

Joint SDG Fund – Component 2 – SDG Financing

Template for the Joint Programme Final Progress Report (preparatory funding)

Purpose: to provide the UN Joint SDG Fund’s donors with evidence that preparatory funding provides good value for money - so that we can continue allocate resources to your programming.

Instructions: be succinct and to the point; emphasize only results and issues that you want to bring to the attention of the Fund; do not go over the max number of pages.

Deadline: January 31st, 2021

Cover page

Reporting period: June 30 – December 30, 2020

Country: Sri Lanka

Joint Programme (JP) title: Supporting the Government of Sri Lanka to develop and issue an SDG Programmatic Bond to finance high-priority social and economic projects

Short title: Sri Lanka SDG Programmatic Bond (SPB)

List of PUNOs: UNDP, UNICEF, WFP

RC (name): Hanaa Singer

Representative of Lead PUNO (name and agency): Robert Juhkam, UNDP

Government JP Focal Point (name and ministry/agency): RMA Ratnayake, Ministry of Finance

RCO JP Focal Point (name): Azam Bakeer Markar **E-mail:** azam.bakeermarkar@un.org

Lead Agency JP Focal Point (name): Faiza Effendi **E-mail:** faiza.effendi@undp.org

Budget (Joint SDG Fund contribution): 200,000 USD

Budget Expenditures: USD 49,277.14

Delivery Rate - *Prep Funding Rate (%)* = $\frac{\text{Expenditures PUNO}}{\text{Total transferred funds Jan 2020 to December 2020}}$: **24.6%**

Short Description of the Joint Programme (1 paragraph for each section)

This description will be used to update your country page in our online platform (please scan the website before answering) <https://sdginvest.jointsdgfund.org/proposals>

Financial leverage (estimated target in US\$): N/A

Challenge:

Explain the key challenge(s) the JP aims to tackle with reference to both development and financing challenges and how they interconnect.

Sri Lanka has made a strong commitment to meeting the SDGs. But the path to attainment poses considerable challenges. Even prior to COVID-19, the country faced a significant financing gap on the goals, estimated at around 4.1 percent of GDP,ⁱ and likely exacerbated by the pandemic. The primary challenge is a weak fiscal position underlined by low revenues, a high public debt burden and low efficiency in public spending. Sri Lanka's revenue collection is one of the lowest among emerging market economies, averaging just 13 percent of GDP over the last decade, compared to an emerging market economy average of 27 percent. An even greater concern is the debt burden. Total public and publicly guaranteed debt topped 92 percent of GDP in 2019; it is likely to breach 100 percent in 2020-2021 and remain at elevated levels over the medium term. A high debt burden with significant debt service costs constrains fiscal space, particularly for social and economic investments. The Government has spent on average 5.2 percent of GDP in interest payments over the last five years, the largest single item of government expenditure,ⁱⁱ even surpassing civil service pay. Insufficient, inconsistent spending on social and economic sectors has led to little progress across the SDGs. Low revenue collection together with the high debt burden further shrinks the fiscal space for SDG related investments. An SDG programmatic bond as a debt neutral instrument aims to expand the fiscal space for spending aligned to the SDGs.

Innovation (financial instrument/mechanism/approach):

Summarize the financial mechanism(s) proposed and why the approach is different from conventional and/or alternative approaches and how it is fit for purpose to address the challenge described above.

The SPB is a model not yet used in financial markets in Sri Lanka. Implementation in Sri Lanka would mark a first. It innovatively combines multiple pathways (refinance/swap and public finance

optimization) to open fiscal space for social and economic sector investments furthering the SDGs. Traditional instruments such as debt swaps have focused mostly on one pathway, while instruments such as green bonds have emphasized traditional debt-financed interventions that are not debt neutral. The SPB's intertemporal nature is also innovative. It not only opens fiscal space in the near term for high-priority socioeconomic investments, but also sets the stage for future fiscal space generation that would allow sustained investments in achieving the SDGs. Higher accountability stemming from the medium-term spending plan embedded in the SPB offers a new and potentially more powerful way to attract private investors and help free government resources for responsible SDG investments. The SPB also forms a model that is highly replicable and scalable and can be pegged to multiple SDG driven development solutions.

SDG Impact:

Please describe the development impact the JP aims to achieve. Do not list the SDGs.

Generating additional fiscal capacity to finance development is critical for all SDG targets, but specifically, under SDG 1, the Joint Programme will contribute to development financing to end poverty. It will increase expenditure on social and economic sectors as a share of GDP, and support investments critical to reducing inequality in line with SDG 10, such as in nutrition, social protection, gender equality and climate vulnerability. By improving long-term debt sustainability, against a background of Sri Lanka's high indebtedness and the imperative of COVID-19 recovery, it will advance SDG 17.

Partners:

Please list key partners involved in implementation as well as secured investors. Do not mention more than 4-5 partners. Do not mention generic stakeholders (e.g. Government, private sector), but only specific institutions/partners.

Prime Minister's Office, Ministry of Finance, Central Bank of Sri Lanka

Final Progress Report (MAX 3 PAGES)

1.1. Progress achieved

Provide brief description of the project's developments, results and achievements during the preparatory phase including 1) financial vehicle design; 2) market assessment; 3) feasibility study; 4) pipeline assessment; 5) legal assessment; 6) investor mapping and matching; 7) others. Please list the names of strategic documents developed (if any).

