FINANCIAL ANALYSIS

A. Introduction

1. This financial analysis is conducted following the guidelines set out by the Asian Development Bank (ADB) for non-revenue-generating projects.[1] This project supports four public universities in Sri Lanka: (i) University of Kelaniya; (ii) Rajarata University of Sri Lanka (RUSL); (iii) University of Sri Jayewardenepura, Sri Lanka (SJP); and (iv) Sabaragamuwa University of Sri Lanka (SUSL). They operate under the University Grants Commission (UGC) and the Ministry of Higher Education and Cultural Affairs (MHECA). The financial analysis is conducted by assessing the capacity of these universities to absorb these costs and projected incremental recurrent costs.

B. Government Fiscal Position

2. Sri Lanka achieved annual economic growth of above 6.4% during 2004–2015, but the rate of growth weakened to 4.5% in 2016 and 3.1% in 2017. The growth rate is expected to recover to 4.2% in 2018 and 4.8% in 2019. Inflation was 7.7% in 2017 but it is expected to be 5.2% in 2018 and 5.0% in 2019 as food prices stabilize. Public debt in Sri Lanka is sizable, which makes the country vulnerable to adverse shocks. The fiscal deficit is more than 5.0% of gross domestic product (GDP) and external debt accounts for 58.2% of GDP.[2] Foreign debt servicing requirements will be the largest ever during 2019–2022 for principal and interest repayments.[3]

3. In 2016, the International Monetary Fund approved a 3-year Extended Fund Facility for an amount equivalent to SDR1.1 billion (about $1.5 billion) to support economic reforms in Sri Lanka. The reform program is broadly on track and the fourth review of the Extended Fund Facility has been completed successfully.[4] There is progress in revenue-based fiscal consolidation. The new Inland Revenue Act was legislated on October 2017 to introduce a simpler and more equitable tax system, and energy pricing reforms are currently being implemented. However, further revenue mobilization is needed to meet the 2018 primary surplus target and reduce the overall deficit to 3.5% of GDP by 2020. The International Monetary Fund also recommends labor market reforms to boost female labor force participation and targeted social protection programs.

C. Financial Sustainability

4. **Expenditure on university education.** The fiscal impact of the project is analyzed with its historical expenditures. The share of education expenditure was around 2% of GDP and 10% of government expenditure in 2017, which was below the international recommendation (at least 4%–6% of GDP and 15%–20% of public expenditure).[5] Yet, the share of education expenditure, particularly university education expenditure, increased during 2012–2016 (Table 1). The majority of university education income comes from government grant (87.2% in 2016) and the rest is from interest, fees, and miscellaneous receipts, and income from extension programs.

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[1] ADB. 2005. *Financial Management and Analysis of Projects*. Manila; ADB. 2009. *Financial Due Diligence: A Methodology Note.* Manila.

[2] Selected macroeconomic indicators are available from Country Economic Indicators (accessible from the list of linked documents in Appendix 2)

[3] Parliament of Sri Lanka. 2017. *Budget Speech – 2018*. Colombo.

[4] International Monetary Fund. 2018. *Sri Lanka Staff Report for the 2018 Article IV Consultation and Fourth Review Under the Extended Arrangement Under the Extended Fund Facility.* Washington, DC.

[5] United Nations Educational, Scientific and Cultural Organization. 2015. *Education 2030 Incheon Declaration and Framework for Action: Towards Inclusive and Equitable Quality Education and Lifelong Learning for All.* Paris.

