



Country Partnership Strategy

July 2017

Sri Lanka, 2018–2022 —Transition to Upper Middle-Income Country Status

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 25 July 2017)

Currency unit	–	Sri Lanka rupee/s (SLRe/SLRs)
SLRe1.00	=	\$0.00643
\$1.00	=	SLRs155.35

ABBREVIATIONS

ADB	–	Asian Development Bank
CDS	–	country diagnostic study
CEB	–	Ceylon Electricity Board
CPS	–	country partnership strategy
CTEC	–	Colombo–Trincomalee Economic Corridor
EFF	–	Extended Fund Facility
FDI	–	foreign direct investment
FTA	–	free trade agreement
GDP	–	gross domestic product
ICT	–	information and communication technology
IMF	–	International Monetary Fund
JICA	–	Japan International Cooperation Agency
LFPR	–	labor force participation rate
O&M	–	operation and maintenance
OCR	–	ordinary capital resources
PPP	–	public–private partnership
SASEC	–	South Asia Subregional Economic Cooperation
SMEs	–	small and medium-sized enterprises
SOE	–	state-owned enterprise
TA	–	technical assistance
TVET	–	technical and vocational education and training
UMIC	–	upper middle-income country

NOTE

In this report, “\$” refers to US dollars.

Vice-President	W. Zhang, Operations 1
Director General	H. Kim, South Asia Department (SARD)
Director	S. Widowati, Sri Lanka Resident Mission (SLRM), SARD
Team leader	T. Hayashi, Senior Country Economist, SARD
Team members	N.M. Amerasinghe, Project Management Specialist, SARD
	P. Bandara, Senior Project Officer (Natural Resources and Environment), SARD
	K. Dahanayake, Senior Project Officer (Urban and Water Supply, Sanitation), SARD
	L. Gore, Senior Water Resources Specialist, SARD
	T. Hoshino, Financial Sector Specialist, SARD
	A. Huang, Finance Specialist, SARD
	J. Huang, Principal Urban Development Specialist, SARD
	S. Jayakody, Economic Analyst, SARD
	H. Jayasundara, Associate Project Officer, SARD
	S. Jayasundera, Social Development Officer (Gender), SARD
	K. Kasahara, Transport Specialist, SARD
	M. Khamudkhanov, Principal Energy Specialist, SARD
	U. Kumar, Economist, SARD
	D. Lambert, Senior Finance Specialist, SARD
	K. Nakai, Senior Transport Specialist, SARD
	M. Nakane, Economist, SARD
	A. Nanayakkara, Senior Project Officer (Transport), SARD
	A. Navera, Senior Operations Officer, SARD
	M. Ozaki, Senior Portfolio Management Specialist, SARD
	M. Roesner, Principal Transport Specialist, SARD
	D. Sinclair, Associate Project Officer, SARD
	R. Slangen, Senior Urban Development Specialist, SARD
	G. Song, Principal Social Sector Specialist, SARD
	F. Tornieri, Principal Social Development Specialist (Gender and Development), SARD
	H. Wickremasinghe, Senior Economics Officer, SARD
	R. Wimalasena, Senior Project Officer (Energy), SARD
	H. Win, Senior Health Specialist, SARD
Peer reviewers	E. Ginting, Director, Economic Research and Regional Cooperation Department
	Y. Zhai, Technical Advisor (Energy), Sustainable Development and Climate Change Department

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COUNTRY AT A GLANCE

Economic	2012	2013	2014	2015	2016
GDP (\$ billion, current)	68.4	74.3	79.4	80.6	81.3
GDP per capita (\$, current)	3,351	3,610	3,821	3,844	3,835
GDP growth (% , in constant prices)	9.1	3.4	5.0	4.8	4.4
Agriculture	3.9	3.2	4.6	4.8	(4.2)
Industry	9.0	4.1	4.7	2.1	6.7
Services	11.2	3.8	4.8	5.7	4.2
Gross domestic investment (% of GDP)	39.1	33.2	32.3	28.4	31.5
Gross domestic saving (% of GDP)	27.2	24.6	24.2	20.9	23.8
Consumer price index (annual % change)	7.6 ^a	6.9 ^a	3.3 ^a	3.8 ^b	4.0 ^b
Liquidity (M2b) (annual % change)	17.6	16.7	13.4	17.8	18.4
Overall fiscal surplus (deficit) (% of GDP)	(5.6)	(5.4)	(5.7)	(7.6)	(5.4)
Merchandise trade balance (% of GDP)	(13.8)	(10.2)	(10.6)	(10.3)	(11.0)
Current account balance (% of GDP)	(5.8)	(3.4)	(2.5)	(2.5)	(2.4)
External debt service (% of exports of goods and services)	19.7	26.8	20.8	27.3	25.0
External debt (% of GDP)	54.2	53.7	54.1	55.7	57.3
Poverty and Social	2000		Latest		
Population (million)	19.1		21.2	[2016]	
Population growth (annual % change)	1.4		1.1	[2016]	
Maternal mortality ratio (per 100,000 live births)	57.0		30.0	[2015]	
Infant mortality rate (below 1 year/per 1,000 live births)	14.0		8.4	[2014]	
Life expectancy at birth (years)	71.1		74.8	[2014]	
Adult literacy (%)	90.7		92.6	[2015]	
Primary school gross enrollment (%)	107.0		101.0	[2014]	
Child malnutrition (% below 5 years old)	22.8		26.3	[2012]	
Population below poverty line (%) ^c	22.7		6.7	[2012]	
Population with access to safe water (%)			95.6	[2015]	
Population with access to sanitation (%)			95.1	[2015]	
Environment			Year		
Carbon dioxide emissions (tons)	16,025	[2013]			
Carbon dioxide emissions per capita (tons)	0.8	[2013]			
Forest area (million hectares)	2.1	[2015]			
Urban population (% of total population)	18.0	[2015]			
ADB Portfolio (active loans and ADF grants)				As of 31 December 2016	
Total number of loans				55	
Sovereign				51	
Nonsovereign ^d				4	
Total loan and ADF grant amount (\$ million) ^e				3,716.1	
Sovereign				3,478.1	
Nonsovereign				238.0	
Disbursements ^f					
Disbursed amount (\$ million, 2016)				342.7	
Disbursement ratio (%)				21.5	

() = negative, [] = latest year for which data are available, ADB = Asian Development Bank, ADF = Asian Development Fund, GDP = gross domestic product, M2 = M2b is based on the aggregated data pertaining to Domestic Banking Units (DBUs) and Offshore Banking Units (OBUs) of Licensed Commercial Banks (LCBs) operating in Sri Lanka.

^a Based on the Colombo Consumers' Price Index.

^b Based on the National Consumer Price Index. This new index was first released in October 2015.

^c Equivalent to \$2.50 a day in purchasing power parity 2011 terms.

^d Includes two B-loans.

^e Net of droppages and cancellation.

^f Sovereign disbursements.

Sources: Asian Development Bank; Central Bank of Sri Lanka Annual Report 2016. http://www.cbsl.gov.lk/pics_n_docs/10_pub_docs/efr/annual_report/AR2016/English/content.htm; Department of Census and Statistics of Sri Lanka; and World Bank. World Development Indicators. <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>

I. COUNTRY PARTNERSHIP STRATEGY SNAPSHOT

1. **Key development challenges.** With robust growth over the last decade (2007–2016), averaging about 6% per annum, Sri Lanka is close to becoming an upper middle-income country (UMIC). The key development challenge is to maintain the momentum of rapid inclusive and sustainable growth and advance its UMIC status. The manufacturing and export base of the economy needs to be diversified and the declining trend of exports to gross domestic product (GDP) reversed. This is necessary as the limited size of the domestic market will be a constraining factor for sustaining future growth. With limited public resources, the private sector will need to drive the transformation of the economy. Improving the investment climate, developing growth-oriented infrastructure, and enhancing the quality of human resources are necessary for catalyzing domestic private investment and attracting higher foreign direct investment (FDI). To ensure inclusiveness of growth, poverty will need to be further reduced, inequality narrowed, and balanced geographical development supported. Maintaining environmental sustainability is also a challenge and needs to be addressed.¹

2. **ADB strategic objectives and priorities.** The Asian Development Bank (ADB), through its country partnership strategy (CPS), 2018–2022, will support Sri Lanka’s transition to UMIC status. The CPS will focus on two strategic objectives: strengthen the drivers of growth by promoting diversification of economic activities and productivity enhancement (pillar 1), and improve the quality of growth by promoting inclusiveness (pillar 2). The priority investment areas for pillar 1 will be to (i) expand the provision of growth-oriented infrastructure (transport, energy, and urban) and logistics; (ii) develop an economic corridor; and (iii) upgrade human capital. For pillar 2, the priority investment areas will be to (i) strengthen agriculture infrastructure and commercialization, (ii) improve rural connectivity, (iii) improve public service delivery, and (iv) expand access to finance for small and medium-sized enterprises (SMEs). Key thematic priorities are (i) promoting private sector development and public–private partnership (PPP); (ii) strengthening environment, climate change, and disaster risk management; and (iii) promoting gender equality.

