



# Country Operations Business Plan

---

February 2008

Sri Lanka  
2008

Asian Development Bank

## CURRENCY EQUIVALENTS

(as of 29 January 2008)

Currency Unit	–	Sri Lankan rupee (SLRe/SLRs)
SLRe1.00	=	\$ 0.01
\$1.00	=	SLRs 107.9

## ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
CEB	–	Ceylon Electricity Board
CSP	–	country strategy and program
CPS	–	country partnership strategy
GDP	–	gross domestic product
LTTE	–	Liberation Tigers of Tamil Eelam
MDG	–	Millennium Development Goal
OCR	–	ordinary capital resources
PUC	–	Public Utility Commission
TA	–	technical assistance

## NOTE

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

<b>Vice President</b>	L. Jin, Operations 1
<b>Director General</b>	K. Senga, South Asia Department (SARD)
<b>Director</b>	R. Vokes, Country Director, Sri Lanka Resident Mission, SARD
<b>Team Leader</b>	J. Boestel, Economist, SARD

## CONTENTS

	<b>Page</b>
I. CONSISTENCY OF BUSINESS PLAN WITH CURRENT COUNTRY STRATEGY AND PROGRAM	1
II. INDICATIVE LENDING AND NONLENDING PROGRAMS	2
III. SUMMARY OF CHANGES TO LENDING AND NONLENDING PROGRAMS	3
IV. INDICATIVE RESOURCE REQUIREMENTS	3
V. RESULTS-BASED MONITORING	4

### TABLES

1. Indicative Assistance Pipeline for Lending Products, 2008	5
2. Indicative Assistance Pipeline for Non-Lending Products and Services, 2008	6
3. Summary Information on Proposed Indicative Lending Products and Services for 2008	7
4. Summary Information on Proposed Indicative Non-Lending Products and Services for 2008	9

## I. CONSISTENCY OF BUSINESS PLAN WITH CURRENT COUNTRY STRATEGY AND PROGRAM

1. The country strategy and program (CSP)<sup>1</sup> presented to the Asian Development Bank (ADB) Board in 2003 was formulated in parallel with the Government's "Regaining Sri Lanka" poverty reduction strategy. The core sectors of the CSP are transport, education, water supply and sanitation, energy, and rural development (small and medium-sized enterprises and agriculture). A new Government, voted into power in November 2005, presented a substantial working paper entitled *Mahinda Chintana: Vision for a New Sri Lanka*<sup>2</sup> at a development forum in January 2007. This new 10-year development plan will be an important basis for ADB's new country partnership strategy (CPS), which is being prepared. Reflecting the uncertainty created by the resurgence of conflict since 2006, the new CPS will cover 3 years rather than 5. In the Eastern province, the Government has reestablished control over areas that had been under control of the Liberation Tigers of Tamil Eelam (LTTE) for 10 years or more. This presents urgent new development opportunities as well as challenges. The Government is in the process of medium-term development plans for the Eastern province. Under its development program for the East, the government has already launched a 180 day program for the restoration of civil administration and service delivery systems<sup>3</sup> and has drafted a medium term development plan for the region. On 16 January 2008, the Government formally withdrew from the Ceasefire Agreement signed with the Liberation Tigers of Tamil Eelam six years earlier. While the Government continues to pursue military operations against the LTTE, it has also restated its commitment to a political settlement. On 23 January 2008 the Government announced interim proposals, based on the implementation of the 13<sup>th</sup> Amendment to the Constitution. The possible implications on the overall economic environment and ADB's operations will be discussed in a Board Information Paper under preparation by the Sri Lanka Resident Mission. As a result of these new developments, the CPS is now scheduled to be presented to the Board in 2008. As such, a country operations business plan covering only 2008 is being prepared to avoid the pre-commitment of resources before the CPS is completed.

