



Country Partnership Strategy

October 2008

Sri Lanka
2009–2011

Asian Development Bank

CURRENCY EQUIVALENTS

(As of 31 August 2008)

Currency Unit	–	Sri Lanka rupee/s (SLRe/SLRs)
SLRe1.00	=	\$0.01
\$1.00	=	SLRs107.89

ABBREVIATIONS

10YDF	–	10-Year Development Framework
ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
CAPE	–	country assistance program evaluation
CBOs	–	Community Based Organizations
CCPI-N	–	New Colombo Consumer Price Index
CEB	–	Ceylon Electricity Board
CPI	–	Corruption Perception Index
CPS	–	country partnership strategy
CSP	–	country strategy and program
DEC	–	Development Effectiveness Committee
EA	–	executing agency
ESD	–	Environment and Social Division
ESDFP	–	Education Sector Development Framework and Program
EU	–	European Union
FBU	–	functional business units
FMRA	–	Fiscal Management Responsibility Act
FMRP	–	Fiscal Management Reform Program
GACAP II	–	Second Governance and Anticorruption Action Plan
GDP	–	gross domestic product
GSP	–	Generalized System of Preferences
HIES	–	household income and expenditure survey
IA	–	implementing agencies
ICT	–	information and communication technology
IFAD	–	International Fund for Agricultural Development
JBIC	–	Japan Bank for International Cooperation
KPI	–	key performance indicators
kWh	–	kilowatt-hours
LECO	–	Lanka Electric Company
LLDF	–	Local Loan and Development Fund
LTTE	–	Liberation Tigers of Tamil Eelam
MDG	–	Millennium Development Goal
MfDR	–	managing for development results
MLGPC	–	Ministry of Local Government and Provincial Councils
MOE	–	Ministry of Education
MOFP	–	Ministry of Finance and Planning
MOHRD	–	Ministry of Highways and Road Development
MOPE	–	Ministry of Power and Energy
MPA	–	Ministry of Ports and Aviation
MPI	–	Ministry of Plan Implementation
MTBF	–	Medium Term Budgetary Framework
MUDSA	–	Ministry of Urban Development and Sacred Areas

NEPS	–	National Energy Policy and Strategies
NETS	–	national evaluation and testing service
NGO	–	nongovernment organization
NHN	–	national highways network
NPA	–	National Procurement Agency
NRMP	–	National Road Master Plan
NVQ	–	national vocational qualifications
NWSDB	–	National Water Supply and Drainage Board
O&M	–	operation and maintenance
OCR	–	ordinary capital resources
OED	–	Operations Evaluation Department
PPP	–	public–private partnership
PRC	–	People's Republic of China
PSOD	–	Private Sector Operations Department
PUCSL	–	Public Utilities Commission of Sri Lanka
RDA	–	Road Development Authority
RSDD	–	Regional and Sustainable Development Department
SAARC	–	South Asian Association for Regional Cooperation
SBA	–	school-based assessment
SEA	–	Sustainable Energy Authority
SEMP	–	Secondary Modernization Project
SEMP II	–	Secondary Education Modernization Project II
SLEF	–	Sri Lanka Energy Fund
SLPA	–	Sri Lanka Ports Authority
SMEs	–	small and medium-sized enterprises
SOE	–	state-owned enterprise
STDP	–	Southern Transport Development Project
TA	–	technical assistance
TEU	–	twenty-foot equivalent units
TEVT	–	technical education and vocational training
UN	–	United Nations
UNDP	–	United Nations Development Programme
USAID	–	United States Agency for International Development
VAT	–	value-added tax

NOTE

In this report, "\$" refers to US dollars.

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SRI LANKA COUNTRY PARTNERSHIP STRATEGY 2009-2011



EXECUTIVE SUMMARY

Development Context

Sri Lanka has grown at an average rate of 5% over the past 30 years, and is on the point of becoming a middle-income country. It is on track to achieve the Millennium Development Goal (MDG) for reducing poverty. The country is also on track to achieve most other MDGs, as Sri Lanka's social indicators are high compared with those of countries of similar income status. However, the civil conflict that started in 1983 has prevented Sri Lanka from reaching its potential. Given the country's strong human resource base and resilient private sector, this potential is substantial. However income inequalities are high among the provinces with the conflict a particular factor in holding back the North and East. Achieving rapid and equitable growth will be vital to reducing poverty further. The main obstacles to growth include a serious infrastructure bottleneck and low productivity in key sectors of the economy.

Government Development Strategy

The goal of the Government's 10-Year Development Framework (10YDF), which emphasizes equitable growth, is to achieve rapid economic growth that benefits the entire population and leads to the social development of the country. To achieve this goal, the Government focuses on a combination of large infrastructure projects, projects linking villages to Sri Lanka's urban centers and the global markets, and measures that increase Sri Lanka's international competitiveness. The 10YDF establishes qualitative and quantitative targets. In meeting these targets, the private sector will play an important role, with the Government providing an enabling environment. While the Government has ruled out privatization to improve the performance of state-owned enterprises, it is attempting to achieve better results by modernizing management practices.

Asian Development Bank Development Strategy

The proposed country partnership strategy (CPS) for 2009–2011 will build on the successful lending and technical assistance program of the Asian Development Bank (ADB). Based on an independent assessment of the country's development challenges, ADB's strategic priorities and country expertise, and the Government's development agenda, ADB's strategy will focus on the two pillars identified in the 10YDF: (i) strengthening the investment climate, and (ii) achieving socially inclusive development. Governance, including piloting an innovative approach to capacity building, and private sector development through improvements in the investment climate are the two major crosscutting themes of the CPS 2009–2011. While faster and more equitable growth can also help in conflict resolution, the main causes of the conflict go beyond development and poverty. However, ADB's assistance, by supporting faster and more equitable growth, will also help to mitigate the impact of the conflict.

Under the first pillar—strengthening the investment climate—ADB will seek to increase the competitiveness of the private sector and the level of private sector investment by addressing the main bottlenecks—poor infrastructure and a volatile macroeconomic environment. ADB support will (i) improve macroeconomic management (streamlined expenditure management, better tax administration); (ii) introduce regulatory frameworks for private sector investments pertaining to public–private partnerships (PPPs); and (iii) most importantly, increase the provision of economic infrastructure. The ability of the public sector to catalyze private sector investment needs to be strengthened: ADB support will lead to better management of resources through stronger project implementation in the public sector, greater efficiencies in state-owned enterprises and banks, and the introduction of PPPs where possible. As Sri Lanka’s experience has shown, a PPP can be a useful tool to improve public sector efficiency. The main targets supported by ADB’s assistance will be higher private investment and upgraded infrastructure in transport and power (not only by focusing on the provision of infrastructure but also by, for example, reducing energy and water losses, and improving the efficiency of state-owned enterprises).

Under the second pillar—achieving socially inclusive development—ADB will seek to expand access to high-quality services in water supply, power, and transport; and to improve education in lagging regions. An important focus will be on introducing decentralized service delivery where possible. Targeted assistance will assist poor households in establishing links to power and water supply systems. Education assistance will establish “schools of excellence” in the poorest districts, and provide stipends for poor students. Greater community involvement in project decisions and implementation will also make the Government more accountable, and raise the “voice” of the poor.

ADB will adopt a conflict-sensitive approach for projects in postconflict and conflict affected areas. This will involve intensive stakeholder consultation and adherence to ADB’s internal operating principles.

Priority Sectors and Themes

Sectors: Energy; law, economic management, and public policy; transport and communication; water supply and sanitation, education.¹

Themes: Sustainable economic growth; private sector development; governance.

¹ Appendix 5 provides Sector Road Maps.

Financing Envelope

Indicative figures: \$100 million–\$110 million annually from ADB's ordinary capital resources; \$100 million–\$120 million annually from ADB's Asian Development Fund; and \$3 million–\$4 million in grants for preparing projects and advisory assistance. The targeted indicative total resource envelope per year is \$300 million, which ADB and the Government seek to obtain from cofinancing, through PPPs and nonsovereign loans.

Partnership Arrangements

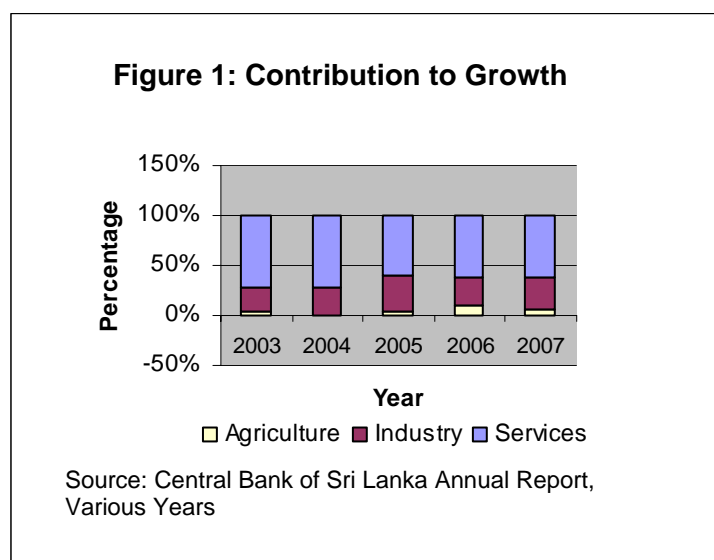
There is an active system of cooperation in place among Sri Lanka's development partners. The main Development Partner Meeting is held on a bi-monthly basis and chaired on a rotation basis by ADB, EU, UN, and the World Bank. ADB is the current chair. There are various subgroups under the main group, as well as other informal thematic groups. ADB will continue to work closely with other development partners in Sri Lanka through consultations, cofinancing, and knowledge sharing.

Risks and Mitigating Actions

The macroeconomic uncertainties and risks have increased because of the impact of high global oil prices and high inflation, in addition to the conflict. To mitigate these risks, ADB will support resource mobilization (through revenue enhancement and streamlining of expenditures), indirectly reducing inflationary pressure, and expand the links between Sri Lanka's economy and the global economy to reduce the trade deficit.

I. DEVELOPMENT CONTEXT: CURRENT TRENDS, ISSUES, AND CONSTRAINTS

1. Over the past 30 years, Sri Lanka's annual economic growth has averaged 5%, with an upward trend since 2003. This growth was achieved despite a civil conflict that started in earnest in 1983. The conflict has remained largely confined to the north and east of the country, leaving the country's commercial center—Western Province—relatively untouched. Per capita income nearly quadrupled from \$431 in 1990 to \$1,600 in 2007, the highest in South Asia after the Maldives. Economic and structural reforms that began in 1977, when the Government switched from import substitution and nationalization to policies supporting deregulation, international trade, and privatization, were largely responsible for the income growth. Government management of tea plantations was gradually transferred to the private sector.¹ Monopoly service providers in the public sector, such as the international airline, insurance company, telecommunication provider, and fuel retailer, have been exposed to international competition, privatization, and private sector management. The Government in most cases has maintained only a minority stake. In South Asia, Sri Lanka's economy is now the most open to international trade and investment.



2. The private sector now accounts for more than 85% of the gross domestic product (GDP). Some of the blue chip companies listed on the Colombo Stock Exchange are highly competitive, profitable, financially strong, and beginning to invest overseas. In the 1990s, growth was driven by manufacturing, especially garments, which now represent 45% of exports. Developed during the early 1980s, the garment sector employs about 270,000 people and produces largely for the high-end niche market. The sector is dominated by about 25 garment factories that produce 50% of total garment exports.² Since 2001, however, services—especially in telecommunications, transport (port services and distribution), and finance—have led economic growth. Agriculture and rural industries have remained stagnant, a condition associated with falling agricultural labor productivity (Figure 1). In addition, the long-running conflict, a serious infrastructure deficit, and high public debt levels have prevented Sri Lanka from reaching its substantial economic potential.

¹ The private sector was given long-term leases of the land, and the Government kept one “golden share” in each divested company.

² Garments exports grew from \$600 million in 1990 to \$3 billion in 2007.

3. While its indirect and direct economic costs have been widely debated, the conflict is estimated to shave 2 percentage points off the growth rate each year (Supplementary Appendix A).³ The conflict has also contributed to migration from the affected areas to the south. This has further reduced the already weak human capital base and reinforced a cycle of slow growth in the conflict-affected areas. In addition, the lack of development activity in recent decades means that the economy in these areas is still based primarily on low-productivity agriculture (rice cultivation) and fishing, despite the substantial economic potential, especially in Eastern Province.

4. The conflict also has a well-recognized impact on the private sector in the rest of the country and on fiscal management, because it contributes to high fiscal deficits and public debt levels. Increased defense expenditure and a larger budget deficit contribute to the crowding-out of private sector credit, while also keeping expenditure on priority economic and social services lower than it could have been. Unless the Government cuts back elsewhere or improves on its 2007 revenue performance, the fiscal deficit will be difficult to contain.

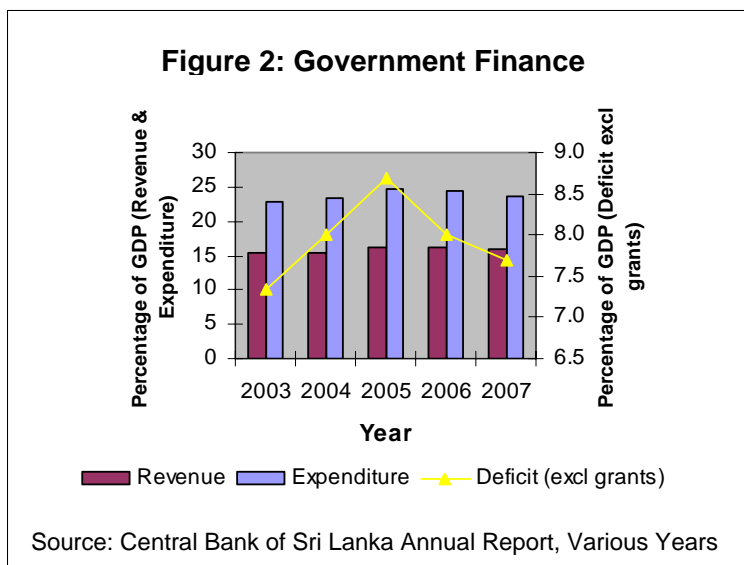
5. While the conflict has taken its toll on the economy, the context of the resurgent conflict is changing fast because of new military and other developments. Eastern Province is under Government control for the first time in 10 years, and the Government held local and provincial elections in the area in March and May 2008 respectively that were largely peaceful. Progress has been made in restoring civil administration, and new development programs are being initiated. The Government continues its military campaign against the Liberation Tigers of Tamil Eelam (LTTE) in the north, while reiterating its willingness to end the conflict with a negotiated settlement. Meanwhile, there have been more attacks on civilians in the south of the country since the start of 2008, leading to a strengthening of security measures. Civil society has expressed concerns about limits on freedom of expression, arguing that the Government perceives criticism as undermining its legitimate effort to neutralize the LTTE threat to the security and safety of Sri Lankans. Human rights violations remain a concern. Stepped-up forced recruitment of adults and children by the LTTE reportedly is continuing, as are “disappearances”, with observers implicating both sides.

6. A major bottleneck to economic growth continues to be the severe infrastructure deficit. A joint investment climate assessment by the Asian Development Bank (ADB) and the World Bank⁴ found that poor infrastructure is the biggest obstacle to private sector development in Sri Lanka. For example, poor roads reduce corporate productivity by as much as 44%, while access to the main power grid increases productivity by 25%. Where electricity is available, the cost is high and the supply unreliable, raising companies’ production costs and exposing them to frequent outages. As a result, more than 80% of urban firms own a generator—a significantly higher percentage than in the Philippines (less than 40%) and in India (less than 70%). For these Sri Lankan firms, generators cost the equivalent of 12% of their fixed assets on average. It can also cost 3–4 times as much to generate electricity with a generator. Transport is another big constraint. Nearly a third of rural enterprises cite transport as a major obstacle to starting or operating a business, a finding supported by many other studies by the Government, ADB, World Bank, and independent local think tanks. Investment in infrastructure has not kept pace with the rapid structural changes in the economy. Except for one major thoroughfare in Colombo, the capital, and a much-delayed expressway still under construction linking Colombo

³ This figure has to be interpreted carefully. Given the serious underinvestment in infrastructure and other constraints outlined in this CPS, a cessation of the conflict last year is unlikely to have raised the growth rate to 8.8% from 6.8%. However, underinvestment was caused substantially by the conflict in the past.

⁴ ADB, World Bank. 2005. *Sri Lanka-Improving the Rural and Urban Investment Climate*, Colombo.

to the south, no new major A class roads have been built in Sri Lanka since independence in 1948. The average travel speed on the country's congested or badly maintained roads is 39 kilometers per hour (km/h). Investment in power generation has stalled for almost 20 years, a trend broken only in 2006 when the current Government began to implement badly needed power generation projects. The railway system also suffers from decades of neglect.



7. Public investment in infrastructure was low for two reasons. First, the Government lacked the fiscal headroom to increase investments—it reduced capital expenditure, rather than recurrent expenditure, to contain the fiscal deficit. Second, Sri Lanka's increasingly complex political economy makes formulating and implementing decisions progressively more difficult. This complexity, as well as the poor performance by some of the contractors, has led to long delays in the implementation of infrastructure projects, even when concessional foreign funding has been available. Nevertheless, the recent improvement in the public investments is encouraging. Fiscal deficits, which ranged between 7.5% and 10.8% of GDP over the past 10 years, have been declining since 2005. The persistent high deficits were partially due to high defense spending, but low revenue collection and high spending on transfers and interest payments were at least as important.

8. The complicated parallel systems of government caused by the incomplete devolution to the provinces and the large number of ministries (now 91) create an exceedingly complex environment in which to implement projects. The situation stands in sharp contrast to the high public investment in the mid-1980s, when large hydropower and irrigation dams, which helped to raise public sector investment to 15% of GDP, were implemented quickly and efficiently. New coordinating bodies intended to streamline the decision-making process and a highly centralized Government (a few ministries control the bulk of expenditures) only partially address the fragmentation. For example, nine ministries are responsible for maintaining and planning roads. Increasing wage compression (the wage differential between the lowest rank in the civil service and a secretary) also makes retaining and attracting high-caliber people difficult. Although successive administrative reform commissions recognized this problem, they were unable to reverse it.

9. In 2008, the development challenges have taken on a new dimension, partially due to the global energy crisis and the country's complete dependence on petroleum products for its

thermal power needs. While the Government has taken bold steps in terms of fuel price adjustments (para. 11), the task of ensuring macroeconomic stability is formidable. The increase in risks stem from high inflation, pressure on the balance of payment position because of high oil and food prices, and higher external commercial borrowing by the Government to fund its fiscal deficit. Although external reserves have been increasing, they remain low at \$3.4 billion (June 2008), the equivalent of almost 4 months merchandise imports.⁵ Combined with the high fiscal deficit, this gives the Government little room to cushion the impact of these shocks.

10. Sri Lanka's public debt as a percentage of GDP, while declining mainly because of fast economic growth, remains high at 85.6%. The composition of public debt has changed, with the Government increasingly borrowing in foreign denominations on commercial terms. However, 87% of its foreign debt is still highly concessional. Borrowing by state-owned enterprises (SOEs) and banks to finance oil imports has also increased sharply since 2004, with short-term external debt and external banking sector liabilities rising by almost \$1 billion in 2007, or 3.2% of GDP.

11. While a limited amount of new commercial borrowing should be sustainable, it needs to be linked to stronger fiscal consolidation than has occurred in the past 5 years, accompanied by consistently robust economic growth. Sri Lanka has made substantial progress in increasing tax revenues and reducing the fiscal deficit since 2005. To reduce the fiscal impact of high oil prices, the Government increased electricity tariffs in April 2008 by an average of 30%, aiming to largely eliminate the need for subsidies to the power sector. However, the recent sharp global price increases have set back this objective. The Government also increased prices by a cumulative 47% for diesel and 30% for gasoline up to June 2008, largely eliminating fuel subsidies. These are important steps toward financial solvency. However, tax revenue collection in 2007 was lower than expected, and the Government also recorded budgetary payment arrears of SLR17.4 billion (2% of total expenditure). The slow fiscal consolidation and perceived Government focus on the conflict led Fitch Ratings to downgrade the country's sovereign bond rating in April 2008. Higher commercial borrowing makes Sri Lanka more vulnerable to exchange rate depreciation, which could quickly lead to a worsening in debt indicators, especially with an anticipated global downturn also threatening to slow growth in Sri Lanka.

12. In addition, the high costs of oil imports, combined with high inflation (26.6% New Colombo Consumer Price Index CCPI-N, July 2008 year-on-year), could weaken the currency, which has appreciated by 25% in real terms since 2005. At the same time, the Government might find it difficult to attract sufficient long-term concessional inflows to cover the higher current account deficit. While the Government is now relying more on short-term commercial borrowings, this increases Sri Lanka's rollover risk⁶ should perceptions of its sovereign risk increase (as it would, for example, if the LTTE attacked economic targets), or the risk appetite of global investors declines because of the fallout of the global credit crisis.

13. Thus, the external risks have increased, compounded by further signs that the global slowdown might be more profound than many had expected⁷, while domestic risks have also increased from the conflict. These risks could have a significant negative impact on Sri Lanka's economy.

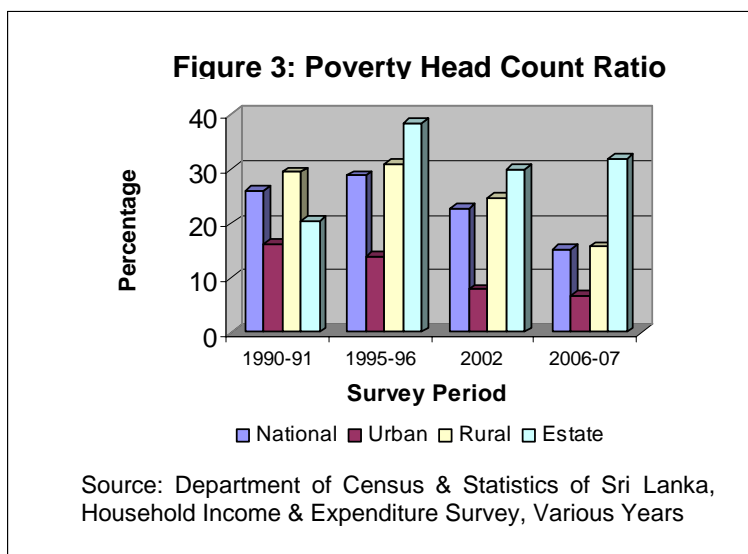
⁵ ADB staff estimates for 2008 imports.

⁶ The risk of having a large amount of short term debt that is coming to maturity, and investors being unwilling to roll over (refinance) such debt.

⁷ Bank for International Settlement. 2008. 78th Annual Report 2008. Basel.

A. Economic Growth and Poverty Reduction

14. Sri Lanka has provided free health and education services to its population since the 1930s, and its key social indicators are on par with those of countries with substantially higher income levels (Supplementary Appendix B).



15. Sri Lanka has made good progress in reducing national poverty levels, especially from 2002 to 2007. However, as income inequalities increased sharply, the impact of growth from 1991 to 2002—the last household income and expenditure survey (HIES) for which a comprehensive analysis is available on poverty reduction—was not as large as it could have been (Figure 3). National poverty levels fell by only 3 percentage points from 26% to 23% during the period 1990–2002.

16. The earlier slow pace of poverty reduction was the result of slower income growth for the poorer quintiles of the population and increasing income inequality. High poverty levels are linked to the lack of access to infrastructure and education, and the type of employment.⁸ The poorest usually work in primary employment⁹ and in the informal service sector. Children of poor families also drop out of school much earlier than children of nonpoor families, as parents see little merit in letting them continue; the quality of education in remote areas is poor and has deteriorated, with much lower pass rates in Advanced level (final year of schooling) and Ordinary level (11th year of schooling) exams. In such circumstances, pulling a child out of school is a rational choice, but it also perpetuates poverty in a family. Intergenerational educational mobility in Sri Lanka, perhaps as a result, is unusually low.¹⁰

17. However, the HIES 2006/07 published in March 2008 shows a substantial drop in national poverty levels to 15%, as well as a decrease in regional income disparities. The findings of this HIES will have to be analyzed in greater depth, but it is likely that a combination of rapid economic growth, tsunami-related inflows (as the coastal belt was able to catch up quickly), and workers' remittances played key roles. Income inequality across the country was

⁸ ADB. 2007. Country Poverty Assessment for Sri Lanka. Unpublished background report for CPS.

⁹ Defined as agriculture, forestry, fishing and mining.

¹⁰ World Bank. Sri Lanka: Underpinning Growth with Equity. Unpublished report.

unchanged during 2002–2007, which meant that fast GDP growth had a strong impact on poverty reduction (i.e., if income inequality had increased, poverty levels would not have fallen as quickly).

18. Income inequality has been linked to differences in access to good quality education and transport. The latter has become much more important in the past decade than in the 1980s, and those who do not have such access are increasingly left behind (footnote 8). Inequality increased particularly quickly in Sri Lanka during the 1990s.¹¹ While income inequality within the population widened, the income gap between regions grew in 1995–2002.¹² Some regions of Sri Lanka have remained very poor; overall levels of poverty even increased in some. However, this does not automatically imply that the same cohort of people has become poorer. A pattern common in many countries is also displayed in Sri Lanka: well-educated and mobile young people are moving out of the poorer regions, leaving the less skilled, the old, and the destitute behind. In Sri Lanka, as mobility has doubled in the past 10 years, it is mainly the well-educated who leave the poorer regions to either move abroad or settle in Colombo and its environs. International experience shows that urban centers have a pull beyond economic opportunities (such as different lifestyles and “modernity”), and that it is extremely difficult to infuse economic development in lagging regions.

19. The long years of conflict have devastated the north and east, where little development occurred until the ceasefire was signed in 2002. Poverty data is not available for those provinces where the recent surge in the conflict was most acute. The Government strengthened its effort to channel funds into Eastern Province starting July 2007. This is leading to greater economic integration of Eastern Province with the national economy. However, some lingering security concerns remain, constraining development. In addition, the large number of internally displaced persons (from the most recent fighting as well as earlier bouts), the blockade of most goods from Jaffna to the rest of the country, and rising food prices in the north make it relatively safe to conclude that pockets of severe poverty remain. However, for those areas where data exist—the most urbanized regions in the north and east—the levels of consumption poverty are on par with, if not lower than, that in the poor central regions of Sri Lanka. This conclusion rests on the fact that families in conflict-affected areas incur higher debts, and rely more on remittances and on transfers (from government and nongovernment organizations [NGOs]) to fund their expenditures.¹³

20. The HIES 2006/07 indicates that Sri Lanka is on track to achieve the income poverty target of the Millennium Development Goals (MDGs). However, the recent surge in food prices is likely to have a severe impact on poverty levels, especially for the urban poor and poor rural households that are net food buyers.¹⁴ Despite its strong commitment to social policies, Sri Lanka might have difficulty meeting some of its MDGs, such as child malnutrition and improving

¹¹ An ADB survey found that the increase in inequality in Sri Lanka in 1990–2002 was among the fastest in developing Asia (of 22 countries surveyed). ADB. 2007. *Key Indicators 2007: Inequality in Asia*. Manila.

¹² The HIES 2006/07 found that regional income inequalities have become narrower. This could be a spillover from the rapid growth in the western region, as well as tsunami funds and remittances concentrating on the poorer provinces. However, HIES 2006/07 does not cover the north and east.

¹³ World Bank. 2007. *Sri Lanka Poverty Assessment—Engendering Growth with Equity: Opportunities and Challenges*. Colombo; Central Bank of Sri Lanka. 2005. *Socio-economic Survey, 2004/05*. Colombo. These findings have to be interpreted with two caveats: (i) food prices are considerably higher in the north; and (ii) non-urban regions in Northern Province are likely to be much poorer than urban Jaffna. ADB surveys in preparation for water supply projects have shown that income levels in rural northern Kilinochchi are much lower than in Jaffna.

¹⁴ It is too early for a conclusive analysis of the impact of high rice prices. The World Food Programme and other organizations are conducting surveys and expect to publish their findings before the end of 2008.

environmental sustainability by 2015. If the Gini coefficient¹⁵ for consumption inequality remains at the 2002 level, and growth continues at the same rate as in the past 3 years, poverty will fall by more than 50% to 8.2% by 2015¹⁶. Child malnutrition, although much lower than that in its South Asian neighbors, has not fallen significantly and is three times higher than in other middle-income countries.¹⁷ The implementation of environmental safeguards has to improve if the country is to meet its MDG targets.

B. Political Environment

21. Sri Lanka has a strong executive president who is head of state and head of Government. The Constitution allows for the prime minister (who leads Parliament) and the president to come from opposing parties, which was the case during 2002–2004. The coalition led by the Sri Lanka Freedom Party won both the parliamentary elections in April 2004 and the presidential elections in November 2005. However, due to the fragile nature of coalition politics and frequent switches of party members from the opposition to the ruling coalition, the number of ministries steadily increased to 91 in 2007. The Government is committed to reducing the transaction costs that this increase entails by setting up coordinating mechanisms, such as the National Council for Economic Development, and by using nine theme clusters in its medium-term expenditure framework. However, the setup makes coordination and avoiding overlaps costly and at times inefficient.

22. An all-party representative committee was established in July 2006 to create a “southern” consensus and formulate a proposal that could be used as the basis for peace negotiations. On 23 January 2008, shortly after the Government officially abrogated the ceasefire with the LTTE, the committee issued an interim report on its proposed political solution. The committee said it would continue to work on a final report. Its main recommendation is the rapid implementation of the 13th amendment to the Constitution, which has not been fully implemented since its introduction as part of the 1987 Indo–Lanka agreement.¹⁸ Although this approach has been criticized as insufficient to gain the wide support of the Tamil community, the Government says it has given precedence to finding a practicable—rather than the ideal—solution. According to the Government, experience shows that any attempt at constitutional change is rendered impractical within the present constitutional framework, electoral system, and fragmented political party system. The Government considers the pursuit of maximum devolution within the existing legislation more feasible than seeking new constitutional amendments. However, decisive moves towards full implementation of the committee’s recommendations remain to be seen.

C. Improving Public Financial Management and Procurement, and Combating Corruption for Development Management

23. Sri Lanka is an effective democracy with universal franchise dating to 1931. Recent parliamentary and presidential elections have been held without major violence. Historically, the

¹⁵ The Gini coefficient measures the inequality in an economy’s income distribution, with values ranging between zero (indicating perfect equality) and 1 (perfect inequality).

¹⁶ See footnote 14

¹⁷ This phenomenon is puzzling, since Sri Lanka has implemented targeted programs for the past 20 years. Mothers are often underweight, a phenomenon that is most marked in the poorest areas. However, malnourished children are not confined to poor families, and the phenomenon has been linked to cultural factors that, for example, do not encourage breast-feeding. United Nations. 2007. *United Nations Development Assistance Framework: Sri Lanka*. Colombo.

¹⁸ The 13th amendment devolved responsibility for certain public services from the Central Government to newly created provincial councils.

high quality of public governance with well-established traditions and institutions for the rule of law, parliamentary democracy, and professional public administration mirrored Sri Lanka's strong social development. Formal accountability mechanisms are well-developed. However, the quality of the civil service started to decline in the late 1970s as appointments became more politicized and real wages, especially for top civil servants, gradually eroded, making it increasingly difficult to attract the best graduates into government service.

24. As a result, as the Government noted in its Ten-Year Development Framework (10YDF) finalized by the end of 2006, inadequacies in public administration are reflected in (i) weak public policy management, (ii) reluctance to engage in participatory consultation, (iii) poor client orientation in the delivery of social services, (iv) absence of system-wide accountability and transparency in the conduct of government business, and (v) inefficient management of resources and low levels of productivity.¹⁹

25. The Fiscal Management Responsibility Act, 2003, was enacted to introduce fiscal discipline (by setting medium-term fiscal targets), transparency, and accountability. Although meeting the fiscal targets of the act proved more difficult than anticipated, the Government substantially improved its financial reporting on budgetary issues. Almost all major public enterprises are loss-incurring, as they provide subsidized services and are often inefficiently managed.

26. The Medium-Term Budgetary Framework for 2006–2009 contains the country's development strategy, translated into sectoral perspectives, as well as the estimates of the likely annual capital expenditures needed to finance them and to meet the associated recurrent expenditures. The public investment program is linked to the projected government revenue, foreign aid commitments and pledges, and the likely Government borrowing program. The budget is prepared with line ministries grouped according to cluster. While projects are still mainly input-based, the Government is moving toward managing for development results (MfDR) in budgeting, supported by ADB and the World Bank. To ensure that projects are aligned with the Government's strategy, the economic viability of any new initiatives on capital projects require clearance from the National Planning Department and the cabinet. The number of supplementary budgetary requests has fallen over the past 5 years.

27. Financial oversight committees to strengthen transparency and accountability have become more active since 2006. The Committee on Public Accounts reviews the accounts of all ministries, departments, and local authorities, while the Committee on Public Enterprises examines those of public corporations and Government businesses. The work of these committees is based on the auditor general's annual reports to Parliament and covers the overall financial performance of departments or corporations under review. Parliament receives all of the auditor general's reports before the following year's budget. This represents substantial progress since 2003, when accounts were in considerable arrears and the auditor general's reports referred to events long past, thus reducing their relevance and policy interest. The Committee on Public Enterprises in particular has become more active, issuing several reports on the financial management of public enterprises and institutions. Some concerns were raised regarding the political nature of some of the committee's enquiries. The Government's efforts uncovered a major value-added tax (VAT) fraud scheme in the inland revenue agencies in 2006, involving the equivalent of SLRs3.6 billion.

¹⁹ Government of Sri Lanka. 2006. *Mahinda Chintana: Vision for a New Sri Lanka*. Colombo.

28. The establishment of the National Procurement Agency (NPA) in 2004 was a major step toward improving transparency and efficiency in national procurement. The NPA introduced guidelines and regulations, procurement templates, and procurement units in ministries. It has also built the capacity of line ministries and responded to their ad hoc requests. In 2008, the NPA was to continue this capacity building. However, the NPA is being disbanded as the Government feels it has completed its main tasks. The key functions of the NPA will be subsumed under the Ministry of Finance and Planning (MOFP). MOFP has indicated its strong commitment to advancing the reforms initiated by the NPA. ADB expects, for example, that the strengthening of procurement divisions in line ministries will continue, as will initiatives on the harmonization of procurement procedures with development partners and the strengthening of procurement expertise within the Government.²⁰ The NPA's analysis shows a widespread lack of procurement expertise in the Government; ADB's assessment indicates that contractors' procurement capacity is also weak, eroding the competitive process (this is discussed further in paragraphs 62–66, Portfolio Performance). Other factors such as lack of competition among contractors, frequent leakages of confidential bidding documentation, and sometimes, recourse to the courts, have all affected the procurement process.

29. In the Transparency International Corruption Perception Index (CPI), Sri Lanka fell from 84th position in 2006 to 94th in 2007 and the CPI score fell from 3.2 to 3.1.²¹ The perception that corruption has worsened is often aired in local media. However a drop in the rank can be caused by the inclusion of additional countries in the index.²² Meanwhile, the latest governance indicators published by the World Bank in 2007 (reflecting 2006 data) do not reflect a deterioration. The World Bank governance indicators, which compare Sri Lanka with the 212 countries in the sample, suggest Sri Lanka is (i) average for rule of law and regulatory quality; (ii) below average for control of corruption, voice and accountability, and government effectiveness; and (iii) weak on political stability and absence of violence (due to the resurgent conflict). Since 2002, almost all the World Bank governance indicators (except rule of law) have fallen slightly. However, these declines are not statistically significant, making any trend in the level of corruption difficult to establish.

30. To depoliticize the appointment of key commissions, such as those on bribery, police, and public service, a constitutional council was set up by an amendment to the Constitution and passed by Parliament in 2001. As a result, the president can only appoint persons to these key commissions upon the recommendation of the constitutional council. However, the term of the constitutional council expired in October 2005, and it has not been reappointed, which has led to a highly charged public debate. The Government argues that the amendment is flawed, and plans to review and change it.²³ The bribery commission has become more active. It has received on average 1,000 allegations a year, with 260 trials pending as of 2006. However, the sudden removal of the director general of the commission in February 2008 adds to public concerns about political interference in the functioning of the commissions.

²⁰ ADB. 2008. Sri Lanka: Country Procurement Risk Assessment. Unpublished background report for CPS.

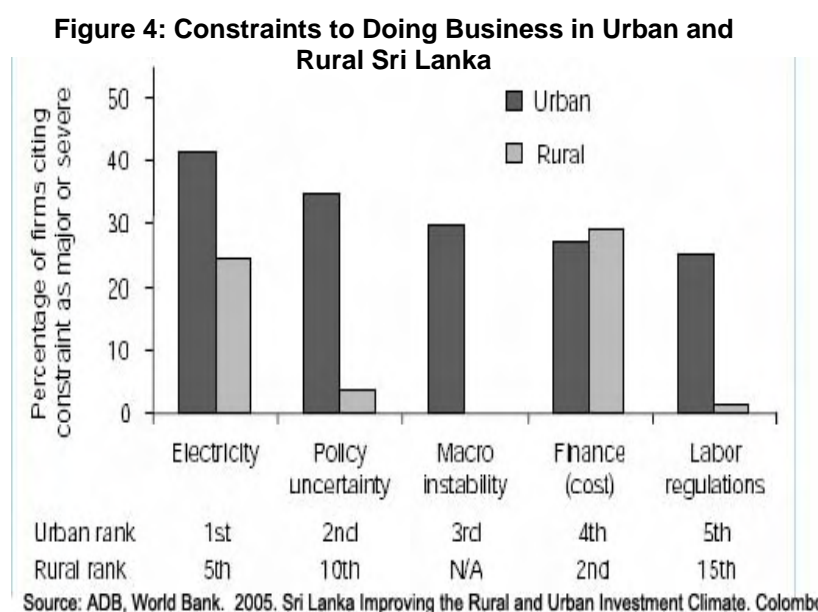
²¹ Both a drop in the rank and a decrease in the score indicate an increase in perceived corruption.

²² From 2006 to 2007, 18 new countries were included in the CPI ranking, with 8 of them ranking above Sri Lanka.

²³ Some independent constitutional lawyers also argue that the amendment was flawed, as it makes the president accountable for appointments without giving him or her the right to choose the candidate.