3. **Alignment with the government’s development plans.** ADB assistance is closely aligned with the development strategy of the Government of Sri Lanka as outlined in (i) the two policy statements of the Prime Minister in Parliament in November 2015 and October 2016; and (ii) the Public Investment Program, 2017–2020.² The CPS is in line with ADB’s corporate strategy under its Midterm Review of Strategy 2020.³

4. **Approach and value addition.** While responding flexibly to the evolving demands of the government, ADB will continue investment programs and projects in sectors where it has strong operational experience, and explore some new areas relevant to a UMIC. Cross-country knowledge sharing and exposure to best practices and innovation will be promoted. Synergies between public and private sector operations will be fostered. Complementarity with other development partners’ efforts will be pursued. ADB will ensure the implementation readiness of projects and support effective and efficient implementation to facilitate the delivery of development impact in a timely manner.

¹ Inclusive and Sustainable Growth Assessment (accessible from the list of linked documents in Appendix 3).

² Government of Sri Lanka, Ministry of National Policies and Economic Affairs, Department of National Planning. 2017. *2017–2020 Public Investment Program*. Colombo.

³ ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific*. Manila.

II. COUNTRY DEVELOPMENT CONTEXT

5. **Robust growth and structural transformation.** Economic growth averaged about 6% per annum during 2007–2016, bringing Sri Lanka close to becoming a UMIC, with per capita GDP of \$3,835 by the end of 2016.⁴ The structure of the economy has undergone a change. Agriculture now accounts for a mere 8.2% of GDP, industry 29.6% (of which manufacturing is 16.9%), and services 62.2%.⁵

6. **Poverty reduced, social indicators improved, and basic infrastructure provided.** Sri Lanka is completing its development as a lower-middle income country. Rapid economic growth, along with the extensive coverage of the government-financed education and health care system, led to a significant drop in severe poverty.⁶ The poverty ratio, based on \$2.50 per day (the national poverty line), declined from 15.2% in 2006–2007 to 6.7% in 2012–2013.⁷ The country also made good progress on the Millennium Development Goals.⁸ Sri Lanka is categorized a high human development country by the United Nations Development Programme, with a rank of 73 (out of 185 countries) in 2015, which compares favorably with countries with higher per capita income. Sri Lanka has been successful in developing basic infrastructure. It has the highest road density in South Asia, 98% of the population has access to electricity, 96% access to safe water, and 95% access to sanitation. Sri Lanka ranks 73 (out of 138 countries) for infrastructure development in the Global Competitive Index, 2016–2017.⁹

7. **Regional transport and trade links.** Sri Lanka is located at strategic position along key maritime routes connecting Europe and, Middle East with East Asia and Southeast Asia. Colombo Port has been identified as the regional hub for handling container traffic. Sri Lanka's active participation in the South Asia Association for Regional Cooperation, the Bay of Bengal Initiative for Multi-Sectorial Technical and Economic Cooperation, and the South Asia Subregional Economic Cooperation (SASEC) has been helping build connectivity with neighboring countries, and the rest of Asia. ADB has supported regional and integration projects through the SASEC program.

8. **Macroeconomic management challenges:**

- (i) **Fiscal balance.** The low and declining tax–GDP ratio¹⁰ is one of the underlying cause of the fiscal imbalances. The declining tax–GDP ratio is due to several reasons: a small percentage of the population pays direct taxes, indirect taxes are determined in an ad hoc manner and are subject to discretionary exemptions, and tax administration is inefficient and weak. The fiscal deficit remained high (5%–7% of GDP) from 2014 to 2016. Government revenue was not even sufficient to finance recurrent expenditure. Public investment was financed entirely by borrowing, crowding out the private sector's

⁴ The World Bank defines a UMIC as a country with per capita income of \$3,956 and above.

⁵ GDP shares are calculated with factor cost. The GDP share of agriculture is as low as that of the UMIC average, while the share of industry or manufacturing is equivalent to the lower middle-income country average.

⁶ The poverty ratio, based on \$1.90 per day (at 2011 purchasing power parity), declined from 3.8% in 2006–2007 to 1.9% in 2012–2013.

⁷ If the benchmark of measuring head count poverty is raised to \$3.10 per day (which is a more suitable measure for UMICs), the World Bank's calculations show that poverty in Sri Lanka doubles to 14.6% in 2012–2013. This means that a significant percentage of the population is just above the national poverty line, vulnerable to falling into poverty in the event of an adverse exogenous or endogenous economic shock, or natural calamity.

⁸ Out of total 23 indicators with targets for 2015, 10 were met, 12 were on track, and 2 were off track as of 2014.

⁹ World Economic Forum. 2016. *The Global Competitiveness Report 2016-2017*. Geneva.

¹⁰ The tax–GDP ratio has seen a sustained decline from 17.2% in 2000 to 13.6% in 2016.

access to credit and increasing public debt.¹¹ Interest and subsidy payments are large components of recurrent expenditure, about 8% of GDP during 2014–2016, which was considerably higher than public investment (5% of GDP). Increasing the tax–GDP ratio, rationalizing expenditure, and making state-owned enterprises (SOEs) commercially oriented remain priorities to contain the fiscal deficit and reduce public debt.

- (ii) **Balance of payments.** The balance of payments has been under pressure as the export–GDP ratio declined from 33% in 2000 to 13% in 2016. Exports are currently able to finance only about half of imports, but the current account deficit of the balance of payments is contained to around 2.5% of GDP mainly by tourism and remittance inflows. Non-debt-creating inflows like FDI provide little cushion to the capital account, averaging a mere 1% of GDP. The domestic capital market is not developed enough to attract portfolio investment on a sustained basis. Foreign exchange reserves are low and provide only 3–4 months of import cover.
- (iii) **Restoring macroeconomic stability.** The government is attempting to restore macroeconomic stability, and is working with multilateral and bilateral agencies to adjust policies and strengthen institutions. The International Monetary Fund (IMF) provided a 3-year Extended Fund Facility (EFF) of \$1.5 billion in June 2016. The main elements of the EFF are fiscal consolidation, improvement of revenue mobilization, strengthening of public financial management, reform of SOEs, enhancement of monetary policy effectiveness, and reform of the trade and investment policy. The World Bank is supporting reforms under a development policy loan to increase private sector competitiveness, enhance transparency and public sector management, and improve fiscal sustainability. The development policy loan is supported by the Japan International Cooperation Agency (JICA) through parallel cofinancing. ADB is assisting in reforming capital markets to attract resources from domestic and foreign sources for private sector expansion.

9. **Development challenges.** Sri Lanka needs to maintain the momentum of growth to advance its status as a UMIC. To address the challenge, policies need to be pursued that facilitate manufacturing and export diversification, increase productivity, enable Sri Lankan firms to become part of global supply chains, and create productive jobs. The small size of the domestic market (population of about 21 million) means that exports will be a key source of growth. With limited fiscal space, the government expects the private sector to drive the transformation of the economy. Accordingly, impediments to private sector development need to be addressed on a priority basis. To ensure inclusiveness of growth, it is important to take measures that narrow inequality, reduce the remaining poverty, and achieve geographically balanced development. Further, rapid growth and higher consumption are likely to add a burden on the environment, unless remedial measures are taken. Thus, environmental sustainability will need closer attention.

- (i) **Lack of diversified products for export, weak linkages to global supply chain.** Exports are constrained, as trade liberalization lost momentum because of the escalation of the civil war (which ended in May 2009) and the economic downturn of the early 2000s. With the deterioration in the fiscal situation, extra fees were imposed

¹¹ Government debt dropped from over 100% of GDP in 2001–2004 to 71% in 2014, but increased to 79% of GDP in 2016. Financing of the fiscal deficit has been increasingly relying on foreign resources, with a higher component of commercial borrowing.

at variable rates in an ad hoc manner on top of existing tariffs. Effective protection for manufacturing made production for the domestic market more profitable compared with exports. The impact of these policies is that Sri Lanka's share in global exports has declined.¹² The composition of exports has not diversified and is concentrated in three items (garments, tea, and rubber products), which account for over 65% of total exports. Little integration has been achieved with global supply chains, except in apparel, which is also at the lower end in terms of value addition.

