RATIONALIZING GOVERNMENT EXPENDITURE IN SRI LANKA

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1. Introduction

Sri Lanka is grappling with an unprecedented economic crisis characterized by mounting debt, fiscal imbalances, and a loss of access to international capital markets. Years of structural vulnerabilities and policy missteps, exacerbated by external shocks such as the COVID-19 pandemic, have culminated in severe economic turmoil. This paper analyzes the ongoing challenges associated with the country's fiscal management and evaluates strategies to rationalize government expenditure within the framework of the International Monetary Fund's (IMF) Extended Fund Facility (EFF) program.

The analysis delves into the inefficiencies of traditional budgeting practices of Sri Lanka, which have often resulted in resource misallocation and unproductive spending. By examining country-specific issues, this paper identifies areas for potential expenditure rationalization and offers recommendations to improve fiscal discipline.

Key findings of this study reveal that addressing inefficiencies in recurrent and capital expenditures, enhancing fiscal transparency, and aligning spending with national priorities are critical steps to ensure sustainable development. Additionally, the paper underscores the importance of integrating reforms in energy pricing, tax administration, and governance to foster long-term economic stability.

By focusing on these critical aspects, this paper aims to provide actionable insights for policymakers seeking to navigate the current economic crisis and establish a resilient fiscal framework. Through these recommendations, the research contributes to the broader discourse on public financial management and economic recovery in Sri Lanka.

1.1. The Context of Economic Crisis of Sri Lanka

Amid the ongoing economic crisis of Sri Lanka, the sharp decline in foreign reserves has had profound and far-reaching effects on the nation's financial and socioeconomic landscape. The annual report of the Central Bank of Sri Lanka indicates that gross official reserves reached critically low levels in 2022. According to the Central Bank 2022, reserves dropped to historical lows, reaching USD 1.8 billion by the end of September 2022, compared to USD 3.1 billion at the end of 2021. This severe depletion made it increasingly difficult for the government to secure external financing, exacerbating the economic challenges faced by the country. The shortage of foreign currency led to a significant depreciation of the Sri Lankan rupee against major currencies. According to the Central Bank of Sri Lanka's reports, the rupee experienced substantial depreciation throughout 2022. The Central Bank Annual Report 2022 highlights that by the end of September 2022, the rupee had depreciated by 44.8% against the US dollar, reflecting the severe impact of the foreign currency shortage on the exchange rate. The Central Bank of Sri Lanka reported that the sharp depreciation of the rupee, combined with rising global commodity prices, led to soaring inflation, which peaked in September 2022. Headline inflation, as measured by the Colombo Consumer Price Index (CCPI), reached 69.8%, driven by food inflation at 94.9% and non-food inflation at 57.6%. The National Consumer Price Index (NCPI) reflected an even higher inflation rate of 73.7% in the same month. The skyrocketing prices of essential goods and services, including food, fuel, and electricity, placed immense financial strain on households and businesses, forcing families to cut back on consumption and businesses to struggle with rising costs, leading to widespread economic hardship.

The government’s decision to halt debt servicing in April 2022 was a pivotal moment in its economic trajectory. This decision was made amid an acute shortage of foreign exchange reserves, which rendered the country unable to meet its external debt obligations. According to the Annual Report of the Central Bank of Sri Lanka for 2022, the economy contracted by a staggering 7.8% during the year, marking one of the most severe recessions in the nation’s history. The contraction was driven by reduced economic activity across all main sectors, reflecting the pervasive impact of the crisis on production, consumption, and investment. The inability to maintain debt servicing also created significant uncertainty, affecting investor confidence and exacerbating the economic downturn.

The depletion of reserves and the suspension of debt servicing triggered a cascade of events that further deepened the crisis. International credit rating agencies, including Moody’s, Fitch, and S&P Global, downgraded Sri Lanka’s sovereign credit ratings to default levels. These downgrades effectively locked the country out of international capital markets, leaving it with limited options for financing its external debt. The inability to secure foreign financing exacerbated shortages of essential imports, including medical supplies, food, and fuel, compounding the hardships faced by the population. Reports indicated that hospitals faced critical shortages of essential medicines, while fuel queues and power outages became a daily reality for many Sri Lankans.

A significant driver of Sri Lanka’s economic distress has been its persistent twin deficits; the fiscal deficit and the current account deficit. The fiscal deficit has been fueled by weak revenue generation, high recurrent expenditures, and inefficiencies in public spending. The Ministry of Finance's Annual Report 2022 indicates that the tax revenue to GDP ratio declined by 0.1 percentage points to 7.3% in 2022 from 7.4% in 2021, reaching historically low levels. This decline significantly undermined the government’s ability to fund critical public services and development projects. In 2022, the Budget deficit of Sri Lanka stood at 10.2% of GDP, reflecting the severe fiscal imbalance caused by declining revenues and rising expenditure pressures. This reliance on borrowing has increased debt-servicing costs, creating a vicious cycle that has further strained public finances.

Compounding the fiscal challenges is the inefficient allocation of resources within the public sector. Traditional budgeting practices have often resulted in fund misallocation, with significant amounts allocated to non-priority areas at the expense of essential sectors such as health and education. The International Monetary Fund (IMF) has underscored the need for expenditure rationalization to improve the efficiency and effectiveness of public spending. In its Article IV consultation report for Sri Lanka, the IMF emphasized that targeted spending cuts and improved fiscal discipline are crucial for restoring macroeconomic stability and ensuring sustainable growth. It also highlighted the importance of aligning expenditures with the development priorities of the country.

The current account deficit, driven by a long-standing dependence on imports and insufficient export earnings, has further strained Sri Lanka's external finances. According to the Central Bank of Sri Lanka's Annual Report 2022, the country's current account deficit contracted to USD 1,453 million in 2022, equivalent to 1.9% of GDP, compared to USD 3,284 million (3.7% of GDP) in 2021.The country’s export base remains narrow, with tea, apparel, and remittances constituting the primary sources of foreign exchange earnings. However, these earnings have been insufficient to cover the cost of imports, leading to trade deficits. According to the Central Bank of Sri Lanka's Annual Report 2022, the country’s trade deficit narrowed to USD 5,185 million in 2022, the lowest level since 2010, compared to USD 8,139 million in 2021. This reduction was driven by a 4.9% increase in export earnings and a decline in import expenditure, largely due to restrictions on non-essential imports and liquidity constraints. While challenges remain, the narrowing of the trade deficit suggests progress in managing external imbalances and highlights the potential for further strengthening export performance and reducing reliance on imports.