2. This business plan is in line with the 10-year development plan of the Government. It emphasizes faster growth by increasing investment and reducing the "infrastructure deficit". The Government's development plan aims to spread development to rural and other underdeveloped areas to achieve the Millennium Development Goals (MDGs), and reduce regional inequality and income poverty. Sri Lanka is well-placed to achieve most MDGs. The country will be able to halve income poverty, provided the income gap between the richest and the poorest does not widen, as it did in 1990–2001. However, some concerns remain about whether the targets for child malnutrition and environmental sustainability will be achieved. To achieve rural development, the Government is emphasizing large infrastructure projects, including highways, ports, and airports, to link the rural economy to international markets. While remaining committed to public–private partnerships, the Government sees a greater role for the state in promoting economic growth. In the Government's budget, public investment (excluding tsunami-related expenditure) is projected to reach 7% of gross domestic product (GDP) in 2007. Plans to reduce rural poverty include (i) helping farmers market their products by strengthening links between producers and sellers; (ii) large tax incentives for companies to shift their production bases to the rural provinces, a program rapidly taken up by the private sector; and

---

<sup>1</sup> ADB. 2003. *Country Strategy and Program (2004–2008): Socialist Republic of Sri Lanka*. Manila.

<sup>2</sup> This was the Election Manifesto of the President, which was later developed into the Government's ten year development plan

<sup>3</sup> This program is called *Negenehira Navodaya*, or 'A New Dawn for the East', and was drawn up by the Ministry of Public Administration and Home Affairs.

(iii) the large and ambitious *Gama Neguma (uplifting of villages)*, a comprehensive village development program.

## II. INDICATIVE LENDING AND NONLENDING PROGRAMS

3. The business plan covers one year since the new CPS under preparation is expected to be presented for Board consideration in 2008. ADB's tentative commitment for 2008 is \$265 million, of which \$67 million is from the Asian Development Fund (ADF) and \$198 million is from ordinary capital resources (OCR). The 2008 pipeline responds to the identified infrastructure gaps, especially in the power sector, where ADB also will support reforms. The planned Small Towns and Rural Arid Areas Water Supply and Sanitation Project will improve the lives of people in less-developed areas of the country, including the conflict-affected areas of Mannar and Vavuniya, by rehabilitating and improving drinking water facilities. The Greater Colombo Waste Water Project, a large infrastructure project, slipped from 2007.

4. The resurgent conflict has severely compromised projects in the north and east of the country, as the transport of key construction material to those regions has become increasingly difficult. Contractors also have been reluctant to work in these areas. While Government offices remain open and staffed (even within LTTE-controlled areas), the tender process for some infrastructure projects was postponed due to security concerns. Since July 2007, the number and volume of proposed subprojects approved by a coordinating committee in Trincomalee for the Eastern province has increased significantly. The Government also has started to issue tenders for larger-scale infrastructure projects that were committed under existing ADB-supported projects.

5. While the second tranche of the Power Sector Development Program<sup>4</sup> loan was canceled in June 2006, the reform process has regained some momentum. The Government has decided to restructure the Ceylon Electricity Board (CEB) separately from the regulatory reform. In addition, the cabinet is being presented with amended legislation that would allow the Public Utilities Commission to regulate tariffs and issue licenses to CEB and other utilities. Work on two key power generation projects, in the pipeline for up to two decades, has finally gone ahead. Once completed, these will bring on stream badly needed base load capacity by 2011 or 2012. Investments are required to increase generation capacity, as well as to strengthen and expand the transmission system and distribution network (including rural electrification). To support the momentum in regulatory reforms, ADB will assist the power sector in Sri Lanka with the Sustainable Power Sector Development Project I in 2008.

6. The size of OCR lending is compatible with the Government's debt strategy and safe prudential limits, as well as the results of an ADB debt sustainability analysis finalized in July 2007. Projects with a strong payback capacity and economic rationale will be financed through OCR lending. Nonsovereign lending (to state-owned enterprises, for example) will be explored more fully as part of the new CPS preparations. OCR needs to be allocated strategically to projects that have a significant impact on economic growth. ADB will assess whether the projects it supports can deliver the expected economic returns, and are conflict sensitive. As a result of having to work in "conflict" and "post-conflict" situations, ADB is developing operating

---

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

guidelines that will apply to projects in conflict-affected areas. ADB's resident mission is also in the process of recruiting a post-conflict advisor.<sup>5</sup>

