

# DYNAMICS AND TRENDS OF FOREIGN AID IN SRI LANKA

Exploring space for context-sensitive  
aid delivery

Research summary



## International Alert

International Alert helps people find peaceful solutions to conflict.

We are one of the world's leading peacebuilding organisations, with nearly 30 years of experience laying the foundations for peace.

We work with local people around the world to help them build peace. And we advise governments, organisations and companies on how to support peace.

We focus on issues which influence peace, including governance, economics, gender relations, social development, climate change, and the role of businesses and international organisations in high-risk places.

**[www.international-alert.org](http://www.international-alert.org)**

© International Alert 2013

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without full attribution.

Cover photo © Thishya Weragoda. Layout by D. R. ink, [www.d-r-ink.com](http://www.d-r-ink.com)

# DYNAMICS AND TRENDS OF FOREIGN AID IN SRI LANKA

## Exploring space for context-sensitive aid delivery

Research summary

Dhanusha Amarasinghe and Johann Rebert

August 2013

## Acknowledgements

We wish to extend our sincere gratitude to the external researchers who contributed to this study: Dr Harini Amarasuriya (Lecturer and social anthropologist, Department of Social Studies, The Open University of Sri Lanka) and Dr Dileepa Witharana (Lecturer, Department of Mathematics and Philosophy of Engineering, The Open University of Sri Lanka) (study topic: ‘Dynamics and trends of non-traditional development partner assistance’); Dr O.G. Dayaratna Banda (Lecturer, Department of Economics and Statistics, University of Peradeniya) (study topic: ‘Political economy of contemporary Sri Lanka’); and Arjuna Seneviratne (Independent Researcher and Head of the Aid and Development Effectiveness Programme, The Green Movement of Sri Lanka Inc.) and Suranjan Kodittuwakku (Former Director to the Sustainable Energy Authority of Sri Lanka, and Chairman and CEO of The Green Movement of Sri Lanka Inc.) (study topic: ‘Dynamics and trends of traditional development partner assistance’). We also express our gratitude to Phil Vernon (Director of Programmes, International Alert) for his feedback and comments.

International Alert is also grateful for the support from our strategic donors: the UK Department for International Development UKAID; the Swedish International Development Cooperation Agency; the Dutch Ministry of Foreign Affairs; and the Department of Foreign Affairs and Trade of Ireland.

The opinions expressed in this report are solely those of International Alert and do not necessarily reflect the opinions or policies of our donors.

## Contents

Abbreviations	4
Executive summary	5
1. Introduction	6
2. Sri Lanka's contemporary political economy	7
3. Key overarching characteristics and trends of foreign aid post-war	9
4. Summary of key concerns	19
5. Moving forward – Some areas of focus	22

## Abbreviations

<b>ADB</b>	Asian Development Bank
<b>ADF</b>	Asian Development Fund (ADB)
<b>CSO</b>	Civil society organisation
<b>EIB</b>	European Investment Bank
<b>ERD</b>	External Resources Department
<b>FAO</b>	Food and Agriculture Organization of the United Nations
<b>FCAS</b>	Fragile and conflict-affected situations
<b>FDI</b>	Foreign direct investment
<b>FDI</b>	Foreign direct investment
<b>IBRD</b>	International Bank for Reconstruction and Development
<b>IDA</b>	International Development Association (World Bank)
<b>IDBs</b>	International development banks
<b>IFAD</b>	International Fund for Agricultural Development
<b>IMF</b>	International Monetary Fund
<b>JBIC</b>	Japan Bank for International Cooperation
<b>LLRC</b>	Lessons Learnt and Reconciliation Committee
<b>LTTE</b>	Liberation Tigers of Tamil Eelam
<b>NDF</b>	Nordic Development Fund
<b>OECD-DAC</b>	Organisation for Economic Cooperation and Development – Development Assistance Committee
<b>UNDAF</b>	United Nations Development Assistance Framework
<b>UNDP</b>	United Nations Development Programme
<b>UNFPA</b>	United Nations Population Fund
<b>UNHCR</b>	United Nations Refugee Agency
<b>UNICEF</b>	United Nations Children’s Fund
<b>WFP</b>	World Food Programme

## Executive summary

The post-war political economy of Sri Lanka is defined by the three-decade-long conflict. The influence of government remains central to the economy, and is increasingly driven by a new bureaucratic class that encompasses the well-connected social, political and economic elite.

The contribution of aid from traditional development partners has decreased since 2009, and a strong government-led development policy has determined their engagement. In contrast, non-traditional donors have significantly increased their presence and support, while international development banks and multilateral agencies have increased their commitments. Although the growing non-traditional presence poses a challenge to the consistency of standards and practices, it provides the government with attractive options for acquiring development finance. This shifting aid landscape has significant implications for the political economy. The increasing reliance on non-concessionary loans to fund development activity and the resultant increase in the debt burden risk creating a “vicious cycle of debt”. This has the potential to ultimately fuel social and political unrest, as increasingly challenging economic conditions could require the government to tighten its belt and prioritise expensive repayments in the future.

In this context, identifying and improving the effectiveness of traditional and non-traditional development partner-financed projects is a challenge. There exists a clear need to improve state–citizen and state–donor consultation to ensure an improved understanding of local needs, local conflict dynamics and emerging risks. This will ensure a greater degree of sustainability of long-term development programmes that address not only economic, but also other human development goals.

