Research Studies: Working Paper No. 7
April 2005

Phoenix from the Ashes?

Economic Policy Challenges and Opportunities for Post-Tsunami Sri Lanka



Paul Steele

INSTITUTE OF POLICY STUDIES
99 St. Michael's Road, Colombo 3, Sri Lanka

Research Studies: Working Paper No. 7

April 2005

Phoenix from the Ashes?

Economic Policy Challenges and Opportunities for Post-Tsunami Sri Lanka

Paul Steele

INSTITUTE OF POLICY STUDIES

Copyright © April 2005
Institute of Policy Studies, Sri Lanka

National Library of Sri Lanka-Cataloguing-In-Publication Data

Phoenix from the Ashes: Economic Policy Challenges and Opportunities for Post-Tsunami Sri Lanka.-
Colombo : Institute of Policy Studies,
2005.- 36p.; 30 c.m.

ISBN 955-8708-31-3 Price:

i. 363.34 DDC 22
1. Disasters 2. Public Safety
3. Tsunami Disasters

ISBN 955-8708-31-3

Please address orders to:
Institute of Policy Studies
99 St Michael's Road, Colombo 3, Sri Lanka
Tel: +94 11 2431 368, 2431 378 Fax: +94 11 2431 395
Email: ips@ips.lk
Website: www.ips.lk

This Working Paper was prepared by a team led by Paul Steele, Associate Research Fellow, IPS. Research contributions were made by the following members of the IPS staff: Roshani de Silva, Asha Gunawardena, Wimal Hettiarachchi, Douglas Jayasekera, Shantha Jayasinghe, S.A. Karunaratne, Malathy Knight-John, Dilhani Marawila, Amrit Rajapakse, Parakrama Samaratunga, Ganga Tillekeratne, Shelton Wanasinghe, Dushni Weerakoon, and Bilesha Weerasinghe. Editorial support from D.D.M Waidyasekera and formatting assistance from Asuntha Paul are acknowledged.

Table of Contents

Executive Summary i

1. Impact of the Tsunami 1
2. Aim of this Publication 2
3. Relief Phase 3
4. Promoting Equitable and Pro-Poor Growth in Tsunami Affected Areas, Addressing the Special Challenges of the North and East 4
5. An Effective, Accountable System to Drive the Reconstruction Process 15
6. Strengthening Sri Lanka's Fiscal and Monetary Position After the Tsunami 19
7. Scientific and Cost Effective Approach to Disaster Prevention, Reduced Vulnerability and Risk Management Strategy 23

References 25

Executive Summary

Objectives of this publication

The devastating tsunami hit Sri Lanka on 26 December, 2004 killing 36,600 following a massive earthquake off the coast of Sumatra, Indonesia. Just over three months later, on the night of March 28, 2005 a tsunami warning was issued by the Sri Lankan government following another large earthquake off the Sumatran coast. While this time the evacuation of the coastal belt took place, fortunately no tsunami reached Sri Lanka. However, this event shows that there is a very real possibility for tsunamis occurring in the future. This publication reviews the policy challenges and presents recommendations, focusing on the economic issues, of the ongoing tsunami relief and reconstruction efforts and plans for risk management strategies for the future.

Deaths and displacement

The human impacts of the tsunami include those who died or were injured, those who lost their loved ones, those who lost their houses or property, and those who lost their livelihoods or whose employment was indirectly affected. The latest death toll is 30,957 people with an additional 5644 missing. This makes a grim total of 36,600. Initially, about 800,000 people were displaced following the destruction and damage of about 119,000 houses. The figure of displaced has gradually fallen to about 500,000 as people who return to their homes even if they are destroyed or damaged are removed from the statistics. The number of people living in camps had fallen by the end of January 2005 to 169,000 or one third of the total displaced. Smaller temporary camps are now being converted into larger transitional camps with corrugated sheets and other material – but living conditions still remain cramped and difficult. The other 333,000 or two thirds of the displaced living with host families (relatives or friends) are also often in very over-crowded accommodation, with much potential for conflict and tension.

Impacts on the livelihoods of the poor

There are many others who lost their means of livelihood – boats and nets, places of business, tools and other assets. This includes both the owners of these assets and those who were hired as labourers, as well as employees of damaged tourist resorts. There are also those who were indirectly affected – those whose markets have been disrupted, whose customers have died or been displaced. Finally, there are many who lost their few savings – their gold, jewellery or cash.

Uneven impacts of the disaster

13 of the country's 25 districts were affected, but the North and East were particularly hard hit accounting for over two thirds of the deaths and almost 60 per cent of the displacement (as at end of January, 2005). The pattern of death and displacement were slightly different with

Ampara suffering one third of the deaths (dead and missing), while Galle has suffered a quarter of the displacement (as at 25 January, 2005). The North and East have already been negatively impacted by the 20 year North-East conflict and related economic marginalization. The 500,000 people displaced by the tsunami at the end of January 2005 is comparable to the estimated 352,000 people registered as internally displaced by the North-East conflict in June 2004. While the economic impact of the tsunami to the national economy is likely to be limited to 1 per cent of GDP, it may have significant impacts in terms of increasing poverty particularly among already impoverished groups such as small-scale fishermen and the inhabitants of the North and East. Certain groups such as women and children are especially vulnerable**.**

Importance of the ongoing debate over policy reform

There is a need to place the tsunami within the broader debate over policy choices facing Sri Lanka. For example, public sector problems and shortcomings in the context of the tsunami highlight many well known and long running challenges to the public service. These include lack of a service culture or consultation, weak procurement and hiring and firing policies, politicization, limited Ministerial coordination, unclear relationship between the centre and local levels and weak oversight of public funds. Some reforms are under discussion or under way to address these failings. The tsunami should provide an added impetus to take these reforms forward.

Main reconstruction priority is process not funds to reduce the growing climate of envy and conflict

To date, the focus by government and many donors has been on funds for reconstruction. This has resulted in long lists of capital projects for roads, schools, housing, etc. However, thanks to the generosity of both Sri Lankans and the international community, funds are not the major constraint. The challenge now is the process of using these funds to rapidly and equitably restore tsunami affected areas so that people are at least as well off as they were before the tsunami. The objective should be to promote equitable and pro-poor growth in tsunami affected areas, addressing the special challenges of the North and East. There are now major procedural issues about the allocation of relief, boats and nets, micro-credit and most importantly land and shelter. The increasingly ad hoc nature of the allocation process has allowed a climate of envy and conflict to develop in the affected areas.

Reconstruction process must have active involvement of the poor and affected people

The reconstruction process must build on the existing capacities and strengths of the poor, affected people e.g., building roads and houses with local skills, constructing fishing craft with local boat builders, and rehabilitation of the destitute through community-level centres. Rehabilitation staff are often in short supply, recruiting and training local volunteers from the villages can improve communication and ensure that some of the skills gained remain after the

support leaves. Likewise, local people are well suited to the local situation and they know best what they want. This also provides income, may reduce depression and helps people engage in constructive activities to rebuild their lives. This is happening in some areas, but there need to be major training programmes launched now to ensure that affected households have the skills to engage in the housing reconstruction.

While targeting of the tsunami affected population is important, it must recognize the needs of other poor groups

The reconstruction must avoid the impression of a two-tier situation developing between tsunami survivors and other poor groups such as those displaced by the conflict and other low income households. The focus must be on regenerating the economies of all low income areas in Sri Lanka. Already there are anomalies developing as the rations provided to those living in tsunami camps are slightly higher than the rations given to the people living in conflict affected camps. The conflict affected IDPs have in some cases been in camps for over a decade, so their needs for housing must not be forgotten in the desire to build houses for those affected by the tsunami. In Jaffna, fishery societies are generally well organized and politically connected so they are able to lobby for tsunami relief. By, contrast conflict IDPs are less politically organized to have their needs met (DFID, USAID, 2005). It is important to avoid social imbalances in the rehabilitation work, with the tsunami affected families receiving special treatment compared to other disadvantaged groups.

