

# The Lure of Chinese Loans

Sri Lanka's experiment with a special framework to finance its infrastructure investments



**Verité Research**

22nd September 2022



THE LURE OF CHINESE LOANS –  
SRI LANKA'S EXPERIMENT WITH A SPECIAL  
FRAMEWORK TO FINANCE ITS INFRASTRUCTURE

## Verité Research

# The Speakers

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## Speaker

**Subhashini Abeysinghe** is an economist specialising in international trade. She is an expert on Sri Lanka economy, private sector development, trade policy, the World Trade Organisation, regional trade agreements, and ports and logistics. In addition to these, her current research includes data driven analysis of China's economic engagement in Sri Lanka.

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## Speaker

**Mathisha Arangala** holds a Bachelor of Business and Commerce in Economics and Banking & Finance from Monash University, Malaysia, and a Higher Diploma in International Relations from the Bandaranaike Centre for International Studies (BCIS). At Verité, he has been involved in research relating to trade facilitation, trade policy reform, logistics and international relations.

# Agenda



6.30 – 6.40 pm Introduction to the Seminar

6.40 – 6.55 pm Part 1 – Legal Framework



Subhashini  
Abeyasinghe

6.55 – 7.00 pm Q&A – clarificatory questions

7.00 – 7.15 pm Part II – Case Study



Mathisha  
Arangala

7.15 – 7.20pm Q&A – clarificatory questions

7.20 – 7.30pm Part III – Way Forward



Subhashini  
Abeyasinghe

7.30 – 8.00 pm Moderated  
Open Forum



Nishan  
de Mel



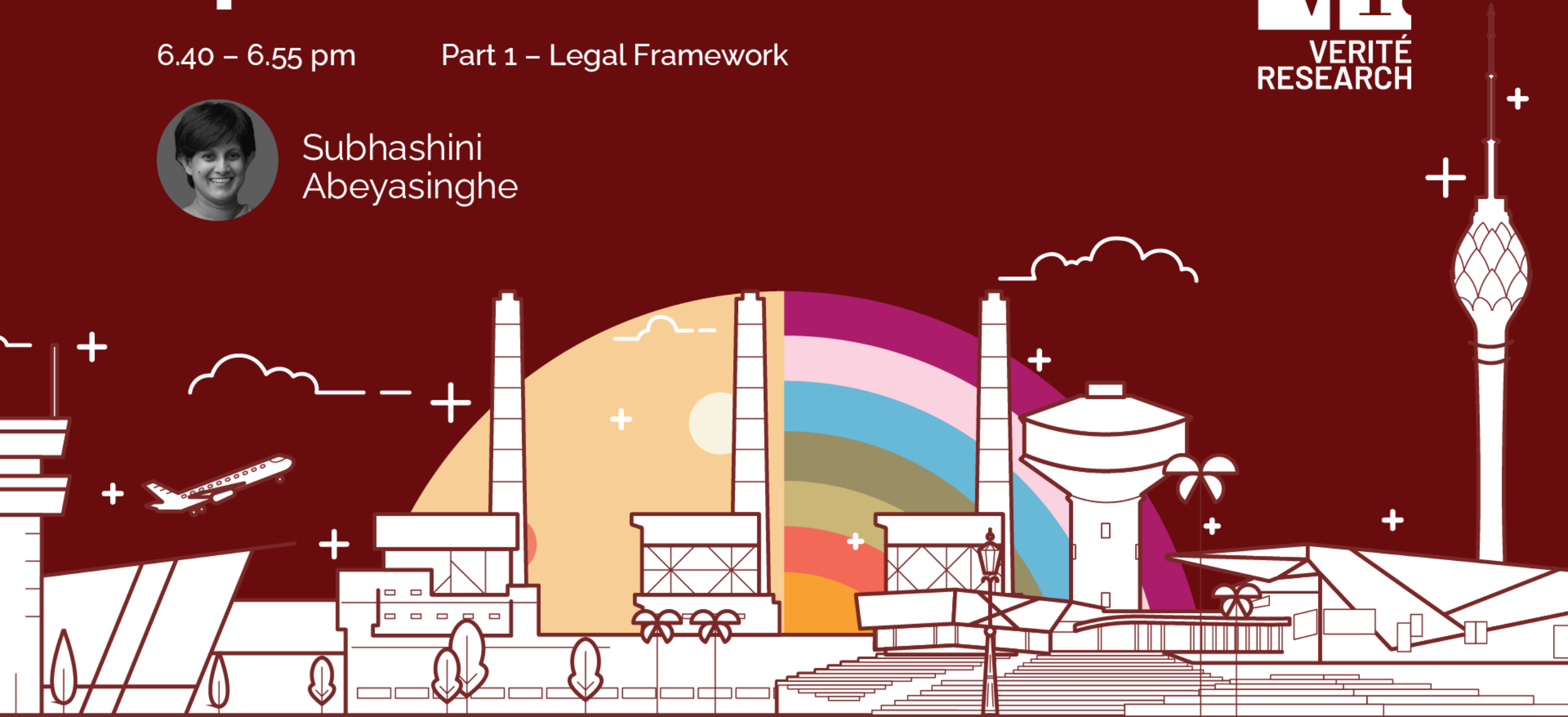
# Up next

6.40 – 6.55 pm

Part 1 – Legal Framework



Subhashini  
Abeyasinghe



# Outline of the Presentation

## Part I – The Special Framework

The Context  
The Need  
The Origin  
The Design  
The Impact  
The Flaws

## Part III – The way forward

An Overview  
Origin & Evolution  
Flaws in execution

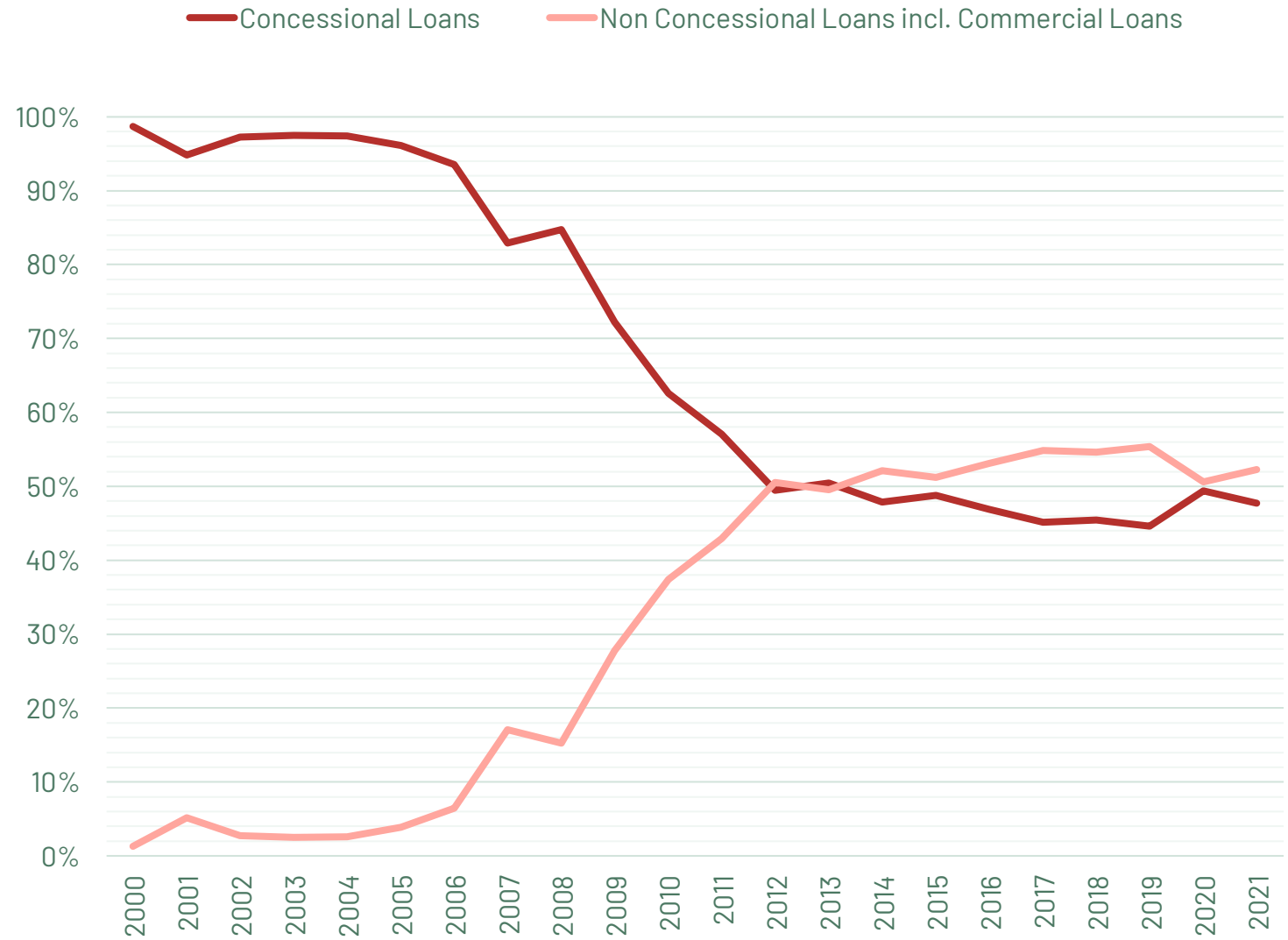
## Part II – The Case Study (GAMWSS)

# Special framework – the context

- Government Policy 2010-2016 prioritized large infrastructure investments
