

## PROGRAM EXPENDITURE AND FINANCING ASSESSMENT

### A. Expenditure Framework

1. **Macroeconomic context.** The Government of Sri Lanka's priority on human resource development is reflected in the increase in public investment in health, education, skills development, sports, and labor relations since 2007. The government has recognized the importance of educated individuals to supply the workforce with the market-oriented skills needed to create rapid economic growth and national development, as literacy alone will no longer suffice in the knowledge era. The government's medium-term development plan, *Mahinda Chintana—Vision for the Future, 2014–2020* intends to transform the education system into one that will provide the technological skills, educational content, and methods to promote the development of inquiring and adaptable minds.<sup>1</sup>

2. **Focal ministry's budget.** The Ministry of Youth Affairs and Skills Development (MYASD) is the focal ministry for skills development; under it, departments and agencies deliver the majority of publicly funded technical and vocational education and training (TVET), overseen by the Tertiary and Vocational Education Commission (TVEC). Despite the emphasis on skills development in the government's medium-term development plan, MYASD expenditure was only 5.2% of the education budget in 2012, and less than 0.6% of budgeted overall government expenditure in 2013. The MYASD budget for 2014 increased by 16% in real terms from 2013. Historically, about two-thirds of MYASD spending has been for recurrent expenditures.<sup>2</sup> However, between 2011 and 2014, the share of recurrent spending has been decreasing (69% in 2011 to 46% in 2014). The economic composition of MYASD expenditures has been moving in the direction of greater focus on development expenditures, which is a positive sign.

3. In the absence of a sector-specific medium-term budgetary framework (MTBF), 2-year expenditure projections are incorporated into annual budget documents, which are usually based on the prior year's expenditure adjusted for inflation assumptions, rather than through a medium-term planning process. The Skills Sector Development Program (SSDP) for 2014–2020—covering MYASD and other participating ministries (higher education, agriculture, industry, construction, economic development, environment, social services, ports, and foreign employment promotion)—is expected to help the government move toward medium-term planning and budgeting that is more tightly linked to outputs, targets, and outcomes for the skills development program. The proposed Skills Sector Enhancement Program (SSEP) covers SSDP implementation from 2014 to 2016 and supports the government's SSDP by helping strengthen the annual budget process and improve efficiency of spending and budget execution.

4. **Expenditure framework.** The SSDP serves as a medium-term development program. The government's indicative costing of the SSDP forms the basis of the TVET sector MTBF. SSDP expenditures are estimated to be \$961 million from January 2014 to December 2020 (Table 1). The government will support the SSDP expenditure framework through an annual budget to be executed by MYASD (\$874 million) and other ministries (\$87 million). The SSEP (2014–2016) will take MYASD's budget and the government budget of all relevant agencies

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<sup>1</sup> Government of Sri Lanka, Ministry of Finance and Planning, Department of National Planning. 2010. *Sri Lanka: The Emerging Wonder of Asia. Mahinda Chintana—Vision for the Future*. Colombo.

<sup>2</sup> MYASD, Department of Technical Education and Training, Vocational Training Authority, National Apprenticeship and Industrial Training Authority, TVEC, University of Vocational Technology, National Youth Services Council, and several smaller agencies.

under MYASD and other ministries (\$386 million) for 2014–2016 as its expenditure framework. The SSEP capital budget is \$265 million (69%).

**Table 1: Summary of Expenditure Framework**  
(At current prices)

Item	SSEP (2014–2016)			SSDP (2014–2020)		
	Amount (SLRs million)	Amount (\$ million)	Share of Total (%)	Amount (SLRs million)	Amount (\$ million)	Share of Total (%)
1. Recurrent budget	<b>15,741</b>	<b>121</b>	<b>31</b>	<b>38,458</b>	<b>296</b>	<b>30.8</b>
Personal cost	3,986	31	8	9,879	76	7.9
Operating expenditure	1,105	9	2	3,084	24	2.5
Transfer to institutions	9,488	73	19	22,639	174	18.1
Subsidies	1,162	9	2	2,855	22	2.3
2. Capital budget	<b>34,437</b>	<b>265</b>	<b>69</b>	<b>86,502</b>	<b>665</b>	<b>69.2</b>
Equipment	5,926	46	12	14,886	115	12
Civil works	10,678	82	21	26,822	206	21
Knowledge enhancement <sup>a</sup>	17,833	137	36	44,793	345	36
3. Total	<b>50,178</b>	<b>386</b>	<b>100</b>	<b>124,960</b>	<b>961</b>	<b>100</b>

SLRs = Sri Lanka rupees, SSDP = Skills Sector Development Program, SSEP = Skills Sector Enhancement Program.

