 Balapitiya	30.9
PHASE 03	10 Kurunegala kuliyapitiya Matale	82.7
PHASE 03	Gampaha	27.0
	NEW CONSTRUCTIONS	
	Trincomalee	85.0
	Jaffna	180.0
	Total	731.4

Procurement

- The establishment of the National Procurement Agency (NPS) as an independent regulatory body to oversee procurement monitoring, capacity building and policy related matters is a strategy policy taken by the government to address public procurement issues.

- Procurement policy reforms include:

    - *Government procurement guidelines*- Revision of Government Tender Procedure of 1997 to provide precise, user friendly policy directions to government agencies on procurement issues.

    - *Harmonization provisions* – Harmonization of government tender procedures with guidelines of international funding agencies

    - *Procurement guidelines for emergency procurement* – Harmonized and simplified procurement guidelines and standard bidding documents (SBD) for emergency procurements

    - *Development of procurement manuals* – Two manuals will be issues giving details of steps to be taken for each procurement action.

    - *Development of NPA website* – This website would provide procurement information such as guidelines. SBDs, advanced procurement notices, publication of contract awards and blacklisted contractors/suppliers, and used for web based monitoring

    - *Procurement appeal board*- Considers appeals/challenges against contract awards

    - *Development of standard functional specifications* – Standard specifications for goods that are commonly and regularly procured

    - *Development of standard bidding documents (SBD) and Requests for Proposals (RFP)* - harmonized SBDs for minor, medium and major works and design and build contract documents and general, health sector goods, supply and installation of plant and information systems and contract documents for general goods have been completed or are in the draft stage. A set of RFPs for consultancy procurement has been completed.

Public Enterprise Reforms ....

The Government in its Economic Policy Framework has given emphasis on effective management of public enterprises to ensure that they are commercially viable and contribute to the national economy. The Strategic Enterprise Management Agency (SEMA)was established to improve efficiency and effectiveness of twelve strategic enterprises namely Bank of Ceylon, Peoples Bank, State Mortgage and Investment Bank, National Savings Bank, National Water Supply and Drainage Board, Ceylon Electricity Board, Ceylon Petroleum Corporation, Sri Lanka Ports Authority, State Pharmaceutical Corporation, Airport and Aviation Services (Pvt.), Sri Lanka Central Transport Board and Sri Lanka Railways. Public Enterprises Reform Commission (PERC) is to restructure the identified non strategic enterprises and concentrate post privatisation issues on already privatises enterprises.

The Department of Public Enterprises of the Treasury works closely with SEMA and PERC to co-ordinate their activities in terms of the governments economic policy framework. In addition, a code of Best Practice in Corporate Governance for Public Enterprises and a set of Implementation Guidelines were published by the Department of Public Enterprises and was applied to strategic enterprises coming under the purview of SEMA.

The state banks adopted new corporate strategies focusing Balance Sheet improvements and portfolio management including quality improvement in their asset portfolio. All State banks were subject to rating arrangements to comply with Central Bank regulatory requirement.

Table XIV: **Banking Sector Performance**

Bank	**Profit after Tax**		**Advances (%)**		**Capital Adequacy (%)**	
	2004		**2004**	**2005**	**2004**	**2005**
Bank of Ceylon	1.97	2.22	8.7	6.6	12.4	13.2
People's Bank	2.09	2.77	14.0	11.0	(2.3)	1.9
State Mortgage & Investment Bank	0.33	0.32	24.4	21.7	77.2	90.2
National Savings Bank	3.11	2.25	5.0	2.4	54.7	44.9
Kandurata Development Bank	0.02	0.04	8.0	7.2	17.5	13.4
Sabaragamuwa Development Bank	0.03	0.05	7.0	6.0	18.0	13.0
Rajarata Development Bank	0.02	0.06	10.0	5.9	14.8	13.6
Ruhuna Development Bank	0.01	0.09	8.5	6.8	20.3	15.6
Uva Development Bank	0.03	0.05	11.8	10.1	14.0	12.0
Wayamba Development Bank	0.08	0.13	7.0	5.2	10.4	15.0

Source: Department of Public Enterprises

SEMA assisted in the development of a business plan for the Petroleum Corporation. The restructuring strategy of the Petroleum Corporation was supported by the adoption of a pricing formula for petroleum products, improved procurement arrangements in coordination with the Bank of Ceylon and the development of a marketing strategy including increased investments in the development of retail sales network The promotion of a 3rd player for the retail market was abandoned. In view of the large difference in the prices of imported refine products -vs- domestic products , steps have been taken to increase the refinery capacity of the CPC to save foreign exchange outflows as well as to reduce domestic prices. The expansion of the refinery would cost around US$ 400 million.

Reform in the Ceylon Electricity Board took a new direction with the government deciding to create separate generation, transmission and distribution units within a holding company framework. In terms of the new approach the CEB will be the shareholder of each of these Special Business Units.The government initiated the required changes to the Electricity Reforms Bill, Public Utility Commission Act and other relevant statutes to create the enabling legal environment for this new business structure, to the CEB. The government also addressed long-awaiting issues relating to a power generation plan and decided to start coal power plants in Puttalam and Trincomalee. In addition decision was also taken to accelerate the implementation of the Upper Kotmale Hydro Power Project, implementation of mini hydro power projects through private sector and promoting other alternative energy source. In response to the expected power shortage in 2009 action was also take to expedite the implementation of the Kerewalapitiya Power Plant for which proposals have been invited. Another aspect of CEB reforms is to move towards a cost-recovery tariff policy and also to reduce transmission losses to make the CEB to operate cost efficiently. The Treasury also initiated the restructuring of the CEB Balance Sheet by committing for a rescheduling of all its outstanding debt to the Government beginning, 2006.

The CEB however continued to experience financial difficulties due to heavy reliance on fuel based power generation during 2005. Although the pressure was eased-off by the increased hydro capacity, that benefit was completely eroded due to the rise in oil prices. over the medium-term the CEB is expected to continue to experience financial difficulties until the least-cost coal power plants are completed and the power generation capacity of CEB is diversified.

National Water Supply Drainage Board continues to incur losses with high over-head expenses and the inability to substantially reduce the non revenue water. However, the National Water Supply and Drainage Board concentrated on the improvement of the billing system and the commercial viability of water supply schemes to economies project costs. The Board has managed to maintain the collection ratio at 100 percent. The performance of National Water Supply and Drainage Board was also affected by the Tsunami destructions and the additional demand created in the Tsunami affected coastal belt for the provision of drinking water. The expansion in water supply schemes, including the community water supplies were given priority in the investment programme of the National Water Supply and Drainage Board. The restructuring strategy also includes improvements in procurements and management structure of the organization.

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Table XV: **Performance of selected public enterprises**

Enterprise	Revenue		Net Profit After Tax		Total Government Debt**	
	2004	2005	2004	2005	2004	2005
Ceylon Petroleum Corporation	121,540	161,852	3,908	7,711	9,365	22,501
Ceylon Electricity Board	51,119	55,977	(15,707)	(5,395)	79,537	70,778
Sri Lanka Ports Authority	17,861	20,549	(3,230)	10,071	52,864	43,101
National Water Supply & Drainage Board	4,264	5,446	(836)	(91)	12,144	14,039
State Pharmaceutical Corporation	2,299	2,276	183	213	845	1,759
Airport & Aviation Sri Lanka Ltd	2,538	2,775	265	432	-	-

* * Previous on lending by the Government for investment activities.

Source: Department of Public Enterprises

Sri Lanka Transport Board

Sri Lanka Transport Board (SLTB) formally Sri Lanka Central Transport Board although continue to incur losses with high overhead expenditure the Board has been successful in introducing new buses to the roads. SLTB since it has to operate on non-profitable routes meeting the social obligations it cannot be expected to perform profitable. The Treasury releases Rs.266.4Million monthly to SLTB to meet the shortfall in the salary bill of the Cluster Bus Companies (CBC). In addition the Treasury has to meet the salary arrears of CBC amounting to Rs.455Million.

Sri Lanka Railways

Sri Lanka Railways, which is operating as a department yet to be restructured as economically viable enterprise, which requires heavy capital infusion for modernisation of its infrastructure, carriages for both passengers as well as goods. Nevertheless in 2005, it incurred total cost of Rs.7,233million (Capital Cost Rs.2,905million and Recurrent cost Rs.4,328million) which generated only Rs.1,958million as revenue while in 2004 , it incurred total cost of Rs.6,239million (Capital Cost Rs.2,308million and Recurrent cost Rs.3,931million) generating Rs.1,678million as revenue.

Committee on Public Enterprises (COPE) Review

The Department of Public Enterprises continue to service the Committee on Public Enterprises which has been constituted in terms of the Standing Orders of the Parliament to ensure the observance of financial discipline in public enterprises. The duty of the Committee is to report to Parliament on accounts examined, budgets and estimates, financial procedures, performance and management of Corporations and other Government Business Undertakings.

The Committee submit its report to the Parliament based on the reports submitted by Auditor General and us there highlighted a number of deficiencies in most of the institutions subjected for examinations by the Committee. These included a lack of professionalism in management, non availability of up-to-date corporate plans, action plans, budgets, delays in submission of Annual Reports and accounts to parliament, absence of a professional and balanced Board, indifference to Public Enterprise guidelines for Good Governance, lack of a succession plan, quality management, poor systems and controls over inventories, creditors and fixed assets, uneconomical transactions and mismanagement of funds.

Towards Promoting a Liberal Trade and Investment Regime

The governments trade and tariff policy aims at providing a predictable medium term framework. Given the increasing integration of the Sri Lankan economy with global markets, the policy framework is designed to facilitate a fair trading environment for export and import sectors..

The Budget 2005 revised down the tariff structure to 5 bands as follows:

- Zero duty – Essential commodities
- 2.5% - Basic raw material
- 6.0% - Semi processed items
- 15.0% - Intermediate goods, spare parts, etc.
- 28.0 – Motor vehicles and other finished products

Sri Lanka's bilateral and regional trade initiatives haven achieved significant results of the years through Free Trade Agreements and other trade agreements with other countries. The country has been able to reap the benefits of the FTA with India, wjere the opening of the Indian market has enabled Sri Lanka to expand its overall export growth by a further 12 percent. These agreements have enabled local entrepreneurs to gain from exporting non traditional products that have duty free market access resulting in diversification of the country's export base. The GSP plus scheme and the FTAs with India and Pakistan would be the key catalysts for an Export Entrepreneur Economy.

I*ndo Sri Lanka Free Trade Agreement (ISFT)*

The Indo-Sri Lanka Free Trade Agreement (ISFTA) singed on 28th of December, 1998 and it was put into operation in March, 2000 following several rounds of negotiations. This was the first bilateral preferential trade agreement pursued by Sri Lanka. The main objective of the establishment of ISFTA with India was to create a common economic space for the free movement of goods (other than those items on the Negative List) between two countries. Modalities of implementation agreed upon were based on principles of asymmetry, socio-economic and political economy considerations of both countries where Sri Lanka was allowed to complete tariff liberalization program in 8 years whereas India undertook to complete it in 3 years from its commencement. The ISFTA has taken only the tariff instrument into account in the phasing out excise leaving non tariff measures untouched. Accordingly, India completed its tariff liberalization commitment as indicated by 2003 whereas Sri Lanka has by 2003 undertaken, as stipulated, partial reduction of tariff of 35% of existing MFN tariffs on agreed products. Sri Lanka will deepen tariff phasing out to 70% in 2006 and bring the agreed tariff lines to zero duty by 2008.

During the last six years of implementation of ISFTA, bilateral trade has been transformed into new heights. Sri Lanka's exports grew from the pre agreement level of US $ 48.6 million in 1999 to US $ 559 million in 2005 whereas imports from India grew from US $ 511.6 million to US $ 1439.5 million for the same period recoding an increase of over 11 fold in Sri Lanka's exports and nearly 3 fold increase in imports from India.

Despite significant growth of bilateral trade, there have been several problems associated with the movement of goods to India under the agreement. Vansapathi and pepper figured high on the agenda on ISFTA discussions, where Sri Lanka's exports to India has been under sever strains. This has created a problem associated with the predictability of the agreement where investors having undertaken investments found it difficult to exports to India as there are impending quota imposed by India against the expectation of the agreement. Besides, export quorta rovided in the agreement on garment and tea has indicated a very dismal progress as there have been many non tariff related restrictions.

However, having seen beneficial effects on two economies after nearly five years of implementation, India and Sri Lanka have embarked on a major in 2005 towards transforming bilateral economic relations into new heights by way of broadening the scope of agreement, to include augmented space for trade in goods, trade in services, investment and economic cooperation under a proposed new agreement called Comprehensive Economic Partnership Agreement (CEPA). Specifically both countries will look into following aspects with a view to deepening and broadening bilateral economic integration under the CEPA:

- Reduction of Negative Lists of ISFTA,
- Relaxation of origin rules of ISFTA,
- Conclusion of Mutual Recognition Agreements (MRA) on product standards and certification procedures
- Customs cooperation and trade facilitation

- Consumer protection and legal metrology
- Liberalization of trade in services
- Liberalization of investment
- Economic cooperation

Pakistan-Sri Lanka Free Trade Agreement (PSFTA)

After the ISFTA signed in 1998, Pakistan and Sri Lanka have indicated to each other the willingness to establish a free trade agreement between two countries. This intension was formalized by signing the Framework Agreement on 1st of august 2002 and after several rounds of negotiation, finality was reached in February 2005 and implementation of the Pakistan-Sri Lanka Free Trade Agreement (PSFTA) commenced on 12 June 2005.

Recognizing the principle of asymmetry and having regard to many political economy considerations, PSFTA allows Sri Lanka to complete its tariff phasing out on agreed product categories in 5 years whereas Pakistan will complete its program in three years from 2005. The coverage and the nature of tariff phasing out is given in the Table ..

Table XVI: **Tariff Reduction Programme under PSFTA**

Nature of Tariff Liberalization	No. of Tariff Lines in Sri Lanka	No. of Tariff Lines in Pakistan
No Concession (Negative List)	697	541
100% Duty Reduction immediately	102	206
Tariff Rate Quota	02	26
Margin of Preference	0	05
Phasing out (Positive List)	4431	4456
Total	5232	5232

As in the case of ISFTA, non tariff measures were left out in the PSFTA. As stipulated in the agreement, Sri Lanka has provided duty free access to 102 products from Pakistan on the day it was implemented ie.12th June, 2005 and in turn Pakistan has provided duty free access to 206 Sri Lanka's products on that day. These products include coconut based products, spices, rubber, precious and semi precious stones, paper and paper boards, graphite etc. The tariff phasing out program under the PSFTA is given in Table...as follows:

Table XVII: **Tariff Phasing out Scheme under PSFTA**

Schedule of Phasing out	% tariff reduction by Sri Lanka (*on the basis of margin of preference)*	% tariff reduction by Pakistan *(on the basis of margin of preference*
Upon the entry into force of the PSFTA (ie.12.06.2005)	20	34
End of the first year	30	34
End of second year	40	66
End of third year	60	100
End of fourth year	80	-
End of fifth year	100	-

Sri Lanka has beenallowed two products under tariff quotas: 6000 mt. of Pakistan Basmati rice and 1000mt. of potato on free of duties. Import of potato under the PSFTA is allowed during the lean season of country's production (ie. import of potato is allowed: 2/3 during June-July and 1/3 during October-November each year). In return, Pakistan has allowed export of 10000 mt. of tea (04 tariff lines) on free of duty, and 1200 mt. of betal leaves on the basis 35 % of reduction of exiting duties. Besides, Pakistan has allowed 3 million pieces of apparel items in 21 tariff lines under Chapters 61 and 62 with a reduction of 35 % of existing tariffs.

GSP + Scheme

Trade is a key strategy for promoting growth and development. Increased trade by developing countries will increase export earnings, promotes industrialisation and encourages product diversification. Following the decision of 1968, by the United Nations Conference on Trade and Development (UNCTAD) for allowing exports from developing countries on the basis of tariff preferences by industrialised countries, the European Community took the initiative to implement a Generalised System of Preferences (GSP) scheme in 1971. The Member States of the European Union (EU) approved new Generalised System of Preferences on the 23rd June 2005 and some of its programs were fast tracked to be effective from 1 July 2005 whereas new GSP scheme as a whole was effective on 1 January 2006. GSP+ (GSP Plus) incentive system provides additional preferences for vulnerable developing countries pursuing good governance practices and sustainable development policies.

