
**SUBMISSION TO THE EXPERT COMMITTEE TO
EVALUATE THE MILLENNIUM CHALLENGE
CORPORATION**

Advocata Institute

Advocata Institute is an independent policy think tank based in Colombo, dedicated to economic development through free-markets. We conduct research, provide commentary, and hold events to promote sound policy ideas compatible with a free society in Sri Lanka.

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Executive Summary

The Millennium Challenge Corporation (MCC) Compact presents Sri Lanka with a much needed source of funding and should be accepted without further delay. The Government of Sri Lanka has been a part of this grant process and has recognised the issues of transport and access to land, and the constraints they place on growth. However, Sri Lanka is in an economically precarious position, with a tight fiscal envelope that does not leave space to these finance projects, even though these projects have the potential to boost economic growth in a meaningful way. The projects that are funded through the MCC Compact are projects that have been conceptualised and designed prior to the MCC Compact, removing any concerns that the projects have been selected for reasons other than utility. Additionally, the Government of Sri Lanka has accepted grants from the Government of the United States of America consistently over the last few years.

Background

In April 2018, Sri Lanka was awarded a compact grant of USD 480 Mn by the Millennium Challenge Corporation.¹ The MCC is an US foreign aid agency created by the US Congress in 2004, which focuses on providing time limited grants that will work towards creating economic growth, reducing poverty and strengthening institutions. The MCC provides funding for developing countries that have a proven commitment to good governance, economic freedom and investing in their citizens.² There are three different types of MCC grants that a country could be eligible for. A compact grant is a large, five year grant for countries that meet the requisite eligibility criteria. Concurrent Compacts for Regional Investments are grants that promote economic integration across borders, and increase regional trade and collaboration. The Threshold Programs are smaller grants and focus on creating policy and institutional reform for countries that are close to the MCC eligibility criteria, and are committed to improving their performance.

¹ Millennium Challenge Corporation Sri Lanka Compact, <https://www.mcc.gov/where-we-work/program/sri-lanka-compact>, (accessed February 13, 2020).

² About MCC, <https://www.mcc.gov/about>, (accessed February 13, 2020).

Timeline of events

Sri Lanka's award of the Compact grant in 2018 was the culmination of over a decade of engagement between the Sri Lankan government and the MCC. In 2004, the year the MCC was founded Sri Lanka expressed interest in this potential source of foreign finance.

Date	Event
January 2004	The MCC was formed in January 2004 as an initiative of U.S. President George W Bush
May 2004	Sri Lanka deemed eligible to apply for the MCC grant. Foreign Minister Lakshman Kadirgamar discusses the grant in his visit to Washington D.C. with U.S. officials including Secretary of State. ³ A delegation from the MCC visits Sri Lanka to discuss a potential agreement and visits officials and government ministers ⁴
November 2004	Sri Lanka Embassy in Washington D.C. announces it has submitted a concept paper to MCC for consideration. ⁵
July 2005	Sri Lankan government through the Department of Development Finance, Ministry of Finance and Planning submits a proposal to MCC
January 2006	Foreign Minister meets with the CEO of MCC in Washington DC and hands over a letter appointing the secretary of the ministry of plan implementation as the MCC counterpart in Sri Lanka. ⁶

³ *Embassy of Sri Lanka - United States of America*, Foreign Minister Kadirgamar assured continued support for Sri Lanka's peace process and enhanced bilateral trade, <http://slembassyusa.org/new/media-center/news/306-12foreign-minister-kadirgamar-assured-continued-u-s-support-for-sri-lanka-s-peace-process-and-enhanced-bilateral-trade.html>, (accessed February 13, 2020).

⁴ *Lanka Business Online*, Scouting trip, <https://www.lankabusinessonline.com/scouting-trip/>, (accessed February 13, 2020).

⁵ *Embassy of Sri Lanka - United States of America*, Sri Lanka among the sixteen countries selected as eligible for MCC financing in FY 2005, http://www.slembassyusa.org/press_releases/fall_2004/sl_among_the_sixteen_countries_10nov04.html, (accessed February 14, 2020).