7. The country-specific ADF allocation was based on the results of the 2005 country performance assessment, after applying the performance-based allocation formula. For 2008, the ADF allocation for Sri Lanka is expected to be about \$67 million. ADF resources are allocated to water supply and sanitation projects (\$63 million), including some in conflict-affected areas. ADF resources also are to be used to expand power connections from the grid to poor households, including in the Eastern province, building on a successful and innovative project funded by the Japan Fund for Poverty Reduction (JFPR) that liaised with microfinance institutions and CEB to enable poorer households to take out loans to pay for their electricity connection. An additional \$2 million in ADF funds will be lent to the Bank of Ceylon to strengthen its project appraisal capacity. The nonlending technical assistance (TA) level has increased to \$3.5 million, supporting (i) new Government initiatives in energy; (ii) a more coordinated approach in planning rural and provincial roads to ensure they link up to the National Road Master Plan; (iii) feasibility studies for improved service delivery and infrastructure in the water sector in Sabaragamuwa Province; and (iv) strengthening of the Government's ability to preserve and manage macroeconomic stability, while enhancing service delivery management in selected sectors.

### **III. SUMMARY OF CHANGES TO LENDING AND NONLENDING PROGRAMS**

8. Changes to the lending program are mostly to reflect the new strategy of the Government and the introduction of agreed upon project readiness criteria. The approval of the supplementary loan for the Southern Transport Development Project has slipped from 2007 to early 2008, while Greater Colombo Waste Water Project has been moved to stand-by in 2008, given complex legal issues that might take longer than expected to resolve. The Agribusiness Development Project and Rural Finance Phase II have been removed to accommodate the new priorities of the Government in light of a smaller-than-expected resource envelope. The loan size for the Road Sector Network Project has been increased, but it has been moved to 2009 to allow ongoing loans to be fully implemented. The Sustainable Power Sector Development Project I is a new project, introduced for reasons outlined in paragraph 5. The advisory TA pipeline, which is both substantial and new, aims to assist the Government in strengthening the capacity of the Public Utility Commission to fulfill its functions as a utility regulator, as well as promote improved planning consistency in the road sector and service delivery in the water sector. For 2009 and beyond, ADB and the Government will explore new ways to build capacity, including the possibility of setting up of a TA grant fund. As these modes are also new to ADB, they will have to go through an internal review.

### **IV. INDICATIVE RESOURCE REQUIREMENTS**

9. About 64 person-months (of staff time) will be needed to process the loan and TA projects in the 1-year business plan.

---

<sup>5</sup> This will be financed by several development partners linked to the Australia-ADB South Asia development partnership facility. The position was previously funded by the UK Department for International Development (DFID).

## **V. RESULTS-BASED MONITORING**

10. The 2003 CSP was not results-based, and its road maps had no medium-term goals and targets. The CPS to be presented to the Board in 2008 will be results-based, and regular reporting and updating will start in 2008.

**Table 1: Indicative Assistance Pipeline for Lending Products, 2008**

Sector Project/Program Name	Targeting Classifi- cation	Thematic Priority	Division	Year of Project Preparatory Assistance	Cost (\$ million)					Govt.	Cofin.	
					Total	OCR	ADB ADF		Total			
							Loans	Grants				HIV Grant
<b>2008 Firm Loans</b>												
<b>Transport</b>												
1. Southern Transport Development Project Supplementary Loan	GI	ECG/PSD			TBD	90.0				90.0		
<b>Subtotal</b>						<b>90.0</b>				<b>90.0</b>		
<b>Water Supply, Sanitation, and Waste Management</b>												
2. Small Towns and Rural Arid Areas Water Supply and Sanitation Project	TI	CD/ENV/ ISD	SAUD		TBD		44.5	18.5		63.0		
<b>Subtotal</b>					<b>TBD</b>		<b>44.5</b>	<b>18.5</b>		<b>163.0</b>		
<b>Energy</b>												
3. Sustainable Power Sector Development I	GI	ECG/PSD	SAEN		TBD	98.0	2.0			100.0		
<b>Subtotal</b>					<b>TBD</b>	<b>98.0</b>	<b>2.0</b>			<b>100.0</b>		
<b>Governance and Finance</b>												
4. Capacity Building for Bank of Ceylon		ECG/PSD					2.0			2.0		
<b>Subtotal</b>							<b>2.0</b>			<b>2.0</b>		
<b>Total</b>					<b>TBD</b>	<b>188.0</b>	<b>48.5</b>	<b>18.5</b>		<b>255.0</b>		
<b>2008 Standby Loans</b>												
5. Fiscal Management and Service Delivery Program	GI	CD/ECG/ GOV	SAGF		TBD	40.0				40.0		
6. Greater Colombo Waste Water Project	GI	CD/ENV/ GOV	SAUD		TBD	100.0				100.0	TBD	TBD

