International Monetary Fund

Sri Lanka and the IMF

Press Release:
IMF Executive Board Approves US$157.5 million in Emergency Assistance for Sri Lanka
February 8, 2005

Country's Policy Intentions Documents

E-Mail Notification
Subscribe or Modify your subscription

Sri Lanka: Letter of Intent

February 8, 2005

> The following item is a Letter of Intent of the government of Sri Lanka, which describes the policies that Sri Lanka intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Sri Lanka, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

February 8, 2005

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, DC 20431
United States of America

Dear Mr. de Rato,

Further to our letter of January 6, 2005, we would like to provide you with our latest assessment of the impact on Sri Lanka of the Indian Ocean Tsunami of December 26, 2004 and an update of our plans for relief, rehabilitation and reconstruction, as well as request a purchase under the Fund's policy for emergency assistance to support our efforts. We also want to thank you for the Fund's prompt and favourable response to our request for an extension of repurchase expectations arising in 2005, approved by the Executive Board on January 14.

The human toll of the tsunami has been enormous, with over 31,000 people dead, over 15,000 injured and 5,600 still missing and hundreds of thousands displaced. The asset losses alone is estimated at least around US$900 million (slightly over 4 percent of GDP). Our latest assessment suggests that the total reconstruction expenditure is around US$1.5 billion particularly in view of the fact that the reconstruction process should avoid vulnerabilities to natural hazards in the future. The underlying strategy has been a multi hazard risk approach during the recovery phase to ensure that communities and assets are less vulnerable to impacts of future disasters. The bulk of this expenditure is on housing and townships, transportation infrastructure, including roads, railways, and ports (US$400 million), the fisheries sector infrastructure requirements such as harbours, anchorages and related facilities (US$200 million), water supply and sanitation projects (US$150 million) and schools and hospitals building (US$120 million). In our reconstruction and recovery program which will take around 2–3 years, provisions will also be made to the coast conservation and natural resources affects as well. Substantial work has to be done in these areas.

To meet the urgent needs of those affected, the response of the government has been swift and comprehensive, supported by the assistance of donors and relief agencies. While immediate efforts have focused on the humanitarian needs of the survivors, we also aim to undertake as much as 40 percent of the required rehabilitation and reconstruction in 2005 with particular emphasis on settlements and livelihood support. With the generous support of international donors, including the IMF, we aim to undertake this work without jeopardizing macroeconomic stability or introducing changes to the prevailing trade and payments arrangements as per the provisions of Article VIII of the IMF.

The government's immediate policy response includes several initiatives to meet the humanitarian needs of the people while also safeguarding key macroeconomic objectives.

These include: (i) immediate humanitarian support to affected individuals amounting to an estimated 0.2 percent of GDP this year; (ii) a concessional refinancing scheme to ensure that funding is available for small and medium enterprises, initially set at Rs. 5 billion; and (iii) measures to ensure availability of liquidity and smooth functioning of payments and settlements systems.

The overall negative impact on GDP growth will be limited by the initiation of rehabilitation and reconstruction. However, this will lead to significant additional government expenditure in 2005. We estimate that the total fiscal cost in 2005 to be about 2¼ percent of GDP, with most of this reflected in development expenditure. While there could be some minor revenue shortfalls in some areas, we expect these to be limited to about ¼ percent of GDP. This will push the fiscal deficit this year to about 9¾ percent of GDP compared to the 7½ percent envisaged in the 2005 budget. The government expects to meet the additional expenditure on account of post-Tsunami relief, rehabilitation and reconstruction programme out of donor assistance. Additionally, external debt relief would help the government to provide fiscal space to accommodate reconstruction expenditure while containing domestic financing, making more resources available to the private sector. The government is seeking more information on the terms of possible debt relief consequent to the recent offer by the Paris Club.

At this time, we are hoping to receive enough commitment from donors in the form of grants and concessional loans, to finance this additional expenditure in 2005. As a result, we do not envisage the need to resort to financing on commercial terms. While the fiscal program for the medium term will also have to accommodate additional rehabilitation expenditure, we remain hopeful that most of it will be financed without adding to the already high debt burden of Sri Lanka.

The impact of the disaster on the balance of payments, which was already affected by high oil prices and drought before the tsunami, will also be significant. Lower tourism receipts and the need for substantially higher imports to finance reconstruction will increase the external current account deficit by about 2 percentage points of GDP, despite a likely increase in remittances. Even with an expected increase in external aid, official reserves at end-2005 are likely to be sufficient to finance about 2½ months of imports. Volatile oil prices and any adverse impact of phasing out the MFA are risks to this scenario. In this context, to support the Sri Lanka’s effort to meet the immediate financing needs without seriously depleting its external reserves, the government requests a purchase from the Fund for the equivalent of SDR 103.35 million (25 percent of quota) under the Fund’s policy on emergency assistance. In line with Fund policy on providing emergency assistance for natural disasters to PRGF-eligible countries, we request the provision of subsidies to reduce the rate of charge on these resources to concessional terms.

The measures taken by the government to help the economy withstand the shock of the recent disaster may temporarily raise the growth rate of the monetary base, our main target in the conduct of monetary policy, but we intend to bring this growth rate down gradually, to contain it at 15 percent at end of the year, in line with our GDP growth and inflation objectives. The CBSL will also continue to maintain exchange rate flexibility.

The government is committed to implementing the reconstruction strategy with full transparency and accountability and improve its communication and community participation to involve every stakeholder in the process. Towards this, the government plans to improve capacity at the District level to ensure effective coordination with donors, including NGOs and civil society. The government will ensure availability of information to all stakeholders regarding policies, aid flows, implementation procedures and outcomes with greatest transparency and accountability. Steps are also being taken to improve donor coordination and harmonise procurement practices to ensure efficient implementation.

While the immediate humanitarian needs are being addressed and major plans for reconstruction are being prepared, the government continues to pursue the policy reform agenda outlined in the 2005 budget, including improving tax administration and restructuring and improving management of public enterprises, and pursuing fiscal reform in line with the policy outlines of the Fiscal Management (Responsibility) Act. The government will continue to work closely with the IMF and looks forward to the Article IV consultation in early May 2005. During the Article IV consultation, we wish to resume discussions on the issues related to the PRGF/EFF supported program as well. The government remains committed to take appropriate action to maintain macroeconomic stability.

Yours sincerely,

/s/

Sarath L. B. Amunugama
Minister of Finance and Planning
and Governor of the Fund