- Such investments heavily depended on multilateral and bilateral concessional loans
- The country was experiencing a decline in access to such concessional finance
- Rise in concessional export credit from emerging economies such as China was an attractive alternative source of infrastructure financing
- Accessing export credits, specially those that originated as unsolicited proposals (USPs) required deviation from competitive bidding

**The Lure of Chinese  
Loans**

# Composition of Foreign Debt: Concessional vs Non-Concessional



Source: Central Bank Annual Reports

# Special framework – the need



Framework that existed at the time

## **Public Sector Infrastructure**

Procurement Guidelines  
2006 (PG 2006)

## **Private Sector Infrastructure**

Part II of the Guidelines on  
Government Tender  
Procedure of 1998 (Part II  
GGTP 1998)



# Special framework – the need

PG 2006 is silent on USPs or stand-alone proposals/projects.

Hence, it had no provisions or procedures outlined on how to manage USPs in relation to public sector infrastructure projects

Framework that existed

Procurement Guidelines 2006 for public funded infrastructure (PG 2006)

**To deviate from the normal procurement process with cabinet approval, it was necessary to demonstrate the existence of an extradentary circumstance**

# Special framework – the need

## 01

the expeditious/  
extraordinarily  
speedy  
processing of  
procurement is  
necessary;

## 02

the supplies are  
immediately  
required to avoid  
acute shortages  
in the market;

## 03

the bid prices of  
goods fluctuate  
frequently;

## 04

the proposed  
project contains  
a large number of  
bid packages  
spread over a  
long-time span;  
and

## 05

security  
considerations  
warrant such  
procurement

# Special framework – the origin

## 23rd June 2010

Appointing the Standing Cabinet Appointed Review Committee (SCARC) by the Cabinet of Ministers to assess unsolicited or stand-alone proposals and to decide how best to proceed with such proposals.

