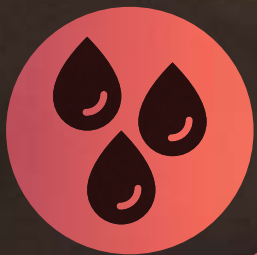


# STATE OF THE BUDGET

# 20 23

Assessment of the Fiscal,  
Financial and Economic  
Assumptions used in the  
Budget Estimates

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# STATE OF THE BUDGET 2023

## Assessment of the Fiscal, Financial and Economic Assumptions used in the Budget Estimates

April 2023

The Economics Team of Verité Research compiled this study. The report is compiled by Dr. Nishan de Mel, Sureni Weerathunga and Raj Prabu Rajakulendran. Research Assistance was provided by Navya Wijewickrema, Sumini Siyamabalapitiya, Ishini Randeniya, Portia Merlyn Kempes and Rishigaran Nagendran. Special thanks to Asita De Silva for his invaluable contribution in reviewing and editing the content of this flagship report. Cover page by Adrian Marcus.

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*State of the Budget- 2023* is a public report compiled by Verité Research, which engages a similar mandate to that of the parliamentary Committee on Public Finance (COPF). The report provides an assessment and analysis of the revenue, expenditure, macro-fiscal and governance outlook on the budget 2023. The report aims to inform a wide audience of stakeholders, including the parliament, and COPF. Verité Research anticipates that the contents of this report can improve the informed engagement, by the wider public and the parliament, with Sri Lanka's annual budget.

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# SECTION I: **INTRODUCTION TO THE REPORT**

# 1.1. Overview

This *State of the Budget* report compiled by Verité Research assesses the financial, economic, and fiscal estimates applied in the 2023 Budget Speech. The report is compiled using two principal sources of information: the 2023 Budget Speech (delivered in Parliament) and the Draft and Approved Budget Estimates for 2023 (provided by the Ministry of Finance).

*State of the Budget* is set out in four main sections. Section one provides an introduction to the report and sets out its objectives and provides some background to Sri Lanka's budget formulation process. Section two draws attention to the various information deficiencies in the budget. These deficiencies include the lack of clarity, and differences in numbers and assumptions presented across different fiscal classifications.

The analysis of budget allocations is mainly in Sections three and four. Section three provides an analysis of the revenue estimates provided in Sri Lanka's 2023 Budget. The focus in this section is primarily on tax revenue, and it is divided into four main categories: (1) taxes on income and profits, (2) taxes on domestic goods and services, (3) taxes on international trade and (4) license taxes and others.

Section three contrasts certain revenue estimates made by Verité Research against those set out in the government budget. The 2023 budget proposes a target of LKR 3,130 billion in tax revenue which is a 69 percent increase from the revised estimates of 2022. Verité Research projects a tax revenue of LKR 2,762 billion, which is 12 percent lower than the projection made by the government.

Section four focuses on expenditure estimates. Three key areas highlighted in this section are (1) interest payments, (2) personal emoluments and (3) capital expenditure. Based on the estimates provided by the government, total expenditure for 2023 is estimated to be LKR 5,854 billion. Limited alternative estimates by Verité Research show an increase in personal emoluments and a decrease in capital expenditure.

Through the dissemination of the research findings of this report, Verité Research seeks to encourage and promote public engagement, accountability and informed decision making in the Annual Budget process in Sri Lanka.

'State of the Budget 2023' will be hosted on the online platform PublicFinance.lk.

## 1.2. Background

The 2023 budget formulation and approval process offered the government the opportunity to announce policies and fiscal measures intended to help navigate the country out of the prevailing economic crisis and steer the long-term development of the country. As stated in the budget speech, the announced policy measures sought to restore macroeconomic stability, alleviate the immediate negative consequences of the crisis on the public, and generate economic growth.

The ability of the public to understand and engage with the budget hinges on the quality of information, assumptions, and estimates that underpin the proposals. In the past, many approved budget proposals were altered because the estimates and assumptions that the budget was based on were later found to be defective. In 2022, additional measures were also be introduced to increase revenue in an effort to control the ongoing crisis. However, these measures have generally been ineffective and failed to address the underlying structural weaknesses in government administration, including poor budgetary governance.

Ad-hoc revisions are costly and are essentially failures of public finance management. They are also disruptive and increase risks to the economy. Sri Lanka can reduce these negative consequences through informed analysis at the point of budget formulation, and robust engagement with parliament and citizens. Currently, these opportunities are curtailed by the lack of information disclosure.

The 2023 budget was presented to the parliament on November 14<sup>th</sup>, 2022, by President Ranil Wickremesinghe.<sup>1,2</sup> The annual budget is the key framework for public financial management (PFM) to plan, monitor, and control the collection and expenditure of public funds. This makes the budget a matter of public interest where the public can reasonably seek explanations and clarifications from the Ministry of Finance (MoF) regarding the formulation and implementation of the budget.

1 Ranil Wickremesinghe is also the Minister of Finance.

2 Ministry of Finance, Budget Speech 2023 (2022) at <https://www.treasury.gov.lk/api/file/192322fd-7967-49d8-ad59-6046470d68c8>.



# SECTION 2: INFORMATION DEFICIENCIES IN THE BUDGET

This section lays out the information deficiencies that posed challenges to the compilation of this report in an accurate and timely manner, and the measures taken to address them. The challenges included: (i) the lack of clarity on certain key macro-fiscal assumptions; (ii) irreconcilable differences in numbers presented across different classifications and formats; and (iii) missing estimates of fiscal consequences relating to the budget proposals and/or associated documentation.

## 2.1. Lack of clarity on key macro-fiscal assumptions

**Real GDP Growth:** The budget speech does not provide a real GDP growth projection for 2023. The Ministry of Finance (MoF), in its creditor update for 2022 (published in September 2022), estimated a real GDP contraction of 8.7 percent in 2022 and 3 percent in 2023.<sup>3</sup> This is in line with the contraction estimates of the International Monetary Fund (IMF), but lower than the contraction estimates of the World Bank (WB) of 4.2 percent for 2023. For the purposes of this analysis, Verité Research considers it reasonable to adopt the growth forecasts of the MoF and the IMF.

**Inflation:** The budget speech does not provide inflation for 2022 or expected inflation for 2023. However, a statement in the macro-fiscal framework suggests that the government expects inflation to return to mid-single digit figures in the medium term.

Over the course of 2022, Sri Lanka experienced a large increase in year-on-year (YoY) inflation – although the rate did begin to decline after October 2022. The Colombo Consumer Price Index (CCPI) recorded YoY inflation at 66 percent for October 2022 and reported that inflation was expected to remain at elevated levels (above 50 percent) through the first quarter of 2023.

In this report, Verité Research adopts the inflation estimates presented in the MoF creditor update (published in September 2022).

**Table 1: Macro-economic and financial assumptions: real GDP growth rate and inflation, presented by various sources (2022, 2023)**

	2022			2023		
	MoF – Creditor Update	IMF	WB	MoF – Creditor Update	IMF	WB
Real GDP growth rate (%)	-8.7	-8.7	-9.2	-3.0	-3.0	-4.2
Inflation rate (%) - Monthly average	48.2	48.2	45.6	29.5	29.5	23.8

Sources: Ministry of Finance-Creditor Update September (2022), Ministry of Finance – Budget Speech 2023, IMF-World Economic Outlook (October 2022 and January 2023), WB-South Asia Overview (October 2022)

3 Central Bank of Sri Lanka and Ministry of Finance, Economic Stabilization and National Policies, Investor Presentation (23<sup>rd</sup> September 2022) at, <https://www.treasury.gov.lk/api/file/3816b192-2bd9-4587-9c69-53e54a3394de>.

**Nominal GDP Growth:** Historically, budgets in Sri Lanka have failed to explicitly quantify expected GDP for the forthcoming year. However, the GDP figures for the fiscal years of 2022 and 2023 can be imputed as the 2023 budget provides nominal values for revenue, expenditure, and the deficit, while also providing the same as a percentage of GDP. Table 2 details the imputed figures.

**Table 2: Imputed GDP, 2022 and 2023**

		2022	2023
<b>Total Revenue and Grants</b>	In LKR BN	2,094	3,415
	% of GDP	8.8%	11.3%
	<b>Imputed GDP</b>	<b>23,795</b>	<b>30,221</b>
<b>Total Expenditure</b>	In LKR BN	4,427	5,819
	% of GDP	18.6%	19.2%
	<b>Imputed GDP</b>	<b>23,801</b>	<b>30,307</b>
<b>Budget Balance</b>	In LKR BN	2,333	2,404
	% of GDP	9.8%	7.9%
	<b>Imputed GDP</b>	<b>23,806</b>	<b>30,430</b>
<b>Average Nominal GDP*</b>	in LKR BN	23,801	30,320

Sources: Budget Estimates 2023

\*Calculated as the average of the imputed GDP based on revenue, expenditure and deficit targets for 2022-2023.

In summary, the economic assumptions used in this report to assess the implications of the 2023 Budget are as follows.

**Table 3: Macro-economic and financial assumptions of this report**

(%)	2021	2022	2023
<b>Real GDP Growth</b>	3.3	-9.2	-4.2
<b>Inflation</b>	5.9	48.2	29.5
<b>Nominal GDP Growth*</b>	11.7	34.6*	27.4*

Sources: Authors' calculations, WB, CBSL and MoF<sup>4</sup>

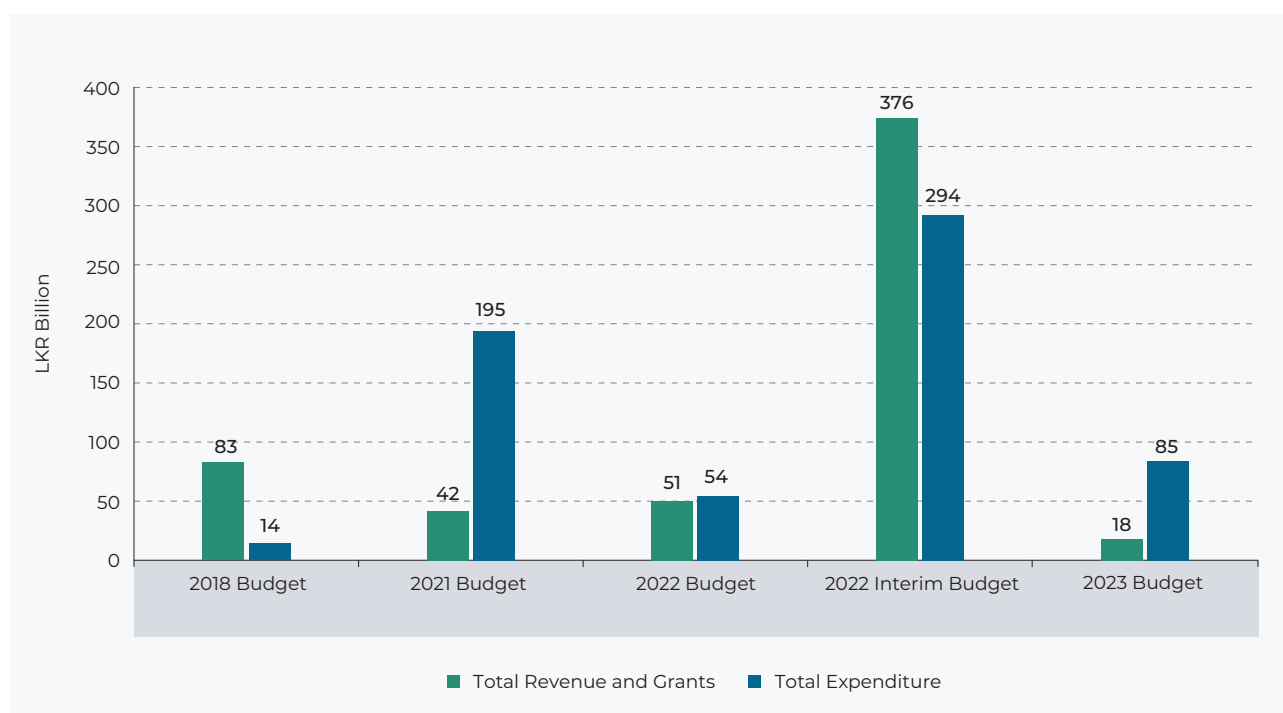
\* Table 2 for reference

4 Central Bank of Sri Lanka and Ministry of Finance, Economic Stabilization and National Policies, Investor Presentation (23<sup>rd</sup> September 2022) at, <https://www.treasury.gov.lk/api/file/3816b192-2bd9-4587-9c69-53e54a3394de>

## 2.2. Irreconcilable differences in numbers presented across different classifications and formats

A recurring problem with the budget documents provided to parliament on the day of the Budget Speech is that there are persistent deficiencies in the reported figures (see Figure 1). Generally, there tend to be mismatches in the figures reported across reports (or even within the same report) and mismatches in the macro-economic assumptions used across reports. Some reasons leading to such deviations include, (i) the introduction of new budget proposals into the Budget Speech after the Budget Estimates are produced, and (ii) different classification formats followed in the Budget Speech and Budget Estimates. The Budget Speech follows the economic classification, while the Budget Estimates follow the accounting classification.

**Figure 1: Sum of the deviations of mismatching figures reported in the Budget Speech and Draft Budget Estimates 2018 – 2023 (LKR billion)**



Sources: Authors' calculations using the Budget Speech and Draft Budget Estimates 2018-2023

These inconsistencies are a violation of parliamentary informational standards and due diligence.<sup>5</sup> The problem is compounded by the fact that parliament does not have the means to reconcile the information provided in different formats and classifications.

<sup>5</sup> Committee on Public Finance, Committee on Public Finance Report on Budget 2019 (2018) at <https://www.parliament.lk/uploads/comreports/1554455725098505.pdf>.

In 2021, Verité Research suggested several measures that could be adopted to resolve such issues.<sup>6</sup> For example, the MoF could provide a detailed breakdown of the budget proposals that are new in the budget speech in the same structure as in the draft budget estimates, which would then allow the figures to be reconciled. Further, the challenges associated with the mismatch in figures due to differences in reporting formats could be significantly reduced by providing additional explanatory information on the deviations, which would then allow for better interpretation of the data notwithstanding the different reporting formats.

In 2023, the total revenue and expenditure figures reported in the Budget Speech differ from that of the Budget Estimates. A detailed breakdown of these differences is presented in Table 4.

**Table 4: Mismatch of revenue estimates in the 2023 Budget (LKR billion)**

Budget Speech <sup>7</sup>		Budget Estimates		Comparability
Revenue Component	Value	Revenue Component	Value	
Total revenue and grants	3,415	Total revenue and grants	3,433	Not reconcilable (18)
Tax revenue	3,130	Tax revenue	3,040	Not reconcilable 90
o/w Taxes on external trade	455	o/w Taxes on international trade	457	Not reconcilable (2)
o/w Taxes on goods and services	1,763	o/w Taxes on domestic goods and services	1,650	Not reconcilable 93
		o/w Licence taxes and other	20	
o/w Income tax	912	o/w Taxes on incomes and profits	912	Reconcilable
Non-tax revenue	278	Non-Tax revenue	320	Not reconcilable (42)
Provincial council tax sharing and devolved revenue	0	Provincial council tax sharing and devolved revenue	67	Not reconcilable (67)
Grants	7	Grants	7	Reconcilable

Source: Authors' calculation using Budget Speech 2023 and the Draft Budget Estimates 2023

**Table 5: Mismatch of the expenditure estimates in the 2023 Budget (LKR billion)**

Budget Speech		Budget Estimates		Expenditure Proposals	Comparability
Expenditure Component	Value	Expenditure Component	Value	Value	
Total Expenditure	5,819	Total Expenditure	5,854	49	Not reconcilable (85)
Recurrent Expenditure	4,609	Recurrent Expenditure	4,634		
o/w Salaries & wages	1,002	o/w Personal emoluments	702		Not reconcilable (300)
o/w Goods & services	300	o/w Goods & services	541		Not reconcilable (241)
o/w Interest	2,193	o/w Interest	2,189		Not reconcilable (4)
o/w Subsidies and transfers	1,114	o/w Transfers	1,202		Not reconcilable (88)
Public investment	1,220	Capital expenditure	1,220		Reconcilable
Other	(10)				Not reconcilable (10)

Sources: Authors' calculations using Budget Speech 2023 and the Draft Budget Estimates 2023

<sup>6</sup> Verité Research, Public Report on the 2021 Budget (2020) at <https://www.veriteresearch.org/publication/public-report-2021-budget-eng/>.

<sup>7</sup> The 2023 Budget Speech did not have any quantified revenue proposals.

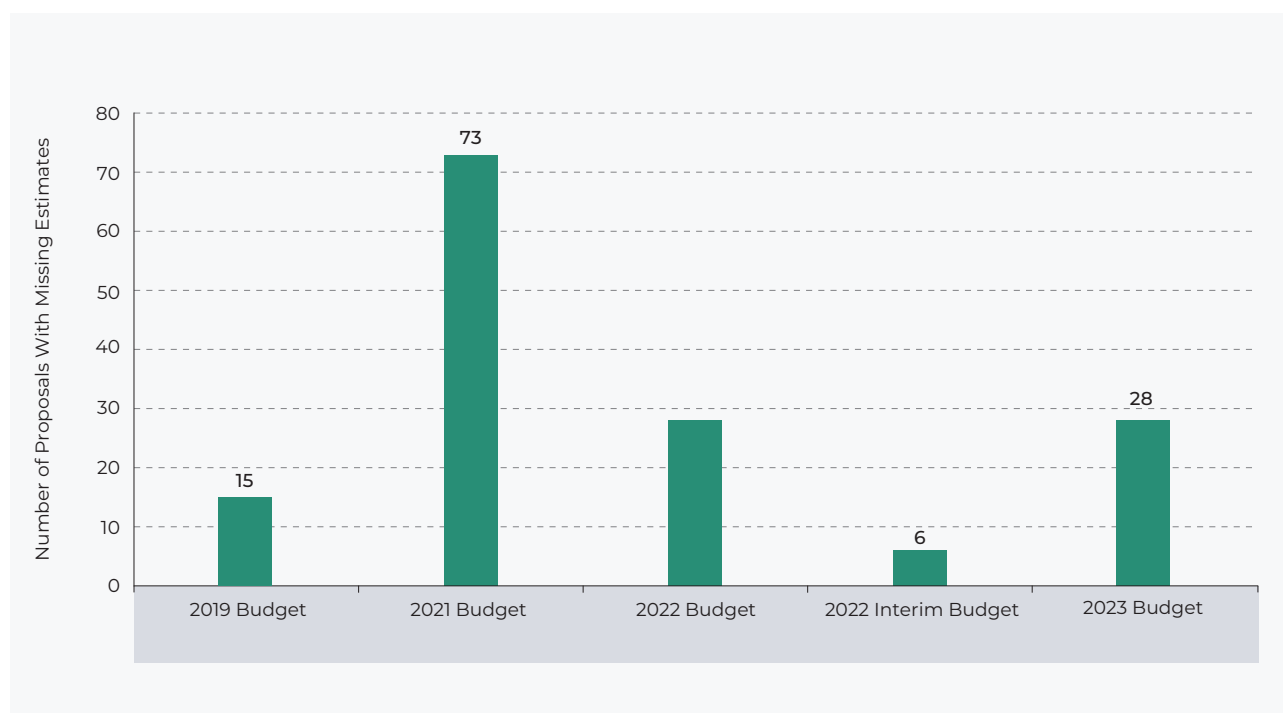
The total revenue and grants figure reported in the 2023 Budget Speech is LKR 18 billion lower than what is reported in the Draft Budget Estimates. Generally, the difference arises in the opposite direction, due to new revenue proposals being brought into the budget after the budget estimates are produced. However, for the year 2023, the budget failed to quantify any additional revenue generated by new revenue proposals in the budget. Therefore, the reduction of LKR 18 billion in the budget speech is unaccounted.

