Sustainable Value Creation through Expenditure and Cost Management in the Government Sector[1]

At the outset, let me express my gratitude to the Institute of Certified Management Accountants for inviting me to speak at this important occasion. The topic provided is also a critical area for discussion at this juncture in Sri Lanka's economic journey.

1. Background

I need not to remind anyone in this audience of the devastating economic crisis that Sri Lanka has undergone since early 2022. I also need not to elaborate on the fact that we as a country are far from being safe from the grip of this crisis. Whilst the country has seen a notable improvement in economic stability over the last 18 months or so, the government is still in the process of addressing the structural issues that led to the crisis and there is a long way to go to complete this process.

Fiscal weakness has been one of the fundamental drivers of macroeconomic instability in Sri Lanka's post-independence history. Persistent budget deficits accumulated to increase debt to unsustainable levels. On top of these long-standing vulnerabilities, ill-timed tax cuts, combined with exogenous shocks such as the COVID-19 pandemic, led to government revenue declining to historic lows since 2020, with revenue falling to around 8.3% of GDP in 2022, one of the lowest in the world.

This resulted in the budget deficit exceeding double digit levels, triggering credit rating downgrades as a result of which Sri Lanka lost global capital market access and the ability to refinance its external debt. Eventually, Sri Lanka had no option but to announce a Moratorium on selected external debt servicing pending the restructuring of debt. Accordingly, addressing fiscal weakness has become one of the key structural reforms that are required to restore macroeconomic and debt sustainability in Sri Lanka.

2. Sustainable Value Creation

In the above context, I wish to briefly talk about the topic today, "*Sustainable Value Creation through Expenditure and Cost Management in the Government Sector*". In fact, the concept of sustainable value creation is not new. What is relatively new, however, is the

[1] *Speech Delivered by Mr. K M Mahinda Siriwardana, Secretary to the Treasury and Ministry of Finance, Economic Stabilisation and National Policies at the Session 2 on "Sustainable Value Creation through Expenditure & Cost Management in Government, SOEs and Private Sector" of the CMA National Management Accounting Conference – 2023 on "Sustainability and Value Creation in an Economic Turmoil", held on 12.09.2023 in Colombo, Sri Lanka.*

increasing realisation that action needs to be taken quickly to address the environmental, social, and governance (ESG) challenges to ensure a sustainable future. This action is the responsibility of everyone: government, businesses, investors, and individuals. As we all are aware, in Sri Lanka, the government provides a vast array of services to the public, which is essential for the smooth functioning of the public administrative organization as well as of the society.

In conventional economics, the concept of value creation by the public sector is largely absent. Value is created in business with the state playing a reactive role in correcting 'market failures' to enhance economic efficiency. The term 'public value' has been adopted by scholars in public management and administration to attempt to go beyond this reactive role, focusing on how public-sector managers play an important democratic role in managing a trade-off between efficiency and the engagement of citizens in shaping policy. "In economics, public actors are recognised as having a role in 'enabling' value creation by investing in areas like skills, research and education, which are key, for example, to the development of technology and for a skilled workforce the labour input"[2]. So, in the remaining part of my speech, I will touch on restoring fiscal stability in the country and public expenditure management to broadly shed light on the efforts that are being taken by the government to address the current serious fiscal issues faced by Sri Lanka to enable the positive public sector value creation, going forward.

3. Restoring Fiscal Stability

Sri Lanka's approach to fiscal sector reform can be characterised as primarily revenue based fiscal consolidation. This is because while the government revenue is well below global averages at around 8.3% of GDP, public expenditure which has ranged between 18% and 20% of GDP, is not high compared to regional and income peers. In fact, there are many areas where government expenditure needs to be increased – sectors such as education, healthcare, digitalization, public transport, and renewable energy infrastructure warrant greater public investment. Investment in these areas are crucial for "sustainable value creation" as outlined in the theme of this discussion. Therefore, the medium term objective relating to expenditure management should occur in the form of re-allocation of spending from low-priority, low returns sectors to high priority areas, as opposed to significant reductions the overall spending envelope.

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[2] "*Putting value creation back into "public value": from market-fixing to market-shaping*", Mariana Mazzucato & Josh Ryan-Collins, Journal of Economic Policy Reform, Volume 25, 2022 - Issue 4, 5 April 2022. https://doi.org/10.1080/17487870.2022.2053537

The government's immediate fiscal priority has been to reset the tax structure to meet the domestic resource mobilisation needs of a middle-income country. Following the tax reforms implemented since mid-2022, Sri Lanka now has an appropriate tax policy framework considering corporate and personal income tax rates, VAT rates, and rates of core excise taxes. As a result, there has been significant improvement in overall tax collection in 2023. Domestic taxes in particular have performed well and are broadly in line with targets, however border tax collection on imports has fallen short due to import restrictions, an appreciated currency, and lower global commodity prices in the first half of the year.

Since tax policy rates are now at appropriate levels, further revenue enhancement should be derived by phasing out of remaining tax exemptions and having a specific focus on tax administration to improve collection. There is significant room for improvement in tax administration, particularly in terms of addressing institutional weaknesses, deployment of technology, and addressing corruption vulnerabilities in all three revenue agencies. A concerted effort is being made by the government towards achieving these improvements in tax administration.

