

**Sri Lanka**  
**State of the Economy Report 2010**

**Chapter 9**  
**The Role of Foreign Aid in Post-conflict**  
**Recovery**

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## **9. The Role of Foreign Aid in Post-conflict Recovery**

### **9.1 Introduction**

Post-conflict societies often face the risk of return to conflict, although this may be lessened in cases where a conflict ends in military defeat of one side. Nonetheless, the choice of policies that are employed to lock in peace is critical. This usually entails a balance between political and economic measures. The economic challenges are usually characterized by damaged infrastructure, loss of human capital and livelihoods. In more extreme cases, economies can collapse entirely. Sri Lanka's experience has been a hybrid of sorts, with widespread socio-economic destruction in the Northern and Eastern Provinces whilst general economic structures in the rest of the country remained in place. Nonetheless, the extent of damage in the North and East (N&E) imposes a heavy reconstruction and rehabilitation burden on government finances. Given Sri Lanka's fiscal constraints, external financial assistance clearly has an important role in supporting the country's post-conflict development. Indeed, effective aid delivery could reduce the risks of return to conflict by enhancing prosperity and poverty reduction through growth.

This Chapter explores the role of external assistance in supporting post-conflict economic development in Sri Lanka. External assistance largely refers to Overseas Development Assistance (ODA) provided at concessional rates by multilateral and bilateral development partners. However, other forms of external flows such as that provided by the International Monetary Fund (IMF) through its Stand-by Arrangement (SBA) are also included. The necessity of foreign aid

given Sri Lanka's macroeconomic circumstances is outlined at first, focusing on the fiscal stresses that constrain the government's spending capacity. The priority interventions for donors are then discussed along with the sectors that could drive economic growth in the short run and how aid can help alleviate productive bottlenecks in these sectors. The domestic policies required in the effective management of aid is dealt with next, particularly focusing on issues of absorptive capacity and macroeconomic management of aid flows. The final section of the Chapter examines the distributional impacts of aid and potential negative socio-political externalities that can result in a return to conflict. In this context, the importance of designing effective institutions for the transparent and inclusive delivery of aid is outlined.

### **9.2 The Prima Facie Necessity for Foreign Aid in Post-conflict Sri Lanka**

Sri Lanka has long been a recipient of foreign aid which has played an important role in contributing to the capital expenditure of the budget. The access to concessionary ODA from international donors, primarily Japan, the Asian Development Bank (ADB) and the World Bank (WB) has enabled the country to carry out developmental activity without placing an excess burden on short term debt financing, since these loans have traditionally been characterized by low interest rates and long repayment horizons. The ADB Special Fund Resources for instance had a 30 year maturity and interest rates of 0.5 per cent and many of Sri Lanka's early World Bank loans had a maturity of up to 40 years

with 0.75 per cent service charge.<sup>1</sup> As a result, even today, the bulk of Sri Lanka's foreign debt stock has long repayment horizons and, therefore, does not place substantial pressure on short term repayment. In the recent past, however, there has been a slight shift away from this favourable position.

The role of foreign assistance has indeed been instrumental in supporting the development process in Sri Lanka, particularly with regard to financing capital intensive infrastructure ranging from power generation to roads. However, at the same time, it could be argued that the easy access to low cost finance undermined discipline in financial management in Sri Lanka. Successive Sri Lankan governments were able to spend the entirety (and more) of government revenue on recurrent consumption, knowing that foreign finances would be available to finance capital intensive investment.

The government's spending power is to a great extent curtailed by a constrained fiscal environment. In such a situation, borrowing becomes a necessity and two options could be pursued. Domestic borrowing could be problematic since it could create upward pressure on interest rates and thus 'crowd out' critical private sector investment to spur post-conflict growth.<sup>2</sup> Foreign borrowing is an alternative and this could be achieved either through commercial markets or concessionary borrowing from donors. The former is costly and brings heightened risks to macroeconomic management as detailed in Chapter 2. Therefore, the most acceptable form to support higher government capital expenditures would be in the form of concessionary borrowing. This is further exemplified by the magnitude of the expenditure required in resurrecting the post-

conflict economy in the North and East (N&E) of the country. The economic, physical and social infrastructure in the two provinces was severely affected during the conflict and reconstruction would require a very substantial degree of financial resources. However, as Sri Lanka's per capita income has increased in recent years, the country's windows of access to concessionary borrowing have become narrower, particularly in the case of multilateral donors.<sup>3</sup> This has made bilateral aid a more attractive option for Sri Lanka, particularly from China which offers low rates of interest and is less rigid in terms of conditionalities. However, bilateral aid has its own constraints, particularly in terms of requirements for sourcing of labour, materials and project implementation.

