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Sri Lanka
Country Assistance Evaluation

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Operations Evaluation Department

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Abbreviations and Acronyms

CAE	Country Assistance Evaluation
CAS	Country Assistance Strategy
DEI	Development Effectiveness Indicators
ERC	Economic Restructuring Credit
ESW	Economic Sector Work
FIAS	Foreign Investments Advisory Services
IFC	International Finance Corporation
NGOs/POs	Non-Governmental Organizations/Private Organizations
OED	Operations Evaluation Department
PFPs	Policy Framework Papers
PMEAC	Public Manufacturing Enterprise Adjustment Credit

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Office of the Director-General
Operations Evaluation

MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT

Sri Lanka: Country Assistance Evaluation

Capitalizing on its high human development, Sri Lanka experienced substantial growth and poverty reduction since embarking on a gradual transition from socialism to a market economy in 1977. However, the potential for faster progress is constrained by a lingering ethnic conflict, low public savings, an inefficient public administration, declining quality of social services, and inadequate infrastructure. A draft of this evaluation was discussed by CODE on December 16, 1998 and a report of that discussion is attached as Annex E. This report is now being re-issued for the purpose of public disclosure.

Throughout the 1990s, the Bank's analysis and advice was sound. Moreover, its strategic objectives were well aligned with the Government's--to promote private sector-led growth, reduce poverty, upgrade human capital, and protect the environment. IDA lending peaked in the early 1990s, extending to adjustment, poverty alleviation and the social sectors. Although fiscal discipline was easily disrupted, most components of Bank-supported adjustment lending progressed satisfactorily (e.g., opening the economy, financial sector liberalization, privatization). Since 1996, the Government has strengthened fiscal management and made further progress on stalled structural reforms (e.g., in trade, taxation, the privatization of tea estates, and private participation in telecom and ports). Even so, it still fell short of triggering a "high case" lending scenario. The country's strong progress in human development (including gender equality) predate the Bank's recent involvement in these sectors, where the health needs of an aging population and quality and access issues in education have been appropriately the focus of Bank assistance.

On the minus side, a major attempt at civil service reform supported by adjustment lending failed. The Bank funded an overly complex, politicized, and ultimately unsuccessful poverty reduction program. Bank assistance was not sufficiently supportive of ethnic harmony--a key element in ensuring the sustainability of the country's development achievements. It brought modest results in key critical infrastructure sectors like power and roads. And while ratings on evaluated projects for outcome and sustainability are average, their institutional development impact ratings are very low.

The Bank overall country assistance in the 1990s had a satisfactory outcome and likely sustainability. Not all of what the Bank set out to change in the policy and institutional framework got done, but what was done helped propel the country's growth and poverty reduction at a substantial speed. However, Bank assistance only had a modest institutional development impact. Thus, OED rates development effectiveness of Bank assistance at the country level as marginally satisfactory. Bank and Borrower performance were also marginally satisfactory, as design and implementation of reforms and projects could have been better and commitment stronger.

The 1996 CAS remains valid. The Bank should continue linking its assistance to progress towards an adequate policy and institutional framework, avoiding projects but continuing to provide analyses and advice in sectors without strong Government's commitment to needed reforms. In addition, the Bank should support more actively the Government's efforts at peace building and strengthening ethnic harmony, and should help prepare for a phase-out of concessional aid by strengthening the country's creditworthiness and capacity to manage capital flows. In light of the high disconnect ratio between supervision and completion ratings, OED recommends a review of the entire portfolio of 14 projects.

PREFACE

Country assistance evaluations take the country as unit of account and concentrate on the *relevance, efficacy* and *efficiency* of the Bank's overall program of assistance, as well as its *sustainability* and its impact on *institutional development.* This Country Assistance Evaluation (CAE) examines World Bank assistance to Sri Lanka during the last ten years (FY89 to FY98), following the re-commitment of the Government to a comprehensive reform program. The CAE, however, is selective as to the instruments, sectors and issues covered. The focus is on priority issues which remain relevant today for decision-making by the Government and the Bank in the preparation of the next Country Assistance Strategy (CAS).

The study is based on OED and Bank reports, including Performance Audit and Implementation Completion Reports, the 1992 and 1996 Country Assistance Strategy Papers, Country Briefs, Country Economic Memoranda, sector reports, management briefs for the Annual Meetings and high-level field visits, and project and general country files. The Bank Field Office in Colombo provided excellent assistance for both logistics and substantive issues during the CAE field mission in August 1998. The study also reflects the views canvassed during interviews with current and past Sri Lanka officials, including at the cabinet level, academia and private sector representatives, foreign donor representatives and Bank staff, conducted between June and September 1998. Their kind cooperation and valuable assistance is gratefully acknowledged. Formal comments by the Government on an earlier draft were received and forwarded to CODE as an addendum before the CODE discussion on December 16, 1998. They are attached as Annex D.

This report was prepared by Gianni Zanini (Task Manager), with general research assistance by Oliver Rajakaruna. Rene Vandendries (peer reviewer), Robert Buckley, Asita de Silva (OEDCR), Linda Dove (peer reviewer, OEDST), Shanta Devarajan (DECRG), S. Salman (LEGSA) offered valuable comments. Roziah Baba provided administrative and editorial assistance.

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1. Growth and Poverty Reduction In Spite Of A Lingering Conflict

Overcoming A Legacy of Economic Duality, Ethnic Tensions, and Inward Focus...[1]

1.1 During the 100 years or so preceding its independence in 1948, a dual structure of economic activities evolved in Sri Lanka, a densely populated island nation off the southern tip of India. British and other European plantation owners dominated all export and commercial activities, largely relying on indentured Indian Tamil workers, while the largest part of the Sinhalese population remained wedded to its traditional village and paddy culture, with little change in per capita income and technology.

1.2 The country's democratic system survived two attempts to subvert civilian rule, one by the military and the other by an armed organization that remained active through the early 1990s. However, ethnic and religious tensions exploded in 1983 in a violent conflict that continues to date, albeit with fluctuating degrees of intensity.

1.3 The government that emerged at independence was more committed to a welfare transfer state than to direct public involvement in economic activities. However, the role of the state expanded after independence, the nationalization of private schools, transport and communication services and infrastructures, and all major enterprises, including foreign-owned oil companies. In 1977, Sri Lanka began a gradual transition from an inward-looking, socialist system to an open market economy. Since then, GDP has grown at 4-5 percent a year, implying a respectable per capita growth above 3 percent.

...Sri Lanka's Development Strategy in the 1990s Pushed The Economy To A Higher Platform

1.4 The Government's priority objectives and strategy since 1989 have been the elimination of poverty and rapid, export-led growth, with the addition of peace, social welfare and equity after 1994. The Government recognized that peace and ethnic harmony are essential elements to restore the productive capacity in the North and East, maintain private sector confidence, realize the country's tourism potential, release resources for productive uses and sustain its social and economic achievements. It opened negotiations with the separatists and placed devolution to provincial governments foremost on its political agenda. Its proposals for far-reaching devolution have found widespread support among moderate Tamil and Sinhalese, but not to a degree sufficient to adopt the required constitutional changes.

