

Country Assistance
Program Evaluation

Sri Lanka



Independent
Evaluation



Raising development impact through evaluation

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Sri Lanka, 2006–2015

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NOTES

- (i) In this report, "\$" refers to US dollars.
- (ii) For an explanation of rating descriptions used in evaluation reports of the Asian Development Bank, see ADB. 2010. *Revised Guidelines for the Preparation of Country Assistance Program Evaluations*. Manila.

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Abbreviations

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
ANR	–	agriculture and natural resources
CAPE	–	country assistance program evaluation
CBO	–	community-based organization
CEB	–	Ceylon Electricity Board
CPS	–	country partnership strategy
DPF	–	Development Policy Framework
FDI	–	Foreign Direct Investment
GDP	–	gross domestic product
ICT	–	information and communication technology
IED	–	Independent Evaluation Department
IFC	–	International Financial Corporation
IMF	–	International Monetary Fund
ITMIS	–	integrated treasury management information system
JICA	–	Japan International Cooperation Agency
km	–	kilometer
kV	–	kilovolt
LTTE	–	Liberation Tigers of Tamil Eelam
MDG	–	Millennium Development Goals
MFF	–	multitranches financing facility
NECCDEP	–	North East Coastal Community Development Project
NECORD	–	North East Community Restoration and Development Project
NGO	–	nongovernment organization
OCR	–	ordinary capital resources
PCR	–	project completion report
PPP	–	public–private partnership
PSM	–	public sector management
PSOD	–	Private Sector Operations Department
PUC	–	Public Utilities Commission
PVR	–	project validation report
RAMIS	–	revenue administration management information system
RDA	–	Road Development Authority
SLRs	–	Sri Lanka rupees
SMEs	–	small and medium-sized enterprises
SOE	–	state-owned enterprises
TA	–	technical assistance
TFP	–	trade finance facilitation program
TVET	–	technical vocational education and training
WMIS	–	water supply and other municipal infrastructure and services

Contents

Acknowledgments	vii
Executive Summary	ix
Chapter 1: The Country Context	1
A. Development Priorities	1
B. The Revenue Challenge	2
C. Binding Constraints	4
D. Evaluation Methods and Limitations	5
Chapter 2: ADB Strategy and Program	7
A. Country Strategies	7
B. Assessment of Overall Strategy	9
Chapter 3: Supporting Inclusive and Sustainable Growth	17
A. Transport	17
B. Water Supply and other Municipal Infrastructure and Services	22
C. Energy	26
D. Summary	31
Chapter 4: Support for Conflict- and Tsunami-Affected Areas	33
A. ADB Strategy	33
B. The Multisector Operational Portfolio	35
C. Doing Things Differently in a Conflict-Affected Context	37
D. Beneficiary Feedback on Results	43
E. Conclusions from ADB's Support to the North and East	46
Chapter 5: Catalyzing Private Sector Investment	48
A. Private Sector Development Context	48
B. Government and ADB Strategy	49
C. ADB Program Assessment	50
Chapter 6: Human Resource Development	59
A. Government Policies and Strategies	60
B. ADB Policies and Strategies and the Lending Program	60
C. Evaluation of Performance: ADB's Education Sector Program	61
Chapter 7: Overall Assessment	65
A. Relevance and Responsiveness	65
B. Effectiveness	68
C. Efficiency	71
D. Sustainability	73
E. Development Impacts	74
F. ADB and Borrower Performance	76
G. Key Findings and Recommendations	77
Appendix: List of Linked Documents	80

Supplementary Appendixes (available on request):

1. Public Sector Financial Institution Assessment
2. Non-sovereign Sector Assessment

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IED remains fully responsible for the report.

Executive Summary

Sri Lanka's economy has performed well after the end of nearly 3 decades of internal conflict in 2009, growing by an average of 6.4% a year from 2010 to 2015. A large proportion of this growth was driven by a spike in public investment to rebuild infrastructure at the end of the conflict, which is not expected to be sustained. Growth has already slowed in the last 2 years, to 4.9% in 2014 and 4.8% in 2015.

While there is a need to foster new sources of sustainable growth, a serious challenge to Sri Lanka's prosperity is the low level of government revenue generated in relation to gross domestic product (GDP), which is now one of the lowest in the world. The tax-to-GDP ratio has fallen consistently over the last 4 decades; from 24.2% in 1978 to 10.1% in 2014 before climbing to 12.1% in 2015 due to one-off tax measures and a surge in imports. Limited tax revenue is driving up the cost of borrowing and weakening the government's ability to sustain public investment and promote inclusive growth.

The new government, which came to power in 2015, appreciates the magnitude of the revenue crisis and is promising action to address it along with other challenging policy adjustments. Following unfavorable external conditions and a deteriorating fiscal balance, in June 2016 the government committed to reduce the fiscal deficit; increase revenue; and reform state-owned enterprises, trade policy, and the investment climate, supported by an International Monetary Fund (IMF) Extended Fund Facility. The government also plans to introduce an automatic pricing mechanism for fuel and electricity prices to reduce the fiscal risk associated with these sectors and to enhance the role of the private sector. These are policies that the Asian Development Bank (ADB) identified in all three of its country partnership strategies (CPSs) and supported during the period covered by this evaluation, 2006–2015.

Assessment of ADB Strategy and Programs

This country assistance program evaluation (CAPE) assesses ADB support for Sri Lanka over the 10 years from 2006 to 2015. ADB's program over this period leaned toward investment in the infrastructure sectors, particularly transport (36% of total approvals by value 2006–2015), water and sanitation (21%), and energy (16%). Education received 11% of total support, and multisector—ADB's support for conflict-affected communities—received 6%, with no new support from 2010. Although no new projects in the agriculture sector were approved in the period 2004–2014, this sector accounted for 4% of the program because of the approval of a large irrigation project in 2015. Public sector management, ADB's support to revenue administration, was 1% as was industry and trade. Nonsovereign private sector operations were 4%. This focus on infrastructure broadly aligned with the government's own Development Policy Framework over the CAPE period, which identified the need for higher levels of infrastructure investment to boost growth and help rebuild conflict-affected areas after nearly 30 years of debilitating internal conflict.

There were three CPSs over the CAPE period and one interim strategy, written in response to the change in government in June 2015. CPS, 2012–2016 organized ADB support around three pillars: inclusive and sustainable economic growth (pillar 1),

catalyzing private investment and enhancing the effectiveness of public investment (pillar 2), and human resource and knowledge development (pillar 3). Cross-cutting themes common to all three CPSs over the evaluation period were climate change, environment, gender, governance, and private sector development. This framework was used to assess ADB's program and its results over the CAPE period, which is discussed in more detail below.

Inclusive and Sustainable Economic Growth

The rehabilitation and expansion of infrastructure and services in lagging and conflict- and tsunami-affected regions was a key part of ADB's strategy to support inclusive growth throughout the CAPE period. It closely aligned with the government's Development Policy Framework, which identified investment in infrastructure as one way to reduce regional disparities, enhance connectivity, and promote employment opportunities throughout the country.

ADB's support for inclusive growth is assessed in two parts. The first assesses ADB support for infrastructure projects in the energy, transport, and water supply and other municipal infrastructure and services sector, while the second assesses support for projects that targeted communities affected by conflict and natural disasters, and included a mix of agriculture, education, health, infrastructure, livelihood support and training in response to community needs.

Energy, Transport, and Water Supply and Sanitation Operations

Energy operations. ADB funded four electricity projects over the period, three of which were already ongoing at the start of the period. Through its support for the expansion of electricity transmission and distribution, particularly in the north and east, ADB helped the energy sector make substantial improvements during the evaluation period. In 2014, the household electrification rate was 98.4%, up from 66% in 2006. This was well ahead of the milestone indicator in the CPS, 2009–2011 sector results framework, which was 88% by 2016. Although electricity services have been extended throughout the country, with some provinces achieving 100%, other areas lag. For example, Killinochchi and Mullaittivu—the worst conflict-affected districts in the Northern Province—have only 70% electrification.

Energy for all is a development priority for Sri Lanka. The challenges are to ensure the power sector is operated and regulated independently, with tariff schemes that allow for the full cost of service recovery; scale-up renewable energy; and to create space for the private sector, especially in nonconventional renewable energy where the size of private investment in generation is limited by current legislation. ADB has provided support for independent regulation of the energy sector, which resulted in the establishment of the Public Utilities Commission in 2002, but political interference in tariff setting made this support largely ineffective. An automatic pricing mechanism for fuel and electricity prices continues to be necessary—and is a condition of the IMF's Extended Fund Facility—in order to reduce the burden that current prices place on public finances and to enable the government to restore fiscal stability by 2020.

Transport operations. Progress was made against the overall development results framework for the infrastructure programs identified in CPS, 2012–2016. Because of the dominance of road projects and their rapid expansion, substantial connectivity improvements were made. ADB approved eight transport projects over the period, six in the roads subsector and two for the expansion of Colombo port. Three road

subsector projects were also ongoing. This resulted in economic efficiency gains, as shown by Sri Lanka's 13% improvement in the Logistics Performance Index over 2007–2014. The impact of the Colombo Port Efficiency and Expansion Project, coupled with road improvements, was likely a key factor here. ADB successfully promoted road development in North Central, Eastern, and Northern Provinces from 2008 (the last two being hardest hit by the former conflict). ADB also improved the effectiveness of public investment in national roads through its support to the Road Development Authority for capacity building.

Water supply and sanitation operations. Sri Lanka made impressive progress toward the Millennium Development Goals (MDGs) target of halving the proportion of the population without sustainable access to safe drinking water, and is one of only three South Asian countries to have met its sanitation MDG. The eight water supply and sanitation projects implemented by ADB during the evaluation period, although they are not yet closed, are expected to achieve their targets and have the potential to benefit over 3 million people (more than 14% of the population)—a substantial contribution to the country's efforts to achieve its Sustainable Development Goals.

However, the many efforts that have been made since 1990 to reform water supply and sanitation policies, strengthen institutions, and develop capacity have not progressed as far as expected. While ADB helped strengthen the capacity of the National Water Supply and Drainage Board, other areas of policy and institutional reform have lagged. Sri Lanka has long recognized that private sector investment will be essential if social services, including water supply and sanitation, are to achieve national development targets. But, as with other sectors, progress in institutional and policy reforms was limited. In the 10 years covered by the evaluation, the most important reform efforts were directed at independent tariff setting and private sector participation in service provision. A comprehensive water resource management planning framework introduced in the 1990s and an attempt in the mid-2000s to establish an independent regulatory framework for water and sanitation services both ran into difficulties, reflecting the difficult policy and institutional context more generally over the CAPE period. However, there are now positive signs that water regulation will be covered by the Sri Lanka Public Utilities Commission.

Communities Affected by Conflict and Natural Disasters

ADB supported a series of projects, encapsulated in the strategic goal of CPS, 2004–2008 to support poverty reduction, reconstruction, and development of those communities affected by conflict and natural disasters. Although subsequent CPSs dropped the term “reconstruction,” they maintained a focus on equitable and inclusive economic growth. These community oriented projects (classified as multisector in ADB's project classification system) implemented during the evaluation period were responsive to the needs of more than 750,000 households and made a substantial contribution to the country's efforts to rehabilitate communities affected by the conflict and the 2004 Indian Ocean tsunami.

An assessment was carried out in three districts in Northern and Eastern Provinces to evaluate the results of these multisector projects, which had beneficiary participation. The assessment consisted of a survey of 482 randomly selected households from 24 villages, 24 focus group discussions (12 male, 12 female) in half of the sample villages, as well as interviews with stakeholders knowledgeable about the projects. It confirmed that the decentralized, demand-driven approach to rehabilitation achieved its objectives of improving connectivity and services in the former conflict-affected

regions. The seven projects completed during the evaluation period were found to be *highly successful* or *successful* in restoring health and education services; expanding connectivity to safe water and electricity; rehabilitating national, provincial, and rural roads; supporting rural livelihoods through the rehabilitation of irrigation schemes; increasing access to agricultural services and microfinance; and supporting community development schemes identified by local communities. They also had a significant impact on the health, living conditions, and social and economic empowerment of women.

While these results were impressive, they were undervalued and not included in the results framework in any of the CPSs. ADB's community-level support and other multisector projects that specifically benefited disadvantaged communities in conflict- and tsunami-affected regions were discontinued in CPS, 2012–2016 even though livelihood needs in the former conflict-affected areas remain large, and many households are not enrolled in Sri Lanka's social protection system.

ADB also had a good measure of success in its efforts to support gender and development in Sri Lanka, largely through its support for female-headed households in conflict- and tsunami-affected communities, and for specific efforts to mainstream gender issues in water supply and sanitation, agriculture and natural resources (ANR), and education and training projects and programs. The female participation rate in the multisector projects was high and comparable to that of males. Substantial benefits accrued to women from livelihood support and village-level projects, including economic and social empowerment, security, and health. Private sector operations targeted female entrepreneurs and included gender targets for the use of ADB funds to support inclusive financial development. ADB education projects targeted female participation in science and commerce, and enrollment by women in these areas is slowly rising.

Catalyzing Private Sector Investment and Enhancing the Effectiveness of Public Investment

The lack of progress in ADB's efforts to catalyze private investment and enhance the effectiveness of public investment—pillar 2 in CPS, 2012–2016—illustrates the difficult political economy context for private sector development and policy reform more generally over the entire CAPE period. Support for policy reforms that predated the evaluation period, such as access to finance, which remains a key constraint on private sector development, were not continued in the CAPE period due to lack of ownership by the government at that time. Support planned for institutionalizing public–private partnerships (PPPs) has not moved forward. Nonsovereign private sector operations had some success in supporting the leasing sector, but the operational context was not favorable to pursuing other investments. ADB is now reengaging in the financial sector and is planning a policy-based operation for capital market reforms first set out in CPS 2004–2008 for Board of Directors' approval in the last quarter of 2016.

Support for revenue generation lost momentum over the evaluation period. ADB had positioned itself at the center of fiscal policy reform through its support for revenue administration and expenditure management in 2003, but more could have been done to make this support effective. ADB's close working relationship with the Ministry of Finance should have been maintained. Since ADB support for the revenue function was cancelled in 2013, a key objective of CPS, 2009–2011 has not been achieved, i.e., to improve macroeconomic management through streamlined expenditure management

and better tax administration. While the IMF is now providing such support for the next 3 years, ADB could have supported the government's economic reform program, as set out in its IMF Extended Fund Facility, by designing a timely policy-based loan targeting taxation reform and revenue administration.

It was found that capacity gaps continue to hamper the effective implementation of the program, particularly the Sri Lanka resident mission's ability to engage in macroeconomic policy dialogue. ADB's support for fiscal policy, especially taxation reform, would have benefited from more intensive support and regular engagement by the resident mission. In the tight fiscal environment facing the government, this gap takes on even greater importance because it reduces the effectiveness of ADB's policy dialogue with the government in areas that are now critical to future growth and development.

Human Resource and Knowledge Development

Support for human resource and knowledge development was elevated to a strategic development priority in CPS, 2012–2016. Sri Lanka has a long history of commitment to free public education and universal access to school education. While it has performed well against its South Asian comparators, public expenditure on education as a share of GDP is now one of the lowest in the region.

Despite impressive achievements in human resource development in Sri Lanka, the links between the education system and the labor market remain weak. ADB support was aligned with government objectives to improve the quality and market relevance of the technical vocational education and training (TVET) system, improve science teaching in secondary schools, and help poorer students gain access to tertiary education. Government ownership and enthusiasm for the ADB-financed program, especially the contributions made by successive TVET projects in introducing competency-based learning and the National Vocational Qualification Framework, were evident and progress has been made.

The TVET subsector's performance has been impressive, with an average student completion rate of 92% in 2014, up from 87% in 2012. The engagement of the private sector in the national framework, competency standards, and on-the-job training set new standards for PPPs in education. On inclusiveness, ADB projects had strong equity components that positively contributed to overall education sector equity outcomes.

Overall, this pillar in the CPS was successful in improving the capacity of the education system to impart the skills students need in the labor market in an equitable manner. This is clearly a long-term agenda of the government, and ADB's contribution was defined through the achievement of its own time-bound targets and limited to its own projects. The education program primarily targeted better youth employability, as well as improving academic results and strengthening the overall education system. Nevertheless, much more work needs to be done to upgrade the skills of youth, especially females, if they are to find employment in a more competitive environment.

Overall Assessment

ADB support for Sri Lanka over 2006–2015 was found to be *successful*. ADB operations achieved substantial progress toward most of their CPS development objectives, particularly in the infrastructure sectors and education in which notable improvements in service delivery were made. ADB support was *relevant* to the government's Development Policy Framework, which called for higher investment in infrastructure in lagging regions and service expansion in transport, energy, and water and sanitation. Even so, while ADB was able to scale up its delivery, there was declining attention to sector and macroeconomic policy reform over the period.

ADB's program in ANR did not align with the government's Development Policy Framework and ANR disappeared from the loan approval portfolio in 2004. Despite ANR being a high priority in CPS, 2004–2008, no ANR approvals were made over that period, and the sector was formally discontinued as an area for support in CPS, 2009–2011. However, ANR loans and grants approved prior to, but implemented during the evaluation period, performed well against ADB development objectives. Although the government redirected ADB and other development partners' support from ANR to infrastructure, ADB could have retained its support for natural resource management given the importance of promoting environmentally sustainable growth as a corporate development objective.

The program was rated broadly *effective* in all sectors, except for sovereign operations in the finance sector, which were rated *less than effective*, on account of poor commitment and ownership by the government plus a lack of political will to carry out reforms. Development impact ratings were also in line with this, with a lower score for the sovereign financial sector program. The efficiency of sector programs varied more, being highly rated for the multisector program, and rated *efficient* for transport, energy and education programs, but *less than efficient* for water, ANR, and finance operations.

The sustainability of the impressive infrastructure achievements remains a key risk, especially for transport, energy, and multisector operations, which were rated *less than likely sustainable*. There is evidence that ADB's attention to policy reform in each infrastructure sector declined over the evaluation period while lending increased. The proportion of technical assistance (TA) to total loan approvals also declined. This reflects the government's push to increase infrastructure investment over the CAPE period, while at the same time closing channels for policy dialogue. In transport, ADB support to the Road Development Authority prior to the CAPE period paid off in terms of greater efficiency in project implementation and a strengthened safeguard division. There were some good safeguard results, but other aspects of sector performance stalled. These included the optimal roles of transport modes; the effective management of passenger and road freight transport; and the facilitation of private investment in rail and urban transport operations for efficiency, safety, and environmental reasons.

The ADB country program operated under difficult circumstances during the evaluation period, which saw the end of the long-running civil conflict followed by the challenging task of reconstruction and rehabilitation in conflict-affected regions. ADB responded quickly to these challenges by scaling up support in these regions. The scaling up of support to respond to the needs of lagging and conflict-affected regions underpins the overall *successful* rating, even though the sustainability of such operations was found to be a concern.

While progress was made on gender there was less progress against other cross-cutting objectives, e.g., governance and environment, especially as policy support weakened over the CAPE period and support for ANR diminished.

Looking ahead to the next CPS period, ADB's loan portfolio and the government's development programs face significant sustainability risks. As Sri Lanka transitions to an upper middle-income country, access to concessional financing and TA will decline putting the development agenda at risk unless domestic revenues can be adequately raised. The current government faces an uphill challenge to increase domestic tax revenues, and to attract the levels of private investment needed to expand services, and sustain growth. Sri Lanka needs ongoing support to consolidate its development achievements, reduce regional disparities, ensure inclusive growth, protect the environment, and sustain peace. In the next CPS, ADB should scale up its support for policy reform, private sector development, environmentally sustainable growth, and human capital development.

Recommendations

Recommendation 1. ADB needs to intensify its policy reform work in the infrastructure sectors, including in the reform of state-owned enterprises. Sri Lanka needs to strengthen its macroeconomic stability and pursue structural reforms if it is to achieve sustainable and inclusive growth. One pillar of the government's reform agenda is improving the performance of SOEs in order to reduce the financial burden they place on the state. ADB has a record of long term engagement with several SOEs, including in water supply and sanitation, and energy. It is also a significant partner in transport development. It should be well placed to leverage its significant loan resources to engage in sector policy dialogue, particularly to ensure that SOEs are not creating further liabilities for the state. It needs to strengthen its support for structural reforms in these sectors, particularly for independent tariff setting by the Public Utilities Commission, which ADB helped establish. This is central to the new government's reform agenda supported by the IMF. ADB should seek ways to support the government in implementing this program, while building its relationship with the Ministry of Finance, and working more closely with other development partners on macroeconomic and fiscal policy issues.

ADB also needs to strengthen the capacity of its country office to engage in policy dialogue at the macroeconomic and sector levels, which is a key part of this recommendation. It needs to ensure there is an appropriate balance between the TA and loan portfolios to ensure that TA allocations for policy reform and capacity development are commensurate with the needs of the expanding loan portfolio.

Recommendation 2. ADB's next CPS should set out a strategy for inclusive growth that draws on the success of its community-based projects. There is evidence that ADB can work differently, engage effectively across multiple sectors, and provide social infrastructure and livelihood support at the community level. The kind of rural and community-level infrastructure support provided through the North East Community Restoration and Development Project and the North East Coastal Community Development Project remains highly relevant to economic and social development throughout the country. ADB's approach to community and rural development was well received and effective in strengthening women's engagement in local economic decision making. It also allowed ADB to remain engaged in agriculture, which employs most of the rural population, is important for inclusive growth, and has a close connection with natural resource management and protecting biodiversity.

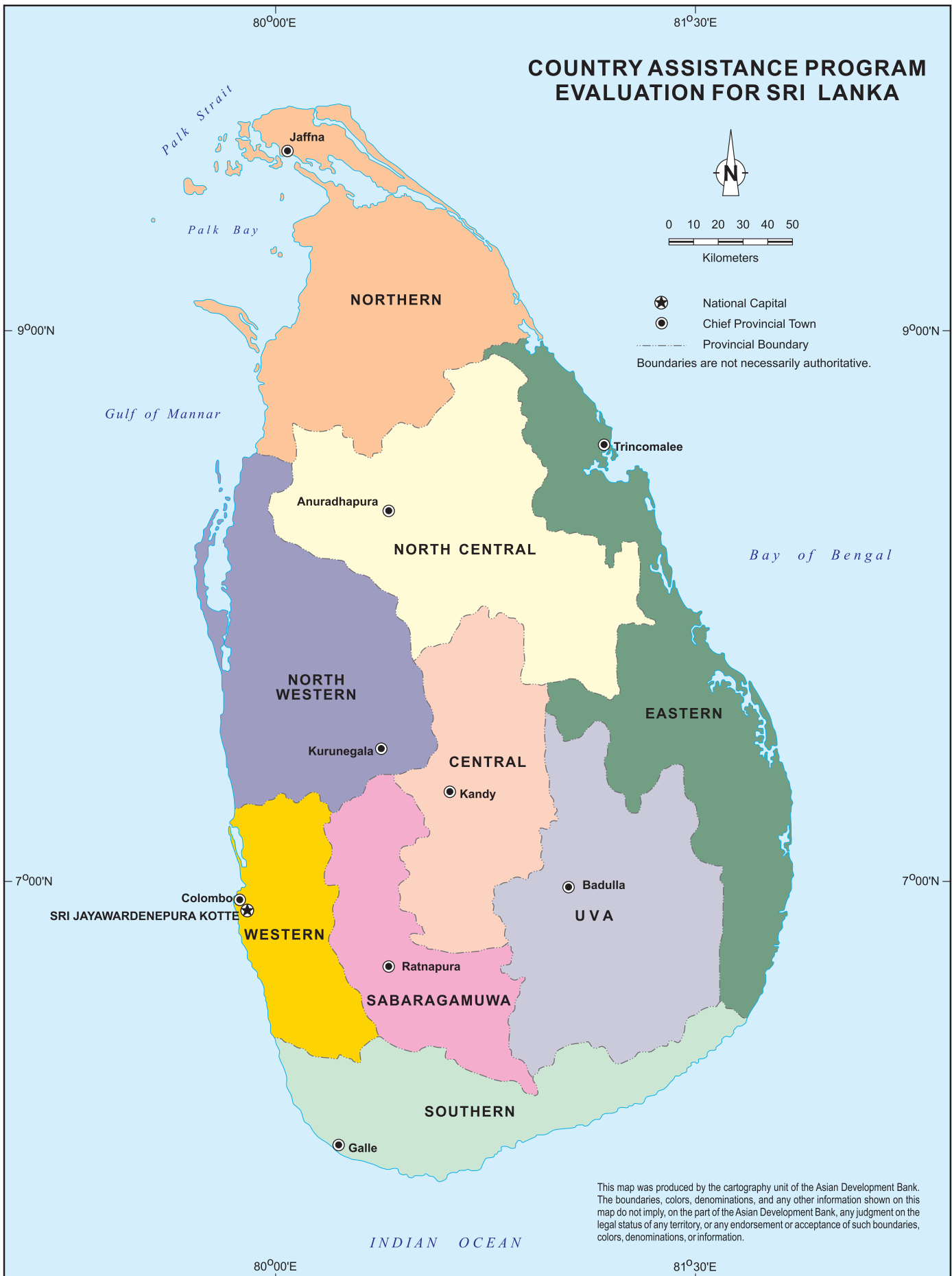
Community-level support also helped ADB build the capacity of local government in service provision. It is recommended that ADB learns from this approach and (i) takes a sectorally integrated approach in those areas where poverty persists and where social protection coverage remains inadequate, and (ii) enhances inclusion by ensuring that agriculture and natural resource management and measures to protect the environment are pursued in parallel with and in addition to infrastructure projects.

Recommendation 3. The new CPS needs to define a clear approach to ADB's support for private sector development, which establishes better synergies between work on the investment climate, public investments, and private sector operations. The need to strengthen the private sector through improving the investment climate, and to increase private investment in infrastructure and other sectors (e.g., education), have been long-running themes in ADB CPSs, but progress has been slow. The investment climate is a binding constraint on private sector development and the reform agenda is challenging. ADB will find it hard to engage in investment activities while the policy environment remains unfavorable. Care needs to be taken to ensure that ADB sovereign loans do not crowd out the potential for private sector investment in roads, energy, water, and financial markets. ADB should look to use its range of financial instruments, such as guarantees, to attract private sector investment.

There should be greater coordination between the Private Sector Operations Department, the South Asia Department (led by the Sri Lanka resident mission), and the Office of Public-Private Partnership, and a unified strategy for private sector development so there is a consistent ADB program of private sector support. The Sri Lanka country director should lead this coordination, monitor its progress, and have an overview of where the program of support is heading. The strategy should set out plans for analytical work, and assist for the business environment over the short to medium term that would support private sector development over the longer term.

Recommendation 4. ADB should expand its support for education as a share of total operations over the next CPS period. The government wants to double its education expenditure from 3% to 6% of GDP but has limited fiscal space to achieve this. The government will not be able to meet the growing demand for tertiary education without restricting access or reducing quality. ADB should help the government develop a strategy for sustainable tertiary education financing that considers options for greater private sector provision in all areas of tertiary education and training.

COUNTRY ASSISTANCE PROGRAM EVALUATION FOR SRI LANKA



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The Country Context

1. Sri Lanka is a lower middle-income country with a gross domestic product (GDP) per capita of \$3,836 in 2015.¹ It is eligible to borrow from the Asian Development Bank (ADB) ordinary capital resources (OCR) and the Asian Development Fund (ADF).

2. Optimism that Sri Lanka can secure lasting national unity and peace has been rising since the end of nearly 3 decades of internal conflict—which devastated Northern and Eastern Provinces—in 2009. Performance on growth and poverty reduction has been impressive but growth started to slow in 2014. In 2015, a new government was elected that signaled its intention to strengthen good governance, pursue economic openness and global integration, and to further national reconciliation.

3. Sri Lanka did better than its regional peers on most Millennium Development Goals (MDGs) and ranked 73 (out of 187 countries) on the Human Development Index in 2014.² The national poverty headcount declined from 22.7% in 2002 to 6.7% in 2012. Extreme poverty fell to 3.2% using the \$1.25-a-day poverty line, and moderate poverty fell to 32.1%, using the \$2.50-a-day measure.³ This reduction reflects investment in human resource development. For example, the share of 17- and 18-year-olds completing secondary education increased from 40% to 60% between 2002 and 2013. Nevertheless, Sri Lanka's Gini coefficient fell from 0.40 in 2002 to 0.36 in 2010, but increased to 0.39 in 2013. Strong growth at the top income distribution indicates that growth is no longer pro-poor, and that disparities remain intact. Pockets of poverty persist in the east, north, and in the estates. Governance remains a challenge in all areas and there are sustainability risks attached to growth and managing environmental assets.

A. Development Priorities

4. The country's development priorities for the 10-year period from 2006 to 2015—the period covered by this evaluation—were initially laid out in its Development Policy Framework (DPF).⁴ The framework aimed to accelerate economic growth to over 8% a year by 2010, reduce income disparities among geographic regions, and reduce poverty by half. It was updated in 2010⁵ with a goal of doubling income per capita to about \$4,000 by 2016, with the increase driven by higher levels of investment, especially in infrastructure (with the private sector playing a much greater role). Under

¹ Central Bank of Sri Lanka. 2015. *Annual Report for 2015*. Colombo

² United Nations Development Program. 2015. *Human Development Report 2015*. New York.

³ World Bank. 2015. *Sri Lanka, Ending Poverty and Promoting Shared Prosperity: A Systematic Country Diagnostic*. Washington DC.

⁴ Ministry of Finance and Planning. 2006. *Mahinda Chintana: A Vision for a New Sri Lanka*. A Ten-Year Horizon Development Framework 2006–2016. Panaluwa.

⁵ The Development Policy Framework of the Government of Sri Lanka was revised in 2010, and published as *Sri Lanka, the Emerging Wonder of Asia, Mahinda Chintana: Vision for the Future*. Department of National Planning, Ministry of Finance and Planning.

the DPF, the government planned to improve the investment climate and increase the efficiency of public spending, as well as shift to a knowledge-based, globally competitive, and internally integrated economy.

5. ADB responded to the government's development priorities with lending and nonlending interventions to support private and public investment and structural shifts in the economy, and to enhance living standards and social inclusion. The latter included infrastructure rehabilitation, support for displaced persons, and the rebuilding of community livelihoods and services. ADB prioritized investments in transport, energy, water supply, and sanitation to meet the government's objectives to expand service delivery throughout the country, especially in lagging regions. ADB interventions also included support for education and skills development, and for private sector development and investment.

6. The government's main strategic challenges are maintaining a high investment rate to sustain economic growth; moving to a more knowledge-based, integrated and competitive economy; and enhancing living standards and social inclusion. Significant macroeconomic obstacles to success are coming to the fore, and are particularly evident in the country's widening trade deficit, low tax to GDP ratio, and insufficient fiscal space. Sri Lanka's rapidly aging population is a major concern. This will put intolerable stress on future social provision that the government will be unable to meet unless it can rapidly increase revenue collection to levels last seen in the 1970s.