## 4th August 2010

Issuing a public finance circular 444 instructing all heads of government agencies to submit USPs to the DG of the Dept. of Public Finance to be placed before SCARC

## 12th May 2011

Publishing Guidelines to be used by line Ministries or Government Agencies when dealing with unsolicited/ stand-alone development proposals

Supplement 23 to Part II of the GGTP 'Procurement Guideline Part II  
Reference: 237

# Special Framework – the Design

**Special Framework**

**Procurement  
Guidelines Part II  
Reference: 237**

**(PGR 237)**

PGR 237 brought under its purview public sector development projects

“Public sector development projects to be financed on credit terms, and where the lender nominates the contractor.”

Introduced six reasons that the SCARC can use to justify deviation from the normal procurement process.



# Special framework – the design

## Ministry Review SCARC Review

### Funding

- attractiveness of the funding compared to alternative funding arrangements

### Proposal

- Falls within the Public Investment Plan of the Ministry or Department and Government's overall policy

### Proponent

- Commands a reputation and the knowhow that is otherwise scarcely available in the field related to the Project

### Proposal

1. is of 'strategic importance' & "benefit the country"
2. Falls 'well within the planned development programs of the Government'.
3. Lead to "transfer of 'superior knowledge/knowhow'
4. Lead to a 'significant inflow/ savings of foreign exchange.'
5. It is justifiable to deviate from the competitive bidding procedure

### Funding

6. Financing 'acceptable/ attractive and there is evidence of firm commitments on the part of the financiers.'



**Cabinet  
Approval**

# Special Framework – the flaws

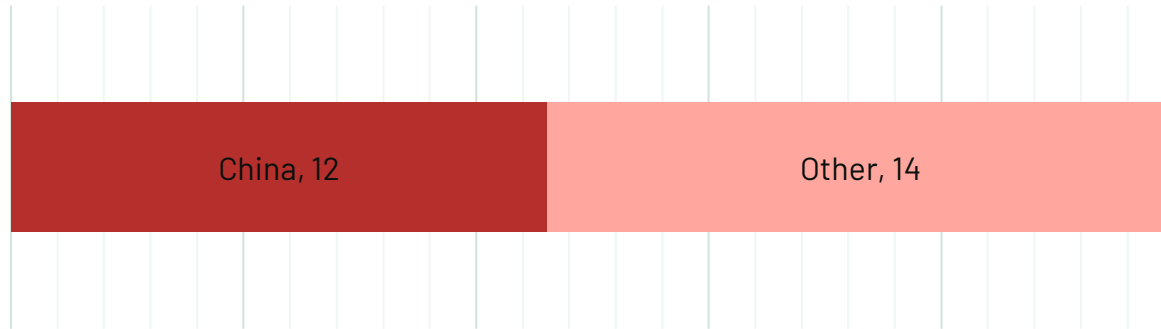


**Evaluation process lacked rigour**

**& excessive official discretion was built into the decision-making process**

- Reasons provided to justify deviations from normal procurement process were
  - ◇ Less stringent
  - ◇ Vaguely defined
  - ◇ Lacked objective criteria
- Meeting one condition was sufficient to justify deviations
- Complete disregarded the grant element when determining suitability/ attractiveness of funding
- Independent technical evaluation of an unsolicited/stand-alone proposal was optional

## Composition of public funded projects that received SCARC approval



## No. of projects

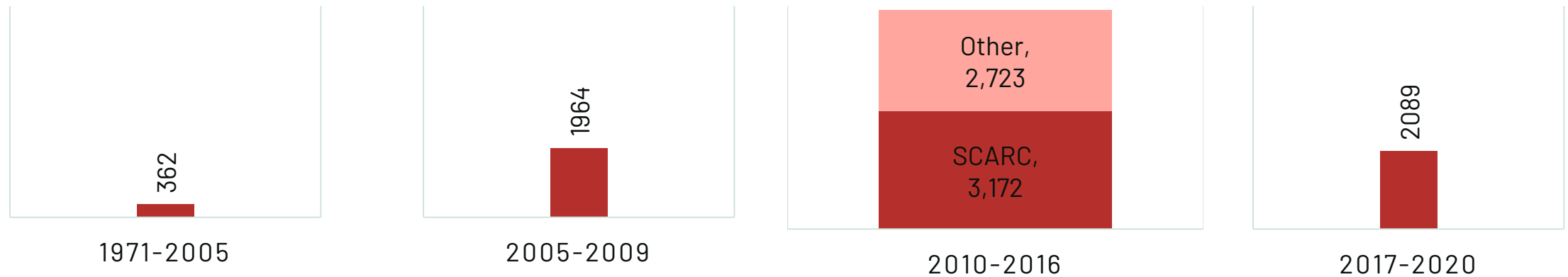


## Value of projects in USD millions

# Special Framework – the impact

China was the leading provider of loans to finance infrastructure 2010-2016 accounting for 37% of the total  
Figures in USD million

# Special Framework – the impact



All financial assistance from China

Loans from China for Infrastructure development





# Experiment ended in 2016

**26 December 2016**

Ministry of Finance issued  
Supplement 30 abolishing the  
SCARC framework

# Up next

7.00 – 7.15 pm

Part 2 – Case Study



Mathisha  
Arangala



# **Special framework – in practice**

**Gampaha,  
Attanagalla,  
Minuwangoda  
Integrated Water  
Supply Scheme  
(GAMWSS)**





# GAMWSS an overview

**Implementing Agency:**  
**National Water Supply & Drainage Board**

## **Objective**

Cater to the growing demand for pipe-borne water in the Gampaha, Attanagalla and Minuwangoda areas

## **Contractor**

China Machinery Engineering Corporation (CMEC)