1.5 The country's human development indicators have been consistently well above those of countries with similar incomes (see Figure 1.1). In 1990, Sri Lanka's 4 percent share of the population living on less than $1 a day was lower than for most middle-income countries, and the 41 percent share below the $2 a day line was only slightly worse than Mexico and better than

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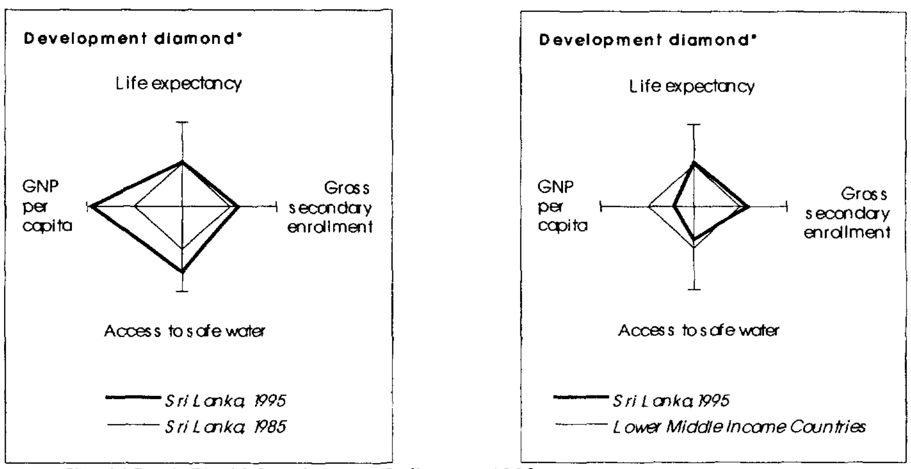
[1] For a thorough economic history of Sri Lanka, see H.J. Bruton and Associates, *The Political Economy of Poverty, Equity, and Growth: Sri Lanka and Malaysia*, Oxford University Press, 1992 and P. Athukorala and S. Jayasuriya, *Macroeconomic Policies, Crises, and Growth in Sri Lanka, 1969-90*, The World Bank, 1994. For a summary treatment of recent political developments, see the World Bank, Country Assistance Strategy, May 1996 (Report No. 15633-CE), pp. 1-2.

Brazil, both upper-middle income economies. Income inequality was only slightly higher than in Eastern European countries[2].

1.6 Although no recent survey data are available yet to gauge poverty trends, Bank simulations suggest that the headcount index based on the national poverty line may have fallen substantially in the 1990s from 22 percent in 1990/91 and 27 percent in 1985/86. Life expectancy (73 years) is higher than in upper middle income countries (70 years). Secondary school enrollment is also higher (75 percent versus 62 percent), with female enrollment registering 78 percent (a smaller gender gap than in Argentina). The status and welfare of Sri Lankan women is far superior to that of women in most other developing countries. Women's participation in public life is in line with Western countries[3]. Puzzlingly, however, access to safe water at 64 percent is worse than for the lower- middle income group, and child malnutrition (at 38 percent) is at Sub-Saharan African levels.

Figure 1.1: Development Diamonds: Income Per Capita Has More Than Doubled since 1985 and Social Indicators Have Remained In Line With Lower Middle Income Countries



Source: World Bank World Development Indicators, 1998

*/ The reference diamonds to which 1995 indicators for Sri Lanka are compared have been scaled in such a way so that the four indicators are equal (and normalized to a value of 1). Points outside the reference diamonds indicate the country's relative progress over time (left diamond) or its position relative to the group's average.

1.7 When compared to other countries in the South Asia region, Sri Lanka's economy grew fast through the 1980s. But its performance was disappointing when compared to that of the East Asian countries with which Sri Lanka shared initial conditions in the 1950s and 1960s and to which it aspires to catch up. The highest sustained GDP annual growth (at around 5 percent) in Sri Lanka's history coincided with the first economic reform period (1977-82) and was propelled by a massive rise in public investment, including by state enterprises. As national savings and foreign aid remained stagnant, the budget deficit rose sharply (see Table 1.1). In parallel, external imbalances grew, with the current account deficit moving from less than 2 percent of GDP to above 5 percent. External debt almost tripled in 1980-89, to reach US$5.2

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2 The Gini coefficient was estimated at a low 0.30 in 1990, down from 0.46-0.50 in 1953 (from the 1997 WDR for 1990 estimates and from Central Bank of Ceylon, Report on Consumer Finances, for 1953 estimates).

3 See *Women in Sri Lanka - A Country Profile,* Statistical Profile No. 13, United Nations, New York, 1997.

billion. These imbalances contributed to a considerable slow-down in GDP growth during 1983-88, to a low of 3 percent.

1.8 At the root of the lackluster economic performance in the 1980s were the cost of civil war and political instability, a shortage of entrepreneurial talent, elected governments committed to the transfer role of the state, poor decision making capacity, lack of regional growth synergies, and the inherent complexity of transforming a plantation economy into a modern and diversified one. Furthermore, the composition of GDP had changed very little, with agriculture and industry accounting for about 26 percent of GDP each.

1.9 A renewed commitment to structural policy reforms after 1989 paid off, as growth performance improved substantially in the 1990s. During the most recent three-year period, 1995-97, annualized GDP growth reached above 5 percent and, thanks to real exchange rate stability and a low population growth rate of 1.2 percent, GNP per capita increased by 27 percent to US$814. Exports have performed well (doubling in both nominal dollar and real terms between 1990 and 1997) and the economy is very open (exports and imports represent 75 percent of GDP). The agriculture sector, however, which still provides 50 percent of employment, grew only at an annualized 2 percent rate. This modest performance is in large part due to continuing uncertainty of land titles and distortive interventions by the public sector in agricultural input and output markets.

Table 1.1: Key Economic Performance Indicators
(period averages and percent of GDP, unless otherwise noted)

	1970-76 [7 yrs.]	*1977-82 [6 yrs.]*	*1983-88 [6 yrs.]*	*1989-94 [6 yrs.]*	*1995-97 [3 yrs.]*
GNP per Capita (US$, end of period)	$300	$330	$400	$640	$814
GDP Growth (%, annualized rate)	3.3	5.1	3.0	3.9	5.1
Savings (Gross Domestic)	12.8	13.7	13.5	14.3	15.7
Investment (Gross Domestic)	16.4	25.4	24.5	24.0	25.2
Budget Deficit (after ext. grants)	-6.1	-12.3	-9.8	-7.7	-8.1
Interest Payments (% of expenditure)	9.8	11.2	16.0	21.6	20.7
Inflation (CPI % growth)	6.4	13.2	10.3	12.8	11.8

Source: World Bank World Development Indicators, 1998

But Sustainability Of Recent Growth Rates Requires Further Reforms...

1.10 The country's achievements remain below its ambitions, due mainly to the continuing heavy human and financial toll of the civil war and the slow implementation of reforms in the public sector. The ever present risk of fiscal indiscipline, low public savings, and a record of lukewarm interest by foreign investors continue to cast a cloud on the sustainability of the country's recent growth rates. Large expenditures on security (which reached a record level of 5.8 percent of GDP in 1996), on servicing domestic debt, on an overly generous pension system for public servants, and on a large wage bill continue to exert heavy pressures on fiscal and external balances (with deficits after grants averaging 8 and 4 percent of GDP, respectively, in 1995-97) and crowd out other recurrent and capital expenditures. Moreover, the economy remains highly dependent on a few products: garments, tea, rubber, gem exports and tourism. Given also the trend of steadily declining aid (from above 10 percent of GNP in 1991 to less than 4 percent in recent years), sustainability of the country's growth performance will require further reforms to strengthen the structural fiscal balance and to attract foreign investment to diversify the economic base.