B. The Revenue Challenge

7. A significant challenge to Sri Lanka's continued prosperity is the extremely low level of public revenue collection. The low intake is driving up the cost of government borrowing, and weakening its ability to sustain public investment and address inequities in service provision. The revenue decline, combined with some fiscal consolidation and the priority given to public infrastructure investment, has led to reduced expenditure on essential public goods, including health, education, and social protection. Sri Lanka was once a model of social development, but its public spending on social development is now among the lowest in Asia. The country's social safety nets are underfunded and inefficient. Private investment, at 22% of GDP in 2010, is not enough to make up for the shortfall in social development spending. Foreign direct investment (FDI), at just 1.4% of GDP in 2012, is hampered by the investment climate. Needed policy reforms have met considerable resistance, particularly from trade unions, students, and small business organizations, resulting to social tensions souring the investment climate.

8. The revenue crisis has deep roots. For about four decades until the end of the 1980s, government revenues averaged 21% of GDP. This declined slowly and steadily, reaching a low of 10.1% in 2014. Sri Lanka suffered near-continuous internal conflict from 1983 to 2009, but this did not significantly impede revenue collection. The conflict was fought mainly in peripheral agricultural areas of the north and east. Nor did the conflict significantly interfere with tax collection at the points where it is heavily concentrated: Colombo port and airport. Indeed, the conflict did not prevent the economy from growing steadily. The decrease in the tax take began to manifest itself in

a big way in 1990, 17 years after the war began; and it is perhaps significant that the rate of decline accelerated after the war ended in 2009.⁶

9. The high revenue collection that the government enjoyed in the 1950s to 1980s stemmed from high taxes on international trade of plantation products (tea and rubber). Sri Lanka was primarily a plantation economy in that period, although it underwent significant diversification in the 1970s. Today, tea and rubber account for a very small proportion of GDP, and are produced mainly by smallholders not large plantations. The revenue collection system has not kept pace with changes in the economic structure. New types of economic activity and new sources of income and wealth—including a large garment export sector, substantial remittance income, broad-based services growth, and major real estate investments—make little contribution to public revenues. Furthermore, the distributional consequences of fiscal activity have changed radically.

10. Before the 1980s, the government redistributed resources from the rich to poor, but it is no longer doing that. A full analysis of why this is so has never been done, but in many respects the current fiscal system is regressive. Transfers to the poor are small in volume, and many public subsidies and services benefit the better-off. Most revenue is generated through indirect taxes, which are largely borne by poor consumers. Taxes on income and wealth are low, with direct taxes accounting for only 20% of total tax revenue.

11. Sri Lanka's tax policy and tax administration score poorly in international comparisons—and even in comparisons within South Asia, which is generally one of the world's weakest regions for revenue raising. The efficiency and elasticity of Sri Lanka's tax collection are generally low, and strikingly so in the case of value-added tax. An increasing number of regressive features of the revenue system are also becoming apparent. Income and wealth is grossly undertaxed, and there is very little public support for—or understanding of—revenue raising initiatives, and little constructive open political debate on taxation.

12. The current government, which came to power in January 2015, appreciates the magnitude of the revenue crisis, and has committed to both short and longer term measures to address it. The ratio of revenue to GDP is projected to reach 12.9% in 2016, from 10.1% in 2014. Continued progress will depend on the capacity of the government to reverse the consequences of deeply-rooted weaknesses in tax policy and administration. Even so, the political conditions for success are challenging. During the 1950s–1970s, an implicit “fiscal social contract” in Sri Lankan public life was in place. Governments taxed heavily in part because citizens were politically motivated to support large-scale spending on public health and education services. That political willingness to finance universalistic public programs no longer exists for a number of reasons. Sri Lankan voters, for one, are no longer organized and mobilized to support such programs, and therefore the taxation that financed them. This became particularly evident after 2009, when the internal conflict was settled.

13. Rather than seeking to raise more revenue to finance reconstruction, the government gave away considerable potential revenue—notably through widespread reductions in tax rates and increases in tax exemptions—to the extent that the ratio of tax to GDP declined more steeply during peacetime than in the 2 previous decades. Part

⁶ Since 2004 ADB has advocated the introduction of a full-fledged value-added tax, the removal of the Board of Investment's authority to grant tax exemptions and tax holidays, and an increase in the proportion of direct tax collected, although there has been little political will to address these issues.

of the price for this was significant, if largely unannounced, reductions in social spending. The more affluent beneficiaries of lower taxes were privileged over the generally poor beneficiaries of social spending—with little political opposition. It is unlikely that the current or any future government will be able to generate or rely on public support for the urgent task of restoring revenue collection to a sensible level. And for that reason, the government may find strategic support from development partners to be particularly valuable.

C. Binding Constraints

14. Sri Lanka faces a number of development challenges as it transitions to an upper middle-income country. As the economy is relatively small, it needs to look outward and to trade in order to grow. But in the last 10 years, Sri Lanka has shifted toward greater protectionism and an anti-export bias. This is not good for the agricultural sector as incentives encourage farmers to produce crops that compete with imports, such as rice and maize, and discourage exports. High export taxes on raw materials such as tea, rubber, and cinnamon is supposed to increase their value addition.

15. Sri Lanka has been particularly slow to attract the FDI needed to diversify its economy and introduce new technology. Rather than tax holidays and exemptions, global evidence suggests that measures to improve the business environment work better together with an appropriately skilled workforce. While Sri Lanka's past achievements in education are impressive, employers cannot find workers with the skills they need. Sri Lanka lags behind regional peers in language and numeracy skills. There are gaps between the technical and vocational skills employers demand and the capacity of the higher education system to supply them.

16. Since the 1990s, the government has recognized that growth will need to be driven by the private sector, particularly through higher levels of private investment. In turn this requires a regulatory environment that is conducive to business. But regulations remain burdensome on the private sector, and most business enterprises are small and informal. The informal sector faces multiple constraints on growth, particularly access to finance. In addition, the framework for public-private partnerships (PPPs) is weak and only a few cases have emerged so far. Hence, infrastructure has continued to be financed by public spending. Given tight fiscal conditions, this has restricted the space for much needed expenditure in health and education, which is now among the lowest in South Asia. Labor market regulations restrict the growth of employment, especially for women. The state is a large participant in the market through its state-owned enterprises (SOEs), which hinders competitiveness and labor market functioning. SOEs make up half of the financial market. The state is a large employer and there is strong demand for public sector jobs, so much so that graduates, particularly women, are willing to queue for them.

17. Given the deteriorating external conditions and unbalanced domestic macroeconomic policies, the government agreed to an Extended Fund Facility with the International Monetary Fund (IMF) in June 2016. This is intended to put tax revenues on an upward path, reduce the fiscal deficit, and lower the debt-to-GDP ratio. The fiscal deficit, which expanded to nearly 7% of GDP in 2015, is expected to fall to 5.4% in 2016, and 3.5% by 2020. Reform of SOEs, trade policy, and the investment environment are also envisaged. Implementation of automatic pricing mechanisms for fuel and electricity prices will be introduced to prevent further fiscal risk and enhance the role of market forces. Trade policy reform and elimination of para-tariffs (extra fees

added to tariffs) is needed for a stronger outward orientation and to build economic resilience.

D. Evaluation Methods and Limitations

18. This evaluation was prepared to assess ADB's support for Sri Lanka over 2006–2015. Its main purpose is to inform the preparation and design of a new country partnership strategy (CPS) that will guide ADB's Sri Lanka operations from 2017 to 2021. This will be a critical period as Sri Lanka is set to transition to an upper middle-income country. The evaluation also provides an assessment of past performance for accountability purposes.

19. The evaluation approach is guided by the Guidelines for the Preparation of Country Assistance Program Evaluations.⁷ The guidelines focus on assessments of the relevance, effectiveness, efficiency, sustainability, and development impacts of the ADB program in Sri Lanka, as well as the performance of ADB, leading to overall recommendations. In addition, the evaluation was designed to assess: (i) ADB's relevance to efforts to reduce regional development disparities within the country in the aftermath of the conflict; (ii) the effectiveness of ADB support for restoring the economic potential of regions affected by the conflict and the 2004 Indian Ocean tsunami, particularly for women; and (iii) the extent to which ADB support for macroeconomic reform and public sector management (PSM) contributed to sustainable and inclusive growth. The evaluation assesses ADB support against the strategic development objectives set out in the CPSs that were implemented over the evaluation period. It should be noted that this is an assessment of the ADB's country strategy and program, not an assessment of Sri Lanka's overall development progress.

20. The evaluation methodology is built on detailed sector assessments of ADB supported programs in agriculture and natural resources (ANR), education, energy, transport, water and sanitation, and private sector development. These sector assessments are available as linked documents to this report (see Appendix, Linked Documents 1–7). The sector assessments rate project performance, consider cross-cutting objectives, and measure ADB performance against CPS sector results frameworks.

21. The evaluation also assessed ADB's support for communities affected by conflict and natural disasters, classified as multisector projects. Although direct support to conflict-affected communities was discontinued in CPS, 2012–2016, a special assessment of ADB support to these communities was considered to be important for two reasons. First, the type of support provided was different from the rest of the ADB program; it was community-based, highly decentralized, and ADB worked with communities and institutions on both sides of the conflict. Second, while Sri Lanka was not formally identified as a fragile and conflict affected-situation country, ADB adopted a conflict-sensitive approach in its Sri Lanka operations, which is being formally recorded and assessed through this evaluation.

22. The methodology for evaluating multisector projects included a participatory assessment that consisted of a survey of 482 households, focus group discussions, and village-level histories in districts in Northern and Eastern provinces. A full account of the

⁷ IED. 2015. *Guidelines for the Preparation of Country Assistance Program Evaluations and Country Partnership Strategy Final Review Validations*. Manila: ADB.

methodology and the survey instruments used is provided in Appendix, Linked Document 4, Section B.

23. The discussion in this report is organized around the three ADB strategic development priorities identified in CPS, 2012–2016, which deliberately reflect the government’s Development Policy Framework over the period. Chapter 2 discusses ADB’s three Sri Lanka CPSs during 2006–2015. The rest of the chapters reflect the strategic priorities or pillars identified in CPS, 2012–2016. Chapters 3 and 4 provide a detailed assessment of ADB’s support for inclusive growth (pillar one). Chapter 5 discusses ADB’s support for private sector development and investment (pillar two) while Chapter 6 focuses on human development (pillar three). Chapter 7 examines the overall results, achievements, and challenges of ADB’s support in the review period and gives recommendations to strengthen that support.

ADB Strategy and Program

24. This country assistance program evaluation (CAPE) covers ADB support for Sri Lanka from 2006–2015. This period saw the end of almost 3 decades of conflict in May 2009, which left the country’s north and east severely impoverished.

A. Country Strategies

25. ADB support over the CAPE period was guided by three CPSs⁸ covering 2004–2016 and one interim CPS⁹ that was produced in response to the change of government in January 2015. Table 1 summarizes the strategic objectives, pillars, sector choices, cross-cutting themes and drivers of change for each. The interim CPS shares the same strategic pillars as the CPS 2012–2016, with ANR as an additional sector for ADB support.

Table 1: Sri Lanka Country Partnership Strategies 2004–2016

Priorities	CPS, 2004–2008	CPS, 2009–2011	CPS, 2012–2016
Strategic Objectives	Poverty reduction and reconstruction and development	Economic growth, social development	Inclusive and sustainable economic growth
Pillars	Social development Pro-poor economic growth Good governance	Stronger investment climate Socially inclusive economic growth	Inclusive growth Catalyzing private investment and enhancing the effectiveness of public investment Human resource and knowledge development
Sector Choices	Agriculture and rural development Transport (roads and ports) Energy (including rural electricity) Financial sector Small and medium-sized enterprises Education (skills and training) Water supply and sanitation	Fiscal management Transport (roads and ports) Energy Education (ongoing programs only) Public–private partnerships (PPPs) Water supply and sanitation Financial sector (ongoing)	Transport Energy Water and sanitation Institutionalizing PPPs Education and skills development Financial Sector (capital market reform) Agriculture and natural resources ^a

⁸ ADB. 2003. *Country Strategy and Program, 2004–2008*. Manila; ADB. 2010. *Country Partnership Strategy, 2009–2011*. Manila; ADB. 2011. *Country Partnership Strategy, 2012–2016*. Manila.

⁹ ADB. 2015. *Sri Lanka: Interim Country Partnership Strategy, 2015–2016*. Manila.

Priorities	CPS, 2004–2008	CPS, 2009–2011	CPS, 2012–2016
Cross-Cutting Themes and Drivers of Change	Private sector development, balanced regional development. Environment and natural resource planning. Governance and public sector management. Gender, especially in education and water, and in projects directly addressing the poor in backward regions including conflict-affected areas.	Governance, private sector development. Faster and more equitable growth to help mitigate the impact of the conflict. Decentralization of service provision. Better management of resources through stronger public sector project implementation, greater efficiencies in state-owned enterprises and banks, and introduction of public-private partnerships.	Environment and climate change, gender, governance and regional cooperation. Substantial infrastructure investments required in transport, energy, water and sanitation and urban sectors to promote inclusive and sustainable growth.

CPS = country partnership strategy

.^a Added in June 2016 interim CPS.

Note: Interim CPS was not included in Table 1 as it shares the same objectives (pillars) as CPS, 2012–2016

Sources: ADB. 2003. *Country Strategy and Program, 2004–2008*. Manila; ADB. 2010. *Country Partnership Strategy, 2009–2011*. Manila; ADB. 2011. *Country Partnership Strategy, 2012–2016*. Manila.

26. Support in the initial part of the evaluation period, 2006–2008, was set out in CPS, 2004–2008, approved in September 2003. The strategic priorities were poverty reduction, social development, pro-poor economic growth, and good governance. ADB’s strategy, as the CPS put it, was to select projects in sectors that had “the greatest potential to lift growth in lagging regions, raise the quality and relevance of education, increase access to social services, rebuild conflict-affected areas, remove barriers to private investment, and promote rural livelihoods.”

27. The second CPS in the evaluation period, approved in October 2008 (before the end of the war), covered a much shorter period, 2009–2011, because of an escalation in the conflict. It also responded to the development agenda of the government that came to power in November 2005 led by Mahinda Rajapaksa. ADB interventions in the second CPS aimed to increase private sector investment, improve international competitiveness, and introduce PPPs in service delivery, especially because domestic resources for development expenditure were constrained. The change in CPS direction was driven by the government’s 10-year DPF (footnote 4) that was presented to development partners at the Sri Lanka DPF in January 2007. The document argued for a more prominent role for the state in economic development and ruled out privatization of SOEs, which reversed the policy focus of the previous government. At the same time, it also supported private sector development and PPPs in new investments. In addition, CPS, 2009–2011 formally ended ADB support for ANR,¹⁰ put new support to education on hold,¹¹ and discontinued policy-based operations, although the economic and social arguments for these strategic changes were not explained in the CPS.

28. The third CPS in the evaluation period (2012–2016), approved in October 2011, was ADB’s first post-conflict strategy for Sri Lanka. The war had ended, the president had been reelected for a second term in January 2010, and a new Development Policy Framework (footnote 5) with clear development goals had been released. The postwar CPS was intended to help the government remove constraints on economic growth and

¹⁰ There were no new ADB loans for ANR from 2004 to 2014.

¹¹ A standby loan scheduled for 2011 would only proceed if the planned government evaluation of the effectiveness of development partner assistance in education produced positive results.

to reorganize ADB support around three pillars which were aligned with the development goals laid out in the government's new development strategy. This evaluation is structured around these pillars because they built upon those of the previous CPSs and many themes remain common to all, e.g., reducing regional disparities. The three pillars in CPS 2012–2016 were to be supported as follows:

- (i) **Inclusive and sustainable economic growth.** This would be supported through infrastructure projects to improve connectivity and service delivery in lagging regions, including former conflict-affected areas. The result would be a reduction in regional disparities to be achieved by expanding employment opportunities, and thereby encouraging inclusive growth. Interventions would incorporate the cross-cutting themes of environment, climate change, gender, governance, and regional cooperation.
- (ii) **Catalyzing private investment and enhancing the effectiveness of public investment.** The strategy to catalyze private investment and enhance the effectiveness of public investment was aimed at accelerating the pace of private sector participation in overall investment. ADB would support capital market reforms, develop an enabling environment, and build public awareness on the benefits of PPP projects.
- (iii) **Human resource and knowledge development.** This support was aimed at improving the quality of and access to secondary education, assisting the government's skills development program with a focus on reducing gender disparities, and building the government's capacity to implement development projects and undertake policy-oriented work. ADB would help build the understanding of policy issues by undertaking joint analytical work with local institutions, thereby enhancing their capacity.

B. Assessment of Overall Strategy

1. Relevance to country context

29. Lagging regions, especially those affected by conflict and natural disasters, were a consistent focus of ADB's development strategy for Sri Lanka over the CAPE period. The operational priority of all three CPSs was to select infrastructure projects that would deliver benefits to poorer and more remote regions. Initially, this approach to project selection underpinned ADB's strategy for poverty reduction (CPS, 2004–2008), and then inclusive growth (CPS, 2012–2016). It also served as ADB's main response to addressing inequities in service provision.

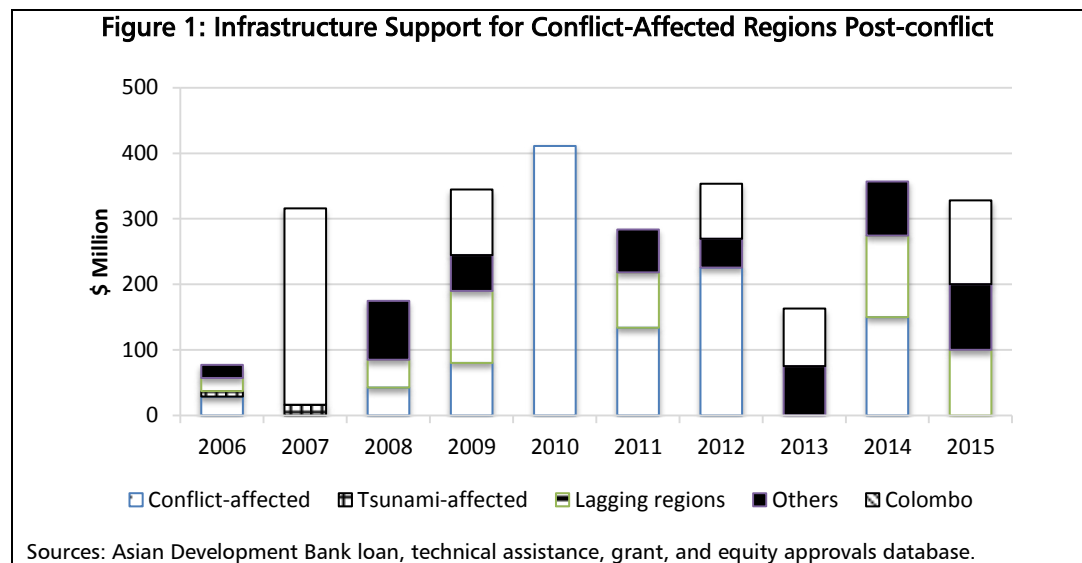
30. The approach was relevant to improving service delivery and access to services in Sri Lanka, which varies widely across provinces and districts and is often central to inter- and intra-communal contestation. Service expansion, especially through a more transparent and accessible governance structure at local, provincial, and national levels is essential for both sustainable peace and inclusive growth,¹² and was a high priority in government development strategies.

31. When the conflict ended in 2009, ADB scaled up support for infrastructure in conflict-affected provinces and those bordering them. This resulted in a more than five-

¹² The Asia Foundation. 2016. *Sri Lanka Strategic Assessment 2016*. Colombo.

fold increase (by amount) in infrastructure approvals in conflict-affected areas in 2010, mainly for the Northern and North Central Provinces (Figure 1).¹³

32. ADB strategy during the CAPE period was *highly relevant* to the needs of communities affected by conflict. While it continued to remain *relevant* post-conflict, the strategy shifted from community-based approaches during the conflict, toward larger-scale infrastructure rehabilitation post-conflict, responding to the government's call for visible delivery of services, particularly through large-scale infrastructure projects. Larger-scale rehabilitation programs were necessary to support the reintegration of conflict-affected areas, build confidence in the state, help promote lasting peace, and restore essential services after decades of neglect. Post-conflict, ADB's approach changed from small-scale, community-based programs delivered through highly decentralized project structures, to larger-scale rehabilitation through nationally driven programs (CPS, 2012–2016). Moreover, support for livelihoods in the north and the east was discontinued.



2. Alignment with National Development Policy Frameworks

33. CPS 2009–2011 was initially derived from the government's DPF 2006–2016 (footnote 4). This 10-year strategy aimed to accelerate economic growth to over 8% a year by 2010 from historical levels of about 5%. It also aimed to promote equitable growth and reduce income disparities among geographic regions and reduce poverty by half. To address equitable growth, the strategy in the DPF focused on three areas: increased infrastructure investment to accelerate growth, rural development, and increased public service delivery especially in education and health.

34. The first postwar CPS, 2012–2016, aligned with the government's strategy for 2010–2016 (footnote 5). The government strategy set out a policy framework for the country to (i) double income per capita to about \$4,000 from 2009 to 2016, driven by higher private investment; (ii) become a more knowledge-based, globally competitive, environmentally friendly, internally integrated, and increasingly urban country; and (iii) improve living standards and social inclusion.

¹³ As outlined in the country operations and business plan, 2010–2012.

35. ADB's CPSs for Sri Lanka were closely aligned with the country's own DPF, with the exception of ANR. Even though ANR was considered core to achieving pro-poor economic growth in CPS, 2004–2008, no new operations were approved after 2003. The two project preparation TA grants closed during this CPS period did not result in new loans due to revised ADB priorities (and other development partners) set by the government. Consequently, no new ANR operations were approved over the 11 years from 2004 to 2014. This reflected Strategy 2020,¹⁴ and the 2007 CAPE which recommended that "ADB should review the focus of its development assistance, particularly within sectors that have fallen short of achieving significant results (e.g., agriculture, power, policy-based programs) but are extremely important for poverty reduction and economic growth".¹⁵ Although the DPF, 2010–2016 stated that "the Government places high priority on modernization of agricultural practices and product diversification to generate new incomes and viable employment opportunities," ANR was not included in CPS, 2012–2016.

36. The fact that ANR was not included in CPS, 2012–2016 despite its prominence in the DPF, was not fully explained. The only references to it are statements in the CPS update for 2005–2006 noting that (i) the government was reassessing its agriculture policy, and there was a need to see what the policy would be prior to further investment; (ii) agriculture and rural development should be up to the private sector to develop; and (iii) sector growth had been poor. ANR investment was close to 26% of total ADB investments in Sri Lanka from 1990–2002, and it was the largest area of support, but no new lending, grants or TA operations were officially proposed in CPS, 2009–2011. This was also the case for education, which received no additional support for the 5 years from 2008–2012, although a large education project was approved in late 2007.¹⁶ In addition, no further policy-based operations were approved after 2004, which signaled a reduction in ADB support for macroeconomic policy reform, although it was a key objective of CPS, 2009–2011.

37. Notwithstanding the loss of ANR as a strategic priority, ADB support for agricultural and rural livelihoods continued, mainly through its support in the north and east of the country. This included investments in water tanks, small-scale irrigation, agricultural research centers, and outreach and training. So while at the country-strategy level support for agriculture faded over the CAPE period, it continued to be highly relevant to ADB's support for conflict-affected communities.

38. All three CPSs prioritized private sector development and investment in line with the government's high-growth strategy. Catalyzing private sector investment became a strategic priority in CPS, 2009–2011 and again in CPS, 2012–2016, although it was known that the government was against privatization of SOEs and was pursuing a policy of greater state involvement in the economy. Private sector development was also a cross-cutting objective in CPS, 2004–2008 and featured in ADB country strategy documents in the 1990s, so the concept was not new. Although the challenges of private sector development were well known, CPS, 2012–2016 did not scale down the ambitious objectives it set in 2009–2011, and both CPSs failed to set out a clear road map or private sector strategy given the scale of the challenges they faced. As such, the

¹⁴ ADB. 2008. *Strategy 2020. The Long-Term Strategic Framework of the Asian Development Bank 2008-2020*. Manila.

¹⁵ Operations Evaluation Department. 2007. *Country Assistance Program Evaluation for Sri Lanka*. ADB: Manila.

¹⁶ ADB. 2007. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Education for Knowledge Society Project*. Manila.

relevance of ADB's strategy for private sector development over the CAPE period remains highly questionable.

39. In CPS, 2012–2016, ADB committed to supporting capital market reforms to promote the development of equity and debt markets and induce higher savings and investments. This was a continuation of the direction set in CPS, 2009–2011, which identified strengthening the investment climate as a strategic objective (pillar), and private sector development as a major-cross cutting theme. But, as with other sectors, there has been insufficient justification to explain why ADB support in this area did not progress as planned. The escalation of the conflict from 2007 followed by a concerted period of rehabilitation might be one reason. A more compelling one is that the private sector development agenda lacked country ownership, particularly by influential and powerful stakeholders such as trade unions, youth movements, and domestic industry groups, who regard reforms in this area as a major threat to their livelihoods and job security.

40. When these civil society organizations converge to resist reform initiatives, the government reversed its policy decisions (footnote 12), which ADB's CPS and programs were supporting. These included the independent setting of electricity and water tariffs and the introduction of PPPs. Political economy analysis before initiating these policy reforms and during implementation would have helped ADB navigate some of the reform objectives and improve overall outcomes. In the absence of staff capacity to undertake such analysis, ADB could have benefited from civil society knowledge partnerships. For example, in meeting its private sector development objectives, more effective engagement with powerful stakeholders to open up an independent internal debate on key policy reforms could have helped navigate the complex political economy surrounding regulatory reform.

41. With hindsight, the objectives for private sector development and investment, particularly through PPPs, were ambitious given the complex political economy surrounding regulatory policy reform in Sri Lanka. ADB support for private sector development dated back to the 1990s and its experience had been built up through policy-based lending programs prior to the CAPE period. However, lessons set out in CPS, 2009–2011 did not appear to influence the strategy for private sector development and investment in CPS, 2012–2016—for example, that the ownership of reforms by all stakeholders should be carefully cultivated. For instance, the proposal that ADB would support stakeholder consultation and create public awareness of the benefits of PPP projects (which major stakeholders in Sri Lanka oppose), came after rather than before the proposal to institutionalize PPPs, develop a sustainable environment for PPP, and identify feasible PPP candidate projects.

42. To align with the government's new strategy in 2010, ADB reorganized its support into three pillars, which elevated human resource and knowledge development to a strategic pillar. This choice aligned with the government's emphasis on skills development, meeting labor market demand for skills, and shifting to a more knowledge-based economy by prioritizing science, mathematics, and information, communication and technology (ICT) in secondary schools. The acknowledgment in CPS, 2012–2016 of education's role in the economy and in securing opportunities, especially for women, revived ADB's financing for education after a 5-year hiatus during which there had been no additional approvals.

43. Following the change of government in 2015, ADB approved an interim CPS to cover the remaining 18 months of the strategy to end 2016. While the three strategic pillars remained unchanged, ANR was added to pillar 1 to address inclusive growth and

in anticipation of the new government's forthcoming development plan. The inclusion of ANR in the interim CPS means that ADB's operational composition is now similar to that identified in the first CPS, 2004–2008, which guided ADB operations in the initial years of the evaluation period.

3. Relevance of Strategy Design

44. This section's assessment centers on four points: (i) the TA allocation was inadequate to meet CPS objectives, (ii) the actual resource allocation was greater than planned, (iii) ADB should have continued its support for conflict-affected communities, and (iv) support for PSM and private sector development did not materialize as planned.

45. ADB's cumulative lending and grant portfolio over the CAPE period consisted of 78 project loan and grant operations with associated approvals of \$5.5 billion. Of these, 39 projects were ongoing operations approved prior to the CAPE period totaling \$1.9 billion.¹⁷ Private Sector Operations Department (PSOD) investments totaled \$1.6 million (six operations). TA operations totaled \$55 million (\$17 million approved before 2006), financing 80 interventions. The TA was for project preparation (\$22 million), capacity development (\$22 million), and advisory assistance (\$11 million). The share of TA to loans and grants fell over the CAPE period, and the amount of TA has not been adequate to meet the CPS objectives to (i) support Sri Lanka's transition to a more knowledge-based economy; (ii) undertake joint analytical work (an objective of CPS, 2012–2016); and (iii) undertake analysis to support difficult policy decisions and long-term policy changes relevant to ADB support (for example, integrated water resource management, financial market reform, and managing the end of energy subsidies).

46. The CPSs over the CAPE period aligned well with government development strategies, although the actual interventions were heavily weighted toward rebuilding regional and local infrastructure. This was appropriate given the development needs of lagging regions and inequities in service provision, the end of the conflict in 2009, and the massive rehabilitation needs of the north and east. The resource allocation for implementation was greater than planned for in CPS, 2009–2011 and CPS, 2012–2016. In total, ADB investments were 34% higher—energy projects 50% higher, water and sanitation projects 33% higher, and transport projects 21% higher.

