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Sri Lanka: Letter of Intent and Technical Memorandum of Understanding

June 19, 2010

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SRI LANKA: LETTER OF INTENT

Colombo, June 19, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

This letter serves as a supplement to the July 16, 2009, Memorandum of Economic and Financial Policies and our October 30, 2009, Letter of Intent.

1. The macroeconomic environment in Sri Lanka continues to improve following the end of the conflict and the approval of the Stand-By Arrangement with the International Monetary Fund. Output growth is rebounding and inflation remains subdued in single digits. Rising investor confidence and an increase in remittances have allowed us to rebuild international reserves from very low to now comfortable levels.
2. With the peace restored and following the Presidential and parliamentary elections, we now face a unique opportunity to ensure continuity in policies that have been initiated in recent times to put Sri Lanka on a path of higher, sustainable future growth and prosperity as per the *Mahinda Chintana* vision for the future. Critical to this will be policies that ensure that macroeconomic stability is maintained while allowing for much-needed infrastructure investment to boost growth prospects and address the development challenges in lagging regions, including the conflict-affected north and east.
3. The government's economic program is ambitious in a wide range of areas, including steps toward (i) fiscal consolidation through continued enhancement of the quality of public spending; (ii) rationalization of the tax system; (iii) improvement in state-owned enterprise performance; and (iv) further strengthening of the financial sector. We continue to believe that our program with the IMF has strengthened the government's efforts toward its policy goals. With the near-term risk of an external crisis averted, the program's emphasis can now shift toward growth-enhancing policies that address some of the economy's key structural weaknesses. In line with this, and to support the wide range of policy reforms that we will be undertaking during this period, we wish to extend through end-2011 our program with the IMF, which we see as a mitigating arrangement against external vulnerabilities.
4. While acknowledging the risks in the global economic environment, the government's policy framework aims at achieving economic growth in excess of 8 per cent, while containing inflation at a moderate level. The higher growth is to be achieved by further

strengthening the enabling environment for the real economy—in particular, agriculture, SMEs, and other value-adding industries—to respond more positively. This will require a significant boost in investment, and we have already begun steps to improve the investment climate and the ease of doing business. On the approval of the Cabinet of Ministers, a high level committee headed by the Senior Advisor to the President, with technical support from the relevant agencies, has been appointed to identify laws and regulations obstructing investment. Moreover, line ministries are actively identifying specific areas in which to attract foreign direct investment, including from the private sector. The Ministry of Economic Development, the Board of Investment (BOI), and the Department of National Planning will jointly work out a new investment strategy based on such information to ensure that projects supported under a new investment incentive regime are carefully selected and better targeted—the aim would be to shift the emphasis away from a heavy reliance on tax concessions towards greater predictability of the investment regime and increasing the ease of doing business, mainly by coordinating the development activities of different ministries, public institutions and other agencies. Progress to this end will be a focus of discussions during the next review.

5. The budget deficit in 2009 reached 9.9 percent of GDP, including rehabilitation expenditures, against a program target of 7 percent. The main factors for the overrun were faster-than-expected aid disbursements for infrastructure projects, higher interest payments, a shortfall in revenue, and post-conflict rehabilitation and humanitarian expenditure, as well as costly demining of conflict affected areas. Although the 2009 budget outturn, particularly in the context of the continuing adverse impact of global economic conditions, calls for some recalibration of fiscal targets, the program's original goals of fundamental and sustainable deficit reduction remain unchanged. Spending for the first four months was managed by the Vote on Account approved by the parliament, and thereafter, until the budget for 2010 is passed by the parliament, spending has been strictly limited, as authorized under the Presidential directive based on Section 150 of the Constitution. On June 8, the government submitted to parliament a budget covering the full-year 2010 spending envelope consistent with a deficit of 8 percent of GDP, a 2 percentage point decline from 2009. Deficit reduction will take place primarily through a reduction in security-related spending due to lower procurement spending and a reduction in other non-interest recurrent spending, including by maintaining subsidies and transfers in nominal terms. Despite a significant reduction in current expenditure (by 1.3 percent of GDP relative to 2009), we recognize that the deficit will exceed our original target of 6 percent of GDP, or 7 percent including reconstruction spending. The higher deficit comes from the higher-than-earlier-expected interest payments, and more cautious revenue projections, given the uncertainty in the speed of recovery of external trade sector activity. Parliamentary approval of the 2010 budget is expected in July. Until the budget is passed, we will continue to restrict spending under the Presidential directive consistent with our full-year deficit target.