The economic crisis has also highlighted vulnerabilities in the energy sector of Sri Lanka. The country's heavy reliance on imported fuel for electricity generation has made it particularly susceptible to global energy price shocks. The sharp increase in oil prices in 2022 exacerbated the foreign exchange crisis, as the government struggled to finance fuel imports. Widespread power outages and fuel shortages became commonplace, disrupting economic activity and affecting the daily lives of citizens. The IMF has recommended structural reforms in the energy sector to reduce dependence on imports and enhance energy security. Transitioning to renewable energy sources and improving energy efficiency are critical steps to address these challenges.

Addressing Sri Lanka's economic challenges requires a comprehensive reform agenda that tackles both immediate and structural issues. The government's engagement with the IMF under the Extended Fund Facility (EFF) program represents a critical step toward restoring economic stability. The EFF program emphasizes fiscal consolidation through revenue-enhancing measures, expenditure rationalization, and structural reforms to improve governance and enhance the investment climate. The IMF's recommendations include broadening the tax base, reducing tax exemptions, and improving tax administration to increase revenue mobilization. These measures are essential for creating a more sustainable fiscal framework and reducing dependence on external borrowing.

In addition to fiscal reforms, the IMF has stressed the importance of monetary and exchange rate policies to stabilize the economy. The Central Bank's decision to adopt a flexible exchange rate regime and raise policy interest rates has helped curb inflation and restore investor confidence. However, sustained efforts are needed to rebuild foreign reserves and strengthen the external position. The IMF has also highlighted the need for a comprehensive debt restructuring strategy to address Sri Lanka's unsustainable debt burden. Collaboration with bilateral and multilateral creditors is essential to achieve debt sustainability and secure the financial support required for economic recovery.

The social impact of Sri Lanka's economic crisis cannot be overstated. Rising inflation has pushed a significant portion of the population into poverty, reversing years of progress in poverty reduction. The World Bank's Sri Lanka Development Update (2023) notes that the poverty rate increased sharply, with vulnerable groups, including women and informal sector workers, disproportionately affected. The government's social protection programs have been stretched thin, underscoring the need for targeted assistance to support the most affected households. Expanding social safety nets and improving their efficiency will be critical in addressing the immediate needs of vulnerable populations.

Looking ahead, Sri Lanka's path to recovery hinges on its ability to implement structural reforms and foster economic resilience. The government must prioritize measures to diversify the economy, enhance export competitiveness, and attract foreign direct investment. Promoting sectors with high growth potential, such as tourism, IT services, and agriculture, is essential for economic development. Investments in human capital, infrastructure, and technology are crucial for driving sustainable and inclusive growth, while policies that support innovation and entrepreneurship can play a key role in revitalizing the economy and creating new employment opportunities.

The economic crisis of Sri Lanka serves as a cautionary tale of the consequences of fiscal indiscipline, overreliance on external borrowing, and weak governance. The challenges are immense, but they also present an opportunity for transformative change. By addressing structural vulnerabilities and building a more resilient economy, Sri Lanka can emerge stronger from this crisis and lay the foundation for long-term prosperity. This will require sustained political commitment, transparent governance, and active engagement with stakeholders, including the private sector and civil society.

1.2. The Current IMF Programme of Sri Lanka

The IMF and Sri Lankan government have reached a staff-level agreement for a 48-month Extended Fund Facility (EFF) program worth approximately USD 2.9 billion. The program aims to restore macroeconomic stability and ensure debt sustainability while safeguarding financial stability and protecting the most vulnerable. Additionally, it focuses on advancing structural reforms to address corruption vulnerabilities and unlocking Sri Lanka's growth potential.

Key elements of the program are:

Enhancing Fiscal Consolidation

The program prioritizes fiscal consolidation through significant tax reforms. These reforms aim to make personal income tax more progressive and broaden the tax base for corporate income tax and VAT. By implementing these measures, the program targets a primary surplus of 2.3% of GDP by 2025, addressing Sri Lanka's historically low revenue levels. The program also emphasizes the importance of spending discipline to support consolidation efforts. It highlights that, given limited fiscal space and the growing need for higher social safety net spending, some reduction in non-priority expenditures may be necessary, alongside efforts to enhance spending efficiency. Additionally, an overarching strategy for managing the public wage bill is required to address the recent upward trend. However, the program underscores that expenditure rationalization cannot replace the need for effective revenue mobilization.

The IMF also emphasized the need for improving budget formulation and execution procedures to support successful fiscal consolidation. Effective budgeting practices can ensure that resources are allocated in alignment with national priorities and development goals.

Cost-Recovery Pricing for Fuel and Electricity

To reduce fiscal risks posed by state-owned enterprises, the program introduces a cost-reflective pricing mechanism for fuel and electricity. The authorities' recent energy pricing reforms and substantial revenue measures are key steps in minimizing these risks. These measures aim to reduce the financial burden on the government while promoting efficiency in energy usage and production.

Protecting the Poor and Vulnerable

Social spending will be increased to mitigate the impact of the crisis on the poor and vulnerable. Efforts will focus on improving the coverage and targeting of social safety net programs, ensuring better protection for those most in need. Enhancing the efficiency of these programs is critical to maximizing their impact and ensuring that limited resources are directed toward those who need them the most.

Restoring Price Stability

The program aims to restore price stability through data-driven monetary policy actions, fiscal consolidation, and phasing out monetary financing. The central bank's independence will be strengthened under a new Central Bank Act to support a flexible inflation-targeting regime. These measures are expected to enhance the credibility of monetary policy and foster economic stability.

Rebuilding Foreign Reserves

Foreign reserves will be restored through a market-determined, flexible exchange rate system. This approach is backed by the program's comprehensive policy package, ensuring stability in external finances. The rebuilding of reserves will be critical for restoring investor confidence and ensuring the availability of foreign currency for essential imports.

