THE LURE OF CHINESE LOANS

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

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SRI LANKA'S EXPERIMENT WITH A SPECIAL FRAMEWORK TO FINANCE ITS INFRASTRUCTURE INVESTMENTS

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Contents

List of Abbreviations

ADB	Asian Development Bank
BOO	Build-Own-Operate
BOOT	Build-Own-Operate-Transfer
BOT	Build-Own-Transfer
CCEM	Cabinet Committee on Economic Management
CDB	China Development Bank
CEA	Central Environmental Authority
CEB	Ceylon Electricity Board
CIABOC	Commission to Investigate Allegations of Bribery or Corruption
CMEC	China Machinery Engineering Corporation
DPF	Department of Public Finance
EIA	Environmental Impact Assessment
ERD	External Resources Department
EXIM Bank of China	The Export-Import Bank of China
FD	Fixed Deposit
GAMWSS	Gampaha Attanagalla Minuwangoda Integrated Water Supply Scheme
GDP	Gross Domestic Product
GGTP	Guidelines on Government Tender Procedure
GKWSSP	Greater Kurunegala Water Supply and Sewerage Project
IMF	International Monetary Fund
JICA	Japan International Cooperation Agency
MOF	Ministry of Finance
MOU	Memorandum of Understanding
MOWSD	Ministry of Water Supply and Drainage
NPD	National Planning Department
NWSDB	National Water Supply and Drainage Board of Sri Lanka
PAC	Project Assessment Committee
PF	Public finance
PG	Procurement Guidelines
PM	Procurement Manual
PPP	Public-Private Partnerships
RTI	Right To Information
SCAPC	Standing Cabinet Appointed Procurement Committee
SCARC	Standing Cabinet Appointed Review Committee
SEMA	Strategic Enterprise Management Agency
SOEs	State-Owned Enterprises
TCE	Total Cost Estimate
TEC	Technical Evaluation Committee
TWIEE	Tianjin Water – Industry Engineering Equipment Co. Ltd
USP	Unsolicited Proposal

Abstract

The Sri Lankan government introduced a special framework in 2010 to facilitate access to export credit provided by emerging economies such as China. In the context of declining access to concessional funding from traditional multilateral and bilateral sources, this alternative funding was intended to finance the government's ambitious infrastructure development programme. The projects backed by concessional export credit often originated as unsolicited proposals that required deviation from the usual competitive bidding process recommended for public infrastructure projects, and the proposals were approved by the Cabinet of Ministers based on the recommendation of a Standing Cabinet Appointed Review Committee (SCARC). This report analyses the design and practical application of this special framework using both published and unpublished official documents as well as information gathered from interviews with key informants. The analysis aims to assess the extent to which the design and the actual execution of the special framework facilitated the realisation of its intended objectives.

The findings point to several weaknesses in the design and application of this framework, which undermined the framework's ability to deliver the expected outcomes, i.e., accessing low-cost export credit facilities, strengthening the evaluation process, and expediting the implementation of priority projects. The key drawback in the design was the excessive official discretion built into the decision-making process by 1) the vaguely defined reasons introduced to justify deviations 2) complete disregard of the level of concessionality (or the grant element) in determining the suitability of funding and 3) making the technical evaluation by an independent committee optional. The analysis of the Gampaha, Attanagalla & Minuwangoda Integrated Water Supply Scheme (GAMWSS) revealed that in addition to the flaws in the design, the special framework failed to realise its objectives in practice due to the lax application of its provisions. In the hope of securing a concessional export credit facility from the EXIM Bank of China, the Sri Lankan government awarded the contract at a higher price to a Chinese contractor that had little to no experience or expertise in the relevant sector. The contract was awarded without a firm commitment of funds and without conducting the minimum due diligence required. As the government failed to secure the expected credit facility, the project completion was also delayed by more than seven years. Further, the analysis highlights the ineffectiveness of the oversight processes in place to detect and prevent malpractices. The case study also sheds light on the hidden costs that the country incurred in securing funds through the special framework to finance its infrastructure.

1
Introduction

At the conclusion of Sri Lanka's three-decade long conflict in 2009, the Sri Lankan government identified investments in infrastructure as a high priority in its development agenda. Closing the "Infrastructure Gap" between Sri Lanka and its neighbours was one of the key objectives of the Development Framework of the government for 2010-2016, across many sectors such as transport, energy, water, sanitation, and irrigation.[1]

However, a key challenge that was faced by the government in realising this objective lay in accessing the necessary finance to fund this ambitious public investment programme. At the time, the government expected to spend at least 6%-7% of GDP on public investment annually, from 2010 to 2016.[2] In the past, the public investment as a % of GDP had remained below 5%,[3] and according to the External Resources Department (ERD) of the Ministry of Finance, around 40% of the funds required for public investment came from foreign sources of financing.[4] However, accessing concessional finance from abroad to fund infrastructure had become increasingly difficult for Sri Lanka with the categorisation of the country as a lower middle-income economy[5] in 2004.[6] Hence, the government actively sought alternative financing options, with lower costs and longer maturities.[7] A key alternative foreign financing option identified was the export credit instruments from developing countries that have evolved to provide funding for infrastructure investments.[8] The export credit, while providing lower cost funds with longer maturities compared to commercial credit, requires the borrower to purchase goods and services (including the contractor) from the country of the lender.

However, in its attempt to make use of this large pool of funds made available in the form of export credits by emerging economies such as China to finance its infrastructure, Sri Lanka faced a regulatory hurdle. The financing from China often originated as letters of intent issued by China's lending institutions, primarily the EXIM Bank of China, which backed unsolicited proposals (USPs) developed by Chinese State-Owned Enterprises (SOEs). USPs are essentially proposals put forth by an external entity of its own volition, i.e., without the government

1. Department of National Planning, *The development policy framework, Government of Sri Lanka 2010*, p.5.
2. Department of National Planning, *The development policy framework, Government of Sri Lanka 2010*, p.3.
3. Central Bank of Sri Lanka,'Statistics Fiscal Sector', at https://www.cbsl.gov.lk/en/statistics/statistical-tables/fiscal-sector, [Last accessed: 20 May 2022].
4. Website of External Resources Department, 'Global Partnership Towards Development 2013', at http://www.erd.gov.lk/images/pdf/global_partnership_towards_development_2013.pdf, [Last accessed: 20 May 2022].
5. Website of External Resources Department, 'Global Partnership Towards Development 2013', at http://www.erd.gov.lk/images/pdf/global_partnership_towards_development_2013.pdf, [Last accessed: 20 May 2022].
6. As per the current classification of GNI USD 1,046 by the World Bank.
7. Website of External Resources Department, 'Global Partnership Towards Development 2013', at http://www.erd.gov.lk/images/pdf/global_partnership_towards_development_2013.pdf, [Last accessed: 20 May 2022].
8. Website of External Resources Department, 'Global Partnership Towards Development 2013', at http://www.erd.gov.lk/images/pdf/global_partnership_towards_development_2013.pdf, [Last accessed: 20 May 2022].

calling for such proposals. There were no clear provisions or procedures in place to manage such unsolicited proposals for public sector infrastructure within Sri Lanka's procurement framework, which provided primacy to competitive bidding and allowed deviations only under extraordinary circumstances with the approval of the Cabinet of Ministers.

This report analyses how Sri Lanka attempted to fix this problem in 2010 by carving out a special regulatory framework that enabled the government to entertain unsolicited proposals for public sector infrastructure projects, and the implications of these measures for the country.

The value and share of the funding that came from China during the period that the special framework was in place, i.e., 2010-2016, is arguably a testament to the success of the special framework in securing the necessary finance for its infrastructure investments. This period can be considered the golden era for financing from China, with Sri Lanka receiving USD 5,895 million worth of loans from China to fund its infrastructure.[9] This is a significant increase compared to before. According to the External Resources Department (ERD) during the 25 years from 1971 to 2005, the financial assistance received from China was equal to USD 362 million.[10] Funding for infrastructure increased substantially since 2005. The data gathered by Verité Research on loans taken from abroad to fund infrastructure from 2005 to 2009 reveals that China had provided USD 1,964 million worth of loans to Sri Lanka. The country received the highest level of funding from China for infrastructure during the period the special framework functioned, and it was a 200% increase compared to funding received during 2005-2009.

China was also the leading provider of foreign loans to finance infrastructure during this period, accounting for 37% of the total foreign loans secured during the period.[11] During the existence of the special framework, a total of 26 public sector projects had been approved by the Standing Cabinet Appointed Review Committee (SCARC), the primary body within the special framework that was tasked with making recommendations to the Cabinet; of these projects, 12 projects were funded by China.[12] The value of these Chinese funded projects SCARC approved amounts to 92% of the total foreign funding for all public sector projects approved by SCARC and is indicative of the scale and the magnitude of the projects funded by China compared to those funded by other countries. The SCARC approved projects also accounted for 53%[13] of the overall funds secured by Sri Lanka from China during this period to finance its infrastructure.

The objective of this report is to look beyond the value of funds raised and focus on the quality of the decisions made; specifically, whether the special framework in its design and actual execution facilitated the efficient and effective utilisation of the funds raised in the best interest of the country. Information for the analysis was obtained predominantly through desk research and applications made under the Right to Information Act, while key informants were also consulted to triangulate the findings.

The structure of this report is as follows. Following the Introduction to the report (Section 1), Section 2 analyses the legal framework in print. It reviews in detail the challenges that the government faced in processing

9. Calculated using the data published and received in response to Right to Information requests from the External Resources Department and the Ministry of Finance.
10. Website of External Resources Department, *'Global Partnership Towards Development 2013'*, at http://www.erd.gov.lk/images/pdf/global_partnership_towards_development_2013.pdf, [Last accessed: 20 May 2022].
11. The actual value of loans taken China could even be higher. This is due to difficulty in finding data about loans taken from China by Sri Lankan SOEs and Statutory Boards.
12. RTI filed with the Department of Public Finance dated 10 February 2022.
13. Four SCARC approved projects funded by China worth USD 454 million including three projects (1) Relocation and development of Institute of Technology University of Moratuwa, 2) Construction of Outer Circular Road in Trincomalee, 3) Waste water infrastructure for greater Hambantota) does not feature in the Central Government's loan agreement list and treasury guarantee list, thus it cannot be confirmed whether a loan agreement has been signed for these projects and the Kattankudy division sewerage disposal project for which the loan agreement has been signed in 2018 have been excluded from the calculation of this number as these projects weren't included in the total value of loans signed in this period.

unsolicited proposals for public sector projects until 2010, and how the special framework was designed to overcome the identified challenges. The discussion also identifies the gaps and weaknesses in the design of the special framework, which undermined its ability to deliver on its mandate. Section 3 analyses the special framework in practice through a detailed investigation of a project that was processed using the provisions in the special framework. It sheds light on the gap between what is written in print and the practice and how these gaps and weaknesses lead to outcomes that contradict the objectives that the government aimed to achieve by establishing the special framework. A summary of the findings and the key takeaways can be found in the conclusion (Section 4) of this report.

2
The Legal Framework

This section analyses the legal framework in Sri Lanka relating to the procurement of large infrastructure projects in general and the special framework that was established to manage the procurement of projects that originate as USPs and are not subject to a competitive bidding process. Large scale infrastructure projects are those above a certain specified value threshold that requires the involvement of Cabinet appointed procurement committees. If the projects are locally funded then the value must be above LKR 500 million and for foreign funded projects, the value must be above LKR 1,000 million.[14]

The section is divided into four sub-sections. The first provides an overview of the general regulatory framework and the regulatory hurdles the government encountered in managing USPs for public sector infrastructure projects. The second provides an overview of the special framework that was established in 2010 to overcome these hurdles and to facilitate the flow of financing from emerging economies such as China to fund the government's ambitious public sector infrastructure programme. The third highlights the gaps and weaknesses in the design of the special framework, which potentially undermined its ability to achieve the outcomes expected. The fourth section provides a brief overview of the changes that took place subsequent to the abolishment of the special framework in 2016.

2.1. The general regulatory framework

The Sri Lankan procurement process is not governed by an Act of Parliament. The rules governing procurement are embodied in several 'procurement guidelines' and 'tender procedures' that have been published with the approval of the Cabinet of Ministers. Nevertheless, the apex courts of Sri Lanka have routinely given legal recognition to these 'procurement guidelines' and 'tender procedures'.[15] As such, even though such 'procurement guidelines' are not Acts of Parliament, they constitute the principal body of rules and principles that govern public procurement in Sri Lanka. The regulatory framework comprises the following sets of guidelines:[16]

14. Website of the Department of Public Finance, '*Supplement 35 to the Procurement Manual*', 2020, at http://122.255.3.82/documents/10181/329538/Supplement+35-dated+25.03.2020/206c9101-a96b-4c76-88f9-8266d43d453e, [Last accessed: 20 May 2022].
15. Tiranthai Public Co. Ld, and others v. CEB and others [2016] SC/FR 108/2016 https://www.supremecourt.lk/images/documents/sc_fr_108_2016j.pdf; Noble Resources International Pte Limited v. Ranjith Siyambalapitiya and others [2015] SC FR No. 394/2015 https://www.supremecourt.lk/images/documents/sc_fr_394_2015.pdf.
16. The two guidelines are accompanied by the 2006 Procurement Manual, the 2007 Consulting Services Manual, and a series of supplements and circulars regularly published by the Department of Public Finance of the Ministry of Finance. All amendments to both guidelines are made through such supplements.

i. The Government Procurement Guidelines of 2006, which applies to the public sector procurement of goods and works (development and infrastructure projects); and,

ii. Part II of the Guidelines on Government Tender Procedure (GGTP) of 1998, which governs the procurements of private sector projects, that is, Build-Own-Operate (BOO), Build-Own-Transfer (BOT) and Build-Own-Operate-Transfer (BOOT) projects[17]

A key feature of the regulatory framework comprising the Procurement Guidelines (PG 2006) and Part II of the Guidelines on Government Tender Procedure (Part II GGTP) was that procurement pursuant to competitive processes was the norm, while deviating from such competitive processes was regarded as the exception.

