

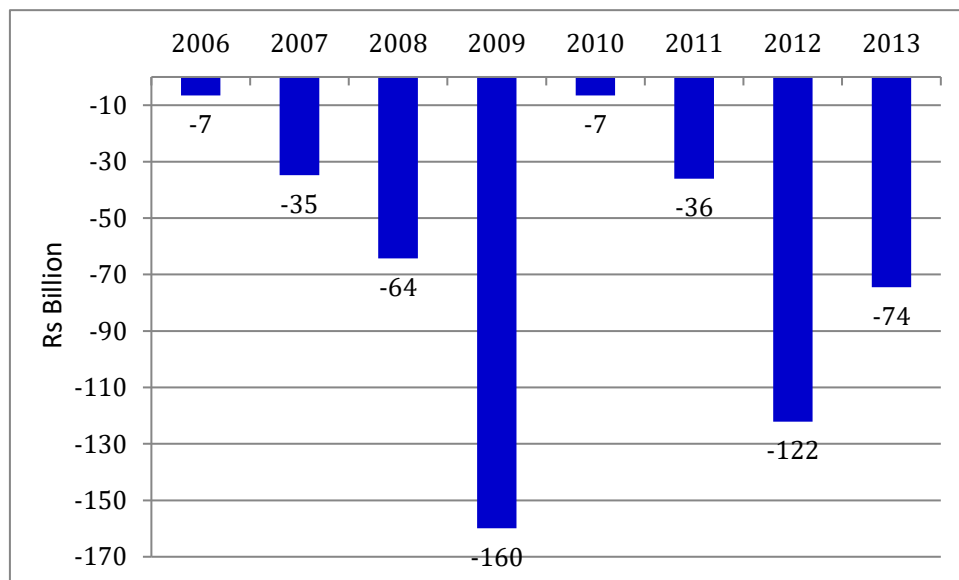


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## Who Bleeds for the Budget?

Previous Verité Insights have documented the “long-procrastination” in the achievements of targets set out in the budget. The mismatch between expectation and reality has been particularly a problem in the area of government revenue. This Insight locates the sectors that have suffered with budget cuts to compensate for the revenue shortfalls.

### Exhibit 1: Gap between the Budgeted and Realised Government Revenue



Source: Central Bank Annual Reports from 2006-2012 and Budget Speech 2014 (2013 gap calculated based on revised estimate given in the Budget)

## Biggest losses and greatest pain

Exhibit 2 shows for 2012 (2013 actuals are not available as yet) both the actual budget cuts in billions of rupees across categories of expenditure, and the level of pain created by those cuts. The pain is calculated by stating the cut as a percentage of the final budget allocation. The logic is simply a cut of 10 billion from a budget of 200 billion will hurt less (cause less pain), than the same cut from a budget of 50 billion.

*Transport and Communication* faced the largest budget cut – 44 billion. That means this sector was bled for more than one third of the revenue shortfall. The pain factor for Transport and Communication was almost 20% (that is how much was cut in relation to

what was received). But the sector that suffered the greatest pain was *Agriculture and Irrigation*: while the cut was 26 billion, the pain factor was almost 34%.

The other sectors subject to substantial pain factors are Energy and Water Supply (17.4%), Public Order and Safety (17.4%), Welfare (16.2%), Community Services (14.5%) and Health Sector (11.1%).

### **The Unkindest Cuts**

Perhaps the unkindest cuts of all were from *Public Order and Safety*, and from *Community Services* where the actual allocation was reduced not only in relation to what was budgeted, but also in absolute amounts compared to the allocation in the previous year (in 2011).