Ensuring Financial Stability

The financial system will be safeguarded by enhancing the health and capitalization of banks. Additional measures include upgrading financial sector safety nets and regulatory standards, supported by a revised Banking Act. These reforms aim to ensure the stability and resilience of the financial sector, which is vital for supporting economic growth.

Reducing Corruption Vulnerabilities

To tackle corruption, the program will improve fiscal transparency and public financial management. A stronger anti-corruption legal framework will be introduced, complemented by an in-depth governance diagnostic with IMF technical assistance. Enhancing governance and transparency is essential for building trust and ensuring the effective use of public resources.

2. Literature Review

The economic crises faced by Sri Lanka in recent years have triggered a significant re-evaluation of fiscal policies, especially concerning government expenditure. Academic and policy research provides essential insights into the broader implications of expenditure rationalization, particularly for developing nations grappling with fiscal imbalances. This literature review synthesizes findings from key studies and reports to contextualize the challenges and opportunities of rationalizing government expenditure in Sri Lanka.

Rising debt levels have emerged as a significant concern for many economies, leading to increased pressure on interest payments and potentially hindering long-term economic growth. This creates a detrimental cycle where high debt is accompanied by slow economic growth, which, in turn, exacerbates the fiscal imbalance and intensifies the need for fiscal adjustments (Kumar and Woo, 2010). As debt levels rise, countries are forced to allocate a greater portion of their budgets to servicing interest payments, leaving fewer resources available for productive investments. The challenge of addressing these fiscal imbalances has become a pressing issue for policymakers around the world, with many turning to fiscal consolidation measures to restore economic stability and prevent further deterioration of their fiscal positions.

One of the critical factors contributing to the strain on government budgets is the increasing share of mandatory recurrent expenditures. These expenditures, including pensions, subsidies, and public sector salaries, have limited the flexibility of governments to adjust to economic fluctuations. As these commitments grow, governments find themselves with limited room to maneuver in response to changing economic conditions. In many cases, this has led governments to rely more heavily on borrowing to cover budget deficits, thereby raising overall debt levels. However, with tax rates already high in some countries, the ability to generate additional revenue through taxation becomes constrained, making expenditure reduction the most viable strategy for managing fiscal imbalances (Tareq et al., n.d.).

Research by Alesina and Perotti (1995) and McDermott and Wescott (1996) underscores the effectiveness of reducing public expenditure in achieving successful fiscal consolidation. Their studies suggest that cutting expenditures, rather than increasing tax revenues, may be more conducive to long-term fiscal stability. By reducing non-essential spending, governments can lower fiscal deficits and create a more sustainable fiscal environment without placing additional burdens on taxpayers. These findings align with the broader view that expenditure cuts can be a more effective tool for fiscal consolidation than tax hikes, which can hinder economic growth and reduce public confidence in the government's fiscal management.

The degree of fiscal consolidation required by a country depends on several factors, including the initial debt level, debt tolerance, and the need to maintain adequate reserves. According to Tareq et al, these factors play a crucial role in determining the extent of fiscal adjustments needed to ensure economic stability. Countries with high debt levels and limited fiscal space may face more significant challenges in implementing fiscal consolidation measures. Therefore, a tailored approach that takes into account the specific circumstances of each country is essential for achieving effective fiscal adjustment without compromising economic growth.

In examining the experiences of individual countries, Horton et al, (2006) highlight the importance of fiscal structural reforms in supporting successful fiscal consolidation. They argue that increased transparency and improved monitoring of fiscal positions are critical to ensuring better oversight and control of contingent liabilities, tax expenditures, and debt management. Additionally, strengthened legal and institutional frameworks can help countries maintain fiscal discipline and build stronger political support for fiscal reforms. For example, in oil-producing nations, fiscal indicators such as the non-resource balance have proven to be valuable tools for tracking the sustainability of government finances and guiding fiscal policy decisions.

Maintaining spending discipline is a key component of any successful fiscal consolidation strategy. With limited fiscal space and growing demands for social safety net expenditures, governments must make difficult decisions about where to cut spending. Non-essential spending may need to be reduced, and efforts to improve spending efficiency should be prioritized. One area that often requires attention is the public wage bill, which has been on an upward trajectory in many countries. To address this, the IMF (2022) recommends a comprehensive strategy to manage public sector wages, streamline expenditures, and improve budget planning and execution. Additionally, reforms to state-owned enterprises and the adoption of cost-recovery pricing for energy can further help governments reduce their fiscal deficits and improve their overall financial position.

The composition of government expenditure plays a crucial role in the effectiveness of fiscal consolidation efforts. Research by Giavazzi et al. (2012) argues that adjustments relying on spending cuts are significantly less detrimental to output compared to those based on tax increases. Spending-based adjustments are often linked to mild and short-lived recessions, and in many cases, no recession occurs at all. Conversely, tax-based adjustments are frequently associated with prolonged and severe recessions.

The importance of expenditure composition is further highlighted by Ilzetzki and Vegh (2008), who explore the relationship between fiscal policy, the composition of government spending, and economic outcomes. Their research suggests that fiscal adjustments that focus on reducing revenue expenditure, rather than increasing taxes or cutting capital expenditure, are more conducive to maintaining economic stability and promoting growth. This finding aligns with the broader view that cutting non-productive spending, is essential for achieving long-term fiscal sustainability.

Baum and Checherita-Westphal (2013) also stress the significance of expenditure composition in their analysis of the long-term effects of fiscal consolidation on economic growth. They argue that reducing non-productive spending, including recurrent expenditure, is crucial for achieving sustainable fiscal consolidation without undermining the potential for long-term economic expansion. This approach is supported by Heylen and Everaert (2000), who suggest that shifting expenditure from recurrent to capital expenditure can have positive effects on economic performance, helping governments manage fiscal deficits without stifling growth.

Debrun et al. (2008) take a similar view, highlighting the importance of reducing the share of recurrent expenditure in total government spending while increasing public investment. This strategy, they argue, can improve long-term economic performance and help manage fiscal deficits effectively. Kumar and Woo (2010) further support this view, suggesting that successful fiscal consolidation involves reorienting government spending away from recurrent expenditure and towards more growth-enhancing expenditures, such as infrastructure and education.