ADB = Asian Development Bank, ADF = Asian Development Fund, CD = capacity development, Cofin. = cofinancing, ECG = sustainable economic growth, ENV = environmental sustainability, GI = general intervention, GOV = governance, Govt. = Government, HIV = Human Immunodeficiency Virus, ISD = inclusive social development, OCR = ordinary capital resources, PSD = private sector development, SAEN = South Asia Energy Division, SAGF = South Asia Governance, Finance, and Trade Division, SATC = South Asia Transport and Communications Division, SAUD = South Asia Urban Development Division, TI = targeting intervention, TBD = to be determined.  
Source: ADB estimates.

**Table 2: Indicative Assistance Pipeline for Nonlending Products and Services, 2008**

Sector Assistance Name	Responsible Division	Assistance Type	Sources of Funding				Total (\$'000)
			ADB		Others		
			Source	Amount (\$'000)	Source	Amount (\$'000)	
<b>2008</b>							
<b>Energy</b>							
1. Capacity Building for Power Sector Regulation	SAEN	ADTA	TASF	1,000			1,000
<b>Subtotal</b>				<b>1,000</b>			<b>1,000</b>
<b>Water Supply, Sanitation and Waste Management</b>							
2. Institutional Strengthening for Decentralized Service Delivery in the Water Sector	SAUD	ADTA	TASF	700			700
3. Sabaragamuwa Water Supply		PPTA	JSF	700			700
<b>Subtotal</b>				<b>1,400</b>			<b>1,400</b>
<b>Finance and Governance</b>							
4. Fiscal Management Reform Project II	SAGF	PPTA	JSF	300			300
<b>Subtotal</b>				<b>300</b>			<b>300</b>
<b>Transport and Communications</b>							
5. Master Plan Provincial Road and Maga Neguma	SATC	ADTA	TASF	800			800
<b>Subtotal</b>				<b>800</b>			<b>800</b>
<b>Total</b>							<b>3,500</b>

ADB = Asian Development Bank, ADTA = advisory technical assistance, PPTA = project preparatory technical assistance, SAEN = South Asia Energy Division, SAGF = South Asia Governance, Finance and Trade Division, SANS = South Asia Agriculture, Natural Resources and Social Sector Division, SATC = South Asia Transport and Communications Division, SAUD = South Asia Urban Development Division, TASF = Technical Assistance Special Fund, JSF = Japan Special Fund.

Source: ADB estimates.

**Table 3: Summary Information on Proposed Indicative Lending Products and Services for 2008**

Project Name	Description
Sustainable Power Sector Development I	<p><b>Impact</b> Increased transmission capacity and affordable and reliable power supply for sustained economic growth</p> <p><b>Major Components</b> 1. Expansion and augmentation of grid substations in the Eastern, Southern, North Western, and Western provinces 2. Construction of system control center 3. Habarana–Valachchenai 132 kV T/L 4. Matara–Galle 132 kV T/L 5. Expansion and augmentation of 33/11 kV substation in Colombo area 6. Augmentation of grid substations associated with new small hydropower stations</p> <p><b>Expected Outputs and Outcomes</b> 1. Reduction of transmission technical loss and achievement of system reliability of internal standards 2. Promotion of clean energy development by removing grid constraints</p>
Greater Colombo Wastewater Project	<p><b>Impact</b> The Project focuses on delivering an investment package consisting of sewerage infrastructure facilities for Greater Colombo and institutional strengthening for improved operational and management performance.</p> <p><b>Major Components</b> The project is expected to have three components:</p> <ol style="list-style-type: none"> <li>1. Component 1 will cover (i) rehabilitation of sewerage infrastructure facilities in Colombo, (ii) expansion of the sewerage system in Colombo, and (iii) on-site sanitation in unsewered areas of Greater Colombo.</li> <li>2. Component 2 will provide institutional strengthening to (i) NWSDB to manage its capital assets, (ii) CMC to operate the sewerage system, and (iii) local authorities to introduce sustainable on-site sanitation.</li> <li>3. Component 3 will focus on project management.</li> </ol> <p><b>Expected Outputs and Outcomes</b> The Project will assist the Government in improving the living conditions of the urban population in Greater Colombo and minimizing the negative environmental impacts of increasing levels of domestic waste.</p>
Small Towns and Rural Arid Areas Water Supply and Sanitation Project	<p><b>Impact</b> The Project will facilitate sustainable development in disadvantaged districts in Sri Lanka.</p> <p><b>Major components</b> The Project encompasses the Northern and North Western provinces (towns of Chilaw, Puttalam, Vavuniya, and Mannar, as well as rural areas in these districts). It will combine water and sanitation infrastructure, and a soft component focusing on public awareness and community strengthening for operation and maintenance in rural areas.</p> <p><b>Expected Outputs and Outcomes</b> The Project will improve basic water supply and sanitation infrastructure and services in dry zone districts of Sri Lanka. It is expected to have three major outputs: (i) urban water supply and sanitation, (ii) rural water supply and sanitation, and (iii) institutional development. While the estimated size of the Project could exceed \$100 million, the current allocation requested is \$70 million.</p>