The PG 2006, which governs public procurement, expressly states that "fair, equal and maximum opportunity" should be provided to interested parties to participate in Procurement, and that the evaluation and selection of tenders is carried out in a manner that ensures "transparency and consistency".[18] The Procurement Manual 2006 (PM 2006) goes on to recognise that "good procurement is unbiased, consistent, competitive and therefore reliable. It offers all interested contractors, suppliers and consultants a level playing field on which to compete and thereby, directly expands the purchaser's options and opportunities."[19]

The same principle of competition is embodied in the guidelines applicable to private sector infrastructure projects as well. While permitting government agencies to entertain USPs for projects that involve private sector participation, Part II GGTP expressly states that "no decision should be taken solely on the basis of unsolicited offers without inviting proposals/bids through public advertisement".[20] Further, Part II GGTP requires the government agency that receives the USP to invite the public to competitively match or improve on the original proposal before it is procured.[21] The original proponent is given a further opportunity to submit a bid, in the event that the scope of the project is revised by the government.[22]

2.1.1. Accessing loans from China; the regulatory hurdles faced

Within this general framework that provided primacy to competition, the government faced two regulatory hurdles that undermined its ability to access concessional financing that originated as assurances of funding from Chinese lending institutions for USPs submitted by Chinese SOEs. The first hurdle was the lack of explicit reference to USPs in relation to public sector infrastructure projects. The second hurdle was the requirement of having to demonstrate to the Cabinet of Ministers the existence of an extradentary circumstance to get permission to deviate from the competitive bidding process.

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. As mentioned above, Part II GGTP is the only framework that contemplates the entertaining of unsolicited and stand-alone proposals/projects in respect of projects that involve private sector participation, such as BOO, BOT, and BOOT projects. When PG 2006 is read together with Part II GGTP, it appears that the general procurement framework in Sri Lanka contemplated entertaining USPs only with respect to private sector infrastructure projects. Thus, the country's procurement framework appears to align with the global trends in procurement in relation to USPs, where such proposals are increasingly looked to as a means of securing private sector capital and technical expertise

17. Website of the Ministry of Finance, 'Guidelines on Government Tender Procedure - Part II', at https://www.treasury.gov.lk/api/file/9f9c06c1-59c4-4d7c-b43e-870c3d71803a, [Last accessed on 13 June 2022].
18. Guidelines 1.2.1(c) and 1.2.1(f), PG 2006.
19. PM, 2006, p. 2.
20. Reference 237(b), II GGTP 1998.
21. Ibid.
22. Ibid.

to meet the growing demand for better infrastructure in developing countries.[23] USPs are widely discussed and used within the context of public private partnerships (PPPs).[24] In contrast, public procurement processes where infrastructure is financed using public money favour competitive bidding. It is considered the best means of protecting the public interest and achieving the highest value for tax money.

Sri Lanka's general procurement framework that embodied the principle of competition in public procurement applied stringent criteria to permit deviations. PG 2006 required the government entity requesting for a deviation to demonstrate the existence of an extraordinary circumstance. PG 2006 outlines what constitutes an extraordinary circumstance, as instances where: i) the expeditious/extraordinarily speedy processing of procurement is necessary; ii) the supplies are immediately required to avoid acute shortages in the market; iii) the Bid prices of goods fluctuate frequently; iv) the proposed project contains a large number of bid packages spread over a long-time span; and v) security considerations warrant such procurement.[25] Demonstrating the existence of such extraordinary circumstances in relation to USPs submitted to build infrastructure was a challenge faced by government entities.

Similar criteria were applied for deviations in relation to private sector infrastructure projects as well. The competitive process outlined in Part II GGTP can be deviated from only in the face of '*urgent and exceptional circumstances*' and with the approval of the Cabinet of Ministers.[26] Unlike PG 2006, however, Part II GGTP of 1998 does not define or provide examples of what constitutes an "urgent and exceptional circumstance".

To proceed with the deviations, both PG 2006 and Part II GGTP state that requests for deviations require the approval of the Cabinet of Ministers. For public sector procurement, PG 2006 makes it mandatory for proposals/projects for which deviations are requested to be vetted by a Standing Cabinet Appointed Procurement Committee (SCAPC) with the support of a Technical Evaluation Committee.[27] The Procurement Guidelines set out specific qualifications that the members of such a Technical Evaluation Committee should possess. Cabinet decision to approve or reject the request for deviation is made based on the recommendations of these committees. For private sector infrastructure projects, however, Part II GGTP does not provide for a review/evaluation process beyond stating that such deviations require the approval of the Cabinet of Ministers. It does not set out a process to be followed in evaluating and approving projects/proposals that justify such deviations.

2.2. The special regulatory framework

The lack of an enabling regulatory framework, however, had not stopped government agencies from implementing public sector infrastructure projects that had originated as USPs, without going through a competitive bidding process and with the approval of the Cabinet of Ministers. The information collected by Verité Research identified six public-funded infrastructure projects worth USD 1,558 million that originated as USPs and had been implemented without going through a competitive bidding process between 2005 - August 2010[28],

23. Public Private Infrastructure Advisory Facility, 'Unsolicited Proposals: An Exception to the Public Initiation of Infrastructure Procurement', (2014), at https://ppp.worldbank.org/public-private-partnership/library/ppiaf-unsolicited-proposals-%E2%80%93-exception-public-initiation-infrastructure-ppps-analysis-global-trends-and-lessons-learned, [Last accessed: 18 November 2020].
24. World Bank, Public Private Partnership Legal Resource Centre, at. https://ppp.worldbank.org/public-private-partnership/ppp-overview/ppp-procurement-bidding/unsolicited-proposals/unsolicited-proposals#:~:text=An%20unsolicited%20proposal%20(USP)%20is,a%20request%20from%20the%20government, [Last accessed on 20 May 2022].
25. Guideline 2.7.3, PG 2006.
26. Reference 237(b), II GGTP 1998.
27. Guideline 2.7.2(b), PG 2006.
28. This includes projects that originated as USPs where the contract/loan agreements were signed between January 2005 and August 2010.

before the establishment of SCARC. Of these six projects, three were funded by the EXIM Bank of China. The Mattala International Airport and the Hambantota Port, which garnered much attention locally as well as globally, were among these three projects. These three projects accounted for 88% of the value of the six projects. The remaining three projects were funded by the UniCredit Bank Austria, the Australia & New Zealand Investment Bank and HSBC Bank PLC (UK).[29]

In 2010, the government took the initiative to establish a special framework to overcome the regulatory hurdles discussed in the previous section and to prevent the misuse of Cabinet discretion to process projects that originated as USPs. This framework was in place between 2010-2016 and was introduced in four steps.[30]

1. 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.

2. 4th August 2010 - Issuing a public finance circular 444 by the Ministry of Finance (MOF) instructing all heads of government agencies to submit USPs to the Director General of the Department of Public Finance (DPF) to be placed before the SCARC for appropriate action.

3. 20th October 2010 - Providing Cabinet approval to have in place one or more supporting committees with relevant expertise to assist SCARC towards expeditious evaluations.

4. 12th May 2011 - Publishing Supplement 23 to Part II of the GGTP titled 'Procurement Guideline Part II Reference: 237' (PGR:237) outlining the process to be followed by the respective government agencies and SCARC when processing USPs/stand-alone proposals.

2.2.1. The objectives

The public finance circular 444 (PF 444) and the preamble of the Supplement 23 (PGR 237) lay down the objectives and motivations that led to the creation of the special framework. According to PF 444, USPs backed by assurances of concessional funding had become an attractive alternative for infrastructure financing due to difficulties faced in raising concessional finance from multilateral and bilateral institutions. Therefore, despite the absence of clear guidelines or a mechanism to process or evaluate USPs outside the competitive process, such proposals have been entertained subject to Cabinet approval on an ad-hoc basis. Further in the absence of a mechanism to evaluate such proposals, commitments have been made without proper evaluations. Hence, as a first step towards addressing this problem and to enable the best use of the alternative financing in the interest of the country, the Cabinet of Ministers appointed the SCARC, which was assigned with two main tasks. The first was to assess USPs and decide how best to process such proposals and to advise line ministries/agencies. The second was to formulate a clear policy to be incorporated into the existing guidelines relating to such proposals.[31]

The second task materialised with the publication of PGR 237 which outlined the procedure to be followed when dealing with USPs submitted along with "acceptable project financing arrangements".[32] In its preamble, PGR 237 clearly states that the target of the special framework is to tap into alternative funding that is made available via

29. Information provided by the External Resources Department of the Ministry of Finance and the responses received to requests for information filed under the Right to Information Act No. 12 of 2016 with respective implementing agencies of the projects in the Government.

30. This special framework ceased to exist with the publication of Supplement 30, in December 2016, which replaced the PGR 237 with a Swiss Challenge System. However, in 2019, Swiss challenge was abolished, reverting to the initial process outlined in Part II of the GGTP. See Letter No. PFD/PPP/Guidelines/2019 dated 25.09.2019, Department of Public Finance, at https://oldportal.treasury.gov.lk/documents/10181/329538/pfd-sup30-letter20200618/a9e05477-fadd-4833-a22f-638bb6e61f15, [Last accessed: 20 May 2022].

31. Ministry of Finance, Public Finance Circular No: PF/444, 4th August 2010.

32. Department of Public Finance, '*Supplement 23 to the PROCUREMENT GUIDELINE PART II REFERENCE: 237*', 2011, at https://www.treasury.gov.lk/api/file/5c891efb-a1cb-4098-aba5-4d4360a5cedb, [Last accessed: 16 May 2022]. Preamble, paragraph 1.3.

"export credit agencies of emerging economies" where the lender nominates their contractor.[33] It notes that such bilateral lending arrangements have expanded and hence, the special framework was established in the national interest to expedite the implementation of development projects.

2.2.2. The design

The special framework was designed to overcome the two regulatory hurdles, faced when accessing such alternative funding. As mentioned, in Section 2.1, one of the hurdles was the lack of explicit reference to USPs in relation to public sector infrastructure projects. To overcome this problem the PGR 237 brings under its purview public sector development projects financed on credit terms where the lender nominates the contractor (refer Table 1).

Table 1: The categories of project proposals processed by the SCARC

Category I	Public sector development projects to be financed on credit terms, and where the lender nominates the contractor.
Category II	Development projects with the participation of the private sector, such as BOO, BOT, BOOT, and public-private partnership projects.
Category III	Private investment initiatives involving the alienation (sale, grant, etc.) of state lands or lands owned by public entities.

To address the second hurdle, i.e., the need to demonstrate the existence of an extraordinary circumstance to qualify for deviations, PGR 237 provided additional reasons that can be used to justify deviations from the competitive bidding process. These reasons formulate the basis of the decision making within the special framework and guides the Ministry, the SCARC and the Cabinet of Ministers in determining whether the deviation is warranted and beneficial to the country.

Ministry-level review

For public sector infrastructure projects classified as Category I, the Secretary to the relevant Ministry or the Head of a government agency seeking to deviate from the competitive bidding process needs to demonstrate that i) the proposal in terms of funding is 'exceptionally beneficial' to Sri Lanka; or ii) it is desirable to proceed with the proposal 'on an urgent basis without going through the normal procurement procedure'. To assist the Ministry in making this determination the special framework provides two factors to consider and having one or both in place was sufficient to demonstrate that the proposal is exceptionally beneficial and it is desirable to proceed with the USP. One refers to the importance of the project proposal and the associated funding and the other to the experience and the expertise of the project proponent.

1. The importance of the project proposed to the country and attractiveness of the funding compared to alternative funding arrangements available. In determining the importance of the project, two conditions need to be met: first, the level of importance and relevance to the Public Investment Plan of the relevant line Ministry or Department; and second, whether the project falls within the Government's overall policy strategies.

2. The expertise and experience of the company that submits the proponent of the USP. The proponent is expected to "command reputation and the know-how that is otherwise scarcely available in the field related to the Project".[34]

Along with its own assessment, the Ministry/Department is required to submit the observations of the National Planning Department and the External Resources Department to the SCARC as well.

33. Ibid.

34. Department of Public Finance, '*Supplement 23 to the PROCUREMENT GUIDELINE PART II REFERENCE: 237*', 2011, at https://www.treasury.gov.lk/api/file/5c891efb-a1cb-4098-aba5-4d4360a5cedb, [Last accessed: 16 May 2022], Section 3.1.