<sup>a</sup> Delivery of skills training and professional development of instructors, managers, and staff.

Source: Ministry of Finance and Planning, Government of Sri Lanka.

5. About 36% of the SSDP budget is allocated to knowledge enhancement, which is for delivery of skills training and professional development of staff, managers, and teachers. Civil works account for about 21% of total SSDP expenditure. The recurrent budget of \$296 million consists of salaries, allowances, operating expenditures, and transfers to semi-autonomous institutions to meet recurrent requirements and subsidies for scholarships and stipends. This estimate assumes that the recurrent budget increases by less than 2.5% annually. In general, the SSDP budget underestimates the total recurrent expenditures and overestimates the total capital expenditures that would be required to implement the medium-term activities under both the SSDP and SSEP. It is important to note that the estimated recurrent budget is inadequate even to adjust for inflation, which is around 6% per annum. However, the SSDP is unlikely to suffer because the shortage of recurrent budget is met through recurrent parts of the additional capital budget, whereby about 32% are allocated to salaries, performance allowances for staff, fees for instructors, and stipends for students.

6. An assessment of the SSDP expenditure framework in terms of effectiveness, efficiency and economy, and adequacy is presented below.

7. **Unit cost projection.** To judge whether the costs of the program are realistic, adequate, and efficient to meet the results of the program, a crude estimate of the per-student recurrent and capital cost was calculated by dividing the 2013 budget estimate for MYASD's capital and recurrent expenditures by the total intake of publicly financed TVET institutions. The unit cost was then projected for the SSDP period using a 6% annual inflation rate. This was then multiplied by the expected intake in future years, based on SSDP targets, to arrive at a rough total recurrent and capital allocation that MYASD would need to receive if the same per-student cost adjusted for inflation were maintained. The findings in Table 2 reveal that the overall SSDP estimate of \$961 million is slightly lower than the one projected from a simple unit cost model (\$985 million). This indicates that the SSDP's emphasis is on overall capacity development rather than the training delivery itself.

**Table 2: Program cost projection based on unit cost estimates (2014–2020)**  
(at current prices)

Items	SLRs million	\$ million
<b>Per-student unit-cost-based projection</b>	<b>128,050</b>	<b>985</b>
Recurrent	55,380	426
Capital	72,670	559
<b>Skills Sector Development Program estimate</b>	<b>124,960</b>	<b>961</b>
Recurrent	38,458	296
Capital	86,502	665

SLRs = Sri Lanka Rupees.

Note: The recurrent unit cost per student for 2013 is estimated at \$260 (SLRs33,855) and the corresponding capital unit cost at \$341 (SLRs44,379).

Source: Asian Development Bank estimates.

8. **Effectiveness.** The SSDP expenditure framework is based on a detailed costing exercise focusing on results and outcomes. The key issues in MYASD budget allocation and expenditure for achieving SSDP results are: (i) inadequate budget for MYASD programs (inadequate allocation for the recurrent budget and the budget for maintenance of facilities and equipment); (ii) focus on input- and activity-based budgeting with little consideration of results; (iii) emphasis on delivery of training through public agencies on the assumption that skills training graduates will get jobs in the private sector; and (iv) no public funds allocated to the private sector. The SSDP expenditure framework incorporates reforms designed to rectify these issues as described below:

- (i) The 7-year SSDP activities are categorized and costed in detail by results, and the government is committed to allocating funds for MYASD, initially based on the SSDP expenditure framework, and to introduce a more robust MTBF over the program period.
- (ii) The government increased the budget allocation for 2014 and adjusted the budget to make it consistent with the SSDP expenditure framework.
- (iii) More than half the capital expenditures have been allocated to “knowledge enhancement” and most of the amount for this category is for recurrent expenditures such as teacher and instructor salaries, training, and consultancy inputs. This is important to ensure availability of resources given MYASD's underestimated recurrent budget.
- (iv) The SSDP has made budget provisions for supporting private training providers based on performance.
- (v) The government has already taken some steps toward better planning, cost estimations, and budget allocation in its early attempts to introduce the bottom-up business planning process and performance-based financing in the public institutions that MYASD finances. This process is expected to lead to allocation of adequate resources for job placement through industry participation.

9. It should be noted that the SSDP reflects large increases in capital expenditure for constructing and/or rehabilitating buildings, which account for over 21% of the total SSDP estimate for the 7-year period. This can be justified for the initial years because most physical facilities and equipment have not been updated and maintained for quality training due to under-financing in the past. Also, high infrastructure costs are expected to expand medium-level skills training. However, the disproportionate emphasis on construction raises concerns about the effectiveness of the expenditure framework and the planned activities to achieve the program's development outcome of creating a market-responsive, inclusive, and quality TVET system. It is clear that more importance and a greater proportion of expenditure needs to be allocated in the

future to the “soft” inputs of teacher training, workshops, and consultancy inputs to ensure that the planned activities effectively deliver program outputs and meet program objectives.