GSP arrangement announced in 2005 has three dimensions:

(a) *A general arrangement*: reduction of 3.5% over the normal customs duty for sensitive products, and reduction of duties to zero for non-sensitive products, in particular the reduction for textile products will be 20%

(b) *'Everything but Arms'*: allowing duty-free and quota free access for all products from the Least Developed Countries

(c) *a new 'GSP+'*: granting tariff preferences to products from vulnerable countries who meet the new objective criteria for sustainable development and good governance. This facility contains reduction to zero duty for a total of 7200 product categories (out of 10300 tariff lines of the Common Customs Tariff).

Countries whose trade enjoy preferential access in the EU market under bilateral agreements have been removed from the list of GSP beneficiaries as they have already had better access to the EU market.These three types of arrangement are in force for beneficiary countries for the period 01.01.2006 - 31.12.2008. All beneficiary countries enjoy the benefit of the general arrangement.

A certain product groups for one or several countries are not eligible for concession under GSP. If a group of products from a particular country exceed 15% of total EU imports of the same products under GSP over the three preceding years, such products are not accorded with concessions under the GSP scheme. It indicates that the products are already competitive in the EU market and are not warranted to be considered for concessions. For textiles, the threshold would be 12.5%. This process will allow GSP benefits to the weakest and the most vulnerable countries. The special incentive scheme for sustainable development and good governance is applicable (the "GSP-plus" or "GSP+" incentive) from 01.07.2005. This concession by EU has been offered for 15 developing countries to include two from Asia- Mongolia and Sri Lanka.

Medium Term Economic Framework

The objective of the Medium Term Economic Framework is to augment investment in excess of 30 percent GDP in order accelerate the national infrastructure development programme, rapidly expand provincial and rural infrastructure facilities, reconstruct infrastructure in the north and east, and modernization of human resource development to place Sri Lanka's economy on a 7-8 percent growth path and to create opportunities to the people.

Table XVIII: **Medium Economic Framework**

Indicator	Units	Provisional 2005	Projections				
			2006	2007	2008	2009	2010
Real Sector							
GDP at Market Prices	Rs. Bn	2,366	2,731	3,139	3,563	4,017	4,538
GDP Growth	%	6.2	6.9	7.4	8.1	8.4	8.6
Inflation- GDP Deflator	%	9.8	8.0	7.0	5.0	4.0	4.0
Domestic Savings	% of GDP	17.2	20.6	22	24.8	26.4	27.4
Private Saving		19.9	21.5	21.5	22.7	23.5	24.2
Public Saving		-2.7	-0.9	0.5	2.1	2.9	3.2
National Saving		23.3	26.5	27.8	30.6	31.9	32.4
Total Investment		26.5	30.0	32.0	33.9	34.8	35.0
Private Investment		20.1	21.6	24.3	26.2	27	26.8
Public Investment		6.4	8.4	7.7	7.7	7.8	8.2
External Sector							
Trade Gap	US$ Million	-2,516	-2,910	-3,369	-3,440	-3,558	-3,682
Trade Gap	% of GDP	-10.7	-11	-11.3	-10.5	-9.8	-9
Exports	US$ Million	6,347	6,995	7,746	8,584	9,459	10,448
Growth	% Change	10.2	10.2	10.7	10.8	10.2	10.5
Imports	US$ Million	8,863	9,904	11,115	12,024	13,017	14,131
Growth	% Change	10.8	11.7	12.2	8.2	8.3	8.6
Services	US$ Million	334	407	409	472	502	552
Receipts		1,541	1,737	1,889	2,063	2,245	2,438
Payments		1,206	1,330	1,479	1,591	1,744	1,886
Private Remittances(gross)		1,968.50	2,110.30	2,225.30	2,421.40	2,572.30	2,726.30
Current Account		-654	-882	-1,123	-1,008	-973	-990
Current Account Deficit	% of GDP	-2.8	-3.3	-3.8	-3.1	-2.7	-2.4
Overall Balance	US$ Million	501.5	400.7	321.8	211.5	353.8	500.2
Overall Balance	% of GDP	2.1	1.5	1.3	0.9	1.2	1.2
External Reserves(without ACU)	US$ Million	2,458	2,749	3,024	3,167	3,428	3,893
External Official Reserves (Months of Imports)	months	3.3	3.3	3.3	3.2	3.2	3.3
Debt Service Ratio (b)	%	8	10.9	10	10.6	10	7.8
Fiscal Sector (with Tsunami)	% of GDP						
Revenue		16.1	17.8	18.1	18.5	18.6	18.8
Expenditure		24.7	26.9	25.3	23.5	23.6	23.8
Revenue (Deficit /Surplus)		-2.7	-0.9	0.5	2.1	2.9	3.2
Overall Budget Deficit		-8.7	-9.1	-7.2	-5.7	-5.0	-5.0
Domestic Financing		5.2	4.5	3.2	2.2	2.4	2.9
Government Debt		93.7	89.9	86.7	82.5	77.2	73.3
Government External Debt		40.4	39.2	39.4	38.7	35.9	34.3
Financial Sector (c)	%						
Reserve Money Growth		15.8	15.0	14.9	14.5	13.0	12.9
Board Money Growth(M2b)		19.1	16.5	15.3	14.5	13.0	12.9
Narrow Money Growth(M1)		22.4	15.0	13.5	12.5	11.0	10.9
Growth in Credit to Private Sector		21.5	17.0	17.0	16.5	13.6	12.9
Growth in Credit to Public Sector		0.7	4.2	-5.7	-5.0	5.1	-5.4

Chapter V

Foreign Aid

Foreign aid has been an important source of financing for Sri Lanka's development efforts to promote economic growth. Effective utilization of foreign aid during previous three years has resulted positive impacts to the national economy. The annual average of foreign aid mobilization from all donors and creditors reached US $ 1,298 million. .

Aid Commitment

The total; aid committed in 2005, at US$ 1,656 million is the highest annual aid commitment made to Sri Lanka in one single year mainly due to additional funds extended by the donors in support of the Post -Tsunami reconstruction and rehabilitation activities of the Government. In 2003, the total commitment of foreign assistance was around US$ 1,060 million. This amount had been increased up to US$ 1,180 million in 2004. The grant assistance increased to US$ 219 million in 2005 compared to US$ 144 million in 2003.

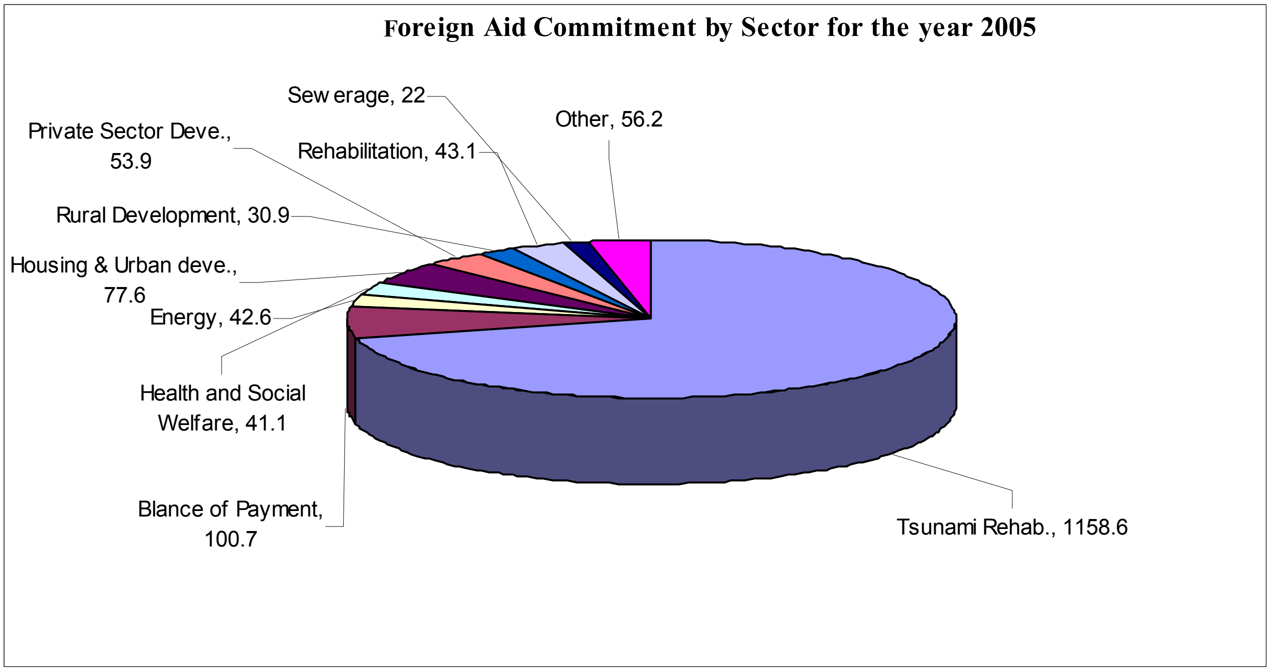
At the first Sri Lanka Development Forum which was held on May 16-17, 2005 in Kandy, US $ 3.3 bn. was pledged by multi-lateral and bi-lateral donors, and the NGOs for post tsunami recovery activities. Of this amount, loans account for US $ 798 million. and the balance US $ 1,139 is in grants. NGOs pledged US $ 853 million. for the same purposes on a grant basis. The total assistance provided by the IMF included US $ 268 million by way of both emergency relief and debt moratorium. Bilateral donors extended debt moratorium providing relief of US $ 263 million.

All pledges made at the donor conference in Kandy were only for the postTsunami related rehabilitation and reconstruction activities. In 2005, the government entered into agreements with donors for a total of US $ 976 million grant aid and US $ 610 million. loans for Tsunami related projects.

There are a substantial number of foreign funded projects for the rehabilitation of North & East in the project portfolio. Total project funding available for the post conflict and post Tsunami reconstruction work in the North and East districts is estimated at US $ 1,280 million.

The foreign funded project portfolio of the country as at end of 2005, consisted of about 216 projects, of which 149 are loan projects and 67 are grant projects, executed by 30 line Ministries. The total foreign aid available as at the end of 2005 amounted to US $ 4,188 million of which US $ 620 million was for post conflict rehabilitation and development of the North and East Districts. Foreign aid available for tsunami rehabilitation was US $ 1,795 million while US $ 1,748 was available for the development projects in the rest of the country.

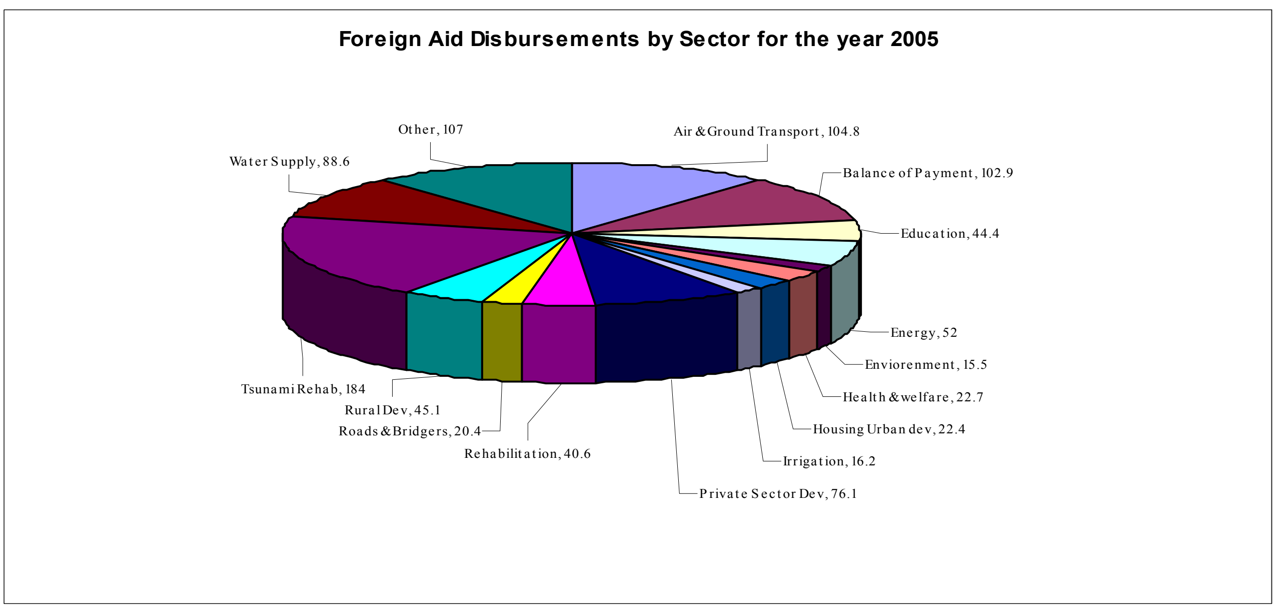
Figure 8:



Aid Disbursements

The aid disbursements by sectors of the year 2005 is given below.

Figure 9:



Sectors such as Water Supply, Ground Transport and Finance have recorded the highest amount of foreign assistance disbursement in the year 2005.

Table XIX: **Foreign Aid Utilization**

US$ million.

Donor Agencies	Disbursements		Disbursement Ratio %	
	2004	**2005**	**2004**	**2005**
Japan	291	235	18	18
ADB	189	155	20	16
World Bank		210	25	47
Other Multilateral	38	190	29	91
Other Bilateral	120	126	31	12
Commercial Borrowing	0	102	0	100
Export Credit	86	40	84	32
Total	805	1058		

Source-External Resources Department

- The total aid disbursed in 2004 was US$ 805 million. It increased by US$ 253 million. or 25% in 2005. The total disbursements of on going project amounts to US$ 862 million

- Of the total disbursements, the largest disbursement was made by the Government of Japan. It disbursement ratio was around 18%.

- Disbursement of ADB has declined from US$ 189 million. to US$ 155 million. due to implementation issues such as land acquisition and delay in awarding contracts.

- There is a significant increase in the disbursement made by the World Bank at 47%.

The government has focused its main attention to minimizing delays in project implementation particularly in the procurement procedures. As a result, considerable progress has been made during the last 3 years with regard to the foreign disbursement. However, disbursement levels of certain projects have been slightly below the projections due to delays in awarding contracts, the long procedures involved in land acquisition and resettlement, provision of insufficient counterpart funds etc. The government has, therefore, taken initiatives for proper utilization of foreign aid by taking the following steps:

- Minimizing the start-up delays of the project by appointing Project Directors and establishing Project Management Units at the very early stage of each project.

- Identifying loan savings and reallocating or restructuring of surplus loan proceeds in consultation with donor agencies, line ministries and other relevant agencies in order to enhance effective utilization of existing resources.

- Improved project monitoring and project management system through intervening to resolve problems affecting project implementation.

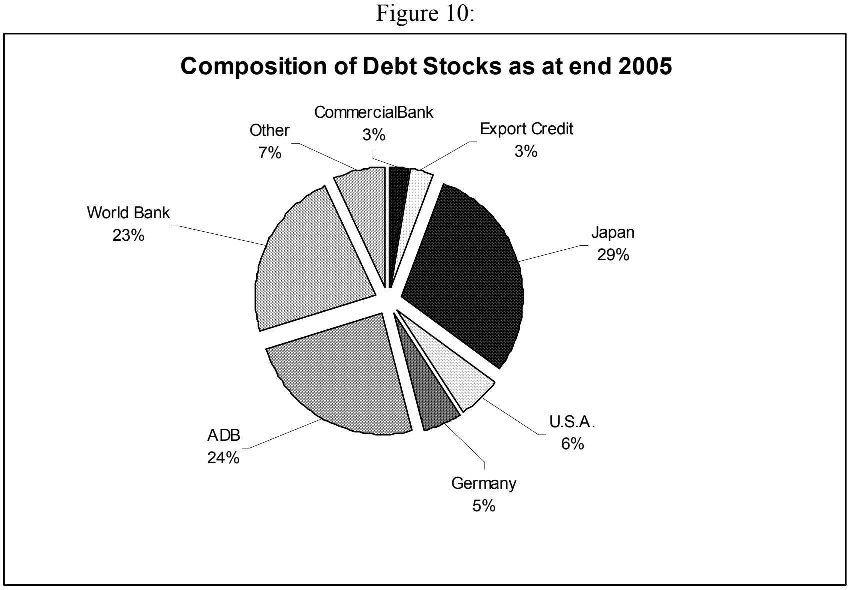
The committed undisbursed balance of foreign aid for government's normal development programmes and tsunami related activities is about US $ 4.2 billion as of 31st December 2005.These funds will be used for projects identified by the government and implemented during a period ranging from 2-5 years. The expected utilization of donor funds for the year 2006 is US $ 1.4 billion or approximately a third of the undisbursed commitment

Therefore, it is necessary to explore other alternate possibilities for borrowing such as accessing international capital markets. Developing necessary guidelines for raising funds from such other sources would be essential in order to ensure that the borrowing costs are competitive.