D. Private Sector

31. The private sector in Sri Lanka is remarkably resilient and remains the engine of economic growth. Overall, the private sector environment is among the strongest in South Asia. A joint investment climate assessment conducted by ADB and the World Bank in 2005 concluded that the private sector environment is strong on governance (as related to the functioning of firms), but weak on infrastructure and access to finance.²⁴ Rural firms are especially constrained by poor transport and electricity, lack of demand for their goods, and cost of and access to finance. Urban firms, on the other hand, cite the following as the biggest obstacles to growth: electricity, a volatile macroeconomic environment and policy uncertainty, finance costs, and stringent labor laws (Figure 4). In a later cross-country assessment on the private sector environment, measuring administrative hurdles to doing business and the tax burden, Sri Lanka still was comfortably above South Asian averages.²⁵



32. However, Sri Lanka's private sector is coping with increasing uncertainty arising from the conflict, high inflation, higher taxation (for those in the tax net), and the risk of losing highly concessional access to markets in the European Union (EU).²⁶ High interest rates are beginning to erode profits in highly leveraged firms. Interest rate spreads (the difference between average weighted deposit rates that banks offer and weighted prime lending rates) have increased since 2003. Furthermore, strict labor standards and a strong commitment to improving the working conditions of workers in the formal sector have proved a double-edged sword: while the garment industry is able to reap the benefits of high labor standards and has gained preferential access to the EU market, restrictive laws also place Sri Lanka among the developing countries with the most difficulty in laying off workers. In response, employers keep most employees as

²⁴ Although private sector firms did complain about corruption in surveys undertaken for the ADB–World Bank investment climate assessment, they did not see it as a major obstacle to functioning effectively.

²⁵ World Bank. 2007. *Doing Business 2008*. Washington, DC.

²⁶ In Asia, only Mongolia and Sri Lanka have the privilege of duty-free access under the Generalized System of Preferences (GSP)-plus scheme, which is only granted to 14 middle-income countries worldwide.

informal laborers with none of the formal protection others enjoy under the Termination of Employed Workman Act.²⁷

E. Role of Nongovernment Organizations in ADB-Supported Projects

33. The contribution of NGOs to development in Sri Lanka has varied over the past several years, depending on the incumbent government's policy towards NGOs. NGOs have demonstrated a fair degree of competence when engaging in community-driven development, raising awareness, and empowering the poor. This capacity has been widely recognized, especially among development partners. NGOs have also been reasonably effective in supporting decentralized delivery, promoting sustainable practices, and strengthening Community Based Organizations (CBOs). There was a sharp rise in the number of NGOs after the tsunami of 2004, some of which, however, are facing significant capacity issues. Coordination and complementation among NGOs, and between NGOs and government, is often ineffective; and some NGOs are highly politicized.

34. ADB will continue collaborating with appropriate NGOs in designing, monitoring, and implementing desirable projects, especially in conflict-affected areas and in community-driven development activities.

F. Environment

35. Sri Lanka is endowed with rich natural resources, including forest covering about 23% of the country; productive coastal and inland fisheries; and an intricate system of rivers, reservoirs, and groundwater aquifers that captures annual rainfall three times that of the world's mean. It is also characterized by rich biodiversity (considered one of the 25 biodiversity "hot spots" in the world), fertile soils, and diverse gem and mineral resources. An independent review done for a local think tank showed considerable progress in environmental management in forestry and wildlife.²⁸ Much of the progress in the forestry and wildlife sectors is due to ADB support. ADB supported the introduction of a participatory approach to natural resource management involving local communities, and ensured that the relevant state organizations and communities understood the issues and were able to benefit. In addition, management of wildlife issues was substantially decentralized, leading to faster decision making and efficiency gains. However, Sri Lanka's resources are being threatened by pressures from a growing population, the needs of development, and the conflict. In addition, although policies are developed through wide stakeholder consultations, lack of coordination during implementation is a key problem. Supplementary Appendix D provides more details.

G. Gender

36. Compared with its regional peers, Sri Lanka has shown a strong commitment to gender equality, including universal franchise and equal rights to contest elections in 1931 (earlier than in many European countries) and equal access to free education and health services since the 1940s. In addition, the 1978 constitutional provision of equal rights without discrimination on the grounds of sex, and the ratification of the United Nations Convention on the Elimination of All Forms of Discrimination Against Women in 1981, contributed significantly to gender equality. However, women tend to study subjects in higher education and in vocational and technical

²⁷ World Bank. 2006. *Sri Lanka: Strengthening Social Protection*. Washington DC.

²⁸ Institute for Policy Studies. *Caring for the Environment 2003–2007*. Unpublished implementation review.

training that reinforce gender imbalances in access to and mobility in the labor market. In effect, women who choose nontechnical subjects in higher education find limited well-paid employment.

37. While most of those killed in the conflict are men, the conflict also places a heavy burden on women. Women in conflict and border areas bear a disproportionate burden in caring for their families and conflict survivors. They also have greater responsibility for survival strategies during displacement in welfare centers and resettlement or relocation sites. They bear the loss of livelihood sources, greater insecurity, and vulnerability to gender-based violence. In addition, they face the trauma of continuing conflict. (For more analysis, see Supplementary Appendix C).

H. Regional Cooperation

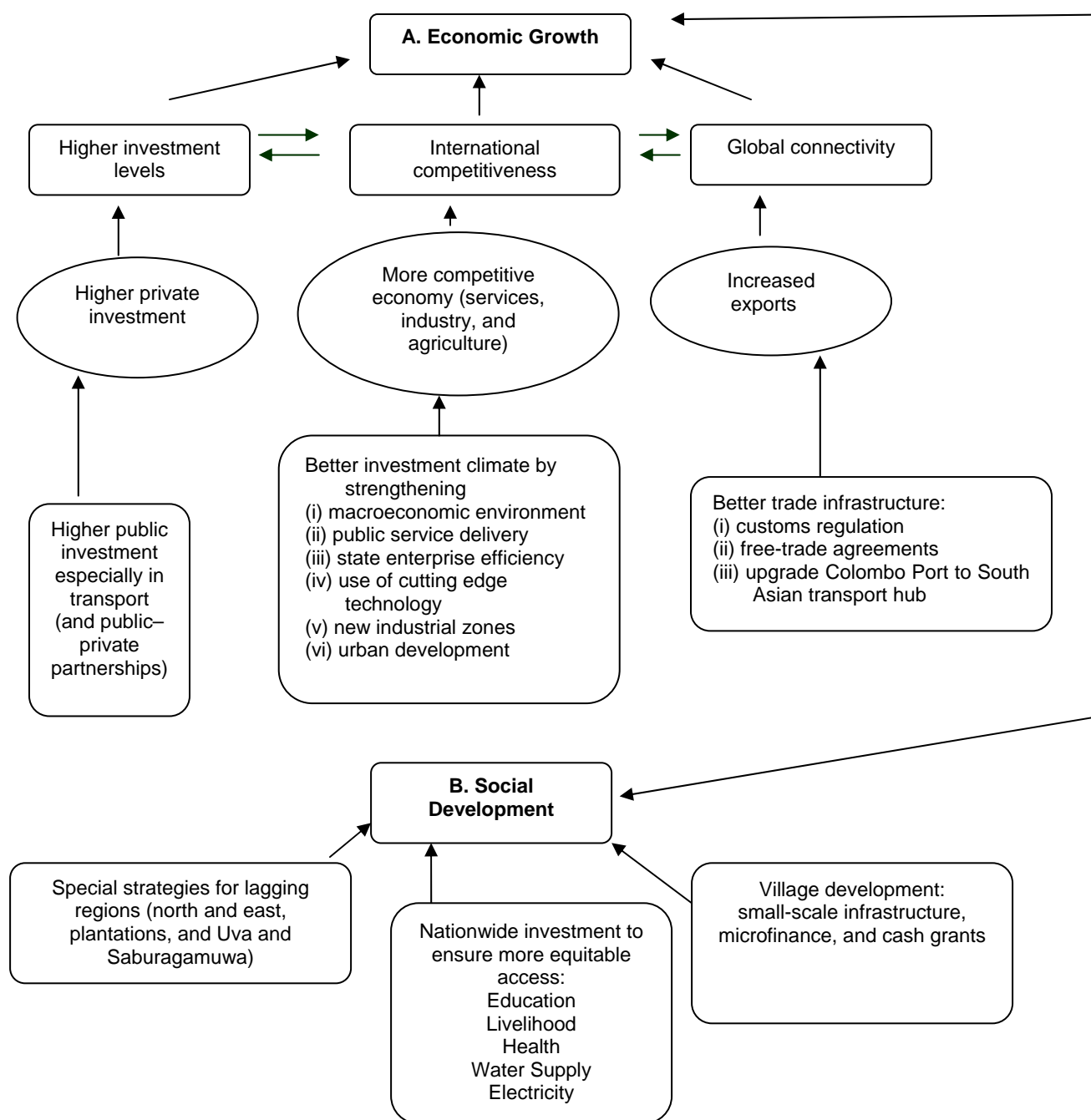
38. Sri Lanka is member of two regional groupings in the region—the South Asian Association for Regional Cooperation (SAARC) and the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation. The Government hosted the SAARC summit in August 2008. Sri Lanka is also participating in the tourism working group of the South Asia Subregional Economic Cooperation Program. While trade with Pakistan has grown (albeit from a low base), India remains by far the most important trading partner because of its proximity, the large and growing market, and the impact of the India Sri Lanka free trade agreement signed in 1999. The governments are exploring the possibility of trade in energy (electricity) through an undersea power cable. This would be a crucial breakthrough in both political and economic relations, and would help reduce Sri Lanka's energy shortfall.

II. THE GOVERNMENT'S DEVELOPMENT STRATEGY

A. Development Goals and Strategy

39. After extensive consultation with line ministries, the Government presented to Parliament a draft discussion paper of its 10YDF in November 2006. The 10YDF was also presented and discussed at the Sri Lanka Development Forum in January 2007. The 10YDF has developed a three-pronged approach to stimulate economic growth and ensure it trickles down equitably (Figure 5).

Figure 5: The Government's Long-Term Development Strategy



Source: ADB staff summary.

40. The strategy focuses on more equitable growth, which the Government feels was neglected in earlier growth strategies, and argues for a more prominent role for the state in economic development. It has ruled out further privatization of SOEs, adopting instead a policy of reforming these institutions to improve service delivery. At the same time, the new strategy proposes to promote private sector development, and expand the role of public-private partnerships (PPPs), especially in lagging regions.

41. The 10YDF focuses on infrastructure development to accelerate growth and narrow regional disparities. Randora, the Government's infrastructure investment plan, looks at major power, highway, and port and airport development projects. Various other programs, such as Maga Neguma, look at rural infrastructure development. These programs are expected to improve connectivity of rural areas to urban areas and the global economy, seen as a key factor in revitalizing the rural economy. The framework aims to improve international competitiveness by creating a vibrant industry sector and technological innovation. The 10YDF plans to facilitate private investment in new industrial zones and to upgrade public service delivery. The framework emphasizes the development of small and medium-sized enterprises (SMEs), microenterprises, and the self-employed. It also looks at promoting global integration by strengthening bilateral and regional trade and investment relationships.

42. The 10YDF plans to improve the macroeconomic environment, in part by reducing the fiscal deficit to 5% by 2011, through substantially higher revenue collection. Economic growth will be fueled mainly by significantly higher public and private investment than in the past. By 2011, the 10YDF aims to increase investment to 34% of GDP from the current 28%, reduce the fiscal deficit to 4.8% of GDP from the current 7.7%, and raise annual GDP growth to 8.7%.

43. The 10YDF sets its ambitious annual sector growth targets at 4.0%–5.0% in agriculture, 7.5%–10.5% in industry, and 8.0%–11.5% in services during 2007–2016. This accelerated growth will raise the country's per capita GDP to \$3,960 by 2016, and firm up Sri Lanka's middle-income status. It would also enable the country to meet all the MDGs.

B. Resource Mobilization and Investment

44. The investment needs under the 10YDF are substantial and focus primarily on infrastructure and livelihood development (Table 1). More than half approximately will be financed through government resources, one-third through development assistance, 4%–20% through PPPs (this varies by sector, with some not having such a detailed breakdown), and 10% from the private sector. More than 55% of the total investment will go to infrastructure (including urban development), 25% to livelihood development (of which 15% will go to pension payments), and 8% to education and health. Thus, the plan seeks to rid the country of its substantial infrastructure deficit, which holds back economic growth.

Table 1: National Expenditure Plans Under the 10-Year Development Framework

Expenditure Item	% of Total ^a
Infrastructure	41.4
Livelihood development	25.2
Of which pensions	15.5
Urban development	14.1
Education and health	7.9

^a As only key items are listed, the total does not add up to 100%.

Source: Government of Sri Lanka. 2006. *Mahinda Chintana: Vision for a New Sri Lanka*. Colombo.

45. Sri Lanka has relied on borrowing to finance public investment, an approach that is not envisaged to change significantly under the 10YDF. National savings are expected to increase as incomes rise, but this will not cover the resource requirement. The Government expects the remainder to be financed through external sources, both official and private. The 10YDF also

envisages a large part to be financed by PPPs in key sectors such as transport, power, education, and water supply.

46. During 1990–2006, Government revenue financed between 61% and 72% of total expenditure, with the rest coming largely from foreign and domestic borrowings. A primary fiscal deficit means the Government has to borrow to finance even recurrent expenditure. A small proportion (generally 1%–2% of total expenditure, annually) has come from privatization proceeds. This contribution was exceptionally high at 10% in 1997, when Sri Lanka Telecom was privatized.

47. To supplement concessional financing, the Government raised \$500 million through an international sovereign bond issue in 2007. In addition, it increasingly negotiates with export banks of key countries to finance large infrastructure projects. Sri Lanka's efforts to mobilize resources are considerably stronger than they have been in the past 20 years. However, these efforts need to be correlated more directly with the Government's debt management strategy. The Government also needs to make full use of available concessional funding.

C. Role of External Assistance

48. Until 1991, foreign and domestic loans covered about 12% of Government expenditure. Foreign grants declined from a high of 23% of total expenditure in 1991 to only 2% in 2002. Meanwhile, between 1992 and 2002, the proportion of foreign loans dropped consistently, reaching a low of 0.05% of expenditure in 1999. Over the past 15 years, the budget deficit has risen steadily in value terms, while foreign financing (grants and concessional loans) have not kept up. The result has been higher commercial borrowings from the domestic market, reaching 31% of total expenditure by 2002. Traditionally, ADB, Japan, and the World Bank, have financed 70%–80% of the public investment program. More recently, Sri Lanka accessed new sources of funding, predominantly from the People's Republic of China (PRC) and Iran. ADB's share in development financing now stands at about 14% of total foreign-funded projects.

49. The coordination among development partners has been effective. ADB has focused on infrastructure (transport, water supply, power, and port development), agriculture, and secondary education. The World Bank has emphasized health, primary education, community development, and development of information technology. Japan has provided assistance for socio-economic infrastructure, rural development, human resource development, and poverty reduction, including micro credit. Other key development partners are the EU (supporting the rehabilitation of tsunami-affected roads), the United States (technical assistance to improve competitiveness), and Germany (postconflict and SME development). All development partners coordinated effectively on policy reforms, which were either jointly implemented (such as in the power sector, where ADB teamed up with Japan), or carefully coordinated (such as fiscal management reform with the World Bank and the International Monetary Fund). A comprehensive list of development partners and their areas of interest in Sri Lanka is in Table A1.5.

D. ADB's Assessment of the Government's Development Strategy

50. The development framework is ambitious. However, perhaps for the first time, the focus is on poverty reduction through a mix of large-scale infrastructure investment and village development. In the past, Governments placed too much emphasis on village and rural

development, ignoring secondary towns and infrastructure development²⁹. Achieving the growth targets depends on increased public sector efficiency, higher private sector investment, and a cessation or at least containment of the civil conflict to check the fiscal deficit and increase domestic investment. The Government has produced many reports on how to improve public sector efficiency, the earliest being the Wanasinghe Report in 1987. However, implementing such civil service reforms remains problematic, because of Sri Lanka's complex political environment. Private sector investment would also need to be encouraged through conducive macroeconomic policies (a stable tax policy regime, fiscal consolidation, and low inflation and interest rates). Business confidence is also heavily affected by the conflict. The 10YDF does not see the conflict as a risk to achieving the targets, and assumes a reduction in defense expenditure in 2008 and 2009. This is an increasingly unrealistic assumption.

51. In the power sector, Government's gazetted policy document, National Energy Policy and Strategies (NEPS), covers all major issues, including the importance of implementing the least-cost generation plan to lower electricity prices and empowering the Public Utility Commission to regulate the energy sector. ADB supports these proposals, and relevant legislation passed the first reading in Parliament in early 2008. In transport, the strategy is intended to provide better access to the entire population, and to have a high-quality road network linking rural and urban markets. The financial viability of investments in the power and transport sectors has improved because of increases in electricity tariffs in March 2008 and the establishment of the Road Maintenance Trust Fund with ADB support. However, two key issues remain: (i) how to fund subsidies for the electricity consumption of the targeted poorer groups; and (ii) how to ensure that sufficient funds are available to maintain roads across the country, other than national roads, which are covered by the Road Maintenance Trust Fund.

52. The analysis of the water supply sector identifies the issues and focuses on better service delivery. However, its discussion of water resource management and how to improve coordination of the many agencies involved needs to be developed more fully. Competing claims to water resources—such as for farming, human consumption, or energy production—are still resolved on an ad hoc basis, and implementation of projects is made more difficult by the large number of agencies involved. Education policies focus on stronger links between general education and technical education and vocational training (TEVT), and between TEVT and higher education. The 10YDF also discusses general education strategies related to curriculum, assessment, and governance. However, the 10YDF's analysis of human resources development could be strengthened, especially of teachers that would need to go along with the sector development strategy. Teacher deployment in the poorer areas remains a major impediment to improving education.

53. The Government plans to use PPPs as a tool to expand public investment in an affordable manner, and to improve the efficiency of the public sector. However, private sector investment, especially in large-scale infrastructure, requires a stronger regulatory framework, such as independent tariff regulation and a transparent procurement process. To achieve this, the Government intends to set up a PPP unit in the Road Development Authority (RDA). It has hosted and organized several workshops, and is sending senior officials on training courses abroad. However, the conflict might heighten the perception of risks among private sector investors and increase their risk premium to invest in public infrastructure. More work is needed,

²⁹ Asian Development Bank (ADB). 2003. *Sri Lanka Poverty Assessment 2003*. Colombo, – ADB. 2007. *Country Poverty Assessment for Sri Lanka*. Unpublished background report for CPS.

which ADB plans to support, to assess the type of PPP that is feasible given each sector's characteristics and the prevailing political economy.

III. THE ASIAN DEVELOPMENT BANK'S DEVELOPMENT EXPERIENCE

A. Development Impact of Past Assistance

54. In preparation for the country partnership strategy (CPS), a country assistance program evaluation (CAPE) examined ADB's role in Sri Lanka from 1986 to 2006, and the development effectiveness of its assistance. The CAPE produced eight extensive reports covering all aspects of ADB's assistance.³⁰ It ranked ADB's overall performance as "partly successful". On the positive side it noted ADB's deep and sustainable development impact in transport, water supply and sanitation, and education. By contrast, ADB assistance was not as successful in agriculture, natural resources, and the environment. This sector is complex, given the different interests and complicated political economy, and suffers from weak implementing capacity and the overall impact of ADB assistance in these sectors was assessed as "modest".³¹ While stakeholder consultation was seen as insufficient in some instances, other impediments to project success were (i) the plethora of government institutions involved in the sectors, (ii) frequent reversal of Government policies, (iii) lack of clear sector policies, and (iv) erratic agricultural trade policies. Although the power sector was also difficult to work in, ADB's impact was seen as high for infrastructure development, especially in rural electrification. Policy reform suffered after the elections in April 2004, which resulted in a change in the political economy environment that did not allow key reforms in the sector to move forward. An Operations Evaluation Department (OED) review³² on capacity building stressed the success of ADB's efforts in the plantation (agriculture), water supply, and education sectors. It also lauded ADB's long-term commitment and the level of trust built between the implementing agencies and ADB staff.

55. A draft OED evaluation of capital market interventions in Sri Lanka found that ADB's assistance had been partly successful overall, held down mainly by the predominance of government banks in the sector. The finance sector as a whole has substantially reduced nonperforming loans since 2002 and modernized its management structures. However, the creation of a functioning bond and debt market has been hampered by the presence of large state-owned banks and the treatment of the pension fund for private sector employees as a "captive source" for government debt. As prices are not determined by markets, it is difficult to establish a secondary market for public debt.

56. The CAPE raised concerns that higher costs because of difficult access, weaker government capacity, and damage to some previously rehabilitated buildings would undermine the sustainability of ADB's postconflict assistance. The CAPE was not optimistic about the impact and overall sustainability, given the resurgent conflict since 2006. However, the overall sustainability of assistance is now less of a concern, because of the rapidly changing environment and renewed access to Eastern Province—something the CAPE did not foresee. The CAPE also assessed ADB's performance in thematic areas such as governance, which was rated generally efficient, likely to be sustainable, and highly relevant. However, the overall rating of ADB's governance support was pulled down by perceived risks created by changes in the political landscape, discontinuity of macroeconomic management reforms, and potential

³⁰ This included a review of sector interventions, postconflict assistance, policy-based lending, and governance.

³¹ Some subsectors were more successful than others, however.

³² ADB. 2006. *Lessons in Capacity Development: Sectoral Studies in Sri Lanka*. Manila

macroeconomic problems. ADB's interventions aimed to improve service delivery and strengthen financial management of the state budget and SOEs, while accountability and transparency were streamlined in all ADB's projects. The CAPE noted the limited success of ADB's policy-related lending. It again stressed the need to learn from mistakes and to ensure full Government ownership, as well as flexibility in lending arrangements.

57. Sri Lanka's 2004–2008 country strategy and program,³³ presented to the ADB Board of Directors in 2003, was prepared under different conditions than those that the country faces today. The strategy was built around strong support for postconflict reconstruction, as the LTTE and the Government had just signed a ceasefire agreement and a major aid conference had pledged more than \$4 billion for postconflict reconstruction and development. In addition, the strategy supported the Government's strong liberalization and deregulation agenda.

58. In light of the changes in economic policies that followed the parliamentary elections in April 2004, project and program designs conceived under the previous Government were revised to the extent possible. Investments (such as those in rural electrification, water supply systems, and roads) were completed largely successfully. However, after the tsunami, cost overruns increasingly became a problem: the demand for housing and other reconstruction materials, skilled labor, and construction companies led to price increases. The cost of cement rose more than 60%, while skilled labor increased 30%. This meant that two supplementary loans had to be financed, partially to cover design changes, but also cost overruns.³⁴

59. Success in institutional development, capacity building, and introducing efficiencies in SOEs was mixed. This is partly due to the changed political environment, which left some projects out of line with the new Government's economic policies. The completion report for the country strategy and program 2004–2008 is in Appendix 4.

B. Portfolio Performance

60. ADB's loan portfolio in Sri Lanka is diverse, covering several major sectors including agriculture, water supply, education, energy, transport, and finance. Despite the tsunami that hit the country in December 2004 and the resurgence of the civil conflict, some portfolio indicators have improved in recent years because of the adoption of an intensified but conflict-sensitive portfolio management strategy combined with action on the ground. For example, the percentage of projects rated "at-risk" has almost halved from 17.0% in 2006 to 8.9% in March 2008, at par with ADB average. However, much remains to be done to improve project implementation and results. Benefiting from a pragmatic approach and intensified efforts by ADB and the Government, portfolio indicators and results are expected to improve during 2008 and onwards. This is expected to increase disbursements, thereby contributing to higher net resource transfers and reversing the decline in recent years.

61. ADB and the Government continue to pursue a wide range of portfolio management initiatives to enhance portfolio performance. These include (i) improving quality at entry by introducing a project readiness filter for all projects being formulated; (ii) improving project design with realistic and well-sequenced policy conditions; (iii) restructuring and redesigning ongoing projects with partial cancellations; (iv) intensifying project and procurement reviews by the ADB Sri Lanka Resident Mission, and reviews by independent auditors as part of anticorruption efforts; (v) using the new monitoring system for efficient and transparent

³³ ADB. 2003. *Sri Lanka: Country Strategy and Program 2004-2008*. Manila

³⁴ One supplementary loan will also cover the costs of expanding the southern expressway into four lanes.

recruitment of consultants along with simplified recruitment procedures; (vi) strengthening executing agencies' implementation capacity with upfront commitment of essential resources, and continuous monitoring and follow-up on results; (vii) strengthening ADB's implementation capacity with further delegation of project administration to the resident mission combined with increasing staff resources for project implementation; (viii) posting in the resident mission a senior staff member with significant experience in project implementation and administration; (ix) strengthening financial management, reporting, and auditing; and (x) conducting regular portfolio reviews and quarterly high-level portfolio reviews, including continuous follow-up meetings with the Government.

62. Implementation of project- and sector-specific action plans are expected to improve project implementation in key sectors. In addition, the Government and ADB will work closely together to (i) build capacity of local contractors, (ii) address the shortage of construction materials, and (iii) ensure timely availability of counterpart funds. However, project implementation in parts of the north continues to be difficult as transport of materials remains restricted.

63. The 10YDF highlights the urgent need to improve the implementation of the annual development program. ADB will continue to work closely with the Government to address common project implementation constraints. Prioritized portfolio management activities include (i) continued and intensified country portfolio reviews, (ii) introduction of results-based project and sector reviews, (iii) special in-depth reviews of poorly performing projects or sectors, (iv) strengthened project management, (v) enhanced financial management with increased resource allocation, and (vi) independent performance and procurement auditing. The Government has agreed to use a results-based framework to assess implementation, as well as to measure project, sector, and country results. Continued support will be provided for capacity building to ensure that the framework is used as an effective management tool.

C. Conclusions and Lessons for the Country Partnership Strategy

64. The following lessons were learned:

- (i) The absorptive capacity in key sectors needs to be strengthened.
- (ii) The impact of the conflict and the tsunami on the prices of materials is severe and might continue beyond the tsunami reconstruction period because of increases in the global price of raw materials.
- (iii) Projects that are delegated to the resident mission are generally more responsive to the client's needs.
- (iv) Sri Lanka's political economy is unusually complex, which has led to mixed results in policy-based lending and reform-based loan covenants.
- (v) It is crucial to remain involved in policy dialogue despite the difficult environment.

65. The following are the key conclusions:

- (i) Designing and implementing an action plan jointly with the Government is important to improve contractors' capacity and reduce input prices of materials.
- (ii) A pragmatic approach that does not rely heavily on legislative changes can also produce positive changes.
- (iii) Greater focus on sectors will strengthen ADB's ability to conduct sector dialogue.
- (iv) Ownership of reforms by all stakeholders has to be carefully cultivated.

66. The CPS 2009–2011 emphasizes project and sector readiness. This conclusion follows the CAPE's recommendations to ensure a high degree of country ownership of proposed

reforms, and to review ADB's assistance in sectors where outputs have fallen short of expectations. This emphasis in the CPS would include (i) prior agreement (such as cabinet approval) on key reforms to be initiated under ADB projects; (ii) satisfactory absorptive capacity, which would include prior strengthening of private sector contractors and implementing institutions; and (iii) assistance to the Government in formulating communication strategies in sectors where the Government is interested in implementing reforms. Given the complex political environment, the CPS will also reduce the number of sectors it covers. ADB's recently approved and future assistance will also substantially strengthen MfDR within government institutions, another CAPE recommendation.

67. Despite the higher costs of doing business in conflict-affected areas and concerns expressed by the CAPE over issues such as sustainability, ADB will remain engaged in those regions, in line with its objective to reduce poverty. Assistance in conflict or postconflict areas across Asia and the Pacific is more expensive than in other areas. What is important is that assistance adheres to a set of core principles (paras. 88–91), and that ADB-assisted projects do not unwittingly contribute to the conflict. ADB has worked in conflict-affected areas—and sometimes in areas of actual conflict—in Sri Lanka since 2001.³⁵ It intends to build on this expertise to continue its assistance to these areas. To ensure that projects in conflict-affected areas meet satisfactory fiduciary and “do no harm” standards, ADB and the Government will implement operational guidelines that focus on project supervision, transparency in decision making, and a thorough and regular process of stakeholder consultation. In some areas, ADB-assisted projects in infrastructure might have to follow the least-cost approach, rather than being justified by high economic rates of return, in the interest of conflict-sensitivity (discussed further in paras. 87–93). Formulation of the CPS, and how the recommendation of the CAPE and the Development Effectiveness Committee were incorporated, is discussed in greater detail in Appendix 3.

IV. THE ASIAN DEVELOPMENT BANK'S STRATEGY

A. Summary of Key Development Challenges

68. The main challenges were discussed in Paragraphs 2–38. Despite facing adversity (Table 2), Sri Lanka's economy has been strong. The country has the second highest per capita income in South Asia and a strong democratic tradition. However, challenges remain. First, the economy has performed far below the country's considerable potential. Second, middle-income countries face challenges that are substantially different from those faced by low-income countries. Third, the current macroeconomic environment, the context of the global conditions and the conflict could have a substantial impact on Sri Lanka's growth trajectory. The challenge is to unlock the growth potential in as equitable way as possible, ensuring maximum conflict-sensitivity while having realistic expectations about how quickly the conflict can be resolved. Given these challenges and the uncertainties of the current environment, as well as the need for ADB to maintain flexibility, the CPS will cover a shortened period of 3 years.

³⁵ ADB's projects were so successful that the North East Community Reconstruction Project implementation unit was used by many other development partners to channel aid (cofinancing) into the north and east.

Table 2: Strengths and Weaknesses of Sri Lanka and Opportunities for Realizing Its Potential

Strengths	Weaknesses
<ul style="list-style-type: none"> • High literacy rates • English widely spoken in urban centers • Continuous robust growth despite 25 years of civil conflict • Open economy • Modern and efficient private sector (services and garments) • Transport hub (for transshipments), strategic location on major trading and shipping routes • Next to fast-growing India • Booming and modern service sector • Tremendous potential for tourism (combining culture, beach, and ecotourism) • Unbroken and active democratic tradition • High labor standards (International Labor Organization) • Potential for commercial agriculture 	<ul style="list-style-type: none"> • High fiscal deficits, loss-incurring state-owned enterprises (SOEs), and low (but rising) public investment • Large infrastructure deficit (lack of reliable and affordable power supply, and good transport) • High regional inequality in growth of gross domestic product and access to high-quality basic services • Complicated government structure (number of ministries, unclear division of functions between provincial and central governments) • Relatively weak structures of public financial management (procurement, audit, budget execution, and formulation) • Inefficient traditional agriculture sector • Brain drain that undermines human capital base; very small age cohort going to university; previous success in education system reduces sense of urgency for reform • Stringent labor laws reducing job creation
Opportunities	Threats
<ul style="list-style-type: none"> • Improve expenditure management • Invest in infrastructure development (power and transport, including improving access to international markets) • Introduce more efficient use of resources (reduce water and power losses in the system); promote better project implementation • Continue to improve service delivery in lagging and postconflict regions • Redevelop and integrate Eastern Province into the wider economy • Improve efficiency of SOEs and strengthen regulation • Mitigate the impact of the conflict by restoring public infrastructure (where damaged), and by building new infrastructure where conflict prevented public investment in the past • Invest in alternate sources of energy (hydropower and other renewable sources) 	<ul style="list-style-type: none"> • Resurgent conflict (higher fiscal deficit, lower economic growth, higher external indebtedness, weakening governance systems, and brain drain) • Limited space for countercyclical policies due to high public debt levels • Difficulties in developing a consensus for politically sensitive reforms due to complex political economy and vested interests • Pressure of high oil imports, high food prices, inflation, and possible loss of trade concessions on balance of payments

69. Sri Lanka is entering middle-income country status, facing development challenges different from those of low-income countries. As incomes rise, labor and other costs of production also increase, eroding price competitiveness of these countries. At the same time, they face substantial obstacles to reaching the same level of technical innovation that propels growth in high-income countries. Good public infrastructure, linkages to global markets, and development of human capital are essential to moving up the income ladder. Meanwhile, the income of the poorest households has to grow faster than before to reduce income inequality. The result will help reduce poverty more quickly than before, while also achieving greater social cohesion.

70. Thus, increasing the competitiveness of the private sector is at least as important as structural change. Despite its resilience, the private sector will need strong support from the public sector to continue as the engine of growth. The capacity of the public sector to catalyze

private sector growth needs to be strengthened. Public infrastructure has suffered from decades of underinvestment, and this remains one of the main bottlenecks identified by the private sector. In addition, the management of public resources (governance issues) in a narrower context—given the complexities created by different layers of government and the large number of ministries—remains another bottleneck that various governments have acknowledged. Introducing PPPs where possible will not only help bridge the resource gap resulting from the Government’s constrained resources, but will also help improve public sector efficiency, sometimes even indirectly (e.g., when public sector entities have to compete with the private sector).

B. Focus of the Country Partnership Strategy

71. The CPS will reduce the number of sectors ADB is involved in, in line with ADB’s long-term strategic framework 2008–2020 (Strategy 2020),³⁶ the Government’s desire for focus, and the priorities of the Government. ADB will not approve new lending for agriculture. Education will be supported primarily through ongoing assistance.³⁷ There will be only limited program lending. A sharper focus will make it easier for ADB to deepen relationships with executing agencies, and to focus its resources better. The sharper focus and fewer public sector projects will be supplemented by nonsovereign operations and private sector operations. Past cooperation between ADB’s Private Sector Operations Department (PSOD) and regional department resulted in investments in the power sector, and helped prepare for Sri Lanka’s largest PPP—the Colombo Port Expansion Project.³⁸ ADB’s private and public sector departments are working closely together on possible new investment opportunities, particularly in the power sector. PPPs are expected to finance 4%–20% (depending on the sector) of the investment in the 10YDF (para. 44).

72. The new strategy will include lessons learned, especially on conflict-sensitivity and governance issues in Sri Lanka. Consistent with the Government’s 10YDF, and the need for stronger Government ownership, the strategy will support the Government’s reform agenda (see paras. 40–42 and Appendix 5). Because this agenda relied little on external policy advice, it is seen as more homegrown and in line with local sociopolitical realities. Ongoing reform projects approved before 2005 have been modified and changed in consultation with the Government. The CPS results framework shows how the strategy is aligned with the 10YDF, including which of the Government’s results ADB will support. Although ADB has some influence on country-level results in a relatively small member such as Sri Lanka, the shortened CPS period makes concrete, monitorable outcomes more difficult to achieve. Details on ADB’s assistance are in Appendixes 3 and 5.

73. Based on OED’s assessment of the country’s development challenges, ADB’s strategic priorities and country expertise, and the Government’s development agenda, ADB’s strategy will focus on the two pillars identified in the 10YDF. As outlined in Figure 6, these are (i) strengthening the investment climate, and (ii) achieving socially inclusive development. Governance, including capacity building, and private sector development through improvements

³⁶ ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank 2008–2020*. Manila.

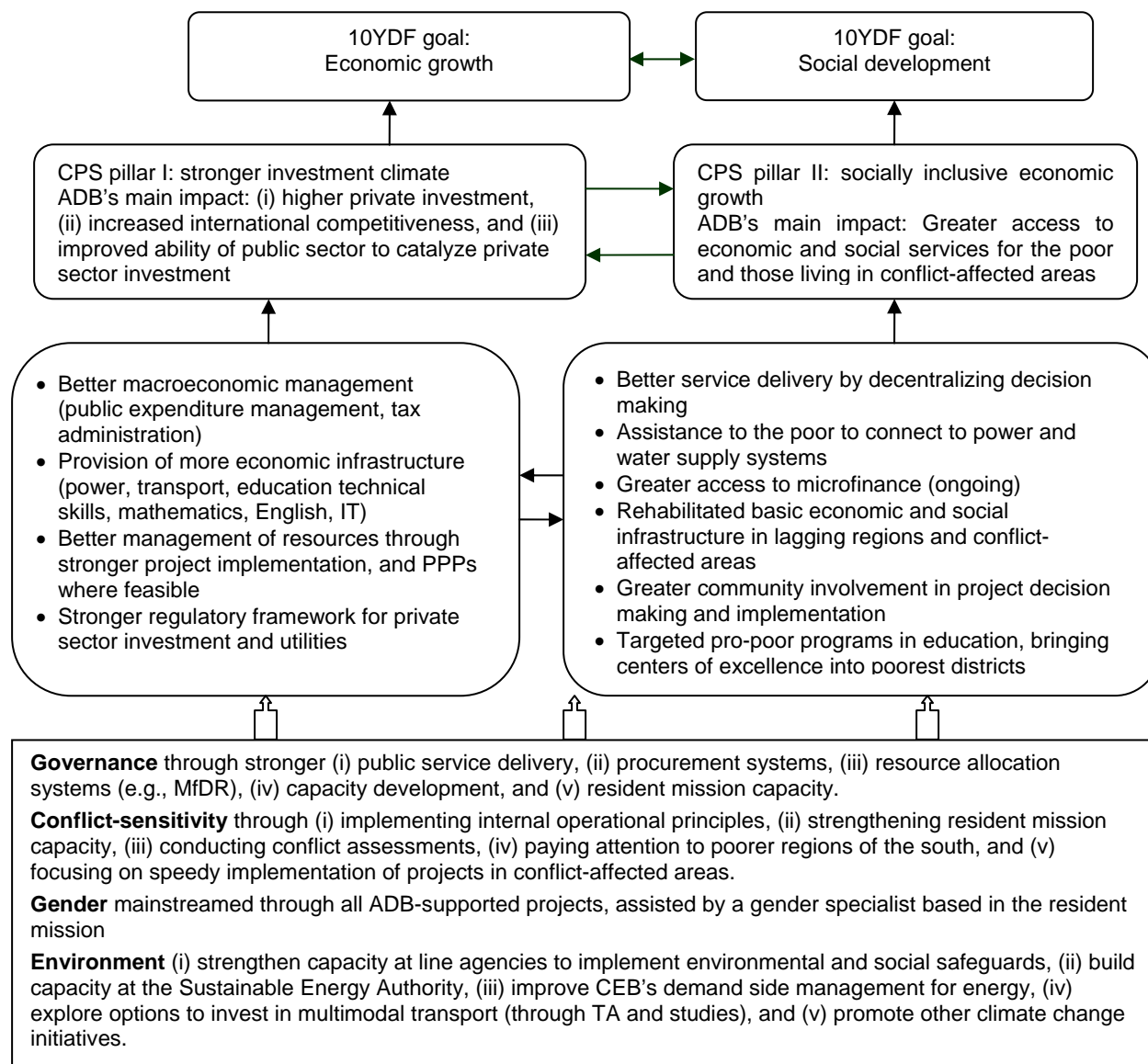
³⁷ This includes Education for Knowledge Society Project (ADB. 2008. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Education for Knowledge Society Project*. Manila.) of \$80 million, which has just started.

(\$80 million) and Colombo Port Expansion Project (\$300 million)—are about to start implementation.

³⁸ ADB. 2007. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Colombo Port Expansion Project*. Manila.

in the investment climate are the two major crosscutting themes of the Sri Lanka CPS for 2009–2011. While faster and more equitable growth can help in resolving the conflict, its main causes are widely recognized to go beyond development and poverty (Supplementary Appendix E describes ADB-supported activities in the conflict-affected areas). ADB's assistance will also help the country bridge the difficult transition from low- to middle-income status. Reflecting the uncertainties created by the conflict, the CPS will cover only 3 years, instead of the usual 5 years, to give ADB's operations and modes of engagement greater flexibility.