Contract signed - 2013

Project Start Date - 2017

Progress end 2021 - 76%

## **Cost**

USD 229.5 Million

## **Funding**

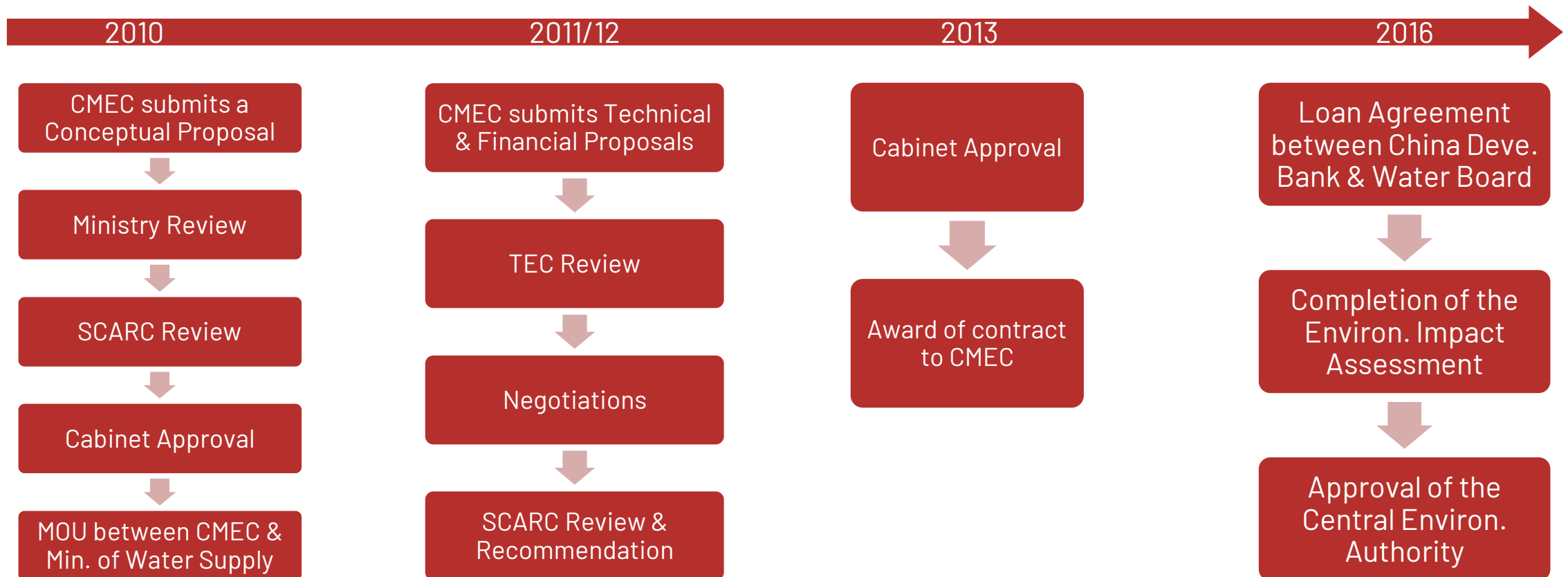
China Development Bank - 85%

Bank of Ceylon - 15%

## **No. of Beneficiaries**

400,000

# GAMWSS an origin and evolution



# GAMWSS – flaws in execution

## Lax application of the guidelines

### Guidelines

#### Ministry Review

Attractiveness of the funding compared to alternative funding arrangements

#### SCARC Review

Financing 'acceptable/ attractive and there is evidence of firm commitments on the part of the financiers.'

### Practice

Contract awarded without firm commitment of funding

Work commenced before securing funding

The parties will support each other to secure “**preferably** a concessional loan from EXIM Bank of China”. *MOU between Ministry of Water Supply & CMEC*

# GAMWSS – flaws in execution

## Lax application of the guidelines

### Guidelines

#### Ministry Review

Project proponent commands a reputation and the knowhow that is otherwise scarcely available in the field related to the Project

#### SCARC Review

Lead to “transfer of ‘superior knowledge/knowhow’ which would be ‘otherwise not available through alternative arrangements.’

### Practice

Contract awarded to a company that had very limited experience and expertise in the field

# GAMWSS – flaws in execution

## Contract awarded without conducting minimum due diligence

### Guidelines

PG 2006 requires the government entities to complete the procurement preparedness activities before calling for tenders/awarding contracts.

The project preparedness activities include carrying out Environmental Impact Assessments (EIAs) and all other project preparedness activities such as the formulation of feasibility studies and the completion of land acquisition, compensation, and resettlement.

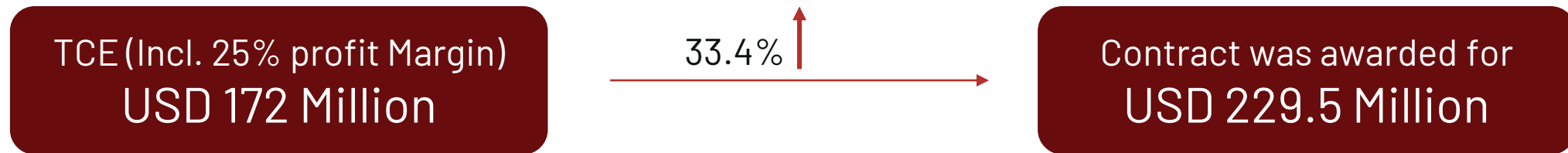
### Practice

Feasibility Report	Completed the same month the contract was signed
Environment Impact Assessment	Completed three years after contract award
Approval of Central Environmental Authority	Completed three years after contract award and four months after signing the loan agreement
Resettlement Action Plan	Completed four years after signing the contract



# GAMWSS – flaws in execution

Contract awarded for a price 33.4% higher than the Total Cost Estimate (TCE)



## Reasons provided to justify higher cost

USD Million

Inflation resulting from delay of 2 years	→	25.0 +
Appreciation of Yuan against the USD	→	19.7 +
Other unforeseen developments	→	12.8 +
<b>Total</b>	→	<b>57.5</b>

Yuan depreciated by 9.7% during 2014-2017

# GAMWSS – flaws in execution

**Sri Lanka failed to secure the expected concessional export credit line from EXIM Bank of China**

	<b>GAMWSS</b>	<b>Kurunegala Water Supply and Sewerage Project</b>
	<b>Loan from China Development Bank</b>	<b>Loan from China EXIM Bank</b>
Interest Rate (%)	2.95% plus USD Libor	2% Fixed Rate
Grant element	3.58	36
Repayment period	15	20
Grace period	3	5