Table 1: Government Expenditure on University Education, 2012–2016

	Item	2012	2013	2014	2015	2016
1.	GDP at current prices (SLRs billion)	8,732	9,592	10,361	10,952	11,839
2.	Total government expenditure (SLRs billion)	1,531	1,659	1,783	2,290	2,335
3.	Total education expenditure (SLRs billion)	133	150	177	229	234
4.	Total expenditure on universities (SLRs billion)	22	28	37	41	49
5.	Share of education expenditure in GDP (%)	1.52	1.57	1.70	2.09	1.98
6.	Share of education in government expenditure (%)	8.68	9.06	9.91	10.00	10.02
7.	Share of university in government expenditure (%)	1.42	1.68	2.07	1.77	2.09

GDP = gross domestic product.
Source: University Grants Commission of Sri Lanka. 2017. *University Statistics 2016.* Colombo.

5. A breakdown of university education expenditures shows university recurrent expenditure increasing steadily by around SLRs4 billion every year during 2012–2016. The share of recurrent expenditure was 69.9% in 2016 (Table 2). The proportion of recurrent expenditure is relatively less than for general education, reflecting the greater cost of infrastructure in higher education. Among the recurrent cost, expenditure for academic services such as salaries accounts for nearly 60%, followed by general administration and staff services.

Table 2: University Education Recurrent and Capital Expenditures, 2012–2016

	Item	2012	2013	2014	2015	2016
1.	Education recurrent expenditures (SLRs billion)	119.5	131.7	141.9	189.9	193.7
2.	Education capital expenditures (SLRs billion)	13.4	18.5	34.8	39.1	40.1
3.	University recurrent expenditures (SLRs billion)	16.9	21.7	25.7	30.8	34.2
4.	University capital expenditures (SLRs billion)	4.9	6.2	11.2	9.7	14.7
5.	Share of recurrent expenditure in total expenditure (%)	73.9	72.6	74.2	74.3	75.3
6.	Share of recurrent expenditure in total education expenditure (%)	89.9	87.7	80.3	82.9	82.8
7.	Share of recurrent expenditure in total university expenditure (%)	77.3	77.8	69.7	76.0	69.9

Source: University Grants Commission of Sri Lanka. 2017. *University Statistics 2016.* Colombo.

6. **Recurrent expenditure in four selected universities.** The four universities use recurrent expenditure relatively efficiently in terms of unit recurrent cost per undergraduate student. In addition, the major recurrent expenditure items on academic services and maintenance services increase during 2014–2016 in absolute terms, except for maintenance services expenditure in RUSL. Yet, among the four universities, the RUSL has the highest maintenance services expenditure proportion (8.6%). The proportion of maintenance services and per student recurrent cost is relatively low in University of Kelaniya compared with the overall average (Table 3).

Table 3: Recurrent Expenditure Breakdown in 2016
(SLRs million)

	Item	KU	RUSL	SJP	SUSL	All HE
1.	General administration and staff services	271.1	224.6	382.8	212.2	6,006.2
2.	Academic services	2,103.7	830.6	2,013.5	665.6	20,069.2
3.	Welfare services	382.8	184.0	528.0	145.8	3,775.2
4.	Maintenance services	126.2	118.8	246.2	78.9	1,687.2
5.	Others	344.0	26.5	376.9	49.3	2,658.0
6.	**Total**	**3,227.9**	**1,384.6**	**3,547.5**	**1,151.9**	**34,195.8**
7.	**Unit recurrent cost per undergraduate student**	**0.277**	**0.272**	**0.241**	**0.270**	**0.298**

HE = higher education, KU = University of Kelaniya, RUSL = Rajarata University of Sri Lanka, SJP = University of Sri Jayewardenepura, Sri Lanka, SUSL = Sabaragamuwa University of Sri Lanka.
Note: "Others" refers to expenditure on postgraduate studies, research expenses, research publications, external examinations, ancillary activities, extension courses, advanced accounts, physical education, farms, etc.
Source: University Grants Commission of Sri Lanka. 2017. *University Statistics 2016.* Colombo.

