

FINANCIAL ANALYSIS

A. Introduction

1. The Asian Development Bank (ADB) has the ongoing Health System Enhancement Project in Sri Lanka, approved in October 2018. Additional financing of \$113 million (\$110 million loan and \$3 million grant) has been requested. The original project was assessed as financially sustainable.¹ In July 2021, as part of financial due diligence for the additional financing for the original project, a financial analysis was conducted in accordance with the ADB Financial Analysis and Evaluation technical guidance note.² The Ministry of Health (MOH), a cabinet ministry of the Government of Sri Lanka, is the executing agency and is responsible for formulating and implementing national policy on health, nutrition, indigenous medicine, and other health-related activities. Provincial councils are mandated to operate the provincial line ministry hospitals, yet these hospitals remain under the direct control and supervision of the central government through the MOH. The central government provides budgetary funding to the MOH, which is used to fund its programs and the provincial line ministry hospitals. The provincial councils are mandated to operate the non-line-ministry provincial hospitals. These provincial hospitals receive budget allocations from the Finance Commission and technical assistance and funding from the MOH to carry out repairs and maintenance of certain equipment.

2. This financial analysis report focuses on the financial sustainability of the additional financing for the ongoing project. The analysis assessed the government's fiscal capacity to provide adequate budgetary support and its commitment to the health sector and analyzed the historical budget performance and financial projections.

B. Government Fiscal Position

3. GDP has been declining since 2015. Reflecting the combined effect of the coronavirus disease (COVID-19) pandemic, the contraction in major economic activities amidst the pandemic, weather-related shocks, and the Easter Sunday attacks, gross domestic product (GDP) growth of the Sri Lankan economy contracted by 3.6% in 2020 compared to 2.3% in 2019.³ The government's economic policy framework, supported by its Vistas of Prosperity and Splendour, is expected to rebound, and sustain the economy before 2025. GDP growth is predicted to be 6% in 2021 and 7% in 2025.⁴ Inflation increased from 4.3% in 2019 to 4.6% in 2020,⁵ and is expected to be in the range of 4.0%–6.0% within the Flexible Inflation Targeting Framework during 2021 – 2025.⁶ Outstanding government debt rose to 101.1% of GDP in 2021 from 86.8% of GDP in 2019, while the fiscal deficit rose from 9.6% of GDP in 2019 to 11.1% of GDP in 2020.⁷ The government aims to contain the fiscal deficit to 4% of GDP by 2025 and the debt–GDP ratio at 80% by 2025 (footnote 4). The country's low tax revenue and reduced fiscal resources pose challenges to expanding public expenditure on health. The 2021 budget focused on strengthening the 2021–2023 medium-term program for poverty alleviation and economic revival, and established

¹ ADB. 2018. *Financial Analysis for Health System Enhancement Project*. Manila.

² ADB. 2019. *Financial Analysis and Evaluation. Technical Guidance Note*. Manila.

³ On 21 April 2019, Easter Sunday, three churches in Sri Lanka and three luxury hotels in the commercial capital, Colombo, were targeted in a series of coordinated terrorist suicide bombings. Later that day, there were smaller explosions at a housing complex in Dematagoda and a guest house in Dehiwala.

⁴ Government of Sri Lanka. 2019. *National Policy Framework Vistas of Prosperity and Splendour*. Colombo.

⁵ ADB. 2021. *Asian Development Outlook Update 2021*. Manila.

⁶ Flexible inflation targeting means that monetary policy aims at stabilizing both inflation around the inflation target and the real economy, whereas strict inflation targeting aims at stabilizing inflation only, with little regard to the stability of the real economy.

⁷ Central Bank of Sri Lanka. 2021. *Annual Report 2020 (Chapter 1)*. Colombo.

investment in public health and expansion of health services to effectively safeguard people from the COVID-19 pandemic as a priority. Despite the tight fiscal position, the health sector is the top government priority. To reduce the pressure on fiscal resources, the International Monetary Fund (IMF) provided a 3-year fund facility in 2016 to support economic reforms to reduce the fiscal deficit, rebuild foreign exchange reserves, and introduce a simpler and more equitable tax system. Based on the latest publicly available IMF report, though the economy is gradually recovering with the government's commitment and policy efforts, it remains vulnerable to shocks.⁸ The IMF's program was extended to June 2020. The IMF recommended sustaining policy discipline and mobilizing revenues efficiently to reduce public debt while making adequate allocations to social and economic investments that are essential and/or urgent. Table 1 summarizes key selected economic indicators of Sri Lanka.