Ardagna, S. (2001) adds to the literature by examining the relationship between fiscal consolidation and economic growth across various countries. His research indicates that fiscal adjustments that focus on reducing recurrent expenditure, rather than increasing taxes, are more likely to be associated with sustained economic growth. This finding underscores the importance of expenditure composition in fiscal consolidation efforts and highlights the potential benefits of prioritizing spending cuts over tax hikes.

Finally, Eyraud and Weber (2013) emphasize that successful fiscal consolidation strategies often involve reducing the growth of public spending, particularly in the area of recurrent expenditure, while safeguarding essential public services. This approach allows governments to maintain fiscal discipline without jeopardizing the provision of crucial public services that are vital for social welfare and economic stability.

In conclusion, the literature suggests that reducing public expenditure, particularly recurrent expenditure, is a more effective strategy for fiscal consolidation than increasing taxes. By focusing on expenditure composition and prioritizing spending cuts over tax hikes, governments can achieve long-term fiscal stability without compromising economic growth. Structural reforms, increased transparency, and improved fiscal management practices are also essential components of successful fiscal consolidation strategies. Ultimately, a balanced approach that combines expenditure cuts with targeted investments in growth-enhancing sectors, such as infrastructure and education, can help countries achieve sustainable fiscal consolidation while maintaining economic stability and growth.

3. Methodology

This chapter outlines the research methodology employed to explore strategies for rationalizing government expenditure in Sri Lanka. The methodology is designed to gather insights from professionals engaging in making economic policies, examine Sri Lanka's fiscal practices, and develop recommendations that align with the objectives of the International Monetary Fund’s Extended Fund Facility (IMF-EFF) program. The chapter details the research design, sampling techniques, data collection methods, data analysis processes, ethical considerations, limitations, and the expected outcome of the study. Given the complexity of government expenditure rationalization, this study seeks to identify both immediate and long-term solutions that will support fiscal sustainability in Sri Lanka.

3.1. Research Design

The research uses a qualitative approach to ensure a comprehensive understanding of government expenditure rationalization in Sri Lanka. The study aims to gather insights from key stakeholders involved in fiscal policy formulation and expenditure management. Through interviews and structured questionnaires, the research seeks to explore the challenges and opportunities for rationalizing government expenditure. This approach is suitable for gaining a deep understanding of the perspectives of stakeholders and for developing actionable recommendations.

3.2. Sampling

Participants in this study are selected based on their professional roles and expertise in public finance. The study focuses on government officials involved in fiscal policy formulation, expenditure management, and budget allocation. This group includes key stakeholders from departments under the Ministry of Finance, such as the Department of National Budget, Department of Public Finance, and Sri Lanka Customs, who provide valuable expertise on fiscal policy and budgeting processes. Their extensive experience in these areas is essential for understanding the effectiveness of current expenditure practices and exploring potential strategies for rationalization.

Convenience sampling is employed to engage these government officials and experts due to their availability and willingness to participate in the study. While this method may limit the diversity of the sample, efforts were made to include professionals engaging in formulating economic policies from various departments, ensuring a diverse set of views on fiscal management and expenditure rationalization. The inclusion of professionals from different departments under the Ministry of Finance contributed to a balanced analysis of Sri Lanka’s fiscal situation and its alignment with the objectives of the IMF-EFF program.

3.3. Data Collection Methods

The primary data for this study was collected through structured questionnaires and semi-structured interviews with key stakeholders. The questionnaires are designed to explore multiple dimensions of government expenditure practices, fiscal management, and the opportunities and challenges for rationalization. The questionnaire included the following key sections:

General Information – To classify respondents based on their experience and roles.

Understanding of Existing Government Expenditure Practices – To identify key challenges in expenditure rationalization.

Allocation of Financial Resources – Focusing on the effectiveness of current budgeting practices.

Expenditure Rationalization Strategies – To assess various approaches to improving fiscal discipline.

IMF-EFF Objectives Alignment – To evaluate the compatibility of current policies with IMF goals.

Recommendations for Expenditure Rationalization – Suggestions for short- and medium-term measures to improve expenditure efficiency.

Knowledge Assessment – To gauge respondents' familiarity with expenditure rationalization principles.

General Feedback – For participants to provide additional comments or suggestions.

Each section aims to provide a comprehensive understanding of the current expenditure system, the effectiveness of budget allocation, and the perceptions of fiscal challenges. This allowed the study to identify potential areas for reform and improvement in expenditure management. The questionnaire was user-friendly, designed to ensure that respondents can provide clear and concise responses, thereby ensuring the collection of relevant and reliable data.

In addition to primary data, secondary data from reliable sources was used to support the findings. Key secondary data sources include:

Official Reports: Data gathered from government institutions such as the Ministry of Finance, the Central Bank of Sri Lanka, and international financial organizations like the IMF, OECD, and World Bank. These reports provided an overview of the current fiscal policies and expenditure trends in Sri Lanka.

Academic Journals: A review of existing literature on fiscal policy, expenditure rationalization, and economic reforms in Sri Lanka was conducted. The literature review helped frame the research within a broader theoretical context and provide a comparison to similar studies conducted in other countries

3.4. Data Analysis

Since statistical software was not used in this study, qualitative analysis played a central role. The responses from the questionnaires and interviews were analyzed using thematic analysis. This involved categorizing and interpreting recurring themes, patterns, and trends in the data. Thematic analysis provided a deeper understanding of the challenges and opportunities for expenditure rationalization in Sri Lanka.

Thematic Analysis: This was used to identify key themes in the qualitative responses from the open-ended sections of the questionnaires.

Content Analysis: Secondary data, including government reports and academic studies, were analyzed to extract actionable recommendations and assess the alignment between Sri Lanka's current policies and IMF-EFF objectives.

3.5. Ethical Considerations

Ethical guidelines were strictly followed throughout the research to ensure the confidentiality and anonymity of all participants. Informed consent was obtained from each participant before data collection, and all information provided was used solely for academic purposes. The research also adhered to the ethical standards set by relevant institutions, ensuring that no harm is done to participants and that the data is handled with integrity.

