Speech by Mr. K. M. Mahinda Siriwardana, Secretary to the Treasury, and the Ministry of Finance, Planning and Economic Development, at the "Earnst & Young Post Budget Conference", held at the Hilton Colombo, on 18th February 2025

1. Background

The 2025 budget is another important step in Sri Lanka's journey of recovering from the deep and complex economic crisis that gripped the country since 2022. This particular budget is very consequential for many reasons. It is the first budget presented by the new government following the Presidential and General Elections of September and November 2024**. In Sri Lanka's history, the general trend has been that a change in the political cycle brings with a reversal of economic reforms.** Such reversals have created tremendous volatility – more devastating than the domestic policy errors that led up to the 2022 economic crisis.

However, this political cycle has been characterised by a continuity in the basic macroeconomic fundamentals that are needed to ensure economic stability. This has been a long-awaited change in Sri Lanka's political culture where we are seeing the first signs of de-politicisation of basic macroeconomic fundamentals of a disciplined fiscal policy and sound monetary policy. It is essential that this practice continues going forward to ensure a stable economic environment upon which economic prosperity can be built.

Whilst the 2025 budget ensures a continuity in fiscal discipline and a stable macroeconomic path, the budget draws on the government's manifesto to set a strong foundation for economic growth and for substantial attention towards the well-being of those who have suffered most due to the crisis. This is not an easy balance to achieve within the tight fiscal constraints faced by the government – however I believe this budget has managed to achieve that balance in a satisfactory manner.

2. Context

Before discussing the 2025 budget, it is important to reflect on the financial context in which this budget is presented. **Preliminary data from 2024 indicates that Sri Lanka has performed well on its key fiscal target** – which is the primary budget balance, achieving a surplus of approximately 2.2% of GDP. This is very close to the medium-term target primary budget surplus of 2.3% of GDP. However, it should be kept in mind that the primary balance over-performance is largely due to under-performance of capital expenditure. This in turn was due to the fact that foreign financing remained low until the debt restructuring process was concluded. Furthermore, due to the two elections in the second half of the last year, expenditure slowed down. Preliminary estimates for government revenue in 2024 are in line with the expected levels of 13.6% of GDP.

Therefore, **the strong primary budget balance performance in 2024 does not indicate space for reduction in taxes at this stage**. In 2025, we expect a more robust capital expenditure execution given the conclusion of the debt restructuring process. Accordingly, it is necessary for revenue to continue to grow in 2025 as well to reach the annual target of 15.1% of GDP in 2025 to enable the higher expenditure to be accommodated whilst ensuring the 2.3% of GDP primary budget balance is met in 2025 as well.

Another important point to note from the preliminary 2024 fiscal data performance is the high interest cost of approximately 9% of GDP. It is important to keep in mind that the Treasury continues to absorb a large cost from the crisis mitigation efforts. **When inflation reached 70% in 2022 and interest rates had to be increased in order to bring inflation under control, the government's cost of borrowing increased significantly.** In fact, the increases in interest rate were essential at that time to control inflation which is the number one enemy of the poor. **But it is important to acknowledge and recognize the fact that this had a large impact on fiscal cashflows and even to date, the ability of the Treasury to provide finances for essential public services is constrained by this large interest burden.** This is a key reason why the government does not have the freedom or flexibility to provide indiscriminate spending to support growth and welfare. Fiscal space, particularly cashflow space, remains very constrained. The debt restructuring process and gradual repricing of domestic debt at lower market rates will enable interest costs to reduce over time, however until such time, including in 2025, interest cost weighs heavily on Treasury cashflow management.

3. Expenditure in 2025

Government expenditure in 2025 is constrained by Treasury cashflow constraints and the legal limit of 13% of GDP primary expenditure ceiling imposed by the Public Financial Management Act No. 44 of 2024. As the Honourable President clearly mentioned in his budget speech, we as a country, are still emerging from the crisis and we do not have unlimited resources at our disposal. **We have limited public funds obtained from the taxes of hard-working citizens. Therefore, every Rupee must be spent with utmost care, and value for money must be ensured at all times.**

In this context, I am confident that the 13% of GDP primary expenditure ceiling can be used to generate substantial value if it is carefully deployed and wastage is minimised. For example, several proposals have been outlined regarding the control of public expenditure – measures such as the rationalisation of public agencies, prudent usage of state assets, the establishment of a State-Owned Enterprises holding company. Digitisation of public services is also expected to contribute substantial savings. New legislation, including the Public Procurement Bill and the State Assets Management Bill, will all contribute to this endeavour.