An expert consultancy (UNDP Senior Economist) was sourced in designing the SPB. The SPB is a unique SDG-aligned sovereign bond. It links two elements of a financing solution on one platform geared towards solving pressing socioeconomic issues and supporting COVID-19 recovery. As per the SDG Dashboard, Sri Lanka's performance has been deteriorating against one of every three SDGs. With visible deterioration on issues related to biodiversity, land degradation, nutritional outcomes across the lifecycle, sizeable social protection errors, climate vulnerability and water security. Based on these identified priorities, a pipeline of portfolio of 1 Billion USD is created where all the solutions for the interventions will be given simultaneous priority. In order to assess the feasibility of the said pipeline, especially in the areas of environment, UNDP's Climate and Environment Team provided support in terms of cost estimates for development solutions aligned with national priorities, while UNICEF's Innovation Manager facilitated engagement with JP Morgan to gauge investor interest. UNDP and UNICEF jointly completed a debt profiling exercise to obtain a better understanding of the country's fiscal space, while UNDP is also in the process of completing an additional study on the country's national planning and financing architecture to inform the design of the SPB.

1.2. Challenges faced

Did the UNCT face any major challenges in the preparatory phase? Briefly explain the challenges, their impacts, and how you overcame those.

- (i) Moody's Investor Relations and Fitch ratings downgraded Sri Lanka's international credit rating two notches from B2 to CAA1 and B- to CCC respectively in 2020. This led the team to calibrate the proposal to suit the new realities mid-way through development. This also meant building on UN agency existing relationships with the SIM to broker new connections for Sri Lanka, support a high-quality investment case and help structure the SPB. Increasingly, large institutional investors have moved into sustainable investments boding well for the SPB. They could still factor-in country specific macro-economic factors and associated risks in influencing their pricing decisions. However, Sri Lanka has an exemplary record on servicing its external debt obligations: the sovereign has never defaulted. This track record would serve as a risk mitigant. Further de-risking could be achieved by underwriting arrangements as facilitated by the JP.
- (ii) Due to the parliamentary elections in August 2020, the government institutional architecture was still in the process of being finalized, and with the COVID-19 pandemic, it limited the capacity of the Government administration to develop and roll out the bond. There was also a high level of unfamiliarity with this financial instrument given its innovative nature in the Sri Lankan context. Therefore, in order to sustain high-level commitment, continuous "hand-holding" support to carry out required interventions,

considering the placement of “resident” advisors in respective ministries or line agencies, periodic updates to ensure Government has adequate notice of issues that arise, allowing for timely redress are some of the interventions carried out to overcome this.

- (iii) In the absence of an overarching, costed National Development Plan, it was challenging to target specific interventions for SPB support. Proposed areas are in line with the New Government’s policy framework and may be further elaborated, if the proposal is approved by the SDG Fund.

1.3 Partnerships leveraged

Did you leverage new partnerships during the preparatory phase (e.g. government, private investors, IFIs, bilateral/multilateral banks, etc.)?

- Yes
- No

Provide in bullet points the main highlights on strategic partnerships and with whom.

The introduction and conceptualisation of the SPB required the widening of the existing partner base and engaging with new actors within Government. New partnerships were formed and deepened with the Ministry of Finance and the Central Bank of Sri Lanka. The process also involved in-depth consultations with organisations such as Morgan Stanley who reviewed and provided feedback on the proposal. The RCO also engaged with the World Bank in country as part of this process.

In addition, the PUNOs involved – UNDP, UNICEF and WFP – together with the RCO further strengthened interagency collaboration and synergies. Beyond the development of the SPB itself, the proposal provided an opportunity for UNICEF and WFP to engage in detailed discussions with line ministries (Ministry of Health and Ministry of Agriculture, respectively) related to the programmatic interventions proposed.

1.4. Co-funding mobilized

Did you secure additional funding or in kind support for the proposal during the preparatory phase?

- Yes
- No

If yes, please include amounts committed during the prep-phase.

Source of funding	Yes	No	Type? (\$ or in kind support)	Name of organization	Amount (USD)	Comments
Government	<input type="checkbox"/>	<input type="checkbox"/>				
Donors/IFIs	<input type="checkbox"/>	<input type="checkbox"/>				
Private sector	<input type="checkbox"/>	<input type="checkbox"/>				

UN/PUNOs	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<i>In Kind</i> \$	UNICEF WFP UNDP	1200 (US\$ 16,000 prep funding) & And US\$ 16,000 from WFP \$13,500	<i>For intern support</i> The Multi-scenario costing analysis of rice fortification is being co-funded by WFP (matching funds from DSM (private sector) Expert Editor for consolidation of interagency inputs
Other partners	<input type="checkbox"/>	<input type="checkbox"/>				

1.5. Budget changes (if relevant)

If there were changes in the actual budget from the one shared as part of the Fund Transfer Request, please briefly justify these changes.

Please, explain briefly:

No changes in the actual budget from the one shared as part of the fund transfer request.

ⁱ Calculations based on IMF April 2019

ⁱⁱ Under economic classification of government expenditure.