3.6. Limitations

The study acknowledges several limitations that may affect the scope of the findings:

Data Availability: There may be challenges in accessing certain government records or sensitive financial data, which could limit the comprehensiveness of the analysis.

Context-Specific Insights: The findings may be specific to the Sri Lankan fiscal environment and may not be directly applicable to other economies.

3.7. Duration of Study

The questionnaire was distributed to 50 professionals working under the Ministry of Finance on October 5, 2025, achieving a response rate of 50%.

3.8. Expected Outcomes

The study is expected to achieve several key outcomes:

Identification of domestic best practices for expenditure rationalization that could be implemented in Sri Lanka.

Recommendations for short- and medium-term measures to improve government expenditure efficiency, particularly focusing on aligning fiscal policies with IMF-EFF objectives.

Insights for policymakers on improving fiscal management to support economic stability and sustainability.

The research methodology outlined in this chapter provides a structured approach to investigating the challenges and opportunities for government expenditure rationalization in Sri Lanka. By utilizing qualitative methods, engaging with key stakeholders, and analyzing secondary data, the study aims to provide actionable recommendations that will inform policymakers and contribute to the ongoing economic reforms in Sri Lanka.

4. Analysis and Findings

The participants exhibit a balanced distribution of experience in public finance, with nearly three-fourths having over six years of experience. Most respondents hold senior positions (Grade I at 60%), underscoring their authority in public finance matters. A significant portion works in human resources (28%), followed by infrastructure (20%), and a diverse array of fields such as taxation, health budgeting, and public financial management, suggesting varied perspectives on expenditure practices.

4.1. Understanding of Existing Government Expenditure Practices

Under the above theme, the questionnaire asked participants to rank nine common government expenditure practices that may hinder efforts to rationalize public spending. Each practice represents a specific challenge to fiscal management and budget efficiency. Participants were instructed to assign a rank to each challenge, with Rank 1 signifying the most significant challenge and Rank 9 the least significant. The nine practices listed were: High recurrent expenditures, Lack of transparency, Redundancy and duplication of activities, Political interference in spending priorities, Limited fiscal space, Delays in project implementation, Insufficient monitoring and evaluation, Lack of accountability, and Inadequate budgetary planning. This ranking exercise was designed to identify which practices participants perceive as the most critical obstacles to effective expenditure rationalization.

Out of the 25 participants fiscal space is considered as the most critical challenge to government expenditure rationalization with 44% of respondents, highlighting constraints in reallocating resources and funding priority areas. Lack of accountability ranked second, cited by 36%, emphasizing the need for stronger mechanisms to address inefficiencies and wastage. Political interference in spending priorities emerged as the third major challenge, noted by 48% of participants, followed closely by concerns over lack of transparency (36%) and delays in project implementation (40%), reflecting governance and operational inefficiencies. Meanwhile, insufficient monitoring and evaluation (28%) and inadequate budgetary planning (32%) were viewed as moderate challenges. Although high recurrent expenditures were cited by 48% of respondents, along with redundancy and duplication of activities (32%), these were perceived as less significant in the current context.

The next question is asking for an evaluation of how well Sri Lanka's current budgeting practices contribute to achieving economic stability. It asks respondents to rate the effectiveness of the budgeting practices on a scale from 1 to 5, where:- 1 means "very ineffective" (indicating that the budgeting practices do not contribute positively to economic stability),and - 5 means "very effective" (indicating that the budgeting practices are highly successful in ensuring economic stability).

Out of 25 participants, 16 (64%) selected "3," suggesting that they view the current budgeting practices as somewhat effective, but not very effective. This indicates a mixed or neutral perception, implying that while the budgeting practices may have some positive impact, there is room for improvement to make them more effective in fostering economic stability. The responses could reflect concerns about inefficiencies or challenges in Sri Lanka's budgeting system, but they also suggest that there may be areas where improvements could enhance the overall effectiveness.

The last question under the above theme asks how familiar someone is with the concept of expenditure rationalization in Sri Lanka, where the participant is asked to rate their familiarity on a scale from 1 to 5.

The scale ranges from 1 (not familiar) to 5 (extremely familiar). Out of 25 participants, 20 (80%) selected rank "4," indicating that they are quite familiar with the concept of expenditure rationalization in Sri Lanka, but not necessarily experts in the field. This suggests that the respondents have a good understanding of the topic, perhaps through general knowledge or previous exposure, but may not have an in-depth or highly specialized expertise.

4.2. Allocation of Financial Resources

Under the above theme, the questionnaire asked participants to rank seven key criteria for the allocation of financial resources. Each criterion represents a specific factor that influences decision-making during the process of reducing budget deficits and managing government finances. Participants were instructed to assign a rank to each criterion, with Rank 1 signifying the most significant factor and Rank 7 the least significant. The seven criteria listed were: Economic impact, Social impact, Urgency of needs, Alignment with national priorities, Revenue-generating potential, IMF conditionalities and objectives, and Political stability and consensus. This ranking exercise was designed to determine which factors participants perceive as the most important in guiding the allocation of resources during fiscal consolidation.

Out of 25 participants, economic impact is considered as the most significant criterion in fiscal consolidation with 44%, prioritizing long-term economic stability and growth. Social impact ranked second, selected by 40%, emphasizing the importance of maintaining or improving social services during the process. Revenue-generating potential was identified as the third most important factor, highlighted by 76%, reflecting the critical need to generate revenue to reduce budget deficits. Political stability and consensus ranked fourth, with 64% recognizing the necessity of securing political support for resource allocation decisions. IMF conditionalities and objectives came in fifth, noted by 60%, pointing to the need to meet international financial conditions, though not as the primary focus for resource allocation. Alignment with national priorities ranked sixth, selected by 52%, indicating its relevance in financial decision-making but with a lower priority compared to economic and social considerations. Finally, urgency of needs was ranked as the least significant factor with 48% of participants, considering long-term stability and growth more important than addressing immediate needs. These findings highlight the need to prioritize economic and social stability, enhance revenue generation, and ensure political consensus while aligning fiscal consolidation efforts with national and international objectives.