SCARC review

Upon receiving the proposal and observations, the SCARC is required to independently assess the proposal, if necessary, with the assistance of a Technical Evaluation Committee/Project Committee. After this assessment is completed, the SCARC is required to either: i) determine that the proposal has no merit and thereby refrain from proceeding with the proposal, or ii) make a recommendation that it is appropriate to proceed with the proposal.

The special framework introduces seven reasons that the SCARC can use to justify deviation from the normal procurement process. The SCARC can make its recommendation to proceed with a proposal to the Cabinet of Ministers based on the USP meeting ***one or more*** of the following six reasons listed.[35]

a. The proposal is of 'strategic importance' and would 'ultimately be of benefit to the economic benefit of the country'.

b. The proposal falls 'well within the planned development programs of the Government'.

c. Implementation of the proposal would create a transfer of 'superior knowledge/knowhow', which would be 'otherwise not available through alternative arrangements.'

d. The proposal contemplates a 'significant inflow/savings of foreign exchange.'

e. The conditions attached to the financing of the implementation of the proposal are 'acceptable/attractive and there is evidence of firm commitments on the part of the financiers.'

f. It is justifiable to deviate from the competitive bidding procedure stipulated in the GGTP.

Of the six reasons, only one (the conditions attached to funding) is specified further with the provision of objective criteria for the assessment. The two conditions that must be satisfied to consider the funding as suitable are the years of repayment (minimum 15 years), and the grace period (minimum 3 years).[36]

2.3. The gaps and weaknesses of the special framework

The special framework was established to achieve two key objectives: first, to facilitate access to alternative concessional finance for public sector infrastructure projects, and second, to prevent irregularities in the approval process and to prevent making commitments to projects without carrying out a logical evaluation.[37] However, several weaknesses in the design of the special framework left loopholes that could be exploited or misused to achieve different outcomes to these stated objectives, as listed in PF 444 and the preamble to PGR 237.

The main source of the weakness in the design was the list of reasons introduced to justify a deviation from the normal procurement process. The reasons listed were far less stringent compared to the general framework and only vaguely defined. Additionally, the decision-making process was made far more lenient by stating that deviations could be justified even if the USP met only one of the reasons listed, and by providing SCARC the discretion to decide whether the USP needed to be evaluated by an independent project/technical evaluation committee. These weaknesses allowed the officials to exercise a

35. Department of Public Finance, '*Supplement 23 to the PROCUREMENT GUIDELINE PART II REFERENCE: 237*', 2011, at https://www.treasury.gov.lk/api/file/5c891efb-a1cb-4098-aba5-4d4360a5cedb, [Last accessed:16 May 2022], Paragraph 3.2.

36. Department of Public Finance, '*Supplement 23 to the PROCUREMENT GUIDELINE PART II REFERENCE: 237*', 2011, at https://www.treasury.gov.lk/api/file/5c891efb-a1cb-4098-aba5-4d4360a5cedb, [Last accessed:16 May 2022], Paragraph 3.3.

37. Ministry of Finance, Public Finance Circular No: PF/444, 4th August 2010.

high level of discretion in decision making, reducing the rigour of the decision-making process and making it prone to abuse/misuse. These weaknesses are discussed in detail below.

2.3.1. Reasons provided for deviations: less stringent and vaguely defined

Several of the reasons listed are loosely defined. For example, to proceed with a USP without going through the competitive bidding process, the Ministry/Department's initial assessment only needs to establish that the project "***appears*** to be exceptionally beneficial to the country in terms of funding or otherwise" (emphasis added).[38] This criterion appears to have been met if the project is in the "public investment plan of the Ministry" and it aligns with the overall policy strategy of the government and the associated funding offer is "important and relevant" compared to available funding arrangements.[39] This means, all projects in the project pipeline qualify for a deviation if they bring in funding that offer better terms and conditions compared to other available funding arrangements.

Among the reasons listed that SCARC should consider, the most problematic is the last criteria which states a deviation from normal procurement process can be considered if such deviation 'is justifiable' which has no objective standard attached to it.[40] Unlike the Procurement Guidelines of 2006, which outlines what constitutes of "extraordinary circumstances", the PGR 237 does not set out any examples or illustrations of what would constitute "justifiable" circumstances to deviate from the competitive bidding. Hence, such criteria can be open to subjective interpretation, which could lead to arbitrary and capricious recommendations being made by the SCARC.

One of the key motivations for setting up the SCARC was to facilitate alternative funding on favourable terms. The importance of the conditions attached to the financing of the project compared to other available funding arrangements is one of the factors to be considered by the Ministry in its initial assessment of the project, and a criterion to be considered by SCARC to proceed with the project proposal. However, in determining whether the funding is suitable/favourable, the only factors that must be considered are the years of repayment (minimum 15 years) and the grace period (minimum 3 years).[41] There is no reference made to the rate of interest that is to be paid or the "grant element" of the loan. The International Monetary Fund (IMF) defines the grant element as the yardstick that measures the concessionality of a loan: "It is the difference between the nominal value (face value) of the loan and the sum of the discounted future debt-service payments (net present value) to be made by the borrower, expressed as a percentage of the face value of the loan".[42] For a loan to be considered a concessional loan according to the IMF, the loan must have a grant element of at least 35%.[43] This omission is highly problematic, especially in relation to Category I projects that are completely funded by the government through a loan which must be paid back with public funds.

2.3.2. The decision-making process lacks rigour

The above discussed issues were compounded by the requirement that *only one or more* of the reasons listed need to be satisfied in order to proceed with an

38. Department of Public Finance, '*Supplement 23 to the PROCUREMENT GUIDELINE PART II REFERENCE: 237*', (2011), at https://www.treasury.gov.lk/api/file/5c891efb-a1cb-4098-aba5-4d4360a5cedb, [Last accessed:16 May 2022], Section 3.1.
39. Ibid.
40. Department of Public Finance, '*Supplement 23 to the PROCUREMENT GUIDELINE PART II REFERENCE: 237*', (2011), at https://www.treasury.gov.lk/api/file/5c891efb-a1cb-4098-aba5-4d4360a5cedb, [Last accessed:16 May 2022], Section 3.2.
41. Department of Public Finance, '*Supplement 23 to the PROCUREMENT GUIDELINE PART II REFERENCE: 237*', (2011), at https://www.treasury.gov.lk/api/file/5c891efb-a1cb-4098-aba5-4d4360a5cedb, [Last accessed:16 May 2022], Section 3.3.
42. Website of International Monetary Fund, '*Calculation of Grant Element*', at https://www.imf.org/en/GECalculator, [Last accessed on 18 May 2022].
43. Website of International Monetary Fund, '*Public Debt Limits in IMF-Supported Programs*', at https://www.imf.org/en/Topics/sovereign-debt/debt-limits-policy, [Last accessed on 18 May 2022].

unsolicited/stand-alone proposal. For example, of the two conditions listed for the Ministry/ Department to pursue a USP outside the normal procurement process, meeting just one condition was sufficient to proceed with the proposal. This permits the Ministry to request deviations for public sector development projects solely on the basis that the company that submitted the proposal commands a superior reputation and knowhow, even if it is not a project of strategic importance to the country. This is highly problematic as it creates room for the implementation of projects that are in the interest of the private entities that initiate the project. The same is true in relation to the SCARC review. The SCARC can recommend processing the USP outside the normal procurement process if the USP meets one of the six reasons listed in the special framework outlined in Section 2.2.2.

Additionally, the review process put in place by the special framework for public sector infrastructure projects that seek to deviate from normal procurement process is weaker than the review process provided for in PG 2006. Under PG 2006, when a deviation from competitive bidding is sought, it is mandatory to appoint a Standing Cabinet Appointed Procurement Committee (SCAPC) to evaluate the proposal, which will be supported by a Technical Evaluation Committee appointed by the Department of Public Finance.[44] As such, under the general framework applicable for public sector infrastructure projects, when competitive bidding is foregone, the technical evaluation appears to be carried out by an independently appointed committee. As mentioned in sub-section 2.1.1., the Procurement Guidelines set out specific qualifications that the members of a Technical Evaluation Committee should possess.

In contrast, under the PGR 237, independent technical evaluation of an unsolicited/stand-alone proposal is not mandatory. For example, the SCARC can make a recommendation on its own, or with the assistance of a Technical Evaluation Committee.[45] Thus, the PGR 237 vested the SCARC with the discretion to decide for itself whether it required the assistance of a Technical Evaluation Committee prior to making a recommendation.

2.4. The revisions made post 2016

In January 2015, a new coalition government led by President Maithripala Sirisena and Prime Minister Ranil Wickramasinghe came into power, promising to eradicate corruption and restore good governance. Given the allegations of corruption associated with the previous regime, especially in relation to the procurement of large infrastructure projects, improving the governance of the procurement process was a key area of focus. Towards this end, an important step taken was the establishment of a National Procurement Commission (NPC) through the 19th amendment to the constitution made in 2015.

Another area of focus was the framework governing USPs. Following a cabinet decision in August 2016, the government abolished the SCARC framework through Supplement 30 to Part II GGTP issued in December 2016. Supplement 30 replaced the SCARC framework with a "Swiss Challenge" procedure. A Swiss Challenge invites counter proposals following the receipt of an unsolicited proposal (Original Proposal), with the original bidder given the opportunity to match a selected counter proposal more competitive than the original proposal.

The rationale for the introduction of the Swiss Challenge Procedure is identical to that which prompted the formulation of the SCARC. However, there are notable differences between the SCARC framework and the Swiss Challenge Procedure.

44. Guideline 2.7.2, PG 2006.

45. Department of Public Finance, '*Supplement 23 to the PROCUREMENT GUIDELINE PART II REFERENCE: 237*', (2011), at https://www.treasury.gov.lk/api/file/5c891efb-a1cb-4098-aba5-4d4360a5cedb, [Last accessed:16 May 2022], Section 3.2.

Firstly, unlike Supplement 23, Supplement 30 outlines explicit details that must be included in the original proposal. Such requirements include detailed feasibility studies and a preliminary financing plan.

Secondly, the Swiss Challenge Procedure follows a two-step approval process similar to the SCARC Framework, with the first stage of approval administered by the Designated Authority.[46] The second stage of approval however is granted by the Special Committee under the Cabinet Committee on Economic Management instead of the SCARC. A key difference is that the criteria outlined by Supplement 30 for both stages of approval are more comprehensive than those listed in Supplement 23.

Finally, Supplement 30 does not classify its applicability to specific categories of projects. Instead, it states that the "guidelines shall apply to all government institutions in reviewing and evaluating development proposals presented by the private investors which are of strategic interest...". By using the phrase 'private investors', the supplement excludes the applicability of the process to Category 1 projects as specified in the SCARC framework, which do not have a private 'investment', thereby effectively excluding public sector funded projects from the Swiss Challenge process. Furthermore, this exclusion must be read together with Public Finance Circular No. 02/2019 which amended the applicability of Part II GGTP. The amendment provided more clarity by explicitly stating that Part II GGTP is only applicable to Public Private Partnerships (PPPs) and by introducing a comprehensive definition for a PPP project. The definition explicitly stated that Part II GGTP is not applicable to public funded projects.[47]

In 2019, the Swiss Challenge Procedure was abolished via a letter dated 25th September by the Secretary to the Treasury. The letter states that the Swiss Challenge was "not practical and that there are deficiencies in the procedure whilst it takes a considerable time to evaluate the project proposals". Thus, the procedure governing unsolicited proposals reverted to Part II GGTP established in 1998. It is notable that this was a temporary measure that was only contemplated until a new mechanism was introduced. At the time, the Ministry of Finance, along with the newly established NPC, were in the midst of approving a new PPP guideline. However, with the 20th amendment to the constitution made by the new government that came to power in November 2019, the NPC was abolished, and the new guidelines were never introduced.

With these changes, the regulatory framework governing the public funded projects appears to have reverted to PG 2006, which is silent on USPs and where deviations from the normal procurement process is allowed only under extraordinary circumstances. However, when read together with amended Part II GGTP, which categorically excludes public funded projects from its ambit, the emphasis is that Sri Lanka's procurement framework contemplates entertaining USPs only with respect to PPPs. As mentioned in section 2.1.1. this is in line with the practice elsewhere in the world, where USPs are widely used within the context of PPPs.

46. The Designated Authority includes the secretary to the line Ministry and the Head of the relevant Government Institution.

47. The circular excluded among other projects, any project where the GoSL provides a direct sovereign guarantee to the lending institution of the private investor's debt and Projects where the GoSL procures an infrastructure asset under traditional procurement methods using public funds, loans, grants, gifts, donations, contributions or similar receipts. (In a PPP, the GoSL procures the infrastructure services and not the asset, which typically will be transferred after the expiry of the long-term concession period). See Amendment to Guideline 225, Public Finance Circular No: 02/2019, at http://oldportal.treasury.gov.lk/documents/10181/49383/PFD-2019-02.pdf/ d613748e-370b-46dd-99cf-357b788d0908?version=1.0, [Last accessed on 26 November 2020], p. 3.