Table 1: Selected Economic Indicators of Sri Lanka

Item	2014	2015	2016	2017	2018	2019	2020
GDP growth (%)	5.0	5.0	4.5	3.6	3.3	2.3	(3.6)
Current account balance (% of GDP)	(1.2)	(2.3)	(0.6)	(0.7)	(1.2)	(3.6)	(7.9)
Central government debt (% of GDP)	72.3	78.5	79	77.9	84.2	86.8	101.0
Government expenditure, net of lending (% of GDP)	17.4	20.9	19.5	19.3	18.8	22.2	20.3

() = negative, GDP = gross domestic product.

Source: Central Bank of Sri Lanka. 2021. *Annual Report 2020*. Colombo.

C. Government Commitment

4. The Government of Sri Lanka has prepared its 2030 vision, under which it commits to providing a decent quality of life for all, especially for the poor and disadvantaged, and meeting the minimum standards in the provision of basic services.⁹ Part of the 2030 vision for the health sector is on securing primary health care for all, with high-end medical services that meet international standards. In Sri Lanka, health care is provided by both the public and private sectors, with the government being the leading health care provider. Health care services are financed from consolidated funds. The country has good social indicators including low maternal and infant mortality rates and long life expectancy, which can largely be attributed to the government's strong commitment to the health sector. Reforms to further strengthen the health care system are included in the National Health Strategic Master Plan 2016–2025. Also, in 2018, the Cabinet approved the policy on universal health coverage.

5. **Health expenditure trends.** There was an increasing trend in the total health expenditure in Sri Lanka during 2012–2016 with a compound annual growth rate of 12.3%. The total health expenditure as a percentage of GDP has also been increasing in absolute terms, from 2.9% in 2012 to 3.4% in 2016. There has also been notable growth in per capita health spending of 13.1% during 2012–2016. Compared to other countries with similar or higher per capita spending on health, Sri Lanka has spent relatively less but achieved comparable health outcomes.¹⁰ Substantial achievements in various health outcomes reflect the effectiveness and efficiency of the health sector. In 2015, the life expectancy for women was 78.6 years and for men 72.0 years, an improvement from the 2005 data when the life expectancy for women was 76.4 years and for

⁸ IMF. 2019. *Sixth Review Under the Extended Arrangement Under the Extended Fund Facility and Request for Waiver of Nonobservance and Modification of Performance Criterion*. Washington, DC.

⁹ Government of Sri Lanka. 2019. *Presidential Expert Committee Report on Sustainable Sri Lanka 2030 Vision and Strategic Plan*. Colombo.

¹⁰ R. Govindaraj et al. 2014. *Health Care in Sri Lanka: What Can the Private Health Sector Offer? Health, Nutrition and Population Discussion Paper*. Washington, DC.

men 71.7 years. The infant mortality rate dropped from 11.70 per 1,000 live births in 2005 to 9.16 per 1,000 live births in 2015.¹¹ In addition, the maternal mortality rate improved from 56 per 100,000 live births in 2000 to 36 per 100,000 live births in 2017.¹² Table 2 shows the trend of health expenditure in Sri Lanka during 2012–2016.

Table 2: Health Expenditure in Sri Lanka

Item	2012	2013	2014	2015	2016 ^a	Average	CAGR (%)
Total health expenditure (SLRs million)	250,117	288,701	321,343	368,621	398,276	325,412	12.3
Increase in total health expenditure (%)	...	15.0	11.0	15.0	8.0		
Total health expenditure as % of GDP	2.9	3.0	3.1	3.4	3.4	3.2	
Per capita health expenditure (SLRs million)	10,795	12,264	14,015	15,524	17,637	14,047	13.1

... = data not available, CAGR = compound annual growth rate, GDP = gross domestic product, SLR = Sri Lanka rupee.

^a Provisional.

Source: Institute for Health Policy. 2018. *Sri Lanka Health Accounts, National Health Expenditures, 1990–2016*. Colombo.