Similarly, the total expenditure figure reported in the 2023 Budget Speech is LKR 85 billion lower than what is reported in the Draft Budget Estimates. The budget does not provide an explanation for the reduction, and also fails to quantify the additional expenditure incurred by new expenditure proposals in the budget speech. Therefore, the reduction of LKR 85 billion in the budget speech is inexplicable.

## 2.3. Missing estimates of fiscal consequences relating to budget proposals

Another recurrent problem across most Sri Lankan budgets is the introduction of budget proposals where their fiscal consequences are either absent or obfuscated (see Figure 2). In principle, every proposal set out must be considered in terms of its estimated fiscal impact in order to facilitate a holistic understanding of the implications of the proposed policy.

**Figure 2: Total number of proposals introduced with missing estimates of fiscal consequences, 2019-2023**



Sources: Budget Speech 2023

Note: The absolute values on top of the bar represent the number of proposals with missing estimates.

As evident, the 2023 budget is no exception; 28 proposals introduced in the 2023 Budget Speech did not lay out the fiscal consequences of those measures adequately. These proposals could be assigned to two general categories: (i) fiscal measures with undisclosed or obfuscated consequences; and (ii) fiscal measures with unquantified positive/negative consequences.

### 2.3.1. Fiscal measures with undisclosed or obfuscated consequences

At least three of the fiscal measures introduced in the 2023 Budget had unclear revenue and expenditure consequences.

**Table 6: Proposals in the 2023 Budget with undisclosed consequences**

No.	Policy Proposal in the Budget Speech
1	Enact a new, updated and unified labour law in a manner to benefit both employer employee segments and the economy.
2	Gradually increase the percentage of admissions to state universities on island wide merit basis from 40 percent to 50 percent with effect from the academic year 2023 / 2024.
3	Allow armed forces personnel, other than special categories, to retire after 18 years of service

Sources: Budget Speech 2023

### 2.3.2. Fiscal measures with unquantified negative consequences/ Negative fiscal measures with missing estimations

The 2023 Budget Speech consisted of four revenue-reducing proposals with missing estimates and a total of 18 expenditure proposals (compared to the previous year's 14) with no allocations. This continues from poor budgeting practices in 2022, where 4 revenue-reducing proposals lacked quantification and 14 expenditure proposals had no allocation.

**Table 7: Revenue-reducing proposals in the 2023 Budget with unquantified consequences**

No.	Policy Proposal in the Budget Speech
1	CESS levy will be eliminated on a phased basis in three years commencing January 01 2023
2	Ports and Airports Development Levy, suggested to be phased out completely in five years
3	In order to promote the production of electricity using renewable energy and to encourage the local production of related solar panels' solar panels used to produce solar energy under the combined classification code 8541.10 and inverters under the combined classification code 8504.40 are currently under taxation on imports. It is proposed to remove Ports and Airport Development Levy and Social Security Levy effective 01.01.2023
4	Social security contribution levy will be waived for organisations that assemble motor vehicles and add at least 25% local value and produce the required parts locally

Sources: Budget Speech 2023

**Table 8: Expenditure proposals in the 2023 Budget with missing estimates**

No.	Policy Proposal in the Budget Speech
1	Establish an International Trade Office to deal with all the international trade negotiations
2	Facilitate promotion of adventure sports such as water rafting in order to popularize Sri Lanka as a destination for sports tourism
3	Information on all agricultural and livestock products of household units should be obtained through an online process and the National Food Security Program should be planned accordingly. This program should be implemented by the National Food Security and Nutrition Unit



No.	Policy Proposal in the Budget Speech
4	Establish a comprehensive Web-based National Development Information System within the NOC as the supportive tool for obtaining updated data and information for decision-making
5	Suggested to commence a joint venture project at a suitable location in the Puttalam - Mannar coastal region
6	Establish a communication technology system for the coordination with all registered electric vehicle component manufacturers and approved local electric vehicle assemblers to ensure local value addition and use of locally produced electric vehicle components under the Ministry of Industry
7	Actions will be taken to provide solar panels to religious places with assistance from foreign sources and the government
8	Upgrade Badulla, Kurunegala and Polonnaruwa hospitals as teaching hospitals
9	Re-implement the Paying Wards System in government hospitals. As the first phase, this system will be established in national and base hospitals
10	Appoint a committee involving experts and relevant officials in the industry to examine and report to the Cabinet of Ministers on the requirement for furtherance of the digital technology industry
11	Appoint a committee comprising the Ministry of Industry, Ministry of Environment, Geological Survey and Mines Bureau, National Agency for Public Private Partnership (NAPPP) and related institutions to formulate and implement an appropriate policy on how the known mineral resources could be effectively utilized for national development
12	Appoint a Presidential Commission to review all the aspects of public service in line with current requirements and make recommendations including necessary reforms
13	Establish a Presidential Commission on Taxation to study and make recommendations on the functioning, coordination and changes to be made in the tax structure, the institutions, procedures etc
14	The government is committed to implement the Personal Data Protection Act No. 9 of 2022 and will take steps to set up the Data Protection Authority in 2023
15	Establish a National Operations Centre (NOC) under the Department of Project Management and Monitoring of the Ministry of Finance for tracking implementation issues of all development interventions of the country and resolve emerging issues on a priority basis
16	Establish a Microfinance and Credit Regulatory Authority
17	Set up a Presidential Task Force to carry out monitoring functions to expedite implementation of all budget proposals
18	Provide opportunities for 75 graduates with excellent degree performances at state universities from selected degree courses to follow post-graduate degrees in recognized foreign universities. The required financial support for the purpose will also be obtained from the private sector and foreign donor agencies

Sources: Budget Speech 2023

### 2.3.3. Fiscal measures with unquantified positive consequences/Positive fiscal measures with missing estimations

The 2023 Budget Speech also has eight fiscal measures that have a positive fiscal impact but are lacking estimates on the magnitude of this impact. Seven are revenue-generating proposals that aim to improve revenue generation and tax administration, while one is an expenditure management proposal that aims to contain government expenditure, although its expected fiscal impact is unquantified.

**Table 9: Revenue-generating proposals in the 2023 Budget with unquantified consequences**

No.	Policy Proposal in the Budget Speech
1	Crude estimates suggest that the revenue forgone due to the VAT exemptions granted to various sectors, including electricity, transport and fuel, is estimated to be more than 1 percent of GDP. It is proposed to remove certain exemptions after reviewing. Amendments to the VAT Act to remove certain exemptions will be made effective from 01 April 2023.
2	Impose a tax of Rs. 2 per Beedi stick.

3	Other fees payable for obtaining certificates and licences for Beedi will be increased.
4	Revising the current rates of Customs Import Duty from 0%, 10% and 15% to 0%, 15% and 20% to accommodate the proposed phasing out of para-tariffs / levies effective from January 01, 2023.
5	Increase fees and charges by 20 percent with effect from 2023. Fees and charges that have already been increased in the years of 2020,2021, and 2022 will not be revised.
6	Increase fees levied by the Department of Immigration and Emigration on Passport, Visa and other charges.
7	Establish a Road Maintenance Fund by charging an annual fee not less than Rs. 100 per vehicle when obtaining revenue licenses.

Sources: Budget Speech 2023

**Table 10: Expenditure management proposals in the 2023 Budget with unquantified consequences**

No.	Policy Proposal in the Budget Speech
1	It is proposed to stop PAYE / APIT tax liability of employees at State-Owned Enterprises (SOEs) effective from 1 January 2023.

Sources: Budget Speech 2023

## 2.4. Recommendations

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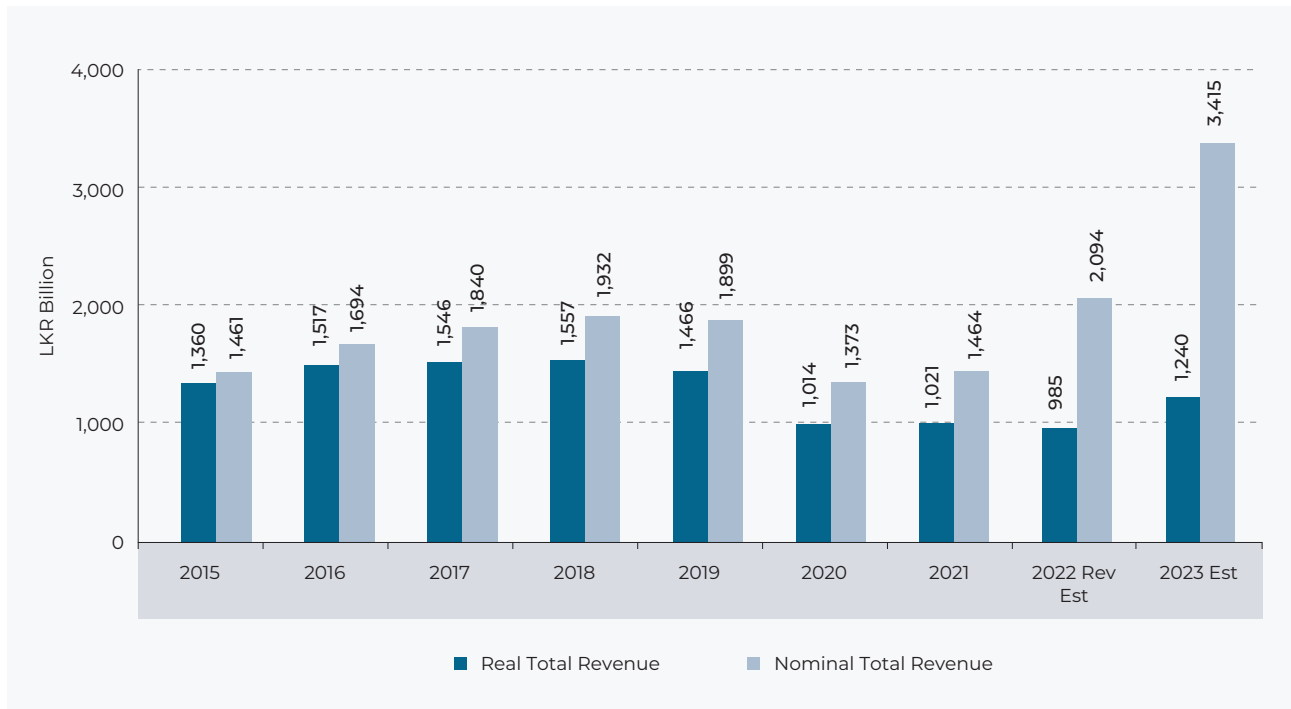
Verité Research makes the following recommendations to minimize the persistent information deficiencies characteristic of Sri Lankan budget documents:

- a.** The MoF should provide a detailed breakdown of the classification of revenue and expenditure in the Budget Speech, or it should provide a complete reconciliation/explanation of the differences between the figures reported in the Budget Speech and the Budget Estimates.
- b.** The MoF should provide additional explanatory information on any reported deviations across documents. This would allow for better interpretation of the data notwithstanding the different reporting formats.
- c.** Each proposal introduced in the Budget Speech must have a corresponding budget allocation.

# SECTION 3: **REVENUE OUTLOOK**

In 2020, both real and nominal revenue fell below 2015 figures. Since then, real revenue has remained below 2015 levels. With rising inflation, the path of nominal and real revenue has diverged sharply since 2022. Nominal revenue was estimated to increase by 43 percent in 2022, while real revenue was estimated to decline by 3.5 percent.

**Figure 3: Total nominal and real government revenue, 2015-2023**

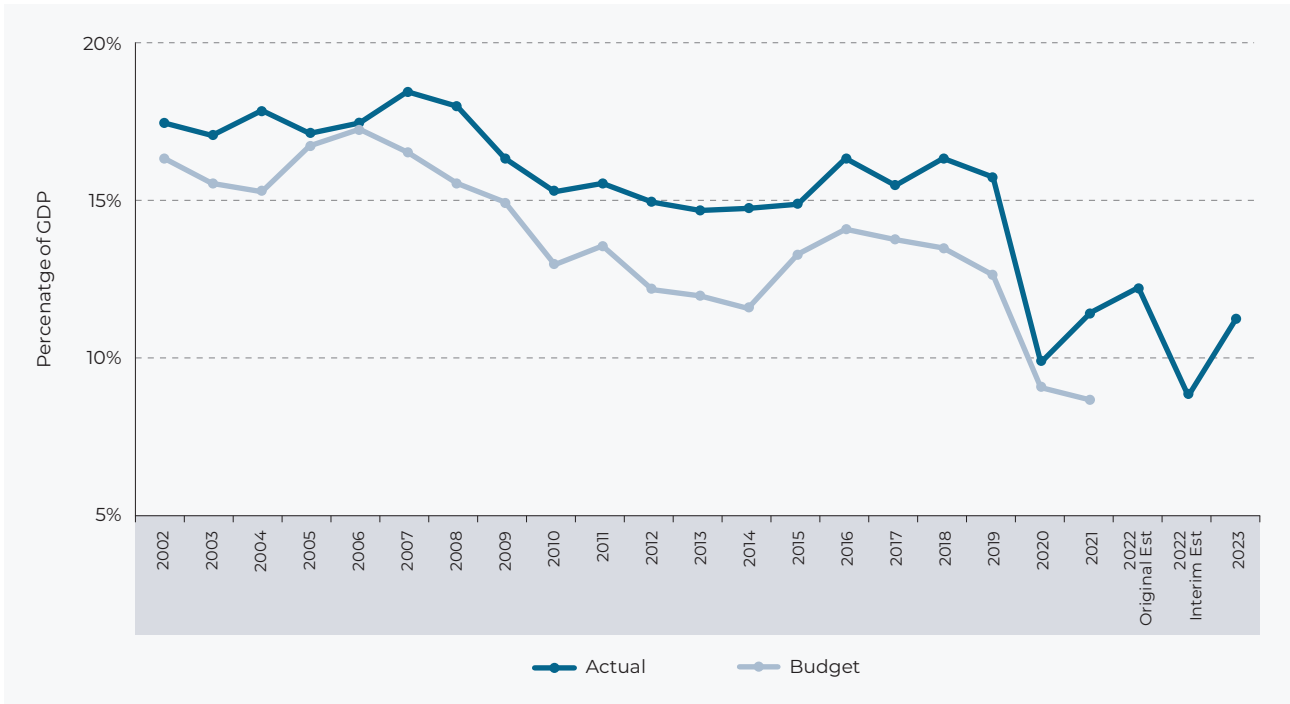


Sources: Budget Speech 2015-2023, CCPI from CBSL

Notes: 2010=100 rupees; 2019 and 2020 nominal expenditure adjusted for accounting error (Annexure 01)

It is unlikely that the government will be able to achieve its total revenue target for 2023 (see Figure 4). According to the 2023 Budget Speech, the government plans to raise LKR 3,415 billion in overall revenue in 2023. In nominal terms, this would be a 63 percent increase over the revised revenue estimate for 2022. Furthermore, when looking at the historical data for the past 20 years, the government has consistently failed to reach its revenue targets (see Figure 4). Therefore, this past record along with closer scrutiny of the expected sources of revenue (discussed below) suggests that it is unlikely that the government will achieve its revenue target for 2023.

**Figure 4: Budgeted versus actual government revenue as a percentage of GDP, 2002-2023**



Source: Budget Speech 2002-2023, CBSL

The sections below examine and scrutinise the revenue estimates provided in the 2023 budget for various revenue sources. The estimates are evaluated in the context of historical budget figures, policy changes introduced in the 2023 Budget Speech, and recent economic events.

## 3.1. Tax revenue

The government projects a total tax revenue of LKR 1,852 billion for 2022 and LKR 3,130 billion for 2023. This projected figure for 2023 is 69 percent higher than the revised 2022 estimates and 141 percent higher than the actual tax revenue in 2021 (see Table 9). Verité Research projects total tax revenue in 2023 to be LKR 2,762 billion, which is 12 percent lower than the government's tax revenue estimate of LKR 3,130 billion (see Table 10).

The following sections examine the government's estimates and provide alternate estimates by Verité Research across four categories of tax revenue: (i) taxes on income and profits; (ii) taxes on domestic goods and services; (iii) taxes on international trade; and (iv) licence taxes and other.

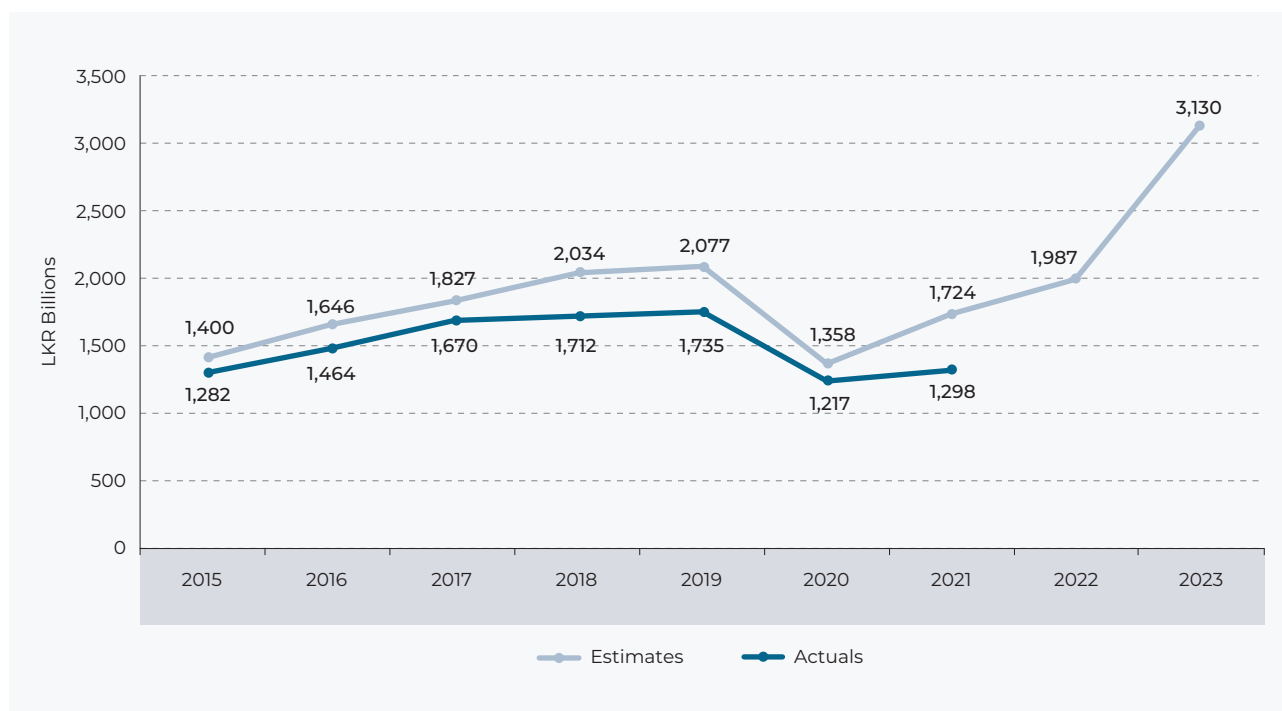
**Table 11: Total Tax revenue projections (LKR billion) 2021-2023**

Item	2021 Actuals	2022 Revised Estimates	2023 Estimates	Y-o-Y Growth	
				2021-2022	2022-2023
Tax Revenue	1,298	1,852	3,130	43%	69%
Taxes on Income and Profits	302	558	912	85%	63%
Income Tax	250	471	597	89%	27%
Taxes on Goods and Services	631	960	1,740	52%	81%
Taxes on International Trade	353	325	458	-8%	41%
Licence Taxes and Other	12	9	20	-30%	129%

Sources: Budget Estimates 2023 and Budget Speech 2023

**Table 12: Government versus Verité Research tax revenue projections (LKR billion) 2022-2023**

	MoF Projections		Projections by Verité Research	
	2022	2023	2022	2023
Total Tax Revenue	1,852	3,130	1,678	2,762

**Figure 5: Estimated versus actual government tax revenue 2015-2023**

Sources: Budget Estimates 2015-2023

### 3.1.1. TAXES ON INCOME AND PROFITS

**Table 13: Government revenue on taxes on income and profits, figures and estimates (LKR billion) 2021-2023**

	Revenue Estimates			Increase from 2022	
	2021 Actuals	2022 Revised Estimates	2023 Budget Estimates	Total Change from 2022	Y-o-Y% Increase in Revenue
Taxes on Income and Profits	302	558	912	354	63%
o/w Corporate Tax	252	475	603	128	27%
o/w Non-Corporate Tax	36	53	215	162	306%
o/w Other	14	30	94	64	213%

Sources: Authors' calculations using Budget Estimates 2023

#### 3.1.1.1. Corporate Tax

According to the 2023 budget documents, corporate tax revenue for 2023 is expected to be LKR 603 billion which is 27 percent higher than the revenue figure for 2022, which was LKR 475 billion.

