

ASIAN DEVELOPMENT BANK

**COUNTRY ASSISTANCE PLAN
(2001-2003)**

SRI LANKA

December 2000

FOREWORD

The Country Assistance Plan describes the planned program of assistance by the Asian Development Bank (ADB) for [Sri Lanka](#) covering the three-year period 2000-2002. It includes loan and technical assistance projects, as well as possible cofinancing from other donors. The CAP was prepared by the ADB between April and June 1999, in close consultation with the Government of [Sri Lanka](#), and other stakeholders, including non-government organizations. The CAP was discussed with the Board of Directors in October 1999. The assistance plan described in the CAP is only indicative and may be revised to reflect more recent developments.

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CURRENCY EQUIVALENTS

(As of 30 November 2000)

Currency Unit	-	Sri Lanka Rupee (SLRs)
SLRs 1.00	=	\$ 0.0123
\$ 1.00	=	SLRs 81.30

The exchange rate of the Rupee is determined under a system of managed float against the currencies of Sri Lanka's major trading partners.

ABBREVIATIONS

ADB	Asian Development Bank
ADF	Asian Development Fund
ADTA	advisory technical assistance
BIMSTIC	Bangladesh, India, Myanmar, Sri Lanka, Thailand Economic Cooperation
BOO	build-own-operate
BOT	build-operate-transfer
CEB	Ceylon Electricity Board
COS	Country Operational Strategy
CPRM	Country Portfolio Review Mission
DMC	developing member countries
GDP	gross domestic product
GEF	Global Environment Facility
GST	goods and services tax
ILO	International Labor Organization
IMF	International Monetary Fund
IRO-ARC	Indian Ocean Rim Association for Regional Cooperation
JBIC	Japan Bank for International Cooperation
JICA	Japan International Cooperation Agency
LCF	local currency financing
NGO	non-government organization
OCR	Ordinary Capital Resources
OPEC	Organization of Petroleum Exporting Countries
PBA	performance-based allocation
PMU	Project Management Unit
PPTA	project preparatory technical assistance
REAP	Regional Economic Advancement Program
RETA	regional technical assistance
SAARC	South Asian Association for Regional Cooperation
SACEP	South Asian Cooperation on Environment Programme
SLRM	Sri Lanka Resident Mission
SME	small and medium enterprise
TA	technical assistance
TEC	Technical Evaluation Committee
UNDP	United Nations Development Programme

NOTES

- (i) The fiscal year of the Government ends on 31 December.
- (ii) In this report, "\$" refers to US dollar.

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APPENDIXES

80°00'E

81°30'E

SRI LANKA

-  National Capital
 -  Provincial Capital
 -  City/Town
 -  National Road
 -  Provincial Road
 -  Railway
 -  River
 -  Provincial Boundary
- Boundaries are not necessarily authoritative.

9°00'N

9°00'N

7°00'N

7°00'N

Gulf of Mannar

Bay of Bengal

INDIAN OCEAN

80°00'E

81°30'E



SRI LANKA

I. Country Performance Assessment

A. Economic Performance Assessment ¹

1. In recent years, the macroeconomic performance in Sri Lanka has improved, in spite of the impacts of civil conflict in the north and east of the country. The economy has grown at an annual average of 5.2 percent during the 1990s. In 1999, Sri Lanka registered a lower economic growth of 4.3 percent compared to 4.7 percent in 1998, mainly the result of declining industrial production and exports that suffered from the slackening world economy. After recording 3.8 percent growth in the first half of 1999, the performance of the industrial sector improved in the second half of the year reflecting a gradual improvement in exports. During 1999, the agriculture sector performed well, reflecting higher output levels of plantation crops. Although gross domestic product (GDP) growth in 1999 is below the average trend in the 1990s, it is heartening if the increased political instability during the period is considered.

2. Domestic investment increased to 27.1 percent of GDP in 1999 compared to 25.1 percent in 1998, mainly due to the re-fleeting of the Sri Lankan Airlines, the privatized national airline, and the expansion of telecommunication services. Infrastructure development projects, together with housing and small-scale construction projects in the rural area also contributed to the increase in investment expenditure in 1999. The ratio of national savings to GDP increased slightly from 23.4 percent in 1998 to 23.9 percent in 1999 owing to higher private savings and the reduction of fiscal deficit.

3. Total government revenue increased by 12 percent from 17.2 percent of GDP in 1998 to 17.6 percent in 1999. Revenue collections from income taxes, excise taxes, national security levy and non-tax revenue showed a substantial improvement. In contrast, revenues from customs duties and goods and services tax (GST) were less than expected largely on account of the low value of imports and high refunds under GST during the first half of 1999. However, due to improvements effected in the refund system, as well as in the enforcement mechanisms, the revenue from GST improved in the second half of 1999.

4. On the expenditure side, the cost of salaries, including those of provincial councils and security forces increased by 8.7 percent. Despite the reduction in interest rates, the cost of public debt increased in 1999 due to increased borrowings. Defense expenditure in 1999 was marginally lower than 1998. All in all, total government expenditure was 25.1 percent of GDP in 1999 compared to 26.3 percent of GDP in 1998. The 1999 budget deficit reached 7.5 percent of GDP, an improvement on the 9.2 percent of GDP in 1998, although it still remains at a high level.

5. Monetary policy in 1999 aimed at maintaining financial market stability, while helping to strengthen the declining trends in inflation. The consolidated broad money supply (M2b), which includes the operations of the foreign currency banking units, increased by 13.4 percent as of end 1999. Inflation showed a declining trend in 1999, averaging 4.7 percent compared to 9.4 percent in 1998, due to improved domestic supply of food items and lower import prices. The unemployment rate declined to 8.9 percent in 1999 compared to 9.5 percent in 1998, due to the growth of employment in tourism sector, a strong growth of small businesses, and increased recruitment to the public sector.

¹ Appendix 1 provides information on key economic, social and environmental indicators.

6. External sector developments in 1999 reflected the lagged effects of depressed global demand and the continued decline in commodity prices. Exports registered a negative growth of 4.1 percent in 1999, mainly because of lower prices for tea, rubber, textile and garment products. Imports marginally increased by 0.2 percent in 1999 as import prices went down across the board with the exception of oil. Accordingly, the trade deficit widened to \$1.3 billion in 1999 compared to \$1.1 billion in 1998. The services account showed a marginal improvement, registering an estimated surplus of \$147 million in 1999 compared to \$145 million in 1998 despite a rapid recovery in the tourism sector. During 1999, tourist arrivals totaled 436,400 persons, a 14.5 percent increase compared to 1998.

7. The current account deficit widened to 3.1 percent of GDP in 1999 and the overall balance of payments registered a deficit of \$263 million in contrast to a surplus of \$37 million recorded in 1998. Gross official reserves, which were \$2 billion at the end of 1998, declined to \$1.6 billion at the end of 1999. This level of reserves was sufficient to finance 3.3 months of imports of goods. External debt to GDP ratio increased in 1999 to 57.4 percent from 55.5 percent in 1998, and debt service ratio also increased from 13.3 percent in 1998 to 15.2 percent in 1999.

8. Despite the escalating conflict in the north, the economy grew by 7.0 percent in the first half of 2000. The agricultural sector grew by 2.9 percent, lower than the previous year. However, the manufacturing sector recorded a higher growth of 11.9 percent. In particular, the expansion of textiles and wearing apparels, and rubber and plastic products was noticeable due to increased world market demand. Meanwhile, the progress in domestic economic activities also created a demand for petroleum, basic metal products, wood and wood products and processed food. The telecommunication sector continued to grow due to the expansion in the communication network and infrastructure following large private sector investment during the past few years.

9. In the second half of 2000, the economic trend of the first half of 2000 is expected to continue. Reflecting better performance in the second half of the previous year, however, the growth rate will be lower than the first half. Overall, real GDP growth rate is projected at 6.0 percent in 2000. Light consumer goods, building materials and agro-based industries are expected to maintain high growth rates. The services sector would grow by 6 percent with higher growth rates reflected in the communications sectors. Private investment will increase steadily owing to the efforts of Government to strengthen private sector confidence. The ratio of current account deficit to GDP is expected to be 7.9 percent in 2000. Exports are expected to increase by 13.1 percent, while imports by a higher rate, 23.1 percent, due to aircraft import and higher oil prices. Privatization proceeds and higher private capital flows will aid the improvement of the overall balance of payments. Debt service payments as a ratio of exports of good and services and current private transfers are projected to decline to 14.3 percent in 2000 from 15.2 percent in 1999.

10. The Government's defense expenditure averaged 3.4 percent of GDP annually during the first half of 1990s. Following a breakdown in negotiations on settlement of the civil conflict in 1995, the defense expenditure increased to 6.5 percent of GDP in 1995, but it continued to decline to 4.4 percent in 1999. In 2000, it is projected to amount to about 5.1 percent of GDP due to the intensification of conflict in the north since April 2000. To finance the additional expenditure on war efforts, the Government has raised the national security levy and excise taxes on alcohol and tobacco, and reduced nonessential capital expenditure by about 10 percent. Having recognized the negative impact of the long-lasting civil conflict on the economy and society, the Government has undertaken to intensify efforts to reach a political and peaceful solution to the conflict in addition to the devolution of more power to the provinces especially the north and east.

11. The 2000 budget estimates expenditure at 26.9 percent of GDP (current expenditure: 19.8 percent, and capital expenditure: 7.2 percent of GDP). Revenue is estimated to increase to 18.5 percent of GDP in 2000. Accordingly, budget deficit is expected to be over 8.0 percent of GDP compared to the original budget of 7.6 percent. Nonetheless, the Government aims to reduce the

budget deficit to 5 percent of GDP by 2002 supported by a number of structural reforms following the completion of the general elections in October 2000. The 2000 budget deficit is planned to be financed by foreign grant (7 percent) and foreign borrowing (10 percent), divestiture proceeds (18 percent), and domestic borrowing (66 percent). The Government aimed at reducing domestic borrowing from 6.7 percent of GDP in 1999 to 5.5 percent of GDP in 2000. This target may not be achieved given the increased spending on security and the delayed divestiture of telecom shares. The 2000 budget also contains various reform measures that will be taken during 2000 including relaxation of restrictions on foreign holdings of banking and insurance companies and tax reforms.

12. The Government was also faced with a deterioration of gross official reserves and shortage of liquidity in the market. In June 2000, the Central Bank of Sri Lanka depreciated the rupee by 4 percent against the dollar in order to increase the competitiveness of exports and encourage repatriation of foreign exchange. Prices of basic goods and services including electricity, gas, bus fare and some food items increased during the first half of 2000 resulting from high oil prices and increased import prices of consumer goods. Inflation is expected to average at about 7.5 percent in 2000. The key economic indicators are given in Appendix 1.

13. Although a gradual recovery of the economy is expected, there still exist areas of concern for sustainable growth in the short to medium term. Civil conflict in the north and east had a long negative impact on the country's economic growth. Other factors constraining growth include sluggish progress in productivity improvements, particularly in agriculture and industry, a substantial budget deficit, inefficiencies in the financial sector, bureaucratic delays in the delivery of public services, and unemployment among educated youth. The recent sharp rise in oil prices could be an additional burden on the economy in 2000.

14. To overcome these obstacles and revive the economy, various structural reforms would need to be implemented in the short to medium term. Major policy initiatives needed to achieve sustainable growth and macroeconomic stability include public administration reform, pension reform, financial sector reform, and public enterprise reform. Public administration reform, including civil service pension reform, has become more important because of the increasing need for a better-equipped public service to perform its role in promoting private sector growth and reduce fiscal deficit. Several donors have made external assistance available for public administration and pension reforms, but only limited progress has been achieved to date.

15. The Government is actively pursuing financial sector reforms with external assistance, aiming to develop a sector that is large enough to mobilize the required capital, both domestic and foreign, and to allocate it efficiently to productive uses. Recent achievements include progress in the development of a long-term debt market by increasing treasury bond issues and mobilizing private resources in the international debt market through the issuing of a 10-year floating rate note. Despite these achievements, the domestic capital market remains small. Traditional fund sources, i.e., the development finance institutions, continue to be the major sources of long-term finance. Limited access to financing, particularly long-term financing, and the high cost of funds in the country hinder private sector activities. The development of market-based financial institutions and instruments through financial market reforms is important to facilitate private sector expansion.

16. Despite the successful implementation of the privatization program, public enterprises still maintain a strong presence in financial services, agriculture, manufacturing, and infrastructure. Public enterprise reforms through private sector participation warrant stronger support in the future. Public enterprise reforms need to be accompanied by vigorous labor market reforms. These should include the determination of labor compensation, the creation of labor retraining and reemployment programs aimed at helping workers displaced during public enterprise reform and the restructuring process, and the establishment of a safety net to make the labor market more

flexible. As both the presidential and the general elections have now been completed, the Government is focusing its efforts on major reforms, evidenced from its firm commitments to key policy and institutional reforms under the private sector development program assisted by ADB and other major external agencies.

B. Poverty Assessment

17. Sri Lanka's current population of about 20.0 million is growing at a rate of 1.2 percent annually. About 17.5 million of the population live in seven of the country's nine provinces, and one-fifth to one-third of the population (3-5 million) is categorized as poor based on a lower poverty line of 860 rupees (\$12) and a higher poverty line of 1,032 rupees (\$15) per person per month. According to the findings in the recently completed *Framework for Poverty Reduction in Sri Lanka*,² poverty is predominantly a rural phenomenon in Sri Lanka, with over 85 percent of the poor in rural areas, 7 percent in urban areas and 6 percent in estate sector. Consumption poverty is estimated at over 33 percent in rural and estate sectors compared to 17 percent in urban sector based on the higher poverty line, largely a result of inadequate basic social and infrastructure services. The findings in the *Framework for Poverty Reduction* will be reinforced by the ongoing integrated household income and expenditure survey by the Department of Census and Statistics to be completed by the end of 2000.

18. Most of the poor are concentrated in the Central, Uva, Sabaragamuwa, and Southern Provinces where agricultural growth has been sluggish and the expansion of non-farm activities has been restricted by major infrastructure deficiencies including especially roads, electricity, irrigation and communication facilities. Malnutrition among children is also prevalent in these provinces. In six of the seven surveyed provinces (excluding the North and Eastern Provinces), and with considerable variation among the province, about 60-75 percent of the population have no access to electricity, about 27-48 percent have no access to safe drinking water and over 20-34 percent lack access to safe sanitation.

19. According to the 1981 census (latest available), about 2.8 million people or 15 percent of the country's population live in the North and Eastern Provinces. Although not included in the national statistics on poverty, a considerable portion of the population is known to be experiencing deprivation in economic welfare, especially for those in the northern area of the North Province which has been the center of the conflict. The ongoing civil conflict in the north and east of the country has had a major impact on poverty. Although difficult to accurately quantify, it has substantially disrupted economic activity and over 5 percent of GDP is being used to finance the conflict. The conflict has caused much damage to physical and social infrastructure facilities including school buildings and medical centers as well as civilian properties. In addition, it has led to the displacement of hundreds of thousands of people from their homes and source of livelihood, and thousands of children have lost one or both parents. The conflict has also led to the increase of female-headed households that are more likely experiencing economic hardship. The next population census, planned to start in early 2001, will cover the North and Eastern Provinces.