Regarding the most pressing issue of permanent housing, there is an urgent need to start a dialogue with beneficiaries about house design, land selection and agreed criteria and priorities to allocate land to beneficiaries

The government is understandably focused on rapidly providing permanent shelter to those who lost their houses. There is also pressure from those "donors" offering to build houses – many of them Sri Lankan companies – to provide land as fast as possible. The government is signing agreements with these donors as quickly as possible. However, this leaves little time or scope to consult with the beneficiaries themselves. Township plans are often drawn up by Colombo based architects with minimum consultation of those who will live in these schemes. For example, many of the low income households can only afford firewood, and this needs to be taken account of in kitchen design. A more demand driven approach may save time and money, and reduce conflict in the long run. In many cases, lands for housing have been identified without consulting the beneficiaries who often have strong views or their own suggestions about the most suitable land. In the Indian state of Gujarat following the earthquake there, 2500 houses were built and never occupied due to their inappropriateness. Finally, there is no agreed criteria or policy on how land will be allocated to beneficiaries - other than that it will be the responsibility of the government, which will make such selection in consultation with Divisional Secretaries and other state agencies and groups associated with disaster relief activity. This provides no role for the beneficiaries to be involved in the process. There are preferences

by many fishing households to be near the sea, and by many communities to stay together, while some other households are more flexible. Without clear agreement and dialogue on allocation criteria before the houses are built, major conflicts may develop as tsunami survivors compete for the best land (for example, nearest the sea) and well designed houses, or reject the worst land (for example, in jungle areas or marshy lands far from the sea).

1. Impact of the Tsunami

Unprecedented disaster brought an unprecedented response

Sri Lankan citizens, the Government of Sri Lanka, private sector, civil society and the international community have responded rapidly to tackle the unprecedented tsunami disaster, which killed 30,957 people with an additional 5644 missing (DCS, 2005) on the morning of 26 December 2004.

Uneven geographical impacts of the disaster

13 of the country's 25 districts were affected, but the North and East were particularly hard hit accounting for over two thirds of the deaths and over half of the displacement. The pattern of death and displacement were slightly different with Ampara suffering one third of the deaths (dead and missing), while Galle has suffered a quarter of the displacement (as at 25 January, 2005). The death toll (dead and missing) was focused on 8 districts with 45 per cent in the Eastern Province, 33 per cent in the Southern Province and 20 per cent in the Northern Province. Ampara alone suffered almost a third of the deaths and those reported missing with 11,312 dead and missing followed by Hambantota at 5,463 and Galle at 4,778. The pattern of displacement was slightly different with Galle the most impacted district and the suburbs of Colombo also affected as many low income huts were washed away. Of the 502,456 people recorded as displaced on January 25, 2005 (DCS, 2005), the Eastern Province had 44 per cent, the Southern Province had 32 per cent, the Northern Province has 13 per cent and the Western Province 11 per cent. Of the displaced, 333,385 or two thirds were living with friends and relatives (on January 25, 2005) and 169,000 or one third still in camps. This compares to the 352,0000 people registered in November 2004 as internally displaced due to the conflict, of which 78,300 people were living in state run camps (MRR and UNHCR data quoted in NRC, 2005).

Disaster for North-East is compounded by conflict related problems

The disaster from the tsunami added to the problems caused by the 20 year North-East conflict and related economic marginalization. The majority of the conflict internally displaced persons are still registered in the Northern and Eastern Provinces, although there is also a large Muslim community in Puttalam evicted by the LTTE in the 1990s. Infant mortality is over double in the North and East compared to the rest of Sri Lanka, maternal mortality is three times as high while 46.2 per cent of children are under-weight in the North and East compared to 29.4 per cent in the rest of the country (WFP, 2005).

Uneven livelihood impacts of the disaster and danger of deepening poverty

While the economic impact of the tsunami to the national economy is likely to be limited to 1 per cent of GDP, it may have significant impacts in terms of increasing poverty particularly

among already impoverished groups – small-scale fishermen and especially among the inhabitants of the North and East. Around 35 per cent of the affected population depended pre-tsunami on fishing for their livelihood (WFP, 2005). Even before the tsunami, 6 per cent of the affected depended on government welfare (samurdhi etc.) and 3 per cent on remittances as their main source of income (WFP, 2005).

Certain groups especially vulnerable – children and female headed households

While exact data are not available, it seems that a large share of the affected people are women and children. There needs to be more gender disaggregated information, a task which the Ministry of Women's Affairs is now starting. The problem of alcoholism and harassment of women is likely in any camp situation. For example, police in Batticaloa reported in late February rising domestic violence, alcoholism and related violence in the camps (OCHA, 2005). In other cases, women have to travel long distances to wash in privacy. In the longer term, women may have to find new income sources if their husbands have died. 168 schools were damaged, but neighbouring schools have been used mornings and afternoons to prevent disruption, and temporary schools are under construction. However in some cases, the welfare camps are too far from existing schools for children to attend and alternatives have not yet been put in place. By late February (OCHA, 2005) UNICEF reported that while school attendance is improving it remains low in Galle and Trincomalee. In the Batticaloa District attendance ranges from 60-80 per cent across the district, while in Matara it is reported to be about 80 per cent. In Jaffna attendance in non-affected schools is 90 per cent, but only about 55 per cent in areas where people are temporarily residing. In the longer term, the government is making arrangements to relocate and rebuild 68 schools which are inside the no-build coastal buffer zone.

2. Aim of this Publication

Need to address tsunami within broader context of the appropriate economic decisions to promote equitable and pro-poor growth in Sri Lanka

This publication will focus on the policy challenges, particularly the economic challenges and opportunities presented by the devastation of the tsunami, and the need for placing the tsunami disaster within the broader debate over policy choices facing Sri Lanka. To date, much of the economic discussion has focused on the capital costs for reconstruction. While this is important, it has tended to overlook long standing policy challenges facing the country which have been highlighted by the tsunami. While the additional funds and sense of national urgency presented by the tsunami can have a positive impact, there is also a concern that the many new stakeholders, imperative for urgency and sudden flow of additional funds may actually prove counter-productive in terms of stalling urgent reforms. This publication seeks to highlight some of these challenges. In addition, although the tsunami was unique in its size and devastation,

much can be learned from similar international experience and reviewing the successes and failures of earlier rehabilitation, particularly in the North and East.

Structure of this publication

The following main five areas are presented with recommendations:

- Relief phase
- Promoting equitable and pro-poor growth in tsunami affected areas, addressing the special challenges of the North and East
- An effective, accountable system to drive the reconstruction process
- Strengthening Sri Lanka's fiscal and monetary position after the tsunami
- Scientific and cost effective approach to disaster prevention, reduced vulnerability and risk management strategy

3. Relief Phase

Swift government response in the relief phase

In the immediate relief phase of the disaster, the government took many decisions to mitigate the humanitarian and economic impacts of the tsunami. Important decisions included rapid mobilization of relief and the creation of a central body for coordination of relief, the Centre for National Operations. Initial fears of post-tsunami epidemics were addressed by fast action. Swift presentation by the government of the relief and reconstruction costs has helped mobilize significant international funds.

Limited shortcomings focused on insufficient use of existing expertise and multiple changing instructions from the centre

The armed forces and police chiefs in their submissions to the Parliamentary Select Committee on Disaster Preparedness stated that they had considerable expertise in disaster management, but other than the Special Task Force they were not initially called upon. District Secretaries at the front line of the relief effort initially had to cope with the confusion caused by instructions issued by several central agencies, particularly in the North and East, which received instructions from the Centre for National Operations (CNO), Ministry for Relief, Rehabilitation and Reconciliation (MRRR) and the Ministry for Social Welfare. There was also some confusion caused by the changing circulars on the amount to be provided in the case of death with two different amounts recommended before the figure of Rs.15,000 was reached in the final circular. However, given the scale of the challenge, overall the state institutions aided by the massive outpouring of voluntary and private sector relief managed the initial relief efforts well.

Localized accessible nature of the affected area made rapid relief possible

While the tsunami had a devastating impact along the coastline, areas just inland were entirely untouched. Even when the sea water did enter further inland, it rapidly drained away. No

major power supplies were affected, and most roads were undamaged. This pattern of tsunami damage along a very long narrow coastal strip allowed good access by road to almost all areas immediately after the disaster. Water could be found from alternative wells and electricity reconnected in many areas. Government officials, such as Grama Niladaris could be brought into coastal areas to assist with administrative duties. This is quite different to many other inland natural disasters or coastal disasters that extend further inland where the most affected area may be inaccessible for some time and infrastructure take months to restore. This made Sri Lanka's relief requirements more manageable.

Counselling urgently needed

The major pressing issue left over from the relief phase is that many are still severely traumatized. Workers are unable to go back to work, and there is a lack of counselling services. Ad hoc efforts are being made at counselling, but there is a need for a comprehensive national programme for counselling and training of trainers. The Ministry of Health lacks the required expertise and the NGO efforts in this area are insufficiently coordinated. The recent tsunami warning of March 28, 2005, caused widespread panic in the coastal areas and many people re-lived the tragedies and horrors that they had experienced on December 26, 2004.