- (ii) **Business environment needs improvement.** Private sector investment has remained constrained because the business environment has not been conducive and the public sector has played a dominant role in the past. Since the government's budgetary resources are limited, the private sector is expected to play a larger role in infrastructure development through PPPs. Policies to improve the investment climate, complemented by upgrades in the quality of infrastructure and human resources, need urgent attention to catalyze domestic investment and attract FDI.
- (iii) **Inequality remains.** Inequality, in its various manifestations, persists. The Gini coefficient of household income has remained around 0.48, and of household expenditure around 0.40 since the year 2007. The share of income of the bottom two deciles declined marginally from 4.8% during 1995–1996 to 4.5% during 2012–2013, while that of the top two deciles increased from 51.3% to 52.9%. The key factor aggravating inequality is the difference in productivity across sectors. Agriculture's share in GDP is a mere 8.2%, but it provides employment to 29% of the workforce, implying low labor productivity in the sector. High-paying productive jobs are concentrated in industry and services.¹³ There are also geographical variations in poverty, being relatively high in the estate areas¹⁴ (10.9%) and rural areas (7.6%), and low in urban areas (2.1%). Some districts in the Northern, Eastern, and Uva provinces still have high incidence of poverty, at 19%–29%, because of weak linkages to labor markets and access to services. Despite encouraging progress in attaining parity at all levels of education and other health indicators, the participation of women in wage employment remains low outside agriculture. The labor force participation rate (LFPR) of women is less than half that of males (74.9% LFPR for males and 35.6% for women).
- (iv) **Environment sustainability, climate change, and disaster risk.** The country is vulnerable to the adverse effects of climate change, especially fluctuations in rainfall. Some areas experience flash floods, and others drought. Management of the environment and occurrence of disasters are linked. The country also faces pollution challenges because of unplanned urbanization and degradation of coastal regions.

¹² The share of global exports declined from 0.074% in 2000–2004 to 0.057% in 2010–2014, a decline of 23%. G. Lopez-Acevedo, D. Medvedev, and V. Palmade, eds. 2017. *South Asia's Turn: Policies to Boost Competitiveness and Create the Next Export Powerhouse*. Washington, DC: World Bank. <https://openknowledge.worldbank.org/bitstream/handle/10986/25094/9781464809736.pdf>

¹³ Labor productivity, as measured by remuneration per hour worked, is 2.89 times higher in industry and 3.23 times higher in services compared with agriculture in 2016. Central Bank of Sri Lanka. 2016. *Annual Report 2016*. Colombo (Table 4.16).

¹⁴ Estate areas refer to plantations with an area of more than 8 hectares, and residential laborers less than 10.

III. COUNTRY STRATEGY FRAMEWORK

A. Lessons from Previous Strategy

10. The country assistance program evaluation¹⁵ for Sri Lanka in 2016 rated the overall support of ADB to Sri Lanka during 2006–2015 *successful*. ADB operations were *relevant* to the needs of the country, *effective* in all sectors, *efficient* in implementation, *satisfactory* in development impact, and *less than likely* in terms of sustainability. Four recommendations were made for the new CPS: (i) policy dialogue in the infrastructure sectors needs to be intensified, including reforms of SOEs; (ii) the strategy on inclusive growth should draw on the success of community-based projects on a selective basis; (iii) a clearer approach to support private sector development needs to be adopted, which establishes better synergies between work on the investment climate, public investment, and private sector operations; and (iv) support for the education sector needs to be expanded.

11. The CPS is addressing these recommendations through its operational interventions. ADB will improve the sustainability of its interventions through more regular and focused policy dialogue. The sustainability of the infrastructure will be enhanced by strengthening the efficiency of relevant institutions. Inclusivity will be strengthened through the involvement of communities in ADB's interventions, as appropriate, complementing the involvement of other development partners. Private sector development will adopt a holistic approach, with stronger synergies between public and private sector operations. ADB will work closely with the government and other development partners to improve the investment climate, and will continue to explore private sector-led investments using PPP or other modalities. Operations in the education sector will expand with ADB's proposed involvement in the tertiary sector.

B. National Development Strategy

12. **Key development goals.** The main elements of the development strategy are outlined in the policy statements of the Prime Minister in Parliament in November 2015 and October 2016. The long-term goals of the government are (i) creating 1 million jobs; (ii) enhancing income levels; (iii) developing the rural economy; (iv) ensuring land ownership to rural and estate sectors, the middle class, and government employees; and (v) creating a wide and strong middle class.

13. **Development strategy.** The Public Investment Program, 2017–2020 provides details of the allocation of government resources to priority areas, as well as the medium-term targets. The targets are to (i) arrest the decline in exports by improving productivity and competitiveness, (ii) promote the inflow of foreign investment through investor-friendly policies, (iii) pursue reforms for increasing government revenues and rationalize government expenditure, (iv) restructure public debt to decrease the annual debt servicing burden, (v) increase government expenditure for upgrading the quality of human resources, (vi) promote equity in the economic and social spheres, (vii) minimize regional disparities and poverty pockets, and (viii) provide special emphasis on environmental protection and natural resources conservation. The sustainability of growth will be pursued by adopting the Sustainable Development Goals as the guiding principles for future development. The quality of governance will be strengthened.

¹⁵ ADB. 2016. *Country Assistance Program Evaluation, Sri Lanka, 2006–2015*. Manila.

14. The government is engaged in entering into free trade agreements (FTAs) and bilateral trade agreements with countries that provide potential markets for Sri Lanka's products.¹⁶ Its strategy acknowledges that export-led growth is critically dependent on increasing productivity and competitiveness across sectors by pursuing strategic public and private investments, adopting appropriate policies, upgrading human capital, strengthening the institutional structure, and making Sri Lanka a knowledge economy. Inclusivity of economic growth will be promoted simultaneously, especially by reducing the existing inequalities, so that the benefits of growth accrue to the population.

15. The private sector is expected to make a major contribution to economic growth and the creation of productive jobs. The government's role will be to improve business climate and finance key economic and social infrastructure projects. The constraints impeding private sector development will be addressed, and integration with the global economy will be supported. The Western Region Megapolis Master Plan provides a conceptual strategy for the economic and geographical transformation of urban agglomerations in the Western Province to become attractive for domestic and foreign investments.¹⁷ Emphasis will be given to expanding the digital economy, tourism, and commercial agriculture. Higher education and skills development will be recalibrated to address the current mismatch with the requirements of the market. Opportunities will also be created for increasing the female LFPR.

16. The government identifies climate change mitigation and adaptation as priorities, and has developed a national policy on disaster management. Sri Lanka's Nationally Determined Contribution aims to reduce greenhouse gas emissions by (i) 20% in the energy sector; and (ii) 10% in the transport, waste, industrial, and forest sectors by 2030. It also aims to build resilience against climate change in the most vulnerable communities, sectors, and areas in terms of human health, food security, water and irrigation, coastal and marine areas, biodiversity, urban infrastructure, human settlements, and tourism.

C. Role of Development Partners

17. **Development assistance scenario.** During the CPS period 2018–2022, infrastructure investment needs are estimated to be \$5 billion–\$6 billion per year to attain the government's economic growth target. The capacity of the government to increase infrastructure investments is currently constrained by a difficult fiscal situation. However, fiscal space is likely to improve with reforms under the ongoing IMF program.¹⁸ Sri Lanka will graduate from concessional borrowing from the World Bank starting July 2017. This makes it imperative for the country to attract non-debt-creating inflows, borrow higher amounts of long-term finance from official sources which are typically at lower interest rates, use commercial external borrowing in a judicious manner, and enhance the debt servicing capacity. Further, private sector participation is expected to increase over time, as the investment climate improves and the capacity to undertake PPP projects develops.

18. **Partnerships and areas of coordination.** An active development coordination forum meets quarterly and has the participation of major bilateral and multilateral development partners,

¹⁶ The government is currently in discussions with People's Republic of China, Singapore, Turkey, and the United States for bilateral trade agreements. The FTA with India is under discussion to upgrade to an economic and technology cooperation agreement.