7. The proposed project aims to support technology and engineering faculties which are relatively expensive, but these faculties would have higher return than average because of high employment prospects. The unit recurrent cost of an undergraduate student for an engineering faculty is SLRs370,944, which is above the overall average of SLRs298,041 in 2016, but the figure is well below other science faculties, such as fisheries and marine (SLRs553,624), medicine (SLRs534,388), and agriculture (SLRs468,583). While the technology faculty unit recurrent cost is not currently available, the figure for information technology is SLRs215,091, which is below the overall average. The tracer study conducted by the UGC in 2017 suggests that more than 90% of computer science, information technology, or engineering graduates get employment.

8. University capital expenditure fluctuates by year, but the capital expenditure in 2016 was three times more than in 2012. Among the capital cost, the highest proportion of capital investment usually goes to construction activities, followed by equipment (Table 4), which collectively accounted for 70%–80% during 2014–2016. The capital expenditure includes rehabilitation and maintenance of capital assets, which was around 10%–25% during 2014–2016. The level of capital investment for rehabilitation and maintenance needs continuous monitoring.

Table 4: Capital Expenditure Breakdown, 2016

(SLRs million)

	Item	KU	RUSL	SJP	SUSL	All HE
1.	Construction	327.3	281.3	656.3	68.8	6,484.3
2.	Equipment, furniture, vehicles	701.3	98.3	286.1	125.2	5,066.7
3.	Rehabilitation and maintenance of capital assets	118.2	108.2	126.3	37.4	1,967.8
4.	Other capital projects	56.2	35.1	260.4	12.7	1,200.6
5.	**Total**	**1,203.1**	**523.0**	**1,329.2**	**244.0**	**14,719.5**

HE = higher education, KU = University of Kelaniya, RUSL = Rajarata University of Sri Lanka, SJP = University of Sri Jayewardenepura, Sri Lanka, SUSL = Sabaragamuwa University of Sri Lanka.

Note: "Other capital projects" refers to grants for technology stream, postgraduate research, knowledge enhancement and institutional development, staff development, etc.

Source: University Grants Commission of Sri Lanka. 2017. *University Statistics 2016.* Colombo.

9. The budget utilization capacity of the SUSL is limited on capital expenditure when planned and actual expenditure are compared (Table 5). The capital expenditure utilization rate of SUSL declined from 74% in 2014 to 43% in 2015 and 35% in 2016, and University of Kelaniya also underutilized its budget in 2014 and 2016. The budget utilization rate of the RUSL is nearly 100% during 2015–2016, and the SJP tends to overuse the planned budget. The implementation capacity of the SUSL needs strengthening to execute the proposed project.

10. The recurrent and capital expenditures are financed largely by government grants, but there are some variations across universities. Among the four selected universities, the share of government grant financing was 96.5% in RUSL and 95.2% SUSL in 2016. The SJP received 90.7% of its income through government grants, but the share in University of Kelaniya was 77.1% in 2016 because this university generated income from extension programs and others. The main focus of the proposed project is to develop new undergraduate technology faculties in University of Kelaniya, RUSL, and SUSL, and an engineering faculty in the SJP. The public undergraduate programs are provided for free in Sri Lanka, and the proposed project does not aim to recover cost directly through tuition and technology and engineering program course fees from undergraduate programs. The universities will run some fee-paying programs at post-graduate level as well as short-term programs for industry workers. The University of Kelaniya and SJP will start generating income from these courses within the project period, leveraging their location advantages from being near Colombo. RUSL and SUSL will also explore opportunities for higher income generation from the technology faculty programs than their existing programs.