4. Promoting Equitable and Pro-Poor Growth in Tsunami Affected Areas, Addressing the Special Challenges of the North and East

Funds have been committed and the key challenge is to develop systems and processes of using these funds to rapidly and equitably restore tsunami affected areas so that people are at least as well off as they were before the tsunami

The United Nations (UN) made an initial commitment of US$ 165 million, while the World Bank announced a total of US$ 150 million in financial support at end February 2005,[1] and the IMF approved US$ 157.5 million in emergency assistance in early March 2005. The ADB has announced its intentions of processing US$ 150 million in new operations in the short and medium-term to be devoted to the reconstruction effort. Many bilateral countries are also providing funds, including an initial commitment of US$ 80 million by Japan to Sri Lanka. Private donations towards tsunami relief (including government, NGOs and others) have totaled Rs. 10.5 billion[2] as of end March 2005 (monitored by the Central Bank of Sri Lanka). The anticipated inflow of funds (along with debt relief) is expected to provide support for balance of payment (BOP)/budget 2005 of around US$ 500-700 million. The overall financial management of the funds rests with TAFREN. Funds are to be routed through TAFREN to

[1] Approving US$ 75 million as an emergency/credit grant in addition to US$ 75 million made available in early February 2005 (made available by pooling resources from the existing portfolio).

[2] Equivalent to approximately US$ 105 million.

government implementing agencies at the central government and district level in the North, East and Southern Provincial Councils.

Focusing on the broad livelihoods of the affected people, especially the poor

There is a need to address the livelihoods of the poor through cash and micro-credit, boats and nets and the provision of transitional shelter, followed by permanent housing. It is important to remember the focus at the start of the disaster to not just rebuild poverty, but to leave people better off and lifted out of poverty. There are advantages from taking a livelihoods approach that stresses support to the poor's five sources of capital – financial, physical, human, social/ political and natural capital. This approach stresses the capacity of the poor. The poor are involved in multi-sectoral activities that are linked through complex relationships. In a disaster situation this whole system of people's livelihoods is affected and trying to look at specific sectoral elements in isolation is bound to miss some of the complexity of the situation (IMM, 2001). The livelihood approach takes a cross-cutting and holistic perspective and thus gives a clearer picture of that complexity. For example, it is not enough simply to provide boats and nets to fishermen when crew members are now dead, or marketing chains disrupted or ice and storage facilities destroyed, or the sea inaccessible due to debris. Housing is not just a physical asset, but takes place within a social network – which can be disrupted if relocation is undertaken without careful dialogue. Similarly, cash for households can help provide financial capital, but can be used for alcohol consumption especially if social networks have been weakened.

Cash and food reaching the affected through government relief efforts, but process remains ad hoc and food quality variable

Initial relief was largely successful with almost all of those entitled receiving (through the Divisional Secretary) Rs.15,000 for deaths and Rs. 2500 for lost cooking equipment. Most of those eligible have received the Rs. 5000 grant for each household paid through the People's Bank (and in some places Bank of Ceylon) which kept branches open on the weekend to process the claims. Generally, food rations (available through the multi-purpose cooperative societies – MPCS) have been available, but in some places there has been limited varieties of food (e.g., vegetables) for the weekly Rs. 200 cash coupon and the rice has been of low quality. For food supplies, there is a need to monitor availability and quality of food from the cooperatives in tsunami affected areas. There are also different rules for the distribution of the rations and Rs. 5000 grants from area to area. In some cases, rations are given to a family, in other areas to individuals and sometimes the criteria has varied from a lost family member, or lost house or lost livelihood (Sida, DFID, GTZ, 2005). For this reason, it seems that more ration cards have been issued than affected families.

Need to continue cash grant scheme for at least 6 months

While the ration programme will continue initially for 6 months, no date has been announced for the length of the Rs. 5000 grant scheme. The People's Bank Rs. 5000 grant scheme has proved very effective in reaching most of the affected population and where its reach was limited, such as the North, alternative arrangements have been made. The scheme has also assisted people with little engagement in the formal financial sector to start bank deposits (which were mandatory to receive the funds). This suggests that the scheme should be extended for at least six months while people recover their livelihood activities. Any longer period would lead to dependency but at present many people have no income sources. This scheme also is very cost effective as it has zero monitoring costs compared to loans which need to be monitored and recovered. The government should announce its plans and termination date as soon as possible so that people have time to plan and make alternative arrangements.

Cash for work and labour intensive employment

In a number of areas particularly the larger international NGOs are introducing cash for work programmes for activities such as clearing of rubble and rebuilding of transitional shelter. Typically, the wage rate offered is Rs. 300-350 for men and women, which is close to the average daily wage rate for men, but considerably higher than the usual Rs. 175 daily wage rate for women. There are also areas where wage rates are considerably higher such as Rs. 500 for men. The advantages of this approach is that it does bring cash into the local economy and there is a shortage of labour to clear debris and put up transitional shelters. However, this approach has faced some resistance, especially from local NGOs, who feel it undermines the voluntary approach to collective action through *shramadana* and these local NGOs may also lack the funds to pay these wage rates. Another concern is that cash for work obviously benefits the able bodied who can undertake the labour. The old, young, sick and disabled and carers (who cannot leave their children) should not be forgotten and alternative arrangements must be made for their needs.

Need for rapid and equitable distribution of nets and boats, taking account of the complexity of fishery livelihoods and multiple fishing gear

It is estimated that at least one third of the affected households were fisherfolk (WFP, 2005). In some areas this figure is much higher, for example, in the Jaffna District the figure is close to 90 per cent. Many nets and boats were lost – possibly as many as 19,000 boats (ADB *et al.*, 2005). The exact figures are hard to estimate as many nets and craft were not registered. Following the ceasefire in 2002 there was a major expansion of fishing in the rich areas of the North and East. The fishing industry includes a wide range of vessels, fishing techniques and practices. Fishing is practised in both the sea and coastal lagoons with fishermen often moving between and some fishermen also practise agriculture and other activities. In the sea, fishing vessels include a small raft (*theppam*), wooden dugout or fibreglass outrigger, large wooden or fibreglass sea canoe (*oru*), fibreglass day boat with outboard or inboard engines, and multi-

day boats (ADB, 2003). In addition, wade fishing takes place using cast nets, and beach seining where a large net is pulled in from the shore. Other types of fishing gear include drift nets, pole and line (for tuna), trammel nets, cast nets, hand line and long line, purse seines (illegal but still in use) and brush parks (*kottu*). This rich variety of boats and nets suggests that replacing lost equipment is a complex task that must be done with close dialogue with the affected fishermen. Unlike many other assets, nets and boats can generate an immediate income. In the rich fisheries round Ampara, fishermen can earn Rs. 500-1000 per day from the beach seine nets known as *kalaveli*. But distribution of fishing gear is only just starting. There remain many problems in distributing nets and boats such as:

- Limited capacity for manufacture of boats.
- Fishing industry is often very inequitable and heavily dominated by *mudalalis* – to what extent will this be repeated again this time around?
- Fishing gear is often being distributed based on registration with the Fisheries Department – but often smaller craft are not registered, so the poor will lose out.
- Fisheries cooperatives are very politicized and there are allegations that some past programmes have provided boats to those who are politically connected and sometimes not even fishermen.
- Many fishermen have now heard that boats are being distributed free and there is discontent from those who have yet to receive any of these. The fact that they are expecting these free has reduced interest in borrowing for boats and nets.
- There was a problem of over-fishing in many areas pre-tsunami through too many fishermen chasing too few fish from a limited number of harbours (10 of these harbours were damaged). There is an urgent need now for a more even distribution of fishing effort. The FAO has been cautioning against haphazard distribution of boats, and the impacts of replacing traditional "*orus*" by modern fibreglass vessels. But many NGOs and private companies are undertaking their own distribution schemes.
- Finally, the coastal buffer relocation scheme is especially disruptive to fishermen who are used to living near the beach.

To overcome these problems it is recommended that a national plan to manage fishing effort is developed and then fishing gear distribution to be coordinated and implemented at the local level. However, this looks unlikely to happen.