In the past, corporate tax revenue has fluctuated significantly in response to government policy changes. In 2022, a major revision to Corporate Tax rates was announced in the Inland Revenue Amendment Bill, October 11, 2022, with the standard tax rate being increased from 24 percent to 30 percent effective October 1<sup>st</sup>, 2022.



Verité Research projects corporate tax collection to be LKR 516 billion in 2023, which is 14 percent lower than the government's corporate tax revenue estimate of LKR 603 billion.

**Table 14: Corporate Tax Revenue Projections (LKR billion), 2022-2023**

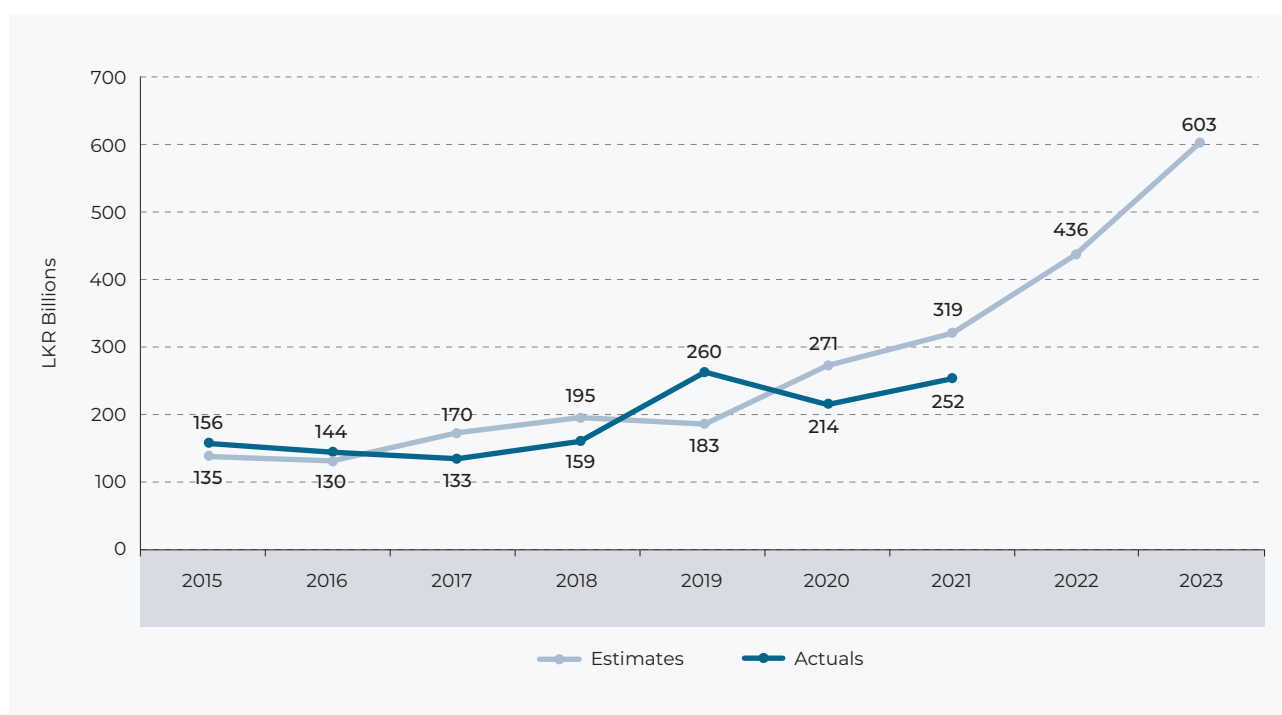
	MoF Projections		Projections by Verité Research	
	2022	2023	2022	2023
Corporate Tax	475	603	360	516

Sources: Authors' calculations and Budget Estimates 2023

**Table 15: Corporate tax growth rate and average shortfall 2015-2021**

	Average Growth Rate	Average Shortfall from Approved Budget Estimations
Corporate Tax	11 %	2%

**Figure 6: Estimates versus actual corporate tax revenue 2015-2023**



Sources: Budget Estimates 2015-2023

These figures were derived by adjusting (increasing): (i) 2021 actual revenue collection by the nominal GDP growth of 2022, which is 34.6 percent; and (ii) the 2021 4<sup>th</sup> quarter revenue to account for the revision to the corporate tax rate (24 percent to 30 percent). Thereafter, the 2023 revenue was projected by adjusting (increasing) the projected revenue collection for 2022 (excluding corporate tax rate change adjustment), using the projected nominal GDP growth of 2023, which is 27.4 percent, and accommodating the increase in tax collection due to the revision to the corporate tax rate (24 percent to 30 percent).

**Table 16: Verité Research corporate tax revenue projections (LKR billion) 2022-2023**

		LKR Billion
<b>Year 2022</b>		
2021 actual corporate tax collection		252
(+) Nominal GDP growth 2022	34.6%	88
2022 tax collection prior change in tax structure		<b>339</b>
(+) Corporate tax rate changed from 24% to 30%	25% increment only in Q4	21
Projected Revenue for 2022 (VR)		<b>360</b>
<b>Year 2023</b>		
2022 tax collection prior change in tax structure		<b>339</b>
(+) Nominal GDP growth 2023	27.4%	93
		<b>432</b>
(+) Corporate tax rate changed from 24% to 30%	25% increment	<b>84</b>
Projected Revenue for 2023 (VR)		<b>516</b>

Source: Authors' calculations using Budget Estimates 2023

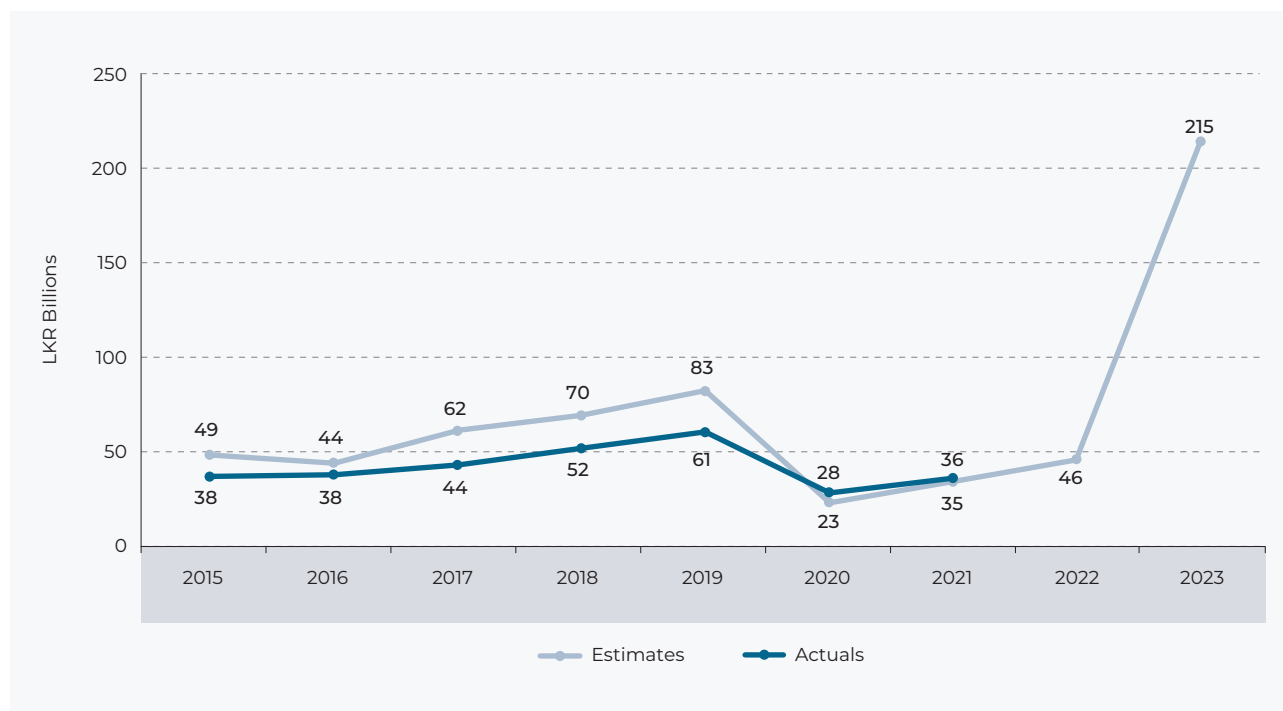
### 3.1.1.2. Non-Corporate Tax

The government estimates non-corporate tax revenue<sup>8</sup> to be LKR 46 billion in 2022 (revised) and LKR 215 billion in 2023. The estimate for 2023 is a 306 percent increase from 2022. Non-Corporate tax policy reforms were not introduced in the 2023 Budget Speech. Although there are no non-corporate tax policy changes in the 2023 Budget Speech, administrative reforms are expected to increase non-corporate tax revenues by 158 percent.

A quantification of such administrative measures has not been provided by the MoF. In the past, non-corporate tax revenues were largely driven by the Pay-As-You-Earn (PAYE) tax. Between 2015-2019, non-corporate tax revenue increased by an average of 13 percent a year. However, in 2020, several major tax policy changes such as abolishing the PAYE tax, raising the tax-free threshold and lowering tax rates for each income category led to a non-corporate tax decline of 53 percent.

Estimates for non-corporate tax collection have improved in the last two years. Whereas in 2015-2019, the average shortfall in non-corporate tax collection was 24 percent below approved budget estimates. In 2020 and 2021, actual non-corporate tax collection exceeded estimates by 24 percent and 4 percent respectively (see Figure 7).

8 Non-corporate tax revenue consists of personal income (PAYE) tax and other taxes.

**Figure 7: Estimates versus actual non-corporate tax revenue 2015-2023**

Source: Budget Estimates 2015-2023

**Table 17: Non-corporate tax growth rate and average shortfall 2015-2021**

	Average Growth Rate	Average Shortfall from Approved Budget Estimations
Non-corporate Tax	4%	13%

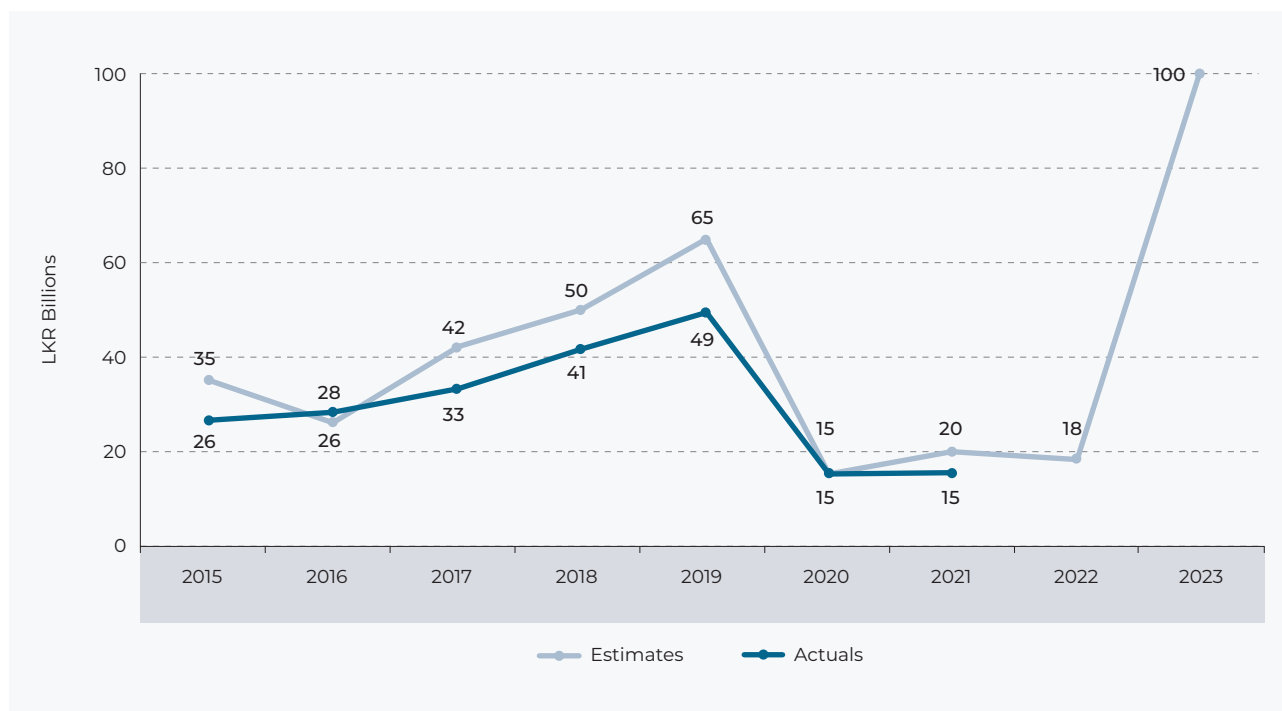
Verité Research does not attempt to calculate an alternative estimate for non-corporate tax collection in 2022 and 2023.

### Pay-As-You-Earn (PAYE) Tax

In conjunction with several other major tax policy revisions, PAYE tax collection was abolished in 2020 and replaced with Advanced Personal Income Tax (APIT). This resulted in the share of PAYE tax in non-corporate tax revenue to drop from 76 percent (2015-2019 average) to 42 percent in 2021. PAYE tax collection was reinstated in October 2022 with the intention of collecting revenues starting from November 2022, but it came into effect only from January 2023.

In the Budget for 2023, the government estimates PAYE tax collection to be LKR 35 billion in 2022 and LKR 100 billion in 2023. This means, in 2023, PAYE tax collection would account for 47 percent of non-corporate tax revenue.

Figures from previous years indicate a tendency of government to overestimate PAYE revenue, with an average annual shortfall in PAYE revenue of 15 percent (see Figure 8 and Table 18).

**Figure 8: Estimates versus actual PAYE tax revenue 2015-2023**

Source: Budget Estimates 2015-2023

**Table 18: PAYE tax growth rate and average shortfall 2015-2021**

	Average Growth Rate	Average Shortfall from Approved Budget Estimations
PAYE tax	0.4%	15%

Verité Research does not attempt to calculate an alternative estimate for PAYE tax collection in 2023. However, an alternative estimate is calculated for 2022 to correct for the delayed implementation of the policy reinstatement. The approach followed to estimate a more accurate revenue figure is detailed in Table 19. Verité Research estimates PAYE tax collection to be LKR 21 billion in 2022. This is 40 percent lower than the government's estimate.

**Table 19: Verité Research PAYE tax revenue projections (LKR billion) 2022**

	2022	
Expected PAYE for 2022		35
(-) PAYE collection under new tax structure for Nov/ Dec	$(100/12) * 2$	16.67
Balance: PAYE collection under old tax structure for 10 months		<b>18.33</b>
(+) PAYE collection under old tax structure for Nov/ Dec	$(18.33/12) * 2$	3.06
Total projected PAYE Collection for 2022		<b>21.38</b>

Source: Authors' calculations using Budget Estimates 2023

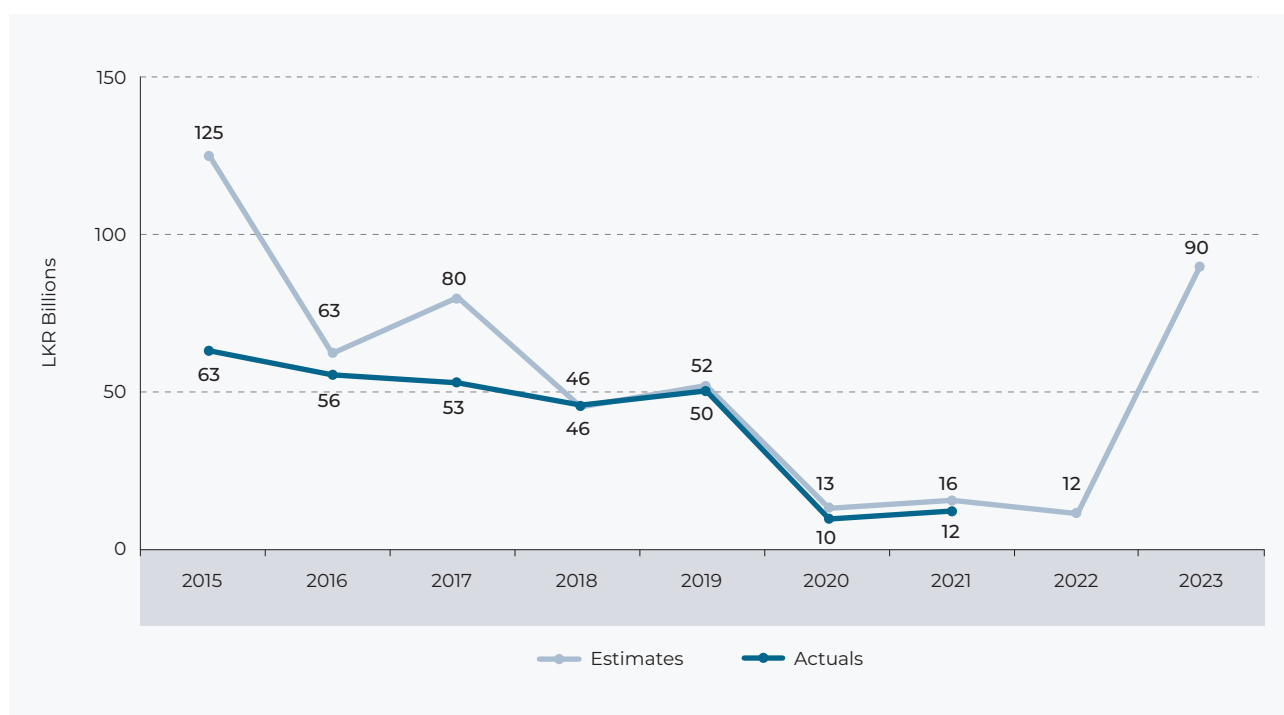
**Table 20: Verité Research PAYE tax revenue projections (LKR Billion) 2022-2023**

	MoF Projections		Projections by Verité Research	
	2022	2023	2022	2023
PAYE	35	100	21	100

### 3.1.1.3. Withholding Tax (WHT)

The government estimates WHT revenue to be LKR 25 billion in 2022 and LKR 90 billion in 2023. The projected figure for 2023 is a 260 percent increase in revenue.