As the second question under the above theme, the questionnaire asked participants to identify the three most significant obstacles that hinder the efficient distribution and management of financial resources in the country. Participants were given five options: Political influence, Lack of data and analytics, Bureaucratic delays, Insufficient expertise, and Rigid budget frameworks. The goal of this exercise was to determine which factors participants perceived as the most pressing challenges to improving the efficiency of financial resource allocation.

The survey, conducted among 25 participants, reveals that political influence is seen as the most significant obstacle to effective resource allocation, with 88% emphasizing how political pressures and interests often lead to inefficient financial decisions. Lack of data and analytics ranked second, cited by 72%, highlighting the critical need for accurate, reliable data and analytical tools to guide decision-making and optimize resource use. Insufficient expertise was identified as the third major challenge, noted by 64%, indicating that a shortage of skilled professionals and technical knowledge in financial management and planning hampers effective resource allocation. These findings underscore the need to address political dynamics, strengthen data-driven decision-making, and enhance technical expertise in financial management to ensure more efficient allocation of resources in Sri Lanka.

As the last question under the above theme, the questionnaire asked participants how they believe fiscal discipline can be improved in the budget allocation process. The options provided included: Better oversight by independent fiscal institutions, Stronger enforcement of fiscal rules, Linking allocations to performance indicators, and Enhancing public financial management systems. The aim of this exercise was to identify key strategies that could improve fiscal discipline in Sri Lanka's budgetary framework.

The survey results indicate that the majority of respondents emphasized all four approaches as essential for improving fiscal discipline. Better oversight by independent fiscal institutions was viewed as crucial, with 84% of participants suggesting that independent bodies can offer unbiased assessments, ensuring transparency and accountability in the budgeting process. Stronger enforcement of fiscal rules was highlighted by 80%, with participants noting that stringent adherence to fiscal rules is necessary to avoid overspending and accumulating unsustainable debt, thus maintaining economic stability. Linking allocations to performance indicators was identified as an effective strategy by 72%, ensuring that funds are allocated based on measurable outcomes, which would lead to more efficient use of resources for the intended purposes. Finally, enhancing public financial management systems was seen as a critical factor by 68%, with respondents stressing the need for modernized systems, improved accountability mechanisms, and better-trained professionals to manage public funds more effectively.

4.3. Expenditure Rationalization Strategies

Under the above theme, the questionnaire asked participants to rank five different budgeting approaches based on their effectiveness (with 1representing the highest rank and 5 representing the lowest rank) in improving fiscal discipline and expenditure management. The options provided included: Performance-based budgeting, Zero-based budgeting, Program budgeting, Priority-based budgeting, and IMF-recommended fiscal adjustment measures. The goal of this exercise was to assess which approaches participants believed would be most effective in ensuring fiscal sustainability and efficient allocation of resources.

The survey, conducted among 25 participants, reveals that IMF-recommended fiscal adjustment measures are considered the most effective approach, with 48% ranking them first. Respondents emphasized that these measures, such as reducing deficits through spending cuts and revenue adjustments, are crucial for stabilizing the country's fiscal health, particularly during economic instability. Performance-based budgeting ranked second, selected by 40%, as participants recognized its value in linking resource allocation to measurable performance outcomes, ensuring efficient use of funds and achievement of desired results. Zero-based budgeting was identified as the third most effective strategy, with 60% acknowledging its role in justifying every expense from the ground up to enhance fiscal accountability, though some noted its time-consuming nature. Priority-based budgeting ranked fourth, with 44% agreeing that it effectively directs funds to high-priority programs, though some felt it might not always align with broader fiscal sustainability goals. Finally, program budgeting was ranked fifth by 48%, with participants noting that while it helps organize expenditures around specific programs, it lacks flexibility to address broader fiscal constraints. These findings underscore the need for a comprehensive approach to fiscal management in Sri Lanka, with a strong emphasis on IMF-recommended fiscal measures, performance-based budgeting, and zero-based budgeting. Implementing these strategies could improve fiscal discipline and enhance the efficiency of financial resource allocation.

The next question asks participants to rank the effectiveness of various strategies for rationalizing government expenditure, from the most effective (ranked 1) to the least effective (ranked 5). The strategies listed include outsourcing non-core government functions, subsidy reforms, reducing public sector employment, strengthening fiscal rules and discipline, and using technology and automation to increase efficiency. Each strategy should be assigned a rank based on its perceived impact on improving government expenditure management.

The survey of participants reveals a strong preference for strengthening fiscal rules and discipline, with 40% ranking it as the most effective strategy for rationalizing government expenditure. The use of technology and automation for efficiency ranked second, selected by 48%, highlighting the importance of digital solutions in improving financial management and operational efficiency. Reducing public sector employment was ranked third by 56%, suggesting that while it is considered a viable strategy, it is not the top priority for expenditure rationalization. Outsourcing non-core government functions ranked fourth, with 44% of participants viewing it as a moderately effective approach compared to other strategies. Finally, subsidy reforms were ranked fifth, with 40% considering them the least effective strategy for optimizing government spending. These findings underscore the need to prioritize fiscal discipline, leverage technology for efficiency, and carefully assess employment and outsourcing policies to enhance government expenditure rationalization.

The last question under the above theme, the questionnaire asked participants to rank eight potential solutions based on their feasibility in optimizing government operations and improving resource efficiency. The options provided included: streamlining government processes, merging similar programs or departments, implementing performance-based evaluations, strengthening accountability mechanisms, reducing bureaucratic layers, increasing use of digital platforms and automation, conducting regular expenditure reviews and audits, and enhancing staff training and capacity building. The goal of this exercise was to assess which solutions participants considered most effective in eliminating inefficiencies and ensuring effective use of public resources.