Micro-finance institutions encouraged to provide loans not grants

There is evidence that a number of tsunami survivors were engaged in micro-enterprises and that about 25,000 micro-enterprises were damaged according to an estimate given by the Ministry of Finance. In addition, there are according to the Ministry of Advanced Technology and National Enterprise Development about 15,000 tsunami survivors involved in self-employment and informal sector activities, such as food processing, coir industry, carpentry,

toddy tapping and tailoring. Many of these workers urgently need funds to replace lost or destroyed assets such as equipment and stocks. Boats and fishing equipment are generally being provided free of charge as equipment, and housing will also be funded separately. However, for other livelihood needs, credit is the most favoured distribution mechanism. A host of micro-finance proposals are under preparation to fill this gap. Prior to the tsunami, Sri Lanka had a relatively well served micro-finance sector (Ausaid and GTZ, 2002). This industry includes both commercial and rural banks serving smaller customers (e.g., Cooperative Rural Banks and Regional Development Banks), and the more grassroots approach to micro-finance where a group will operate a revolving credit fund (e.g., Sanasa, Sarvodya SEEDs). To support a strong repayment culture, most micro-finance organizations are being encouraged post-tsunami not to switch to grants (see www.microfinance.lk). Where grants are necessary, for example for housing and food, they are best provided not by micro-finance organizations.

Micro-finance schemes well subscribed, but may not be reaching the poorest

The Central Bank has been implementing the "*Susahana*" scheme through the state banks, viz., the People's Bank and the Bank of Ceylon. Through providing the Rs. 5000 to affected families, the People's Bank has an impressive data base of those affected. The National Development Trust Fund is also offering similar terms through its partner organizations. The "*susahana*" loan is provided with no repayment required for the first year and then interest at a fixed rate of 6 per cent. No collateral is required but the initial payment will be on an invoice basis and then the initial asset can be used as collateral for future loans. The scheme has seen significant demand, but this may be largely by the bigger enterprises. Some smaller micro-entrepreneurs have been turned away by onerous and often erroneous requests by local bank staff for collateral and loan guarantors. So, while there are funds available for the poorest micro-entrepreneurs, the constraints are providing this knowledge to those in the camps, helping with application forms and monitoring the banks and providing incentives to overcome the extra cost of processing the smaller loans. There are also non-financial services required to help the poor develop new skills and access markets so that they can put micro-finance to good use. Finally, there may be problems accessing credit for those who are not already members of revolving credit societies.

Challenge of pre-existing loans - loan write-offs, loan forgiveness and rescheduling

While there is much interest in providing new loans, a pressing issue is how to handle old loans. In general, individual banks and micro-finance institutions are being left to negotiate this on a case by case basis as they have the best knowledge of a client's needs and ability to repay. Typically micro-finance organizations only forgive loans in the event of death or permanent disability, but many recognize that the tsunami presents a situation where it is not wilful defaulting. However, there are concerns that borrowers face many unforeseen risks such as drought, floods or political volatility and risk. In this context, some micro-finance organizations

prefer to avoid using the tsunami to create a precedence for loan forgiveness. Instead, the preference is for loan rescheduling allowing the client time to return to normal positive cash flow. Loans can even be provided to replace lost assets and increase future earnings. This can often be in the long term interest of the client as loan defaults will make it harder to access future credit. However, where clients take a long time to repay (e.g., over 18 months), it may be necessary to continue to pursue these loans, but to write the loans off as an accounting entry in order to keep balance sheets transparent (GTZ, 2005).

Limited damage to agriculture and expected large harvest has lead to ban on rice imports

According to the Department of Agriculture, only a small share of agricultural land was affected by the tsunami, about 1500ha of standing crops and another 1500ha of fallow land (IRRI, 2005). Of the land affected, a considerable portion is well drained and is returning to normal with the rains. The rest of the affected land will take some time to return to normal and salt tolerant crop varieties available with the Department of Agriculture will be required (IRRI, 2005). There are also impacts to some coastal coconut lands. On the unaffected lands, such as the productive rice fields of the Eastern Province, a bumper harvest season is providing employment for many displaced labourers – although this will only be short term. The large expected crop has also encouraged the government to ban imported rice and the World Food Programme has agreed to purchase locally which will further stimulate the local economy.

Importance of transitional shelter for economic activity

The government with the support of international and local NGOs is now focused on providing transitional shelter for those who had been in emergency shelter, such as tents. Transitional shelters are larger rooms typically constructed of timber or corrugated sheets. Until the basics of shelter are provided, a return to normal economic activities is difficult. People are concerned to leave family members and possessions in tents where there is minimal security. While the government aims to put up all the permanent houses in under a year, this is an ambitious time frame given the need to identify, clear and prepare the land, provide the necessary infrastructure and put up the houses. Building work for the transitional shelters can provide immediate additional income. Surveys are now ongoing to ensure that all the camps are appropriately designed and laid out with water, toilets and privacy for washing, especially for women. Results of a UNICEF survey suggest that water and sanitation are still a problem in some areas, especially in the East. In some cases, temporary schools may need to be set up in the camps. There are also problems in some cases of access to wood fuel for cooking. National level shelter coordination is being undertaken by the Task Force for Relief (TAFOR) under the Chairmanship of the Commissioner for Essential Services. Shelter coordination is administered through the Transitional Accommodation Project (TAP), which will act as the intermediary agency between government institutions and the agencies implementing emergency and transitional accommodation including UN organizations, IOM, international and national

NGOs. A TAP sub-office is to be established in each district, to assist the District Secretariat, and resolve issues associated with providing transitional accommodation, as far as possible at a local level. It should include a full time Land Officer, and Technical Officer identified by TAFOR.

Economics of permanent housing construction

Permanent shelter is vital for longer term economic restoration. However, there are many constraints related to land, labour, building materials and management capacity and perhaps most importantly, resistance by the affected population to the government's approach. The government has made its task more challenging by creating a no-build coastal buffer zone of 100 metres in the South and West and 200 metres in the North and East. The initial government estimates by the Commissioner for Essential Services are that about 64,000 houses will need to be built for those within this buffer zone. The scale of this challenge is that this is almost 12 times as many houses as the 5000 houses built by the government in a normal year – although the private sector builds about another 15,000 in a normal year. The government unit charged with this task is the Tsunami Housing Reconstruction Unit (THRU) based in the Urban Development Authority. The THRU has been signing a Memorandum of Understanding with so called "donors" who have offered to construct houses. These donors are often Sri Lankan private companies and some international and national NGOs. The government had by the week of March 7, 2005 signed Memoranda of Understanding (MoU) for the construction of 40,000 houses out of the 64,000 target. The MoU states that "the donor shall bear the cost of construction of the housing units which has been estimated to be around Rs. 400,000 per single storey detached type housing unit including the cost of basic amenities such as water, electricity and sewage within the house." The MoU also states that the house must have a minimum of 500 square feet with two bedrooms, a living room, kitchen and toilet; and that construction must be in keeping with planning guidelines, design specification and standards given by the Urban Development Authority. The donor must employ a contractor registered with the Institute for Construction Training and Development (ICTAD) or a government construction agency.

No-build coastal zone buffer zone

The government has instituted a no-build coastal zone buffer zone of 100 metres in the South and West, and 200 metres in the North and East (CPA, 2005). Within these buffer zones, damaged houses will not be able to be rebuilt although partially damaged hotels can do so. The owners of damaged houses will be allowed to keep their land for agriculture and will be offered free land and houses at an alternative site. Undamaged houses and hotels will be allowed to remain in the buffer zone. It is still not yet known exactly how many damaged houses are within these buffer zones, although various surveys are under way.

Land for housing

A major constraint is availability of land to relocate the affected people. The government has a strong preference for using government land as it avoids potentially protracted negotiations with private owners over land values. However, much of the available state land is only 1 to 5km away from the coast, while anecdotal evidence suggests that most people prefer to be within 200m to 1km of the coast. Another problem is that some of the available government land is on marshy lands, or in jungle areas where there are wild elephants. Prior to house construction, sites may have to be filled and levelled, with drainage, access roads and electricity provided. In some cases where government land is very limited, it is accepted that private land will be the only option and will be purchased based on the valuation given by the Chief Valuer. However, land need not be such a constraint if there is proper consultation and site selection is less rushed than at present. Some groups are already identifying land where they would like to be rehoused.

Housing type and design

Housing type will depend on the land available. If there is adequate land, the preferred option is single storey detached houses on individual land plots of about 10 perches. As land becomes more limited, (1) single storey attached houses with individual gardens; or (2) two-storey attached terraced houses with individual gardens (Town-houses); or (3) as a last resort, condominiums (limited to ground plus 2 or ground plus 3), are proposed. Donors will construct houses according to UDA guidance and site plans by NHDA and UDA. Most site plans are being prepared by architects visiting from Colombo with no consultation with users, which may create problems if for example, low income families can only afford to cook with wood, but appropriate ventilation is not provided.

