

Aid Effectiveness in Sri Lanka

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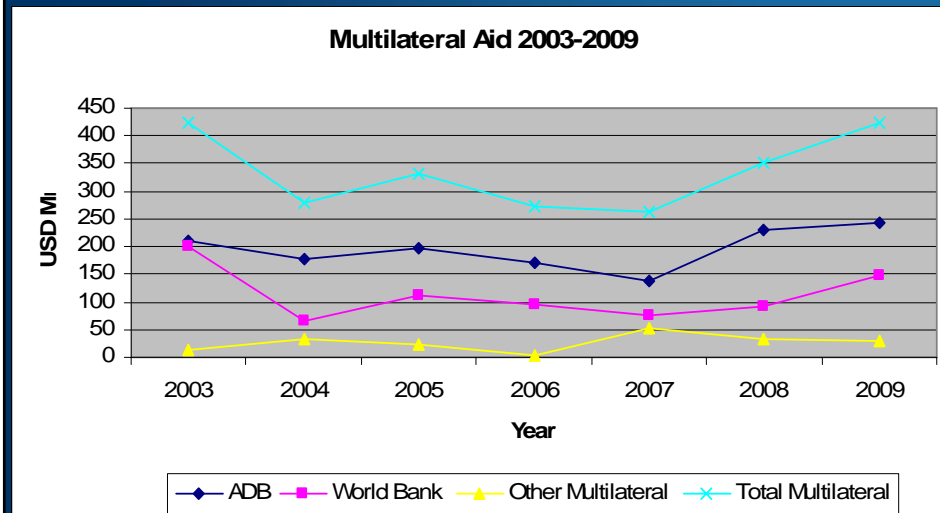
Outline

- Trends in foreign aid in SL
- Contemporary role of aid in SL
- Potential costs of aid
- Priorities for enhancing aid effectiveness
- Domestic reform priorities
- Conclusion

Trends in Foreign Aid in Sri Lanka

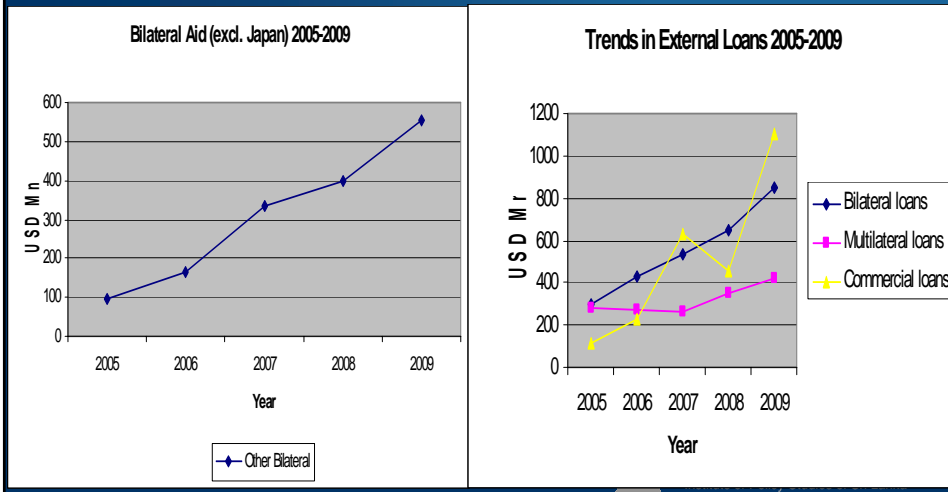
- Significant role of aid in financing capital expenditure – Mahaweli development program a watershed in terms of scale
- Majority of Sri Lanka's aid flows have been from Japan, ADB and World Bank – until recently accounting for 80% of flows
- Concessionary rates – ADB 30 years and 0.5% interest, WB 40 years and 0.75% service charge
- Decline in multilateral aid flows in recent years as per capita income has increased above US\$ 2000
- Also increased uncertainty regarding aid flows from western bilateral donors and in some cases multilaterals (PRGF/PRSC funding in 2003) as a result of continued conflict in the country

Multilateral Aid Flows to Sri Lanka



Changing Role of Aid Flows

- As a result of the uncertainty in traditional aid flows and the continued necessity for concessional finance for development projects, GoSL turned to Eastern bilateral donors and commercial finance



Bilateral Aid and Commercial Finance

- Bilateral aid flows in recent years have been dominated by China which became the second highest donor in 2009 in terms of disbursements
- India has traditionally provided SL with lines of credit, but in the last 2 years has begun to engage in project based lending – financing railway development and housing in the North and East – a commitment of close to US\$ 1 billion being made in June 2010
- In October 2007 GoSL launched its debut international sovereign bond issue – US\$ 500 mn, 5 year repayment at 8.25% per annum
- Since then increased commercial borrowing through Sri Lanka Development Bonds (SLDBs) and other syndicated loans and a second sovereign bond issue in October 2009