This paper suggests that development assistance could be a more effective tool for consolidating peace in Sri Lanka by:

- Increasing coordination among traditional and non-traditional international development partners;
- Encouraging wider citizen participation in development processes;
- Engaging non-state actors such as civil society organisations (CSOs), trade unions and business communities;
- Establishing an early warning process for regular analysis and dissemination of emerging economic development trends; and
- Allowing independent structures for evaluation and monitoring of project processes.

## 1. Introduction

The end of the war in Sri Lanka in 2009 has impacted significantly on the traditional aid landscape. For many years, the focus was on responding to development needs in the context of violent conflict. However, in the past four years, the critical need has been to support economic recovery and rehabilitation of conflict-affected areas, along with a wider focus on economic growth as means to spur reconciliation.

Because implications of aid and development in this changing context could have far-reaching impacts on existing or dormant conflict dynamics, International Alert sought to better understand some of these key trends. Alert was keen to explore three perspectives, namely: the changing trends of bilateral and multilateral aid; the emergence of non-traditional donors; and the overall model of political economy that is driving economic development. It is important that Sri Lanka's development partners are aware of, and responsive to, the impact their funding has on the complex conflict dynamics in Sri Lanka.

Following consultation and review, the initial objective to conduct a comprehensive study on aid effectiveness was tempered to first understand the immediate post-war setting. This is seen as a first step to revive a wider dialogue on context-sensitive aid over the next year. Information in the three snapshot papers developed thus far was drawn from primary and secondary sources, interviews, structured discussions, and roundtables and dialogues with international development partners, government officials, retired government officials, academics and citizens at a community level.



## 2. Sri Lanka's contemporary political economy

During the past three decades, the political economy of the Sri Lankan state was significantly influenced by the protracted armed conflict. The response of the post-colonial state to the armed movement of the Liberation Tigers of Tamil Eelam (LTTE) led to the formation of a political and economic system in which various power bases were created at the centre and in the periphery. These were formed through alliances that included the governing hierarchy and ruling factions at the top, business communities, government bureaucracy, the military and the media as an indispensable requirement for the fight against terrorism. The resultant large politico-economic functions of the state resulted in a new interdependent de-facto bureaucratic class, which has access to and control of a significant amount of the economy's resources.

In the post-war and contemporary political economy, the government's reach, impact and relevance in the economy appear to be significant. This is due to several factors that include: significant state ownership and control of key resources of the economy (including public utilities, large industries, major banks, insurance and other financial institutions, and the retail and wholesale industry); the increasing reach of the new bureaucratic class into the economic sphere; and the development of private economic activity that increasingly relies on state patronage. Nevertheless, statistically a state with public spending of less than 25% of gross domestic product (GDP) is considered to be "free" in terms of the government's influence and impact in state economic activity. Sri Lanka's public spending as a percentage of GDP has declined from 40% in 1980 to 21% in 2012. Thus, since the end of the war the traditional state-capitalist nature of the political economy in Sri Lanka has increasingly taken on neo-liberal policies.

Increasing centralisation of pro-development institutions – for example, through the consolidation of poverty alleviation programmes – increases the dependency of citizens on the government. Centralised processes that inevitably expand the distance between citizen and state undermine the need for post-war recovery that is sensitive to the local context and is responding to emerging post-war dynamics, reconciliation, sustainable peace and sustainable political economy.

From an additional perspective, Sri Lanka ranks significantly low for each qualitative indicator for measuring the "quality of government", as defined by the World Bank (see Table 1). South Korea offers a useful comparison to Sri Lanka, as both shared a similar economic fortune and ranking in the 1950s. The percentile global ranks for Sri Lanka show improvement for 2011 in all indicators.

**Table 1: World governance indicators for Sri Lanka and South Korea, 2010**

	Indicator	Percentile rank (0–100)	
		Sri Lanka	South Korea
1.	Voice and accountability	38.8	69.2
2.	Political stability/absence of violence	21.2	50.0
3.	Government effectiveness	49.3	84.2
4.	Regulatory quality	45.5	78.9
5.	Rule of law	52.6	81.0
6.	Control of corruption	40.7	69.4

Note: Zero represents the worst situation and one hundred represents the best situation.

Source: World Bank (Extracted September 2012)

On the macroeconomic front, successive governments of Sri Lanka have stalled vital economic reforms that sought to reduce state subsidies and bring in greater financial discipline to the government budget. The stalled reforms (which the International Monetary Fund (IMF) recently advocated for) impose additional economic burdens on citizens through higher prices of goods (see Table 2), higher taxes, higher cost and low quality of public services delivered, and lower wages (as a result of lower productivity). The increasing economic burden on citizens, especially the poor, could provide fertile ground for exacerbating tensions and triggering new conflicts.

**Table 2: Colombo Consumer Price Index movements/inflation, year-to-year (Feb to Feb)**

	2009	2010	2011	2012	2013
CCPI movements	7.5%	7.5%	7.2%	2.7%	9.8%

Source: Department of Census and Statistics, Sri Lanka (Extracted March 2013)

### 3. Key overarching characteristics and trends of foreign aid post-war

Development finance flowing into Sri Lanka is from traditional donors,<sup>1</sup> non-traditional donors,<sup>2</sup> quasi-governmental organisations (e.g. export credit agencies), and through sovereign bond sales. Since the end of the war in 2009, non-traditional development partner financial disbursements have increased from 9.32% to 10.56%, quasi-government and sovereign bond sales have risen from 41.93% to 60.14%, and traditional development partners' finances have decreased from around 48.76% to 29.30% (2009/2012) of all foreign development finance (FDF) disbursements in Sri Lanka (Table 3).