Figure 6: Focus of the ADB Strategy



10YDF- Ten Year Development Framework, ADB- Asian Development Bank, CEB= Ceylon Electricity Board, CPS- Country Partnership Strategy, IT- Information Technology, MfDR= Management for Development Results, PPP- Private Public Partnership

C. Assistance for the Strategic Priorities

1. Stronger Investment Climate

74. Urban firms have cited macroeconomic instability as one of the main obstacles to growth (see figure 4 and paragraph 31). Macroeconomic management has become more difficult because of high global commodity prices, high inflation, and a high budget deficit. ADB's ongoing and planned interventions will focus on two systemically important state-owned banks and fiscal management. Better fiscal management supported by ADB has already increased revenue collection, while ADB-supported restructuring of the state-owned banks has made some inroads in improving their performance. The CPS 2009–2011 will support the continued modernization of revenue administration, as well as the streamlining of expenditure management and treasury management. The result should be lower fiscal deficits, better fiscal resource allocation, and ultimately slower inflation. Improving the management of state-owned banks, and strengthening their ability to support SMEs and private infrastructure investment, will also improve cross-sector resource allocation. Lower operating costs of state-owned banks will also lead to a reduction in the interest rate margin, making it less expensive for firms to borrow. ADB-supported interventions in fiscal management will build on earlier work by the World Bank, which conducted extensive public expenditure reviews. ADB also will maintain a close dialogue with and provide inputs to the International Monetary Fund and World Bank financial sector assessments.

75. **Increased International Competitiveness.** This will address primarily the infrastructure deficit. ADB's assistance will aim to improve global–local infrastructure links, and to use existing resources more efficiently to support this goal. Ongoing and planned interventions will improve (i) links between the poorer provinces and Colombo through road improvements and electrification that also cover the east, and a major expressway that will connect the poorer south to the capital; and (ii) Sri Lanka's links to global markets through the Colombo Port Expansion Project. These will support the 10YDF target of higher exports and lower trade deficits through better global connectivity.³⁹ Colombo will benefit from an urgently needed upgrading of electrical substations, without which the electricity supply to the entire growth hub in the western region might be threatened. The Colombo port expansion will be the country's largest PPP, with the breakwater to be built by the public sector and the terminals to be tendered to the private sector on an open and competitive basis.⁴⁰

76. ADB's projects will support the 10YDF vision of greater connectivity. In concrete terms, this means reducing road roughness and increasing the average travel speed from key secondary centers to Colombo from 39 km/h to 45 km/h by 2012. A multimodal transport study will explore opportunities to support public transport development toward the end of the CPS period. The development of alternate modes of transport is important, providing some counterweight to the heavy investment in the road infrastructure planned for the next few years (with ADB, the Japan Bank for International Cooperation (JBIC), and the World Bank providing substantial resources to upgrade the road network). To ensure project readiness and to accommodate a Government request, ADB will finance roads that involve a minimum of resettlement and land acquisition. In part, this is a lesson from the Southern Transport

³⁹ The Colombo Port Expansion Project and investments in better roads are crucial to achieving this goal; if the Colombo Port loses its transshipment status, cost of shipments for Sri Lankan exporters will increase dramatically because of the loss of economies of scale.

⁴⁰ The first two terminals (of a possible four) are to be tendered on that basis, according to the public sector loan agreement signed by the Government and ADB.

Development Project,⁴¹ which is building Sri Lanka's first four-lane expressway. Progress on the sustainability of public investment in transport has been made: the Road Maintenance Trust Fund, set up with ADB and World Bank support, should ensure sustainable funding for maintenance of national highways.

77. The high costs and unreliability of electricity represent a serious bottleneck to economic growth and private sector development. ADB supports the main energy sector targets of the 10YDF and NEPS —i.e., greater access to electricity, and more reliable and affordable power. ADB will seek to strengthen sector governance and private sector participation. Further, ADB will support the Government's investments in transmission and distribution systems throughout the country. ADB is also planning an extensive technical assistance (TA) program to support the implementation of Government initiated regulatory reforms that would attract more private sector investment to the power sector and improve energy efficiency through demand-side management. In the power sector, ADB is closely liaising with other major donors in the sector; Japan, PRC, World Bank as well as Kreditanstalt Für Wiederaufbau of Germany.⁴²

78. Although education indicators such as literacy, access, female enrollment, are high, the quality of education is an obstacle to Sri Lanka's aspirations of developing a modern service industry.⁴³ Nurturing a technologically skilled workforce is a goal of the 10YDF. The focus will be on consolidating the substantial ongoing assistance program, which has been developed to be part of the Government-led, sector-wide approach. One standby loan scheduled for 2011 is the only planned new investment in education. However, this loan will proceed only if the planned Government evaluation of the effectiveness of development partners' assistance in that sector yields positive results. Ongoing support aims to; (i) improve the quality of and access to English, science and mathematics education, (ii) provide training in technical skills, (iii) establish enabling legislation, (iv) develop curriculum, and (v) strengthen the accreditation process of private sector vocational training institutes. The accreditation process is crucial to improving the quality of services delivered.

79. **Improved Ability of the Public Sector to Catalyze Private Sector Investment.** ADB will promote PPPs to improve the management of public resources, which is in line with the Government's strategy to raise resources for its ambitious investment program. ADB will work closely with other development partners such as the International Finance Corporation.

80. PPPs are not a panacea for public underinvestment, and require a good regulatory framework. Nevertheless, it is encouraging that the Government is starting to adopt a PPP approach in some sectors, most significantly in ports and transport. On a smaller scale, PPPs are being used in agriculture, including for the private provision of extension services, notably in the more commercial agribusiness subsector. ADB-supported projects in the transport and power sector will pilot a more gradual PPP approach in recognition of local sensitivities and a market assessment. These projects (e.g., outsourcing road maintenance and bill collection franchises) will be scaled up if they are successful. ADB will provide support throughout the PPP development process, i.e., from project development to financing. The aim is to identify and develop PPP projects⁴⁴ leading to financial closure within 3 years. As the first step, it is

⁴¹ ADB. 1999. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Southern Transport Development Project*. Manila.

⁴² Listed in the order of importance in the sector.

⁴³ Several studies identified the lack of English language and science as serious bottlenecks to private sector growth. ADB and World Bank. 2005. *Sri Lanka Investment Climate Assessment*. Colombo; World Bank. 2007. *Knowledge Economy Report*. Colombo.

⁴⁴ Project development may not automatically lead to successful bidding and financial closure.

proposed that the public–private infrastructure advisory facility⁴⁵ (i) assess the environment for PPPs, and (ii) identify (across sectors) possible PPPs in selected sectors and regions.⁴⁶

81. Another target of this CPS is more direct investment in private firms, which is in line with Strategy 2020. There is potential for PSOD to expand its presence in Sri Lanka through investments and financing. Building on its existing loan portfolio, PSOD is working with a leasing company to provide longer-term financing for SMEs. ADB's Trade Finance Facilitation Program is active in Sri Lanka.⁴⁷ Currently, the major opportunities for private sector interventions seem to be in power generation and potentially transmission (if the Government is prepared to open that market to private investments), and in port terminals. To facilitate investments in the power sector, where the Government is supporting small-scale renewable power projects as part of its climate change initiatives, PSOD is working on four small demonstration projects that are being processed in parallel to reduce transaction costs. The energy sector road map also integrates public and possible private sector investments. In the past, ADB's private and public sector departments have worked hand in hand in Sri Lanka's port sector, and intend to continue this approach.

2. Socially Inclusive Development

82. Substantial investments and policy changes are required to achieve socially inclusive growth, and to support the 10YDF aim to meet all MDGs by 2015. ADB has to be selective. Poverty in Sri Lanka is highly correlated with access to and quality of infrastructure, and inversely related to distances from urban centers. Investment in infrastructure in the poorer regions can also help social mobility. Except for the proposed Greater Colombo Wastewater Project, a carryover from the Country Strategy and Partnership 2004-2008, this CPS will focus on provinces outside the relatively wealthy Western Province. This will be one of the driving forces of the CPS 2009–2011, especially (i) electrifying rural areas, (ii) linking provincial roads to national highways (while the World Bank provides assistance for linking provincial roads to rural roads and villages), (iii) upgrading water supply in lagging regions, and (iv) supporting urban development in selected secondary towns. This will be achieved through a comprehensive TA and investment program that will build capacity and strengthen management and planning skills at the provincial council level. However, infrastructure alone is often not enough; it is important to strengthen administrative and absorptive capacity in the poorer regions to improve the delivery of public services. To do this, ADB will continue to support the Government's drive to decentralize public services, particularly in transport and in water supply. This will also ensure greater accountability of the public sector (and greater voice of the beneficiary). Another key to this effort is an ongoing project⁴⁸ that strengthens the capacity of local authorities to increase revenue collection, and to borrow from local state-owned development finance institutions (on a partial grant basis) for local infrastructure projects, such as public libraries, sewage and drainage systems, and local authority roads. Part of the planned Fiscal Management Reform Project II will similarly strengthen the capacity of two provincial councils to raise revenue. Economic development in the poorer regions is also the focus of a

⁴⁵ This TA facility, involving multiple development partners (including ADB), helps developing member countries improve the quality of infrastructure through partnerships with the private sector.

⁴⁶ To maximize value addition, the identified PPP projects will focus on regions other than Western Province.

⁴⁷ The Trade Finance Facilitation Program works with private international banks to assume risk on nine Sri Lankan financial institutions in support of international trade (import and export transactions).

⁴⁸ ADB. 2004. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Fiscal Management Reform Program*. Manila.

regional SME project⁴⁹, approved last year, which provides credit lines through private banks to SMEs outside Western Province. The project was developed in close cooperation with the International Finance Corporation, and the competitiveness program of the United States Agency for International Development (USAID).

83. In the north and east, ADB will implement ongoing projects and small livelihood projects (providing rural finance, upgrading fishery harbors, providing chilling facilities for milk, repairing minor irrigation tanks, supporting the dairy industry, etc.), and will rehabilitate small-scale infrastructure (hospitals, schools, markets). ADB will also continue to support training and skills development in the north and east. Most preparatory work for the Jaffna Water Supply Project has been completed.⁵⁰ ADB and the Government want to implement it as soon as the security situation allows.

84. In addition, ADB will continue to support the Government's systematic approach to providing clean water and electricity to all poor regions of the country. The water supply systems in many areas have already been upgraded. Current projects support access to clean drinking water in Eastern Province (Batticaloa); one of the projects is among the biggest investments in the province in decades. Assistance is planned for conflict-affected areas and adjacent districts, such as Mannar, Vavuniya, and Puttalam. These are among the poorest and most neglected in the country. Power transmission and distribution in Eastern Province will also be a major component of ADB's assistance in the sector. ADB will support the Government's rural electrification program through innovative financing of connections to the electricity grid for the poor households. This was pilot-tested under an earlier Japan Fund for Poverty Reduction project and proved very successful. ADB will also support climate change mitigation in its energy sector projects by improving the demand-side management capacity of Ceylon Electricity Board (CEB), and by supporting the Sustainable Energy Authority. ADB is monitoring several indicators to see if its interventions are achieving their goals, such as the number of new water and power connections delivered to poor households, the number of high-quality secondary schools established in the poorest 150 districts in the country, the number of scholarships to poor students, and the rate of youth unemployment.

85. No new investments from the public finance window are planned in the plantation sector. ADB has been engaged in the plantation sector for more than 20 years. It has supported the transfer of plantations from state ownership to the private sector, leading to improvement in their financial and managerial performance. Continuing social issues (such as the high poverty levels of plantation workers) are being addressed through ongoing projects of the International Fund for Agricultural Development (IFAD) and the United Nations (UN), and NGOs, as well as planned interventions by the World Bank. ADB's ongoing education sector programs have substantial components for the poorest districts in the country (such as upgrading of schools, focusing on English language and science), and provide scholarship programs for students from poor households. Improving education services provided outside Colombo (the best schools are clustered in the capital) remains an essential ingredient in promoting socially inclusive growth.⁵¹

⁴⁹ ADB. 2007. Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Small and Medium Enterprise Regional Development Program. Manila.

⁵⁰ Substantial discussions have taken place among all stakeholders, and an agreement in principle has been reached. It involves taking water from Kilinochchi to Jaffna; farmers in the Vanni will be beneficiaries of a new irrigation scheme, planned by the Government with the assistance of the World Bank.

⁵¹ Internally displaced persons' access to training facilities is often better than or on par with that of non-internally displaced persons (footnote 8). ADB-supported activities also cover a range of training for those regions. Supplementary Appendix E gives examples of ADB activities in conflict areas.

ADB is also supporting non-university tertiary education, scholarships to poor students, and technical and vocational training (which is particularly relevant for internally displaced persons, who often have only their skills to rely on).

86. Increasing agriculture efficiency has become even more important than in the past, because of the sudden spike in wheat and rice prices across the globe. Most experts predict this price increase will persist in the medium term. Although Sri Lanka is almost entirely self-sufficient in rice, prices have risen. To reduce its dependence on agricultural imports, Sri Lanka initiated in late 2007 a program called Let Us Grow Our Own Food. The program promoted domestic agricultural investment by extending support to establish more than 4 million home gardens. In addition, Iran is likely to finance a major project costing an estimated \$400 million to irrigate paddies. The World Bank plans to strengthen agricultural extension and research services, and to improve the water resources management. ADB-supported projects that improve rural infrastructure, such as roads and electrification, will also increase agriculture productivity, while smaller-scale agricultural support in conflict-affected areas more directly increases agriculture productivity.

D. ADB Assistance and the Conflict

87. Conflict is not a new phenomenon in Sri Lanka. It is primarily a political issue with deep and entrenched causes.⁵² International experience suggests that sustainable peace is likely to take a long time to achieve. The past 3 years have shown the limited influence of the international community, and that the peace dividend (i.e., the idea that more development assistance to the north and east would lead to faster economic growth, and in turn contribute to a sustainable peace process) has not prevented the conflict from breaking out again. The role of aid in promoting peace has been substantially overestimated, according to a major study conducted on behalf of key development partners.⁵³

88. ADB's assistance to conflict-affected areas will fall under the two pillars governing this CPS. When implementing new and ongoing projects, ADB will draw heavily on analysis conducted in the run-up to the preparation of the CPS 2009–2011. That analysis identified four lessons:

- (i) It is important to maintain a long-term perspective and not to hold the development of the country as a whole hostage to positive developments in peace negotiations.
- (ii) The poor, especially in the north and east, should not have to wait for development projects until a durable solution has been found. Rehabilitation and development should proceed wherever conditions allow.⁵⁴
- (iii) Support for regions in the south will help prevent the alienation of the poor living in the south (as well as the larger polity of the country), and ultimately will assist in creating a greater consensus toward a political solution to the conflict.⁵⁵

⁵² For more details, see the appendix of the CAPE dealing specifically with ADB's postconflict analysis.

⁵³ Goodhand, Jonathan, and Bart Klem. 2005. *Aid, Conflict, and Peace Building in Sri Lanka 2000–2005*. Colombo: The Asia Foundation. The study builds upon a previous strategic conflict assessment conducted in 2000.

⁵⁴ The strategic conflict assessment notes that "investments to improve the livelihood of the population in the north-east unfortunately became trapped in the politics of trying to get a deal between the LTTE and the Government. This link should be broken." Bastian, Sunil. 2005. *The Economic Agenda and the Peace Process 2000–2005*. Part of the Sri Lanka Strategic Conflict Assessment 2005. Colombo: The Asia Foundation.

⁵⁵ The importance of including the south has been analyzed in many publications, such as the strategic conflict assessment, and several publications by the International Crisis Group. While some conclusions remain contentious, such as the assertion that economic reforms per se hurt the Government's constituencies in the south, a common thread in all assessments is the importance of continuing financial assistance to the south.

- (iv) While ADB projects successfully incorporated conflict-sensitivity in project and program design, according to the strategic conflict assessment, there is still scope to improve and continually evaluate approaches.⁵⁶

89. Throughout the 25-year conflict, the Government has maintained basic social infrastructure in the north and east. It runs hospitals and schools, and administers food and fertilizer subsidies, even in areas under LTTE control, including Kilinochchi. Other agencies are substantially involved in reconstruction and peace building, in line with their mandates. The new UN Development Assistance Framework identifies peace building and national reconciliation as a prime objective. Further, it focuses on helping internally displaced persons and strengthening civil society and public institutions to promote human rights. The Government of Japan, USAID, and the World Bank continue their assistance to conflict-affected areas. The World Bank and USAID in particular are allocating a significant proportion of their support to Eastern Province. At the same time, bilateral development partners and international NGOs take the lead in direct peace-building activities, often supporting local NGOs that advance the dialogue on peace-building initiatives, decentralization, and governance; and build trust between ethnic communities.⁵⁷

90. ADB proposes several ways to remain engaged in Sri Lanka in a conflict-sensitive manner, building on the substantial experience it has acquired over the years. If implementation in conflict-affected areas is not possible for security reasons, the relevant components would be put on hold until they can be implemented. If prospects for implementation remain limited, funds could be reallocated without changing the overall allocation to each province. If, despite reallocation, implementation remains impossible within a reasonable time frame, those components would be canceled. In addition, ADB and the Government will

- (i) continue to implement, whenever possible, the existing pipeline of projects for the north and east, which still has about \$129 million in undisbursed funds;
- (ii) implement projects in conflict-affected areas (adjacent areas, provinces, and districts), devoting more staff resources, if necessary, to ensure efficient management and oversight;⁵⁸
- (iii) develop new, nationwide projects with components for the north and east;
- (iv) conduct a security and conflict assessment for projects in the north and east to ensure maximum development effectiveness and adherence to the “do no harm” principle; and
- (v) strictly adhere to newly updated internal operational guidelines.

91. The key operational guidelines, based on ADB’s experience working in Sri Lanka’s conflict-affected areas over the past 8 years, are as follows:

- (i) Projects should emphasize transparency and the involvement of all stakeholders and beneficiaries, while trying to ensure that public relations are not used by either side for political purposes.
- (ii) Because of the complexity of the situation, several conflict analyses might be needed for one project if it covers several areas with different stakeholders.
- (iii) Consultations have to be clear and simple, and all relevant documents must be shared up front.

⁵⁶ Burke, Adam, and Anthea Mulakala. 2005. *Donors and Peace Building 2000–2005*. Part of the Sri Lanka Strategic Conflict Assessment 2005. Colombo: The Asia Foundation (p. 39); ADB 2007. *Country Assistance Program Evaluation for Sri Lanka*. Manila.

⁵⁷ Peace-building and related activities have been a core activity of many western bilateral development partners.

⁵⁸ In addition to ongoing projects with a geographic focus, ongoing nationwide projects supported by ADB in water supply and sanitation, education, and power often include substantial components for these areas.

- (iv) During project implementation, all implementation partners and stakeholders have to be made aware of ADB's policies on ethnic, gender, environment, and resettlement issues, as well as how ADB procurement guidelines work.
- (v) Expectations regarding the benefits of a project need to be managed carefully.
- (vi) All stakeholders must respect the project management staff, who in turn must be able to build trust between the communities.
- (vii) Resources must be allocated equitably to ensure no community feels advantaged (or disadvantaged) compared with other ethnic groups.

92. ADB has assisted the Government's reconstruction efforts in the north and east since 2000—and even before that whenever a credible ceasefire was in place. Assistance was (and continues to be) delivered through geographically targeted projects. However, the type of assistance provided will have to change. While some humanitarian assistance in Eastern Province is still necessary and delivered mostly through UN agencies and international NGOs, the initiation of development projects in the province is also important. This will reduce the impact of the past 25 years of conflict and tap the province's substantial potential for economic growth. Detailed Government assessments have found that sectors with economic potential include tourism (with the area's stunning coastline), port development (Trincomalee has one of the best natural deep-sea ports in the world), and high-end agriculture. Given the complicated ethnic structure of Eastern Province—all three ethnic groups are almost equally represented in terms of population—healthy economic growth that benefits all ethnic groups equally could help alleviate the legitimate grievances of all groups—and build trust between these groups. Therefore, support for eastern economic development will be mainstreamed as part of ADB-supported national projects wherever possible and appropriate. Targeted projects could be considered for Northern Province if the situation changes dramatically and access to the province improves. Future assistance will include investments in the power sector, water supply and sanitation, and roads. Supplementary Appendix E has more information on current ADB-supported activities in the north and east.

93. Finally, to help ensure that ADB's program is implemented efficiently and effectively, the resident mission's capacity will be further strengthened through recruitment of additional staff. The new staff will assist implementation throughout the ADB-supported program in Sri Lanka, provide necessary training, and assist ADB's Country Director in effective coordination with other development partners. For 2 years beginning in 2008, ADB will also have small grant funds available to support innovative projects (implemented by, for example, the private sector, NGOs or other civil society organizations, as well as government entities) agreed with prior concurrence of the government.

E. Crosscutting Issues

1. Governance

94. In line with ADB's governance action plan,⁵⁹ the focus of the CPS will be on (i) improving the efficiency and transparency of ADB-related procurement; (ii) strengthening and streamlining public financial management (budgetary procedures, expenditures, tax administration, and the introduction of MfDR in selected agencies); and (iii) piloting an innovative approach to capacity building. In addition, ADB will help the Government deliver better services to its citizens by

⁵⁹ ADB. 2006. Second Governance and Anticorruption Action Plan (GACAP II). Manila.

supporting greater decentralization of service delivery, in line with the Government's commitment to fully implement the 13th amendment to the Constitution.

95. ADB will improve the procurement capacity at the resident mission (through the recruitment of one new national officer and additional support staff in 2008), and at selected line ministries by providing TA to build and strengthen the procurement units in those ministries. Improving efficiency in procurement will be mainstreamed in all ADB-supported projects: starting with the CPS 2009–2011, all ADB project teams will conduct procurement risk assessments (building on the sectoral risk assessments done for the CPS) in cooperation with the Government, the resident mission, the Central Operations Services Office, and the Regional and Sustainable Development Department (RSDD). ADB has been in close dialogue with the World Bank and the United Nations Development Programme (UNDP), each of which has substantial public financial management components in their future and ongoing programs. The World Bank plans a public financial management project which will include the strengthening of functions of the auditor general. The UNDP has been assisting the Commission to Investigate Allegation of Bribery and Corruption, as well as the parliament. ADB projects in turn will strengthen the central Government's tax administration and help improve expenditure management, building on the public expenditure reviews conducted by the World Bank. Jointly with the UN, ADB provides long-term support to the Ministry of Plan Implementation (MPI) to strengthen the Government's systems for MfDR. These efforts have already produced an analysis of the institutional gap in four pilot agencies, focusing on what they need to change to effectively fulfill their purpose. Additional TA planned by RSDD in 2009 will help implement the main findings of those pilot studies, as well as extend them to other agencies.

96. ADB will support the Government's plans to introduce decentralized delivery in key Government agencies where ADB has an active investment program, such as the CEB, National Water Supply and Drainage Board (NWSDB), and RDA. ADB will continue to support decentralization of public services, for example in water and power, which has already yielded good results. ADB has maintained a close dialogue with the Asia Foundation and UN agencies that have undertaken extensive capacity building in local governments.

97. The feedback mechanism from users of the services provided by the Government is weakened by the number of ministries and considerable administrative overlaps. ADB will improve the transparency and accountability mechanisms in ADB-supported projects to enhance feedback by introducing public and social audits, and by broadening stakeholder participation in design, monitoring, and evaluation. Supplementary Appendix F provides details on initial Governance Risk Management Plans for two of the CPS priority sectors, namely power and water supply and sanitation. These will be further developed during the course of CPS implementation in cooperation with relevant government entities.

98. Acknowledging the complexities of project implementation and the importance of maintaining strong governance standards in development projects, ADB recruited a governance advisor to the resident mission in mid 2008. This will enable ADB to play a greater role in the policy dialogue with the wider development community. The advisor will enhance the effectiveness of ADB's development aid and project implementation, as well as that of all development partners. The position is intended as a resource that can support the governance work of other development partners. The added governance expertise will substantially strengthen ADB's capacity to design projects that fully support the implementation of the 13th amendment to the Constitution.

99. Thus, all ADB-supported projects will promote the full implementation of the 13th amendment, i.e., implement wherever possible projects that are in a devolved sector at the provincial council level. Many ADB-supported projects are already routed through provincial councils, but ADB expects the decentralization of project implementation to increase. As the capacity of some provincial councils is weak, ADB will support a “learning by doing” implementation strategy, coupled with TA (such as in the water sector) and close cooperation with ongoing capacity building work at the local level by other development partners. This will be an important part of the strategy, which might entail slower project implementation. In light of the Government’s commitment to fully implement the 13th amendment as a first step to a political solution to the conflict, this is fully justified.

2. Knowledge Products

100. At the same time, the CPS 2009–2011 introduces an innovative approach to capacity building in the public sector, linking it to the ongoing MfDR work at the MPI, and the analytical work undertaken in selected pilot agencies. Capacity building remains an important issue in improving governance within line agencies and ministries, and has too often been driven by supply rather than demand. The result at times has been low Government interest and ownership, specifically of stand-alone TA. Preliminary assessments of capacity needs will form the basis of future, Government-led TA initiatives, which should be able to deliver substantial and more unifying benefits to the country. ADB Management strongly supports innovative capacity-building pilots; one option for further exploration through TA would be the setting up a capacity development grant fund run by the Government. Other technical and advisory support includes promoting regulatory reforms in the utility sector, decentralizing services, improving planning in the road sector, and strengthening the environment for PPPs, including developing projects attractive to investors.

3. Gender

101. Gender will continue to be mainstreamed in all operations of ADB. ADB’s gender strategy will aim to narrow the gender gap and empower women. A gender specialist in the resident mission will continue to play an important role in ensuring the gender focus of all ADB operations, as well as in liaising with relevant government agencies, civil society organizations, and development partners on gender issues. The CPS 2009–2011 will contribute to measures that foster greater female participation in and contribution to the national economy, by ensuring that gender issues are identified and incorporated in ADB-financed operations. Gender concerns will be mainstreamed through gender design features in loans, and reflected in project-specific gender action plans. In education, projects assist in (i) reducing gender imbalances in technical and vocational training, (ii) promoting skills training for women through support for tertiary education, (iii) strengthening women’s access to nontraditional technical and vocational education and information and communication technology, and (iv) eliminating gender stereotypes in teaching material. In agriculture, ongoing projects promote rural women’s access to agro-technology and markets to increase productivity and incomes. Infrastructure development (e.g., projects in water supply and sanitation and road and transport sectors) pays special attention to strengthening women’s capacities for active participation in community-based organizations. It also incorporates special measures for households headed by women and vulnerable groups in resettlement programs. Multisector projects in the north and east and other conflict- and tsunami-affected districts will target vulnerable women (i.e., war widows, households headed by women) in village reconstruction and income-restoring activities. Based on its experience, ADB will continue to provide selective support to build the capacity of the

national gender machinery, with possible extension to relevant line ministries and Government agencies for greater integration of gender concerns.

4. Natural Resources and the Environment

102. The country strategy and program 2004–2008 warned that future ADB interventions in the environment sector would have to be reexamined based on the Government's institutional capacity and Sri Lanka's development priorities. While some sections (such as forestry) have shown considerable progress, ADB's operations require more focus and resources (lending to the sector is traditionally small) to maximize effectiveness. The infrastructure deficit and high income inequality—both caused by, and potentially a cause for, the conflict—are the most pressing issues in Sri Lanka. This means that environmental concerns will be addressed during ADB's project implementation, especially given the Government's emphasis on infrastructure development. In line with Strategy 2020, ADB-supported projects will promote sound environmental management, especially in transport, water supply, energy, and rural development. That will involve strengthening the implementation of environmental safeguards, especially in the transport sector where ADB is already providing TA to strengthen the environmental safeguard unit of RDA.⁶⁰ To address pollution and climate change issues, ADB will closely liaise with the World Bank and its ongoing assessment of ways to reduce the environmental impact of using coal to generate power. ADB also extends TA to the new Sustainable Energy Authority, and plans to assist CEB in reducing wasteful energy demand. Exploring renewable energy will not solve Sri Lanka's urgent need for base-load energy, but can fill a vital gap in the system. In line with Strategy 2020, which calls for supporting public transport, a multimodal transport study toward the end of the CPS period will also establish the basis to move away from car-based (and therefore high-polluting) transport to public transport (such as railways and buses).

5. Cost-Sharing Arrangements

103. During preparation of the CPS, cost-sharing limits were reviewed in light of ADB's new cost-sharing policy. Given an increasingly difficult macroeconomic environment and the CPS focus on development outside the wealthy Western Province, including support for the Government's plan to develop Eastern Province, it is proposed that the cost-sharing limit be raised to a maximum of 90% for loans and 85% for TAs. Cost sharing ceilings for individual projects will be determined on a case-by-case basis. Under the new policy, ADB may finance taxes and duties in projects as long as they are nondiscriminatory. The recommendations for the cost-sharing, ceiling and other financing parameters are set out in Appendix 2. The Government has concurred with this proposal.

F. Funding Level for the CPS Period

104. The indicative resource envelope for public sector operations over 2009–2011 will be \$630 million, of which \$320 million will be from the Asian Development Fund (subject to the country performance assessment) and \$310 million will be from ADB's ordinary capital resources. The targeted indicative total resource envelope per year is \$300 million, which ADB and the Government seek to obtain from cofinancing, through PPPs and nonsovereign loans. The country operations business plan is in Appendix 6.

⁶⁰ ADB has piloted a joint environmental assessment with the EU and the World Bank. To mainstream environmental best practices, ADB will draw heavily on the World Bank's inputs.

G. External Funding Coordination and Partnership Arrangements

105. Sri Lanka's largest external development partners are ADB, Japan, and the World Bank. New development partners recently have provided considerable assistance. ADB regularly consults with these development partners, as well as with many other bilateral development partners, such as Canada, Germany, Sweden, the United Kingdom, and the United States. An effective framework for development partner coordination is in place. The framework, which concentrates on peace, governance, and poverty issues, involves civil society, the private sector, bilateral partners, multilateral partners, and the Government. During the preparation of the CPS 2009–2011, other development partners were consulted extensively on their strategies and approaches, especially regarding operating in Sri Lanka's conflict-affected environment. ADB also played an active part in the donor peace support group. The UN and civil society are also regularly consulted on working in conflict-affected areas.

106. ADB and the World Bank maintain a close dialogue on key policy issues and opportunities for supporting economic reforms in the country. The country teams worked closely during the preparations of the CPS and the World Bank's country assistance strategy. The World Bank strategy, approved in June 2008, has three pillars: (i) expanding economic opportunities in lagging regions, (ii) improving the investment climate, and (iii) enhancing the quality of services and accountability. The World Bank plans to stay engaged in health and education, and will also expand its involvement in infrastructure, particularly roads. Japan, the country's largest development partner, will continue to focus mainly on large-scale infrastructure projects. The UN system has finalized its UN development assistance framework, which emphasizes peace, gender, environment, and rights-based governance issues in development.

107. ADB consulted with local and international NGOs during the preparation of the CPS, as well as on sector-specific issues relevant to ADB operations in Sri Lanka. In consultation with all stakeholders, a consultation and participation plan was prepared in 2007 for ADB in Sri Lanka to identify best practices and improve communication. To date, attracting cofinancing for ADB-funded projects has not been a problem. A matrix on aid coordination summarizing strategies and activities of ADB and other development partners is in Appendix 1.

V. RISKS AND PERFORMANCE MONITORING AND EVALUATION

A. Risks

108. The main risks to successful implementation of the CPS 2009–2011 come from the possible impact of (i) the conflict on the fiscal deficit and economic growth, (ii) high oil prices on the current account deficit and the value of the Sri Lanka rupee, and (iii) high global food prices and expansionary macroeconomic policies on inflation. The unpredictable course of the conflict also adds to the uncertainty facing Sri Lanka at this time. As noted in paragraph 68, reflecting this uncertainty of the current environment, the strategy will cover 3 years instead of the more common 5 years. However, despite the relatively high-risk environment, ADB's continued engagement with Sri Lanka, based on investment support similar in size to that in the past, can be justified. Sri Lanka has faced serious difficulties in the past, some perhaps even larger than those experienced today, but has been resilient. The Government maintains a strong commitment to improving the living conditions of all Sri Lankans, including those in the east and north, and has continued to provide basic social services, even in LTTE-controlled areas, throughout the past 25 years.

109. The specific risks and how these will be mitigated are as follows:

- (i) **Conflict and peace.** Risks emanate not only from an unpredictable conflict but also from (a) any LTTE attacks on economic and civilian targets, (b) fiscal consolidation suffering because of increased expenditure, and (c) its impact on wider governance issues in the country. Mitigation: Even with heightened confrontation and conflict, the strategy in the CPS remains valid; it outlines how to remain conflict-sensitive, and how to operate in conflict and postconflict areas. A prolonged and intense conflict that prevents projects from being implemented in affected areas, as outlined, effectively leads to a smaller overall resource envelope and some reduction in ADB-supported activities. A severe constraint on counterpart funds, a possible outcome of higher defense expenditure, would also lead to a readjustment in the size of ADB's program. ADB will monitor this risk closely through quarterly portfolio performance reviews and, if necessary, adjust the size of the program.
- (ii) **Balance of payments.** Sri Lanka is a small, open economy, which depends especially on markets in the United States and the EU for its garments exports. Apart from the adverse impact of the global slowdown, there remains considerable uncertainty over the renewal of the GSP+ concessions by the EU. At the same time, Sri Lanka's economy remains highly dependent on oil imports, which have tripled in price in 3 years. This has led to high current account deficits, and pressure on foreign reserves and the currency. The current macroeconomic situation of high inflation, high fiscal deficits, and relatively low (but increasing) foreign reserves give the Government little room to maneuver to cushion these shocks. Mitigation: Slower growth should not have an impact on the validity of the CPS; on the contrary, it makes the two pillars of competitiveness and social inclusion even more urgent. High global oil prices are structural issues that all non-oil-exporting countries have to deal with. The resident mission is monitoring the situation closely and maintaining a close dialogue with the Government on these risks.
- (iii) **Public debt levels.** This risk includes the impact of the escalating conflict on the fiscal deficit and public debt levels. While greater access to international capital markets is in line with Sri Lanka's middle-income status, the recent rise in commercial borrowing has to be monitored closely. Mitigation: A detailed assessment of public debt sustainability will be updated annually and discussed with the Government, as has been done in preparing the CPS 2009–2011. Debt indicators have an almost automatic impact on the size of the program by adjusting lending levels through the country performance-based allocation.
- (iv) **Complex political economy.** Sri Lanka's complex political economy makes major structural reforms difficult and hard to sustain. Mitigation: The CPS 2009–2011 adopts a pragmatic approach by supporting economic reforms that are carefully calibrated in the context of the political economy and have strong Government ownership. Program loans will be used sparingly, with reforms generally undertaken at project level through sector development loans, investment loans, and nonsovereign lending, the preferred mode of operation.
- (v) **Public financial management.** During preparation for the CPS 2009–2011, substantial governance risks were identified. Mitigation: The main risks are being

mitigated by strengthening key institutions with support from the World Bank (audit), the UN (public accountability and Parliament), and ADB (fiscal management). The resident mission will also strengthen the capacity of its staff to deal with contracts, procurement issues, and governance to ensure effective and efficient use of funds and minimize the risk of their misuse.

B. Results-Based Monitoring Process and Plan

110. The CPS 2009–2011 describes the expected outputs, outcomes, and impact of the planned interventions, and also identifies the indicators to measure their success. ADB will contribute to higher investments in the public and private sector that will be used more efficiently. Indicators measuring ADB's impact on resource mobilization cover revenue collection, as well as reductions in losses and improved performance at state-owned utilities and banks. Improvements in global–local connectivity will be indicated by faster transport (both on roads and Colombo's port) and lower transport costs through better maintenance of roads. Decentralization and greater local participation will be indicated by higher revenue of local authorities, increased involvement of provincial and local authorities in project design and implementation, strengthening of local authorities and TA implemented to decentralize service delivery in the NWSDB. Improved competitiveness will be measured by better English and information technology skills, while social inclusion will be a function of poor households having access to electricity, water, and high-quality education. However, it is unlikely that any short-term measurable impacts in key social indicators, poverty reduction, or the MDGs can be achieved during this CPS period, as it spans only 3 years. The CPS indicators will be monitored annually as part of project and portfolio reviews. They also will be part of a shortened CPS progress report that the country team will prepare every year, rather than only once during the CPS period. The current volatile environment calls for frequent monitoring and possible adjustment of the program.

111. The Government of Sri Lanka, as is the case in other developing countries, has recognized the importance of results-based monitoring to be implemented in the state sector. The Government has taken significant steps in this regard and has shown a high degree of ownership even before ADB initiated support. It is incorporating a results-based framework into its development planning, project implementation, and monitoring of development impact. The institutionalization of results-based management at key ministries and Government organizations is now a high priority of the Government.

112. The MPI, in conjunction with the MOFP, is leading the introduction of results-based management and organizational capacity building in ministries. The main ministries working with MPI are the ministries of health, education, highways, and agriculture. MPI plans to extend its assistance and guidance to other ministries and organizations once its own capacity is developed. Many development partners support the program, which this CPS complements with a parallel framework. In addition to ADB's assistance for mainstreaming MfDR in support of poverty reduction in South Asia,⁶¹ UNDP and the World Bank are providing assistance for the Government's results-based management initiatives. Most of the assistance will continue until 2008, while specific programs initiated by the World Bank, such as capacity building in monitoring and evaluation at the Ministry of Health, will continue until 2011.

⁶¹ ADB. 2006. *Technical Assistance for Mainstreaming Managing for Development Results in Support of Poverty Reduction in South Asia*. Manila (RETA 6306).

113. The country needs continued TA in capacity building. Therefore, ADB will continue its partnership with the Government and other development partners with new TA projects starting in 2009.

Country Partnership Strategy Results Framework

Key Constraints to Achieving the National Objective	Desired Country Outcomes (resulting from addressing the constraints)	CPS Outcomes (national outcomes to which ADB operations will contribute)	Indicators to Track Progress toward CPS Outcomes, Baseline and Targets	ADB's Ongoing and Proposed that will Contribute to Achieving these CPS Outcomes	Risks
<p>National goal: increase economic growth to 8.5% by 2010 and national investment levels to 34% by 2011 CPS pillar I: improved investment climate ADB's impact: higher investment and improved competitiveness of economy</p>					
<p>Constraints on Higher Public Sector Investment</p> <ul style="list-style-type: none"> • High fiscal deficits (also conflict-related) crowding out public and private investment • High public debt burden 	<p>Increase in annual public investment to 8.0%–8.5% of GDP</p>	<ul style="list-style-type: none"> • Lower fiscal deficit • More sustainable government spending • More efficient state owned enterprises and banks • Better regulatory environment for utilities and for PPPs 	<ul style="list-style-type: none"> • Increase in revenue collection from 15.8% of GDP to 18.5% by 2011 • Drop in debt service ratio from 13.0% to 8.8% by 2011 • Reduction in operational losses of CEB from Rs20 billion in 2007 to Rs10 billion in 2011 • Reduction in electricity losses of CEB from 16.5% in 2007 to 13.9% in 2009, 12.0% by 2016 • Reduction in NRW from the 2007 average of 37% to 20% by 2011 • Improvement in operational performance of state banks (nonperforming loan ratio of People's Bank reduced from 6.8% in 2007 to 4.0% by 2014) • Exposure to Government and all SOEs maintained at 45% or less of all assets for Bank of Ceylon 	<p>Ongoing</p> <ul style="list-style-type: none"> • Fiscal Management Reform • Financial Markets for Private Sector Development • Power Sector Development Project <p>Planned</p> <ul style="list-style-type: none"> • Fiscal Management Reform II (2009) • Sustainable Power Sector Development I and II <p>Advisory</p> <ul style="list-style-type: none"> • TA for capacity development of Public Utilities Commission • TA to develop PPPs in hydropower generation • TA to develop power distribution franchising • Background study to evaluate PPP environment potential 	<ul style="list-style-type: none"> • Continued conflict makes fiscal consolidation difficult to achieve • Government continues to rely on borrowing from state-owned banks • Parliament does not approve regulatory amendments
<p>Constraints on Higher Private Sector Investment</p> <ul style="list-style-type: none"> • Uncertain 	<ul style="list-style-type: none"> • Increase in private 	<ul style="list-style-type: none"> • Better road network • Better environment 	<ul style="list-style-type: none"> • 100% funding for national highways maintained by 2010 through the Road 	<p>Ongoing</p> <ul style="list-style-type: none"> • Road Sector Development • Power Sector 	<ul style="list-style-type: none"> • Vested interests resist increased use of PPPs.