3
The Case Study

This section of the report analyses the origin and the evolution of the Gampaha, Attanagalla, Minuwangoda Integrated Water Supply Scheme (GAMWSS), that was awarded to a company that submitted an unsolicited proposal (USP). The proposal did not go through the standard procurement process but approval to proceed with the USP was granted based on the recommendation of the SCARC. The USP was submitted by the China Machinery Engineering Corporation (CMEC) in 2010. The contract for GAMWSS was awarded to the CMEC for USD 229.5 million in 2013, upon the approval of the Cabinet of Ministers and based on the recommendation of the SCARC. The funding for the project was secured by the National Water Supply and Drainage Board of Sri Lanka (NWSDB) through loans taken from the China Development Bank (CDB) (USD 195 million) in 2016 and the Bank of Ceylon (BOC) (USD 34.5 million) in 2017 with guarantees from the Treasury.[48] The NWSDB is the implementing agency of the project.

The objective of the case study is to examine how the special framework functioned in practice with respect to public sector infrastructure projects and whether the special framework achieved its intended objectives, i.e., improving the rigour of the evaluation process, accessing export credit lines of emerging economies, and expediting the implementation of priority projects.

The analysis finds that the lax application of the provisions introduced by the special framework led to the government failing to achieve its intended objectives. First, the evaluation process lacked rigour due to the relaxed application of the criteria introduced by the framework to guide the decision-making process, and the failure to conduct the minimum due diligence required prior to the awarding of the contract (i.e., completing the feasibility studies, environmental impact assessments, and obtaining the related approvals). Second, the government failed to obtain a preferential export buyer's credit line from the EXIM Bank of China due to lax application of the conditions attached to funding (i.e., securing a firm commitment on funding prior to awarding the contract). Third, the project completion was delayed by more than seven years.

In addition to failing to meet the intended objectives, the government also agreed to pay the CMEC a price 33.4% higher than the total cost estimate of the NWSDB engineers. Further, the GAMWSS exposed the hidden debt problem relating to Chinese loans, where the loans were taken out of the books of the central government and hidden in the books of the SOEs, despite the final liability of paying these debts ultimately falling on the central government.

48. Ministry of Finance and Mass Media, *'Note to the Cabinet: Gampaha Attanagalla, Minuwangoda Integrated Water Supply Project'*, 21 May 2018.

3.1. Chinese funding for water infrastructure

The NWSDB's main functions are to provide safe drinking water and to facilitate the provision of sanitation. Funding for most large-scale water supply projects implemented by the NWSDB is secured from external sources. Discussions with senior officials from the NWSD revealed that the NWSDB faced challenges in securing concessional financing from traditional multilateral and bilateral sources of finance such as the ADB, World Bank and JICA.[49] As a solution to this problem, and under the guidance of the Ministry of Finance (MOF), from 2010 onwards the NWSDB utilised funding that came along with USPs mainly from China. The USPs submitted in 2009/2010 by the CMEC for two projects appear to mark the entry of China (and the CMEC) into the water sector in Sri Lanka. These two projects were the Greater Kurunegala Water Supply and Sewerage Project (GKWSSP) funded by the China EXIM bank and the GAMWSS funded by the CDB.

From there onwards, China became an important source of funding for water projects in Sri Lanka. For example, in 2018 the Ministry of Water Supply stated that it had earmarked nine projects to be implemented with funding from China.[50] Information collected by Verité Research from the External Resources Department (ERD) about external finance secured for infrastructure during 2005-2019 further confirms this trend. Between 2005-2009, there had not been any funding for water projects from China, but between 2010-2019, Sri Lanka had earmarked or implemented 11 water projects worth over USD 1.4 billion with Chinese funding. Further, China had also been a source of funds for relatively large water supply projects. For example, during the 2010-2015 period, SCARC approved ten public sector funded water infrastructure projects.[51] While only three of these projects originated from China, they accounted for 60% of the value of the ten projects approved by the SCARC. The other seven projects were funded by Austria, Belgium, and France.[52]

3.2. The objectives, origin and evolution of the GAMWSS

3.2.1. Objective of the Project

Hailed as the largest water purification plant in Sri Lanka at the time, the GAMWSS was expected to cater to the growing demand for pipe-borne water in the Gampaha, Attanagalla and Minuwangoda areas, which could not be met by existing schemes due to their limited capacity. As a result of the rapid increase in the population of these areas, the demand for pipe-borne water was estimated to increase from 12,000m3/day in 2010 to 79,500m3/day by the year 2030.[53] The GAMWSS was designed to provide clean drinking water to approximately 400,000 beneficiaries in Gampaha, Attanagalla, and Minuwangoda. Of the beneficiaries, 300,000 were expected to get new water connections and 100,000 were expected to benefit from improvements to the existing connections.[54]

49. KII with NWSDB officials conducted on 11th April 2022 and 24th June 2022.
50. Ministry of City Planning and Water Supply, *'Observations of the Ministry of City Planning and Water Supply Note to the Cabinet dated 21.05.2018'*.
51. Based on data collected by the External Resources Department and the Ministry of Finance.
52. RTI filed with the Department of Public Finance dated 10 February 2022.
53. Ministry of Finance and Mass Media, 'Note to the Cabinet: Gampaha Attanagalla, Minuwangoda Integrated Water Supply Project', 21 May 2018.
54. Website of the Parliament, Sri Lanka, '*Annual performance report of Ministry of City Planning and Water supply 2017*', p.43 at https://www.parliament.lk/uploads/documents/paperspresented/performance-report-ministry-of-city-planning-water-supply-2017.pdf, [Last accessed: 09 May 2022].

3.2.2. Origin of the Project

The NWSDB received an unsolicited conceptual proposal from the CMEC to implement the GAMWSS in 2010,[55] along with a letter of intent issued by the CDB to grant a credit line for GAMWSS[56] and an endorsement letter issued by the Chinese Embassy.[57] As was the common practice of Chinese SOEs, CMEC had submitted the proposal for a project that was already identified by the NWSDB. For example, in 2008 the NWSDB had listed the project among the organisations' list of proposed projects.[58] However, at that time, the project appeared to still be in the early stages of development, as the complete project cost had not yet been estimated and the feasibility studies had not been carried out.[59]

3.2.3. Initial review and approval of the conceptual proposal

The Project Assessment Committee (PAC) reviewed the conceptual proposal submitted by the CMEC in June 2010. In its report, the PAC noted that the CMEC had limited experience with water supply projects and the qualifications listed were that of an associate company, the Tiajin Water – Industry Engineering & Equipment Co. Ltd (TWIEE). Hence, the PAC noted that the project should only be implemented jointly, by both these companies.[60]

The NWSDB submitted the project concept note for the approval of the National Planning Department (NPD)[61] and SCARC[62] in July 2010. It is important to note here that the total cost of the project which was submitted for NPD approval in July 2010 was just LKR 10,675 million (USD 94 million),[63] which amounted to just 32% of the final contracted value of the project (which was LKR 33,060 million or USD 229.5 million). Based on the recommendation by SCARC, the Cabinet of Ministers approved the request for technical and financial proposals from CMEC on 31st July 2010.[64]

The Ministry of Water Supply and Drainage (MOWSD) signed a Memorandum of Understanding (MOU) with the CMEC on 15th November 2010. According to the MOU, the CMEC was to submit the technical and financial proposals by 31st January 2011. The MOU does not refer to funding from CDB, and states instead that the parties will support each other to secure "preferably a concessional loan from EXIM Bank of China".[65] This suggests that the initial funding offer from the CDB had been rejected during the approval process, and a request had been made to secure a loan from the EXIM Bank of China in its place. It also indicates that at the time of signing the MOU, there was no firm commitment from the EXIM Bank of China to provide funding for the project. Despite the lack of a firm commitment on funding, and without having seen technical and financial proposals from the CMEC, the MOWSD agreed in the MOU not to "solicit or initiate any proposals or

55. National Water Supply and Drainage Board, *'Memorandum of Understanding of Gampaha, Atthanagalle, Minuwangoda Integrated Water Supply Project'*, received through an RTI filed to National Water Supply and Drainage Board, 29 November 2021.
    National Water Supply and Drainage Board, *'Annual report 2010'*, p.55 at http://ebis.waterboard.lk/documentation/it/Annual_Report_2017/Annual_%20Report_2017_English.pdf, [Last accessed: 09 May 2022].
56. Auditor General's Department, *'Audit Query addressed to Secretary of Ministry of City Planning and Water Supply'*, 16 January 2018, WSS/A/NWSDB/2018/AQ/01, Part 2(a).
57. Ibid.
58. National Water supply and Drainage Board, *'Annual report 2008'*, p.42 at http://www.waterboard.lk/web/index.php?option=com_content&view=article&id=56&Itemid=216&lang=en, [Last accessed 09 May 2022].
59. Ibid.
60. Auditor General's Department, *'Audit Query addressed to Secretary of Ministry of City Planning and Water Supply'*, 16 January 2018, WSS/A/NWSDB/2018/AQ/01.
61. The NPD approval was given subject to change of scope of the project to meet O&M costs.
62. National Water Supply and Drainage Board, *'Memorandum of Understanding of Gampaha, Atthanagalle, Minuwangoda Integrated Water Supply Project, 15th November 2010'*, received through an RTI filed to National Water Supply and Drainage Board, 29 November 2021.
63. Converted to USD in the annual average exchange rate in 2010 of LKR 113.1 per USD.
64. Auditor General's Department, *'Audit Query addressed to Chairman of National water supply and drainage Board'*, 31 December 2016, WSS/A/NWSDB/2016/AQ/02, Part 5(2c).
65. National Water Supply and Drainage Board, *'Memorandum of Understanding of Gampaha, Atthanagalle, Minuwangoda Integrated Water Supply Project'*, Para.3, received through an RTI filed to National Water Supply and Drainage Board, 29 November 2021.

respond to any proposals from any other party" for the implementation of the project.[66] According to the MOU, this commitment remains valid (unless both parties agree in writing to withdraw from the project) up to 77 days from the date of signing the MOU and can be further extended if there had been delays attributable to either party.[67]

3.2.4. Review and approval of the technical and financial proposals

The Technical Evaluation Committee (TEC) that reviewed the technical and financial proposals received from the CMEC submitted its report on 31st July 2012.[68] The initial price quoted by the CMEC was USD 258 million, 50% higher than the total cost estimate (TCE) of the project prepared by NWSDB engineers of USD 172 million. This engineer's estimate had factored in a 25% profit margin for the contractor as well. The TEC noted that the CMEC had quoted very high prices for certain civil works and in order to reduce these costs, the NWSDB agreed to undertake the implementation of these civil work items including the Basnagoda reservoir as a sub-contractor. The price quoted by the CMEC for this component was USD 72 million and NWSDB agreed to complete this work for USD 64 million, resulting in a saving of USD 8 million.[69]

By the time the MOWSD submitted a memorandum to the Cabinet of Ministers on 3rd September 2012, the contract price had been further reduced to USD 232.5 million.[70] This was still 35.2%[71] higher than the TCE prepared by the NWSDB engineers which already had a 25% profit margin factored into it.

The Strategic Enterprise Management Agency (SEMA),[72] an organization tasked with ensuring that SOEs and statutory boards such as the NWSDB are sustainably managed, requested the government to reconsider awarding the contract to CMEC. SEMA noted in its observations that CMEC has already caused numerous problems for the Ceylon Electricity Board (CEB) as the primary contractor of the Norochcholai Coal Power Plant.[73]

SCARC appears to have conducted a second round of negotiations with the contractor in response to a request made by the Cabinet of Ministers on 26th September 2012, to further reduce the gap between TCE and the contract price. During the meeting SCARC held on 10th October 2012, the TCE was first increased from USD 172 million to USD 197 million considering the inflation due to the delay in the project start year from 2012 to 2014 (the original TCE had assumed that the project would commence in 2012). The TCE was further increased from USD 197 million to USD 216.7 million considering the potential future appreciation of the Yuan against the US dollar. The SCARC, noting that the original TCE by the engineers had factored in a 25% profit margin, had requested the CMEC to reduce its contract price from USD 232.5 million to USD 216.7 million. However, CMEC has refused to do so citing the rapid appreciation of the Yuan and the price reduction already made from USD 258 million to USD 232.5 million. The CMEC agreed to bring down the contract price to USD 229.5 million.[74]

66. National Water Supply and Drainage Board, *'Memorandum of Understanding of Gampaha, Atthanagalle, Minuwangoda Integrated Water Supply Project'*, Para.4, received through an RTI filed to National Water Supply and Drainage Board, 29 November 2021.
67. Ibid.
68. Auditor General's Department, *'Audit Query addressed to Secretary of Ministry of City Planning and Water Supply'*, 16 January 2018, WSS/A/NWSDB/2018/AQ/01, Part 4.
69. Auditor General's Department, *'Audit Query addressed to Secretary of Ministry of City Planning and Water Supply'*, 16 January 2018, WSS/A/NWSDB/2018/AQ/01, Part 4.
70. Auditor General's Department, *'Audit Query addressed to Chairman of National water supply and drainage Board'*, 06 January 2016, WSS/A/NWSDB/2016/AQ/02, Part 5(2c).
71. The difference between the engineer's estimate of USD 172 Mn and the contract price of USD 232.5 Mn quoted by the AG in its audit query from 06 January 2016 is 34.8%.
72. The SEMA was established under Article 33 of the Constitution of the Democratic Socialist Republic of Sri Lanka to ensure that strategic state-owned enterprises are sustainably managed as autonomous, commercially viable enterprises by providing expert guidance. Both the NWSDB and CEB were among the strategic institutions that came under the purview of SEMA.
73. Auditor General's Department, *'Audit Query addressed to Chairman of National water supply and drainage Board'*, 06 January 2016, WSS/A/NWSDB/2016/AQ/02.
74. Observations of the SCARC in a meeting held on 10.20.2012 for the implementation of the Gampaha Attanagalla, Minuwangoda Integrated Water Supply Project.