Equitable process for matching beneficiaries with available land and houses

So far, the government has not agreed a process or criteria for matching beneficiaries with the land and houses available. The MoU between the donors and the Tsunami Housing Reconstruction Unit (THRU) states that: "the selection of recipients of the housing units in the housing project will be the responsibility of the Government of Sri Lanka which will make the selection in consultation with the Divisional Secretaries and other State Agencies and groups associated with Disaster Relief activity." One concern is that this approach does not allow any role for the affected people themselves. Preliminary discussions with affected people suggest that this process is complicated as there are a range of different preferences depending on livelihoods, degree of damage, community cohesiveness and extent of local organization. Based on their livelihoods, fisherfolk and those working in tourist sites places (e.g., Hikkaduwa and Pottuvil) prefer to be close to the sea, while labourers are not so concerned. Based on the degree of damage and loss suffered, many traumatized people do not want to stay in old houses which are within 100 –200 metres. Based on community cohesiveness, more cohesive

communities (e.g., Muslims in Ampara, Burghers in Batticaloa) want to move together. Organizational characteristics are important, as well organized communities (e.g., Mosque committees of Ampara such as Karaitivu and Nintavur) have identified nearby paddy lands that they want the government to buy so they can move to these locations.

Management capacity

The huge increase in housing stock compared to a normal year will place major demands on the UDA and NHDA. Even though many organizations will undertake the actual house building, UDA and NHDA will be required to coordinate and monitor progress, in some cases provide common infrastructure to the sites, and handle the vexed issue of housing allocation. Inspection of the so-called model village of Zakat in Ampara supported by the NHDA in the late 1990s found that the village was built without funds for toilets.

Need to solve sand shortage by dredging off-shore sand

One of the major constraints is sand for cement which is already in short supply and prices are very high. River sand is in short supply and its removal largely restricted as is sand from lagoons. Both sources are particularly counter-productive as they undermine the very natural processes which helped mitigate the force of the tsunami in some areas. Possible solutions include imports, quarry dust and washed off-shore sand. Off-shore sand is the easiest and cheapest solution. In the UK much of the aggregate for construction is from off- shore sand and this has not caused any durability problems over the past 60 years of use (Moratuwa University, 2002). Detailed tests by Moratuwa University conclude that the main concern is the chloride level but "it may be concluded that free drained sea sand will have chloride levels that are generally at the acceptable level, although some care should be taken if seawater is lost through evaporation. Even when moisture is trapped by capillary action, a small amount of rainwater (e.g., 80 mm which is around the lowest mean monthly rainfall in Colombo) will be sufficient to reduce chlorine to acceptable levels. It must be appreciated that these results are for a 2m height of sand and that some care, experience and perhaps mathematical modelling will be needed to extend the conclusions to greater heights of stockpile" (Moratuwa, 2002). This indicates that with the monsoons coming, this will be more than sufficient to wash the sand. The off-shore sand can be brought in by large dredgers which regularly pass Sri Lanka's coasts on their way to Singapore. These could easily provide additional sand to the existing stockpiles of off-shore sand at Muthurajewela, north of Colombo, which the construction industry is already using. These dredgers could provide sand on to Sri Lanka's beaches at strategic points where house construction is expected (e.g., Galle, Hambantota, Batticaloa, Kalmunai) and this also saves transport costs. The government must issue licences for these dredgers to start to deliver the sand. This would need to include possible sites where off-shore mining is permitted and where the sand could be deposited.

Problem of labour shortage and need for reputable contractors

To build the estimated 64,000 houses will require a major increase in skilled and unskilled labour, and increase in contracting firms. It is estimated that at least 100,000 workers will be required according to the chief executive of the Chamber of Construction Industry (Financial Times, Daily Mirror, February 21). This will include about 13,000 masons, 2000 carpenters, 2500 painters and nearly 54,000 unskilled labourers. There is an urgent need to start training tsunami labourers and other affected people in building skills through Vocational Institutes, National Youth Services and other organizations. The shortage of contractors is being addressed by discussions with Indian firms to form joint ventures.

Grants and loans to rebuild houses outside the buffer zone

The government is providing through the state banks a grant of Rs. 250,000 for anyone with a fully damaged house to rebuild and Rs. 100,000 for anyone with a partially damaged house provided they live outside the buffer zone. An additional Rs. 500,000 will be available as a concessionary loan. The government built new houses have been costed at Rs. 400,000 and the difference between this figure and the value of the grant is attributed to the cost of infrastructure services that have to be provided for the new settlements (assumed to already exist in the other areas). The World Bank is piloting the use of village level committees to estimate the degree of damage and monitoring of effective use of the funds. It is intended to appoint international audit firms to monitor disbursement progress of these housing funds.

Impact on tourist hotels

In the short run, the tsunami has dealt yet another blow to Sri Lanka's volatile tourist industry, just when it was yet again gearing up for a record season. About half of the 105 large and medium scale hotels in the affected areas were partially damaged and 8 hotels were fully damaged according to the joint donor assessment report (ADB, JBIC, World Bank, 2005). About a quarter or 58 of the 242 registered hotels in the country were affected. In terms of rooms about 3,500 out of the total 14,000 rooms in medium to large scale hotels were not in operation by late February 2005.

Hotel sector and insurance coverage

The larger and medium scale tourist hotels and guest houses generally had insurance cover for natural catastrophe including earthquakes and this was interpreted as providing tsunami liability. An estimated $150 million was paid out as liable claims and the bulk of this was to the hotel industry. This suggests that some hotels were able to cover the costs of their reconstruction. However, most hoteliers did not have cover for the consequential impacts of the disasters i.e., cancellations etc., so they have had to bear these costs in full. Since the tsunami, insurance companies are including tsunami as part of their natural catastrophe cover and this has led to about a one third increase in the cost of insurance which has risen from 0.1 per cent of the value of assets to about 0.13 per cent. For a medium sized hotel worth about $ 3 million, this

would be an increase in premiums of about $ 900, while for a large hotel worth about $ 15 million, the increase in premium would be $ 4500.

Impact on future tourist arrivals and occupancy rates

The tourism sector had reached its historic high in 2004 at 565,000 arrivals. The two biggest markets UK and India each topped 100,000 for the first time. Tourist arrivals were expected to reach 600,000 in 2005, with 150,000 arrivals during the first 3 months of the year. This estimate has now been revised downwards by the Ministry of Tourism to about 550,000 arrivals in 2005 – although some feel this is still too optimistic. Around 40 per cent of the foreign guest nights stays in Sri Lanka are spent along the beaches of the island's southern and eastern coasts (ADB et al., 2005).

New approaches in the tourist industry

For the coastal beach industry, the tsunami could provide an opportunity, as with the fisheries industry, to rebuild the industry in a more planned and sustainable fashion. Most hotels have already started reconstruction work. The Ministry of Tourism is assisting the tourism sector by a $320 million "Bounce Back Sri Lanka" campaign which combines public relations with the development of world class coastal tourist facilities. The industry is also receiving duty free import privileges for necessary equipment for reconstruction, and the Central Bank has a loan facility available through the major banks for small and medium scale enterprises (SMEs) for which some in the tourist industry are eligible. Confidence in the industry is indicated by a number of luxury boutique hotels being opened, but many others are on hold pending clarifications regarding the no-build coastal buffer zone. The Tourist Board has taken steps to offer new Tourist Zones where land and other infrastructure will be provided. The Tourist Board aims to develop 15 tourist zones at a cost of $12 million each with donor funding. The zones identified are Kalpitiya, Wadduwa, Beruwela, Bentota in the west coast; Hikkaduwa, Galle, Unawatuna, Koggala, Matara, Hambantota and Tangalle on the south coast and Yala, Arugam Bay, Passekudah and Nilaveli on the east coast. The balance between up market boutique hotels and more traditional mass scale hotels is still under debate. The Secretary of Tourism recently stated (Financial Times, Daily Mirror, March 7) that "although we have launched programmes for upmarket responsible tourism, it is very important that we keep supporting the mass market tourism as well since it saves livelihoods of many in the country".

Improved infrastructure with long running policy issues addressed

The tsunami reconstruction plans include a number of long running infrastructure projects such as the Southern Expressway and revitalizing the rail network. While the tsunami is a good opportunity to highlight these important capital projects, their success depends on much more than just financing. For example, there are serious policy issues regarding the lack of profitability of the railway and which need to be addressed in addition to simply injecting funds or identifying an investor.

Revitalising the North and East

The tsunami has disproportionately affected the North and East and it makes even more imperative to fully integrate these areas into the rest of the economy. Unemployment in Jaffna is estimated at 90 per cent for 18-35 year olds by IOM (DFID and USAID, 2005). There is a need to increase government and private sector investment into these regions to reduce the prevailing economic marginalization.