Key Constraints to Achieving the National Objective	Desired Country Outcomes (resulting from addressing the constraints)	CPS Outcomes (national outcomes to which ADB operations will contribute)	Indicators to Track Progress toward CPS Outcomes, Baseline and Targets	ADB's Ongoing and Proposed that will Contribute to Achieving these CPS Outcomes	Risks
<p>macroeconomic environment</p> <ul style="list-style-type: none"> • Conflict-related uncertainty • Infrastructure deficiencies • Weaknesses in road planning • Roads poorly maintained • Lack of reliable and affordable power • Lack of access to finance 	<ul style="list-style-type: none"> • investment from 23.4% to 25.5% of GDP by 2010 • Higher growth rates in provinces other than Western Province 	<p>to recoup user costs</p> <ul style="list-style-type: none"> • Better provision of electricity (fewer technical losses) • More electricity connections • More lending to firms in rural areas and/or outside Western Province • More soundness in finance sector and lower borrowing costs 	<p>Maintenance Trust Fund (RMTF)</p> <ul style="list-style-type: none"> • Parliamentary approval to allow Government or private sector to charge tolls for road usage by 2009 • Framework for PPPs established • Increase in percentage of households connected to the grid from 79% in 2007 to 88%; off-grid from 4%–6% in 2007 to 10% by 2016 • Lending to firms outside Western Province reaches \$50 million by 2011 (i.e., regional SME credit line fully disbursed) 	<p>Development Project</p> <ul style="list-style-type: none"> • Financial Markets for Private Sector Development • Regional Small and Medium-Sized Enterprises (SME) Development Project <p>Planned</p> <ul style="list-style-type: none"> • Provincial and National Highways Project (2009) • Power Support Project (2008, 2010) <p>Advisory/Economic</p> <ul style="list-style-type: none"> • TA for provincial road master plan and Maga Neguma • Background study to evaluate PPP environment potential 	<ul style="list-style-type: none"> • Inadequate regulatory framework for PPPs. • Insufficient funds for RMTF
<p>Constraints on Increased Competitiveness</p> <ul style="list-style-type: none"> • High transport costs, rigid labor markets, lack of people with marketable skills, limited ability to retain expert personnel 	<ul style="list-style-type: none"> • Export growth of 10% a year up to 2016 • Highly skilled labor force that makes up for shortcomings in labor market 	<ul style="list-style-type: none"> • Higher capacity of Colombo port • Shorter travel time to Colombo port from all parts of the country • Better access to relevant tertiary education 	<ul style="list-style-type: none"> • Increase in handling capacity from 3.3 million TEUs to 5.7 million in 2010 • Rehabilitate 900 Km of Provincial Council road by 2012 • Rehabilitate 2400 Km of National Roads by 2012 • Reduction in travel time from Colombo to Matara from 4–5 hours in 2007 to 2 hours by 2011 • Reduce the length of priority National Highways with International Roughness 	<p>Ongoing</p> <ul style="list-style-type: none"> • Colombo Port Expansion Project • Southern Transport and Development Project • Road Development Project • National Highway Sector Project • Technical Education Development Project • Education for Knowledge Society Project <p>Planned</p>	<ul style="list-style-type: none"> • Global slowdown affects Sri Lankan export markets • Delayed implementation of transport projects

Key Constraints to Achieving the National Objective	Desired Country Outcomes (resulting from addressing the constraints)	CPS Outcomes (national outcomes to which ADB operations will contribute)	Indicators to Track Progress toward CPS Outcomes, Baseline and Targets	ADB's Ongoing and Proposed that will Contribute to Achieving these CPS Outcomes	Risks
			<ul style="list-style-type: none"> • Index above 5.5 from 37% in 2007 to 30% in 2012 and 25% in 2017. • Increase the average travel speed on priority National Highways from 39km/h in 2007 to 45 km/h in 2012 and 49 km/h in 2017. • Increase in enrollment in technical fields by 10% • Increase in completion rate of students in grades 9–13 from 78% to 85% 	<ul style="list-style-type: none"> • Provincial and National Highways Project (2009) <p>Advisory/Economic</p> <ul style="list-style-type: none"> • TA for intermodal transport study 	
<p>Constraints on Improved Governance</p> <ul style="list-style-type: none"> • Inability to retain highly qualified senior staff • Large number of ministries and overlapping functions • Weak public service delivery • Lack of funds for maintaining public infrastructure 	<ul style="list-style-type: none"> • Efficient public sector management • Greater transparency 	<ul style="list-style-type: none"> • Better human resource management in selected agencies • Better public financial management (e.g., MfDR) • Greater transparency in fiscal planning and decision making • Higher investment and maintenance of local infrastructure 	<ul style="list-style-type: none"> • Full implementation of human resource policy (linked to performance, grievances system, performance evaluation) in MOFP by 2009. • Expansion of MfDR to 16 agencies by 2011 from 4 in 2008 • Regular publication of fiscal developments through semiannual reports (internet and hardcopy) • Approval of road sector master plan by Government and steps taken to implement it (to streamline road sector investments in national highways) • NWSDB: full cost recovery (debt, O&M, depreciation) through tariff reduction in NRW and operational improvements by 2011. • RMTF 100% funded by 	<p>Ongoing</p> <ul style="list-style-type: none"> • Fiscal Management Reform Project • Secondary Towns and Rural Community Based Water Supply and Sanitation Project • Local Government Basic Social Infrastructure Project • MfDR TA <p>Planned</p> <ul style="list-style-type: none"> • Fiscal Management Reform Project II <p>Advisory/Economic</p> <ul style="list-style-type: none"> • TA for decentralized service delivery to NWSDB. • TA for MfDR II • Umbrella TA for Capacity Development Fund 	<ul style="list-style-type: none"> • Lack of political will to implement human resource development policies in civil service • Weak provincial governments slows decentralization

Key Constraints to Achieving the National Objective	Desired Country Outcomes (resulting from addressing the constraints)	CPS Outcomes (national outcomes to which ADB operations will contribute)	Indicators to Track Progress toward CPS Outcomes, Baseline and Targets	ADB's Ongoing and Proposed that will Contribute to Achieving these CPS Outcomes	Risks
			2010 (currently in test phase)		
National Goal: Socially inclusive development—meeting all Millennium Development Goals by 2015 CPS pillar II: inclusive economic growth ADB's impact: better service delivery to poor					
Constraints on Improving Access to Economic and Social Infrastructure <ul style="list-style-type: none"> Poor connectivity of regions outside Western Province, poor quality of basic services infrastructure in towns and rural areas, and inequalities increased by the conflict 	<ul style="list-style-type: none"> Greater social justice and socioeconomic stability 	<ul style="list-style-type: none"> Better provision of basic services (education, water, power, sanitation, sewage, garbage) Increase in capacity of local authorities to invest in infrastructure and to raise funds Scholarships to students of poor families Support for establishing "schools of excellence" in all districts 	<ul style="list-style-type: none"> 200,000 new water connections provided, of which (i) about 40,000 are to poor households, and (ii) about 60,000 are in the east, by 2011 Access to electricity grid provided to 1% of poorest households (i.e., an extra 8,000) by 2011 Increase in number of scholarships to poor students by 10% by 2011 Reduction in youth unemployment rate (after school) from 14% in 2006 to 8% in 2012 Rise in information technology (IT) achievement scores of undergraduates from 49% to 60% by 2012 Rise in English achievement scores from 59% to 67% 2012 Increase in number of trained technicians from 600 in 2006 to 2,200 in 2012 150 high-quality secondary schools available in the 	Ongoing <ul style="list-style-type: none"> Secondary Towns and Rural Community-Based Water Supply and Sanitation Project Secondary Education Modernization I and II Distance Education Modernization Technical Education Development Project Education for Knowledge Society Project Regional SME Development Project Local Government Basic Social Infrastructure Project North Eastern Community Coastal Community Development Project Conflict-Affected Areas Rehabilitation Project Tsunami-Affected Areas Rehabilitation Project Planned <ul style="list-style-type: none"> Dry Zone Urban Water Supply and Sanitation Project Urban Environment 	<ul style="list-style-type: none"> Conflict makes access to areas difficult and/or costly Economic slowdown has an impact on uptake of youth in employment

Key Constraints to Achieving the National Objective	Desired Country Outcomes (resulting from addressing the constraints)	CPS Outcomes (national outcomes to which ADB operations will contribute)	Indicators to Track Progress toward CPS Outcomes, Baseline and Targets	ADB's Ongoing and Proposed that will Contribute to Achieving these CPS Outcomes	Risks
			poorest 150 Pradeshiya Sabhas by 2012	Improvement Project (Secondary Towns) <ul style="list-style-type: none"> Nationwide projects with components for lagging and conflict affected areas. 	
<p>Constraints to improved quality of services</p> <ul style="list-style-type: none"> Lack of effective decentralization 	<ul style="list-style-type: none"> Greater decentralization of service provision 	<ul style="list-style-type: none"> Rehabilitation of basic infrastructure Effective decentralization of investment and maintenance of local infrastructure 	<ul style="list-style-type: none"> By 2011, in at least 30 project assisted local authorities: (i) increase in revenue from stamp and other duties by 10% a year; (ii) increase in annual expenditure on operation and maintenance by about 5%, and (iii) reduction in local authority default percentage levels to LLDF by 50% NWSDDB: Full decentralization of responsibility and staffing for commercial, planning and development, and financial and management functions to provinces 	<p>Ongoing</p> <ul style="list-style-type: none"> North East Community Rehabilitation Project Southern Province Rural Economic Advancement Project Local Government Basic Social Infrastructure Project <p>Planned</p> <ul style="list-style-type: none"> Greater Colombo Wastewater Management Project Urban Environment Improvement Project (Secondary Towns) Nationwide projects that support implementation of the 13th amendment <p>Advisory and Economic</p> <ul style="list-style-type: none"> TA for decentralized service delivery to NWSDDB 	<ul style="list-style-type: none"> Delays in progress of fiscal decentralization.

CEB= Ceylon Electricity Board, GDP= Gross Domestic Product, IT= Information Technology, LLDF= Local Loans and Development Fund, MfDR= Management for Development Results, MOFP= Ministry of Finance and Planning, NRW= Non Revenue Water, NWSDP= National Water Supply and Drainage Board, O&M= Operations and Maintenance, PPP= Public Private Partnership, RMTF= Road Maintenance Trust Fund, SME= Small and Medium Enterprises, SOE= State Owned Enterprises, TA= Technical Assistance, TEU= Twenty-foot Equivalent Units

COUNTRY AND PORTFOLIO INDICATORS

Table A1.1: Progress Toward the Millennium Development Goals and Targets

Goals and Targets	Country Status
<p>Goal 1: Eradicate Extreme Poverty and Hunger</p> <p>Target 1.A: Halve, between 1990 and 2015, the proportion of people whose income is less than \$1 a day.</p> <p>Target 1.C: Halve, between 1990 and 2015, the proportion of people who suffer from hunger.</p>	<p>On track. The population living below the national poverty line fell from 22.7% in 2002 to 15.2% by 2007. The target for 2015 is 13.1%. Extreme poverty, measured as the proportion of the population living on less than \$1 per day, is the lowest (6.6%) among South Asian countries.</p> <p>More than one-fifth of the population is undernourished. The high prevalence of underweight children (below 5 years) is a source of concern, although it has decreased from 38% in 1993 to 29% in 2000.</p>
<p>Goal 2: Achieve Universal Primary Education</p> <p>Target 2.A: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.</p>	<p>On track. The net enrollment rate in primary education increased from 91.7% in 1990 to 96.4% by 2002, which is much higher than the South Asian regional average. The target is 100% by 2015. The completion rate for primary education was 96.9% for males and 98.3% for females in 2001.</p>
<p>Goal 3: Promote Gender Equality and Empower Women</p> <p>Target 3.A: Eliminate gender disparity in primary and secondary education, preferably by 2005, and in all levels of education no later than 2015.</p>	<p>On track. The ratio of girls to boys rose from 93.1% in 1990 to 95.3% in 2001 at the primary level; from 104.0% to 104.2% at the secondary level; and from 66.2% to 89.8% at the tertiary level. The target for 2015 is 100% at all levels.</p>
<p>Goal 4: Reduce Child Mortality</p> <p>Target 4.A: Reduce by two-thirds, between 1990 and 2015, the under-5 mortality rate.</p>	<p>On track. Under-5 mortality per 1,000 live births was 22.2 in 1991, falling to 18.8 in 1999. The target is 12.0 by 2015. The under-5 child mortality rate has decreased but is still far from the 2015 target. Basic health care and immunization services are widely available in most areas.</p>
<p>Goal 5: Improve Maternal Health</p> <p>Target 5.A: Reduce by three quarters, between 1990 and 2015, the maternal mortality ratio.</p>	<p>On track. Maternal mortality per 1,000 births was 0.92 in 1990 and 0.47 in 2001. The target is 0.36 by 2015. Maternal mortality has decreased substantially since 1990 and is the lowest in South Asia.</p>
<p>Goal 6: Combat HIV/AIDS, Malaria, and Other Diseases</p> <p>Target 6.A: Have halted by 2015, and begun to reverse, the spread of HIV/AIDS.</p> <p>Target 6.B: Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases.</p>	<p>Rates of HIV/AIDS prevalence are still relatively low in Sri Lanka. The prevalence of HIV/AIDS in the 15–24 age group was 0.05% (2000). There are indications that actual infection rates are higher, and risk factors such as low contraceptive use, prostitution, and high migration pose serious challenges.</p> <p>On track. The incidence of malaria per 100,000 population dropped from 1,520 in 1994 to 350 in 2001. The target is the eradication of malaria by 2015. The number of new malaria cases varies greatly from year to year; there were 10 times as many infected in 1992 as in 2002 (400,000 compared to 40,000).</p> <p>Not on track. The incidence of tuberculosis per 100,000 population rose from 39.1 in 1994 to 44.1 in 2001. The target is the eradication of tuberculosis by 2015. New tuberculosis cases increased from 6,174 in 1991 to 8,639 in 2001, but a treatment schedule introduced in the late 1990s is intended to reverse this trend.</p>

Goals and Targets	Country Status
<p>Goal 7: Ensure Environmental Sustainability</p> <p>Target 7.A: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources.</p> <p>Target 7.C: Halve, by 2015, the proportion of people without sustainable access to safe drinking water.</p> <p>Target 7.D: By 2020, achieve a significant improvement in the lives of at least 100 million slum dwellers.</p>	<p>Not on track. Land area covered by forests dropped from 17.4% in 1990 to 16.3% by 2001. The land area covered by forest shrunk by more than 5 percent during the 1990s, indicating rapid deforestation. Carbon dioxide emissions (per capita consumption of ozone depleting Chloro Fluro Carbons- Ozone Depleting Potential tons) increased from 0.201 in 1990 to 0.382 by 2001. Increasing carbon dioxide emissions is a cause of concern. The use of renewable energy sources has increased recently, and the overall consumption of substances harmful to the ozone layer has fallen.</p> <p>On track. The percentage of population with sustainable access to improved water sources rose from 72% in 1994 to 82% in 2001. The target is 86% by 2015. The share of households with access to safe water increased from 68% in 1994 to 77% in 2000, putting the 2015 target within reach.</p> <p>On track. The percentage of the population with sustainable access to improved sanitation increased from 73% in 1994 to 80% in 2001. The target is 93% by 2015.</p> <p>Sri Lanka's level of safe sanitation is higher than the world average of 61%. It is also well above the average for developing countries (51%) and South Asian countries (37%).</p>

Source: UNDP, NCED..2005. *Millennium Development Goals, Country Report 2005*.Colombo.

Table A1.2: Country Economic Indicators

Item	Fiscal Year				
	2003	2004	2005	2006	2007 ^a
A. Income and Growth					
1. GDP per Capita (\$, current)	981	1,062	1,241	1,421	1,617
2. GDP Growth (% , in constant prices)	5.9	5.4	6.2	7.7	6.8
a. Agriculture	1.7	0.0	1.8	6.3	3.3
b. Industry	4.7	5.4	8.0	8.1	7.6
c. Services	7.6	6.7	6.4	7.7	7.1
B. Saving and Investment (current and market prices, % of GDP)					
1. Gross Domestic Investment	22.0	25.3	26.8	28.0	27.9
2. Gross National Saving	21.5	22.0	23.8	22.3	23.3
C. Money and Inflation (annual change)					
1. Consumer Price Index	6.3	7.6	11.6	13.7	17.5
2. Total Liquidity (M2) ^b	15.3	19.6	19.1	17.8	16.6
D. Government Finance (% of GDP)					
1. Revenue and Grants	16.2	15.8	17.5	17.3	16.7
2. Expenditure and Onlending	23.7	23.5	24.7	24.3	23.5
3. Overall Fiscal Surplus (deficit)	(7.5)	(7.8)	(8.7)	(8.0)	(7.7)
E. Balance of Payments					
1. Merchandise Trade Balance (% of GDP)	(8.1)	(10.9)	(10.3)	(11.9)	(11.0)
2. Current Account Balance (% of GDP)	(0.4)	(3.1)	(2.7)	(5.3)	(4.2)
3. Merchandise Export (\$) Growth (annual % change)	9.2	12.2	10.2	8.4	12.5
4. Merchandise Import (\$) Growth (annual % change)	9.2	19.9	10.8	15.7	10.2
F. External Payments Indicators					
1. Gross Official Reserves (including gold, \$ million in weeks of current year's imports of goods)	16.8	13.2	14.8	13.2	14.8
2. Gross Official Reserves (\$ million)	2,329	2,196	2,735	2,837	3,508
3. External Debt Service (% of exports of goods and services)	11.6	11.6	7.9	12.7	13.0
4. Total External Debt (% of GDP)	62.5	63.9	54.2	52.1	50.9
G. Memorandum Items					
1. GDP (current prices, SLRs billion)	1,822	2,091	2,453	2,939	3,578
2. Exchange Rate (SLRs/\$, average)	96.52	101.19	100.50	103.96	110.62
3. Population (million)	19.3	19.5	19.7	19.9	20.0

() = negative, GDP = gross domestic product. SLR= Sri Lankan Rupees

^a Provisional.

^b M2 includes operations of foreign currency banking units.

Source: Central Bank of Sri Lanka. *Annual Report* (various years).

Table A1.3: Country Poverty and Social Indicators

Item	Period		
	1998	2001	Latest Year
A. Population Indicators			
1. Total Population (million)	17.9	18.7	20.0 (2007)
2. Annual Population Growth Rate (% change)	1.3	1.4	1.1 (2007)
B. Social Indicators			
1. Total Fertility Rate (births/woman)	—	—	2.0 (2000–2005)
2. Maternal Mortality Rate (per 100,000 live births)	—	92.0 (1990)	47 (2004)
3. Infant Mortality Rate (below 1 year/1,000 live births)	—	—	12.0 (2004)
4. Life Expectancy at Birth (years)	—	—	73.9 (2000–2005)
a. Female	—	75.5	77.0 (2004)
b. Male	—	69.6	71.7 (2004)
5. Adult Literacy (%)	91.1	91.9	92.1 (2002)
a. Female	88.1	89.3	90.0 (2002)
b. Male	—	94.5	95.0 (2002)
6. Primary School Gross Enrollment (%)	109.0	110.4	96.4 (2002)
7. Secondary School Gross Enrollment (%)	74.0	80.8	—
8. Child Malnutrition (% below age 5)	—	—	29.0 (1996–2004)
9. Population with Access to Safe Water (%)	—	—	79.0 (2004)
10. Population with Access to Sanitation (%)	—	—	91.0 (2004)
11. Public Education Expenditure (% of GDP)	2.62	2.22 (2003)	2.8 (2006)
12. Human Development Index Rank	—	—	93.0 (2006)
13. Gender-Related Development Index Rank	—	80	68 (2004)
	1995/96	2002	2006/07
C. Poverty Indicators			
1. Poverty Incidence	28.8	22.7	15.2
2. Percent of Poor to Total Population			
a. Urban	14.0	7.9	6.7
b. Rural	30.9	24.7	15.7
c. Estate	38.4	30.0	32.0
3. Poverty Gap	—	—	3.1
4. Poverty Severity Index	—	—	0.260 (1995)
5. Inequality (Theil L Index)	—	—	—
6. Human Poverty Index Rank	—	18.0 (1999)	18.3 (2003)
	—	31.0 (1999)	34 (2003)

— = not available, GDP = gross domestic product.

Sources: Central Bank of Sri Lanka. 2007. *Annual Report 2006*. Colombo; Department of Census and Statistics Sri Lanka. <http://www.statistics.gov.lk/>; UNDP. <http://www.undp.org/>; World Bank. <http://www.worldbank.org/>

Table A1.4: Country Environment Indicators

Indicator	1998	Latest Year
A. Energy Efficiency of Emissions		
1. GDP/Unit of Energy Use (PPP\$/kgoe)	5.1 (1980)	8.8 (2003)
2. Traditional Fuel Use (% of total energy use)	—	60.4 (2003)
3. Carbon Dioxide Emissions		
a. Tons	7.1 (1996)	—
b. Tons per Capita	0.4 (1996)	0.5 (2003)
B. Water Pollution: Water and Sanitation		
1. % Urban Population with Access to Safe Water	88.0 (1990–1995)	95.9 (2001)
2. % Rural Population with Access to Safe Water	65.0 (1990–1995)	81.2 (2001)
3. % Urban Population with Access to Sanitation	67.0 (1990–1995)	77.8 (2001)
C. Land Use and Deforestation		
1. Forest Area (million hectares)	2.1 (2001)	1.9 (2004)
2. Average Annual Deforestation		
a. Km ²	—	202.0 (1990–1995)
b. % Change	1.0 (1980–1990)	1.1 (1990–1995)
3. Rural Population Density (people/km ² of arable land)	—	—
4. Arable Land (% of total land)	13.4	13.9 (2001)
5. Permanent Cropland (% of total land)	15.8	15.7 (2001)
D. Biodiversity and Protected Areas		
1. Nationally Protected Area		
a. Million Hectares	—	—
b. % of Total Land	9.9 (1985)	13.0 (2003)
2. Mammals (number of threatened species)	14 (2000)	21 (2006)
3. Birds (number of threatened species)	11 (2000)	17 (2006)
4. Higher Plants (number of threatened species)	431 (2000)	280 (2006)
5. Reptiles (number of threatened species)	8 (2000)	8 (2006)
6. Amphibians (number of threatened species)	0 (2000)	520 (2006)
E. Urban Areas		
1. Urban Population		
a. Million	4.1	4.4 (2002)
b. % of Total Population	22.3	23.4 (2002)
2. Per Capita Water Use (liters/day)	—	—
3. Wastewater Treated (%)	—	—
4. Solid Waste Generated per Capita (kg/day)	—	—

— = not available, GDP = gross domestic product, kg = kilogram, kgoe = kilograms of oil equivalent, km² = square kilometer, PPP = purchasing power parity.

Sources: Central Bank of Sri Lanka, *Annual Report 2007*, Department of Census and Statistics, FAO, www.fao.org, IUCN, www.iucnredlist.org, UNDP, www.undp.org

Table A1.5: Development Coordination Matrix

Sectors and Themes	Current ADB Strategy and/or Activities	Other Development Partners' Strategies and/or Activities
Sector		
Agriculture and Natural Resources	<p>Agriculture: continuing support for sector productivity through a better policy and regulatory environment and broader sector commercialization; greater private sector participation in research extension, marketing, and financial services; agribusiness capacity expansion; natural and environmental resource management; and flexibility in responding to rehabilitation needs in the north and east.</p> <p>Fishery environment and biodiversity: an integrated approach to rehabilitation of coastal habitats and beaches; reduction of erosion-prone areas; and improvement of fish-breeding habitats and fisheries management, creation of income-generating opportunities for impoverished coastal people, and strengthening of sector institutions.</p> <p>Water resource management: supporting comprehensive water resource management, strengthening the capability of the Government's newly created institutional framework, and facilitating agency restructuring in the sector.</p>	<p>Agriculture: FAO, the World Bank and IFAD, and bilateral sources such as Australia, JBIC, the Netherlands, NORAD, and Sida, supported agriculture production.</p> <p>Fishery environment and biodiversity: FAO, UNDP, World Bank, and bilateral sources such as Abu Dhabi Fund, CIDA, DANIDA, GTZ, DFID, EU, JBIC, JICA, Korean International Cooperation Agency, Netherlands., NORAD, Sida, and USAID. The World Bank (like ADB) has adopted a sector approach in expanding facilities, and Denmark and Finland have been active in promoting community-based approaches.</p> <p>Water resource management: USAID assistance has been mainly for the National Water Supply and Drainage Board, and UNDP has assisted sector coordination and preparation of master plans. Australia, CIDA, FAO, France, JICA, the Republic of Korea, the Netherlands, and NORAD support water resources management. Iran has also recently emerged as an important partner in water resource development.</p>
Transport and Communications	<p>To support the optimum integration of the road network with other modes of transport.</p> <p>Roads: to improve overall sector performance by (i) supporting institutional and policy reforms; (ii) strengthening private sector participation; and (iii) financing strategic investments in the network, including the need to link less-developed regions to markets and service centers.</p> <p>Ports: to be internationally competitive and tap optimum private sector financing in its expansion.</p>	<p>Roads: The World Bank supports maintenance and rehabilitation of national and provincial road networks. JBIC supports all levels of roads network development, ranging from expressway and national highways to provincial and rural roads, and capacity building of the private construction industry. AFD, Australia, Austria, EU, Kuwait Fund, Saudi Fund, Sida, the Republic of Korea, the People's Republic of China, and UNDP also provide funding to the sector.</p> <p>Ports: JBIC and the People's Republic of China support port development.</p>

Sectors and Themes	Current ADB Strategy and/or Activities	Other Development Partners' Strategies and/or Activities
Energy	To help develop power sector and petroleum sector structures that ensure adequate amounts of electricity and petroleum products at economic and affordable prices; participate in power generation projects; provide continuing support for transmission and distribution investment, particularly if it underpins important sector reforms; assist rural electrification; and provide continued support for the required capacity building of Government institutions in the areas of petroleum resources (oil and gas).	The World Bank, Japan, and other bilateral sources such as Germany, Kuwait Fund, the People's Republic of China, Sida, the United States, and the United Kingdom, and a small amount from the Netherlands, supported the power sector. The People's Republic of China and the Republic of Korea also provided assistance to the petroleum sector. The World Bank supports renewable energy generation in rural areas. JBIC covers generation, transmission, and distribution, and supports the diversification and lowering generation cost of power through financing the introduction of LNG. Germany's assistance in the power sector goes back over 2–3 decades, and supported transmission.
Finance	Promote an enabling environment for private sector development using ADB's public sector window; and directly invest in private sector companies using loans and equity through ADB's Private Sector Operations Department.	In coordination with IMF, Japan and the World Bank support private sector development. The World Bank has provided assistance for central bank restructuring, legal reform, land titling, and policy dialogue in these and related sectors. Other development partners in financial reforms include USAID and Sida.
Industry and Trade	Through its private sector development program, ADB supports further restructuring and commercialization of SOEs, deregulating and streamlining ports and customs, and streamlining regulatory requirements for running and operating businesses.	EU supported trade development. JBIC supports small and micro firms (including environment investments by the private firms), and JICA supports technology acquisition by firms and particular clusters of firms in specific subsectors. In the poverty reduction support credit, Germany provided credit lines to promote SMEs, and GTZ provided assistance to SMEs and microfinance sectors. NORAD and Sida provide assistance to SMEs. International Finance Corporation has approved a SME fund for higher-end SMEs.
Education	Emphasizes secondary and postsecondary education by improving access of the poor to quality schools and/or teaching, and providing opportunities for all pupils from grade 10 onwards to meet the demands of the labor market.	The World Bank supports long-term tertiary education reform program by enhancing institutional capacity to achieve greater relevance and quality in undergraduate programs. Bilateral funding agencies (JICA, Sida, and GTZ, DFID, and British Council) have provided the most assistance to pilot programs for primary education, including for English language, plantation schools, and schools in conflict zones, and peace education and psycho-social care; and GTZ had provided assistance to National Institute of Education and Ministry of Education. JICA supported middle schools (grades 6–9) and provided computers for grades 1–11. Kuwait Fund supported university level education. The Republic of Korea supports vocational training center and technical colleges.

Sectors and Themes	Current ADB Strategy and/or Activities	Other Development Partners' Strategies and/or Activities
Water Supply, Sanitation and Waste Management	To support water supply and sanitation, and waste management.	The World Bank supports the rural water supply sector. JBIC supports water supply developments and sewerage development, and institutional capacity building of NWSDB. Germany's assistance in the water supply and sanitation went back to the late 1990's, with ongoing activities in four towns, including tariff study, and decentralization of services. Australia, Austria, DANIDA, the Netherlands, and Sida support water supply and sanitation development. USAID assistance has been mainly for the National Water Supply and Drainage Board, and UNDP has assisted sector coordination and preparation of master plans. France and Spain provide water treatment facilities. NORAD has provided cofinancing in an ongoing ADB project. The Republic of Korea has also provided water supply and sanitation schemes in the country.
Health	Indirect interventions to improve the health status of the population are mainly through assistance in water supply and sanitation, and rural electrification. In the overall rehabilitation and reconstruction efforts, access to health services in the conflict-affected areas is a priority, including support to rehabilitate hospital services.	The World Bank provides assistance to support the Government's health sector reform program, and supports HIV/AIDS prevention program. Japan and United Nations agencies support improvement of access and quality of health services in the conflict-affected areas, among others, in the country. The Republic of Korea and Saudi Fund support improvement of access and quality of health services.
Multisector	ADB's strategy in the urban development and housing sector includes the following: (i) develop an environmentally sustainable economic base with adequate infrastructure and services in urban areas outside Colombo; (ii) strengthen the technical, financial, and management aspects of local urban institutions; (iii) improve access to housing for low-income groups; (iv) develop an urban land management system; and (v) become an "agent for change" on a sector basis.	The World Bank is providing assistance for homeowner-driven housing reconstruction for those affected by the December 2004 tsunami. Assistance to low-income housing alone has come from Japan, the Republic of Korea, and USAID (the latter since 1980, initially through its low-income shelter and housing guarantee programs). GTZ provided assistance in enhancing sustainable housing construction and community development standards.

Sectors and Themes	Current ADB Strategy and/or Activities	Other Development Partners' Strategies and/or Activities
Theme		
Governance and Public Management	ADB's approach is to enable governance to be mainstreamed in sector investments through (i) a core service delivery reform initiative that allows for evolving and introducing a service delivery policy framework through pilot projects in selected priority services in certain areas (including the north and east), and the subsequent scaling up of these; (ii) development and implementation of service delivery policies for road, energy, and water supply and sanitation sectors; and (iii) improvement in public sector resource management by enhancing public expenditure management and resource mobilization, as well as human resource development.	The World Bank assisted in land titling of selected areas on a pilot basis, judiciary reform, procurement reforms, and e-governance. The Republic of Korea is also providing support in this area. DFID has provided assistance to the Ministry of Finance to improve financial management and public sector performance. The United States provided long-term budget advice to the Ministry of Finance until 2007. GTZ provided organization skills to Trincomalee provincial council and to the various partner ministries and organizations of the projects in different sectors. UNDP provides support to harmonize information management systems, supports the development of national capacities for the preparation of strategies and policies, and assists in strengthening oversight mechanisms.
Private Sector Development	Enabling conditions are being created for private sector development through public sector operations via the following: (i) policy dialogue to remove the remaining constraints on private sector development or creation of sustainable public-private partnerships, with emphasis on deregulation in the production, manufacturing, and financial markets, and on ensuring fair competition; (ii) credit lines for small and medium-sized enterprises (SMEs), supplemented by leveraging of resources through partial credit guarantees; (iii) promotion of business service support facilities provided by the private sector; and (iv) catalyzing of private investment through the Private Sector Operations Department.	The World Bank provided Poverty Reduction Support Credit to support an enabling environment, labor and land markets, public enterprise restructuring, private participation in infrastructure, and financial sector reforms. Japan is supporting technology acquisition, business development services, and credit lines for small and micro firms. Germany supports development of private sector infrastructure, information and communications technology services, and extension of long-term credit line financing to private sector companies. GTZ is providing assistance to vocational training, and cooperation with SME and trade promotion (i.e., under SAARC). Sida is involved in entrepreneurship development, regional chamber development, and arbitration. USAID is focusing on improving competitiveness in key subsectors, policy and regulatory reforms for financial markets, trade, and investment.

ADB= Asian Development Bank, AFD= Agence Française de Développement, CIDA= Canadian International Development Agency, DANIDA= Danish International Development Assistance, DFID= Department for International Development, EU= European Union, FAO Food and Agriculture Organization of the United Nations, GTZ= Deutsche Gesellschaft für Technische Zusammenarbeit, HIV/AIDS= Human Immunodeficiency Virus/ Acquired Immunodeficiency Syndrome, IFAD= International Fund for Agricultural Development, IMF= International Monetary Fund, JBIC= Japan Bank for International Cooperation, JICA= Japan International Cooperation Agency, LNG= Liquefied Natural Gas, NORAD= Norwegian Agency for Development Cooperation, NWSDB= National Water Supply and Drainage Board, SAARC= South Asia Association for Regional Cooperation, Sida= Swedish International Development Cooperation Agency, SME= Small and Medium Enterprise, SOE= State Owned Enterprises, UNDP= United Nations Development Programme, USAID= United States Agency for International Development

Table A1.6: Portfolio Indicators—Portfolio Amounts and Ratings
(public sector loans, as of 30 June 2008)

Sector	Net Loan Amount (\$ million) (%)		Total (no.) (%)		Rating ^a								Potential Problem ^b (no.) (%)		At Risk ^c (no.) (%)	
					Highly Satisfactory		Satisfactory		Partly Satisfactory		Unsatisfactory					
					(no.)	(%)	(no.)	(%)	(no.)	(%)	(no.)	(%)				
Agriculture and Natural Resources	146.18	7.51	8	18.60	-	-	7	17.95	1	33.33	-	-	-	-	1	33.33
Education	172.86	8.88	4	9.30	-	-	4	10.26	-	-	-	-	-	-	-	-
Energy	82.49	4.24	1	2.33	-	-	1	2.56	-	-	-	-	-	-	-	-
Finance	117.06	6.01	5	11.63	-	-	4	10.26	1	33.33	-	-	-	-	1	33.33
Health, Nutrition, and Social Protection	0.00	0.00	0	0.00	-	-	-	0.00	-	-	-	-	-	-	-	-
Industry and Trade	114.62	5.89	3	6.98	-	-	2	5.13	1	33.33	-	-	-	-	1	33.33
Law, Economic Management and Public Policy	25.55	1.31	2	4.65	-	-	2	5.13	-	-	-	-	-	-	-	-
Transport and Communications	823.81	42.31	8	18.60	-	-	8	20.51	-	-	-	-	-	-	-	-
Water Supply, Sanitation & Waste Management	276.31	14.19	5	11.63	-	-	5	12.82	-	-	-	-	-	-	-	-
Multisector	188.13	9.66	7	16.28	1	100.00	6	15.38	-	-	-	-	-	-	-	-
Total	1947.01	100.00	43	100.00	1	100.00	39	100.00	3	100.00	-	-	-	-	3	100.00

^a One rating for implementation progress and development objectives, based on the lower rating of either.

^b Potential problem loans are satisfactory loans but have four or more risk factors associated with partly satisfactory or unsatisfactory performance.

^c A loan is "at risk" if it is rated as partly satisfactory, as unsatisfactory, or as a potential problem.

Source: Asian Development Bank estimates

Table A1.7: Portfolio Indicators—Disbursements and Net Transfers of Resources
(public sector loans, as of 31 March 2008)

Disbursements and Transfers	OCR	ADF	Total
Disbursements ^a			
Total Funds Available for Withdrawal (\$ million)	448.5	1161.9	1610.4
Disbursed Amount (\$ million, cumulative)	165.0	639.4	804.4
Percentage Disbursed (disbursed amount/total available)	36.8	55.0	50.0
Disbursements (\$ million, latest year)	1.0	36.2	37.2
Disbursement Ratio (%) ^b	0.4	6.7	4.5
Net Transfer of Resources (\$ million)			
1999	0.0	68.0	68.0
2000	0.0	40.4	40.4
2001	(0.1)	54.1	54.0
2002	35.9	71.1	107.0
2003	32.8	129.4	162.2
2004	46.4	79.7	126.1
2005	32.2	101.5	133.7
2006	30.3	66.4	96.7
2007	(13.7)	58.1	44.4
31 March 2008	(3.7)	12.9	9.1

ADF = Asian Development Fund, OCR = ordinary capital resources.

^a Includes ongoing loans and closed loans with disbursements in 2007.

^b Ratio of disbursements during the year over the undisbursed net loan balance at the beginning of the year less cancellations during the year. Effective loans during the year have also been added to the beginning balance of undisbursed loans.

Source: Asian Development Bank Central Operations Services Office.