6. Beyond 2010, we remain committed to further fiscal consolidation in terms of the broad framework stipulated in the Fiscal Management Responsibility Act (FMRA) to reduce the budget deficit. We have thus set a fiscal deficit target of 6.8 percent for 2011 and 5 percent for 2012, and, as required by the FMRA, this medium-term deficit reduction strategy will be presented to with the 2011 budget due in November 2010. The 2011 budget will continue to implement the growth-oriented fiscal and structural policies outlined below. Submission of this budget to Parliament is expected in November 2010.

7. We have developed a plan for comprehensive reform of our tax system in order to make it more conducive to private-sector growth and to reverse the declining trend in tax revenues, so as to support needed reconstruction and infrastructure investment. According to the timetable for this reform plan, we have launched key reforms now, followed by further reforms during the remaining months of 2010 and legislative changes as part of the 2011 budget. Taking into consideration the Presidential Tax Commission's recommendations, key goals of the Government's tax reform plan are to simplify the existing tax system, broaden the base, and improve tax administration, with the aim to bring about a sustainable increase in tax revenue. Specifically, the reform will focus on the following areas.

- **Streamlining trade and excise taxes:** We have already taken steps to simplify a number of trade and excise taxes. The government has reduced the number of tariff bands to four—viz., 0, 5, 15, and 30 percent—and exemptions will be allowed only on the grounds of national security, health, environment, and international commitments, thus streamlining the dual customs duty structure prevailing for almost ten years. Import surcharges have been incorporated into the new duty structure, and remaining duty waivers granted to limit the impact of high international commodity prices in 2009 are being phased out. Beyond these changes, prohibitive excise taxes applicable on a wide range of items including motor vehicles have been simplified. Moreover, most essential commodities that are being imported and subjected to about ten different taxes will now face a unified “special commodity levy” to make tax administration more efficient and taxation simpler.
- **Reducing tax concessions:** One key element of reforms described above will be to reduce lost tax revenue from various concessions including ad hoc tax holidays and duty exemptions. The budget proposal announced in 2008 to cap new tax holidays and limit the granting of exemptions under section 17 of the BOI Act will be taken into consideration in the context of formulation the new incentive regime. The implementation of these together with a new tax incentive regime will be announced before end 2010. We have requested the Board of Investment to reformulate the investment strategy and refrain from granting new concessions until new regulations are finalized. These measures are expected to make a significant contribution to growth and increase in revenue elasticity in the medium term.

- **Broadening the VAT and income tax bases:** The operational modalities of the VAT system and income taxes need simplification to eliminate weaknesses, including the complex and cumbersome VAT refund mechanism, and to improve revenue collection. We have sought technical assistance, with a view to taking concrete steps for improvement. In addition, taking into account the tax commission's recommendations, our specific actions under review include reducing the number of numeral taxes and broadening the base of remaining taxes. The enabling legislation required for these tax reforms will be finalized as part of the 2011 budget. We expect to make significant progress toward this goal by the time of the next review.
- **Improving tax administration:** With financial support from the Asian development Bank under the Fiscal Management Efficiency Project, action has already begun for simplification of procedures and processes, management information system, human resource development, tax audit, and IT use.

These initiatives together with expected private sector investment and growth will sufficiently broaden the tax base and improve the revenue-to-GDP ratio to 15½ percent in 2011, with the aim of reaching 16½ percent by 2012.

8. Improving the performance and efficiency of loss-making state enterprises will help free resources for infrastructure investment and lending to the private sector. Newly reconstituted management in key public enterprises is expected to improve the performance of these enterprises. A separate Ministry of State Resources and Enterprise Development has been established to concentrate on under-performing state assets and addressing the issues in loss-making enterprises. Electricity prices are comparatively high in Sri Lanka, and a committee has been set up to rationalize the tariff regime and also address the high cost structure by utilizing low-cost coal and alternative energy sources. The government is also committed to dealing with the restructuring of non-performing debt of SOEs, including the Ceylon Petroleum Corporation and Ceylon Electricity Board.