20. Development assistance focusing on poverty reduction in Sri Lanka must take the conflict into consideration. The specific role of ADB in poverty reduction in the conflict situation is seen in the following aspects: first, providing direct assistance to the conflict-affected areas through development of basic infrastructure projects and projects that target employment generation especially for the youth and poor, to bring them into the mainstream of economy; second, mainstreaming conflict concerns either by including specific components in development projects to address the needs of the conflict-affected people or by ensuring development projects does not exacerbate conflict; third, building local capacities to support the Government's policy of

² The *Framework for Poverty Reduction in Sri Lanka*, formulated by the Government with participation of major stakeholders in the country including the donor agencies, has recently been completed. It will be presented at the forthcoming Development Forum of Sri Lanka in December 2000.

decentralization and the devolution of power through both sector and integrated approach. In 2000, ADB approved two TA projects for preparation of an *Emergency Assistance for Rehabilitation of North and East* in 2001 and *Eastern Province Coastal Community Development Project* in 2002.³

21. Another significant finding in the *Framework for Poverty Reduction* is that education assists the poor to rise out of poverty. Education has a strong impact on earning and poverty levels decline as the schooling attainment of household heads and principal earners rises. The impact of education on the increase of earnings ranges from 14 percent for primary education to 320 percent for postgraduate for males and 1 percent for primary education to 348 percent for postgraduate for females. The poverty level is estimated at 57 percent for no-schooling illiterate, 45 percent for primary school, 13 percent for O-level qualified, 6.5 percent for A-level qualified and nil for undergraduates.

22. The Government's *Framework for Poverty Reduction* advocates a three-pronged strategy for poverty reduction: (i) improving economic and social opportunities for the poor, and broad-basing the benefits of growth; (ii) providing security to people unable to participate in mainstream economic activities and protecting excluded, marginalized and vulnerable groups; and (iii) empowering people to lead decent lives, with a voice in decision making, and enjoying dignity, freedom, social esteem and self-respect. The poverty framework also aims to identify new roles for local governments, the private sector, and civil society in poverty reduction. Prevalent efforts by the Government in poverty reduction include the Samurdhi (Prosperity) Program, introduced in 1994, aiming to provide support to provide social services and a social safety net to very poor households.

23. The *Framework for Poverty Reduction* further concluded that a stable and competitive macro economy is a prerequisite to sustained poverty reduction. In the medium term, the main macroeconomic challenge is to reduce the size of the fiscal deficit, since the public debt is already large, and recourse to concessional sources of finance is diminishing. Downsizing the public sector, raising the efficiency of public expenditures, and increasing the direct tax base are likely to be parts of the solution to rebuilding fiscal sustainability. Other challenges include the need to complete the privatization of commercial parastatals, enhance commercial management and governance standards in government-owned banks and public enterprises, introduce more flexible labor market regulations, improve the sustainability of public pensions, and increase the scope for private sector initiatives in non-bank services. To this end, the Government's private sector development program assisted by ADB is addressing several of these issues. These are technically complex reforms with potentially large and unpredictable adjustment costs. Progress in these areas will need sustained investment support, technical assistance and policy dialogue over a period of years.

24. Another aspect of poverty is the incidence of child labor. The International Labor Organization (ILO) estimates that there are between 250,000 and 500,000 child laborers in Sri Lanka today⁴. The most common forms of child labor are domestic employment (i.e. as household servants), involuntary begging on the streets, child prostitution, working in the informal sector, in the gemstones industry and in sectors such as tourism and fishing. It has been estimated by the Government and by international organizations such as the ILO and United Nations Children's Fund that there are 30,000 child prostitutes in Sri Lanka. The problem of child labor is especially prevalent in the plantation sector. In 1997, the total resident labor force of the plantation sector was estimated at 305,000 of which 33,000 (or 11 percent) were child laborers below 14 years of age. Overall, 4 percent of children between the ages of 10 and 14 are economically active. By

³ TA 3479-SRI: *Eastern Province Coastal Community Development*, for \$1.0 million, approved on 16 August 2000 and TA 3542-SRI: *North East Emergency Rehabilitation Project*, for \$150,000, approved on 10 November 2000.

⁴ Background report prepared for the ILO-GOSL Tripartite Meeting on Convention 138. This Convention stipulates that the minimum age for employment should be 15 years.

comparison, 14 percent of children work in India, 30 percent in Bangladesh, 45 percent in Nepal and 18 percent in Pakistan.

25. Sri Lanka joined the ILO International Program for the Elimination of Child Labor (IPEC) in 1997, the 21st fully participating country to do so. ILO's efforts to eliminate child labor were implemented mainly through the IPEC program. The Government is currently implementing a plan of action, including actions in policy, institutional strengthening and awareness raising. One activity is a survey of household child labor in Sri Lanka. The Bureau of Statistics has now completed two rounds and the results will be published in 2000. The Government has established a Child Protection Authority (1997) which is trying to increase both reporting and awareness of this issue.

C. Assessment of Socio-Environmental Performance

1. Gender Issues

26. Sri Lanka has relatively favorable indicators on the status of women. Literacy (88 percent) and life expectancy (75 years) are high and the participation rate of women in the labor force has increased from 26 percent in 1971 to 35 percent in 1998. The introduction of free education and health services over 40 years ago made a significant contribution to the improvement in the overall status and well being of women in Sri Lanka. Female participation rates are satisfactory across education levels and compare favorably to that of males, including at the tertiary level, where women account for about 50 percent of university enrollments. However, women's unemployment in 1998 (15 percent) is higher than for men (7 percent). Underemployment for women also remains a serious problem. Health indicators are generally good, although the incidence of preventable diseases usually associated with poverty such as diarrhea; dysentery, respiratory diseases and malaria remain relatively high. An emerging concern for women is the general aging of the population and the related health and socioeconomic implications. This issue is particularly significant for women since they constitute a growing proportion of the aging population. Sri Lanka ranks 68th out of 143 countries (1998) on the UNDP gender development index. Despite this sound level of achievement, scope exists for the ADB to direct more attention to addressing key gender issues at the project design stage. Both the **Secondary Education Modernization Project** (2001) and the **Postsecondary Education Development Project** (2002) will include components that address the specific education and training needs of women. The **Eastern Province Coastal Community Development Project** (in 2002) will also have an impact on women through the development of income-generating activities especially for female-headed households.

2. Human Development

27. Human development achievements in Sri Lanka have been impressive, considering the country's relatively low per capita income. Life expectancy (73 years) is higher than in most developing countries and infant mortality (17 per 1,000 live births) is relatively low. The population growth rate is about 1.2 percent per annum. According to the 2000 UNDP Human Development Report, Sri Lanka is ranked 84th among 174 countries in the world on the Human Development Index. Sri Lanka's social indicators have generally shown steady improvement during the 1990s. (See Appendix 1 for details). Noteworthy among these indicators is the improvement in the maternal mortality rate, which declined from 80 to 30 per 100,000 live births. Another significant achievement in this period was the increased access by the rural population to safe water (from 29 percent to 65 percent) and sanitation (from 39 percent to 60 percent). Throughout the 1990s annual public health expenditure has remained fairly constant at about 1.7 percent of GDP. However, anecdotal evidence indicates that the quality and efficiency of health care delivery may have declined. Under RETA 5671,⁵ a study on child nutrition in Sri Lanka was completed in 1998.

⁵ RETA 5671: *Reducing Child Malnutrition in Eight Asian Countries*, for \$750,000, approved on 29 January 1996.

Available data indicate that the incidence of malaria has increased and there has also been a slight worsening (from 37 to 38 percent) in the malnutrition rate in children under the age of five years. The Government's Samurdhi Program is assisting particularly the vulnerable groups to reduce mother and child malnutrition. Given the role of other external funding agencies including the World Bank in this area, there is no planned assistance by ADB in the health sector in the medium term.

28. Sri Lanka also has an enviable record in the equitable provision of basic education and this is in part reflected in the country's high literacy rate (91 percent) and high gross enrolment rates for primary and secondary education (109 percent and 75 percent, respectively). In contrast, however, the gross enrolment rate for higher education is only 3 percent, compared with an average in Asia of 7-8 percent. Despite annual public education expenditure remaining fairly constant at about 3 percent of GDP throughout the 1990s, concerns have recently been expressed about the quality and efficiency of the education system and its relevance to the future labor requirements of the country. For instance, at the senior secondary level the student dropout rate is 33 percent while the student repetition rates are about 40 percent at O level and 67 percent at A level. The issue will be addressed specifically in ADB's proposed **Secondary Education Modernization Project** (2001) and **Postsecondary Education Development Project** (2002).

3. Environment

29. Degradation of land, depletion of water resources, deterioration of coastal habitat and pollution associated with industrial and urban activities are significant environmental problems that have important implications for economic and social conditions as well as on the biological diversity of the country. Land degradation due to soil erosion remains a critical issue, as is the adverse impact of forestry and other human activities on the hydrological cycle through disturbances in the catchment areas. Deterioration of coastal resources due to erosion and population pressures is also a serious environmental concern, particularly in the western and southern regions. The policy and legal framework for dealing with these environmental issues have been improved in recent years along with the formulation of a number of actions and master plans. However, further efforts are required in these areas as well as the strengthening of the relevant sector institutions to effectively address the emerging challenges and to achieve sustainable development.

30. Many of the environmental problems have a significant and disproportionate bearing on the poor. Low-income urban settlements are particularly vulnerable to diseases caused by water pollution due to the lack of water supply and sanitation facilities and poor drainage conditions. Environmental health has a relatively greater impact on the poor. First, proper healthcare facilities are less accessible to the poor; hence they need to spend more time obtaining health care. Second, since they are usually employed on a daily wage, occasional absence from work has a more significant bearing on their income. The poor are also more vulnerable to the effects of air pollution, many low-income settlements being located on road and railways. Due to the lack of sanitary landfill or other solid waste disposal facilities, many local authorities simply dump solid waste on vacant lands. Such open dumps are often found close to low-income settlements since they are the least insistent on their civic rights. Low-income settlements account for one third of the urban population in the Western Province, the most densely populated region of the country.

31. In rural areas the poor are partially the cause, but also the victims, of environmental problems. Many encroach on state lands to eke out a subsistence livelihood. The lack of ownership and access to credit or training schemes cause them to adopt unsustainable land use practices which eventually degrade the land to non-productive levels and force them to further encroachment. The poor have least access to electricity in rural areas. They rely on biomass, which is increasingly scarce due to increased population pressure. Hence they spend a significant part of the day collecting firewood. Communities adjacent to protected areas rely heavily on the

protected area for biomass as well as game. Increasing pressure on protected areas due to such extractive uses tends to threaten the integrity of these ecosystems. Collection of firewood and water are usually the responsibility of women and children. Hence they are particularly affected by the increasing shortage of these resources.

32. The Government's National Environmental Action Plan (1998) recommends that the role of the Government should be to move away from activities related to extraction/exploitation of resources, to a role of establishing and enforcing a framework for sustainable resource use within which the private sector could operate. Such a shift is reflected in newly revised Acts of several sectors including forestry, fisheries and minerals. The Government has also encouraged private sector involvement in provision of environmental services such as solid waste collection, wastewater and sewerage treatment and management of industrial estates. In addition private sector collaboration is sought on providing laboratory testing and monitoring services; consultancy services on waste management, clean technology and ISO standards, and environment related financing. However, involvement of the private sector in all these areas has been weak mainly due to uncertainty with the policy and institutional climate that is typically associated with government collaboration.

33. The Government has suggested several additional areas in which the private sector could take a lead role with regard to environmental management. In the area of land use management some suggestions include: concessional financing to small holder cultivators adopting conservation practices, incentives to plantation management companies to undertake forestry on unproductive or marginally productive plantation lands, and engaging companies to undertake restoration of excavated lands to a useful state. Other suggestions include encouraging private sector involvement in: (i) issuing of licenses (e.g., the Environmental Pollution License); (ii) research and development financed with funds generated from pollution control charges; (iii) providing insurance and financial guarantee schemes against natural disasters (e.g., damage caused by wild animals).

D. Governance: Sound Development Management

34. The structural and management weaknesses in the public administration system are beginning to reach levels where they are a constraint on development and reform is needed. There is a broad consensus on the measures required to improve public sector performance, including streamlining the central government institutions and agencies; downsizing of institutions; restoration of professionalism to the civil service; and ensuring that clear responsibilities, authority and resources are available to the provincial councils and local government authorities. Despite the weaknesses in the public administration system there remains a reasonable amount of accountability, transparency and predictability in the functioning of government. On assuming office in 1994, the current Government took a strong stance against public sector corruption, establishing a Permanent Commission for the Prevention of Bribery and Corruption and appointing a Special Presidential Commission to inquire into Malpractices and Irregularities in Public Bodies. The former had investigated about 6,000 cases for prosecution between 1995 and 1997. However, in the last two years, legal disputation and resource constraints have limited the Commission's capacity to carry out its mandate.

E. Implementation Assessment

1. The Portfolio

35. ADB operations commenced in Sri Lanka in 1968 and since then 89 loans (83 ADF and 6 OCR), amounting to about \$2.3 billion have been approved by ADB. The first six loans were from OCR resources, but commencing in 1969 all public sector loans have been provided from ADF resources. The sectoral distribution of the lending program has been agriculture 38 percent, social

infrastructure 20 percent, finance and industry 15 percent, energy 12 percent, and transport and communications about 14 percent. ADB has also provided \$55.7 million for 162 TA projects, of which 94 were advisory and 68 for project preparation. The main sectors that have received TAs are agriculture and natural resources (42 percent), social infrastructure (20 percent), transport and communications (14 percent) and finance and industry (8 percent).

36. As of 31 December 1999, there were 22 ongoing loan projects in Sri Lanka, with total loan commitments of \$854.8 million, of which net undisbursed funds amounted to \$587.0 million (69 percent of portfolio)⁶. Thirty-six percent (8 out of 22) of the loan projects in the portfolio are scheduled to close by the end of 2000. Only one loan is classified as partially satisfactory. The sectoral distribution of the ongoing loans is agriculture and natural resources 33 percent, transport 29 percent, social infrastructure 27 percent, and energy 11 percent. Appendix 2 provides details of the ongoing loans.