10. **Efficiency and economy.** The annual process of MYASD preparing budget allocation requests for the Ministry of Finance and Planning (MOFP), and MOFP making budget estimates, is suboptimal as indicated by the allocation, release, and expenditure trends. The budget process for MYASD has been quite arbitrary, with allocations usually being incremental, i.e., based on the previous year’s spending and not on targets or needs for the sector. As the World Bank skills development report comments, “budget allocations are .... related neither to performance nor to national priorities .... Budget estimates are based on the traditional “negotiated” approach. Even allocation of recurrent expenditures is not strictly based on inputs, such as number of students.”<sup>3</sup> In addition to the weaknesses in the budget preparation and execution process, the following shortcomings are likely to affect timely and cost-effective achievement of SSDP results:

- (i) Large-scale vacancies in public institutions—a key problem in filling vacant positions required to achieve SSDP results is the lack of budget because the government recurrent budget does not include the salaries and allowances for vacant positions. The SSDP manages this issue by providing recurrent funds for incentives to instructors under the capital budget. This arrangement may not be efficient unless there is a good management information system, and is difficult to sustain in the long run.
- (ii) Effective program implementation by MYASD institutions—the achievement of results depends largely on the performance of MYASD institutions. Most of them (except the Department of Technical Education and Training) are semi-autonomous institutions and receive most of the recurrent funds and some capital funds through transfers. One of the key observations in the World Bank skills development report was that, “The most obvious shortcoming is that the largest increases go to the institutions that spent the most in the past, no matter whether they did so efficiently. Aligning budget allocations with the performance of training agencies and centers could promote innovation, efficiency, and accountability.” MYASD plans to manage additional capital budget directly through the ministry to ensure that all implementing units achieve results.
- (iii) Involvement of the private sector, especially in job placement—lack of full mobilization of the private sector has constrained the skills training program in several ways, not least through the limited employability of graduates because of weak job placement arrangements in the sector industries. The SSDP includes various measures such as cost sharing between the private and public sectors by improving system efficiency; and involvement of industry working groups and compulsory provision of on-the-job training to engage the private sector and increase public–private partnerships in skills development in Sri Lanka.

11. **Adequacy.** The SSDP expenditure framework is adequate to achieve intended results, provided it is reflected in MYASD’s annual budgeting and execution. Under the SSDP expenditure framework, MYASD is required to request budget allocations from MOFP based on an agreed annual implementation plan with fully costed interventions to achieve results. The plan projections will include both capital and recurrent expenditures and reflect detailed costing of activities for each component of the program. Most of the capital budget for 2014 is ongoing, and the additional capital budget is only for initiating new programs. Subsequent budget allocations for 2015 onward will be determined based on a performance partnership agreement between MOFP and MYASD confirming the performance targets.

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<sup>3</sup> World Bank. 2013. *Sri Lanka: Building the Skills for Economic Growth and Competitiveness*. Washington, DC.

## B. Financing Plan

12. **Sources of financing.** The government will provide \$520 million (54%), and development partners will contribute \$441 million (42%); the gap is expected to be mobilized from the development partners. The Asian Development Bank (ADB) will provide \$100 million in the beginning and \$100 million through additional financing to meet the funding gap. The remaining \$200 million will be mobilized from other partners like the World Bank, which will contribute \$100 million during the first 5 years of the program (Table 3). Government financing for 2013 was \$58 million. It is assumed that the government contribution will increase gradually. The main challenge is to get the development partners to finance the gap (\$200 million) and also meet the government share in case the government fails to mobilize committed funds. The government has initiated discussions with other development partners, such as Korea International Cooperation Agency (KOICA), Australia, and Canada to fill SSDP financing gaps.

**Table 3: Program Financing Plan**  
(at current prices)

Source	SSEP (2014–2016)			SSDP (2014–2020)		
	(SLRs million)	(\$ million)	%	(SLRs million)	(\$ million)	%
Government	24,048	185	48	67,609	520	54
ADB	13,000	100	26	13,000	100	10
World Bank	7,800	60	16	13,000	100	10
Other DPs <sup>a</sup>	5,330	41	11	5,330	41	4
Gap	0	0	0	26,000	200	21
<b>Total</b>	<b>50,178</b>	<b>386</b>	<b>100</b>	<b>124,939</b>	<b>961</b>	<b>100</b>

ADB = Asian Development Bank, DP = development partner, SLRs = Sri Lanka rupees, SSDP = Skills Sector Development Program, SSEP = Skills Sector Enhancement Program.