5. An Effective, Accountable System to Drive the Reconstruction Process

Reconstruction process must be primarily demand driven serving local needs

Recovery programmes need to consider all interventions from the point of view of the affected population. The affected people want as little bureaucracy and simple accessible procedures. The decision to use the state banks – the People's Bank and Bank of Ceylon – for the Rs. 5000 allowance as well as micro-credit and housing funds is a good example of this. However, there are concerns that each of the 50 or so Ministries are keen to launch their own tsunami relief schemes and coordination is vital. There are attempts to coordinate livelihood assistance being offered by the Ministry of Fisheries, Ministry for National Enterprise and Ministry of Rural Industries, but this coordination needs to be extended across other Ministries.

Communication – both up and down - is crucial

Some tsunami affected people are unaware of government policies and their entitlements. Posters on relief were put up along the South coast and the media have been carrying announcements from TAFREN, but many people in the camps lack access to the media. There is a need for grama niladaris, People's Bank, cooperatives and other channels to be used to provide information to people in languages they can understand. Even when people are aware, they need to understand the motivation for the policy. For example, some people in the North and East see the larger 200 metre buffer zone compared to the 100 metre in the South and West as discriminatory and have not been given any scientific rationale to explain it. There is also a need for much more listening and discussion with the affected people by government and politicians – in the development of policy, in the selection of lands for housing and in the provision of boats and other equipment.

Reconstruction process requires appropriate decision making given to the local level

The District and Divisional Secretaries working with grama niladaris become the front line in the reconstruction process. Grama niladaris (GNs) are the key officials for filling in application forms for damage with households. They are the village level government officials. The GN's paperwork is then forwarded to the Divisional Secretary and finally the District Secretary (also known as the Government Agent or GA). The GN's approval is required for access to the monthly Rs. 5000 allowance. The GNs also played the initial role in distribution of relief (but

this is now done through the MPCS). This key role of these local officials must be given greater public recognition with enhanced administrative support and maximum appropriate decision-making powers at this level. This is especially important over the issue of relocation of land and housing in the North and East as these are key to the ethnic conflict and ill-informed or rushed decisions could lead to long running conflicts. Provincial Councils and pradeshiya sabhas could be given a greater role. In most cases, a District level disaster coordinating committee has been set up chaired by the District Secretary. But in some cases politicians have been appointed above the GA to manage District level activities, and this can complicate matters especially if the politicians are not familiar with the area.

Need for tough public service disciplinary and firing policy

To balance these stronger local powers, there must be tough action taken against local officials who fail in their duties, for example, a complaints procedure against ineffective or corrupt grama niladaris. It has been reported that to date about 6 GN officers were suspended and there are 20 cases pending. At present the Ministry of Public Administration lacks effective systems to monitor GNs and respond to complaints, but there are plans to set up an investigative unit.

Monitoring of the progress of reconstruction

Government policy is only as good as its implementation. The government took important steps to monitor receipt of the Rs. 5000 allowance and when the results were disappointing took action to keep banks open on all holidays. This pro-active approach to monitoring and prompt action in response must be continued in other areas – the allocation of micro-credit, housing funds, new houses and lands and boats and nets. NGOs and the media working with the affected people also have an important role to play in monitoring the government and holding it accountable for its promises and for effective progress during the reconstruction phase.

Transparency and accountability of funds

Long running recommendations to strengthen financial oversight by the Auditor General's Department and Parliament through the Committee on Public Accounts are important. There is a need to strengthen the limited mandate and capacity of the Auditor General's Department. Parliamentary financial oversight mechanisms remain weak as they tend to handle old issues, lack interaction with the public and have limited access to expertise. Transparency International (TI) has proposed a Special Parliamentary Committee to oversee the foreign aid inflow and expenditure, for which they suggest a chair from a member of the opposition. To improve public interaction, the TI proposes to provide access to public and media to cover proceedings and follow up on any matter under their purview. The high profile public proceedings of the Parliamentary Select Committee on Disaster Preparedness provides a good model. Finally, the Bribery Commission needs to start active business now that the Bribery Commissioners are

being appointed. Transparency also needs to improve for funds handled at the local level. However, transparency is not enough without accountability. If any corruption is unearthed over the tsunami funds, action should be taken including resignation by those holding public office.

Reconstruction process needs effective dispute resolution mechanisms

The reconstruction process is riddled with potential conflicts. Conflicts about who is eligible for what - about land, housing, food, boats and nets. Public officials are in positions of enormous power in allocating assets and funds. Disputes have already appeared and will inevitably worsen as time passes and the larger grants, such as for housing, are implemented. There is a pressing need to introduce a whole host of effective dispute resolution mechanisms and appeal processes for such grievances to be aired and hopefully resolved. There are already moves under way to expand the mediation boards to deal with land and property and this may also apply to decisions by local officials.

Need for care in evolving public and private sector relationships

The private sector has played a key role in TAFREN and this is expected to continue in the planned reconstruction (such as housing). This is an interesting development given the long running controversy over the role of the private sector in public policy. The private sector has taken over key activities to support reconstruction. For example, John Keells Holdings (JKH) is assisting in processing relief cargo at the airport and port – for which it is receiving matching funds from the International Finance Corporation (IFC). It will be important to later review whether there were any efficiency gains from private sector involvement. The public sector remains responsible for standard setting. The public sector will require strong skills in contract negotiation, supervision and management. The private sector while it has many of these skills will need to guard against actual or perceived conflicts of interest.

Improved cooperation between government and LTTE structures for reconstruction

At the local level, the tsunami has stimulated improved cooperation between the government and the LTTE. In the uncleared areas, the LTTE's Planning and Development Secretariat (PDS) is part of a task force with the LTTE political wing, District Government Agent, international and national NGOs and other civil society representatives to coordinate relief.

Strengthened procurement procedures

A potent source of corruption is during procurement of large projects when members of tender boards may be offered or request bribes and other favours. This is very hard to regulate, but there needs to be increased transparency to root this out. Simple practical measures can be taken such as requiring meetings of the tender board on the day the tender is closed with a decision taken that day itself.

Ensure balanced development

At the start of the disaster there were concerns that the North was proving more effective in initially handling relief, but now there are suggestions by some that the South is recovering faster as a result of more assistance. Any actual or perceived unbalanced development will undermine the initial impetus to national unity and be detrimental to the peace process.

Improve aid absorption

While the Sri Lankan government has recently raised some concerns about aid pledges being converted into commitments, there are also constraints regarding the ability of the government to spend the aid which is committed. Sri Lanka has a poor track record in aid absorption with aid utilization rates estimated at 15-20%. This low level of aid absorption is attributed to several administrative factors including slow procurement procedures, lack of counter-part funds and lack of effective financial monitoring and management (IPS, 2001). It is imperative that this same fate does not arise with tsunami funds.

Need for strong coordination between funding agencies

The government is to be applauded for its strong stand in requesting that the donors undertake a joint needs assessment by the World Bank (WB), Asian Development Bank (ADB) and Japan Bank for International Cooperation (JBIC) which encouraged donors to take a coordinated approach. The main international financial institutions and UN agencies have regular coordination meetings and the second stage of the donor needs assessment has seen a larger number of development agencies working together.

Need to avoid NGO competition and larger international NGOs crowding out Sri Lankan NGOs

The Central Bank has been taking active steps to promote financial accountability among the host of agencies operating in Sri Lanka. At district level, coordinating committees have often been set up to try to limit the "humanitarian free-for-all" that exists in many emergencies and the mistrust that sometimes characterize relations among actors within the humanitarian enterprise. There is a danger that in the scramble among international NGOs for attention and funds, there is crowding out of Sri Lankan NGOs, and an uncoordinated process for priority setting. There is already deep mistrust in several locations between local NGOs who have often been working in the area for many years and the international NGOs who have arrived in the area post-tsunami. While the international NGOs may have the expertise in large scale disaster relief, there has often been a lack of consultation and engagement with local NGOs who have a much greater appreciation of local conditions and sensitivities.

6. Strengthening Sri Lanka's Fiscal and Monetary Position After the Tsunami

Fall in GDP Limited to 1 Per Cent

The typical pattern for economies struck by unanticipated natural disasters is for a brief deceleration in growth, followed by a rebound as a result of the stimulative effect of reconstruction (Benson and Clay, 2004). The scale of the rebound (and medium to longer term impact) will depend on the prior macroeconomic or structural strength (or vulnerability) of the economy to such a 'shock'. On the face of it, the immediate adverse impact on Sri Lanka's growth prospects appears to be fairly limited despite the massive loss of life and structural damage. The most severely affected areas were confined to coastal regions – with key industrial, agricultural and metropolitan centres unaffected – and the damage was limited to specific production sectors, primarily tourism and fisheries where the economic effect is relatively localized. These sectors are each estimated to contribute less than 2 per cent of GDP. There is little indication to suggest that export earnings will be affected by the disaster given that the key earnings sectors – garments and tea – remain largely unaffected. Most estimates suggest that economic growth in 2005 is therefore likely to dip by about 1 percentage point as a result.