2. Issues in Project Implementation

37. The annual portfolio disbursement ratio (excluding programs loans) in the period 1996-1999 was 24.2 percent, 20.4 percent, 25 percent and 17.9 percent respectively, compared to the corresponding ADB-wide average in those years of 17.4 percent, 18.6 percent, 19.8 percent and 17.6 percent. Although Sri Lanka achieved the disbursement target in 1999, the disbursement ratio for 1999 was 17.9 percent as compared with ADB-wide average of 17.6 percent. The lower disbursement ratio in 1999 was largely due to project cycle effects, nonetheless, disbursement would need to be about \$120-\$150 million every year to match the projected loan commitments. It is currently estimated that up to one-third of the undisbursed loan funds are a result of previous delays in project implementation. The delays, which have been evident across most of the portfolio, were mainly caused by cumbersome and time consuming contracting and procurement rules and procedures as well as non-compliance with some major financial loan covenants. Some sectors (i.e. road, energy, water supply and urban development) were affected by (i) delays in timely action by the technical evaluation committees (TEC); (ii) poor quality of TEC reports; and (iii) delays in final clearance by the Cabinet Appointed Tender Boards.

38. Poor performance has also been observed in respect of recruitment of consultants. Delays in recruitment of consultants for the ongoing projects were over ten months, which is 65 percent of the active projects. These delays affected the start up operations and subsequently the completion of the projects. Another major delay in project implementation has been identified in setting up Project Management Units (PMUs). About 25 percent failed to establish PMUs even six months after approval of projects. The Government has recently taken actions to avoid these delays by setting up PMUs before loan negotiations, and introducing advance procurement for new projects.

39. The Government, with ADB's technical assistance, has initiated measures to enhance and accelerate procurement and to remove other impediments to sound project implementation.⁷ One of the key actions taken was the recent establishment of the Procurement Support Bureau.⁸ The Bureau's purpose is to speed up Government contracting and procurement, and to strengthen the capacity of the tender boards and tender evaluation committees to efficiently carry out this task. Major achievements in streamlining the government procurement procedures to enhance its effectiveness and strengthen the capacity of procurement staff include: (i) increase in the authority limits to handle/recommend awards of tenders under donor-funded projects; (ii) include project directors in TEC to promote ownership and timely and efficient conduct of committee functions; (iii) include guidelines on advance procurement action into the Guidelines on Government Tender

⁶ This undisbursed loan amount includes approved loan projects in 1999.

⁷ TA 2433-SRI: *Improvement of Contract Approval and Implementation Procedures*, for \$100,000, approved on 25 October 1995.

⁸ TA 2950-SRI: *Establishment of Sri Lanka Tender Support Bureau*, for \$1.0 million, approved on 12 December 1997.

Procurement Procedure to facilitate advance procurement action; and (iv) use donor's standard bidding documents in all procurement under international competitive bidding.

40. In 1997 an ADB TA assisted in the preparation of an Action Plan for improved management of the portfolio.⁹ The Action Plan was prepared in order to address generic and project specific implementation weaknesses in ADB's loan portfolio. By the end of 1999, with the assistance of the Forum of ADB Project Directors and Sri Lanka Resident Mission (SLRM), the Government had made substantial progress in addressing the matters identified in the Action Plan. Of the 51 items listed in the Action Plan, 42 had been substantially completed. A detailed review and updating of the Action Plan will be jointly undertaken by the Government and SLRM during the Country Portfolio Review Mission (CPRM) in September 2000. The Procurement Support Bureau is assisting in completing the remaining items.

41. The improvements in the portfolio performance, particularly over the last two years, is a reflection of the more intensive contact between the Government and the ADB on project implementation matters since the SLRM was established in 1997. In this period, the Government and staff of SLRM have undertaken quarterly project performances review meetings and they have also initiated special project review meetings when required. Background studies for the September 2000 CPRM concluded that there has been clear evidence of improved portfolio performance, but that the extent of the improvements are not fully reflected in the statistical analysis because of the overhang of past delays and other portfolio weaknesses.

42. Out of the 29 projects that have been post-evaluated to-date, 45 percent were generally successful, 45 percent were partially successful and 10 percent unsuccessful compared to bank-wide averages of 53 percent, 41 percent and 6 percent, respectively. In 1997, ADB's Operations Evaluation Office undertook a study of post-evaluation findings for Sri Lanka. The main conclusions were that: (i) project outcomes are highly influenced by economic policy and therefore the policy environment needs to be carefully assessed during project formulation; (ii) projects that involve new design options and technological changes would benefit from a pilot testing approach; (iii) the performance of the ADB's projects often depend on the capability of the executing agencies; and (iv) beneficiary involvement during project preparation and implementation is critical to project success. These findings have been fully taken into account during the formulation of the country programs and in detailed TA and loan project design during project processing.

43. ADB's proposed Performance-based allocation (PBA) is being designed to: (i) promote aid effectiveness and aid-selectivity; (ii) provide input to ADB's poverty reduction strategy; (iii) support good governance among borrowers; (iv) carry out significant policy dialogue; (v) highlight achievements in borrowers' economies; and (vi) benchmark ADB's graduation policy.

44. PBA as being currently designed use both top-down and bottom-up approaches in evaluating country performance. Common standardized criteria across all borrowers comprising, e.g., economic growth, or monetary policy stance, is an example of a top down criteria; while specific tariff adjustment, or a specific policy reform in borrower's economy, or portfolio management would be examples of a bottom-up approach. Under the proposed system, country specific allocation will depend upon the borrower's per capita gross national product, the size of its population, and performance of its economy. The factors that will be critical in determining country specific performance in Sri Lanka relate to: (i) macroeconomic management; (ii) structural policies; (iii) poverty reduction policies; (iv) protection of environment; (v) governance and public sector management; and (vi) portfolio performance. The development of specific indicators to measure country performance is expected to complete by the end of 2000, in consultations with key Government agencies, policy institutes, and other donors. While some criteria are based on objective quantitative indicators and some others are subjective in nature, the PBA assessment is also based on both immediate past performance and the promise of future performance.

⁹ TA 2745-SRI: *Improvement of Project Implementation in Sri Lanka*, for \$45,000, approved on 7 January 1997.

II. Country Operational Strategy

F. The Country Operational Strategy

45. The current Country Operational Strategy (COS)¹⁰ for Sri Lanka was finalized in 1999. The strategy aims to assist Sri Lanka reduce poverty and achieve a sustainably higher level of economic growth by supporting: (i) policy and institutional reforms to promote private sector development and improved public sector management; (ii) human development to address the gap in marketable skills and thereby improve employment and income levels targeting especially the poor concentrated areas; (iii) enhancement of the country's infrastructure endowment through public and private investment and improvement of sector policy and regulatory environment; (iv) preservation of the country's natural resource base; and (v) measures to mitigate the social and environmental impact of the transition to a higher growth path. The strategy assumes that ADB operations will be geographically located away from areas directly affected by the civil conflict. However, flexibility will be allowed to enable rapid extension of ADB activities to those areas, if peace is achieved.

G. Progress in Implementation

46. ADB's operational programs in 1999 and 2000 have been full operationalization of the COS in that all projects were selected to improve economic efficiency, reduce poverty, improve environmental management and enhance the enabling environment for the development of the private sector. Expansion of the role of the private sector in the economy is a fundamental concern. ADB's dialogue with the Government across all sectors has consistently emphasized the need to harness the resources and potential efficiency gains by opening up the economy to greater private participation. As noted in Chapter I, the public sector does not currently have the necessary resources or capacity to address the major development challenges facing the country. The Government has recognized this situation and constructive measures have been taken in recent years to increase the scope and depth of private participation in the economy. In the area of privatization, significant progress has been achieved in several sectors, including agriculture (plantation privatization), telecommunications (partial privatization of Sri Lanka Telecom) and aviation (partial privatization of Air Lanka) and energy (privatization of Lanka Gas Company). A private build-operate-transfer (BOT) operation, in which ADB is participating, has been introduced in the Colombo Port, as a first step in the future expansion of private sector operations in the sector. In addition, build-own-operate (BOO) operations have already been undertaken (Asia Power) and BOT operations are currently being developed (Kelantissa) in the power sector. These changes have occurred with the encouragement and support of the donor community, including ADB.

47. Another area of policy dialogue concerns public sector efficiency and performance to overcome weaknesses in the public administration system and to take the actions required to increase its effectiveness. ADB's policy discussions with the Government have emphasized the importance of improving public sector management. Some progress has been made at the sectoral level, particularly in the road, energy, environment and natural resources management, and water and urban development sectors.

48. The Government has established several Presidential Task Forces and special commissions to identify the scope and direction of reforms in priority sectors, such as urban development and housing, local government, education and health. Sector analysis has also been undertaken by the National Development Council Secretariat, covering areas such as agricultural

¹⁰ Country Operational Strategy: Promoting the Environment for Growth, circulated to the Board of Directors on 23 March 1999.

reform, rail and road transportation policies. As a result of these measures, program of reform in key sectors has been identified. ADB's technical assistance program has also been an important source of policy and planning advisory services, and will be expanded in the future to strengthen the orientation of the public investment program and the overall reform process.

H. Poverty Reduction Partnership Agreement

49. The recently completed *Framework for Poverty Reduction in Sri Lanka* by the Government will form the basis of the poverty analysis, the country-specific poverty reduction strategy and the poverty reduction partnership agreement by ADB to be completed by early 2001. The partnership agreement will outline specific operational targets and measures to optimize the poverty impact of ADB operations in the country and the Government's own commitments to this objective.

50. A proposal was recently approved by ADB to fund consultations with the poor under RETA 5894 (Facility for Capacity Building and Participatory Activities II) in three districts of Sri Lanka in July to September 2000. The consultation will add input from the poor to the poverty analysis and, in turn, to the country-specific poverty reduction strategy, the high level forum and the poverty reduction partnership agreement. The results of the consultation will be integrated into the poverty analysis and also presented at the high level forum. The first draft of the poverty analysis is expected to be completed by the end of October 2000. The high level forum will be held in late November 2000, after adequate review of the poverty analysis and the country-specific poverty reduction strategy by major stakeholders, and the poverty reduction partnership agreement will be signed in early 2001.

III. Sector Strategies

A. Agriculture

1. Agriculture and Rural Development

51. The Government continues to accord high priority to broad-based rural development to achieve the twin objectives of economic growth and poverty reduction. This is reflected in, among other things, the Regional Economic Advancement Program (REAP) initiated by the Government in 1997. The REAP concept includes four basic elements: (i) regional development plans; (ii) integrated village development; (iii) market-based farm enterprise development; and (iv) rural non-farm enterprise development. The Government also recognizes the significance of policy and institutional reforms for sustainable rural finance development and is moving toward a market-based system of rural finance to establish a strong link between rural financial markets and rural development.

52. The Government is currently implementing a program to phase out the subsidies given under the ongoing New Comprehensive Rural Credit Scheme, the interest subsidy cost of which was about 23 million rupees during 1999. The financial market reforms have already facilitated the entry of private sector development banks and commercial banks into rural and micro-finance. A number of such banks, including the National Development Bank and Development Finance Corporation of Ceylon Bank, are gradually expanding these operations. This trend is being further strengthened by the increasing competitiveness in the urban-oriented formal financial operations and the increasing recognition of opportunities for commercial rural and micro-finance operations by private sector service providers. The service providers are in need of support for downscaling and risk and transaction cost reduction of their operations, in addition to access for on-lending resources in the medium term. Furthermore, the rural population needs access to a broader spectrum of efficient financial services such as safe and reliable deposit service facilities and insurance services rather than just credit. These are well reflected in the innovative forward contract system that the Central Bank of Sri Lanka has introduced on a pilot basis through the

Kandurata Development Bank¹¹ as a solution to the perennial problem of price fluctuations in agricultural produce between the season and off-season.

53. Given their strong poverty focus, ADB will support the Government's rural development initiatives mainly through assistance for rural development projects, needed policy and institutional reforms and strengthening, and for rural and micro-finance development. ADB's support for rural and micro-finance is expected to enhance access of the poor to sustainable financial services on a continuing basis and assist a wide spectrum of financial institutions including NGOs to provide these services on a viable basis in response to the market demand. ADB has already approved a PPTA¹² to assist the Government to translate the REAP concept into a strategic framework, formulate an operational plan and prepare a detailed proposal for the **Southern Province Rural Economic Advancement Project** (2001) to address the high incidence of poverty in the province. ADB will provide a PPTA for **Rural Finance Sector Development** in 2001 to (i) assist the Government to address the key issues in rural finance policy and institutions and thereby further improve the enabling environment for sustainable operations, and (ii) prepare a rural finance sector development project for ADB assistance in 2003.

54. ADB approved the **Plantation Reform Project** in 1995, **Second Perennial Crops Project** in 1997, and **Tea Development Project**¹³ in 1998 to support the Government's efforts in plantation crop sector reforms and development. In view of its significance for both economic growth and poverty reduction, continued support will be provided in the plantation sector. However, future assistance would need to focus more on development of processing of plantation products and improvement of research and marketing with a view to increasing its contribution to value addition while continuing support for productivity enhancing activities such as replanting and soil rehabilitation. It is also essential to harness land that is not viable for plantation crop production for other productive purposes. Currently, there are about 10,000 hectares of such land in the plantation sector.

2. Forestry and Natural Resources

55. The COS suggests that sustainable natural resources management should be one of the key areas for ADB's involvement to ensure long-term sustainability of economic growth and reduce poverty. Strong emphasis on forestry, natural resources and environmental management as a feature of the ADB's operations was derived from the recognition that some parts of the agriculture sector are experiencing a decline in productivity, while inter-sectoral competition for water resources is also emerging as a serious issue. Indicators, such as the incidence of human encroachment into protected areas, decline in forest cover and soil degradation indicate the growing and unsustainable imbalance between the supply and demand for the use of the country's natural resources. In view of the need for improved management of environment and the natural resource base in Sri Lanka to ensure its long-term sustainability, support is planned for aquatic resources, biodiversity conservation, forestry development, and water resources management. Experience gained through several project preparatory activities indicates the need for future lending operations in the sector to particularly focus on: (i) definitional issues with regard to institutional and legislative arrangements; (ii) clarity of purpose and institutional mandates; (iii) effective engagement of stakeholders in policy making and management functions; and (iv) development of suitable mechanisms for effective coordination of agencies concerned with natural resources management.

¹¹ The Kandurata Development Bank is a rural financial institution in the Central Province.

¹² TA No. 3385-SRI: *Southern Province Rural Economic Advancement*, for \$800,000, approved on 29 December 1999.

¹³ Loan No: 1402-SRI: *Plantation Reform*, for \$60 million, approved on 9 November 1995, Loan No. 1552-SRI: *Second Perennial Crop Development*, for \$20 million, approved on 25 September 1997, and Loan No.1639-SRI: *Tea Development*, for \$35 million, approved on 10 November 1998.