In January 2020, the government abolished the WHT method of collecting taxes and discontinued collection of the tax. This meant, a significant portion of individuals no longer fell within the tax net. As a result, collection of WHT dropped sharply from LKR 63 billion in 2015 to LKR 12 billion in 2021 and WHT collection declined by 13 percent (average growth rate) over the same period (see Table 21).

**Figure 9: Estimates versus actual WHT revenue 2015-2023**

Sources: Budget Estimates 2015-2023

**Table 21: WHT growth rate and average shortfall 2015-2021**

	Average Growth Rate	Average Shortfall from Approved Budget Estimations
WHT	-13%	20%

The government reinstated WHT in October 2022 at a rate of 5 percent, in line with published recommendations from Verité Research.<sup>9</sup> The revenue estimates in the budget are also in line with the estimates previously published by Verité Research for WHT collection in 2022 and 2023.

**Table 22: Verité Research WHT revenue projections (LKR Billion) 2022-2023**

	MoF Projections		Projections by Verité Research	
	2022	2023	2022	2023
WHT	25	90	25	90

### 3.1.2. TAXES ON DOMESTIC GOODS AND SERVICES

**Table 23: Government revenue on taxes on domestic goods and services, figures and estimates (LKR billion) 2021-2023**

	Revenue Estimates			Increase from 2022	
	2021 Actuals	2022 Revised Estimates	2023 Budget Estimates	Total Change from 2022	Y-o-Y% increase in Revenue
Taxes on Goods and Services	631	960	1,740	780	81%
o/w VAT	308	533	908	375	70%
Excise (Ordinance) Duty	139	185	214	29	16%
Excise (Special Provisions) Duty	168	189	343	154	81%
Social Security Contribution Levy	-	35	250	215	614%
Tobacco Tax	0.04	0.04	3.04	3	7500%
Telecommunication Levy	13	16	20	4	25%
Other taxes on goods and services	3	2	2	0	0%

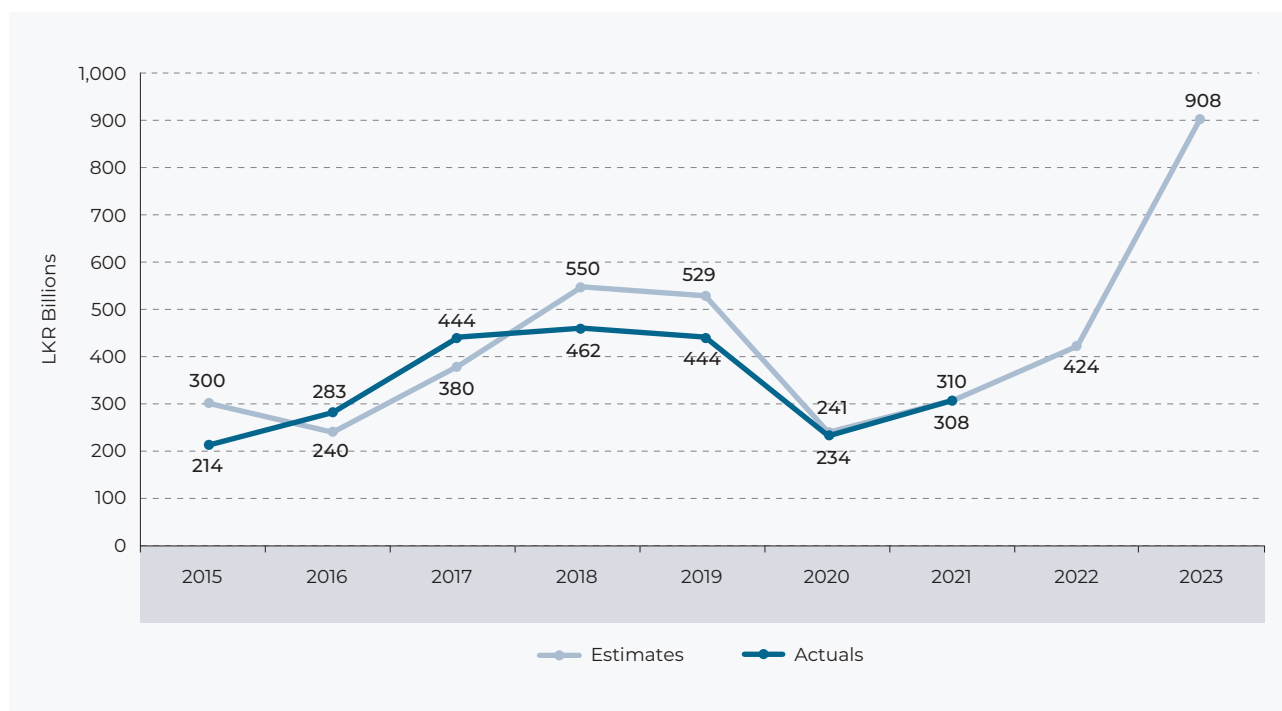
Sources: Authors' calculations and Budget Estimates 2023

#### 3.1.2.1. Value Added Tax (VAT)

The government estimates VAT revenue to be LKR 533 billion in 2022 and LKR 908 billion in 2023. According to these figures, VAT is expected to account for 52 percent of total revenue earned through domestic goods and services taxes in 2023.

Between 2015-2021, VAT collection grew at an annual rate of 12 percent. However, this growth was interrupted in 2020, when VAT revenue declined by 47 percent due to a policy revision that reduced the rate of VAT from 15 percent to 8 percent. The government also has a history of overestimating VAT collection; the only years this has not been the case are 2016 and 2017, when the tax rate was revised up from 11 percent to 15 percent (see Figure 10).

9 Verité Research Sri Lanka Economic Policy Group (2022), Restoring Efficient Tax Collection Methods: Withholding Tax and Pay-As-You-Earn, available at, [https://www.veriteresearch.org/wp-content/uploads/2022/06/VR\\_EN\\_BN\\_Jun2022\\_Restoring-Efficient-Tax-Collection-Methods-Withholding-Tax-and-Pay-as-you-earn.pdf](https://www.veriteresearch.org/wp-content/uploads/2022/06/VR_EN_BN_Jun2022_Restoring-Efficient-Tax-Collection-Methods-Withholding-Tax-and-Pay-as-you-earn.pdf).

**Figure 10: Estimates versus actual VAT revenue 2015-2023**

Sources: Budget Estimates 2015-2023

**Table 24: VAT growth rate and average shortfall 2015-2021**

	Average Growth Rate	Average Shortfall from Approved Budget Estimations
VAT	12%	4%

The VAT rate was revised twice in 2022. First, the rate was increased to 12 percent from 8 percent in June 2022. Subsequently, in September 2022, the rate further increased to 15 percent.<sup>10</sup> Additionally, the Budget Speech included proposals to: (i) remove certain VAT exemptions granted to various sectors, including electricity, transport and fuel effective 1<sup>st</sup> April 2023;<sup>11</sup> (ii) publish a list of active VAT registered persons on the Inland Revenue website; (iii) rationalize exemptions specified in the First Schedule of the VAT Act effective 1<sup>st</sup> April, 2023; and (iv) introduce a new Value Added Tax Act that consolidates the amendments introduced since the inception of the law in 2002.

Despite these revisions, Verité Research projects lower VAT collection for 2022 and 2023 than government estimates. Specifically, Verité Research projects a collection of LKR 506 billion in 2022 and LKR 846 billion in 2023, which is 5 percent and 7 percent lower respectively than government estimates.

The 2022 figure was derived by adjusting the 2021 revenue collection for nominal GDP growth and prorating the impact of the increase in VAT rate on revenue collection. In order to project for 2023, Verité Research considered the VAT revenue collection from 2019, as the same VAT rate was applicable. This figure was adjusted for GDP growth. It is notable, however, that the VAT threshold in 2019 stood at LKR 12 million while for 2023 the applicable threshold

<sup>10</sup> This was the VAT rate prior to the revision in 2020.

<sup>11</sup> The impact of this proposal on revenue collection could not be quantified as the budget speech doesn't provide sufficient information. Therefore, it is excluded from calculations done by Verité Research.

stands at LKR 80 million per annum. The projection does not adjust for the difference in threshold as there is insufficient information available to make an accurate adjustment; however, had this adjustment been made, it would have resulted in an even lower projection.

**Table 25: Verité Research VAT revenue projections (LKR billion) 2022-2023**

		LKR Billion
<b>Year 2022</b>		
2021 actual VAT collection		308
(+) Nominal GDP growth 2022	34.6%	107
2022 VAT collection prior to change in the tax structure		<b>415</b>
(+) VAT rate changed from 8% to,		
12% - 3 months: June to August 2022	50% increment for 3 months	
15% - 4 months: September to December 2022	25% increment in 4 months	
Projected Revenue for 2022 (VR)		<b>506</b>
<b>Year 2023</b>		
2019 actual VAT collection at 15%		<b>444</b>
(+) Nominal GDP growth (2019-2023)	91%	402
Projected Revenue for 2023 (VR) at 15% (reinstated VAT rate to 2019 rate)		<b>846</b>

Sources: Authors' calculations using Budget Estimates 2023

**Table 26: Verité Research VAT revenue projections (LKR Billion) 2022-2023**

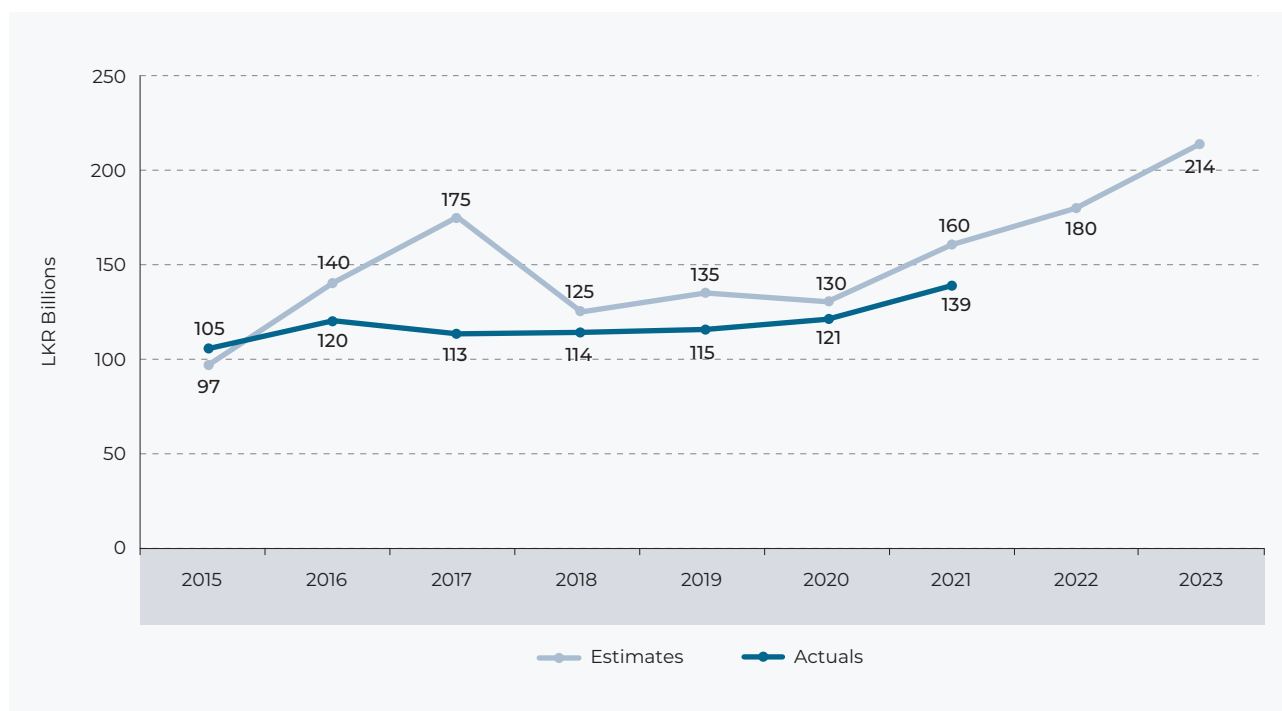
	MoF Projections		Projections by Verité Research	
	2022	2023	2022	2023
VAT	533	908	506	846

### 3.1.2.2. Excise (Ordinance) Duty

The government estimates revenue from excise duty, specifically from duty for liquor, to amount to LKR 185 billion in 2022 and grow by 16 percent to LKR 214 billion in 2023.

Between 2015 and 2020, the average growth rate of excise duty collection for liquor was modest, at only 3 percent a year. In 2021, however, there was a 15 percent increase in excise duty collection on liquor. During this entire period, the government has generally overestimated revenue collection from excise duty.



**Figure 11: Estimates versus actual excise (ordinance) duty revenue 2015-2023**

Sources: Budget Estimates 2015-2023

**Table 27: Excise (ordinance) duty growth rate and average shortfall 2015-2021**

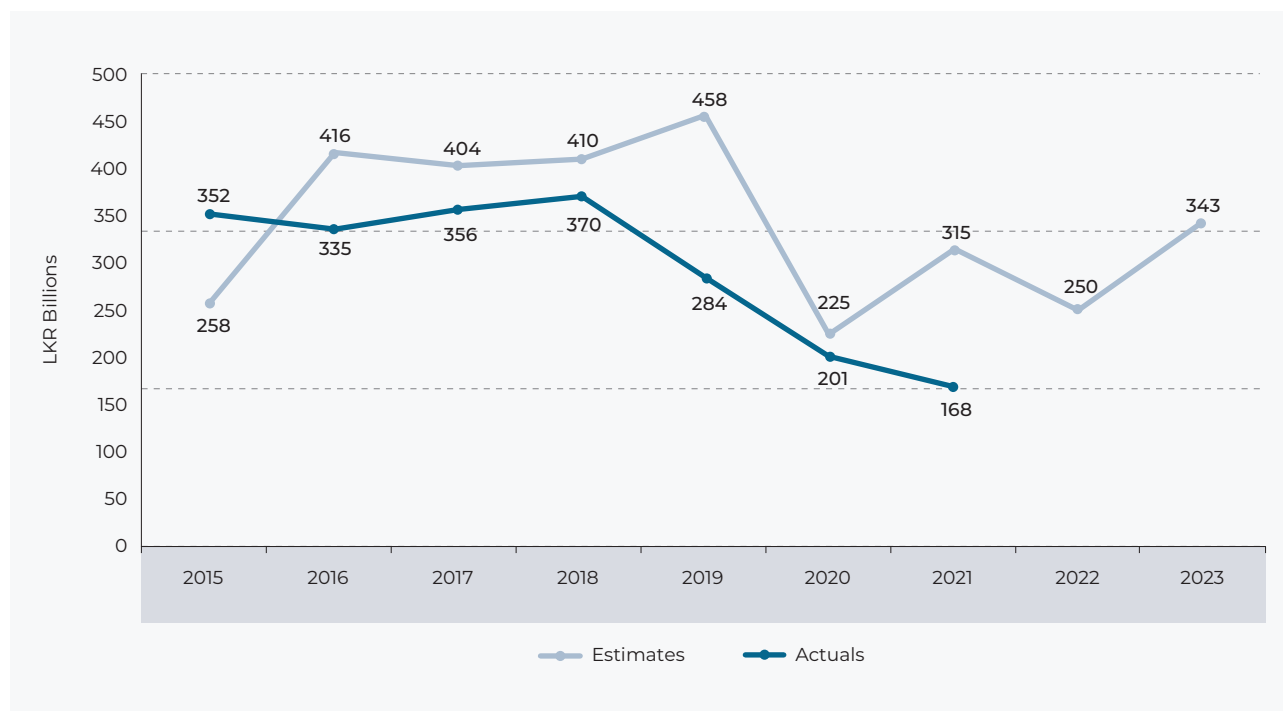
	Average Growth Rate	Average Shortfall from Approved Budget Estimations
Excise (ordinance) duty	5%	12%

Verité Research does not attempt to project its own figures for excise (ordinance) duty collection for liquor for 2022 and 2023, as the Budget Speech for 2023 does not contain any policy changes on excise (ordinance) duty and the policy mix on which excise duty depends is unknown.

### 3.1.2.3. Excise (Special Provisions) Duty

The government estimates revenue from excise (special provision) duty –including taxes on cigarettes, motor vehicles and petroleum products – to amount to LKR 189 billion in 2022 and grow by 81 percent to LKR 343 billion in 2023.

Between 2015-2021, revenue from excise (special provision) duty contracted by an average of 11 percent a year. This was largely due to a sharp drop between 2019-2021 (with a three-year average contraction of 23 percent) due to the impact of lockdowns, import controls, and the ban on motor vehicle imports. Revenue from excise duty has been consistently overestimated in the past, with an average revenue shortfall of 14 percent below estimates.

**Figure 12: Estimates versus actual excise (special provisions) duty revenue 2015-2023**

Sources: Budget Estimates 2015-2023

**Table 28: Excise (special provisions) duty growth rate and average shortfall 2015-2021**

	Average Growth Rate	Average Shortfall from Approved Budget Estimations
Excise (special provisions) duty	-11%	14%

Verité Research projects the collection from excise (special provisions) duty to be lower than government estimates, at LKR 167 billion in 2022 and LKR 298 billion in 2023. This is based on adjustments for the impact of cigarette taxation (see section below). The projection by Verité Research for 2023 is therefore 13 percent lower than the government estimate.

### Excise (Special Provisions) Duty – Cigarette Tax

Cigarettes are the most significantly consumed tobacco product in Sri Lanka, and at present, they are taxed at relatively low levels. The World Health Organisation (WHO) recommends raising cigarette taxes to exceed inflation, with the tax on each cigarette stick ideally being maintained at 75 percent of the retail price of the most popular brand (WHO, 2014). Currently, in Sri Lanka, cigarette sticks are taxed at only 69 percent of their retail price.

The Ceylon Tobacco Company (CTC) has a monopoly in the production and sale of cigarettes and can determine prices on its own, without facing competitive pressures. The government of Sri Lanka sets the absolute rupee value of the tax on cigarettes through section 3 of the Excise (Special Provisions) Act, No. 13 of 1989. By setting taxes, the government can influence the price of cigarettes as the company passes the tax on to the consumer.