9. We continue to remain committed to maintain exchange rate flexibility that reflects market conditions. Monetary policy aims at maintaining price stability while ensuring adequate provision of credit to the private sector. The Central Bank of Sri Lanka also intends to further promote capital inflows, inward investments, and remittances.

10. The comprehensive financial sector regulatory reform agenda remains on track. Prudential regulations for credit card companies and payment service providers (structural benchmark) have been issued. The CBSL intends to issue guidelines to improve banks' integrated risk management frameworks by end-July 2010. In addition, guidelines to enhance consumer protection will be issued by end-September 2010 to improve transparency and disclosure of banks' business practices. Amendments to the Finance Companies Act clarifying the legal authority of the Central Bank in enforcing its regulations on all deposit-

taking finance companies are to be submitted to Parliament (structural benchmark). Amendments to the Banking Act will also be submitted to Parliament by end-September), incorporating comments already received by stakeholders.

11. The CBSL *Roadmap for Monetary and Financial Sector Policies for 2010 and Beyond* also announced a number of new reform initiatives including the creation of a deposit insurance fund, regulation of pension funds, and capital market development.

- The proposed deposit insurance scheme under the Monetary Law Act (MLA) will have a clear governance structure and can be mandated on all licensed banks and finance companies, with the issuance of implementation regulations by end-August 2010 (new structural benchmark). The premiums charged will initially be based on broadly flat rates, with a view to moving toward a more risk-based charging approach later on.
- The government is proposing to introduce a comprehensive regulatory framework for private-sector superannuation funds by empowering an existing regulatory body (Insurance Board of Sri Lanka) to undertake this function by end-December 2010 (structural benchmark).
- The government is planning measures to develop the capital market. These measures focus on diversifying the investor base, such as relaxing the restrictions on foreign investors' participation in the corporate bond market, as well as encouraging listing of securities, and developing a medium-term, benchmark-oriented government debt issuance strategy.

12. Beyond these changes, our policy agenda remains as described in the July 16, 2009 Memorandum of Economic and Financial Policies. We have set program performance criteria for end-June 2010 and end-September 2010, in addition to the respective reviews (Table 1). In view of Sri Lanka's graduation, in the IMF's classification, from low-income to middle-income emerging economy status, we request the elimination of the performance criterion setting a ceiling on non-concessional debt contracted and guaranteed by the government; our borrowing and government guarantee limits are stipulated in the FMRA and the annual borrowing limits authorized by the parliament. We are of the view that the debt dynamics are favourable, indicating that there is further scope for capital market participation.

13. As we have met all end-March 2010 performance criteria, and given our demonstrated strong commitment to the program to date, we request completion of the second and third reviews of the Stand-By Arrangement, following which we intend to draw two tranches amounting to SDR 275.6 million. We request that the SBA be extended by 12 months and that the remaining tranches be rephased accordingly. The fourth review is

contemplated to be completed on or after August 15, 2010 and the fifth review is contemplated to be completed on or after November 15, 2010.

14. We believe that the policies set forth in the July 16, 2009 letter, the October 30, 2009 letter, and in this letter are adequate to achieve the objectives of our economic program, but the Government stands ready to take additional measures as appropriate to ensure achievement of its objectives. As is standard under all IMF arrangements, we will consult with the IMF before modifying measures contained in this letter, or adopting new measures that would deviate from the goals of the program, and provide the IMF with the necessary information for program monitoring.

15. In keeping with its policy of transparency, the Government has authorized the publication of this letter and the attached Technical Memorandum of Understanding.

Sincerely yours,

/s/

Sarath Amunugama
Deputy Minister of Finance and Planning
and Senior Advisor to His Excellency the President

/s/

Ajith Nivard Cabraal
Governor, Central Bank of Sri Lanka

Table 1. Sri Lanka: Quantitative Performance Criteria (PC) and Indicative Targets (IT)