Table A1.8: Portfolio Implementation Status
(public sector loans, as of 30 June 2008)

Sector	Loan No.	Seg	Fund	Project Name	Net Loan Amount		Closing Date		Progress % complete	Cumulative Contract Awards / Commitments (\$ million)	Cumulative Disbursements (\$ million)	IP	IO	Potential Problem ^a	At Risk ^b		
					OCR (\$ million)	ADF (\$ million)	Approval	Effectivity								Original	Revised
1	AGR	1716-SRI(SF)	SF	CRMP		42.1	7-Dec-99	14-Jun-00	30-Dec-05	31-May-08	80.0	40.2	39.1	S	S	No	No
2	AGR	1744-SRI(SF)	SF	FRMSP		25.3	28-Jun-00	23-Oct-00	30-Jun-08	30-Jun-09	86.0	23.0	24.0	S	PS	No	Yes
3	AGR	1767-SRI(SF)	SF	PROTECTED AREA MGT.		13.7	19-Oct-00	17-Sep-01	30-Jun-07	31-Dec-08	87.5	10.7	10.2	S	S	No	No
4	AGR	1910-SRI	2	OCR AQUATIC RESOURCE DEV	6.0		5-Sep-02	3-Nov-03	30-Jun-10	30-Jun-10	14.0	0.6	0.9	S	S	No	No
-	AGR	1910-SRI	1	OCR AQUATIC RESOURCE DEV	0.8							0.0		S	S	No	No
5	AGR	1911-SRI(SF)	SF	AQUATIC RESOURCE DEV		16.3	5-Sep-02	7-May-03	30-Jun-10	30-Jun-10	52.0	9.7	7.8	S	S	No	No
6	AGR	1913-SRI(SF)	SF	PDP		9.4	13-Sep-02	29-Aug-03	30-Jun-09	30-Jun-09	45.0	3.7	4.3	S	S	No	No
7	AGR	1914-SRI	1	OCR PDP	4.6		13-Sep-02	29-Aug-03	30-Jun-09	30-Jun-09	60.0	3.6	8.8	S	S	No	No
-	AGR	1914-SRI	2	OCR PDP	5.5							0.0		S	S	No	No
8	AGR	2027-SRI(SF)	SF	NECCD		22.6	28-Nov-03	16-Nov-04	30-Jun-10	30-Jun-10	51.0	6.5	4.0	S	S	No	No
9	ED	1999-SRI(SF)	SF	DISTANCE ED MOD		44.4	11-Jun-03	4-Nov-03	31-Dec-09	31-Dec-09	49.0	22.2	17.2	S	S	No	No
10	ED	2096-SRI(SF)	SF	SEMP II		38.2	25-Oct-04	19-May-05	30-Jun-10	30-Jun-10	47.0	15.9	14.9	S	S	No	No
11	ED	2197-SRI(SF)	SF	TEDP		22.1	21-Nov-05	19-Apr-06	31-Aug-11	31-Aug-11	5.0	3.0	1.4	S	S	No	No
12	ED	2371-SRI(SF)	SF	EDUC FOR KNOWLEDGE		68.2	26-Nov-07	7-Mar-08	30-Jun-13	30-Jun-13	5.0	0.1	2.1	S	S	No	No
13	EN	1930-SRI(SF)	SF	PSDS (PROJECT)		82.5	31-Oct-02	28-Nov-02	30-Jun-07	30-Jun-09	30.0	63.6	54.3	S	S	No	No
14	FI	2040-SRI	OCR	RFSDP	35.3		11-Dec-03	12-May-04	30-Jun-08	30-Jun-08		35.0	35.3	S	PS	No	Yes
15	FI	2041-SRI	OCR	RFSDP	10.0		11-Dec-03	12-May-04	30-Jun-08	30-Jun-08		7.4	8.4	S	S	No	No
16	FI	2042-SRI(SF)	SF	RFSDP		11.1	11-Dec-03	12-May-04	30-Jun-08	30-Jun-08	40.0	6.2	4.8	S	S	No	No
17	FI	2138-SRI	OCR	FMP PSD	60.0		15-Dec-04	21-Mar-05	31-Dec-07	31-Dec-08		20.0	20.0	S	S	No	No
18	FI	2139-SRI(SF)	SF	SUPPORTING PS & FMDP		0.7	15-Dec-04	21-Mar-05	1-Dec-07	31-Dec-08		0.5	0.4	S	S	No	No
19	IN	1895-SRI(SF)	SF	SME BSSF		2.1	20-Dec-01	19-Sep-02	30-Jun-05	15-Apr-06	50.0	2.7	2.0	PS	S	Yes	Yes
20	IN	1896-SRI	OCR	SME CREDIT ASSISTANC	60.0		20-Dec-01	19-Sep-02	19-Sep-07	19-Sep-07		61.2	60.0	S	S	No	No
21	IN	2381-SRI(SF)	SF	SMERDP		52.5	6-Dec-07	8-Apr-08	30-Jun-11	30-Jun-11		0.0	5.0	S	S	No	No
22	LW	2131-SRI(SF)	SF	SFMP		10.5	14-Dec-04	21-Dec-04	30-Jun-08	30-Jun-09		5.3	4.9	S	S	No	No
23	LW	2132-SRI	OCR	SFMP	15.0		14-Dec-04	21-Dec-04	30-Jun-08	30-Jun-09		0.2	0.6	S	S	No	No
24	TC	1849-SRI(SF)	SF	RNIP		94.8	8-Dec-98	26-Feb-99	30-Jun-05	31-Dec-08	98.0	90.0	93.5	S	S	No	No
25	TC	1711-SRI(SF)	SF	STDP		96.7	25-Nov-99	30-Oct-02	31-Dec-06	31-Dec-10	47.0	93.0	88.9	S	S	No	No
26	TC	1841-SRI(SF)	SF	CPEEP		11.9	27-Sep-01	7-May-02	29-Feb-04	28-Feb-10	95.0	10.5	8.4	HS	S	No	No
27	TC	1986-SRI(SF)	SF	RSDP		64.1	19-Dec-02	22-May-03	30-Jun-08	30-Jun-08	80.0	61.1	56.9	S	S	No	No
28	TC	2080-SRI(SF)	SF	RPPF		16.3	13-Apr-04	15-Sep-04	31-Dec-08	31-Dec-08	35.0	8.0	3.5	S	S	No	No
29	TC	2217-SRI	OCR	NATL HIGHWAYS SECTOR	150.0		15-Dec-05	20-Feb-07	31-Dec-10	31-Dec-10		24.4	2.4	S	S	No	No
30	TC	2319-SRI	OCR	CPEP	300.0		27-Feb-07	2-May-08	30-Apr-11	30-Apr-11		301.9	29.7	S	S	No	No
31	TC	2413-SRI	OCR	STDP(SUPPLEMENTARY)	90.0		6-Mar-08	13-Jun-08	30-Dec-10	30-Dec-10		0.0	0.0	S	S	No	No
32	WS	1575-SRI(SF)	SF	3RD WATER SUPPLY/SAN		83.2	6-Nov-97	17-Jul-98	30-Jun-05	31-Dec-07	96.0	80.4	83.1	S	S	No	No
33	WS	1993-SRI(SF)	SF	2NDARY TOWNS WS&S		72.6	16-Jan-03	21-Nov-03	30-Sep-09	30-Sep-09	45.0	44.4	26.3	S	S	No	No
34	WS	2201-SRI(SF)	SF	LOCAL GOVT INFRAS		55.9	24-Nov-05	30-Jun-06	30-Apr-12	30-Apr-12	25.0	4.2	3.9	S	S	No	No
35	WS	2275-SRI	OCR	2NDARY TOWNS (SUPP)	13.5		29-Nov-06	28-Aug-07	30-Jun-10	30-Jun-10	15.0	4.5	1.3	S	S	No	No
36	WS	2276-SRI(SF)	SF	2NDARY TOWNS (SUPP)		51.1	29-Nov-06	10-Apr-07	30-Jun-10	30-Jun-10		39.3	13.9	S	S	No	No
37	MS	1846-SRI(SF)	SF	NORTH EAST COMM RES		29.2	16-Oct-01	9-Jan-02	30-Jun-07	30-Jun-07	85.0	27.7	25.8	HS	HS	No	No
38	MS	1849-SRI(SF)	SF	SOUTH PROV RURAL		29.8	26-Oct-01	12-Dec-02	31-Jul-08	31-Jul-09	84.0	24.7	20.2	S	S	No	No
39	MS	2043-SRI(SF)	1	SF CNFLCT AFFCTD REHAB		53.2	11-Dec-03	10-Mar-04	30-Jun-08	31-Dec-09	60.0	35.1	29.4	HS	S	No	No
-	MS	2043-SRI(SF)	2	SF CNFL AREAS REHAB-D		1.0					100.0	0.9		S	S	No	No
40	MS	2044-SRI	OCR	CAARP	30.0		11-Dec-03	21-Feb-05	30-Jun-08	30-Jun-10	10.0	0.0	0.5	S	S	No	No
41	MS	2084-SRI(SF)	SF	NECORD EXTENSION PRJ		10.8	15-Jun-04	28-Dec-04	30-Jun-07	30-Jun-09	45.0	8.4	5.1	S	S	No	No
42	MS	2167-SRI(SF)	SF	TAARP		7.1	14-Apr-05	28-Jul-05	30-Jun-09	30-Jun-09	62.0	2.5	3.2	S	S	No	No
43	MS	2168-SRI(SF)	SF	NECORD II		26.9	14-Apr-05	28-Jul-05	30-Jun-09	30-Jun-09	17.0	14.8	9.1	S	S	No	No
TOTAL					780.6	1166.4						1216.8	835.6				

ADF=Asian Development Fund, AGR = Agriculture and Natural Resources, ED = Education, EN = Energy, FI = Finance, IO = impact and outcome, IP = implementation progress, LW = Law, Economic Management and Public Policy, MS = Multisector, OCR = ordinary capital resources, PS = partly satisfactory, S = satisfactory, Seg=segment (pertaining to loans with more than one withdrawal authority), SOC = social infrastructure, TC = Transport & Communication, U = unsatisfactory, WS = Water Supply, Sanitation & Waste Management.

a "Yes" for loans with four or more risk factors associated with partly satisfactory or unsatisfactory performance.

b A loan is considered "at risk" if it is rated "PS" or "U" in either implementation progress or impact and outcome, or if it is a potential problem loan.

Source: Asian Development Bank Consulting Services Division 1.

**Table A1.9: Evaluation Rating by Sector
(1998-2007)**

Sector	Highly Successful		Successful		Partly Successful		Unsuccessful		No Rating		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
Agriculture and Natural Resources	0	0	1	50.0	1	50.0	0	0	0	0	2	100.0
Energy	1	100.0	0	0	0	0	0	0	0	0	1	100.0
Finance	0	0	0	0	0	0	0	0	0	0	0	0
Industry and Nonfuel Minerals	0	0	1	100.0	0	0	0	0	0	0	1	100.0
Multisector	0	0	1	33.3	2	66.7	0	0	0	0	3	100.0
Others	0	0	0	0	0	0	0	0	0	0	0	0
Social Infrastructure	0	0	1	100.0	0	0	0	0	0	0	1	100.0
Transport and Communications	0	0	0	0	1	100.0	0	0	0	0	1	100.0
Total	1	11.1	4	44.4	4	44.4	0	0	0	0	9	100.0

Source: Post Evaluation Information System (PEIS)

COUNTRY COST-SHARING ARRANGEMENTS AND OTHER FINANCING PARAMETERS

Item	Parameter	Remarks/Explanation
Country cost-sharing ^a ceiling for the loan portfolio of projects over the CPS period (2009–2011)	Up to 90%	The cost-sharing ceiling has been increased from 75% to 90% for the new CPS period. The ceiling was increased in consideration of new pressures on counterpart funding faced by the Government. The pressures include reconstruction of conflict and tsunami-affected areas, development of Eastern Province, and increasingly limited access to concessional funds due to Sri Lanka's middle-income status. Under these conditions, it was considered necessary to increase the cost-sharing ceiling to ensure that ADB projects are not affected by a lack of counterpart funds. Cost sharing for individual projects will be decided on a case-by-case basis, depending on cost of structure, project design, and availability of cofinancing.
Country cost-sharing ceiling with respect to the portfolio TA and other grants over the CPS period (2009–2011)	Up to 85%	Under the current arrangement, the Government's contribution is in kind, consisting of counterpart staff, office accommodation, and facilities. The Government does not provide counterpart funding for TA projects. Currently ADB contributes 80%–85% of total costs. No major change in this arrangement is expected during the new CPS period, and the same level is recommended as the new ceiling.
Cost-sharing ceiling for specific sectors	None	Sector-specific ceilings are not proposed, but it is possible to go up to 99% on a project basis.
Recurrent cost financing. Do any limits apply to the overall amount of recurrent expenditures that ADB may finance?	No country limits	While there is no ceiling, currently a larger portion of the recurrent costs is borne by the Government. This trend is likely to continue. In determining ADB financing of recurrent costs at the project level, issues of sustainability at project and sector levels will be considered. ADB will continue to monitor the fiscal situation and its implications for recurrent costs.
Taxes and duties. Are there any taxes and duties that ADB would not finance?	None	Changing from the current practice of not financing taxes and duties, ADB may finance these components in projects as long as they are nondiscriminatory. ADB will continue to monitor developments in the tax system and the application of taxes on ADB-funded projects.

ADB = Asian Development Bank, CPS = country partnership strategy, TA = technical assistance.

^a ADB policy on cost sharing is governed by ADB. 2005. *Cost Sharing and Eligibility of Expenditures for Asian Development Bank Financing: A New Approach*. Manila.

Source: Asian Development Bank estimates.

COUNTRY PARTNERSHIP STRATEGY AND PROGRAM FORMULATION

A. Analytical Input

1. The first step in developing the country partnership strategy (CPS) was to start thematic and sector research. In 2005, the Asian Development Bank (ADB) and the World Bank conducted a joint Sri Lanka investment climate survey⁶³, which involved far-reaching consultation and dissemination of its findings. Another joint report by funding agencies—the country environmental analysis—was kicked off in 2007, with ADB’s findings, derived from several consultative workshops, summed up in Supplementary Appendix D. A gender assessment update was also completed in time for the CPS, again involving widespread consultation, including with nongovernment organizations (NGOs) from Eastern and Northern provinces. The findings are summed up in Supplementary Appendix C. Procurement and governance work also informed the formulation and approach taken in the CPS.
2. ADB has published detailed research on poverty and the private sector, and these studies were reviewed and updated where necessary.
3. Research was carried out to develop road maps for ADB’s public sector operations in agriculture (subsequently dropped), finance, energy, transport, and urban development.
4. ADB began a thorough internal study of its experience in March 2007, and this formed the basis for the country strategy and program (CSP) completion report (Appendix 4). More far-reaching was the country assistance program evaluation (CAPE) by the Operations Evaluation Department (OED). The CAPE was complemented by several other OED evaluations, including those on capacity development and a capital markets. The CAPE involved thorough consultations with and reviews by the Government and international organizations working in the Sri Lanka. Lessons from the CAPE are summarized in the main text of this CPS and in this appendix.
5. The Development Effectiveness Committee (DEC) recommendations arising from the CAPE focus on (i) the need to carefully select the sectors ADB would disengage from, (ii) the need for continued engagement in conflict and post-conflict assistance in a conflict-sensitive manner; and (iii) the resident mission policy review undertaken by Strategy and Policy Department and its recommendations, so that some of CAPE’s suggestions can be implemented.

⁶³ ADB and World Bank. 2005. *Investment Climate Assessment—Sri Lanka: Improving the Rural and Urban Investment Climate*. Colombo; ADB. 2005. *Sri Lanka: Financial Sector Assessment*. Manila.

Table A3.1: Country Assistance Program Evaluation Findings and Proposed Country Partnership Strategy Approach

Country Assistance Program Evaluation Recommendation	Country Partnership Strategy Approach
(i) Review how assistance is delivered to conflict-affected areas	In the preparation for the CPS, the country team set up a "conflict and governance" group that discussed how to deliver assistance most effectively, calling in external resource persons to discuss key questions (such as involvement in the east, issues surrounding the 13th amendment to the constitution). Projects already had been temporarily suspended at the time of CAPE assessments; new approaches include, use of formal operational guidelines on how to operate in conflict-affected areas, continuous and updated conflict assessments of relevant projects, and recruitment of an advisor at the resident mission to assist effective project implementation in these areas and throughout Sri Lanka.
(ii) Strengthen MfDR	MfDR is being supported through RETA delegated to the resident mission, and follow-up TA is planned with the support of RSDD. Work on capacity development, key under this CPS, is also closely linked to the MfDR framework. The resident mission also initiated an MfDR approach in its own organizational setup with several workshops, and intends to use MfDR to improve its service delivery.
(iii) Review focus of development assistance, particularly within sectors that have fallen short of achieving significant results	The CPS is more focused now, with no new assistance planned in agriculture, forestry, wildlife, and finance, and no new lending in education. However, ADB will remain engaged in the power sector, with a strong focus on environmental sustainability and gradual reforms as this sector is too important to completely disengage from, and ADB's assistance in rehabilitating and building rural infrastructure has been successful. Agriculture was dropped from the program after intense consultation on demand by the Government, which was keen to keep ADB's interventions focused given the relatively small resource envelope. While no new lending in education is envisaged unless a positive evaluation of the sector is undertaken, the focus will be on implementing projects that are just coming on stream during the early CPS period.
(iv) Remain engaged in policy dialogue despite complex political economy environment, and review Sri Lanka Resident Mission resources both at the resident mission and headquarters	The resident mission was strengthened through recruitment of a long-term governance advisor who joined in July 2008, and a new procurement officer. Project administration, especially procurement and project analysts, will increase to be able to respond quickly to stakeholders' needs. Other issues, such as resident mission staffing, need to be addressed in the context of institutional reforms (such as the resident mission policy paper).

ADB=Asian Development Bank, CAPE =Country Assistance Performance Evaluation, CPS=Country Partnership Strategy, MfDR=Managing for Development Results, RETA=Regional Technical Assistance, RSDD=Regional and Sustainable Development Department, TA=Technical Assistance

Source: ADB staff.

B. Consultation

6. Consultations on the CPS started in March 2007 with a meeting between ADB and the Government, represented by the Ministry of Finance and Planning (MOFP) and line ministries involved in ADB's operations. ADB briefed the Government on the expected process of developing the CPS and invited the Government's comments.

7. Following the initial meeting, ADB started preparing the CPS initiating paper and began background research on sectors likely to be involved in ADB's future operations. The initiating paper for the CPS was presented to the ADB Board of Directors in an informal seminar on 11 June 2007; separate meetings were also held with some Board members before the seminar. The Board members supported the strategic focus and sequencing of the proposed strategy. The chief concern raised was how ADB intends to ensure that the funds reach its intended beneficiaries.

8. In June 2007, ADB started CPS consultation in Sri Lanka. This included consultation with the participants from central and local government agencies, line ministries, sector agencies, executing agencies (EAs) and implementing agencies (IAs) of ADB projects, civil society (e.g., academics and NGOs), and the international community. The Sri Lanka Resident Mission is piloting a new consultation and participation strategy, which focused initially on the CPS process—both the strategy document and consultations on the road maps. The consultation process had three phases:

- (i) phase I—sector consultation (workshops and bilateral consultations)
- (ii) phase II—consultations on the CPS initiating paper
- (iii) phase III—final consultations on the CPS draft with all those involved in the earlier consultation process, as well as key political opposition parties

9. During the consultations, the participants expressed appreciation for ADB's comprehensive consultation. Overall, most agreed with the focus on infrastructure, though some would like to see greater emphasis on public transport. However, civil society and development partners were concerned about how ADB would ensure good governance in its projects, and also how to ensure that ADB funds would not be used to finance defense expenditure. Development partners stressed the need to put the conflict much more up front than it was in the initiating paper. When discussing sector road maps, there was overall agreement with the key issues, and the suggested solutions, though some disillusionment was expressed on how to implement the solutions. Most issues and problems confronting Sri Lanka are well known, and have been extensively studied.

10. While infrastructure will remain an important focus of the CPS, ADB is also exploring the possibility of becoming involved in public transport towards the end of the CPS period. ADB recognizes that rehabilitating roads, though crucial, cannot be the only answer to a sustainable transport system in the country. The conflict approach has been fleshed out more, both the internal operational guidelines and ADB's lessons from past years of in-conflict and post-conflict rehabilitation in Sri Lanka. Program loans will be used sparingly and only where Government commitment to reforms is strong; funds for project financing are closely monitored and supervised, and ADB's procedures minimize the risk of funds being spent on other projects and for other purposes. The difficulties of implementing projects and making political decisions have been fully recognized in the CPS, which adopts a pragmatic and realistic approach to what can and cannot be done in a complex environment like Sri Lanka. At the same time, ADB will continue an intense policy dialogue—on economic reforms and on governance—through its strengthened resident mission.

COMPLETION REPORT FOR PREVIOUS COUNTRY STRATEGY

<p>Country development goals</p> <p>Raise productivity and incomes, and reduce poverty, by fundamentally changing the relationship between the public and private sector. Five elements to bring this about</p> <ul style="list-style-type: none"> (i) build a supportive macroeconomic environment (ii) reduce conflict-related poverty (iii) create opportunities for the poor to participate in economic growth (iv) invest in people (v) empower the poor and strengthen governance
<p>Expected CSP outcomes</p> <p>Supporting pro-poor growth through</p> <ul style="list-style-type: none"> (i) private sector development (access to markets, PPP in education, agriculture and roads, skill development) (ii) economic reforms in power, banking, agriculture, and transport to improve efficiency and bring in the private sector (iii) focus on social development, regional imbalances through rural infrastructure development and greater access to quality education (iv) improve governance (improve local governance and SOE governance to improve service delivery, and strengthen pro-poor service delivery)
<p>Remarks:</p> <p>The context within which the CSP was implemented changed dramatically in 2004, i.e., only one year after it was approved. The CSP was based on the United National Party's (UNP) growth strategy "Regaining Sri Lanka," which treated the state as the prime obstacle to, rather than a means of, economic development and poverty reduction. It therefore sought to reduce the role of the state by privatizing and restructuring state owned enterprises, by privatizing key state banks controlling 60% of the financial assets in the country, and by letting the private sector become more involved in areas that had previously been the mandate of the Government (ranging from providing education to health services, to investing and running water supply facilities, power supply and others).</p> <p>The UNP lost parliamentary elections in April 2004 to the Sri Lanka Freedom Party (SLFP), after only little more than 2 years in office and despite substantial improvement in key macroeconomic indicators. November 2005 ushered in a new president of the SLFP, Mahinda Rajapakse. His new economic policy assumes that the private sector has underperformed, and that it is time to rectify "market failures" rather than Government failure. The new SLFP Government has reversed or put on hold most of the radical economic reform policies, arguing that the "trickle down" effect of such policies was slow, or non-existent, and that it was concerned about the growing inequality in the country.</p> <p>The resurgence of the conflict since August 2006 was another unanticipated change slowing down project implementation, but since 2007, project implementation in the east of the country improved.</p>

CSP strategy and Outputs	Outcome	Reason	Lesson learned
(i) Private Sector Development (access to markets, PPP in education, agriculture and roads, skill development)			
Improve productivity by greater private sector participation in research and extension, infrastructure provision, marketing and financial services	<p>Some extension services have been provided by private sector (may however exclude poorer farmers); research and extension services had difficulties in expanding as there was not enough demand (farmers lived too far away from service providers); crop diversification successful in project area, but nationally, crop diversification low, if not falling (some added value crops like cashew and cinnamon had stagnating output).</p>	<p>Expanding extension services are hampered by devolution process and overlapping responsibilities.</p>	<p>Extension services: How to work around overlapping functions is more difficult and probably “here to stay,” given the plethora of new ministries.</p>
	<p>Microfinance outreach in various subprojects did not move as competing products, including schemes by the Government ,charged even lower interest rates.</p>	<p>Microfinance outreach was uncoordinated and “runs counter to best practice” as subsidizing interest rate. These interest rates in turn are undercut by Government that has its own credit schemes, and often writes off debt as election time approaches.</p>	<p>Microfinance outreach: Need to coordinate microfinance strategies across all sectors in the bank, as eligibility criteria and interest rates vary. This has been addressed with the rural finance (RF) loan approved in 2004: all new MF activities are channeled through the National Development Trust Fund following consistent selection criteria and interest rates.</p>
	<p>Rural finance legislation and supervisory agency yet to be established. Issues: Draft MFI Act provides excessive powers of the Government over MFI operations.</p>	<p>RF legislation: The new Government effected a decisive reform reversal, which puts the outstanding policy reforms at risk.</p>	<p>RF legislation: Policy reversal is a significant risk.</p>
Expand agribusiness (use plantation sector as best practice)	Plantations successfully privatized, but problems appear to be more pervasive, as privatized plantations continue to struggle.	Problems in agribusiness development are similar to private sector development issues across the country (i.e., need for stable macroeconomic policies, good infrastructure and access to market)	More careful analysis of binding constraints.
Strengthen nonbank financial services and capital markets	Capital market reforms (ongoing). Supervision frameworks for banks and	Capital market development: OED is concerned about the	Capital market development: Notable progress achieved.

CSP strategy and Outputs	Outcome	Reason	Lesson learned
<p>SME development: Improve competitiveness of SMEs through (i) policy reforms, (ii) improving access to business development services, and (iii) access to SME finance</p>	<p>investigative powers of SEC have been strengthened. Asset and capital adequacy requirements for banks improved. Profitability in the banking system improved. Strong anti-money-laundering laws and oversight arrangements put in place. Secured transactions legislation and registry being established.</p>	<p>premature introduction of derivatives markets in the absence of liquid bond and equity markets in FMPPSD.</p>	<p>In the absence of an overall strategy to develop the bond and equity markets Government remains the major borrower and pension funds the major supplier of funds. It is premature to introduce derivative markets in the absence of a liquid market.</p>
	<p>Reform of People’s Bank and Bank of Ceylon (BOC) (ongoing): People’s Bank made reasonable progress in achieving quantitative targets of reform. However policy reversal of the Government poses risk to achieve acceptable profitability and solvency levels for People’s Bank. Laws limiting powers of the Government to interfere in management decision making of the People’s Bank and BOC are yet to be passed.</p>	<p>Reform of People’s Bank and Bank of Ceylon (ongoing): Policy reversal of Government—discussions with Government ongoing.</p>	<p>People’s Bank reform remains a challenging process under the current environment.</p>
	<p>Broaden institutional investor base: The public sector institutions continue to be the major investor in debt markets through the Employee Provident Fund (EPF), the Employees’ Trust Fund (ETF), the National Savings Bank as well as BOC and People’s Bank. Private investors still insignificant. Measures to liberalize and better regulate the insurance industry have been implemented, but resulting investments remain small.</p>	<p>Broaden institutional investor base: Public sector investors remain under instructions to invest in Government paper resulting in a lack of alternative instruments</p>	<p>Broaden institutional investor base: This is unlikely to change unless Government relies less on public sector investors to finance deficit.</p>
	<p>Policy loan actions (completed): White Paper passed by cabinet. However lacking focus on key issues undermines implementation. Frequent change of line ministry in charge undermined continuity of reforms. Excessive number of ministries involved in SME development.</p>	<p>Political instability undermined implementation of reforms. Champion of reforms is missing. ADB treated three loans as separate interventions.</p>	<p>Top level support at the President’s office is needed to implement reforms.</p>

CSP strategy and Outputs	Outcome	Reason	Lesson learned
Financial market reform: More independent board of state-owned banks	<p>State-owned banks reform: Good progress under UNP Government that installed private sector managers at state-owned banks, but reversed starting 2004; no progress in changing legislation that would enshrine independence of banks. Management of SOEs moved to new body SEMA (away from PERC that had very similar powers). With the change of president in November 2005, future of SEMA uncertain since mid-2005.</p>	<p>SOE banks reform: (i) Substantial change in policies; and (ii) substantial reforms of the state banks has to go hand in hand with fiscal consolidation, and reforms of the public utilities, especially the Ceylon Electricity Board.</p>	<p>SOE and state-owned bank reforms: Type of intervention might have to change to be more gradual, allowing for only slow improvements in the fiscal deficit. In light of change of Government, alternative approaches to reforms—like in the port sector—might have to be found, other than privatization and without formalization of agreements with trade unions. Need to explore administrative regulations and amendments to the fullest.</p>
Develop skills-based competitiveness	<p>Skills development: IT programs and science labs have been provided in 1,000 centers; unemployment rates among youth have fallen (ADB might have contributed to this), IT training taken up keenly and 800 teachers and 200,000 students trained.</p>	<p>Skills development: There are some concerns about sustainability of running the multimedia labs and IT labs (in SEMP II review); Jobsnet has had limited success in placing people (labor markets may work differently)</p>	<p>Skills development: Good uptake of IT education that is on offer, with many enrolling in computer labs and taking up science streams (could therefore be expanded); need to plan more carefully</p>
Curriculum reform	<p>Reduce fragmentation: TEVT agencies streamlined. PPP in education: Attempts to bring in PPP in providing general education sector not successful; but some innovative PPP in ICT in education has been initiated.</p>	<p>Reduce fragmentation: successful policy dialogue resulted in bringing agencies under one umbrella ministry PPP in general education not successful as legislation to have cost recovery and other regulations in place too controversial.</p>	<p>PPP in general education: incremental approach, based on intensive dialogue, may be more successful than a “big bang” approach.</p>
Curriculum reform	<p>Curriculum reform: Piecemeal introduction of changes impedes progress in curriculum reform, and rote learning continues. School-based management (SBM) is being recognized as viable way to improve teaching and learning. School-based assessment (SBA) brings an important element of continuous assessment to the examination dominated education system</p>	<p>Curriculum reform: Structural barriers of curriculum revision cycles have precluded changes in syllabuses or teaching–learning methods. Changing rote learning may take decades. Multimedia units have been established in schools mainly for the purpose of improving the quality of lesson presentations by teachers. However, the multimedia units receive a low priority in schools.</p>	<p>Curriculum reform: Teacher training institutions need to be involved, and in spearheading innovative practices such as computer-assisted learning. SBM and SBA are important reforms but it takes time to be effectively implemented.</p>

CSP strategy and Outputs	Outcome	Reason	Lesson learned
(ii) Economic Reforms in Power, Banking, Agriculture, and Transport to Improve Efficiency and Bring in the Private Sector			
Provide sufficient road maintenance funds	Road maintenance trust fund set up after 20 years of intense dialogue.	Road maintenance trust fund: Fiscal position remains constrained with high deficits and earmarked funds tend to go to consolidated fund to fund overall budget deficit; however, 2007 allocation almost 100% of required funds.	Road maintenance trust fund: The effectiveness of the fund in securing sustainable financing for road maintenance needs to be assessed. The efficient use of the fund including the planning and execution of the maintenance works will also need to be reviewed.
Strengthen institutions for improved planning, fewer overlaps in road agencies	Reengineering Road Development Authority progressing but less than expected. The focus on: Planning and programming Maintenance management Construction management Technical audit Environmental and social organization restructuring	Reengineering RDA: Although the ADTA for the reengineering was completed satisfactorily, building strong participation and ownership, the ownership for implementation was low due to change of Government, loss of momentum due to initial delays, and absence of senior champions for change.	Reengineering RDA: Institutional and policy changes are very difficult and sensitive matter. These cannot be imposed from outside, but should be initiated from within. ADB can support the reform agenda and provide expert advice in terms of developing and implementing reforms, but the political will has to come from within the Government.
Promote greater private participation in financing, building, operating and maintaining road network	Attempts to have the Colombo Airport road built on a PPP basis failed; since late 2006 RDA begins to outsource road maintenance contracts on a pilot basis; all ADB contracts go to private sector construction firms	Resettlement would also have to follow ADB guidelines if ADB's PSOD or public sector to come in; unsolicited bids came in, but initially rejected as ADB's PPTA established costs (and unsolicited bids were substantially higher). Current status is impasse.	Environment for PPP more difficult than assumed; need to be less ambitious especially in current political environment.
Develop low-cost base load generation facilities through power sector reform (unbundling) to attract private sector investment	Low-cost base load: failure to implement a least cost option meant CEB resorted to small thermals, driven by an IPP policy, which has increased supply costs.	Low-cost base load: Small-scale IPPs were sourced as no other major investment was forthcoming; unbundling would still mean Government to finance large-scale investment, but as a stand-alone project (outside the realm of CEB)	Low-cost base load: Need to consider low-cost options that might involve CEB as excluding CEB politically not feasible. Government stance not that consistent, and most future projects are officially on BOO and BOT basis (but perhaps not on open competitive tender).
Unbundle and restructure power sector, and empower PUC to set tariffs in water and energy	CEB unbundling: Unbundling abandoned; some amount of restructuring within CEB taking place, with different regional units established. Good	CEB unbundling: Political change meant Government unwilling to implement such radical reforms—political change and	CEB unbundling: Lack of political will could not have been foreseen, given program foundation was laid under SLFP Government.

CSP strategy and Outputs	Outcome	Reason	Lesson learned
	preparatory work before unbundling, detailed models worked on, Public Utility Commission established, internal CEB structure established	influence that ADB could not foresee	
Greater efficiency in port operations through promoting PPP and port regulator	Promoting PPP successful: PPP approach accepted by Government for expansion of Colombo Port. Request for proposals for private sector component i.e., container terminals issued on 23 February 2007; breakwater to be financed through the public sector	Promoting PPP: Original approach in promoting PPP through corporatization of Jaya Container Terminal JCT too sensitive in current environment; which would have been boycotted by trade unions, fearing this was only a step to privatization. Insisting on corporatization would have been a deal breaker.	Promoting PPP: Project would not have materialized had ADB not proved more flexible, and shifted dialogue, by exploring all avenues how to promote PPP. Corporatization of JCT is still on the cards, as only corporatized entities can bid for terminal concessions (eventually, JCT would have to do this to survive in competitive environment)

(iii) Social Development, Regional Imbalances (also conflict area rehabilitation) through Rural Infrastructure Development and Greater Access to Quality Education

Build expressways to connect major cities	Building the first expressway of the country, in pipeline since 1999, experienced long delays.	Involuntary resettlement of a small number of families became a major problem. Compliance review found ADB guidelines had not been followed in some respects.	Great care needed when dealing with large-scale infrastructure investments in Sri Lanka that involve land acquisition and resettlement.
Rehabilitate improve rundown provincial road network in a coherent manner	Proceeding well, but needs to be more coordinated through a strengthened road sector master plan. Issues of rising construction costs and shortage of skilled construction companies slowing down implementation.	Road building politicized and selection criteria not always transparent. In addition, implementation delays (shortage of contractors, material).	Implement road sector master plan after it has been revised and established clear criteria on road selection. Long-term approach to building up local construction capacity; policy dialogue to bring more competition in provision of basic material at lower costs.
Improve services in underserved regions	Rural electrification program and improved access to safe water in secondary towns (connections to grid and mainlines above targets, however, water supply projects experienced significant cost overruns).	Rural electrification program very successful and above technical targets for rural electrification, the same applies to water supply expansion; committed EA and Government.	Water schemes may need to be carefully costed to prevent cost overruns and unnecessary overdesigning. Projects may also have to have very specific criteria to minimize political interference in selection of villages to be electrified and to have road access.

CSP strategy and Outputs	Outcome	Reason	Lesson learned
Help raise educational attainment of low income groups and reduce gender gap in access to technical and vocational training	<p>Educational Attainment: Pass rates at O and A level have increased (but no disaggregated data available) from 50.5% to 55% at A-level;</p> <p>Access: stipends given to over 40,000 disadvantaged students with dropout rates “miniscule”; suburban schools (77 out of a targeted 100) upgraded with science facilities; some technical vocational schools though seem left out, and there may be some problems with selection criteria of suburban schools)</p>	<p>Educational Attainment: Latest available data still shows large gaps in quality of schooling. Little political will to deal with teacher absenteeism and deployment.</p> <p>Access: There may be a political bias in selection of schools despite clear guidelines and criteria.</p>	<p>Access: Need system to monitor and “trace” recipients of stipends, and to find ways to reduce scope for political interference and overcome “deployment” issue bottleneck.</p> <p>Educational Attainment: no data available on whether target of increasing achievement of rural students has been achieved.</p>
Provide safe water for larger population and help community based systems that have elements of cost recovery and operation	Expansion of safe and reliable water supply “on track,” 1.6 million people gained access, and about 1.2 million will have access to water and/or sanitation with ongoing projects; but overall water resource management deficient		Public utility services highly politicized, on central and local government level. Alternative means of coordinating water use between users and line ministries needed. Careful costing needed to avoid cost overruns.
Rebuild the north and east	<p>Small-scale community projects very quickly committed and spent; NECORD attracted large cofinancing because of successful project design</p> <p>CAARP: Larger works in road rehabilitation have been delayed but substantial cofinancing attracted in large-scale infrastructure.</p>	<p>Involved a very participatory approach with villages putting forward proposals that were then screened on a provincial level.</p> <p>CAARP: Security reasons delay procurement and implementation of road rehabilitation in the area.</p>	<p>In addition to “hardware,” i.e., infrastructure, need to focus on “software,” e.g. teachers, nurses deployment in future interventions, and link to bilateral projects.</p> <p>CAARP: Large-scale infrastructure projects in fragile regions take time, perhaps 10 years or so, as capacity of understaffed government agencies, and of contractors, has to be built almost from scratch.</p>
(iv) Governance (improve public expenditure management and improve local governance and SOE governance to improve service delivery, and strengthen pro-poor service delivery)			
<p>Fiscal administrative reform</p> <p>Trigger in CSP: Fiscal deficit within $\pm 0.5\%$ of GDP of fiscal deficit target</p> <p>Extension of tax base—VAT</p>	Against unexpected pressure on public expenditure through tsunami, oil price shock, and defense spending, fiscal deficit is within targets (but targets rather high—8.7% in 2005 and 2006); fiscal	Government’s policies changed even during SLFP term: fiscal consolidation still stated priority, but less through expenditure cuts than through	Public administration reform very difficult, given combination of fragile government coalition, powerful trade unions and sensitive issues of promotion and new

CSP strategy and Outputs	Outcome	Reason	Lesson learned
extended to wholesale and retail sectors	responsibility act (reducing fiscal deficit to 5% of GDP by 2006) postponed to 2009; VAT base not extended to wholesale and retail sectors; however, progress has been made towards improving tax administration, introduce budgetary ceilings, reduce number of supplementary budgets to only 1 in 2006, and revenue collection increased.	increasing revenue collection (which increased substantially, albeit by a complicated cascading tax system and taxes on international imports); no reform or changes to VAT since 2007; VAT almost a quasi withholding tax.	HR policy; extension of VAT might also politically not be possible. Possible that similar lessons as in agriculture and other sectors apply: even if Government agrees to reforms.
Mainstream governance and implement service delivery policies	Service delivery was improved through investment projects, as part of sector dialogue (ranging from education, to water supply, power sector)	Gradual process made in many key agencies.	Gradual process and long-term commitment—cemented by trust building and substantial involvement by ADB staff seems to be most effective.
Core service delivery reform initiative	Was not implemented	Lack of Government ownership	

ADB=Asian Development Bank, ADTA=Advisory Technical Assistant, BOC=Bank of Ceylon, BOO=Build Own Operate, BOT=Build Operate Transfer, CAARP=Conflict Affected Areas Rehabilitation Project, CSP=Country Strategy and Partnership, EA=Executing Agency, EPF=Employees Provident Fund, ETF=Employees Trust Fund, FMPPSD=Financial Markets Program for Private Sector Development, GDP=Gross Domestic Product, HR=Human Resources, IT=Information Technology, JCT=Jaya Container Terminal, MFI=Microfinance Institutions, NECORD=North East Community Restoration and Development Project, OED=Operations Evaluation Department, PERC=Public Enterprise Reform Commission, PPP=Public Private Partnership, RDA=Road Development Authority, SBA=School Based Assessment, SBM=School Based Management, SEC=Securities Exchange Commission, SEMA=Strategic Enterprise Management Agency, SEMP=Secondary Education Modernization Project, SLFP=Sri Lanka Freedom Party, SME=Small and Medium Enterprises, SOE=State Owned Enterprises, TEVT=Technical Education and Vocational Training, UNP=United National Party, VAT=Value Added Tax

COUNTRY SECTOR ROAD MAPS

1. During the country partnership strategy (CPS) period, the Asian Development Bank (ADB) will concentrate on the following priority sectors.