56. Specific emphasis in ADB's operations will be to effectively integrate natural resources management and related economic concerns into Sri Lanka's development agenda. ADB's program will continue to emphasize the need to strengthen policy development and strategic management capacity of public sector organizations. Simultaneously, emphasis on modernization of the legislative framework, greater reliance on stakeholder involvement, decentralization and introduction of economic price and mechanisms need to be pursued. Attention is also required to improve Government-wide systems for taking integrated policy decisions, determining the best service delivery agent and allocating financial resources to achieve stated objectives. ADB will support efforts to address poverty related environmental degradation and comprehensive natural resources management through more coordinated and integrated approach with increased private sector and community involvement.

57. An ADTA for **Sustainable Natural Resources Management for Development**¹⁴ was approved in 1999, to provide support to the Government in its efforts to identify urgently required policy and institutional changes and to rationalize the legislative framework for improving the present capacities for natural resources management. Over the period 2001-2003, ADB will continue its efforts to improve the policy environment. In addition to the provision of technical assistance to implement the main recommendations of the ongoing TA, there is also support planned for adopting policy changes through a sector development program planned in 2003 for **Sustainable Eco-Management**.

58. In the area of coastal resource development, ADB expects to cover part of the East Coast, based on the experience gained in the recently approved **Coastal Resources Management Project**¹⁵. Particular emphasis will be placed on addressing the needs of the poorer sections of the coastal population in the Eastern Province to enable them to improve their livelihood activities. In coordination with Department of Wildlife Conservation, it is also expected to address the preservation of natural habitat in the water bodies along the East Coast. In view of the particular importance of aquatic resources development and quality improvement in Sri Lanka, a PPTA for **Aquatic Resources Development and Quality Improvement** (2001) is planned to develop a project to encourage private sector involvement in the above areas, particularly emphasizing inland fishery development.

59. Another important area of concern relates to the impact of the degradation of upper watersheds in Sri Lanka on water availability and quality in the lowlands. This is closely linked with the efforts of ADB to introduce a more efficient policy and practices for water resources management. These are to be implemented in the **Water Resources Management Project** being processed in 2000 and ADB will be keen to further expand these to the other river basins. Arresting the degradation of upper watersheds will be accorded priority, based on the experience gained in the ongoing project for the purpose. Similarly, protected area management will continue to be supported and a wider area covered under a second stage intervention. The primary objective of further support in protected area management is to improve management of these areas by involving all stakeholders, developing income-generating alternatives for the communities, in close proximity to the protected areas, to prevent encroachment and poaching and to combine protection with other compatible uses, such as tourism.

B. Infrastructure

1. Energy

60. Following the severe economic and social dislocation in the country in 1996, due to a power shortage resulting from the capacity constraints of the hydroelectricity grid at the time of a

¹⁴ TA No. 3271-SRI: *Sustainable Natural Resources Management for Development*, for \$800,000, approved on 6 October 1999.

¹⁵ Loan No. 1716-SRI: *Coastal Resources Management*, for \$40 million, approved on 7 December 1999.

severe drought, the Government's Public Investment Program started to reduce the level of dependence on the hydroelectricity part of the power system by expanding investments in thermal energy. However, severe budget constraints have continued to limit the public sector's ability to expand the power grid. Accordingly, substantial reliance is placed on private and concessional sources of finance to ensure that priority investment projects proceed in a timely manner. Today, four major private sector thermal power projects have been negotiated and one of the projects is already fully operational.¹⁶

61. The Government has acknowledged the need for and its commitment to sector reforms and, with the ADB's assistance¹⁷, has embarked on a program to restructure the sector, to ensure adequate and reliable power supplies at competitive prices through increased private sector participation and improved management and operational efficiencies. Under the new arrangements all future thermal generation power projects are to be developed by the private sector, while major hydroelectric projects will be developed by corporate public companies. The new power sector reform legislation is expected to be in place by mid 2001, to unbundle power generation, transmission and distribution operations of the Government controlled Ceylon Electricity Board (CEB) into separate companies. These companies are likely to include two or more power generating companies (in addition to the private sector power generation plants that are already in operation), a power transmission company, and appropriate number of power distribution companies. The companies would be set up under the Companies Act. The new power sector reforms legislation, which would replace the existing CEB Act and the Electricity Act, would simultaneously institutionalize the establishment of a Power Regulatory Commission. ADB, in close cooperation with the World Bank, is the principal dialogue partner of the Government concerning the reform program. The proposed **Power Sector Development Program** in 2001 will assist the Government in the restructuring of CEB, while the World Bank would assist to set up the power regulator.

62. Together with this ambitious sector reform program, rural electrification has been accorded high priority by the Government through continued public sector investment to ensure the access of poor to adequate supply of electricity. In line with ADB's overarching objective of poverty reduction and the Government's firm commitment to extension of electricity supply to the poverty-stricken rural areas, rural electrification remains an important area of support by ADB in the medium term.

63. Given the above, ADB's strategic objectives in the energy sector are to: (i) assist in developing a framework for ownership and management which will ensure adequate amounts of electricity at economic and affordable prices; (ii) promote and participate with loans and equity in private power projects, particularly in new power generation projects, in order to increase the total financial resources available for expansion of the sector and to improve efficiency of operations and management; (iii) provide continuing financial support for investments in transmission and distribution projects, particularly if they underpin important reforms in the sector; (iv) assist with financing rural electrification to ensure that the benefits of economic development reach the disadvantaged rural population; (v) improve the financial viability and management of power companies through implementation of an appropriate tariff policy, rate of return on capital and self-financing ratio; (vi) ensure that the tariff structure is reasonably close to the actual cost of service to each major consumer category, with minimum cross subsidies, in order to promote economic efficiency in consumption, and to reduce the heavy burden of paying cross subsidies for industrial and commercial consumers; and (vii) support reforms that will improve the operating efficiency of the sector through the promotion of competition and improved management of the power sector

¹⁶ These include a 60 MW barge mounted power plant by Colombo Power (Pvt.) Ltd (operational), a 163 MW combined cycle power plant by AED Kelanitissa (Pvt.) Ltd (to commence in 2001) an 8 MW diesel power plant by Kool Air (Pvt.) Ltd (expected to commence in 2000), and two diesel power plants by Aitken Spence & Co., each with capacity of 20 MW (to commence in 2000).

¹⁷ TA 3141-SRI: *Power Sector Restructuring*, for \$1 million, approved on 23 December 1998.

companies. In the petroleum subsector, ADB is, through the provision of an ADTA for **Study of Pricing Policy in the Petroleum Subsector**, addressing structural distortions in the liquid petroleum side.

2. Transport

64. The Government acknowledges that the lack of high mobility roads and an efficient transport network linking villages, towns and cities has been major constraint facing the poor working predominantly in agriculture and rural non-farm activities. Currently, about 90 percent of people and goods depend on the road network for conveyance, which makes it the dominant transport mode in the country. While private sector investments have been limited to financially viable infrastructure projects, the development of strategic infrastructure such as non-revenue-generating roads and ports through public sector investments and improved sector efficiency are critical to expand economic opportunities and make accessible to the poor employment, education, health care and market facilities. Especially, the Government noted the importance of institutional reforms and restructuring with increasing private sector participation in the provision and/or operations of road and port facilities, to ensure that the facilities are efficiently managed to meet the increasing demands of society.

65. In response to the development needs of the sector, ADB's approach has over time broadened beyond investment in rehabilitation of key road links and ad hoc policy engagement in the 1980s and early 1990s towards a consistent dialogue that encompasses policy, institutional and investment matters of the entire road network. ADB's strategy over the medium-term aims to mobilize resources to remove the physical bottlenecks in the road network and also to support efforts to improve the policy and institutional environment and raise subsector efficiency and performance.¹⁸ Toll road projects could also be considered for ADB participation through its private sector window. In the pursuit of this objective, key issues to be addressed include: (i) institutional reform and capacity building; (ii) subsector financing - road user charges, operation and maintenance financial allocations and practices, private sector participation; (iii) environmental and social impact of civil works; (iv) the optimum integration of the road network with other modes of transport; and (v) road safety.

66. ADB is the main dialogue partner with the Government on policy and institutional reforms in the road subsector to improve sector efficiency, and continues to have a solid portfolio of projects in the pipeline in the medium term. The ongoing ADB-assisted TA for **Re-engineering of Road Sector Institutions** is assisting the Government to identify and address the key impediments to the orderly and efficient management of the road subsector. The TA will provide a basis for the review of subsector policies and operating procedures and assist the Government to formulate an action plan for implementation under future ADB-assisted road projects. The processing of the planned **Road Sector Development Program** in the medium term will depend on the effective implementation of the ongoing projects, and especially, on the creation of a satisfactory policy and institutional environment. Furthermore, scope for future road projects will mainly target poorer provinces of the country and areas that connect poor or isolated areas to the economic mainstream, in line with ADB's overarching objective of poverty reduction. The results of project social and environmental impact assessments will also be important in determining ADB's support in the infrastructure sector.

67. In the port subsector, following approval of an equity and loan participation in private sector development of the Queen Elizabeth Quay at Colombo Port,¹⁹ ADB also approved in 1999 a PPTA

¹⁸ TA 3110-SRI: *Reengineering of Road Sector Institutions*, for \$640,000, approved on 8 December 1998, will assist the Government examine the key issues and options in the subsector.

¹⁹ Loan 1689-SRI: *Colombo Port Development Project*, for \$36.1 million and equity of \$7.4 million, approved on 11 May 1999.

for **Colombo Port South Harbor Development**,²⁰ to examine the technical and institutional feasibility of developing Colombo port's south harbor. The south harbor project will initially involve the construction of a breakwater by the public sector, which will then enable private port operators to build and operate new container terminals in the south harbor. The proposed loan for **Colombo Port South Harbor Development** with substantial co-financing requirement is provisionally included in 2003, which will systematically address the issue of port sector efficiency through sector reform and restructuring. In the rail subsector, ADB has approved a small-scale TA²¹ to assist the Government in finalizing a strategy and action plan for establishing public-private partnership for railways, involving consultations with stakeholders and deliberations at a high-level workshop, in line with its overall policy to promote public-private partnership in infrastructure development.

3. Finance and Industry

68. Policy reform and creation of a favorable environment for private sector development is the focus of ADB operations in industry and finance. The Government has been active in promoting private participation in the economy. Since 1995 when the Public Enterprise Reform Commission commenced work, the Government has made considerable progress in its privatization programs particularly in the plantation, telecommunication, port, power, and aviation subsectors. Despite these achievements, there has been less progress in other state-controlled sector including roads, railways, urban transport, water supply and sanitation, which are characterized by less efficient management and service provision.

69. There are two major impediments to increased private sector participation in the economy. These are: (i) continued public sector engagement in economic activities which are commercial in nature; and (ii) weak enabling environment for private sector participation largely due to the lack of a level-playing field, labor market rigidities, difficult access to financing, particularly long-term debt, and poor governance practices. Accordingly, ADB through a proposed **Private Sector Development Program** in 2000, to be implemented over 2000-2003, is supporting (i) further privatization and restructuring of state-owned enterprises; (ii) adoption of legislation which would define a competition policy and safeguards the right of consumers; (iii) address labor market rigidities to accelerate private sector investments and raise industrial productivity and cost efficiency, and at the same time, to promote social safety net for labor; and (iv) elimination of distortions in the market arising from regulatory barriers and special privileges accorded to state-owned financial institutions. More specifically, the proposed Program would support for capacity building for the Securities and Exchange Commission, consumer protection as well as insurance and pension regulatory authorities, and the Skills Development Fund.

70. The domestic capital market has made sound progress since liberalization measures were first instituted in the early 1990s. The market infrastructure compares favorably with those found elsewhere in the South Asian subregion, but the equities and private debt securities markets remain thin and underdeveloped. There is good potential for capital market development - with a large number of unlisted companies; considerable long-term financing needs; and a sizable pool of savings mobilized by contractual savings institutions, such as the Employees Provident and Trust Funds and insurance companies. These sources should be channeled to meet the long-term financing needs of the private sector and shift gradually away from funding public sector deficits. Appropriately regulated development of new financial instruments and mechanisms would also contribute to broadening and deepening the market, while an effective competition policy must be in place to facilitate a reduction in intermediation costs. ADB's approach to facilitating financial sector development in the short to medium term is to: (i) promote good governance over the financial markets by improving the understanding of key governance principles and best practices,

²⁰ TA No. 3276-SRI: *Colombo Port South Harbor Development*, for \$1.46 million, approved on 13 October 1999.

²¹ TA No. 3410-SRI: *Small-scale Technical Assistance to Establish Public-Private Partnership for Railways*, for \$150,000, approved on 8 March 2000.

building capacity for good governance, and institutionalization of good governance principles through organizational restructuring; (ii) mobilize financial resources from commercial sources, and when necessary, with support of ADB's guarantee facility, for re-lending to the private sector through domestic financial institutions; and (iii) develop a network of specialized financial institutions (e.g. cooperatives, NGOs, and credit funds) and mainstream suitable credit facilities among the existing financial intermediaries to target the weaker economic sectors including micro-enterprises, small and medium scale industries, retail low cost housing, and the rural areas.

C. Social Infrastructure and Environment

1. Education

71. As noted in Chapter I, Sri Lanka has impressive human development indicators (paragraphs 27-28). However, there are signs that the quality and efficiency of the education system has deteriorated. Improving the access to and quality of basic and formal education and vocational training to create skills that are essential for modern economic progress and poverty reduction are primary objectives of the education reforms led by the Presidential Task Forces in recent years. In basic education, the Government has recently enacted legislation to make education compulsory through age 14 to enforce universal basic education, and is aiming to extend compulsory education to age 16 to improve educational opportunities especially for disadvantaged students in rural areas. Reforms in general education focus on extending educational opportunities to reduce inequalities between students attending full curriculum and limited curriculum schools, improving quality through improved curriculum relevance, teaching and educational management, and resource provision.

72. Reforms in university education emphasizes expansion of university education, diversification of university courses and curriculum reform to develop employable skills for private sector employment, provision of career guidance for students, partial cost recovery and regulated private education for improved quality and sustainability, and improved university administration and management. In vocational training and technical education, reforms have been aimed at increasing the role of private sector participation and private-public partnership in technical and vocational training to enable all those who do not seek higher education to develop skills required by the labor market.

73. Consistent with the strategic objectives of the COS, ADB's proposed assistance for the sector in the period 2001-2003 includes technical assistance and loans to improve the efficiency and output of the sector and to attain a better match between the quality and skill level of the labor force and the human resource requirements of the modernizing economy. In addition, the ADB has continued policy dialogue with the Government on the sector, specifically with regard to internal and external efficiency as well as private sector participation in the sector. Following the approval of a loan for **Skills Development** in 1999,²² the proposed loans for the sector include a **Secondary Education Modernization** in 2000 and **Post-Secondary Education Development** in 2002.

2. Water Supply and Sanitation

²² Loan No. 1707-SRI: *Skills Development*, for \$18.8 million, approved on 25 October 1999.