The government estimates an excise duty revenue from cigarette taxes of LKR 110 billion in 2022 and LKR 137 billion in 2023. This is a 25 percent increase in expected revenue for 2023. These figures follow from an increment of 20 percent to the excise tax (special provision) introduced in 2022.

Projections by Verité Research suggest that the government's estimates are not likely to be achieved. According to calculations by Verité Research, if the change in the market structure towards lower priced cigarettes persists, the government might collect only LKR 88 billion in 2022 and LKR 92 billion in 2023. These figures were calculated by first estimating the quantity of cigarettes (sticks) sold in 2022 and 2023 based on the market share of six cigarette brands in 2020, and a price elasticity of 0.5 (ped), and then multiplying the estimated quantity by the excise duty per stick (see Table 29).

However, revenue can outperform these status-quo based projections if (a) there is a significant increase in cigarette sales due to the increased affordability – with the prices of other goods having increased much more relative to the prices of cigarettes in 2022, and (a) the market share of the lower-taxed Navycut brand is reduced in favour of the higher-taxed JPGL brand.

**Table 29: Verité Research excise duty of cigarette tax revenue projections (LKR billion) 2022-2023**

	2022		2023	
	Estimated Quantity (no. of sticks)	Excise Tax (LKR)	Estimated Quantity (no. of sticks)	Excise Tax (LKR)
JPGL	1,571,985,924	46.60	1,353,654,545	55.92
Capstan	273,611,881	6.75	209,354,545	13.36
Navycut	68,513,857	41.10	61,958,519	49.32
Bristol	31,895,898	41.10	27,662,800	49.32
Benson & Hedges	4,768,438	46.60	4,265,882	55.92
Dunhill	175,112,149	46.60	161,807,059	55.92
Total Excise Revenue		<b>LKR 88 billion</b>		<b>LKR 92 billion</b>

Sources: Authors' calculations

**Table 30: Verité Research cigarette tax revenue projections (LKR Billion) 2022-2023**

	MoF Projections		Projections by Verité Research	
	2022	2023	2022	2023
Cigarette Tax	110	137	88	92

### 3.1.2.4. Social Security Contribution Levy (SSCL)

The government estimates a tax revenue of LKR 35 billion in 2022 and LKR 250 billion in 2023, through the SSCL. The estimated revenue for 2023 is an increase of 614 percent from the 2022 figure.

The SSCL is a relatively new tax, it was only introduced in the Budget for 2022. Collection of the levy only took place during the last four months of 2022.

SSCL is similar to the previous Nation Building Tax (NBT) that existed in 2019. There are three considerations when estimating SSCL collections: (a) the increase in collection due to nominal GDP growth since 2019; (b) the SSCL rate increasing to 2.5% from the 2% NBT; and (c) the threshold of the SSCL increasing 10-fold to LKR 120 million, whereas the NBT threshold was LKR 12 million per annum. The projections for SSCL by the MoF also follow the same method by adjusting the 2019 NBT revenue for changes “a” and “b” but failed to adjust for the change “c”.

When adjusting for all three variables, the SSCL collection for 2022 (as the tax was only in effect from Sept 2022 onwards) and 2023, was LKR 39 Bn and LKR 200 Bn respectively.

**Table 31: Verité Research SSCL projections (LKR billion) 2022-2023**

	Verité Research Projections	
	2022	2023
NBT 2019	105	105
GDP Growth	1.50	1.91
Higher rate	1.25	1.25
Low threshold	0.8	0.8
Collection period	0.25 (4 months)	1 (One year)
<b>SSCL</b>	<b>39</b>	<b>200</b>

Source: Authors' calculations

**Table 32: Verité Research SSCL revenue projections (LKR Billion) 2022-2023**

	MoF Projections		Projections by Verité Research	
	2022	2023	2022	2023
SSCL	35	250	39	200

### 3.1.3. TAXES ON INTERNATIONAL TRADE

**Table 33: Government revenue on taxes on international trade, figures and estimates (LKR billion) 2021-2023**

	Revenue Estimates			Increase from 2022	
	2021 Actuals	2022 Revised Estimates	2023 Budget Estimates	Total Change from 2022	Y-o-Y% increase in Revenue
Taxes on External Trade	353	325	458	133	41%
o/w Import Duties	64	42	80	38	90%
o/w CESS	76	68	85	17	25%
o/w PAL	154	177	220	43	24%
o/w SCL	56	35	70	35	100%
o/w other taxes	3.0	3.0	2.7	-0.4	-0.1

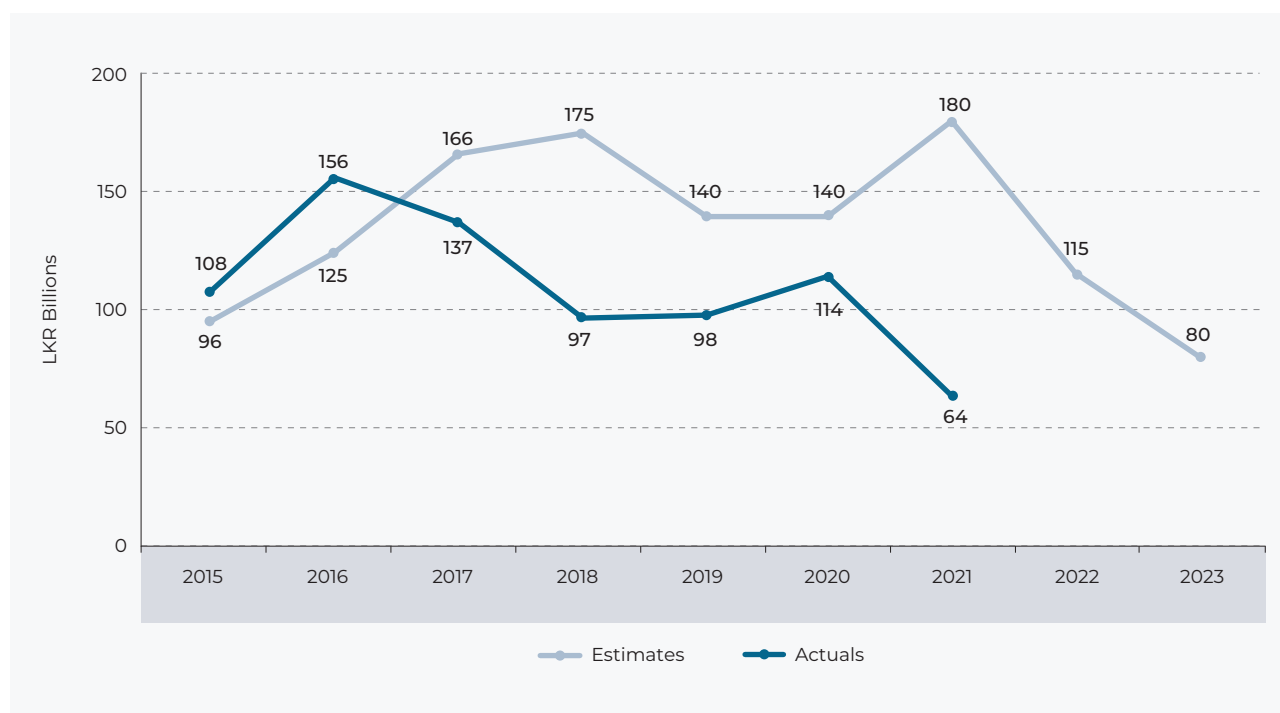
Sources: Authors' calculations and Budget Estimates 2023

### 3.1.3.1. Customs Import Duty

The government estimates the collection from customs import duties to be LKR 42 billion in 2022 and LKR 80 billion in 2023. The 2023 estimate would mean a 90 percent increase in revenue from the previous year. This follows from a revision introduced in the Budget Speech of 2023, where customs import duty rates were revised from 0/10/15 percent to 0/15/20 percent in order to accommodate the proposed phasing out of para-tariffs/levies from January 1<sup>st</sup>, 2023.

The government's estimates for customs import duty collection generally tend to be inaccurate; import duty revenue was underestimated in 2015 and 2016 and then consistently overestimated between 2017-2021 (see Figure 13). Within the same period of 2015-2021, revenue from import duties has followed a fluctuating trend, with an average contraction rate of 4 percent every year.

**Figure 13: Estimates versus actual customs import duty revenue 2015-2023**



Sources: Budget Estimate 2015-2023

**Table 34: Customs import duty growth rate and average shortfall 2015-2021**

	Average Growth Rate	Average Shortfall from Approved Budget Estimations
Customs import duty	-4%	20%

Verité Research did not calculate an alternative collection estimate for 2022. However, a figure for 2023 was projected, based on the government's estimates for 2022, adjusting for policy changes in import duty (introduced in the 2023 Budget Speech), the import volumes projected by the IMF, and the currency depreciation. The calculation was done based on two main assumptions: (i) that the total value of imports will be unchanged, after switching from current duty rates (0%, 10% and 15%) to the proposed duty rates (0%, 15% and 20%); and (ii) that the increase

in import volume translates into an increase in revenue – i.e. that import value grows proportionate to the volume. Verité Research projects LKR 67 billion (instead of LKR 80 billion) as the import duty collection by customs in 2023.

**Table 35: Verité Research Custom import duty projections 2022-2023**

	Projections by Verité Research	
	2022	2023
Previous Import Duty collection		42
Volume of Imports (1+% change)		1.14183
Depreciation Effect (1+%)**		1.038
		<b>49.779</b>
Impact of policy change (%)		42%
2022 collection adj. to policy change		<b>17.64</b>
<b>Custom Import Duty</b>	<b>42</b>	<b>67</b>

Source: Authors' calculations

\*\*Difference between the IMF projections for the end of the period inflation of Sri Lanka and global.

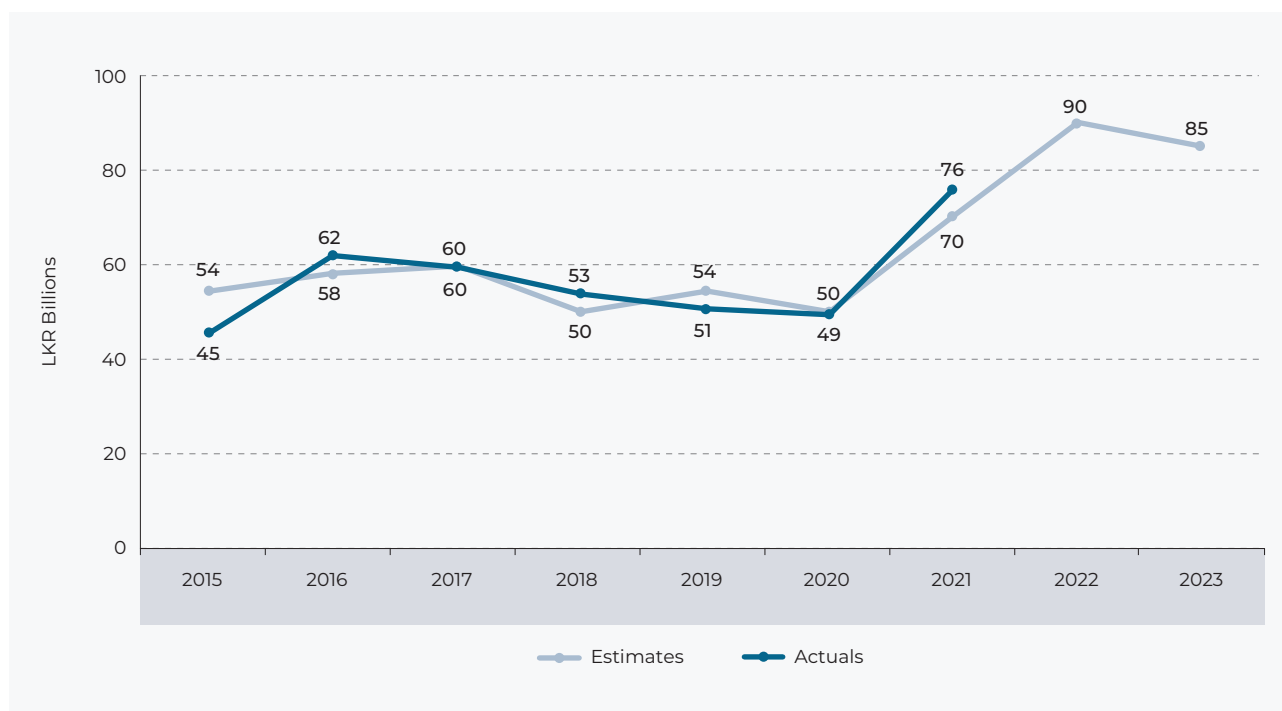
**Table 36: Verité Research customs import duty revenue projections (LKR Billion) 2022-2023**

	MoF Projections		Projections by Verité Research	
	2022	2023	2022	2023
SSCL	42	80	42	67

### 3.1.3.2. CESS

The government estimates the CESS collection to be LKR 68 billion in 2022 and LKR 85 billion in 2023. The 2023 Budget Speech proposes that the CESS levy be eliminated on a phased basis in three years commencing from January 01, 2023. However, the proposed tax policy is to be implemented in such a way that it does not interfere with the CESS levy on agriculture-based value-added industries.

Between 2015 and 2021, actual collection from CESS has generally not diverged substantially from government estimates, with the average shortfall in 2015-2021 being -0.3 percent less than estimates. In 2016, 2018 and 2021, revenue from CESS exceeded estimates.

**Figure 14: Estimates versus actual CESS revenue 2015-2023**

Sources: Budget Estimate 2015-2023

**Table 37: CESS growth rate and average shortfall 2015-2021**

	Average Growth Rate	Average Shortfall from Approved Budget Estimations
CESS	11%	-0.3%

Verité Research did not calculate an alternative estimate for CESS collection in 2022, as the government estimate did account for the impact of import controls imposed that year - the government estimated figure is a 10 percent decrease from the 2021 revenue figures.

Verité Research projected a collection figure for 2023, adjusting for the impact of CESS policy changes introduced in the budget speech 2023, the import volume projections by IMF, and the currency depreciation effect (see Table 38). The calculation was done based on the assumption that growth in import volume translates to more revenue (i.e. that import value grows proportionately to the import volume). Accordingly, Verité Research estimates CESS collection for 2023 to be LKR 54 billion (in contrast to 85 billion in the budget estimates).

**Table 38: Verité Research CESS projections 2022-2023**

	Projections by Verité Research	
	2022	2023
Previous CESS collection		68
Volume of Imports (1+% change)		1.14183
Depreciation Effect (1+%)**		1.038
Phasing out of CESS (1/3 p.a)		2/3
<b>CESS</b>	<b>68</b>	<b>54</b>

Source: Authors' calculations

\*\*Difference between the IMF projections for the end of the period inflation of Sri Lanka and global.

**Table 39: Verité Research CESS revenue projections (LKR Billion) 2022-2023**

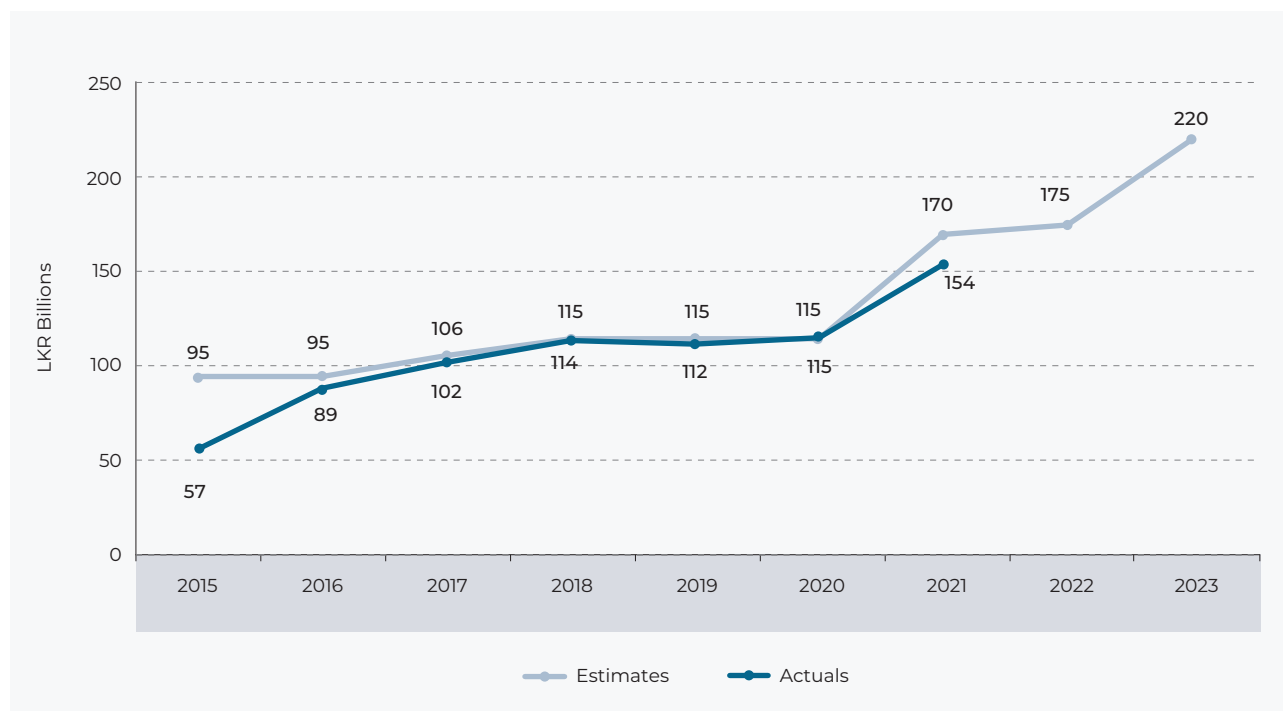
	MoF Projections		Projections by Verité Research	
	2022	2023	2022	2023
CESS	68	85	68	54

### 3.1.3.3. Ports and Airports Development Levy (PAL)

The government estimates PAL collection to be LKR 177 billion in 2022 and LKR 220 billion in 2023, which represents a 24 percent year-on-year increase in revenue. This increased projected revenue is despite a proposal introduced in the 2023 Budget Speech that PAL be phased out completely in five years.

Generally, actual PAL collection has not differed greatly from the estimated figures, except in 2015, 2016 and 2021, when there were noteworthy shortfalls. Due to this, the average annual shortfall for the entire period is 9 percent (see Figure 15 and Table 40).



**Figure 15: Estimates versus actual PAL revenue 2015-2023**

Sources: Budget Estimate 2015-2023

**Table 40: PAL growth rate and average shortfall 2015-2021**

	Average Growth Rate	Average Shortfall from Approved Budget Estimations
PAL	20%	9%

Verité Research did not calculate an alternative estimate for PAL collection in 2022. However, Verité Research projected a collection figure for 2023, adjusting for the impact of PAL policy changes introduced in the budget speech 2023, the import volume projections by IMF, and the currency depreciation effect. The calculation was done based on the assumption that growth in import volume translates to more revenue (i.e. that import value grows proportionately to the volume). Accordingly, Verité Research estimates that PAL collection in 2023 will be LKR 168 billion, a 5 percent decrease from the 2022 figure, as opposed to the 24 percent increase expected in the budget.