¹⁷ Government of Sri Lanka, Ministry of Megapolis and Western Development. 2016. *Western Region Megapolis Master Plan 2030*. Colombo.

¹⁸ The IMF's debt sustainability analysis indicates that, as the EFF reform program is implemented, the debt indicators will steadily attain manageable levels, although there are downside risks related to contingent liability and public debt sustainability.

including United Nations agencies. The forum has created technical groups on specific sectors to enable focused and detailed discussion of issues. ADB has coordinated closely with the World Bank in the transport, energy, urban, education, agriculture, health, and finance sectors. With the IMF taking the lead, coordination meetings have been held with the World Bank and JICA on macroeconomic reforms. Coordination and partnership are also pursued with: (i) JICA on infrastructure sector, (ii) the European Investment Bank and Agence Française de Développement (French Development Agency) on urban development, and water supply and sanitation; (iii) the Government of Australia, the Government of Canada, and Deutsche Gesellschaft für Internationale Zusammenarbeit on education and technical and vocational education and training (TVET); (iv) the United States Agency for International Development in public financial management; (v) United Nations agencies in social sectors; and (vi) the Asian Infrastructure Investment Bank in the agriculture, natural resources and rural development sector. ADB also coordinates with development partners in adopting a harmonized approach for using the country system for accounting, auditing, procurement, and safeguards. An active coordinated approach is adopted in policy dialogue, implementation arrangements, capacity building, and monitoring and review.¹⁹

D. ADB's Strategic and Thematic Objectives, and Operational Priorities

19. **Country partnership strategy objectives.** ADB will support Sri Lanka's transition to a UMIC by focusing the CPS on two strategic objectives: (i) strengthen the drivers of growth by promoting diversification of economic activities and productivity enhancement (pillar 1); and (ii) improve the quality of growth by promoting inclusiveness and thematic priorities (pillar 2).²⁰ The CPS will address the sustainability of economic growth at both policy and project and/or program levels. Assistance will address the impediments to attaining these objectives in a flexible manner, depending on the evolving needs of the country. ADB interventions under pillars 1 and 2 will contribute to the government's key development goals of job creation, enhance income level, and develop rural economy.

20. **ADB's approach.** ADB will adjust areas of intervention over time based on the framework of the ongoing country diagnostic study (CDS) and integrated multisector economic corridor development study. The CDS has undertaken a comprehensive review of the economy and identified bottlenecks in Sri Lanka's future development. The economic corridor study examines the coordination of growth-promoting interventions among sectors, with a focus on creating growth centers. A "One ADB" approach will be taken in knowledge management and interdepartmental coordination. ADB's Sri Lanka Resident Mission will serve as the custodian of all knowledge work undertaken by ADB on Sri Lanka, and will respond to the government's knowledge needs depending on the requirements. Interventions will focus increasingly on policy reforms, providing knowledge solutions, and institutional capacity building to meet the demands of complex economic challenges. ADB's Sri Lanka Resident Mission will continue to actively coordinate ADB's sovereign and nonsovereign operations to maximize synergies. ADB's support will be designed taking into consideration its comparative advantage, lessons from past engagement, and implementation capacity; and will complement the efforts of other development partners.

21. ADB will use the most appropriate lending instruments and modalities to increase the effectiveness of its operations. Depending on the requirement, the support could include

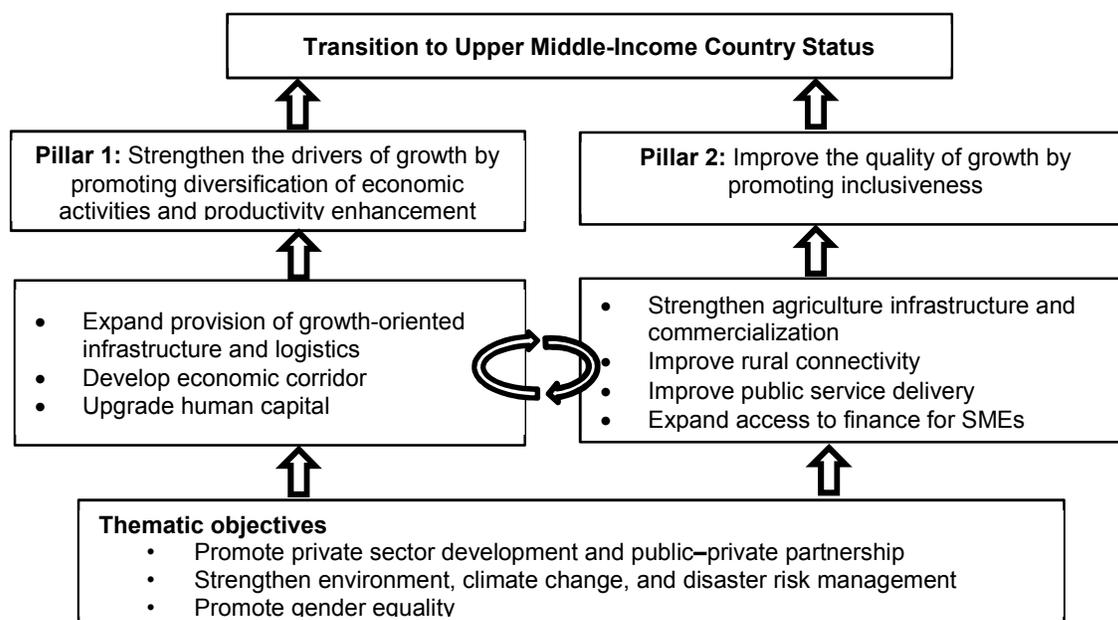
¹⁹ Development Coordination Matrix (accessible from the list of linked documents in Appendix 3).

²⁰ The strategic objectives under the CPS are in line with ADB. 2015. *Clients–Contributors–Collaborators: A New Partnership with Upper Middle-Income Countries*. Manila (February).

nonsovereign lending, policy-based loans, results-based loans, and multitranche financing facilities. Direct lending to SOEs could also be considered, depending on the improvement of their governance standards and financial management capacity. Results-based loans may be used in the education sector. Multitranche financing facilities will continue to be used for infrastructure projects in sectors requiring a long-term commitment.

22. **ADB's value addition.** Sri Lanka's assistance requirements will change as its income level rises. ADB will expand operations selectively into new growth-oriented areas, such as railways, smart and green cities, wind and solar energy, and higher education, possibly with private sector participation. ADB will also add value by providing relevant knowledge products and solutions, exposing to best practices, lay the foundation for innovations, and increasing the absorptive capacity for contemporary technologies. Focus on policy reforms, and strengthening the capacity of existing institutions will contribute to the sustainability of ADB's intervention. It will require ADB to be engaged with the government, development partners, and think tanks on a continuous basis to develop knowledge solutions to country-specific emerging constraints. Synergies between public and private sector interventions will be fostered by expanding ADB's private sector operations to complement the public-sector interventions.

Focus Areas for Country Partnership Strategy, 2018–2022



SMEs = small and medium-sized enterprises.

Source: Asian Development Bank.

1. Pillar 1: Strengthen the Drivers of Growth by Promoting Diversification of Economic Activities and Productivity Enhancement

23. **Expand provision of growth-oriented infrastructure and logistics.** ADB will upgrade and expand infrastructure by supporting strategic investments in key sectors.

- In the transport sector, ADB will improve connectivity by providing support for roads, ports, and railways. The burden on the road network will be reduced by developing other transport modes. Regional cooperation will get a boost by improving international port facilities and providing better connectivity through roads and railways.

- In the urban sector, ADB will continue support to Greater Colombo and Jaffna water supply and sewerage systems, and to secondary cities with growth potential, including those in the Colombo–Trincomalee economic corridor (CTEC) and the Western Megapolis. The strategy will support growth by boosting urban agglomerations to attract high-quality investments and improve urban governance. Water desalination, solid waste management, smart urban infrastructure, and land development will be explored.
- In the energy sector, interventions will focus on expanding nontraditional renewable energy using wind and solar, and introducing innovation and advanced technology. The reliability of power supply will be improved. The potential of using a gas-based power plant will be explored, and regional cooperation initiatives will be encouraged by facilitating a possible Sri Lanka–India power interconnection.

24. Emphasis will be given to institutional capacity strengthening, especially of SOEs involved in infrastructure and utilities.