74. The Government aims to provide safe drinking water to all by 2010. The sector strategy includes community water supply programs and rural water and sanitation schemes covering operation and maintenance as well as opening selected urban areas for private sector to operate on a BOO/BOT basis to supplement public investments as announced by the Government in its 2000 Budget Speech. A regulatory body is being established under the ADB-assisted **Third Water Supply and Sanitation Sector Project**²³ to, among other things, regulate private sector participation. Major tariff revisions are scheduled for 1 December 2000, with a view to maintaining the National Water Supply and Drainage Board as a financially viable institution. The conflict of water rights between irrigation and domestic water supplies will be resolved through integrated water resources management under the National Water Resources Authority to be established under the National Water Resources Act by 2001 with ADB assistance.²⁴

75. It is proposed to continue the ADB's partnership with the Government and the local communities to address unmet sector investments outside the Colombo region and provision has been made for this in the operational program. The proposed programs in the medium term include the **Secondary Towns Water Supply and Sanitation** in 2002, to be prepared by a PPTA in 2000, and an ADTA for **Strengthening of Regulatory Framework in Water Supply and Sanitation** in 2001. The proposed loan project will be the fourth such project assisted by ADB (the first two projects were successfully completed and the third project is expected to be completed by 2002).

3. Urban Development and Environment

76. The dominance of the Greater Colombo region has resulted in Colombo's infrastructure being overburdened. At the same time, secondary towns are deprived of a growth impetus because investment and employment opportunities are drawn to Colombo. The Government accords high priority to urban development with focus on (i) physical investment to improve especially the urban poor's access to basic infrastructure and services, and (ii) strengthening the technical and financial capabilities of urban local authorities for improved management and sector efficiency. Greater responsibilities have been devolved to urban local authorities for provision and financing of urban infrastructure and municipal services to facilitate participation of beneficiary communities and sustainable development of urban infrastructure and services. Accordingly, ADB's strategy is to improve the infrastructure and services of the main urban centers outside Colombo, and at the same time upgrade the road network that links the towns with the rest of the economy. A crucial element in the successful application of this strategy is to ensure that new or improved infrastructure is efficiently operated and maintained and that the management and financial capacity of the responsible urban administrations is sufficient to sustain the urban infrastructure and services.

77. ADB approved the **Urban Development and Low Income Housing Project** in 1998²⁵ to improve the urban infrastructure in the country's secondary towns. However, the needs of the urban sector are substantial. Subject to satisfactory performance of the ongoing project, the proposed loan and TA program include provision for a follow-up PPTA for **Secondary Towns Infrastructure Improvement** in 2001, to prepare a loan project in 2003, and a PPTA for **Housing Finance** in 2002. The basic principles that govern ADB's support for the sector include (i) continued strong commitment and ownership at the national and local government levels for the reform and capacity building process, (ii) ADB's role as a change agent in facilitating policy and institutional reforms, and (iii) equity (both socioeconomic and gender) considerations in the selection of urban projects for financing.

²³ Loan No. 1575-SRI: *Third Water Supply and Sanitation*, for \$75 million, approved on 6 November 1997.

²⁴ Water Resources Management, proposed for ADB approval in 2000.

²⁵ Loan 1632-SRI: *Urban Development and Low Income Housing*, for \$70 million, approved on 24 September 1998.

78. The increasing production outputs of manufacturing industries have been associated with increased environmental costs. The country's environmental indicator indicates that the level of waste emissions from industrial activities cannot be ignored. The health impacts of industrial pollution are heightened by the fact that industries are concentrated in urban areas and other areas with high population densities (i.e. Colombo and Gampaha district in the Western Province). With growing congestion and pollution in the urban centers, it will become increasingly difficult for the country to compete for foreign direct investments. Therefore, the challenge facing the country is how to promote industrial development with minimal adverse environmental impacts.

79. The Government has adopted several approaches including proper industrial zoning to locate industries having common pollution control abatement costs together in the same zone, licensing for waste discharge, low-interest loans and tax waivers for pollution abatement equipment. However, such approaches to deal with pollution problems heavily depend on treating wastes that is very costly. To achieve the objective of reducing pollution at the least cost, and at the same time, enhance industrial efficiency, productivity and competitiveness, the Government is increasingly focusing on cleaner production. Accordingly, an ADTA for **Cleaner Production** (in 2001) has been included to assist the Government in formulating strategies and policies to implement cleaner production in the industry sector, while investment frameworks would be prepared through a PPTA for **Cleaner Production** in 2002.

D. Governance Dimensions of ADB Operations

80. ADB is assisting the Government at two levels on governance issues in Sri Lanka. At one level support is being provided to the Government to improve key segments of the public administration system, particularly the institutions in the sectors where ADB operations are focused. In 1999, a cluster TA was approved to strengthen the public expenditure management system in the Ministry of Finance and Planning.²⁶ At another level, assistance is being provided to the Government strengthen capacity and performance across the public sector. ADB's ongoing support for the improvement of procurement practices and procedures is an example.²⁷ In support of a more substantial and broader program of reform especially in decentralization to increase managerial and administrative capabilities at provincial and local government levels, a PPTA is included in 2001 for preparation of an **Action Plan for Public Administration Reform/Decentralization**. The PPTA is expected to lead to a program loan in 2002 for implementation of the action plan.

81. In order for Sri Lanka to successfully achieve self-sustained growth, it will need to take measures to re-establish the capacity of the public sector and effectively harness the efficiency gains inherent in the expansion of the role of the private sector in the economy. With respect to the former, ADB, in recent years, has recognized the potential for a wider and more sustainable impact on public sector performance if a multi-dimensional approach is adopted, including ensuring the appropriateness of the policy environment, rationalization of the institutional setup, improving the procedural arrangements of the public administration system, facilitating technology modernization and manpower development. This approach is increasingly being applied in the areas where ADB operations are focused, such as the power, water supply, urban development, roads and natural resources management subsectors.

E. Gender Dimensions of ADB Operations

82. The COS includes a revised gender strategy for Sri Lanka. Some of the strategy's main components are: (i) strengthening the Government's capacity to analyze the situation and needs of poor women, especially aging women, in order to identify some of the main issues and how they

²⁶ TA 3301-SRI: *Strengthening Public Expenditure Management Systems*, for \$3.0 million, approved on 16 November 1999.

²⁷ TA 2950-SRI: *Establishment of the Tender Support Bureau*, for \$1 million, approved on 12 December 1997.

can be incorporated into the ADB's future lending program; (ii) supporting the Government's efforts to collect, monitor and evaluate data on the impact of poverty reduction programs on women; (iii) if feasible, to document the impact of the civil conflict on women, particularly the economic impact of the creation of thousands of female-headed households; and (iv) assessing the needs of returning women migrant workers and how they could best be reintegrated into the economy. The first step to operationalise the gender strategy will be the inclusion of gender issues in the poverty analysis in 2000.

F. Private Sector Operations

83. ADB's strategy to enhance private sector development to contribute to enhanced growth and poverty reduction has a two-pronged approach: (i) the promotion of an enabling environment for private sector activities through ADB's public sector operations, and (ii) direct investment in private sector companies in the form of loan and equity through operations of ADB's Private Sector Group. Consistent with this approach, ADB places strong emphasis on creating a suitable environment for the expansion of private participation in the economy and to identify specific opportunities for private investment. Noteworthy examples include support for the plantation privatization programs and private sector participation in fishery harbor management and service, private sector provision of advisory services for perennial crops, development of the private construction industry, establishment of a regulatory framework for private sector participation in urban water supply. In the port subsector, ADB is assisting the Government to undertake a feasibility study to determine the viability of developing the south harbor at Colombo Port, through the building of a breakwater and the construction of additional container terminals which are being built and operated by the private sector.²⁸ In natural resources, the Government with ADB assistance is undertaking a set of legal and institutional reforms to improve the investment environment for private sector participation, the access of the poor to productive natural resources, and natural resources and environmental management. The proposed support for **Private Sector Development Program** in 2000 will further assist the creation of an enabling policy, legal and regulatory environment to promote private sector growth and improved public sector management in major sectors on the economy (paragraphs 68-69).

84. In 1997 and 1998, ADB assisted the private sector to borrow from the international capital market to onlend to domestic industries. These assistance included **Small and Medium Enterprise Assistance Project** and **Credit Enhancement Facility for Private Enterprises**.²⁹ Both initiatives played an important catalytic role in attracting private capital inflows under difficult financial market conditions to support private sector growth, and more importantly, a role in creating employment opportunities for the poor and reduce poverty in the rural and semi-rural areas. A PPTA for **Small-Medium Enterprise (SME) Support for Employment Generation and Poverty Reduction** is included in 2000, to prepare a project in 2001 and also look into the nature and means of financing of SMEs and ways of ADB support particularly in the provision of credit guarantees. It is envisaged that the scope of future support to SMEs will be broadened to include support to improve the policy framework within which the SMEs operate, ensure appropriate technology transfer, provide adequate research and extension services, introduce modern management system and adequate forward and backward linkages with manufacturing sectors.

85. ADB is monitoring the project proposals that are emerging to ascertain whether there is a catalytic role for ADB. Specific cases of ADB's public sector operations that assist the Government in preparing the way for the emergence of BOO/BOT projects include: (i) the **Colombo Port South Harbor Development Project** where ADB is assisting the Government to prepare a feasibility study, and (ii) the **Power Sector Development Program**,³⁰ that may lead to

²⁸ TA 3276-SRI: *Colombo Port South Harbor Development Project*, for \$1.46 million, approved on 13 October 1999.

²⁹ Loan 1522-SRI: *Small and Medium Enterprise Assistance Project*, for \$5 million, approved on 5 June 1997 and Loan 1629-SRI: *Credit Enhancement Facility for Private Enterprises*, for \$5 million, approved on 8 September 1998.

³⁰ TA 3141-SRI: *Power Sector Restructuring*, for \$1 million, approved on 23 December 1998.

disaggregated utility companies emerging with possible private sector management or equity participation. ADB's ongoing analysis of the road sector³¹ may also lead to future private participation in the construction and management of selected highways. Similarly, the feasibility of private sector involvement in the water sector is being examined under an ongoing ADB project.³²

86. ADB's direct private sector operations in Sri Lanka have so far included three loans totaling \$46.1 million and six equity investments totaling \$10.9 million for nine projects. The most recent loan and equity investment was provided for the private sector development of the Queen Elizabeth Quay in Colombo Port.³³ ADB's private sector groups operations will continue to focus mainly on infrastructure projects where large funding is required and where ADB can play a catalytic role in attracting co-financing. ADB may consider assistance to the Colombo-Kandy Expressway project and the Greater Negombo Water Supply project. Both projects are still under study. As mandated by ADB's overarching policy of poverty alleviation, ADB will consider health and education sector projects on a case-by-case basis for its future private sector operations.

IV. Regional Cooperation

87. As an island country with a limited domestic market, Sri Lanka looks to regional organizations such as South Asian Association for Regional Cooperation (SAARC), Bangladesh, India, Myanmar, Sri Lanka, Thailand Economic Cooperation (BIMSTIC) and Indian Ocean Rim Association for Regional Cooperation (IRO-ARC) as potential avenues to expand markets for its products. Sri Lanka also hopes to fully exploit its locational advantages over the medium- to long-term to establish itself as a regional hub for shipping, aviation and financial services. Trade liberalization under SAARC has made slow progress, although the Sri Lankan Government continues to make reforms. In 1999 there was a major breakthrough in trade negotiations with India when agreement was reached on the removal of trade restrictions on a broad range of goods. ADB through a TA for **Trade Promotion** (in 2000) will assist the Government to operationalize the trade agreement. Sri Lanka's participation in BIMSTIC and IRO-ARC has been quite recent, but the Government is hopeful that both initiatives will give priority to opening up markets to enable a freer movement of commodities and services across the Indian Ocean region. The Government indicated that it would welcome the strengthening of ties between ADB, the SAARC Secretariat, and other regional cooperation initiatives. ADB is prepared to assist under the Regional Economic Monitoring Unit the initiatives of the Central Bank Governors under SAARC in developing and exchanging ideas on macro and especially financial policies. ADB is also involved in sub-regional environmental cooperation. ADB is assisting in the development of a SAARC protocol on air quality management and in the development of a regional coastal and marine resource management agreement at request of the South Asian Cooperation on Environment Program (SACEP). Potential opportunities for regional cooperation with the Indian Ocean countries is also being explored with the aim to expand the country's economic activities and share development experiences.

V. Donor Activities and Aid Coordination

88. Japan, ADB, and the World Bank continue to be the largest donors to Sri Lanka. Significant assistance also continues to be provided by bilateral funding agencies.³⁴ The Development Forum (formerly the Aide Group Meeting), chaired by the World Bank, is held every 1-2 years. The last

³¹ TA 3110-SRI: *Re-engineering of Road Sector Institutions*, for \$640,000, approved on 8 December 1998.

³² Loan 1575-SRI: *Third Water Supply and Sanitation Sector Project*, for \$75 million, approved on 6 November 1997.

³³ Loan No. 1689-SRI: *Colombo Port Development Project*, for \$36.1 million loan and \$7.4 million equity investment, approved on 11 May 1999.

³⁴ Among the other leading bilateral and multilateral donors are Germany, Norway, Netherlands, USA, Sweden and the United Nations agencies.

Forum was held in May 1998, and the next will be held in December 2000. Due to the significant economic and financial impact of the civil conflict and the Government's efforts to reduce the budget deficit, donor-financed projects constitute a significant proportion of the overall public sector investment program. This situation is expected to continue in the medium-term. In view of the substantial assistance programs provided by Japan, ADB and the World Bank, special attention has been paid to close coordination to ensure compatibility of policy advice and avoidance of duplication of investments. Specifically, broad understandings have been reached between ADB and the World Bank on areas of respective sectoral focus and cooperation through regular interagency consultations. Since the opening of the Resident Mission in Colombo in October 1997, ADB has been prominent in local donor coordination, particularly in the sectors where ADB has a major role, including especially roads, energy, water, urban development, environmental and natural resources management.

89. International Monetary Fund (IMF) has a resident advisor in Sri Lanka, mainly advising the Government on macroeconomic policy related issues. The IMF's Article IV Consultation mission visits the country on annual basis and ADB has been closely consulted and/or actively participating in the consultation missions. Close contact with IMF is also maintained through meetings during ADB's project and especially programs loan processing stages. The proposed ADTA for **Governance and Institutional Support for Private Sector Development** (2000) has been formulated and in close consultation with both the IMF and the World Bank, aiming to promote good governance over the financial markets. The IMF is considering formulating a program of reform under its poverty reduction and growth facility in 2000, which would compliment ADB's work toward a poverty reduction partnership agreement.