**Table 3: Total disbursements by borrowing (US\$ million)**

	2009	2010	2011	2012
Non-traditional donors	185.1	176.4	269.9	359.4
Export credit, Bonds, etc.	833.0	1,957.0	1,595.0	2,046.4
Traditional donors	968.7	988.0	1,051.1	997.8
Total development finance	1,986.8	3,121.4	2,916.0	3,403.6

Note: Decimal figures are rounded to the closest 0.1

Source: External Resource Department, Government of Sri Lanka, 2009–2012

#### Diminishing presence of traditional bilateral development partners

At present, there are definite “wait-and-see” policies on the part of traditional donors with respect to future funding for Sri Lanka. Relatively small bilateral traditional donors are moving away from Sri Lanka and will be less significant in the near future. Some are frustrated with regard to their engagement with the government on increasing the effectiveness of development activity. This is not only due to the challenging environment for engagement, but also because of the government’s gradual movement towards non-traditional development partners. Significant amounts of traditional bilateral finance still flow into the Sri Lankan economy through multilateral donors and international development banks (IDBs), but far less is disbursed bilaterally.

1 Traditional donors are composed of the founders and members of the Bretten Woods institutions – typically Western (the US, Japan and the EU bloc) and international development banks (IDBs) – which belong to the Development Assistance Committee (DAC) of the Organisation for Economic Cooperation and Development (OECD), thereby in general referred to as OECD-DAC.

2 Non-traditional donors are the donors that have become global financial powers over the last decade or so. They are typically composed of countries in the Southern Hemisphere and their relevance in the global aid landscape is perceived to be relatively new and is significantly increasing. Thereby, they are generally known as “emerging donors”, “new donors”, “new development partners” and “non-DAC donors”. Moreover, their processes of aid distributions are sometimes referred to as “South-South cooperation” by the DAC group.

Table 4: Traditional donor disbursements by agency (US\$ million)

Donor	2009	2010	2011	2012
ADB	283.0	342.1	290.7	301.0
EC	32.6	12.5	1.6	0
EIB	21.1	6.6	0	32.0
FAO	2.0	13.5	15.4	1.7
Government of Australia	0	0	9.0	0
Government of Denmark	4.2	2.5	0	0
Government of France	19.4	50.1	16.9	20.0
Government of Germany	8.2	9.6	5.2	2.5
Government of Japan	311.3	325.5	373.5	395.7
Government of Netherlands	49.7	13.3	6.4	0
Government of Norway	0.2	0	0	0
Government of Spain	10.8	0.3	0	0
Government of Sweden	0.7	1	0	0
Government of Switzerland	0	1.5	0	0
Government of the US	3.6	9.8	18.2	23.8
IBRD	0	0	0	2.5
IDA	202.0	154.3	217.2	170.1
IFAD	9.7	10.2	17.5	14.4
JBIC	0.02	7.3	6.7	0
NDF	0.3	0	0	0
UNDP	4.8	7.0	6.1	2.9
UNFPA	1.6	0.4	2.1	0.9
UNHCR	0	2.0	0.5	0.3
UNICEF	2.0	7.0	23.5	19.0
WFP	0	9.8	40.1	9.9
<b>Total</b>	<b>967.2</b>	<b>986.3</b>	<b>1,050.6</b>	<b>996.7</b>

Note: This information could be incomplete, because some donors may not have updated their information with the External Resource Department. Decimal figures are rounded to the closest 0.1. See list of abbreviations at the front of report for the full names of organisations.

Source: External Resource Department, Government of Sri Lanka, 2012

## Increasing non-traditional development partner finances

As the relationship between the government of Sri Lanka and traditional donors becomes challenging, there has been a greater reliance on funding from non-traditional development partners that show greater alignment with the Sri Lankan government's own domestic and foreign policy. "Western-based" processes of aid

disbursement, effectiveness and engagement are seen as being out of sync with ground realities and (Asian) cultural norms. Non-traditional donors, especially China and India, have been crucial allies of Sri Lanka in international and regional politics. They have also both contributed extensively to support post-war development plans of the government (see boxes 1 and 2). Traditional development partner measures of effectiveness, driven by the desire for social justice, inclusiveness, transparency and accountability, are clearly at odds with regard to policies of non-traditional development partners.

### Increasing relevance of multilateral agencies and international development banks

Trust fund instruments such as the Global Environment Facility (GEF), the Montreal Protocol, the Habitat Conservation Trust Fund (HCTF), etc. were utilised by some bilateral donors as a means of channelling development funding into Sri Lanka. Despite recent political tensions between sections of the UN and the government, the recently signed UN Development Assistance Framework (UNDAF) for 2013–2017 strikes a positive note in terms of development areas that are relevant to traditional donor funding. The World Bank and the Asian Development Bank (ADB) seem to have substantive buy-in to the government policy framework, which includes principles such as delivering early results to build public trust and confidence, strengthening institutions in a phased approach, focusing on social accountability, and enhancing political and economic inclusion.