....And Faster Relative Progress In Institutional Development

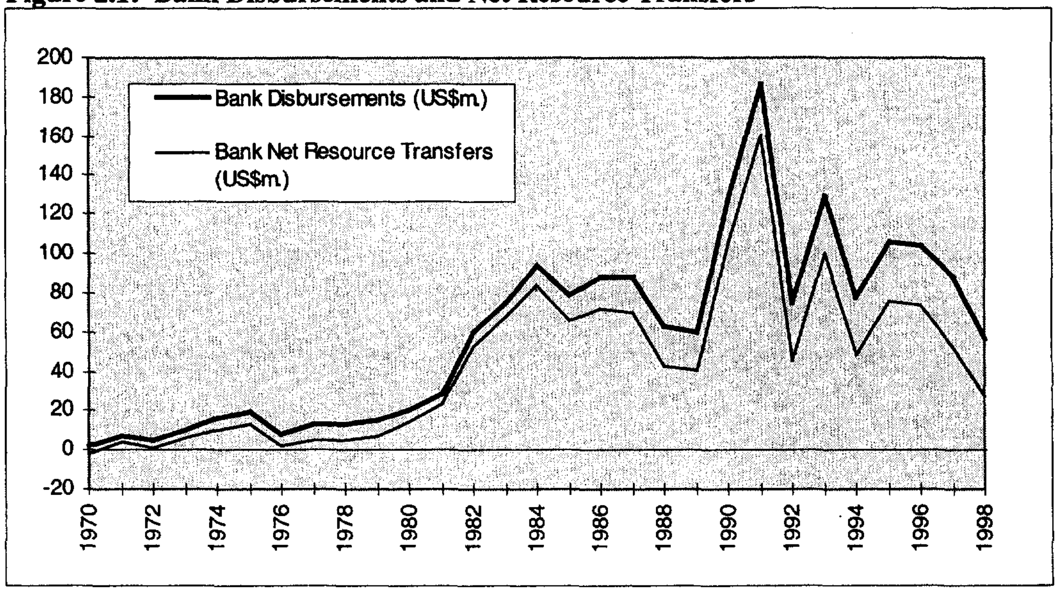
1.11 In 1998, surveys of policy and institutional quality among international investors and analysts placed Sri Lanka in the second top quintile among developing countries (together with regional neighbors Bhutan, Thailand, India and Bangladesh, and not too far below China and the Philippines), the same ranking of previous years. The country's rating is pulled down largely by poor accountability in the inefficient and overbloated civil service, perceptions of a still uncertain commitment to structural reforms and weak environmental regulations and enforcement, in addition to poor fiscal management.

2. Bank Assistance in the 1990s

Poverty Alleviation Became An Important Objective Of Bank Assistance

2.1 Bank lending was consistent with its analytical work and policy recommendations, which emphasized growth and questioned the size and efficiency of the very large budgetary transfers in reducing poverty. [4] Its assistance expanded heavily in support of the market-oriented reforms adopted since 1977.

Figure 2.1: Bank Disbursements and Net Resource Transfers



2.2 The Bank's strategy shifted in the late 1980s from primary concern with growth as the objective and investment as the instrument, to a greater emphasis on poverty alleviation as the main objective and a combination of policy reform, institutional change and investment as the instruments. Given the Government's strong commitment to the outstanding reform agenda, the Bank was right to offer structural adjustment lending, although an earlier OED country study had recommended only opportunistic sectoral lending tied to progress on sectoral reforms [5].

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4 The Bank argued that while welfare transfers might meet basic needs in the short term, their financing were slowing growth. Over the longer term inadequate growth would endanger welfare measures, since a stagnant economy could not afford to finance them.

5 *The World Bank and Sri Lanka: A Review Of A Relationship,* OED, February 1986 (Report No. 6074) recommended that the Bank concentrate its lending and non-lending services on a few key current and future problem areas (e.g.. tree crops, manufacturing), while at the same time tying the size of its total lending program and its donor coordination efforts explicitly to policy changes in the targeted sectors. It also suggested reducing the extent of macroeconomic conditionality and abandoning attempts to negotiate a structural adjustment loan. Another set of recommendations was made to improve the effectiveness of interaction between the Government and the Bank, which included more efforts to work with dirigiste regimes, strengthen the Bank resident mission, expand Bank dialogue beyond the Ministry of Finance and Planning, less emphasis on general and known policy recommendations in favor of more in-depth economic and sector work, and reducing the frequency of rotation of Bank staff.

Throughout, Bank assistance aimed to accelerate the transition to an incentive-based, export-oriented market economy, while supporting the country's traditional deep commitment to social development.

2.3 Five consecutive Policy Framework Papers (PFPs) agreed upon with the IMF and the Bank between the late 1980s and 1995, and annual meeting by the Consultative Group of donors, provided a high degree of congruency among Bank and Government objectives and strategies, and allowed effective aid coordination. In a number of areas the Bank has yielded the lead donor role to other institutions willing and capable to fulfill that role. For example, in energy it has ceded leadership to the Asian Development Bank (whose gross disbursements have been about twice as large as the Bank in recent years). And USAID has taken the lead in capacity building in securities regulation. Throughout, donors emphasized that stabilization, structural reforms and peace were of the highest priority to put economic growth and poverty reduction on a more rapid and sustainable path. Some donors, nevertheless, continue to provide large financial resources without requiring the needed institutional changes encouraged by the multilateral banks.

The Results Of Adjustment Lending Were Positive, But With Shortcomings [6]

2.4 Under the PFPs umbrella, the Bank supported structural adjustment with two operations, an *Economic Restructuring Credit* (ERC, FY90-95 for US$117 million) and a *Public Manufacturing Enterprise Adjustment Credit* (PMEAC, FY91-97 for US$136 million). Other operations also provided technical assistance or support for regulatory and privatization activities. The Bank rightly operated on the belief that, even with the conflict lingering on, there was nonetheless room for reforms to strengthen macroeconomic management, openness, financial institutions, private sector development, safety nets and the civil service. It constantly reminded the Government of the reform agenda in its ESW (see list of ESW in Annex C, Table C.5), policy dialogue, and aid coordination activities, which have been timely, of good-quality and appreciated by successive governments.

2.5 By 1996, the Government had considerably liberalized and rationalized the investment, tax, trade and exchange regimes; had made substantial progress in commercialization and privatization of public enterprises; and had begun restructuring, privatizing and devolving to farmers' organizations parts of the giant irrigation and power authority (Mahaweli). An important factor in sustaining Sri Lanka's economic growth was financial sector reform during the previous decade, supported by IDA with a series of financial intermediary loans. The policy reforms helped liberalize the sector (including by allowing entry by foreign banks) and establish real positive interest rates, an auction market for Treasury securities, and a credit rating agency. Moreover, they supported the privatization of two leading development finance institutions. And beneficiary firms of the Bank-supported lending for small and medium industries expanded employment faster than non-beneficiaries. [7] During 1996-98, without an IMF program or Bank adjustment lending in place, the Government adopted a number of tax reforms, privatized the tea plantations, and took various steps to strengthen the performance of the two remaining state banks and banking supervision.

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6 See the *Performance Audit Report* for the ERC and the PMEAC, OED, July 1996 (Report No. 15820).

7 *World Bank Support for SMIs in Sri Lanka: An Impact Evaluation*, OED, 1997 (Report No. 16790).

Table 2.1: Macroeconomic Targets of the Policy Framework Paper, 1989-93 and Results 1993-97

Indicators (%)	*Realized 1989*	*Target 1993*	*Realized 1993*	*Target 1995*	*Realized 1995*	*Realized 1997*
Real GDP growth	2.3	About 5	6.9	About 5	5.5	6.4
Budget balance (% of GDP)	-12.5	About -8	-8.7	About -7	-10.1	-7.9
Inflation (CPI-based)	12	About 6	11.7	< 10	7.7	9.6
External CA Balance (% of GDP; before grants)	-7.1	About -5	-5.3	-5.4	-6.4	-2.8

Sources: PFPs, 1989-93 and 1993-95; and World Bank, Recent Economic Developments and Prospects, May 1998

2.6 These efforts, also involving assistance from IFC and FIAS, succeeded in opening the economy to competition and the private sector, and in restoring growth. But progress on stabilization was again undermined, as it had been during 1977-87, by an intensification of military operations following the collapse of peace talks in 1995. The Government's determination to press ahead with structural reforms slackened and economic conditions deteriorated in 1996. Good weather, improvements in the terms of trade, corrective measures taken by the Government and a rebound of investors' confidence contributed to a substantial improvement of economic and financial conditions in 1997-98.