Foreign aid is also useful to support a country's balance of payments (BOP). Indeed, it was the need for BOP support that prompted Sri Lanka to approach the IMF for an SBA in February 2009. With the ongoing recovery in global commodity prices, the import intensity of reconstruction measures could be substantial. This may not, however, be a major short term concern in Sri Lanka as, despite the fact that prospects for export earnings in the short term are not optimal, foreign exchange inflows due to remittances and short term capital inflows (particularly in government securities and equity) have supported Sri Lanka's foreign exchange reserve position in the post-conflict era. Increased investor confidence in the Sri Lankan economy was also influenced by the SBA with the IMF.

### 9.3 Priority Interventions

The conflict in Sri Lanka had differentiated impacts on the economies of the N&E and on the overall national economy. Whilst the

<sup>1</sup> Kelegama, S., and D. de Mel, 2007, "Sri Lankan Perspectives on Reform of the International Aid Architecture" North-South Institute, Canada.

<sup>2</sup> Furthermore, by the terms of Sri Lanka's Stand-by Arrangement with the IMF arrived at in July 2009, there is a ceiling on permitted volumes of borrowing - both domestic and external borrowing on commercial terms.

<sup>3</sup> Ibid.

former saw extensive destruction, the national economy displayed substantial resilience, with overall economic infrastructure remaining intact. Therefore, the purpose of foreign aid differs at the national and local levels. At the national level, foreign aid is desirable primarily in terms of supporting macroeconomic stability. It was in this context that IMF assistance approved in July 2009 was important in terms of supporting post-conflict recovery in Sri Lanka. Given the relatively weak fiscal situation, the role of foreign aid at the macroeconomic level would be in terms of supporting expenditure on reconstruction, thereby enabling fiscal consolidation by the government. If foreign aid were not available, either reconstruction and humanitarian assistance would be compromised, or the fiscal position would further deteriorate if even more government expenditure was utilized in reconstruction, resulting in macroeconomic stress that could undermine post-conflict recovery and long term growth.

In the conflict-affected N&E, the role of foreign aid is more precise in terms of supporting interventions towards reconstructing the economy in the region. The creation of livelihood opportunities and enhancement of productive capacity becomes a priority in a post-conflict scenario. This needs to be considered from different time frames - short and long term. In the long term, employment generation is facilitated by a stable macroeconomic framework, a sound investment regime, access to inputs, secure property rights, etc. However, in a post-conflict situation, job creation needs to be conducted on a more urgent basis. The most rapid measure is to maximize generation of local job opportunities through reconstruction activities, particularly those related to infrastructure such as roads, railways, etc.

This is one area where foreign aid in Sri Lanka has not always had a positive record. Many large scale donor supported programmes in infrastructure have required the utilization of donor country labour and sourcing of raw materials from the donor country. In the context of post-conflict reconstruction, such conditionalities would generate a sub-optimal outcome, since the utilization of local labour and sourcing (contingent on supply capacity) would maximize the multiplier growth impacts of aid.

### 9.3.1 Key Sectors

In the short term, whilst addressing issues of refugee return, housing and de-mining, aid should be channelled into supporting reconstruction measures that address current impediments to employment creation. For example, support to the reconstruction of reservoirs and irrigation systems could assist the creation of employment in agricultural activities. Given the traditional strengths of fisheries and agriculture in the conflict-affected provinces, these sectors would be good starting points in terms of aid supporting livelihood generation in the N&E. In the fisheries sector, for instance, much of the reconstruction efforts would require high fixed costs of construction, for example, reconstruction of damaged fishery harbours, piers, quality testing facilities, storage facilities and ice plants.<sup>4</sup> This high cost entails a potential necessity of ODA in supporting such reconstruction. Whilst there is also a need for access to boats and other direct fishery implements, care needs to be taken in terms of targeting such aid effectively. The issue of targeting aid is discussed in some detail later.