<p>Bank of Ceylon Capacity Building Loan</p>	<p><b>Impact</b> The impact of the loan will be the establishment of an infrastructure project finance unit to develop and gradually grow a portfolio of viable projects, while encouraging other banks to begin long-term project finance. Appropriate environmental and social safeguard policies also will be established, with particular reference to larger projects and customers.</p> <p><b>Major components</b> The main components will be (i) a dedicated project finance unit, and (ii) a dedicated SME program to assist BOC in developing new SME lending processes and introduce cash flow-based lending methodologies. While BOC is the proposed borrower, the Government would guarantee the loan.</p> <p><b>Expected Outputs and Outcomes</b> The loan will support improving BOC's governance and management structure, its risk management capacity through appropriate policies and systems. It will also help the bank effectively prepare for the prudential requirements associated with the forthcoming introduction of Basle 2 regulations by the Central Bank; and improve the outreach of commercial funding of viable SMEs with a particular emphasis of creating business and job opportunities through a dedicated SME finance unit and a cash flow-based lending approach.</p>
<p>Jaffna Water Supply and Sanitation Project</p>	<p><b>Impact</b> The Project is expected to improve the standard of living on the Jaffna peninsula.</p> <p><b>Major Components</b> The Project will have three components:</p> <ol style="list-style-type: none"> <li>1. Component 1 will cover the rehabilitation, expansion, and development of water and environmental infrastructure for the Jaffna peninsula, including (i) urban and rural water supply, (ii) sewerage and sanitation, and (iii) solid waste management for Jaffna city.</li> <li>2. Component 2 will strengthen water resource management in the Jaffna peninsula by providing the foundations to (i) operationalize a water management committee to coordinate, plan, and oversee monitoring activities in Jaffna; and (ii) increase public awareness.</li> <li>3. Component 3 will enhance implementation and management capacity of key institutions, and provide support for project management and implementation activities.</li> </ol> <p><b>Expected Outputs and Outcomes</b> The expected outcome of the Project is improved water protection and management in the same area. The Project concentrates on supporting the Government's efforts to meet the Millennium Development Goals in the Jaffna peninsula. The Project combines the three principal thrusts of policy support, capacity building, and infrastructure investment/improvement. It will focus on poverty reduction.</p>