**Table 41: Verité Research PAL projections 2022-2023**

	Projections by Verité Research	
	2022	2023
Previous PAL collection		177
Volume of Imports (1+% change)		1.14183
Depreciation Effect (1+%)**		1.038
Phasing out of PAL (1/5 p.a)		4/5
<b>PAL</b>	<b>177</b>	<b>168</b>

Source: Authors' calculations

\*\*Difference between the IMF projections for the end of the period inflation of Sri Lanka and global.

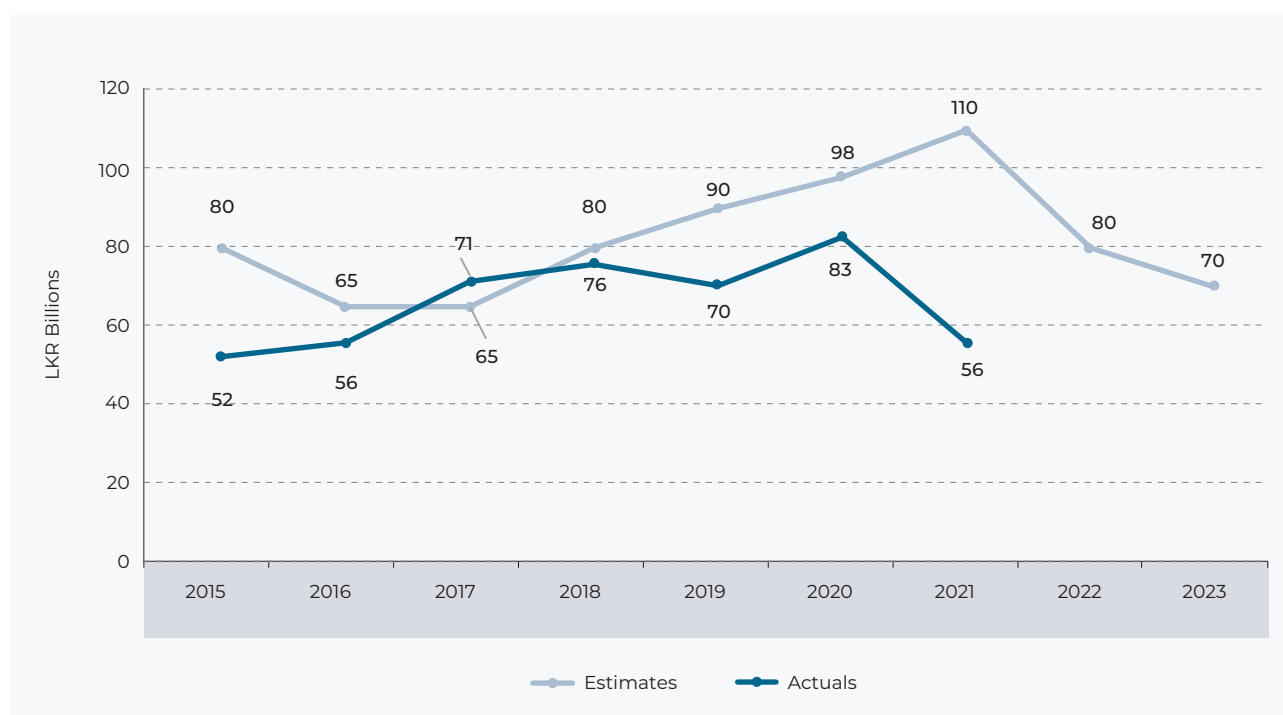
**Table 42: Verité Research PAL revenue projections (LKR Billion) 2022-2023**

	MoF Projections		Projections by Verité Research	
	2022	2023	2022	2023
CESS	177	220	177	168

### 3.1.3.4. Special Commodity Levy (SCL)

The government expects collection from SCL to be LKR 35 billion in 2022 (a 38 percent decrease from the previous year). However, a 100 percent increase is expected in 2023, with an estimate of LKR 70 billion.

Between 2015 and 2021, the average shortfall in collection of SCL against estimates was 19 percent. One exception was in 2017, when revenue from SCL was 10 percent higher than projected (see Figure 16).

**Figure 16: Estimates versus actual SCL revenue 2015-2023**

Sources: Budget Estimate 2015-2023

**Table 43: SCL growth rate and average shortfall 2015-2021**

	Average Growth Rate	Average Shortfall from Approved Budget Estimations
SCL	3%	19%

Verité Research did not calculate an alternative estimate for SCL collection in 2022. However, based on the government projections for 2022, Verité Research projected a collection figure for 2023, adjusting for the impact of the import volume projections by the IMF and the currency depreciation effect. The calculation was done based on the

assumption that growth in import volume translates to more revenue (i.e. that import value grows proportionately to the volume). Verité Research estimates that SCL collection in 2023 will be LKR 41 billion, a 19 percent increase from the 2022 figure, as opposed to the 100 percent increase expected in the budget.

**Table 44: Verité Research SCL projections 2022-2023**

	Projections by Verité Research	
	2022	2023
Previous SCL collection		35
Volume of Imports (1+ % change)		1.14183
Depreciation Effect (1+ %) **		1.038
<b>SCL</b>	<b>35</b>	<b>41</b>

Source: Authors' calculations

\*\*Difference between the IMF projections for the end of the period inflation of Sri Lanka and global.

**Table 45: Verité Research SCL revenue projections (LKR Billion) 2022-2023**

	MoF Projections		Projections by Verité Research	
	2022	2023	2022	2023
SCL	35	70	35	41

### 3.1.4. LICENCE TAXES AND OTHER

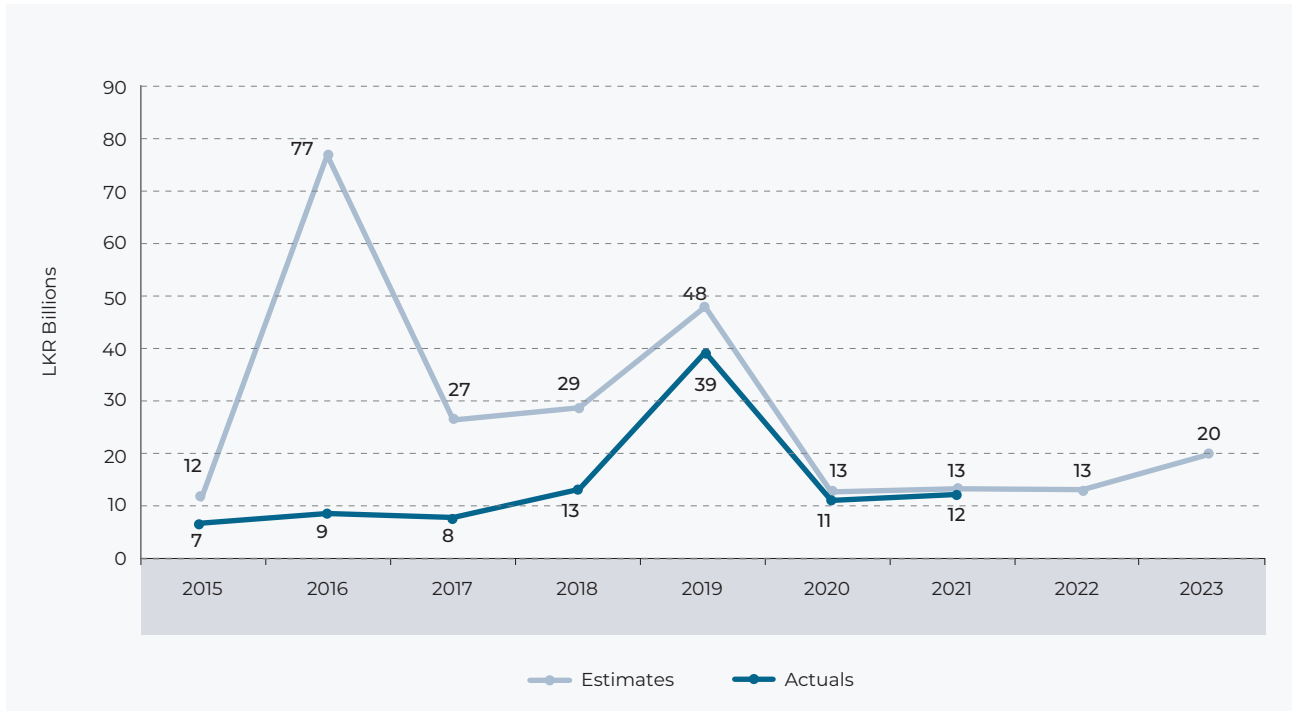
The government estimates collection from licence taxes and other taxes to be LKR 9 billion in 2022 and LKR 20 billion in 2023. Licence taxes constitute a relatively small proportion of total tax revenue. Between 2015 and 2021, they have accounted for less than 1 percent of tax revenue, with the exception of 2019, due to a sharp increase in the dept repayment levy, which was subsequently normalized in 2020. Significant sources of revenue within Licence Taxes and Other Taxes include the luxury motor vehicle tax, the betting and gaming levy, and the share transaction levy (see Table 46).

**Table 46: Government revenue on licence taxes and other taxes, figures and estimates (LKR billion) 2021-2023**

	Revenue Estimates			Increase from 2022	
	2021 Actuals	2022 Revised Estimates	2023 Budget Estimates	Total Change from 2022	Y-o-Y% increase in Revenue
Licence Taxes and others	12	9	20	11	129%
Luxury Motor Vehicle taxes	1	1	1	0	10%
Betting and Gaming Levy	2	2	10	8	400%
Share Transaction Levy	7	3	6	3	100%
Migrating Tax	0.017	0.011	0.012	0.001	9%

Sources: Authors' calculations and Budget Estimates 2023

**Figure 17: Estimates versus actual license taxes and other taxes revenue 2015-2023**



Sources: Budget Estimate 2015-2023

Verité Research did not attempt to project revenue collection from licence taxes and other taxes in 2022 and 2023 because the 2023 budget speech does not contain any policy changes related to these taxes and the policy mix on which licence tax revenue depends on is unknown.

## 3.2. Non-tax revenue

The government estimates non-tax revenue to be LKR 232 billion in 2022 and LKR 278 billion in 2023, representing a 20 percent year-on-year increase (see Table 47).

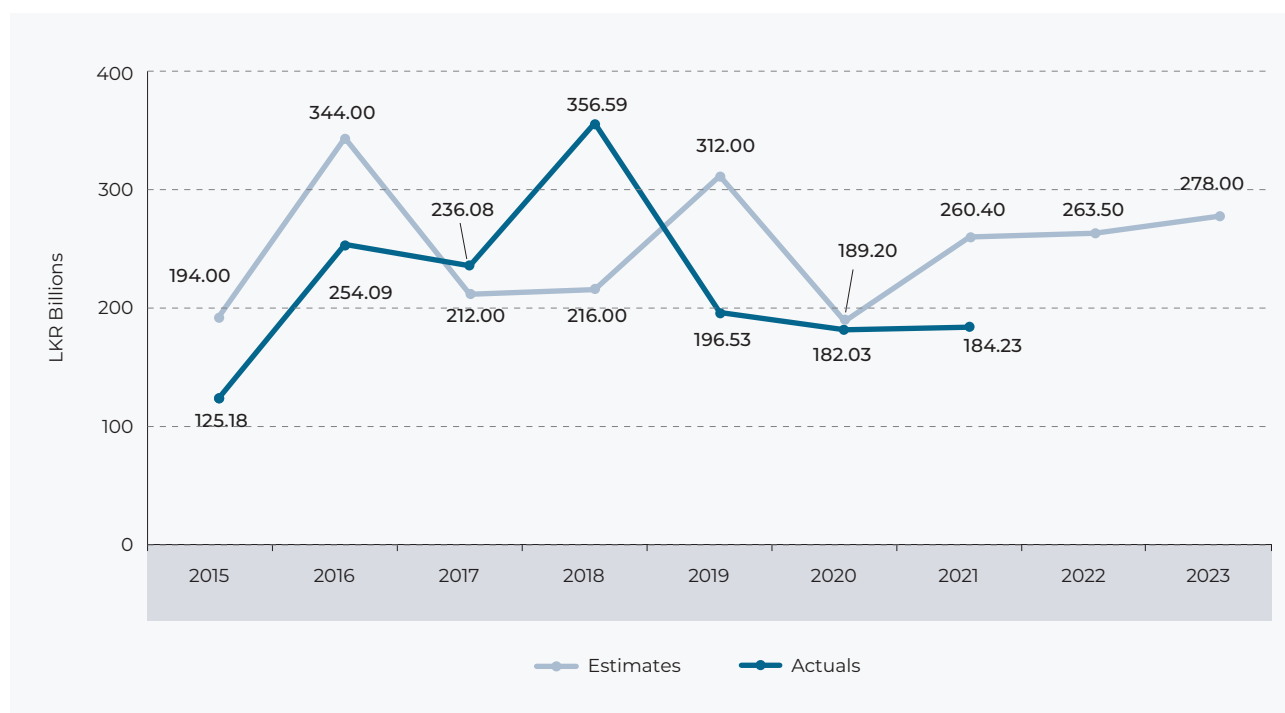
**Table 47: Government revenue on non-tax revenue, figures and estimates (LKR billion) 2021-2023**

	Revenue Estimates			Increase from 2022	
	2021 Actuals	2022 Revised Estimates	2023 Budget Estimates	Total Change from 2022	Y-o-Y increase in Revenue (%)
Non-Tax Revenue	184	232	278	46	20%

Sources: Authors' calculations and Budget Estimates 2023

The realisation of non-tax revenue estimates in the past has been erratic. Between 2015 and 2021, average shortfall in collection of non-tax revenue against estimates was 8 percent (see Figure 18 and Table 48). In 2017 and 2018, however, revenue from non-tax line items were respectively 11 percent and 65 percent higher than expected.

**Figure 18: Estimates versus actual non-tax revenue 2015-2023**



Sources: Budget Estimate 2015-2023

**Table 48: Non-tax revenue growth rate and average shortfall 2015-2021**

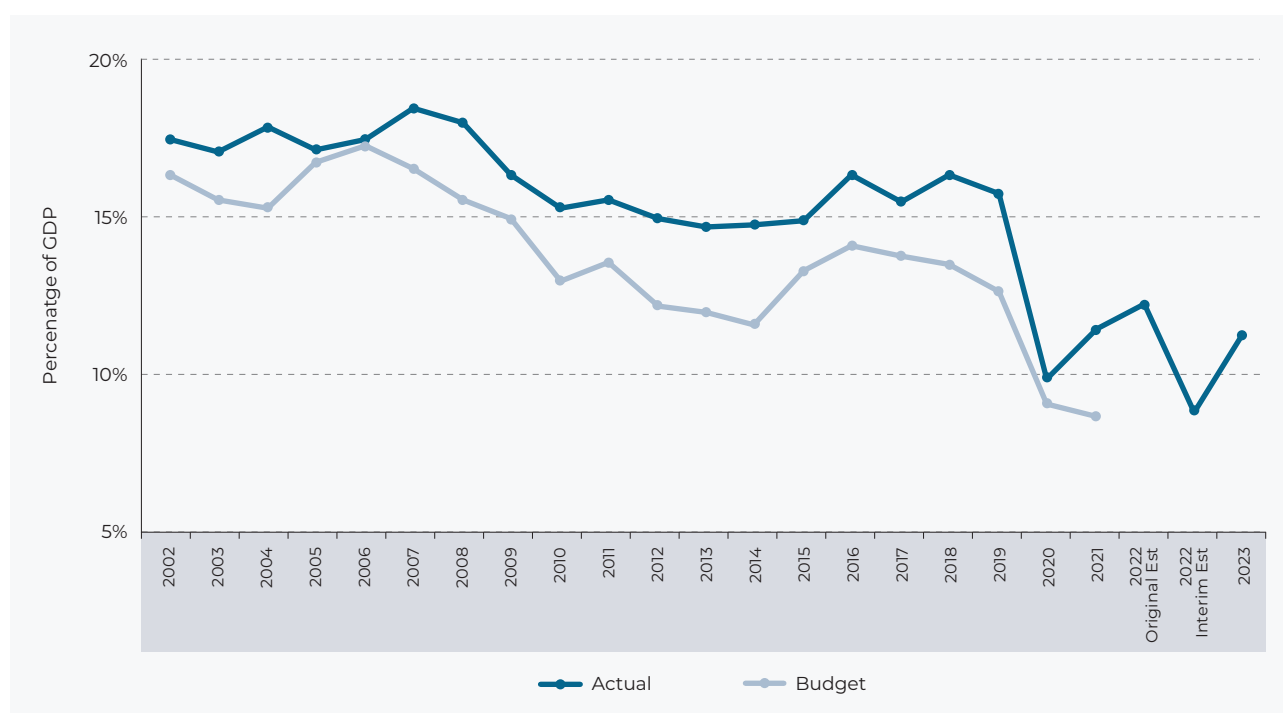
	Average Growth Rate	Average Shortfall from Approved Budget Estimations
Non-tax revenue	16%	8%

Verité Research does not attempt to project non-tax revenue collection and calculate alternative figures for 2022 and 2023 due to limited data availability.

### 3.3. Summary of government revenue estimates and revisions recommended by Verité Research

**Based on its own projections, Verité Research projects government tax revenue in 2023 to be 12 percent lower than the government's budget estimates.** Sri Lanka has a two-decade long history of falling short of its revenue targets (see Figure 19). Thus, there is a low probability that the country's revenue projections for 2023 are accurate. Verité Research attempted to correct some of the deficiencies in government estimates through calculating alternative projections, where possible. Through this exercise, Verité Research projected a total government tax revenue of LKR 2,762, which is 12 percent lower than the government's projection (see Table 49).

**Figure 19: Budgeted versus actual government revenue as a percentage of GDP, 2002-2023**



Source: Budget Speech 2002-2023, CBSL

**Table 49: Verité Research total revenue projections (LKR Billion) 2022-2023**

	MoF Projections		Projections by Verité Research	
	2022	2023	2022	2023
Tax Revenue	1,852	3,130	1,678	2,762
Taxes on Income and Profits	558	912	429	825

Corporate Tax	475	603	360	516
Non-corporate tax	53	215	39	215
PAYE	35	100	21	100
Other	18	115	18	115
WHT	25	90	25	90
Other	5	4	5	4
<b>Taxes on International Trade</b>	<b>325</b>	<b>458</b>	<b>325</b>	<b>333</b>
Import Duties	42	80	42	67
Ports & Airports Development Levy	177	220	177	168
CESS	68	85	68	54
Special Commodity Levy	35	70	35	41
Other	3	3	3	3
<b>Taxes on Domestic Good and Services</b>	<b>960</b>	<b>1,740</b>	<b>915</b>	<b>1,583</b>
VAT	533	908	506	846
Excise (Ordinance) Duty	185	214	185	214
Excise (Special Provisions) Duty	189	343	167	298
Cigarette Tax	110	137	88	92
Other	79	206	79	206
Tobacco Tax	0.04	3.04	0.04	3.04
Telecommunications Levy	16	20	16	20
Social Security Contribution Levy	35	250	39	200
Other	2	2	2	2
<b>License Taxes &amp; Other</b>	<b>9</b>	<b>20</b>	<b>9</b>	<b>20</b>

Source: Budget Speech 2023, Budget Estimates, 2023 and Authors' calculations

Note: Verité Research does not attempt to project collections from tobacco tax, telecommunication levy, grants and provincial council revenues for 2022 and 2023 as,

01) the revenue collection from above modes is insignificant or small, and/or

02) the budget speech 2023 does not contain information on any policy changes to the above-mentioned modes of revenues.