- A. Energy
- B. Law and Public Sector Management (Public Finance)
- C. Transport and Communications
- D. Water, Sanitation, and Urban Services Delivery
- E. Education

A. Energy

1. Key Issues in the Sector

2. Sri Lanka's power sector struggled through the late 1980s, 1990s, and early 2000s to meet the growing demand for electricity. Given the growing demand for power at about 8% per year, the country will face serious shortage of power and slowdown of economic growth unless generation capacity is significantly increased and transmission and distribution network is strengthened in parallel. Sri Lanka's national electrification ratio improved significantly from 10.9% in 1986 to 79% in 2007 and compares favorably to other South Asian countries. However, substantial disparities in access to electricity still exist. As of end 2007, per capita electricity consumption stood at about 414 kilowatt-hours (kWh), which is lower than India and Pakistan. System losses are estimated at 16.7%. While this is relatively low compared to the average of the region, there is still room for reducing losses by another 4 to 5 percentage points.

3. In Sri Lanka, the total power generation capacity available to the grid was 2,334 megawatts (MW) at the end of 2007. Of the total energy provided to the grid, 50.8% is hydro, 44.0% is thermal (oil), and 5.2 % is non-conventional renewable energy. Ceylon Electricity Board (CEB) and Lanka Electric Company (LECO) are the only two utilities in the power sector. CEB, an integrated utility fully owned by the Government, owns the installed generation capacity of 1,688MW, serving about 90% of all customers. The private sector owns 567MW. LECO was formed as a distribution company under the Sri Lankan Companies Act and the majority of its shares are owned by CEB and the Government. LECO purchases bulk power from CEB and distributes it to around 400,000 consumers in Colombo and other urban areas in the western and southern coastal belt townships between Negombo and Galle, representing about 10% of all consumers.

4. The major issues in the power sector are (i) the lack of availability of electricity for about 25% of households, (ii) the high cost and instability of the electricity supply, and (iii) a debt overhang restricting capital investments by CEB and discouraging private sector investments in the sector. These are the results of a combination of factors (paras. 5–8).

5. **High Cost of Generation.** The share of hydrothermal generation in the power mix has declined from 99:1 in 1986 to 55:45 in 2007. As a result, the entire growth in demand has been served by oil-fired thermal generation. The 1998 policy of building thermal power plants only with private financing has resulted in a proliferation of relatively small, high-cost oil-fired plants. Due to lack of appropriate political decisions and financial resources, CEB has not been able to implement the least-cost generation plan, which proposes coal as the most economical source of energy. Coupled with the recent fuel price increase and delayed construction of new hydropower plants, this change of generation mix has pushed up generation cost significantly. Base-load generation capacity urgently needs to be built up with low-cost fuels such as imported coal, hydro, and other renewable resources.

6. **Skewed Tariff Structure.** The drastic increase in generation costs since the 1998 policy has not been passed on to electricity consumers because the Government (i) as the sector regulator, lacked the political will to have consumers bear the cost of supply; and (ii) did not have the technical capacity to evaluate CEB's cost structure to decide the appropriate tariff levels. As a result, CEB has posted operating losses since 2000, leading to an estimated total liability of SLRs144 billion at the end of 2006. This includes long-term loans from the Government totaling SLRs61.9 billion, which the Government has decided to restructure. Sri Lanka's electricity customers, particularly commercial, industrial, and large households, pay higher prices than most of the regional comparators. It is critical that the cost of supply be reduced, while ensuring a stable and high-quality supply of electricity.

7. **Inadequate and Aging Transmission and Distribution Network.** Retail tariffs that do not reflect the cost of supply, coupled with CEB's institutional weakness in project implementation, have continued to squeeze CEB's investments in transmission and distribution. The low-voltage distribution network requires improvements to meet the expansion in housing and commercial developments. Delayed investments in the medium-voltage distribution network have caused overloading, poor reliability, and fluctuating voltage at many locations in the country. The demand growth on the medium-voltage network requires a matching investment in the transmission network and grid substation. Immediate investment in the transmission and distribution network will be needed, not only to reduce system losses and ensure stability of the entire power system but also to remove the capacity constraint on promoting private sector investment in nonconventional renewable energy.

8. **High Commercial Losses and Lack of Penetration in Rural Areas.** The low customer density in suburban and rural areas of the country causes inherently higher network losses than in urban areas. Parallel to network strengthening, further efforts are needed to upgrade and improve meters and the metering system, and to enforce strict surveillance to prevent theft. Another major challenge in rural areas is low penetration in electrified villages. Many households remain unconnected as they cannot afford the connection charges, although distribution feeders have already reached the neighborhood.

2. Government's Sector Policy and Planning Framework

9. The 2006 10YDF envisions "sustainable development of energy resources, conversion facilities and delivery systems to enable access to and use of energy services by the entire population, and the safe, reliable delivery of such energy services at a regionally competitive price, through a commercially viable institution subjected to independent regulation".¹ 10YDF, to underpin its overall objectives, also includes the National Energy Policy and Strategies (NEPS), a ten year plan for the energy sector. The plan is a comprehensive sector development road map including a long term investment program as well as policy and reform measures. It aims to (i) supply electricity to 86% of households by 2010 and 98% by 2016, and (ii) adopt electricity tariffs that are competitive with those of other countries and sufficient for utilities to be viable. Government gazetted NEPS in June 2008.

10. To address key problems in the sector, NEPS is based on the major guiding policy elements of (i) providing basic energy needs, (ii) ensuring energy security, (iii) promoting energy efficiency and conservation, (iv) promoting indigenous resources, (v) adopting an appropriate pricing policy, (vi) enhancing energy sector management capacity, (vii) protecting consumers and

¹ Government of Sri Lanka. 2006. Mahinda Chintana: Vision for a New Sri Lanka. Colombo. pg. 63.

ensuring a level playing field, (viii) enhancing the quality of energy services, and (ix) protecting the community from adverse environmental impacts of energy facilities.

11. To achieve the above goals and with specific targets and institutional responsibilities, the Government strategies focus on the following:

- (i) Increase supply capacity and reduce generation cost by adding a base-load capacity of about 2,400 MW including three coal-fired plants of 2,000 MW.
- (ii) 10% of grid energy to be supplied from nonconventional energy sources.
- (iii) Reduce total technical and commercial losses of the CEB network to 13.5% of net generation by 2009 and 12% by 2016.
- (iv) Establish an independent regulatory framework and rationalize the tariff structure.
- (v) Restructure CEB's long- and short-term debts.
- (vi) Make all energy efficiency codes and appliance labeling mandatory by 2016.

3. Government's Institutional Arrangements and Capacity in the Sector

12. **Clean Energy Development and Energy Efficiency.** To diversify energy sources and promote clean energy development, the Government established the Sustainable Energy Authority (SEA) in July 2007 as a focal agency for developing nonconventional energy and improving energy efficiency. The Government has also introduced multiyear, cost-based, technology-specific tariffs for nonconventional energy projects to attract more private sector investments in small hydro, wind, and biomass power generation. The new tariffs will comprise 90% of avoided cost² to be paid by CEB and subsidies to be paid by the Government through the Sri Lanka Energy Fund (SLEF). The Government has set up the Sri Lanka Guarantee Fund to provide credit enhancement support to the private sector for projects to improve energy efficiency. To promote conventional hydropower generation, the Government has opened medium-scale projects of 10 MW to 50 MW to the private sector on a public-private partnership (PPP) basis.

13. SEA is mandated to develop and implement policies to reduce consumption and achieve better energy efficiency in residential, municipal, and industrial end-user applications. The Government of Sri Lanka has established a sustainable guarantee facility within SEA to facilitate access to financing for energy conservation projects. The Government has identified eight technology priority areas for the development of pilot demand-side and energy conservation projects: (i) power factor correction in transmission networks, (ii) efficiency improvements in lighting applications in residential and commercial buildings and lighting grids, (iii) industrial boilers, (iv) air conditioning systems, (v) compressed air systems, (vi) industrial motors and drives, (vii) fans and air blow installations, and (viii) municipal water and irrigation pumps and systems. These initiatives, combined with programs on reducing losses in transmission and distribution networks, can reduce the use of and demand for imported fuels and mitigate environmental impacts associated with the increase of greenhouse gas, sulfur dioxide, and particulate matter emissions.

14. **Independent Regulation.** The Government established the Public Utilities Commission of Sri Lanka (PUCSL) in 2002 as a regulator for energy and water sectors under the PUCSL Act 2002. While the Act ensures independent status of PUCSL staff, an industry act was required to empower PUCSL to issue licenses and determine electricity tariffs. The Electricity Act, 2002 was introduced for this purpose. However, the Act did not become fully effective due to the failure of the previous sector reform program and PUCSL had been playing only an advisory role for the Government to make policy decisions including tariff settings. To rectify this situation, the Government has submitted Sri Lanka Electricity Bill to the parliament in April 2008. The Bill

² Three-year moving average of the thermal power generation cost of CEB.

requires power utilities to obtain licenses from PUCSL and file tariff petitions with PUCSL every year. Final tariff determination will be done by the cabinet based on PUCSL's recommendation. The Bill is expected to be approved by the parliament in the third quarter of 2008 and first licenses to CEB, LECO and other utilities will be issued within 6 months from the enactment of the Bill.

15. **CEB's Internal Reforms.** CEB has converted its generation, transmission and distribution operations into six functional business units (FBUs) (one for generation, one for transmission and four for distributions). Financial accounts have been segregated so that each FBU will operate as profit centers. CEB is developing a long-term corporate plan ("Corporate Plan") to set strategic objectives of each FBU based on corporate vision and goals. Performance of each FBU will be measured by key performance indicators (KPIs) to be identified under the Corporate Plan. PUCSL will regulate each FBU separately and give function-wise conditions to each FBU in granting licenses to CEB. The KPIs will be included in the licensing conditions. The Corporate Plan will also identify functions to be decentralized at FBU level and to be centralized at corporate level. To fully operationalize FBUs, CEB board needs to (i) determine provisional transfer pricings among FBUs; (ii) delegate to the respective heads of the FBU and further sub-delegate to officers of the FBU powers required to fulfill regulatory requirements and implement the Corporate Plan; and (iii) sign with heads of FBUs memorandum of performance based on the KPIs and regulatory requirements.

16. **Debt Restructuring.** In 2005, the Government wrote off SLR 7.8 billion of CEB's deferred tax and other payment arrears to the Treasury and made direct payments of SLR 3.5 billion to the Ceylon Petroleum Corporation on account of CEB. Restructuring plan of CEB's long-term debt of SLR 61 billion was approved by the Government in April 2006. 50% of the long term liabilities has been converted to equity and 50% has been rescheduled. CEB is fully servicing its short-term debt of SLR 7.5 billion.

17. **Tariff Rationalization.** To ensure electricity prices reflect cost of supply and improve the revenue for the sector, the Government decided to rationalize tariff structure so that all recurrent expenses of CEB will be met by the tariffs. In March 2008, the Government introduced new tariff structure whereby average retail tariffs have been increased by about 30%. The new tariffs aim to mainly raise tariffs for domestic consumers which have been heavily cross-subsidized by commercial and industrial consumers while minimizing impacts on lifeline tariffs.³ The consumers in higher domestic consumption blocks will not get the benefits of lower tariff rates of the lower blocks. A fuel surcharge now applies to all consumers. This is a significant deviation from the past and provides the domestic consumer greater incentive to save energy.

4. ADB's Sector Experience

18. The power sector strategies of ADB in Sri Lanka were largely shaped by the country's development agenda, particularly by the need to promote economic growth, as well as by the imperative of making the power sector viable. ADB's assistance has focused on expanding the power infrastructure and strengthening CEB and LECO, while providing complementary support for power reforms since 1998. ADB has approved five public sector loans, three of which have been completed. Under one of the three loans, ADB helped LECO develop into an efficient and customer-oriented distribution company by expanding its distribution network, reducing system losses, and improving billing and revenue collections. ADB's investment support for CEB strengthened its transmission and distribution systems and expanded rural electrification. While the support has contributed to making power available to more consumers in rural areas, the sector still faces serious challenges to restore its viability and sustainability.

³ A pricing formula to make electricity affordable to poorer households to maintain a basic standard of living.

19. Under its 1998–2003 sector strategies, ADB mainstreamed support for power sector restructuring by encouraging (i) the unbundling of the power sector into separate functional companies; (ii) the promotion of private sector participation, particularly in generation; (iii) establishment of an independent regulatory body; and (iv) competitive markets to determine the price of power. On the investment side, it focused on transmission and distribution, while abstaining from providing public sector loans to generation projects that could attract private sector funding. Under its program loan approved in 2002,⁴ ADB supported the Government's power sector reform program comprising the functional unbundling of CEB and establishment of PUCSL. Although new organizational and management models for restructuring CEB had been developed with ADB technical assistance (TA), and much of the legislation and contractual preparation was in place, the program loan was terminated in September 2006 with the second tranche undisbursed because the Government did not take the final steps in implementing the unbundling of CEB and decided to hold back from a policy that it had endorsed by enacting the Electricity Reform Act, 2002.

20. ADB and the Government had agreed on the reform program after consultation with key stakeholders. However, the reform program was launched without full buy-in from some people in the Government and CEB, who had believed that building a cheaper base-load capacity was the highest priority to restore the financial viability of the sector. It was also true that the reform process was perceived as largely donor-driven.

21. When it terminated the program loan at Government request, ADB agreed with the Government that future sector policies and reforms should be Government driven. The Government prepared and approved NEPS after intensive consultation with stakeholders, including ADB. In both NEPS and 10YDF, the Government showed a strong commitment to sector reform and proposed a pragmatic approach under the prevailing political environment. The Government decided to separate CEB restructuring from regulatory reforms, and to replace the Electricity Reforms Act with a new act that would empower PUCSL without unbundling CEB. While CEB remains vertically integrated, the Government introduced functional business units within CEB to encourage efficiency improvements and to facilitate the ease of regulation. Appreciating these policies as a solid basis for resuming its support, ADB approved a TA project⁵ in December 2007 and County Operations Business Plan, which includes the Clean Energy and Access Improvement Project for 2008.

5. Role of Other Development Partners

22. ADB, Japan Bank for International Cooperation (JBIC) and the World Bank are the main development partners in the power sector of Sri Lanka. The three institutions have been closely coordinating on key policy issues and investment support. JBIC has been the largest development partner in the sector, providing investment support for generation, transmission and distribution. ADB and JBIC co-financed program lending for the sector reforms and jointly undertook policy dialogues with the Government. JBIC has been active in generation sub-sector and currently funding Upper Kotmale hydro power plant (150 MW). A feasibility study for use of imported liquefied natural gas for power generation will be prepared under JBIC funding. WB has provided line of credit for off-grid electrification by private sector. Recently, China and India have emerged as a major development partner for the sector. A new coal-fired base load power plant of 300MW is under construction with the Chinese funding and a 500MW coal-fired plant is planned in Trincomalee as a joint venture project between India and Sri Lanka.

⁴ ADB. 2002. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Power Sector Development Program*. Manila.

⁵ ADB. 2007. *Technical Assistance to Sri Lanka for Building the Capacity of Sustainable Energy Authority*. Manila.

6. Intended Sector Outcomes and Key Outputs Supported by ADB

23. The Government's main goals are to improve the quantity, quality, and cost of service delivery, and to increase electricity connections in rural areas. The country partnership strategy (CPS) shares these goals, as major outcomes are relevant to the power sector. To help the Government achieve these goals, ADB will focus on (i) mitigating climate change, (ii) strengthening sector governance, (iii) improving connectivity for the poor, and (iv) promoting private sector participation.

24. **Mitigating Climate Change.** ADB will play a catalytic role in promoting private sector investment in renewable energy projects by (i) funding transmission projects to remove grid constraints on absorbing additional capacity from renewable energy sources; (ii) providing capacity-building assistance to SEA and PUCSL; and (iii) financing individual clean energy projects, such as small and medium-scale hydro, wind, and biomass on a PPP basis. ADB will support energy-efficiency improvements by (i) financing strengthening of the transmission network to avoid system collapse in the short term and meet essential reliability level in the long term; and (ii) support the Government's distribution-loss reduction and demand-side management programs, mainly through TA.

25. **Strengthening Sector Governance.** Since 2006, ADB has been conducting intensive policy dialogue with the Government to strengthen sector governance. With a new regulatory regime soon to be launched under the Sri Lanka Electricity Act, ADB will redirect its support from development of the regulatory framework to its implementation. To ensure effective regulation and support CEB's efficiency improvement efforts, ADB will provide TA for building the capacity of PUCSL and implementing CEB's internal reform measures.

26. **Improving Connectivity for the Poor.** To achieve the electrification target under the 10-year plan, particular attention needs to be paid to regions of the country that lag behind, including the conflict-affected areas where power shortages are serious and many households remain unconnected. ADB will support the expansion of the transmission network to the lagging regions. To complement the Government's intensive investment program to extend the distribution network, ADB will also support the development of an institutional mechanism to promote service connection for the poor and reduce commercial losses in rural areas.

27. **Private Sector Participation.** ADB will promote private sector participation in generation and distribution by providing TA to introduce the PPP approach for energy efficiency improvement, and financing environmentally sustainable generation projects on a PPP basis and/or through nonsovereign loans.

7. Links to CPS Outcomes and Other Sector and Themes

28. ADB's power sector strategies in Sri Lanka are aligned with the 10YDF under the two pillars of ADB's CPS for 2009–2011: (i) improved investment climate, and (ii) socially inclusive development. The sector-level outcomes of the improved provision of electricity and increased electricity connection are highly relevant to these two pillars. Better provision and increased connection of electricity will help remove one of the major infrastructure constraints, allowing Sri Lanka to achieve the national goal of 8.5% economic growth by 2010. Increasing rural electrification and ensuring a reliable power supply will contribute to improving the quality of life in lagging regions.

8. Indicative Areas for Interventions

29. During 2009–2011, ADB plans to provide the following assistance to the sector:

2009: Project preparatory TA for Sustainable Power Sector Development II (\$0.8 million)

2010: Loan for Sustainable Power Sector Development II (\$100 million)

ADB will continue to support electricity network development to improve energy efficiency and connectivity for the poor. Innovative approaches such as PPP-based financing and nonsovereign loans will be explored to promote private sector investment in environmentally sustainable generation projects and other projects to mitigate climate change.

9. Monitoring Mechanism

30. The proposed loan and TA project will have sector- and project-specific indicators and targets. The sector-specific target will be related to the overall performance of the sector in terms of major policy measures in the 10-year development strategy. The project-specific indicators will include the timely implementation and disbursement of the project, and compliance with environmental and social safeguards, among others. Policy dialogue will be maintained with the Government on sector-wide issues during the preparation of new investment and TA project, and the project-specific issues will be taken with the Government counterparts during review missions. Technical milestones will be monitored by reports to be issued by the Ministry of Power and Energy (MOPE), PUCSL, CEB, and LECO. Milestones for policy and institutional matters will be monitored by public gazettes, codes, and regulations to be issued by MOPE, SEA, and PUCSL, as well as progress reports to be prepared by CEB.

Table A5.1: Energy Sector Results Framework

Relevant CPS Outcomes		Sector-Level Outputs		ADB Assistance	Risks
CPS Outcomes Relevant to the Power Sector	Key Opportunities and Constraints	Sub sector Outcomes/ Key Sector Outputs	Sector Milestones/Tracking Indicators/Interim Indicators		
<ul style="list-style-type: none"> Improved provision of electricity (quality, quantity, and cost) Increased electricity connections Improved financial viability of the sector 	<ul style="list-style-type: none"> Lack of generation capacity High cost of generation due to excessive dependence on thermal power plants running on imported oil 	<ul style="list-style-type: none"> Increase supply capacity and reduce generation cost by adding base-load plants Increase nonconventional energy sources Improve energy efficiency by reducing system losses and promoting demand-side management 	<ul style="list-style-type: none"> Add approximately 2,400 MW by 2016, including three coal-fired power plants with total capacity of 2,000 MW Achieve full operation of Sustainable Energy Authority by 2008 Increase share of nonconventional energy in grid supply from 4.1% in 2007 to 8% by 2011 and 10.7% by 2016 Add at least 500 MW of renewable energy by 2016 Increase percentage of households electrified through off-grid system from 4% in 2007 to 6% by 2010 and 10% by 2016 Reduce system losses from 16.7% in 2007 to 12% by 2016 Introduce modernized system control by 2012 Launch demand-side management programs Make labeling of appliances for energy efficiency mandatory by 2010 Update energy efficiency building code and make mandatory by 2009 	<p>Ongoing Loan to increase the coverage of Rural Electrification and increase capacity of the Distribution and Transmission network.</p> <p>Planned Loan and TA to promote private sector participation in environmentally sustainable conventional generation projects</p> <p>Investment loan to augment transmission system and relieve grid constraints for renewable energy development</p> <p>TA for capacity building of SEA and PUCSL</p> <p>Investment loan to strengthen transmission system</p> <p>TA and investment support for demand-side management program for municipal street lighting</p>	<p>Appropriate risk sharing between the Government and private investors</p> <p>Lack of capacity of SEA</p> <p>Lack of capacity of provincial governments</p> <p>National Government cannot meet subsidy requirements under new tariff regime for renewable energy development</p> <p>Lack of awareness among private sector on energy conservation</p>

Relevant CPS Outcomes		Sector-Level Outputs		ADB Assistance	Risks
CPS Outcomes Relevant to the Power Sector	Key Opportunities and Constraints	Sub sector Outcomes/ Key Sector Outputs	Sector Milestones/Tracking Indicators/Interim Indicators		
	<ul style="list-style-type: none"> Inadequate and aging transmission and distribution network 	<ul style="list-style-type: none"> Augment the existing transmission network Expand transmission network for new power plants Strengthen MV and LV system 	<ul style="list-style-type: none"> Reduce system losses from 16.7% in 2007 to 12.0% by 2016 Introduce modernized system control by 2012 	Investment loan to augment transmission system and modernize system control	<ul style="list-style-type: none"> Delay in procurement of meters Lack of counterpart funding
	<ul style="list-style-type: none"> High commercial losses and lack of penetration in rural areas 	<ul style="list-style-type: none"> Expand grid to rural areas Provide financial assistance to poor household for connection cost Reduce commercial losses through metering and theft control 	<ul style="list-style-type: none"> Increase percentage of households connected to grid from 79% in 2007 to 80% by 2010 and 88% by 2016 	<ul style="list-style-type: none"> Support credit scheme for household connection through investment loan and TA TA for loss-reduction program through PPP 	<ul style="list-style-type: none"> Delay in generation capacity addition Affordability of rural households for connection charge Delay in procurement and installation of meters Disconnection policy not enforced strictly.
	<ul style="list-style-type: none"> Operational inefficiency and debt overhang of CEB 	<ul style="list-style-type: none"> Restructure CEB debt 	<ul style="list-style-type: none"> Fully implement debt restructuring plan of CEB by 2008 CEB to break even by 2012 	TA for restructuring of short-term debt	No restructuring plan for short-term liability of CEB
		<ul style="list-style-type: none"> Establish independent regulatory framework and tariff rationalization 	<ul style="list-style-type: none"> Make PUCSL fully functional by 2008 Licenses to be issued to power utilities by 2009 	TA for capacity building of PUSCL	Sri Lanka Electricity Bill not enacted
		<ul style="list-style-type: none"> Implement functional business unit 	<ul style="list-style-type: none"> Delegation of powers to heads of FBUs by CEB board by 2008 	TA for implementation of FBU	<ul style="list-style-type: none"> More Government interference in CEB's routine operations Lack of ownership in CEB

Relevant CPS Outcomes		Sector-Level Outputs		ADB Assistance	Risks
CPS Outcomes Relevant to the Power Sector	Key Opportunities and Constraints	Sub sector Outcomes/ Key Sector Outputs	Sector Milestones/Tracking Indicators/Interim Indicators		
					Lack of human resources and appropriate incentive mechanism.

CEB=Ceylon Electricity Board, FBU= Functional Business Units, LV= Low Voltage, MV= Medium Voltage, MW= Megawatts, PPP= Public Private Partnership, PUCSL= Public Utility Commission of Sri Lanka, SEA= Sustainable Energy Authority, TA = Technical Assistance

B. Law, Economic Management, and Public Policy (Public Finance)

1. Key Issues in the Sector

31. Despite the Government's continued efforts and achievements, and notwithstanding resilient and robust economic growth, Sri Lanka's fiscal sector still faces a series of challenges. Apart from pressure on security related spending due to the ongoing civil conflict which has been a major impediment for expenditure containment, the country has been suffering from a substantial infrastructure deficit reflecting both limited fiscal space and the past practice of cutting back on the capital budget to accommodate excess recurrent spending. While MOFP has targeted more robust investment spending over the past four years, the pressure from recurrent expenditure remains high and the shortfalls on capital expenditure remain large. Concerted effort to overcome the country's infrastructure deficit is necessary to ensure sustainable and inclusive economic growth. Furthermore, the recent global energy crisis as well as the rising international commodity prices has exacerbated inflation which was already at a historically high level. Against these backdrops, Sri Lanka's public debt levels remain high at 85.8% of GDP.

32. Albeit more slowly than originally envisaged, the fiscal sector has followed an improving trend. Salient features include (i) fiscal deficit reduced from 8.2% of gross domestic product (GDP) in 2004 to 7.7% in 2007, (ii) current balance deficit reduced from 3.9% of GDP in 2004 to 1.6% of GDP in 2007, and (iii) total outstanding debt decreased from 105.4% of GDP in 2004 to 85.8% in 2007. The Government's Fiscal Management Reform Program (FMRP)⁶ supported by ADB has played an important role in achieving the positive trend. However, the fiscal deficit requires further consolidation to restore economic fundamentals and thereby enhance macroeconomic stability. From a welfare position, national debt remains large and its recent reduction in terms of GDP mainly reflects the impact of higher inflation and faster real GDP growth, rather than fiscal consolidation. Interest payment on this debt, representing a dead-weight loss,⁶⁹ continues to absorb a large share of current expenditure—thereby diverting it from more productive or welfare-enhancing objectives.

33. While significant achievements have been made with regard to revenue enhancement at the central administration under the FMRP, expenditure containment measures and fiscal decentralization have been less successful. Despite introduction of expenditure ceiling frameworks and notions of performance-based budgeting, public expenditure, as a share of GDP, has not stabilized. Reasons behind this reflect Government policy priorities including Government attempts to insulate the population, especially poorer groups, against increases in international prices of fuel, food, fertilizer, and other inputs through price subsidies. While sharp upward adjustment of prices (fuel, electricity, and transport) have been made recently and direct welfare payments have been kept stagnant in nominal terms, input subsidies have been continuing. The impact of the conflict on security spending has also led to limited progress on the expenditure front. Finally, efforts to reduce expenditure by restructuring line ministries have made little progress.

2. Government's Sector Policy and Planning Framework

34. The Government's 10YDF sets out a vision to ensure Sri Lanka's long-term economic development and poverty reduction objectives. The strategy focuses on more equitable growth and places a high priority on infrastructure development to accelerate growth and narrow regional

⁶ ADB. 2004. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Fiscal Management Reform Program*. Manila (Loans 2130/2131/2132-SRI, approved on 14 December).

⁷ The costs to society created by an inefficiency in the market.

disparities. It aims to improve the connectivity of rural areas to urban areas and to the global economy. The 10YDF seeks to improve international competitiveness by creating a vibrant industry sector and technological innovation linked to development of a knowledge economy. However, medium-term financial stability, with the gradual reduction of the long standing budget deficit and national debt, provides the macroeconomic foundations to support the strategy.

35. The Fiscal Management Responsibility Act (FMRA) of 2003 underpins the Government's statutory commitment to fiscal stability and associated reporting requirements. The medium-term fiscal framework (MTFF) sets relevant fiscal indicators in accordance with FMRA. The original targets set in the FMRA proved to be difficult to achieve and the Government has revised MTFF several times. The latest MTFF targets a fiscal deficit of 5% of GDP and total outstanding debt of 82% of GDP by 2010.

3. Government's Institutional Arrangements and Capacity in the Sector

36. Sri Lanka used to operate a traditional, centralized, and compliance-based budget system. A set of policy objectives was determined at the beginning of the cycle. Subsequently, and following a process of review where sector spending limits were set based on an expenditure framework, resources were committed to the spending agencies to meet these objectives. Budget execution followed, with ensuing disbursements based on agreed-on appropriations. Finally, rudimentary ex post monitoring took place with limited accountability for the implementation of line ministries' programs.

37. However, the Government is moving toward results-based or performance budgeting. Under the FMRP, the Government introduced (i) an internationally accepted budget classification system (ii) expenditure ceilings, and (iii) 3-year rolling forward estimates of current and capital budgets based on a medium-term budget programming and expenditure framework, among other things. The Medium-Term Budgetary Framework for 2006 to 2009 contains the country's development strategy, translated into sectoral perspectives, and the estimates of the likely annual capital expenditures needed to finance them as well as to meet the associated recurrent expenditures.

38. Fiscal reforms under and beyond FMRP targeted the strengthening of systems and procedures to improve fiscal management across key departments in the Ministry of Finance and Planning – such as Treasury Operations Department, State Accounts Department and Fiscal Policy Department combined with operational restructuring of the three revenue departments, namely Inland Revenue Department, Customs Department, and Excise Department.

39. Beside MOFP, the FMRP also called for restructuring of ministries—including (i) education, (ii) foreign affairs, (iii) health care and nutrition, and (iv) railways and transport—as part of efforts to rationalize expenditures. However, no restructuring plans have been submitted to date except for the Ministry of Education which highlights the difficulties for expenditure containment.

40. FMRP also supported efforts towards strengthening fiscal de-concentration by developing greater coordination between the relevant institutions and reviewing the existing system of inter-governmental transfers. Institutional strengthening of the Finance Commission has been a priority under FMRP. Strengthening of the Finance Commission now requires complementary strengthening of the Provincial Councils under subprogram 2. In addition, strengthening expenditure and revenue assignments will go a long way towards incremental fiscal space creation, particularly through efforts to reduce expenditure overlap between central ministries and provincial administrations. Further capacity development at the provincial level is an important element in this effort.

4. ADB's Sector Experience

41. ADB's support for strengthening Sri Lanka's public finances began in October 1999 with the approval of the Strengthening Public Expenditure Management Systems technical assistance (TA) project.⁷⁰ Key contributions under the TA included the development of a budget accounting software system still in use today, improved budget and planning procedures, and improved investment planning. This was followed in August 2002 with the Public Sector Resource Management TA project.⁷¹ It provided background studies and recommendations for modernizing the revenue administration. In December 2004, and based on the TA findings, the FMRP was approved. The FMRP, a sector development program, principally focused on restructuring and modernizing the revenue administration.

42. The main FMRP was completed in June 2008 following the release of the third and final tranche. However, the accompanying investment and TA loans remain under implementation to continue the support for ongoing procurement and capacity building initiatives. The FMRP has led to the successful transformation of the revenue department, improvement of revenue collection, and narrowing of the country's fiscal deficit. The Sri Lanka country operations business plan (2008)⁷² includes a TA project to prepare the second phase of fiscal management for 2008 and the Fiscal Management and Service Delivery Program as a firm loan for 2009. The PPTA for the second phase of fiscal management was approved in July 2008.⁷³

5. Role of Other Development Partners

43. There were no program loans extended by the World Bank, IMF, and other donors in the sector since the implementation of the FMRP in 2005. The World Bank approved a public sector capacity building project in June 2008. While the planned ADB program and the World Bank project will both assist in strengthening public financial management capacity in a broad sense, subsector demarcation between the two projects is clear as the proposed World Bank project comprises components that do not overlap with the ADB program (i) upgrading statistical capacity at the Department of Census and Statistics, and (ii) improving audit standards at the Auditor General's Department.

6. Intended Sector Outcomes and Key Outputs Supported by ADB

44. ADB's intended sector outcomes will closely align with the FMRA. The main focus over the next three years is expected to be (i) expenditure containment based on public expenditure reviews, improving the treasury fund transfer system at MOFP and developing management audits, (ii) modernization of revenue administration at the provincial level; and (iii) developing an operational framework for improving service delivery working closely with line ministries and provincial counterparts. These measures will be complemented by institutional strengthening and capacity development initiatives including at the provincial level. While more concrete and detailed sector outcomes will be specified through implementation of the just approved PPTA (see para. 42), relevant target indicators include (i) increased revenue collection from 15.8% of GDP in 2007 to 18.5% by 2011, and (ii) debt service ratio falling from 13.0% in 2007 to 8.8% by 2011.

⁷⁰ ADB. 1999. *Technical Assistance to the Democratic Socialist Republic of Sri Lanka for Strengthening Public Expenditure Management Systems*. Manila (TA 3301-SRI, approved on 16 November).

⁷¹ ADB. 2002. *Technical Assistance to the Democratic Socialist Republic of Sri Lanka for Preparing the Public Sector Resource Management Project*. Manila (TA 3906-SRI, approved on 23 August).

⁷² ADB. 2008. *Sri Lanka: Country Operations Business Plan 2008*. Manila.

⁷³ ADB. 2008. *Technical Assistance to the Democratic Socialist Republic of Sri Lanka for Preparing the Deepening of Fiscal Management Reforms (Financed by the Japan Special Fund)*. Manila (TA 7104-SRI, approved on 25 July).

7. Links to CPS Outcomes and Other Sector and Themes

45. ADB's fiscal sector strategies in Sri Lanka are in line with the two pillars of ADB's CPS (2009–2011); (i) strengthening the investment climate, and (ii) socially inclusive development. The intended sector outcomes of lower fiscal deficit, and more sustainable government spending will support the CPS pillar I. The intended outcome of improved provision of basic services, and increase in capacity of local authorities to invest in infrastructure and to raise funds, will support the CPS pillar II.

46. The sector outcomes envisage contributing indirectly to poverty reduction through sustainable fiscal management and good governance. Strengthening fiscal management ultimately supports the development of a sustainable public service delivery mechanism that contributes to improved social welfare and that, in turn, helps the poor. Furthermore, macroeconomic stability in general will form the basis for sustainable pro-poor economic growth.

8. Indicative Areas for Interventions

47. During 2009–2011, ADB plans to provide the following assistance to the sector:

2009: Program and Project Loans for Deepening of Fiscal Management Reforms (\$40 million)

9. Monitoring Mechanism

48. The development of specific indicators, targets, and other milestones linked to the Government's proposed reforms in the key areas covered by the program will be developed as part of the PPTA like the FRMP, the new program is expected to be a multi- tranche program with release linked to progress in the implementation of agreed policy actions. The performance and timely implementation of the program will be undertaken by regular joint Government and ADB project review missions which will assess the progress in achieving the proposed outcomes and outputs set out in the Sector Road Map, which will be updated and finalized following completion of the PPTA. The project will also include an investment component to finance the development and roll out of the Revenue Administration Management Information System that is currently being programmed under TA linked to FMRP.

Table A5.2: Public Finance Sector Results Framework

Relevant CPS Outcomes		Sector-Level Outputs		ADB Assistance	Risks
CPS Outcomes Relevant to the Public Finance Sector	Key Opportunities and Constraints	Subsector Outcomes/ Key Sector Outputs	Sector Milestones/Tracking Indicators/Interim Indicators		
<ul style="list-style-type: none"> Lower fiscal deficit and external indebtedness More effective and sustainable government spending Improved provision of basic services (education, water, power, sanitation, sewage, garbage) Increase in capacity of local authorities to invest in infrastructure and to raise funds 	<ul style="list-style-type: none"> Uncertain macroeconomic environment Room for expenditure containment Improved tracking and monitoring of public spending Recognition that gains in service delivery improvements are closely inter-linked with gains in fiscal space creation Limited fiscal decentralization Strengthening of Finance Commission High inflation 	<ul style="list-style-type: none"> Developing a compliance based taxation system extended to the provincial councils and supported by enforcement through risk based audit systems Automated revenue management information system operating expenditure containment based on public expenditure reviews and a treasury fund transfer system human resources capacity building and institutional development at the provincial level modernization of revenue administration at the provincial level Fiscal space creation through more effective spending and incremental 	<ul style="list-style-type: none"> Increased revenue collection from 15.8% of GDP in 2007 to 18.5% by 2011 Debt service ratio falling from 13.0% in 2007 to 8.8% by 2011 	<ul style="list-style-type: none"> Program and Project Loans for Deepening of Fiscal Management Reforms 	<ul style="list-style-type: none"> Escalation of conflict with Liberation Tigers of Tamil Eelam limits political space to prepare for fiscal reforms Limited political will and capacity to proactively undertake policy actions Lack of capacity within individual line ministries to effectively operationalize containment measures Lack of provincial council capacity for reforming revenue administration Quality of basic services compromised by fiscal containment

Relevant CPS Outcomes		Sector-Level Outputs		ADB Assistance	Risks
CPS Outcomes Relevant to the Public Finance Sector	Key Opportunities and Constraints	Subsector Outcomes/ Key Sector Outputs	Sector Milestones/Tracking Indicators/Interim Indicators		
		revenue improvements <ul style="list-style-type: none"> Improvements in expenditure assignments at the sub-national level. 			

GDP=Gross Domestic Products.

C. Transport and Communications

1. Sector Situation and Key Issues

49. The current state of Sri Lanka's transport sector infrastructure is considered a major impediment to achieving the Government's ambitious and interconnected economic development and socially inclusive development goals. Reducing transport cost and improving global–local connectivity are critical sector outcomes for achieving the overall national growth targets.

50. **Roads Subsector.** Roads are the dominant form of transport in Sri Lanka, accounting for 93.5% of freight and 91.0% of passenger traffic. The private sector provides all road freight services, while a mix of private (77%) and public (23%) operators provide bus passenger transport services. The most recent analysis by the Road Development Authority (RDA) indicates that traffic grew at an average of 4% a year during 1991–2006—a rate that is estimated to be maintained annually over the next 10 years. The road network comprises about 115,900 kilometers (km): about 11,700 km of national roads (class A and B roads⁷⁴); 15,500 km of provincial roads (class C, D, and E); 64,700 km of local authority roads; and 24,000 km of roads owned or controlled by irrigation, wildlife, and land development authorities. National roads, accounting for about 10% of the total road network, carry about 70% of the traffic. More than 50% of the road network, including national and provincial roads, is in poor to bad condition, requiring either rehabilitation or upgrading.⁷⁵ Current traffic levels exceed the design capacity of the existing network, and the rising traffic volumes and traffic mix have increased travel times and accident rates. In the rural areas, where about 80% of the population lives, limited connectivity to both economic opportunities and social services widens the inequality between Western Province and the rest of the country.