- The establishment of an expressway corporation will be supported to strengthen business planning, financial management, operation and maintenance (O&M), and toll policy and collection systems.
- The capacity of Sri Lanka Railways will be developed for planning, project development, procurement, project management, and safeguards implementation.
- Sri Lanka Ports Authority will be strengthened in planning, institutional efficiency, and PPP.
- The institutional capacity of Ceylon Electricity Board in financial management and in involving the private sector using the PPP modality, will be enhanced. Institutionalizing a cost-based pricing mechanism for fuel and electricity, and financial separation of Ceylon Electricity Board's functional business units will be supported.
- The capacity of local governments and related institutions will be enhanced through programs that encourage performance-based financing linked to reforms such as increased property tax collection, improved urban planning, and strengthened utility O&M. Support will also include catalyzing PPP initiatives in the National Water Supply and Drainage Board and in some municipalities. ADB will continue to pursue reforms, including establishing an independent regulator and tariff setting mechanism.

25. **Develop economic corridor.** To facilitate private sector development beyond the Western province, ADB is undertaking a study for developing a comprehensive plan for the CTEC. A multisector approach will be adopted in developing an economic corridor by integrating and synergizing industry, infrastructure, logistics, and urbanization. This will entail constructing high-quality infrastructure, typically aligned with a major transport network. The economic corridor will connect urban clusters with vibrant industrial zones, institutional areas, and residential houses for workers; provide a favorable and competitive environment for setting up businesses; and facilitate the efficient movement of goods and people.²¹

26. Successful development of the economic corridor is a large agenda and will require the active participation of the government, other development partners, and the private sector. Given ADB's comparative advantage, it can play a role in infrastructure strengthening in the economic corridor, especially in the transport (roads, railways, and ports); energy; and urban sectors. It could also potentially play a role in developing support infrastructure like logistic hubs, dry ports, warehouses, waste management, and water treatment plants. ADB will assist in assessing the

²¹ While the economic corridors will be planned by the government, the private sector is expected to play an active role. Over time, the economic corridor will contribute to economic diversification and job creation through the participation of firms in global value chains.

education and skills gaps, and orient its human resource development operations to the needs of the corridor. The nature of the assistance will be worked out more specifically during the CPS implementation period.

27. **Upgrade human capital.** ADB's support will focus on an integrated human capital development program involving secondary education, TVET, and higher education. ADB will give greater attention to the linkages between its education sector interventions and emerging jobs. Efforts will also be made to introduce new training programs for selected industries, especially those identified by the government and the economic corridor study. Interventions in the higher education sector will support the government in establishing a technology university using the PPP modality, and assist in preparing market-oriented degree programs. Support for technology education will be extended to selected state universities, so the model can be replicated. By initiating expansion in the human resource base in science and technology, ADB's intervention will provide the first steps toward greater infusion of technology and innovation in the economy. As a next step, ADB will initiate and continue dialogue with the government and other development partners for strengthening the linkages between industry and technology institutes, and increasing the scale of research and development expenditure.

2. Pillar 2: Improve the Quality of Growth by Promoting Inclusiveness

28. **Strengthen agriculture infrastructure and commercialization.** ADB's focus has been on (i) optimum harnessing of available water by increasing reservoir capacity, enhancing water conveyance capacity, and introducing climate change adaptation investment and technologies; (ii) enhancing the productivity of water use; and (iii) improving the governance of national water management. ADB will continue to support (i) enhancing water use efficiency by strengthening O&M to prevent deterioration of the irrigation system, (ii) updating irrigation information systems, and (iii) increasing the returns on irrigation investment through higher crop intensity, crop diversification, and commercialization of agriculture. ADB will also support the government's initiative of institutional strengthening, and better coordination among planning and implementing agencies, to improve the governance of national water resources. In the fisheries subsector, the objective is to enhance livelihoods by improving infrastructure in conflict-affected coastal districts of the Northern Province, with possible replication in other areas.

29. ADB will explore support that complements the government's plan of modernizing agriculture by developing agriculture mega zones, and providing them with infrastructure like rural roads, storage facilities (including cold storage), collecting centers, and marketing places. This will diversify production into high-value crops and increase the productivity of workers and their incomes. ADB's private sector operations will support agribusiness by exploring business opportunities in the entire agriculture and food value chain (farm inputs, farming, processing, storage, distribution, and export).

30. **Improve rural connectivity.** Rural economic growth centers in lagging regions will be connected to the main logistic network, integrating rural access to the national highways and expressways network. This will assist in improving connectivity between the rural communities and the socioeconomic centers in the country, which will increase productivity in rural areas.

31. **Improve public service delivery.** ADB will provide access to basic services to poor and underserved areas. Provision of water supply and sanitation facilities will aim to reduce regional disparities. Emphasis will also be given to the provision of safe water supply to chronic kidney disease-affected areas. Access to secondary education will be strengthened. Greater attention will be given to linking TVET programs to emerging jobs. In supporting the development of the

economic corridor, modalities will be explored for promoting agribusiness industries that will help the rural sector grow by establishing linkages between farm and factory. ADB will also expand the quality of basic health care services to the underserved and vulnerable population living in the estate sector, in partnership with the estate companies, involving private sector financing. The current health care system will be strengthened to track and control infectious diseases through better technologies. Support will also be extended for research and policy formulation for developing sustainable financing models for public health programs.

32. Expand access to finance for small and medium-sized enterprises. ADB is taking a comprehensive and integrated approach to strengthening financial intermediation for SMEs. Credit lines to SMEs have been provided to facilitate credit access to underserved segments of SMEs, such as women entrepreneurs, SMEs that have not previously borrowed from banks, and SMEs outside of Colombo. Through technical assistance (TA), ADB is also providing hands-on business development support in the export-oriented food and ICT-business process outsourcing clusters. Currently, ADB is working with the government to (i) set up an SME credit guarantee institution to improve financial access for SMEs that have viable business plans but inadequate collateral, and (ii) develop an SME venture capital fund that will improve SMEs' access to equity or risk capital.

3. Thematic Priorities

33. Promote private sector development and public–private partnership. ADB's support in the creation of an enabling environment for private sector development includes (i) support for strengthening the judicial system, especially in commercial law, so that it can better respond to the demands of the private sector; (ii) capital market development, which includes strengthening the legal and regulatory structures, bond market development, creating an enabling environment for derivatives, and developing the insurance and pension industries; (iii) establishing a credit guarantee institution for SMEs as an innovative approach for Sri Lanka; and (iv) facilitating PPPs in large infrastructure, higher education, and TVET projects. Support for trade facilitation will also be explored under the South Asia Subregional Economic Cooperation program. ADB's private sector operations will continue to provide loans, equity investments, or guarantees for public and private banks, nonbanking financial institutions, and corporations to expand activities in targeted areas. PSOD will also increase involvement in infrastructure, industry, and agribusiness to increase their share of ADB operations in Sri Lanka. Opportunities in PPP transaction advisory services will also be explored.

34. Strengthen environment, climate change, and disaster risk management. ADB will strengthen environment, climate change, and disaster risk management. ADB will expand its assistance in clean energy (wind and solar), natural resource management, expansion of the sewerage network, water conservation through leakage reduction, and sustainable transport through railways network improvement. Considerations of environmental, climate, and disaster resilience will be mainstreamed in ADB operations. ADB will support the government's efforts to mitigate greenhouse gas emissions, and in implementing climate change adaptation technologies and an integrated disaster risk management mechanism.

35. Promote gender equality. Through its projects and programs, ADB is addressing gender equality concerns by undertaking detailed gender assessment at the project preparatory stage, and categorizing the projects at the design stage. Gender action plans are prepared for projects that have the potential to mainstream gender concerns significantly or that are likely to have a substantial gender impact. These plans are closely monitored and progress is reported in quarterly project reviews. ADB will strengthen its efforts toward gender equality and women's

empowerment in priority areas. Capacity development initiatives for gender equality and social inclusion will be enhanced by involving sector agencies associated with the implementation of ADB-funded projects. The identification of areas for possible engagement, in collaboration with the government, will be pursued to support gender equality and women's empowerment.

E. Priorities for Knowledge Support

36. As a new UMIC, Sri Lanka will face diverse economic challenges. ADB will blend its financial assistance with knowledge products that address the current constraints and those that are likely to be faced as the economy matures to a higher level of development. Knowledge support will adopt a One ADB approach. The country knowledge plan is in Appendix 2.