Following this meeting held on the 10th of October 2012, the SCARC made a recommendation to the Cabinet of Ministers to award the contract to CMEC for USD 229.5 million. On the 09th May 2013, the Cabinet gave its nod to award the contract to CMEC based on the recommendation of the SCARC and instructed the Ministry and the External Resources Department (ERD) to work towards obtaining a preferential buyers' credit facility from the EXIM Bank of China to fund the project.[75]

3.2.5. Signing the contract and the loan agreement

On 15th May 2013, the NWSDB signed the commercial contract with the CMEC for the implementation of GAMWSS, agreeing to pay CMEC for the design, execution and completion of the works a sum of USD 229.5 million. CMEC signed the sub-contract with NWSDB for the Civil Works and the Basnagoda Reservoir on 6th October 2014. The project is listed by NWSDB in its annual report under ongoing projects funded by China for the first time in 2014. The report states that the project had commenced with opening ceremonies in five locations on 5th December 2014, and that design groups had been appointed to design the distribution and transmission pipelines and the tower and reservoir.[76]

Thus, the contract was awarded, and the implementation of the project commenced without a firm commitment from the EXIM Bank of China to fund the project. It took another three years for CMEC and NWSDB to secure the funding for the project and, contrary to the recommendation of the SCARC and the Cabinet of Ministers in 2013, the funds were secured not from the EXIM Bank of China but from the CDB. The NWSDB signed the loan agreement with the CDB on 29th August 2016, to the value of USD 195.075 million. The balance sum of USD 34.5 million was secured from the Bank of Ceylon (BOC) on 16th January 2017.[77]

3.2.6. Assessment of the project feasibility and environmental impact

Assessment of project feasibility

Multiple feasibility reports appear to have been prepared for the project and the scope and the cost of the project seemed to vary across these studies.

The concept note submitted by NWSDB in July 2010 for NPD approval states that the feasibility study for the project had been completed in 2008. However, the 2008 annual report (which usually gets published in 2009 or after) states that feasibility studies have not yet been undertaken for the proposed project. Further, on 27th August 2010, the Cabinet made a request to the Ministry to conduct a feasibility study to evaluate whether there was sufficient water in the Basnagoda reservoir to supply the proposed project, raising questions about whether a feasibility study had ever been conducted for the project until that time.[78]

According to the feasibility reports received by Verité Research from the NWSDB in response to an RTI filed, a pre-feasibility study for the project was carried out in 2011 and the report was dated December 2011. The final feasibility report for the project was dated May 2013, the same month the contract was awarded to the CMEC.[79] In addition, a technical feasibility report for the

75. Ministry of Finance, *'Letter addressed to Ministry of Water supply on the memorandum on 11th April 2013 seeking approval to award the contract to CMEC to implement GAMWSS'*, 22 May 2013, received through an RTI filed to with office of Cabinet of Minister and subsequently transferred to the Ministry of Water Supply on, 22 October 2021.

    Prime Minister's Office, 'Minutes of the meeting of the Cabinet Committee on Economic Management (CCEM)', 01 February 2017, received through an RTI filed to with office of Cabinet of Minister and subsequently transferred to the Ministry of Water Supply on, 22 October 2021.

76. National Water supply and Drainage Board, *'Annual Report 2014'*, p.51 at http://ebis.waterboard.lk/documentation/it/Annual_Report_2014/3-NWSDB%20AR-2014%20English.pdf, [Last accessed 09 May 2022].
77. Ministry of Finance and Mass Media, 'Note to the Cabinet: Gampaha Attanagalla, Minuwangoda Integrated Water Supply Project', 21 May 2018.
78. Auditor General's Department, *'Audit Query addressed to Secretary of Ministry of City Planning and Water Supply'*, 16 January 2018, WSS/A/NWSDB/2018/AQ/01, Part 1.
79. National Water Supply and Drainage Board, 'Feasibility Study May 2013', received through an RTI filed to National Water Supply and Drainage Board, 29 November 2021.

Basnagoda Reservoir dated July 2014 was carried out to assess the ability of the reservoir to supply water to the areas identified in the GAMWSS project.

Further, the scope of the project that was finally contracted in 2013 appears to be very different in scope to that which was approved by the NPD in 2010. The project scope had expanded substantially from the time of the first feasibility study that NWSDB claims to have been done in 2008 to the time the final feasibility study was completed in 2013. The project that was submitted for NPD approval in July 2010 had an intake capacity of 67,500 m^3/day and a water treatment plant of 22,500 m^3/day. In contrast, by May 2013, the project had an intake capacity of 85,000 m^3/day and a water treatment plant with a capacity of 54,000 m^3/day.[80] The cost of the project had also increased by 153%, from LKR 10,675 million (USD 94 million[81]) quoted in the concept note submitted to the NPD in July 2010 to LKR 26,957 million (USD 197 million[82]) in the final feasibility study conducted in May 2013. The contract with CMEC was signed in the same month that the feasibility study was completed, for LKR 33,060 million (USD 229.5 million).[83]

Assessment of the environmental impact of the project

The concept note submitted by the NWSDB to the NPD for its approval dated 08 July 2010 states that the project does not require an Environment Impact Assessment (EIA) as it is not a prescribed project.[84] However, this research reveals that this to be inaccurate.

The Basnagoda reservoir, which is a central component of the project and the key source of water for the project required an EIA. The Central Engineering Consultancy Bureau (CECB), the entity that prepared the EIA for the Basnagoda Reservoir has published a cover page of the EIA on the company's website, which states the start date of the EIA as November 2010 and the end date as September 2013.[85] The complete report is not available and there is no information to ascertain whether this EIA report which was completed in 2013 was submitted to Central Environmental Authority (CEA).

The CECB is a fully state-owned enterprise of the government of Sri Lanka and at the time was attached to the Ministry of Irrigation and Water Resource Management, the same Ministry that initiated the GAMWSS. When contacted, an official from the CECB stated that the dates given on the cover page published on their website to be inaccurate, and that the EIA contract period was from November 2013 to September 2016.

The EIA report that Verité Research received from the CEA in response to an RTI filed for the EIA of the GAMWSS was dated August 2016 (the same month the loan agreement with CDB was signed) and was also conducted by CECB. The CEA approved the project on 9th December 2016.[86]

80. National Water Supply and Drainage Board, 'Concept Note to National Planning Division', 8 July 2010, received through an RTI filed to National Water Supply and Drainage Board, 29 November 2021.
National Water Supply and Drainage Board, 'Feasibility Study May 2013', received through an RTI filed to National Water Supply and Drainage Board, 29 November 2021.
81. Converted to USD in the annual average exchange rate in 2010 of LKR 113.1 per USD.
82. Auditor General's Department, *'Audit Query addressed to Secretary of Ministry of City Planning and Water Supply'*, 16 January 2018, WSS/A/NWSDB/2018/AQ/01, Part 4.
83. Auditor General's Department, *'Audit of the Financial Statements of the Gampaha, Attanagalla and Minuwangoda Integrated Water Supply Scheme for the year ended 31 December 2015'*, 2017 at http://www.auditorgeneral.gov.lk/web/images/audit-reports/upload/2015/Projects_2015/4-xv/Gampaha-Attanagalla-and-Minuwangoda-E.pdf, [Last accessed: 20 May 2022].
84. The EIA framework is governed by the National Environmental Act No. 47 of 1980 (NEA) and the Coastal Conservation Act No. 57 of 1981. Prescribed projects are all projects that have been specifically prescribed to apply the impact assessment framework of the NEA by the Minister of Environment based on magnitude and location of implementation.
85. Central Engineering Consultancy Bureau (CECB): Natural Resources Management & Laboratory Services, *'Assignment Name – Basnagoda'*, 2017 at http://crdcecbsl.lk/wp-content/uploads/2017/03/7Assignment-name_basnagoda.pdf, [Last accessed: 20 June 2022].
86. Central Environmental Authority, 'Proposed Basnagoda Reservoir Environmental Impact Assessment – Approval', 09 December 2016, received through an RTI filed to the National Water Supply and Drainage Board, 29 November 2021.

3.3. Allegations and investigations

As mentioned in Section 2.2, the government scrapped the SCARC and the special framework in 2016. Further, the newly elected government initially decided to halt all projects initiated through unsolicited proposals by the previous government but later relaxed this stance.[87] The government decided to proceed with certain projects to which commitments had already been made, based on the recommendations of the Cabinet Committee on Economic Management (CCEM). GAMWSS was one of the projects the CCEM approved to proceed with on 24th June 2015.[88] However, the MOF requested the line Ministry to stop any work carried out until funds were secured for the project.[89] It noted that the contractor had commenced and completed 6% of the work on the ground[90] without securing any funding.

In 2016, the Auditor General's Department carried out an investigation of the GAMWSS. The Auditor General's Department raised concerns over 1) the higher cost of the contract awarded when compared to the estimated cost, 2) awarding the contract to a company that lacked experience in water projects, 3) awarding the contract without a firm commitment of funds and 4) commencing work and making payments without securing funds (despite the contract stating that the contract will be effective only after funds are secured).[91]

The above concerns were raised by several parties, including the Auditor General's Department, in 2017 and 2018 as well. The former President Chandrika Bandaranaike Kumaratunga, whose hometown is Attanagalla had also written to the Prime Minister, the Minister of Finance and the Attorney General, drawing their attention to the concerns raised by the Auditor General in relation to the project; and requesting them to take necessary action.[92]

In response to the letter received from the former President Chandrika Bandaranaike Kumaratunga, the Attorney General in a letter dated 16th May 2018 requested the MOF to take action to 1) assess and evaluate the work done by the contractor, 2) calculate the monetary payments made, 3) ascertain whether the contractor has caused undue delays in performing the contract, 4) whether liquidated damages have been levied by NWSDB on such delays, and to submit a note to the Cabinet of Ministers for their consideration along with the four reports produced by the Auditor General's Department on GAMWSS. Based on this evidence, the Attorney General indicates that the Cabinet of Ministers had two options: termination of the contract, or a renegotiation of the contract terms. The letter also states that legal action must be taken against the officials who were involved in squandering public funds. It also requests the MOF to lodge a written complaint with the Commission to Investigate Allegations of Bribery or Corruption (CIABOC), as the available material discloses an "element of corruption by public officials".[93] The former President Chandrika Bandaranaike Kumaratunga alleged that due to corruption ongoing investigations were sabotaged by high level government officials.

In response to the complaints received, the MOF appointed a committee to review the procurement process. The committee unanimously recommended the continuation of the GAMWSS project with CMEC. The reasons given were 1) the negotiation of a new contract would delay the project by a further two years, 2) USD 99.9 million had already been

87. Ministry of Finance and Mass Media, 'Note to the Cabinet: Gampaha Attanagalla, Minuwangoda Integrated Water Supply Project', 21 May 2018.
88. Ibid.
89. Auditor General's Department, *'Audit Query addressed to Chairman of National Water Supply and Drainage Board'*, 06 January 2016, WSS/A/NWSDB/2016/AQ/02.
90. Auditor General's Department, *'Audit Query addressed to Chairman of National Water Supply and Drainage Board'*, 31 December 2016, WSS/A/NWSDB/2016/AQ/02, Part 10.
91. Auditor General's Department, *'Audit Query addressed to Chairman of National Water Supply and Drainage Board'*, 06 January 2016, WSS/A/NWSDB/2016/AQ/02.
92. Former President Chandrika Bandaranaike Kumaratunga, 'Letter to the Prime Minister Ranil Wickremasinghe: Thunokinda/Attanagalla Water Supply Project', 16 October 2017; Former President Chandrika Bandaranaike Kumaratunga, 'Report on the Gampaha, Attanagalla Minuwangoda water supply project', 11 January 2018; Former President Chandrika Bandaranaike Kumaratunga, "Report on the Gampaha, Attanagalla Minuwangoda water supply project', 09 May 2018; Attorney General's Department, *'Letter addressed to Ministry of Finance on Gampaha, Attanagalla Minuwangoda water supply project'*, 16 May 2018.
93. Attorney General's Department, *'Letter addressed to Ministry of Finance on Gampaha, Attanagalla Minuwangoda water supply project'*, 16 May 2018.

paid to the contractor, 3) cancellation would affect good relations between China and Sri Lanka, 4) cancellation can have a negative effect on future borrowings, 5) the cancellation costs would include termination charges, and 6) cancellation without default by the contractor may lead to litigation and additional costs.[94] Following the recommendations of the committee, in a note to Cabinet dated 21st May 2018, the MOF recommended the continuation of the project. However, the MOF also requested the Cabinet of Ministers to instruct the secretary to the Ministry of Water Supply to renegotiate with the CMEC, CDB and BOC citing the higher cost, unfavourable terms and conditions, and the contractor's lack of experience.[95]

In his response to the Cabinet on the observations made by MOF, the Minister of Water Supply opposed the request to renegotiate stating 1) that the financial progress of the project at the time was at 43.51% and physical progress was at 22.5%, 2) renegotiation would affect the relationship between China and Sri Lanka and 3) the negative impact on nine water and sewerage projects that the NWSDB was planning to implement with Chinese proponents and funding from China.[96]

The Cabinet of Ministers taking note of the observations made by both parties, instructed the Ministry of Water Supply to renegotiate with the CMEC, CDB and BOC and to submit outcomes to the Cabinet of Ministers for consideration.[97] Subsequent developments and discussions with officials from the NWSDB however indicate that the project proceeded as is, without any change. As of the end of December 2021, the physical progress of the project was 75.8%.[98]

3.4. Key findings

The analysis of the GAMWSS reveals that deviating from the competitive bidding process was made easier in practice by the lax application of the guidelines introduced by the special framework and the minimum due diligence requirements provided for in PG 2006. As a result, the report finds that the special framework failed to achieve its intended objectives in relation to GAMWSS, i.e., improving the rigour of the evaluation process of USPs, and accessing concessional export credit lines offered by emerging economies. In addition, the analysis finds that the lack of competition, coupled with delays and payment irregularities, led to the escalation of the project cost. Finally, the case study reveals a problem that has been identified by Verité in its previous research: the poor visibility of loans taken from China, which results from shifting loans to the books of the SOEs, despite the central government being liable to pay back these debts. These key findings are explained in detail below.