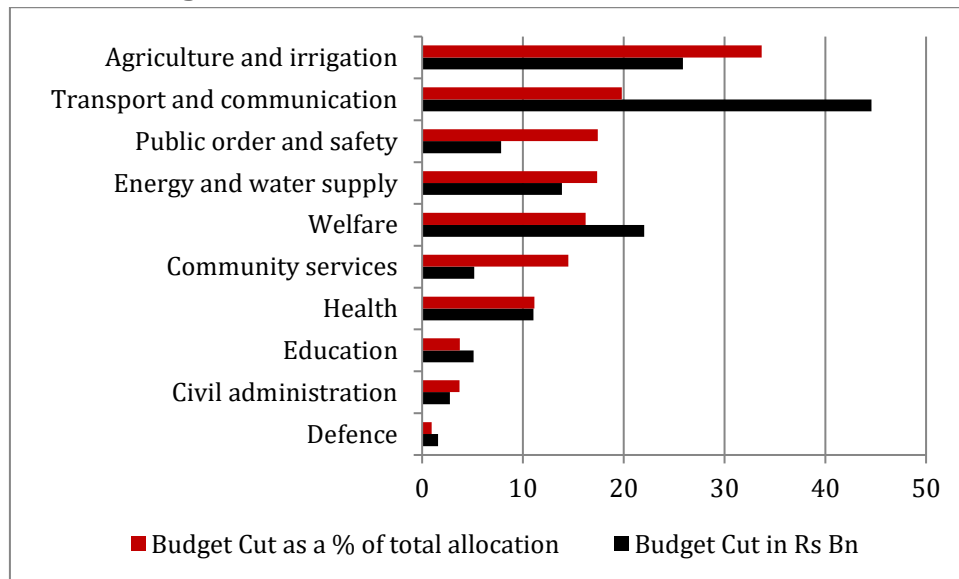
It is also unkind (and probably unwise) that a few categories of expenditure have been disproportionately bled, to cover up for the revenue shortfalls. 75% of the revenue shortfall was covered up by bleeding (taking away money from) just three budget categories: *Transport and Communication* (36%), *Agriculture and Irrigation* (21%), and, *Welfare* (18%). Additionally, *Health* bled for another 9% of the revenue shortfall.

### **Defense vs. the Rest**

**The Police and the Military:** A new development is that the police has been separated from the defense ministry, under public order and safety. The final budget for *public order and safety* was Rs. 45 billion, after it was cut by 7.8 billion, with a pain factor of 17.4%. But the final budget for defense is recorded as Rs.163 billion after it is cut by a mere 1.6 billion with a pain factor of just 1%. The approach to cutting suggests that police was given less priority than the military.

**Deference for Defense:** In fact, the defense spending, despite having amongst the highest budget allocations, faces the lowest level of absolute cut, and the lowest level of pain, of any spending category. The defense spending is also disguised by the fact that not all allocations directed at towards the military are counted in defense spending. For instance, spending on the Kothalawela defense Academy would be counted under education. A curious feature of the budget 2014 was that total capital expenditure allocation for this military academy was 16.3 billion, which was an amount greater than the combined total capital expenditure for all the other universities in Sri Lanka.

## Exhibit 2: Budget Cut in Rs Billion and as a % of Total Actual Allocation



Central Bank Annual Report 2012

### Interest payments are an indictment on budget accounting

There is a category of expenditure where the difference between the budgeted amounts and actual expenditure is puzzling and worrying. That is *Interest Payments*. Increased dependency on international commercial borrowing has in recent years significantly increased the cost of interest payments. But the discrepancy between what was estimated and what was actually paid out is flabbergasting.

The budget estimated 13 billion in interest payments, but when the final numbers came in, interest payments were 4 times that estimate – a whopping 52 billion. Un-anticipated depreciations in currency could have added 10 to 20% to an estimate, but it could not have increased it by 400%. Much more than in the case of most other expenditures, the government debt, and its terms are well-known, and the interest payments on existing debt should be predictable with a high degree of accuracy. But budget accounting has mis-estimated it by four million miles.

The problem in such mis-estimation is not only the inaccuracy of information provided to parliament and public during budget debates but that other sectors will again face further unexpected budget cuts in order to meet this extra interest payments. In-fact the mis-estimation of interest payments to the revenue shortfall problem by a third – which then explains is why the budget cuts in the various sectors adds up to more than 100% of the revenue shortfall.

## **Prognosis on 2013-2014**

An important implication from this analysis is that, going by previous years, spending promises made in the budget and lauded in public are in fact quite unreliable.

This same pattern can be expected when the final numbers are eventually reported for 2013 as well. The Verité Research analysis of Budget 2013 last year predicted that the revenue targets were unrealistic and would not be achieved. This prediction turns out to be correct: revised estimates now indicate a significant shortfall in revenue. When the next Central Bank Report is published, we will know again which sectors paid for it and how much pain they suffered.

This is a recurring problem. The government has two options in the forthcoming year: choosing between maintaining a low budget deficit – which is important for international financial ratings and lower borrowing costs – or keeping its budget promise to the public.

If the government chooses to break its budget promises, rather than face a high deficit, perhaps this analysis might help it reconsider the sectors which are made to bleed for the price of poor accounting and financial management.

**Verité Research provides strategic analysis and advice to governments and the private sector in Asia. Comments welcome, email [insights@veritresearch.org](mailto:insights@veritresearch.org).**