### Increasing non-concessional finances

The graduation of Sri Lanka to the status of a middle-income country, with a per capita income of US\$2,923 (2012), has begun to close many avenues for obtaining concessional loans. European donors no longer provide concessional loans but lend through export-import banks, where terms are largely market guided. Funds from some UN agencies such as World Food Programme (WFP) are also no longer accessible unless in very exceptional circumstances (such as natural disasters). Concessional funding from the ADB (Asian Development Fund (ADF)) and the World Bank (International Development Association (IDA)) is also on the decline. While the World Bank, for example, sees the need for a set of behavioural and structural changes – such as realigning public spending and policy in line with Sri Lanka's middle-income status – the situation seems organically to lead to the government exploring other borrowing opportunities without such conditions, and reducing the level of engagement with traditional donors.

*(Continues on page 16)*

### Box 1: Snapshot of Chinese development aid in Sri Lanka

By 2011, the total amount of development assistance received from China exceeded the total assistance by Japan, traditionally the main provider of development assistance for Sri Lanka. The portfolio of development assistance from China during 1971–2012 stands at US\$5,056 million, of which 94% was provided during the last eight years. Chinese commitments have risen from 3% of all foreign assistance in 2002 to 32% in 2012, reaching a peak of 38% in 2011.

China has provided soft loans at concessional rates of 2%–3% with maturity terms of 20 years, and 2–5-year grace periods for repayment. However, most loans are non-concessional or in the form of export credit. For most loans, high interest rates and strict commercial conditions are common.<sup>3</sup> For example, US\$306 million for Phase I of the Hambantota port project is at an interest rate of 6%, with a one-year grace period and a loan repayment period of 11 years. US\$891 million has been committed for the Norachcholaï Coal Power plant at a 4% interest rate.<sup>4</sup> Funding that is being received as grants is provided by the government of China. Some of the typical conditions attached with Chinese loans include Chinese companies as project contractors and that priority is usually given to equipment, material, technology or services (at least 50%) from China.<sup>5</sup>

Chinese funds have been utilised mainly for roads and bridges (58%), power generation (20%), and ports and aviation (17%). The majority of these loans are from the Export-Import (Exim) Bank of China, the China Development Bank (CDB), and the Industrial and Commercial Bank of China (ICBC). Leading Chinese companies involved in project implementation are the Metallurgical Group Corporation, the China Harbour Engineering Company, the Sinohydro Corporation, the China National Group Corporation, and the China Huanqiu Contracting and Engineering Corporation, with Sri Lankan agent companies facilitating operations.

Global and regional strategic reasoning behind Chinese development assistance is oftentimes undeniable. When it comes to Chinese strategic interests in Sri Lanka, there are several theories that have been articulated by foreign policy observers. Firstly, with the emergence of China as a global power centre, the

3 T. Wheeler et al (2012). *China and Conflict-Affected States: Between Principles and Pragmatism – Sri Lanka*. London: Saferworld. Available at <http://www.saferworld.org.uk/downloads/pubdocs/China%20and%20conflict-affected%20states.pdf>

4 B. Sirimanna (2011). 'Chinese and Indian Companies Dominate Sri Lanka's Mega Project Business', *The Sunday Times* (Sri Lanka), 5th September 2010. Available at <http://www.sundaytimes.lk/100905/BusinessTimes/bt21.html>

5 Ibid.

geographic position of Sri Lanka is important to China's vital trade routes. Secondly, China's engagement is a tit-for-tat strategy in response to India's engagement in China's own South East Asian backyard. Thirdly, it is argued that this is a part of China's "String of Pearls" strategy establishing Chinese naval bases in Myanmar, Pakistan, Bangladesh and Sri Lanka; and finally that it is a general gesture of goodwill and building political capital in Sri Lanka.

Main Chinese projects	US\$ million
67km Navathkuli-Karaitvu-Mannar road (non-concessional loan, China Development Bank)	48.4
113km length of Puttalam-Marichchikadde-Mannar road (non-concessional loan, China Development Bank)	73.2
Southern Expressway from Pinnaduwa-Godagama	138.2
Material for lighting Sri Lanka Una Province Project (Uva Udanaya)	24.9
Priority road projects II (non-concessional loan, China Development Bank)	500
Hambanthota Port development (non-concessional loan, Exim Bank)	306.73
Bunkering facility and tank farm at Hambanthota (non-concessional loan, Exim Bank)	65.09
Colombo-Katunayake Expressway project (Concessional loan, Exim Bank)	248.2
Puttalam coal power project – Phase II (non-concessional loan, Exim Bank)	891
Puttalam coal power project – Phase I (non-concessional loan, Exim Bank)	455
Mattala Hambanthota international airport (concessional loan, Exim Bank)	190
13 Diesel engines for Sri Lankan railway (concessional loan, Exim Bank)	100
National performing arts theatre (grant, Government of China)	17
Construction of roads (non-concessional loan, China Development Bank)	10
Reconstruction of BMICH	7.2
100 Passenger Railway Carriages	27.0
Colombo Port Terminal Expansion (non-concessional loan)	350

## Box 2: Snapshot of Indian development aid in Sri Lanka

Indian assistance to Sri Lanka has increased significantly since 2008, but there has been 40 years of formal development cooperation between the two states. Development assistance from 2008 to 2012 stood at US\$1,453 million, of which 78% comprised loans and 22% grants.