It is well known that tax administration reforms take time to yield results in terms of revenue gains. There is nonetheless an urgency to see continued improvement in the fiscal balance, particularly in terms of the primary budget balance. Therefore, until the full results of tax policy enhancement and tax administration yield results, it becomes essential to implement careful expenditure management to ensure the primary budget balance targets are met. Towards this end, several steps have been taken by the government over the last 18 months.

4. Public Expenditure Management

At the outset, it is important to understand that the public expenditure in Sri Lanka is very rigid as most expenditure is mandatory in nature and the Treasury has very limited discretion over most spending items. For example, spending on salaries, pensions, debt service cost, social protection payments, significantly exceed government revenues. None of these can be easily reduced overnight. Therefore, in a practical sense, there is very limited space to control expenditure in the short term. Nonetheless, the government has taken every effort to manage expenditure to the greatest extent possible.

a. *Short Term Measures to Prioritise Expenditure*

Since early 2022, the Treasury has issued a number of circulars that impose significant restrictions on public expenditure to maintain fiscal discipline and support the fiscal consolidation process. This has included enhanced disciplines on new hiring, over-time payments, fuel consumption and vehicle usage, expenditure on events, foreign travel, and so on. These policies have continued into 2023 and to date. Subsequent circulars issued in early 2023 required line ministries to implement a 6% reduction in expenditure compared to the 2023 budgeted levels through efficiency gains and other savings. Public expenditure on areas outside of identified priority or mandatory expenditure required explicit approval of the Minister of Finance.

As a result of these measures, in the first 6 months of 2023, primary expenditure (government expenditure minus interest cost) grew by only 10.5% whilst tax revenue grew by 50% during the same period. This enabled a primary surplus of Rs. 31 billion during the first 6 months of the year, an over-performance compared to the primary balance target for this period under the ongoing International Monetary Fund (IMF) supported Extended Fund Facility (EFF) programme.

b. *Use of Technology and Digitalization in Expenditure Management, and Public Service Delivery*

Several other initiatives are being deployed to improve expenditure management. One key initiative is the deployment of greater levels of technology in expenditure management. The government expects to complete the roll-out of the Integrated Treasury Management Information System (ITMIS) in the near term. This will improve commitment controls over expenditure by all government spending agencies. Enhanced oversight will play an important role in ensuring arrears are managed more effectively and spending over-runs are avoided. The government is also expanding the roll-out of e-procurement, which will provide a greater transparency over procurement expenditure and enable better price discovery, again contributing to cost savings over the medium term. These measures are part of a broader effort to implement widespread digitalization of government processes and public service delivery.

Digital transformation and unification of public services can help create sustainable value for the government and society in several ways. By offering all public services in one place, citizens can easily access the services they need, which can lead to greater productivity for the economy and cost savings for the government. This can improve citizen's satisfaction and trust in government institutions. In addition, digital platforms can enable the government to collect and analyze data on citizen's needs and behaviours, which can improve service delivery. This data can also be used to identify areas for improvement, innovation, and better targeting in public services.

Building capacities of civil servants for new skills on digital, data, and adaptive governance can help the government achieve sustainable value creation in the public sector in several ways. It fosters a culture of innovation and continuous improvement in the public sector. The use of data and Artificial Intelligence (AI) in policy making can help improve decision-making by providing the government with real-time insights and predictive analytics. This can help them make more informed and evidence-based decisions. As these measures are rolled out, it is expected to significantly improve efficiency, improve business operations and create new value for the people, and drive down costs as well which would have a material positive fiscal impact.

c. Zero Based Budgeting

Sri Lanka's budgetary practice has been on the basis of incremental budgeting where only new expenditure has to be justified by the spending agencies in the annual budget. However, the government has introduced a new initiative of zero-based budgeting specifically for 10 of the largest spending ministries. Accordingly, these spending agencies will need to justify all expenditure incurred, including legacy expenditure, to demonstrate the purpose of such spending and that spending is taking place in the most efficient manner possible. This would help eliminate wastage, duplicate spending, and identify redundant processes – all of which will help manage overall public expenditure. Under this budgeting approach, these agencies are expected to carry out only the core activities in terms of their respective mandate while gradually withdrawing from non-core activities. Further, all Spending Agencies were informed through the 2024 Budget Call to pay due attention to the principals of zero-based budgeting, when Annual Budget Estimates for the year 2024 are prepared.

d. Reduction of SOE Losses

Another critical area of public expenditure management is the reduction of transfers to fund losses of state-owned enterprises (SOEs). The government has implemented a number of strategies to limit the losses of the largest loss making SOEs – particularly Ceylon Petroleum Corporation (CPC), Ceylon Electricity Board (CEB), and Sri Lankan Airlines (SLA). Cost-reflective pricing has been introduced to CPC and CEB, along with broader structural reforms, including restructuring balance sheets of these entities. Competition has been introduced in petroleum retail which will drive efficiencies in CPC, whilst the process of unbundling the CEB is progressing to improve financial and operational transparency and competition within the entity, which will also serve to improve competitiveness and reduce losses. The improved financial position of the SOEs is expected to provide material fiscal savings through reduced expenditure obligations for the Treasury. Already, this year, CPC has made a profit, and the losses of CEB are expected to decline substantially.