3.4.1. Deviations made easier in practice by lax application of the guidelines

As mentioned in Section 2, the special framework was introduced to ensure that USPs undergo a rigorous process of evaluation. The two-step review process, first by the Ministry and second by the SCARC, was expected to ensure that the USPs were appropriately evaluated and that the recommendations were made in the national interest of the country. The case study however revealed that in practice, the evaluation process lacked rigour and led to the recommendation and approval of deviations for projects that failed to meet even the basic requirements set out in the special framework to qualify for a deviation.

As discussed in Section 2, the special framework provides two factors to assist the Ministry/Government Agency to determine whether a project is exceptionally beneficial to

94. Ministry of Finance and Mass Media, *'Note to the Cabinet: Gampaha Attanagalla, Minuwangoda Integrated Water Supply Project'*, 21 May 2018.
95. Ibid.
96. Ministry of City Planning and Water Supply, *'Observations of the Ministry of City Planning and Water Supply Note to the Cabinet dated 21.05.2018'*.
97. Cabinet paper No. 18/1147/809/032: *Procurement Related Matters, On a note to the Cabinet dated 2018.06.21 by the Ministry of Finance Mass Media on Gampaha Attanagalla, Minuwangoda Integrated Water Supply Project.*
98. Website of Ministry of Finance, *'Progress of Mega Scale Development Projects Fourth Quarter - Year 2021'* at https://www.treasury.gov.lk/api/file/ae4f8dfe-1a2b-4cd5-bf90-e95bd78fb8e9, [Last accessed: 09 May 2022].

the country and qualifies for a deviation from the normal procurement process. It was of course, sufficient if the USP met just one of these factors listed. The first relates to the project proposal and had two conditions attached to it: 1) the importance and relevance of the proposal (it is in the project pipeline of the relevant Ministry and aligned to government strategy) and 2) the importance and relevance of the funding offer compared to available funding arrangements. This research finds that the project met the first condition, but not the second condition. The second factor relates to the project proponent and states that the proposed investor must command a reputation and know-how that is otherwise scarcely available in the field. The research finds that the CMEC did not meet this requirement.

Despite the project proposal and the project proponent not meeting the factors listed to guide the Ministry's decision, the Ministry appears to have determined that the project proposal to be exceptionally beneficial and desirable to proceed outside the normal procurement process. Further, based on the Ministry's request, the SCARC recommended, and the Cabinet of Ministers approved the request made by the Ministry to deviate from the normal procurement process.

CMEC did not command a reputation nor possess know-how that is scarcely available

The expertise of the project proponent is one of the factors that is expected to be taken into consideration, not only by the Ministry in its review, but also by SCARC. However, the analyses reveal that both the Ministry and the SCARC failed to establish that the CMEC had superior knowledge or know-how that is scarcely available in the field. Furthermore, the available official information reveals instead that at the time CMEC submitted the USP for the project, it had very limited experience in the field.

The lack of experience and expertise of the CMEC was also highlighted as a concern on numerous occasions by multiple parties. The first was in June 2010, by the Project Assessment Committee (PAC) prior to the signing of the MOU. Thereafter, the same issue was raised by the Auditor General's Department in 2016,[99] prior to the signing of the loan agreement, and again in 2018.[100] In 2017, and 2018, the former President Chandrika Bandaranaike Kumaratunga also raised the same concern drawing the attention of the Prime Minister, the Minister of Finance and the Attorney General to the findings of the Auditor General.

The PAC in 2010 concluded that the CMEC did not have the necessary experience in the water supply sector to carry out the project alone but should do so jointly with Tiajin Water-Industry Engineering & Equipment Co. Ltd (TWIEE), which possessed the relevant experience.[101] However, there is no mention of the TWIEE in the subsequent agreements signed with the CMEC and no evidence of its involvement in the implementation of the project. This was also noted by the Auditor General's Department in its claim that the TWIEE involvement if at all has no legality.[102] Verité Research also failed to find information that showed an official link between the CMEC and TWIEE. The only references which could be found online to TWIEE was in multiple online business registries which referred to a company called Tianjin Water Industry Engineering & Equipment Pty (Hong Kong Office) Limited which was incorporated on 27 March 2014 as a private company limited by shares registered in Hong Kong and was dissolved on 20 December 2019.[103]

99. Auditor General's Department, *'Audit Query addressed to Chairman of National water supply and drainage Board'*, 26 January 2016, WSS/A/NWSDB/2016/AQ/02.
100. Auditor General's Department, *'Audit Query addressed to Secretary of Ministry of City Planning and Water Supply'*, 16 January 2018, WSS/A/NWSDB/2018/AQ/01.
101. Auditor General's Department, *'Audit Query addressed to Secretary of Ministry of City Planning and Water Supply'*, 16 January 2018, WSS/A/NWSDB/2018/AQ/01, Part 2(g).
102. Auditor General's Department, *'Audit Query addressed to Secretary of Ministry of City Planning and Water Supply'*, 16 January 2018, WSS/A/NWSDB/2018/AQ/01, Part 2(i).
103. Website of HK Corporation, *'Tianjin Water Industry Engineering & Equipment PTY (Hong Kong Office) Limited'*, at https://www.hkcorporationsearch.com/companies/2067824/, [Last accessed 09 May 2022].
   Website of Crhk.guru, *'Tianjin Water Industry Engineering & Equipment PTY (Hong Kong Office) Limited'*, at https://crhk.guru/company/2067824, [Last accessed 09 May 2022].

The information provided by the ERD in 2017 in response to the concerns raised about the experience and expertise of the CMEC, although intended to demonstrate the qualifications of the company, demonstrated exactly the opposite. The ERD report which appears to have copy-pasted information from the website of the CMEC, demonstrates that the CMEC was able to secure many projects even when the company had no experience, because of the attractiveness of the concessional funding made available by China's policy banks. For example, the ERD report states that the CMEC is identified as a leading player in the "international contracting market" and has been recognized as "China's first" in several international projects. The ERD also lists a broad range of sectors as core businesses of CMEC but states that water is a non-core sector and that CMEC has only undertaken three water projects up to that time – two in Angola and one in Congo.[104]

The special framework lists "transformation of superior knowledge/knowhow that is otherwise not available through alternative arrangements" as one of the factors SCARC must consider in its review. Discussions with an NWSDB official revealed that this is not the case in general with Chinese funded projects executed by Chinese SOEs. He has experience working on projects executed by Chinese SOEs with funding from China, as well as projects conducted with funding from other lending agencies. According to him Chinese companies often implement projects by sub-contracting to others in areas that they lack experience. However, the transfer of knowledge, in his experience is the lowest with Chinese projects, compared to projects executed by other donors. According to this official, when projects were carried out by the ADB or JICA, the NWSDB engineers got to work closely with the contractors and there was active training taking place for local engineers which included opportunities to visit similar projects in other countries. In contrast, with Chinese projects, there is little interaction between the contractors and local engineers attached to the NWSDB.[105]

Approval granted without knowledge of the terms and conditions of the loan

In relation to determining the relevance and the importance of the project proposal and the funding offer, as mentioned earlier two conditions were provided to guide the Ministry in making its decision. The GAMWSS met one, i.e., the relevance and the importance of the project proposal. The project appears to have been already identified by the Ministry, and hence can be argued that it was in the project pipeline of the Ministry. Additionally, as the water sector was among the priority sectors the government had identified in its development framework and the government had a goal of providing safe drinking water to 82% of the population by 2030,[106] it can be considered a project that was aligned to the government's development strategy.

The second condition, however, was not met at the time the decision was made to proceed with the USP bypassing the normal procurement process, i.e., the relevance and importance of the funding offer compared to alternative arrangements. The initial funding offer attached to the USP from the CDB appears to have not been acceptable to the Cabinet of Ministers which instructed the Ministry to secure a preferential export buyers' credit line from the EXIM Bank of China.[107] However, at the time the approvals were given to proceed with the project, the Ministry did not have a funding offer from the EXIM Bank of China. The case study clearly shows that although on paper, the special framework required a firm commitment to suitable funding, in practice, this was not strictly enforced. The SCARC and the Cabinet of Ministers seem to have been content to

104. External Resources Department, 'Report on China Machinery Engineering Corporation (CMEC)', 13 December 2017.

105. KII with NWSDB official conducted on 11th April 2022

106. National Water Supply and Drainage Board, 'Project Concept Paper for Gampaha Attanagalla and Minuwangoda Water Supply Project, Section 3.5', 8 July 2010, received through an RTI filed to National Water Supply and Drainage Board, 29 November 2021.

107. Ministry of Finance, *'Letter addressed to Ministry of Water Supply on the memorandum on 11th April 2013 seeking approval to award the contract to CMEC to implement GAMWSS'*, 22 May 2013, received through an RTI filed to Auditor General's Department, 29 November 2021.

Prime Minister's Office, 'Minutes of the meeting of the Cabinet Committee on Economic Management (CCEM)', 1st February 2017, received through an RTI filed to Auditor General's Department, 29 November 2021.

proceed with the USP based on a mere assurance from the Ministry and the CMEC that they will work towards securing "preferably a concessional loan from EXIM Bank of China".[108] The term "preferably" indicates that there was no firm commitment by either party to even secure funding from the EXIM Bank of China. This further demonstrates the lax application of the conditions in practice. The Ministry also agrees in the MOU not to "solicit or initiate any proposals or respond to any proposals from any other party" for the implementation of the project,[109] without any firm commitment of suitable funding from a reputed lending agency, as was required by the special framework.

Contrary to the expectations of the Cabinet of Ministers at the time it gave its nod to proceed with the USP, the Ministry and the CMEC failed to secure a preferential export buyers' credit line from the EXIM Bank of China. Finally, in 2016 (i.e., six years after signing the MOU), the government had to be content with a loan from the CDB, which came at less favourable terms compared to the terms attached to preferential export buyers' credit lines offered by the EXIM Bank of China.

A comparison of the terms and conditions of funding between the GAMWSS and the Greater Kurunegala Water Supply and Sewerage Project (KWSSP), which also originated as an unsolicited proposal from the CMEC in 2009/2010 but was funded by the EXIM Bank of China, clearly demonstrates the difference. According to the International Monetary Fund (IMF), for a loan to be classified as a concessional loan, it must have a grant element of at least 35%.[110] Calculations by Verité Research revealed that the loan from the CDB cannot be classified as a concessional loan as it had a grant element of 3.58% at a 6.5% discount rate (which is the average commercial rate at which the government could raise funds at that time by issuing International Sovereign Bonds). In contrast, the loan taken from the EXIM Bank of China for the implementation of the Greater Kurunegala Water Supply and Sewerage Project was a concessional loan with a grant element of 36.61% at a 6.5% discount rate. This difference in the grant element is primarily due to the interest rate and the maturity and grace period differences between the two loans. For instance, the loan from the EXIM Bank of China came at a fixed interest rate of 2% as opposed to the loan from the CDB which carried a variable interest USD LIBOR rate of 2.95%. The loan from the EXIM Bank of China also had a longer repayment period of 20 years compared to the 15 years given by the CDB, and a longer grace period of five years compared to the three years offered by the CDB.

3.4.2. Contract awarded without conducting minimum due diligence

The public finance circular 444 issued on 4th August 2010 by the Ministry of Finance clearly states that one of the key problems the SCARC aimed to address was that of agencies seeking cabinet approval and making commitments for proposals without having conducted the proper evaluations. Hence an objective of the SCARC was to evaluate and identify proposals and to instruct the respective agencies on the proper procedures to be followed to ensure greater economic benefit to the country.[111]

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. The special framework does not provide any explicit permission for the government agencies to deviate from these procedures outlined in the procurement guidelines.

108. National Water Supply and Drainage Board, *'Memorandum of Understanding of Gampaha, Atthanagalle, Minuwangoda Integrated Water Supply Project'*, Para.3, received through an RTI filed to National Water Supply and Drainage Board, 29 November 2021.
109. National Water Supply and Drainage Board, *'Memorandum of Understanding of Gampaha, Atthanagalle, Minuwangoda Integrated Water Supply Project'*, Para.4, received through an RTI filed to National Water Supply and Drainage Board, 29 November 2021.
110. Refer to Section 2.2.3 for a detailed explanation of the grant element.
111. Paragraph 3 and 5, Public Finance circular 444 issued on 4th August 2010.