The majority of these loans come from the Exim Bank of India under credit lines. Funding received as grants is provided by the government of India. Many Indian companies are involved in projects funded by Indian assistance, such as the construction of railway lines in the Northern province. The management of the construction of 12,500 houses in Killinochchi, 12,500 in Mulaithivu, 10,000 in Vavuniya, and 15,000 in Jaffna and Mannar is also carried out by Mumbai-based companies. The Indians are mainly involved in railway, power generation, water supply and importation of capital goods.<sup>6</sup>

India's economic involvement in Sri Lanka goes beyond development assistance. India is also largely interested in foreign direct investments (FDIs), both in the public and private sector. By 2008, 50% of Indian investment in SAARC countries was located in Sri Lanka.

### Some of the main Indian FDI investors

- Indian National Thermal Power Corporation (NTPC) collaboration with Ceylon Electricity Board (CEB) for Sampur 500 MW coal-fuelled plant (US\$200 million pledged)
- Bharti Airtel (US\$200 million pledged for 2012)
- Cairn India in oil exploration in Sri Lanka (approved for US\$400 million)
- ICICI Bank of India
- Indian Company, L&T in civil construction
- Power Grid Corporation India Ltd. in collaboration with Lanka Indian Oil Corporation
- Aditya Birla Group (in the process of investing)
- The Mahindra Group (in the process of investing)
- HCL (in the process of investing)
- TATA group (in the process of investing)
- Lanka Ashok Leyland (in the process of investing)

<sup>6</sup> B. Sirimanna (2011). *Op. cit.*



Main Indian projects	US\$ million
Vocational training centre Vantharamulai, Onthachchimadam and Batticaloa	Grant, 3.1
Vocational training centre at Nuwara Eliya	Grant, 2
Women's trade facilitation and community learning centre, Batticaloa	Grant, 1.9
Rehabilitation of the Harbour at Kankasanthurai	Grant, 2.2
Indian line of credit	25
Indian Dollar Credit Line Agreement	100
Upgrading of Railway Line Colombo-Matara	167.4
150-bed District Hospital	Grant, 8.3
Humanitarian Assistance for Northern and Eastern Provinces	Grant, 9.7
De-mining Assistance	Grant, 2.34
Track laying of Northern Railway Lines (India has pledged a credit line of US\$800 million for the entire project)	416.39
Construction of 50,000 houses in North and East	Grant, 300

India's position as a leading member of the Non-Aligned Movement influences its position on foreign aid. India seeks to promote south-south cooperation and partnership for mutual benefit based on collective self-reliance. The overall logic that drives India's development assistance, however, can be seen as the desire to consolidate its place as a regional power.

In Sri Lanka, India attaches few conditions to grants. A large proportion of its own loan programme is tied and aid is motivated by its own security priorities, electoral considerations in Tamil Nadu, commercial opportunities, and geopolitical concerns surrounding deepening Chinese and Pakistani relations with Sri Lanka.<sup>7</sup>

<sup>7</sup> Reality of Aid Management Committee (2010). *South-South Development Cooperation: A Challenge to the Aid System?* Available at <http://www.realityofaid.org/wp-content/uploads/2013/02/ROA-SSDC-Special-ReportEnglish.pdf>

*(Continued from page 11)*

## Increasingly diverse options for development finances

Even though funding from small traditional bilateral development partners has been in decline, overall bilateral development assistance (including non-traditional) has expanded. From a decidedly Western-dominated aid landscape, this has changed to include a wider aid community. The expansion and addition of new development partners has given the government of Sri Lanka greater leverage with donors to insist that aid be aligned to national development priorities. It should also be noted that significant non-traditional donors such as India and China are not necessarily or by definition “new donors”. However, their relevance and importance have changed significantly in the recent past.

## Lack of consistency within the donor community regarding standards and practices of aid

The advent of new donors, and their increasing significance, has resulted in a lack of consistency within the overall donor community with regards to standards and practices of aid delivery and disbursement. While there had earlier been relatively greater consistency, there are now clear differences with respect to prioritisation of activities and implementation methodology between the traditional and emergent bloc. Visible differences remain in strategies for bilateral engagement with the government. Reducing standards of consistency between donors can be a concern due to issues such as overlap and duplication of activities, weak planning processes for ensuring sustainability, and inconsistencies in community consultation and participation.

## The impact of potentially high and increasing indebtedness

The debt service payment forecast is a good indicator to investigate future trends in the volume of funding and interest rates of donors (Table 5).

**Table 5: External debt service to GDP (%)**

	2005	2006	2007	2008	2009	2010	2011	2012
External debt service to GDP (%)	1.02	2.10	2.59	2.44	2.48	1.70	1.75	2.69

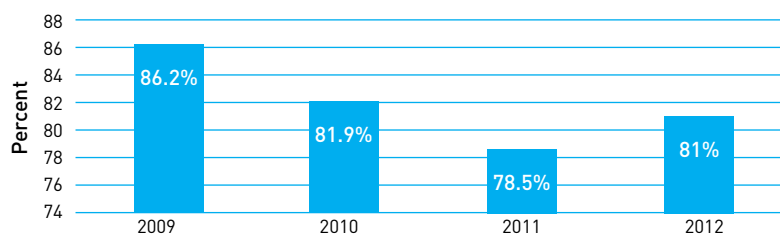
Source: External Resource Department, 2012

It is evident that there is a trend of borrowing more from China, as the debt service payment (percentage of total bilateral debt) has increased from 4% in 2010

to 11% in 2012. The trend is similar for India, with a rise from 3% in 2010 to 7% in 2012. This trend towards depending more on non-traditional development partners could potentially and significantly deepen the country's debt burden. There are indicative signs that Sri Lanka could potentially fall not only into serious indebtedness, but also into a vicious cycle of debt (see Figure 1).