90. Japanese development assistance continues to place emphasis on supporting improvements in key physical infrastructure, but in more recent times has also been broadened to include social infrastructure and environment. Accordingly, there are several sectors where cofinancing is being explored, including roads, port development, energy, natural resources management and rural development. The World Bank assistance, through International Development Association (IDA), amounted to \$341 million during 1997-1999, with focus on general education and teacher education, health, irrigation rehabilitation (including in the conflict-affected regions), telecommunications reform, Y2K assistance, and urban transport. About \$440 million is programmed by the World Bank for Sri Lanka for the period of 2001-2003, targeting legal reform, postal service reform, land titling, port efficiency improvement, water and sanitation, power restructuring (in cooperation with the ADB), food marketing, and health. Depending on the commitment of the Government to reforms, the World Bank is also considering providing assistance for civil service and pension reforms. Details of external assistance provided to Sri Lanka are at Appendix 3.

VI. Cofinancing and Catalyzing External Resources

91. ADB will continue its efforts to mobilize resources from other sources for its operations in Sri Lanka. In the past, official cofinancing played the major role and it will continue to do so, while ADB will pursue commercial cofinancing, including financing from export credit agencies, for commercially viable projects. Since the mid-1990s more attention has been accorded to closer coordination of donor policies and programs in Sri Lanka. Simultaneously, the ADB has placed greater emphasis on the identification of opportunities for project cofinancing. Japan, France, Norway, Netherlands, Nordic Development Fund, Organization of Petroleum Exporting Countries Fund and Australia are donors that have ongoing cofinancing arrangements with the ADB. Germany, GEF, and UNDP, among others, have expressed interest in exploring cofinancing arrangements in areas including such as environment and natural resources conservation and social infrastructure development.

92. ADB's 2000 Country Programming Mission had extensive discussions with the Government and the donor community regarding cofinancing possibilities. It was confirmed that significant potential for cofinancing exists in the period 2001-2003. All of the 14 projects in the pipeline in this period have the potential to secure cofinancing from Japan Bank for International Cooperation (JBIC), Japan International Cooperation Agency, the World Bank, Germany, Sweden, Netherlands³⁵, Norway, Australia and others. The ADB, with the assistance of SLRM, will actively follow-up on the cofinancing opportunities.

VII. ADB's Operational Program

93. During the 1990s the average annual ADB public sector lending to Sri Lanka amounted to \$141 million. In the first lending cycle of the decade (1990-1992) the average annual lending was at its highest at \$171 million. Thereafter, it declined to an average in the 1996-1999 period of \$132 million. All the lending has been on ADF terms. In the mid-1990s the lending level declined because of a weakening in portfolio performance. However, in the last few years (1996-1999) portfolio performance improved to be among the best of ADB's DMCs and there was also a strengthening of the lending pipeline. The rise in the lending level in these years generally reflects the sound macroeconomic performance and increased absorptive capacity of the country.

94. In 1998, ADB's public sector lending amounted to \$185 million, which was one of the highest annual commitment levels since ADB lending operations began in the country. In late 1998, Sri Lanka was graduated to B1 country status.³⁶ In addition, ADB faced constraints on the availability of ADF resources, which necessitated a reduction in ADF lending to several ADF eligible DMCs, including Sri Lanka. However, in recognition of the sound country performance and the improvements made in the implementation of the existing loan portfolio, about \$149 million was approved in 1999. For 2000, a lending level of \$209 million (\$194 million ADF and \$15 million OCR) is envisaged. Despite the reduction in the overall lending level from that achieved in 1997-1998, the planned project pipeline has been largely retained through the judicious use of cofinancing to bridge the gap in project financing.³⁷ In the medium-term, ADB is expected to remain one of the three largest donors in Sri Lanka, together with Japan and the World Bank.

95. The proposed lending program during 2001-2003 consists of 14 projects totaling \$600 million, or an average of about \$150 million ADF per year and \$50 million OCR per year. The proposed lending level is consistent with the country's need for continued external concessional assistance and based on the satisfactory portfolio performance achieved in recent years. The OCR lending is directed to only revenue-generating infrastructure projects and program loans that promote policy reforms and private sector growth due to the vulnerability of the country's key exports to market fluctuations, high external debt and the continuing fiscal constraints. However, the actual lending levels will depend on the country and sector performance in line with ADB's policy on performance based allocation (paragraphs 43 and 44). This is to ensure that future levels of ADB investments will be commensurate with the necessary policy and institutional environment of the country to generate and sustain desired development impact.

96. In line with the ADB's overarching objective of poverty reduction, an important feature of the lending program is the inclusion of projects with scope to maximize poverty impact. The locations of almost all of the programmed social and infrastructure projects are within the poor concentrated areas, and where security permits, the scope of the projects has included the North and Eastern Provinces. Out of a total of 14 projects over the period 2001-2003, projects targeting core poverty intervention constitute 50 percent by the number of projects and 48 percent by the

³⁵ The Netherlands Government is considering entering into a strategic partnership with the Bank in the planning and implementation of its development program in Sri Lanka.

³⁶ B1 Country Status allows borrowing on Asian Development Fund (ADF) terms, with limited access to Ordinary Capital Resources (OCR).

³⁷ Southern Transport Development Project in 1999 is an example. JBIC has agreed to cofinance the Project with resource input significantly larger than ADB financing share.

total value.

97. Over the period 2001-2003 the sectoral distribution of the proposed loan program (by number of loans) is: agriculture and natural resources 36 percent, social infrastructure 29 percent, transport 14 percent, energy 7 percent, and industry and finance 7 percent, and governance 7 percent. The sectoral focus of the program is consistent with the objectives of ADB's operations in Sri Lanka and will assist in meeting the Government's development priorities and commitment to sector reforms, ADB's role as a long-term development partner, and the assistance provided by other donor governments and agencies. The program has a narrower sector focus than in the past, linkages between projects to increase the synergy effect of projects, and higher priority for sectors where ADB is the lead dialogue partner for institutional and policy reforms. All of the projects at least in part address crosscutting concerns.

98. The TA program comprises projects that reflect the national development priorities of the Government and the strategic development objectives of ADB. The TA program aims to help sustain a robust pipeline of quality projects for ADB financing with at least four PPTAs per year and meanwhile, providing support for financial sector developments and institutional capacity building for improved management efficiency and support for policy reforms to promote private investments in infrastructures. The TA program for 2001-2003 includes 25 TAs with a total value of \$19.6 million (13 PPTAs totaling \$10.8 million and 12 ADTAs totaling \$8.8 million), which averages about \$6.5 million per annum. The TA program for 2002 and 2003 will be further refined during ADB's Country Program Confirmation Mission in 2000, following further consultation with the Government based on the results of planned sector strategy studies in several sectors. Details of the Loan and TA program are provided in Appendixes 4 and 5. The project profiles for the 2001 projects are at Appendix 6.

99. Although portfolio performance has improved in recent years, project implementation delays still exist in various forms including delays in procurement and recruitment of consultants. ADB therefore needs to follow a strict performance-based approach in determining the level of new ADB assistance in Sri Lanka. ADB is also paying more attention to the policy environment in which projects are formulated, in addition to the performance of specific projects. In this regard, crosscutting issues, such as governance, capacity building and achievement of development objectives will be more intensively monitored and taken into consideration in preparing the operational program of the ADB. Furthermore, postevaluation findings will also be considered prior to approval of new projects.

Table 1: Lending and Technical Assistance Program, 1999-2003

A. Public Sector Lending Program (number of loans; amount in \$million)										
	1999 (Actual)		2000		2001		2002		2003	
	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount
Lending Program^a	3	148.8	5	208.7	4	220	6	170	4	210
ADF	3	148.8	5	193.7	4	130	6	170	4	150
OCR	-	-	1	15	2	90	-	-	2	60
Lending Pipeline^b	3	148.8	5	208.7	4	220	6	170	5	260
ADF	3	148.8	5	193.7	4	130	6	170	5	190
OCR	-	-	1	15	2	90	-	-	3	70

B. Technical Assistance Program (number of TAs; amount in \$'000)										
	1999 (Actual)		2000		2001		2002		2003	
	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount
Technical assistance Program ^a	12	7,930	9	5,685	10	7,750	8	6,950	7	4,900
Technical assistance Pipeline ^b	12	7,930	12	9,985	10	7,750	8	6,950	7	4,900

^a The Program comprised the firm projects.

^b The Pipeline consists of firm and standby projects.

Note: Blend loans are counted as one.

VIII. Economic and Sector Work Program

100. Economic and sector work will be undertaken to provide crucial inputs for implementation of the COS, the poverty reduction strategy, and private sector development strategy as well as policy and project planning and implementation. One of the most important tasks in 2001-2003 will be to complete the poverty-related studies including poverty profile, poverty reduction strategy, and poverty reduction partnership agreement. The economic and sector work will provide a basis for dialogue with the Government and will be reflected in the design of ADB-financed projects. In addition to the above poverty-related studies, the areas that have been identified by the COS for further review, assessment, and strengthening include rural financial policy and institutional development, institutional support for financial sector development, project contract management, private participation in oil/gas exploration, pricing policy in the petroleum subsector, integrated energy sector masterplan, regulatory framework in water supply and sanitation, cleaner production, and environmental impact assessment at provincial level, and the development of a national policy on involuntary resettlement.

IX. Local Cost Financing

101. Throughout the 1990s³⁸, ADB has approved lending for local currency financing (LCF) amounting to about \$352 million or 28 percent of total ADB lending for 27 projects. The LCF level has been determined based on the medium-term economic prospects of the country and the Government's ability to finance the public investment program required for the country to undergo the economic and social transition to a higher level of development and to reduce the high rate of poverty.

102. In recent years, the Government has recognized that there are severe limits on the extent of public sector financing of the country's investment program. Accordingly, it has taken a number of important actions to mobilize non-budget investment, including the implementation of an ambitious privatization program in key sectors such as civil aviation, telecommunications and the plantation industry. In 1997 and again in 1998, the Government counter-guaranteed private sector borrowing on the international capital market under the ADB's guarantee scheme. In addition, the Government has secured substantial private investment in capital intensive industries such as power supply and ports. The Government, with ADB support, has initiated an ambitious private sector development program in 2000, aiming to further privatize and restructure state-owned enterprises and address labor market rigidities to accelerate private sector investments and raise industrial productivity and cost efficiency. The proceeds from the privatization program are expected to be amounting to about 1.5 percent of GDP in 2000, the second largest achievement since the Public Enterprise Reform Commission commenced work in 1995. The largest receipts of privatization proceeds was achieved in 1997, when the public enterprise reform program generated about SLRs23 billion (equivalent to 2.5 percent of GDP), of which SLRs10 billion were used to retire public debt during the year.

103. However, despite these actions, the overall capacity of the Government to self-finance the public investment program in the coming years is expected to remain limited, as debt servicing and the costs related to the ongoing civil conflict continue to absorb about 50 percent of budget outlays. The 1999 budget deficit was 7.5 percent of GDP, an improvement on the 9.2 percent of GDP in 1998, but still remained at a high level. This outcome was largely because of lower than anticipated tax receipts in the initial years of operation of the goods and services tax that was introduced in 1998, and the larger than anticipated outlays on capital investment and defense. While the Government intends to reduce the budget deficit to 5 percent of GDP by 2002, in 2000, it has been projected at 8.0 percent of GDP compared to the original budget of 7.6 resulting from increased defence expenditure.

³⁸ Covering the period 1990 to 1999.

104. In recent years, most ADB-financed projects have received adequate counterpart funds, although some delays in the release of funds have occurred, which slowed project implementation. However, continued ADB support for LCF is considered to be justified in view of the prevailing difficult country circumstances and the need for a substantial program of rehabilitation, replacement and improvement of the country's capital stock, for it to successfully undergo a transition to a higher growth path. Over the medium-term the ADB's lending program will include several environment projects that will produce national as well as global benefits and they may warrant special consideration with respect to local cost financing.

SRI LANKA
COUNTRY PERFORMANCE INDICATORS

Item	1995	1996	1997	1998	1999 ^a	2000 ^b
Economic Indicators						
A. Income						
GNP per Capita (\$, current prices)	710	748	804	823	807	835
GDP Growth (%)	5.5	3.8	6.3	4.7	4.3	6.0
Agriculture	3.3	-4.6	3.0	2.5	4.5	3.6
Industry	7.8	5.6	7.7	5.9	4.8	7.9
Services	4.9	6.0	7.1	5.1	4.0	5.9
B. Saving and Investment (Percent of GDP)						
National Saving	19.5	19.0	21.5	23.4	23.9	26.0
Domestic Investment	25.7	24.2	24.4	25.1	27.1	31.0
C. Money and Inflation (Annual percent change)						
Consumer Prices	7.7	15.9	9.6	9.4	4.7	7.5
Money Supply (M2)	19.2	10.8	13.9	9.7	13.3	13.5
D. Government Finance (Percent of GDP)						
Revenue	20.4	19.0	18.5	17.2	17.6	18.5
Expenditure	30.5	28.5	26.4	26.3	25.1	26.9
Overall Surplus/Deficit (-) (before grants & w/o privatization)	-10.1	-9.4	-7.9	-9.2	-7.5	-8.4
E. Balance of Payments						
Merchandise Trade Balance (% of GDP)	-11.5	-9.7	-8.1	-6.9	-8.2	-12.7
Current Account Balance (% of GDP)	-6.0	-4.9	-2.6	-1.4	-3.1	-7.9
Export (\$) growth (%)	18.6	7.6	13.3	3.4	-4.1	13.1
Import (\$) growth (%)	11.4	2.4	7.8	0.4	0.2	23.1
F. External Payments Indicators						
Total Official Assets (\$ million)	2063	1937	2029	1984	1639	1523
(months of import of goods)	4.7	4.3	4.2	4.0	3.3	2.5
Debt Service Ratio	16.5	15.3	13.3	13.3	15.2	14.3
External Debt (% of GDP)	66.7	61.1	54.3	55.5	57.4	59.9
Memorandum Items:						
GDP (current prices, \$ million)	13,030	13,898	15,092	15,760	15,779	16,195
Exchange Rate, annual average (SLRs per \$)	51.3	55.3	59.0	64.6	70.4	78.0