The analysis of GAMWSS, however, reveals a project that has not completed the minimum due diligence required before entering the tendering stage. For example, at the time SCARC recommended proceeding with the CMEC for GAMWSS, the project had not undergone the basic evaluations required and mandated by PG 2006 for public sector projects.

The final feasibility study was completed the same month the contract was awarded

The feasibility study for GAMWSS received in response to an RTI filed by Verité Research is dated May 2013. The contract between NWSDB and CMEC to implement GAMWSS was also signed the same month, on 15th May 2013. The AG's Department also raised concerns over the NWSDB entering an MOU with the CMEC without having completed the feasibility study.[112] This suggests that the evaluation of the technical proposal submitted by the CMEC, and the cost negotiations took place in 2012 prior to the completion of the final feasibility study of the project.

EIA approval was received after signing both the contract and the loan agreement

The EIA report submitted to the Central Environmental Authority (CEA) is dated August 2016, the same month the NWSDB signed the loan agreement with the CDB. The CEA approved the project only on 9th December 2016, i.e., almost three years after signing the contract with the CMEC and three months after signing the loan agreement with the CDB.

Resettlement action plans were carried out after signing the contract and the loan agreement

If the procurement guidelines had been followed, the resettlement activities needed to have been completed before calling for bids and signing the contract. However, the resettlement action plan for one of the key components of the GAMWSS project. i.e., the Basnagoda Reservoir, was completed in June 2017; the contract and the loan agreement were signed in May 2013 and August 2016 respectively.[113]

Assessments conducted to meet the lender's requirements

The feasibility studies, environmental impact assessments and resettlement action plans are critical documents for the planning and costing of a project, which is why PG2006 listed these as project preparedness activities that must be completed during the planning stage, before entering the tendering stage of the project. However, the timing of the feasibility and EIA reports indicate that they were not prepared as planning documents vital to determining the technical and environmental feasibility of GAMWSS or its costing, but merely as documents to be submitted to secure funding from China.

The contract with the CMEC was signed on 15 May 2013. The final feasibility study was completed in May 2013 and according to CECB, the EIA only commenced in November 2013. The expectation at the time the contract was signed was to secure preferential export buyers' credit from the EXIM Bank of China. The project feasibility study report and the environmental impact assessment report are among the supporting documents the borrowing government must submit to the EXIM Bank of China along with the business contract and the loan application to secure export buyers' credit.[114]

Compliance with the environmental laws of the country appears to be a factor that is taken into account by the China Development Bank (CDB) as well. The loan agreement, for example, states that the borrower should have complied with all environmental laws to which it may be subject, and should have obtained all material

112. Auditor General's Department, *'Audit Query addressed to Secretary of Ministry of City Planning and Water Supply'*, 16 January 2018, WSS/A/NWSDB/2018/AQ/01, Part 1.
113. National Water Supply and Drainage Board, '*Resettlement Action Plan, Basnagoda Reservoir*', 2017, received through an RTI filed to the National Water Supply and Drainage Board, 29 November 2021.
114. The Export-Import Bank of China, *'Chinese Government Concessional Loan and Preferential Export Buyer's Credit (Two Concessional Facilities)*, at http://english.eximbank.gov.cn/Business/CreditB/SupportingFC/201810/t20181016_6972.html, [Last accessed 09 May 2022].

environmental permits and authorizations.[115] However, it is evident that at the time the loan agreement was signed, i.e., in August 2016, the project EIA had not received the approval of the CEA. This raises the question of whether the CDB is lax in applying this criterion and is content to proceed based on the assurance of the borrowing government that the project is compliant with the environmental laws of the country.

In addition, considering the high costs of reneging on any signed agreements, by committing to these agreements with private companies like the CMEC and lending agencies such as the CDB before necessary approvals and permits are obtained, the government is stuck in a situation where there is little choice but for the EIA to be approved. According to a senior retired official of the CEA, this brings undue influence and pressure on the officials of the oversight agencies like the CEA to make a favourable decision within a short time period.[116]

3.4.3. Lack of competition & delays led to higher costs

Agreed contract price was 33.4% higher than the original total cost estimate

A key issue raised in relation to projects that originate as USPs is that the failure to generate competition risks project costs being higher than the cost of projects that go through a competitive bidding process. This was a concern that was raised in relation to GAMWSS by multiple parties on numerous occasions.

The original bid price of USD 258 million from CMEC was 50% higher than the total cost estimate (TCE) prepared by the NWSDB engineers of USD 172 million. In the first round of negotiations, the contract price was brought down to USD 232.5 million through negotiations and upon the NWSDB agreeing to carry out certain civil works at a lower cost (saving USD 8 million).[117]

The Cabinet of Ministers noted that it was still 34.8% higher than the engineer's estimate and sought a further reduction in the gap between the contract price and the engineer's estimate. In response to this request, the SCARC reduced the gap to 5.9%. It did so mainly by increasing the cost estimated by the engineers. The TCE was increased by 26% (from USD 172 million to USD 216.7 million) and the contract price was reduced only by 1.3% (USD 232.5 million to USD 229.5 million).[118]

The justifications given for higher price are questionable. First, the total cost estimate by the engineers was raised to USD 197 million due to inflation resulting from a change in the project commencement year from 2012 to 2014. Next, the estimate was raised further to USD 216.7 million to account for a possible 10% appreciation of the Yuan against the US dollar.[119] And lastly, when the CMEC refused to bring down the contract price, the additional USD 12.8 million was justified as a means of accounting for any unexpected physical or financial issues that may occur over the course of the project as the contract was a lump-sum contract.[120] Such contracts are known to be potentially more expensive, as the contractors tend to quote a higher price to mitigate the impact of potential unforeseen costs.

115. Section 13,16,16.5, 'China Development Facility Agreement' August 29th, 2016. received through an RTI filed to the National Water Supply and Drainage Board, 29 November 2021.
116. KII with a retired senior official of CEA conducted on 25 March 2022.
117. Auditor General's Department, *'Audit Query addressed to Chairman of National water supply and drainage Board'*, 22 December 2016, WSS/A/NWSDB/2016/AQ/02.
118. Auditor General's Department, *'Audit Query addressed to Chairman of National water supply and drainage Board'*, 22 December 2016, WSS/A/NWSDB/2016/AQ/02.
119. Auditor General's Department, *'Audit Query addressed to Chairman of National water supply and drainage Board'*, 22 December 2016, WSS/A/NWSDB/2016/AQ/02.
120. This means that "the project owner provides explicit specifications for the work and based on these specifications the contractor then estimates the costs of materials, tools, labour and indirect costs such as overhead and profit margin and provides a predetermined price which they agree to complete the project at. With lump-sum contracts, if the project's final costs are lower than the contactor's estimate, then the profit for the contractor increases. If the estimate is too low, the contractor's bottom line suffers. However, the project owner's finances are unaffected in either scenario."

     Oracle NetSuite - Joseph Clancey, "Lump Sum Contracts: Advantages, Disadvantages & When to Use", 12 April 2021, at https://www.netsuite.com/portal/resource/articles/accounting/lump-sum-contracts.shtml, [Last accessed: 09 May 2022].

The cost escalation that results from the lack of competition is evident. For example, the possible appreciation of the Yuan is a key concern because the project was to be awarded to a Chinese contractor, and funding was at the time expected to come from the EXIM Bank of China, which requires the goods and services to be purchased for the project from China.

Deviation from the competitive bidding process with the objective of securing concessional funding may be beneficial purely from a cost perspective if the cost escalation that results from the lack of competition is lower than the grant element of the loan. The maximum cost escalation threshold can be defined as the cost escalation that a project can experience resulting from, for example, a lack of competition at which point the funding for the project ceases to be concessional. In such instances, securing a loan at commercial rates where the government has the freedom to go for a competitive bidding process is more beneficial for the country. For example, if the government secured a loan from the China EXIM Bank, as it did for the Greater Kurunegala Water Supply and Sewerage Project (GKWSSP) project, which had a grant element of 36.6%, a cost escalation below that threshold would still make the funding cheaper than the options available to the government from the financial markets. The longer repayment period and the grace period offer added advantages.

However, the country ended up paying dearly for the decision that was made to proceed with the project without a firm commitment (for example, in the form of a letter of intent) from the EXIM Bank of China to fund the project. The government not only failed to secure a concessional loan from the EXIM Bank of China but also ended up with a loan from the CDB, which had a grant element of 3.58% (which is the maximum cost escalation threshold and beyond that the loan ceases to be concessional) and a shorter repayment period and grace period compared to the EXIM Bank of China.

Additionally, contrary to the expectation of the CMEC that the Yuan would appreciate by 10% against the US dollar, the Yuan actually depreciated by 9.7% during the intended project implementation period of 2014-2017.[121] Further, the loan agreement with the CDB did not have a requirement to purchase goods and services from China, further highlighting underexplored opportunities within the funding that was made available.

Project completion delayed by more than 7 years

The analysis reveals that the contractor and the government authorities had been over-ambitious about the time it would take to finalise the contract and secure funding. At the time the MOU was signed it was expected that the contract would be finalized by 30th April 2011. The TCE of USD 172 million was calculated expecting the project to commence in 2012 and be completed by 2015.

The contract however, was signed in 2013, two years later than anticipated. The project timeline as a result was revised and the project was expected to commence in 2014 and to have been completed by 2017. As a result, the total cost estimate was revised upwards adjusting for inflation and exchange rate appreciation (Yuan against the USD) from USD 172 million to USD 216.7 million.

However, the funding for the project was secured only in 2016, three years after the signing of the contract, further delaying the project's completion to 2020.[122] The project implementation experienced further setbacks and delays in 2018 due to the investigation carried out by the Auditor General's Department and the MOF. As a result, the subcontracts that came under the work commissioned to the NWSDB were halted for months until the matter was resolved.

The project implementation was further delayed due to COVID-19 and lockdowns/mobility restrictions and the project completion time was further extended to 2022.[123] As of 31st December 2021, only 75% of the project

121. Fxtop.com, '*Historical Rates USD/Yuan*',2022, at https://fxtop.com/, [Last accessed: 09 May 2022].
122. National Water Supply and Drainage Board, *'Annual report 2018'*, at http://ebis.waterboard.lk/documentation/It/Annual%20Report%202018/03.%20Annual%20Report%20%202018%20-%20English%20-%2003.pdf, [Last accessed: 09 May 2022].
123. Ministry of Finance, Department of Project Management and Monitoring, 'Progress of Mega Scale Development Projects 3rd Quarter', at https://www.treasury.gov.lk/api/file/06e140f3-2081-46d8-a8cc-9b33ea890493, [Last accessed 09 May 2022].

had been completed.[124] The current economic crisis the country is facing is likely to further delay the completion of the project.

Overall, the project completion has already been delayed by almost 7 years, with further delays anticipated. One of the key problems with extensive delays of this nature is the higher project cost.

In the case of GAMWSS, by also being a sub-contractor for the project, and by agreeing to a price lower than the price quoted by CMEC, the NWSDB took on the risk of unforeseen incidents and costs while losing the allowance to absorb possible cost escalations. For example, the initial price quoted by CMEC for the portion subcontracted to NWSDB was USD 72 million. The NWSDB, to reduce costs, took it upon itself to do this part of the project for USD 64 million.[125]

By December 2021, the selected sub-contractors for the portion initially subcontracted to the NWSDB had refused to honour their contracts due to price escalations, and according to the NWSDB these contracts will need to be re-awarded at a higher price.[126] In addition to the direct monetary costs, the delay has other indirect costs, in terms of foregone benefits. If the project had been completed as expected, 400,000 people would have benefitted from having clean, pipe borne water for the last seven years.