<sup>a</sup> Contribution of \$41.4 million (\$15.4 million from the Government of Germany for the establishment of a vocational training center in the Northern Province, under the framework of the SSDP; and a \$26 million loan from the Export-Import Bank of Korea for the Establishment of Colombo Vocational Training Center and Gampaha College of Technology Project) is included in the expenditure framework.

Source: Ministry of Finance and Planning, Government of Sri Lanka and Asian Development Bank estimates.

13. **Fiscal affordability and sustainability.** To analyze the SSDP's fiscal affordability, the government resource envelope for MYASD, which provides the fiscal space of the government for the skills development program, is estimated on the basis of gross domestic product (GDP) growth in current prices—13% per annum (6% inflation and 7% real economic growth), and allocations of (i) 20.0% of GDP for total government expenditure, (ii) 8.7% of government expenditure in education, (iii) 0.6% of government expenditure for MYASD, and (iv) 57.1% of MYASD's budget financed from domestic resources. The estimated resource envelope indicates that the SSDP program expenditure would remain at 99% of the resource envelope during 2014–2020, indicating the feasibility of allocating \$874 million for MYASD and \$87 million for other ministries, and \$520 million from domestic resources by MOFP— if the economy grows at the annual rate of 13% at current prices. The SSDP expenditure framework is affordable because (i) a disbursement-linked indicator on sector finance incentivizes MOFP to increase sector budget allocations in line with the expenditure framework and (ii) the government is likely to allocate a higher budget share to MYASD given its commitment to reducing youth unemployment through investment in skills development. However, in the case of lower economic growth, the government may find it difficult to allocate the required resources for the SSDP. Long-term sustainability considerations are built into the SSDP design through (i) using country systems for budgeting, accounting, reporting, and auditing; (ii) strengthening institutions involved in skills development; (iii) leveraging development partner financing to increase government spending in skills development over time; and (iv) introducing new mechanisms to improve system efficiency (performance-based financing and performance-based allowance

scheme) and private sector participation (public–private partnerships in university colleges and an employment offer agreement model, including a cost-sharing formula).

### C. Managing Risks and Improving Capacity

14. Table 4 summarizes key risks associated with the expenditure framework. The mitigating measures are reflected in the disbursement-linked indicators and the program action plan.

**Table 4: Expenditure and Financing Risks, and Mitigating Measures**

Risks	Rating without the Mitigating Measures	Key Mitigating Measures
<b>Effectiveness of expenditure framework:</b> Achievement of the outcome goal may be constrained due to (i) inadequate recurrent and capital budget allocation as per the SSDP expenditure framework, (ii) continuation of input and activity-based costing, and (iii) fewer than targeted job placements because of limited private sector participation	High	<ul style="list-style-type: none"> <li>– Medium-term planning and budgeting frameworks are prepared annually for the skills sector, thereby establishing a results chain of inputs, process, outputs, and outcome</li> <li>– Performance partnership framework will be concluded and updated annually between (i) MOFP and MYASD, and (ii) MYASD and TVET agencies to increase results-oriented planning and budgeting</li> <li>– Public–private partnership arrangements are designed, including purchase model for private sector participation</li> </ul>
<b>Efficiency and economy:</b> (i) suboptimal use of funds unlike envisaged in the SSDP framework by each of the semi-autonomous agencies under MYASD, (ii) suboptimal use of enhanced physical facilities and training equipment due to inadequate recurrent budget to fill vacant positions in the implementing agencies	Substantial	<ul style="list-style-type: none"> <li>– SDD within MYASD will harmonize the activities of different agencies</li> <li>– Recurrent budget is included in the capital budget</li> <li>– Preparation of realistic annual budget based on agreed AIP</li> </ul>
<b>Adequacy:</b> Given the underfunding of the sector in recent years, the estimated budget for achieving results may be inadequate, especially the recurrent budget given increased operational costs	Substantial	<ul style="list-style-type: none"> <li>– SSDP estimates will be part of a rolling plan and actual budgeting will be done based on AIP, and this arrangement ensures that adequate funds are released for achieving the results</li> </ul>
<b>Sustainability:</b> The government may not be able to maintain the level of sector financing after 7 years because skills sector is not included in the priority sectors of the government	Medium	<ul style="list-style-type: none"> <li>– The government is required to include the skills sector among the priority sectors during the SSDP period</li> <li>– The government should assess and expand the private cost sharing over time</li> </ul>

AIP = annual implementation plan, MOFP = Ministry of Finance and Planning, MYASD = Ministry of Youth Affairs and Skills Development, SDD = Skills Development Division, SSDP = Skills Sector Development Program, TVET = technical and vocational education and training.

Source: Asian Development Bank.