External Debt

The estimated total debt repayment for the year 2006 is about US $ 545 million which includes US $ 162 million as interest payments and US $ 382 million as principal payment. The government debt stock as of 31st December 2005 is about US $ 9265 million. A graphical representation of the composition of the debt stock as of end 2005 by major donor category is demonstrated below.

Figure 10:



There is a significant decrease on debt service payment in 2005 due to debt moratorium extended by the Bi-lateral and Multilateral donors to facilitate Tsunami recovery and reconstruction programme. The table given below illustrates the status of the External Debt Service from 2000 to 2005.

Table XX: **External Debt Service**

USD million

Type \ Year	2000	2001	2002	2003	2004	2005
Total Disbursed Outstanding Debt (DOD)	6778	6571	7345	8726	9490	9265
Principal payments	231	224	236	261	295	173
Interest Payments	127	119	119	131	148	73
Total Debt Service Payment	358	343	355	392	443	246

Source- Department of External Resources

Debt Relief and Deferment

At end December 2004, the external debt stock of Sri Lanka was US $ 9.5 billion and debt service payments (Principal and Interest) for the year 2005 was estimated at US $ 550 million. Considering the exceptional scale of devastating effects of the Tsunami catastrophe occurred on 26th December 2004, the government of Sri Lanka requested a debt relief from the Paris Club

The Paris Club met on 10th June 2005 agreed to provide a one year debt moratorium for Sri Lanka. The Memorandum of Understanding (MOU) for debt moratorium was concluded with Paris Club member countries on 15th June 2005. The government of Sri Lanka has to pay 100 percent of the amounts of principal and interest (excluding late interest) due from January 1, 2005 up to December 31st, 2005 in 7 equal successive and semi-annual installments, the first one to be made on December 1, 2006 and the last one to be made on December 1, 2009. The rates and the conditions of interest on the financial arrangements are determined bilaterally between the government of Sri Lanka and participating creditor countries. However, this interest rate is at the concessional rates applying to the original debts.

Government of India extended its moratorium for three years. The total debt moratorium includes the annualized debt relief on account of debt written off by China, and Italy and debt relief grant provided by the United Kingdom. China and Italy have written off US $ 4.33 million and US $ 9.31 million respectively. The United Kingdom paid US $ 5.7 million which is equivalent to 10% of Sri Lanka debt service owing to International Development Agency (IDA) of the World Bank.

Participating creditor countries are USA, Canada, Denmark, France, Germany, Japan, the Netherlands and Korea. Total debt moratorium received by Sri Lanka is US $ 272 million. Out of which, US $ 265.48 is applicable for the year 2005.

The debt relief and moratorium enabled Sri Lanka to finance the required counterpart expenses of foreign funded projects on reconstruction and rehabilitation of Tsunami affected infrastructure and provide livelihood support as well as humanitarian assistance.
Total debt moratorium and debt relief received by donor category for the year 2005 are as follows:

Table XXI: **Debt Relief and Deferment - 2005**

No.	Country	Average Ex.Rate	Currency	*Principal*	*Interest*	*Total*
	Write Off					
1	China	Rs =12.1	RMBY	35,640,000		
		99.5	$	4.334.110		4.3
2	Italy	Rs= 128	€	7,237,226		
		99.5	$	9,310,200		1.3
3	UK(FOR 10% World Bank debt)		$	4,270,000	1,660,000	5.7
	Sub Total		**$**	**17,914,310**	**1,660,000**	**11.3**
	Deferment					
1	U.S.A.		$	24,736,536	15,265,753	33.73
2	India		$	5,781,600	1,745,200	4.5
3	Frnace	Rs= 128	€	4,451,558	1,738,858	
			$	5,726,627	2,236,922	7.35
4	Japan	Rs..88	¥	14,043,565,270	6,272,551,561	
			$	122,359,785	54,651,934	177.1
5	Germany	Rs.=128	€	10,545,432	2,526,088	
			$	13,565,982	3,249,640	15.7
6	Canada	Rs.80.1	C$	4,250,409	5,028	
			$	3,421,686	4,048	3.5
7	The Netherlands	Rs 128	€	3,972,115	453,918	
			$	5,052,012	583,934	5.6
8	Denmark	Rs.17.2	DKK	4,800,000		
			$	829,748		0.8
9	Korea	Rs. 0.10	Won	3,304,898,000	2,569,023,020	
			$	3,321,505	2,581,932	5.9
	Sub Total		**$**	**184,795,481**	**80,319,363**	**254.18**
	Grand Total		**$**	**202,709,791**	**81,979,363**	**273.78**

Source: External Resources Department

Due to debt moratorium and debt relief received, debt service payment for the year 2005 is comparatively less than the year 2004. The following table shows the debt service payment by major donors.

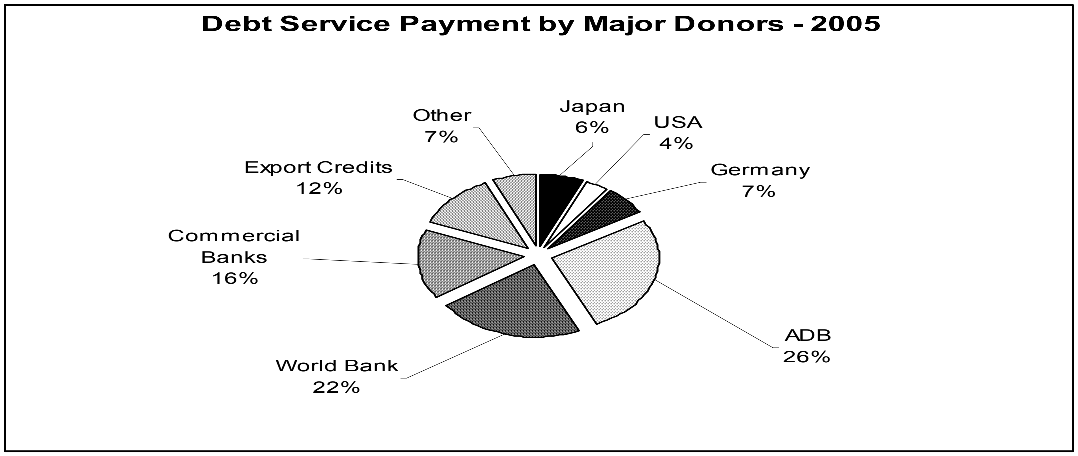
Table XII: **Debt Service Payments to Donors/Creditor 2000-2005**

Donor/Creditor	2000	2001	2002	2003	2004	2005	%
Bilateral	**231**	**225.1**	**239.4**	**260.9**	**301.5**	**51.7**	**20.91**
Japan	145.6	140	149.5	169.2	198.2	15.7	6.35
USA	41.2	42.2	43.2	43.7	43.4	8.9	3.60
Germany	17.4	16.5	19.1	22	23.6	16.1	6.51
France	5.7	5.4	6.3	7.3	8.2	0	0.00
Netherlands	4.5	4.3	0	0	5.1	0.6	0.24
Canada	2.9	2.7	2.8	3	3.4	0.1	0.04
Kuwait	3.1	3.1	3.1	3.2	3.2	3.3	1.33
Korea	1.8	2.6	4.2	4.6	5	0.1	0.04
India	2.8	3.6	5.3	3.8	4.9	3.8	1.54
China	1.8	2.1	2.7	2.7	4	2.9	1.17
Others	4.2	2.6	3.2	1.4	2.5	0.2	0.08
Multilateral	**70.4**	**80**	**87.7**	**103.5**	**112.3**	**127.1**	**51.40**
ADB	33.4	35.4	38.4	48.5	53.4	65.7	26.57
World Bank (IDA, IBRD)	34	41.1	46.6	51.6	55	55.6	22.48
IFAD	1.5	2.3	2.3	2.6	2.7	2.6	1.05
Others	1.5	1.2	0.4	0.8	1.2	3.2	1.29
Commercial Banks	**37.1**	**17**	**9.3**	**9**	**10.2**	**38.5**	**15.57**
Export Credits	**21**	**22**	**19**	**19**	**20**	**30**	**12.13**
Grand Total	**359.5**	**344.1**	**355.4**	**392.4**	**444**	**247.3**	**100.00**
Period average exchange rate [2]	**75.6879**	**89.2364**	**95.6344**	**96.5155**	**101.0818**	**100.5288**	
Period end exchange rate [2]	80.0098	93.0568	96.708	96.3518	104.3327	102.0883	

Source: External Resources Department

Graphical Presentation of debt service payments to major donors in 2005 are shown in the Chart below.

Figure 11:



A debt service payment forecast based on the current debt stock is given in table below.

Table XXIII: **Debt Service Payment Forecast on Current Debt stock**

	2005	2006	2007	2008	2009	2010
Bilateral	**51.7**	**326**	**353.9**	**364.7**	**369.9**	**381.5**
Japan	15.7	**199.2**	215	225.9	231.4	230.4
China	2.9	**3.4**	8.3	9.5	10.7	30.9
Canada	0.1	**3.7**	3.8	3.8	3.8	3.8
France	0	**7.5**	7.8	8.3	8.4	8.2
Germany	16.1	**39.1**	39.6	40.1	39.5	34.1
India	3.8	**10.7**	14.2	12.6	14	13.6
Korea	0.1	**6.7**	8.9	9	8.9	8.7
Kuwait	3.3	**5.1**	5.3	5.4	5.5	5.9
Netherlands	0.6	**5.2**	4.8	3.9	2.2	1.5
USA	8.9	**42.7**	42.3	41.7	41.1	40.5
Other	**0.2**	**2.7**	**3.9**	**4.5**	**4.4**	**3.9**
Multilateral	**127**	**143.5**	**161.5**	**194.8**	**217.3**	**230.6**
ADB	65.7	**78.8**	91.2	116.9	134.4	144.7
World Bank(IDA)	55.5	**60**	64	69.1	70.9	73.9
IFAD	2.6	**2.3**	3	3	3.5	3.5
OPEC Fund	1.5	**1.6**	2.4	2.7	3	2.9
Nordic Fund	0.1	**0.2**	0.3	0.3	0.6	0.7
European Investment Bank	1.6	**0.6**	0.6	2.8	4.9	4.9
Commercial Bank	**38.6**	**42.8**	**42.2**	**140.8**	**7**	**6.3**
Export Credits	**29.5**	**32.5**	**35.4**	**39**	**39.8**	**43**
Grand Total	**246.8**	**544.8**	**593**	**739.3**	**634**	**661.4**
Percentage Increase		**120.7**	**8.8**	**24.7**	**-14.2**	**4.3**

Source: External Resources Department

Repayment of moratorium debt has to be started from December 2006 and those amounts are not reflected in the amounts given in the table. The debt rescheduling will be incorporated for this debt service by March 2006. According to the forecast, the debt service payments on the current debt stock will increase by an annual average of 9.2 percent in the period from 2005 to 2010

Table XXIV: **Net Flow on Foreign Aid - US $ million**

Creditor Category	Description	2000	2001	2002	2003	2004	2005
Multilateral							
ADB	Disbursement	77.6	93.6	154.6	214.6	189.1	210.0
	Interest	15.1	14.8	15.9	18.7	20.6	24.0
	Principal Payment	18.3	20.6	23.4	30.8	32.0	40.9
	Net Flow	44.2	58.2	115.3	165.1	136.5	145.1
WB	Disbursement	47.0	40.6	94.4	208.6	72.1	154.3
	Interest Payment	12.6	12.5	12.7	13.8	15.3	16.0
	Principal payment	22.5	30.2	35.6	37.9	38.4	38.9
	Net Flow	11.9	-2.1	46.1	156.9	18.4	99.4
IMF	Disbursement	0.0	121.5	123.5	82.1	0.0	0.0
	Interest payment	1.0	3.2	2.1	0.0	5.4	0.0
	Principal Payment	81.1	67.8	50.2	23.2	107.8	0.0
	Net Flow	-82.1	50.5	71.2	58.9	-113.2	0.0
Other	Disbursement	10.7	11.7	20.2	33.0	47.6	190.7
	Interest Payment	0.4	0.6	0.7	1.0	1.4	2.8
	Principal payment	2.6	2.7	1.9	2.5	2.5	3.1
	Net Flow	7.7	8.4	17.6	29.5	43.7	184.8
Bilateral							
Japan	Disbursement	206.2	231.5	185.1	250.6	290.4	235.3
	Interest Payment	55.8	51.9	53.8	60.6	65.7	6.6
	Principal Payment	81.9	82.4	94.1	108.8	126.3	10.2
	Net Flow	68.5	97.2	37.2	81.2	98.4	218.5
USA	Disbursement	7.5	12.8	0.0	0.0	7.8	15.0
	Interest Payment	18.8	18.8	18.3	17.9	17.3	3.7
	Principal Payment	22.4	23.5	24.9	25.9	26.1	5.2
	Net Flow	-33.7	-29.5	-43.2	-43.8	-35.6	6.1
Germany	Disbursement	27.2	39.4	11.5	21.3	40.3	48.2
	Interest Payment	3.1	4.6	6.0	7.2	8.0	5.4
	Principal payment	13.4	11.3	12.9	14.8	14.8	10.4
	Net Flow	10.7	23.5	-7.4	-0.7	17.5	32.4
Other	Disbursement	28.3	44.2	53.1	89.1	72.1	63.6
	Interest	5.6	5.3	5.4	6.0	8.0	2.3
	Principal Payment	19.9	20.2	21.8	19.9	27.1	8.6
	Net Flow	2.8	18.7	25.9	63.2	37.0	52.7
Total	Disbursement	404.5	595.3	642.4	899.3	719.4	917.1
	Interest Payment	112.4	111.7	114.9	125.2	141.7	60.8
	Principal Payment	262.1	258.7	264.8	263.8	375.0	117.3
	Net Flow	30.0	224.9	262.7	510.3	202.7	739.0

Note 1. Disbursement includes grants and Loans
Net Flow = Disbursement - (Interest Payments + Principal Payments)
As a result of debt moratorium extended by the Government of Japan, USA, India, the Netherlands, France, Denmark, China, U.K., Italy, ,Canada and Korea, net flow of the foreign aid is much higher in the year 2005.
Source- External Resources Department

Table XXV: **Donor Assistance and Commitments– update as at 31.12.2005**

Donor Countries & Agencies	Expected Assistance (US$ million)			Total Commitments (US $ million)		
	Loan	Grant	Total	Loan	Grant	Total
a. Bilateral Donors	**599.5**	**482.2**	**1081.7**	**582.3**	**461.6**	**1043.9**
Australia		7.4	7.4		7.4	7.4
China	300	18	318	300	18	318
Denmark		8	8		8	8
France	104		104	86.8		86.8
Germany		102	102		102.5	102.5
Hungary		22	22		22	22
Iceland		3	3		1	1
India		23	23		23	23
Italy		72	72		72	72
Japan	95.8	79.2	175	95.8	79.2	175
Korea	19.7	13.2	32.9	19.7	13.2	32.9
Kuwait	20		20	20		20
Netherlands		28.4	28.4		16.4	16.4
Norway		19	19		9.8	9.8
Venezuela		6.2	6.2		6.2	6.2
Spain	60	2	62	60	2	62
Sweden		10.5	10.5		12.8	12.8
Switzerland		9	9		8.9	8.9
USA		59.3	59.3		59.2	59.2
b. Multilateral Agencies	**198.5**	**578.8**	**777.3**	**108.5**	**510.5**	**619**
ADB	7	154	161	7	154	161
EIB	90		90			0
EU		118	118		52	52
IFAD	16.5	1.5	18	16.5	1.5	18
UN Agencies			0			0
FAO		24.3	24.3		25.7	25.7
UNDP		21	21		17.6	17.6
UNICEF		136	136		136	136
UNFPA		10	10		9.7	9.7
WFP		49	49		49	49
World Bank	85	65	150	85	65	150
Sub Total (a + b)	***798***	***1061***	***1859***	***690.8***	***972.1***	***1662.9***
c. NGO & INGOs		**853**	**853**		**773**	**773**
Sub Total (a+b+c)	***798***	***1914***	***2712***	***690.8***	***1745.1***	***2435.9***
d. Debt Relief/						
Bilateral Donors	308		308	308		308
Sub Total (a+b+c+d)	***1106***	**1914**	**3020**	**998.8**	**1745.1**	**2743.9**
e. IMF	**157**		157	157		157
	111		111	111		111
Sub Total (e)	***268***		***268***	***268***		268
# Grand Total (a+b+c+d+e)	**1374**	**1914**	**3288**	**1266.8**	**1745.1**	**3011.9**

Emergency relief not included   Source- External Resources Department

Chapter VI

Sectoral Development

Agriculture

Performance of agriculture sector excluding fishing industry has shown the highest growth rate of 6.5% in 2005 after 1990. The growth rate of 1.2 % was recorded for the agriculture sector including fishing industry in 2005 as against a -0.5 per cent growth in 2004.