**Table 4: Summary Information on Proposed Indicative Nonlending Products and Services for 2008**

Project Name	Description
Capacity building for the Power Sector Regulation	<p><b>Impact</b> The TA will aim to establish a competitive, commercially managed, financially viable, and efficient power sector by helping to functionalize a new sector regulatory framework by building the capacity of PUCSL to regulate the sector and of CEB to respond to regulatory requirements.</p> <p><b>Major Components</b> The TA will (i) provide hands-on support for licensing and tariff review by PUCSL, (ii) provide basic training for PUCSL staff and organize a study tour to regulators in the neighboring countries, (iii) support CEB in realigning its business process and reporting system to respond to regulatory requirement, and (iv) support CEB in its first tariff filing.</p> <p><b>Expected Outputs and Outcomes</b> The Project will support PUCSL to issue licenses to CEB and other utilities, and process the first tariff petition by PUCSL to CEB. It will also support the CEB to develop a new business processes and operations plan, and a financial data reporting system to be in line with regulatory requirements.</p>
Institutional Strengthening for Decentralized Service Delivery in the Water Sector	<p><b>Impact</b> The ADTA will improve service delivery performance in the water and sewerage sectors. To be prepared in support of NWSDB's corporate plan objectives, the ADTA will aim to support decentralization of planning, financial, and administrative activities to regional support centers (RSCs) and regional offices of NWSDB.</p> <p><b>Major Components</b> Major components will include</p> <ol style="list-style-type: none"> <li>1. Improving operational and financial performance</li> <li>2. Enhancing regional capacity</li> </ol> <p><b>Expected Outputs and Outcomes</b> The Project will assist the Government in improving management of the NWSDB activities envisaged, which include (i) RSCs' benchmarking; (ii) formulation of systems and guidelines to transfer given financial, planning, construction, and operational responsibilities to RSCs, and design and strengthening of monitoring and auditing functions at Colombo's main office; and (iii) training and capacity development at the local level.</p>
Sabaragamuwa Water Supply and Sanitation	<p><b>Impact</b> The PPTA will improve basic water supply and sanitation infrastructure and services in towns and rural areas of Sabaragamuwa Province.</p> <p><b>Major Components</b> The PPTA is expected to have a single component consisting of a feasibility study for integrated water supply and sanitation in small towns and rural areas of this province, which will be suitable for ADB financing and which emphasizes inclusive development and responds to needs expressed by the community regarding priority infrastructure.</p> <p><b>Expected Outputs and Outcomes</b> Phase I will consist of a detailed evaluation of the water supply and sanitation sector. The evaluation will (i) collect and review basic planning data, capabilities, and resources for development in four urban centers, emphasizing more deprived areas; (ii) assess sample ADB subprojects and identify lessons learned; (iii) initiate a socioeconomic assessment in identified target areas; (iv) map and analyze poverty data, the incidence of waterborne diseases, and the</p>

	<p>concentration of minority and disadvantaged groups; (v) undertake engineering field surveys and mapping to ascertain the condition of basic infrastructure and amenities, including collecting data on water and sanitation facilities; and (vi) identify priority urban and rural areas based on needs for improved coverage, and determine population projections and demand for services. Results will be analyzed and discussed at stakeholder consultations at the national and district levels.</p> <p>Phase II will (i) select and refine project-specific investment components in urban and rural areas; (ii) develop technical options acceptable to all stakeholders; and (iii) conduct economic and financial feasibility studies, environmental and social studies, and other documentation as required by ADB guidelines. An institutional development and capacity-building program will support prioritized infrastructure rehabilitation, augmentation, and development in selected towns, and will include a detailed nonrevenue water reduction program.</p>
Fiscal Management Reform Program 2	<p><b>Impact</b> The Program will strengthen the Government's ability to preserve and manage macroeconomic stability, while enhancing service delivery management in selected sectors.</p> <p><b>Major Components</b> The main components are (i) expenditure management, (ii) internal audit, and (iii) service delivery.</p> <p><b>Expected Outputs and Outcomes</b> The Project will result in better expenditure management, and internal audit. It will support performance budgeting at sub-national level of government strengthen institutional and regulatory framework for service delivery.</p>
Master Plan for Provincial Roads and a Framework for Rural Roads	<p>A 2008 master plan for provincial roads (PRs) and a framework for rural roads (RRs) will be aligned with <i>Maga Neguma</i> to ensure links of PRs and RRs into the National Road Master Plan through a TA of \$800,000.</p> <p><b>Impact</b> The impact of the TA will be sustainable nationwide economic growth.</p> <p><b>Major Components</b> The TA will assist the Government in developing a master plan for the provincial and rural road network.</p> <p><b>Expected Outputs and Outcome</b> The output is provision of capacity building for strategic planning.</p> <p>The outcome is improved national transport sector efficiency through increased institutional capacity for strategic planning, enabling connectivity at all levels of the road network.</p>