	2008		2009			2010				
	End-December	End-Dec Performance Criteria			End-March Performance Criteria			End-June Performance Criteria	End-Sept. Performance Criteria	End-Dec. Indicative Target
		Actual	EBS/09/164	Adj.	Prel.	EBS/09/164	Adj.				Prel.
Quantitative performance criteria										
Net international Reserves (NIR) of the Central Bank of Sri Lanka (CBSL) (floor, cumulative change from the beginning of the year, in million US\$) 1/ 2/ 3/ 4/ 5/	-1,385	360	2,607	2,725	35	96	136	-215	-165	-115
Reserve money of the CBSL (ceiling, eop stock, in million rupees)	268,425	315,032	...	303,500	331,308	...	330,900	340,134	349,297	360,000
Net domestic financing (NDF) of the central government from the banking system and the non-bank sector (ceiling, cumulative from the beginning of the year, in million rupees) 6/ 7/ 8/ 9/	296,710	342,210	298,791	392,476	102,500	106,561	106,441	198,242	279,600	341,101
Continous performance criteria										
Contracting and guaranteeing of medium and long-term non-concessional external debt by the government (ceiling, cumulative from end-April 2009, in million US\$)	...	1,750	1,750	921	1,750	1,750	1,562	...	...	...
Accumulation of new external payment arrears (ceiling, eop, in million US\$)	0	0	...	0	0	...	0	0	0	0
Indicative targets										
Overall balance of the Ceylon Petroleum Corporation and the Ceylon Electricity Board (floor, cumulative from the beginning of the year, in million rupees)	-49,847	-35,387	...	-19,400	...	...	...	...	...	-29,966
Memorandum items:										
External loans assumed under the program (cumulative from the beginning of the year, in million rupees) 6/	80,415	...	...	...	...	...	...	...	...	...
External debt service assumed under the program (cumulative from the beginning of the year, in million rupees) 7/	109,268	139,010	...	141,914	24,040	...	28,101	46,092	72,618	96,555
Privatization proceeds to the central government in connection with the sale of central government assets (in million rupees) 8/	0	0	...	0	0	...	0	0	0	0
Outstanding claims by the Bank of Ceylon on the central government (item VIII (e, 1) on the balance sheet of the Bank of Ceylon, in million rupees) 9/	10,897	17,120	...	6,038	17,120	...	6,038	6,038	6,038	6,038
Foreign program financing assumed under the program (cumulative from the beginning of the year, in million US\$) 1/	23	40	...	0	0	...	0	0	0	50
External commercial loans (including Eurobonds and syndicated loans) assumed under the program (cumulative from the beginning of the year, in million US\$) 2/	150	0	...	500	0	...	0	0	0	0
Cumulative net inflows into the Treasury Bill and Treasury Bond market assumed under the program (cumulative from the beginning of the year, in million US\$) 1/	-213	15	...	1,345	0	...	182	0	0	0
Official external debt service assumed under the program (cumulative from the beginning of the year, in million US\$) 3/	802	827	...	878	191	...	194	393	620	824
Settlement of syndicated loans assumed under the program (cumulative from the beginning of the year, in million US\$) 4/	104	225	...	225	0	...	0	25	25	25
Repayment of foreign currency loan from the CBSL by the Bank of Ceylon and the People's Bank (cumulative from the beginning of the year, in million US\$) 5/	40	283	...	283	0	...	0	...	...	...

1/ If the amount of program financing and the cumulative net inflows into the Treasury Bill market and Treasury Bond market is higher/lower in U.S. dollar terms than assumed under the program, the floor on NIR will be adjusted upward/downward by the cumulative differences on the test date.

2/ If the amount of commercial borrowing (including Eurobonds and syndicated loans) is higher/lower in U.S. dollar terms than assumed under the program, the floor on NIR will be adjusted upward/downward by the cumulative difference on the test date.

3/ If the amount of official external debt service by the central government in U.S. dollars is higher/lower than assumed under the program, the floor on NIR will be adjusted downward/upward by the cumulative differences on the test date.

4/ If the amount of debt service on syndicated loans by the central government in U.S. dollars is higher/lower than assumed under the program, the floor on NIR will be adjusted downward/upward by the cumulative differences on the test date. The adjustor is introduced from end-December 2009.

5/ The floor on NIR will be adjusted upwards by any repayments for the foreign currency loan from the CBSL by the Bank of Ceylon and the People's Bank in excess of the repayment schedule. This adjustor is not applicable from January 2010 onwards.