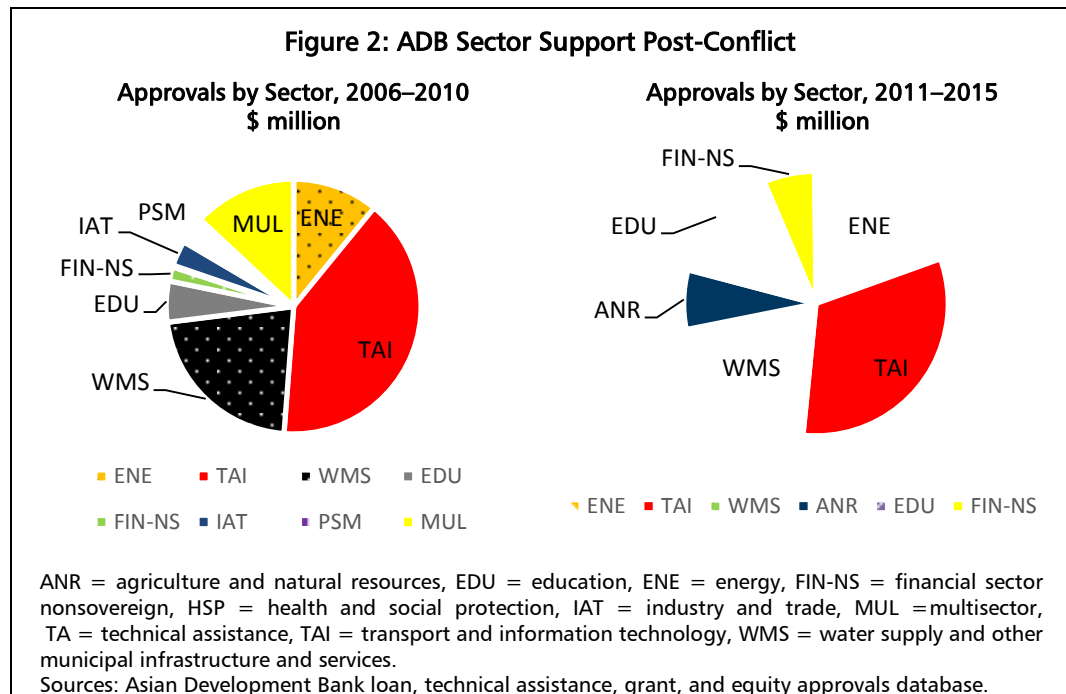
47. ADB's ability to rapidly scale up support to help meet these needs was notable and underpins its strategy relevance over the period. In contrast, investments in other sectors did not materialize as expected. For example, investment in PSM was a quarter of what had been planned in CPS, 2012–2016. Moreover, there were no planned allocations for ADB's support for conflict-affected communities, (multisector projects) in any planning documents.¹⁸ This reflected security conditions at the time and uncertainty over the end of the conflict. It also suggests that support for communities affected by conflict and natural disasters was a reactive rather than a proactive response and that ADB was able to respond positively to urgent development needs in a conflict-affected context. Planned ANR allocations from CPS, 2004–2008 were not achieved and fell to zero in CPS, 2009–2011.

¹⁷ The full list of ADB approved Loans, Grants and TAs of the evaluation period is at Linked Document 1. ADB's Project Classification System (PCS) was revised in 2014. This CAPE, however, uses the 2009 PCS sector/subsector classification namely water and other municipal infrastructure and services (WMS) and ANR, since project reclassification has not been completed at the time the portfolio analysis was undertaken.

¹⁸ For instance, in the pipelines of the annual ADB country operations business plans.

48. In line with the government's DPF, CPS, 2012–2016 shifted quickly toward supporting large-scale national infrastructure projects with less emphasis on support for conflict-affected regions, except through the implementation of existing programs. Figure 2 shows a fall in the number of sectors, with no support for multisector projects in the latter period. While ANR appears in the second chart, it grew from zero in 2014, so there were five sectors in that year.

49. There were strong arguments for continuing ADB's livelihood support for conflict-affected communities over the longer term, especially in the poorer and more traumatized districts of the Northern and Eastern Provinces (in Batticaloa, Kilinochchi, Mannar, and Mullaitivu, for example). ADB could have reduced the scope and scale of community-based support or attached it to its larger scale interventions. Also, while the shift was in line with government objectives at that time, other development partners had successfully negotiated to maintain their community driven programs.¹⁹ ADB had built institutional capacity to deliver targeted and more specialized support to these areas for more than 10 years and more effort could have been made to sustain this support. The lessons learned from years of operating through community driven programs in conflict-affected areas are now at risk of being lost.



50. On selectivity and investment choices, the CPSs set ambitious objectives for private sector development and investment, particularly for PPPs in transport, energy, and water and sanitation. CPS 2009–2011 noted that the government had ruled out further privatization of SOEs and that it envisaged a much greater role for the state in economic development.²⁰ At the same time, the government's new strategy targeted higher private investment and an expanded role for PPPs. ADB continued to support the drive toward PPPs without fully considering the contrary position or political

¹⁹ For instance the World Bank continued its North East Local Services Improvement Project approved in 2010 for completion in 2017 with additional support approved in 2016. The World Bank also had a community development and livelihood program that did not have a geographic restriction but was intended for lagging regions approved in 2010 and closed in 2015.

²⁰ ADB. 2008. *Country Partnership Strategy: Sri Lanka, 2009–2011*. Manila.

economy of these policy statements. CPS 2012–2016 elevated private sector development, including support for PPPs, to a strategic objective even though there was little evidence to suggest that the government supported this policy direction, e.g., the government renationalized the equity component of one partially privatized firm (Sri Lankan Airlines) and established another public sector airline. The state was asserting its power to shape economic activity and outcomes, ranging from greater political interference in regulatory authorities, direct political pressure on the financial sector, and larger state involvement in economic infrastructure²¹ which would impact on the implementation of ADB Sri Lanka CPS development objectives.

51. Higher investment through PPPs did not materialize over the CAPE period, except in the case of the port of Colombo. ADB had provided over 7 years of TA support for improving port efficiency and for designing the port expansion project. While the TA operations ran for over 5 years longer than expected, this was appropriate given that the TA helped to attract over \$500 million in additional private investment. The consistent support provided by ADB over a prolonged period no doubt played a role in securing Sri Lanka's first major PPP for the operation of a terminal in the expanded port infrastructure. It demonstrates the degree of effort and time involved in introducing this different way of operating in a country that does not have an institutional framework or enabling environment for PPPs. Whether ADB is able to secure the next PPP for the operation of another port terminal will be a good indicator of the longer-term success of ADB's support for the expanded port facility.

4. Alignment with ADB's Strategy

52. Strategy 2020 sets out three strategic agenda: inclusive economic growth, environmentally sustainable growth, and regional cooperation and integration to achieve the broader goal of a poverty-free Asia and the Pacific (footnote 14). Although these objectives are not expected to be carried out equally in all countries at all times, they should be key elements of ADB's country strategy.

a. Inclusive Economic Growth

53. ADB's strategy for inclusive growth leans heavily on investment in infrastructure, which was the government's main thrust for higher economic growth. Inclusive growth outcomes hinged on the geographical distribution of transport, water, sanitation, and energy sector projects; and their capacity to improve service delivery in lagging and conflict-affected regions. While this was ADB's strategy for more than a decade, it may no longer be appropriate since the conflict ended in 2009, and basic infrastructure in most of the conflict-affected regions has been rehabilitated.²² More recently, ADB support has shifted toward large-scale, national infrastructure programs funded through longer-term multitranches financing facility (MFF) instruments and therefore the regional distribution of ADB project benefits is harder to identify. Although these projects contain elements of support for inclusive growth—for example, through improved access to sanitation services in Colombo—ADB's approach to inclusive growth will need to be revisited in its new CPS.

54. ADB support for social protection, a key component of ADB's corporate strategy for inclusive growth, was absent in all three CPSs. ADB's inclusive growth

²¹ J. Goodhand, et al. Sri Lanka: Strategic Policy Assessment. Unpublished.

²² With the notable exception of Jaffna's water supply which is ongoing.

framework calls for action to support each of its three pillars.²³ ADB could have considered providing support to ensure that vulnerable households in conflict-affected communities were better integrated with Sri Lanka's cash transfer program, the national social protection system. Providing support for *Samurdhi* program reform so that it is targeted at poor households, especially in lagging regions, may also help the government reduce broad-based subsidies for electricity and fuel, which are an inefficient way to assist the poor.

b. Environmentally Sustainable Growth

55. Environmentally sustainable growth declined as a strategic priority over the CAPE period in parallel with declining support for ANR. In CPS, 2012–2016, it was envisioned that strengthening Sri Lanka's country safeguard systems and direct interventions to support climate change adaptation would bolster environmental sustainability. ADB also planned to promote a multimodal transport system to ease congested road traffic, and to build on its TA for strengthening climate change adaptation.

56. Several ANR projects approved before 2004 but ongoing during the CAPE period were relevant to the government's DPF, 2006–2016. Along with agriculture, the DPF outlined an ambitious program for protecting natural resources through reforestation, watershed stabilization, water resources conservation, biodiversity protection measures, and coastal stabilization. ADB supported these activities with projects before the suspension of new ANR lending in 2003. Six of the eight ANR projects ongoing during the CAPE period—targeting resource conservation, environmental improvement, and, by extension, climate change mitigation—would not have been possible without direct support. While the interim CPS, 2015–2016 reintroduced ANR as part of the inclusive growth objective, a strategy for environmentally sustainable growth remains to be defined.

c. Regional Cooperation and Integration

57. ADB support for regional cooperation and integration in Asia has been dominated by projects in transport and energy connectivity across large and neighbouring countries.²⁴ Island countries, including Sri Lanka, have received less support. While all three Sri Lanka CPSs recognized the importance of regional cooperation and integration, no explicit operations were identified beyond support for the port of Colombo. Needless to say, the use of the port has increased due to the rapid growth of the Indian economy and the expansion of global trade, which have made Sri Lanka a major transshipment center.²⁵

²³ Strategy 2020's inclusive growth framework has three pillars: (i) high, sustainable growth that creates and expands economic opportunities (pillar 1); (ii) broader access to these opportunities to ensure that all segments of the population can participate in and benefit from economic growth by improving human capacities through investments in education, health, and basic social protection, as well as enhancing the poor's access to markets and productive assets (pillar 2); and (iii) social safety nets to prevent extreme deprivation (pillar 3).

²⁴ IED. 2015. *ADB Support for Regional Cooperation and Integration*. Manila: ADB.

²⁵ It was estimated in 2013 that, because of limited facilities at India's ports, about one-sixth of all containers bound for India were transhipped through Colombo (*Economist*, 10 August 2013).

Supporting Inclusive and Sustainable Growth

58. Inclusive and sustainable growth is one of three strategic pillars set out in CPS, 2012–2016.²⁶ The CPS approach for helping Sri Lanka achieve this hinges on the geographical distribution of infrastructure projects, especially to lagging regions and former conflict-affected areas. This aligns with the government’s development strategy, which emphasizes greater equity in access to infrastructure. ADB support was expected to promote inclusive growth through increased regional connectivity, higher employment opportunities, and reduced regional disparities.

59. While CPS, 2012–2016 regards inclusive growth as an outcome of its infrastructure investments, other investments in Sri Lanka also promote inclusive growth, for example ADB’s support for livelihoods in conflict-affected communities, nonsovereign investments with financial institutions that target female entrepreneurs, and skills development under the human resources pillar. Nevertheless, this Chapter assesses only ADB’s support for infrastructure, which is the primary strategy for inclusive growth outlined in the CPS.

59. The evaluation of ADB’s support for inclusive growth is divided into two parts. This Chapter assesses ADB support for infrastructure projects while Chapter 4 assesses support for multisector projects, which targeted communities affected by conflict and natural disasters, and included a mix of infrastructure, agriculture, education, health, training, and livelihood support.

60. The sections that follow assess the relevance, responsiveness, and results of ADB interventions in transport, water and sanitation, and energy, the three sectors considered essential for achieving poverty reduction (CPS, 2004–2008) and inclusive growth (CPS, 2012–2016). Issues of efficiency, effectiveness, sustainability, and impact are discussed in Chapter 7.

A. Transport

61. Inadequate and poor quality infrastructure was identified as a major constraint on sustaining rapid economic growth in the government’s DPF, 2006–2016. Large infrastructure development projects were planned to reduce rural–urban imbalances in access to transport, electricity, drinking water quality, education, and health. The strategy was expected to result in rapid economic growth, and a change in the structure of the economy. Inclusive growth would be achieved by transforming the rural economy. This envisaged wider networking through, for example, electricity for all, better telecommunications, and a network of rural and agricultural roads. Projects

²⁶ The other pillars are catalyzing private sector investment and enhancing the effectiveness of public investment, and human resource development.

would be rural-centric through such interventions as community water supply, rural irrigation, better storage and marketing facilities, and greater access to credit.

1. ADB Strategy and Program

62. The government's priorities included developing an expressway network with well-connected national and provincial roads, and expanding the rural roads network linking to major growth centers. The plan promoted improving roads in remote and rural areas, with a target of connecting all rural villages to rural roads by 2016.

63. ADB has historically been a major source of financing for Sri Lanka's transport sector, in particular for roads. Cumulative ADB financing for transport to the end of 2015 was \$1.94 billion (approvals plus ongoing projects), covering 29 sovereign and 1 nonsovereign project, and 26 advisory TA operations. Although ADB significantly increased its share of finance for transport compared with the CPS period before 2009, its role as a source of finance for new investment for national roads declined with the entry of new development partners, including the People's Republic of China (PRC), since 2009. ADB nevertheless remains a key source of finance for provincial roads.²⁷

64. ADB's transport support was responsive to government development priorities and consistent with the strategic objectives of the last two CPSs, which shifted from poverty reduction and reconstruction (CPS, 2004–2008) to a greater focus on inclusive and sustainable economic growth (CPS, 2012–2016), as shown in Table 2. Accordingly, ADB's strategy shifted from institutional reforms and selective investments for roads (CPS, 2004–2008) to improving nationwide connectivity focusing on national and provincial roads (CPS, 2012–2016), with special attention to restoring transport infrastructure in districts affected by conflict and natural disasters.

Table 2: Country Partnership Strategy Objectives and Associated Transport Strategies

CPS, 2004–2008	CPS, 2009–2011	CPS, 2012–2016
CPS Outcomes and Relevant Pillars for Transport		
Poverty reduction and reconstruction and development	Economic growth, social development	Inclusive and sustainable growth
Transport Strategies		
Institutional reforms and selective investments for roads, making Colombo port efficient and removing impediments to private sector participation in transport (and other sectors)	Removing constraints on economic growth and higher private sector investment by improved enabling frameworks for private investment and improvements in road planning, road infrastructure investment and reducing high logistics cost	Improving nationwide connectivity focusing on national and provincial roads

CPS = country partnership strategy.

Sources: ADB. 2003. *Country Strategy and Program, 2004–2008*. Manila; ADB. 2010. *Country Partnership Strategy, 2009–2011*. Manila; ADB. 2011. *Country Partnership Strategy, 2012–2016*. Manila

65. CPS, 2012–2016 envisaged that ADB would focus on the main arterial national road links, improving provincial and rural roads (especially in lagging areas), and pursuing a more environmentally sustainable integrated strategy by developing viable multimodal transport systems, including railways and public transport. This emphasis on better transport access for the entire population and business community continued the direction of the previous CPS, 2009–2011. The strategy for better access was to develop a high-quality road network linking rural and urban markets. ADB's focus was

²⁷ The portfolio of projects assessed as part of the evaluation is in Linked Document 1.

consistent with government priorities, but it also continued the priority that it had given to the roads subsector since the 1980s. In addition, ADB would continue over 2012–2016 to develop Sri Lanka's ports, which would contribute to regional cooperation, trade, and tourism.

66. From 2012, specific gender action plans have typically focused on strengthening gender considerations in physical designs and implementation through (i) employing women, especially from poor female-headed households, for road maintenance at equal pay to men; (ii) providing women employed in civil works with post-contract training; (iii) building the capacity of the Road Development Authority (RDA) for gender-inclusive road design, construction, rehabilitation, and operation and maintenance; (iv) providing road safety awareness training to community members; (v) identifying beneficiaries by gender; and (vi) including gender-responsive strategies and design features in road connectivity plans. Since 2012, most of these measures have been included in project designs. In most projects, women usually represent more than 50% of the workers in the initial labor-intensive stages of road construction.

67. ADB's attention to institutional and policy reforms declined over the evaluation period, while lending for roads increased, with risks for the future sustainability of the transport sector. Concerns related to sustainability include the following areas:

- (i) **Road conditions have improved because of new investment, not maintenance.** Future maintenance for national roads is likely to be underfunded, and the funding is even more precarious for provincial roads. The Northern and North Central Provinces report that they will prioritize maintenance of ADB-funded roads because of the loan conditions, but, according to the authorities, they receive less than 30% of the recurrent maintenance financing needed for their road networks. In 2015, the World Bank estimated that the total funding requirement for routine and periodic road maintenance from 2007 to 2013 was about Sri Lanka Rupees (SLRs) 81 billion but only SLRs38 billion was made available during the period. Moreover, the allocated budget for national road maintenance was used for rehabilitation, not regular maintenance.²⁸ Insufficient funding will undermine the achievement of intended outcomes, such as shorter travel times, better connectivity and safety, and reduced planned asset lives.
- (ii) **Dialogue on policy and regulatory measures.** ADB has reduced its strong emphasis on policy and institutional reforms in the road subsector in the period from 2005.
- (iii) **Road safety.** Road-related fatalities and injuries are a serious public health issue. Estimates of Sri Lanka's road fatality rate by the World Health Organization in 2013 were high at 17.3 fatalities per 100,000 population.²⁹ By comparison with its regional peers, Sri Lanka's road safety deteriorated between 2010 and 2013, because of an increase in vehicle ownership and higher speeds facilitated by better roads.³⁰ In

²⁸ World Bank. 2015. *Directions and Destinations, 2006–2015*. Washington.

²⁹ World Health Organization (WHO). 2015. *Global Status Report on Road Safety*. Geneva (Table A2, pp. 264–270 on the situation in 2013). In 2013, Sri Lanka's estimated fatality rate of 17.3 deaths per 100,000 population was estimated to be higher than all of its regional peers of Bangladesh, India, Nepal, and Pakistan.

³⁰ WHO. 2013. *Global Status Report on Road Safety*. Geneva. (Table A2, pp. 244–251 on the situation in 2010). This report shows that Sri Lanka had an estimated fatality rate of 13.7 deaths per 100,000 population in 2010. This was estimated to be significantly lower than that for the nearby countries of India, Nepal, Pakistan but higher than that for Bangladesh.

2013, 40% of fatalities were pedestrians and cyclists, which likely included a high proportion of vulnerable people.

- (iv) **Transport barriers to inclusion in urban areas.** The urban population is expanding and congestion is already quite severe in Colombo and Kandy. Attention to improving all modes of urban transport is therefore desirable and overdue.

68. Promoting policy reform in Sri Lanka was a major ADB strategy thrust until 2006. Following an agreement with the World Bank and the Japan International Cooperation Agency (JICA) in 2004, responsibility for promoting policy reform was divided among the three organizations. ADB was to focus on the Road Development Authority's governance and implementation performance, JICA on developing the private contracting industry, and the World Bank on operationalizing a road maintenance trust fund.³¹

69. The more targeted development support from this division of responsibilities permitted ADB to scale up its investment in transport to over 42% of net loans outstanding and over 40% for CPS, 2012–2016.³² It has also improved the Road Development Authority's performance on procurement, implementation, and management of social safeguards in recent years in contrast to its poor performance before 2008.³³

70. The agreement between ADB and its two development partners focused on key road issues but overlooked other aspects of sector performance. These included the optimal roles of transport modes; the effective management of passenger and road freight transport operations; and the facilitation of private investment in rail and urban transport operations for efficiency, safety and environmental reasons. The 2012 sector assistance program evaluation (footnote 33) also noted several of these issues that ADB should have pursued with the government.

71. **Results.** ADB investment in transport has supported the three strategic pillars under CPS 2012–2016. For ports, private investment was catalyzed with the Colombo Port Efficiency and Expansion Project,³⁴ which closed in 2013 and was successful in securing significant private investment with substantial risk transfer. However, no major PPPs in transport were achieved except for ADB's promotion of conventional road construction contracts combined with performance-based road maintenance.

72. Because of the dominance of roads, and their rapid expansion, substantial connectivity improvements were made that resulted in economic efficiency gains, as was shown by Sri Lanka's 13% improvement in the Logistics Performance Index³⁵ from 2007 to 2014. The impact of the Colombo port project coupled with road improvements was a key factor in this stronger performance.

³¹ The road maintenance trust fund account was set up in 2006 to finance national road maintenance. The World Bank no longer funds roads but is focused on asset management.

³² As set out in Appendix 6 of CPS 2009–2011 as at June 2008, and shown in Appendix A of the Business Plan for 2012–2014. During 1990–2002, transport represented just over 18% of ADB's program for Sri Lanka.

³³ IED. 2012. *Sector Assistance Program Evaluation: The Asian Development Bank's Support for Transport Sector in Sri Lanka*. Manila: ADB.

³⁴ ADB. 2001. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Colombo Port Efficiency and Expansion Project*. Manila.

³⁵ Logistics Performance Index is a tool created to help countries identify the challenges and opportunities they face in their performance on trade logistics. Logistics Performance Index is reported by the World Bank every 2 years.

73. ADB has successfully promoted road development in the North Central, Eastern, and Northern Provinces since 2008, leading to improved inclusion. Through its support to the RDA on capacity building, ADB has improved the effectiveness of public investment in national roads (pillar 2). When asked about the government's accomplishments, in a survey undertaken by The Asia Foundation in 2012 most respondents reported the end of the war and then commented that peace had made development possible—this development was seen almost entirely in terms of infrastructure. Most respondents pointed to highly visible road construction as critical for short-term economic productivity and the country's long-term future. People in the north noted school refurbishment and road development as the most visible signs of progress post-conflict.³⁶ The national road output target of 1,200 kilometers (km) for 2012–2016 seems to have been set unrealistically low given that the target for the Road Sector Master Plan used as the basis for the roads subsector plan in the DPF (2007–2016) was to construct 5,700 km³⁷ of roads (Table 3).

Table 3: Transport Sector Results Framework, Country Partnership Strategy, 2012–2016

Outcome with ADB Contribution: Improved Nationwide Connectivity for the Movement of People and Goods	
Country Level Indicators	Status
Number of beneficiaries from new or rehabilitated rural or provincial roads increased by 600,000 (no baseline)	> 0.75 million beneficiaries. Data for Northern, Eastern and North Provinces where ADB has been working since 2008 indicate on average 550 persons per km of provincial road (located within 2 km either side). Data are not available for other provinces.
Average travel speed on priority national roads increased to 49 km per hour by 2016 (2011 baseline: 40 km per hour)	May have been achieved on improved roads but may not be sustained due to rising traffic volumes. Data are not available.
Targeted Sector Outputs by 2016 Compared to 2011 with ADB Contribution	
Indicators	
1,200 km of national roads rehabilitated	3,592 km
2,500 km of provincial roads rehabilitated	1,384 km in total in Northern, North Central and Eastern Provinces. Data are not available for the other six provinces.
Expressway length increased to 190 km (2011 baseline: 90 km)	170 km compared to actual expressway length at 2011 of 95.3 km. A 96 km extension to the Southern Expressway is underway.
Percent of priority national roads with IRI > 5.5 decreases to 25% (2011 baseline: 30%)	33% of priority national roads estimated by Road Development Authority to have an IRI > 5.5 at 2014 compared to 52% at 2011.

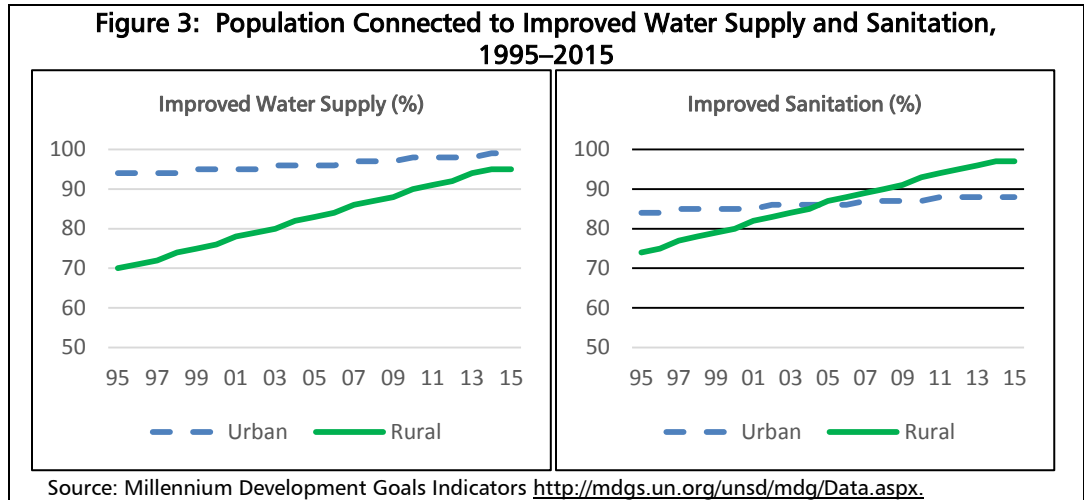
ADB = Asian Development Bank, IRI = International Roughness Index, km = kilometer, > = greater than.
Source: ADB. 2011. *Country Partnership Strategy: Sri Lanka, 2012–2016*. Manila.

³⁶ The Asia Foundation. 2012. *Survey of the Sri Lankan People*. Unpublished qualitative research report. The Asia Foundation conducted a follow-on qualitative study following its survey of the *Sri Lankan People 2010*, available at <http://www.asiafoundation.org/publications/pdf/906>. The qualitative research was conducted by Nielsen Co and completed by May 2012 in preparation for a full scale *Survey of the Sri Lankan People* (2012). The research was conducted in Colombo, Puttalam, Jaffna, Trincomalee, Batticaloa, Kandy, Nuwara Eliya and Matara through focus group discussions and key informant interviews. The findings were not published as the report was for internal circulation only.

³⁷ This may be because the 2012 sector assistance program evaluation noted a 22% shortfall in road length outputs for the Road Sector Development Program in the previous CPS period, and poor performance with the associated reform plan for the Road Development Authority noted by the post-project evaluation report.

B. Water Supply and other Municipal Infrastructure and Services

74. Sri Lanka made impressive progress toward the MDG target of halving the proportion of the population without sustainable access to safe drinking water (Figure 3), and is one of only three South Asian countries to have met its sanitation MDG despite having a predominantly rural population.³⁸ The government aims to provide safe drinking water for all by 2025, and to increase access to piped water services in urban areas from 65% to 90% by 2016.



75. Water supply and sanitation accounted for 21% of total ADB-approved investment over the CAPE period by amount, the second largest area of support after transport. Total approved lending was \$682 million, financing eight projects.³⁹ In addition, 18 TA projects were approved: 9 project preparatory, 7 capacity development, and 2 advisory. TA support for water supply and sanitation was generally aligned with government strategies from 2006–2015, and supported the institutional and capacity development of the National Water Supply and Drainage Board, Colombo Municipal Council, and efforts to introduce policy reforms.

76. ADB's water supply and sanitation strategy and program were aligned with the government's DPF. The program was designed to support the government in providing safe water for all, improving sanitation, expanding services to lagging and conflict-affected areas, and strengthening policy making. However, following the difficulties experienced by two policy-focused TA projects⁴⁰ in the 2000s and noncompliance with the policy-oriented loan covenants under the Third Water and Sanitation Supply Project,⁴¹ CPS, 2009–2011 made little mention of policy change. Few covenants directed toward policy change were included in loans from the Secondary Towns

³⁸ Maldives and Pakistan are the other two.

³⁹ This excludes multisector projects but includes the Third Water Supply and Sanitation Sector Project, which was largely implemented before the CAPE period. The number of loans is greater, since the projects often included OCR and ADF loans, as well as additional financing. For the list of projects see Table 5 in Appendix, Linked Document 3.

⁴⁰ IED. 2016. *Performance Evaluation Report: Technical Assistance for Water Supply and Sanitation in Sri Lanka*. Manila: ADB.

⁴¹ ADB. 1997. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Third Water Supply and Sanitation Sector Project*. Manila.

Project (approved in 2003) onward.⁴² CPS, 2012–2016 indicated that it would support reform in the sector; in practice, however, little has been achieved (footnote 40), although the ongoing MFF does respond to the CPS objective of reducing non-revenue water in Colombo.

77. ADB supported projects to improve both the urban and rural water supply. With the World Bank and other partners, it supported the rapid development of community-based water supplies in line with government objectives, which now extend to 4,300 community-based organization (CBO) systems. The establishment of CBOs was an important contribution to service decentralization and village organizational welfare in areas where these were developed. Most CBO schemes are operating effectively, with individual households receiving a metered supply of treated water, and regular quality monitoring carried out. Community and public health has also greatly improved, with the incidence of waterborne diseases falling significantly in the few completed post-project surveys.⁴³ CBO schemes show that consumers are willing to pay for reliable and high-quality service provision.

78. All projects from 2003 had gender action plans, which assisted executing agencies in promoting gender impacts. The Jaffna and Kilinochchi Water Supply and Sanitation Project⁴⁴ and the Greater Colombo Water and Waste Water Management Improvement Project⁴⁵ were the first projects under which full gender action plans were undertaken. Analysis carried out during the preparation of these plans demonstrated that women were disadvantaged and discriminated against in the sociocultural, economic, and political spheres and denied equal access to resources, services, and economic opportunities.⁴⁶ Projects encouraged and supported women's increased participation in the consultative processes in the planning and implementation of project activities, and ensured that women benefited equally from project outcomes.⁴⁷

79. Although ADB has shifted its emphasis from rural to urban water supply projects, it is still implementing some rural small town water supply projects under the Local Government Infrastructure Improvement Project.⁴⁸ This is particularly the case in areas affected by chronic kidney disease, because the government considers the provision of water to these areas as a priority. Under this project, water will be supplied to rural areas, but will be maintained by the National Water Supply and Drainage Board or by local authorities, rather than by CBOs. Additional financing of \$60 million has been processed, of which \$42 million will be used for water projects in areas affected by chronic kidney disease.⁴⁹ Although ADB projects did not focus on chronic kidney disease, they laid the foundation for addressing this issue by the National Water Supply and Drainage Board, nongovernment organizations (NGOs), and

⁴² ADB. 2002. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Secondary Towns and Rural Community Based Water Supply and Sanitation Project*. Manila.

⁴³ COWI. 2008. *Consultant Report: Component A Completion Report*. Denmark.

⁴⁴ ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Jaffna and Kilinochchi Water Supply and Sanitation Project*. Manila.

⁴⁵ ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Proposed Multitranche Financing Facility Greater Colombo Water and Wastewater Management Improvement Investment Program*. Manila.

⁴⁶ ADB. 2008. *Country Gender Assessment: Sri Lanka*. Manila.

⁴⁷ H. Thomas and J. Hunt. 2010. *Gender equality results in ADB projects: Sri Lanka Country Report*. Manila.

⁴⁸ ADB. 2011. *Proposed Loan and Technical Assistance Grant to the Democratic Socialist Republic of Sri Lanka: Local Government Enhancement Sector Project*. Manila.

⁴⁹ Scheduled for Board approval in September 2016.

engaged individuals, through the provision of reverse osmosis units at CBOs, hence potentially limiting the future impact of chronic kidney disease in these areas.

80. Overall, ADB-supported water and sanitation projects were *relevant* to government objectives in national plans to promote inclusive development. Even so, health shocks and chronic illness from contaminated drinking water continue to cause a high incidence of diarrhea and other waterborne diseases in rural areas, especially in the Northern Province, where years of conflict disrupted development and where ADB is now scaling up its support.⁵⁰

81. **Results.** The two completed projects in the water and sanitation portfolio have met their outcome objectives. The remaining ongoing projects are on track and have the potential to meet their outcome targets of providing access to good quality water to more than 600,000 households and to rehabilitate supplies to a further 143,000 (in Colombo). The projects should benefit about 3.1 million people (based on an average household of 4.2 persons), or more than 14% of the population.