For fisheries, agriculture and all other economic production (tourism is also an important post-conflict sector), a key

<sup>4</sup> See policy brief on "Fishery Sector and Post-conflict Development Challenges".

component for viability and income generation would be connectivity to markets. Again, given the high costs entailed in reconstruction of transport infrastructure, the role of concessional ODA would be significant in this endeavour. Since information is likely to be a significant market failure, donors could provide support to business chambers both at the national and regional levels in order to link producers in the N&E with firms and consumers in the rest of the country. A parallel approach would be for donors to work with firms who actively source from suppliers in the conflict-affected provinces.

When examining the existing disbursements of ODA to the N&E during 2009 and leading up to June 2010, it is clear that the bulk of financing has indeed gone into the costly heavy infrastructure sector, along with urgent needs of housing and resettlement (Table 9.1).

There has also been support for the priority livelihood sectors of agriculture and fisheries - for instance, one of the community support projects of the ADB targets coastal communities. The aid that has gone into the N&E reflects the short term priorities in the region. With time, however, more support can be expected to filter into social services sectors such as health and education along with increased support to SMEs and entrepreneurs to ensure sustainability of economic recovery.

#### 9.4 Domestic Aid Management

The effectiveness of aid in achieving its objectives is contingent on the confluence between sound aid delivery policies and prudent domestic management of aid receipts. The literature points to the role of domestic policy quality for ensuring aid effectiveness given the importance of policies and institu-

**Table 9.1**  
**ODA Disbursed by Sector for N&E Specific Projects (2009-10)<sup>a</sup>**

Sector	US\$ Million	
	2009	Jan-June 2010
Roads	8.7	2.1
Bridges	8.1	0.7
Ports	13.4	9.1
Power		0.2
Other infrastructure <sup>b</sup>	29.4	15.9
Agriculture	11.1	3.6
SMEs	0.2	0.1
Housing	18.5	3.8
Local services	2.0	0.3
IDPs	0.4	1.4
Community support	18.4	4.1
Education	0.1	
Other <sup>c</sup>	19.4	12.4
Total	129.7	53.6

Notes: a: This data does not include national level projects which may have some N&E aid components; b: Other infrastructure refers to general infrastructure rehabilitation programmes (such as the French funded Trincomalee Integrated Infrastructure Project and the Japanese funded Pro-poor Eastern Infrastructure Project); c: Other refers to general projects in the N&E (such as the ADB Conflict Areas Rehabilitation Project, the UNDP Transition Recovery Programme and the World Bank emergency NE recovery project).

Source: External Resources Department ([www.erd.gov.lk](http://www.erd.gov.lk)).

tions in determining absorptive capacity.<sup>5</sup> Studies that have looked at the role of aid in supporting peace find that aid, in combination with good policies affects economic growth and prosperity which in turn reduces the risk of conflict.<sup>6</sup> In post-conflict situations, absorptive capacity tends to suffer due to disruptions to government aid delivery institutions and in other cases due to loss of control over macroeconomic policy during conflict. Studies find that the period in which absorptive capacity is maximized is between the 4th and 7th years following the end of the war.<sup>7</sup> Hence, the flow of aid into a post-conflict country should gradually build-up as opposed to petering out following the first few years of peace, which is what tends to occur in many cases.

In Sri Lanka's case, however, central government institutions remained intact and macroeconomic conditions are well above par compared to most post-conflict economies which often suffer from hyper-inflation and chronic indebtedness. Many post-conflict economies suffer due to poor aid absorption in the immediate post-conflict period, which tends to coincide with spikes in aid receipts. Evidence from countries which saw conflicts end in the 1990s and 2000s saw aid increasing at the immediate onset of peace and then tapering off back to trend levels.<sup>8</sup> The conflict is unlikely to have a significant effect on aid absorption capacity at the national level in Sri Lanka. Nonetheless, regardless of the conflict, there have been gaps in Sri Lanka's general aid absorptive capacity due to factors such as delays in providing counterpart funding, delays in ob-

taining land and administrative capacity constraints.