⁶ *Embassy of Sri Lanka - United States of America*, US Senator Lugar says Sri Lanka has the full support of the US Congress as it seeks to move the peace process forward, http://www.slembassyusa.org/press_releases/winter_2005/us_senator_says_04jan06.html, (accessed February 14, 2020).

December 2015	MCC Boards select five countries including Sri Lanka for partnering with the MCC. Sri Lanka and Togo are selected for threshold programs. The Philippines, Nepal and Niger are selected for “MCC Compacts”. ⁷
March 2016	MCC delegation visits Sri Lanka to begin discussions about developing a threshold program. The delegation meets with H.E. President, Prime Minister, top cabinet ministers, and civil society. ⁸
September 2016	President meets with MCC head as part of an official visit to the United States ⁹
March 2017	Establishment of the MCC Project unit in the Prime Minister’s office to coordinate activities of the MCC compact. ¹⁰
July 2017	U.S. Announces a grant of 1.1 billion LKR (7.4 million USD) to support the development of an MCC Compact. ¹¹
June 2018	U.S. Announces a further 2.1 Million USD to continue the development of the compact to supplement the earlier grant in July 2017. ¹² Further visits by U.S. delegations in September 2018

⁷US Embassy in Sri Lanka, MCC board selects five countries for MCC partnerships, <https://lk.usembassy.gov/mcc-board-selects-five-countries-mcc-partnerships/>, (accessed February 14, 2020).

⁸ US Embassy in Sri Lanka, U.S. and Sri Lanka Expand Partnership for Economic Growth and Poverty Reduction, <https://lk.usembassy.gov/u-s-sri-lanka-expand-partnership-economic-growth-poverty-reduction/>, (accessed February 14, 2020).

⁹ Presidential Secretariat, President arrives in New York, <https://www.presidentsoffice.gov.lk/index.php/2016/09/19/president-arrives-in-new-york/?lang=en>, (accessed February 14, 2020).

¹⁰ Office of the Cabinet of Ministers - Sri Lanka, Press briefing of Cabinet Decision taken on 2017-03-14, http://www.cabinetoffice.gov.lk/cab/index.php?option=com_content&view=article&id=16&Itemid=49&lang=en&dID=7548, (accessed February 14, 2020).

¹¹ US Embassy in Sri Lanka, U.S. Millennium Challenge Corporation, Announces LKR 1.1 Billion to Advance Progress on Development of Compact, <https://lk.usembassy.gov/u-s-millennium-challenge-corporation-announces-lkr-1-1-billion-advance-progress-development-compact/>, (accessed February 14, 2020).

¹² Ibid.

September 2018	Joint Proposal by Finance Minister and Prime Minister in his capacity as minister of national policies and economic affairs to establish a company named 'Millenium Challenge Account (Guarantee) ltd' for the implementation of MCC compact.
October - December 2018	MCC is 'paused' until the resolution of the constitutional crisis in Sri Lanka. ¹³
May 2019	National Economic Council shares its views on the MCC Agreement. ¹⁴
July 2019	MCC Compact details are publicized with a total grant amount of \$480 million USD. ¹⁵
October 2019	The Cabinet approves the MCC Compact
November 2019	The Ministry of Finance releases the MCC Agreement drafted with the consent of the AG ¹⁶
December 2019	The new cabinet suspends further actions on the MCC agreements and appoints the committee to study the agreement. ¹⁷

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¹³ *US Embassy in Sri Lanka*, Transcription of Ambassador Teplitz's Interview with Daily FT, <https://lk.usembassy.gov/transcription-of-ambassador-teplitzs-interview-with-daily-ft/>, (accessed February 14, 2020).

¹⁴ Government of Sri Lanka, Presidential Secretariat, National Economic Council, *Report on the Millennium Challenge Corporation*, <https://drive.google.com/file/d/0B3JduhkbnbyblbVI4WW1MZGdiVzI2U0FoVEt5U1F4V0pCWDNF/view>, (accessed February 14, 2020).

¹⁵ *US Embassy in Sri Lanka*, Highlights of MCC Compact, <https://lk.usembassy.gov/highlights-of-mcc-compact/>, (accessed February 14, 2020).