### **In the past, the projections made by Verité Research have been more accurate than the government's projections.**

In the Budget Speech made in November 2022, the government reported the actual tax revenue from 2021 to be LKR 1,298 billion, which was a **25 percent deviation** from the government's original estimate for 2021. In the Public Report on the Budget 2021 published in December 2020, Verité Research projected government revenue for 2021 to be LKR 1,263 billion, which turned out to be **just a 27 percent deviation** from actual 2021 revenue.

In the Central Bank Annual Report for 2022, the government reported the actual tax revenue for 2022 to be LKR 1,751 billion. This was a **14.7 percent deviation** from the government's original estimate for 2022. The Public Report on the Budget 2022 published by Verité Research in December 2021 projected government revenue for 2022 to be LKR 1,657 billion, which turned out to be **be 5.7 percent deviation** from actual 2022 revenue.

Verité Research has consistently provided more accurate projections on actual revenue with smaller deviations in comparison to the government's actual tax revenue figures. This shows that past projections provided by Verité Research have been more accurate than those of the government.



## 3.4. Recommendations

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Based on the analysis presented in Section III of this report, Verité Research makes the following recommendations:

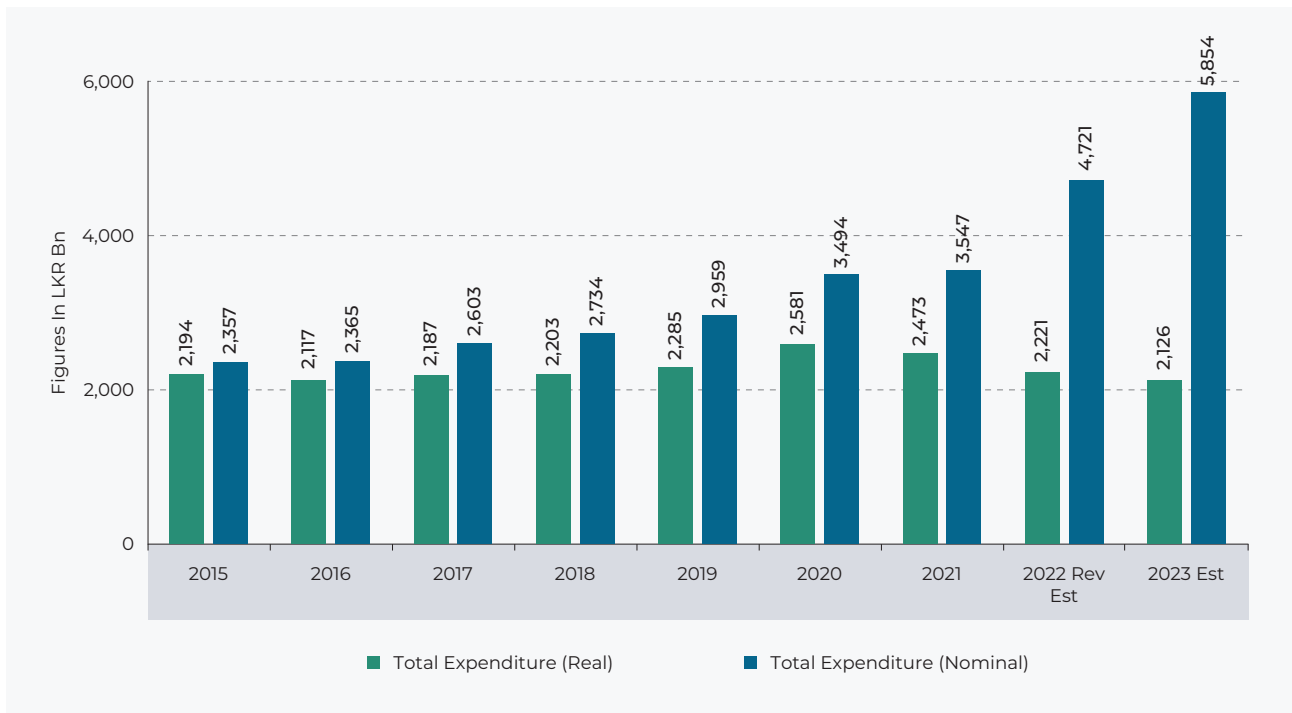
- a.** The MoF should consider revising its revenue estimates to reduce inaccuracies and break the 2-decade trend of overestimating both total revenue collection and specific taxes. This can be achieved by conducting rigorous review of its estimates with specific numerical analysis and presenting it for public scrutiny. The present analysis has demonstrated how the projections can be significantly improved.
- b.** The MoF should provide disaggregated data on the collection of the betting and gaming levy as the aggregated data currently obfuscates the collection of the casino entrance levy, which has been highlighted in past COPF reports as not being collected.

# SECTION 4: **EXPENDITURE OUTLOOK**

This section examines the estimated expenditures in Budget 2023, focusing on interest payments, salaries and wages, and capital expenditure.

There are two observations on this budget item. First, the government departed from the previous practice of projecting total expenditure for a period of three years, and only projected the expenditure of 2023. Second, total expenditure declined in real terms by 17.6% from 2020 even though it increased by 67.5% in nominal terms. In fact, in real terms the expenditure declined to 3% below the 2015 level.

**Figure 20: Total nominal and real government expenditure, 2015-2023**



Source: Budget Estimates, 2017-2023, CCPI from CBSL  
 Note: 2019 and 2020 nominal expenditure adjusted for accounting error (Annexure 01)

# 4.1. Expenditure estimates

## 4.1.1. INTEREST PAYMENTS

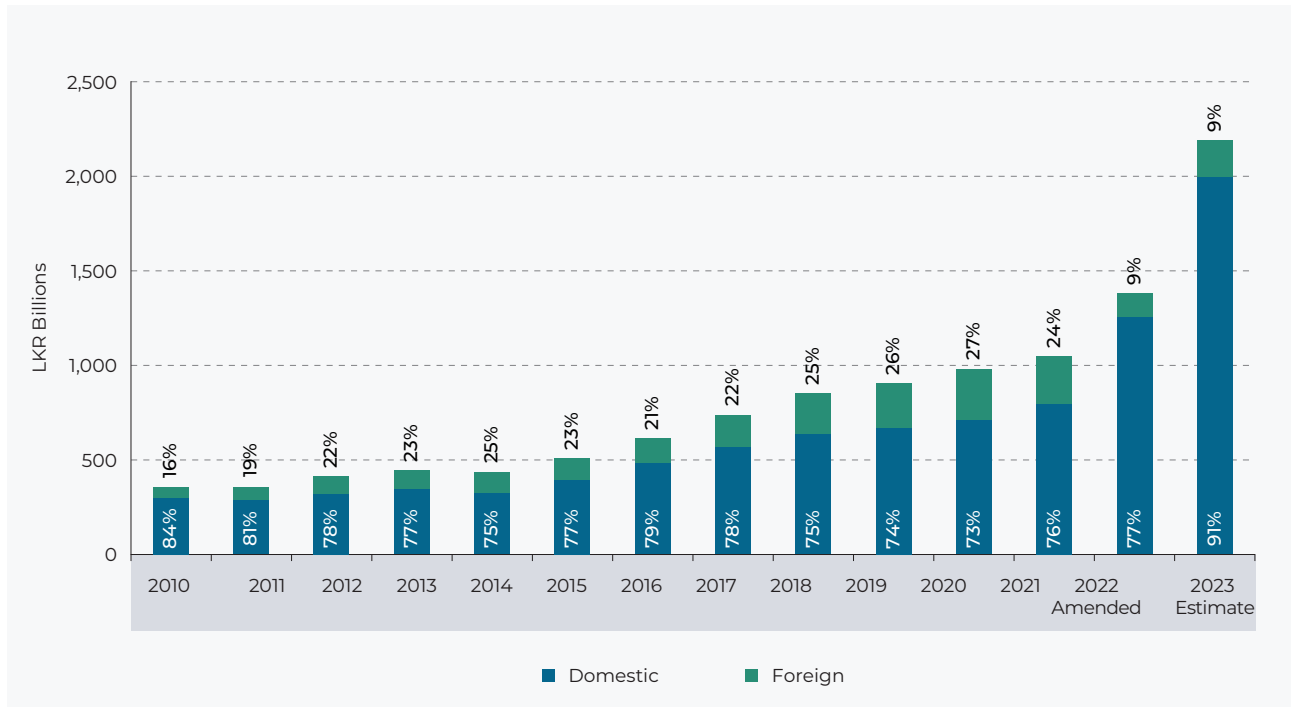
Expected expenditure share on the domestic interest cost increased from 77% in 2022 to 91% in 2023. The share of interest payments on foreign debt shrank due to both the suspension of interest payments on much of the foreign debt as well as the increase in interest rates on domestic rupee denominated debt.

At the same time, the expected expenditure on interest payments for 2023 increased by 96% from 2022; that is to LKR 2,189 billion in 2023, from LKR 1,116 billion in 2022.

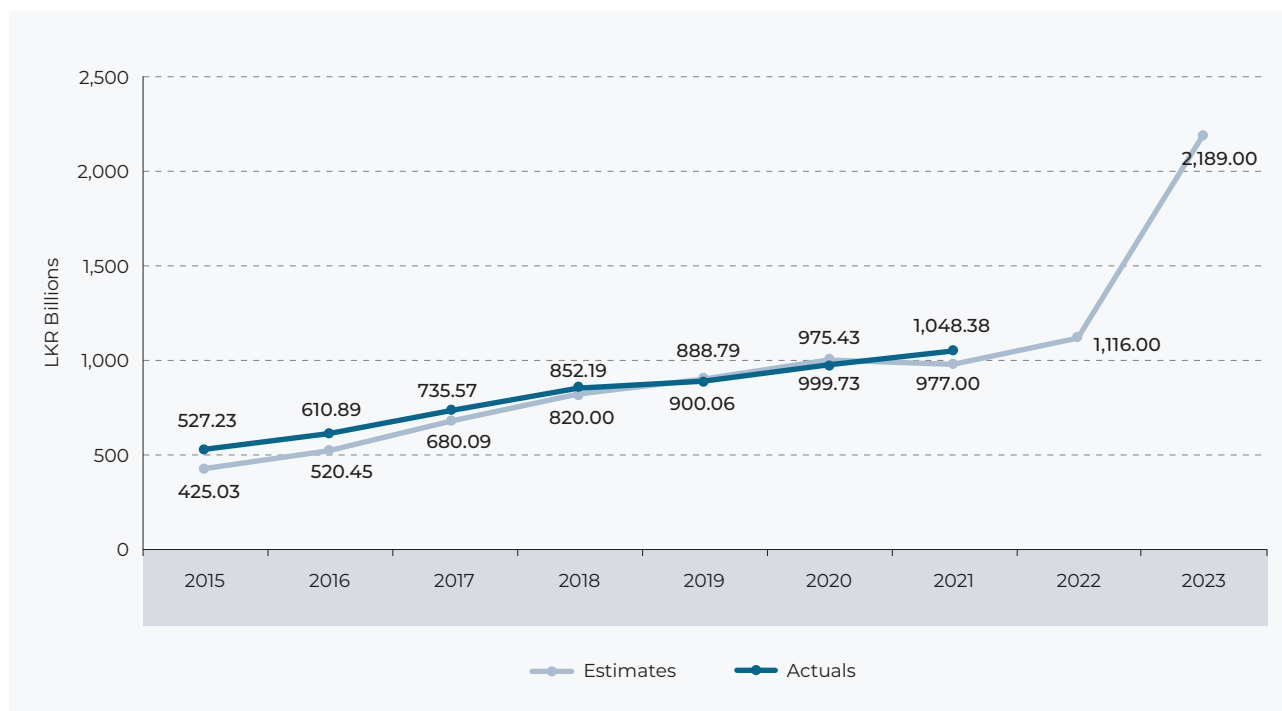
Within this increase, the interest payments on foreign debt declined by 60 billion from LKR 257 billion in 2022 to an expected LKR 197 billion in 2023. The decrease was due to the suspension of debt payments being offset to some extent by the steep depreciation of the LKR, starting in March 2022.

However, the domestic component of interest payments increased by 132% from LKR 859 billion in 2022 to an expected LKR 1,992 billion in 2023.

**Figure 21: Composition of Interest Payments, 2015-2023**



Sources: MOF Annual Report (2010 - 2021), Budget Estimates 2023

**Figure 22: Estimates versus actual interest payment expenditure 2015-2023**

Sources: Budget Estimate 2015-2023

**Table 50: Government expenditure on Interest Payments, figures and estimates (LKR billion), 2021-2023**

	Expenditure Estimates		Increase from 2022	
	2022 Estimate	2023 Estimate	Total Change from 2022	Y-o-Y % increase in Expenditure
Interest Payments	1,116	2,189	1,073	96%

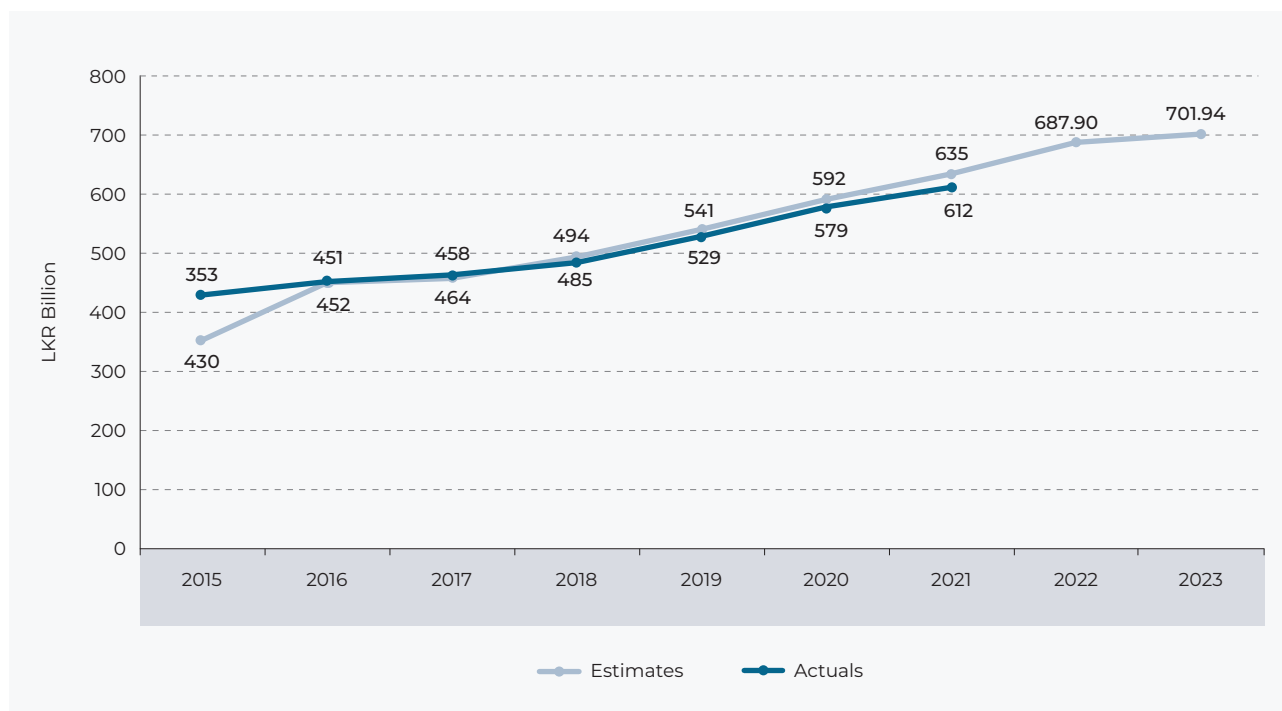
Sources: Budget Estimate 2022-2023

## 4.1.2. PERSONAL EMOLUMENTS

Personal emoluments expenditure grew by an average of 6 percent per year between 2015 – 2021. Government estimates for personal emoluments between this period have been generally accurate with actual expenditures between 2016 – 2021 being consistent with estimates (see Figure 23).

However, the numbers presented in budget documents with regard to personal emoluments for 2023 have some discrepancies and contradictions.

The budget estimates project a 5% decline in personal emoluments for government employees, from LKR 739.6 billion in (2022 revised) to LKR 701.9 billion in 2023. However, the budget speech (Annexure I) expects that the salaries and wages will go up by 7 billion in that period, and cites completely different figures (an increase from 995 billion to 1,002 billion). This colossal discrepancy of 256 billion in the 2022 budget estimates and budget speech could not be reconciled.

**Figure 23: Estimates versus Actual figures for Personal Emoluments, 2015-2023**

Source: Budget Estimates 2015-2023

**Table 51: Government expenditure on personal emoluments, figures and estimates (LKR billion) 2021-2023**

	Expenditure Estimates		Increase from 2022	
	2022 Estimates	2023 Budget Estimates	Total Change from 2022	Y-o-Y % change in Expenditure
Personal Emoluments	687.90	701.94	14.04	2%

Source: Budget Estimates 2023

The government's reasoning for estimating a 5 percent contraction in personal emoluments is not explained in any of the 2023 budget documents. Given past trends, reducing the cost of personal emoluments would require some overall reduction in employment, which has not been proposed. Therefore, it is difficult to justify projecting a decrease in personal emoluments expenditure.

Given the discrepancy in the numbers, Verité Research has used the numbers in the Approved Budget Estimates document as the basis for the projection. It used the 7 billion increase suggested in the budget speech as the absolute expected increase in the expenditure on this line item and thereby projected a total expenditure of LKR 747 billion.

**Table 52: Projections for personal emoluments by MoF and Verité Research (LKR billion), 2022-2023**

	MoF Projections			Projections by Verité Research	
	2022 Est	2022 Revised Estimates	2023	2022	2023
Personal Emoluments	688	740	702	740	747

Source: Budget Estimates 2022 - 2023 and Authors' calculations

### 4.1.3. CAPITAL EXPENDITURE

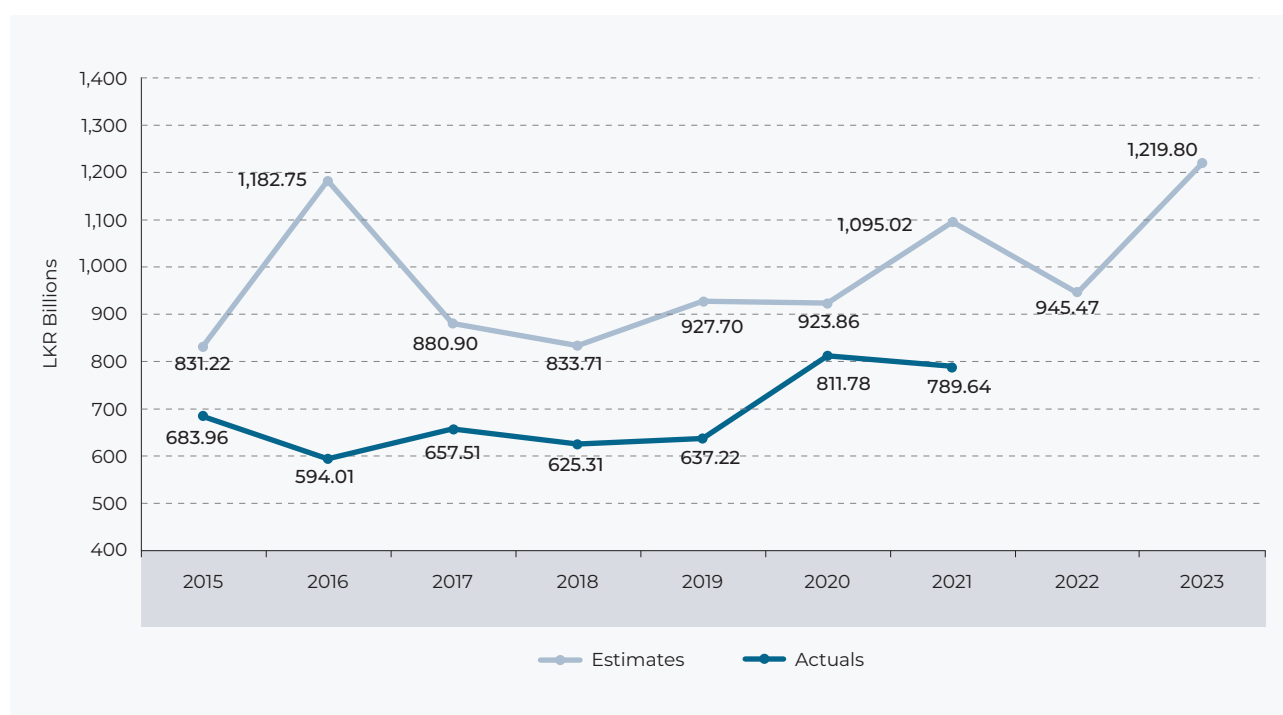
The government estimates capital expenditure to be LKR 1,085 billion in 2022 and LKR 1,220 in 2023, which is a 12 percent year-on-year increase. However, when looking at historical figures, actual capital expenditure has significantly fallen short of the estimates provided in the budget (see Figure 24).