Achieving self-sufficiency in rice...

- The highest ever paddy production of 3.24 million mt was recorded in 2005. This was mainly due to increased fertilizer subsidy which cost the government Rs. 4,700 million in 2005, enhanced usage of quality seed paddy, better producer prices, favourable weather condition and improved irrigation facilities. All these have contributed to increase the average production of paddy per ha from 3,363 kg in 1994 to 4,080 kg in 2005.

- As a major step towards rebuilding the rural economy, a new "Dahasak Maha Wev" development programme was continued to improve water resources in small tanks. The government investment in this programme was increased to Rs.765 million in 2005 from Rs.400 million in 2004. 980 tanks and anicuts were rehabilitated at the end of the year.

- Paddy production indicated a growth rate of 23.4 % in 2005 as against a negative growth rate of 14.3 % in 2004. This is the highest production after independence and the production is above 0.9% of the domestic demand. Fertilizer application has increased by 17.5 % in 2005 over the last year. The paddy production extent has increased by 20.4% in 2005 to 832,552 ha. The producer price of quality paddy has increased from Rs. 15.75 in 2004 to Rs.17.10 in 2005 indicating 8.6% increase.

Increasing trend in fertilizer consumption.....

- Total Fertilizer consumption was 650,503 MT in 2005- a 17.3% increase over the last year. Paddy agriculture consumed 54% of total fertilizer usage for the year 2005 and it indicates a 17.5% increase in consumption. Rubber cultivation has indicated 5.8% increase in fertilizer consumption in 2005 over the last year. All the other agricultural crops have consumed lower quantity in 2005 compared to 2004.

A significant growth in the tea production

- Sri Lanka boosted its annual black tea production by a whopping 2.2% to 314.8 million kg, and retained the third position in the list of main producers behind India and Kenya, in 2005. This year's black tea production is an all time record in producing 317.2 million kg. surpassing the previous record production of 310.6 million kg achieved in 2002.

- The highest ever record in tea exports was established in 2005, with 298.8 million kg surpassing the previous record of 291.9 million kg exported in 2003. The export earnings too reached an all time high value of Rs.77,326 million (US $ 758 million) in 2005.

Steady growth in prices of natural rubber.....

- Total extent of land under rubber was 115,000 hectares in 2004 and it increased to 115,280 hectares in 2005 indicating 2.4% increase over 2004.

- Rubber production was estimated to have increased by 10.1% in 2005 as against the growth rate of 3.0 per cent in 2004. The latex price and the fertilizer application have increased by 11.0% and 5.8% respectively from 2004 to 2005.

- The average price of latex has increased by 24.2% in 2005. Colombo auction price of crape rubber also increased by 9.6 % in 2005 over 2004.

Intensive re-planting and new planting of coconut.....

- Government policy to encourage coconut re-planting and new planting is reflected in acreage expansion. Re-planting and new planting acreage has increased by 479.4% in 2005 over the last year. However, the national coconut production in 2005 was 2511 million nuts, which is slightly lower than 2004. This is mainly due to the prevailed drought condition in the previous year.

- The value added of Coconut and Toddy production has increased by 0.9% in 2005 as against last year.

- The coconut production however declined from 2562 million nuts in 2004 to 2511 million nuts in 2005. The prevailed dry weather condition in 2004 was the main reason for this decline.

High potential for export agricultural crops....

- In real terms, the value added in the export agriculture increased by 16.3% from Rs.5,139 million in 2004 to Rs.5, 975 million in 2005. An increase of 31.1 per cent was shown in 2005 due to the increases in export prices for many items of export crops in 2005 particularly in cinnamon, cardamom, coffee, cloves, cashew as well as in the foliage and cut flowers.

- The value added of other food crop sector, which consists of highland crops, vegetables and fruits have shown a growth rate of 4.7 % for the year 2005 and this is mainly due to the production increases in highland crops, vegetables and fruits in 2005. The value addition of the fruit and vegetable sector has increased by 17.9% in 2005.

More benefits for dairy farmers......

- The government paid special attention for the development of the domestic dairy industry which is considered one of the high priority areas for future growth, investment and poverty alleviation. Number of priority programmes which were implemented in 2005 included the establishment of around 200 new dairy villages (Kiri Gammana) empowering more than 4,000 farmers, increasing the purchasing price of fresh milk from Rs.15 per liter in 2004 to Rs.21 per liter in 2005, upgrading the local cattle stock, and promotion of consumption of fresh milk. All these programmes were contributed to increase the fresh milk production by 18,000 liter per day.

- Government has invested more than Rs.300 million to promote fresh milk consumption by establishing fresh milk stalls in strategic locations in the country and establishing home delivery system in selected areas. As a result, farmers were able to secure higher prices with the increased demand for their produce.

The post-tsunami recovery in the fisheries industry...

- The government has identified the recovery and reconstruction strategy of the fisheries industry as an important national priority and started reconstruction and rehabilitation activities immediately.

- The government released Rs.600 million to restore livelihood of fishermen immediately at the beginning of the year 2005. Replacement of fishing boats/crafts by the government and other NGOO were 15,501 at the end of 2005, out of destroyed number of 16,919. Under the fuel subsidy scheme implemented by the government in 2005, each multi-day boat was given a subsidy of Rs.30,000 while the amount was Rs.7000 and Rs.5000 for one day and other mechanized crafts respectively. As a result of the government remedial actions the fish production has increased to 19,600mt in November and 17,900 mt in December 2005 when comparing with the production of 980 mt in January 2005. The average fish production prior to tsunami was 280,000 mt.

- Under the fishery harbour rehabilitation and modernization programme, the harbour development activities with all modern shore facilities in badly affected 10 fishery harbours have been commenced with the assistance of various donors. The Chinese government assistance extended for the development of Panadura, Beruwala, and Kudawella fishery harbours. Puranawella, Mirissa, and Hikkaduwa fishery harbours are being developed under the USAID assistance. The Japanese government supported for the rehabilitation and modernization activities of the fishery harbours at Galle and Tangalla. Kirinda harbour rehabilitation activities have been undertaken by the Korean Government.

- In addition to the fishery harbour development, improvement of 34 anchorages and 300 fish landing sites were undertaken by the UNDP.

Industrial Development...

Manufacturing industry recorded a growth rate of 6.1 percent in 2005 as against 5.7 per cent in 2004. Factory industry recorded a growth rate of 6.4 percent for 2005 compared of 5.6 per cent recorded in 2004. This sector was dominating the over all economic growth for the last few years by contributing around one third to the total growth. Exports of apparel clothing accessories, knitted or crotched have increased in quantity terms by 35% and value terms by 15.8% in 2005 over 2004. This sector has around 38% share in total garment exports, the not knitted apparel exports decreased in quantity terms by 4.8% and value terms by 4.5% in 2005 over 2004. This sector has 56% weightage in garment exports. The value of exports of textile garments has increased by 2.8% in 2005 over the last year. Its share is 60% of total industrial exports.

Food, beverages and tobacco have increased by 86% in 2005 over the last year at current terms. The export-processing sector recorded a growth rate of 0.8 percent in 2005 as against a growth rate of 4.5 percent for 2004.

The industrial development strategy focused on some selected areas and achievements made in 2005 are as follows:

Strategic priorities	Achievements in 2005
1. Thrust industries • The Apparel Sector	• **Productivity improvement program** Following actions were initiated with a view to enhance productivity in the apparel sector in collaboration with Joint Apparel Association Forum (JAAF). ▪ An assessment of productivity levels by benchmarking the productivity performances of identified factories ▪ provision of training facilities for production staff • **International image building program** A program was initiated in collaboration with JAAF to promote Sri Lankan product image. • **Design and product development program** This is an ongoing project of the Government aimed at establishing a clothing design degree course at the University of Moratuwa. The first batch of students graduated in July 2005. In addition, four students are also following post graduate courses in Fashion Design (M.Phil) degree at University of the Art, London.

Strategic priorities	Achievements in 2005
	• **Restructuring of Textile Quota Board** With the abolition of the Multi Fiber Arrangement in December 2004, the Government assigned the following new functions to the textile Quota Board. They are, to act as a focal point for the apparel industry, administration of the simplified VAT system for the apparel sector and the facilitation of the process of procuring textile requirement of the Ministry of Education, Armed Forces, Police and other government institutions from local textile manufacturers. These activities are in progress.
• **Agri-food and coir industries**	• **"Sri Lanka Brand" promotion through international exhibitions and seminars**. The organic food sector was identified as a thrust area with new incentives from Budget 2005. Initiatives have been taken by the Industrial Development Ministry with the National Agri Business Council to promote SME's engaged in the manufacture of organic food. • There is a growing demand for coir as geotextile (an erosion control material) in the global market and horticulture sector locally and internationally. A study has been carried out to introduce geotextile as an erosion control material. The findings and recommendations of this study were disseminated to all stakeholders at a seminar in Colombo. Moreover, 500 coir spinning machines at a cost of Rs.1.5 million were distributed in February 2005.
2. Revival of Lagging Industries	• Revival of the textile industry through promotion of Government sector procurement -- school, armed forces and police uniforms, etc Opportunities were given to local industrialists to enter the government supply chain by placing orders for the supply of quality school uniform material, knitted items, armed forces and police uniforms. For school uniforms, local quotas have been finalized. Tenders were called for knitted items, armed forces and police uniforms
3. Environment friendly industries	• **Application of cleaner production process.** Cleaner production assessment was completed for textiles, rubber, tea, hotel and food industries. Awareness programs have been planned for industries, Universities and Technical Colleges. Cleaner technology includes waste minimization principle and technological upgrading. Future programs will be designed based on the clients needs.

Strategic priorities	Achievements in 2005
4. Small & Medium Scale Enterprises	• The Export Development Board provided information on technology and market information for the local companies to facilitate exports and for foreign companies to facilitate imports. • Establishment of SME Bank The SME bank was established in May 2005. Of the initial capital of Rs. 5 billion, Rs 1.5 bn was released by end of 2005, Rs.200 million worth of 497 loans were approved. • 209 industrial villages in 20 districts have been initiated under the 1000 Industrial Villages Development Program during 2005

Mining and Quarrying .....

The Mining and Quarrying output in 2005 increased by 17.8 percent. For the year 2004, a growth rate of 5.1 per cent was recorded for this sector. Precious stone production increased by 45.8 percent for 2005 and geuda production decreased by 25.8 percent. The total gem exports increased by 12.4 percent for the year 2005.

Tourism ......

- Tourism has emerged as one of the key industries providing employment opportunities, foreign exchange earnings and generation of income. In 2005, earnings from tourism exceeded Rs. 42 bn (US$ 420 million) being the fourth largest foreign exchange earner despite the tsunami setback.

- Sri Lanka is promoted as an attractive tourist destination, an aggressive tourism marketing campaign was launched in 2005.

- A journalist program was launched with the assistance of WTO to bring down to Sri Lanka reputed journalists to write about Sri Lanka's recovery as an immediate measure to restore confidence on Sri Lanka as a safe tourist destination.

- Under the SUSAHANA loan scheme, Rs.903 million have been given to more than 411 small and medium tourism business operations affected by tsunami. Loans have been disbursed by 12 banks, 3 leasing companies and 2 finance companies. A duty free scheme for the importation of material and equipment for refurbishment of hotels was introduced. Other than the 8 hotels, almost every other hotel vigoursly commenced their refurbishment programme.

- A meeting of the SAARC Tourism Ministers was undertaken by the Ministry of Tourism together with the SAARC Chamber of Commerce and Industry in Colombo in July 2005.

- The inaugural Sri Lankan flight to Beijing took place in May 2005 as Sri Lanka was granted approved destination status by the Chinese Government.

- The South Asia Trade Fair was held in June 2005 which was attended by more than 100 foreign buyers.

- The WOMAD Drum festival was held in September 2005 exclusively to boost up the image of the country.

- Sri Lanka was selected as the host country for the World Tourism Day in the year 2007 at the General Assembly of the WTO 23 tourism generating markets have been approached as a result of the public relations campaign.

- Sri Lanka currently attracts over 600,000 tourist arrival and expects to reach one million high spending tourist arrival by 2010. The industry has been selected as a major Thrust area for private investment and the government has selected 03 Tourist Zones to attract large investment.

Construction Industry......

The construction industry grew 9% in 2005 as against 5.9% in 2004. The expansion of the construction industry can be partly explained by the reconstruction of infrastructure facilities such as roads, railways, bridges, fishery harbours, pipelines and telecommunication lines, as well as the rehabilitation of schools, health facilities and other public buildings and the rebuilding of boats, hotels and restaurants and home and business premises in the aftermath of the December 2004 tsunami.

The reconstruction and rehabilitation activities in the North East also led to boost the construction industry in the country. The anchor projects implemented in the area focused mainly on resettlement of displaced people, improvement of damaged infrastructure and the restoration of livelihoods.

Major construction activities completed in 2005 are as follows:

Housing......

- Around 27,000 permanent houses were constructed in 2005 under the tsunami reconstruction programme,. Of this, 22,000 housing units were completed through the owner-driven programme. The remainder was constructed under the donor-driven programme.

- Housing reconstruction programme in the North East conflict affected areas was able to construct around 7,900 houses in 2005.

- The public sector houses programme has completed 6,940housing units aimed at low-income families. Of this 1,725 housing units are for estate worker families. Another 47,600 housing units were upgraded with re-roofing using public assistance.

- The Plantation Human Development Trust has constructed 2,100 new houses for estate worker families. In addition, 170 line-rooms were upgraded and 9,800 line-rooms were re-roofed.

- The housing scheme for public servants comprises 272 housing units at Jaltara was completed in 2005.

- Two private housing and property development projects were commissioned in 2005. They are the residential housing complex by Park Hall Development PVT Ltd. in Bambalapitiya and the residential housing complex with 100 apartments by LHP Property Development Company in Mount-Lavinia.

Roads and Bridges ....,,

Under the Maga Neguma rural road development programme, 731 km of rural roads were rehabilitated. Maintenance work of 12,000 km. of national road network was completed. Rehabilitation and improvement works of 188 national roads and 36 bridges have commenced. Of these rehabilitated national roads, the major ones include Ratnapura-Balangoda road, W.A. de Silva Mawatha at Borella, Pitakotte-Thalawathugoda road, Gampola-Nawalapitiya road, Peliyagoda-Puttalam road and Weerawila-Kataragama road. Among the rehabilitated bridges Akuressa, Deniyaya and Gatambe bridges were the major ones.

Aviation.......

A terminal building with four apron stands at Bandaranaike International Airport was commissioned in 2005.

Water Supply.......

Twelve new water supply projects were commissioned in 2005 and the details of them are given below.

Province	Name of the Project
Western	• Pugoda Moveable Water Treatment Plnt
	• Mabima – Heiyanthuduwa WS Project
Southern & Uva	• Greater Galle WSP Stage I – Augmentation

	• Sewanagala Small Towns WS Project • Okkampitiya Small Town WS Project
North Central & North Western	• Anuradhapura Group Town WS Project - Augmentation
Northern & Eastern	• Inginiyagala WS Project – Augmentation • Killinochchi WS Project – Augmentation • Thiruketheeswaram WSP (Ext.) • Vankalai WS Project (Ext.) • Varothayangagar WSP (Ext.) • Nedunkerny WSP

Hospitals ....

- The Sirimavo Bandaranaike Children's Hospital was constructed with state of art technologies in the premises of the Teaching Hospital, Peradeniya in 2005.