¹⁶ *Ministry of Finance*, MCC Agreement drafted with the consent of AG, <http://treasury.gov.lk/article/-/article-viewer-portlet/render/view/mcc-agreement-drafted-with-the-consent-of-ag>, (accessed February 14, 2020).

¹⁷ *News First*, Cabinet suspends MCC agreement process, <https://www.newsfirst.lk/2019/12/19/mcc-agreement-process-temporarily-suspended/>, (accessed February 14, 2020).

Constraints Analysis Findings

Prior to the MCC engaging with the Government of Sri Lanka for the Threshold Program, the Sri Lankan Government had independently engaged the Harvard Center for International Development to conduct a growth diagnostic of the country. Given that the MCC required a constraints analysis to be conducted, this was carried out by the Government of Sri Lanka and the MCC in partnership with the Harvard University's Center for International Development.

The Constraints Analysis identified the three constraints to private sector investment and economic growth as 'binding'. These were areas were:¹⁸

1. Lack of access to land
2. Policy uncertainty
3. Inadequate overland transport

The Government of Sri Lanka and the MCC focus on the first and third constraint for project implementation, detailed below.

Access to Land

Access to land was identified as a binding constraint to growth and economic transformation. The Government of Sri Lanka owns approximately 80% of land in the country, but the land is administered through a myriad of government entities. A lack of coordination and slow processes when attempting to acquire land has limited the private sector's ability to invest; and is a barrier to inward flows of FDI.

Inadequate Overland Transport

Weak transport and logistics infrastructure was identified as a binding constraint to growth in the Western Province and its surrounding regions. The quality of the country's trade and transport related infrastructure is poor. The speed of travel is an indicator of the costs that firms have to bear, and travel speeds in Sri Lanka are lower than in comparator countries. Congestion is predicted to rise, and daily average road speeds in Colombo are estimated to decrease from 26 km/hour to 19km/hour, with peak hour travel speeds dropping as low as 11 km/hour.

¹⁸ Government of Sri Lanka, Millennium Challenge Corporation, Harvard University's Center for International Development, *Sri Lanka Constraints Analysis Report*, (2017), <https://assets.mcc.gov/content/uploads/constraints-analysis-sri-lanka.pdf>, (accessed February 14, 2020).

Projects Funded by the MCC

Based on the findings of the constraints analysis, two main projects were selected to be funded through the MCC Compact; a transport project (\$350 million) and a land project (\$67.3 million). The main components of each project are detailed below.¹⁹

Transport Project

1. Advanced Traffic Management System
2. Bus Transport Modernisation Activity
3. Central Ring Road Network

Land Project

1. Parcel Fabric Map and State Land Inventory Activity
2. Deeds Registry Improvement Activity
3. Land Valuation System Improvement Activity
4. Land Grants Registration and Deeds Conversion Activity
5. Land Policy and Legal Governance Improvement Activity

The Land Project, although the recipient of the smaller grant amount, has been the subject of scrutiny and debate. However, although these projects will be implemented through MCC funding, they were not created for the MCC Compact. The Land project in particular comprises several smaller projects that the Government of Sri Lanka has begun. The table below refers to this in some detail.

¹⁹ Government of the United States of America, Congressional Notification Transmittal Sheet, <https://assets.mcc.gov/content/uploads/cn-042519-sri-lanka-intent-to-sign.pdf>, (accessed February 14, 2020)

Activities	Corresponding GoSL Project
1. Parcel Fabric Map and State Land Inventory (\$23.4 million)	eState Land Information & Management System Established in 2014
2. Deeds Registry Improvement (\$11.4 million)	eLand Registry Established in 2015
3. Land Valuation System Improvement Activity (\$6.5 million)	(Provides General Support for Valuation Department of the Sri Lanka government)
4. Land Grants Registration and Deed Conversion (\$19.3 million)	Bim Saviya established in 2007.
5. Land Policy and Legal Governance Improvement (\$6.7 million)	Land Governance

Although critics of the MCC Compact have raised concerns over the geo-political implications of accepting the MCC Compact grant money, the Government of Sri Lanka has in the recent past accepted grants from the United States of America. The table below details a series of grants that have been accepted over the last few years. While the MCC Compact offers a larger grant value, Sri Lanka has been consistently accepting money from the United States of America.