Even though issues of absorption may not be as significant a constraint in Sri Lanka compared to many other post-conflict economies, the value of securing longer term aid flows remains high. Increasing the time-span with which aid enters into a nation, following the cessation of conflict, is conditional upon a number of pre-requisites which would facilitate such an arrangement. Securing donor funds in the medium term would require a stronger relationship between the donor and the recipient country, as the agreement would necessarily require a greater degree of planning and commitment on behalf of the donor. Increasing transparency of government policy would be one such measure that could help to secure longer term funding. A credible long term development plan would assist in increasing transparency and securing donor funds, through signaling greater organization and commitment to executing development proposals.

Demonstrating greater direction in the long term development of the country may also help in reducing the conditionalities demanded by donors as a prerequisite to aid. Externally devised conditionalities run the risk of being biased towards certain social groups, as donors may fail to interact with a wide spectrum of stakeholders and instead consult only donor-friendly groups. Sri Lanka's earlier experiences of conditionalities related to aid and peace did not have positive outcomes.<sup>9</sup> The 2003 Tokyo Donor Conference saw donors pledge US\$ 4.5

<sup>5</sup> Burnside, C., D. Dollar, 2002, "Aid, Policies and Growth", *American Economic Review*, 90 (4), 847-68; and Collier, P. and D. Dollar, 2002, "Aid Allocation and Poverty Reduction", *European Economic Review*, 46, 1475-1500.

<sup>6</sup> Collier, P. and A. Hoeffler, 2002, "Aid, Policy and Growth in Post-conflict Societies", World Bank, Washington, D.C.

<sup>7</sup> *Ibid.*

<sup>8</sup> Elbadawi, I, L. Kaltani, and K. Schmidt-Hebbel, 2007, "Post Conflict Aid, Real Exchange Rate Adjustment and Catch Up Growth", *Policy Research Working Paper Series 4187*, World Bank, Washington, D.C.

<sup>9</sup> Kelegama, S., and D. de Mel, 2007, "Sri Lankan Perspectives on Reform of the International Aid Architecture", North-South Institute, Canada.

billion of aid to Sri Lanka conditional upon the fulfillment of a number of peace-related requirements.<sup>10</sup> Such involvement saw a diversification of international actors from their traditional roles as overseers of long term development and economic stability. The peace process related to short term developments, and was unavoidably of a highly political nature. The external influence of donors in political factors further disrupted the peace process through pursuing policies which undermined the needs of communities in the 'conflict-unaffected' areas. This led to a backlash against the involvement of 'neo-imperial' donors.<sup>11</sup> In a post-conflict context, employing policies which can be perceived as being biased towards different social groups can be detrimental to the success of 'peace' and subsequent reconstruction.

The experience of the 2002-04 'peace process' indicates the difficulty with which political and economic objectives are aligned. Therefore, it may be beneficial to all stakeholders for the government to take on a more active role in pursuing transparent, inclusive policies which consult and incorporate the needs of different groups in society. Along with clarity and transparency of long term development planning, greater transparency in short term activities of a peace building process would help to direct foreign assistance to long term plans for economic development, by signaling greater commitment to social equity. Such measures will work to increase the ease with which the government can secure aid for the medium term; wherein absorptive capacity would be further enhanced.

#### 9.4.1 Macroeconomic Management

The other important consideration is the macroeconomic impact of aid inflows. Capital inflows such as aid can have various macroeconomic implications, which manifest in different ways depending on the policy priorities and targets of the relevant monetary authority. The most common impacts are on exchange rate, monetary base, inflation and interest rates. Significant capital inflows in the form of aid can result in an appreciation of the real exchange rate (RER) which in turn will undermine the net export position and thereby reduce incomes through the 'Dutch disease' effect. The manifestation of this is contingent on how aid inflows are utilized by the government.