According to a senior official of the NWSDB, delays can prompt the contractor to request an increased payment beyond USD 229.5 million and even claim damages for the delays by referring the relevant disputes to the stipulated dispute resolution mechanisms set out in the Contract. The official also said that if the contract cost does increase beyond USD 229.5 million the increased costs may have to be borne by additional government funds. Currently, however, there are no allocations made available for such contingencies.[127]

Adverse terms & conditions, and payment irregularities further increased the cost

Adverse terms and conditions

The MOWSD according to the Auditor General's Department had agreed to pay an advance of 50% to the contractor, which was far higher than the 20% recommended by Supplement 18 to the PG 2006.[128] The justification given by CMEC, which was also accepted by MOWSD & SCARC in 2013, was that it was required to mitigate the exchange rate risks that may arise from the appreciation of the Yuan against the US dollar.[129]

It is important to note that Yuan appreciation is a unique issue that arises due to the decision taken by SCARC to proceed with CMEC with the expectation of securing a preferential export buyers' credit line from China. In reality, the government failed to secure the expected credit line and contrary to the expectations of the contractor, the Yuan actually depreciated during the period that was under consideration.[130]

Referring to the adverse terms and conditions agreed to by the Ministry, the Auditor General's Department in 2016 points out that the cost of funding was likely to be higher than other possible alternatives due to 1) the interest cost accruing as a result of the contractual obligation of the NWSDB to pay 50% as an advance to CMEC and 2) the loan conditions that include the payment of a 4% insurance premium and 0.5% management

124. Ministry of Finance, Department of Project Management and Monitoring, '*Progress of Mega Scale Development Projects 3rd Quarter*', at https://www.treasury.gov.lk/api/file/06e140f3-2081-46d8-a8cc-9b33ea890493, [Last accessed 09 May 2022].
125. Auditor General's Department, 'Audit Query addressed to Secretary of Ministry of City Planning and Water Supply', 16 January 2018, WSS/A/NWSDB/2018/AQ/01.
126. Ministry of Finance, Department of Project Management and Monitoring, '*Progress of Mega Scale Development Projects 3rd Quarter*', at https://www.treasury.gov.lk/api/file/06e140f3-2081-46d8-a8cc-9b33ea890493, [Last accessed: 09 May 2022].
127. KII with NWSDB official conducted on the 11th of April 2022.
128. Section 5.4.4, Supplement 18 to the procurement manual, 08 September 2010.
129. Auditor General's Department, *'Audit Query addressed to Chairman of National water supply and drainage Board'*, 22 December 2016, WSS/A/NWSDB/2016/AQ/02, Para 04 and 05.
130. Fxtop.com, *'Historical Rates USD/Yuan'*,2022, at https://fxtop.com/, [Last accessed: 09 May 2022].

fees.[131] In response to the concerns raised in relation to the 50% advance payment, it is important to note that it was brought down to 34% through an amendment to the contract in April 2017.[132] The insurance premium referred to by the Auditor General's Department is an additional unforeseen cost that resulted from having to settle for a loan from the CDB.

Payment irregularities

The Auditor General's Department in its investigations found that due to the NWSDB making premature payments to the CMEC, the CMEC earned interest for seven months by depositing the money (USD 34 million) in a fixed deposit at the BOC. During these seven months, the NWSDB paid interest of up to LKR 454.4 million (USD 3 million)[133] for the USD 34 million borrowed from BOC to pay the advance to the CMEC.[134]

This confusion resulted due to NWSDB being the borrower of the funds and the implementing agency of the project that pays the CMEC for the work carried out and at the same time a sub-contractor of the CMEC that gets paid by the CMEC. So, as per the main contract, the NWSDB appears to be the employer that pays CMEC, the principal contractor. As per the sub-contract, CMEC is the employer that pays the NWSDB. Due to this confusion (or the conflict of interest), the NWSDB could not withdraw money directly from BOC to carry out the work. Instead, NWSDB had to first withdraw USD 34 million from BOC and pay the CMEC, and thereafter receive the advance payment of USD 32 million from CMEC to execute the sub-contract. The USD 34 million that was paid to CMEC however had remained without being spent in a fixed deposit for seven months (from May 2017 to December 2017) generating interest income for CMEC. At the same time, for that money, the NWSDB had been paying interest to BOC.

In December 2017, the NWSDB received the USD 32 million due from the CMEC as advance payment to carry out the work sub-contracted. However, due to NWSDB not having an action plan in place to commence the work immediately, these funds were invested in a fixed deposit at BOC. However, the interest rate on the fixed deposit was lower than the rate that the NWSDB paid as interest on the loan that it had taken from the BOC to make the advance payment to CMEC.[135]

Cancelling an agreement was not as easy as entering into it

By 2018, despite the malpractices, adverse terms and conditions and higher costs, the government realised that it was too late and too costly to cancel the project. It had been five years since the contract was awarded and two years since the loan agreement was signed. One-fifth of the project has already been completed by that time and over two-fifths of the funds had already been disbursed. The cancellation risked the dispute resolution mechanism's stipulated in the contract kicking in leading to additional costs for litigation and arbitration and payment for compensation for halting without a fault of the contractor. This may result in further delays in completing the project leading to even greater increases in the project cost. The government was also worried about the negative impact that such a decision may have had on the good relationship between Sri Lanka and China, and the potential funding for other future projects. Therefore, the decision taken by the Cabinet of Ministers was to go ahead with the project but to renegotiate the terms and conditions with the contractor and the funding agencies. However, as previously mentioned, the project appears to have continued on the same terms

131. Auditor General's Department, *'Audit Query addressed to Chairman of National water supply and drainage Board'*, 22 December 2016, WSS/A/NWSDB/2016/AQ/02, Para 07 and 08.
132. Auditor General's Department, *'Audit Query addressed to Secretary of Ministry of City Planning and Water Supply'*, 16 January 2018, WSS/A/NWSDB/2018/AQ/01, Part 6.
133. Converted to USD in the annual average exchange rate in 2017 of LKR 152.5 per USD.
134. Auditor General's Department, *'Audit Query addressed to Secretary of Ministry of City Planning and Water Suppl'*, 16 January 2018, WSS/A/NWSDB/2018/AQ/01, Part 6.
135. Auditor General's Department, *'Audit Query addressed to Secretary of Ministry of City Planning and Water Supply'*, 16 January 2018, WSS/A/NWSDB/2018/AQ/01, Part 6.

and conditions, indicating either that such a renegotiation had not taken place at all or that the Ministry had not succeeded in securing better terms and conditions through negotiations.

3.4.4. Shifting loans to SOE books reduces the visibility of the overall debt

According to a report by the ERD published in 2013, the Government encouraged strategic public enterprises and corporations to raise foreign financing directly from development partners and lending agencies to expand and improve their services. The intention was to "ease the burden on the National Budget and allow the Government to allocate more resources to priority areas while adhering to the overall foreign financing exposure limit".[136] The expectation is that the SOE is ultimately responsible for paying back the loan through the income received from its operations.

The loan for the GAMWSS project from CDB was a similar arrangement. The loan agreement was not signed by the central government through the Ministry of Finance but directly by the NWSDB. As a result, like many similar loans, the loan taken by the NWSDB of USD 195 million from the CDB will not be counted as a liability of the central government but will be listed as a liability of the NWSDB in its accounts. However, this loan, like many other similar loans, was taken with a guarantee from the treasury and hence a contingent liability in the MOFs annual reports.[137] Further, similar to most other Sri Lankan SOEs that borrow with guarantees from the treasury, the NWSDB is also a loss-making entity that struggles to generate sufficient income to meet its operational cost and is hence not in a position to repay these loans. This was further confirmed by an official attached to the NWSDB who stated that the fees levied for water have not changed since 2012 and that the NWSDB cannot afford to repay loans for projects such as GAMWSS through their revenue.[138] The NPD conditional approval for the project from 28 July 2010 (with narrower scope and cost compared to the project contracted with the CMEC) also stated that the revenue generated from GAMWSS will not be sufficient to recover the operational and maintenance costs of the scheme.[139]

What this means is that despite shifting the loan to the books of the NWSDB, the final responsibility for paying back these loans falls on the Central Government. Shifting the loan amount to the books of the NWSDB helps mask the reality by enabling the government to hide the actual foreign debt burden as loans such as GAMWSS, which are taken out by institutions such as the NWSDB that are not capable of paying back these loans, are hidden from the central government foreign debt exposure.

Previous research conducted by Verité found this to be a substantial problem, especially concerning the debt the country owes to China. When the debt of SOEs is added to the Central Government debt, the debt that Sri Lanka owes to China as of 2019 increased by 60% from USD 3.4 billion to USD 5.4 billion.[140] Such opacity in foreign debt liabilities makes it all the more challenging to sustainably manage the country's growing debt burden.

136. Website of External Resources Department, '*Global Partnership Towards Development 2013*', at http://www.erd.gov.lk/images/pdf/global_partnership_towards_development_2013.pdf, [Last accessed: 09 May 2022].
137. During discussions held with officials from the NWSDB, it was stated that the repayment of the loan is split between NWSDB and the Treasury with the treasury being responsible for 75% of the payment and the NWSDB being responsible for the remaining 25%.
138. KII with NWSDB official conducted on the 11th of April 2022.
139. National Water Supply and Drainage Board," Project Concept Paper for Gampaha Attanagalla and Minuwangoda Water Supply Project ", 8 July 2010, received through an RTI filed to National Water Supply and Drainage Board, 29 November 2021.
140. Verité Research, '*Navigating Sri Lanka's Debt: Better reporting can help – a case study on China debt*', 2021 at https://www.veriteresearch.org/wp-content/uploads/2021/03/VeriteResearch_ResearchBrief_NavigatingSriLankasDebt_March2021.pdf, [Last accessed: 09 May 2022].

4
Conclusion

To finance its ambitious infrastructure development programme, the Sri Lankan government introduced a special framework in 2010 to facilitate access to export credit provided by emerging economies such as China. Alternative funding sources such as these this were considered an important means of bridging the financing gap created by the gradual decrease in concessional financing from other traditional multilateral and bilateral sources, due to Sri Lanka's transition to lower middle-income country status in 2004. The special framework functioned from 2010-2016. During this period, 26 public sector projects were approved by the Standing Cabinet Appointed Review Committee (SCARC) using the provisions of the special framework. Among these were 12 projects funded by China, which accounted for 92% of the total value of all public funded projects approved by SCARC.

Carving out a special framework was necessary because the government faced challenges accommodating such financing that originated as USPs with assurances of financing from Chinese policy banks within the existing public procurement framework. The public procurement guidelines of 2006 (PG 2006) applicable at the time had no explicit provisions for USPs, and deviations from the established procurement process was allowed only under "extraordinary circumstances". The special framework established in 2010 was designed to accommodate USPs for publicly funded projects and to provide additional reasons (other than extraordinary circumstances) that could be used to justify proceeding with USPs outside the normal procurement process outlined in PG 2006.

Even before the special framework was put in place, the government had implemented publicly funded projects that originated as USPs with the financial backing from export credit agencies. These had been implemented with cabinet approval, despite the regulatory framework governing public procurement not having provisions to entertain USPs for publicly funded projects. Hence, in addition to creating an enabling environment to accommodate USPs for publicly funded projects, the special framework was proposed to overcome the misuse of provisions in the existing framework. By instituting the special framework, the government expected to make use of this new funding opportunity, improve the evaluation process of USPs and expedite the implementation of priority projects.

However, this research found that, although proposed with laudable intentions, several weaknesses in the design of the special framework created loopholes that could be exploited or misused by the parties involved in the decision making process, which led to outcomes different from the stated objectives. First among these weaknesses was the inclusion of a vaguely defined list of reasons to justify deviations from the established procurement process. Second was the complete disregard of the cost of the funding and the grant element (which is crucial to assessing the concessionality of the loan) in determining the suitability of funding. Third was the lenient decision-making process which allowed the authorities to proceed with the USP, even if only one of the loosely defined reasons listed were met. The rigour of the evaluation process was further compromised by the discretion provided to SCARC to decide whether the USP needed to be evaluated by an independent project/technical evaluation committee. Overall, the high level of discretion vested with the officials involved in the decision-making process made the weaknesses in the framework highly vulnerable to abuse/misuse.

The GAMWSS, a project that aimed to provide pipe-borne water to 400,000 people, provides valuable insights into the application of the special framework. The contract to implement the project was awarded in 2013 to CMEC, a company that submitted a USP without going through a competitive bidding process but with the recommendation of the SCARC and the approval of the Cabinet of Ministers. The case study reveals how the flawed design of the process coupled with its flawed execution led the government to award a contract without carrying out even the minimum due diligence and to agree to pay a higher price than would have been the case had the project been procured through the standard process, to a company that had little experience and no expertise in the sector. Further, the case study shows how such frameworks fail to deliver expected outcomes due to the failure to adhere to the process outlined by the parties involved.

Despite concerns such as higher costs and the lack of experience and expertise being identified in the early stages by the committees appointed to evaluate the proposals, these had been overlooked in the approval process. Further, as mentioned by the Attorney General's Department in its letter to the MOF, the presence of "elements of corruption" was likely to be a potential reason behind the irregularities and malpractices identified in the decision-making process. As a result, the government failed to secure the expected concessional loan from the EXIM Bank of China and the expected rigour of the evaluation process was compromised by the Ministry and SCARC, which completely overlooked vital factors such as the completion of the feasibility study, environmental impact assessment, terms and conditions of the funding as well as the experience and the expertise of the company. Further, the project completion has been delayed by more than seven years. As a result, 400,000 people are still waiting for the promised water connections and the project, which was once hailed as the largest water supply scheme, may not be sufficient to meet the increasing demand for pipe-borne water resulting from the rapid urbanisation in the area by the time it is completed.

Between 2010-2016, Sri Lanka secured loans to the value of USD 5,895 million from China to finance its infrastructure. China was the leading provider of foreign loans for infrastructure development in Sri Lanka during this period accounting for 37% of the total. Over half of these funds (53%) were realised through projects that originated as USPs, which were approved by SCARC. The analysis reveals that although the special framework succeeded in tapping into the large pool of financing from China, in the process of securing these funds, the country incurred numerous additional costs. The lack of visibility of these costs can lead to an over-estimation of the benefits of such funding and an under-estimation of the actual costs.

The case study also sheds light on the ineffectiveness of the oversight processes in place. Despite the oversight institutions such as the Auditor General's Department frequently reporting on financial and other irregularities related to the project, there was no evidence of any legal action being taken against the individuals involved. This is a key factor that contributes to the recurrence of these problems. Weak and ineffective oversight makes the rewards of bypassing the processes far higher than the risks of getting caught.

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