2.7 Although both outcome and sustainability ratings of the ERC and the PMEAC were positive, the institutional development impact of both operations was rated as modest. The privatization program did not extend to the two remaining state banks and raised questions of transparency and equity, which reduced public support for the program and contributed to slowing down its momentum in the mid-1990s. Only limited progress was achieved in rationalizing the social transfer program. And the attempt at civil service reform failed: its size continued to increase despite early retirements and retrenchments which allowed the most skilled civil servants to leave with generous separation packages. Mainly due to these shortcomings, Bank and Borrower performance in the ERC were both rated as unsatisfactory.

Bank Assistance for Poverty-Reduction Was Partly Ineffective

2.8 Activities under Bank operations in poverty alleviation, rural development, health and education likely had a positive impact on poverty, child malnutrition (which fell from 38% in 1987 to 33% in 1995) and unemployment (which declined from 14% in 1985-90 to 10% in 1997), but their direct impact remains nebulous for lack of clear a priori quantitative targets, ex-post measurements, and updated and disaggregated data on poverty and access to social services. Bank economists' own simulations suggested in 1995 that large gains in poverty reduction could be expected from the economic growth experienced during the 1990s and the Bank can certainly take some credit for its contribution to these improvements through its adjustment lending. The Bank is at present conducting a new poverty assessment, which will help in redefining a new strategy for poverty reduction.

2.9 Equity and equal access have always been emphasized by the Government in education and health, where substantial involvement by the Bank only started in the late 1980s. In education, however, in addition to problems of adequacy and efficiency of services, a Bank sector study in 1986 provided evidence of the existence of regional inequities. The Bank followed up with two general education projects, which aimed, among other goals, to reduce local disparities in the quality and financing of schools. Although the outcome of the first completed project (FY90-97) was rated satisfactory, Bank sector studies were still reporting wide discrepancies in 1995 in resource allocation per student between smaller and larger schools, and among provinces. [8]

2.10 Similarly in health, the Bank has focused on improving institutional capacity, quality of, and access by the poor to, services, and on addressing second generation health issues typical of more advanced countries with aging populations. An ongoing health services project include community-based nutrition programs targeted to mothers and children, including those on the estates--where the rate of malnutrition is double the national average (none of the other 13 ongoing projects have specific gender development goals or implications).

2.11 The Bank has analyzed candidly the reasons for the failure of the *Poverty Alleviation* project (FY90-98 for US$52 million). [9] The project was the first of its kind in Sri Lanka, based on a production-oriented, participatory poverty strategy in place of previous top-down, welfare-oriented poverty reduction approaches. At appraisal, the project was consistent with the Government's own strategy for poverty reduction, but its complex design hurt its implementation from the outset.

2.12 Furthermore, its close association with the Government's own highly politicized Janasaviya Program hurt its sustainability following the 1994 change of administration. The new administration, moreover, preferred to deliver assistance to the poor directly through government channels under its new Samurdhi program, rather than through the project's semi-autonomous apex body which contracted NGOs and private organizations (POs) to implement its poverty programs. Also, the combination of continuing Bank support for these programs in spite of their shortcomings until 1996 (when IDA stopped new commitments and canceled US$10 million of the original loan) and in spite of the limited progress achieved in the rationalization of general social transfers in the budget under the ERC may have undermined the chances for deeper reform of the entire system of social welfare programs.

2.13 The main objective of expanding institutional capacity to serve the poor was met only to a limited extent, partly due to poor knowledge transfer by the international consultants and to inadequate training. Insufficient entrepreneurship training undermined the success of the micro-enterprise development component. Only 37 percent of the 117,000 microenterprises established during the project life survived beyond three years (compared to a survival rate of 53 percent for small and medium size firms in Sri Lanka, above 70 percent in Colombia, Chile and Germany, and 80 percent in the Philippines) and net direct employment creation was only 40,000 jobs or about 23 percent of targets at appraisal. The objectives of the rural works component were also only partially met and sound maintenance arrangements had not been established for rural works facilities.

2.14 The activities of the nutrition fund, mostly aimed at women and children, were the most successful. Beneficiary targeting was sound, with benefits concentrated among the poorest members of village communities. The reliance on participatory approaches succeeded in enhancing nutrition awareness and improving feeding practices, as compared to previous

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8 See the World Bank's 1986 *Education and Training Sector Memorandum*, Vol. II, p. 32 (Report No. 5696-CE), the 1994 *Education And Training Sector Strategy Review* (p. 82-86, Report No. 12460-CE) and the 1995 *Poverty Assessment* (p. 53, Report No. 13431-CE).

9 See the excellent *Implementation Completion Report - Poverty Alleviation Project*, (Report No. 17998-CE) World Bank, 1998.

prescriptive approaches which had yielded insignificant results. In general, the mobilization efforts under the project enhanced social capital in low income communities. The participatory approaches used resulted in improved bargaining power and self-reliance among the poor, including women.

The Bank's Assistance Program Was Not Sufficiently Supportive Of Ethnic Harmony

2.15 External development agencies' ability to help ethnic harmony is limited. Nevertheless, conscious of its criticality for the sustainability of the country's development achievements, the Bank has struggled to find ways and opportunities to be more effective in this regard without overstepping its institutional mandate. The Bank made continuous references to the economic costs of the conflict in its ESW and policy dialogue; financed in the late 1980s an emergency reconstruction operation during a window of opportunity; remained on a stand-by for financing a large-scale reconstruction program since; is currently providing support for very small-scale irrigation rehabilitation activities in the conflict areas; is looking at the issue of youth unemployment under an ongoing labor market study; and plans to explore the impact on poverty of ethnic variations in access to social services and employment opportunities.

2.16 Moreover, it has recently begun to address in the education sector the system of de-facto language and curriculum segregation. [10] The *Second General Education* project (approved in FY98 for US$70 million) supports initial steps to boost the teaching of English and to revise textbooks and curriculum, with the multiple goals of helping international competitiveness, social equity and ethnic harmony.

2.17 The conflict areas of the North and East, where the Tamil-speaking population lives, however, did not benefit from Bank-supported projects (in fact, through the early 1980s, the Bank actually supported unbalanced resettlement and irrigation investments). The *Emergency Reconstruction* project (FY88-94) failed due to the intensification of the conflict, but a critical delay of ten months between approval and effectiveness and the lack of local participation in the formulation and implementation of the reconstruction program were contributing factors to its failure. [11]

2.18 In other areas also relevant for institutional development the Bank was absent. The Bank's recent policy dialogue in higher education focused on cost recovery and private sector entry, both very sensitive issues for the Government. It did not study the equity dimension of the mechanism of regional admission quotas to the monopolistic public university system, mainly because it was leery of addressing another controversial subject in a sector from which it had long been excluded. [12] Bank assistance also did not focus on municipal development and addressed only superficially the economic and institutional implications of the constitutional proposals for devolution.

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10 See *Sri Lanka - Social Services: A Review of Recent Trends and Issues*, p. ii, World Bank, April 1998 (Report No. 17748-CE); and Proceedings of the 1998 Consultative Group meeting.

11 See *The World Bank's Experience With Post-conflict Reconstruction*, vol. II, p. 136, OED, May 1998 (Report No. 17769), for a recent evaluation of Bank assistance to the Accelerated Mahaweli Development Program and to the reconstruction efforts of the late 1980s.

12 Some analysts think that the system of regional admission quotas to the monopolistic public university system has provided fuel to the ethnic conflict. See Tambiah, Stanley J., *Buddhism Betrayed?; Religion, Politics, And Violence In Sri Lanka*, Foreword by Jayawardena, Lal, p. 67, University of Chicago Press, May 1992.