If these trends continue, the government will steer clear of aid from traditional donors that have relatively longer approval cycles, controls and safeguards on spending, along with stringent mechanisms of monitoring the actual impact of their funding. Nevertheless, there is a genuine concern that increased levels of debt repayments will put the government's budget under great stress in the coming years, with potential knock-on effects in society.

**Figure 2: Outstanding government debt as a % of GDP in Sri Lanka**



Source: Central Bank of Sri Lanka (2013). *Road Map 2013 – Monetary and Financial Sector Policies for 2013 and Beyond*

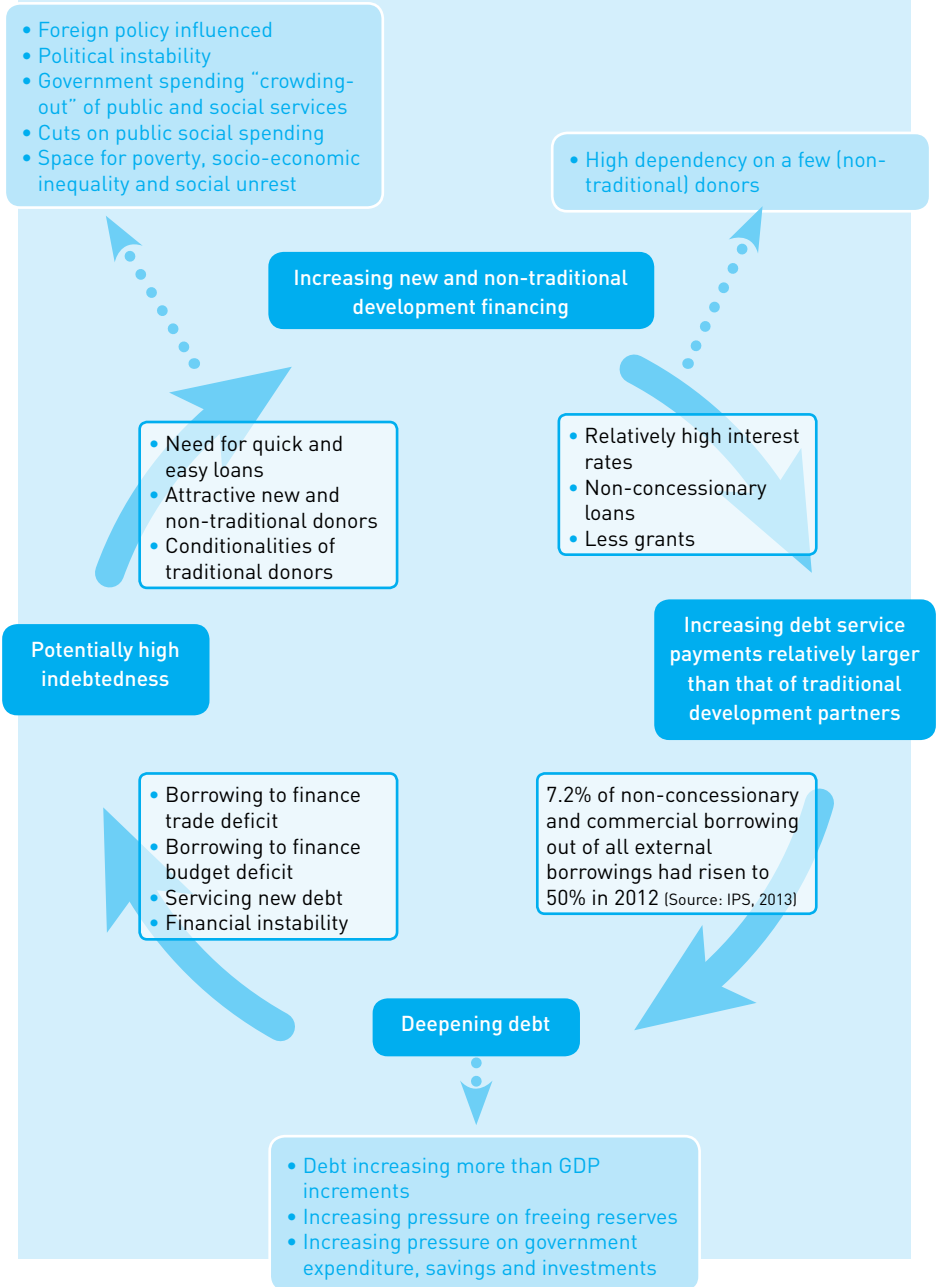
Higher debt servicing ratios also “crowd out” government spending, meaning less funding is available for state spending on key sectors. Public spending on social services (education and health) declined from 7.9% of GDP in 2007 to 5.4% in 2012 (see Table 6), leading to popular trade union activism. Declining social spending also contributes to widening economic disparity and impacts most on the economically poor communities. Nevertheless, while social spending has decreased by 7% in 2012, the government's defence spending has increased by 7%.