Pre-tsunami weak fiscal and monetary position

The scale of the disaster's impact will subsequently be determined partly by the prior degree of exposure to a 'shock' faced by the economy. In this respect, the Sri Lankan economy remains vulnerable to downside risks in the medium-term. Sri Lanka was already grappling with widening macro-economic imbalances prior to the tsunami disaster – a weakening fiscal position and external sector payments. A surging deficit on the trade balance on the back of high global oil prices was draining foreign exchange reserves and exerting sharp downward pressure on the rupee. Despite a fairly reasonable growth rate of 5.4 per cent expected in 2004 (compared to a growth rate of 6 per cent in the previous year), the tsunami disaster occurred as the Sri Lankan economy was showing signs of deceleration in GDP growth. Growth in the fourth quarter of 2004 declined to 4.4 per cent compared to 6.6 per cent recorded in the fourth quarter of 2003.

Fiscal impacts from increased expenditure on reconstruction

The primary macroeconomic impact will be on the fiscal balance as funds are reshuffled and diverted into reconstruction. For Sri Lanka, relatively weak domestic and external financial balances make large-scale international aid imperative to finance reconstruction and prevent additional macroeconomic stress. A needs assessment by the donor community estimates the overall tsunami damage to be US$ 900-930 million (4.5 per cent of GDP). Financing needs are estimated to amount to US$ 1.5-1.6 billion, in line with government estimates of the cumulative cost of immediate reconstruction needs to be US$ 1.5-1.8 billion, while the medium-term requirement is estimated at US$ 3.5 billion.

Benefits from debt repayment moratorium

In addition to pledges of outright grants and concessionary loan assistance, the relief package also seeks to address a moratorium on debt repayments. Following an initiative by the G-7 industrialized nations, the 19 member Paris Club of rich creditor nations has offered to freeze payments (of principle and interest) till the end of 2005 and allow the differed payments to be repaid over 5 years, with a 1 year grace period. At present, only Sri Lanka and the Seychelles have accepted the offer. Other affected economies with greater private sector exposure to external debt are reluctant to accept the offer in the event that debt relief measures in turn lead to a lowering of the country's credit rating and make it vulnerable to higher interest rates on future loans. According to the latest figures, Sri Lanka's total external debt is estimated at US$ 8.8 billion and servicing this debt in 2005 is expected to cost the country US$ 476 million. Although not all of this is owed to Paris Club nations, nearly 45 per cent of Sri Lanka's total outstanding debt is owed to Paris Club nations and the bilateral debt moratorium is expected to release around US$ 328 million for tsunami reconstruction in 2005. The IMF in the meantime has also granted Sri Lanka a moratorium on its debt repayment of US$ 113.5 million in 2005.

Aid and monetary impacts

It is as yet unclear what volume of incremental assistance Sri Lanka can expect to receive for tsunami related reconstruction and rehabilitation. The country receives on average US$ 600-800 million in foreign aid each year – there is a possibility that donors may redirect some of their existing allocation towards tsunami relief. Nevertheless, there is likely to be a significant additional inflow of funds that will pose policy challenges on two critical fronts: the ability for a recipient economy to manage the aid effectively and transparently and avoid large-scale corruption, and secondly, the ability to ensure that the economy absorbs the aid inflows without undue pressure on domestic economic stability.

Prior to the tsunami disaster, Sri Lanka has seen its official reserves decline from US$ 2329 million at end December 2003 to US$ 1872 million at end November 2004.[3] The January-December trade deficit for 2004 had risen to US$ 2216 million – an expansion of US$ 667 million over the comparable period in the previous year. Concurrently, the rupee had depreciated by over 7.7 per cent against the US dollar from the beginning of 2004 to mid-December 2004. In the backdrop of the tsunami disaster and the significant increase in aid flows that followed, the rupee appreciated by over 5.7 per cent in the week following the disaster. The primary focus centres on the potential problem that aid inflows appreciate the real exchange rate and thereby undermine the competitiveness of the export sector – a process known as the 'Dutch Disease'.

[3] Total official reserves increased to US$ 2195 million at end December 2004, primarily, as a result of an inflow of funds to the government as bilateral lines of credit.

Potential for exchange rate appreciation

As capital flows in, the required real exchange rate appreciation can come about through an appreciation of the nominal exchange rate, a reduction in the level of net trade taxes or through an increase in the nominal price of non-traded (domestically produced) goods and services. If either of the first two mechanisms is induced, the overall price level in the country will fall, whilst with the third mechanism it will rise. In the case of the latter, increased inflows of aid are likely to raise the demand for both imports and domestically produced goods and services. While imports can be acquired directly from the world market at fixed world prices, non-tradables can, by definition, only be supplied by the domestic economy. Unless there is considerable excess supply in the economy, the higher demand for domestic goods will result in an increase in their prices to induce the necessary supply response. Simply put, the real exchange rate (i.e., the price of non-tradable relative to tradable goods) must appreciate to induce the switching of resources from producing tradables (i.e., exportable and import substituting goods) to producing non-tradable goods and services. In the process, the real exchange rate appreciates and the tradable goods sector contracts relative to the non-tradable sector. While debt relief and initial aid flows can be expected to have a positive impact in the short run on the currency, particularly because it is a very thin market, there is a danger of an element of overshooting both in equity and currency markets fed by unwarranted expectations.

Possible monetary policy responses

The macroeconomic impact of large aid inflows would depend on the size of the flows, the import composition of the use of these flows and whether these flows are spent effectively and productively.[4] If the aid inflows place pressure on the exchange rate, the effects could be minimized through monetary and exchange rate policies (since tightening fiscal policy is not an immediate option). Permitting a nominal appreciation in line with a 'free float' insulates the money supply but can induce volatile movements in the real exchange rate. To smooth over volatility and stabilize the exchange rate, the Central Bank can intervene to increase its holdings of foreign exchange reserves. But rising net foreign assets in turn become a major source of money supply growth. In order to prevent consequent overheating of the economy and the real exchange rate appreciation taking place through higher domestic inflation (excessive credit creation), the government can resort to sterilization of the domestic monetary expansion. In effect, it calls for tightening monetary policy in line with capital inflows. Such a policy mix is feasible given that Sri Lanka does not have a fully liberalized capital account.[5] Nevertheless, given that a significant volume of credit is expected to be channelled for reconstruction (some at concessionary rates of interest) calls for a phased absorption of aid if the economy is not to be destabilized by rising inflation.

---

[4] If a large proportion of aid inflows are used to finance imports there is less demand for domestic output and hence less direct inflationary pressure.

[5] If an open capital account operates, policy measures aimed at controlling both the exchange rate and the inflation rate simultaneously would result in adverse consequences for the economy in the longer term as higher domestic interest rates

Potential need for domestic resource mobilization

As the initial humanitarian effort scales down, the government will be faced with the task of not only ensuring that aid pledges translate into hard commitments but also that the obstacles to implementing projects are overcome. Some of the aid that comes in is likely to be 'tied' – used to buy anything from food products, telecommunications, transport and technical advice from the donor country – estimated to cut the value of aid to recipient countries by 25-40 per cent. Additional domestic resources would also need to be generated to meet the reconstruction cost, placing an added burden on an already overburdened fiscal position.

Medium term fiscal and monetary challenges

In the post-tsunami economic environment, the fiscal deficit (before grants) is expected to increase to 9.6 per cent of GDP in 2005 while the forecast rate of inflation has been upped to 12 per cent. Moreover, as the scale of recovery moves from humanitarian emergency assistance to reconstruction, the composition of aid assistance is likely to weigh more heavily towards concessional loans rather than outright grants. Thus, debt repayment pressure is unlikely to recede in the medium to longer term as Sri Lanka absorbs more foreign aid for post-tsunami reconstruction.