82. The two completed water supply and sanitation projects over the CAPE period benefited about 426,000 households (target 373,500) through the development of new water supply schemes and the expansion of existing schemes. The Dry Zone Urban Water and Sanitation Project,⁵¹ which assists the government in providing improved water and sanitation services in four major towns in former conflict-affected areas in northern and northwestern Sri Lanka has also progressed well, and is projected to achieve the target of supplying 50,000 households with improved water supply and 25,000 with improved sanitation when completed by 2017.

83. Water supply and sanitation outcomes against CPS sector-level results frameworks are listed in Table 4.

Table 4: Water Sector Results Framework CPS, 2012–2016

Sector Outcomes with ADB Contribution: Total Population Improved Access to Drinking Water and Sanitation Services	
Country Indicators	Status
Safe water coverage: 100% by 2020 (baseline: 85% in 2009)	The proportion of urban households accessing an improved water supply rose from 94% to 99% over 1995–2015, and rural households increased from 70% to 95%. On track to achieve the national target of 100% coverage by 2020.
Increasing the water connections to 1,600,000 in 2015 (baseline: 1,267,000 in 2009)	2,002,906 pipe-borne water connections achieved in 2015.
Pipe-borne water availability: 60% by 2020 (baseline: 37% in 2009)	31% pipe-borne coverage in 2006 and 47.2% as of August 2015. On track to achieve 60% target by 2020.
Increasing the coverage of households with piped sewerage connections to 3% by 2020 and 3.5% by 2025	2% of the population connected to network sewerage facilities as of August 2015.
Access to improved sanitation to reach 87% in 2015 and 100% in 2025 (baseline: 86.5% in 2010)	95% access to improved sanitation achieved in 2015

ADB = Asian Development Bank, CPS = Country Partnership Strategies
Source: ADB. *Sri Lanka Water Sector Assessment CPS, 2012–2016*. Manila.

⁵⁰ World Bank. 2007. *Sri Lanka Poverty Assessment: Engendering Growth with Equity: Opportunities and Challenges*. Washington.

⁵¹ ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Loan and Asian Development Fund Grant Dry Zone Urban Water and Sanitation Project*. Manila.

84. ADB support for water supply and sanitation has probably had a significant impact on health and improved living conditions, particularly for women and children. Diarrheal disease, for instance, fell from being the fourth major cause of death in 1990 to 34th in 2013. Under the Third Water Supply and Sanitation Project (footnote 41), the decline in waterborne disease incidence among rural beneficiaries in the survey areas fell from 17% in 2001 to 0.9% in 2004.⁵² Beneficiaries' knowledge of key health messages was reinforced by health education programs supported by this project. Use of latrines by children subsequently increased from 54% (2001 baseline data) to 96% in 2004. Improving the water supply seems to be essential to limiting chronic kidney disease, which is reported to have been prevalent in North Central Province for over 20 years, but was not mentioned in ADB strategy documents.

85. Provisions in gender action plans were broadly achieved with regard to the identified targets for the participation of women in the rural components of water supply schemes. The distance to drinking water sources and time spent collecting water have been significantly reduced by project interventions. Benefit monitoring and evaluation surveys at the end of the Third Water Supply and Sanitation Project indicate that 82% of women experienced less burden in collecting water,⁵³ and 60% reported increased income due to home gardens promoted by the project. The distance travelled to dry season drinking water sources declined in all six districts, by an average of 273 meters. Women interviewed reported time savings due to improved water supply (57% of respondents) and sanitation (19%). Women were also involved in project construction activities. The Secondary Towns Project also implemented measures to ensure that women and men received equal wages for similar work.

86. Many efforts have been made since 1990 to reform water supply and sanitation policies, strengthen institutions, and develop capacity, but these have not progressed as far as expected. The capacity of the National Water Supply and Drainage Board has been strengthened, but other reform areas have lagged. For instance, Sri Lanka has long recognized that private investment will be essential if social services, including water supply and sanitation, are to achieve national development targets. However, no significant progress has been made in institutional and policy reform following difficulties in introducing a comprehensive water resource management planning framework⁵⁴ in the 1990s and subsequent problems in the mid-2000s relating to ADB support for an independent regulatory framework for water and sanitation services.⁵⁵ An opportunity to depoliticize tariff setting and sector development planning—and thus attract private investment—was therefore missed.⁵⁶ Nevertheless, there are signs that water regulation will now be covered by the Public Utilities Commission (PUC).

87. The key challenge facing the water supply and other municipal infrastructure and services sector (WMIS) is how to bring the policy environment up to date. There is a clear need for a national water law that adopts an integrated water resources management approach and defines resource use priorities, especially for pricing water use and to avoid future conflict. Domestic water supply needs to be the priority for

⁵² COWI. 2004. *Consultancy Report: L1575 Third WSS 2004 Benefit Monitoring and Evaluation Survey*. Denmark.

⁵³ COWI. 2008. *Consultancy Report Component A Project Completion Report (L1575)*. pp. 39. Denmark.

⁵⁴ ADB. 1995. *Technical Assistance to the Democratic Socialist Republic of Sri Lanka for Institutional Strengthening for Comprehensive Water Resources Management*. Manila.

⁵⁵ ADB. 2002. *Technical Assistance to the Democratic Socialist Republic of Sri Lanka for Strengthening the Regulatory Framework for Water Supply and Sanitation*. Manila.

⁵⁶ Future plans are beyond the scope of the CAPE review, but plans include the Colombo wastewater treatment plants to be developed under the third tranche of the Greater Colombo Multitranchise Financing Facility, expected to be operated by a private company initially for 18 years.

adequate water in almost all circumstances. In drier parts of the country, this can lead to competition between domestic and agricultural demand which may increase because of the effects of climate change on the agricultural water supply. For example, following a severe drought in 2014, a project to divert water from Iranamadu tank, the primary water source for Kilinochchi district, to supply water-starved localities in Jaffna had to be put on hold. Instead, ADB is financing a desalination plant in Jaffna, while also increasing the capacity of the Iranamadu tank.

88. ADB advocated national water management reforms through earlier project interventions such as the Sri Lanka Water Resources Management Project.⁵⁷ Unfortunately ADB was unable to secure support from politicians and other decision makers and the project was cancelled in 2007. There is a need for policy and regulatory reform of the WMIS sector to bring it in line with best practice principles, but the experience of the Water Resources Management Project and the related policy-focused TA projects (footnote 40) reveals the complexity and challenges of negotiating policy reform in the highly politicized and complex environment facing Sri Lanka's water sector, which is regulated by 51 separate laws and has some 40 public agencies all dealing with water.⁵⁸ ADB support must continue to advocate policy and institutional reform over the medium to longer term, but to do so in a manner that is consistent with the sector development road map. ADB must also continue to engage and influence political and sector leaders to ensure that proposed reforms receive bipartisan support and ownership that can survive changes in government.

C. Energy

89. Electricity for all is a high development priority. The government's DPF, 2006–2016 aimed to make electricity reliable, competitively priced, commercially viable, and subject to independent regulation.

90. The electricity generating system has changed since the mid-1990s, from a predominantly hydroelectric to a mixed hydrothermal system. Hydropower and other renewables are the main indigenous sources of electricity, but substantial shortages occur in years with below-average rainfall, which significantly affects the cost of supply. Consequently, oil-fired production, which accounted for 1% of total generation in 1986, expanded to 58% by 2008.

91. The updated government strategy in 2010 aimed to improve energy security and reduce unit costs through the construction of three coal-fired power plants. Coal was added to the generation mix in 2011, contributing 9% that year, 12% in 2012, and 26% in 2014. At the same time, government policy is committed to promoting private sector investment in nonconventional renewable energy sources, increasing household connections, reducing technical losses, and ensuring energy conservation.

⁵⁷ ADB. 2007. *Sri Lanka: Water Resources Management Project, Project Completion Report*. Manila. This project was the result of several years of cooperation on water-related issues between the government and ADB. It followed two advisory TA studies that supported the preparation of an action plan for comprehensive water resources management and the drafting of a national water policy. The government successfully established a national water sector apex body in 1996—the national Water Resources Council, supported by a full-time Water Resources Secretariat. This was an interim arrangement, pending the establishment of a permanent agency in the National Water Resources Authority by an act of parliament. However, opposition from influential vested interest groups derailed the proposed reforms, significantly setting back plans for sector development.

⁵⁸ R. Ratnayake. 2014. Whither Water Resources Policy in Sri Lanka? *Sunday Times*. 23 March. Colombo

92. The key challenges facing Sri Lanka's energy sector are threefold: (i) ensuring that the power sector is independently operated and regulated with adequate tariff schemes allowing full cost of service recovery; (ii) scaling up nonconventional renewable energy; and (iii) creating space for the private sector (especially in nonconventional renewable energy) when active legislation restricts private sector investments in energy.

1. ADB's Strategy and Program

93. In CPS, 2004–2008, ADB focused on power sector restructuring and oil and gas exploration. The CPS planned to support rural electrification, especially access by the poor, and private sector participation as competition in power generation, transmission and distribution increased. The approach was continued in CPS, 2009–2011 but ADB expected to redirect its support from development of the regulatory framework to its implementation. ADB would also assess ways to reduce the environmental impact of using coal to generate power by supporting energy-efficiency, and to reduce technical losses and improve efficiency by strengthening transmission and distribution networks. Private sector development would be supported by removing grid constraints to absorb renewable energy outputs. ADB would strengthen the Sustainable Energy Authority, and sector regulation, and use PPPs to finance clean energy projects.

94. In CPS, 2012–2016, ADB focused on renewable energy development (including wind and other clean energy sources), energy efficiency, transmission and distribution, and energy access for lagging regions. ADB intended to continue to help efforts to reduce system losses by improving metering efficiency, establishing better management systems, and creating an enabling environment for clean power development, particularly through PPPs. ADB was to pursue sector reforms by accelerating unbundling of the power system and greater private sector participation.

95. Investment in the energy sector accounted for about 19% of total ADB support for Sri Lanka over the evaluation period, and it was the third largest sector after transport, and WMIS. There were 4 projects and ten loans (and grants) over the CAPE period, totaling \$564 million. Three other projects approved before 2006 were ongoing during the period, bringing the total portfolio to \$697 million.⁵⁹ An additional \$10 million was approved for 10 TA interventions. The full list of project loans, grants and TA over the period is in Appendix, Linked Document 1. Sixteen infrastructure projects across transport, energy, and WMIS were classified as having a gender equity theme or effective gender mainstreaming; of these, one was in energy.

96. ADB supported government objectives to expand electricity supply to the entire population, especially to lagging regions and communities affected by conflict and natural disasters; for example, through the building of transmission lines to conflict-affected areas and credit lines for household connections. ADB programs also aimed to reduce transmission losses, and to achieve greater financial and managerial autonomy for the public utility, Ceylon Electricity Board (CEB). ADB also supported institutional capacity building of an independent regulator and the preparation and adoption of a tariff methodology (Table 5). ADB also played a role in mitigating climate change by promoting private sector investment in nonconventional renewable energy projects.

⁵⁹ Two of the three projects are grants from the Japan Fund for Poverty Reduction totaling \$2.5 million.

Table 5: CPS Strategic Objectives and Associated Energy Strategies

CPS, 2004–2008	CPS, 2009–2011	CPS, 2012–2016
CPS Outcomes and Relevant Pillars for Energy		
Pro-poor growth, social development, improved governance	Strengthening the investment climate, socially inclusive development	Inclusive and sustainable growth
Energy Strategies		
Ensure adequate amounts of electricity at economic and affordable prices, support transmission and distribution, assist rural electrification, improve financial viability via an appropriate tariff policy, address structural distortions in petroleum sector	Increase rural electrification to improve quality of life in lagging regions, support transmission and distribution, attract private investment through regulatory reforms and efficiency improvements, support decentralization of service delivery, and build the capacity of the electricity regulator and the Sustainable Energy Authority	Reliable power to the entire population, public–private partnerships for clean power development, energy efficiency improvement, transmission and distribution, improve energy access for lagging regions, reduce system losses through improved metering, accelerate power system unbundling, and support greater private sector participation.

CPS = county partnership strategy.

Sources: ADB. 2003. *Country Strategy and Program, 2004–2008*. Manila; ADB. 2010. *Country Partnership Strategy, 2009–2011*. Manila; ADB. 2011. *Country Partnership Strategy, 2012–2016*. Manila.

97. **Results.** Sri Lanka saw a substantial improvement in the electricity subsector at the end of the conflict in 2009, particularly for household access (Table 6). In 2014, the household electrification rate reached 98.4%, from 66.0% in 2006. This was also well ahead of the milestone indicator in the CPS, 2009–2011 sector results framework, 88% by 2016. While electricity services have been extended throughout the country, with some provinces achieving 100% electrification, others lag behind. For example, Northern Province has achieved 92% electrification and Eastern Province 94%. By contrast, Killinochchi and Mullaittivu—the most war-affected districts in Northern Province—have 70% electrification.

Table 6: Energy Sector Results Framework, Country Partnership Strategy, 2012–2016

Sector Outcome with ADB Contributions	
Country Indicators	Status
Increase share of nonconventional energy in grid from 4.1% in 2007 to 8.5% in 2012 to 10.0% by 2016, and 20.0% by 2020	9.9% in 2014, 11.2% in 2015 and on track for 2020 milestone
Energy savings of 4.3% in 2012, 6.4% in 2016, and 8.7% in 2020 achieved	Sri Lanka Sustainable Energy Authority was instrumental in saving 100 gigawatt-hours by promoting energy-efficient activities in industrial and commercial sectors
Reduce system losses from 16.7% in 2007 to 14.0% by 2012, 13.0% by 2016, and 12.0% by 2020	On track for 2020 milestone
Electrification ratio increased from 88% in 2010 to 100% by 2012	98.4% in 2014, 98.5% in 2015
Percentage of households electrified through off-grid systems increased from 4% in 2007 to 6% by 2010 and 10% by 2016	Not available
System supply capacity increased to 3,470 megawatts (MW) by 2012 and 6,367 MW by 2020 (2010 baseline: 2,891 MW)	2020 target unlikely to be achieved, partly due to change in demand projections, which is lower than initial projects

CPS = county partnership strategy.

Source: ADB. 2012. *Country Partnership Strategy: Sri Lanka, 2012–2016*. Manila.

98. ADB support was found to be *effective* overall based on individual project outputs. For example, the Clean Energy and Access Improvement Project⁶⁰ aimed to provide affordable and reliable power. The project outputs were: (i) a stronger transmission and distribution network and demand-side management of municipal street lighting, (ii) removal of network bottlenecks for small hydropower plants, (iii) a stronger transmission network in Eastern Province, and (iv) an expanded credit support program for service connections. Most components of the transmission system strengthening are complete and operational. They include four 132 Kilo Volts (kV) transmission lines, four 132 kV/33 kV grid substations, and nine augmented grid substations, four of which were financed with loan savings. The demand-side management of municipal street lighting was implemented through TA. Poor households' access to power was supported through a credit support program which was later expanded from \$3.5 million to \$4.7 million from loan savings to connect 5,000 additional households.

99. Most of the outputs of the Sustainable Power Sector Support Project⁶¹ are also complete and operational. These include three transmission lines and one transmission line augmentation. There were four new grid substations and two augmentations (one financed with loan savings). About 90% of the rural electrification and distribution component is complete as is the energy efficiency improvement component. The Clean Energy and Network Efficiency Improvement Project⁶² is also on track to meet its outputs in 2017. The expected outcome was to increase the supply of clean power and improve the efficiency and reliability of electricity. Expected outputs are: (i) transmission system strengthening in Northern Province; (ii) an improved transmission and distribution network, and (iii) a rooftop solar power generation pilot project. All components of this project are still being implemented. The design of the 125 km, 220 kV transmission line at Mannar is complete and construction has just begun. Implementation of all subprojects is on schedule. It is too early to rate the effectiveness of the Green Power Development and Energy Efficiency Improvement Investment Program⁶³ (tranche 1) approved in 2014, although tranche 1 components appear to be on track.

100. Despite this enormous progress, the power system remains fragile. It lacks the necessary redundancies⁶⁴ that power systems need to operate efficiently and continuously without rolling blackouts and interruptions to service delivery.⁶⁵ The CEB operates satisfactorily at a technical level in terms of engineering and overall management and ADB support has contributed to the system's greater efficiency (in terms of reduced system losses) and the increase in clean energy supply and energy-use efficiency. But in the absence of recovering the full cost of services, and without full autonomy given to the power regulator, substantial institutional weaknesses

⁶⁰ ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Clean Energy and Access Improvement Project*. Manila.

⁶¹ ADB. 2011. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Sri Lanka for the Sustainable Power Sector Support*. Manila.

⁶² ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Clean Energy and Network Efficiency Improvement Project*. Manila.

⁶³ ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Power Development and Energy Efficiency Improvement Investment Program*. Manila.

⁶⁴ Systematic and asset-based engineering requirements that keep a system operable despite one or more failures in one or more parts of the system. Redundancies are vital to operations and service delivery reliability.

⁶⁵ For example, on 13 March 2016 a failure in the central grid substation resulted in a total blackout. This led to rolling power cuts throughout Sri Lanka that lasted several days.

undermine sector sustainability. Moreover, participation by the private sector and PPPs have not progressed to the extent envisaged in successive CPSs.

101. In 2011, the PUC issued a tariff that would better reflect market costs. This was not enforced, however, and revenues fell short of costs by an estimated SLRs11.7 billion (about \$105.8 million). In 2012, the CEB's financial position worsened because of a severe drought, and, with no off-setting tariff adjustments, its deficit grew. Without an explicit subsidy, the CEB maintained its cash flow through short-term borrowing from state-owned banks and by increasing its liabilities with the Ceylon Petroleum Company.⁶⁶ The CEB's losses in 2012 were estimated at 1.5% of Sri Lanka's GDP,⁶⁷ roughly half that spent on education. With normal rainfall in 2013, the CEB announced savings, which were subsequently used to settle outstanding fuel bills with Ceylon Petroleum Company for 2011 and 2012. The government uses electricity pricing to achieve wider social policy objectives, which has led to an accumulation of arrears by CEB, especially in years when tariff prices are below the cost of energy generation. This implicit social policy objective is not well targeted. There are better and more effective ways of reaching the poor including through the reform of the existing national safety net, *Samurdhi*, so that it is better targeted at the poorest.

102. The demand for electricity grew in 2014 and 2015 mainly because of a substantial downward revision of the domestic (household) tariff in September 2014 and a 4% increase in the number of consumers. The CEB's financial position improved in 2015 despite the tariff reduction. This was largely supported by an increase in the mix of hydro and coal in overall power generation, and a dramatic decline in oil prices which drove down the average cost of generation (Table 7). The CEB recorded an operating profit in 2015 of SLRs20.1 billion after an operating loss of SLRs14.6 million in 2014. As a result, CEB's short-term borrowing from banks and short-term liabilities declined, although its longer-term liabilities, mainly to the banking sector and the government totaled SLRs302.9 billion at the end of 2015.

103. The government intends to introduce a formula-based automatic pricing mechanism for petroleum products, so as to ensure that future losses by the Ceylon Petroleum Corporation and large retail adjustments are avoided. In addition, the PUC will be granted enhanced authority to set electricity and water tariffs to reflect costs. To support these objectives, the fiscal cost of non-commercial obligations SOEs will be included in the central government budget.⁶⁸ This would help improve the financial sustainability of the electricity sub-sector and reduce fiscal risks.

⁶⁶ To pay its bills, the CEB resorted to a mix of short-term borrowing and not paying its fuel bills to Ceylon Petroleum Company.

⁶⁷ JICA estimated CEB's losses in 2012 at 1.5% of Sri Lanka's GDP. For more details, see JICA. 2015. *Sri Lanka Ceylon Electricity Board: Development Planning on Optimal Power Generation for Peak Demand in Sri Lanka*. Tokyo.

⁶⁸ IMF. 2016. *Sri Lanka: Staff Report for the 2016 Article IV Consultation and request for a three-year extended arrangement under the Extended Fund Facility*. Washington.

Table 7: Sri Lanka Electricity Generation Mix

Generation Mix	2014 (%)	2015 (%)	2015 Average Cost/Unit (SLRs)
fuel oil	34.8	17.4	29.8
hydro (excluding mini-hydro)	29.4	37.5	1.7
coal	25.9	33.9	7.3
NCRE	9.9	11.2	17.0
Total			10.2

NCRE = nonconventional renewable energy, SLR = Sri Lankan rupee.

Source: Central Bank of Sri Lanka Annual Report.

104. Following the Paris Agreement on Climate Change in December 2015, nearly all countries committed to reducing greenhouse gas emissions. Political commitment to develop renewable energy in Sri Lanka has not receded even with the fall in world prices of coal and oil. The main issue is the technical limitations of small power systems, which cannot accommodate the intermittency of renewable energy. With ADB support, however, inroads have been made in increasing off-grid nonconventional renewable energy.⁶⁹

D. Summary

105. Inadequate and poor quality infrastructure was identified as a major constraint on sustaining rapid economic growth in the government's DPF, 2006–2016. ADB's CPSSs have consistently regarded the distribution of infrastructure projects as one way to balance regional development and achieve inclusive growth. Access to transport, water and energy has increased since the end of the conflict in 2009.

106. Transport is by far the largest sector supported by ADB. From 2009, ADB significantly increased its support for this sector, but its share of financing for new national roads declined with the entry of new development partners since 2009, including the PRC.

107. Because of the dominance of roads, and their rapid expansion, substantial connectivity improvements were made that have resulted in economic efficiency gains. ADB has successfully promoted road development in the North Central, Eastern, and Northern Provinces since 2008, leading to more inclusion. Through its capacity-building support for the RDA it has improved the effectiveness of public investment in national roads. Sri Lankans regard roads as important for development.

108. The amount of attention ADB paid to institutional and policy reforms for transport declined over the evaluation period, while lending for roads increased, leading to risks for the future sustainability of the transport sector.

109. Sri Lanka made impressive progress toward the MDG target of halving the proportion of people without sustainable access to safe drinking water. ADB has supported the government in providing safe water for all, improving sanitation, expanding services to lagging and conflict-affected areas, and strengthening policy making. Results have been impressive.

⁶⁹ Various off-grid renewable energy pilot projects are successfully providing off-grid electricity to remote households, including a pilot hybrid mini-grid system subproject on Elevaithivu Island under ADB regional TA (ADB. 2009. *Effective Deployment of Distributed Small Wind Power Systems in Asian Rural Areas*. Manila).

110. Efforts to reform water supply and sanitation policies, strengthen institutions, and develop capacity have not progressed as far as expected. The key challenge facing the WMIS sector is bringing the policy environment up to date. The need for sector reform is urgent but the sector is highly politicized, regulated by 51 separate laws and some 40 public agencies dealing with it.

111. Electricity for all is a high development priority. The DPF 2006–2016 aimed to make electricity reliable, competitively priced, commercially viable, and subject to independent regulation. Investment in the energy sector accounted for about 19% of total ADB support for Sri Lanka over the evaluation period, and was the third largest sector after transport, and WMIS.

112. ADB supported government objectives to expand electricity supply to the entire population, especially to lagging regions and communities affected by conflict and natural disasters; for example, through transmission line construction to conflict-affected areas and credit lines for household connections.

113. Sri Lanka saw a substantial improvement in the electricity subsector at the end of the conflict in 2009, particularly for household access. In 2014, the household electrification rate reached 98.4%, from 66.0% in 2006. While some areas have achieved 100% electrification, others lag behind.

114. Despite this enormous progress, the power system remains fragile, prices are determined by the government, and the CEB often operates at a loss. Enhanced authority for the PUC to set electricity and water tariffs that reflect costs should help reduce the fiscal risks associated with these two sectors.

Support for Conflict- and Tsunami-Affected Areas

115. Support for areas affected by 26 years of conflict and areas impacted by the 2004 tsunami through decentralized, community-based projects to promote inclusive growth was an important component of ADB's support for Sri Lanka during most of the evaluation period (2006–2015).

116. Armed conflict between the government and the Liberation Tigers of Tamil Eelam (LTTE) from 1983–2009 resulted in over 65,000 people killed and over 800,000 displaced. It also caused a severe breakdown of infrastructure, services, and access to markets, which hit local livelihoods and the regional economy, reducing the contribution to GDP from the north and east from 15% in the 1980s to 7.5% by 2001. Peace prospects improved in 2001, and a ceasefire agreement was signed between the government and the LTTE in February 2002. The government requested ADB support for its program of relief and rehabilitation for North Eastern Province;⁷⁰ ADB responded with two multisector projects approved in 2001 and 2003.

117. The Indian Ocean tsunami of December 2004 generated another shock which severely affected coastal districts in the north, east, and southern areas of the country. ADB responded by supporting additional community-based projects.

118. This chapter evaluates these community-based projects by reviewing their strategic objectives and intended outcomes and assessing the results of ADB support. Because of the complex operating environment and the spread of ADB support to the conflict- and tsunami-affected Northern and Eastern Provinces, the evaluation covers field visits to all eight districts of these provinces. It also conducted an intensive field study using participatory evaluation tools in three districts.⁷¹ Participatory evaluation tools included preparation of village profiles, a beneficiary survey of 482 randomly selected households from the 24 sample villages (8 per district), 24 focus group discussions (12 male, 12 female) in half of the sample villages, and interviews with key stakeholders knowledgeable about the projects.

A. ADB Strategy

119. As described in Chapter 1, the strategic objectives of the CPS, 2004–2008, which overlapped with the initial years of the evaluation period, were poverty reduction, reconstruction, and development. The CPS envisaged investments in lagging regions to rehabilitate services in conflict-affected areas and promote rural livelihoods. A joint needs assessment by ADB, the United Nations, and World Bank with the participation of the government and the LTTE estimated financing needs of at least

⁷⁰ North Eastern Province was divided into two: Northern Province and Eastern Province in 2006.

⁷¹ The participatory evaluation was undertaken by the Centre for Poverty Analysis in Batticaloa district in Eastern Province, and Jaffna and Vavuniya districts in Northern Province.

\$1.5 billion to rebuild war-ravaged regions, one-third in the short term and two-thirds in the medium term.⁷² This laid the basis for ADB's support to Northern and Eastern Provinces, which is the focus of this chapter.

120. ADB's subsequent CPSs dropped the reference to reconstruction from their strategic objectives, but CPS, 2009–2011 maintained two relevant themes: Faster and more equitable economic growth to help mitigate the impact of conflict; and decentralization of service provision, which subsumed support for conflict-affected areas. CPS, 2012–2016 retained support for inclusive and sustainable economic growth, but no new lending was explicitly approved for conflict-affected areas, with support extended through national road and power sector infrastructure programs (Table 8).

Table 8: Country Partnership Strategic Objectives and Associated Multisector Strategies

CPS, 2004–2008	CPS, 2009–2011	CPS, 2012–2016
CPS Outcomes/Relevant Pillars for Multisector Projects		
Pro-poor economic growth, good governance	Inclusive economic growth	Inclusive and sustainable economic growth
Multisector Strategies		
Removing regional development imbalance by rehabilitation and reconstruction in conflict-affected and other poor areas	Better service delivery by provision of basic services: education, water, power, sanitation, sewage, garbage) to the poor (NECCDEP, CAARP and TAARP); and rehabilitation of basic infrastructure (NECORD)	Infrastructure development that improves connectivity and service delivery to lagging regions, including the former conflict-affected regions of the country

CAARP = Conflict-Affected Areas Rehabilitation Project, CPS = country partnership strategy, NECCDEP = North East Coastal Community Development Project, NECORD = North East Community Restoration and Development Project, TAARP = Tsunami-Affected Areas Rebuilding Project.

Sources: ADB. 2003. *Country Strategy and Program, 2004–2008*. Manila; ADB. 2010. *Country Partnership Strategy, 2009–2011*. Manila; ADB. 2011. *Country Partnership Strategy, 2012–2016*. Manila.

121. ADB support for conflict-affected regions had already begun with the approval of the North East Community Restoration and Development Project in October 2001.⁷³ CPS 2004–2008 proposed to follow this with a second loan in 2004 for the North East Community Restoration and Development Project II under the good governance pillar. CPS 2009–2011 declared it would include lessons learned on conflict-sensitivity and governance issues. The CPS pillar on socially inclusive development was designed to provide “greater access to economic and social services for the poor and those living in conflict-affected areas.” The strategy aimed to improve service delivery; connect the poor to power and water supply systems; and increase access to microfinance to rehabilitate basic economic and social infrastructure in lagging regions and conflict-affected areas, and to secure greater community involvement in project design and implementation.

122. In response to the government's request after the conflict ended in 2009, ADB provided support for immediate reconstruction needs in transport, power, and water supply and sanitation for Northern Province, approving a \$150 million multisector

⁷² Government of Sri Lanka, ADB, United Nations, and World Bank. 2003. *Sri Lanka: Assessment of Needs in the Conflict-affected Areas*. Colombo.

⁷³ ADB. 2001. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the North East Community Restoration and Development Project*. Manila.

emergency project.⁷⁴ CPS 2012–2016 noted that “while the government has resettled most of the war-affected internally displaced persons, economic prospects in the former conflict areas need to be revived to full potential.” By improving infrastructure connectivity and service delivery to lagging regions, the strategy aimed to reduce regional disparities and expand employment opportunities, thereby promoting inclusive growth. The strategy supported national programs to expand infrastructure, education, and PSM, but it did not include new commitments for conflict-affected areas. Although the community-based (multisector) interventions approved under previous CPS cycles were highly relevant to the needs of conflict- and tsunami-affected areas, which are still considered lagging regions, CPS 2012–2016 moved away from addressing such needs and directed its support largely at infrastructure connectivity. The results framework of CPS 2012–2016 did not allow for progress on regional disparities or inclusive growth to be assessed. It tracked only sector outcomes at the national level, organized around ADB’s strategy.

B. The Multisector Operational Portfolio

123. The North East Community Restoration and Development Project aimed to improve the living conditions and well-being of communities in the project area affected by the conflict, particularly communities with significant proportions of internally displaced people. This was designed as a \$40 million project of which \$25 million was to be financed by the ADF, \$7 million by the government, \$7 million by development partners, and \$1 million by community contributions.⁷⁵ It was implemented with a customized, decentralized, bottom-up institutional design.

124. In 2003, ADB approved another multisector project, the North East Coastal Community Development Project, for coastal districts in the north and east.⁷⁶ This was designed as a \$31 million project, of which \$20 million was to be financed by the ADF and \$11 million by the government. The purpose was sustainable livelihoods improvement and sound management of natural resources.

125. The first North East Community Restoration and Development Project closed in 2007 and by then it had become a brand name for a generation of follow-on projects. These were prepared as timely responses to reconstruction and livelihood support needs when opportunities were provided by peace agreements. There were three dedicated follow-on projects: North East Community Restoration and Development Project II⁷⁷ and two rounds of additional financing through an extension project and a supplementary loan program for the second project. In addition, the project implemented components of two other projects in conflict- and tsunami-affected areas. The eight ADB multisector projects assessed were: (i) North East Community Restoration and Development Project, (ii) North East Coastal Community Development

⁷⁴ ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Conflict-Affected Region Emergency*. Manila.