The survey, conducted among 25 participants, identifies performance-based evaluations, strengthening accountability mechanisms, and increasing the use of digital platforms and automation as the most feasible solutions for optimizing government operations. Performance-based evaluations ranked first, with a majority (64%) emphasizing their role in linking government activities to measurable outcomes, improving efficiency, and enhancing accountability. Strengthening accountability mechanisms was ranked second, selected by 52%, highlighting the importance of transparency and robust oversight in minimizing waste and resource misuse. Increasing the use of digital platforms and automation ranked third, with 44% recognizing that technology can streamline processes, reduce human error, and accelerate service delivery, ultimately improving operational efficiency. These findings suggest that prioritizing performance-based evaluations, stronger accountability frameworks, and digital transformation could be key to reducing redundancies and enhancing the effectiveness of government operations.

4.4. IMF-EFF Objectives Alignment

Sri Lanka's government spending matches the goals set forth in the IMF's Extended Fund Facility (EFF) program. This program, which is designed to support countries facing balance of payments problems, outlines specific fiscal and structural reform objectives that countries must adhere to in exchange for financial assistance. In this context, the question asks whether the respondent believes the government's current expenditure aligns with these goals, with a scale from 1 (not at all aligned) to 5 (completely aligned).

The majority of respondents (18 out of 25) selected a 4, indicating that they believe government expenditure is generally in line with the IMF-EFF program's objectives, though not perfectly aligned. A score of 4 suggests that while there is a significant level of alignment, there may still be areas where expenditure practices could be adjusted or refined to more fully meet the program's targets. This response reflects the perception that, while progress is being made, challenges or discrepancies in certain sectors of government spending likely remain, which need to be addressed to fully comply with the IMF's fiscal guidelines.

As the second question under the above theme, the questionnaire asked participants to rank eight potential adjustments based on their importance for optimizing fiscal management and ensuring sustainable economic growth. The options provided included: revenue mobilization through taxation reforms, rationalizing public sector wages and pensions, increasing investment in social safety nets, prioritizing capital expenditures for growth-oriented projects, strengthening governance and reducing corruption, aligning energy pricing with actual costs, debt restructuring and sustainability, and reducing subsidies on state-owned enterprises (SOEs). The goal of this exercise was to assess which adjustments participants viewed as most critical for aligning Sri Lanka's fiscal policies with the IMF-EFF program's goals.

The survey responses reveal several key priorities for fiscal reform. Rationalizing public sector wages and pensions was considered critical by 48% of participants, emphasizing the need for wage and pension reforms to ensure fiscal sustainability. Aligning energy pricing with actual costs (cost-recovery pricing for electricity and fuel) was rated as critical by a significant majority, 76%, reflecting the importance of adjusting energy prices to reflect actual costs for better fiscal management. Revenue mobilization through taxation reforms was viewed as important by 72%, highlighting the necessity of reforming tax systems, such as increasing VAT and income taxes, to generate sustainable government income. Increasing investment in social safety nets was considered important by 56%, signaling the need for enhanced support systems for vulnerable populations. Prioritizing capital expenditures for growth-oriented projects was also deemed important by 68%, underlining the role of capital investments in driving economic growth. Strengthening governance and reducing corruption was identified as important by 84%, stressing the critical role of transparent governance in improving resource allocation and public trust. Debt restructuring and sustainability was rated as important by 80%, highlighting the need for long-term debt management strategies to ensure fiscal stability. Finally, reducing subsidies on state-owned enterprises (SOEs) was rated neutral by 56%, indicating that, while not viewed as a top priority, it remains a potential area for reform. These findings suggest that energy pricing adjustments, governance improvements, and debt sustainability are seen as particularly critical, while other areas such as tax reforms, social safety net investments, and capital expenditures are viewed as important for fiscal stability and growth.

The next question was asking participants to prioritize various fiscal measures to ensure sustained fiscal consolidation, which is the process of reducing a government's budget deficit and debt accumulation. The options presented are categorized into short-term, medium-term, and long-term policy measures. The goal is to prioritize these options based on their timeline, from the immediate actions that can be taken (short-term) to those requiring a longer time frame to implement and realize results (long-term).

The survey responses suggest that the majority of participants prioritize measures that provide immediate fiscal relief and stability, such as improving efficiency in public investment (88%), cutting wasteful spending (88%) reducing subsidies for state-owned enterprises (60%), maintaining inflation control (64%), and building stronger social safety nets (52%). These short-term policy measures aim to address immediate fiscal challenges while laying the groundwork for future reforms. For medium-term policy measures, strengthening debt management (68%) and improving governance (56%) are viewed as essential for ensuring long-term fiscal sustainability. Additionally, implementing cost-recovery pricing for public utilities (60%) is seen as a necessary step for improving fiscal health in the medium term. In terms of long-term policy measures, enhancing tax revenue (48%) and gradually reducing the public wage bill (76%) are viewed as key to achieving structural reforms and ensuring sustained fiscal health. These findings reflect a clear focus on short-term measures for immediate stability, while medium- and long-term strategies are seen as vital for establishing a foundation for long-term fiscal sustainability.

4.5. Knowledge Assessment

This question is designed to gauge participants' confidence in understanding the principles of expenditure rationalization, which involves optimizing government spending to ensure more efficient and sustainable fiscal policies. The options range from "not confident" to "extremely confident," allowing respondents to reflect on their level of knowledge regarding these principles.

The majority of respondents (20 out of 25) selected a 4 on the scale, indicating a high level of confidence in their understanding of expenditure rationalization. This suggests that while most individuals feel well-versed in the subject, they recognize there may still be some aspects requiring further exploration or refinement. The responses likely reflect a solid grasp of the basic principles of expenditure rationalization, with an awareness that further learning or application might be necessary for complete mastery. The high confidence level indicates that the majority are familiar with the core concepts but might still be refining their ability to implement or apply these principles in complex fiscal contexts.

The next question was asking respondents to identify which knowledge or skills would help them contribute more effectively to expenditure rationalization efforts. Expenditure rationalization refers to the process of optimizing government spending to ensure that resources are allocated efficiently and effectively, often in alignment with broader fiscal or economic goals. The options provided in the question (Advanced data analytics, policy analysis and development, financial management techniques, strategic planning, IMF program implementation strategies.) focus on various technical and strategic areas that could aid individuals in this process

The majority of respondents selected advanced data analytics (68%), financial management techniques (60%), and IMF program implementation strategies (48%). These choices suggest that the respondents believe that having a strong grasp of data analytics would help in making evidence-based decisions regarding expenditure, while financial management techniques are essential for managing and controlling public finances effectively. Additionally, familiarity with IMF program implementation strategies indicates the importance of understanding international financial frameworks and how they can be applied to local government expenditure policies, particularly in countries like Sri Lanka that are working within such frameworks.