Table 5: Planned and Actual Budget in Higher Education
(SLRs million)

Year	Budget Type	KU	RUSL	SJP	SUSL	All HE
2014	Planned estimate (recurrent expenditure)	1,419	783	1,670	656	18,641
	Actual (recurrent expenditure)	1,815	894	1,856	713	20,638
	Actual / planned (%, recurrent expenditure)	128	114	111	109	111
	Planned estimate (capital expenditure)	749	450	879	367	10,291
	Actual (capital expenditure)	570	450	948	270	10,000
	Actual / planned (%, capital expenditure)	76	100	108	74	97
2015	Planned estimate (recurrent expenditure)	1,900	915	2,000	770	21,872
	Actual (recurrent expenditure)	2,244	959	2,360	890	25,761
	Actual / planned (%, recurrent expenditure)	118	105	118	116	118
	Planned estimate (capital expenditure)	700	460	725	385	8,860
	Actual (capital expenditure)	700	482	875	167	8,735
	Actual / planned (%, capital expenditure)	100	105	121	43	99
2016	Planned estimate (recurrent expenditure)	2,270	1,235	2,419	1,014	28,981
	Actual (recurrent expenditure)	2,430	1,255	2,538	1,019	27,998
	Actual / planned (%, recurrent expenditure)	107	102	105	100	97
	Planned estimate (capital expenditure)	966	542	1,186	563	15,942
	Actual (capital expenditure)	881	584	1,197	195	15,162
	Actual / planned (%, capital expenditure)	91	108	101	35	95

HE = higher education, KU = University of Kelaniya, RUSL = Rajarata University of Sri Lanka, SJP = University of Sri Jayewardenepura, Sri Lanka, SUSL = Sabaragamuwa University of Sri Lanka.
Source: Ministry of Finance and Mass Media. 2014–2018. *Budget Estimates.* Colombo.

11. **Future higher education expenditure projections.** Based on the budget estimates by the Ministry of Finance in Sri Lanka for 2018–2020, and assuming that the same level of increase in 2019–2020 will be maintained until 2022, the total higher education expenditure will be SLRs437,439 million during 2018–2022 (Table 6). The proportion of the proposed ADB-funded project accounts for 4.9% of the total higher education expenditure during 2018–2022, and the proportion of recurrent cost from the project in the recurrent cost budget of four universities will be within 6.0% (Table 7). Yet, it accounts for 90% of capital expenditure of the four selected universities during 2018–2022. The SJP and RUSL have reasonable staff and capacity, but the implementation capacity of the University of Kelaniya and SUSL needs close monitoring during implementation.

Table 6: Higher Education Expenditure Projections, 2018–2022
(SLRs million)

Item	2018	2019	2020	2021	2022
1. KU (recurrent expenditure)	2,750	3,100	3,500	3,900	4,300
2. KU (capital expenditure)	900	1,000	1,200	1,400	1,600
3. RUSL (recurrent expenditure)	1,350	1,500	1,700	1,900	2,100
4. RUSL (capital expenditure)	600	800	1,000	1,200	1,400
5. SJP (recurrent expenditure)	2,926	3,250	3,600	3,950	4,300
6. SJP (capital expenditure)	900	1,200	1,500	1,800	2,100
7. SUSL (recurrent expenditure)	1,120	1,300	1,500	1,700	1,900
8. SUSL (capital expenditure)	450	800	1,100	1,400	1,700
9. All HEIs (recurrent expenditure)	30,825	34,800	39,100	43,400	47,700
10. All HEIs (capital expenditure)	19,500	25,870	29,729	33,588	37,447
11. MHECA (recurrent expenditure)	1,669	1,987	2,187	2,387	2,587
12. MHECA (capital expenditure)	10,347	17,527	14,632	23,982	18,176
13. Total (All HEI + MHECA, recurrent expenditure)	**32,494**	**36,787**	**41,287**	**45,787**	**50,287**
14. Total (All HEI + MHECA, capital expenditure)	**29,847**	**43,397**	**44,361**	**57,570**	**55,623**

HEI = higher education institution, KU = University of Kelaniya, MHECA = Ministry of Higher Education and Cultural Affairs, RUSL = Rajarata University of Sri Lanka, SJP = University of Sri Jayewardenepura, Sri Lanka, SUSL = Sabaragamuwa University of Sri Lanka.
Source: Ministry of Finance. *Budget Estimates 2018*. Colombo; Asian Development Bank estimates.