⁷⁵ Actual financing at project closing was \$44.6 million (\$35.8 million ADF, \$9.7 million Government, \$8.0 development partners). Cofinancing was provided primarily by the Organization of Petroleum Exporting Countries Fund (\$3.9 million) and Germany (\$2.5 million), with less than \$1.0 million each from Finland, Netherlands, and Norway.

⁷⁶ ADB. 2003. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the North East Coastal Community Development Project*. Manila.

⁷⁷ ADB. 2005. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the North East Community Restoration and Development Project II*. Manila.

Project, (iii) Conflict-Affected Areas Rehabilitation Project,⁷⁸ (iv) Tsunami-Affected Areas Rebuilding Project,⁷⁹ (v) North East Community Restoration and Development Project Extension⁸⁰ (vi) North East Community Restoration and Development Project II, (vii) North East Community Restoration and Development Project II Supplementary,⁸¹ and (viii) Conflict Affected Region Emergency Project.

126. These projects fall into two categories:

- (i) North East Community Restoration and Development Project and its follow-on projects, the Conflict-Affected Areas Rehabilitation Project and the Conflict Affected Region Emergency Project for rehabilitation of infrastructure and services in conflict-affected areas; and
- (ii) natural resource management and community livelihoods financed by the North East Coastal Community Development Project, but with additional funding from the Tsunami-Affected Areas Rebuilding Project, which morphed into a project for post-disaster rehabilitation.

127. Most of the activities financed by these multisector projects were demand driven, directly selected by communities or in consultation with local stakeholders, including community members and district and divisional level planning authorities. Projects also leveraged financing from other development partners. The total cost for these projects was \$706 million with ADB's financing at 68% (Table 9).

Table 9: Multisector Project Portfolio Data

Project	Approval to Closing dates	Total Cost \$ million	ADB Financing		Co-Financing \$ million
			\$ million	%	
Conflict Affected Areas Rehabilitation Project	December 2003–December 2011	114.71	73.50	64	Government: 30.72; Norway: 8.10
North East Coastal Community Development Project	November 2003–January 2012	31.44	19.46	62	Government: 10.98 Netherlands: 0.52 Beneficiaries: 0.17
North East Community Restoration and Development Project	October 2001–June 2007	44.55	25.3	57	Government: 9.7; OPEC: 3.7; Germany: 2.5; Netherlands: 0.80; Beneficiaries: ^a 1.0; Norway: 0.59; Finland: 0.26
Tsunami-Affected Areas Rebuilding Project	April 2005 – April 2011	261.7	154.6	59	Government: 20.7; European Commission: 67; Netherlands: 8.1; France: 11.3

⁷⁸ ADB. 2003. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Conflict-Affected Areas Rehabilitation*. Manila.

⁷⁹ ADB. 2005. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Tsunami-Affected Areas Rebuilding Project*. Manila.

⁸⁰ ADB. 2004. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the North East Community Restoration and Development Project (Extension)*. Manila.

⁸¹ ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the North East Community Restoration and Development II Project (Supplementary)*. Manila.

Project	Approval to Closing dates	Total Cost \$ million	ADB Financing		Co-Financing \$ million
			\$ million	%	
North East Community Restoration and Development Project Follow-On Projects					
North East Community Restoration and Development Project extension	June 2004–June 2009	12.90	8.60	67	Government: 4.3
North East Community Restoration and Development Project II and North East Community Restoration and Development Project II Supplementary Loan Program ^b	April 2005–December 2011; March 2010–September 2012	72.50	50.20	69	Government: 10.7 SIDA grant: 4.9 AusAID grant: 6.7
Sub-total follow-on projects		85.40	58.80	69	
Conflict Affected Region Emergency Project	April 2010–2014	168.24	150.00	89	Government: 18.24
Total Approvals		706.04	481.66	68	Government: 105.34 Donors: 114.47

ADB = Asian Development bank, AusAID = Australia's Aid Program, Ministry of Foreign Affairs and Trade, OPEC = Organization of Petroleum Exporting Countries, SIDA = Swedish International Development Cooperation Agency.

^a Beneficiary contributions for all projects were in-kind in nature, or beneficiary in-kind contributions for all projects.

^b Financing for North East Community Restoration and Development Project II and its supplementary loan program is reported together in the project completion report, and therefore presented together in the table.

Sources: Project completion reports for all projects (except for the Conflict Affected Region Emergency Project, for which only the report and recommendation of the President was available).

C. Doing Things Differently in a Conflict-Affected Context

128. Project management and implementation arrangements for the North East Community Restoration and Development Project series were tailored to the context. Participatory planning, decentralized screening and decision making, and collaborative implementation which relied on government structures and procedures at appropriate levels and local contractors or communities were key ingredients of project success.

129. The North East Community Restoration and Development Project was implemented in a conflict-affected area where some parts were under the control of the government and others under the LTTE. To ensure transparency and fairness, the project used a process approach to identify local needs and select subprojects. The project management arrangements initially developed for this project were later applied to all the follow-on projects and, with minor adjustments, to North East Coastal Community Development Project.

130. **Results.** The North East Community Restoration and Development Project financed 610 subprojects in various sectors, with a project design that emphasized the

needs of conflict-affected communities; most of these were anchor subprojects.⁸² However, 58 communities received a community development subproject, which allowed them to choose and finance their own subprojects. Communities selected activities that included roads, multipurpose buildings, houses, wells, and livelihood training and activities. This model of anchor subprojects and community development subprojects was repeated throughout the North East Community Restoration and Development Project series.

131. The eight multisector projects implemented during the CAPE period were responsive to the needs of more than 750,000 households, a substantial contribution to the country's efforts to rehabilitate conflict- and tsunami-affected communities in lagging regions. ADB support achieved its objectives of improving connectivity and service delivery in the former conflict-affected regions in the north and east. The seven completed projects over the CAPE period validated by the Independent Evaluation Department (IED) were found to be *highly successful* or *successful* in restoring health and education services; expanding connectivity to safe water and electricity; rehabilitating national, provincial, and rural roads; supporting rural livelihoods through the rehabilitation of irrigation schemes; increasing access to agricultural services and microfinance; and supporting community development schemes identified by local communities.

132. ADB support also had a significant impact on the health, improved living conditions, and social and economic empowerment of women. However, most of these outcomes are not specifically monitored or included in the CPSs and sector results frameworks (Table 10). Results were compiled from the completion and validation reports and further substantiated by extensive fieldwork by the CAPE team in Northern and Eastern Provinces, supplemented by a participatory evaluation to obtain beneficiary feedback on the implementation and outcomes of these multisector projects.

Table 10: Multisector Results Framework

Sector Outcomes with ADB Contribution ^a	
Country Indicators	Status
Transport: Rehabilitate 2,400 kilometers (km) of national roads by 2012	The CAARP financed 198 km of class A and B national roads including bridges and drainage in the north and east. The TAARP financed rehabilitation of 392 km of coastal highway, 76 km of additional roads, 96 km of access roads, and 38 km of provincial roads. The NECORD, CAARP, NECCDEP, and NECORD follow-on projects constructed or rehabilitated 762 km of rural roads. This complemented the outputs of the CAREP and the Northern Road Connectivity Project. Travel time was reduced by 30% from 2009 levels.
Electricity access: Electrification ratio increased to 100% by 2012 (2010 baseline: 88%)	CAARP and NECORD follow-on projects completed 184 rural electrification schemes and 11 medium-volt schemes reaching 44,300 new customers, and financed 9 renewable energy subprojects. This has complemented the outputs of the CAREP and Sustainable Power Sector Support Project, providing reliable power supply to the Northern Province and improving access to 750,000 people.
Water supply: Safe water coverage:	49 water supply projects, including 1 water tank, and

⁸² According to project documents, a "process approach was followed during implementation based on two general concepts, that there would be (i) larger anchor subprojects in each of the main sectors of health, water and sanitation, education, shelter, agriculture, and fisheries; and (ii) community subprojects" (North East Community Restoration and Development Project Completion Report, p. 1).

Sector Outcomes with ADB Contribution ^a	
100% by 2020 (2009 baseline: 85%)	222 dug wells, improved water supply of rural households which were financed by NECORD, CAARP, TAARP, and NECORD follow-on projects in the Northern and Eastern Provinces. The national target of achieving 100% coverage by 2020 appears attainable.
Water supply: 200,000 new water connections provided, of which 40,000 are to poor households, and about 60,000 are in the east, by 2011	12 NECORD projects alone benefited 18,000 people. Beneficiary feedback indicates the target has likely been achieved.
Education: Low secondary enrollment: 100% in 2020 (2010 baseline: 90%)	NECORD, CAARP, TAARP, and NECORD follow-on projects supported 685 subprojects to rehabilitate or construct schools. The 219 subprojects financed by NECORD alone benefited over 179,000 people.
Health: No outcomes listed in results framework	NECORD, CAARP, and NECORD follow-on projects undertook 186 health subprojects, including 2 district hospitals in Kilinochchi and Vavuniya. The 103 subprojects financed by NECORD alone benefited over 272,000 people.
Community development and livelihoods: No outcomes listed in results framework	14.3% of financing from NECORD and its follow-on projects were on demand-driven community development and an equal amount on irrigation and agriculture subprojects. NECCDEP spent 53% of its funds on livelihood improvement (skills training and community development) and 17% on fisheries subprojects.

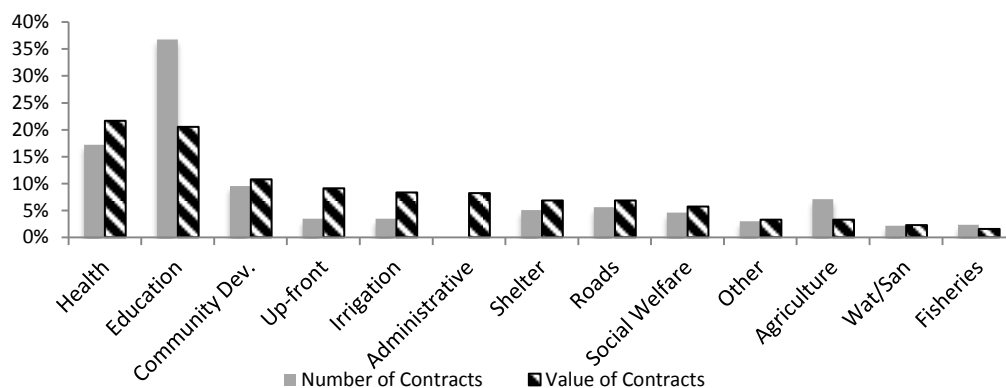
CAARP = Conflict-Affected Areas Rehabilitation Project, CAREP = Conflict Affected Region Emergency Project, CPS = country partnership strategies, NECCDEP = North East Coastal Community Development Project, NECORD = North East Community Restoration and Development Project, TAARP = Tsunami-Affected Areas Rebuilding Project

^a The results frameworks in the CPSs do not have separate outcomes for multisector projects.

Sources: ADB. 2010. *Country Partnership Strategy, 2009–2011*. Manila; ADB. 2011. *Country Partnership Strategy, 2012–2016*. Manila; and project completion reports.

133. The largest share of North East Community Restoration and Development Project subprojects were for education, followed by health and community development. The values of the health (22% of total value) and education (21%) projects were similar, but health subprojects were more expensive than education subprojects (Figure 4).

Figure 4: North East Community Restoration and Development Project Subproject Distribution by Number and Value, 2001–2007

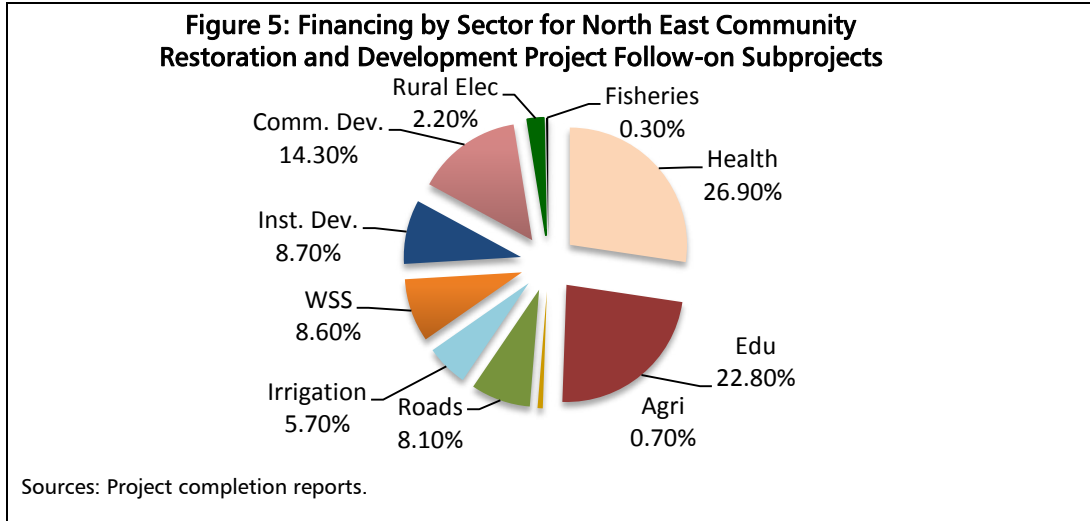


Wat/San = water supply and sanitation.

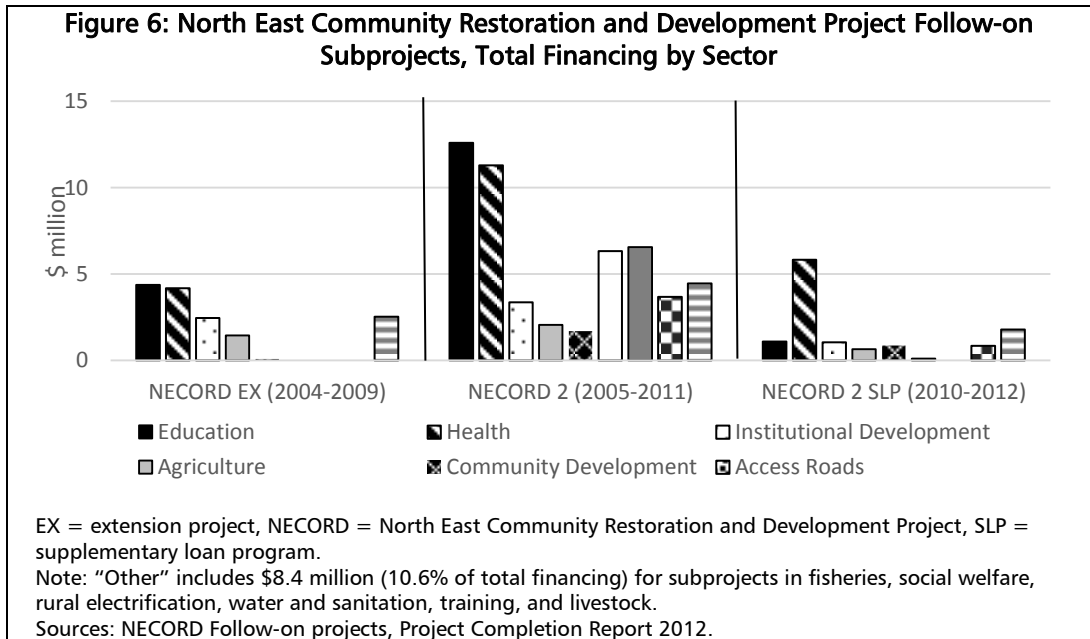
Note: Total number of subproject contracts = 610; value = \$43.4 million.

Source: Asian Development Bank.

134. The three North East Community Restoration and Development Project follow-on projects financed 956 subprojects costing \$85.4 million, of which \$58.8 million was from ADB and \$20.7 million from the government.⁸³ These follow-on projects together had a distribution similar to the original project, the largest share going to health and education, followed by community development (Figure 5).



135. This aggregation masks some notable variations, reflecting the timing of the different interventions (Figure 6). The extension project (2004–2009) focused more on livelihoods with greater investments in livestock, agriculture, and training; while North East Community Restoration and Development Project II (2005–2011) invested more in shelter, access roads, and irrigation; and its supplementary loan program (2010–2012) supported health, community development, and irrigation but invested less in education.



⁸³ Sweden provided \$5.9 million for access roads and Australia \$7.3 million for livelihood assistance to returning internally displaced persons.

136. In contrast to the North East Community Restoration and Development Project, the Conflict-Affected Areas Rehabilitation Project, which started in 2003, emphasized the rehabilitation of infrastructure. The total project cost was \$114.7 million, of which 61% was earmarked for roads and 16% for power, and there was a special allocation for the feasibility of water supply in Jaffna. The project also allocated 20% (\$22.59 million) for activities to be implemented by North East Community Restoration and Development Project.

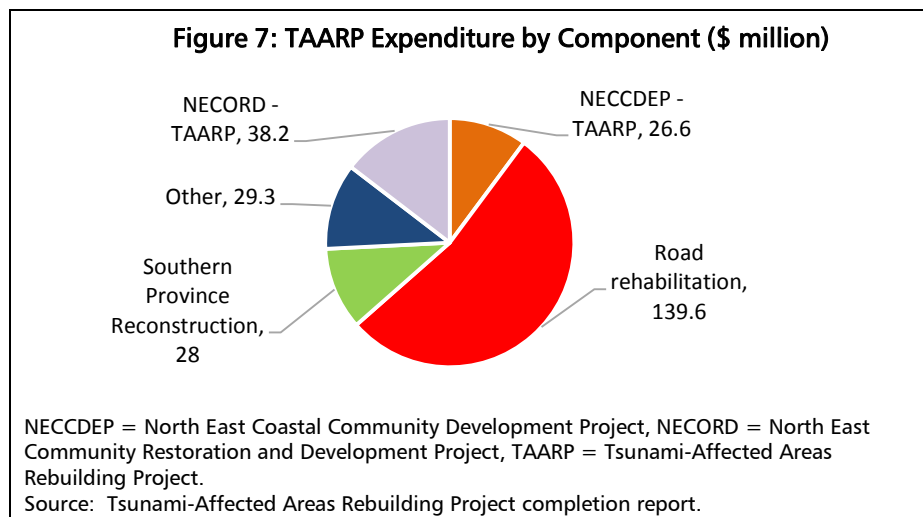
137. The Conflict-Affected Regional Emergency Project (approved in 2010) had a heavy emphasis on rebuilding infrastructure, but in the postwar period it also emphasized the reconstruction of government facilities in conflict-affected areas. The project's objective was to significantly expand and strengthen the reconstruction of urgently needed essential infrastructure and administrative services, assist in meeting basic human needs and create livelihood and sustainable employment opportunities in the conflict-affected areas by supporting the recovery of the region's economy. ADB provided \$150 million, with \$18 million in government cofinancing. Of this, 39% was allocated to roads; 20% to electricity and water utilities; and 20% to social services and livelihoods, which included irrigation schemes, administrative offices, and training centers. An allocation of 5% was set aside for legal infrastructure such as courthouses.⁸⁴ Despite the severity of the final phase of the conflict in 2009, ADB did not provide support to address the psychosocial trauma faced by war-affected and displaced communities. The CAPE found that this remains a gap not covered adequately by other development partners either.

138. The bulk of North East Coastal Community Development Project resources (53%) supported livelihoods in coastal communities, followed by 17% for fisheries subprojects and 15% for natural resources management. The livelihood component targeted 129 *Grama Niladhari* Divisions⁸⁵ and financed skills training for 13,500 people as well as microfinance loans. The project also financed the construction or rehabilitation of infrastructure for 596 small-scale community-level and 65 cluster-level subprojects, which pooled funds from nearby villages to create larger, shared structures. About 70% of the funds for small-scale community infrastructure schemes were spent equally on rural roads and multipurpose buildings, with about 5% each on drainage, wells, and preschool and production centers. Multipurpose buildings were very popular among beneficiary communities because they house the lowest tier of government services, ensuring easy access. These buildings also typically contain a community hall and often a preschool as well.

139. The Tsunami-Affected Areas Rebuilding Project (\$261.7 million), designed to rehabilitate social infrastructure and community services and restore livelihoods, was much larger than the North East Coastal Community Development Project. ADB provided \$154.6 million and the European Commission \$67 million for tsunami-affected areas in Northern, Eastern, and Southern Provinces. About half (53%) was used for road rehabilitation, and one-fourth for community development implemented by the North East Community Restoration and Development Project and North East Coastal Community Development Project (Figure 7). The cluster subprojects rehabilitated or constructed infrastructure for storage and repair for fishermen (85), markets (22), and agricultural and handicraft training centers (20). Community-level subprojects were largely for multipurpose buildings (307), wells (167), and preschool buildings/centers (87).

⁸⁴ The balance was project management and contingency cost.

⁸⁵ This is the lowest administrative tier, consisting of about five villages.



140. The community development subprojects under the North East Community Restoration and Development Project and the North East Coastal Community Development Project consisted of a block grant averaging SLRs5 million (about \$50,000) to village communities. A village plan was developed in a consultative manner at community meetings facilitated either by project staff or NGOs. The North East Coastal Community Development Project relied more on NGOs than North East Community Restoration and Development Project did. These subprojects usually financed multiple activities, and many of them included a revolving fund which received 10%–20% of the community development funds as seed capital. Most of the revolving funds were managed by a women’s rural development society.⁸⁶ The revolving funds are a success story and were very popular, especially among women. Of the households surveyed, 60% reported the existence of a revolving fund (78% in North East Coastal Community Development Project and North East Community Restoration and Development Project villages). Over three-fourths reported the revolving fund was still active several years after it was established and over 40% accessed credit from the fund. The fund is valued because it is available at the village level and accessible to those who cannot get formal bank loans. The funds are used for rotational credit but also to purchase assets owned by the Women’s Rural Development Society. These are rented out to increase the funds’ capital, with 60% reporting the funds had grown over time, in some instances by 200%–300%.

141. From 2002–2012, the North East Community Restoration and Development Project and its follow-on projects completed over 2,280 subprojects in addition to the construction of 6,500 houses financed by the Tsunami-Affected Areas Rebuilding Project. With supplementary financing from the Tsunami Project, the North East Coastal Community Development Project completed at least 844 discrete subprojects and built 365 km of rural roads. The large number of subprojects financed by these emergency assistance projects would not have been possible without the expedited processing and decentralized procurement employed to fast-track implementation. In addition, rural electrification benefited at least 44,300 households and at least 17,000 households received new water connections. The number of beneficiaries cannot be estimated due to duplication of benefits from multiple projects but a minimum estimate is that 750,000 people benefited from these interventions.

⁸⁶ The community development projects financed by the North East Coastal Community Development Project relied on NGOs to manage the village microfinance schemes, which were less likely to be sustainable since the NGOs had to recover and repay the seed capital.

D. Beneficiary Feedback on Results

142. Feedback from beneficiaries and other stakeholders was solicited during fieldwork in all eight districts of Northern and Eastern Provinces. This was supplemented by the structured participatory evaluation in three districts using mixed methods to obtain more in-depth beneficiary feedback on results. The quantitative data provided an aggregate quantified picture of how beneficiaries viewed the process, benefits, and impacts of the multisector program. The qualitative data, generated through focus group discussions and interviews, deepened those findings by illustrating the nature and depth of variations and the multiplicity of narratives prevalent in the project area. The main findings from the participatory evaluation are:

- (i) **High responsiveness to immediate needs.** The process for selecting subprojects incorporated beneficiary priorities and needs in the planning process. Immediate needs varied somewhat across villages, but housing and roads were consistently ranked highly, followed by schools and water, although male groups tended to give a higher priority to income-generating activities. Since some of these needs were supported by other agencies, the evaluation found that ADB interventions were demand-driven and filled essential gaps in social infrastructure.
- (ii) **Inclusive subproject distribution across villages.** ADB-financed projects explicitly tried to ensure that subprojects were distributed in a manner transparent and inclusive of different cultural and religious communities. The North East Community Restoration and Development Project's targeting criteria included ethnicity (Muslim, Sinhalese and Tamil villages), as well as a focus on internally displaced persons and other vulnerable groups (widows and female-headed households). The North East Coastal Community Development Project used the lens of conflict sensitivity to ensure equitable treatment of ethnic groups in the distribution of benefits to avoid widening ethnic divisions. Important documents were translated into Tamil to ensure equitable access to information. Survey results revealed that 77% of respondents felt that projects were distributed across villages in a "fair" or "somewhat fair" manner.
- (iii) **Most project benefits within villages were accessed equitably.** Villages were mostly ethnically homogeneous and there was no evidence of ethnic exclusion from project benefits within any village. The projects included targeting mechanisms to ensure that assets reached vulnerable groups, including female-headed households. The majority of survey respondents indicated that the resources were distributed in a fair manner; however, a few reported instances of favoritism or unequal access, especially with regard to shelter projects.⁸⁷ Government criteria for receiving housing excluded some of the most vulnerable, such as the elderly without family members to care for them, or younger couples who lacked the title to their housing before the community was displaced.
- (iv) **High community participation.** Participation was consistently high overall, though with some variance across districts. The emphasis on the process of drawing up a village-level plan through a participatory method and reviewing and prioritizing needs in a participatory manner,

⁸⁷ The shelter subprojects comprised 4% of the total number of NECORD and NECORD follow-on subprojects.

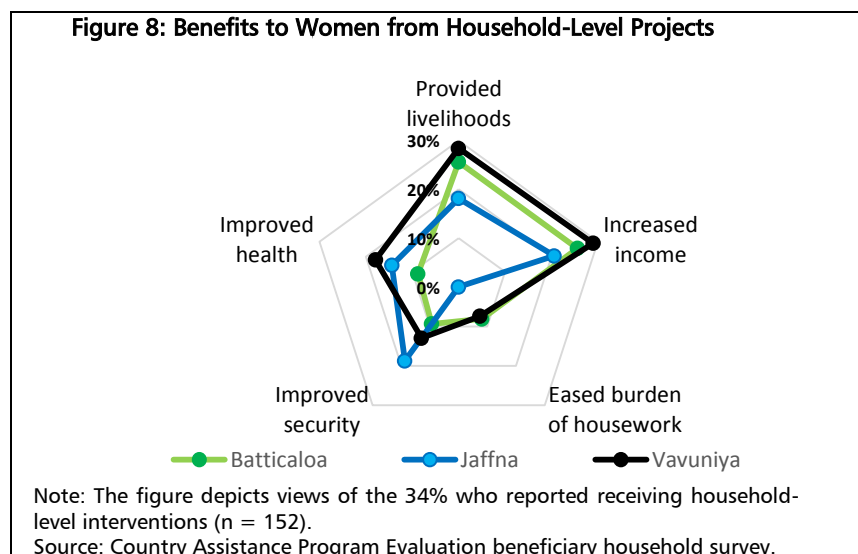
usually facilitated by an implementing NGO, was one of the distinctive features of both the North East Community Restoration and Development Project and the North East Coastal Community Development Project community-driven programs. Across all three districts and for all programs taken together, the average level of participation in project selection was 73% (Table 11), with higher participation rates in Batticaloa (78%) and lower rates in Jaffna (67%). The legacy of conflict and the difficult operating environment may have limited the social mobilization required for participatory processes in some areas. Participatory policies and procedures were adopted more effectively for project selection and design, and to a lesser extent in implementation (66%) and maintenance (65%). Government and project officials reported high levels of participation by community members and local government staff in the planning process. However, the household survey reflects higher rates of community participation in the North East Community Restoration and Development Project than in the North East Coastal Community Development Project.

Table 11: Level of Participation in Multisector Projects

District	Project Selection		Project Design		Project Implementation		Maintenance	
	Number	%	Number	%	Number	%	Number	%
Batticaloa	125	78	118	74	109	68	114	71
Vavuniya	118	72	116	72	111	69	114	70
Jaffna	107	67	101	63	97	61	86	54
Total	350	73	335	70	317	66	314	65

Source: Country Assistance Program Evaluation beneficiary household survey.

- (v) **High participation of women in most districts.** Women participation rates were high, except in Jaffna, which also had lower participation by men. Women participation in Batticaloa and Vavuniya was 71%, similar to that of men. The participation of women may have been facilitated by the fact that in many villages the Women's Rural Development Society led community development projects. The strategy to channel the revolving fund and livelihood activities through women's groups gave them a direct operational role in project implementation.
- (vi) **Substantial benefits accrued to women from livelihood support and village-level subprojects.** Of the households sampled by the evaluation, 60% indicated the presence of a revolving fund in the village, ranging from 78% in North East Coastal Community Development Project villages to 51% in North East Community Restoration and Development Project villages. Of the households surveyed in villages with a revolving fund, 77% said the fund was still active, and 60% said it had multiplied over time. In villages with a revolving fund, 42% said that their household had accessed the fund. In addition to their own livelihood activities, 32% of respondents said women also benefited from household-level subprojects (Figure 8) through improved livelihoods (24%), incomes (25%), security (14%), and health (14%). Responses from Jaffna were different, improved security being the most cited benefit, with other benefits being lower than in other districts.



- (vii) **Overall subproject impacts perceived as satisfactory.** The subprojects were for the most part useful and appreciated, but sometimes not enough to fill all the gaps. Many groups reported that the project left the village too soon, and that villages would have benefited from additional rounds of participatory development. In three of the sample villages, focus group participants were less satisfied with the subprojects because of quality and selection issues. One common thread in the focus group discussions was the current and past need for psychosocial support. A few groups pointed out that, although livelihood training was provided, few people took advantage of this, as many were not in an emotional state to benefit from such support. During the participatory evaluation, some communities asked for additional rounds of training, as people had more time to adjust after the traumatic effects of the conflict. Some of the livelihood subprojects and training were criticized for lack of market assessments. However, of the beneficiaries that received livelihood support, 86% reported they were still using the assets and training provided, and 80% were able to enhance their income with this support.
- (viii) **Sector distribution of benefits from larger projects was similar.** Village-level interventions were mostly in the education and health subsectors, but they also included subprojects for multipurpose buildings, roads, community buildings, water and sanitation, rural electrification, and agriculture support. The household survey probed village-level benefits from these interventions, and, overall, the most widespread benefits were access to health care (75%), education (61%), and transport (53%). Benefits from the meso level projects (i.e., between the macro and micro levels) were similar: improved access to health care (54%), education (49%), and transport (39%) were the most frequently reported benefits. However, the perceived benefits of the meso level projects were lower than those from village-level services. Distance may be a constraint in accessing services from meso level projects.
- (ix) **Adverse impact on eligibility for social safety net program.** Some of the project beneficiaries were ineligible for enrollment in *Samurdhi*, the national safety net program. When the *Samurdhi* list was being prepared, families who were displaced or families who benefited from

another household project such as a shelter project were ineligible to enroll in the program as they were already receiving a cash transfer from the government. As a result, project beneficiaries who received short-term assistance from the project suffered the unintended consequence of losing the ongoing benefit stream provided by the government safety net program. Half of the households surveyed were enrolled in the *Samurdhi* program, but 37% believed that they should have been eligible for the program.