- Health infrastructure facilities which included district hospitals, rural hospitals and ayurvedic dispensaries were improved in 18 districts.

Schools........

- 205 computer learning centres and 467 audio-visual rooms were constructed island-wide with the aim of providing quality secondary education.

- Rehabilitation and reconstruction works were carried out in 11 national schools. Also 35 primary and secondary schools were developed in order to ease the congestion at popular schools.

Vocational Training.......

National Apprenticeship and Industrial Authority constructed 10 centres in 5 districts. Nine rural vocational centres were constructed with the objective of providing vocational education to rural youth.

Irrigation........

Under the phase 2 of the Udawalawa Left Bank Project, construction of roads and irrigation canals have been completed benefiting 5,800 families through expanding cultivable lands of 5,152 ha.

Courts Infrastructure......

Ministry of Justice has completed courts complexes in Kandy and Trincomalee . Each court complex consist of Magistrate Courts, District courts, High courts, Labour Tribunal, state counsels' rooms, lawyers' rooms, record rooms and litigants' rooms under one roof. The construction of Jaffna court complex made substantial progress and ready for commissioning in 2006.

INFRASTRUCTURE DEVELOPMENT

Road Sector......

Road transport is the predominant transport mode in the country carrying 93 percent of the passengers and 98 percent of good transports.

The Sri Lanka Road sector is divided into National (12009 Km), Provincial (15144 Km) and Local roads (64658 Km). The 2005 Budget provided a total of Rs. 19 billion for the development of the national road network. In addition, the road maintenance fund was established in 2005 to finance the road sector maintenance programmes. The Master Plan of the road sector was prepared in 2005 to identify mega road projects, national, provincial and local level road projects for future implementation up to 2020.

Programme	Progress
1. Maga Neguma – development of local roads for maximum benefits to the rural community.	▪ 731 km of roads rehabilitated.
2. **Road Maintenance** – implementation of regular maintenance works.	▪ Maintenance work of 12,000 km of national road network completed.
3. **Expressways** – expedited construction of proposed expressways	▪ Southern expressway –The bottlenecks have been removed for the rapid implementation of the project which is now under construction. ▪ Outer circular road – preliminary works for awarding the contract for the construction (first phase from Kottawa to Kaduwela) have been completed. ▪ Colombo – Katunayake expressway -- steps have been taken to implement the project under foreign assistance.
4. National Road Improvement and Rehabilitation	▪ Rehabilitation and improvement works covering 188 national roads were implemented. Roads Completed (Highlights) 1. Ratnapura – Balangoda Road 2. W.A. De Silva Mawatha 3. Nonagama – Pelmadulla Road 4. Pitakotte – Thalawathugoda Road 5. Seeduwa – Udugampola Road

Programme	Progress
	▪ 36 bridges were constructed. Bridges Completed (highlights) 1. Gatambe Bridge 2. Deniyaya Bridge 3. Akuressa Bridge

Bus Transport.......

Bus transport accounts for over 70% total passenger transportation in Sri Lanka. There are both state and private transport services operators, with the latter carrying the large share of passenger traffic. The quality of road passenger transportation showed no significant improvement in 2005. Out of about 16,000 private buses, 90% belonged to single-bus owners. The state sector operated over 5,000 buses under 11 Regional Transport Companies, providing bus services in remote areas and along uneconomical bus routes.

Sri Lanka Transport Board (SLTB) was re-established in October 2005. 76 new buses with Japanese Assistance and 17 new double deckers from United Kingdom were added to the fleet of SLTB during 2005. Further, 155 buses were rehabilitated under the Bus rehabilitation Programme. 200 engine kits and 2,000 buses were repaired with using imported spare parts through Provincial workshops. 185 school bus services under the Sisu Sariya – School Bus Project were established with emphasis on a reliable, safe and affordable service that is cost-effective to the government. Under the Gami Sariya – Social Services Subsidy programme was established to provide 31 services which are reliable, rural bus services to developing areas where there was no bus service available at that time.

Rail Transport........

The contribution of rail transport to passenger transport was 6% and freight transport was 2% in 2005. Since railways comprise more fuel saving and less congested system of transport, the development of railway network cannot be overlooked.

- Commenced construction work on 5 railway bridges at Ja Ela, Seeduwa, Kelaniya, Pinwatta and Kalutara. Pinwatta Railway Bridge has been completed.
- Introduced a new tariff system, resulting in 25% increase in revenue from rail passenger transport in the last year.

Tsunami disaster hit the coast railway line very badly and severely damaged the track, signaling, rolling stock and building infrastructure. The restoration work of the railway track and the signaling system were completed within 57 days. Passenger transport began in March 2005. This Colombo – Matara Railway Line has been identified for complete modernization with about US$ about 200 million investment.

Ports and Aviation.....

Ports

A significant growth in shipping was seen in 2005.

- The number of ships arriving at the Colombo Port increased by 6.5%.
- Total cargo handled increased by M.T.3.3million (9.8%) in 2005.
- Total container throughput increased by 234,772 TEUs (10.6%) and transshipments increased by 185,066TEUs (12.6%) in 2005.

A number of ports related developments were initiated in 2005, including:

- Colombo South Harbour development **-** this has been initiated as a priority project to enhance transshipment and cargo handling capacity in the Colombo Port. A business plan, detailed design and environmental impact have been completed.
- Trincomalee Harbour and area development **-** a zoning plan has been completed with emphasis on developing an Investment and Tourism Zone.
- Oluvil harbour – initial steps were taken to develop Oluvil Harbour as a regional port.
- Galle Port **–** Funding arrangements for the development of Galle Port was finalized.

Aviation

2005 was marked by a 16% increase in air traffic movement and 6% increase in each of the number of passengers and the amount freight using the Katunayake Airport.

The following development initiatives were undertaken in 2005 at Bandaranaike International Airport:

- New cargo terminal – increased annual cargo-handling capacity from 150,000 to 250,000MT
- New Pier and Renovated Passenger Building – increased annual passenger handling capacity from 3.4million to 6million. The new airport terminal was completed at Rs.5110 million (Japanese Yen.5, 874 million) and commissioned in 2005.
- Aircraft parking facilities – enhanced through construction of new apron, repairs of existing apron, overlay of parallel taxiway, construction of four apron stands, and aerobridge for embarking / disembarking passengers.
- Infrastructure facilities – expanded utility services to meet future demand through construction of Water Pumping Station, Water Distribution System, Water Storage System, Sewage Pump Station and Treatment System.

Electricity......

The total power generated by public and private sector in 2005 increased by 8.4 per cent. The hydropower generated by Ceylon Electricity Board (CEB) increased by 14.9 per cent and the thermal power generated decreased by 15.2 per cent in 2005. With regard to the power generation of the private sector, hydropower generation increased by 35.0 per cent and the thermal power generation increased by 22.6 per cent. The private sector produced 39.1 per cent of the total power generation for the year 2005. The total hydropower to thermal power generation ration was 1:1.72 in 2004 and it was 1:1.54 in 2005. The ratio of total generation of CEB to private sector was 1:0.64 in 2005.

The total capital expenditure in 2005 was Rs. 8,976 million, an increase of 15 per cent over the previous year. The system losses of electricity decreased marginally from 17.4 to 17 percent as a result of several power sector development programmes and action taken to prevent the illegal electricity connections. Table provides highlights of the performance of 2005.

Programme	Progress
1. Embilipitiya Thermal Power Plant	▪ 100 MW plant commissioned ▪ Increased installed capacity by 2% to 2480 MW ▪ Increased electricity generation by 6% to 7,553 GWh
2.Vavuniya–Kilinochchi Transmission Line Project: ▪ Reconstruct Kilinochchi Grid Substation ▪ Rehabilitate Vavuniya – Kilinochchi transmission line ▪ Restore power supply to Kilinochchi area.	▪ Project was started in 2005 ▪ Way clearing up to Omanthai completed
3. Upper Kotmale Hydro Power Project -150 MW.	▪ Resettlement programme started ▪ Preparatory work commenced
4. Norochcholai Coal Power Plant- Phase I - 300 MW	▪ Financial assistance obtained from China ▪ Initial steps for plant design and resettlement began
5.Combined Cycle power plant at Kerawalapitiya -300 MW ▪ Operational by 2008 ▪ Cater to need until coal plants come on board ▪ Later shift to Liquefied Natural Gas (LNG).	▪ Project was redesigned as a Dual Fuel Combined Cycle Power Plant ▪ It is planned to implement as a Design, Build and Transfer (DBT) basis

Water Supply and Sanitation......

Capital investment to augment the Water Supply capacity amounted to Rs. 13,240 million. The Population receiving pipe-borne water totaled 29 percent of the population in 2005

- Increased capacity and augmentation of existing network of pipe-borne water supply at 20 townships in different regions of the country.
- Completion and commissioning of water supply projects in Greater Galle, Anuradhapura, Pugoda, Mabima/ Heiyanthuduwa, and Patha-Dumbara.
- The main industrial and services centers of Kandy, Galle, Matara, Ampara, and the New Town and Sacred City area of Anuradhapura have been selected to improve the service with 24- hour pipe borne water supply.
- Opening of a public environment centre at Kalatuwawa.
- Reduced non-revenue water in Greater Colombo by 0.6%.
- Revised the National Water Tariff System with effect from 31.03.2005 to improve the efficiency of the National Water Supply and Drainage Board, water tariff increased by 30 percent..
- Expanded community water supply schemes to improve safe water in rural areas in:
    - 107 Grama Niladari Divisions (GNDs) in Ukuwela, Wilgamuwa, Galewela, Dambulla Pradeshiya Saba (PS) areas in Matale District,
    - 58 GNDs in Hanguranketa, Walapane, Ambagamuwa PS areas in Nuwara Eliya District,
    - 186 GNDs in Minipe, Ududumbara, Madadumbara, Ganga Ihala, Udapalatha, Pata Hewaheta, Panwila, Thumpane, Pujapitiya PS areas in Kandy District,
    - 142 GNDs in Polgahawela, Bingiriya, Udubaddawa, Rideegama, Galgamuwa, Alawwa, Nikaweratiya, Polpitigama PS areas in Kurunegala District

Construction of 11,646 latrines under Sanitation Programme was commenced in Matale, Nuwara Eliya, Kandy and Kurunegala Districts.

Postal Service....

Sri Lanka Post is dedicated to perform the communication requirements of the community by providing postal activities including delivery of letters and parcels, transfer of funds and other agency services more creatively and efficiently.

Programme	Progress
1. Improvement of Post office network -- to provide new services to the rural areas	▪ Upgraded Thummodara, Kosgama, Halkandawila and Moragalla sub-post offices to full phase Post offices
2. Call metering units for Post offices	▪ 120 call metering units provided for rural sub post offices.
3. Post Fax services -- deliver emergency messages to doorsteps of houses through Post Fax services	▪ This service has been introduced in 120 post offices within 2005.
4. Construction of New Post Office buildings	▪ 23 number of new building with sufficient facilities for postal customers.
5. Delivery of Letters	▪ 420 million letters were delivered.

Telecommunications......

The public and private telecom services have reported value added increase of 27.8 percent and 23.9 percent for 2005 and 2004 respectively. The main achievements in the year included :

- 14 percent increase in fixed access telephone lines to 1,130,923.
- 39 percent expansion of mobile telephone connections to 3,084,845.
- Increase in tele-density (telephones per 100 persons) from 16.6 in 2004 to 21.4.
- Establishment of 142 new pay phone connections, raising total pay phone connections to 6285.

- Increase in the number of data communication connections from 93,444 in 2004 to 111,259 in 2005

- Introduction of new CDMA Technology – enabling rural people to subscribe new value added services such as SMS (Short Message Service), VMS (Voice Mail Service), Internet Access, Data service and CLI (Calling Line Identification Presentation).

POVERTY REDUCTION AND WELFARE SERVICES

Poverty Reduction Initiatives in 2005

Projects	Main Activities	Main Beneficiaries and Achievements
Cash Programme	Monthly allowance as an income supplement.	Provided allowance to around 1.6 million families or 8.4 million people (43% of population)
Gam Pubuduwa	Improved basic infrastructure facilities in remote areas in order to create conducive environment for starting micro level income generating projects and improve general life in rural areas.	1.4 million families participated since 2004, starting around 12,880 projects, of which 12,240 (95%) have been completed.
Jana Pubuduwa	Provided concessionary financial assistance to Samurdhi families to start income generating projects.	In 2005, 100,000 projects were targeted, of which 98,230 (98%) were implemented.
Gemi Diriya	Supported rural communities to come together and formally organize and plan and implement village. Activities include infrastructure improvement, entrepreneurial skills development, micro-finance and marketing facilities.	Since 2004, a total of 14,640 families in 7 Dry Zone Districts have benefited from Gemi Diriya: - 1,020 families from improved rural infrastructure - 6,620 from the livelihoods programme - 7,000 from the skills development programme.
Unified Assistance Scheme	Accelerated programme of resettlement of IDPs in their places of origin or new settlements.	So far resettled about 130,000 families, 5,000 in 2005. Also providing livelihood assistance of Rs. 25,000 per family and Rs. 135 worth of dry rations per week.
World Food Programme Assistance	Provided food and nutritional supplement to IDPs through sustainable livelihoods measures.	During 2005, 14,685 mt of food provided to 1.3 million people: Mother and child – 3,598 mt Food for work – 7,260 mt Food for Training – 796 mt Food for education – 3,033 mt

Assistance to Differently Abled People.......

There are approximately 106,900 differently abled people in the country. The Department of Social Services and the National Secretariat for Persons are the main agencies entrusted with protection and promotion of right of the disabled persons.

Programme	Progress in 2005
Department of Social Services	
Pre-School Centers	• Allowances paid to Teachers in pre-schools for deaf and mentally retarded
Vocational Training Programme	• Vocational training provided for 745 disabled persons
Artificial Limbs	• 39 persons provided artificial limbs • Supported to Friend in Need Societies' Transit Hostels
Rehabilitation Services	• Rehabilitation services for 32 orphaned mentally retarded boys provided
Issuing Special Identity Cards	• 71 cards issued for the hearing impaired persons
National Secretariat for Persons with Disabilities	
Mobile Services	• Assistive devices provided to 18,500 persons through 26 Mobile Services
Self Employment	• 150 persons provided self-employment
Medical Assistance	• Medical assistance to 186 persons provided

Protection of Elderly People.......

The population of elderly, i.e. over 60 persons, was 6.4% in 2005. They will be increased by 20% in 2025. The National Secretariat for Elders has spent Rs. 21.3 million on protection and welfare of elderly persons under the following programmes in 2005.

Programme	Progress in 2005
Volunteer village level committees for elderly.	• Assistance provided to 270 villages for promotion of self-employment.
Construction and renovation of homes for the aged.	• Aged people's homes were renovated.
Special identity cards for elderly.	• 14,888 cards issued to elderly persons.
Eye lenses.	• Eye lenses issued to the elderly people free of charge
Training and awareness programmes for leaders of elder's village committee, matrons of elder's homes and elder's rights promotion assistants.	• 4 Seminars and 15 awareness programmes conducted.
Conducting of medical clinics	• 2 medical camps were held.
Issue of hearing aids	• 18 aids issued up to 2005.
Registration of societies and service providers	• 8 institutions registered

Culture and National Heritage.....

Establishment of cultural centers were further expanded by adding 2 cultural centers at Ambangaga Korale and Matale in 2005, increasing the total number of cultural centers to 122. There were 44,482 students, 1,170 resource persons and 544 staff members have been enrolled in these centers. In year 2005, these centres carried out important programmes such as conducting skills development programmes, and programmes for up holding cultural values of the society.

National Art Festival and World Children's Day Festival were jointly conducted by the Department of Cultural Affairs and the Art Council. International Shankar Children's Creations Competition awards ceremony was conducted, giving publicity to our indigenous cultural heritage. 85 traditional and creative dancing troupes have been sent to participate in international cultural displays held in countries like India, Nepal, China, Pakistan and Singapore.

Chapter VII

Rehabilitation and Reconstruction of North & East Districts

- During the last three years, a considerable amount of resources has been allocated for the reconstruction of conflict affected areas and the Post – Tsunami recovery activities in the North and East. The total value of the project portfolio to the North and East development at the end of 2005 is about US$ 1,280 million of which US$ 660 million has been extended for post-tsunami reconstruction and recovery activities in the area. The balance US$ 620 million was allocated for conflict affected rehabilitation and reconstruction activities. In 2005, the total commitment for both conflict affected rehabilitation and post-tsunami recovery activities in the North and East area is around US$ 832 million.