Discount rate of 6.5%: Average ISB rate of Sri Lanka  
Source: Auditor General, ERD, IMF

# GAMWSS – flaws in execution

At the time of signing the MOU expected to complete by 2015

+ 7 years

Current developments risk the project not being completed even by 2022

**Special framework was established to expedite the implementation of priority projects**

	Start	End
At the time of signing the MOU	2012	2015
At the time of signing the contract	2014	2017
At the time of signing the Loan agreement	2017	2020
Re-commencing after investigations		2022

# GAMWSS – Investigations



Source: Auditor General, NWSDB, MOF, Letters from CBK

# GAMWSS – Justification for Continuation

- 1) Negotiation of a new contract would delay the project by two years
- 2) USD 99.9 million already paid to the contractor
- 3) Cancellation/renegotiation would affect good relations between China and Sri Lanka**
- 4) Cancellation/renegotiation can have a negative effect on future borrowings**
- 5) Cancellation costs would include termination charges, and
- 6) Cancellation without default by the contractor may lead to litigation

NWSDB at the time had planned to implement 9 water projects with Chinese proponents and funding from China (according to Min. of Water Supply)

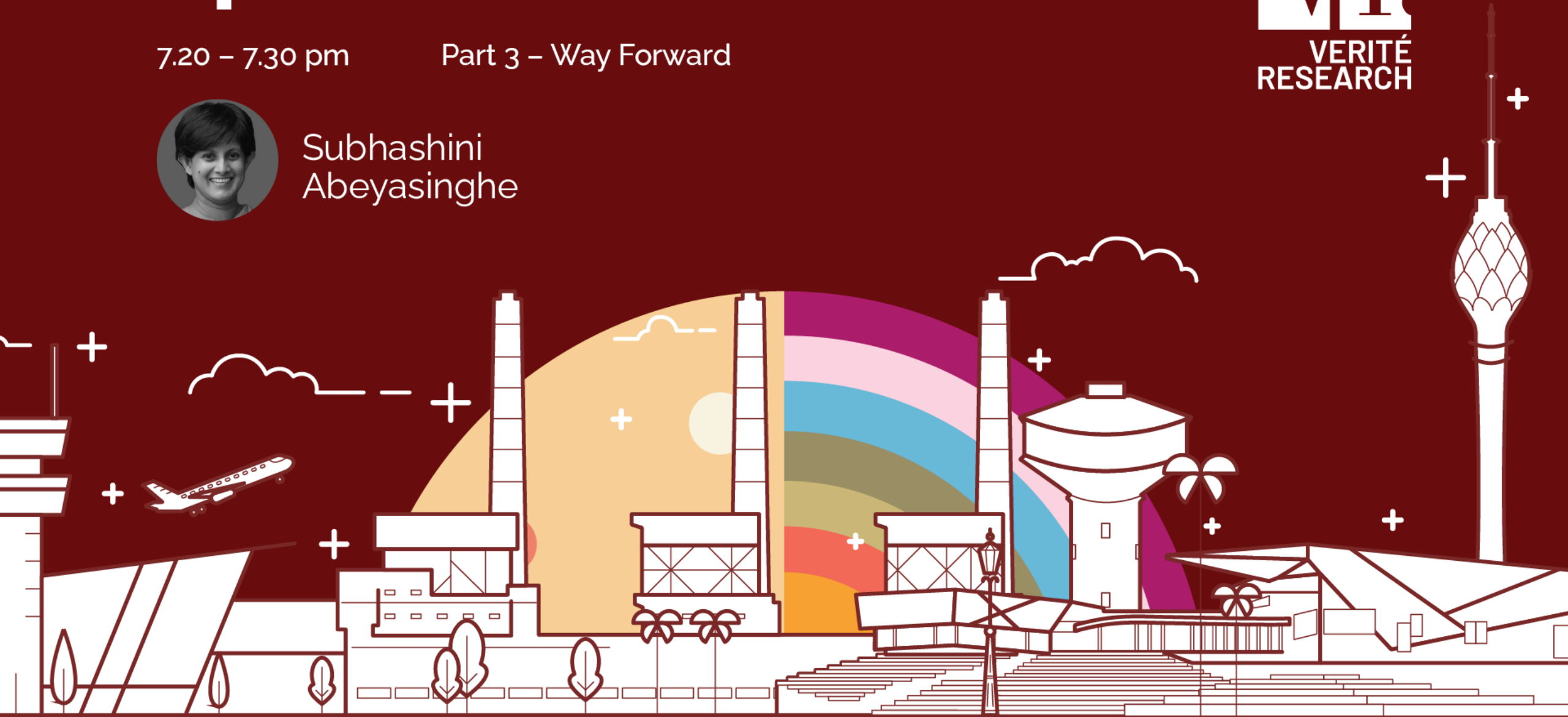
# Up next


7.20 – 7.30 pm

Part 3 – Way Forward



Subhashini  
Abeyasinghe



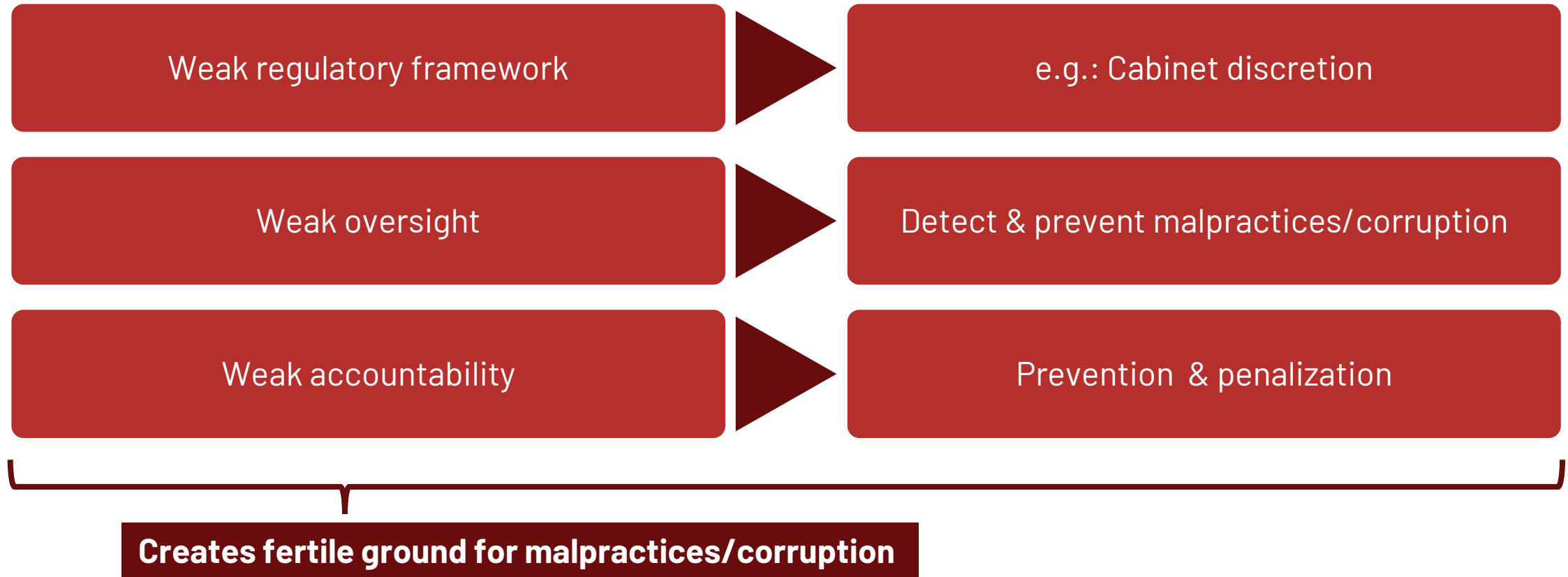


# **The Way Forward**

**The Lure of  
Chinese Loans**

# Key Insights

Three problems that must be fixed going forward





# A Window of Opportunity

## PUBLIC DEMAND



## INTERNATIONAL PRESSURE/SUPPORT

The new EFF arrangement will support Sri Lanka's program to restore macroeconomic stability and debt sustainability, while safeguarding financial stability, **reducing corruption vulnerabilities** and unlocking Sri Lanka's growth potential.

**International Monetary Fund**

## POLITICAL ALIGNMENT

A comprehensive legal framework will be established to strengthen governance and fight corruption.

**- Interim Budget 2022**

# Key Insights

Three problems that must be fixed going forward

Weak regulatory framework

Revise the existing regulations

Weak oversight

Independent oversight (e.g.: NPC)

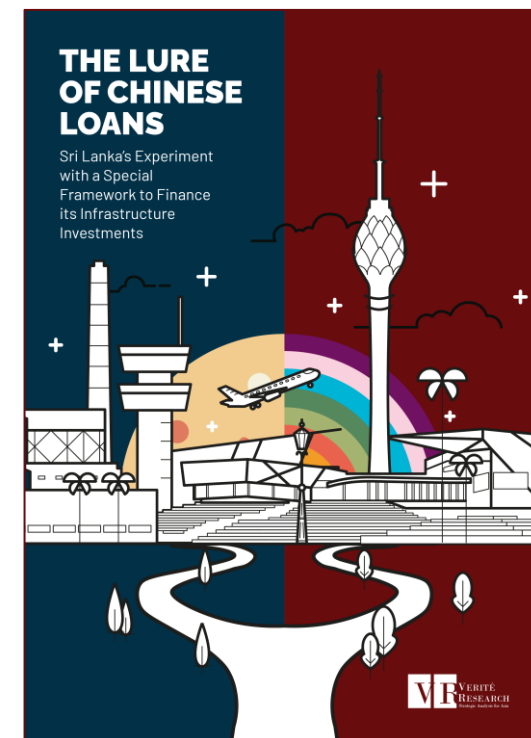
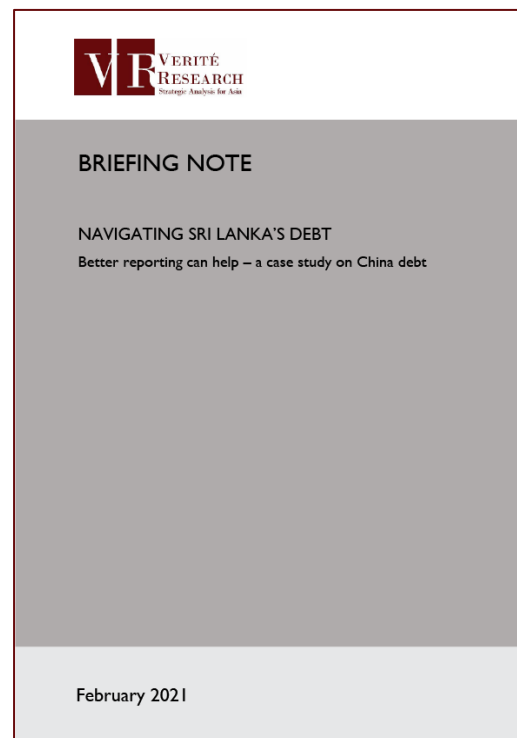
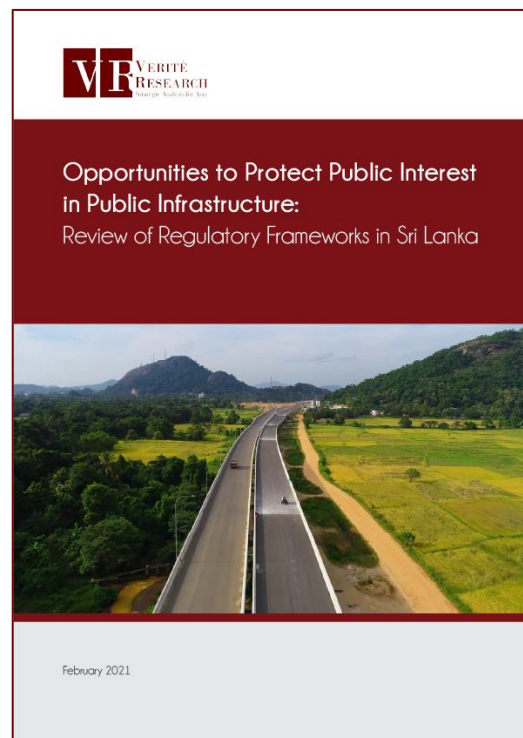
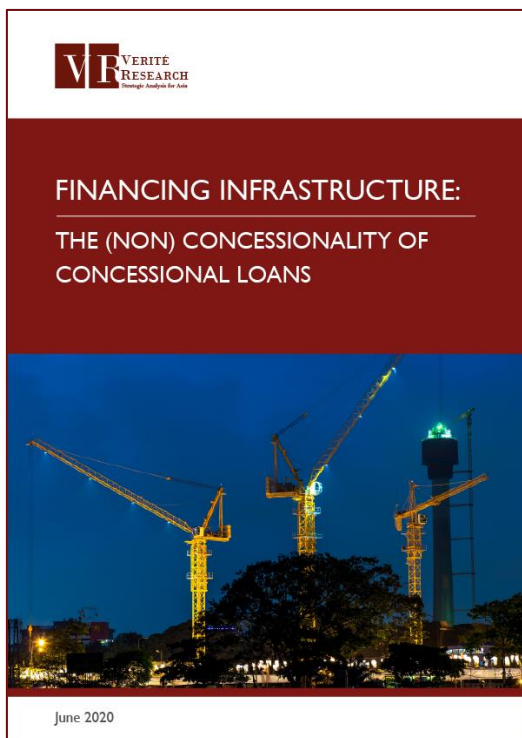
Weak accountability