37. The CPS has considered the preliminary findings of the CDS. ADB operations would be further reviewed and adjusted, as necessary, taking into account the final findings of the CDS. Some of the issues analyzed go beyond what is likely to be included in ADB's program during the CPS period. The CDS has examined two sets of measures to address the development challenges: (i) those that will assist Sri Lanka to sustain high growth rates, promote diversification of economic activities, enhance productivity across sectors, assist the economy to integrate with the global economy, and create productive jobs; and (ii) those that promote inclusivity of growth so that the benefits are more equitably shared. These are also the key challenges recognized in the government's development strategy. To supplement the CDS, ADB is undertaking other studies to assist the government in formulating policies, covering areas of employment; value chain prospects; human capital development capacity; elderly care; and social insurance.

38. ADB is undertaking a study of the CTEC development plan, including a feasibility analysis, an infrastructure strategy, as well as regulatory, institutional framework and financing plan. The study will provide the conceptual framework for the development of other planned economic corridors. Sector-specific studies are also planned during the CPS period, including master plans for the development of ports and railways, evaluation of the transmission system's stability and protection standards, weaknesses of the current water policies and legislation, and sustainable financing models for public health programs. Depending on the government's needs, other knowledge products will be prepared during the implementation of the CPS.

IV. STRATEGY IMPLEMENTATION

A. Indicative Resource Parameters

39. ADB proposes to scale up its sovereign operations to \$800 million–\$1,000 million per annum over 2018–2022 to support the government in achieving infrastructure and social needs toward reaching UMIC status. Sri Lanka's portfolio performance has been satisfactory, with high absorptive capacity,²² and it is ready to absorb more. While public debt stands at 79% of GDP in 2016, the ongoing IMF program targets to reduce public debt as the reform package is implemented. Larger borrowing from ADB will decrease commercial borrowing and will contribute to debt sustainability. As the proposed assistance exceeds the indicative resource allocation of \$600 million–\$650 million per annum during 2018–2020, efforts will be made to access additional resources set aside for regional cooperation and integration and concessional resources for the health sector, as well as additional regular ordinary capital resources (OCR). Additional resources to meet the gap are justifiable given the absorptive capacity of Sri Lanka. More cofinancing from

²² As of 15 June 2017, out of \$2.91 billion effective loans (32 projects), 74% have been awarded and 52% have been disbursed.

development partners will also be pursued to leverage both financial and knowledge resources. ADB will also increase its private sector operations by expanding into non-finance sectors (infrastructure, health, and agriculture), and uplift its role in facilitating PPP. Sri Lanka is currently a group B country. It is expected that Sri Lanka will graduate in 2019 to a group C country,²³ and more regular OCR will be allocated thereafter to compensate for the end of concessional assistance.

40. TA resources for the CPS period need to be increased to support a larger volume of lending. The resources will be used for project or program development and preparation, implementation support, capacity development, and for developing knowledge products and services. The TA support is expected to be about \$8 million per year during 2018–2022, which includes financing from ADB's Technical Assistance Special Fund, the Japan Fund for Poverty Reduction, and other trust funds.

41. In view of the constrained financial situation of the government, the current cost-sharing arrangement is proposed to remain unchanged. The country cost-sharing ceiling for loans will be at 90% for the CPS period. Cost sharing for individual projects will be decided on a case-by-case basis and might go up to 99%, depending on the project cost, project design, and availability of cofinancing. No sector-specific ceilings are in place. The country cost-sharing ceiling for TA and other grants will remain at 85% of the total cost. These cost-sharing limits can be reconsidered during the CPS period depending on the fiscal situation and the government's financial ability to provide adequate resources for counterpart funds.

B. Implementation Priorities

42. **Building a strong project pipeline through over-programming.** ADB will over-program to strengthen the pipeline of projects and programs. Projects will be processed and taken up when additional resources are available. The over-programming will contribute to a strong pipeline as it will ensure the readiness of projects, adopting a first-come first-served approach. This will also provide an opportunity for ADB to respond flexibly to the government's needs.

43. **Developing manageable number of loans and contracts.** ADB will attempt to increase the size of loans and contracts, to contain the total number of loans and contracts as well as the demand for additional staff resources. Larger contracts will attract bigger and stronger contractors to participate, minimizing problems during implementation.

44. **Designing projects with focused sector policy and strong implementation arrangements.** ADB will strengthen its project designs, with clear and focused coverage of sector and institutional aspects based on continuous policy dialogue. Realistic implementation arrangements will be proposed and supported by capacity building.

45. **Stricter project readiness filters.** ADB will adopt stricter project readiness criteria including early establishment of the project office and its staffing, commencement of the land acquisition and resettlement process, and advance procurement actions. ADB will bring projects to its Board of Directors with high implementation readiness. This will avoid accumulation of uncommitted funds and help maintain good portfolio performance. To help achieve compliance with the criteria, ADB will mainstream the use of TA loans and project design advances.

²³ This will provide 1.5 years for the government to adjust after graduation from the International Development Association in July 2017.

46. **Strengthening project execution.** ADB will continue to be involved in building the capacity of implementing agencies in all sectors of operations. Training and hands-on assistance will be provided in procurement, safeguards, contract management, and financial management. These efforts will be strengthened by more active collaboration with other development partners.

47. **Use of country system and managing governance risks.** ADB will (i) ensure predictability in the availability of funds by making full use of country public financial management systems, in particular country budgeting, treasury, accounting, and auditing systems; (ii) adopt the use of country systems selectively in safeguards and procurement, taking into consideration agency capacity and associated fiduciary risks; and (iii) raise awareness of ADB's Anticorruption Policy (1998, as amended to date) and its impact on operations in collaboration and engagement with ADB's Office of Anticorruption and Integrity and Sri Lanka's Commission to Investigate Allegations of Bribery or Corruption.

48. **Enhancing linkages between sovereign and nonsovereign operations.** ADB will continue to support an improved business-enabling environment, including capital market development, and promoting PPP and development of SMEs. Public sector capacity to develop and prepare PPP projects will be strengthened. Opportunities for local currency lending, which have been a key constraint to nonsovereign domestic borrowing, will be pursued.

C. Monitoring of Results

49. The CPS results framework focuses on outcomes in priority areas to attain UMIC status. It is closely aligned with the government's goals, and includes the results of collective effort by the government, development partners, and other key stakeholders. ADB will continue to support the Sustainable Development Goals as reflected in outcome indicators in Appendix 1.

50. ADB will closely monitor the results annually during the country programming missions, including progress on the three cross-cutting areas. Depending on the outcomes, the results framework will be modified to reflect the changing scenario. The changes will be reflected in the annual 3-year rolling country operations business plans.

D. Risks

51. The CPS has been formulated in an environment of considerable risks, which have the potential to influence the outcome and impact of the program. Two important potential risks are:

- (i) **Delay in restoring macroeconomic stability.** Progress on the IMF's EFF program for restoring macroeconomic stability might not proceed per schedule because of the inability of the government to take politically sensitive policy decisions. This could constrain the government's ability to undertake public investment and provide adequate counterpart funds for ongoing projects. Private investment would also be adversely affected. Nevertheless, the current government stance indicates a strong commitment to pursuing reforms per schedule. A major reform of value-added tax has already been implemented. Other tax reform measures were announced in the national budget 2017. For successful implementation of SOE reforms, development partners are working closely to assist the implementation of reforms in their respective areas of operations.
- (ii) **Weak implementation capacity of executing agencies new to ADB operations.** As the program involves new areas (railways, municipalities, health, and fishery), ADB

will support the new executing and implementing agencies by targeted capacity-building activities including training, workshops to share best practices, and hand-holding training through day-to-day operations.