51. The key road sector issues include ensuring (i) greater institutional capacities at central, provincial, and local levels; (ii) asset sustainability through better maintenance and maintenance funding for existing roads; (iii) protection of the environment and mitigation of social impacts of road works and traffic; (iv) development of the national contracting industry; and (v) larger supply of aggregates, sand, and bitumen to control price escalations.⁷⁶

52. **Ports Subsector.** The port subsector is dominated by Colombo Port. As the only port equipped to handle container traffic, it accounts for more than 90% of the total cargo volume handled by Sri Lanka's three existing ports: Colombo, Galle, and Trincomalee. Colombo Port enjoys a competitive advantage due to its strategic location on major sea trade routes and serves as a hub port for South Asia. Transshipment traffic to and from the Indian Subcontinent accounts for 70% of Colombo's container volume consists of. Since 2002, container volumes in Colombo Port have risen after a slowdown in the mid-1990s. Current capacity is estimated at 3.3 million twenty-foot equivalent units (TEUs). With expected annual growth of 8%, demand is anticipated to exceed capacity by 2010. The port has a depth of 15 meters, which is inadequate for larger container ships that are increasingly used. Road or rail access for container traffic to Colombo Port is limited. In addition to the capacity constraints, more intra-port competition is necessary to

¹² National Road Master Plan (NRMP), Table 2, page 4, prepared by the Ministry of Highways and Road Development (MOHRD), RDA, December 2007 with Asian Development Bank assistance (TA 4315-SRI: Road Master Plan).

¹³ RDA estimates from March 2007 indicate that 43% of the national highways network is in either poor or bad condition, with the remaining 57% is in excellent (5%), good (34%), and fair (18%) condition. Current data for provincial roads is not available. A 1999 survey indicated that 11% of provincial roads were in good or very good condition, 15% in fair condition, and 74% in poor and very poor condition.

¹⁴ NRMP, Table 3, page 13, Design Framework. The Sri Lanka Resident Mission is developing an action plan primarily to address the significant cost increases experienced in the road sector since the 2004 tsunami.

increase efficiency and enhance the competitive position of Colombo Port. These issues are being addressed partly through the Colombo Port Expansion Project.⁷⁷

2. Government's Sector Policy and Planning Framework

53. The Government's 10-year development framework (10YDF)⁷⁸ emphasizes that implementation of large-scale infrastructure projects is necessary conditions to achieve its ambitious development and poverty-reduction objectives. The 10YDF targets economic growth of more than 8% annually and identifies a nationwide transport network as a key to balancing growth across regions. The 10YDF's vision for development of economic infrastructure is "to provide accessibility to all population in the country, and to have a high and quality mobility road network for the transportation of passengers and goods."⁷⁹

54. To achieve this vision for the road sector, and the goal of connecting poor regions and productive centers to domestic and international markets, the Government's policy is to maintain ownership of road transport infrastructure and to seek development of new assets (expressways) through PPPs. In the past, public sector involvement in construction and maintenance activities "crowded out" the private sector and limited its potential for capacity development. Private contractors have gradually been involved in project preparation, construction supervision, and construction activities in the road sector. The Ministry of Highways and Road Development (MOHRD), with ADB assistance, is pursuing private sector participation in rehabilitating, upgrading, and maintaining existing assets through performance-based maintenance contracts and PPPs.⁸⁰ While the Road Maintenance Trust Fund, established in 2006, currently covers only maintenance requirements for the national highways network (NHN), the 10YDF establishes that the trust fund will be used for rehabilitation, widening, and improvement purposes, if sufficient funding is generated to cover all necessary maintenance. The 10YDF outlines principles for sustainable cost-recovery mechanisms for road transport services and maintains the previous policy directions of allowing private sector participation.

55. With ADB assistance, MOHRD finalized the National Road Master Plan (NRMP) covering the NHN in December 2007. The plan, which is based on the policy directions outlined in the 10YDF and the National Road Policy of 2000, provides a strong technical framework for the development of national roads with the aim of achieving maintainability of the NHN. The NRMP defines how the NHN will be maintained, improved, and expanded to promote national integration and economic growth. The NRMP estimates investment needs of \$6.1 billion over the plan period, 2007–2017. The expected distribution of financing sources is as follows: (i) Government, 45%; (ii) multilateral development institutions, 49%; and (iii) PPPs, 6%. This translates into a requirement equivalent to \$270 million annually in external funding. A master plan for provincial roads and a framework for rural roads in alignment with Maga Neguma⁸¹ is to be developed under the leadership of the Ministry of Local Government and Provincial Councils (MLGPC) in coordination with MOHRD to achieve the 10YDF's global–local connectivity objectives.

¹⁵ ADB. 2007. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Colombo Port Expansion Project*. Manila .

¹⁶ Government of Sri Lanka. 2006. *Mahinda Chintana: Vision for a New Sri Lanka*. Colombo..

¹⁷ Government of Sri Lanka. 2006. *Mahinda Chintana: Vision for a New Sri Lanka*. Colombo.p.88.

¹⁸ An increase in private sector participation is a pillar of the medium-term development framework agreed upon with the Government under ADB. 2002. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grants to the Democratic Socialist Republic of Sri Lanka for the Road Sector Development Project*. Manila (Loan 1986-SRI, 19 December). This focus has been maintained in ADB. 2005. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grant to the Democratic Socialist Republic of Sri Lanka for the National Highways Sector Project*. Manila (Loan 2217-SRI, approved 15 December).

¹⁹ Advisory technical assistance of \$800,000 for this purpose is included in the 2008 country operations business plan.

56. The vision for the ports subsector outlined in the 10YDF is to “develop Sri Lanka as the leading navigational, trading, and commercial center in South Asia.”⁸² The policy directions to achieve this vision focus on (i) developing the main ports to facilitate the increase in export and import trade triggered by economic growth in Sri Lanka and globalization; (ii) increasing the capacity of Colombo’s south harbor, and developing Galle and Hambantota ports; (iii) developing ports in identified provinces, such as those in the south, east, and north, to divert the increasing volumes of domestic bulk freight from road to sea transport; (iv) encouraging alternative sources of financing for port infrastructure development, including PPPs for new investments; and (v) operating ports as commercial entities. While public ownership of existing ports will continue, the Government’s strategy is to encourage improvements in capacity, efficiency, and productivity; and to establish container terminals on a PPP basis.

3. Government’s Institutional Arrangements and Capacity in the Sector

57. The multitude of ministries⁸³ involved in planning and decision making in the sector are a major challenge. The absence of a lead agency to coordinate overall transport planning and implementation has resulted in lack of an intermodal focus on the development of transport strategies and plans, and a fragmented decision-making process that impedes strategic budget allocations and project implementation. Crosscutting sector issues have traditionally been dealt with through interagency committees.

58. **Road Subsector.** MOHRD has overall responsibility for policies and programs relating to the NHN. RDA, established in 1981 as a statutory institution reporting to MOHRD, is responsible for planning and managing the development and maintenance of the NHN. RDA’s technical engineering capacity is strong. Its capacity for strategic planning has been enhanced through several ADB interventions.⁸⁴ Organizational capacity in the area of social services, including land acquisition and resettlement, and environmental safeguards was enhanced with the establishment of the Environment and Social Division (ESD) in RDA. Land acquisition has caused significant delays in project implementation; continued capacity building in this area, along with project selection aimed at limiting land acquisition, is required to ensure timely completion of future projects.⁸⁵ The agreed-upon gradual abolition of project management units will help preserve project-related experience within RDA. Public sector capacity with regard to PPPs and development of performance-based maintenance contracts to improve national contractor capacity are being enhanced under various ADB loan and TA projects. A PPP unit was established in RDA on 1 June 2007.

59. Following the 13th amendment to the Constitution in 1989, responsibility for provincial roads was devolved from RDA to the MLGPC. Through ADB loans, institutional capacity of the provincial road agencies has been strengthened, resulting in (depending on provincial preference)

²⁰ Government of Sri Lanka. 2006. *Mahinda Chintana: Vision for a New Sri Lanka*. Colombo.p.100

²¹ Following the January 2007 reorganization of the cabinet, nine ministries have direct responsibility for the transport sector: (i) MOHRD (cabinet ministry), (ii) Ministry of Ports and Aviation (cabinet), (iii) Ministry of Transport and Railways (cabinet), (iv) Ministry of Construction and Engineering Services (cabinet) (v) Ministry of Highways (non-cabinet), (vi) Ministry of Export Development (non-cabinet), (vii) Ministry of Road Passenger Transport (non-cabinet), and (viii) Ministry of Local Government (non-cabinet).

²² Such as ADB. 2002. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grants to the Democratic Socialist Republic of Sri Lanka for the Road Sector Development Project*. Manila (Loan 1986-SRI, 19 December, institutional strengthening component); ADB. 2004. *Technical Assistance to the Democratic Socialist Republic of Sri Lanka for the Road Sector Master Plan*. Manila (TA 4315-SRI, 20 January).

²³ Experience also shows that cost estimates related to land acquisition are particularly volatile. Reference is made to the NRMP, p. 30, sections 63–67.

the establishment of either dedicated provincial road development authorities or provincial departments. The capacity developed included skills for undertaking road condition surveys, preparing road maintenance management systems, producing road maintenance budgets, and developing and implementing annual work programs. Further efforts are necessary to strengthen and institutionalize these skills, and to develop capacity for master planning to enable NHN links. Critical issues that need continuous support are (i) ensuring sustainable financing mechanisms for funding of routine and periodic maintenance in support of the powers devolved to provinces; and (ii) implementing performance-based road maintenance contracts by provincial road development authorities and departments, initially on a pilot basis.

60. **Ports Subsector.** The Ministry of Ports and Aviation (MPA) is responsible for ports. The Sri Lanka Ports Authority (SLPA), a statutory corporation established under the Sri Lanka Ports Authority Act, 1979, is the owner, operator, and sole supplier of marine and cargo-handling services at the country's ports. SLPA is managed by a board comprising eight appointees; the minister appoints the chairperson and five of the members. SLPA operates the three container facilities at Colombo Port; the main container terminal, Jaya Container Terminal, has a capacity of 2 million TEUs. In addition, a private company, South Asia Gateway Terminal, upgraded and now operates Queen Elizabeth Quay, which has a capacity of 1 million TEUs. Both MPA and SLPA have the capacity to develop sector plans, and develop and implement projects.

4. ADB's Transport Sector Experience

61. The transport sector strategy included in the 2004–2008 country strategy and program (CSP) retained the main emphasis on roads and sought to address the following sector needs: (i) rehabilitating and improving the road network; (ii) constructing expressways to connect major cities to expand and integrate the domestic market; (iii) providing sufficient road maintenance funds to sustain new or refurbished construction; (iv) improving bus transport services; (v) strengthening deficient institutional capabilities to manage the road network; and (vi) promoting greater private participation in financing, building, operating, and maintaining the road network. In the ports subsector, ADB's strategy was to continue supporting the Government's policy of strengthening the position of Colombo Port as a hub port in South Asia, enhance private sector development by fostering an enabling environment, and encourage PPPs.

62. The country assistance program evaluation (CAPE) rated the contribution of the transport sector assistance program to development impact "substantial."⁸⁶ The transport sector assistance evaluation⁸⁷ observed that ADB's performance in the transport sector (i) had been aligned with Government strategies and had been sensitive to the conditions of the country's political economy, (ii) had responded well to evolving priorities, and (iii) had positioned ADB effectively to provide support in areas where it had a competitive advantage. The CAPE concluded that, in preparing the new CPS, greater attention should be given to planning for intermodal transport and to ensuring appropriate funding for maintaining the prioritized road network and, hence, the sustainability of investments.⁸⁸

²⁴ ADB. 2007. *Country Assistance Program Evaluation for Sri Lanka*. Manila (para. 81).

²⁵ ADB. 2007. *Transport Sector Assistance Evaluation—Supplementary Appendix D to the Country Assistance Program Evaluation for Sri Lanka*. Manila.

²⁶ ADB. 2007. *Country Assistance Program Evaluation for Sri Lanka*. Manila (para. 83).

5. Role of Other Development Partners in the Transport Sector

63. JBIC is the largest source of assistance to Sri Lanka, with an annual lending totaling about \$300 million, of which the transport subsector accounts for about \$150 million.⁸⁹ The World Bank did not lend to the sector during 1999–2005, apart from assistance to a Post-Tsunami Rehabilitation Project when it reentered with a \$100 million loan for the Road Sector Assistance Project.⁹⁰ Since the mid-1990s, ADB has been the lead sector agency in terms of policy dialogue and institutional reforms, and is the only development partner that has provided assistance to all levels of the road network. ADB has provided 10 loans for road development, totaling \$645 million since 1985, and 1 loan of \$300 million for the Colombo Port Expansion Project. Aid coordination between JBIC, World Bank, and ADB have intensified since 2004, with ADB as the lead agency.⁹¹

6. Intended Sector Outcomes and Key Outputs Supported by ADB

64. Greater connectivity is vital to efficiently link rural areas with national roads and urban areas, and is a key to improving Sri Lanka's international competitive position. Therefore, to support the overall objective of improving access to economic infrastructure, ADB's strategy in the sector will continue to focus on (i) reducing transport cost, (ii) improving connectivity, (iii) increasing port capacity, and (iv) increasing PPPs. Ongoing assistance for improving the policy, regulatory, and institutional frameworks will continue in the following areas: (i) policy frameworks: enhance the RMTF in terms of independence and resources; (ii) regulatory frameworks: submission to Parliament of the National Thoroughfares Bill and of the Motor Traffic Act by September 2008; and (iii) institutional strengthening: (a) complete and continue past institutional strengthening efforts at central and provincial road authority levels; and (b) enhance institutional capacity for development of policy, and planning and programming frameworks for intermodal transport. Capacity building in technical strengthening will continue with support to RDA for establishing a centralized procurement unit, and enhancing RDA's capacity to independently prepare feasibility studies and detailed designs. Capacity building in financial management will focus on (i) ensuring a gradual increase of resources to the Road Maintenance Trust Fund, and transparent disbursement of funds to comply with the agreed-upon requirement for 100% of maintenance requirements for NHN being met by 2010;⁹² and (ii) developing effective investment programs for intermodal transport. Details of the physical infrastructure sector outputs are in Table A6.3.

7. Links to CPS Outcomes and Other Sectors and Themes

65. The proposed transport sector interventions will directly support the CPS outcomes of enhancing economic growth through increased public sector investment and improving access to economic infrastructure. An improved road network will reduce transport cost and increase connectivity between local and global markets connecting via Colombo Port. Transport sector interventions to support development of policy, regulatory, and institutional frameworks will help address the core issue of ensuring sustainable funding to maintain the road network. The capacity

²⁷ JBIC's assistance to the transport sector has focused on national highways in Colombo and those included in the Southern Transport Development Project, and provincial roads. JBIC has also provided a loan of \$120 million for the development of Galle Port, and has provided assistance for upgrading the Colombo-Katunayake International Airport.

²⁸ The project cost is estimated to cost \$144 million.

²⁹ Other development partners in the sector include Swedish International Development Cooperation Agency, Nordic Development Fund, Organization of Petroleum-Exporting Companies (OPEC), the Republic of Korea, Kuwait, and Saudi Arabia. The European Union (EU) has been providing €39.4 million for the Tsunami Rehabilitation Project. An additional EU contribution of €13 million is being discussed. Japan International Cooperation Agency has undertaken a study on Colombo urban transport.

³⁰ The requirement is a covenant under ADB. 2005. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grant to the Democratic Socialist Republic of Sri Lanka for the National Highways Sector Project*. Manila (Loan 2217-SRI, approved 15 December).

development initiatives will help develop technical and financial management capacities at central and provincial government levels and will support effective decentralization of investment and maintenance of infrastructure. The past⁹³ approach to mainstreaming governance in the project design will be continued, and specific assistance will be offered through small-scale TA for establishing a centralized procurement unit in RDA. The transport sector interventions will also support the development of the national contracting industry to gradually undertake more maintenance work in the road sector through increased application of performance-based maintenance contracts.

8. Indicative Areas for Interventions

66. In line with the recommendations of the CAPE, ADB's proposed assistance to the transport sector throughout the CPS period is based on the following rationale: (i) the Government has asked ADB to continue its assistance in developing large-scale infrastructure and (ii) the outcomes to be supported under the CPS are to be developed as a subset of the Government's sector plan for the NHN.

67. To support the target outputs of ongoing assistance and to achieve the intended sector outcomes, ADB interventions will support the NRMP and provincial roads. ADB will assist improvements to the national highways and provincial roads network and adopt a conflict-sensitive approach in selecting project roads for (a) a 2009 Road Network Project of \$70 million,⁹⁴ (b) a 2010 second Road Network Project of \$100 million, and (c) a 2011 National and Provincial Roads Project of \$200 million. The tentative TA and project preparatory technical assistance (PPTA) program includes (i) a 2008 small-scale TA for establishing a centralized procurement unit in RDA; (ii) support for developing sustainable intermodal transport planning⁹⁵ through a multimodal transport study TA of \$1 million, focusing on the trade logistics chain as the primary means for raising incomes; (iii) a 2010 National and Provincial Roads PPTA for \$800,000; and (iv) a 2010 Multimodal Transport Project PPTA.

68. In line with its commitment to social inclusion, ADB will support activities that consider the needs of disabled persons in planning and implementing transport strategies and projects. Transport sector interventions will be aligned with existing national legislation.⁹⁶ Better transport infrastructure and services will create opportunities for women and men, especially those in the lagging regions, to increase their participation in and contribution to processes of economic growth.

³¹ In the past, transport sector governance issues were addressed by mainstreaming relevant issues into project designs. Sector governance has been supported through (i) capacity building to RDA to strengthen its performance under a reengineering plan and to provincial road agencies; (ii) reorganization support to RDA; (iii) support for developing a new human resources strategy to enhance the new organizational structure; (iv) strengthening of RDA's planning and programming capacity through the development of needs-based road maintenance programs and NRMP, including the preparation of an accompanying investment plan, which will be made available to the public for 90 days for comments; (v) support for the development of PPPs and greater private sector participation in road construction by phasing out the state-owned construction company; and (vi) establishment of the Road Maintenance Trust Fund. Procurement and anticorruption governance issues have been addressed through the application of ADB's Anticorruption Policy (1998, as amended from time to time) and project performance monitoring systems, including the use of information technology to increase transparency, accountability, and efficiency through disclosure of project-related information such as public disclosure of bid awards.

³² The Government has indicated its preference that provincial roads from Eastern, Uva, and North Central provinces be included in the next loan for provincial roads.

³³ Intermodal connectivity issues that need to be addressed include (i) rail connections to ports, (ii) road-to-port connections, and (iii) bus-to-rail services.

³⁴ Regulation No. 1 of 17 October 2006 regarding Access to Public Buildings, Places and Transport; and Act No. 28 of 1996 for Protection of Rights of Persons with Disabilities, which provide the framework for the protection of the rights of persons with disabilities.

Where possible, ADB will design projects that help narrow gender gaps by addressing the different mobility needs and travel patterns of women and men.⁹⁷

9. Monitoring Mechanism

69. The Government and ADB will monitor the achievement of the overall CPS outcomes. At the sector level, MOHRD and RDA will monitor the intended sector outcome of lower transport costs, MOHRD, RDA, and MPA will monitor the outcome of improved connectivity of the NHN and more PPPs, and MPA will monitor the indicators in relation to higher port capacity (Table A6.3). Results at the project level will be monitored by assessing progress against the project-specific design and monitoring frameworks. Monitoring will focus in particular on risk-mitigation measures: the success of the implementation of the national action plan (referred to in the main CPS text) in reducing the cost of aggregates (opening more quarries, speed up licensing process) and strengthening the capacity of contractors will be critical. The capacity of the Sri Lank Resident Mission will be strengthened, and contractors' capacity to prepare good bids will be enhanced. All ADB-financed projects will continue to have strong capacity-building components, and RDA will also be taking on a more active role in training young professionals.

³⁵ For instance, by ensuring that stations and terminals provide separate rest areas with easy access for women and men, and that transport is available at times best suited to the varied needs of people to maximize the use of transport infrastructure.

Table A5.3: Transport Sector Results Framework

Relevant CPS Outcomes		Sector-level Outputs		ADB Assistance	Risk
CPS Outcomes Relevant to the Sector	Key Opportunities and Constraints	Sub-sector Outcomes/Key Sector Outputs	Sector Milestone/ Tracking Indicators/Interim Indicators		
<p>Increase Economic Growth to 8.5% by 2010</p> <ul style="list-style-type: none"> Improved nationwide connectivity. Improved capacity of Colombo Port. Reduced travel time to and from Colombo Port to all parts of the country. Improved human resource management in selected agencies. <p>Socially Inclusive Development</p> <ul style="list-style-type: none"> Improved nationwide connectivity. Meeting all MDGs by 2015. Increased capacity of local authorities to invest in infrastructure and to raise funds. Effective decentralization of investment and maintenance of local infrastructure. 	<p>General</p> <p>Opportunities</p> <ul style="list-style-type: none"> 10YDF emphasizes the importance of the transport network in achieving (i) connectivity between global and domestic markets; and (ii) ensuring regionally balanced growth. <p>Constraints</p> <ul style="list-style-type: none"> Current condition of the transport network. <p>Sector Specific</p> <p>Opportunities</p> <ul style="list-style-type: none"> Development of National Road Master Plan to develop an integrated NHN from 2007-2017. Establishment of Road Maintenance Trust Fund. <p>Constraints</p> <ul style="list-style-type: none"> Planning of inter-linkages and connectivity 	<p>Sector Outputs</p> <ul style="list-style-type: none"> Reduce road transport cost. Improved connectivity. 	<ul style="list-style-type: none"> By 2017, 2,374 km of National Highways and by 2016 6,000 km of Provincial Roads upgraded and rehabilitated. By 2017, increase average travel speed to 49 km/h; from 45 km/h in 2012; and 39 km/h in 2007 on priority National Highways. By 2017, reduce the length of priority National Highways with International Roughness Index above 5.5 to 25%; from 30% in 2012; and 37% in 2007. Connect national growth centers; i.e (i) Anuradhapura; (ii) Jaffna; (iii) Trincomale; (iv) Batticaloa; (v) Dambulla; and (vi) Hambantota to Colombo via the National Highway Network; and connect all regional growth centers to Colombo via the National Highway Network by 2017. National Highway Network: <ul style="list-style-type: none"> (i) Complete Southern Highway by 2009; (ii) In 2017, complete two lane widening of National Highways to 6,072 km; from 4,105 km in 2012; and 4,099 km in 2007. (iii) In 2017, complete four lane widening of National Highways to 490 km; from 178 km in 2012; and 104 km in 2007. Provincial Roads: <ul style="list-style-type: none"> (i) Rehabilitate 6,000 km of Provincial Roads by 2016. 	<p>I. Road sub Sector Ongoing</p> <ul style="list-style-type: none"> Loans and TAs to improve/rehabilitate existing National and provincial roads Loans and Technical Assistance to implement Southern Road Transport Development Project Loans to improve or rehabilitate national, provincial and local roads in conflict affected areas Grant to improve/rehabilitate national, provincial and local roads in Tsunami-affected areas. TAs for Capacity Building for the Environment and Social Division of the Road Development Authority and Financial Management of Road Projects TA for Sustainable Urban Transport 	<ul style="list-style-type: none"> Conflict prevents work in some areas. Security restrictions add increased costs and implementation delays. Policy directions of the Government's 10-years development framework will remain valid in the CPS period. Cost overruns, in particular on sand, bitumen and aggregate. Availability of funds. Capacity of contractors. Implementation capacity of road agencies, in particular on resettlement aspects. Maintenance capacity of road agencies in terms of

	<p>between NHN, Provincial Roads, and Rural Roads.</p> <ul style="list-style-type: none"> • Lack of inter-modal transport planning. • Lack of single transport agency responsible for the entire sector. 	<ul style="list-style-type: none"> • Increased Port capacity. • Increased PPPs 	<ul style="list-style-type: none"> • Rural Roads: (i) Rehabilitate 20,000 km of Rural Roads by 2016. • Reduced travel time: Travel time between Colombo and Matara reduced from 4-5 hours in 2007 to 1.5 to 2 hours in 2010. • Increase container handling capacity in Colombo Port from 3.3 million TEU in 2007 to 5.7 million TEU by 2012 and 8.1 million TEU by 2017. • Increase PPPs by (i) developing and operating a new container terminal in Colombo Port on a BOT basis by the private sector in 2012; and (ii) piloting performance based maintenance contracts for priority National Highways by 2010. 	<p>Planned</p> <ul style="list-style-type: none"> • TAs for establishment of the central procurement unit in RDA and preparation of Master Plan for Provincial Roads to ensure linkages into NRMP • TAs to support the development of sustainable inter-modal transport planning through a transport study and Multi-modal Transport Project • Loans and TAs to improve/rehabilitate existing National and provincial roads <p>II. PORT SUB-SECTOR</p> <p>Ongoing</p> <ul style="list-style-type: none"> • Loan to expand the Colombo Port and the increase the efficiency of the port 	<p>both physical activities and funding requirements.</p> <ul style="list-style-type: none"> • Timely engagement of a private operator
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10YDF= 10 Year Development Framework, BOT= Build, Operate, Transfer, CPS= Country Partnership Strategy, km=Kilometers, km/h=Kilometers per hour, MDG= Millennium Development Goals, NHN= National Highway Network, NRMP= National Road Master Plan, PPP=Public Private Partnership, RDA= Road Development Authority, TA= Technical Assistance, TEU= Twenty-foot Equivalent Units

D. Water, Sanitation, and Urban Services Delivery

1. Sector Situation and Key Issues in the Sector

70. In Sri Lanka, millions of people still do not have access to adequate water supply and sanitation. In 2004, the country achieved 79% coverage of improved water supply, according to the United Nations Development Programme (UNDP).⁹⁸ While recent reports indicate that Sri Lanka will meet the Millennium Development Goal (MDG) Target 10⁹⁹ by 2015, the country faces major challenges, such as regional disparities and urban–rural differences. Statistics show that the urban population with access to improved water sources increased from 91% in 1990 to 98% in 2004, whereas in rural areas the population served increased from 62% to 74% over the same period. Although 75% of the urban population has access to piped water supply, only 14% of the rural population benefits from such service; 65% of them rely on water from protected wells. The differences among the provinces are even more pronounced, and conditions in the north and east, particularly in areas affected by the protracted conflict, are not fully reflected in aggregate statistics.¹⁰⁰ According to the same sources, about 91% of the population in Western Province had access to safe drinking water, with Colombo district recording the highest access at 96%; whereas the proportion of households in northern districts with access to improved water supply in 2001 was reportedly only 21.2% in Mannar and 67.8% in Vavuniya. The World Bank reported that only 46% of the population in the north and east has access to safe drinking water.¹⁰¹ Considerable improvements have been achieved over the years in respect to sanitation; the urban population with access to improved sanitation increased from 89% in 1990 to 98% in 2004, whereas rural coverage rose from 64% to 89%.¹⁰² Access to improved sanitation across districts in Sri Lanka is highest in Colombo (96.2%) and Gampaha (96.5%), and lowest in Batticaloa (57%) in the east. However, data available for the north and east are sometimes incomplete and less reliable.¹⁰³

71. Prolonged conflict and low productivity in rural areas have had a severe impact on urban centers. On average, the urban population (27% of the national total) is growing nearly twice as fast as the rural population. By 2015, the urban population is projected to reach 45% of the total. Regional disparities in the quality and level of public infrastructure services are wide. With limited infrastructure and services, the old and new urban centers cannot adequately support the increasing economic productivity of households. The country's urban areas exhibit problems such as slum and squatter settlements, degraded environment, low standards of infrastructure and services, and overloaded physical infrastructure.¹⁰⁴ In small and medium-sized towns, lack of basic infrastructure for economic development is considered a major challenge.

³⁶ Improved water supply means piped water supply, borehole, protected dug well, protected spring water, rainwater collection, and other technological means for improving water supply to consumers.

³⁷ Halving the proportion of people without sustainable access to safe drinking water and improved sanitation by 2015.

³⁸ National Council for Economic Development. 2005. *Millennium Development Goals Country Report 2005: Sri Lanka*. Colombo.

³⁹ World Bank. 2007. *Sri Lanka Poverty Assessment: Engendering Growth with Equity: Opportunities and Challenges*. Washington, DC.

⁴⁰ Country-wide, the population with access to sanitation increased from 69% in 1990 to 91% in 2004.

⁴¹ Few urban areas in the country have sewer systems, and only Hikkaduwa has treatment facilities. Colombo has a sewerage network that is badly silted and in need of repairs. The Government, recognizing the importance of planned sanitation in urban centers, has programmed the development of sewerage infrastructure in Kandy, Nuwara Eliya, and Jaffna.

⁴² Deficiencies include deteriorated roads, inadequate potable water supplies, and poor drainage and domestic sanitation.

2. Government's Sector Policy and Planning Framework

72. The objectives of the Government's 10YDF (2006–2016) are defined in Table A6.4. In addition, the NWSDB is set to achieve (i) piped water supply coverage of 40% of the total population by 2011; (ii) access to water supply for 85% of the population by 2015, at the same time ensuring a high degree of water security with respect to quality and quantity for all water supply systems; and (iii) piped sewerage coverage of 3% of the population by 2011.¹⁰⁵ The Government's sector strategy and associated investment program focus on (i) providing support to rural and more deprived areas; (ii) investing through all three tiers of Government mandated to provide water and sanitation (central Government, provincial councils, and local authorities); (iii) establishing adequate regulatory and institutional frameworks; (iv) improving performance and reducing nonrevenue water; (v) pursuing community-driven schemes in rural areas, paying special attention to women's participation; (vi) applying integrated urban water supply and management principles; and (vii) ensuring environmental integrity. In addition, the Government's strategy lays out the importance of sustainability and the need to secure adequate (yet socially acceptable) tariffs for water supply and sewerage schemes.

Table A5.4: The Government's Ten-Year Development Framework Objectives (2006–2016)

Target		Year		
		2009	2013	2016
		% of Population		
Increasing population access to improved water supply facilities with sufficient water supply, and achieve service levels and quality of national standards	Overall	80	85	90
	Urban	90	95	100
	Rural	80	85	90
	Estate Sector	70	75	80
Increasing access to adequate and improved sanitation facilities, and service levels and quality of (discharge) waters to achieve national standards	Overall	76	80	88
	Urban	80	85	95
	Rural	75	80	85
	Estate Sector	65	70	75

Source: Government of Sri Lanka. 2006. *Mahinda Chintana: Vision for a New Sri Lanka*. Colombo.

73. The Government's long-term vision¹⁰⁶ of the urban development policy framework seeks to achieve "a systematic urbanization process which will ensure that the life of all citizens is made comfortable, decent, and healthy"¹⁰⁷ by (i) introducing the concept of city and town development as an engine to regional development, (ii) arresting haphazard and ribbon-type urban expansions through appropriate land-use planning, (iii) having relevant agencies and local authorities exercise proper regulation and guidance, (iv) arresting migration to urban areas through proper city and town development programs, (v) improving local townships with modern amenities that make them more attractive, and (vi) introducing new laws and means for enforcing existing ones to effectively protect the environment. The proposed strategies include (i) establishing national growth centers to ensure geographically balanced development in the country, (ii) developing small and medium-sized townships throughout the country as second- and third-order cities, and (iii) developing the capacity of urban local authorities to ensure good governance and reduce regional disparities.

3. Government's Institutional Arrangements and Capacity in the Sector

74. The central Government, through the Ministry of Water Supply and Drainage as well as the Ministry of Urban Development and Sacred Areas (MUDSA), has responsibility for policy making, regulation, and development of the water sector; provincial councils and local authorities are responsible for ensuring equitable resource allocation, quality, and standards of service under the

⁴³ Draft policies on drinking water supply (2006) and on sanitation (2006).

⁴⁴ Government of Sri Lanka. 2006. *Mahinda Chintana: Vision for a New Sri Lanka*. Colombo.

⁴⁵ Government of Sri Lanka. 2006. *Mahinda Chintana: Vision for a New Sri Lanka*. Colombo.

National Policy on Rural Water Supply and Sanitation Sector. Before 1975, providing piped water and public wells was mainly the responsibility of local authorities. In 1974, an act of Parliament established NWSDB as the primary agency responsible for water supply and sanitation in the country. Several major urban water supply schemes operated by local authorities were subsequently transferred to NWSDB to improve coverage and service. In accordance with the laws of the country, NWSDB,¹⁰⁸ urban and municipal councils, and Pradeshiya sabhas (the smallest administrative unit) have retained their mandate to provide water and sanitation. Generally, NWSDB is responsible for planning, designing, constructing, and managing larger urban schemes, as well as for developing rural schemes in areas declared under the NWSDB Act. All other rural areas are within the purview of local government.¹⁰⁹ Since 1996, NWSDB has developed corporate plans for 5-year durations. The limited private sector participation in the water and sanitation sector has come mostly in the form of small-scale providers supplying drinking water to households, and civil works providers where selected functions have been outsourced.

75. MUDSA is responsible for making policies and developing the urban sector. The Urban Development Authority, attached to MUDSA, coordinates urban planning and sustainable urban development and is responsible for designating urban areas, planning, and development. Both agencies have extensive experience in their areas of responsibility. Through the 13th amendment to the Constitution, institutions of local self-government that had operated under a centralized system became a devolved subject of the provincial council, and operational aspects (e.g., local authority operation and administration) were assigned to the provinces. Local authorities should be fully responsible and accountable for providing local services.

76. Capacity varies within the sector. While NWSDB's capacity is generally adequate, support remains necessary to implement its vision for gradual devolution of operational, capital planning, commercial, and financial functions to the provincial centers. Local authorities' human resource capabilities also need to be improved, particularly in financial management and technical skills to manage infrastructure under their control.¹¹⁰ Progress in policy reform has been influenced by Government changes and associated differences in their policy stance; nevertheless, modest and sometimes slow advancement continues. Major policy areas where the Government remains engaged include (i) rationalization of water tariffs and establishment of an independent regulatory authority; and (ii) strengthening of local authorities' capacity to perform their devolved mandates, particularly for delivering water supply and sanitation services.

4. ADB's Sector Experience

77. The evolution of ADB's presence in the sector has been guided by evolving development priorities of the country and areas of external assistance to the sector. While ADB initially positioned itself in secondary towns and rural areas, the introduction of national water tariffs and the withdrawal of other partners from the sector in 1991 presented new opportunities for ADB to deepen its involvement in the sector. Since 1998, ADB's water and sanitation sector strategy has aimed to improve service coverage, enhance cost recovery, and promote self-financing capacity of sector agencies. However, ADB has maintained its focus on secondary urban centers and the concomitant strengthening needed at the local level. Several identified lessons from ADB's operations in Sri Lanka in the water sector include the need to (i) incorporate greater consultation,

⁴⁶ NWSDB operates 287 water supply schemes, which service 38.6% of the population: 28.6% with piped water supply and 10% with hand-pumped tube wells. The rest of the population relies on water systems operated by communities, local authorities, and individual households, including wells and rain-harvesting systems.

⁴⁷ There are largely overlapping functions among different agencies at both central and local levels.

⁴⁸ Except for Colombo and large municipal councils, local authorities have few senior engineers, planners, or financial specialists, although the larger local authorities do have mid-level technical personnel. ADB. 2005. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Local Government Infrastructure Improvement Project*. Manila.

participatory processes, and local government involvement; (ii) avoid conflicts among water users and secure adequate rights; (iii) conduct adequate costing, minimizing inaccuracies in estimates that may lead to significant cost overruns; (iv) increase water and sewerage tariffs annually, taking inflation and tariff objectives into consideration; (v) promote sustainable water resource development and establish frameworks for water resource management; and (vi) develop capacity, targeting all levels of influence. Other lessons learned are the following:

- (i) Handover of management of water schemes to local authorities and community-based organizations requires continued support during transition and the follow-up period to ensure the sustainability of the schemes.
- (ii) While tariff adjustments have been effective in recovering a large portion of operation and maintenance (O&M) costs, they are generally insufficient for reinvesting and replacing assets.
- (iv) Benchmarking by setting operational performance targets should be streamlined.
- (v) Closer links with health outcomes should be supported through the inclusion of sanitation, hygiene, and health promotion programs in project design.

78. From its early stages, ADB assistance in urban development has taken a balanced approach to integrating urban infrastructure, community development, housing finance, and institutional development. While investment initially concentrated on the provision of economic and commercial infrastructure, it later recognized the importance of basic urban service delivery. Lessons in the urban sector, which have been incorporated in the design of recent projects (footnote 11) to redress the issues, include the following:

- (i) The local government must be involved in preparing and implementing the project to ensure proper O&M of completed project facilities.
- (ii) A systematic approach in institutional strengthening should be adopted instead of providing ad hoc training or seminars.
- (iii) The selected executing agency should have a strong link to the local government.
- (iv) Investment priorities should be discussed extensively at the council level to prevent major revisions when the local government changes.

5. Role of Other Development Partners in the Sector

79. In recent years, ADB has been the major development partner in both water supply and sanitation and urban sectors. In rural areas, both Ministry of Urban Development and Water Supply (now MUDSA) and NWSDB, with support from the World Bank and ADB (and, to a lesser extent, JBIC), have extensively promoted community participation in water and sanitation for more than a decade. Other development partners working in this sector include the governments of Denmark (engaged in small towns in Central Province and Colombo), Japan (supporting large programs through NWSDB and local authorities in Kandy and Colombo, and towns around Colombo and some smaller initiatives in the central region), France, and Germany. Several externally funded projects in urban infrastructure have been implemented during the past decade. The Sustainable Cities Programme of the United Nations Human Settlements Programme (UN-Habitat) and UNDP evolved into the Urban Governance Support Programme (2004–2005). It provided capacity-building support to the Urban Development Authority and some selected municipalities. Pilot projects in solid waste management have produced tangible progress in garbage collection and communal participation, and instilled confidence in local authority staff and local communities concerned. UN-Habitat has provided assistance to MUDSA for designing credit guarantees for low-income housing development, while the Government of Germany has provided grant assistance to support participatory improvements in underserved settlements in Colombo.

6. Intended Sector Outcomes and Key Outputs Supported by ADB

80. ADB's strategy in the water sector will continue to focus on (i) bridging the rural–urban gap with regard to access to water supply and sanitation; (ii) supporting the development of new or rehabilitation of schemes in more deprived areas of the country where water is scarce; and (iii) providing basic infrastructure and services in secondary towns, as a means to promoting economic development and supporting growth in small centers across the country. The strategy will align itself with essential governance principles, including increased accountability, participation, and transparency. In addition, it will aim to provide the necessary environment and capacity development to (i) allow increased institutional capacity at the local level, (ii) enable the Government to establish adequate regulatory and institutional frameworks in the water sector, and (iii) improve the sector's performance by introducing adequate benchmarking and performance-monitoring mechanisms. ADB's strategy in the urban sector will continue to focus on (i) improving urban management capacity and living conditions for local authorities in growth centers; (ii) providing basic infrastructure and services in secondary towns, as a means to promote economic development and support growth in small centers across the country; and (iii) encouraging private sector participation. The strategy will seek to strengthen the capacity of local urban authorities to ensure adequate implementation and management, and local enforcement capacity.