**Table 53: Estimates for capital expenditure by MoF and Verité Research (LKR billion), 2022-2023**

	Expenditure			Increase from 2022
	2022 Revised Estimates	2023 Estimate	Change from 2022 Revised Estimate	Y-o-Y% Increase in Expenditure
Capital Expenditure (Public Investment)	1,085	1,220	135	12%

Source: Budget Estimates 2023

**Figure 24: Estimates versus actual capital expenditure**



Source: Budget Estimates, 2015-2023

Despite the discrepancies between budgeted and actual spending in the past, there were two factors that were noted in projecting capital expenditure: (a) 2021 spending was suppressed by Covid-19 dynamics as well as large shortfalls in revenue; and (b) 2022 and 2023 were years in which the GDP deflator was unusually high at 34.6% and 27.4% respectively.

To derive the capital expenditure forecasts for 2022, the GDP deflator was applied to the actual capital expenditure from 2021. This calculated projection for 2022 was then compared with the government's forecast, and the lower value was selected as the forecast for 2022.

Subsequently, this approach was repeated for 2023, using the above calculated forecast for 2022. In doing so, we established that the government's projections for both 2022 and 2023 were lower than the GDP deflator adjusted increase from the previous year. Therefore, the government's capital expenditure projections, LKR 1,085 million for 2022 and LKR 1,220 million for 2023, were maintained as is for both the years without recommending revisions.

**Table 54: Projections for capital expenditure by MoF and Verité Research (LKR billion), 2022-2023**

	2022 Revised		2023 Estimates	
	MoF	Verité Research	MoF	Verité Research
Capital Expenditure	1,085	1,085	1,220	1,220

Source: Budget Estimates 2023, Budget Speech 2023.



## 4.2. Summary of Government Expenditure Estimated in 2022-2023 and Recommended Revisions

Based on the concerns addressed in sections 4.1.1, 4.1.2 and 4.1.3, it is unlikely that the government will attempt to accurately project government expenditure in 2023. To address this gap, Verité Research suggests some revisions to expenditure projections for 2023 (see Table 55).

**Table 55: Estimates for government expenditure (LKR billions) Verité Research, 2022-2023**

	MoF Projections		Projections by Verité Research	
	2022 (Revised)	2023	2022	2023
Total Expenditure	4,721	5,854	4,721	5,899
Recurrent Expenditure	3,636	4,634	3,636	4,679
o/w Personal Emoluments	740	702	740	747
o/w Interest	1,379	2,189	1,379	2,189
o/w Other Recurrent	1,517	1,743	1,517	1,743
Capital Expenditure	1,085	1,220	1,085	1,220

Source: Budget Estimates 2022-2023 and Authors' Calculations

## 4.3. Recommendations

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Based on the analysis presented in Section IV of this report, Verité Research makes the following recommendations:

- a.** The analysis anticipates that capital expenditure for 2023 will be adjusted downwards to align with the shortfall in revenue, as in the past. To minimize the deviation of the budget deficit, Verité Research recommends that the government pre-identify capital expenditure reductions in advance so that the areas from which expenditure is cut have lower marginal value than the areas that are protected from cuts (instead of vice-versa).
- b.** Estimates on expenditure on personal emoluments are confusing with the budget speech contradicting the budget estimates and what was enacted by parliament. It is recommended that the government clarify its expectation on this budget item, and work with realistic estimates of expected costs, to facilitate better planning in the budget and in public finance.

# CONCLUDING REMARKS

*The State of the Budget* report compiled by Verité Research provides an assessment of the 2023 government budget, which is characterised by a lack of fiscal analysis of revenue and expenditure estimates. Two key concerns highlighted in this report are: (i) overly optimistic revenue targets by successive governments over the past 20 years and (ii) the lack of transparency and accountability in government expenditure. The report forecasts that the government's revenue collection will fall short for 2022 and 2023. On expenditure, the report highlights a significant increase in interest payments due to higher domestic interest rates and debt costs. It also points out that the government's projection of a decline in personal emoluments expenditure to be unrealistic. Finally, the report provides recommendations for better fiscal management, by improving transparency and accountability.

Verité Research recommends that the government consider these observations and utilise them to improve the process of budgeting, to enhance trust between the government and citizens, and to improve the economic prospects of country.

# GLOSSARY

<b>Bn</b> .....	Billion
<b>CBSL</b> .....	Central Bank of Sri Lanka
<b>CCPI</b> .....	Colombo Consumer Price Index
<b>COPF</b> .....	Committee on Public Finance
<b>GDP</b> .....	Gross Domestic Product
<b>IFI</b> .....	Independent Fiscal Institution
<b>IMF</b> .....	International Monetary Fund
<b>LKR</b> .....	Sri Lankan Rupees
<b>Mn</b> .....	Million
<b>MoF</b> .....	Ministry of Finance
<b>NBD</b> .....	Department of the National Budget
<b>NBT</b> .....	Nation Building Tax
<b>o/w</b> .....	out of which
<b>PAL</b> .....	Ports and Airport Development Levy
<b>PAYE</b> .....	Pay-As-You-Earn
<b>SCL</b> .....	Special Commodity Levy
<b>SE</b> .....	Supplementary Estimate
<b>SSCL</b> .....	Social Security Contribution Levy
<b>Tn</b> .....	Trillion
<b>VAT</b> .....	Value Added Tax
<b>VR</b> .....	Verité Research
<b>WB</b> .....	World Bank
<b>WHT</b> .....	Withholding Tax

# ANNEXURES

# Annexure 01: Accounting Fraud, 2020

**In 2020, the government deviated from accounting principles to create a false impression of fiscal health, which is tantamount to accounting fraud.** The 2020 Annual Report of the Central Bank of Sri Lanka stated that the government budget deficit for 2020 was -11.1 percent of GDP. The deficit for 2019 was also revised from -6.8 percent of GDP in the 2019 Annual Report to -9.6 percent of GDP in the 2020 Annual Report. This increase in the 2019 deficit was due to the shifting of LKR 422.6 billion in government expenditure that was incurred in 2020 to 2019. As explained by the MoF, this was done “*in the view of accounting for the payment of arrears spilled over from 2019*”. The result was an underestimate of the budget deficit in 2020 and an overestimate of the deficit in 2019. The 2019 Annual Report of the Ministry of Finance states that Sri Lanka’s national accounting system uses the modified cash-based accounting method. Under this method, expenditure and revenue are only recognized when cash is paid or received, which means that unspent budget allocations are cancelled at the end of the financial year. According to this modified cash-based accounting method, it is not permissible to record an expenditure outlay of Rs. 422.6 billion made in 2020 in the accounts of 2019. It is also inaccurate to deviate from cash-based accounting for expenditure and not apply the same accounting measure for revenue in arriving at the budget balance.

Table A1.1 provides the original values reported by the MoF and the corrected values calculated by Verité Research.

**Table A1.1: Corrected Fiscal balance, 2019-2020**

	2019				2020			
	MoF		After correcting for accounting fraud		MoF		After correcting for accounting fraud	
	LKR Million	% of GDP	LKR Million	% of GDP	LKR Million	% of GDP	LKR Million	% of GDP
Total Revenue and Grants	1,898,808	11.9	1,898,808	11.9	1,373,308	8.7	1,373,308	8.7
Total Expenditure	3,337,896	21.0	2,915,290	18.3	3,040,996	19.2	3,463,602	21.9
Primary Balance	(537,736)	-3.4	(115,130)	-0.7	(687,386)	-4.3	(1,109,992)	-7.0
Budget Balance	(1,439,088)	-9.0	(1,016,482)	-6.4	(1,667,688)	-10.5	(2,090,294)	-13.2

Source: Annual Report of MoF



# Annexure 02: Revenue Projections by Verité Research, 2022-2023

## Annexure 2.1: Corporate Tax

Corporate tax collection for 2022 was projected by adjusting (increasing) 2021 actual revenue collection to (i) the nominal GDP growth of 2022, which is 34.6 percent; and (ii) the 25 percent increase into the tax collection in the last quarter of 2022 due to the changes in corporate tax policy (24 percent to 30 percent). Thereafter, 2023 revenue was projected by adjusting (increasing) the projected revenue collection for 2022 (excluding corporate tax rate change adjustment), using the projected nominal GDP growth of 2023, which is 27.4 percent, and the 25 percent increase in tax collection due to the changes in corporate tax policy (24 percent to 30 percent).

**Table A2.1: Corporate Tax Revenue Projections (LKR billion), 2022-2023**

		LKR Billion
<b>Year 2022</b>		
2021 actual corporate tax collection		252
(+) Nominal GDP growth 2022	34.6%	88
2022 tax collection prior change in tax structure		<b>339</b>
(+) Corporate tax rate changed from 24% to 30%	25% increment only in Q4	21
Projected Revenue for 2022 (VR)		<b>360</b>
<b>Year 2023</b>		
2022 tax collection prior change in tax structure		<b>339</b>
(+) Nominal GDP growth 2023	27.4%	93
		<b>432</b>
(+) Corporate tax rate changed from 24% to 30%	25% increment	<b>84</b>
Projected Revenue for 2023 (VR)		<b>516</b>

Source: Authors' calculations using Budget Estimates 2023

## Annexure 2.2: PAYE Tax

Even though the government introduced the new PAYE tax structure in October 2022 with the intention of collecting revenues starting from November 2022, the taxes were collected only starting from January 2023. Therefore, Verité Research attempted to correct the PAYE tax revenue collection of 35 billion for 2022 reported by the government, to reflect the actual potential revenue for 2022.

**Table A2.2: PAYE Tax Revenue Projections (LKR billion), 2022**

		2022
Expected PAYE for 2022		35
(-)PAYE collection under new tax structure for Nov/ Dec	(100/12)*2	16.67
Balance: PAYE collection under old tax structure for 10 months		<b>18.33</b>
(+)PAYE collection under old tax structure for Nov/ Dec	(18.33/12)*2	3.06
Total projected PAYE Collection for 2022 (VR)		<b>21.38</b>

Source: Authors' calculations using Budget Estimates 2023

## Annexure 2.3: VAT

The government introduced policy changes to the VAT rate multiple times in 2022. First, the VAT rate was raised to 12 percent from 8 percent in June 2022. Then in September 2022, it was increased to 15 percent (a return to 2019 levels). Due to these policy changes the government expected tax collection to increase by LKR 89 billion in 2022. However, Verité Research projected the 2022 revenue to be LKR 506 billion.

Verité Research arrived at this figure after adjusting the 2021 revenue collection for nominal GDP growth and prorating the impact of the VAT rate increase on revenue collection (table A2.3). In order to project for 2023, Verité Research used the 2019 VAT revenue collection as 2019 had the same VAT rate as 2023. Additionally, the VAT threshold in 2019 stood at LKR 12 million while for 2023 the threshold stands at LKR 80 million per annum. Therefore, by adjusting the 2019 collection for GDP growth, Verité arrives at a projection of LKR 846 million which, with a higher threshold in 2023, would be lower. However, due to the lack of information Verité Research will not be adjusting for the 2023 threshold to be lower and the projected VAT collection for 2023 stands at LKR 846 million (Table A2.3)

**Table A2.3: VAT revenue projections (LKR billion), 2022-2023**

		LKR Billion
<b>Year 2022</b>		
2021 actual VAT collection		308
(+) Nominal GDP growth 2022	34.6%	107
2022 VAT collection prior to change in the tax structure		<b>415</b>
(+) VAT rate changed from 8% to:		
12% - for 3 months: June to August 2022	50% increment for 3 months	
15% - for 4 months: September to December 2022	25% increment in 4 months	
Projected Revenue for 2022 (VR)		<b>506</b>
<b>Year 2023</b>		
2019 actual VAT collection at 15%		<b>444</b>
(+) Nominal GDP growth (2019-2023)	91%	402
Projected Revenue for 2023 (VR) at 15% (reinstated VAT rate to 2019 rate)		<b>846</b>

## Annexure 2.4: Cigarette Tax

The excise duty on cigarettes (without indexation) has been projected by: (i) first estimating the quantity of cigarettes (sticks) sold in 2022 and 2023 based on the market share of six cigarettes in 2020 (reference year) and a price elasticity of 0.5 (ped); and (ii) then multiplying the estimated quantity by the excise duty per stick.

**Table A2.4: Excise Duty of Cigarette Tax Revenue Projections (LKR billion), 2022-2023**

	2022		2023	
	Estimated Quantity (no. of sticks)	Excise Tax (LKR)	Estimated Quantity (no. of sticks)	Excise Tax (LKR)
JPGL	1,571,985,924	46.60	1,353,654,545	55.92
Capstan	273,611,881	6.75	209,354,545	13.36
Navycut	68,513,857	41.10	61,958,519	49.32
Bristol	31,895,898	41.10	27,662,800	49.32
Benson & Hedges	4,768,438	46.60	4,265,882	55.92
Dunhill	175,112,149	46.60	161,807,059	55.92
<b>Total Excise Revenue</b>		<b>LKR 88 billion</b>		<b>LKR 92 billion</b>

## Annexure 2.5: Social Security Contribution Levy (SSCL)

Given that both National Building Tax (NBT) and SSCL are turnover taxes, Verité Research tested how NBT collection can be adjusted to predict the SSCL collection. The NBT collection in 2019 was fuelled by the GDP growth, the SSCL rate (2.5 percent) and a lower threshold. Though the rate of the SSCL is straightforward, the threshold is not. The government estimation of LKR 250 billion for 2023 can be reached by adjusting the NBT collection in 2019 to the GDP growth rate and the SSCL rate. Therefore, it seems that the government has not taken into account the change to the threshold, when projecting the SSCL for 2023. Therefore, Verité Research assumes the threshold change impact of 25 percent, given the threshold increased by 10 times when projecting the SSCL for 2022 and 2023.

**Table A2.5: SSCL Projections, 2022-2023**

	LKR Billion	
	2022	2023
NBT 2019	105	105
GDP Growth	1.50	1.91
Higher rate	1.25	1.25
Low threshold	0.8	0.8
Collection period	0.25 (four months)	1 (one year)
<b>SSCL</b>	<b>39</b>	<b>200</b>

Source: Authors' calculations

## Annexure 2.6: Custom Import Duty

Custom import duty collection for 2022 was assumed to be same as the government estimation. However, the revenue for 2023 was projected by adjusting the impact of custom import duty policy changes introduced in the budget speech 2023, the import volume projections by the IMF, and the depreciation effect. The calculation was done based on two main assumptions: (i) that the value of imports will be consistent, at current duty rates (0%, 10% and 15%) and proposed duty rates (0%, 15% and 20%); and (ii) that the increase in import volume translates into an increase in revenue – i.e. that import value grows proportionate to the volume.

**Table A2.6: Custom Import Duty Projections, 2022-2023**

	LKR Billion	
	2022	2023
Previous Import Duty collection		42
Volume of Imports(1+% change)		1.14183
Depreciation Effect (1+%)**		1.038
		<b>49.779</b>
Impact of policy change (%)		42%
2022 collection adj. to policy change		<b>17.64</b>
<b>Custom Import Duty</b>	<b>42</b>	<b>67</b>

Source: Authors' calculations

\*\*Difference between the IMF projections for the end of the period inflation of Sri Lanka and global .

## Annexure 2.7: CESS

CESS collection for 2022 was assumed to be the same as the government estimation. However, 2023 was projected by adjusting the impact of CESS policy changes introduced in the budget speech 2023, the import volume projections by the IMF, and the depreciation effect. The calculation was done based on the assumption that growth in import volume translates into more revenue (i.e. that import value grows proportionately to the volume).

**Table A2.7: CESS Projections, 2022-2023**

	LKR Billion	
	2022	2023
Previous CESS collection		68
Volume of Imports(1+% change)		1.14183
Depreciation Effect (1+%)**		1.038
Phasing out of CESS (1/3 p.a)		2/3
<b>CESS</b>	<b>68</b>	<b>54</b>

Source: Authors' calculations

\*\*Difference between the IMF projections for the end of the period inflation of Sri Lanka and global.

## Annexure 2.8: Ports and Airports Development Levy (PAL)

PAL collection for 2022 was assumed to be the same as the government estimation. The revenue for 2023 was projected by adjusting the impact of PAL policy changes introduced in the budget speech 2023, the import volume projections by the IMF, and the depreciation effect. The calculation was done based on the assumption that growth in import volume translates to more revenue (i.e. that import value grows proportionately to the volume).

**Table 2.8: PAL Projections, 2022-2023**

	LKR Billion	
	2022	2023
Previous PAL collection		177
Volume of Imports(1+% change)		1.14183
Depreciation Effect (1+%)**		1.038
Phasing out of PAL (1/5 p.a)		4/5
<b>PAL</b>	<b>177</b>	<b>168</b>

Source: Authors' calculations

\*\*Difference between the IMF projections for the end of the period inflation of Sri Lanka and global .

## Annexure 2.9: Special Commodity Levy (SCL)

SCL collection for 2022 was assumed to be same as the government estimation. Revenue for 2023 was projected by adjusting the impact of the import volume projections by the IMF and the depreciation effect. The calculation was done based on the assumption that growth in import volume translates to more revenue (i.e. that import value grows proportionately to the volume).

**Table A2.9: SCL Projections, 2022-2023**

	LKR Billion	
	2022	2023
Previous SCL collection		35
Volume of Imports(1+% change)		1.14183
Depreciation Effect (1+%)**		1.038
<b>SCL</b>	<b>35</b>	<b>41</b>

Source: Authors' calculations

\*\*Difference between the IMF projections for the end of the period inflation of Sri Lanka and global.



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