- (x) **Lack of institutional sustainability.** Although the North East Community Restoration and Development Project is widely recognized as a beneficial intervention, and has become a brand name in the project area, institutional memory and continuity within the government and ADB is weak. Individual subprojects are maintained either by sectoral line departments or local communities, but no organization was created or designated to take over the decentralized and effective institutional structure for these programs. The approach was discontinued prematurely and replaced by national infrastructure programs; these are necessary but insufficient to complete the rehabilitation of conflict-affected communities. The computerized management information systems established for these projects disappeared after project closing, and PCRs are available only in hard copy. This limits knowledge about these projects to only those who directly worked on them. ADB and the government should have come up with a better system to document and store valuable lessons from these projects which could be used and replicated in the future.

E. Conclusions from ADB's Support to the North and East

143. ADB's support for the conflict-affected north and east achieved noteworthy outcomes under challenging circumstances. The following were the main outcomes:

- (i) ADB responded to the conflict context with a highly relevant program of support through the North East Community Restoration and Development Project and its follow-on projects to help rebuild local infrastructure and services in conflict-affected areas.
- (ii) CPS, 2004–2008 reflected conflict sensitivity and a strategic commitment to support the government's rehabilitation efforts; CPS, 2009–2011 retained an emphasis on inclusive economic growth in lagging regions. However, the nature of support changed after the conflict ended in 2009 and by CPS, 2012–2016, the North East Community Restoration and Development Project's participatory approach was no longer appreciated.
- (iii) The program design and implementation arrangements integrated a bottom-up approach for needs identification with a decentralized, well-coordinated decision-making mechanism to ensure responsiveness to the priority needs of conflict-affected communities.
- (iv) The North East Community Restoration and Development Project generation of projects, which included the implementation of community development components financed by the Conflict-Affected Areas Rehabilitation Project and the Tsunami-Affected Areas Rebuilding Project, received strong support from local government staff and local communities, which enabled the projects to implement most of their subprojects successfully.

- (v) The content of the North East Community Restoration and Development Project subprojects evolved over time, with early priority given to reestablishing education and health services. Later on emphasis was placed on livelihoods, agricultural infrastructure, and community development.
- (vi) The participation of women was built into program design. Beneficiary feedback from the participatory evaluation revealed that this led to substantial benefits for women's economic and social empowerment.
- (vii) Parallel projects financed rehabilitation of livelihoods in tsunami-affected areas through the North East Coastal Community Development Project (with more financing subsequently from the Tsunami-Affected Areas Rebuilding Project), which had a similar implementation mechanism with some modifications, such as decision-making by the divisional secretary and implementation through NGOs, that reduced its ability to engage directly with local communities.
- (viii) The Conflict Affected Region Emergency Project shifted focus in the postwar period to rehabilitation of essential infrastructure and the restoration of administrative services in conflict-affected areas. While these are necessary investments, the success of support to restore community-level services and livelihoods was curtailed prematurely.
- (ix) Despite the severity of the final conflict in 2009, and the commitment to conflict sensitivity in previous CPSs, no effort was made to address the psychosocial trauma faced by war-affected and displaced persons. This prevented many possible beneficiaries from taking advantage of the improving economic situation.
- (x) Institutional memory was lost due to lessons from successful community-driven development implemented from 2002–2012 which helped build resilience among conflict- and tsunami-affected communities have not been integrated into ADB's strategy or the government's development programs. Many of those lessons are still relevant and could be applied to achieve inclusive growth in lagging regions.

CHAPTER 5

Catalyzing Private Sector Investment

144. The second pillar of CPS, 2012–2016 was catalyzing private sector investment and enhancing the effectiveness of public investment. The pillar builds on the government’s DPF which recognized the need to increase private sector investment and improve service delivery to sustain inclusive economic growth. It also builds on CPS, 2009–2011 which envisaged a greater role for nonsovereign operations in ADB’s program. All three CPSs during the evaluation period set out ADB support to help develop financial markets, particularly through capital market reforms. In order to increase the effectiveness of public sector investment, CPS, 2012–2016 envisaged ADB would support institutionalizing, identifying, and assessing PPPs. In addition, nonsovereign operations would be catalyzed through cofinancing, guarantees covering commercial and political risk, and syndication with other private financial entities, with ADB taking on the role of lender or guarantor of record. Providing loans in local currency to lower the exchange risk and deepening the domestic capital markets by issuing local currency bonds would also be explored.

145. This chapter assesses ADB’s support for private sector development, which included sovereign⁸⁸ and nonsovereign⁸⁹ operations during the evaluation period. Although individual interventions were assessed to have been successful, overall progress against pillar 2 has fallen short of that envisaged under successive CPSs, and this is the weakest of the three strategic pillars. This largely reflects the policy context for private sector development and the inconsistent government support over the CAPE period. Progress was also affected by the escalation of conflict in 2008.

A. Private Sector Development Context

146. A joint ADB and World Bank investment climate assessment in 2005 identified a number of constraints on private sector development.⁹⁰ Heading these were: the unreliability and high cost of electricity, economic and regulatory policy uncertainty, macroeconomic instability, and lack of access to finance. Other constraints included labor market regulations, poor transportation infrastructure, the low level of skills and education of available workers, and anticompetitive and informal practices.

147. A decade on from this assessment, the cumbersome regulation of the private sector continues to restrict private sector participation in the economy.⁹¹ The result is a large informal sector that affects the ability of the private sector, especially small and medium-sized enterprises (SMEs) to grow and create new jobs. Sri Lanka was ranked

⁸⁸ Supplementary Appendix 1

⁸⁹ Supplementary Appendix 2

⁹⁰ World Bank. 2005. *Sri Lanka: Improving the Rural and Urban Investment Climate*. Washington.

⁹¹ World Bank 2015. *Sri Lanka Ending Poverty and Promoting Shared Prosperity: A Systematic Country Diagnostic*. Washington.

107 out of 189 countries in the World Bank's overall 2015 Ease of Doing Business ranking, ahead of India (130), Pakistan (138) and Bangladesh (174), but well behind Malaysia (18), Thailand (49), and Viet Nam (90).⁹² So while Sri Lanka is ahead of its South Asian neighbors, it lags behind some South East Asian economies.⁹³

148. SOEs remain a key constraint and they impede efficient resource allocation, impose high costs on the private sector, and reduce private sector participation in infrastructure development. The 10 largest of these enterprises, accounting for nearly 17% of GDP in 2014, are banks and public utilities. State-owned banks account for a large share of the banking sector and lend a significant share of their funds to other SOEs, crowding out the private sector. The investment climate⁹⁴ impedes the development of PPPs, a key objective of CPS, 2012–2016, and foreign direct investment, which was central to the government's DPF (footnote 5). CPS, 2009–2011 noted the government's opposition to privatization of SOEs while at the same time supporting private sector development and PPPs. Public resistance to the privatization of SOEs, which extends to PPPs, represents a strong obstacle to policy changes, as the public sees reform as a threat to livelihoods (footnote 12).

B. Government and ADB Strategy

149. The government's DPF recognized the importance of private sector development and greater private investment for sustaining its growth objectives. It aimed to double per capita incomes to about \$4,000 between 2009 and 2016, a goal requiring at least 8% annual GDP growth and annual investment levels of 33%–35% of GDP. Since public investment was planned at 6%–7% of GDP a year, private sector investment would need to increase from 21% in 2010 to 26%–27% annually and FDI would need to double to 3%. Despite this aspiration, over the CAPE period there was little political will to advance key policy reforms to develop the financial sector, which ADB had supported for several years. Nor was there a serious government effort to institutionalize PPPs, which meant that efforts to attract private investment into the transport, energy, and water sectors did not materialize, except for the Colombo port project.

150. Private sector development in Sri Lanka has been a significant strategic objective for ADB for well over a decade, and is a key feature of its CPSs. All three CPSs over the CAPE period recognized the importance of the private sector in lifting the supply of essential services by increasing investment in infrastructure and sustaining longer-term growth. Strengthening the investment climate was a strategic objective with private sector development as a cross-cutting theme in CPS, 2009–2011. However, in that CPS, investment in infrastructure was seen as ADB's main contribution to private sector development. CPS, 2012–2016 further emphasized private sector investment. Catalyzing private investment and enhancing the effectiveness of public investment became a key strategic priority. ADB would support capital market reforms to promote the development of equity and debt markets to induce higher savings and investment, support the policy and institutional framework for PPPs, and improve the supply of marketable skills.

⁹² World Bank. 2015. Ease of Doing Business Rankings (<http://www.doingbusiness.org/rankings>).

⁹³ Sri Lanka is marginally ahead of Indonesia (109) but behind the Philippines (103).

⁹⁴ For instance, Sri Lanka lags behind its competitors in Ease of Doing Business indicators such as registration of property and time taken to obtain a construction permit.

C. ADB Program Assessment

1. Overview

151. ADB sovereign support for private sector development consistently focused on the provision of infrastructure, financial market development, and the institutionalization of PPPs, while CPS, 2009–2011 added support for macroeconomic management, particularly through support for tax administration and PSM. To accelerate the pace of private sector participation, CPS, 2012–2016 committed to support capital market development and institutionalize PPPs, which were expected to finance 4%–20% of the government’s 10-year development framework. ADB’s support for establishing an institutional structure and process for PPPs was expected to contribute to their increased utilization and to help the government achieve its investment objectives.

152. ADB’s nonsovereign operations in Sri Lanka were expected to increase over the CAPE period to supplement the smaller number of sectors supported through sovereign operations.⁹⁵ The Private Sector Operations Department (PSOD) was expected to expand its presence through more direct investment in privately owned projects. CPS 2009–2011 noted that PSOD was building its portfolio with a leasing company to provide longer-term financing for SMEs. ADB’s Trade Finance Facilitation Program⁹⁶ was also active in Sri Lanka. The major opportunities for private sector interventions were seen to be in port terminals and in power generation and potentially transmission if the government was prepared to open that market to private investments. This however did not materialize as Electricity transmission continues to be nearly all owned and operated by the public sector state utility, CEB. Sri Lanka has grid connectivity of 98% as of 2015.

153. To facilitate investments in the power sector, where the government was supporting small-scale renewable power projects as part of its climate change initiatives, PSOD worked in parallel on four small demonstration projects.⁹⁷ The energy sector road map also integrated public and possible private sector investments. In CPS, 2012–2016, PSOD was expected to explore potential projects in renewable energy, thermal power,⁹⁸ waste-to-energy, cargo handling and logistics, trade finance, housing, finance, leasing, and telecommunications. ADB would also provide nonsovereign loans for reforming SOEs and growing financial institutions. Additional private investments in these activities would be catalyzed through cofinancing using ADB’s credit enhancement products and local currency loans.

2. Sovereign Operations

154. Sovereign operations supported financial sector development but there was no new support after 2007, the entire portfolio falling under CPS, 2004–2008. This reflected the political economy which was not conducive to any further policy reform at the time.

⁹⁵ ADB. 2009. *Country Partnership Strategy: Sri Lanka, 2009–2011*. Manila.

⁹⁶ ADB. 2009. *Trade Finance Facilitation Program*. Manila.

⁹⁷ These projects were small-scale agricultural and biomass waste-to-energy power projects but did not proceed as planned.

⁹⁸ Thermal power was included in response to a specific identified opportunity that did not proceed. Thermal power projects are not part of PSOD’s current strategy for Sri Lanka.

155. The portfolio consisted of three sovereign loans and two TA approvals totaling \$185.8 million over the CAPE period (Table 12). Support for the business environment as envisaged in CPS, 2009–2011 and CPS, 2012–2016 did not materialize. In January 2016, however, ADB approved a line of credit for onlending to SMEs.⁹⁹ A proposed policy-based loan to support capital market development is also expected to be approved in 2016. The increase in the level of support reflects the change of government in January 2015. This loan would support the new government's program of structural reforms, along with support from the IMF Extended Fund Facility agreed in June 2016, and a World Bank development policy loan approved in July 2016.

Table 12: Financial Sector Approvals, 2006–2015

Approval Year	Approval Number	Approval	Loan \$ million	TA \$ million
2007	2381	Small and Medium Enterprise Regional Development	50.0	
2006	4761	Microinsurance Sector Development		0.76
2004	2138/2139	Financial Markets Program for Private Sector Development	60.0	5.00
2003	34320	Rural Finance Sector Development	70.0	
2001	33246	Small and Medium Enterprise Sector Development Program	86.0	
Total			266.0	5.76

TA = technical assistance.

Sources: Asian Development Bank loan, technical assistance, grant, and equity approvals database and loan.

156. The 2001 Small and Medium Enterprise Sector Development Program¹⁰⁰ is included in the CAPE assessment because it ran until 2011. A more dynamic SME sector and an improved business environment were expected from the program plus greater access to financing, and strengthened business capabilities. A credit line for participating credit institutions would improve SMEs' access to finance. This was to be complemented by a partial credit guarantee scheme for commercial cofinancing to commercial banks to enhance onlending to SMEs. TA projects would help the government formulate an SME development strategy.

157. The 2003 Rural Finance Sector Development Program¹⁰¹ was a program loan with additional project loans (one for a credit line and one for capacity building). The program aimed to support 10,000 small and microrural enterprises and 850 community subprojects. The target was for rural financial institutions, using their own resources, to reach 200,000 new clients during program implementation, which was expected to have a significant impact in generating jobs and increasing income.

158. The 2004 Financial Markets Program for Private Sector Development was a policy-based loan¹⁰² that was part of a cluster loan series for private sector development, with the first loan approved in 2000. This series of loans aimed to

⁹⁹ 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 the Small and Medium-Sized Enterprise Line of Credit Project*. Manila.

¹⁰⁰ ADB. 2001. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Small and Medium Enterprises Sector Development Program*. Manila.

¹⁰¹ ADB. 2003. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Rural Finance Sector Development Program*. Manila.

¹⁰² ADB. 2004. *Report and Recommendation of the President to the Board of Directors: Proposed Loans to the Democratic Socialist Republic of Sri Lanka for the Financial Markets Program for Private Sector Development*. Manila.

strengthen the regulatory policy context and, in terms of sequencing, was relevant to the overall objective of improving access to finance. The second subprogram loan aimed to further develop financial markets, private sector access to finance, and support reform of state-owned banks. The 2004 cluster loan appears to be the flagship in the financial sector portfolio with its focus on regulatory and institutional reform, while other interventions were focused on financial inclusion. This appears to be appropriate in terms of sequencing and ADB used it to support financial service expansion, including rural financial services.

159. In 2006, ADB approved a small TA program¹⁰³ to help improve access to affordable life and general insurance for poor households, especially those in conflict- and tsunami-affected areas. In 2007, the Small and Medium Enterprise Regional Development Project¹⁰⁴ was approved. Its objective was to enable the Central Bank of Sri Lanka to on lend ADB project resources to participating commercial banks so they could extend loans to SMEs outside the Western Province, in particular those in conflict-affected areas.

3. Sovereign Operations Performance

160. Lack of ownership of the policy reforms and capacity building components of the 2001 SME Sector Development program were reasons cited in the project validation report (PVR) for the project's *less than successful* outcome. It also noted that more rigorous monitoring and supervision by ADB could have resulted in better outcomes, particularly for the Business Services Support Facility where no significant progress was realized.¹⁰⁵

161. The 2003 Rural Finance Sector Development Program was also not successful.¹⁰⁶ It aimed to develop a sustainable rural finance system through policy, legal, regulatory, and institutional reforms, but the institutional complexities of rural finance were not sufficiently assessed in the project design, and the capacity of the executing and implementing agencies to tackle these complexities was overlooked. Nearly \$21 million of the \$70 million loan was not disbursed. The project's validation report recommended more careful sequencing of reforms using a cluster-loan approach that would initially focus on addressing the most binding constraints. It recommended that ADB continue to engage in policy dialogue to ensure the enactment of the Microfinance Act.¹⁰⁷

162. The 2004 program loan together with a \$5 million TA loan resulted in parliamentary approval of a Secured Transaction Act, which ADB helped develop.¹⁰⁸ The TA loan helped develop an online movable assets registry, among other things, but was cancelled in 2008 before it was finalized. World Bank reports that although a registry is available, it is limited in operations and has not led to transformational change in private sector access to finance (footnote 3). Support for the moveable assets registry is

¹⁰³ ADB. 2006. *Technical Assistance to Sri Lanka for Microinsurance Sector Development*. Manila.

¹⁰⁴ ADB. 2007. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Small and Medium Enterprise Regional Development Project*. Manila.

¹⁰⁵ IED. 2013. *Validation Report. Small and Medium Enterprise Sector Development Program in Sri Lanka*. Manila: ADB.

¹⁰⁶ ADB. 2012. *Sri Lanka: Rural Finance Sector Development Program Project Completion Report*. Manila.

¹⁰⁷ The Microfinance Act was approved in May 2016.

¹⁰⁸ The policy-based operation also aimed to improve insurance regulation and corporate governance of state-owned banks, as well as ongoing restructuring and recapitalization of state-owned People's Bank. It also aimed to strengthen several financial institutions. But the TA loan of \$5 million for this was cancelled after disbursing \$453,120.

now provided by the International Financial Corporation (IFC). With World Bank support, a new Secured Transactions Act will repeal the 2009 act, facilitating the use of movable assets as collateral for bank loans.¹⁰⁹ While the PVR found the project *successful*, it stated that more work is needed to develop capital markets and the private sector.¹¹⁰

163. ADB support for microinsurance (2006) appears to be the most innovative intervention. The TA contract resulted in a business partnership between a local private insurance company and a microfinance NGO. A composite life, funeral, and hospitalization insurance product was piloted and marketed through the NGO's women member group networks. Despite its potential, ADB terminated the TA contract with almost 40% undisbursed because the leading contractor misrepresented its status. This may have been a missed opportunity, especially as insurance remains significantly underdeveloped in Sri Lanka, where personal insurance premiums account for 1.2% of GDP, well below the percentage in India, Malaysia, and Thailand (footnote 3). ADB's proposed policy-based operation (2016) for capital market development, however, includes support for the insurance sector.

164. The SME development project approved in 2007 resulted in 966 loans to SMEs and was rated *successful* in the PCR and the PVR.¹¹¹ Nevertheless, Sri Lanka has had numerous programs of this type (11 for SMEs, 9 for agriculture, and 7 for microfinance). Despite this support, access to finance continues to be a major problem (footnote 3). Lessons validated by the PVR suggest that SME capacity constraints in business planning could have been better supported through TA. The recently approved line of credit for SMEs (footnote 99) has a TA attached to it, financed by the Japan Fund for Poverty Reduction (JFPR), that will support business development services and financial literacy training for borrowers outside the formal financial system in the areas of ICT and agriculture, and focused particularly on female entrepreneurs.

4. Enhancing Public Investment

165. ADB support for macroeconomic management, particularly through its support for tax administration, is discussed here as it falls under the banner of public sector management, although its support for private sector development is indirect. Performance in this area is therefore not reflected in the overall rating for private sector development. In the overall assessment (Chapter 7), the rating for PSM is reflected under the cross-cutting theme of governance.

166. Revenue as a share of GDP has declined since the 1970s and Sri Lanka now has one of the lowest revenue to GDP ratios in the world, declining from 24.2% in 1978 to 10.1% in 2014 (footnote 3). Tax exemptions and tax holidays are the main reasons for this. Tax policy has also not adapted to structural changes in the economy.

167. In 2004, ADB approved a \$70 million sector development program whose long-term goal was to strengthen public finance, and place it on a sustainable path.¹¹² In the medium term, the program was to create an enabling environment to foster mobilization of tax revenues and improve the effectiveness of public expenditures. The

¹⁰⁹ World Bank. 2016. *Competitiveness, Transparency and Fiscal Sustainability Development Policy Financing*. Washington, DC.

¹¹⁰ IED. 2013. *Validation Report: Financial Markets Program for Private Sector Development*. Manila: ADB.

¹¹¹ IED. 2014. *Validation Report: Small and Medium Enterprise Regional Development Project in Sri Lanka*. Manila: ADB.

¹¹² ADB. 2004. *Report and Recommendation of the President to the Board of Directors: Proposed Loans to the Democratic Socialist Republic of Sri Lanka for the Fiscal Management Reform Program*. Manila.

program had three loans: (i) a program loan of \$45 million to support fiscal management policy reforms; (ii) a project loan of \$15 million for the Modernization of the Revenue Administration Project, mainly for procurement of the revenue administration management information system (RAMIS); and (iii) a TA loan of \$10 million from ADB's Special Funds for institutional strengthening of fiscal management institutions through capacity building, including implementation.

168. The program was highly relevant to the fiscal challenges at the time and remains so today. It also supported tax policy reforms put forward by the IMF.¹¹³ The program included several challenging outputs on both the revenue and expenditure side, e.g., the creation of a modern revenue administration, strengthened tax collection and compliance, streamlined budget processes, improved public expenditure management and control, strengthened management of off-budget expenditures and borrowings, improved cash and asset management systems, strengthened fiscal discipline, stronger fiscal and macroeconomic coordination, and enhanced fiscal decentralization.

169. While progress was made on some of these, including human resource development, expenditure management, and tax exemptions, overall progress was less than planned. Nearly 25% of the project loan was not disbursed, though the program loan was disbursed fully. The lack of progress related mainly to capacity limitations in information technology, which, according to the PCR, proved more severe than anticipated and delayed implementation. The procurement contract for RAMIS and the integrated treasury management information system (ITMIS) was initially planned for June 2005 to December 2006 but this was pushed back to 2012–2013 with installation in 2013–2014, with both systems expected to be operational in 2014–2015. This would be supported by ADB in a follow-up program requested by the government.

170. ADB continued its support for revenue administration with the approval of the Fiscal Management Efficiency Project¹¹⁴ in 2010 at a cost of \$60 million, \$50 million from OCR and \$10 million as in-kind counterpart funding by the government. The outcome would be enhanced fiscal space for social and economic development resulting from better tax administration and compliance as well as more efficient public financial management systems. Outcome indicators included a decrease in the revenue deficit-to-GDP ratio, progressively reduced budget deficits that would remain within the 5% prescribed by the Fiscal Management Act, a year-on-year increase in the tax-to-GDP ratio, annual decreases in the stock of public debt, and the ratio of interest payments to GDP halved. The project would provide funds to RAMIS and ITMIS.

171. While ADB support was central to the most challenging macroeconomic reforms facing the government then and now, project outcomes were not sustained. The fiscal deficit expanded to 6.9% of GDP in 2015, and public debt increased from 70.7% in 2014 to 76% of GDP in 2015. The RAMIS component of the project was cancelled due to a procurement issue. Following the technical evaluation of the bids for the RAMIS component, ADB recommended that the preferred bidder (assessed as qualified by the technical evaluation) be disqualified as it did not meet the qualification criteria, i.e., it had less than the required number of years in business prior to the bid submission. The government did not want to open the financial proposal of the one remaining qualified bidder, and asked that ADB consider other options including

¹¹³ ADB. 2012. *Completion Report: Fiscal Management Reform Program in Sri Lanka*. Manila.

¹¹⁴ ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Loans to the Democratic Socialist Republic of Sri Lanka for the Fiscal Management Efficiency Project*. Manila.

rebidding. In February 2013, almost 2 years after the initial invitation to bid, ADB issued a declaration of misprocurement, which led to cancellation of nearly \$19.2 million of the initial TA loan.

172. The RAMIS component was subsequently financed by the Government of Singapore and its implementation is ongoing. It is notable that the project had six different task managers over a period of 5 years, some of whom appear to have had no fiscal policy expertise. The project was delegated to the Sri Lanka resident mission in December 2011 and transferred back to ADB Headquarters in April 2012. It is now managed by the resident mission. An IMF Extended Fund Facility was approved in July 2016 which targets urgent fiscal issues. The IMF is now leading the revenue reform effort for the next three years with World Bank support. Given the lack of success in its earlier efforts, and the IMF's lead in this area, no further ADB support to revenue administration is expected.

5. Nonsovereign Operations

173. Eleven nonsovereign loan approvals were fully or partially invested in Sri Lanka from 2006–2015 in ADB targeted sectors of infrastructure and financial markets (table 13).¹¹⁵ Renewable energy approvals aimed to contribute to the development of small hydropower and energy efficiency. Financial sector investments were designed to help expand commercial leasing facilities and bank branch networks, and especially to support SME development in the north and east. Some financial facilities also targeted female entrepreneurs and included gender targets for the use of ADB funds, which aligned with ADB's inclusive growth and gender equality initiatives. In addition, ADB supported the provision of commercial financing for small, privately financed infrastructure projects, and housing mortgages, both of which are in line with earlier ADB objectives to diversify the range of financial products available to the public. ADB's commercial cofinancing products were used to attract new commercial cofinanciers to Sri Lanka for two transactions.

Table 13: Private Sector Operations Department, Sector Approvals, 2006–2015

Approval Sector	Number of Approvals	\$ millions	% of approvals by \$ volume
Renewable energy	2 ^a	55.0	15
Infrastructure FIs	1	100.0	27
MSME FIs	7 ^b	198.2	54
Housing FIs	1	15.0	4
Total	11 ^c	368.2 ^c	100

FI = financial institution, MSME = micro, small, and medium-sized enterprises.

^a Regional funds exclude Asia Climate Partners. If included, number of renewable energy approvals is three, and amount is \$155 million.

^b Excludes the Trade Finance Facilitation Program. If included, total number of MSME FI approvals is 8, and amount is \$1.198 billion.

^c Excludes Asia Climate Partners and the Trade Finance Facilitation Program. If included, total number of approvals is 13, and total amount is \$1.468 billion.

Sources: Asian Development Bank loans, technical assistance, grant and equity approval database.

174. **Leasing and microcredit.** Three nonsovereign operations supported the expansion of the leasing industry. The three companies supported so far have opened

¹¹⁵ These figures do not include the 2009 \$1 billion Trade Finance Facilitation Program, and the 2012 \$100 million Asia Climate Partners (formerly CP3, reapproved 2014). The Trade Finance Facilitation Program is available to support trade in ADB member countries, including Sri Lanka. Asia Climate Partners has raised \$750 million, with one-third to be invested in PRC, India, and other ADB member countries, including Sri Lanka. If these approvals are included, the number of approvals to be fully or partially invested in Sri Lanka is 13 and the amount is \$1.48 billion.

new branches in the north and east, and steadily increased transactions. From 2008–2013, the leasing sector grew by 17% annually.

175. **Commercial banks.** One of the objectives of ADB support to the banking sector is to increase lending to SMEs.¹¹⁶ Projects were selected for their focus on conflict-affected regions, and for financing private sector investment in small-scale infrastructure. ADB loans to one institution set geographic targets (for example, 50% of loans should be outside Colombo; 30% of this should be in Northern and Eastern Provinces), and also gender lending targets (20% to SMEs owned or controlled by women) to promote inclusive financial development. The most recent monitoring report for one commercial bank noted the expansion of its branch network, with half of the subloans to SMEs made outside Colombo—and 84% of these made to SMEs in Northern and Eastern Provinces. Thirty-seven percent of the first tranche disbursed was lent to eligible women borrowers.

176. Another project¹¹⁷ targeted longer-term commercial bank lending for private sector investment in infrastructure. Many infrastructure projects in Sri Lanka are small and not attractive to international financial institutions. By December 2015, \$20 million was on lent for infrastructure projects, with the remaining loan proceeds to be on-lent by 2017.

177. ADB also supported home loan financing to increase the availability of longer-term funding for mortgage loans to serve the market's middle- and lower middle-income segments. The government intended to reduce its role in the provision of housing finance, as it expected the private sector to increase services in this segment. ADB's client in this project has a presence in the home mortgage sector through its 127-branch network (105 branches outside Colombo, including 8 in the north and east). While it is too early to assess the impact of the project, the mortgage loan portfolio grew by 10% to \$30.3 million in the first 6 months of 2015.

178. **Trade financing facility.** The purpose of the Trade Finance Facilitation Program (TFP) is to address the lack of access to trade finance by ADB's member countries. A significant program increase in 2009 was approved as a direct response to the global financial crisis, which had severely affected the availability of trade finance. The program supported \$787 million of trade finance for Sri Lanka through 339 transactions over 2006–2015. An evaluation in 2014 found that the relevance of TFP to private sector development in Sri Lanka had been fairly modest. The program had primarily been used by the two large state-owned banks to secure confirmations for large trades of petroleum and fertilizer for loss-making SOEs. The evaluation argued that the development impact of the TFP could be greater in Sri Lanka if its resources were used in those banks that have a stronger focus on supporting trade by SMEs.¹¹⁸

179. **Funds.** Five approvals (for six equity investments) were made through funds, representing 46% of the 11 approvals for nonsovereign operations over 2006–2015.¹¹⁹ Three of these were regional equity funds for clean energy development in ADB's member countries. Although Sri Lanka was part of the rationale for these investment

¹¹⁶ Other areas of support focused on microbusiness, housing (especially mortgages), infrastructure financing, and trade.

¹¹⁷ ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Loan Hatton National Bank Supporting Infrastructure Development in Sri Lanka*. Manila.

¹¹⁸ IED. 2014. *Corporate Evaluation Study: ADB Trade Finance Program*. Manila: ADB.

¹¹⁹ If the TFP and Asia Climate Partners are included, the number of approvals is 13 and the financial commitments total \$1.48 billion; the fund approvals increase to 6 (\$207.7 million of commitments) and represent 46% of 13 approvals and 14% of the \$1.48 billion financing commitments.

approvals, these funds did not invest in the country. Three other funds were established to catalyze investments in the ADB member countries. The first fund invested in 18 companies, but none of these were in Sri Lanka. The second invested in 14 companies, 4 of which were in Sri Lanka. As of June 2014, the third fund had made 7 investments of which one was in Sri Lanka (a microfinance institution).

180. ADB's investment through these funds has generally not delivered the expected returns or development results, and the funds do not appear likely to catalyze future equity investments in Sri Lanka. The instrument is not to be faulted perhaps the investment conditions in Sri Lanka are not sufficiently mature or adequate, in comparison with other countries in the region, to attract this type of investment. It also suggests that further support for the business enabling environment is needed.