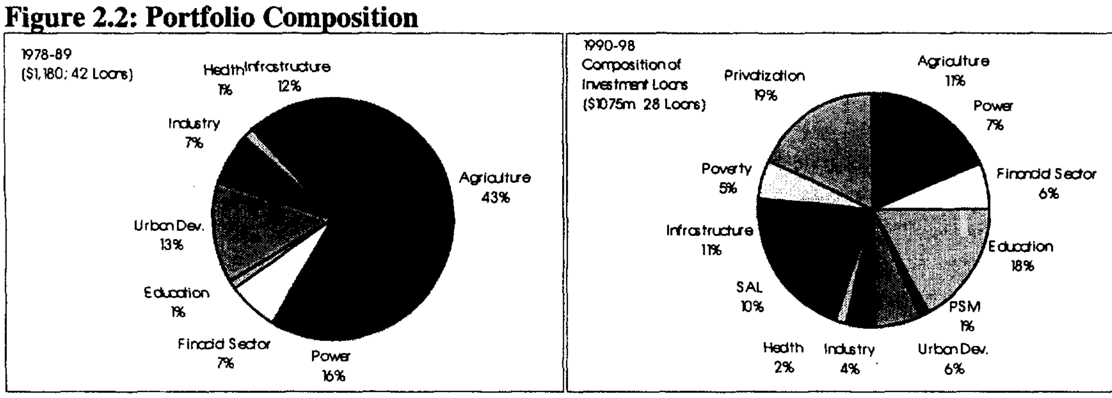
Bank Assistance For Infrastructure Development Had Mixed Results

2.19 Infrastructure development was and, with the exception of telecommunications, remains grossly inadequate. In some cases, indicators paint a poorer picture than in most Sub-Saharan African countries. The Bank had helped the country in the first half of the 1980s with a road project, five power projects and a telecommunications project. All received satisfactory outcome ratings. But in 1984 half of the paved roads were in poor condition. In 1990, local calls failed at the record rate of 65 percent (same as for Ethiopia and Madagascar) and electricity losses had increased to 17 percent from 15 percent in 1980.

2.20 The limited available data (from a World Bank database on infrastructure quality and from the 1998 WDI) suggest a worsening situation in the decade up to the mid-1990s. The only information on paved roads is that they expanded by 25 percent during 1991-96, although a second project was completed in 1991 (with satisfactory outcome) and a third project has been under supervision since 1991 (rated satisfactory as well). In 1995, the waiting list for telephone lines had increased to 238,000 from 48,000 in 1990, in spite of a second telecommunications project (FY91-98, yet to be rated). And as of 1996, in spite of three new power projects (two with satisfactory outcome ratings), electricity transmission and distribution losses had increased to 18 percent. This highlights the limitation of "objective-based" outcome ratings and the importance of additional rating categories, such as sustainability and institutional development impact, to better capture the project's development effectiveness (see para. 2.19 below). It also highlights the need for the Bank to assure adequate data to monitor sector wide performance.

2.21 Since the mid-1990s, however, the portfolio has been appropriately refocused to support institutional capacity building, private sector participation and privatization of public utilities. In telecom, where the Bank has an ongoing project to assist the regulatory agency, privatization and competition have improved the sector's performance dramatically. And in ports, where the Bank and IFC are also preparing to assist, private investment has already been committed to major expansion and rehabilitation efforts.

Figure 2.2: Portfolio Composition



Portfolio Performance Is Only Average

2.22 In the last ten years (FY89 through October 17, 1998), the Bank approved 28 credits amounting to $1.075 billion. Its annual assistance has been in the $120 million range. IFC's cumulative investment to date amounts to about $50 million. Lending composition shifted in the 1990s away from agriculture and power, and towards support for structural adjustment, general education and poverty alleviation. In the most recent 3-year period, in line with the 1996 CAS base case lending program, the Bank has approved 10 loans for $354 million, expanding its emphasis on education and the environment, and continuing support for privatization and irrigation infrastructure rehabilitation.

Table 2.2: OED Ratings of Completed Projects (FY94-98)

By exit year	*Rated Projects*	*Net Commitments US$*	*Satisfactory Outcome [%]*	*Likely Sustainability [%]*	*Substantial ID [%]*	*Average DEI*
Sri Lanka	17	739	71	53	18	6.32
SAR	144	15,229	67	47	28	6.19
EAP	180	19,119	84	67	42	7.20
Bank	1045	86,337	70	48	33	6.47
Bank w/o Africa	694	71,429	76	56	36	6.76
IDA/Blend	534	27,619	68	41	30	6.30
Top 5 IDA Countries						
Ethiopia	13	953	92	54	23	6.96
Bolivia	12	322	92	58	50	7.35
China	56	7,463	88	80	48	7.53
Benin	11	253	82	64	36	7.27
Ghana	19	854	79	53	37	6.76

Note: The Development Effectiveness Indicator (DEI) is a cardinal index, ranging from 2 to 10, which summarizes the project-specific ordinal ratings on Outcome, Sustainability and Institutional Development (ID) Impact (a score of 6.75 corresponds to a project with Satisfactory Outcome, Uncertain Sustainability and Modest ID impact). The average DEI in the Bank-wide portfolio (for all projects evaluated and rated since FY93) is 6.47, its standard deviation is 1.85.
Source: OED database.

2.23 During the last ten years (as of August 26, 1998), 73 percent of the 26 rated projects had a satisfactory outcome (three additional projects were canceled before implementation). Completed project performance in the last five years has deteriorated and does not compare well with the rest of the Bank. Satisfactory outcomes are about average, but, at 71 percent, are lower than for the Bank without Africa and for the top five IDA borrowers. Substantial institutional development impact has been extremely low, at 18 percent. The OED's Development Effectiveness Indicator (DEI) portrays a sub-par portfolio performance (Table 2.2). The worst performing sector is infrastructure (Annex C, Table C.2).

2.24 Contributing to these poor results were the Bank's failure to assure broad ownership between core and line agencies (e.g. in health) or between changing governments (e.g. in water supply and sanitation, municipal management, poverty alleviation), and to tailor projects' design to the institutional capabilities of the implementing agencies (e.g. in irrigation and in poverty alleviation). Cost indicators for new lending, supervision, and ESW work are in line with comparator countries and regions (see Annex C, Table C.4). Given the sub-par portfolio performance, however, the efficiency of Bank lending assistance appears low.

Table 2.3: Performance of the Ongoing Portfolio *(as of October 21, 1998)*

Country/Group	*No. of Projects*	*Commitment US$m.*	*Projects at Risk [%]*	*Commitment at Risk US$m*
Sri Lanka	14	551.7	14	18
SAR	154	19,176.2	25	19
EAP	273	34,825.3	27	23
LCR	326	27,566.7	19	15
Bankwide	1556	124,319.6	25	22

Source: World Bank, OPR Projects At Risk Tables

2.25 Supervision ratings for the current portfolio (as of October 1998) pointed to only two projects at risk (corresponding to 18 percent of commitments) out of a portfolio of 14 projects and $552 million, which is significantly better than every other region but Latin America and the Caribbean. The $25 million *Irrigation Rehabilitation* project, approved in FY91 and due to be closed at end 1998, suffers from serious institutional shortcomings and is unsatisfactory for both development objectives and implementation progress. The 2-year old, $77 million *Private Sector Infrastructure Development* project approved in 1996, on the other hand, has since suffered from unsatisfactory implementation, due to lack of interest by the line agencies targeted at appraisal (e.g., in power). The Government's core agencies and the Bank, nonetheless, remain hopeful that the project will begin proving its usefulness in other areas (e.g. ports).

2.26 A recent Bank supervision mission of the *Teacher Education and Teacher Development* (TETD) and the *Second General Education* (GEP II) projects, however, found political interference in teacher appointment. [13] As a result, both TETD and GEP II have been rated unsatisfactory for development objectives (and the TETD also for implementation). Moreover, the very high disconnect ratio with completion ratings for the last five years (at 24 percent, see Annex C, Table C.1) calls for caution in relying on supervision ratings in assessing the health of the current portfolio.