- The World Bank has extended US$ 176 million for the reconstruction of agriculture, irrigation, housing, health, water sectors in the North & East. Under the North East Irrigated Agriculture Project (US$ 64 million) it is expected to restore livelihood and enhance income through agricultural and other productions and build capacity for sustainable social and economic reintegration of the conflict affected communities. Design work of five major irrigation schemes of Karawahu, Rugam, Allai, Yoda Wawe and Iranamadu have been completed.

- The North East Housing Reconstruction Programme is being implemented at a cost of US$ 75 million to assist reconstruction of 46,000 houses over a period of 4 years. Under this project, 4,459 beneficiaries received Rs.50, 000 as the 1st installment for the fully damaged houses. The 2nd installment of Rs.60, 000/= each was paid for 4,212 of the beneficiaries (94% of the target group) who have completed their houses up to the foundation level. The 3rd installment of Rs.80, 000/= each was paid for 2,367 beneficiaries (53% of the target) who have completed their houses up to the roof level. The final installment of Rs.30, 000/= each was paid for 2,298 beneficiaries as Stage 1 and Rs.60, 000/= each for the 5 beneficiaries as the Stage 2 of the final installment. Total housing grant paid is Rs.733.97million as at 31st December 2005 for the fully damaged houses.

- The Government also received funds from to rehabilitate Internally Displaced Persons and restore primary healthcare and water supply by strengthening the capacity of the North East Provincial Council to implement long term reconstruction activities under the North East Emergency Reconstruction project (US$ 36 million),. The project has undertaken 200 civil structural works in the Government buildings inclusive of water supply & healthcare facilities and 178 items have been completed up to the end Sept. 2005. US $ 12.1 million and US $ 15 million have been disbursed in the category of civil works and livelihood support respectively.

- In addition, US$ 90million has been earmarked to rehabilitate housing and health sectors including livelihood support in the Tsunami affected areas. Under these recovery activities nearly 25,000 houses are under construction. 110,000 families were benefited from the livelihood cash grant programme. Design work of the Kalmunai Hospital has been completed.

- The Government has secured financial assistance from ADB for the implementation of rehabilitation projects in the conflict affected areas with five major ongoing projects totaling US $ 180 million. Under the North East Community Restoration and Development Project, it is expected to contribute to the government's overall relief and rehabilitation programme by improving living conditions and well-being of communities. As at December 2005, nearly 2,112 sub projects were completed in the health, education, water, shelter, agriculture, fisheries and road sectors under this project.

- It is expected to reconstruct essential infrastructure and restore the livelihood of the affected people by the conflict under the Conflict Affected Area Rehabilitation Project (US$ 80 million). As at December 2005, feasibility for the Jaffna Water Supply schemes was completed and the community development activities have been commenced. Under the Secondary Water Supply and Sanitation project, large water supply schemes in Batticaloa and Muthur districts are to be constructed consisting of Unnichchai Tank bunt raising and design and build contract for Batticaloa water supply schemes have been initiated while construction of sanitary facilities in the Muthur is underway.

- North East Coastal Community Development Project with US$ 22 million aiming at uplifting of the living condition of the community through providing basic needs facilities and development of enterprises have undertaken 307 community infrastructure sub projects and village Development Plans have been finalized.

- US$ 100 million has been channeled for tsunami reconstruction activities in the sectors of roads, water and housing. Ground water investigations and surveys have been commenced and sub projects have been identified. For coastal community development, necessary equipment and materials have been procured. Around Rs 95 million have been disbursed for Bank of Ceylon and People's Bank for Tsunami housing reconstruction.

- A variety of projects aimed at post conflict rehabilitating and reconstruction in the districts in the North and East (NE) for the restoration of livelihood to meet the humanitarian needs of the people. During 2002-05 the Government mobilized US$ 31 million from the Government of Japan towards rehabilitation and reconstruction activities in the NE, under its various ODA schemes.

- The Grant Assistance for Grassroots Human Security Project scheme with a resource base of US$ 12.3 million for the development of water supply, rural development, irrigation, health, and de-mining activities. For de-mining activities US$ 10 million has been allocated with Japan being the key player in this sector. The ongoing de-mining activities aim to create a conducive environment for the return of normalcy and the safely of the people in these areas

- Rehabilitation of the Kilinochchi Hospital US $ 2.2 million has been secured under its Bilateral Grant Aid Scheme and from the Yen Loan scheme US$ 12 million has been provided towards the Vavuniya - Kilinochchi Transmission Line Project. The project will connect the area from Vavuniya to Killinochchi to the national grid by rehabilitating and augmenting a 132 Kv transmission line and constructing a Grid sub-station at Kilinochchi.

- Nine irrigation schemes, i.e. Akkarayan Kulam (Kilinochchi) Tenniyan Kulan (Mullativu), Mamaduwa Tank & Nampan Kulam (Vavunia), Borapota Tank (Ampara), Thandchanamaruthanmadu Tank (Mannar) Puluganawa Tank (Batticaloa), and Morawewa Tank & Kurangupaanchan Kulam (Trincomalee) are being rehabilitated with a total cost of US$ 10 million allocated under Pro-poor Economic Advancement & Community Enhancement Project aiming to irrigate 6,081 ha of land in order to improve the family income of farming community by increasing the productivity and achieving sustainable agricultural development.
- For the relief, rehabilitation and reconstruction of the tsunami affected areas in the North and East under its Non-Project Grant Aid scheme approximately US$ 40 million has been provided for reviving the fisheries industry, building of schools, causeways, police stations, providing houses and power for the displaced, water & sanitation, health equipment etc.
- Preliminary work has been completed for the improvement of the central functions of the Jaffna Teaching Hospital, this inititiative will also ensure a modern medical equipment to be installed in a newly constructed building for the Hospital at a cost of about US$ 16 million.

Besides, there are considerable number of projects are being implemented in the Northern and Eastern area; namely, Rehabilitate Vavniya Killinochchi Transmission line project(US$ 12 million- Japan) Construction of Bridges across Kinniya Ferry on Batticoloa Trincomalee road (US$ 11 million- Saudi Fund), Rehabilitation of Killinochchi to Jaffna power transmission project (US$ 15 million- Germany) , Rehabilitation of 81 Bridges (US$36million - UK) , Road rehabilitation Project (US$ 16 million - EC), Integrated Water Supply Scheme (US$ 72 million- Australia) and Development and Rehabilitation for Batticaloa District (US$ 8 million – Norway). These projects are providing visible peace dividends to the people in the conflict affected areas.

Post Tsunami Recovery and Reconstruction

The tsunami on December 2004 affected two-thirds of coastline in 13 Districts, causing extensive loss of life, displacement of people, damage to property and disruption of livelihoods and services. The Government has been at the helm of guiding the emergency response and relief effort as well as the recovery and reconstruction effort. The main area of action and achievement in assisting the tsunami affected people, are summarized in the following table.

Programme	Performance in 2005
Emergency Response and Relief Issues: ▪ Over 35,000 killed and 1 million displaced. ▪ Extensive damage to property and infrastructure and basic services (roads, railways, electricity, water, etc). ▪ Disruption of social services (health, schools, etc) and livelihoods (fisheries, tourism, SMEs, financial institutions, etc)	▪ Emergency coordination mechanisms was established by the government facilitating timely combined response from communities, Government, local NGOs, private sector and international community. ▪ Nearly 600 schools and worship places provided emergency shelter and food aid to over 910,000 persons. ▪ Compensation scheme was operational within days. ▪ National and international emergency response teams helped in rescue operations, identification of dead persons, and clearance of most acute debris within days. ▪ No additional death due to epidemics reported from tsunami-related diseases or lack of care. ▪ Immediate repairs of basic infrastructure completed within days and services restored. ▪ Programme of emergency assistance for the tsunami affected people by the Ministry of Women's Affairs and Children catered to funeral expenses of dead persons; allowance for kitchen utensils; weekly dry-ration and cash grants; livelihoods restoration grant (through state banks). ▪ Programmes for food items for NE tsunami victims was implemented benefiting 915,000 tsunami victims.
Getting Back Home: Emergency Shelter to Permanent Housing Issues: ▪ Over 98,000 permanent houses required. ▪ Transitional shelter would be needed until completion of construction. ▪ Challenges to be overcome included further debate and rationalization of the buffer zone concept, balancing of	▪ Over 54,100 transitional shelters completed by Dec 2005, out of targeted number of 60,000. ▪ Outside Buffer Zone, nearly 66,525 families for permanent house construction under home owner-driven programme – are being funded. ▪ Inside Buffer Zone, 32,000 families to be assigned new locations under donor-driven schemes – at

Programme	Performance in 2005
demand for housing and with supply from Government, donors, etc, and constraints in availability of material and technical capacities and skills.	Dec 2005, 10,707 units under construction and 4,299 completed.
Restoring Livelihoods Issues: ▪ About 150,000 people lost means of livelihood – about 50% in fisheries and rest in tourism, SMEs, agriculture, etc. ▪ Around 80% of families are back at their old livelihoods, but full recovery requires more sustained effort. ▪ Challenges included lack of comprehensive information to facilitate targeting and transparency.	▪ <u>Cash grants and food assistance</u>: Over 250,000 families received for rounds of start up allowance of Rs. 5,000 per each round plus Rs. 175 worth of food and Rs. 200 cash grant per person per week for 32 weeks. ▪ <u>Microfinance and SME</u>: More than 13,000 loqans worth Rs. 3.8 million disbursed. ▪ <u>Fisheries</u>: About 90% of destroyed boats replaced or repaired. ▪ <u>Agriculture</u>: Seeds, fertilizers, etc to about 80% of affected area, and desalination work commenced. ▪ <u>Tourism</u>: 41 out of 52 damaged hotels have been restored and made operational.
Health, Education and Protection Issues: ▪ Increased vulnerability to disease and trauma due to displacement and disruption of health services and facilities. ▪ Deep psychological impact, trauma and void from devastation, loss of family and friends, etc. ▪ Many children orphaned or with only one parent and many women widowed and vulnerable.	▪ <u>Health</u>: Primary health care and preventative facilities restored; Funds allocated for rehabilitation of 97 such facilities and construction in progress. ▪ <u>Education</u>: Over 95% of tsunami-affected children back in school; progress in integrating psycho-social counseling in schools; Child-Friendly approach to rehabilitation adopted; Funds allocated for 180 damaged schools and construction work being completed. ▪ <u>Protection</u>: Numerous initiatives taken by Government, NGOs, communities and donors to protect the vulnerable. ▪ Human Rights Commission monitored operation of laws, policies and practices related to tsunami affected and acted on more than 19,000 cases.
Upgrading Tsunami Affected Infrastructure Issues: ▪ After attending to emergency repairs, the Government, with Development Partners, has entered the phase reconstruction of national infrastructure in affected areas. ▪ Challenges included shortages of contractors, skills, equipment and management practices, and spiraling costs of construction.	▪ The immediate restoration work of the Southern railway track was completed within two months. ▪ 10 damaged railway bridges were renovated. ▪ 60 damaged railway stations renovated. ▪ 20 damaged road bridges were rehabilitated. ▪ Rehabilitation of Kalutara-Matara Highway commenced in October 2005. ▪ Temporary repairs have brought Galle and Trincomallee ports back into operation. ▪ 120,000 electricity connections restored.

Programme	Performance in 2005
Recovery in the Fisheries Industry Issues: • 4,480 FRP boats destroyed. • 11,158 Canoes, Theppam and Vallam destroyed. • 818 Madels destroyed. • Loss of livelihoods.	• 3,368 FRP boats replaced. • 8,231 fishing crafts replaced. • 133 Madels replaced. • Rs. 103 million. worth fuel subsidy given to fishermen.

- The report "Post Tsunami Recovery and Reconstruction: Progress, Challenges and Way Forward," which was jointly prepared by the Department of National Planning and development partners provides a critical assessment of post-tsunami relief, recovery and reconstruction interventions and the way forward. The report examines the initial response and relief, the housing and livelihood support programs; the management of health, education, social protection programs; and measures undertaken to upgrade the national infrastructure.

- For Sri Lanka provision of relief and rehabilitation was made more difficult as the majority of tsunami affected was from economically vulnerable sections. At the end of a year of intensive relief, rehabilitating and reconstruction effort it is now estimated that full recovery from this tragedy will take about three years. This effort will cost approximately US $ 2.2 billion.

- The international community has committed US $ 2.1 billion and an estimated US $ 0.6 billion has been disbursed by the end of 2005.

- By the end of 2005, more than 32,000 permanent housing units were under construction and construction of 4,300 units have been completed. Out of 150,000 people who lost their main source of income, about 85% have regained their income sources.

- Government has provided cash grants (Rs.5000 in four installments) and food assistance (Rs. 375 a week) to over 250,000 families. Cash for work programmes have spent an estimated Rs. 700 million. More than 13,000 subsidized loans amounting to Rs. 3.8 billion have been disbursed under the two main microfinance and SME support schemes.

- Towards restoration of livelihood in the fisheries sector, about 90% of boats destroyed have been repaired or replaced. For those engaged in agriculture, seeds and fertilizer were distributed to approximately 80% of the affected areas.

- In tourism, 41 out of 52 damaged hotels are back in business. Rehabilitation of 97 damaged institutions is now underway and will be completed by end of 2006.

- Some significant policy changes have been introduced in terms of disaster preparedness, mental health and nutrition. Affected schools are being built better and more child-friendly. Construction of 18 schools has started with the participation of some 30 donors. About 95 percent of school-aged children in tsunami-affected areas have resumed schooling.

- The post tsunami reconstruction poses new challenges as well as opportunities. Government has already taken steps to expedite balance work. The recently established Reconstruction and Development Authority functioning under the President's direct supervision will be the apex agency vested with the responsibility of accelerating the program and achieving results from now onwards.

Chapter IX

Provincial Disparities

Regional Imbalances Reduced ……

The 8th Consumer Finances and Socioeconomic Survey (CFS 2003/04) was conducted by the Central Bank from October 2003 to October 2004, and covered the entire country, except Kilinochchi, Mannar and Mulativu districts in the Northern Province1. A major step forward in the latest survey was the coverage of a greater part of the North and East after a lapse of 20 years. This multi purpose household survey series that began in 1953 provides a continuous series of information on key socio economic developments in the country. The survey findings provided evidence of changing lifestyles in the country since the previous survey was conducted in 1996/97.

- ***The average number of persons and dependents in a household are falling***

In the last 40 years, household size had declined from nearly 6 persons to around 4 -5 persons in all 3 sectors. During this period, the number of income receivers per household had risen overall, while rising in the urban and rural sectors and declining in the estate sector. Overall, the dependents per income receiver ratio in a household had declined.

- ***The quality of housing and access to household amenities and utilities are improving***

Housing conditions and access to utilities and amenities improved dramatically with income level and were significantly better in the Western Province (WP) compared to all other provinces.

Housing has improved, and over 80% had permanent walls, flooring and roofing. In addition, households with access to electricity (75%), a safe source of water (62%) and sanitary toilet facilities (77%) had risen.

Despite improvements, housing conditions remained poorest in the estate sector. Access to electricity was lowest in Uva (UP) (57%), while access to safe water and sanitation was poorest in the Eastern (EP) and Northern (NP) Provinces.

Radios and TVs were available in over 70% of households, while 30% had refrigerators. Access to motorized transport and telephone facilities had increased from 15% and 5% to 22% and 25%, respectively. Again, the estate sector lagged behind, despite improvements over time.

- ***Shift in employment towards services sector***

The employment structure recorded around 33% in the Agriculture Sector, another 25% in Industry and the balance 42% in Services. The shift over time away from Agriculture to Industry and, more particularly Services, continued, consistent with overall economic development in the country. Around 70% of the employed were in the informal sector, which provides no formal social security benefits after retirement. Wage earners accounted for 57%, while non-wage earners - the self-employed, employers and unpaid family workers - accounted for the rest. The non wage earner share of employment was highest in Agriculture.

- ***Household income in all income quintiles and sectors had risen. Yet, though the overall structure remained unchanged, income distribution had further skewed slightly towards the richest***

Household income in real terms (deflated by the SLCPI) had increased annually by 2.4%. The real change rose with each quintile from 0.4% to 3.3%. Income distribution had not changed significantly. The Gini Coefficient (0.46) had risen marginally since the 1996/97 survey and was around the same as in 1986/87. Per capita incomes were lowest in the UP (Rs. 2,570), next Sabaragamuwa (SaP) (Rs. 2,894) and then EP (Rs. 2,905). They were significantly higher in the WP (Rs. 5,999) than the country average (Rs. 3,969).