As discussed in Chapter 3, the role of exports will be important in post-conflict development, therefore management of the RER will be an important policy objective. However, governments have sufficient tools to prevent exchange rate appreciation in the event of foreign aid inflows. Studies have found that in a sample of 36 countries, 30 did not demonstrate a significant correlation between aid and the RER.<sup>12</sup> However, it is not just aid inflows that can influence the RER but also capital inflows such as remittances and short term inflows into equity and bond markets. In a post-conflict situation, increased confidence in the economy could attract significant capital inflows into equity and debt markets and remittances also tend to spike in support of relief and rehabilitation measures.

Another important risk to keep in mind is the impact of aid and reconstruction on the

<sup>10</sup> Goodhand, J., B. Klem, D. Fonseka, S. Keethaponcalan, and S. Sardesi, 2005, "Aid, Conflict and Peace Building in Sri Lanka", World Bank, Washington, D.C.

<sup>11</sup> *Ibid.*

<sup>12</sup> Elbadawi, I, L. Kaltani, and K. Schmidt-Hebbel, 2007, "Post-conflict Aid, Real Exchange Rate Adjustment and Catch Up Growth", *Policy Research Working Paper Series 4187*, World Bank, Washington, D.C.

Spend All	Spend all on non-trade sector – Complete aid absorption but RER appreciation
	Spend all on tradable sector – No aid absorption but no RER appreciation
Save All	Build up international reserves or use aid to repay foreign debt – No impact on RER
	Use aid to repay local debt – RER appreciation

non-traded sector. Due to supply constraints, particularly in post-conflict areas, reconstruction activity can drive up prices of raw materials and construction related labour. This is problematic due to its inflationary impacts and also due to the resultant challenges in terms of costing aid projects. This was experienced by Sri Lanka in the aftermath of the December 2004 Asian tsunami where many projects ran into budgetary problems due to mis-estimations of costs.<sup>13</sup>

### 9.5 Distributional Effects of Aid: Lessons from the Past

The injection of aid into a country can have a number of social implications, which need to be considered before devising and implementing projects. The distributional effects of aid can be a potential hindrance to long term development and, within a post-conflict context, detrimental to social reconciliation. The experience of the Mahaweli Development Project (MDP) initiated in the 1970s - funded largely by donors - is one such example. The project was intended to provide jobs and land for the landless through irrigating surplus land in the dry zones of the North-Central, Northern and Eastern Provinces. This newly irrigated land was to

be allocated between approximately 18,500 families with each receiving 0.2ha on which they could live and cultivate paddy and other crops.<sup>14</sup> Despite its development component, the MDP was perceived to have aggravated social tensions between communities, including ethnic rivalries.<sup>15</sup> The experience of the MDP illustrates the susceptibility of development projects to scrutiny from domestic stakeholders. The role of perceptions is essential in donor engagement in post-conflict areas. Especially in order to ensure that policy cannot be misconstrued as favouring any one group, projects must be sensitive to the demographic and socio-economic composition of the regions concerned. Given that restructuring social capital is a vital prerequisite to post-conflict development, a degree of redistribution may be unavoidable. Nonetheless, policies should aim to minimize such disturbances. Such measures would require greater engagement with domestic stakeholders on behalf of both the government and donors.

The relief effort following the December 2004 Asian tsunami is another example of negative externalities accruing from donor-funded activities. In the post-tsunami period,

<sup>13</sup> Weerakoon, D, S. Jayasuriya, N. Arunatilake and P. Steele, 2007, "Economic Challenges of Post-tsunami Reconstruction in Sri Lanka", Asian Development Bank Institute, Tokyo.

<sup>14</sup> World Bank, "Independent Evaluators' Report on Mahaweli Ganga Development", accessed at <http://lnweb90.worldbank.org/oeo/oeodoclib.nsf/DocUNIDViewForJavaSearch/0D869807701D1EEE852567F5005D8903>.