Development Effectiveness Of Bank Assistance Has Been Marginally Satisfactory

2.27 Overall, the Bank country assistance had a satisfactory outcome. Sectoral-level results of Bank assistance are mixed (e.g., in infrastructure) and not all of what the Bank set out to change in the policy and institutional framework got done. But what was done proved sufficient to propel the country's growth and poverty reduction in the 1990s at a substantial speed. Sustainability of the development achievements generated by the Bank country assistance strategy is likely, as the Government is close to adopting a new comprehensive reform program. The development effectiveness of overall Bank assistance, however, is rated as marginally satisfactory, as its institutional development impact has been only modest. [14]

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[13] The Government has hired as teachers in recent months 12,000 untrained young people, including village mobilizers of the Samurdhi anti-poverty program, a repeat of past practice associated with a deterioration in educational achievements beyond enrollment and basic literacy.

[14] The *1998 Annual Review Of Development Effectiveness (ARDE),* OED, November 1998 (Report No. 18630), pp. 9-17 discusses the merits of a composite rating of development effectiveness that integrates standard OED measures of outcomes, sustainability and institutional development impact at

Bank And Borrower Performance Have Also Been Marginally Satisfactory

2.28 On the positive side, during difficult years of civil strife, the Bank supported effectively the overall reform agenda in the late 1980s and early 1990s and provided effective aid coordination. In the mid-1990s, it contributed to preventing a major policy reversal. Since 1996, in light of the slow-down in the reform momentum, the Bank timely adopted a "base case" assistance mode, avoided new adjustment lending and major new projects in sectors with poor commitment to reforms, while continuing technical assistance, ESW and policy dialogue.

2.29 The relevance of Bank assistance, however, was diminished by insufficient support for ethnic harmony. The main poverty-reduction operation was faulty in design and implementation. The design of the civil service component in adjustment lending was also faulty. Due to fear of offending political sensitivities, the Bank has been at times too cautious in publicizing its views (e.g. cost recovery and private entry in tertiary education). Moreover, Bank performance was also rated unsatisfactory in 6 projects of the 29 rated projects completed in FY89-98, equivalent to 27 percent of commitments (2 projects, though, still achieved a satisfactory outcome; see Annex C, Table C.3). In light of the shortcomings noted above, Bank performance is rated as marginally satisfactory.

2.30 Borrower's performance is also rated as marginally satisfactory, as the Government's commitment to macro stabilization and structural reforms was inadequate to maintain a steady and strong pace of policy and institutional improvements. In addition, unsatisfactory Borrower performance affected 5 of the 23 projects rated and completed in FY91-98, equivalent to 27 percent of commitments.

Box 2.1: Views from Regional Bank Staff

In its comments, the Region noted that the CAE's tone and emphasis fails to reflect adequately the impact of the civil conflict and the 1994 presidential elections on the reform program and the Bank assistance strategy. The Region also stressed that the present administration, after an initial period of fiscal indiscipline and indecisiveness on structural reforms, resumed the reform program, and that the Bank played a substantial role in this process.

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the project level. The same conceptual framework has been applied here to evaluate the Bank country assistance.

3. Preparing To Support Sri Lanka's Economic Take-off

3.1 Sri Lanka's development experience holds three important lessons for the Bank and for other countries. First, countries with deep-rooted commitment to human capital development and equity can achieve substantial gains over the long-term in social sector indicators, even if institutions and policies are sub-optimal for economic growth. But when coupled with structural reforms, the impact of such commitment on poverty reduction and economic growth is magnified, social costs of adjustment are minimized and mitigated, and sustainability of both social and economic gains is strengthened. However, protracted civil strife exerts a powerful negative influence on economic performance, through its direct human and financial costs, as well as through the large uncertainty it creates about protection of property rights and personal security.

3.2 Completion of the structural reform agenda and a resolution of the conflict in the North and the East are the key missing elements for Sri Lanka to accelerate growth and achieve further poverty reduction. Bank assistance should help overcome both these constraints. Narrowly targeted interventions may still be required, but only to address the few pockets of deep poverty remaining. Sri Lanka women are well placed to benefit from broad-based growth, given their social status, educational levels, skills, and their accumulated savings and earnings from overseas and factory employment.

3.3 Bank assistance should support key reforms to would improve the structural fiscal balance and efficiency of public services, enhance private sector development, foster continuing human and social development, and prevent land and coastal environmental degradation. These include:

- pension reform, further consolidation and better targeting of safety nets, public employment reduction, better accountability and results orientation of the public service, decentralization;
- privatization of the two remaining state banks, expansion of infrastructure including with private sector participation, land reform and full liberalization of agricultural markets;
- reforming the legal framework for private higher education, strengthening the institutional capacity of line agencies to deliver quality educational services;
- addressing the poor sanitation conditions, the poor nutritional status of children, and second generation health issues typical of countries with aging populations; and
- strengthening the regulatory institutions for environment protection and relying more on economic incentives than on administrative enforcement.

3.4 The 1996 CAS priorities and scenarios remain valid. If Sri Lanka were to commit to a medium-term reform program, Bank assistance should move from the current base case to the high case scenario, relying mostly on sector and adjustment operations. If risks to macroeconomic stabilization and slow progress on structural reforms were to persist, Bank assistance should instead remain in its current base case scenario. Even so, the Bank should maintain its analytical work and policy dialogue, and expand the use of lending instruments that foster private sector investments within a sound regulatory environment (e.g., guarantees, financial intermediary loans). Lending assistance should continue to be linked to progress towards strong policy and institutional frameworks (e.g., environment, privatization, education), to the exclusion of sectors without a strong government commitment to, and popular support for, the needed reforms (e.g., agriculture, energy).

3.5 The Government is aware of the need to accelerate the pace of the economic and social reforms, but its commitment is constrained by a difficult political and security environment and the ongoing debate on the proposed constitutional changes for greater devolution. In support of the Government's efforts at peace building and strengthening ethnic harmony, the Bank should analyze the economic and institutional implications of the constitutional proposals for devolution with a major piece of ESW and use EDI-led workshops to inform the public on these issues. It should include technical assistance and demand-driven municipal development-type projects in its lending program. In education, it should intensify its support for boosting the supply of English-language teachers. It should also conduct a review of the public university system, including its admission policies, and disseminate its findings. [15]

3.6 Aid from donors has been declining since the early 1990s. Moreover, IDA eligibility beyond the next three years is less than assured, with the country's per capita income quickly approaching the IDA cut-off point, its low external debt service ratio, its high share and growth rate of exports, and IDA donors' resource constraints. Thus, the Bank should provide advice and technical assistance to strengthen the country's creditworthiness, while avoiding the pitfalls of high dependency on short-term capital inflows.

3.7 Finally, in light of the high disconnect between supervision and OED project ratings and past portfolio weaknesses, the Bank should review and monitor carefully the performance and the results on the ground of its ongoing portfolio. It should also help the Government implement its own recently-adopted guidelines to assure efficiency as well as transparency in procurement.

Box 3.1 - Government's Views

Senior government officials agreed with the thrust of the preliminary evaluation findings and recommendations discussed during an OED field mission in August 1998.

Most officials, however, objected to the early note's characterization of a weak government commitment to reforms and also of a fragile macroeconomic situation in recent years. They pointed to the quick correction in the fiscal stance in early 1996 as an example of commitment to macroeconomic stabilization and to a number of reforms introduced since (e.g., sharply reduced interventions in agricultural marketing, tax reform, tough performance contracts signed with the management of the two state banks, privatization of the tea plantations) as examples of strong government commitment to the structural reform agenda, even in the absence of Fund- and Bank-supported programs. Thus, these officials objected to the early note's recommendation of reducing Bank lending if current conditions were to continue. They emphasized that soon after the upcoming elections the Government intends to conclude an agreement with both institutions, and that there remain no substantial differences of views as to the thrust of the reforms, but only about their sequencing and pace.