Duty concessions on Sri Lankan exports

One of the positive outcomes of the tsunami has been in encouraging key importers such as the EU and the United States to offer Sri Lankan exports some concessions. For apparel in particular this comes at a key time given the phase-out of the Multi-Fibre Agreement. However in practice, the concessions are taking some time to be agreed on and will still have some strings attached. The EU decided to implement their new 10 year GSP (Generalized System of Preferences) from July 2005. Initially for tsunami affected countries, the EU intended to advance their scheme to April 2005. However, in late March it was announced that the concessions to be extended to Sri Lanka, etc. under the new GSP plus scheme, may now be delayed by 2 -3 months, as the E.U. member states failed to agree on which sectors of beneficiary countries would be phased out from the current GSP scheme. Thus, it is not clear whether the tsunami concessions will begin before the new GSP scheme in July 2005.

With regard to the U.S. market, Sri Lanka is seeking duty free treatment for her exports for a specific period of time. Duty free access is provided by the U.S. to 33 Central American, Caribbean and African countries. It is proposed to extend this facility to certain LDCs in Asia and Oceania, and it has been suggested that Sri Lanka and possibly Indonesia—the worst affected tsunami countries — be added to the list.

Response of international and national insurance industry

Tsunami related insurance claims are expected to be Rs. 20 billion (Jayasundera, 2005). These are primarily claims by the hotel industry, motor vehicles and a limited amount of life insurance (few of the victims had life insurance). The government has decided through the Insurance Board of Sri Lanka that the insurance industry will have to bear these costs. Almost all companies have been honouring their claims. Initial discussions to tap into the Fund for Civil Commotion, Strikes, Riots, Terrorism have been rejected. In general, most companies were not over exposed and may even expect an increase in profits in the medium term as people increase their use of insurance. There have however been some proposals to develop a National Disaster Fund.

Impacts on banking sector

The tsunami has provided a significant illustration of the strengths of the state banks with their strong rural networks in reaching the affected population. The state banks are being closely monitored by the donors to remain profitable, after years of unprofitability and political interference. However, through their effective role in providing tsunami relief, the state banks have earned a much more positive profile and are benefiting from the liquidity flowing through their books as grants and loans for the tsunami victims.

7. Scientific and Cost Effective Approach to Disaster Prevention, Reduced Vulnerability and Risk Management Strategy

A comprehensive risk management strategy includes mitigation, preparedness, detection, and public response before the disaster occurs

It is widely acknowledged that few of these aspects existed in Sri Lanka prior to the tsunami. The earthquake on December 26, 2004 was reported by Indonesia at 6.59 am, a tsunami hit Sumatra at 7.30 am and the Pacific Tsunami Warning Centre issued a tsunami warning at 8.04am. By 8.36 am the tsunami hit Sri Lanka's east coast at Kalmunai and then 14 minutes later the tsunami hit Batticaloa and Trincomalee at 8.50am, and then a further forty minutes onwards from 9.30-12.55 the tsunami hit the south and north coast (LIRNEasia, 2005 www.lirneasia.net). However, while there is considerable public concern and political attention to limit damage from a future tsunami, it is important not to rush into sudden decisions without carefully evaluating all possible options to reduce future disasters. The costs involved in some of the approaches are significant and there is no point in developing an overly complex, expensive system that falls into disuse over time. A cross party Parliamentary Select Committee chaired by the opposition is reviewing these issues. The substance of this Committee's recommendations and the process of its deliberations through public, televised, cross party discussions suggest that this will be a key step in ensuring that Sri Lanka develops a proper risk management strategy.

Tsunami is only one possible risk in the context of growing climate variability

The second major Sumatran earthquake on March 28, 2005 which many world experts had expected would produce a tsunami suggests that the events of December 26, 2004 may not be a one-off with a long period before the next such event. Regardless of future tsunamis, there is a scientific consensus that Sri Lanka faces an increased risk from climate variability related to global climate change. The east coast of Sri Lanka has experienced cyclones in the past and these and other climate extremes such as floods and droughts are likely to increase. More powerful monsoons associated with storm surges are already increasing in frequency. A few limited areas of the west coast experienced cyclone conditions in the week of March 7, 2005. This suggests that responding to the tsunami should be accompanied by broader concerns with disaster management and a new Disaster Management Bill is now being debated in Parliament and should be passed into law by about May, 2005.

Disaster mitigation refers to reducing potential human and physical damage through for example by land use planning, coastal protection and building design

This could include protecting and reintroducing natural barriers to sea surges (such as sand dunes and mangroves), moving important infrastructure away from the coast and limiting coastal land use. Even prior to the tsunami, coastal land use within 300 metres of the sea was covered by a series of "set backs" administered by the Coast Conservation Department, but these were often ignored.

Housing and building design can include simple cost effective measures to reduce the damage from future natural disasters

For example, houses can be built with apertures to allow water to flow through and rising water to drain rapidly away. Roofs can also be built at a particular angle and fastened securely to the walls to reduce the likelihood that they will be blown off during a cyclone or other strong winds. Some of the reconstructed coastal hotels are being reconstructed with the guest rooms on the first floor leaving the ground floor for service areas.

Disaster preparedness refers to the need for the government and public to be aware and able to take appropriate action in the event of a tsunami or other such disaster

This includes agreed emergency planning by the political authorities, relevant scientific agencies, armed forces and emergency services, such as police and hospital authorities, as well as the media. This would need to cover hazard detection and monitoring, relevant evacuation plans and other precautionary steps, and swift action to respond to the aftermath of the disaster. This requires planning and disaster awareness and education. While for now people are acutely aware of the threat, this public awareness may fade in a few years.

A public warning system is urgently needed, even as discussions and implementation continue for a more long term disaster reduction strategy

The fact that on 26 December, 2004 the tsunami hit Sri Lanka's south coast over one and a half hours after the Pacific Tsunami Warning Centre issued a tsunami warning, and almost one hour after the tsunami struck the east coast, suggests the need for an effective warning system. There are many aspects of an early warning system from the scientific detection of the original earthquake to communicating with vulnerable people to move to safer ground. All aspects need to be considered and often the weak link is communication, especially if people are sleeping. Bangladesh has considerable experience with the use of sirens and evacuation to high concrete shelters. These proved their success in the 1990s when the death toll from the floods was much lower than the catastrophic 500,000 who died in 1976 when little protection was in place. The events of March 28, 2005 showed that the government, media and public can ensure quick evacuation, but there is a need for a clearer system of warnings. The government has now taken steps to put in place a more streamlined clear line of authority.

References

ADB (2003), 'North East Coastal Community Development Project, Supplementary Appendix G', Detailed Poverty and Social Analysis, Asian Development Bank, Colombo Office.

ADB, JBIC and World Bank (2005), 'Sri Lanka 2005 Post-Tsunami Recovery Program, Preliminary Damage and Needs Asessment', Asian Development Bank, Japan Bank for International Cooperation and World Bank, Colombo.

Ausaid and GTZ (2002), 'National Microfinance Study of Sri Lanka: Survey of Practices and Policies' (mimeo).

Benson, C. & E. J. Clay (2004), 'Understanding the Economic and Financial Impacts of Natural Disaster', The World Bank, Washington D.C.

CPA (2005), 'Consultation on the Proposed Coastal Zone', Centre for Policy Alternatives, Colombo.

DCS (2005), Department of Census and Statistics, 'Tables on Impact of Tsunami at 25 January 2005', www.statistics.gov.lk.

DFID and USAID (2005), 'Report on the Joint Donor Fact Finding Mission to Jaffna', 2-4 February.

GTZ (2005), Workshop Report on 'Micro-finance Post Tsunami', March 4, 2005, GTZ, Colombo.

IPS (2001), 'Sri Lanka: State of the Economy', Institute of Policy Studies, Colombo.

IRRI (2005), 'Sri Lanka Trip Report', by Bell and Rickman, February 7-12, IRRI, Manila, Philippines.

Jayasundera, P. B. (2005), 'Impacts of the Tsunami', Central Bank Independence Commemoration Lecture.

Moratuwa University (2002), 'Properties of Concrete and Plaster Made Using Off-shore, Sand, Manufactured Sand and Quarry Dust', prepared for the Ministry of Fisheries and Asian Development Bank (mimeo).

NRC (2005), 'Sri Lanka: Response to Tsunami Crisis Must Also Target Conflict-affected IDPS', Norwegian Refugee Council, 7 March 2005, www.idproject.org.

OCHA (2005), 'Humanitarian Situation in Sri Lanka', Reporting Period 18-24 February, (mimeo).

Sida, DFID and GTZ (2005), 'Hambantota Verification Mission', February 13-15, (mimeo).

WFP (2005), 'WFO Emergency Needs Assessment Report', 7-28 January 2005, (mimeo).

IMM Ltd (2001), 'Coping with the Cyclone', www.livelihoods.org/post/Env9-postit.html.