181. There are no full-time international officers in PSOD working solely on Sri Lanka. Since 2015, however, a national officer from PSOD has been out-posted to the Sri Lanka resident mission. Part-time work is provided by three or four international staff¹²⁰ to identify, develop, implement, and monitor transactions. Over 2006–2015, PSOD approvals were one or two transactions each year (except for 2011, when no PSOD approvals were made). The portfolio remained stable and was \$177.75 million in December 2006 and \$189.1 million in December 2015.¹²¹ While PSOD has so far been able to manage its portfolio and develop new and relevant transactions in Sri Lanka, with so few staff resources there is potential for operational risk and missed opportunities; it is not possible to suggest new sectors of focus for PSOD with no staff available to pursue them. By comparison, the IFC has an office in Colombo with six full-time investment officers, six advisory staff, and two general practitioners connected to both IFC and the World Bank. In addition, two additional positions are currently advertised for the IFC office, with the new roles intended to support the country manager on business development efforts. IFC's website reports that its committed Sri Lanka portfolio has grown from \$137 million in June 2011 to \$517 million in January 2015.¹²²

6. Pillar 2: Assessment Summary

182. Given the challenges of private sector development and the need for higher private investment for inclusive growth and poverty reduction outlined in the government's DPF and all three Sri Lanka CPSs over the CAPE period, ADB's overall approach to private sector development appears patchy. Apart from support for lines of credit to SMEs, ADB sovereign support for the enabling environment declined over 2008–2015 and the investment environment remained unfavorable. While private sector development was identified as a high priority in all three CPSs, none articulated a coherent strategy that would contribute effectively to achieving government and CPS objectives. However, both sovereign and nonsovereign support to financial institutions emphasized inclusion, particularly access to credit for SMEs and female entrepreneurs in former conflict-affected areas. The activities to support the investment climate support by ADB in the earlier part of the CAPE period were continued by other development partners.¹²³

¹²⁰ This estimate includes PSOD and Office of General Council staff.

¹²¹ Portfolio information provided by PSOD.

¹²² IFC staff information provided by PSOD; IFC website page:

http://www.ifc.org/wps/wcm/connect/region_ext_content/regions/south+asia/countries/southasia-sri+lanka

¹²³ IFC signed an agreement with the Credit Information Bureau to provide technical support to enhance the Movable Asset Registry. The German Agency for International Cooperation (GIZ) provided grant funds through its SME program to the government to develop an SME strategy.

183. The fact that ADB did not continue its support for financial market regulatory reform reflects the difficult political economy and the government's reluctance to move forward with necessary legislative reforms, e.g., the Securitization and Microfinance Bills were not submitted to Parliament as planned, although the Microfinance Act was since approved in May 2016. Moreover, TA attached to policy-based operations was cancelled by the government, removing a key instrument for policy support. As the conflict was also escalating at this time, policy-based operations were no longer considered appropriate by ADB's Board of Directors, which left operations with fewer options. Nor was this situation unique to private sector development or to ADB. As discussed in Chapter 3, ADB support for sector regulatory reforms also dissipated over the CAPE period.

184. While a simple summation of project-level ratings for ADB support for private sector development across both its sovereign and nonsovereign operations might create the impression that ADB support was *satisfactory*, access to finance in Sri Lanka remains a key constraint on SME growth, and on private sector development more generally. This is shown by a number of surveys and indicators. Sri Lanka's access-to-credit ranking was downgraded in the World Bank's Cost of Doing Business Survey from a rank of 68 in 2009 to 89 in 2015,¹²⁴ and the private sector share of domestic credit declined from 33% in 2007 to 27% in 2015. Sri Lanka's ratio of FDI to GDP is below that of peers such as Thailand and Viet Nam. The 27% private sector investment in GDP target in the government's DPF was not met. Following the 2015 change of government, ADB approved a sovereign loan in 2016 to support access to finance (footnote 99) and a capital market development program is expected. ADB's proposed loan for capital market development would be the first policy-based operation since 2007, suggesting that the political economy context has changed to reconsider the potential of policy-based lending to support other policy reforms.

185. Although the CPS, 2012–2016 envisaged a role for ADB in institutionalizing PPPs development through strengthening policy, legal, and regulatory frameworks, this has not been realized. Attempts to establish a dedicated government PPP unit were discontinued over the CAPE period, and a recent report (footnote 3) notes that Sri Lanka lacks robust legislation as well as the necessary technical expertise to enter into large-scale projects of this kind. As a result, most of the post-conflict investment in infrastructure has been financed through public sector borrowing at near commercial rates. There were very few PPP infrastructure developments over the CAPE period outside the transport sector. Even in sectors where the government has recognized the need to attract PPPs, e.g., energy, the private sector is rarely offered more than 50% ownership, which deters investors about government interference. Support to establish a PPP unit is now under discussion with the World Bank.

¹²⁴This does not mean that access to finance in Sri Lanka deteriorated but that other countries were pursuing policy changes at a faster rate to improve their ranking relative to Sri Lanka.

Human Resource Development

186. Sri Lanka has consistently ranked above other countries in South Asia on education measures and overall inequality has been lower than in more economically developed countries in the region. Sri Lanka has a high rank in the Gender Development Index, and has improved its ranking in the Human Development Index, placing 73 out of 188 countries in 2014, from 93 in 2005.¹²⁵ Even so, the education sector faces challenges in providing an educated and a trained workforce.

187. By 2015, Sri Lanka had dropped to 68 out of 140 countries in the Global Competitiveness Index, from 22 in 2011.¹²⁶ As the economy shifted from agriculture to higher value-added manufacturing and services, the private sector has become the largest employer, but it has difficulty in finding skilled labor, and this—as is commonly cited by the private sector—remains a major constraint on business development and growth.¹²⁷ At a disaggregated level, much higher rates of unemployment persist among young people with high levels of education, with educated women having the highest unemployment rate of all groups.¹²⁸

188. The government responded to these and other underlying changes with the declared aim of creating a more market responsive workforce by transforming Sri Lanka into a knowledge-based and technologically advanced economy by 2020.¹²⁹ Reorienting the education sector (primary, secondary, tertiary, and vocational education) toward greater market relevance would, according to the government's vision, deliver an adequate supply of well-educated high- and mid-level professionals with solid technological and technical skills. Given Sri Lanka's regional, ethnic, and economic differences, ensuring inclusiveness was also seen as important.

189. The government has made concerted efforts to maximize access to education at all levels and to reduce economic, gender, and regional disparities, but the challenges to achieving these goals are ongoing. One manifestation of this is that better-off schools have better A-level¹³⁰ results than less well-off schools and students, who therefore find it harder to enter university. Although access to technical vocational education and training (TVET) is more equitable, most A-level graduates aspire for the prestigious but limited university internal degree because they are free, have high

¹²⁵The education sector assessment in Appendix, Linked Document 6 gives a more detailed description and analysis of the sector.

¹²⁶World Economic Forum. 2015. *The Global Competitiveness Report 2015–2016*. Geneva.

¹²⁷ADB. 2015. *Innovative Strategies in Technical and Vocational Education and Training for Accelerated Human Resource Development in South Asia*. Manila; World Bank. 2013. *Building the Skills for Economic Growth and Competitiveness*. Washington.

¹²⁸Department of Census and Statistics. *Sri Lanka Labour Force Statistics Quarterly Bulletins*. Colombo.

¹²⁹Government of Sri Lanka. 2010. *Sri Lanka. The Emerging Wonder of Asia. Mahinda Chintana: Vision for the Future. Development Policy Framework*. Colombo.

¹³⁰A-Level is the school level examination taken at age 17 or 18.

status, and traditionally lead to well-paid government service or other white-collar employment.

A. Government Policies and Strategies

190. The government's Education Sector Framework and Program, 2013–2017¹³¹ is structured under four themes: equity in education access; improved education quality; strengthened governance and service delivery; and better education planning, monitoring, and evaluation. These themes include universal basic education and selected high-quality schools to provide superior training in science, ICT, and English. The program also aims to eliminate disparities in the education system, foster teacher development, strengthen school-based assessment, and introduce ICT studies and integrate ICT into the curriculum. For higher education, the priorities included expanded access and enrollment to higher education, improved quality and relevance of degree programs, implementation of a quality assurance and accreditation system, and development of market-oriented degree programs. Past TVET policies to expand access and quality are now guided by the 2014 Skills Sector Development Plan, developed in collaboration with ADB to target accreditation, quality, training, and certification to expand and enhance relevance.

B. ADB Policies and Strategies and the Lending Program

191. All three CPSs built on earlier interventions in education. Sector strategies targeted the weak links between the education system and the labor market, as well as unequal education access, and complemented the work of other development partners.

192. The CAPE period saw 8 education projects and 11 loans totalling \$549 million, of which 75% went to secondary education (4 projects), 17% to TVET (3 projects), and 8% to tertiary education (1 project).¹³² Before 2013 all loans were sourced from the ADF. Two of the four loans approved after 2013 were from OCR. All of these loans were for investment projects except for the ongoing Education Sector Development Program¹³³ and the Skills Sector Enhancement Project,¹³⁴ which use a results-based lending modality.¹³⁵ TA was provided largely to support project design; this included one capacity development TA for \$2.4 million to support human resource development through interventions in secondary education, TVET and higher education.¹³⁶

¹³¹Ministry of Education. 2013. *Education First. Education Sector Development Framework and Program 2013–2017*. Colombo.

¹³²Linked Document 6 provides the project details.

¹³³ADB. 2013. *Report and Recommendation of the President to the Board of Directors: Proposed Loan for Education Sector Development Program in Sri Lanka*. Manila.

¹³⁴ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Loan for Skills Sector Enhancement Program in Sri Lanka*. Manila.

¹³⁵ADB introduced results-based lending (RBL) as a financing modality on a pilot-basis in 2013. RBL as a modality intends to support government-owned sector programs, and link disbursements directly to the achievement of program results. Source: ADB. 2013. *Policy Paper: Piloting Results-based Lending for Programs*. Manila.

¹³⁶ADB. 2012. *Technical Assistance to Sri Lanka for Human Capital Development Capacity and Implementation Support*. Manila.

C. Evaluation of Performance: ADB's Education Sector Program

1. Relevance

193. The relevance of the education program was assessed according to its alignment with education sector strategies, its strategic positioning, and its design. All projects were designed to improve the capacity of the education system to impart the skills students need in the labor market. The major thrust of the four secondary education projects was to modernize the school system and improve the chances of poor rural students entering tertiary education. Similarly, the three skills development projects incrementally worked toward improving the quality and market relevance of the TVET system. The Distance Education Modernization Project¹³⁷ was innovative in trying to improve the quality and relevance of education for external university students and those who did not get into university. The programs were consistent with ADB's education policy in 2005,¹³⁸ which had a strong pro-poor focus. Education by 2020, ADB's long-term education strategy set out in 2010, emphasizes strengthening quality, inclusiveness, and relevant skills at all levels of education, including universal secondary education and ensuring that TVET contributes to filling labor market gaps. The Education Sector Development Program and the Skills Sector Enhancement Program are based on government sector strategies and were implemented through the results-based lending modality. Discussions with the government highlighted government ownership and enthusiasm for the ADB-financed program, especially the contributions made by successive TVET projects in introducing competency-based learning and the National Vocational Qualification Framework.¹³⁹ The Education Sector Development Program helped link general education with TVET through the new technology program in secondary education.

194. **Strategic positioning of the program.** The positioning of ADB support at the upper levels of the education system to bolster secondary education and TVET was appropriate. First, the interface between the general and tertiary education systems in which ADB is positioned plays a critical role in addressing graduate unemployment. Second, the government's DPF stated that, although primary schooling received support from other development partners, secondary and tertiary education remains weak. Third, the government views ADB as its primary partner in TVET and, to a lesser extent, the vocational aspects of secondary education.

195. **Project and program design.** In general, project outcomes were aligned with education sector strategies and the results chains linking inputs with declared outputs. Intended outcomes were also realistic. The key lesson is the value added that comes from sustained support provided in well-considered phases grounded in government policy objectives and strategies. At an individual project level there were design weaknesses, with overly optimistic time frames for the introduction of government legislation, ambitious programming that failed to take into account the enabling environment, and overly complex design. The temptation to try to cover too much in one project, and to set targets that will clearly take longer to achieve than allowed by the time frame, should have been resisted. However, this did not compromise the overall thrust of the education program, which had transformational and innovative elements.

¹³⁷ ADB. 2003. *Report and Recommendation of the President to the Board of Directors: Proposed Loan for Distance Education Modernization Project in Sri Lanka*. Manila.

¹³⁸ ADB. 2003. *Education Policies and Strategies*. Manila.

¹³⁹ ADB. 2011. *National Qualifications Framework for Skills Training Reform in Sri Lanka*. Manila

196. The underlying theory of change behind ADB's projects worked on the assumption that supply-side initiatives targeting reforms at the secondary school and tertiary TVET levels (the outputs) would improve student performance and encourage them to enter tertiary programs, whose graduates have better employment prospects (the outcome). But the reality in Sri Lanka is that students are unlikely to reorient their preference toward more market-oriented education at the secondary level unless there are more university places to enable them to further enhance skills, and there is demand for those skills from employers that would guarantee employment. There could have been more overt recognition that competitive university systems providing more market-oriented programs and a robust private sector that can absorb a greater proportion of the workforce have to go hand-in-hand with supply-side education reforms and initiatives—as does a lean public sector without its generous employment conditions.

197. Nonetheless, all the projects were designed around the overall goal of improving employability with the common threads of broadening student options for tertiary education and employment, and enhancing equity in secondary and tertiary education. It is commendable that this targeted strategy was so consistently followed by all of the projects. Overall the program is rated *highly relevant* in addressing the key constraints of the growth of the education sector.

2. Results

198. Table 14 shows the overall outcome for the education sector, subsector outcomes at the secondary, TVET, and tertiary levels, together with the related major outputs. Overall, the program was successful in improving the capacity of the education system to impart the skills students would need in the labor market in an equitable manner. This is clearly a long-term agenda item of the government, and ADB's contribution was defined through the achievement of its own time-bound targets limited to its financed interventions.

Table 14: Education Sector Outcome for ADB Interventions

Outcomes and Outputs	Higher Level Outcomes		
	Secondary School Level	TVET	Tertiary Level
Intended Outcomes	A modernized school management system and improved chances of poor rural students to enter tertiary education in marketable areas.	Improved quality and market relevance of the TVET system.	Improved quality and relevance of education for external university students and those not successful in entering the university system.
Outputs	Better access to secondary-level science, ICT and English education; and decentralized school management.	Established competency-based training, new colleges of technology, a vocational university, and a long-term TVET road map.	Established national distance education platform and network for the use of universities and other public and private training providers.

ADB = Asian Development Bank, ICT = information and communication technology, TVET = technical vocational education and training.

Source: Independent Evaluation Department.

199. At the secondary level, O-level¹⁴⁰ exam pass rates increased from 40% in 2005 to 69% in 2014. Nevertheless, there was no significant change in specific subject performance over 2013–2015. Pass rates in English and math reduced marginally while science was erratic but still positive. At A-level, the overall pass rate was fairly stable at 60% from 2012–2015. Pass rates in science and technology subjects hovered around 50%, but with an upward trend. Enrollment rates in technology and ICT streams increased overall and are expected to improve when the tertiary subsector also becomes more responsive in providing university-level options. Work still needs to be done to strengthen pass rates in the newer and more market-relevant streams, and to enhance a more effective management information system.

200. The TVET subsector's performance has been impressive, with an average completion rate of 92% in 2014, up from 87% in 2012. A highly significant achievement was the institutionalization of competency-based training throughout the vocational training system. This allowed the development and introduction of a National Vocational Qualifications Framework.¹⁴¹ With ADB support, the Technical and Vocational Education Commission set national competency standards, issuing National Vocational Qualifications Framework certificates that allow students to follow a training path leading to a degree. A quality management system for Vocational Training Certificates is being rolled out, supported by career guidance and colleges of technology. The newly-established University of Vocational Technology offers technology degrees and also supports the training of technology teachers. The engagement of the private sector in establishing the national framework, competency standards, and on-the-job training set new standards for PPPs in education.

201. ADB's direct engagement at the tertiary level successfully strengthened the position of the Open University, which offers distance learning modules, and this innovative project showed that technology can be applied to the delivery of tertiary education programs. Almost all universities have developed online platforms as a delivery and repository of education material for students. With regard to inclusiveness, ADB projects had strong equity components that positively contributed to overall education sector equity outcomes. At the secondary level, project components focused on the main conflict-affected provinces and plantation areas. Disaggregated data show that ADB project schools saw significant improvements in O-level exam pass rates among rural students, with especially impressive gains in science and English. A-level exam pass rates for some regions are still below the national 60% although they are increasing (and Northern Province, as of 2015, was above the national rate). The additional facilities for better access to newer education streams will increase the relevance of the course and the employability of the graduates, although this is potentially constrained by a lack of skilled teachers. For TVET, the intention is to encourage self-financing, but outcomes are very dependent on the quality of facilities provided. Full disaggregated data of pass rates are not available

202. At the secondary level, there are no significant issues between boys and girls in either enrollment or achievements up to A-level. In 2015, 70% of the students who sat for the A-level exam were girls; 67% passed compared with just 52% of the boys. The concentration of girls in the arts and humanities is the biggest concern because of the effect on their later employability. ADB projects targeted female participation in science and commerce and enrollment in these areas is rising. The participation of women in TVET is low: in 2015, only 31% of University of Vocational Technology students were

¹⁴⁰ O-Level examinations are school-leaving exams taken at the ages of 15 or 16.

¹⁴¹ Tertiary and Vocational Education Commission. 2005 (revised 2009). *National Vocational Qualifications Framework of Sri Lanka. Operations Manual*. Colombo.

women. At the craft and technician level, enrollment of women is rising, although this level is still dominated by men, and there is a clear segregation of courses, with women not taking those in demand by the private sector e.g., construction. Girls are overrepresented at university, but are concentrated in arts faculties. While jobs exist in the services sector, especially in tourism, due to sociocultural norms women's employment is low.

203. An important lesson has been the strong, negative influence on schooling exerted by the higher education system. Its highly unequal structure makes any option except conventional university unattractive to students, and renders social marketing campaigns ineffective. Tertiary and higher education options need to be treated more fairly. Other lessons include the need to ensure the availability of qualified teachers before providing expensive new facilities and equipment, as well as better systems for recruiting and deploying school teachers.

204. The education program primarily targeted enhanced youth employability, although it also established targets for academic results and aimed to strengthen the overall education system. With regard to employability, trends show that ADB's education program has had a positive impact, although they also highlight that much more work needs to be done to upgrade the skills of youth, especially females, if they are to find employment in a more competitive environment. The trends are as follows:

- (i) The drop in unemployment seen at all levels of education over the decade flows from Sri Lanka's consistently high economic growth. Unemployment fell more rapidly for males than females, and although female unemployment is still three times higher than for males (12.3% compared with 3.8%) the gap is narrowing.
- (ii) Employment of educated youth in the private sector increased by 30% from 2008 to 2012. The extent to which the ADB-supported projects contributed to these positive developments cannot be determined other than noting that they were responsive to the demands of the private sector.
- (iii) Unemployment fell in all age groups and the downward trend is continuing, but little progress has been made in reducing unemployment among young women since 2012 (indeed, it has worsened slightly). The improvement seen from 2005 to 2012 has apparently not continued and unemployment is on the rise, indicating that more effort is needed on that front.

205. On academic performance, ADB had an impact on examination results and participation in science. Pass rates have been better at A-level than O-levels in the new technology and science streams. The achievements of students in conflict-affected provinces have improved over the last few years, particularly at A-level, and in 2014 results show that Western (60.1), Central (59.8), North Western (59.7) and North Central (59.1) Provinces remained below the national average of 61.25. The introduction of technology subjects into the A-level program through the pilot technology stream is widely regarded as a significant achievement, and this made a significant contribution to developing the technology and computer skills needed for Sri Lanka's transition to a high-tech, knowledge economy. The ADB program also contributed to narrowing the urban-rural and gender digital divides through the Computer Learning Centers and the online distance education network. To support and sustain the project interventions and improve education planning and management, the program gave significant support to the strengthening of institutional capacity. The impact of the sector program is assessed as *substantial*.

Overall Assessment

206. The period for this evaluation of the Sri Lanka country program was unusual, since it covered the years after the end of the long-running conflict in 2009. ADB responded quickly by scaling up its support for infrastructure reconstruction and rehabilitation in conflict-affected regions, while continuing to support lagging regions. Economic growth accelerated after the conflict and the outlook for lasting peace and reconciliation is positive. Sri Lanka is now at a cross roads. Its transition to higher middle income status will reduce concessional resources and increase borrowing costs. The current government faces a worrying decline in its capacity to mobilize domestic tax revenues, and attract the levels of private investment needed to expand services and sustain growth, which is creating significant development risks.

207. Sri Lanka's economy went through a typical peace dividend after the end of the conflict. GDP growth peaked at 8% immediately after 2009 but dropped to 4.5% in 2014. The fiscal position has deteriorated since then; public debt has risen as a share of GDP and the government is relying on borrowing to finance its fiscal deficit and defend the exchange rate, which is unsustainable. On the plus side, Sri Lanka's strong human capital base, relatively reliable infrastructure, and geographical location in a fast-growing region continues to support a positive outlook for growth over the medium term. Unless action can be taken to lower fiscal deficits, enhance tax revenues, and reduce the liabilities of SOEs, Sri Lanka's economy will remain highly vulnerable to downside risks. Inaction by the government on these policy fronts would jeopardize inclusive and sustainable economic growth.¹⁴²

208. This chapter provides an evaluation of ADB's overall program of support for Sri Lanka using the criteria of: relevance, efficiency, effectiveness, sustainability and impact. The ratings for these criteria are based on sector assessments, which are available as linked documents to this report.

A. Relevance and Responsiveness

209. Overall, ADB operations achieved substantial progress toward most CPS development objectives, particularly in the infrastructure sectors and service delivery in conflict- and tsunami-affected regions. Notable improvements were made in all these areas. ADB responded to the government's DPF, which called for higher investment in infrastructure in lagging regions and service expansion in transport, energy, water, sanitation, and social services.

210. This evaluation considers ADB support for infrastructure in Sri Lanka *relevant* and responsive to client needs, particularly its response to the government's request for help with rehabilitation and services in conflict-affected communities both during and after the war (Table 15). Service equity remains an important government objective. ADB supported this in all three CPSs by ensuring that the disbursement of

¹⁴² IMF. 2016. *Staff Report for the 2016 Article IV Consultation and Request for a Three-Year Extended Arrangement under the Extended Fund Facility*. Washington, DC.

infrastructure investments leaned toward lagging regions. Supporting the capacity to rehabilitate infrastructure in conflict-affected provinces was also critical for securing long-term peace.

Table 15: Overall Rating of Sector Performance

Sector Programs and Cross-Sector Objectives (Sector Share)	Relevance 20%	Effectiveness 20%	Efficiency 20%	Sustainability 20%	Development Impacts 20%	Overall Rating
Transport (32%)	2	2	2	1	2	1.8
Water (18%)	2	2	1	2	2	1.8
Energy (14%)	2	2	2	1	2	1.8
Multisector (13%)	3	2	3	1	2	2.2
Education (11%)	3	2	2	2	2	2.2
ANR (7%)	2	2	1	2	2	1.8
FIN-SOV (5%)	2	1	1	2	1	1.4
CPS Cross-cutting objective						
Gender	3				3	
Climate Change	1				1	
Governance ^a	1				1	
Weighted Score of Sovereign Operations	2.0	2.0	1.8	1.4	1.8	1.8
Overall Rating Sovereign Program	<i>Relevant</i>	<i>Effective</i>	<i>Efficient</i>	<i>Less than Likely Sustainable</i>	<i>Satisfactory</i>	<i>Successful</i>
Nonsovereign Operations	Development Results	ADB Investment Profitability	ADB Work Quality	ADB Additionality	Overall Rating	
Nonsovereign Operations	2	2	2	2	2	
Overall Sovereign and Nonsovereign Program Rating						1.8

ANR = agriculture and natural resources, FIN-SOV = financial sector sovereign, I, NSO = non sovereign operations.

^a To avoid double counting, ADB's support for Public Sector Management i.e. taxation reform, is included under the cross cutting objective of governance as public sector management was only 2% of the total program.

The rating categories for the five evaluation criteria are as follows:

- (i) Relevance: highly relevant (3 points), relevant (2 points), less than relevant (1 point), and irrelevant (0 point).
- (ii) Effectiveness: highly effective (3 points), effective (2 points), less than effective (1 point), and ineffective (0 point).
- (iii) Efficiency: highly efficient (3), efficient (2 points), less than efficient (1 point), and inefficient (0 point).
- (iv) Sustainability: most likely sustainable (3 points), likely sustainable (2 points), less than likely sustainable (1 point), and unlikely sustainable (0 point).
- (v) Development Impacts: highly satisfactory (3 points), satisfactory (2 points), less than satisfactory (1 point), and unsatisfactory (0 point).
- (vi) Overall rating:
 2.5 =< HS <= 3.0;
 1.6 =< S < 2.5;
 0.8 =< LS < 1.6;
 0.0 =< US < 0.8.

Source: Independent Evaluation Department.

211. ADB multisector projects were *highly relevant* to communities affected by conflict and natural disasters. Before CPS, 2012–2016, this was delivered through a highly decentralized mechanism that responded to development needs in Northern and Eastern Provinces. The process was unusual for ADB because it consisted of hundreds of subprojects at district, division, and village levels identified through participatory processes, which responded to local needs. This approach was particularly effective in ensuring female participation in project identification and accessing benefits. But this community-based design changed once the war ended. Instead of retaining the institutional structures created, ADB's support shifted from community development needs to rebuilding state institutions. Although this helped to restore essential state presence, ADB became less responsive post-conflict to the development needs of conflict-affected communities, particularly in restoring livelihoods and promoting inclusive growth. CPS, 2012–2016 became less responsive to community needs in the north and the east, shifting instead to nationally driven development projects for transport, energy, and water.

212. On the basis of its support for communities affected by conflict and natural disasters, and in response to scaling up its support for rebuilding conflict-affected regions since 2009, this evaluation considers ADB's overall program to have been *relevant* to inclusive growth. This is because after nearly three decades of civil war Northern and Eastern Provinces had the highest levels of poverty in the country, severely damaged infrastructure, and the lowest access to services.

213. ADB's support for education centered on skills development and enhancing the employability of youth, which was consistent with government policy objectives. All projects were designed around the overall goal of improving employability with the common threads of broadening student options for tertiary education and employment, and enhancing equity in secondary and tertiary education. It is commendable that this targeted strategy was consistently followed by all projects. Overall the program is rated *highly relevant* in addressing the key constraints in the growth of the education sector. The positioning of ADB support at the upper levels of the education system to bolster secondary education and TVET was appropriate. Secondary and tertiary education remains weak, although the government views ADB as its primary partner in TVET and, to a lesser extent, the vocational aspects of secondary education. The major thrust of the four secondary education projects was to modernize the school system and improve the chances of poor rural students entering tertiary education. Similarly, the three skills development projects incrementally worked toward improving the quality and market relevance of the TVET system. The Distance Education Modernization Project was innovative in trying to improve the quality and relevance of education for external university students and those who did not get into university.

214. ADB's strategies for Sri Lanka over the CAPE period were less aligned with government policy objectives on ANR.¹⁴³ While the residual projects in this sector (that is, those approved before the CAPE period), performed well, ADB did not support any new operations in this sector after 2003, except through the indirect support for rehabilitation of rural roads, irrigation schemes, and agriculture extension under multisector projects. The absence of new operations for ANR also affected direct

¹⁴³ These are discussed in Appendix, Linked Document 7.

support for environmental issues such as reforestation, which is prominent in ADB's results framework (CPS, 2012–2016) as one of three country development goals.¹⁴⁴

215. ADB strategies for private sector development and private sector operations aligned with the government's DPF, but they did not consider the political economy context or pay enough attention to the investment climate. The higher levels of FDI that were expected after 2009 have not been achieved. Private sector operations were elevated from a cross-cutting theme in CPS, 2004–2008 to a priority CPS objective (or pillar) in successive CPSs. However, ADB did not modify its approach or introduce greater realism to reflect the political context, including entrenched opposition to reform by powerful stakeholders who regard policy reform as a threat to their well-being. Moreover, lessons from policy-based operations used before the CAPE period for financial market development do not appear to have informed strategy or influenced more recent operational design. Interventions that supported policy reform before this period were not continued and the reform agenda lost momentum across all sectors. This was partly related to ADB's concern that policy-based lending was not an appropriate financing instrument in a conflict context. Policy-based loans dropped from the program were not replaced by TA operations to help sustain reform momentum. Had ADB continued the policy engagement that was evident before the CAPE period, ADB support for this sector would have been rated highly relevant.

216. While CPS, 2009–2011 and CPS, 2012–2016 recognized that macroeconomic policy was important for private sector development and growth, little support was provided in practice. The support that ADB provided for revenue administration was critical to the entire governance agenda, but, while ADB financed the procurement of computerized systems for both expenditure (ITMIS) and taxation (RAMIS), it should have developed a closer working relationship with the Ministry of Finance to ensure it had a sense of ownership of these critical initiatives. The revenue administration management information system was eventually funded by the Government of Singapore.

B. Effectiveness

217. ADB investments achieved substantial physical progress over the CAPE period. Support for infrastructure, especially rehabilitation and reconstruction of the north and east, was scaled up and access to electricity and water supply increased. However, many of the related policy reforms that ADB pursued before the CAPE period, such as independent tariff setting, were not continued.

218. The government's DPF, 2006–2016 set a target of 100% of villages to be connected by roads by 2016, with 95% of roads to be in good condition. Although most physical targets were achieved, no attempt was made to measure the targeted achievement levels; sustainability also received inadequate attention. To achieve the desired transport outcome of "improved nationwide connectivity," ADB focused on delivering increased road length outputs by 2016 compared to 2011.¹⁴⁵ National and provincial road length outputs exceeded CPS, 2012–2016 targets, and they probably made a substantial contribution to achieving the objective of connecting rural villages to enhance inclusion and redress regional imbalance. However, road improvement data

¹⁴⁴ Alongside accelerating economic growth maintained at 8% over the medium term and eradicating hard-core poverty and hunger by 2016. The forestry goal was to increase forest coverage from 23% in 2010 to 28% by 2016.

¹⁴⁵ As set out in the Transport Sector Results Framework (2011–2016) that accompanied the CPS for the same period.

for each province were not collected, nor were the number of beneficiaries systematically identified. Achievement of physical targets has brought other issues to the fore and rising congestion, high fatality rates, and uncertainties surrounding the ability to maintain road networks are risks to sustainability and inclusion. ADB support to the transport sector was *effective* primarily because this was one of the government's key development priorities, and the focus on investment since 2008 allowed output and outcome targets to be substantially achieved, albeit with risks to sustainability.