COUNTRY PARTNERSHIP STRATEGY RESULTS FRAMEWORK

Country Development Impact Indicators with which the CPS is Aligned: (i) One million jobs generated; (ii) Income levels enhanced; (iii) Rural economies developed				
CPS Objectives and Related Impacts	CPS Priority Areas	Key Outcomes that ADB Contributes to	Outcome Indicators	CPS Resources
Strengthen driver of growth along with diversification of economic activities and productivity enhancement	Expand provision of growth-oriented infrastructure Support economic corridor development Upgrade human capital Promote private sector development and PPP	<p>Energy sector Improved provision of electricity services through sustainable development and efficient use of energy resources</p> <p>Urban and water sector Improved urban water supply and sanitation services, with greater availability and reliability</p> <p>Transport sector More efficient, sustainable, and integrated transport infrastructure and better connectivity</p> <p>Education sector Improved equitable access to relevant and high quality secondary education, skills development programs, and employment-oriented higher education</p> <p>PPP</p>	<p>By 2022</p> <ul style="list-style-type: none"> • System supply capacity increased to 6,367 MW (2015 baseline: 3,847 MW)—SDG 7 • Energy supply from nonconventional renewable energy sources increased to 20.0% (2015 baseline: 11.0%) – SDGs 7, SDG 8 • System losses of Ceylon Electricity Board network reduced to 8.0% of net generation (2015 baseline: 9.9%). – SDG 7 • Access to piped water supply increased to 60% (2015 baseline: 46%)—SDG 3, SDG 6 • Proportion of access to improved sanitation increased to 100% (2015 baseline: 87%)—SDG 3, SDG 6 • Access to pipe sewerage facilities increased to 7% of urban population (2015 baseline: 2%)—SDG 3, SDG 6 • 1,000 tons of municipal solid waste generated in Colombo Municipal area will be efficiently disposed (2015 baseline: 349 tons per day)—SDG 11 • Passenger transport share of railway increased to 6% from 5% in 2015—SDG 11 • Freight transport share of railway increased to 2% from 1% in 2015—SDG 9 • Cargo handling volume of Colombo port increased to 7.6 million TEU from 5.2 million TEU in 2015—SDG 8, SDG 9 • Expressway connectivity between international trade facilities (ports and airports) and economic centers improved—SDG 8, SDG 9 • Employment rate of national vocational qualification graduates increased from 57% in 2015 (female: 47% / male: 64%) to 62% (female: 50% / male: 65%)—SDG 4, SDG 8, SDG 9 • Enrollment in technology disciplines increased from 7.41% in 2015 to 10%—SDG 4 • Unemployment rates for youth (15–24 years old) reduced from 17.8% (15.7% male; 21.6% female) in 2012 to 12% in 2021—SDG 4, SDG 8, SDG 9 • Private investment as percent of gross domestic product increased—SDG 8, SDG 17 	<p>Ongoing portfolio Ongoing sovereign loans (as of 31 December 2016) Number: 51 Amount: \$3.5 billion</p> <p>Ongoing TA (as of 31 December 2016) Number: 18 Amount: \$19.9 million</p> <p>Planned operations and contribution: Sovereign lending: \$4 billion—\$5 billion for 2018–2022</p> <p>TA: \$40 million for 2018–2022</p>

CPS Objectives and Related Impacts	CPS Priority Areas	Key Outcomes that ADB Contributes to	Outcome Indicators	CPS Resources
		Developed policy and regulatory framework; PPPs introduced in education, health, and infrastructure		
Improve quality of growth to promote inclusiveness	<p>Strengthen agriculture infrastructure and commercialization</p> <p>Improve rural connectivity</p> <p>Improve quality of public service delivery</p> <p>Expand access to finance for SMEs</p> <p>Strengthen environment, climate change, and disaster risk management</p> <p>Promote gender equality</p>	<p>Agriculture, natural resources and rural development sector Secured access to water resources and improved fish production</p> <p>Transport Improved rural access roads and rail-based public transport</p> <p>Urban and water sector Expanded access to safe drinking water</p> <p>Social sector Improved access to school education and skills development programs</p> <p>Improved estate sector health care delivery system</p> <p>Finance sector SMEs' access to finance strengthened</p>	<p>By 2022</p> <ul style="list-style-type: none"> 974 mcm/year of water available in North Central Province, inclusive of 70 mcm/year of raw water for 358,000 people (2014 baseline: 60 mcm/year with 0 mcm/year for drinking)—SDG 2, SDG 6 130 mcm/year water available in North Western Province (2015 baseline = 0 mcm)—SDGs 2, SDG 6 Irrigated area serviced by Mahaweli system increased to 162,000 ha with cropping intensity of 191% (2014 baseline: 146,000 ha and 188%)—SDG 2, SDG 6 Marine fish production increased to 85,000 tons per year (2015 baseline: 72,560 ton)—SDG 2 Aquaculture production increased to 500 tons per year (2015 baseline: 275 tons)—SDG 2 Connectivity of 1,500 villages in Uva, Northern, Eastern, and Colombo provinces improved—SDG 9 Railways passenger transport share increased to 6% (2015 baseline: 5%) 100.0% access to safe drinking water (2015 baseline: 86.0%)—SDG 3, SDG 6 Disparity between districts and/or provinces in ordinary level pass rate reduced from 14.8% in 2015 to 7.0%—SDG 4 Survival rate at the end of grades 1–11 cycle increased from 85.42% (88.5% girls/82.4% boys) in 2015 to 87.0% (with better gender parity)—SDG 4 Home deliveries among estate women reduced from 2.2% to 0%—SDG 3, SDG 10 Infant mortality rate among estate populations reduced from 29 to 10—SDG 2, SDG 3, SDG 10 Outstanding bank loans to SMEs increased by 7% per annum from SLRs843 billion (as of September 2016) to SLRs1,204 billion—SDG 1, SDG 5, SDG 8, SDG 9 	

ADB = Asian Development Bank, CPS = country partnership strategy, ha = hectare, mcm = million cubic meters, MW = megawatt, PPP = public–private partnership, SDG = sustainable development goal, SLR = Sri Lanka rupee, SMEs = small and medium-sized enterprises, TA = technical assistance, TEU = twenty-foot equivalent unit
Source: Asian Development Bank.

COUNTRY KNOWLEDGE PLAN

A. Knowledge Needs

1. Sri Lanka is close to achieving upper middle-income country (UMIC) status. To assist in the transition to a UMIC, Sri Lanka will face several challenges such as increasing productivity across sectors, developing new products, and providing more sophisticated and complex services. Improving productivity requires bridging the knowledge and technology gap that exists between Sri Lanka and higher-income countries through innovation; the introduction of contemporary technology; and improvement of the education system, especially in higher education geared toward science. Sri Lanka also needs to eradicate the remaining poverty, tackle the prevailing high inequality, and mitigate environmental challenges. At the same time, the government needs to restore macroeconomic stability by undertaking the required reform measures, many of which are part of the International Monetary Fund's Extended Fund Facility.
2. Sri Lanka has developed the basic infrastructure such as rural road networks and access to power, and is providing basic education and health services across the country. The rural electrification ratio was 98% in 2015, and the country will attain 100% coverage under an ongoing ADB-funded project.¹
3. Road density in Sri Lanka is one of the highest in developing Asia. The country's human development index is better than the average for countries with similar per capita income, and it is classified a high human development country. However, to sustain economic growth over the medium to long term, the quality and availability of infrastructure needs to be improved, and higher education and research capacity needs strengthening.
4. Knowledge will play an important role in supporting the requirements of an emerging UMIC. Economic planning will guide the selection of priority locations for advanced infrastructure and focus areas in the education sector to meet the future market demand. This will enable limited public resources to be used in areas that generate maximum returns and maintain efficiency of public spending in hard and soft infrastructure. Further, the business environment will need to be improved since sustaining rapid economic growth will require considerably larger private sector participation, both domestic and foreign. As Sri Lanka implements policies and develops institutions that facilitate the structural transformation of the economy, lessons from the successful experiences of other countries will provide insights into formulating policies and restructuring institutions. ADB's knowledge of the experiences of successful Asian countries will be a key factor in this process.
5. To facilitate the transition to a UMIC, the government needs to have a clear idea of which sectors have potential for future development and its appropriate locations. Knowledge of advanced technologies and best practices that are suitable for Sri Lanka will also be necessary. For this purpose, the government plans to form groups of technocrats, who have professional knowledge in different areas. These groups will play an important role in promoting innovative thinking among civil servants, sharing knowledge about global best practices, and encouraging their application in policy making.

¹ ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Administration of Grant to the Democratic Socialist Republic of Sri Lanka for the Ceylon Electricity Board Supporting Electricity Supply Reliability Improvement Project*. Manila.

6. As the poverty rate drops further, the role of social protection schemes will increase to protect the vulnerable and underserved sections of the population. Since the provision of basic social services is developed, and geographical inequalities are being addressed, the emphasis of policy actions to ensure inclusiveness will shift toward developing cash transfer schemes, social insurance, and reducing the distortions in the labor market. As Sri Lanka is an aging society, the social protection expenditure will increase. As a first step, knowledge products are required to assess the efficacy and reach of the current social protection schemes to determine reforms in policies and institutional arrangements.

7. Environmental protection is necessary for sustainable development. The government requires advice for managing environmental protection and natural resource conservation. Developing renewable energy is a desirable step, but other measures are also required to tackle the challenges of climate change.