6/ If the amount of external loans is higher/lower in rupee terms than assumed under the program, the cumulative ceiling on net domestic financing of the central government will be adjusted downward/upward by the cumulative difference in external loans on the test date. From end-December, external loans will be defined as external program loans and external commercial loans (including Eurobonds and syndicated loans).

7/ If the amount of external debt service by the central government in rupee terms is higher/lower than assumed under the program, the ceiling on net domestic financing of the central government will be adjusted upward/downward by the cumulative difference in external debt service payments measured in rupees.

8/ If the amount of privatization proceeds to the central government in connection with the sale of central government assets is higher/lower than assumed under the program, the cumulative ceiling on NDF of the central government will be adjusted downward/upward by the cumulative receipt/reimbursement of any privatization proceeds.

9/ If the amount of outstanding claims by the Bank of Ceylon on the central government (item VIII (e, 1) on the balance sheet of the Bank of Ceylon) is lower in rupee terms than assumed under the program, the NDF of the central government will be adjusted upward by the difference on the test date.

Table 2. Sri Lanka: Structural Benchmarks (SB)

Structural Benchmarks	Date	Status
Recapitalization of Seylan Bank through a public share issuance.	9/30/2009	Implemented
A contingency plan for orderly workouts of problem banks and financial institutions will be developed by the CBSL.	9/30/2009	Implemented
Approval by the Monetary Board of a revised Banking Act and other pertinent laws and legislations that: (i) improve the bank resolution framework that more clearly defines the provisions for acquisition, and roles of the conservator and liquidator; and (ii) strengthens the definition of large exposures and related parties to better capture all material risks.	9/30/2009	Implemented
Submission by the tax review commission of an interim report, including on base broadening measures to be incorporated into the 2010 budget.	10/15/2009	Implemented with delays
Approval by Parliament of an interim budget for the first four months of 2010 consistent with program targets.	12/15/2009	Implemented
Develop a plan to address outstanding debts between the CEB, CPC and state-owned banks.	12/31/2009	Implemented
Issuance of prudential regulations and guidelines to credit card companies and payment service providers.	12/31/2009	Implemented
Submission to parliament of the 2010 budget consistent with program targets.	4/30/2010	Not met
Submission to the parliament of a revised Finance Company Act which includes clarifying the legal authority of the CBSL in enforcing its regulations on all deposit taking finance companies.	5/31/2010	Delayed
Submission by the Presidential Tax Commission of a final report, including specific tax reform measures.	8/31/2010	Structural Benchmark
Parliamentary approval of full-year 2010 budget consistent with program targets	8/31/2010	Structural Benchmark
Issuance of regulations to establish a deposit insurance scheme.	9/30/2010	Structural Benchmark
Submission to parliament of the 2011 budget consistent with program targets, including income tax and VAT reform measures.	11/30/2010	Structural Benchmark
Introduce a regulatory framework for private-sector superannuation funds.	12/31/2010	Structural Benchmark

Technical Memorandum of Understanding

1. **This Technical Memorandum of Understanding sets out a framework for monitoring the performance of Sri Lanka under the program supported by the Stand-By Arrangement (SBA).** It specifies the performance criteria and indicative targets (including adjustors) under which Sri Lanka's performance will be assessed through quarterly reviews, starting with the performance criteria for end-June 2010. Monitoring procedures and reporting requirements are also specified. The fourth review will take place on or after August 15, 2010, the fifth review on or after November 15, 2010, 2010, and the sixth review on or after February 15, 2011.

I. FISCAL TARGETS

A. Performance Criterion on Net Domestic Financing of the Central Government

2. **Net domestic financing (NDF) is defined as the change in net credit to the central government by the domestic banking system and the net change in holdings of treasury bills and other government securities by the domestic non-bank sector.** For the purpose of program monitoring, the central government is defined to include line ministries, departments, and other public institutions. The Central Bank of Sri Lanka (CBSL), state-owned enterprise, parastatals and other agencies that do not receive subventions from the central government are excluded from the definition of central government. NDF of the central government is defined as the sum of (i) net borrowing from the CBSL (ways and means advances, loans, holdings of treasury bills, treasury bonds, and other central government bonds minus deposits); (ii) net borrowing from domestic commercial banks and the domestic non-bank sector (loans, advances, holdings of restructuring bonds, and holdings of treasury bills and other central government securities minus deposits); and foreign holdings of Treasury Bills and Treasury Bonds. In 2009, NDF of the central government defined in this manner amounted to Rs. 392.5 billion. Of this amount, Rs. 49.0 billion was net borrowing from the domestic banking system, Rs. 185.2 billion was net borrowing from the domestic non-bank sector, Rs. 146.9 billion was net foreign inflows into the Treasury Bill and Treasury Bond markets and Rs. 11.3 billion was net borrowing from other sources.