**Table 6: Functional classification of government spending (% of GDP)**

	2007	2008	2009	2010	2011	2012
General public services	5.4	5.5	5.1	4.5	4.2	3.7
Social services	7.9	6.8	6.5	6.1	5.8	5.4
Economic services	5.3	4.9	7.1	6.8	6.1	5.8

Source: Central Bank Annual Reports

Figure 1: Vicious cycle of debt



## 4. Summary of key concerns

The changing global and local aid landscape means that FDF is delivered through changed and evolving mechanisms and institutions. The interplay among policies, politics, economic functions and strategic interests of the state has a significant influence on the delivery and effectiveness of FDF. Some of the key observations of the practical realities of overall FDF in contemporary Sri Lanka are outlined in the following section.

### State–citizen relations

#### **FDF focus on material well-being rather than on all aspects of citizen/human life**

The efforts of the state have been directed more towards building physical capacity, and less attention has been paid to social and human aspects of development. Much of the FDF has been devoted to activities that would only generate material results in the medium to long term; there is less of a focus on the interweaving human and social development priorities. Investment in enhancing the quality of people’s social life appears to be a challenge. Government opinion is that infrastructure and a quick response to material needs of citizens in the medium term should be addressed before more quality-of-life-based aspects are undertaken. However, this position is beginning to soften of late.

#### **Lack of local ownership due to dearth of wider public and non-state actor consultation**

The state dominates many development actions, thereby limiting the ability of partners to play any oversight or monitoring and evaluation role. Even though it is the responsibility of the state to invest in delivering, measuring and communicating the results of FDF-led activity, these processes remain opaque. Under this structure, there is no space for whistleblowers to investigate or expose corruption, misallocation, waste, political influence, economic unsustainability, or to point out where development approaches may risk exacerbating tensions in society. This approach appears to work efficiently for projects where spending and timeframe for completion are the main success criteria. However, it seems to be problematic when it comes to equity considerations and non-material aspects of development.

The government is principally adopting a “top-down” approach in the planning and initiation of large FDF-financed development projects. However, as needs assessments are conducted at the community level and the benefits are received primarily by the citizens and communities, it is essential that some elements of “bottom-up” processes are put in place. Public participation and public awareness

about projects is low. As local communities and beneficiaries have not been actively engaged in the project process, and lack awareness of the project benefits, the maintenance of these projects has become problematic. The lack of maintenance funding for some infrastructure projects also directly contributes to a lack of sustainability of projects. In managing competing interests, the state tends to unwittingly adopt a short-term perspective in development processes, potentially jeopardising long-term common interests such as security, choice and well-being of its citizens.

### Decentralised political structures lack quality and democratic decision-making approaches

The structure of the current political system that flows from central government to the provincial and local levels lacks the powers necessary for effective implementation. Powers have been bestowed on the provincial and local councils to execute some development functions. However, given the tendency to centralise these powers, ensuring community-level participation and inclusion is challenging. Fully functioning provincial councils and local governments would allow for constructive scrutiny of FDF projects by local citizens and wider civil society.

### Conflict and context sensitivities are given marginal importance

The desire for social justice, particularly in areas emerging from the lengthy conflict, is often not fully addressed. The situation is complex, since neither the government nor local representatives of the Tamil community see eye-to-eye on the matter. A dialogue is critical to maintaining peace and mitigating conflict risks, especially in Sri Lanka's post-war setting.

## State–donor relations

### Limited space for traditional donor engagement with the government

Space for traditional donor engagement with the government has dwindled considerably since 2005. All development activity in the country is aligned with the “*Mahinda Chinthana*”.<sup>8</sup> The government has focused on the principles of alignment with and ownership of the Paris Declaration, asserting the strong mandate gained at elections. It insists that foreign aid aligns with its own development policies and strategies, and requires that donor agencies fall in line with government policies,

8 *Mahinda Chinthana* (Mahinda's Vision) is the overarching socio-economic and development policy vision of His Excellency, President Mahinda Rajapaksa. The vision was expressed through the two election mandates of 2005 (see: M. Chinthana (2005). *Towards a new Sri Lanka*. Available at <http://www.priu.gov.lk/mahindachinthana/MahindaChinthanaEnglish.pdf>) and 2010 (see: M. Chinthana (2010). *A brighter future*. Available at [http://www.asiantribune.com/sites/asiantribune.com/files/Mahinda\\_Chinthana.pdf](http://www.asiantribune.com/sites/asiantribune.com/files/Mahinda_Chinthana.pdf)). These mandates have been integrated into the government's overarching development policy and framework (see: M. Chinthana (2010). *A vision for the future*. Available at <http://www.treasury.gov.lk/publications/mahindaChintanaVision-2010full-eng.pdf>).

mechanisms and evaluation methods. This strategy marginalises the international processes of engagement for effectiveness that complement processes such as the “new deal for fragile and conflict-affected situations (FCAS)”, “do no harm”, “gender mainstreaming” and “conflict sensitivity”. This trend is more in keeping with non-traditional donor modalities than those of the traditional donors, and challenges the global aid effectiveness discourse.

### **Prevalence of development “projects” over systematic “programmes”**

Given the fact that public institutions are tasked with formulating projects, and despite recent calls by the government for a more programmatic approach (ERD Budget Report 2012), the primary instrument of delivering development aid still remains the “project”. As such, there is little evidence of systematic programme-based planning, with each line ministry and authority creating projects that risk duplication and relevance.