Whilst carefully staying within the fiscal limits, the 2025 budget has provided significant resources to key priority areas which are aligned with the mandate of the government. Rs. 749 billion is allocated for social protection. This includes a substantial increase in allocations for *Aswesuma* as the government increasingly focuses on driving its welfare agenda through direct targeted cash transfers. This is important in order to break from past practices of tinkering with the tax structure and administered prices in order to provide public welfare. Going forward as well, it is important for the government to use targeted direct cash transfers to achieve its welfare objectives.

Rs. 604 billion is allocated for public health services. Rs. 619 billion is allocated for the education sector. Substantial attention is paid to addressing pressing issues such as child nutrition, pre-school education, and other areas that require focus as developmental objectives. Rs. 483 billion is allocated for public transportation and transport related infrastructure, another key driver of inclusive economic expansion.

All in all, the budget allocates 4% of GDP for capital expenditure from 2.7% of GDP capital expenditure executed in 2024. **This is a clear signal of the shift from stabilisation to growth.** This increase in government capex will have important implications for sectors such as construction which have long been subdued due to the decline in government capital expenditure, large arrears in the past, and elevated interest rates. The government has now completely eliminated arrears above 90 days and interest rates continue to decline, supported by low inflation and disciplined fiscal policy.

4. Revenue Sources

The budget speech does not elaborate a great deal on the government revenue sources expected to fund the 2025 public expenditure. That is because most of these revenue measures have already been previously announced in Parliament and in many cases are already being implemented. For example, the bulk of the revenue gain required to fund the 2025 budget is expected from the taxes associated with the liberalisation of motor vehicle imports. We expect approximately 1% of GDP to be raised from taxes associated with motor vehicle imports, including excise, VAT, Customs Duty, and luxury tax. Vehicle imports were opened again after 5 years on February 1st 2025 and thus far, we are comfortable with the observed trend in vehicle imports. The government continues to carefully monitor import trends to ensure there would not be any adverse impacts on the external sector.

Other revenue measures have already been announced, including VAT on digital services, higher corporate income tax on cigarettes, alcohol, and gaming, and the corporate income tax on export of services. These revenue measures have also been discussed and agreed with the IMF staff when arriving at the Staff Level Agreement (SLA) in November last year. Another tax policy adjustment is the increase in the individual capital gains tax (CGT) from 10% to 15%. I want to reiterate that this is not a new measure since at present as well, CGT is charged on corporates at 30% and individuals and partnerships at 10%. The CGT on individuals and partnerships is proposed to be raised from 10% to 15%, which is a progressive measure. Necessary amendments to the Inland Revenue Act will be drafted. In addition to the tax policy measures, significant attention is being paid to tax administration and improving tax compliance. Honourable President was very firm in his commitment towards this in the budget speech.

Whilst a key focus of this budget is the effort to drive economic recovery and growth, it is not feasible to do this through tax incentives and tax holidays. In the past, governments have tried to use tax policy to achieve investment promotion objectives. However, this has led to a proliferation of tax exemptions which contributed to the weak fiscal base and eventually led to the crisis. I wish to reiterate that tax policy should be seen solely as a means of collecting revenue to finance public services. Investment attraction should be achieved by reducing costs of doing business and facilitating access to factors of production; land, labour, and capital. Economic expansion must be driven by productivity gains and efficiency improvements. Whenever the government does provide limited tax incentives, these would be well targeted, based on rational and objective criteria, clearly linked to the risk undertaken by the investor, and ensured to have minimal fiscal risk.

As part of this disciplined approach to fiscal policy, we are confident that the revenue measures outlined will enable government revenue to reach the required 15.1% of GDP to finance expenditure in 2025 whilst delivering a primary budget surplus of 2.3% of GDP.

5. Fiscal Disclosures

Another important aspect of this budget is the higher level of disclosures relating to the government's fiscal policy measures. These stem largely from the requirements of the Public Financial Management Act No. 44 of 2024.

In terms of Section 20 (2) of the PFMA, the Annual Budget Document shall be accompanied by; -

(a) budget speech summarizing the contents of the annual budget and the overall thrust of the Government's fiscal policy;

(b) a public-friendly version of the annual budget containing easy-to-understand summary of the main features of the annual budget;

(c) the fiscal strategy statement and the budget, economic and fiscal position report;

(d) medium-term debt management strategy and annual borrowing plan;

(e) the list of ongoing and newly approved public investment projects, including public-private partnership projects in accordance with subsection (1) of section 45;

(f) the list of outstanding loans and outstanding guarantees provided by the Government and other contingent liabilities of the Government, including those related to public-private partnership projects;

(g) a summary of public service employment across budgetary entities;

(h) a statement of tax expenditures, including the total cost of existing tax expenditures and the disclosure of new tax expenditures; and

(i) any other documents or information as required under this Act or any other written law or as may deemed appropriate by the Minister of Finance.