7. Links to CPS Outcomes and Other Sectors and Themes

81. The proposed water and sanitation support interventions will directly support CPS outcomes that aim to achieve sustainable and inclusive development (Table A6.5), as water is a vital resource, indispensable to life and essential for economic and social development of a country. In Sri Lanka, access to safe water is considered an inalienable right of its people. As such, the provision of water is a top priority of the Government. To a lesser degree, water supply and sanitation outcomes will also support the CPS outcome that aims to promote higher economic growth by providing essential large-scale sewerage infrastructure in Colombo. The proposed urban sector outcomes will directly support CPS outcomes that aim to achieve sustainable and inclusive development by exploring the growth potential and reducing poverty. For this purpose, projects will seek to (i) increase local authorities' capacity, accountability, and responsiveness to the governance system; (ii) provide a foundation for sustainable and reliable urban services through more effective local authority management and financing systems; (iii) improve economic and social conditions in the local authorities as a result of investments in essential and small-scale community infrastructure; and (iv) promote the establishment of partnerships with the private sector. The productivity and health of the urban poor will benefit from environmental infrastructure investments, as they suffer disproportionately from the ill effects of the lack of such services. Sector outcomes will also support the CPS outcome on governance in the form of greater accountability and participation (decentralization of services, human resource base reform, and support to the introduction of independent regulation).

8. Indicative Areas for Interventions

82. ADB will continue to provide assistance to small towns and rural areas suffering from greater shortages in water, sanitation, and general urban infrastructure. For example, NWSDB statistics show that following districts have low levels of piped water: Mannar (11.4% of households), Puttalam (2.5%), and Vavuniya (6.7%). Similarly, in Jaffna district (where about 3% of the households have piped water), only Jaffna town has limited coverage, largely through standposts for 1 or 2 hours a day. Therefore, it is proposed that during 2008–2010 ADB provide financial assistance to the Government through new direct investment in the form of new projects for rural and small towns water supply and sanitation in the northern (Vavuniya, Mannar, and Jaffna districts) and northwestern (Puttalam district) provinces, as well as through ongoing projects in the southern (Hambantota), north central (Polonnaruwa), and eastern (Batticaloa and Muttur)

provinces. During this period, ADB will also assist the Government through the ongoing local government infrastructure improvement projects with countrywide coverage and the preparation of a follow-up project (phase II). Technical assistance is also proposed to help achieve the Government's vision to decentralize basic urban service delivery and promote independent regulation.

9. Monitoring Mechanism

83. Monitoring mechanisms in this sector will include (i) joint annual reviews of ongoing projects, (ii) sector performance reviews, and (iii) aid coordination meetings led by the Government. Programs to ensure that rural water supply projects do not prevent the poorest from benefiting have been introduced in the last project and are regularly monitored (measures introduced include contribution through labor). More private sector participation will be encouraged to reduce the risks of political interference; lack of staff at the Local Loan and Development Fund (LLDF) will be countered by implementing assurances of sufficient counterpart staff. The decentralization drive will be pushed at project level that by passing down responsibility of implementation to the regions. Intense policy dialogue, supported by the Sri Lank Resident Mission's governance experts and economists, will be aimed at strengthening the local authorities' ability to increase their revenue base. Intense training of key government officials, including trips to successful schemes abroad, will increase the understanding of proposed reforms.

Table A5.5: Water Supply, Sanitation, and Urban Services Delivery Sector Results Framework

Relevant CPS Outcomes		Sector-Level Outputs		ADB Assistance	Risks
CPS Outcomes Relevant to the Sector	Key Opportunities and Constraints	Subsector Outcomes/Key Sector Outputs	Sector Milestone/ Tracking Indicators/Interim Indicators		
Socially Inclusive Development	<p>Constraints</p> <ol style="list-style-type: none"> 1. Access to conflict-affected areas 2. Securing financial sustainability 3. Reaching the poorest of the poor <p>Opportunities</p> <ol style="list-style-type: none"> 1. An established framework 2. Government commitment and leadership 	<ol style="list-style-type: none"> 1. 350,000 people gain access to water in rural Polonnaruwa, Anuradhpura, and Batticaloa districts; 550,000 people gain access to water in the towns of Polonnaruwa, Muttur, Hambantota, and Batticaloa. This represents nearly 5% of the country's population with additional access to safe water (currently estimated at about 80%); about 4% through piped water systems (which is 50% of the National Water Supply and Drainage Board's target to increase piped water supply coverage from 31.1% in 2006 to 40.3% in 2011). 2. Better sanitation for 1% of the population 3. Better basic local government infrastructure and services delivery 	<p>By 2011</p> <ol style="list-style-type: none"> 1. The following indicators are provided: (i) construction of four intakes in project towns amounting to 210 Million Liters per Day (MLD), (ii) construction of four water treatment plants to treat 77 MLD, (iii) supply and laying out of 118 km of raw water and transmission mains, (iv) supply and laying out of about 500 km of distribution lines 2. Construction of 33,000 low-cost latrines in three districts, and sewerage system and sewage treatment plant for Batticaloa 3. Local authority indicators: (i) higher volume and quality of water supply in 20 local authorities and increase in duration to 24 hours in 15 local authorities, (ii) 85 km of improved and new drainage systems, (iii) increase in frequency of collection of solid waste in 15 local authorities and safe collection and disposal of about 275 tons, (iv) improvements to about 350 km of local authority roads. 	<p>Ongoing</p> <p>Secondary Towns and Rural Community-Based Water Supply and Sanitation Project</p> <p>Dry Zone Urban Water Supply and Sanitation Project</p> <p>Planned</p> <p>Urban Environment Improvement Project (Secondary Towns)</p>	<p>Difficulties associated with gaining access for implementation in conflict-affected areas</p> <p>Ensuring that demand-driven projects in rural areas do not prevent the poorest of the poor from benefiting</p>
Strengthened Investment Climate (Governance)	<p>Constraints</p> <ol style="list-style-type: none"> 1. Access to conflict-affected areas 	<ol style="list-style-type: none"> 1. Better technical and financial performance in the sector 	<ol style="list-style-type: none"> 1. Better institutional performance by NWSDB: (i) decentralization of service delivery and regional 	<p>Ongoing</p> <p>TA for Strengthening the Regulatory Framework in the Water</p>	<p>Lack of understanding of proposed reforms</p> <p>Competing interests</p>

Relevant CPS Outcomes		Sector-Level Outputs		ADB Assistance	Risks
CPS Outcomes Relevant to the Sector	Key Opportunities and Constraints	Subsector Outcomes/Key Sector Outputs	Sector Milestone/ Tracking Indicators/Interim Indicators		
	<p>Opportunities</p> <p>1. Will to pursue reform measures for improved performance</p>	<p>2. Better urban, provincial, and, municipal management</p>	<p>benchmarking in at least 50% of territory, (ii) all agreed-upon operational performance indicators enhanced by no less than 2 points each, (iii) improvement in cost recovery and self-financing capacity of sector agencies to achieve positive income statements, (iv) NWSDB regulated by PUCSL (target by 2009)</p> <p>2. Local authority indicators: (i) growth in own-source annual revenue by at least 10% in 30 local authorities, (ii) annual expenditure on operation and maintenance increased by about 5% in 20 local authorities, (iii) defaults reduced by 50%</p>	<p>Supply and Sanitation Sector</p> <p>TA for Decentralized Institutional Strengthening in the Water Sector</p> <p>Secondary Towns and Rural Community-Based Water Supply and Sanitation Project</p> <p>Planned TA for Supporting Capacity Development in Urban Local Authorities</p>	<p>and political interference</p> <p>Inadequate availability of staff in the local authorities, provincial councils, and LLDF</p> <p>Participating local authorities unable to increase their revenue base</p> <p>Enabling framework for decentralization not effective</p>

LLDF= Local Loan and Development Fund, MLD= Million Liters per Day, NWSDB= National Water Supply and Sanitation Project, PUCSL= Public Utilities Commission of Sri Lanka, TA= Technical Assistance

E. Education Sector

1. Sector Situation and Key Issues in the Sector

84. Sri Lanka has achieved universal primary education, high literacy rates, and gender equity in basic education. In 2006, the completion rate at junior secondary level reached 84%. Performance at senior secondary level has significantly improved since 2001 as result of the Government's efforts and external support such as that provided by ADB. Between 2001 and 2006, the general certificate ordinary level (O level) examination pass rate increased from 37% to 49%, and the general certificate advanced level (A level) examination pass rate increased from 50% to 60%. Since pass rates in science, mathematics, and English remain below average, further improvement is needed. Students who fail the O level examination repeat the test. Those who passed O level generally continue to A level. A-level graduates compete for university and other tertiary education institutions, but the system has such limited intake capacity that only about 11% of those who qualify are admitted to tertiary education institutions. Others enroll in technical education and vocational training (TEVT) programs. With ADB support, the quality and relevance of TEVT programs have improved, but options for higher skills upgrade are still limited. Overall, performance at the secondary level has improved, but bottlenecks entering tertiary-level institutions, including TEVT undermine the achievement and efficiency gained in primary level.

85. Unemployment declined from 8.8% in 2002 to 6.6% in 2006. However, the unemployment rate among O-level graduates was 12% and among A-level was 14%. Of the total unemployed, 44% were below O level, 28% were O-level graduates, and another 28% were A-level graduates, while 55% of the unemployed were below 29 years old. These figures show that many unemployed are educated youth. This is partly because of a lack of job opportunities, but also due to the mismatch between the supply from the education system and the demands of the labor market. Thus, Sri Lanka needs to increase internal and external efficiency of its education system, if the sector is to play a key role in national economic growth.

86. The school system has traditionally focused on screening and selection for conventional university education. As a consequence, students lack practical and generic skills and attitudes that are needed in the labor market, such as communications, teamwork, problem solving, and critical thinking. Career guidance is weak. Although only a few students can enroll in university, parents and students traditionally prefer university degree admission, which is the only option considered for higher skills upgrade. As the economy becomes more dynamic, education must become more practical and relevant to labor market needs. Thus, the school system needs to prepare and orient students to wider learning options and career paths, including non-university tertiary education and TEVT programs. Education content and teaching methodologies should become more competency-based, life-oriented, and applied to current and future labor market needs.

87. An important challenge is to increase the equity of access to quality secondary education in key subjects—across regions, gender, and ethnic groups. Though science streams have better employment perspectives, many A-level students opt for art streams because of the lack of science teachers and laboratories, especially in rural areas. Of the 2,300 senior secondary schools, only about 700 offer an A-level science stream. Access to information and communication technology (ICT) in education has gradually expanded since 2001; however, it is still limited to larger schools in the urban areas. As such, regional disparities in access to quality education persist, with the unequal distribution of school facilities, teachers, and teaching-learning resources. Conflict-affected Northern and Eastern provinces and resource-starved rural and plantation areas particularly suffer. Ultimately, children from disadvantaged areas have little chance to break into areas with better incomes and employment prospects.

88. Better performance and more graduates at the secondary level increases demand for tertiary education. However, public resource constraints limit the expansion and modernization of tertiary education. Sri Lanka spends relatively little on education: 3% of its gross domestic product and about 9% of total government expenditure in 2007. Moreover, as education is free up to the university first degree level, it relies heavily on public resources. With Government budget constraints, access, quality, and relevance of education cannot be maintained or enhanced without cost-recovery measures and greater private sector involvement. However, the current political environment does not favor establishment of private universities or the concept of cost recovery in the university system. Therefore, tertiary education institutions outside of the university system, including postsecondary TEVT programs, will play a greater role in providing opportunities to upgrade higher skills.

89. Globalization and the impact of economic and technological change in Asia open opportunities and challenges for Sri Lanka's future labor force. Asia's transition to a knowledge-based economy will create more jobs for educated youth. As a productive and competitive economy, it will require high-level and mid-level professionals in selected fields. Labor market data and projections show an increasing demand for skilled and semiskilled labor in construction, health care, communication technologies, and other manufacturing and service sectors in local and foreign markets. To meet such demand and to increase Sri Lanka skill-based competitiveness, the education system needs to expand high-quality and relevant secondary and tertiary education, including TEVT.

2. Government's Sector Policy and Planning Framework

90. The Government's 10-year development framework (10YDF) calls for an education system that will provide the technological skills required for rapid economic and social growth for national development. The Government's main strategies are to (i) introduce competency-based education (CBE) in secondary education to make education more life-skills oriented; (ii) strengthen teaching in ICT, languages including English, sciences, and technical subjects; (iii) upgrade one secondary school in each of the 325 administrative divisions to full-fledged school to enhance equitable access to quality education across the nation; (iv) strengthen links between general education, tertiary education, and TEVT; (v) introduce school-based teacher appointment as a measure to ensure more equitable distribution of teachers; and (vi) strengthen PPPs in selected fields. The Government's strategies to improve quality and relevance of TEVT are to introduce national skill standards, a national vocational qualifications (NVQ) system in all participating institutes, and registration and accreditation of courses of all vocational institutions. TEVT will be expanded to provide opportunities to upgrade skills for secondary school leavers and employees, and to ensure equity of access to all TEVT centers for women and disadvantaged groups. The 10YDF also envisages an expansion of higher education opportunities, including alternative ways using distance education delivery methods.

3. Government's Institutional Arrangements and Capacity in the Sector

91. Because of the national policy of free education, the regulatory framework restricts private sector involvement in education financing and service delivery, and cost recovery. However, the public sector alone cannot meet the diversified demands for education and training of the modern economy. The Government is aware of these constraints and intends to explore PPPs in some fields. A regulatory framework that facilitates the provision of non-degree public and private tertiary education, and regulates the quality of services, would be required.

92. In general education, different policies, procedures, and resource management are used at national schools administered at the central level and provincial schools administered at the provincial level. This dual system, and the inadequate management capacities at various levels of

administration, impedes the efficiency of education governance. One positive development is the introduction of school-based management to improve school governance and the quality of teaching through bottom-up planning and resource management. Strengthening of managerial capacity, and professional development of school principals and education officers at all levels, will help improve management efficiency. Furthermore, streamlining and modernizing administrative systems by introducing an integrated management information system will help rationalize operational procedures at all levels.

4. ADB Sector Experience

93. Consistent with the Government's priorities, ADB's sector strategy aims to raise the quality and relevance of education, increase equity of access, and enhance employability of graduates. ADB's education sector policy calls for more investment in post-basic and tertiary education, including TEVT, to support the transformation to a high-technology and service-oriented economy. In line with the sector policy and strategy, ADB is investing in several spheres of secondary and tertiary education, including TEVT, through a series of investment loans between 2000 and 2010. The earlier Secondary Modernization Project (SEMP)¹¹¹ and the ongoing Secondary Education Modernization Project II (SEMP II)¹¹² have initiated support in modernizing secondary curriculum and teaching-learning methods through curriculum revision and greater use of ICT in learning, science teaching, and reform in school-based assessment (SBA). SEMP II further supports devolution of education management through school-based management and facilitation of teaching-learning in zones. At the tertiary level, the Distance Education Modernization Project¹¹³ supports the expansion of tertiary education opportunities through the greater use of distance education for service delivery, PPP in distance education, and capacity upgrade of the Open University. The Technical Education Development Project supports further upgrading of technical colleges and expansion of post-A level technical education through a new university of vocational technology. The Education for Knowledge Society Project further expands quality secondary education in ICT, English, science, and technical subjects. It upgrades the Sri Lanka Institute of Advanced Technological Education institutions into more market-responsive tertiary education providers. The project also promotes interagency policy dialogue to strengthen links and partnerships between general and tertiary education, TEVT, and the private sector in career guidance, competency-based curriculum, assessment, and quality standards, assurance, and accreditation.

94. The CAPE found that education sector assistance is relevant, efficient, effective, and likely to be sustainable. Outcomes in secondary education were (i) an increase in pass rates during 2001–2006 from 37% to 49% at O level, and from 50% to 60% at A level; (ii) relatively high entry to A level (73%) and university (58%) of scholarship recipients under SEMP; (iii) higher access to senior secondary level of economically disadvantaged children; (iv) the initiation of access to ICT in school through 1,000 computer learning centers and school network, and teaching of general information technology at O and A level; (v) wider recognition of SBA; and (vi) stronger capacity of the national evaluation and testing service (NETS). The outcome in tertiary education was 72% employment rates of graduates of ADB loan-assisted science and technology institutions in 2002, while outcomes in TEVT were (i) higher job relevance and self-employment rates of TEVT graduates, (ii) an institutionalized competency-based training system, and (iii) a national vocational qualification system established that offers a career path and alternative avenue to higher education.

¹¹¹ ADB. 2000. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Secondary Education Modernization Project*. Manila.

¹¹² ADB. 2004. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Secondary Education Modernization Project II*. Manila.

¹¹³ ADB. 2003. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Distance Education Modernization Project*. Manila.

5. Role of Other Development Partners in the Sector

95. The Government has developed an Education Sector Development Framework and Program (ESDFP) 2006–2010, which provides a policy framework and a guide for development assistance in general education. ESDFP calls for a harmonized and programmatic approach to external assistance in general education. External assistance is integrated into ESDFP under the leadership and coordination of the Ministry of Education (MOE). ADB and the World Bank provide the largest assistance through project investments and budgetary support. Bilateral agencies and nongovernment organizations (NGOs) have been active in peace education, school improvement, TEVT, and rehabilitation in Northern and Eastern provinces and tsunami-affected areas.

6. Intended Sector Outcomes and Key Outputs Supported by ADB

96. The expected sector outcome is an education system that is more responsive to the diversified needs of the modern economy. The major targets are secondary school students, graduates, and school leavers who seek higher skills upgrades to compete in and benefit from the knowledge economy. ADB's strategy is to continue focusing on improving the quality, relevance, and equity of access to secondary and tertiary education including TEVT. Key sector outputs include (i) greater and more equitable access to quality secondary education in key subjects such as sciences, English, and ICT; (ii) a competency-based curriculum, teaching methodologies, and assessment implemented in all secondary schools; (iii) a wider range of quality and relevant tertiary education programs available for secondary school graduates; (iv) quality and relevant TEVT programs in selected service and industry sectors available for secondary school graduates and school leavers; and (v) an interagency policy coordination mechanism between general education, TEVT, higher education, and industry sector institutionalized and made operational.

7. Links to CPS Outcomes and Other Sectors and Themes

97. ADB's interventions in education will support achieving CPS outcomes of higher economic growth and socially inclusive development. Improving quality, relevance, and access to secondary and tertiary education, including TEVT, will help increase Sri Lanka's skills-based competitiveness and support the transformation to a high-technology and service-oriented economy. More equitable access to education opportunities across regions, gender, and ethnic groups will support more socially inclusive development, thereby contributing to greater social justice and socioeconomic stability.

8. Indicative Areas for Interventions

98. Areas for interventions in secondary education include (i) continued strengthening and expansion of teaching in science, English, and ICT and other technologies in secondary schools; (ii) upgrading of selected secondary schools in poor and remote areas to full-fledged schools; and (iii) support for reform in competency-based curriculum, teaching methodologies, and assessment. Areas for interventions in tertiary education include (i) support for establishing a regulatory framework and institutional mechanism that facilitates the provision of nonconventional public and private tertiary education, regulating quality of services, and facilitating links with local and foreign universities for credit transfer and laddering;¹¹⁴ (ii) continued expansion of the use of distance education as an alternative path to tertiary education; (iii) support for PPPs for cost sharing and credit transfer; and

⁵² To provide different levels of programs so that students can progress from one level to the other, eg: from certificate courses to diplomas to degrees.

(iv) expansion and upgrading of nonconventional tertiary education by modernizing curriculum, teaching methodologies, budgeting and management, and by providing stipends to support disadvantaged students. Areas for interventions in TEVT include (i) expansion of training programs under the national vocational qualification system, especially in the service sector; (ii) expansion and consolidation of mid-level technical education and development of facilities for post-employment training; (iii) technical teacher education at all levels and subjects, especially targeting rural areas and disadvantaged groups, including disabled people and girls; and (iv) development of management information systems for quality assurance, budgeting, and accounting for all TEVT institutions.

9. Monitoring Mechanism

99. Progress in achieving the outcomes and outputs of this sector road map will be assessed through (i) project review missions; (ii) project performance management systems; and (iii) selected impact and tracer studies.

Table A5.6: Education Sector Results Framework (2009–2011)

Relevant CPS Outcomes		Sector Level Outputs		ADB Assistance	Risks
CPS Outcomes Relevant to the Sector	Key Opportunities and Constraints	Sub sector Outcomes/Key Sector Outputs	Sector Milestone/Tracking Indicators/Interim Indicators		
Increased skills-based competitiveness for higher economic growth	<ol style="list-style-type: none"> 1. Lack of relevance of secondary and tertiary education to local and foreign labor markets demand 2. Constraints on public resources and private sector involvement to expand tertiary education 3. Lack of TEVT opportunities in areas of high demand 4. Lack of investment capacity to conduct TEVT program 5. Lack of links between general education, TEVT, higher education, and the private sector 	<ol style="list-style-type: none"> 1. Better quality and relevance of secondary and tertiary education to the demand of modern economy 2. Wider range of quality and relevant tertiary education programs available for secondary school graduates 3. Quality and relevant TEVT programs in selected service and industry sectors available 4. Increase in numbers of qualified TEVT staff 	<ol style="list-style-type: none"> 1. Unemployment of educated youth reduced from 14% in 2006 to 8% in 2012 2. Secondary education graduates enrolled in tertiary education, especially nonconventional tertiary education, increased from 11% in 2006 to 16% by 2012 3. Graduation of technicians increased from about 600 graduates in 2006 to about 2,200 by 2012 4. About 900 TEVT staff trained by 2012 5. Interagency policy coordination mechanism between general education, TEVT, higher education, and industry sector institutionalized and operational 	<p>Ongoing</p> <p>Secondary Education Modernization Project II</p> <p>Distance Education Modernization Project</p> <p>Technical Education Development Project</p> <p>Education Sector Development Project</p> <p>Education for Knowledge Society Project</p> <p>Planned</p> <p>National Education Sector Project (standby)</p>	<p>Delays in recruitment of TEVT staff cadre</p> <p>Political interference in education resource management</p> <p>Resistance to coordinate among educational institutions</p>

Relevant CPS Outcomes		Sector Level Outputs		ADB Assistance	Risks
CPS Outcomes Relevant to the Sector	Key Opportunities and Constraints	Subsector Outcomes/Key Sector Outputs	Sector Milestone/Tracking Indicators/Interim Indicators		
More equitable access to quality and relevant education for socially inclusive development	<p>1. Regional disparities in access to quality secondary education, especially in key subjects such as science, English, ICT</p> <p>2. Lack of quality and affordable tertiary education and TEVT for school leavers and disadvantaged students</p>	<p>1. Better quality, relevance, and effectiveness of secondary education</p> <p>2. Greater capacity of secondary schools in poorest areas to offer Advance level science, ICT, English</p> <p>3. Wider range of quality and affordable tertiary education and TEVT programs available for secondary school graduates from poor families</p>	<p>1. Pass rates of GCE Ordinary level and Advance level increased from 49% and 60% respectively in 2006 by 7% by 2012 (gender, ethnic groups, and geographical locations segregated data to be used)</p> <p>2. 150 high-quality secondary schools available in 150 poor districts, with an equitable regional, ethnic, and medium of instruction distribution by 2012</p> <p>3. 10 technician diploma programs and 2 degree programs that do not require A level qualification available by 2011</p> <p>4. A fair, well-managed, and sustainable scholarship program for disadvantaged students to continue secondary, tertiary, and TEVT is implemented</p>	<p>Ongoing Secondary Education Modernization Project II</p> <p>Distance Education Modernization Project</p> <p>Education for Knowledge Society Project</p> <p>Planned National Education Sector Project (standby)</p>	<p>Difficulties in implementing activities in conflict - affected areas.</p> <p>Equitable deployment of teachers not enforced</p>

GCE= General Certificate of Education, ICT= Information and Communication Technology, TEVT= Technical Education and Vocational Training.

INDICATIVE ROLLING COUNTRY OPERATIONS BUSINESS PLAN 2009–2011

I. INDICATIVE LENDING AND NONLENDING PROGRAM

1. A total of \$320 million in Asian Development Fund (ADF) loans is programmed to finance reconstruction of dilapidated infrastructure in conflict-affected areas and in the poorer regions of Sri Lanka. The ADF allocations are indicative, hinging on the availability of ADF resources for that period and on the continued improvement in Sri Lanka's annual country performance assessment rankings. The indicative ordinary capital resources (OCR) allocation is \$310 million for public sector operations.¹ The total indicative targeted resource envelope per year for Sri Lanka is \$300 million, which the Government and ADB will seek to meet by attracting cofinancing, private sector financing, and nonsovereign loans.

II. INDICATIVE INTERNAL RESOURCE REQUIREMENTS

2. It is estimated that the internal resource requirements will be unchanged for 2009–2010 as the Sri Lanka Resident Mission staff is supplemented through externally financed governance and post-conflict advisors.

¹ This could be lower depending on ADB's resource availability.

Table A6.1: Indicative Assistance Pipeline for Lending Products, 2009–2011

Sector Project/Program Name	Targeting Classifi- cation	Thematic Priority	Division	Year of Project Preparatory Assistance	Total	Cost (\$ million)					
						OCR	ADB		Total	Gov't.	Co- financing
							ADF				
							Loans	Grants			
2009 Firm Loans											
Transportation and Communications											
1. Road Network (including Eastern Province)	GI	ECO	SATC	2004	00.00	70.00	0.00	70.00	TBD	0.00	
Subtotal					00.00	70.00	0.00	70.00	TBD	0.00	
Water Supply, Sanitation, and Waste Management											
2. Greater Colombo Wastewater Management Project	GI	ENV	SAUD	2006	80.00	20.00	0.00	100.00	0.00	0.00	
Subtotal					80.00	20.00	0.00	100.00	TBD	0.00	
Law, Economic Management, and Public Policy											
3. Fiscal Management Reform Project II	GI	GOV	SAGF	2008	30.00	10.00	0.00	40.00	TBD	0.00	
Subtotal					30.00	10.00	0.00	40.00	TBD	0.00	
Total					110.00	100.00	0.00	210.00	TBD	0.00	
2009 Standby Loans											
Water Supply, Sanitation, and Waste Management											
1. Jaffna Water Supply and Sanitation ^a	GI	ECO	SAUD	2005	0.00	0.00	0.00	80.00	0.00	0.00	
Subtotal					0.00	0.00	0.00	80.00	0.00	0.00	
Total					0.00	0.00	0.00	80.00	0.00	0.00	
2010 Firm Loans											
Energy											
1. Sustainable Power Sector Support II	GI	ECO	SAEN	2009	100.00	0.00	0.00	100.00	0.00	0.00	
Subtotal					100.00	0.00	0.00	100.00	0.00	0.00	

Sector Project/Program Name	Targeting Classifi- cation	Thematic Priority	Division	Year of Project Preparatory Assistance	Total	Cost (\$ million)					
						OCR	ADB		Total	Gov't.	Co- financing
							Loans	Grants			
Transportation and Communications											
2.Road Network (Provincial)	GI	ECO	SATC	2004		0.00	120.00	0.00	100.00	TBD	0.00
II											
Subtotal						0.00	120.00	0.00	120.00	TBD	0.00
Total						100.00	120.00	0.00	220.00	0.00	0.00
2010 Standby Loans											
Water Supply, Sanitation, and Waste Management											
1. Lagging Regions Community Infrastructure ^a	GI	ECO	SAUD			0.00	00.00	0.00	20.0	TBD	30.00
Subtotal						0.00	0.00	0.00	20.0	0.00	30.00
Total						0.00	0.00	0.00	20.0	0.00	30.00
2011 Firm Loans											
Transportation and Communication											
1. National and Provincial Roads	GI	ECO	SATC	2004		60.00	90.00		150.00	TBD	
Subtotal						60.00	90.00		150.00	TBD	
Water Supply, Sanitation, and Waste Management											
2. Urban Environment Improvement Project (secondary towns)	GI	ECO	SAUD	2010		40.00	10.00		40.00	TBD	
Subtotal						40.00	10.00		50.00	TBD	
Total						100.00	100.00		200.00	TBD	
2011 Standby Loans											
Education											
1. National Education Sector Project	GI	ECO	SANS	2010			10.0		40.0		30.0

ADB = Asian Development Bank, ADF = Asian Development Fund, ECO = sustainable economic growth, ENV = environmental sustainability, GI = general intervention, GOV = governance, OCR = ordinary capital resources, SAEN = South Asia Energy Division, SAGF = South Asia Governance, Finance, and Trade Division, SATC = South Asia Transport and Communications Division, SAUD = South Asia Urban Development Division, TI = targeting intervention, TBD = to be determined.

^a These projects will be implemented only once the security situation improves at which time their funding will be revisited. For this reason, the funding for these projects are not included in the total figures for the firm program.

Source: ADB estimates.

Table A6.2: Indicative Assistance Pipeline for Nonlending Products and Services, 2009–2011

Sector Assistance Name	Responsible Division	Assistance Type ^a	Sources of Funding				Total (\$'000)
			ADB		Others		
			Source ^b	Amount (\$'000)	Source ^c	Amount (\$'000)	
2009							
Law, Economic Management, and Public Policy							
1. Umbrella TA Capacity Development Fund	SLRM	ADTA		2,000.00		0.00	2,000.00
2. Supporting Capacity Development in Urban Local Authorities	SAUD	ADTA		800.00		0.00	800.00
Subtotal				2,800.00		0.00	2,800.00
Transportation and Communication							
2. Multi-modal Transport Study	SATC	ADTA		1,000.00		0.00	1,000.00
Subtotal				1,000.00		0.00	1,000.00
Energy							
3. Sustainable Power II	SAEN	PPTA		800.00		0.00	800.00
Subtotal				800.00		0.00	800.00
Total				4,600.00		0.00	4,600.00
2010							
Transportation and Communication							
1. National and Provincial Roads	SATC	PPTA		1,000.00		0.00	1,000.00
2. Multimodal Transport Project	SATC	PPTA		1,000.00		0.00	1,000.00
Subtotal				2,000.00		0.00	2,000.00
Law, Economic Management, and Public Policy							
3. Public Financial Management	SAGF	PPTA		1,000.00		0.00	1,000.00
Subtotal				1,000.00		0.00	1,000.00
Water Supply, Sanitation, and Waste Management							
4. Urban Environment Improvement Project (Secondary Towns)	SAUD	PPTA		800.00		0.00	800.00
Subtotal				800.00		0.00	800.00
Education							
5. National Education Sector Project	SANS	PPTA		800.00		0.00	800.00
Subtotal				800.00		0.00	800.00

Sector Assistance Name	Responsible Division	Assistance Type ^a	Sources of Funding		Total (\$'000)	
			ADB			
			Source ^b	Amount (\$'000)		Others
Total				4,600.00	0.00	4,600.00
2011						
Law, Economic Management, and Public Policy						
1. Umbrella TA for Capacity Development Fund II	SLRM	ADTA		2,000.00	0.00	2,000.00
Subtotal				2,000.00	0.00	2,000.00
Water Supply, Sanitation, and Waste Management						
2. Urban Areas (Secondary Towns) Development Project	SAUD	PPTA		1,000.00	0.00	1,000.00
Subtotal				1,000.00	0.00	1,000.00
Total				3,000.00	0.00	3,000.00

ADB = Asian Development Bank, ADTA = advisory technical assistance, PPTA = project preparatory technical assistance.
Source: ADB estimates.

Table A6.3: Summary Information on Proposed Indicative Lending Products and Services for 2009

Project Name	Description
Fiscal Management Reform Program II (FMRPII)	<p>Impact Government implementation of reforms to (i) further contain expenditure and augment revenue in support of fiscal objectives set forth under the Fiscal Management (Responsibility) Act, and (ii) improve the quality and cost of service delivery</p> <p>Major Components FMRP II will cover (i) continuity of reforms initiated under the FMRP (i.e., implementation of tax modernization programs at two selected provincial councils); (ii) deepening of reforms following the FMRP (i.e., implementation of recommendations from public expenditure reviews and rollout of the extension of the Treasury Fund Transfer System [TFTS]); and (iii) complementary reforms following the FMRP (i.e., develop capacity for management audit functions of the Treasury, and develop and implement foundations of a service delivery framework).</p> <p>Expected Outputs (i) Expenditure rationalization based on the outcome of public expenditure reviews; (ii) stronger expenditure oversight and control through the development of better management audit functions at the Ministry of Finance and Planning (MOFP); (iii) higher revenue collection from modernized tax administration in two provincial councils; (iv) better delivery service in targeted sectors, including agriculture, education, and health, owing to the implementation of the service delivery framework; and (v) higher savings to the Treasury combined with better efficiency and control of payments from deepening reforms on the TFTS.</p> <p>Outcome FMRP II will build on the FMRP to generate greater fiscal space to support priority development programs and improve service delivery in Sri Lanka.</p>
Greater Colombo Wastewater Management Project	<p>Impact An investment package consisting of sewerage infrastructure facilities for Greater Colombo, and institutional strengthening to improve operational and management performance</p> <p>Major Components The project will have three components:</p> <p>Component 1 will (i) rehabilitate sewerage infrastructure facilities in Colombo, (ii) expand the sewerage system in Colombo, and (iii) introduce on-site sanitation in areas without a sewer system in Greater Colombo.</p> <p>Component 2 will provide institutional strengthening to (i) the National Water Supply and Drainage Board to manage its capital assets, (ii) Colombo Municipal Council to operate the sewerage system, and (iii) local authorities to introduce sustainable on-site sanitation.</p> <p>Component 3 will focus on project management.</p> <p>Expected Outputs and Outcomes The project will assist the Government in improving the living conditions of the urban population in Greater Colombo and minimizing the negative environmental impacts of increasing levels of domestic waste.</p>

Project Name	Description
Jaffna Water Supply and Sanitation Project	<p>Impact Improvements in the standard of living on the Jaffna peninsula.</p> <p>Major Components The project will have three components:</p> <p>Component 1 will rehabilitate, expand, and develop water and environmental infrastructure for the Jaffna peninsula, including (i) urban and rural water supply, (ii) sewerage and sanitation, and (iii) solid waste management for Jaffna city.</p> <p>Component 2 will strengthen water resource management in the Jaffna peninsula by providing the foundations to (i) operationalize a water management committee to coordinate, plan, and oversee monitoring activities in Jaffna; and (ii) increase public awareness.</p> <p>Component 3 will enhance implementation and management capacity of key institutions, and support project management and implementation activities.</p> <p>Expected Outputs and Outcomes The expected outcome is better water protection and management in the same area. The project concentrates on supporting the Government's efforts to meet the Millennium Development Goals on the Jaffna peninsula. The project combines the three principal thrusts of policy support, capacity building, and infrastructure investment and improvement. It will focus on poverty reduction.</p>
Road Network Project	<p>Impact Sustainable nationwide economic growth and reduction of regional disparities.</p> <p>Major Components The loan will provide assistance for rehabilitating and upgrading the national highways network and the provincial roads network. Capacity building will be provided at relevant government levels to ensure that both maintenance activities and funding levels are sufficient to guarantee sustainability of the investments.</p> <p>Expected Outputs and Outcome The outputs are (i) 80 kilometers (km) of rehabilitated and upgraded national highways, (ii) 300 km of rehabilitated and upgraded provincial roads, and (iii) enhanced institutional maintenance capacity.</p> <p>Unit cost per km of national highways under Loan 2217 is \$780,000. Recent cost estimates for provincial roads under Loan 2080 indicate unit cost of \$200,000 per km. These figures do not include land acquisition and resettlement cost.</p> <p>The outcomes are better global–local connectivity and lower transport costs.</p>

Source: Asian Development Bank staff.

Table A6.4: Summary Information on Proposed Indicative Nonlending Products and Services, 2009

Project Name	Description
Capacity Development for Municipal Infrastructure Sector Financing	<p>Impact Improvement in the urban environment and better quality of life of urban inhabitants in cities across Sri Lanka</p> <p>Major Components Consistent with the principles of a newly proposed strategy, and building on phase 1 findings from an earlier project preparatory technical assistance project, the advisory technical assistance (ADTA) will (i) prepare a road map to implement in sectors in key provinces; (ii) prepare a comprehensive urban sector reform program (this might include accounting systems reform, e-governance applications, property tax reform, introduction and/or reform of user charges systems for specific services, land-related reforms, disclosure and community participation); (iii) strengthen capacity and pilot reforms in selected urban centers committed to change; and (iv) undertake capacity programs to strengthen support functions at the Ministry of Provincial Councils and Local Government and provincial council levels.</p> <p>Expected Outputs and Outcomes The project will assist Government efforts to increase the number of cities providing improved urban services.</p>
Multimodal Transport Study	<p>Impact Sustainable nationwide economic growth and reduction of regional disparities</p> <p>Major Components The ADTA will provide assistance for sustainable intermodal transport planning to address interface problems and integrate transport modes to make the transport system more efficient. The study will include analysis of (i) effective institutional mechanisms to enable strategic intermodal coordination and approach to development of transport strategies; (ii) options for intermodal transport investments such as rail-to-port and road-to-port links, and feeder bus-to-rail services; and (iii) priorities for intermodal investment projects for subsequent feasibility analysis.</p> <p>Expected Outputs and Outcomes The project will provide capacity building for (i) intermodal transport planning, and (ii) prioritization of intermodal investment projects.</p> <p>The outcome is enhanced capacity for intermodal transport planning, resulting in better connectivity between global and local markets connecting via Colombo Port and lower transport costs.</p>
Sustainable Power Sector Development II	<p>Impact Stable and affordable supply of electricity and better connectivity for the poor</p> <p>Major Components The technical assistance (TA) will identify technical bottlenecks in the transmission network to improve system stability, and in the distribution network to promote rural electrification and support the Government in preparing project reports for Asian Development Bank (ADB) funding. The TA will also (i) identify transmission bottlenecks in development of renewable energy sources by the private sector; (ii) develop a public-private partnership structure for identified generation projects, including a risk-sharing mechanism between the Government and the private sector and a financing plan; and (iii) develop due diligence reports for ADB funding.</p>

Project Name	Description
	<p>Expected Outputs and Outcomes The project will improve energy efficiency, enhance connectivity in rural areas, and promote development of clean energy by strengthening transmission and distribution networks and mobilizing private sector investment in power generation.</p>
Umbrella TA Capacity Development Fund (CDF)	<p>Impact Fundamental changes in responsibilities and accountability for capacity development by increasing ownership, and the long-term, coherent, holistic, and strategic orientation in development projects</p> <p>Major Components (i) Devise and operationalize a CDF. (ii) Channel through the CDF (a) grants to support training, consulting services, networking, knowledge management, organizational twinning, international exchange of information, and the on-the-job-experience and activities currently financed by grant TA; and (b) loans to finance capacity development projects and/or pilots, including adjustment costs of organizational change. CDF design and implementation will draw from the experience with and expertise on the managing for development results process launched under a regional TA (RETA 6306).</p> <p>Expected Outputs and Outcomes The CDF will address fundamental causes of capacity deficiencies and encourage the view that capacity development is a continuing process that requires a proper strategy.</p> <p>To foster ownership, government counterparts will lead and manage the identification of development priorities and focus on priorities as identified by executing agencies.</p> <p>It will introduce change in institutional, organizational, and inter-organizational spheres to enhance effectiveness and efficiency in development projects with an emphasis on results.</p>

Source: Asian Development Bank staff.