While officials were appreciative of the Bank and other donors' substantive assistance with lending, economic and sector work, and donor coordination, the view was expressed that the Government, not donors, should take the lead in aid coordination, at both the country and the sector level.

On policies that affect peace and ethnic harmony, officials stressed the Government's commitment to devolution through constitutional changes. Most expressed support for expanding the use of the English language and for reviewing curricula and the system of university access. An alternative view was put forward that the conflict had its root not in ethnic politics, but in demographic and labor market developments cutting across ethnic groups and negatively impacting youth employment prospects. In this view, only growth and employment-generation offer solutions for peace.

15 This work should expand on a recently prepared note of comments by the Bank on a Government commission's review of the public university system.

ANNEXES

ANNEX A

Recent Political and Economic Timeline

- *August 1994* - The UNP loses the general elections to the SLPA, led by Ms. Kumaratunga, on the strength of their promise of negotiating peace, raising social expenditures, restoring popular subsidies and worker's rights.
- *February 1995* - The leader of the LTTE personally attend peace talks with the Government, signaling a new commitment to the peace process.
- *March 1995* - Ms. Kamaratunga tables new proposals in an effort to resume stalled peace negotiations and a new budget for 1995, aiming at reducing the budget deficit and encouraging investment through privatization and other incentives. However, uncertainty over the Government's relative commitment to promised market reforms and to its electoral pledges on social welfare is exacerbated by open divisions within the cabinet and the ruling SLPA.
- *June 1995* - The Government's economic strategy is thrown into disarray by the breakdown of peace talks and the renewal of military conflict with the LTTE.
- *August 1995* - The Government puts forward proposals for a new constitution that would radically devolve most powers (in all but foreign affairs, defense), to provincial councils. These proposals, however, could not yet (as of July 1998) master the two thirds parliamentary majority required for their adoption.
- *Fall-1995* - The Kumaratunga's administration decides to intensify the war against the LTTE.
- *December 1995* - The LTTE loses the northern regional capital, Jaffna, to the Government.
- *April 1996* - The Government extends the state of emergency to the whole of the country, in an attempt to isolate.
- *November 1996* - The fiscal 1997 budget seeks to stabilize a deteriorating economy, marked by escalating military expenditures, loss of foreign confidence and the effects of a serious drought. The budget includes tax and other reforms designed to bolster domestic and foreign investment.
- *January 1997* - Civil war battles continue in the North.
- *March 1997* - The ruling SLPA wins decisively in local council elections. Both the ruling party and the opposition had treated these elections as a referendum on the national government's performance and on President Kumaratunga's proposals for peace and constitutional devolution. However, the conditions for an enduring peace remain far from being realized.
- *June 1997* - The Government is making steady, but as yet inconclusive, progress in its latest military offensive against the LTTE, with the effect of strengthening popular Sinhalese support for its devolution proposals.
- *September 1997* - President Kumaratunga proposes a referendum on constitutional reform in order to overcome the parliamentary impasse.
- *October 1997* - The LTTE step up attacks on the country's capital, Colombo, directly threatening foreign tourists and investors.
- *November 1997* - The 1998 budget seeks to consolidate recent improvements in economic conditions, by lowering at the same time defense expenditures, taxes and the budget deficit.
- *February 1998* - The opposition UNP rejects the Government's proposals for constitutional reform and puts forward an alternative proposal based on preserving the powers of the central government while increasing the representation of the minorities in ruling institutions and creating checks and balances against the abuse of power.

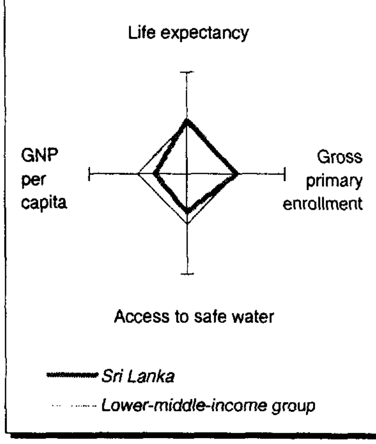
Source : Oxford Analytical briefs, various issues, 1995 through 1998.

Sri Lanka at a glance

10/1/98

POVERTY and SOCIAL	Sri Lanka	South Asia	Lower-middle-income
1997			
Population, mid-year *(millions)*	18.5	1,289	2,285
GNP per capita *(Atlas method, US$)*	800	390	1,230
GNP *(Atlas method, US$ billions)*	14.8	502	2,818
Average annual growth, 1991-97			
Population *(%)*	1.2	1.9	1.2
Labor force *(%)*	1.8	2.2	1.3
Most recent estimate (latest year available, 1991-97)			
Poverty *(% of population below national poverty line)*	22	..	..
Urban population *(% of total population)*	23	27	42
Life expectancy at birth *(years)*	72	62	69
Infant mortality *(per 1,000 live births)*	16	71	36
Child malnutrition *(% of children under 5)*	38	63	..
Access to safe water *(% of population)*	64	77	84
Illiteracy *(% of population age 15+)*	10	51	19
Gross primary enrollment *(% of school-age population)*	113	99	111
Male	114	109	116
Female	112	89	113

Development diamond*

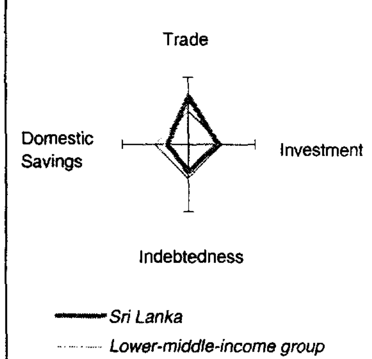


KEY ECONOMIC RATIOS and LONG-TERM TRENDS

	1976	1986	1996	1997
GDP *(US$ billions)*	3.6	6.4	13.8	14.8
Gross domestic investment/GDP	16.2	23.7	24.2	24.4
Exports of goods and services/GDP	29.0	23.7	35.0	36.5
Gross domestic savings/GDP	13.9	12.0	15.3	17.3
Gross national savings/GDP	14.8	19.0	19.0	21.4
Current account balance/GDP	-0.2	-6.5	-4.9	-2.6
Interest payments/GDP	0.6	1.9	2.1	1.8
Total debt/GDP	25.9	63.7	67.5	61.0
Total debt service/exports	24.4	20.9	13.6	16.2
Present value of debt/GDP	..	..	37.9	..
Present value of debt/exports	..	..	89.7	..

	1976-86	1987-97	1996	1997	1998-02
(average annual growth)					
GDP	5.3	5.0	3.8	6.4	..
GNP per capita	3.8	2.8	2.1	5.8	..
Exports of goods and services	4.7	9.1	3.2	11.6	..