The following adjustment will apply:

3. If the amount of external program loans and external commercial loans (including Eurobonds and syndicated loans) to the central government—as set out in Table 1—is higher/lower in rupee terms than assumed under the program, the cumulative ceiling on NDF of the central government will be adjusted downward/upward by the cumulative difference on the test date.

4. If the amount of external debt service by the central government in rupee terms—as set out in Table 1—is higher/lower than assumed under the program, the cumulative ceiling

on NDF of the central government will be adjusted upward/downward by the cumulative difference in external debt service payments measured in rupees.

5. If the amount of privatization proceeds to the central government in connection with the sale of central government assets—as set out in Table 2—is higher/lower than assumed under the program, the cumulative ceiling on NDF of the central government will be adjusted downward/upward by the cumulative receipt/reimbursement of any privatization proceeds.

6. If the amount of outstanding claims by the Bank of Ceylon on the central government (item VIII (e, 1) on the balance sheet of the Bank of Ceylon)—as set out in Table 3—is lower in rupee terms than assumed under the program, the NDF of the central government will be adjusted upward by the difference on the test date.

B. Indicative Target on the Sum of the Overall Balance of the Ceylon Electricity Board and the Ceylon Petroleum Corporation.

7. The balance of the overall profit or loss position of the Ceylon Electricity Board (CEB) and the Ceylon Petroleum Corporation (CPC) from their operating income statements is measured from above the line on an accrual basis. At end-December 2009, the sum of that overall position of the CEB and CPC defined in this manner stood at Rs. -19.4 billion.

II. MONETARY TARGETS

A. Performance Criterion on Reserve Money of the CBSL

Reserve money of the CBSL consists of currency in circulation (with banks and with the rest of the public), financial institutions' domestic currency deposits at the CBSL, and the deposits of following government agencies: the National Defense Fund (General Ledger Acc. No. 4278), the Buddha Sasana Fund A/C (General Ledger Acc. No. 4279); and the Road Maintenance Trust Fund (General Ledger Acc. No. 4281). At end-December 2009, reserve money defined in this manner stood at Rs. 303.5 billion. For the purpose of program monitoring, reserve money on the test date shall be measured as average reserve money during the prevailing reserve week (Friday to Thursday).

The following adjustment will apply:

8. If any bank fails to meet its legal reserve requirement, the ceiling on reserve money will be adjusted downward to the extent of any shortfall in compliance with the requirement.

9. Changes in required reserve regulations will modify the reserve money ceiling according to the formula:

$$\Delta M = \Delta r B_0 + r_0 \Delta B + \Delta r \Delta B$$

where ΔM denotes the change in reserve money, r_0 denotes the reserve requirement ratio prior to any change; B_0 denotes the reservable base in the period prior to any change; Δr is the change in the reserve requirement ratio; and ΔB denotes the immediate change in the reservable base as a result of changes to its definition.

III. EXTERNAL SECTOR TARGETS

A. Performance Criterion on Net Official International Reserves

10. **Net official international reserves (NIR) is defined as (i) the difference between the gross foreign assets and liabilities of the CBSL and (ii) the balance of State Treasury's (DSTs) Special Dollar and Yen Revolving accounts, both expressed in terms of market values.** Gross foreign assets of the CBSL consists of monetary gold; foreign exchange balances held outside Sri Lanka; foreign securities (valued in market prices); foreign bills purchased and discounted; the reserve position at the IMF and SDR holdings; and the Crown Agent's credit balance. Excluded from gross foreign assets will be participation in international financial institutions; holdings of nonconvertible currencies; holdings of precious metals other than monetary gold; claims on residents (e.g., statutory reserves on foreign currency deposits of commercial banks and central bank foreign currency deposits with resident commercial banks) pledged, non-liquid, collateralized or otherwise encumbered foreign assets (such as the government's war risk insurance deposit with Lloyds during 2001/02); and claims in foreign exchange arising from derivative transactions (such as futures, forwards, swaps and options). Gross foreign liabilities are all foreign currency denominated liabilities of the CBSL to non-residents; the use of Fund credit; Asian Clearing Union debit balance and commitments to sell foreign exchange arising from derivatives such as futures, forwards, swaps, and options. In addition, NIR will include the balance of the DSTs' Special Dollar and Yen Revolving accounts. DST accounts are foreign currency accounts held by the Treasury and managed by the CBSL as an agent of the government. At end-December 2009, NIR defined in this manner stood at U.S. dollars 4,150 million.