219. Improved water supply is expected to benefit about 3 million people, and a further 1.2 million will benefit from improved sanitation when ADB-supported projects are completed. Community and public health has greatly improved, with the incidence of waterborne diseases falling significantly in the few completed post-project surveys. These impacts are impressive, but they are to some degree limited by cost and time overruns, which mean the investment of both loan and government funds has been less than it could have been. With ADB support, the National Water Sanitation and Drainage Board is becoming a more efficient and profitable organization although its outlook is constrained by the failure to advance policy and agree required tariff levels. ADB support is rated *effective* for achieving outcomes against the objectives of providing greater access to safe water and improved sanitation services. Water sector projects generally met or exceeded their targets albeit with some delay and with cost over-runs, justifying an *effective* rating.

220. Sri Lanka has almost achieved country-wide electrification and ADB support for the sector made a substantial contribution. In 2014, the household electrification rate reached 98.4%, up from 66.0% in 2006. This was well ahead of the milestone indicator in the CPS, 2009–2011 sector results framework, which was 88% by 2016. While electricity services have been extended throughout the country, some areas lag behind e.g., Killinochchi and Mullaittivu—the most war-affected districts in Northern Province—have 70% electrification. While ADB support has been *effective* in extending energy services throughout the country, it has been *less effective* in achieving policy reforms, particularly the independent setting of tariffs, which is now a condition of the IMF-supported reform program.

221. All completed and validated multisector projects achieved their development objectives and were *effective*. They played a major role, complemented by support from other development partners, in rehabilitating local infrastructure and services in conflict- and tsunami-affected regions. Overall, this group of projects is rated *highly effective*.

222. Education sector performance improved over 2005–2015 with better O-level pass rates, which rose from 40% in 2005 to 69% in 2014. A-level pass rates were relatively stable at 60%. Pass rates in science and technology subjects are about 50%, but with an upward trend. Enrollment rates in technology and ICT streams are increasing overall. These are positive outcomes. TVET subsector gains have been impressive with an average completion rate of 92% in 2014, up from 87% in 2012. The engagement of the private sector on national framework and competency standards and on-the-job training set new standards for the level of PPP in education. ADB projects had strong equity components. At the secondary level, these focused on the main conflicted-affected provinces and plantation areas. Disaggregated data show ADB project schools achieved significant improvements in O-level passes among rural students, and that especially impressive gains were made in science and English. A-level

pass rates for some regions are still below the national 60% level though they are increasing.

223. The biggest concern for gender equity is the concentration of girls in arts and humanities because of the effect this has on their later employability. ADB projects did target female participation in science and commerce streams and enrollments in these areas are on the increase. The participation of women in TVET is low; in 2015, only 31% of University of Technology students were female. At the craft and technician level, enrollment of women is rising, though this level is still dominated by men. There is a clear segregation of courses that are dominated by either men or women, with women taking courses that are in least demand by the private sector. At university, girls are overrepresented and, again, concentrated in arts faculties. Their employability is very much affected by ability of the services sector to create jobs for women, and this could be greatly enhanced by increasing their technical and computer skills to enable them compete more effectively in the job market.

224. ADB sovereign interventions sought to improve access to finance in Sri Lanka over the CAPE period through a mix of policy support, SME credit lines, and TA. Interventions made before the CAPE period in 2001 and 2003 were considered to be less than successful; ADB had supported areas with potentially high inclusive outcomes, i.e., rural finance, and support for SMEs, but also with high risks. While ADB's sovereign support for the financial sector was relevant, it was not effective over the CAPE period. Poor commitment and ownership by government plus a lack of political will to carry out reforms were the main reasons.¹⁴⁶ The overall rating for effectiveness is also based on the fact that ADB sovereign support withered over the CAPE period despite it being identified as a key area for ADB intervention in all three CPSs. ADB's CPS commitment to support capital market development and access to finance was reignited in 2016, with the approval of a line of credit for SMEs. Support for capital market development is expected in the final quarter of 2016. While these interventions signal re-engagement, they are not sufficient to make up for a lack of support over the period. Hence the overall rating for pillar 2 is *less than effective*.

225. The ANR portfolio was *effective* in achieving a wide range of strategic objectives and thematic priorities. For example, five projects were directly aimed at poverty reduction. The Upper Watershed Management Project¹⁴⁷ recorded that beneficiary incomes had increased by around 48%. In addition, 370 interventions for habitat conservation, resource management, and reengineering of lagoons are estimated to have benefited 1 million people, many of whom were poor coastal dwellers. Three of the eight projects had documented gender outputs. For instance, 247 CBOs were formed under the Upper Watershed Development Project, where the majority of members were women. The Protected Area Management and Wildlife Conservation Project¹⁴⁸ also involved CBOs with women members. Field interviews with women beneficiaries indicated that with the seed money provided they had engaged in a range of activities such as curry powder grinding, dried fish production, sewing and local handicrafts. Several had expanded their businesses and been able to provide their

¹⁴⁶IED. 2013. *Project Validation Reports. Sri Lanka: Small and Medium Enterprise Sector Development Program, and Sri Lanka: Rural Finance Sector Development Program*. Manila: ADB.

¹⁴⁷ ADB.1997. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Upper Watershed Management Project in Sri Lanka*. Manila.

¹⁴⁸ ADB.2000. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Protected Area Management and Wildlife Conservation Project*. Manila.

children with a high school education.¹⁴⁹ Several of the projects in the portfolio were aimed directly at resource conservation, environmental improvement and, by extension, climate change mitigation. The most environmentally-oriented project was the Protected Area Management and Wildlife Conservation Project. According to this project's PCR, "the project achieved the target outcome of strengthening protected area management and developing operational partnerships with local communities and other stakeholders to reduce illegal use of park resources."¹⁵⁰

C. Efficiency

226. The evaluation regarded ADB support as *efficient*, although this rating is borderline, varies across sectors and appears correlated with long-term TA support to strengthen executing agency performance; for example, in transport before the CAPE period.¹⁵¹ The transport, energy, and education sectors performed more efficiently than water and sanitation, and ANR, where most projects suffered time and cost overruns during implementation, and the TA allocation declined.

227. ADB's focus on strengthening the capacity of the RDA for project preparation, design, implementation, and management of safeguards paid off with significant improvements in project implementation. Since 2010, projects have not been significantly delayed and they have complied with ADB rules and procedures, unlike in the previous decade.¹⁵² ADB's incremental and tactical approach has been well received by the RDA and the government as a whole. The unit cost per kilometre of ADB national road projects is lower than for the sector as a whole.¹⁵³

228. To improve the efficiency of public sector investments, ADB's strategy envisaged helping the government attract private sector investment, particularly through PPPs. Only the Colombo Port Expansion Project successfully achieved this objective. The earlier Colombo Port Efficiency and Expansion Project was a TA loan implemented over 7 years that helped to ensure a high level of project readiness that supported the smooth running of the ensuing Colombo Port Expansion Project. The success of the project in mobilizing private participation, despite a 27-month extension, accounts for its *efficient* rating.

229. High cost and time overruns were one of the weakest features of most WMIS projects. Cost overruns in this sector averaged 48% and time overruns 34% during the CAPE period, and these significantly reduced the estimated economic returns. Overall, the balance between an inefficient process and probable economic efficiency merits an overall rating of *less than efficient*, although water supply and sanitation benefits could be higher than estimated because health benefits are not taken into account in economic return calculations. The rating also reflects a declining TA ratio to overall investment size.

¹⁴⁹ In the vicinity of the Kirindi Oya boundary of Bundala National Park, the evaluation mission met with members of two CBOs which were established under the project - approximately 25 members (70:30 female:male ratio) of the CBO in the office of community development in Kone Elaiya, and 15 members (60:40 female:male ratio) of another CBO in the community hall of Magama Temple. Both CBOs are located in Hambatota district, Southern Province.

¹⁵⁰ ADB. 2010. *Project Completion Report for the Protected Area Management and Wildlife Conservation Project*. Manila.

¹⁵¹ The rating of efficiency is based on a review of process efficiency and not based on re-estimation of projects' economic internal rates of return.

¹⁵² The Southern Transport Development Project was subject to a Compliance Review Panel, which submitted its report in May 2005.

¹⁵³ Appendix, Linked Document 2.

230. ADB's sovereign support for financial market development was considered *less than efficient* overall. The Financial Markets Program for Private Sector Development in 2004 was considered to have been successful, although it was not regarded as efficient, as the program took much longer than expected and important elements of the TA were cancelled.

231. Despite the challenge of implementing hundreds of subprojects in conflict- and tsunami-affected areas, the multisector projects were implemented efficiently. This is evidenced by the ability of the original project structures to fully utilize their project allocations. These structures were then scaled up from the initial small amounts to subprojects worth \$330 million in ADB funds alone¹⁵⁴ (\$540 million in total project costs) financed by three extensions of the North East Community Restoration and Development Project, as well as large components of ADB's post-conflict support, cofinanced with other development partners. Given their demonstrated ability to absorb additional funds and scale up implementation capacity, the multisector projects are rated *highly efficient*.

232. Education projects also suffered time overruns, most by over a year. Initial implementation delays and poor use of new and upgraded education facilities were recurring themes. For the secondary education projects, two out of four completed projects efficiently delivered an economic rate of return above ADB's benchmark of 12%. The Education for Knowledge Society Project (which has not yet been rated) had a 15-month extension caused by delays in the delivery of school furniture. Project implementation was not efficient due to the multitude of small contracts involved in school refurbishment, which proved difficult to manage. Contracts were also awarded to unqualified contractors in some instances.

233. The Tertiary Distance Education Modernisation Project suffered significant delays, initially due to a long delay in fielding consultants and the complexities involved in building a national information technology network. The delay reflected difficulties in finding appropriately qualified consultants who were familiar with establishing an online nodal network for distance learning. The University of Technology had low student output at project completion due to its late opening, and suffered serious teacher shortages as well. This was also the case for the colleges of technology established under the project, which had extremely low enrollment and therefore low benefit streams. The efficient utilization of science laboratories in the secondary education projects was hampered by a lack of teachers. The lack of effective management information systems also impeded the efficiency of education projects; despite sustained attempts to improve the situation over several projects, efficiency has still not been achieved. Three of the five projects with PCRs or PVR ratings were assessed as *efficient*, and two as *less than efficient*, mainly because of the low utilization of facilities provided, though the trend is toward increased utilization. ADB support to education is rated *efficient* overall.

234. Delays in project completion ranged from 5 to 57 months in ANR with an average delay of 22 months. While most ADB projects suffer implementation delays,¹⁵⁵ completion delays for the ANR portfolio overall suggest a less than efficient implementation history. Also, in two projects, more than 20% of the original loan had

¹⁵⁴ These numbers exclude the \$150 million ADB financing approved in 2010, after the conflict ended for the Conflict-Affected Region Emergency Project (see Table 9) which was not implemented by the North East Community Restoration and Development Project and has not yet been evaluated.

¹⁵⁵ The Development Effectiveness Review 2014 indicates that between 2012 and 2014 only 48% of projects were completed on time.

to be cancelled. This hints at a less than efficient use of scarce ADF funds. While seven out of eight projects were rated *efficient* in their respective PCRs, many of them were less efficient from a process point of view, with long completion delays in some and a high level of unspent funds for others. The rating for the ANR portfolio is thus assessed as *less than efficient*.

D. Sustainability

235. A number of factors detract from the overall sustainability of ADB investments. These mainly relate to political economy and institutional issues that reflect a deep aversion to change. There has also been a long-term decline in central government revenues, which raises serious issues for financial sustainability. One example of the complex political economy is the inability to attract private sector investment for infrastructure development. This was a core objective of both CPS, 2009–2011 and CPS, 2012–2016. As the government veered away from its DPF reform agenda, which included higher levels of private sector investment, ADB reduced its support for reform.

236. In transport, the incomplete attention to policy reforms undermined the sustainability of ADB support, in particular for achieving efficient and safe road operations. There have been persistent constraints on road maintenance financing, where more work needs to be done. In energy, the shift from a policy of independently regulated electricity pricing has meant that other policy objectives, such as social protection through universal energy subsidies, are pursued through the CEB—an inefficient, expensive, and non-targeted approach to poverty reduction. As long as tariff setting is politically motivated, the National Water Sanitation and Drainage Board will continue to rely on public investments to meet its expansion costs. Rather than maintaining utility prices below full-cost recovery to achieve populist social objectives, which has long-term consequences for utility viability, the government should introduce well targeted and more generous cash transfers, and allow utilities to be run on a commercial basis. The long-term decline in the ratio of revenue to GDP, combined with slow progress against sector policy reforms, means that ADB support is considered by this evaluation to have been *less than likely sustainable*. The rating also reflects the decline in TA to the overall loan portfolio.¹⁵⁶

237. The majority of the subprojects financed by the multisector projects in communities affected by conflict and natural disasters were found to be functioning several years after project completion. The community development components have created assets, such as the multipurpose centers or revolving funds managed by the rural women’s development societies, that are still yielding benefits and have grown in value for the community. Individual subprojects are maintained either by sector line departments or local communities, but no successor organization was created or designated to take over the decentralized and effective institutional structure for these programs. Even the computerized management information systems disappeared after project closing. The projects therefore suffered from lack of institutional sustainability. Although the North East Community Restoration and Development Project is widely recognized as a beneficial intervention, and has become a brand name in the project areas, the approach was discontinued prematurely, and ADB and the government allowed the valuable lessons from these participatory, community-driven projects to be forgotten or lost. As a group of projects, these multisector interventions are therefore rated *less than likely sustainable*.

¹⁵⁶ Using a 3-year rolling average of TA and projects.

238. Education reforms also met with opposition. Private sector involvement in general education and the university sector has been a particular flashpoint. Political influence in education administration, especially in the hiring and deployment of teachers, undermined efforts to provide specialized math and science teachers to rural areas.¹⁵⁷ The intention by the new government to double education spending to 6% of GDP is highly constrained by rigidities in the structure of public spending and by the current revenue crisis. ADB support for education was considered *sustainable*, however, largely due to strong government ownership and commitment by development partners to the sector development frameworks, the continuing high demand for job-relevant training by students and employers, and the acute need to develop the skills needed for economic development.

239. Environmental sustainability is also an important issue. Sri Lanka is one of the world's biodiversity hotspots and is also prone to large-scale natural disasters, including fatal landslides and frequent flooding. There is evidence that, while ADB support for ANR was discontinued, its projects in natural resource management were effective and sustained. This element of the program has diminished as infrastructure investments have increased. ADB should now rebalance its portfolio by financing stand-alone ANR projects or include ANR components explicitly in infrastructure projects.

E. Development Impacts

240. The results framework in CPS, 2012–2016 identified three higher-level development goals that ADB interventions intended to support: (i) accelerated economic growth (maintained at 8% per annum over the medium term); (ii) eradication of hard-core poverty and hunger by 2016; and (iii) protection of the environment (increased forest cover from 23% in 2010 to 28% by 2016). ADB intended to contribute to these goals through support for infrastructure development and service delivery in lagging regions, restoring livelihoods in conflict-affected regions, reducing regional disparities, and increasing transport connectivity, private sector development, and employment.

241. The ADB contribution to development impacts for the transport sector is rated *satisfactory* as it scaled-up investment in transport infrastructure and enhanced Road Development Authority capacity for project implementation and safeguards management. ADB continues to be the major contributor to capacity enhancement and technology transfer for roads, particularly in conflict-affected provinces. Overall, ADB rose to the need to increase investment in transport infrastructure from 2006 to 2015 following the end of the war. In doing so, it was able to focus on supporting RDA with project implementation and safeguards management, which had substantially improved by 2010. While this focused support has proven effective, it appears to have been at the expense of maintaining key dialogue on transport sector efficiency, concerns about future sustainability of maintenance financing, and road safety. Nevertheless, considerable weight must be given to the achievement of key outputs and outcomes, and this is the basis of the *satisfactory* rating.

242. ADB has provided support to Sri Lanka's energy and water sector institutions, through both investment projects and TA for a long time, and this partnership will continue into the next CPS cycle.¹⁵⁸ The impact of this long-term support on Sri Lanka's

¹⁵⁷ A. Little. 2010. *The Politics, Policies and Progress of Basic Education in Sri Lanka*. CREATE Pathways to Access. Research Monograph No. 38. United Kingdom.

¹⁵⁸ The first loans for energy and water were approved in 1979 and 1986 respectively.

institutions is relatively strong and the country has made considerable achievements in increasing access to water and energy services, and in achieving its MDGs. Nevertheless, SOEs are a drain on the government's budget and improving their financial performance and operations is part of the government's economic reform program, supported by the IMF with World Bank and planned ADB financial support. A key part of the planned reforms includes the introduction of an automatic pricing mechanism for fuel and electricity prices. ADB has provided support for an independent regulator, but political interference in tariff setting was common over the CAPE period. The sustainable financial operation of these sectors is where ADB should continue to provide support as Sri Lanka transitions to a higher middle-income country status. This should include policy advice on sustainable water financing.

243. There are signs that ADB's strategy to reduce regional disparities through targeted investment in infrastructure and service delivery may not be sufficient to reduce overall disparities and inequality and may not be able to support a sustained recovery in Northern and Eastern Provinces. For instance, over 2010–2014, Northern Province's share in GDP changed marginally from 3.4% to 3.6%, and Eastern Province's share stayed at 6%.¹⁵⁹ This suggests further support is needed, not just in infrastructure but in targeted support for livelihood and skills development, and to encourage private sector investment in lagging regions.

244. The development impact of ADB's focus on the rehabilitation of livelihoods and services in conflict-affected and lagging regions has been *satisfactory*. These initiatives are complemented by the impacts of the WMIS sector program. At the household level, the impact of ADB support for access to electricity has also been substantial, with anecdotal evidence of improved health and safety and household savings as electricity has displaced higher-cost kerosene.

245. The development impact of ADB's support for ANR was curtailed by ADB discontinuing support for the sector. All eight ANR projects that were ongoing had impacts which were *satisfactory*, with four assessed as having *significant* impacts. Projects helped formulate a number of key policy documents including the National Watershed Management Policy, the National Coastal Zone Management Plan, 16 operational integrated forest resources management plans, and 65 range plans under the Forest Resources Management Project;¹⁶⁰ the Fauna and Flora Protection Ordinance under the Protected Area Management and Wildlife Conservation Project;¹⁶¹ and the Fisheries and Aquatic Resources Act under the Aquatic Resource Development and Quality Improvement Project.¹⁶² Physical development impacts were significant and most agencies continued to expand activities and investments after the projects had closed. The use of revolving funds in some projects assisted in this process.

246. The Forest Department, the Department of Wildlife Conservation, and the Coast Conservation Department indicated that (i) forest cover had remained stable at 29% coverage against the target increase of 32%; (ii) encroachment on protected areas had notably decreased and confrontations between residents around protected forest and wildlife areas had been reduced; and (iii) water resources management activities such as lagoon management promoted by the Coastal Resources Management Project

¹⁵⁹ Central Bank of Sri Lanka. 2015. *Annual Report 2015*. Colombo.

¹⁶⁰ ADB. 2000. *Report and Recommendation of the President to the Board of Directors: Proposed Loan for Forest Resources Management Sector Project in Sri Lanka*. Manila.

¹⁶¹ ADB. 2000. *Report and Recommendation of the President to the Board of Directors: Proposed Loan for Protected Area Management and Wildlife Conservation Project in Sri Lanka*. Manila.

¹⁶² ADB. 2002. *Report and Recommendation of the President to the Board of Directors: Proposed Loan for Aquatic Resource Development and Quality Improvement Project in Sri Lanka*. Manila.

continued to function, which contributed to biodiversity and sustainable natural resource management. Nevertheless, the momentum of these projects was lost. Promising new investment subsectors and modalities that could have been applied to the recovery of Northern and Eastern Provinces were not pursued. ADB links with key executing and implementing agencies have faded. ADB's ANR expertise in Sri Lanka has dissipated and a number of opportunities to invest in key activities which meet the core areas of Strategy 2020 (infrastructure, the environment and finance) have been missed. Nevertheless, the evaluation finds that the development impact of this truncated program was *significant*.

247. There is evidence that, since 2012, the focus of ADB support shifted away from lagging regions. The shift in project location to larger towns and cities is consistent with inclusive growth, as the largest numbers of poor are concentrated in the Colombo and Kandy conglomeration. Ongoing projects, including the Dry Zone Urban Water and Sanitation Project, the Jaffna and Killinochchi Water Supply and Sanitation Project, the Greater Colombo Wastewater Management Project, and the Greater Colombo Multitranchise Financing Facility, all focus on large towns and cities, particularly Greater Colombo. The Greater Colombo projects will improve water supply and sanitation services for the urban poor. The reduction of sewage leaks, blockages, and overflows will benefit the poor who often live in Colombo's low-lying areas and near its polluted inland waterways. The Greater Colombo MFF also includes a subcomponent to institutionalize pro-poor and gender-inclusive sanitation services in underserved settlements in the service area, and to pilot alternative and unconventional on-site sanitation in underserved areas. ADB needs to balance this shift in the geographical location of projects from rural to urban with an equal focus on livelihoods in lagging regions where pockets of high poverty persist.

F. ADB and Borrower Performance

248. ADB performance varies by sector. In transport, ADB helped the government scale up the quantity, quality and timeliness of road infrastructure but it neglected important policy dialogue on reform of the RDA that was left unfinished in 2005. The role and efficiency of state agencies involved in transport service delivery, identified as a deficiency by the 2012 sector assistance program evaluation (footnote 33), was also not pursued. When ADB increased its investment in roads, it should have included road safety. While sustainable urban transport is a key plank of ADB Sustainable Transport Initiative (in line with Strategy 2020), ADB has only recently approved a TA, the first since 2002,¹⁶³ examining suburban railway investment without complementary proposals to address bus transport or traffic management. A significant portion of the population of Colombo and Kandy, the premier urban centres, are considered poor and rely on bus transport that is impeded by road congestion.

249. ADB has devoted substantial resources to supporting government programs in water and sanitation and contributed to satisfactory performance. Sri Lanka achieved its national water MDGs, with the best performance of any South Asian country. But ADB had less success in driving policy change. Resistance to change has been due to concerns by farmers that their access to irrigation water would be limited and (in some cases) attitudes within the National Water Supply and Drainage Board in relation to (i) limiting the extent of decentralization, and (ii) retaining control of water tariffs. ADB has a close dialogue with other agencies supporting the sector and has involved

¹⁶³Following the unsuccessful implementation of the TA Passenger Transport Services Improvement, ADB transferred the remaining TA funds to project preparatory technical assistance for a 20-km bus rapid transit system, but failed to formally submit the proposal on time (IED. 2011. *Project Performance Evaluation Report Road Sector Development Report, Sri Lanka*. Manila: ADB)

bilateral agencies in cofinancing. This was also the case for energy and education. In summary, it could be argued that overall ADB support was *satisfactory* in infrastructure delivery, but *less than satisfactory* in sustaining its policy dialogue. The performance of executing agencies mirrors this finding, particularly as government ownership of the sector and macroeconomic policy reform agenda deteriorated over the period.

G. Key Findings and Recommendations

250. **Finding 1: (a) The financial performance of state-owned enterprises is a burden on the overall fiscal balance.** This is true for the energy, water, financial, and transport sectors, which continue to rely on public subsidies for capital investment and operational maintenance and running costs. While state-owned financial institutions generate returns, this is below the country's cost of capital. ADB has a long record of investment in these sectors. This includes a mix of capital investment; institutional strengthening and capacity building; and sector policy reform, pricing, and sector regulation. While good progress was made on the investment side over the CAPE period, less attention was paid to sector policy for political economy reasons. ADB now needs to strengthen its support for state-owned enterprise reform as part of its capital investment program. The pricing of public goods such as electricity is now included in the government's policy reform framework. It should consider using well designed policy-based operations, TA or sector development loans to support SOE reforms that complement the Enhanced Fund Facility supported by the IMF, and related programs by the World Bank and other development partners.

251. **(b) The ADB Sri Lanka resident mission does not systematically engage in macro and sector policy dialogue.** As noted by the previous CAPE, ADB does not appear to be involved in important policy discussion even though it has a long record of sector and macroeconomic support. While ADB's support for fiscal policy, particularly revenue administration, is now central to the government's reform agenda supported by the IMF, ADB is no longer playing a central role. Nor is there sufficient capacity in the resident mission to engage in fiscal policy issues including those that impact on sectors where ADB is providing significant support.

252. **Recommendation 1: ADB needs to intensify its policy reform work in the infrastructure sectors, including in the reform of state-owned enterprises.** Sri Lanka needs to strengthen its macroeconomic stability and pursue structural reforms if it is to achieve sustainable and inclusive growth. One pillar of the government's reform agenda is improving the performance of SOEs in order to reduce the financial burden they place on the state. ADB has a record of long-term engagement with several SOEs including in water supply and sanitation, and energy. It is also a significant partner in transport development. It should be well placed to leverage its significant loan resources to engage in sector policy dialogue, particularly to ensure that SOEs are not creating further liabilities for the state. It needs to strengthen its support for structural reforms in these sectors, particularly for independent tariff setting by the PUC, which ADB helped to establish. This is central to the new government's reform agenda supported by the IMF. ADB should seek ways to support the government in implementing this program, while building its relationship with the Ministry of Finance and working more closely with other development partners on macroeconomic and fiscal policy issues.

253. To do this well, ADB also needs to strengthen the capacity of its country office to engage in policy dialogue at the macroeconomic and sector levels, a key part of this recommendation. It needs to ensure there is an appropriate balance between the TA

and loan portfolios to ensure that TA allocations for policy reform and capacity development are commensurate with the needs of the expanding loan portfolio.

254. **Finding 2: ADB can work differently.** ADB had a strong program of support for communities affected by conflict and natural disasters, which used a highly decentralized approach for project administration and delivery. The program proved highly effective on the ground especially for women. While ADB had discontinued its support for ANR following a direction from government in 2003, support for ANR was pursued through multisector projects in the north and east, particularly irrigation and rural roads. Working in this way permitted ADB to support ANR even though it was no longer a priority sector. As a result of another direction from government, the multisector community-based approach was not continued after the war ended.

255. **Recommendation 2: ADB's next CPS should set out a strategy for inclusive growth that draws on the success of its community based projects.** There is evidence that ADB can work differently, engage effectively across multiple sectors, and provide social infrastructure, and livelihood support at the community level. The kind of rural and community-level infrastructure support provided through the North East Community Restoration and Development Project and the North East Coastal Community Development Project remains highly relevant to economic and social development throughout the country. ADB's approach to community and rural development was well received and effective in strengthening women's engagement in local economic decision making. It also allowed ADB to remain engaged in agriculture, which employs most of the rural population, is important for inclusive growth, and has a close connection with natural resource management and protecting biodiversity. Community-level support also helped ADB to build the capacity of local government in service provision. It is recommended that ADB learns from this approach and: (i) designs multisector project support in those areas where poverty persists and where social protection coverage remains inadequate; (ii) enhances inclusion by ensuring that agriculture and natural resource management is pursued in parallel with infrastructure projects, especially in the case of rural roads and other rural interventions.

256. **Finding 3: Results of ADB support for private sector development and public sector management were disappointing.** Support for private sector development was elevated to a key strategic objective in CPS 2012–2016 but the political context had changed well before this CPS, making it harder to pursue such projects. The situation changed again in 2015 and ADB approved new support for SMEs; support for capital market development is expected to start in the final quarter of 2016. ADB had positioned itself to support macroeconomic reform by supporting revenue administration in an attempt to address the tax-to-GDP ratio, which has fallen to exceptionally low levels, with the government borrowing to cover its debt servicing repayments and support the exchange rate. A large component of ADB's support for revenue administration was cancelled due to a procurement issue that proved difficult to resolve. The urgent need to reverse the long-term decline in revenue is now central to the government's policy framework supported by the IMF's Enhanced Fund Facility.

257. **Recommendation 3. The new CPS needs to define a clear approach to ADB's support for private sector development, which establishes better synergies between work on the investment climate, public investments, and private sector operations.** The need to strengthen the private sector through improving the investment climate, and to increase private investment in infrastructure and other sectors (e.g., education), have been long-running themes in ADB CPSs, but progress has been slow. The investment climate is a binding constraint on private sector development and the reform agenda is

challenging. ADB will find it hard to engage in investment activities while the policy environment remains unfavorable. Care needs to be taken to ensure that ADB sovereign loans do not crowd out the potential for private sector investment in roads, energy, water, and financial markets. ADB should look to use its range of financial instruments, such as guarantees, to attract private sector investment.

258. The approval in 2016 of a sovereign loan that provides a line of credit through commercial banks for SMEs suggests that coordination at a strategic level between ADB's private sector operations and the regional department is not as effective as it could be. Both departments support the provision of credit to small and medium-sized enterprises using nonsovereign and sovereign financial instruments but currently neither is involved in improving the business environment. While Sri Lanka is a small market, its reform agenda for private sector development is large and complex. There should be greater coordination between the PSOD, the South Asia Department (led by the Sri Lanka resident mission), and the Office of Public Private Partnership and a unified strategy for private sector development so there is a consistent ADB program of private sector support. The Sri Lanka country director should lead this coordination, monitor its progress, and have an overview of where the program of support is heading. The strategy should set out plans for analytical work, and support for the business environment over the short to medium term that would support private sector development over the longer term.

259. **Finding 4: ADB has achieved good results in the education sector.** ADB is in a good position to work with the government to restore Sri Lanka's position as an education leader in the region and contribute to inclusive growth.

260. **Recommendation 4: ADB should grow its support for the education sector as a share of total operations over the next CPS period.** The government wants to double its education expenditure from 3% to 6% of GDP but has limited fiscal space to enable it to achieve this. The government will not be able to meet the growing demand for tertiary education without restricting access or reducing quality. ADB should help the government develop a strategy for sustainable tertiary education financing that considers options for greater private sector provision in all areas of tertiary education and training.

Appendix

APPENDIX: LIST OF LINKED DOCUMENTS

1. Sri Lanka Loans, Grants and Technical Assistance Portfolio, 2006–2014
<https://www.adb.org/sites/default/files/linked-documents/1-SRI-Loans-and-Grants-Portolfio-2006-2014.pdf>
2. Sector Assessment: Transport
<https://www.adb.org/sites/default/files/linked-documents/2-SRI-Sector-Assessment-Transport.pdf>
3. Sector Assessment: Water Supply and Other Municipal Infrastructure and Services
<https://www.adb.org/sites/default/files/linked-documents/3-SRI-Sector-Assessment-Water.pdf>
4. Sector Assessment: Energy
<https://www.adb.org/sites/default/files/linked-documents/4-SRI-Sector-Assessment-Energy.pdf>
5. Sector Assessment: Multisector
<https://www.adb.org/sites/default/files/linked-documents/5-SRI-Sector-Assessment-Multisector.pdf>
6. Sector Assessment: Education
<https://www.adb.org/sites/default/files/linked-documents/6-SRI-Sector-Assessment-Education.pdf>
7. Sector Assessment: Agriculture and Natural Resources
<https://www.adb.org/sites/default/files/linked-documents/7-SRI-Sector-Assessment-Agriculture-and-Natural-Resources.pdf>