B. Scope of ADB's Planned Knowledge Operations

8. The ongoing and planned knowledge solutions consist of knowledge services and knowledge products. All relevant departments in ADB, as well as the ADB Institute, will contribute in planning and delivering the services and products. Since the CPS covers 5 years, it is difficult to predetermine a comprehensive knowledge plan for the entire period. Changes in the internal and external environment may trigger a need for adjustment of the plan, so it is built in a flexible manner, and will be monitored and adjusted in response to the evolving knowledge needs of the country.

9. **Knowledge services.** ADB will provide training and facilitate knowledge-sharing events involving Sri Lanka and other developing member countries. These may include sector forums (transport forum, water resource forum, energy forum, urban forum, and education and skill forum), as well as thematic forums and workshops (safeguards, gender, climate change, and anticorruption). Specific topical workshops (preparing development outlook, women leaders, macroeconomic management, and fiscal policy) will also be pursued.

10. **Overall economic challenges.** The country diagnostic study (CDS) and employment diagnostic study are being prepared by ADB's Economic Research and Regional Cooperation Department. The studies address the major constraints likely to be faced by Sri Lanka in its transition to a UMIC, such as (i) Sri Lanka's fiscal challenges: an international perspective; (ii) strengthening state-owned enterprises in Sri Lanka—the way forward; (iii) a diagnostic study of manufacturing exports of Sri Lanka—opportunities, achievements, and policy options; (iv) the services sector in Sri Lanka—driver of competitiveness and growth; (v) challenges and opportunities in modernizing agriculture in Sri Lanka; (vi) financing and sustaining Sri Lanka's urbanization and urban development; (vii) wage policies and industrial relations; (viii) skills and higher education; and (ix) aging and its implications. Once the studies are completed and the recommendations are presented, follow-up actions will be pursued with the government in ADB operations.

11. **Private sector development.** The following studies are planned to support the government in economic planning and addressing the constraints in improving the business climate:

- (i) **Economic corridor study.** The economic corridor study, focusing on the Colombo–Trincomalee corridor, explores potential sectors that can drive Sri Lanka's economic growth in the future, and identifies where they can be most

efficiently located. The findings of the study will help the government to plan the location of advanced infrastructure and target areas for higher education.

- (ii) **Study on value chain in light manufacturing, construction, and information and communication technology.** This study is funded by technical assistance (TA) attached to the ongoing Small and Medium-Sized Enterprises Line of Credit Project.²
- (iii) **Justice sector reform.** TA under ADB's Office of the General Counsel will undertake a needs assessment and prepare a road map for justice sector reforms. It will primarily focus on commercial law to assist private sector development.

12. **Provision of infrastructure.** To assist the government in planning infrastructure projects better, the following knowledge products will be prepared in the energy and transport sectors.

- (i) **Energy sector assessment.** This is a comprehensive study of Sri Lanka's energy sector, providing policy recommendations on future directions of development.
- (ii) **Wind power development in Sri Lanka.** This presents the developments in wind power generation in Sri Lanka, and analyzes the experience of wind power generation and lessons for future wind generation expansion in the country.
- (iii) **Port master plan.** The master plan will examine the entire ports sector, with detailed plans for Colombo and Trincomalee ports.
- (iv) **Railway master plan.** The plan prioritizes investment and identifies areas for public-private partnership. It will also cover institutional strengthening and reforms in tariff and cost-sharing (subsidy) structure.
- (v) **Water treatment plant operations.** This will cover the experience and lessons learned from a pilot project.

13. **Human capital development.** Sri Lanka is reorienting secondary education and technical and vocational education and training, with a greater focus on science and technology, information and communication technology (ICT), and the English language to meet market demand. Higher education needs to be strengthened to prepare for absorption of contemporary technology transfer, and to enhance the capacity of the country for knowledge creation and innovation. A study will be undertaken covering the following areas: demand analysis for science and technology graduates; a tracer study of secondary school graduates; a perception survey of employers of secondary, technical and vocational education and training, and higher education graduates; and higher education financing mechanisms.

14. **Strengthening infrastructure sector institutions.** Strengthening infrastructure sector institutions is critical for greater private sector participation. It will also limit financial losses, enhance financial and managerial independence, and reduce the burden on the budget. Public-private partnership will be explored to decrease the public investment requirement and introduce private efficiency in public service provision. Knowledge transfer and capacity building are equally important. Ongoing and planned knowledge operations in this area are listed below:

- (i) The CDS is undertaking studies on Ceylon Electricity Board (CEB), Sri Lanka Ports Authority, and Sri Lanka Transport Board. The recommendations will be examined for further actions in ADB operations.

² ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Administration of Technical Assistance Grant to the Democratic Socialist Republic of Sri Lanka for Small and Medium-Sized Enterprises Line of Credit Project.* Manila.

- (ii) Institutional strengthening will also be pursued in ADB-supported infrastructure projects. Target state-owned enterprises will include CEB, Sri Lanka Ports Authority, Sri Lanka Railways, the National Water Supply and Drainage Board, and the expressway authority (to be established).
- (iii) Direct lending to CEB with government guarantee started in 2016. The financial management capacity of CEB will be enhanced so that it can borrow from ADB without a government guarantee in the future.
- (iv) Capacity building TA will be provided to support Sri Lanka Railways in institutional development; procurement; and project management, including safeguards implementation.
- (v) Ongoing capacity building TA³ will continue support for strengthening institutional capacity development in the National Water Supply and Drainage Board.
- (vi) TA for institutional strengthening of expressway operations and management will support the establishment of the expressway corporation.

15. **Promoting Inclusiveness.** Knowledge operations below contributes to promote inclusive growth in Sri Lanka.

- (i) Strengthening Developing Member Countries' Capacity in Elderly Care. Regional TA by ADB's Sustainable Development and Climate Change Department is conducting a country diagnostic study for Sri Lanka. ⁴
- (ii) Study on social insurance. The study, funded by TA attached to the Capital Market Development Program, reviews social insurance development for increasing inclusivity. ⁵
- (iii) Study on value chain in light manufacturing, construction, and ICT.
- (iv) Study on SMEs credit guarantee institute.
- (v) CDS. The topic on aging explores its implications for the social security system in Sri Lanka.
- (vi) Employment diagnostic study. The study explores how to address labor constraints by promoting female workers (low female labor participation) and youth (high unemployment rate) in the labor force.

16. **Environment management.** Environment management—including conservation, adaptation, and mitigation—is critical for sustainable economic growth in Sri Lanka.

- (i) Study on improving system efficiencies and water productivity. This study will investigate inefficiencies in the conveyance and irrigation systems and constraints to improving water productivity, and recommend on-farm and system-wide improvements.
- (ii) Study on strengthening institutions with integrated water resources management. This will recommend programs for modernizing policy and governance

³ ADB. 2014. *Technical Assistance to the Democratic Socialist Republic of Sri Lanka for Institutional Development of National Water Supply and Drainage Board*. Manila.

⁴ ADB. 2016. *Technical Assistance to the Democratic Socialist Republic of Sri Lanka Strengthening Developing Member Countries' Capacity in Elderly Care*. Manila. <https://www.adb.org/projects/documents/strengthening-dmc-capacity-in-elderly-care-tar>

⁵ ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Policy Based Loan, Technical Assistance Grant and Administration of Technical Assistance Grant to the Democratic Socialist Republic of Sri Lanka for Capital Market Development Program*. Manila. <https://www.adb.org/sites/default/files/project-document/202466/49365-002-rrp.pdf>

frameworks, and institutional strengthening to improve national water resources planning and management, and operation and maintenance procedures.

- (iii) Study on water productivity assessment for improved irrigation performance. Satellite remote sensing techniques will be used. The study will support irrigation managers to take appropriate measures during crop water stress and water shortages.

C. Areas of Collaboration with Partners

17. ADB will closely coordinate with the government, development partners, and other stakeholders, including local think tanks and academic institutions, in planning, programming, and delivering knowledge services and products, as well as in encouraging wider knowledge sharing and exchange.

D. Resource Allocation

18. TA and staff consultancies will be an important resource for the delivery of outputs. Investment projects will also include suitable knowledge products and services. In addition to country-specific assistance, the findings of regional TA by ADB and the ADB Institute will be utilized in assisting the government. Trust funds, cofinancing from development partners, and cost sharing with the government will also support knowledge work.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/CPS/?id=SRI-2018>

1. Inclusive and Sustainable Growth Assessment
2. Development Coordination Matrix
3. Country Operations Business Plan: Sri Lanka, 2018–2020