The following adjustment will apply:

11. If the amount of foreign program financing and the cumulative net foreign inflows into the Treasury Bill or Treasury Bond market—as set out in Table 4—is higher/lower in U.S. dollar terms than assumed under the program, the floor on NIR will be adjusted upward/downward by the cumulative differences on the test date.

12. If the amount of commercial borrowing (including Eurobonds and syndicated loans)—as set out in Table 4—is higher/lower in U.S. dollar terms than assumed under the program, the floor on NIR will be adjusted upward/downward by the cumulative difference on the test date.

13. If the amount of official external debt service by the central government in U.S. dollar terms (including debt service on syndicated loans)—as defined in Table 4—is higher/lower

than assumed under the program, the floor on the NIR will be adjusted downward/upward by the cumulative difference in official external debt service payments.

14. The floor on NIR will be adjusted upward for any increase in Sri Lanka's allocation of Special Drawing Rights (SDR) from the IMF. Sri Lanka's SDR allocation at the time of approval of this arrangement amounted to SDR 70.868 million.

B. Performance Criterion on External Payment Arrears

15. **A continuous performance criterion applies to the nonaccumulation of external payments arrears on external debt contracted or guaranteed by the central government (as defined in ¶12) or the CBSL.** External payments arrears consist of external debt-service obligations (principal and interest) on debt as defined in ¶16 that have not been paid at the time they are due, as specified in the contractual agreements. However, overdue debt and debt service obligations that are in dispute will not be considered as external payments arrears for the purposes of program monitoring.

IV. DATA REPORTING REQUIREMENTS

16. Sri Lanka shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Sri Lanka in achieving the objectives and policies set forth in the Memorandum of Economic and Financial Policies. All the program monitoring data will be provided by the Ministry of Finance and the Central Bank of Sri Lanka (CBSL). Data relating to the external and monetary targets will be furnished within no more than three weeks after the end of each month.¹ With regards to the fiscal targets, the data in table 5 will be furnished within no more than five weeks after the end of each month and the data in table 6 within no more than nine weeks after the end of each month. For the overall balance of the CEB and the CPC, estimates will be available within four weeks.

17. For the purpose of monitoring the fiscal performance under the program, data will be provided in the format as shown in Tables 5 and 6.

18. For the purpose of monitoring the monetary targets under the program, data will be provided in the format shown in Table 7.

19. For the purpose of monitoring the external sector performance under the program, data will be provided in the format shown in Tables 8 and 9.

¹ The deadline for submitting monetary and external data for end-December 2010 will be five weeks due to the added time needed to close the books at the end of the year.

Table 1. Sri Lanka: External Financing Assumptions
(cumulative from the beginning of the year, in millions of rupees)

	2010		
	June	Sept	Dec
External Program Loans	0	0	50
External Commercial Loans	0	0	0
External Debt Service	46,092	72,618	96,555

Table 2. Sri Lanka: Assumptions on Privatization Proceeds
(Cumulative from the beginning of the year, in millions of rupees)

	2010		
	June	Sept	Dec
Privatization Proceeds	0	0	0

Table 3. Sri Lanka: Outstanding Claims by the Bank of Ceylon on the
Central Government
(item VIII (e, 1) on the balance sheet of the Bank of Ceylon, in millions)

	2010		
	June	Sept	Dec.
Foreign Bills Inward	6,038	6,038	6,038

Table 4. Sri Lanka: External Financing for NIR Purposes
(Cumulative from the beginning of the year, in millions of U.S. dollars)