### **Lack of constructive traditional-emerging donor coordination**

Donor coordination in Sri Lanka is struggling to maintain relevance given the decreasing influence of traditional donors and the growing influence of the non-traditional donors, which do not actively participate in existing donor coordination forums. While India has begun to engage other donors at some levels, China generally engages only the Sri Lankan government. The lack of coordination of non-traditional donors underlines the fact that a high proportion of their funding does not fall into any conventional definition of development assistance. While donor coordination between traditional and non-traditional donors is lacking, there are also instances where the political priorities of traditional donors may inhibit constructive coordination.

### **Lack of public information on foreign assistance**

Both donors and government are failing to provide clear information on foreign assistance. There is a lack of transparency on how assistance is utilised, especially on the part of non-traditional donors and by the various partners involved in the different stages of implementation. Given these gaps, gauging FDF-funded projects and activities is limited to primarily qualitative information gathered from case studies, which are not exhaustive. Lack of accurate and current information on projects, especially on the finances involved, raises concerns about corruption and waste.

## 5. Moving forward – Some areas of focus

From a post-conflict perspective, effective economic recovery, effective development and sustainable peace are essential to the overall development goals and national priorities of Sri Lanka. However, paving the way for sustainable peace and development in the face of three decades of social and capital destruction needs time and additional financial resources. The *Lessons Learnt and Reconciliation Commission Report* not only stresses the value of external assistance, but also recommends that the government adopts a more engaged and constructive policy towards its partners.<sup>9</sup> Moreover, it is also the rightful responsibility of donors to ensure that their financial, technical and knowledge-based commitments contribute to and increase the prospects for sustainable peace, prosperity, sustainable development and citizens' well-being. In order to positively and effectively contribute, donors must take into account the dynamics and trends of the contemporary post-war political economy of Sri Lanka, the changing international development partner landscape of Sri Lanka, and the interactions between these two factors.

Given the post-war political, economic and psychosocial environment, development approaches and measures that are not thoroughly context sensitive can exacerbate and trigger tension between ethnic, social and economic groups. Therefore, donors not only risk creating unsustainable projects but also miss opportunities to support citizen and state interaction for sustainable peace and development.

Improving the effectiveness of aid is a process that needs constant shaping and reshaping to be sensitive to ground realities and dynamics.

The following are a few key areas of focus for further reflection and action:

### **Increase coordination among international development partners**

Donor coordination, especially with and between non-traditional donors, is perceived to be lacking. Traditional donors' tendency towards increasing bilateral coordination with the state, and the state's approach to deal with bilaterals in silos, tend to complicate this. It is acknowledged that strong collective coordination among and between traditional donors is essential to advocate for common standards for all development actors. A platform created for open dialogue, which would ideally go beyond bilateral realities and donor divisions, will help to forge effective dialogue on issues of collective relevance.

---

<sup>9</sup> Commission of Inquiry on Lessons Learnt and Reconciliation [2011]. *Report of the Commission of Inquiry on Lessons Learnt and Reconciliation*. Sections: 8.264, 8.6, 9.170, 9.262. Available at [http://www.priu.gov.lk/news\\_update/Current\\_Affairs/ca201112/FINAL%20LLRC%20REPORT.pdf](http://www.priu.gov.lk/news_update/Current_Affairs/ca201112/FINAL%20LLRC%20REPORT.pdf)



### Encourage wider citizen participation in development processes

Most development projects fail to include citizens in consultation of project objectives and outcomes. It was also expressed that some projects tend to fail due to the mismatch between project objectives and community needs. Engaging citizens in project processes, especially at the design stage, will allow the implementing agencies to thoroughly understand the ground realities and priority needs. Active citizen participation will also allow a sense of “ownership” towards the project, ensuring a greater degree of sustainability.

### Engage non-state actors such as CSOs, trade unions and business communities

Engaging with non-state actors in development processes helps donors to increase their effectiveness. Non-state actors have good access to and understanding of citizens and their needs. Moreover, national-level CSOs, apex bodies and thematic non-state actor consortia can act as watchdog agencies on aid and development effectiveness, while providing good-quality triangulation of data and information.

### Create an early warning process for regular analysis and dissemination of emerging trends

The lack of information on aid commitments, disbursements and development processes has hindered the potential for more rigorous analysis of effectiveness. This can blindside stakeholders that have an interest in ensuring that aid is conflict sensitive, yet effective. A process to better inform citizens, donors, non-state actors and other interested parties on emerging dynamics of aid delivery will help to improve the effectiveness of aid.

In large part, development practitioners, especially international donors, utilise personnel and institutions that are not fully independent to analyse and report on the impact of development initiatives. The personnel and institutions are perceived to be less independent, because at times they are from within the respective donor agencies. These initiatives tend to highlight the few positive impacts and reduce the visibility of bigger negative impacts. Increasing the independence of project evaluations could yield significant learning for all development practitioners.





International Alert.

346 Clapham Road, London SW9 9AP, United Kingdom

Tel +44 (0)20 7627 6800, Fax +44 (0)20 7627 6900

[info@international-alert.org](mailto:info@international-alert.org)

[www.international-alert.org](http://www.international-alert.org)



[/InternationalAlert](https://www.facebook.com/InternationalAlert)



[@intalert](https://twitter.com/intalert)

ISBN: 978-1-909578-26-5