Strengthen systems in place to penalize individuals/ organisations

**Fixing procurement framework remains key to reduce corruption and to put Sri Lanka on a sustainable growth path**

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# Q & A

**Ask your questions in the chat or raise your hand and you may raise your question when acknowledged**

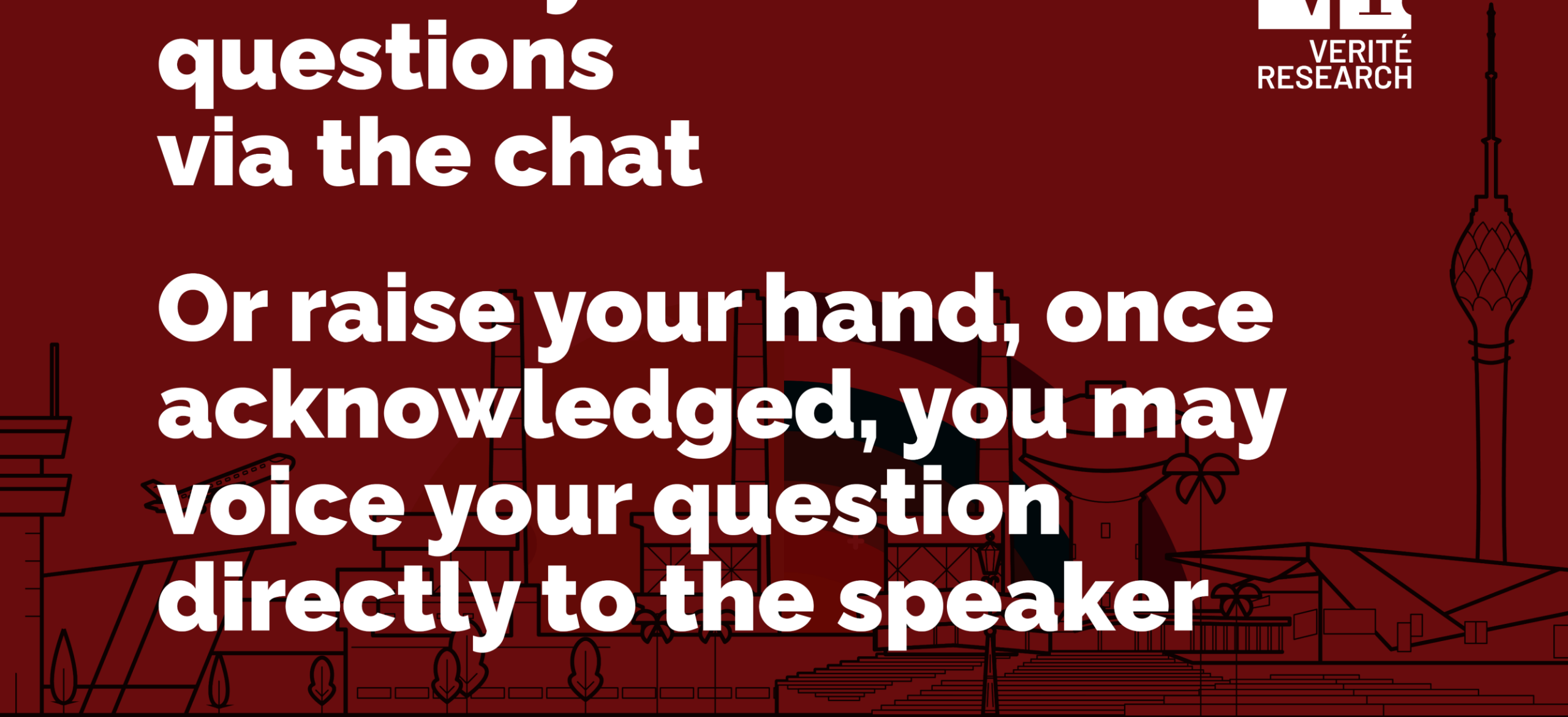
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**Send us your  
questions  
via the chat**