	2010		
	June	Sept	Dec
Program Loans	0	0	50
External Commercial Loans	0	0	0
Treasury Bills/Bonds	0	0	0
Official External debt service	393	620	824
Settlement of Syndicated Loans	25	25	25

Table 5. Sri Lanka: Summary of Central Government Operations 1/	
(In millions of rupees)	
Total revenue	
Tax revenue	
	Income taxes
	Value added tax
	Domestic
	Imports
	Excise taxes
	Tax on liquor
	Tax on cigarettes/tobacco
	Petroleum
	Motor vehicle
	Other
	Stamp duties
	Port and airport development duty
	Debit tax
	Import duties
	Cess levy
	Special commodity levy
	Nation Building Tax
	Telephone subscriber levy
	Licence taxes and other
Nontax revenue	
Grants	
Total expenditure and net lending	
	<i>of which:</i> Interest payments
	Foreign
	Commercial
	Domestic
Overall balance of central Government	
Financing	
	Net domestic financing
	Net external financing
	<i>of which:</i> Program loans
	<i>of which:</i> Project loans
	<i>of which:</i> Commercial borrowing
	<i>of which:</i> Amortization
	Privatization

1/ As agreed for the purpose of monitoring the program

Table 6. Sri Lanka: Central Government Expenditure 1/
(In millions of rupees)
Total expenditure and net lending
<i>Current expenditure</i>
Civil service wages and salaries
Other civilian goods and services
Security related expenditure
Subsidies and transfers
Households
<i>Of which</i> : Samurdhi
Pensions
Fertilizer
Institutions, corporations, other government agencies
Interest payments
Foreign
Commercial
Domestic
<i>Capital expenditure and net lending</i>

1/ As agreed for the purpose of monitoring the program

Table 7. Sri Lanka: Balance Sheet of the Central Bank 1/
(In millions of rupees)
Net foreign assets
<i>Foreign assets</i>
Cash and balances abroad
Foreign securities
Claims on ACU
SDRs
IMF related assets
Receivables
Foreign currency reserve
<i>Foreign liabilities</i>
IMF and nonresident account
Liabilities to ACU
Net domestic assets
<i>Claims on government</i>
Advances
Treasury bills and bonds
Cash items in collection
<i>Government deposits</i>
<i>Claims on commercial banks</i>
Medium and long term
Short term
<i>Other items net</i>
Reserve money
Currency in circulation
Commercial bank deposits
Government agencies deposits

1/ As agreed for the purpose of monitoring the program

Table 8. Sri Lanka: Summary of Central Bank Foreign Exchange Operations 1/

(In millions of USD)

1. Total inflows

Loans
 Program
 IMF
 Project (cash component only)
 Interest earnings, forex trading profits, cap gains
 Purchases of foreign exchange
 Change in balances in DST's A/Cs
 Other inflows
 Borrowing from SLDBs
 Loans from FCBUs
 Syndicated Loans
 Commercial loans
 Repayments of BOC and PB claims

2. Total outflows

Public Debt Service Payments
 Amortization
 Principal (foreign loans)
 Settlement SLDBs
 Settlement FCBU
 Settlement of syndicated loans
 Interest
 Foreign loans
 Domestic foreign currency loans
 Payments to the IMF/ change in valuation of liabilities
 Foreign exchange sales to commercial banks
 Foreign exchange deposits at BOC and PB

3. Net flow at current rates (1-2)**Net International Reserves****Gross International Reserves****Cumulative net inflows into the Treasury Bill/Bond market**

1/ As agreed for the purpose of monitoring the program

Table 9. Sri Lanka: Estimated Gross Official Reserve Position (in US\$ million) 1/

Date	Central Bank		Government					Total Gross Official Reserves		Liabilities				Net International Reserves	Overall balance		
	Reserves managed by IOD		Reserve Position at I.M.F. & SDR hol.	Total {2}+{3}	Crown Agent's Credit Balance	D S T's Special Dollar Revolving Cr.balance	DST's Yen Accounts	Total (5)+(6) +(7) 8	(without ACU) {1}+{3}+{8} 9	(with ACU) (4)+(8) 10	Other Deposits	Asian Clearing Union	Drawings from the IMF			Currency Swap	Total
	(without ACU) 1	(with ACU) 2															

1/ As agreed for the purpose of monitoring the program