6. **Budgetary support.** During 2015–2020, the average annual growth rate of the total government budget was 5.8%, and the MOH budget as a percentage of the total government budget was 4.0%–5.0% (4.3% on average). The government has provided the sector with the required budgetary support, and historical financial information attests to the government's strong support to the sector. During 2015–2020 (except for 2017), there was a notable increasing trend in the MOH budget allocation, with a compound annual growth rate of 17.2%. Further, when comparing the annual budget allocation and the projected annual requirement for the MOH, the budget allocation exceeds the projected annual requirement. This is commendable given the government's tight fiscal resources. Out of the MOH's total budget during 2015–2020, an average of 78% was allocated for recurrent expenditure and 22% for capital expenditure. The compound annual growth rate for the MOH recurrent budget was 20.7% during 2015–2020. Likewise, the provincial budget has been increasing, with a growth rate of 2.2% during 2018–2020, with recurrent expenditure accounting for 94% of the total provincial budget. The rising budgetary allocation demonstrates the government's strong commitment to strengthening the health care system in the country. Table 3 shows the breakdown of government health sector budget allocation during 2015–2020.

Table 3: Government of Sri Lanka, Ministry of Health, and Provincial Budgets, 2015–2020
(SLRs million)

Item	2015	2016	2017	2018	2019	2020	Average	CAGR (%)
Government Budget	3,405,000	3,699,592	3,628,110	4,147,844	4,640,000	4,718,155	4,039,784	6.7
Recurrent	1,547,910	1,867,868	1,947,026	2,164,132	2,412,305	2,806,427	2,124,278	12.6
Capital	1,857,090	1,831,724	1,681,084	1,983,712	2,227,695	1,911,728	1,915,506	0.6
Budget increase / (decrease) (%)	-	8.7	-1.9	14.3	11.9	1.7	5.8	
MOH budget as % of government budget	4.0	5.0	4.0	4.0	4.0	4.0	4.3	

¹¹ Government of Sri Lanka, Ministry of Health, Nutrition, and Indigenous Medicine. 2018. *Performance and progress report 2016–2017*. Colombo.

¹² World Health Organization. 2019. *Trend in Maternal Mortality 2000 to 2017*. Geneva.

Item	2015	2016	2017	2018	2019	2020	Average	CAGR (%)
MOH								
Projected	144,528	155,500	187,000	177,148	184,331	170,341	169,808	3.3
Budget	148,184	174,078	160,972	178,400	185,482	328,148	195,877	17.2
Recurrent (%)	73	79	75	75	77	85	78	20.7
Capital (%)	27	21	25	25	23	15	22	4.6
Provincial								
Budget	...	...	...	53,989	44,090	56,404	51,494	2.2
Recurrent (%)	...	...	...	95	96	94	94	
Capital (%)	...	...	...	5	4	6	6	

() = negative, ... = data not available, CAGR = compound annual growth rate, MOH = Ministry of Health.

Note: 2020 budget financial information included in Government of Sri Lanka budget codes 111, 416, and 423. The 2020 actual expenditures are based on estimated amounts.

Source: Government of Sri Lanka, Ministry of Finance. *Sri Lanka Budget Estimates, 2015–2021*. Colombo.

D. Financial Performance Review

7. **Historical budget performance.** The MOH funds the programs and hospitals under its purview and receives budgetary support from the government for its recurrent and capital expenditures. Since 2015, the budget and actual recurrent expenditure have been increasing. Further, the MOH performed well in utilizing the budget, with an average utilization rate of 91% during 2015–2019. The average utilization rate was 97% for recurrent expenditure and 70% for capital expenditure. The high utilization rate and the increasing trend of recurrent actual expenditures demonstrate that the MOH has strong capacity and commitment to maintain its assets. In 2019, the actual utilization was more than the budget, which is largely because of the increasing demand for health services. The COVID-19 pandemic presents immense challenges to the country's health system. In 2020, the government accelerated its efforts to identify and treat COVID-19 patients and adjusted the budget and allocations to support the sector with the needed resources. The annual capital utilization rate may be an indication of suboptimal budget practices, including delays in release of government funds, which may result in procurement delays. The demand for quality health care services increases as the population grows and when coupled with emerging new diseases. The unutilized budget offers opportunities to increase efficiency for better use of resources to improve service delivery. Table 4 shows MOH budget utilization since 2015.