Figure12:

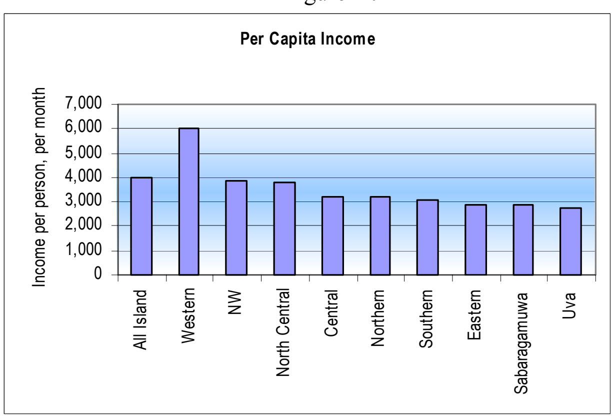
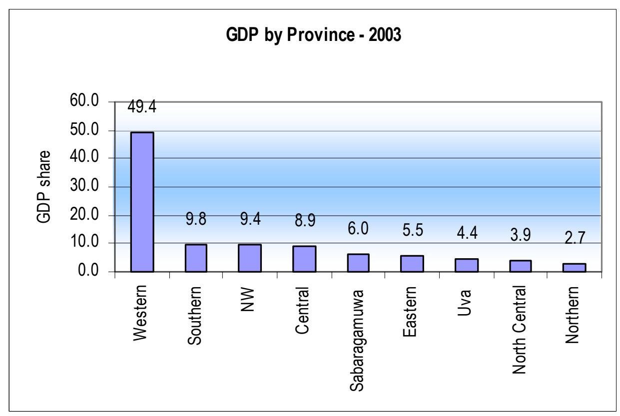


Figure 13:



- *With the increase in income levels, consumption had shifted from food to communication, education, recreation, housing and utilities*

Although the major share of expenditure goes to food and beverage, expenditure categories like housing and utilities, transport, recreation and culture and education has gained importance.

- *Households borrowed mainly to finance consumption expenditure. The expansion of formal financial sector institutions had helped households to diversify their loan portfolios. Meanwhile, the role played by money- lenders appears to be diminishing.*

The highest number of loans (58%) continued to be taken for consumption. However, in terms of amounts, the largest shares were for business and trade (27%) and housing (21%), while consumption loans, including for ceremonies, accounted for 20%. However, there was no discernible shift in the overall structure of loans from 1996/97 to 2003/04.

Of the total lending, 61% was from institutional sources. There was no shift in the number of loans taken between institutional (43%) and non-institutional sources (57%). However, the amount taken from commercial banks had fallen (51% to 34%), to be replaced by loans from other financial institutions and friends and relatives.

Table XXVI: **Sri Lanka: Key Economic Indicators by Province – 2003/04 – A Summary**

Item	All Island	Western	Central	Southern	Northern (a)	Eastern	North Western	North Central	Uva	Sabaragamuwa
Income										
Per Household	17,109	25,602	14,029	13,733	15,201	13,395	15,792	15,624	11,178	12,225
Per Person	5,999	3,222	3,060	3,208	2,905	3,872	3,814	2,570	2,894	3,968
Gini Coefficient, One Month Income										
Household	0.46	0.44	0.43	0.39	0.44	0.51	0.42	0.47	0.43	0.41
Spending Units	0.46	0.47	0.42	0.39	0.44	0.51	0.42	0.48	0.43	0.40
Income Receivers	0.50	0.51	0.47	0.46	0.52	0.55	0.47	0.51	0.46	0.45
Savings and Borrowings										
Savings Rate, % of Household Income	11.1	11.5	10.5	6.4	7.6	-0.9	14.5	26.2	8.2	11.4
Net Investment Rate, % of Household Income	24.9	20.0	18.8	10.5	37.4	30.2	28.6	83.2	21.5	22.0
Borrowing Rate, % of Household Income	22.1	19.1	18.4	31.3	39.0	43.6	22.3	14.2	21.3	14.7
Educational Attainment, %										
No Schooling	7.9	3.9	11.1	7.7	7.6	13.8	6.7	7.6	11.9	9.0
Primary	29.9	23.6	31.6	31.6	32.1	37.9	30.4	30.7	35.6	30.6
Secondary	41.0	45.5	39.6	38.3	31.8	31.3	42.4	44.4	38.7	43.1
Post Secondary	21.2	27.0	17.7	22.4	28.5	17.0	20.6	17.3	13.8	17.2
Health - Persons in ill Health, %of Population	13.3	15.2	9.6	14.1	12.3	12.4	14.7	12.2	14.2	11.5
Labour Force and Employment										
Labour Force, % of Population Aged 10 and above	47.2	47.4	46.7	32.9	37.2	46.1	48.3	48.1	51.4	46.4
Employment by Industrial Sector, % of Employed										
Agriculture, Forestry and Fishing	32.8	9.3	43.8	39.8	25.9	36.1	28.5	50.9	63.7	44.9
Industry	26.0	35.9	19.1	24.1	17.7	16.6	32.5	15.6	9.2	27.4
Services	41.2	54.8	37.1	36.1	56.4	47.3	39.0	33.5	27.2	27.8
Housing, Household Amenities and Land Ownership										
Availability of Electricity, % of Households	74.9	92.4	72.7	78.4	63.6	65.6	68.5	62.0	56.7	64.7
Water Supply and Sanitation, % of Households										
Pipe Borne Water to House	30.8	51.7	29.8	34.1	3.1	17.4	15.5	15.2	21.3	25.1
Availability of Household Equipment, % of Households										
Radio	78.3	84.1	78.1	79.4	68.9	62.7	78.1	75.7	76.6	78.2
Television	70.8	85.8	70.6	67.7	43.9	49.2	72.6	65.7	57.3	67.6
Telephone/ Cellular Phone	24.5	45.3	17.1	18.3	19.7	13.9	23.1	13.9	9.1	13.4
Motor Cycle/ Scooter	16.3	19.9	6.6	14.8	20.3	16.1	27.2	20.9	6.5	9.4
Motor Car / Van	5.8	12.1	3.5	2.8	3.1	2.7	5.5	3.8	2.3	2.7
Refrigerator	29.7	53.6	21.8	24.1	12.8	16.9	27.6	19.4	11.1	18.9
Sewing Machine	43.6	58.4	38.8	45.7	25.6	23.8	44.1	36.9	28.5	39.9
Personal Computer	4.1	9.9	2.6	2.5	2.8	1.2	2.5	1.2	0.5	1.6

(a) Excluding Killinochchi, Mannar and Mullativu districts

(b) Household members who worked more than one hour as paid employee, employer, own account worker (self employed) or unpaid family worker during the reference period were considered as employed

Source: The Consumer Finance and Socio Economic Survey Report, 2003/04

Chapter X

Human Resource Development

Healthcare.......

The health strategies implemented in 2005 were directed mainly towards the provision of equitable health care services. Special attention was placed on the recovery and reconstruction of healthcare institutions, facilities and activities among the Tsunami-affected population and the sustainable achievement of the MDGs. The choice of programmes and activities continued to be guided by the recommendations of the Presidential Task Force on Health, especially related to the four priority areas: i.e., improving one hospital in each District in a planned manner, expanding services to areas of special need, promotion of a public health, preventative and wellness concepts and improving efficiency and effectiveness of the healthcare delivery system.

Disease Control Programmes:

Under the vaccination programmes implemented by the Ministry of Health and the Provincial Ministries of Health, inoculation programmes against poliomyelitis, tetanus, whooping cough, mashes and tuberculosis were carried out island wide in 2005. As a result, the poliomyelitis was completely eliminated by the end of 2005. Action was taken at provincial and central levels to eliminate the Polio. The necessary laws and regulations were formulated and published to prevent entering of the SARS disease into Sri Lanka and the outbreak of the disease did not take place as a result. The hepatitis B vaccine was introduced to the expanded programme on immunization as a sustainable intervention to prevent this disease.

Human Resources Development:

Lack of skilled human resources, shortage of trained nurses in particular has been a major constraint for the development of healthcare delivery system in Sri Lanka. As a solution, a major requirement drive has been implemented and about 4,200 nurses have been recruited and trained since 2004. Facilitating this process the Nurses Training Colleges at Batticaloa and Galle have now been expanded and the quality of training has been improved.

South Asia's Foremost Children Hospital

With the objective of providing better medical service to children, the Sirimavo Bandaranayake Childrens' Hospital was constructed with state of art technologies in the premises of the Teaching Hospital, Peradeniya in 2005. This hospital provides specialized treatment to diseases including child cardiac diseases, neurological diseases and kidney ailments.

Special Medical Units and Upgrading of Hospitals:

Construction of a Neuo-trauma Unit allied with the National Hospital of Sri Lanka and a new Blood Transfusion Unit has commenced with the objectives of reducing the overcrowding of existing Neuro-trauma Units and providing patients with increased access to safe blood in adequate volumes

Emphasis on maternal and child nutrition....

Government paid a special attention to maternal and child nutrition programmes and the beneficiaries for the Thriposha programme which consist mainly of pregnant and lactating mothers and children who are growth faltering has increased to 580,000 by 2005. This is about 81% of the targeted population. In addition, government in connection with the World Food Programme is implementing a maternal and child nutrition programme and about 80,000 people in the Districts of Ratnapura, Hambantota*, Moneragala and Puttlam are benefited from this programme*

North and East....

Health infrastructure facilities were developed in following areas:

- General Hospital in Trincomalee, 4 District Hospitals in Murunkan, Chilawathurai, Alankemy, Sithamparapuram and 6 Rural Hospitals in Ulukulam, Vidathaltivu, Adampan, Chilavathurai, Mandapaththady, Sithamparapuram and 2 Central Dispensaries in Mamaduwa, Puliyakulam, 2 PUs in Nedunkerny and Vaharai and 4 Ayurvedic Dispensaries in Oddusudan, Olumandu, Pampaimadu, Pallai

- Paediatric wards, Maternity wards, OPD buildings, Staff quarters etc. in 4 Base Hospitals in Ampara & Batticaloa and 11 District and Rural Hospitals in Mullaitivu, Vavuniya, Ampara, Batticaloa & Jaffna are being developed. Two major hospitals- Jaffna and Kilinochchi, 2 Blood Banks and Nurses Training school are also being developed. In addition, 5 Gramodaya Health Centres in Ampara & Trincomalee and 2 MOH offices in Mullaitivu & Vavuniya were constructed.

Indigenous Medicine: The Ayurveda sector, which was earlier confined only to treatments has now been expanded into the areas of primary healthcare and research. Upgrading the Borella Ayurveda Hospital to the level of a Teaching Hospital was continued during 2005. Under the Osu Gammana programme which was announced in 2005 budget, 500 farmers produced medicinal plants on their own lands using forward contracting system. The extent covered under the Osu Gammana Programme was 100 acres in 2005.

Education........

Teacher training and infrastructure facilities of 150 schools in the outskirts of main cities were improved to ease the high demand for popular schools. Under the Navodya School Development project at Divisional Secretariat Divisions level, 388 schools were improved in terms of the physical facilities, such as libraries, computer units, laboratories, class rooms etc. thereby improving the quality of education. All 54 Central Colleges, were developed by constructing hostels, class room buildings and other infrastructure facilities to a great extent in 2005. Disadvantaged villages and estates too, were provided with equal educational opportunities.

In order to improve the reading habits among school children, 4,000 libraries were established in schools under the World Bank assisted General Education Project 2.

Teaching Tamil to Sinhala speaking children and Sinhala to Tamil Speaking children, was further promoted in 2005 by providing trained teachers and text books for schools in the country. By 2005, teaching in the English medium from Grade 6 onwards was carried out in 320 selected schools. Teaching in Science Subjects at G.C.E. (A/L) in the English medium was carried out in 64 schools. In 2005, the Institute of English was established at Peradeniya including modern language laboratory facilities for the use of teachers and students.

The Department of Examination has taken initiatives to modernize the examination and assessment system to promote the acquisition of higher–order transferable skills: analysis, understanding, creativity, association, application and problem solving skills of students. In 2005, actions has been taken to develop a bank of test items and to prepare, publish and disseminate examinations guidelines specifying the expected learning competencies for GCE (O/L) and GCE (A/L) examinations.

University education was expanded in 2005. Two new universities were established; ie. the University of Visual and Performing Arts, and the Uva Wellassa University. Former Institute of Aesthetic Studies had been upgraded to a fully pledged University. The Uva Wellassa University will commence its academic programes with 3 Faculties, namely, Science and Technology, Management, and Animal Science Export Agriculture. Anticipated student capacity is 1000 students. It is planned to commence programmes in 2006 with 2005 A/L students.

The intake of students in to universities was in the range of 17,000 in 2005. While this number was around 12,000 four years ago.

Brought Para Medical Courses such as nursing, pharmacy, laboratory technicians etc. which were being conducted by the Ministry of Health under Universities and develop them to become degree earning programmes.

Universities have introduced 35 job oriented, productive, new degree programmes such as Information Technology, para-medical courses- pharmacy, nursing etc. in order to make sure every graduate find employment opportunities and to meet the requirements of the economy.

Skills Development.....

In 2005, there were 53,000 students enrolled in the public sector technical and vocational education institutions. Out of this, 11,700 were enrolled in 36 Technical Colleges, 22,400 in 200 rural Vocational Training Centers, 11, 200 in 3 National Apprentice and Industrial Training Centers and the rest in other training centers under the Ministry of Vocational and Technical Training. In 2005 there was a significant increase in enrollment of females in courses like Aluminum Fabrication, Auto Electrician, Domestic and Industrial sector wiring, which were represented by males in the past.

In 2005 the Technical and Vocational Education Commission established national training standards and accredited courses. Vocational Training sector was able to approve National Vocational Qualification System (NVQ) for 45 trade level courses.

Initial action was taken to upgrade selected 9 Technical Colleges as Colleges of Technology, and to establish the University of Vocational Technology in order to provide high level, standard, quality training for students.

Technical Colleges at Jaffna and Maradana were upgraded to the level of Colleges of Technology with the assistance of KOICA and JICA respectively.

Steps was taken to provide autonomous status to Technical Colleges at Maradana and Kandy on pilot basis in order to develop independently.

Entrepreneurship development and self-employment programmes were promoted by providing entrepreneurship training, loan facilities and awarding national certificates for National Vocational Qualification. Skills Development Project has offered Rs.17.91 million loans to 190 youths to promote self-employment at the end of 2005.

Information Technology......

Integrating Information Communication Technology (ICT), to the school curriculum is part of the declared national policy. Accordingly, ICT was included in the curriculum of Advanced Level classes in 2300 schools. Students of all streams such as science, commerce and Arts, were allowed to study ICT as a common subject. A large number of Information Technology Resource Centres were established throughout the country to provide IT education in schools. School leavers were also given an opportunity to use this facility after school hours. For the use of students, computers and other necessary equipment were made available to 1500 schools.

The intake of students in Information Technology and Computer Science related programmes were increased by 500 in 4 universities: Moratuwa, Colombo, Kelaniya and Peradeniya in 2005.

Rural youth were given an opportunity to acquire computer skills under the Nenasala" programme. 1000 Nena-Sala Centers were proposed to establish across rural landscape through out the country. Each centre is expected to provide with 4 to 10 computers to match the varying demands of the locality. Telecommunication back bone is to provide minimum of 512 Kbps connectivity to enable smooth browsing. Services of e-governance, e-commerce, are expected to serve the local community needs enabling them to break the shackles of poverty.

Gamata Thakshanaya Programme (Vidatha) aims at taking science and technology to rural areas to provide a means of developing medium and small enterprises to help solve the problem of unemployment to reduce poverty in the rural and estate sectors. Vidatha societies were established at village level. This programme facilitated the rural villagers by dissimilating the knowledge owned by research and development centers. Through this process, a dialog between scientists and villagers through the network of vidatha centers are provided. 66 Vidatha Centers provided technological knowledge for interested people in 2005.

Youth Development......