SL Commercial Borrowing June 2008-June 2010

Month	Type	Amount	Payment Period	Interest
June 2008	Syndicated Loan	US\$ 150 Mn	3 years	5.69%
June 2008	SLDB	US\$ 230.3 Mn	2 years	6.13%
September 2008	SLDB	US\$ 60 Mn	2 years	5.98%
June 2009	SLDB	US\$ 115.8 Mn	2 years	6.13%
August 2009	SLDB	US\$ 190 Mn	2 years	5.4%
October 2009	Sovereign Bond Issue	US\$ 500 Mn	5 years	7.4%
June 2010	SLDB	US\$ 102 Mn	3 years	4.7%
June 2010	SLDB	US\$ 176 Mn	2 years	4.55%

Contemporary Role of Foreign Aid in Sri Lanka

- Concessional foreign aid remains a necessity in the short term due to weak fiscal position.
- Budget deficit 9.7% and public debt 86.5% in 2009 – situation improving with planned budget deficit of 8% in 2010
- Financing required for reconstruction activity in post war situation – particularly resource intensive capital investment projects
- Domestic borrowing could increase pressure on interest rates (have remained low thus far but in the context of weak private sector demand post downturn) – also IMF ceiling
- External borrowing is the option – but commercial borrowing can be expensive and risk appetite of global investors is uncertain

Potential Costs of Aid: Dependence and economic management

- Dependence – consistent access to concessional finance with long repayment periods that extend beyond the political cycle could undermine long term fiscal management.
- Allowed countries like SL to run budgets characterised by recurrent expenditure exceeding revenue for many decades.
- As access to concessional finance dries up there are structural rigidities that prevent quick transition into more sustainable fiscal policy
- Short term challenges for macroeconomic management – large aid inflows in response to a shock can result in appreciation of the real exchange rate – undermining export competitiveness.



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Potential Costs of Foreign Aid: Conditionality

- However preventing exchange rate appreciation by building up foreign reserves can cause inflationary pressure by expanding the monetary base
- Attempting to control monetary expansion by selling securities could put pressure on interest rates.
- At present SL is facing declining interest rates and inflation, therefore despite significant capital inflows, this is not a short term concern. Nonetheless, there has been upward pressure on the exchange rate.
- Conditionality – Political conditionality – Tokyo Donor Conference 2003 US\$ 4.5 Billion conditional on progress in the peace process, withdrawal of bilateral aid
- Donors overestimated capacity to influence domestic political outcomes in SL – considering leverage of GoSL through alternative donors



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Potential Costs of Aid Cont.

- Political conditionality undermines predictability of aid – against Paris Declaration principals
- Economic conditionality – potential positive influence of conditionality. SL's recent IMF SBA technical MoU and letters of intent have been in line with fiscal policy priorities that are important to support long term growth
- Agreement provides flexibility by framing overall policy approach but leaving the nuances of implementation up to the government
- Past IMF agreements have specified issues such as privatisation and structural reform of institutions. These objectives failed due to political realities.
- In this case objective of SOEs breaking even is spelled out without specification of how this should occur

Potential Costs of Aid: Loan Covenants

- Covenants and safeguards – Whilst an improvement on rigid conditionalities of the past – covenants and safeguards are characterised by extensive bureaucratic procedures and absorb significant capacity whilst delaying implementation in many cases

Implications for Domestic Capacity

- Donor dominance in implementation of projects excluding domestic institutions from development
- Problems of domestic capacity constraints at sub national level institutions, especially in Northern and Eastern Provinces
- The creation of dual institutions in development processes hindering the opportunity for augmenting domestic capacity
- Need for shared responsibility of development between both the government and respective development partners
 - Post conflict context: importance of social perceptions of the state's involvement in rehabilitation and reconstruction



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Domestic Capacity cont.

- Tsunami experience: use of foreign workers in donor-funded workers over local country experts
- Important to use the opportunity of post conflict reconstruction to strengthen local skills and encourage sustainable development
- Distortions created by the donor presence in the labour market – higher wages offered by donors creating competition for resources
- Lack of capacity at the sub-national level to administrate donor-funded projects



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Domestic Private Sector Capacity

- Opportunity for the local private sector to positively gain from the post conflict reconstruction process – expanding capacity and domestic ownership of development
- Donors face dilemma between supporting the domestic private sector in their activities, through positive discrimination, and competitive bidding
- However, high demand for local resources can place upwards pressure on prices which would become a further hindrance to sustainable development – a greater threat where there exists competition between donors for local resources as experienced in the post-tsunami recovery period
- Domestic private sector may lack the capacity to meet demands of donor-funded project - supporting the local private sector may not always be a practical objective



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Improved Targeting of Aid

- Poor targeting of aid projects as a direct impediment to aid effectiveness
- Post-tsunami recovery experience: provision of fishing boats and tools to affected households
 - 52% of fishing households that lost their boats did not receive the boat aid transfers
 - Non-traditional fishing households receiving boat aid transfers placed downwards pressure on domestic prices
- Risks associated with poor targeting in a post-conflict environment – need for inclusive policies and stakeholder consultation
- Practical issues associated with improving targeting in the short term
 - Problems of displacement reducing the opportunity to adequately consult with stakeholders. Civil Society Organisations (CSOs) may not always represent all groups in society
 - Beneficiaries changing behaviour so as to receive transfers