Table 4: Ministry of Health Budget Utilization, 2015–2020
(SLRs million)

Item	2015	2016	2017	2018	2019	2020 ^a	Average	CAGR (%)
Recurrent (budget)	108,891	138,078	120,554	134,400	143,626	278,884	154,072	20.7
Capital (budget)	39,293	36,000	40,418	44,000	41,856	49,264	41,805	4.6
Recurrent (actual)	101,863	112,992	118,034	134,970	159,899	...	125,579	11.9
Capital (actual)	29,033	23,641	28,039	32,677	28,677	...	28,650	-0.3
Recurrent utilization rate (%)	94	82	98	100	111		97	
Capital utilization rate (%)	74	66	69	74	69		70	
Total utilization rate (%)	88	78	91	94	102		91	

() = negative, ... = data not available, CAGR = compound annual growth rate.

^a 2020 budget financial information included in Government of Sri Lanka budget codes 111, 416, and 423.

Source: Government of Sri Lanka, Ministry of Finance. *Sri Lanka Budget Estimates 2015–2021*. Colombo.

8. **Health sector budget projection.** The 2021–2023 MOH budget projections are based on the Ministry of Finance's projected financial information. Expenditure projections for 2024 and beyond are estimated based on historical growth. The project investment cost is estimated at \$125 million. Out of the total project investment, 54% pertains to renovation, small-value equipment, intensive care unit beds, medical consumables, services, and consultant support with

no incremental recurrent costs expected. The remaining project financing will be for the extension of health facilities, upgrade of sewage systems, and procurement of computer equipment and information technology systems for selected hospitals. Incremental recurrent expenditure for the civil works will apply after completion, and for equipment only after the warranty and service maintenance period. The annual incremental recurrent costs for operating and maintaining the project assets are estimated at SLRs 415 million. This represents approximately 0.17% of the total government health expenditure. The financial sustainability of the project investment was assessed based on the government's ability to absorb the incremental recurrent costs arising from the project. Based on the analysis, evaluating the combined impact of annual inflation and the estimated annual incremental recurrent costs, the impact on the total government health expenditure is negligible and the government has plenty of room under the health sector budget to absorb the incremental recurrent cost requirements. The government will be able to sustain its financial commitment to the project investments during and after project completion. Table 5 shows the projection of health sector expenditure of MOH and provincial governments.

Table 5: Ministry of Health and Provincial Expenditure Projections
(SLRs million)

Year	Ministry of Health			Provincial		
	Recurrent	Capital	Total	Recurrent	Capital	Total
2021	192,895	32,000	224,895	56,000	8,820	64,820
2022	195,454	43,557	239,011	59,000	12,197	71,197
2023	199,377	37,152	236,529	62,000	14,266	76,266
2024	207,156	37,840	244,996	65,153	16,686	81,839
2025	215,238	38,540	253,779	68,465	19,516	87,982
2026	223,636	39,254	262,890	71,947	22,827	94,774
2027	232,362	39,981	272,343	75,605	26,699	102,304
2028	241,428	40,721	282,149	79,449	31,228	110,678
2029	250,847	41,475	292,322	83,489	36,526	120,015
2030	260,634	42,243	302,877	87,734	42,722	130,456
2031	270,803	43,025	313,828	92,195	49,968	142,164

Note: 2021 projected information included in Government of Sri Lanka budget for spending units 111, 416, and 423.

Source: Government of Sri Lanka, Ministry of Finance. 2021. *Sri Lanka Budget Estimate*. Colombo; Asian Development Bank estimates.

9. In summary, the financial sustainability of the project investments can be ensured given the strong government commitment and support to the health sector, as evidenced by increasing budget allocations. Historical financial information demonstrates that adequate financial support is provided for health expenditures. Also, the MOH has demonstrated strong capacity and commitment to maintaining its assets. The incremental recurrent costs are negligible relative to the total government health expenditure. The MOH and the provinces can meet the incremental recurrent cost requirements of the ADB-supported assets out of budget allocations. In addition, the government has provided assurances on (i) sufficient and timely counterpart funds being available each fiscal year, and (ii) adequate funds being provided to support the operation and maintenance of project facilities through budget allocation to the executing agency during the project and after the completion date.