Under the Additional Insights section, respondents stressed the importance of results-oriented government expenditure, accountability, long-term planning, and rational ministry formation. Recommendations included restructuring recurrent expenditure, prioritizing economically beneficial capital projects, and enforcing policy continuity.

5. Recommendations for Aligning Government Expenditure of Sri Lanka with IMF-EFF Objectives

The following recommendations are derived from the questionnaire and its findings, particularly the analysis chapters presented in this report. These insights reflect the challenges and opportunities identified through the responses and are intended to enhance government expenditure practices and the allocation of financial resources in Sri Lanka. Based on these findings, the following key strategies and recommendations have been outlined to address fiscal challenges, improve resource allocation, and foster sustainable economic growth.

Based on the insights from Section 4.2 of the analysis, several key recommendations are derived to improve government expenditure practices in Sri Lanka. Addressing the constraints in fiscal space, identified as the most significant challenge, is crucial. Strengthening resource allocation mechanisms, enhancing tax compliance, and exploring public-private partnerships will help free up fiscal space for priority areas. Furthermore, the second major issue, the lack of accountability, necessitates the strengthening of auditing and oversight systems to ensure public funds are used effectively. It is also essential to depoliticize the budgeting process, as political interference in spending priorities has been a significant obstacle. Transparency in government spending should be enhanced through open-data platforms to foster public trust and reduce inefficiencies. Additionally, adopting modern project management methods and ensuring regular monitoring of milestones will help address delays in project implementation. Strengthening monitoring and evaluation (M&E) systems is vital to track and adjust expenditures based on performance outcomes, ensuring the effectiveness of programs. Budgetary planning should align more closely with long-term development goals. While concerns over high recurrent expenditures and redundancy are not seen as critical, streamlining operations to reduce waste remains important. A stronger focus on expenditure rationalization through further training and practical knowledge will also help to improve its implementation. Lastly, although current budgeting practices contribute somewhat to economic stability, a comprehensive review is needed to adopt best practices and improve fiscal management.

Section 4.3 of the analysis reveals several recommendations to enhance the allocation of financial resources in Sri Lanka. Economic and social stability should be prioritized, as these are the most significant factors guiding resource allocation. Policies that stimulate economic growth while ensuring the maintenance of social services, especially for vulnerable populations, should be a primary focus. Strengthening revenue collection mechanisms, including improving tax administration, compliance, and exploring new sources of revenue, is essential for fiscal consolidation. Political stability and consensus are also crucial to ensure that resource allocation decisions are supported across the political spectrum, helping to avoid delays and preventing short-term political interests from influencing fiscal decisions. Aligning fiscal efforts with national priorities and international objectives, such as those outlined by the IMF, remains important, but should not overshadow economic and social considerations.

The analysis also identified key obstacles to efficient resource management, such as political influence, which can be mitigated through institutional reforms and greater independence for financial management bodies. Enhancing data collection and analysis capabilities, as well as building expertise in financial management and planning, are necessary to overcome these challenges. Strengthening independent oversight bodies and enforcing strict fiscal rules will help maintain discipline, avoid excessive borrowing, and ensure that resources are allocated based on performance indicators. Additionally, improving public financial management systems through modernization and enhanced training opportunities for professionals and technical staff will ensure more effective and efficient use of public funds.

Section 4.4 of the analysis emphasizes the need for expenditure rationalization strategies. Prioritizing IMF-recommended fiscal adjustment measures will help stabilize Sri Lanka's fiscal health, especially in times of economic instability. Performance-based budgeting, linking resource allocation to measurable outcomes, and zero-based budgeting, which justifies every expenditure, are critical strategies to enhance fiscal accountability and optimize government spending. Priority-based budgeting should be used in conjunction with other strategies to ensure alignment with fiscal sustainability goals. Strengthening fiscal rules and discipline is essential to prevent overspending. Technology and automation should be leveraged to improve efficiency, reduce redundancies, and streamline operations. Reducing public sector employment could be considered, but its broader social and economic impact should be carefully evaluated. Outsourcing non-core functions and reforming subsidies can contribute to expenditure reduction, but their long-term effectiveness should be assessed. To further optimize government operations, the analysis recommends implementing performance-based evaluations and strengthening accountability mechanisms to ensure that government activities are aligned with measurable outcomes. Increasing the use of digital platforms and automation will reduce inefficiencies and improve service delivery, contributing to better resource management. These strategies will help eliminate inefficiencies and ensure effective deployment of public resources.

Section 4.5 of the analysis emphasizes the need for aligning Sri Lanka’s government spending with the IMF-EFF program’s objectives, a phased approach should be taken. In the short term, efforts should focus on improving public investment efficiency, cutting wasteful spending, reducing subsidies for state-owned enterprises, controlling inflation, and strengthening social safety nets. In the medium term, priorities should include strengthening debt management, reducing corruption, enhancing transparency, and implementing cost-recovery pricing for public utilities. For long-term sustainability, the government should focus on tax reform, reducing the public wage bill, and rationalizing public sector wages and introducing a contributory pension scheme to reduce fiscal pressures. By pursuing these actions across short, medium, and long-term timelines, Sri Lanka can align its expenditure practices with IMF guidelines and ensure sustainable economic growth.

Lastly, to enhance expenditure rationalization, it is crucial to build on the existing understanding of fiscal management by providing advanced training in data analytics, financial management techniques, and IMF program implementation strategies. Additionally, developing results-oriented expenditure systems, emphasizing accountability, long-term planning, and rational ministry formation, will help optimize government spending. Restructuring recurrent expenditure to focus on essential programs and prioritizing capital projects with clear economic benefits will promote fiscal discipline and policy continuity. By investing in these areas, Sri Lanka can strengthen its capacity to promote sustainable fiscal policies and achieve long-term economic stability.

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