ODA grants from the United States of America²⁰

Agreement Date	Project/Programme	Commitment (million)
2018	American Engagement with Sri Lanka Strengthened Partnership for Democratic Governance & Social Cohesion (Enhancement)	USD 9.67
	Sustained and Inclusive Economic Growth (Enhancement)	USD 8.21
	Sustained and Inclusive Economic Growth (Enhancement)	USD 1.15
	Sustained and Inclusive Economic Growth (Enhancement)	USD 3
2017	Strengthened Partnership for Social Integration	USD 3.6
	Development and facilitation of Implementation of a Millennium Challenge Compact	USD 7.4
	Strengthened Partnership for Domestic Reform & Social Integration	USD 8.5
2016	-	USD 23.83
2015	Strengthened Partnership for Social Integration	USD 2.1

(Source: Ministry of Finance Annual Reports 2015-2018)

²⁰ Ministry of Finance, Annual Reports, <http://treasury.gov.lk/publications/annual-report>, (accessed February 14, 2020).

Sri Lanka's Fiscal Position

Sri Lanka has experienced a large and persistent budget deficit, averaging over 7.7% of GDP since 1990. The deficit has been met partly by borrowing which is why the debt-to-GDP has averaged 89.1% during the same period, almost double that of our peer group. Our revenue-to-GDP ratio has been on a secular decline from 20% in 1990 to about 13% in 2015.²¹

Sri Lanka will have to face an unprecedented ballooning of foreign debt repayments between 2020-25 amounting to a massive US\$ 19 bn.²² Sri Lanka has also witnessed a change in debt dynamics with regard to government foreign debt composition. The share of non-concessionary (sum of "non-concessional" plus commercial borrowing by the government) external debt increased from just over 7% in 2006 to 50% by 2017.²³

Reflecting our precarious fiscal position, Fitch Ratings has downgraded the outlook on Sri Lanka's Long-Term Foreign-Currency Issuer Default Rating (IDR) to Negative. Fitch warns that this "revision of the Outlook to Negative from Stable reflects rising risks to debt sustainability from a significant shift in fiscal policy and the potential for roll-back of fiscal and economic reforms in the aftermath of November's Presidential elections. We believe the departure from the previous revenue-based fiscal consolidation path has created policy uncertainty and increased external financing risk for the sovereign, particularly given the large external debt repayments due in 2020 and beyond."²⁴

This tight fiscal envelope means that the government will have to prioritise spending. The projects funded by the MCC grant were those that the government was already committed to. In the event the MCC grant is rejected, funds for these projects would have to be drawn from the general treasury, creating consequent pressure on the deficit and debt.

²¹ Ravi Ratnasabapathy, Echelon, Bringing Sanity to Public Finance, <https://echelon.lk/bringing-sanity-to-public-finances/>, (accessed February 14, 2020). ²² Government of Sri Lanka, Ministry of Finance, Annual Budget Speech (2018), <http://www.treasury.gov.lk/documents/10181/470884/budgetspeech2018E.pdf/9a9b081b-a709-418f-88ee-64f397db6ab4>, (accessed February 14, 2020)

²³ Dushni Weerakoon, Utsav Kumar, and Roselle Dime, "Sri Lanka's Macroeconomic Challenges: A tale of two deficits", *ADB South Asia Working Paper Series*, No. 63, (2019), <https://www.adb.org/sites/default/files/publication/493451/swp-063-sri-lanka-macroeconomic-challenges-two-deficits.pdf>, (accessed February 14, 2020)

²⁴ *Economy Next*, Sri Lanka Sovereign Rating Outlook Downgraded to Negative by Fitch over tax cut, <https://economynext.com/sri-lanka-sovereign-rating-outlook-downgraded-to-negative-by-fitch-over-tax-cut-s-36605/>, (accessed February 14, 2020)