^a provisional

^b Staff estimates

Source: Central Bank of Sri Lanka Annual Report 1999

SRI LANKA
COUNTRY PERFORMANCE INDICATORS

Population Indicators	1993	1999	
Total Population (million)	17.6	20.0	
Annual population growth rate	1.2	1.2	
Social Indicators	1990	latest year	
Total fertility rate (births per women)	2.4 (1993)	2.2 (1997)	WDR 00
Contraceptive prevalence rate	62.0	66.0 (1990-99)	HDR 00
Maternal mortality rate (per 100,000 live births)	80.0 (1980-92)	30.0 (1990-97)	WDR 00
Infant mortality rate (per 1,000 live births)	17.0 (1993)	17.0 (1998)	HDR 00
Life expectancy at birth (years)	72.0 (1993)	73.3 (1998)	HDR 00
Adult literacy rate (%)	89.0	91.1 (1998)	HDR 00
Primary school enrollment (% of school age population)	108.0 (1987-92)	109.0 (1997)	WDI 00
Secondary school enrollment (% of school age population)	74.0 (1987-92)	75.0 (1997)	WDI 00
Child malnutrition (% of under age five)	36.6 (1987-92)	37.0 (1990-98)	HDR 00
Population with access to safe water (%)		70.0 (1996)	WDI 99
Rural	29.0 (1985-87)	65.0 (1995)	WDR 00
Urban	82.0 (1985-87)	88.0 (1995)	WDR 00
Population with access to sanitation (%)		75.0 (1995)	WDR 00
Rural	39.0 (1985-87)	60.0 (1990-95)	-
Urban	65.0 (1985-87)	67.0 (1990-95)	-
Public education expenditure as % of GDP	3.3 (1992)	2.6 (1998)	CBSL AR 9
Public health expenditure as % of GDP	1.7	1.4 (1998)	CBSL AR 9
Human Development Index	0.704 (1992)	0.733 (1998)	HDR 00
Human Development Ranking		84/174 (1998)	HDR 00
Environmental Indicators	1980	1995	
Energy Efficiency of Emissions			
GDP per unit of energy use (1987 \$ per kg oil equivalent)	3.4	3.8	
Traditional fuel use (% of total energy use)	54.3	48.4	
Carbon dioxide emissions (total metric tons)	3.4	7.1 (1996)	WDR 00
(per capita metric tons)	0.2	0.4 (1996)	WDR 00
Water Pollution			
Emissions of organic pollutants (kg/day)	30,000	51,300 (1993)	
Industry share of emissions of organic water pollutants			
Wood		0.7 (1993)	
Primary Metals		1.4 (1993)	
Pulp and Paper		8.0 (1993)	
Chemical		6.4 (1993)	
Food and Beverages		52.0 (1993)	
Textiles		28.9 (1993)	
Land Use			
Cropland (% of land area)	29.0	15.5 (1996)	WDR 00
Permanent Pasture (% of land area)	7.0	7.0 (1994)	
Forest area (thousand sq. km.)	-	18.0	WDR 99
Annual deforestation (sq. km.)	-	202.0 (1990-95)	HDR 99
Annual deforestation (average % change)	-	1.1 (1990-95)	HDR 99
Biodiversity			
Nationally protected area (% of total land area)		13.3 (1996)	WDR 00
Official UNESCO Biosphere Reserves		2 (1978)	
Official UNESCO World Heritage Sites		7 (1991)	
Ramsar (wetlands) site: Bundala - 6,210 ha.		1 (1990)	
Threatened species			
Mammals		14.0 (1996)	WDI 00
Birds		11.0 (1996)	WDI 00
Higher Plants		455.0 (1997)	WDI 00

Sources: UNDP's Human Development Report 2000, World Bank's World Development Report 1999/2000 and World Bank's World Development Indicators 2000

**SRI LANKA
PORTFOLIO PERFORMANCE**

**Table 1 : Implementation, Disbursement Performance and Postevaluation Results
Public Sector Projects only
(as of 31 December 1999)**

A. Project Portfolio	Net Loan Amount \$ million %		Rating (No.) ^a									
			Total No. %		Implementation Progress				Development Objectives			
					HS	S	PS	U	HS	S	PS	U
Agriculture and Natural Resources	279.8	32.7	10	45.5	-	10	-	-	-	10	-	-
Energy	95.9	11.2	2	9.1	-	1	1	-	-	2	-	-
Finance and Industry	0.0	0.0	0	0.0	-	-	-	-	-	-	-	-
Social Infrastructure	229.2	26.8	6	27.3	1	5	-	-	-	6	-	-
Transport and Communications	249.9	29.2	4	18.2	-	4	-	-	-	4	-	-
Others/Multisector		0.0		0.0	-	-	-	-	-	-	-	-
Total	854.8	100.0	22	100.0	1	20	1	0	0	22	0	0

B. Disbursements	OCR	ADF	Total
(1) Total funds available for withdrawal (\$ mn, active loans only)	0.0	731.6	731.6
(2) Disbursed amount (\$ mn, cumulative, active loans only)	0.0	267.8	267.8
(3) Percentage disbursed [(2)/(1)] (%)	0.0	36.6	36.6
(4) Disbursements (\$mn, active loans only, latest year)	0.0	98.2	98.2
(5) Disbursement ratio (%) ^b	0.0	17.9	17.9

C. Net Transfer of Resources ^c (\$ million)	OCR	ADF	Total
Net transfer in 1995	-	66.5	66.5
Net transfer in 1996	-	126.9	126.9
Net transfer in 1997	5.0	66.0	71.0
Net transfer in 1998	-0.47	92.9	92.4
Net transfer in 1999	4.40	68.0	72.4

D. Post-Evaluated Projects (By Year of Loan Approval)	1968 - 1977		1978 - 1987		1988 - 1998		1968 - 1998	
	No.	%	No.	%	No.	%	No.	%
1. Postevaluation Rating (as of 31 December 1999)								
Rated Generally Successful (GS)	5	50.0	8	47.1	0	0.0	13	44.8
Rated Partly Successful (PS)	3	30.0	8	47.1	2	100.0	13	44.8
Rated Unsuccessful (US)	2	20.0	1	5.9	0	0.0	3	10.3
No Rating	0	0.0	0	0.0	0	0.0	0	0.0
Total	10	100.0	17	100.0	2	100.0	29	100.0
2. Postevaluation Rating by Sector (as of 31 December 1999)								
	GS	PS	US	NR	Total			
	No. %	No. %	No. %	No. %	No. %			
Agriculture and Natural Resources	4 30.8	10 76.9	3 100.0	0 0.0	17 58.6			
Energy	4 30.8	1 7.7	0 0.0	0 0.0	5 17.2			
Finance and Industry	3 23.1	2 15.4	0 0.0	0 0.0	5 17.2			
Social Infrastructure	1 7.7	0 0.0	0 0.0	0 0.0	1 3.4			
Transport and Communications	1 7.7	0 0.0	0 0.0	0 0.0	1 3.4			
Others/Multisector	0 0.0	0 0.0	0 0.0	0 0.0	0 0.0			
Total	13 100.0	13 100.0	3 100.0	0 0.0	29 100.0			

^a HS: Highly satisfactory; S: Satisfactory; PS: Partially satisfactory; U: Unsatisfactory

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

^c Includes private sector projects for countries with private sector operations.

Source : Programs (A), CTD (B & C), OEO (D)

PORTFOLIO PERFORMANCE
PORTFOLIO PERFORMANCE

Table 2: Status of Project Implementation
Public Sector Projects Only
(As of 31 December 1999)

Sector a/	Ln No.	Project Name	Net Ln Amt (\$Mn)	Loan Approval Date	Loan Effectivity Date	Closing Date		Physical Progress (%)	Cumulative Contracts Awards (\$Mn)	Cumulative Disbursement Amt. (\$Mn)	Project Performance Rating ^{b/}	
						Original Ln Clsng Date	Revised Ln Clsng Date				Implement Progress	Development Objective
		Agriculture										
AGR	1128	1 Southern Province Rural Dev.	39.33	Nov-91	Feb-92	Dec-99	-	85%	35.709	36.380	S	S
AGR	1166	2 Northwest Prov. Water Res. Dev.	18.431	Jun-92	Sep-92	Dec-99	Jun-00	96%	15.817	16.248	S	S
AGR	1402	3 Plantation Reform Program	56.208	Nov-95	May-96	Dec-02	-	48%	44.945	33.048	S	S
AGR	1462	4 NCP Rural Development	18.819	Sep-96	Feb-97	Jun-04	-	39%	6.637	7.302	S	S
AGR	1552	5 Second Perennial Crops	20.269	Sep-97	Aug-98	Jun-04	-	11%	1.480	2.917	S	S
AGR	1639	6 Tea Development	36.131	Nov-98	nye	Jun-05	-	3%	0.229	1.672	S	S
AGR	1183	7 Participatory Forestry	8.086	Nov-92	Aug-93	Jun-99	Jun-00	99%	7.299	7.308	S	S
AGR	1201	8 Fisheries Sector	26.128	Dec-92	May-93	Dec-99	Dec-00	82%	24.719	23.774	S	S
AGR	1545	9 Upper Watershed Mgt.	16.807	Sep-97	May-98	Dec-04	-	15%	1.624	0.848	S	S
AGR	1716	10 Coastal Resource Management	39.562	Dec-99	-	Dec-05	-	0%	0.000	0.000	S	S
		Subtotal	279.771						138.459	129.497		
SOC	1575	11 Third Water Supply & Sanitation	75.437	Nov-97	Jul-98	Jun-05	-	15%	5.635	2.605	S	S
SOC	1632	12 Urban Dev't and Low Income Housing	72.53	Sep-98	nye	Jun-05	-	15%	3.274	2.857	S	S
SOC	1247	13 Secondary Education Dev.	30.702	Aug-93	Nov-93	Jun-99	Dec-00	100%	29.929	30.052	HS	S
SOC	1275	14 Financial Mgt Training	11.484	Nov-93	Apr-94	Mar-99	Jun-99	100%	11.519	11.484	S	S
SOC	1535	15 Science & Technology Personnel	20.199	Sep-97	Jun-98	Jun-03	-	20%	0.431	0.897	S	S
SOC	1707	16 Skills Development	18.848	Oct-99	Mar-99	Oct-06	-	0%	0.000	0.000	S	S
		Subtotal	229.200						50.788	47.895		
T&C	1312	19 Third Road Improvement	52.602	Sep-94	Jul-95	Dec-99	Dec-01	55%	47.153	28.154	S	S
T&C	1567	20 Southern Provincial Roads Improv	30.266	Oct-97	Apr-98	Dec-03	-	6%	11.584	4.135	S	S
T&C	1649	21 Road Network Improvement	77.97	Dec-98	nye	Jun-05	-	0%	3.814	0.734	S	S
T&C	1711	21 Southern Transport Devevelopment	89.072	Nov-99	-	Dec-06	-	0%	0.000	0.000	S	S
		Subtotal	249.910						62.551	33.023		
ENE	1414	22 Power System Exp. Sector II	73.342	Dec-95	Jun-96	Dec-00	-	35%	54.361	35.752	PS	S
ENE	1438	23 Emergency Rehab of Petroleum Facilities	22.546	May-96	Jul-96	Dec-99	-	95%	21.947	21.626	S	S
		Subtotal	95.888						76.308	57.378		
		Total	854.769						328.106	267.793		

^a Sector: AGR: Agriculture & Natural Resources; ENE: Energy; F&I: Finance and Industry; T&C: Transport and Communications

^b HS: Highly satisfactory; S: Satisfactory; PS: Partially satisfactory; U: Unsatisfactory

Note: 6 loans closed during the 1999 with cumulative disbursements of \$207.062 million and 1999 disbursements of \$16.072 million

SRI LANKA
OVERALL EXTERNAL ASSISTANCE ^a

in \$ million

External Source	1994 - 1998 (Annual Average)		1999 Approvals	
	Loan	Grant	Loan	Grant
A. Multilateral Assistance				
ADB	131.5	3.7	148.8	7.2
EU	2.3	2.2	-	-
FAO	-	0.2	11.1	0.3
IFAD	2.8	-	-	-
Nordic Development Fund	-	-	14.0	-
UN Group	-	14.0	-	5.3
World Bank Group (IDA, IBRD)	75.4	2.3	57.4	0.4
Subtotal (A)	211.9	22.4	231.3	13.2
B. Bilateral Assistance				
Australia	-	4.4	-	1.5
Canada	-	2.2	-	-
China, People's Republic of	1.0	1.0	-	-
Finland	3.7	-	-	-
France	2.9	-	-	-
Germany	28.5	11.7	37.5	10.6
India	5.3	-	-	-
Japan	331.0	58.2	206.7	23.1
Korea, Republic of	24.0	1.0	-	-
Kuwait	16.8	-	12.0	-
Netherlands	8.5	8.8	-	-
Norway	11.3	8.2	-	-
Sweden	8.6	0.2	-	2.6
United Kingdom	5.0	5.5	-	-
United States	45.5	32.9	-	9.9
New Zealand	-	-	-	0.3
Subtotal (B)	492.1	134.1	256.2	48.0
Total (A + B)	704.0	156.5	487.5	61.2
Memo Items:				
External Assistance as % of Current Expenditures in 1999 was 18.8%.				
External Assistance as % of Capital Expenditures in 1999 was 27.6%.				

^a Data based on the dates of agreements signed between the Government and the donors.
Source: External Resources Department, Ministry of Finance and Planning

SRI LANKA
LENDING PIPELINE AND TECHNICAL ASSISTANCE PROGRAM, 2001-2003

Sector/Project Name	Poverty Classification ^{a*}	Cross-cutting Operational Priority ^{b*}	Projects Division	PPTA Year	PROJECT COST (\$ million)					
					TOTAL	Bank			Govern-ment ^{b/}	Co-f'cing Reqmnt.
						OCR	ADF	Total		
2001 LOAN PIPELINE										
Agriculture and Natural Resources										
1 Southern Province Rural Economic Advancement (Sector)	CPI	ENV	AWAR	1999	39	0	30	30	9	tbd
Subtotal					39	0	30	30	9	tbd
Energy										
2 Power Sector Development Program	ODI/CPI	PSD	IWEN	1998	221	40	45	85	66	70
Subtotal					221	40	45	85	66	70
Transport										
3 Road Sector Development (Provincial Roads)	PI	PSD	IWTC	1997	129	0	40	40	39	50
Subtotal					129	0	40	40	39	50
Industry and Finance										
4 Small-Medium Enterprise Support for Employment Generation and Poverty Reduction	CPI	PSD	IWFI	2000	181	50	15	65	26	90 (com'l)
Subtotal					181	50	15	65	26	90
Total					570	90	130	220	140	210
2002 LOAN PIPELINE										
Agriculture and Natural Resources										
1 Eastern Province Coastal Community Development	CPI	ENV	AWFN	2000	29	0	20	20	9	20
2 Export Diversification of Plantation Sector	ODI	PSD	AWAR	2000	58	0	20	20	8	30
Subtotal					87	0	40	40	17	50
Social Infrastructure										
3 Secondary Towns Water Supply and Sanitation	CPI	HD	AWWU	2000	57	0	40	40	17	tbd
4 Postsecondary Education Development	CPI	HD	AWEH	2000	76	0	30	30	26	20
Subtotal					133	0	70	70	43	20
Transport										
5 Road Sector Development (Program)	ODI	PSD	IWTC	2000	114	0	40	40	24	50
Subtotal					114	0	40	40	24	30
Other										
6 Public Administration Reform/Decentralization (Program)	ODI	GG	PW1	2001	29	0	20	20	9	tbd
Subtotal					29	0	20	20	9	tbd
Total					363	0	170	170	93	100
2003 FIRM LOANS										
Agriculture and Natural Resources										
1 Rural Finance Sector Development	CPI	ENV	AWAR	2001	86	30	30	60	26	tbd
2 Sustainable Eco-Management	PI	ENV	AWFN	2001	66	0	50	50	16	tbd
Subtotal					152	30	80	110	42	tbd
Social Infrastructure										
3 Secondary Towns Infrastructure Improvement	CPI	HD	AWWU	2001	58	0	40	40	18	tbd
Subtotal					58	0	40	40	18	tbd
Transport										
4 Colombo Port South Harbor Development ^c	ODI	PSD	IWTC	1999	tbd	30	30	60	tbd	tbd
Subtotal					60	30	30	60	0	tbd
Total					270	60	150	210	60	tbd
2003 STANDBY LOAN										
Transport										
5 Road Sector Development II (Program)	ODI	PSD	IWTC	2000	80	10	40	50	30	tbd

^a CPI=Core Poverty Intervention, PI=Poverty Intervention, and ODI=Other Development Interventions.