In order to promote the micro entrepreneurship among youth, 348 programmes were held in 17 districts and 10,378 youth benefited from this programme. Out of this, more than 500 became entrepreneurs and started new ventures while more than 900 improved the performance of their enterprises. More than 235 entrepreneurs obtain loans to improve their enterprises. For the promotion of cultural values, 80 talented youths were trained in the fields of dancing and singing at Belwood and Maharagama Training Centers. 822 youths got employed under the job fair conducted by the National Youth Services Council. Youths were trained in job oriented fields and facilitated to start micro enterprises entering them fully into autonomous adult life.

Sugathadasa Stadium and Welisara Navy Camp along with the indoor stadiums of Royal college, St. Joseph's College were improved according to the international standards in order to hold South Asian Games (SAF) in 2006 in Sri Lanka. The annual 31st National Sports Festival 2005 was held at the Aluvihare Stadium, Matale. A programme called “Kreeda Shakthi” was implemented to identify sports talented youths at district level to come to the national pool. 250 sportsmen/women participated in this programme in 2005.

Financial Statements - 2005

Statement of Financial Performance and Cash Flows for the year, and the Statement of Financial Position as at the end of the year 2005 with relevant explanatory "Notes" and a Statement of Contingent Liabilities have been prepared and presented by the Department of State Accounts of the General Treasury.

These Statements have been prepared in full compliance with Generally Accepted Accounting Practices. The required guidance has been obtained from Sri Lanka Accounting Standards and International Public Sector Accounting Standards. This is the first time that these Financial Statements are presented in these formats. This is indeed the first step towards preparing and presenting the Government Financial Statements on the Basis of Accrual Accounting as against the present practice of Cash Based Accounting. In designing these formats for presenting these reports, different types of formats adopted by different countries for making advanced Public Sector financial reporting had been considered and ideas were taken from them to have an advanced presentation in consistent with the classification and presentation of the Annual Budget of the Government to enable to provide the with a clear view on the Financial Performance of the Government in compared with main targets of the Annual Budget as approved by Parliament.

These financial statements encompass the financial operations of forty four Government Ministries, one hundred and six Departments and twenty five District Secretariats performed in the process of making use of the financial resources allocated to them during the year 2005 in terms of the Annual Budget. Basic information pertaining to the financial resources allocated by the Government in 2005 to eight Provincial Councils and state institutions comprising thirty Commercial Public Corporations, Public Institutions and Statutory Boards has also been furnished.

In compiling these statements, the relevant data is collected in a specially designed system making use of electronic data transmission methodologies. Through this network all financial data generated in the system gets transmitted to the central data base of the Department of State Accounts, being the Central Agency of the Government for financial information processing. In conformity with the vision of the Department to be the Centre for Excellence is in Government Financial Information, all the necessary internal controls, checks and balances and required level of supervision we maintained to maintain the integrity, accuracy and completeness of the data collected, stored and processed in order to assure the quality of information generated and furnished. Department of State Accounts is responsible for presenting the Annual Financial Statements of the Government to Parliament.

These Financial Statements are presented subject to audit.

FINANCIAL STATEMENTS

FINANCING THE BUDGET DEFICIT

70,112	000	Foreign Borrowings	**11**	64,402,747,970	73,464,714,54
(33,041)	42,316)	Foreign Debt Repayments		(18,171,926,665)	(29,959,232,951
37,071	**48,684**	**NET FOREIGN BORROWINGS**		**46,230,821,305**	**43,505,481,59**
8,681	200	Foreign Grants	**12**	8,918,113,959	3,802,849,48
45,752	**58,884**	**TOTAL FOREIGN FINANCING**		**55,148,935,264**	**47,308,331,07**
		Domestic Non-bank Borrowings	**13**	308,801,111,78 9	262,187,897,42
		Domestic Debt Repayments	**14**	(215,673,235,29 1)	(152,342,820,400
117,243	**104,761**	**NET DOMESTIC BORROWINGS**		**93,127,876,498**	**109,845,077,02**
4,680	5,782	Recoveries from On Lent Loans	**15**	10,363,597,348	15,920,556,82
2,437	7,500	Divestiture Proceeds & others		1,100,234,495	2,329,570,21
5,724		Net Change in Deposit Accounts and Liabilities		(20,566,634,713)	2,959,411,67
		(Increase)/Decrease in Cash & Cash Equivalents		5,036,866,064	(6,013,746,185
175,836	**173,936**	**TOTAL FINANCING(Excluding Tsunami Related Financing)**		**144,210,874,95 6**	**172,349,200,63**
		TSUNAMI RELATED FINANCIAL PERFORMANCE			
		RECURRENT & CAPITAL EXPENDITURE			
N.A.	10,588	Recurrent Expenditure	**16**	5,561,195,223	N.A
N.A.	36,849	Public Investments/Capital Expenditure	**17**	28,488,119,625	N.A
N.A.*	**47,437**	**TSUNAMI RELATED TOTAL EXPENDITURE**	**18**	**34,049,314,848**	**N.A.**
		FINANCING OF TSUNAMI RELATED TOTAL EXPENDITURE			
N.A.	11,800	Foreign Borrowings	**11**	8,966,929,064	N.A
N.A.	8,800	Foreign Grants	**12**	5,532,702,868	N.A
N.A.	-	Donations Received locally	**19**	#REF!	N.A
N.A.	26,837	Consolidated Fund including change in Deposit Accounts	**13**	19,395,693,360	N.A
N.A.*	**47,437**	**TOTAL FINANCING OF TSUNAMI RELATED EXPENDITURE**			**N.A.***

The accompanying Statement of Accounting Policies & "Notes" form an integral part of these Financial Statements.

Statement of Cash Flows
for the year ended 31st December, 2005

	Actual 2,005 Rs.	2004 Rs.
Cash Flows from Operating Activities		
Total Tax Receipts	345,863,828,903	274,895,082,875
Interest	16,459,588,364	8,673,259,833
Dividends	3,053,340,040	2,286,201,868
Fees, Fines, Penalties and Licenses	8,210,207,469	6,446,773,700
Profit	9,124,184,289	5,166,209,035
Other Receipts	18,566,849,715	13,647,471,463
Total Cash provided from Operations (a)	**401,277,998,780**	**311,114,998,774**
Less - Cash was disbursed to:		
Personal Emoluments & Operating Payments	(140,915,611,734)	(111,487,477,621)
Tsunami Related Payments	(5,561,195,223)	-
Subsidies & Transfer Payments	(141,998,192,853)	(122,502,206,808)
Finance Costs	(120,161,512,364)	(119,868,253,783)
Other Payments	(7,227,016,243)	(7,391,703,085)
Total Cash disbursed to Operations including Tsunami related Disbursements (b)	**(415,863,528,417)**	**(361,249,641,297)**
NET CASH FLOWS FROM OPERATING ACTIVITIES (c) = (a) - (b)	**(14,585,529,637)**	**(50,134,642,523)**
Cash Flows from Investing Activities		
Divestiture Proceeds & Sale of Physical Assets	1,100,234,495	2,329,570,215
Recoveries from On Lent Loans	10,363,597,348	15,920,556,826
Total Cash provided from Investing Activities (d)	**11,463,831,843**	**18,250,127,041**
Less - Cash was disbursed to:		
Purchase or Construction of Physical Assets &Other Investment Expenditures	(158,774,720,077)	(120,854,612,115)
Net Increase in Equity Investments in Commercial Public Enterprises	(4,899,940,090)	(1,359,946,000)
Total Cash disbursed to Investing Activities (e)	**(163,674,660,167)**	**(122,214,558,115)**
NET CASH FLOWS FROM INVESTING ACTIVITIES (f) = (d) - (e)	**(152,210,828,324)**	**(103,964,431,074)**
NET CASH FLOWS FROM OPERATING & INVESTING ACTIVITIES (g) = (c) + (f)	**(166,796,357,961)**	**(154,099,073,597)**
Cash Flows from Financing Activities		
Local Borrowings, including for Post Tsunami Related Expenditure	328,196,805,149	262,187,897,427
Foreign Borrowings, including for Post Tsunami Related Expenditure	73,369,677,034	73,464,714,546
Grants Received, including for Post Tsunami Related Expenditure	14,450,816,827	3,802,849,484
Donations Received Locally for Tsunami Related Expenditure	153,989,556	
Total Cash provided from Financing Activities (h)	**416,171,288,566**	**339,455,461,457**
Less - Cash was disbursed to:		
Repayment of Local Borrowings	(215,673,235,291)	(152,342,820,400)
Repayment of Foreign Borrowings	(18,171,926,665)	(29,959,232,951)
Change in Deposit Accounts and Other Liabilities	(20,566,634,713)	2,959,411,676
Total Cash disbursed to Financing Activities (i)	**(254,411,796,669)**	**(179,342,641,675)**
NET CASH FLOWS FROM FINANCING ACTIVITIES (j) = (h) - (i)	**161,759,491,897**	**160,112,819,782**
Net Movement in Cash (k) = (g) -(j)	**(5,036,866,064)**	**6,013,746,185**
Opening Cash Balance as at 01st January	**2,271,506,747**	**(3,742,239,438)**
Closing Cash Balance as at 31st December	**(2,765,359,317)**	**2,271,506,747**

Statement of Financial Position - As at 31st December, 2005

	Note	2005	2004
		Rs.	Rs.
Financial Assets			
Cash & Bank Balance		-	2,271,506,747
Loans to Public Officers	20	18,964,716,666	19,197,334,599
Advances to Govt. Departments	21	9,010,239,618	6,856,823,965
Foreign Aid Counterpart Funds	22	2,725,761,479	4,360,540,902
Membership Fees Paid	23	1,885,484,941	1,885,484,941
On Lent Loans	24	192,595,689,062	180,840,637,239
Capital Contribution in State Owned Enterprises	25	67,604,832,106	63,253,765,366
Total Financial Assets		**292,786,723,872**	**278,666,093,759**
Liabilities			
Bank Overdrafts		2,765,359,317	-
Advance from the Central Bank	26	39,746,300,000	34,791,100,000
Foreign Loan Revolving Funds	27	13,903,918,713	13,465,308,844
Miscellaneous Funds	28	1,166,045,668	529,646,849
Government Borrowings	29	2,101,663,030,025	2,027,634,003,798
Deposits and Other Liabilities	30	14,362,868,573	38,653,042,944
Operating Accounts with Government Departments	31	2,170,478,218	3,661,109,833
Sundry Accounts	32	2,589,381,510	46,119,074
	31		
Total Liabilities		**2,178,367,382,024**	**2,118,780,331,342**
Contingency Fund		**140,000,000**	**140,000,000**
Total Liabilities & Contingency Fund Balance		**2,178,507,382,024**	**2,118,920,331,342**
Total Liabilities and Contingentcy Fund Balance over Financial Assets		**1,885,720,658,152**	**1,840,254,237,583**
Consolidated Fund- Accumulated Deficit	33	**43,242,407,556**	**58,772,176,205**
Total Investments in Physical Assets and Accumulated Net Revenue Deficit	34	**1,842,478,250,596**	**1,781,482,061,378**
		1,885,720,658,152	**1,840,254,237,583**
Contingencies & Commitments	35	**92,893,050,000**	**91,420,000,000**

The accompanying "Statement of Accounting Policies" and "Notes" to Financial Statements form an integral part of these Financial
Statements. The Department of State Accounts is responsible for the preparation and presentation of these Financial Statements.

Sgd. P.A Pematilaka
Director General of State Accounts

Sgd. P.B.Jayasundera
Secretary, Ministry of Finance & Planning
and Secretary to the Treasury

19th April, 2006
Colombo-01.

Analysis of Total Expenses of the Statement of Financial Performance

for the year ended 31st December, 2005

By Functional Classification (Including Related Overhead Expenditure)	Actual (Rs. Million)							
	2005				2004			
	Recurrent	Capital	Total	%	Recurrent	Capital	Total	%
General Public Service	31,775	51,632	83,407	14.39	31,325	16,612	47,937	9.92
Finance Costs	120,371	-	120,371	20.77	120,048	-	120,048	24.83
Law & Order	22,469	2,152	24,621	4.25	19,030	1,882	20,912	4.33
National Defence	53,961	7,494	61,455	10.60	46,156	10,117	56,273	11.64
Economic Affairs	75,201	64,051	139,252	24.03	53,360	54,306	107,666	22.27
Environment	794	1,874	2,668	0.46	599	1,496	2,095	0.43
Housing and Community Amenities	145	17,633	17,778	3.07	203	20,134	20,337	4.21
Health	22,903	6,903	29,806	5.14	19,313	7,438	26,751	5.53
Education	20,117	9,785	29,902	5.16	15,451	8,796	24,247	5.02
Recreation, Culture and Religion	1,826	936	2,762	0.48	1,264	757	2,021	0.42
Pension Expenses	46,523	-	46,523	8.03	36,217	-	36,217	7.49
Other Social Protection Expenses	19,778	1,214	20,992	3.62	18,284	677	18,961	3.92
Total Expenses ,Including Tsunami Related Expenditure	**415,863**	**163,674**	**579,537**	**100**	**361,250**	**122,215**	**483,465**	**100**

NOTE: Figures are in accounting format for analytical work. The figures are presented in economic format prepared in compliance with Government Financial Statistic manual of the IMF

Statement of Accounting Policies

Reporting Entity....

These Financial Statements are of the Government of the Democratic Socialist Republic of Sri Lanka and encompass the Reporting Entity of the Central Government comprised of Government Ministries & Departments. Public Corporations, State Owned Enterprises, Statutory Boards and Provincial Councils are excluded. However cash outflows to those entities taken place during the reporting year and the total interest the Government is having in the Commercial Public Corporations and State Owned Enterprises in the form of capital contribution and loans granted are recognized in these Financial Statements**.**

Accounting Policies.....

These Financial Statements comply with Generally Accepted Accounting Practices. Required guidance has been obtained from Sri Lanaka Accounting Standards and International Public Sector Accounting Standards. The measurement base applied is historical cost. The cash based accounting has been used unless otherwise stated.

Reporting Period......

The reporting period of these Financial Statements is the year ended 31st December 2005

Basis of Combination....

Ministries & Departments are combined using the classification codes for revenue collected and expenditures incurred. Accordingly total financial assets, liabilities, revenues and expenses are added together line by line.

Revenue......

Central Government provides many services and benefits that do not generate to revenue. Therefore revenue is levied through Parliament by way of imposing taxes, and fees & charges.

Revenue is earned by the Government in exchange for the provision of its products and services to the society.

All such revenue collected through the relevant Ministries & Departments is recognized at the time of collection.

Investment Income is recognized in the period it is earned and collected.

Premiums and Discounts...

Premiums and discounts on the issue of a debt instrument are treated as a adjustment to the cost of borrowings.

Gains......

Related gains arising from sale of assets are recognized in the period in which transaction occurs.

Unrealized foreign exchange gains on monetary assets and liabilities are recognized in the Statements of Financial Position as at the end of the reporting period.

Expenses....

All expenses are recognized in the period in which it is incurred.

Foreign Currency Transactions......

Transactions in Foreign currencies are translated into Sri lanka Rupee using the buyer's exchange rate on the date of transaction. Exchange differences arising on settlement of these transactions are recognized in the Statement of Financial Performance.

Depreciation on Property, Plant & Equipment is not charged.

Assets...

Equity investments in State Owned Enterprises are recorded at cost but investments in Statutory Boards are not separately disclosed in the accounts as they operate like other Government Departments depending on the Government for their recurrent and capital expenditures.

Liabilities.....

In the Statement of Financial Position, all local borrowings are recorded at cost. Where foreign borrowings are subject to variation of exchange rates such foreign monetary liabilities are translated at the exchange rate as at the end of the reporting period..

Employee Entitlements.....

Employee entitlements to salaries and wages, annual leave, retiring leave and other similar benefits are recognized when they accrue to employees. Retired Government employee entitlements for their pension payments are also recognized in the same manner.

Contingent Liabilities.....

Contingent liabilities are recorded in the Statement of Contingent Liabilities at the point at which the contingency is evident.

Changes in Accounting Policies.....

Financial Statements for the year 2005 have been prepared and presented by the Department of State Accounts in a newly designed formats in order to make a fair presentation of all the relevant financial information without making any change in the fundamentals applied and all policies have been applied on a basis consistent with the previous year.

Comparatives......

To ensure consistency with the current period and classification method adopted to make a fair presentation of financial information, comparative figures have been restated where appropriate.

The Budget Outturn presented in Economic Classification under Government Financial Statistics (GFS) vary from the information presented in these Financial Statements due to the different classification methods adopted for economic analysis.