Honourable President also made it clear in his budget speech that all members of Parliament should closely scrutinize these documents. I would go further to say that the public should also closely scrutinize these documents. After all, Sri Lanka's economic crisis was triggered by the failure of the government to adhere to fiscal rules. Sri Lanka has had a Fiscal Management (Responsibility) Act since the year 2003, however the Act was never truly adhered to, and there was very little attention given to this by law makers, the media, or the public, until it was too late. **That same mistake cannot be repeated.** At present, we have all the laws needed to provide a solid foundation to ensure disciplined macroeconomic management. This includes the Central Bank of Sri Lanka Act No. 16 of 2023, the Public Financial Management Act No. 44 of 2024, the Public Debt Management Act No. 33 of 2024, and the Economic Transformation Act No. 45 of 2024. But as we have seen in the past, laws along are insufficient to deliver results. It requires strong institutional commitment, and also continuous scrutiny by the legislature, civil society, business chambers, and the general public. Therefore, I urge you all to pay attention to the budget documents presented along with yesterday's budget.

6. Alternative Paths

Many groups continue to claim that Sri Lanka can afford to deviate from the current macroeconomic reform trajectory. However, these same groups fail to provide a concrete alternative path. The reality is that Sri Lanka has no alternative except the prevailing trajectory which is the result of a carefully designed comprehensive reform programme. Whilst there is space to make adjustments within the broad parameters of the Extended Fund Facility (EFF) programme, as has been done in adjustments to the PAYE tax and other tax measures, deviating from the overall parameters would have devastating consequences.

The fact of the matter is that the policy errors made by Sri Lankan authorities in the lead up to the 2022 crisis resulted in a complete loss of the country's economic sovereignty. The only way that we can regain sovereignty is to ensure we follow macroeconomic policy discipline and continue with key reforms until such time the

economy is strengthened with robust fiscal and external reserves, along with sizable volumes of non-debt creating forex inflows.

Criticism for the sake of criticism, without a sound analytical basis and without presenting a feasible alternative, adds little value to the public debate. In a democracy, it is important to have a vibrant discussion and critique about government policy – but this should be based on credible and realistic alternatives. It is important for Sri Lanka's political culture to evolve in such a progressive manner.

7. Concluding Remarks

A budget is not just about balancing the fiscal numbers to ensure budget targets are met. It is also necessary to balance the various expectations of different stakeholders in the country. This is never an easy task since often times these interests and expectations can be in conflict with one another.

This budget had the particularly difficult challenge of ensuring a continued adherence to economic stability, whilst also providing relief to the poor and vulnerable, and also setting the foundation for economic recovery and growth. A strong governance culture is an essential component of this objective. The budget speech clearly projects the government's policy of zero tolerance for corruption and abuse of public funds. The legal framework to support this has a good foundation with the Anti Corruption Act of 2023 already in place, the Proceeds of Crime Bill is in advanced stages of drafting following review, and the Public Procurement Bill will be developed this year. From an institutional perspective, all entities in government have an important responsibility to deliver on this commitment by the government. The Ministry of Finance will be pay special attention to the key revenue agencies, the IRD, Customs, and Excise, to ensure the elimination of corruption vulnerabilities in those entities.

Honourable President also clearly articulated how the budget sets the pathway to grow non-debt creating inflows whilst building fiscal and external buffers. This would enable a seamless settlement of the gradually increasing debt service obligations from 2028, when the first capital repayments resume. **I wish to reiterate his message that as long as we maintain this reform trajectory and continue to build fiscal and external buffers, whilst growing non-debt creating inflows, Sri Lanka will be able to comfortably manage its external debt service liabilities.**

However, the government alone can't take the economy to the next level. The major driver of economic expansion will be the private sector, particularly when it comes to growth of exports, investment, and job creation. The same applies to the elimination of corruption – as the saying goes, it takes two hands to clap. Therefore, it is crucial that we all take responsibility as stakeholders in Sri Lanka's economic recovery and make our contribution to improving Sri Lanka's economic prospects. **The 2025 budget has provided clear direction on the way forward for the country, it is up to all of us to convert this vision into a reality which would create a prosperous and inclusive economy that would benefit all Sri Lankans.**

Thank you.