<sup>15</sup> See Silva, K.T., 2005, "Politicization of Ethnicity, Ethnification of the Stage and Challenges for Post-conflict Transformation in Sri Lanka", in Raghavan, V. and K. Fischer (eds.), *Conflict Resolution and Peace Building in Sri Lanka*, McGraw-Hill; and Gunatilake, G., 2001, "The Ethnic Dimension of Socio-economic Development", Marga Institute.

there was a large influx of donor aid directed at restoring the fishery sector. However, due to insufficient data on pre-tsunami levels of participation in the fishery sector, donors ended up providing fishing boats and tools to households that were not previously employed in the sector. For instance, studies have found that 52 per cent of fishing households that lost their boats in the tsunami did not receive the boat aid transfers that they were eligible for.<sup>16</sup> This led to over-fishing which subsequently dampened domestic prices. The poor targeting of donor activities experienced after the tsunami highlights the importance of social consultation, especially in the absence of micro-level data. In addition to this, had there been adequate harmonization of donor projects, the over-provision of boat transfers could have been avoided. Poor targeting of donor projects following the end of the conflict can be detrimental to peace, especially if, as in the post-tsunami experience, transfers are misdirected and fail to reach those eligible for them.

Maintaining peace and developing social capital is understood as being an essential prerequisite from which economic development can ensue. Conflict sensitive development is understood as:<sup>17</sup>

- Assisting those directly affected by the conflict and reducing the economic disparity between populations in the conflict regions and the rest of the country
- Ensuring that aid is distributed evenly amongst varying regions and social groups, so as not to fuel regional inequality and grievances
- Safeguarding ethnic ratios in the conflict regions to avoid further aggravating ethnic conflict

- Greater consultation of those who are to be directly affected by development proposals
- Greater monitoring and transparency of the effect of development projects on conflict dynamics

In the early experiences of Sri Lanka's post-conflict development, particularly in the Eastern Province, the extent to which donors exercise conflict sensitive programming varies from donor to donor. The World Bank is an institution that has demonstrated their commitment to conflict-sensitive development, through passing all proposed projects through a 'conflict filter' before they are approved. The filter assess whether or not the project consulted a broad range of stakeholders, established independent grievance mechanisms, management and administration is sensitive to inter-ethnic relations, identifies conflict-generated needs, and has identified opportunities for inter-ethnic reconciliation.<sup>18</sup> Similarly, the ADB consults a specialist from an external organization to advise them on conflict sensitive procedures and also subjects conflict area programmes to special reviews in order to ensure sensitivity to conflict related particularities.

However, a report on post-conflict development in the Eastern Province suggests that many international donors are poorly informed on the scope of conflict sensitive development and what it entails.<sup>19</sup> The report comments on the redundancy of donor consultations in having an impact on the beneficiaries and the type of development that is implemented in the East. Furthermore, the report discussed the lack of transparency of aid-funded projects, with donors showing a

<sup>16</sup> Gunawardena, A., 2010, "Targeting and Distribution of Post-Disaster Aid", IPS (forthcoming).

<sup>17</sup> International Crisis Group, 2009, "Development Assistance and Conflict in Sri Lanka: Lessons from the Eastern Province", Asia Report No. 165.

<sup>18</sup> World Bank, "Sri Lanka Country Assistance Strategy 2009-2012".

<sup>19</sup> Ibid.

lack of commitment to monitoring progress and disseminating information. Not only does this impair donors' ability to assess the impact of projects on the conflict dynamics of the country, but it may further add to the political market imperfections that hinder post-conflict development.<sup>20</sup>

### 9.6 Institutional Factors

Given the risks inherent in failing to address sensitivities relating to the distribution of aid, and the imperfections among donors in their ability to address this issue themselves, it is essential that the government takes the lead in the design of institutions for the effective delivery of aid in a manner that is sensitive to post-conflict social structures. Ensuring that resources are efficiently distributed requires strong institutions which demonstrate a high degree of transparency and the ability to communicate well with ground-level, central government and international actors. Within a post-conflict context, the creation of new institutions can help in overcoming animosity felt amongst society towards old institutions which may impede progress in reconstruction.<sup>21</sup> More importantly, inclusive institutions can help alleviate concerns regarding capture of aid by elites or particular social groups, and this will be important in terms of ensuring medium term peace.

Institutional capacity constraints are one of the main impediments to enhancing the effectiveness of aid. As outlined in the Paris Declaration (PD), increasing domestic ownership of development can help in overcoming these constraints by heavier employment of local resources in the design and implementation of development projects. This is especially important in a post-conflict economy as the use of domestic resources can assist in the normalization of

development processes. Therefore, there is likely to be less resistance to development, which can be helpful to the restructuring of social capital.