^b ENV= Environmental Protection; GAD = Gender and Development; GG = Good Governance; HD = Human Development; PSD = Private Sector Development and RC = Regional Cooperation

^c Amount indicated is preliminary.

* This classification was completed prior to the finalization of the improved and redesigned system in December 2000, which will be applied in 2001.

SRI LANKA
LENDING PIPELINE AND TECHNICAL ASSISTANCE PROGRAM, 2001-2003 ^{a/}

Sector/Project Name	Responsible Division	Type of TA	Amount (\$ '000)		
			Bank	Others	Total
2001 TECHNICAL ASSISTANCE PROGRAM					
Agriculture and Natural Resources					
1 Capacity Building for Natural Resources Management	AWFN	ADTA	1,500		1,500
2 Aquatic Resource Development and Quality Improvement	AWFN	PPTA	800		800
3 Cleaner Production	ENVD	ADTA	800	-	800
4 Rural Finance Sector Development	AWAR	PPTA	800		800
	Subtotal		3,900		3,900
Social Infrastructure					
5 Secondary Towns Infrastructure Improvement	AWWU	PPTA	800	-	800
6 Strengthening of Regulatory Framework in Water Supply and Sanitation	AWWU	ADTA	500	-	500
	Subtotal		1,300		1,300
Industry and Finance					
7 Institutional Support for Financial Sector Development	IWFI	ADTA	1,000	-	1,000
	Subtotal		1,000		1,000
Energy					
8 Study of Pricing Policy in the Petroleum Subsector	IWEN	ADTA	150	-	150
	Subtotal		150		150
Other					
9 Action Plan for Public Administration Reform/Decentralization	PW1	PPTA	800		800
10 Capacity Strengthening of Procurement Support Bureau	IWTC	ADTA	600	-	600
	Subtotal		1,400		1,400
Total			7,750		7,750
2002 TECHNICAL ASSISTANCE PROGRAM					
Agriculture and Natural Resources					
1 River Basin Management	AWFN	PPTA	1,000	-	1,000
2 Integrated Protected Area Management	AWFN	PPTA	1,000	-	1,000
3 Sustainable Eco-Management	AWFN	PPTA	1,500	-	1,500
4 Institutional Strengthening of EIA at Provincial Level	ENVD	ADTA	600	-	600
5 Cleaner Production	IWFI	PPTA	850	-	850
	Subtotal		4,950		4,950
Social Infrastructure					
6 Housing Finance	AWWU	PPTA	500	-	500
	Subtotal		500		500
Energy					
7 Integrated Energy Sector Masterplan	IWEN	ADTA	1,000	-	1,000
	Subtotal		1,000		1,000
Other					
8 Training in Project Contract Management	COPP	ADTA	500	-	500
	Subtotal		500		500
Total			6,950		6,950
2003 TECHNICAL ASSISTANCE PROGRAM					
Agriculture and Natural Resources					
1 Support for Micro Finance Development	AWAR	ADTA	500		500
2 Institutional Support for Sustainable Eco-Management	AWFN	ADTA	800		800
	Subtotal		1,300		1,300
Social Infrastructure					
3 Secondary Education Modernization II	AWEH	PPTA	500	-	500
	Subtotal		500		500
Industry and Finance					
4 Financial Sector Development	IWFI	PPTA	800	-	800
	Subtotal		800		800
Transport					
5 Road Sector Management	IWTC	ADTA	800		800
	Subtotal		800		800
Energy					
6 Rural Electrification	IWEN	PPTA	500	-	500
7 Petroleum Subsector Development	IWEN	PPTA	1,000	-	1,000
	Subtotal		1,500		1,500
Total			4,900		4,900

a/ Although the proposed TA program has been generally agreed upon by Management, ADB financing may be subject to further reprioritization to fit in with the ADB-wide annual resource envelope.

SRI LANKA
FIRM LENDING PROGRAM, 2001-2003
BY POVERTY CLASSIFICATION, CROSSCUTTING OPERATIONAL PRIORITY AND SECTOR

Classification	2001		2002-2003	
	No.	% ^a	No.	% ^a
I. By Poverty Classification*				
A. Core Poverty Intervention	1	50	1	50
B. Poverty Intervention (Non-core)	-	-	1	50
C. Other Development Interventions	1	50	-	-
Total	2	100	2	100
II. By Crosscutting Operational Priority*				
A. Environment	1	50	-	-
B. Gender and Development	-	-	-	-
C. Good Governance	1	50	-	-
D. Human Development	-	-	2	100
E. Private Sector Development	-	-	-	-
F. Regional Cooperation	-	-	-	-
Total	2	100	2	100
III. By Sector				
A. Agriculture and Natural Resources	-	-	-	-
B. Energy	1	50	-	-
C. Industry	-	-	-	-
D. Finance	-	-	-	-
E. Transport and Communications	-	-	-	-
F. Social Infrastructure	1	50	2	100
G. Others/Multisector	-	-	-	-
Total	2	100	2	100

^a rounded off.

* This classification was completed prior to the finalization of the improved and redesigned classification system in December 2000, which will be applied from January 2001.

SRI LANKA

PROJECT PROFILE					
1. Project Name: Southern Province Rural Economic Advancement Project			2. Sector/Subsector: Rural Development		
3. Poverty Classification: ^a * CPI			4. Crosscutting Operational Priority: ^b * ENV		
5. Rationale & Objectives: Despite generally high level of social and economic development in the country, the Southern Province remains one of the most poverty-stricken areas. Development of this province requires more active participation of the private sector to create sustainable employment and incomes for the poor households. For this purpose it is necessary to promote rural farm and nonfarm enterprises through greater public-private sector cooperation. It is also necessary to address specific constraints of infrastructure and capacities of relevant agencies to ensure sustainable development. The objective of the project is to promote broad-based development to reduce poverty.			6. Beneficiary Participation/Consultation Needs: The Project will be formulated in close consultation with potential beneficiaries and other stakeholders including the Southern Area Development Authority and NGOs active in economic development of the province.		
7. Scope: The Project scope will include (i) development of rural infrastructure; (ii) improvement of support services for small farm and non-farm activities; and (iii) institutional strengthening. The scope will be refined on the basis of the PPTA.					
8. Estimated Cost & Financing Plan:			Remarks: PPTA for this Project was approved in December 1999. The PPTA will be completed during 2000 and lessons of the Southern Province Rural Development Project will be fully taken into account in the Project design.		
Loan Project Cost (\$m)					
Financing (Source)	FC	LC			Total
ADB					30.0
Co-financing					tbd
Borrower					9.0
Sub-borrowers					-
Total			39.0		
9. Estimated Benefits and Beneficiary Groups: Low income households in the Province will be the major beneficiaries of the Project. Women are expected to be a major category of beneficiary groups. The Project is also expected to benefit the youth who currently suffer from high unemployment.					
10. Executing Agency: The Ministry of Plan Implementation and Parliamentary Affairs			11. Project Implementation Period: Start: 2001 End: 2005		
12. Environment Category:			13. Processing Year: 2001		

^a CPI = Core Poverty Intervention; PI = Poverty Intervention; ODI = Other Development Interventions

^b ENV = Environmental Protection; GAD = Gender and Development; GG = Good Governance; HD = Human Development; PSD=Private Sector Development and RC = Regional Cooperation

* This classification was completed prior to the finalization of the improved and redesigned system in December 2000, which will be applied in 2001.

SRI LANKA

PROJECT PROFILE					
1. Project Name: Power Sector Development (Program)			2. Sector/Subsector: Energy/Power		
3. Poverty Classification: ^{a*} ODI/CPI			4. Crosscutting Operational Priority: ^{b*} PSD		
5. Rationale & Objectives: The Government confirmed the need for, and its commitment to sector reforms to ensure adequate and reliable power supplies at competitive price through increased private sector participation and improvement management and operational efficiencies. The Government has also accorded highest priority through continued public sector investments to ensure the access of poor to adequate supply of electricity, given the fact that currently 60-75 percent of the population in six provinces (excluding the North Eastern Province) has no access to electricity.			6. Beneficiary Participation/Consultation Needs: The Project will be formulated in close consultation with concerned government agencies, rural communities and stakeholders, among others.		
7. Scope: The scope of the Project will include (i) restructuring of Ceylon Electric Board; and (ii) establishment of the power regulator. The Project will include physical investments to generate and transmit electricity to identified rural area, supported by necessary regulatory and cost recovery mechanisms.					
8. Estimated Cost & Financing Plan:			Remarks:		
Loan Project Cost (\$m)					
Financing (Source)	FC	LC			Total
ADB					85.0
Co-financing					70.0
Borrower					66.0
Sub-borrowers					-
Total			221.0		
9. Estimated Benefits and Beneficiary Groups: All electricity consumers in the country will benefit from the additional electricity supplied by the Project at competitive price. The Project will benefit rural communities who will be connected to the grid through the Project.					
10. Executing Agency: Ceylon Electricity Board			11. Project Implementation Period: Start: 2001 End: tbd		
12. Environment Category: A			13. Processing Year: 2001		

^a CPI = Core Poverty Intervention; PI = Poverty Intervention; ODI= Other Development Interventions

^b ENV = Environmental Protection; GAD = Gender and Development; GG = Good Governance; HD = Human Development; PSD=Private Sector Development and RC = Regional Cooperation

* This classification was completed prior to finalization of the improved and redesigned system in December 2000, which will be applied in 2001.

SRI LANKA

PROJECT PROFILE					
1. Project Name: Roads Sector Development (Provincial Roads)			2. Sector/Subsector: Transport/Roads		
3. Poverty Classification: ^{a*} PI			4. Crosscutting Operational Priority: ^{b*} PSD		
5. Rationale & Objectives: To assist the Government to reduce total road transport costs in the selected provinces of Sri Lanka by rehabilitating secondary roads and implement of institutional and maintenance reform program.			6. Beneficiary Participation/Consultation Needs: Consultation will be required with both Central Provincial Government agencies as well as local authorities, utilities, land owners and the public in the project influence areas.		
7. Scope: The investment of the Project will include rehabilitation of secondary (class C and D) roads through small civil works contracts to facilitate building up the capacity of local private sector contractors to execute roadworks. The Project will also address policy reforms including implementation of institutional and maintenance reform program being developed under on-going Road Sector Reengineering ADTA, institutional strengthening of Provincial Councils roads function, and committing the Government to sector-wide reforms to be developed under Road Sector Management ADTA (2000).					
8. Estimated Cost & Financing Plan:			Remarks: Project size and scope are preliminary pending outcome of PPTA. Project to include policy development initiatives designed to ensure the sustainability of provincial road network.		
Loan Project Cost (\$m)					
Financing (Source)	FC	LC			Total
ADB					40.0
Co-financing					50.0
Borrower					39.0
Sub-borrowers					-
Total			129.0		
9. Estimated Benefits and Beneficiary Groups: Road users, road transport operators, other people and enterprises in the project influence areas who will have improved farm-to-market road access and improved opportunities to benefit from economic development and social facilities accessible via secondary roads.					
10. Executing Agency: Ministry of Provincial Councils and Local Government Provincial Councils Provincial RDAs			11. Project Implementation Period: Start: 2001 End: 2004		
12. Environment Category: A/B			13. Processing Year: 2001		

^a CPI = Core Poverty Intervention; PI = Poverty Intervention; ODI = Other Development Interventions

^b ENV = Environmental Protection; GAD = Gender and Development; GG = Good Governance; HD = Human Development; PSD=Private Sector Development and RC = Regional Cooperation

* This classification was completed prior to the finalization of the improved and redesigned system in December 2000, which will be applied in 2001.

SRI LANKA

PROJECT PROFILE					
1. Project Name: Small-Medium Enterprise Support for Employment Generation and Poverty Reduction			2. Sector/Subsector: Finance		
3. Poverty Classification: ^{a*} CPI			4. Crosscutting Operational Priority: ^{b*} PSD		
5. Rationale & Objectives: The Project's basic aim is to create employment opportunities for the poor and thus reduce poverty in the semi-rural and rural areas through the generation of investments in small and medium enterprises. It will also aim to improve the policy framework within which the small and medium enterprises operate, ensure appropriate technology transfer, provide adequate research and extension services, introduce modern management system and adequate forward and backward linkages with manufacturing sectors.			6. Beneficiary Participation/Consultation Needs: - Private Sector - Small and Medium Enterprises - NGOs, RDBs and commercial banks		
7. Scope: An essential component of the Project will be a credit line to the small and medium enterprises sector. A number of qualified banks will be assisted to borrow long-term money from international capital market to finance these enterprises and to expand credit outreach to underserved private sector business through active participation of selected non-governmental organizations, rural development banks, and commercial banks.					
8. Estimated Cost & Financing Plan:			Remarks: Careful assessment should be undertaken to the proposal, especially in terms of: (i) absorptive capacity of borrowers; (ii) appropriate mechanisms for foreign exchange cover under the facility; (iii) total cost of the funds; (iv) impact on improving Sri Lanka's access to the international capital market; and (iv) consistency with overall financial and capital market policies.		
Loan Project Cost (\$m)					
Financing (Source)	FC	LC			Total
ADB					65.0
Co-financing					90.0
Borrower					26.0
Sub-borrowers			-		
Total			181.0		
9. Estimated Benefits and Beneficiary Groups: The Project will generate investments in small and medium enterprises, which will assist generate employment and reduce poverty.					
10. Executing Agency: National Development Bank of Sri Lanka (NDBSL) Development Finance Corporation of Ceylon (DFCC)			11. Project Implementation Period: Start: 2001 End: tbd		
12. Environment Category: C			13. Processing Year: 2001		

^a CPI = Core Poverty Intervention; PI = Poverty Intervention; ODI = Other Development Interventions

^d ENV = Environmental Protection; GAD = Gender and Development; GG = Good Governance; HD = Human Development; PSD=Private Sector Development and RC = Regional Cooperation

* This classification was completed prior to the finalization of the improved and redesigned system in December 2000, which will be applied in 2001.