**Or raise your hand, once  
acknowledged, you may  
voice your question  
directly to the speaker**

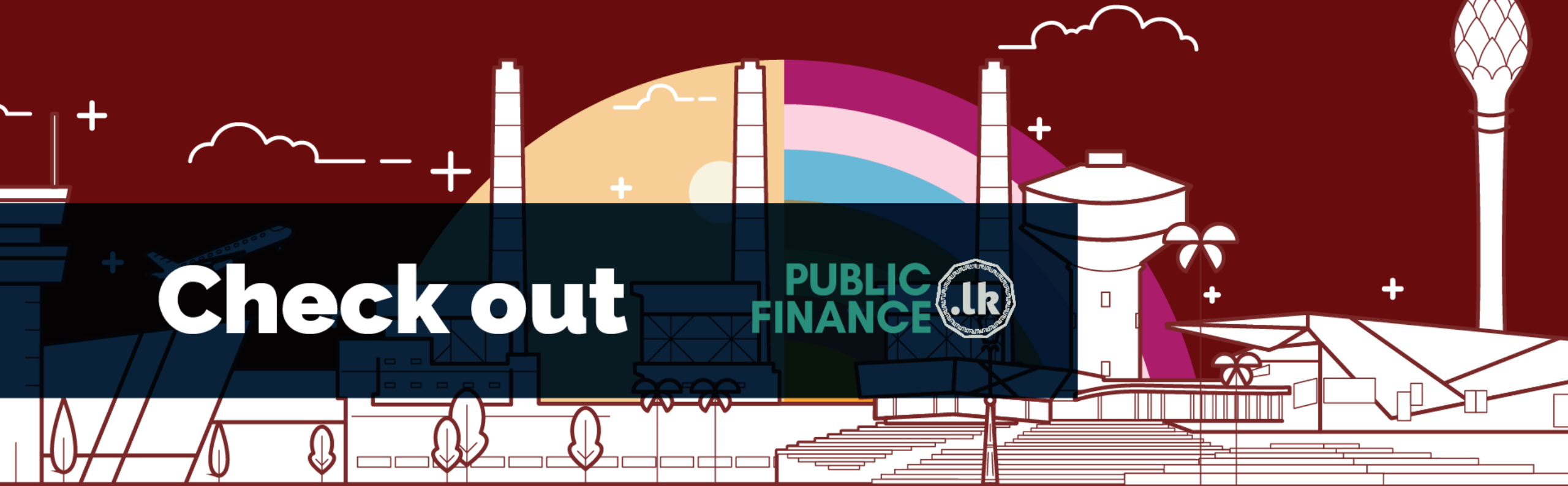


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# Check out



# List of SCARC approved public funded projects

No.	Project	Funder	Country
1	Construction of Expressway from Hambantota Seaport to Mattala Airport	The Export-Import Bank of China	China
2	Construction of headworks of Moragahakanda reservoir	China Development Bank	China
3	Extension of Southern Expressway from Beliatte to Wetiya	The Export-Import Bank of China	China
4	Extension of Southern Expressway from Matara to Beliatte	The Export-Import Bank of China	China
5	Gampaha, Attanagalla, Minuwangoda Integrated Water Supply Scheme	China Development Bank	China
6	Hunan Road and Bridge construction Corp for the construction of Outer Circular Road in Trincomalee	Industrial and Commercial Bank of China(80%), Consolidated fund	China
7	Kattankudy division sewerage disposal project	The Export-Import Bank of China	China
8	Loan Facility US\$.500 Million from China Development - "CATIC"	China Development Bank Corporation	China
9	Matara-Hambantota Highway and other Four Road Section in the Hambantota Hub Development Project	The Export-Import Bank of China	China
10	Outer circular highway from Kadawatha to Kerawalapitiya	The Export-Import Bank of China	China
11	Relocation and development of Institute of Technology University of Moratuwa	The Export-Import Bank of China, GoSL	China
12	Waste water infrastructure for greater Hambantota	China Development Bank	China
13	Kolonna and Balangoda Water Supply Scheme - Phase II Extension of distribution networks - Part II	Fortis Bank NV/Fortis Banque SA	Belgium
14	Monaragala and Buttala Integrated Water Supply Scheme	KBC Bank of Belgium.	Belgium
15	Kirama Katuwana integrated water supply scheme	UniCredit Bank Austria AG	Austria
16	Mahiyanganaya Water Supply Scheme	UniCredit Bank Austria, GoSL	Austria
17	Reconstruction of BridgeNo.38/3- Peliyagoda - Puttalam Road (Kochchidade Bridge)	Raiffeisen Bank International AG, Austria, GoSL	Austria
18	Sewerage infrastructure for Katharagma Sacred City	Uni Credit Bank of Austria, GoSL	Austria
19	Clinical waste management system in the needy hospitals in Sri Lanka under government's assistance	Export Finance & Insurance Corporation (Australia), HNB	Australia
20	196 Rural Bridges in Sri Lanka		
21	Supply and Construction of 141 Bridges - Mabey Bridge Ltd, United Kingdom	HSBC, UK	UK
22	Veyangoda Railway Crossing Flyover	Banco Bilbao Vizcaya Argentaria S.A.	Spain
23	National blood transfusion service of Sri Lanka with state of the art technology giving special emphasis to North and East1	Co-op Centrale Raiffeisen-Boerenleenbank	Netherlands
24	National emergency response project - III	Rabobank	Netherlands
25	Development of greater Ratnapura Water Supply Project Phase II	Local bank	GOSL
26	Greater Matale Water Supply Project	Calyon Credit Agricole CIB	France