The potential benefits of decentralizing reconstruction remain important, such as its role in helping to foster greater interaction between social groups directly affected by the redevelopment process and the authorities in control of redevelopment - the principle of subsidiarity. This will allow for more inclusive policies to be implemented, which in a post-conflict context is vital to maintaining peace and supporting effective development. This raises interesting questions about the applicability of the Paris Declaration in Sri Lanka's context. Whilst there is currently strong national ownership of development at the central government level - embodied by the 'Mahinda Chinthanaya' - ownership at the sub-national level is less prominent due to relatively weak regional institutions. It is therefore important to create avenues for greater sub-national ownership of the developmental agenda.

The problem regarding decentralization is the issue of limitations in institutional capacity at the sub-national level. Capacity is a greater issue within the Northern and Eastern Provinces wherein the conflict has adversely affected the establishment of local institutions. Such features may be the cause for the heavy donor presence in the implementation process of many donor-funded projects. However, this can further exclude domestic participation, fostering capacity constraints in the process. The extensive use of foreign workers over the employment of local experts, and donor processes were major criticisms of the post-tsunami recovery

<sup>20</sup> Keefer, P., 2008, "Foreign Assistance and the Political Economy of Post-conflict Countries", World Bank, Washington, D.C.

<sup>21</sup> International Crisis Group, 2009, "Development Assistance and Conflict in Sri Lanka: Lessons from the Eastern Province", Asia Report No. 165.

### Box 9.1

#### Paris Declaration on Aid Effectiveness (2005) and Accra Agenda for Action (2008)

The Paris Declaration (PD) on Aid Effectiveness is the result of the Second High Level Forum held in Paris, France, in 2005. The agreement recognized the need for reforms in aid deliverance so as to increase the likelihood of achieving the Millennium Development Goals by 2015.

The Declaration consisted of 5 principles which, if satisfied, were believed to enhance the effectiveness of aid. These principles are:

- *Ownership* – partner countries take greater control over development activities with a clear agenda.
- *Alignment* – donors align their development priorities to the priorities of the government as specified in their development plan.
- *Harmonization* – donors use common arrangements for planning, disbursement and reporting so as to reduce transaction costs.
- *Managing for results* – improving the country assessment and monitoring of national development strategies.
- *Mutual accountability* – increasing the transparency of both countries and their development partners' roles in aid decisions.

As an adjunct to the PD, the Accra Agenda for Action (AAA) was developed at the Third High Level Forum held in Accra, Ghana, in 2008. The intention behind the AAA was to accelerate the implementation of the PD through greater emphasis on the following principles:

- *Country ownership* – need for greater government leadership in development plans, which consult both the Parliament and the public. Donors should remain committed to assisting with these plans whilst using local resources.
- *Building more effective and inclusive partnerships* – engaging with all stakeholders in the design of policies, such as the private sector, global funds and civil society.
- *Achieving development results and enhancing accountability* – increasing transparency and provision of tangible results so as to enhance accountability to all stakeholders of development.

effort. Whilst it may not be feasible to wholly rely on local institutions for undertaking development activities, they should be adequately incorporated so as to ensure that development is sustainable through the transfer of skills.

In the PD evaluation report conducted in Sri Lanka, 50 per cent of donors interviewed used Parallel Implementation Units (PIUs) in their operations. Such systems can work to create parallel institutions, with development work being conducted separately from the govern-

ment, reducing the scope for domestic institutions to benefit from such activity. Furthermore, in a post-conflict society, parallel institutions have the potential to negatively affect social cohesion.

With regard to alignment, while there is a strong alignment between many of the major multilateral donors and the government, this is less so amongst some of the bilateral donors. Following the cessation of the war, much of the bilateral aid has been directed towards the immediate rehabilitation effort,

whereas the government has focused development efforts in infrastructure - of which there is a longer time span associated with the realized benefits. Such misalignment of activities could create a perception that rehabilitation is donor driven and this could undermine the credibility of the government, which in turn is detrimental to longer term peace efforts. It is therefore important in this context that donor agencies take extra care to prevent the creation of perceptions of donor driven rehabilitation efforts.