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Priorities for Enhancing Aid Effectiveness: PD in SL

- Ownership (partner countries set the development agenda)
- Alignment (donors align programs with this development agenda and partner country financial systems)
- Harmonisation (donors to use common arrangements for planning, disbursement and reporting to reduce transaction costs)
- Managing for results (improving management of aid to ensure better results – such as performance based budgeting)
- Mutual accountability (increasing the role of parliaments in aid decisions and participatory approaches to national development strategies).
- Gap between PD priorities and priorities in Sri Lanka



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Ownership

- SL has strong recent history of national development plans that provide direction for economic development – major donors align
- Therefore enhancing ownership of the development agenda in this sense is not really a priority in SL
- If at all, there is a need for more inclusive consultation and coordination between government and donors in the process of allocating work/projects to donors to ensure that work is in line comparative advantages and capacity
- Ownership is needed more at the micro-level in terms of design of projects and in implementation
- Also increased role needed for sub-national governments, CSOs in formulation of national development strategies – specially post conflict



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Alignment

- According to the Sri Lanka country evaluation of the PD, 89% of aid was to the public sector with 77.6% of aid going through the national budget
- Only 40% of bilateral aid (excluding Japan) was to the public sector.
- National procurement systems were utilised 50.7% of the time with 40% of donors not using National Procurement Agency guidelines, all of which were bilateral donors
- 70.5% of aid used national accounting systems and 65.9% used national audit systems
- Traditional donors – WB, ADB, Japan – use national systems to a greater extent than bilateral donors

Alignment cont.

- Half the donors interviewed in Sri Lanka's PD evaluation used Parallel Implementation Units (PIU) amounting to 50 such project units.
- In the short term PIUs are useful to fill in capacity gaps but in the medium term they should be phased out or absorbed into national systems
- Tied aid – ADB, WB, Japan don't use tied aid. But the Sri Lanka PD evaluation estimates that only 25% of non-Japanese bilateral aid is untied.
- Tied aid can drive up costs due to requirements on sourcing of materials and labour and in some cases could undermine the quality of the final product
- In post conflict situations a failure by donors/NGOs providing relief services to signal alignment with the government could create perceptions of government failure and donor dominance – this is detrimental to the peace building process

Harmonisation

- Sri Lankan PD evaluation report finds that donors fell short of meeting PD targets in 2005 with only 16.5% of 236 donor missions that year being coordinated amongst donors (PD target 40%) and 52.3% of donor analytic works were coordinated, short of the 66% PD target.
- However, by avoiding donor-led coordination, the government can maintain choices amongst different donors, and is thus able to strengthen its own bargaining position.
- Government led harmonisation could achieve both ends of maintaining government prerogative of donor selection, whilst contributing to the reduction of transaction costs associated with multiple missions, systems and reporting procedures
- Such harmonisation requires improved communication channels between donors and government – annual development forum is insufficient

Managing for Development Results/ Mutual Accountability

- These two issues are very much in line with SL's priorities for enhancing aid effectiveness
- Broader stakeholder engagement in formulation on national development strategies
- Results based budgeting
- Enhanced review mechanisms and evaluations of performance
- Department of Foreign Aid and Budget Monitoring has taken steps to enhance transparency and publicize information on M&E
- Important to provide avenues for those benefitting/affected by projects to participate in review and evaluation activities

Domestic Reform Priorities

- Institutional capacity – investment in agencies dealing with donors particularly in terms of capacity for monitoring and evaluation of donor funded projects.
- Also – ownership of project conceptualisation, implementation is contingent on capacity within respective line ministries, implementing agencies
- Coordination of government agencies – transaction costs increased as a result of a government responsibilities spread across many agencies – necessity to streamline aid project implementation processes.
- Necessity for clarity in demarcation of responsibilities between central and sub-national governments. Important role for sub-national governments in aid project implementation given the principal of subsidiarity – but again issues of capacity and coordination failures



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Domestic Reform Priorities Cont.

- Domestic Counterpart Funding – A major cause for poor aid absorption in SL has been delays in provision of counterpart funding. Reflective of fiscal stresses in SL.
- Lack of emphasis on maintenance – in the past many projects have not had sustainable measures to ensure continuity of effectiveness of outcomes. Joint measures needed to invest in financial and human resources dedicated to maintenance
- Transparency – DoFABM and multilateral donor websites make public evaluations of past projects and also in cases information on inputs, time frames and objectives, benchmarked against performance. Should be rolled out for all donor funded projects.



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Conclusion

- In the long term it is important to reduce reliance on concessional finance for support government investment – necessity for enhanced fiscal management and domestic resource mobilisation
- Particularly important given lower access to concessional aid from traditional sources and the lack of predictability of bilateral aid
- However concessional ODA is necessary in SL in the short term given fiscal constraints and reconstruction needs in the NE
- In this context it is important to maximise effectiveness of this aid through identified measures – investing in domestic institutions, enhance targeting of aid, broaden stakeholder involvement in donor funded projects – particularly in a post conflict environment

Thank You

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