Table 7: Higher Education Capital Financing Projections by Source, 2018–2022
(SLRs million)

	Item	2018	2019	2020	2021	2022
1.	KU (government grant)	900	1,000	1,200	1,400	1,600
2.	KU (other income)	450	450	450	450	450
3.	RUSL (government grant)	600	800	1,000	1,200	1,400
4.	RUSL (other income)	75	75	75	75	75
5.	SJP (government grant)	900	1,200	1,500	1,800	2,100
6.	SJP (other income)	850	850	850	850	850
7.	SUSL (government grant)	450	800	1,100	1,400	1,700
8.	SUSL (other income)	55	55	55	55	55
9.	All HEIs (government grant)	13,500	19,870	23,729	27,588	31,447
10.	All HEIs (other income)	6,000	6,000	6,000	6,000	6,000
11.	MHECA (government grant)	3,480	2,808	3,048	3,748	4,449
12.	MHECA (development partners)	6,773	14,891	12,006	19,357	12,351
13.	**Total (All HEIs + MHECA, government grant)**	**16,980**	**22,678**	**26,777**	**31,337**	**35,896**
14.	**Total (All HEIs + MHECA, other income)**	**6,000**	**6,000**	**6,000**	**6,000**	**6,000**
15.	**Total (All HEIs + MHECA, all DP)**	**6,867**	**14,719**	**11,584**	**20,233**	**13,727**
16.	**Total (All HEIs + MHECA, ADB)**	**297**	**4,927**	**1,861**	**10,510**	**4,004**
17.	**Total (All HEIs + MHECA, grand total)**	**29,847**	**43,397**	**44,361**	**57,570**	**55,623**

DP = development partners, HEI = higher education institution, KU = University of Kelaniya, MHECA = Ministry of Higher Education and Cultural Affairs, RUSL = Rajarata University of Sri Lanka, SJP = University of Sri Jayewardenepura, Sri Lanka, SUSL = Sabaragamuwa University of Sri Lanka.
Source: Ministry of Finance. *Budget Estimates 2018*. Colombo; Sri Lanka University Statistics 2016 University Grants Commission. Colombo; Asian Development Bank estimates.

12. The UGC will gradually introduce a more comprehensive performance-based funding mechanism. Currently, the UGC allocates funds to universities based on historical records, students, and other inputs such as staff salaries and operational costs. The ongoing funding mechanism does not give due credit to well-performing universities, and performance-based funding and procedures are discussed for research grants. This performance-based funding scheme could be further expanded to improve the quality of curriculum, teaching, and assessment. The proposed project will include a competitive grant mechanism (output 3) funded from loan proceeds to support innovative industry links and international collaborations. The mechanism will build upon the practices under the previous and ongoing World Bank higher education interventions and will allow more resources for universities to strengthen relevance and innovation in technology education and research.

13. In conclusion, the fiscal resources in Sri Lanka are constrained by sizable public debt, but macroeconomic reforms supported by the International Monetary Fund are on track and policy measures have been taken for revenue-based fiscal consolidation. Despite limited fiscal resources, the government puts high priority on higher education in Vision 2025. The higher education expenditure has been growing in recent years, and it is expected to increase or at least be maintained at the current level during the project implementation periods. The unit recurrent cost of undergraduate students suggests that investment in technology and engineering faculties is not excessively expensive compared with other science disciplines. The selected four public universities manage their programs efficiently given the below-average unit recurrent cost of undergraduate students, and supporting technology and engineering faculties in these four universities will result in higher return with high employment prospects. The project will also support the introduction of performance-based budget allocations for research grants, but the project needs to discuss with the MHECA, the UGC, and the four selected universities continuously so that adequate government budget for rehabilitation and maintenance of capital assets (capital expenditure) and maintenance services (recurrent expenditure) is allocated for the sustainability of the project.