Increasing the tangibility of development outcomes of donor funded projects is another priority specified in the PD and one that is of great relevance to post-conflict development in Sri Lanka. Enhancing the transparency of projects is a key component that can help to monitor and, subsequently, augment the ease with which development outcomes can be achieved. The Department of Foreign Aid and Budget Monitoring has taken steps towards greater transparency through publishing reviews of donor-funded projects and the achievement of Paris Declaration goals in Sri Lanka on their website. These reviews outline the effectiveness of past projects and provide lessons learned on how effectiveness can be improved. Increased transparency combined with monitoring and evaluation creates the correct incentives for both donors and governments to ensure greater effectiveness of donor funded projects. For monitoring and evaluation to be more successful, it is important to invest greater resources in domestic institutions that would carry out evaluation of projects whilst at the same time encouraging the involvement of independent institutions to take part in such evaluations.

To maximize the impact of monitoring and evaluation, it is necessary to create avenues for the communities affected by donor

projects to contribute to evaluations. It is both the responsibility of donors and domestic institutions to increase both consultation of stakeholders and accessibility to project evaluations. Stakeholder consultations are of particular importance in post-conflict situations. However, there are many logistical challenges that undermine the feasibility of such consultations - particularly issues such as displacement and time constraints. Hence, with regards to the immediate post-conflict recovery period, the scope for effective consultation may be limited, resulting in a much more ad hoc approach to development processes. This reality puts greater emphasis on the importance of monitoring and accountability in reducing any potential negative externalities of reconstruction, as greater transparency is another measure that can facilitate inclusive development.

The lack of capacity of sub-national level institutions in effectively managing donor activity was evident during the post-tsunami recovery period. Whilst development partners were effective in providing relief in the immediate aftermath of the disaster, their efforts in the medium term were called into question for having many negative externalities which further dampened economic growth. The previously discussed over-provision of boats and restrictive housing policies was partly the fault of a lack of coordination of donor interests, budgets and time constraints.<sup>22</sup> The poor levels of harmonization between donor activities can also be attributed to the lack of a clear, medium term government plan which restricted the ability with which government institutions were able to coordinate the reconstruction process. The difficulty experienced with designing and implementing successful policies for redistribution was compounded by a lack of micro-level data. Some of this data had been

<sup>22</sup> Gunawardena, A., 2010, "Targeting and Distribution of Post Disaster Aid", IPS (forthcoming).

lost in the event of the tsunami; however, the inability of government institutions to supplement this loss of information reflected their insufficient capacity. Such information is imperative to the ability with which the government and development partners can restore pre-disaster conditions. In a post-conflict context, the redistribution of assets must be done with the utmost sensitivity so as to not further evoke social tension and conflict. This would require a high degree of information on pre-conflict asset ownership so that policy makers can address the grievances of those members of society who have lost land during the war.

The benefits of decentralizing reconstruction remain important. It can help to foster greater interaction between the social groups directly affected by the redevelopment process and the authorities in control of redevelopment - the principle of subsidiarity. This will allow for more inclusive policies to be implemented which, in a post-conflict context, is vital to maintaining peace and supporting effective development. Establishing a formal conduit through which the central government is informed of region-specific needs of the population can help to harness the authority with

which they devise inclusive policies and, thus, the likelihood that proposed projects will receive donor support with minimal imposed conditionalities. Whilst the international debate on aid reform is focused on ownership of aid at a national level, in the post-conflict scenario, ownership becomes important at more disaggregated levels.

### **9.7 Conclusion**

At the end of a three decade long conflict, Sri Lanka finds itself at a crucial juncture in its development. Accelerated economic development is required to lock in sustainable long term peace. The role of external finance in supporting this economic development is important given the fiscal constraints faced by the government. Nonetheless, the absorption and delivery of this aid will have to be conducted in a carefully managed manner in order to prevent discord in macroeconomic balances, and also to maintain sustainable peace in the country through the development of appropriate institutions that can effectively distribute aid. The discussion has outlined some of the potential pitfalls in post-conflict aid in Sri Lanka, and some of the priorities in terms of ensuring an effective contribution to post-conflict development.