e. Public Sector Wage and Pension Bill

Beyond the reforms identified thus far, there are other longer term, deeper reforms that are required to address the most rigid expenditure items. The public sector has a cadre of around 1.4 million, which leads to a large public wage and pension bill. It is necessary to right size the public sector such that the salary and pension bill can be better managed. This would also enable the payment of competitive remuneration to attract and retain the required talent into the public service. However, this right sizing of the public sector as a whole, and subsets such as the military, cannot happen overnight. For example, measures have been taken to allow early retirements in the military – but a broader and deeper reform is required, which the government is working towards at present. Pension management is another important challenge. As a first step, it is necessary to quantify the pension liability of public sector and identify funding options going forward. In the future, it will become necessary to consider new options such as contributory pensions in order to achieve a more sustainable fiscal path in the country.

f. Increasing Efficiency of Social Welfare Programs

Taking into consideration the fact that some of the neediest people of the society are not properly benefited from social welfare programs while some people deemed to be ineligible are benefited, reforms are being introduced to enhance the targeting efficiency and allocation efficiency of social welfare programs, through the "*Aswesuma Program*" and digital payment systems thereof.

g. Bridging the Gap Between Intent and Action

Another crucial aspect is the identification and establishment of a mechanism to bridge the gap between intent and action, essentially aligning Key Performance Indicators (KPIs) with accountability. While we can impart essential skills and knowledge through various learning experiences to public sector workers, instilling a sense of accountability and responsibility is equally paramount. Often, we witness the creation of numerous visions, commissions, and committees. However, the execution of these intentions is either absent or significantly delayed. The government requires assistance in translating these intentions into tangible actions, yielding "quick wins" and addressing the "low-hanging fruits" to bolster the trust between citizens and their government. Efforts are also underway to introduce a holistic and continuous process of evaluation across government. This is expected to create a culture of learning from past practices and improve transparency and efficiency of all government activity.

h. Promoting Accountability and Whole of Government Culture

Accountability is a serious concern and one of the critical issues dominating public sector management in Sri Lanka like in many other countries, owing mainly to widespread public demands for transparency in governance and the global outcry against corruption, which is considered as a "macro-critical" issue in economic growth. In fact, limitations in accountability and transparency in the public sector creates opportunities for corruption with its associated negative consequences. Accountability is closely tied to the promotion of a system's thinking perspective and a 'whole of government' approach. The demand for these approaches has been widespread, not only from the government but also from the private sector and civil society. When we talk about a 'Systems Thinking' lens, it means looking at the bigger picture and understanding how different parts of the government interact and affect one another. This perspective is especially important when dealing with ministries that provide common public services. Instead of each ministry working in isolation, a System Thinking approach would encourage them to collaborate and coordinate their efforts for more effective and efficient service delivery. In other words, it means breaking down silos between different government departments and agencies for a more integrated and holistic approach. A 'Whole of Government' culture refers to a mindset and approach where the entire government apparatus works together as a cohesive unit to address complex issues and challenges. The Ministry of Finance, Economic Stabilisation, and National Policies has a key role to play in this new approach. In fact, after the experience gained through the unprecedented economic crisis, there is a strong need to revisit the country's administrative structure and its service delivery.

5. Legislative Framework for Fiscal Management

Whilst many of these challenging expenditure management reforms have been motivated by the economic crisis, it is imperative that this discipline is not rolled back once normalcy has been fully established. Towards this end, the government is drafting legislation that would provide a legally binding framework for robust fiscal management. The most important such piece of legislation is the draft Public Financial Management (PFM) Bill, which will establish binding fiscal rules and other disciplines, including key areas such as procurement, capital expenditure management, and medium term fiscal frameworks. In addition to the PFM legislation, new laws on SOE reform are also being drafted which will address long standing governance concerns.

6. Concluding Remarks

The reforms and related measures outlined here are part of a broader effort by the government to restore fiscal, debt, and macroeconomic sustainability. The expenditure savings envisaged through these measures can be channelled into public investments in crucial sectors such as education, healthcare, public transport, water, housing, digitalisation, the green economy, and other priorities that will be essential to drive economic recovery and growth in the medium to long term. This would result in a better quality and balance of public expenditure which can drive sustainable value creation in the economy. By emphasizing sustainable value creation, the government can work towards building trust, improving efficiency, and enhancing the public perception of the public sector in a way that will continue to benefit the country and its citizens in the future, rather than merely addressing the issues temporarily.

In most cases, these reform measures attempt to change long standing, rigid structures which requires careful change management and broad public support. It is crucial that all stakeholders, the government, trade unions, civil society, private sector, and academia, are able to work together to achieve these fundamental changes that are essential pre-requisites to ensure that Sri Lanka does not slip back into the worst of the debilitating economic crisis that the country has endured over the last 2 years.