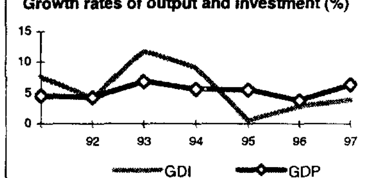
Economic ratios*



STRUCTURE of the ECONOMY

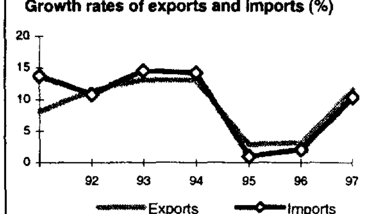
	1976	1986	1996	1997
(% of GDP)				
Agriculture	29.0	27.1	22.4	21.9
Industry	27.1	26.6	25.1	25.5
Manufacturing	20.0	15.2	16.2	16.4
Services	43.9	46.3	52.4	52.6
Private consumption	76.1	77.7	74.1	72.3
General government consumption	10.0	10.3	10.5	10.4
Imports of goods and services	31.4	35.3	43.9	43.5

Growth rates of output and investment (%)



	1976-86	1987-97	1996	1997
(average annual growth)				
Agriculture	4.2	2.1	-4.6	3.1
Industry	4.9	6.1	6.0	7.9
Manufacturing	4.8	8.2	6.5	9.3
Services	6.7	5.6	5.8	6.8
Private consumption	6.2	4.9	1.7	6.6
General government consumption	6.1	5.6	18.6	10.3
Gross domestic investment	10.0	4.0	2.8	4.0
Imports of goods and services	9.9	7.1	2.1	10.5
Gross national product	5.4	4.0	3.2	6.9

Growth rates of exports and imports (%)



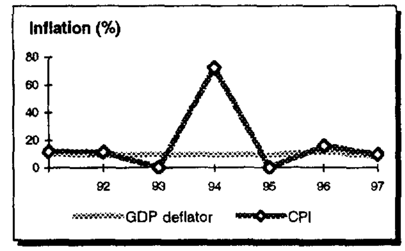
Note: 1997 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

Sri Lanka

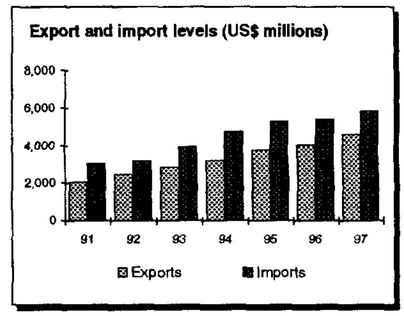
PRICES and GOVERNMENT FINANCE

	1976	1986	1996	1997
Domestic prices				
(% change)				
Consumer prices	..	8.0	15.9	9.6
Implicit GDP deflator	10.0	5.9	12.1	8.5
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	20.7	19.9	19.4
Current budget balance	..	1.8	-2.9	-1.4
Overall surplus/deficit	..	-12.2	-8.5	-7.1



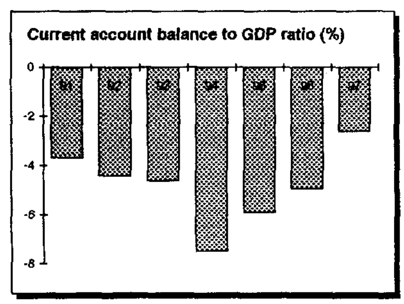
TRADE

	1976	1986	1996	1997
(US$ millions)				
Total exports (fob)	..	1,216	4,095	4,639
Tea	..	330	615	719
Other agricultural goods	..	94	346	341
Manufactures	..	223	2,989	3,422
Total imports (cif)	..	1,947	5,438	5,852
Food	..	241	801	781
Fuel and energy	..	225	479	539
Capital goods	..	377	1,204	1,325
Export price index *(1995=100)*	..	84	103	106
Import price index *(1995=100)*	..	63	103	105
Terms of trade *(1995=100)*	..	132	100	100



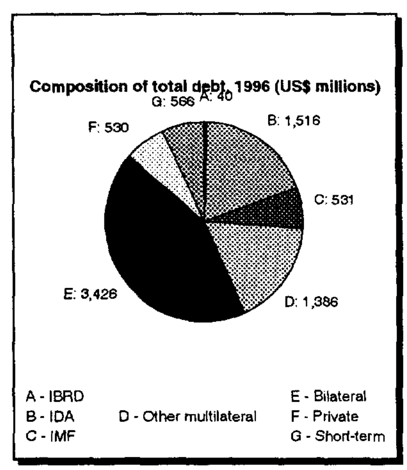
BALANCE of PAYMENTS

	1976	1986	1996	1997
(US$ millions)				
Exports of goods and services	632	1,514	4,861	5,514
Imports of goods and services	683	2,264	6,099	6,568
Resource balance	-51	-750	-1,239	-1,054
Net income	-20	-138	-203	-165
Net current transfers	65	471	759	831
Current account balance	-6	-417	-683	-387
Financing items (net)	43	306	666	481
Changes in net reserves	-37	112	17	-94
Memo:				
Reserves including gold *(US$ millions)*	..	..	1,937	2,029
Conversion rate *(DEC, local/US$)*	8.4	28.0	55.5	60.0



EXTERNAL DEBT and RESOURCE FLOWS

	1976	1986	1996	1997
(US$ millions)				
Total debt outstanding and disbursed	930	4,083	7,995	..
IBRD	36	72	40	31
IDA	44	498	1,516	1,514
Total debt service	158	399	427	..
IBRD	6	12	11	9
IDA	0	5	20	22
Composition of net resource flows				
Official grants	59	175	147	..
Official creditors	85	349	304	..
Private creditors	12	10	-67	..
Foreign direct investment	0	30	120	..
Portfolio equity	0	0	70	..
World Bank program				
Commitments	0	137	156	128
Disbursements	8	88	104	78
Principal repayments	4	6	16	16
Net flows	5	82	89	62
Interest payments	3	11	15	14
Net transfers	2	72	73	48



SUMMARY OF PROJECT INFORMATION: SRI LANKA

TOTAL APPROVED PROJECTS*	Number	Percent	Value $m	Percent
Adjustment Loans	6	7%	247.4	10%
Non-Adjustment Loans	79	93%	2205.5	90%
TOTAL	85	100%	2452.9	100%

OED OUTCOME RATINGS	Number	Percent	Value $m	Percent
Satisfactory Outcome				
Adjustment Loans	3	100%	245.3	100%
Non-Adjustment Loans	42	78%	793.3	69%
Total	45	79%	1038.6	75%
Unsatisfactory Outcome				
Adjustment Loans	0	0%	0	0%
Non-Adjustment Loans	12	22%	350.3	31%
Total	12	21%	350.3	25%
TOTAL RATED	57		1388.8	

OED SUSTAINABILITY RATINGS	Number	Percent	Value $m	Percent
Likely Sustainability				
Adjustment Loans	1	50%	125.0	54%
Non-Adjustment Loans	17	49%	495.0	55%
Total Likely Sustainability	18	49%	620.0	54%
Uncertain Sustainability				
Adjustment Loans	1	50%	105	46%
Non-Adjustment Loans	14	40%	295.6	33%
Total Uncertain Sustainability	15	41%	401.0	35%
Unlikely Sustainability				
Adjustment Loans	0	0%	0	0%
Non-Adjustment Loans	4	11%	116.9	13%
Total Unlikely Sustainability	4	11%	116.9	10%
TOTAL RATED	37	100%	1137.9	100%

OED INSTITUTIONAL DEVELOPMENT RATINGS	Number	Percent	Value $m	Percent
Substantial ID				
Adjustment Loans	0	0%	0.0	0%
Non-Adjustment Loans	10	29%	189.9	22%
Total Substantial ID	10	27%	189.9	17%
Moderate ID				
Adjustment Loans	1	50%	125.0	54%
Non-Adjustment Loans	18	51%	483.5	56%
Total Moderate ID	19	51%	608.4	56%
Negligible ID				
Adjustment Loans	1	50%	105	46%
Non-Adjustment Loans	7	20%	183	21%
Total Negligible ID	8	22%	289	27%
TOTAL RATED	37	100%	1087.0	100%

TOTAL APPROVED PROJECTS, BY PERIOD (FY)				
Period	*Number*	*Percent*	*Value $m*	*Percent*
1954-1982	39	46%	759.2	31%
1983-1986	12	14%	318.1	13%
1987-1990	11	13%	457.2	19%
1991-1999*	23	27%	918.4	37%
TOTAL	85	100%	2452.9	100%

OED SATISFACTORY OUTCOME RATINGS BY PERIOD**	Loans Rated	% Satisfact.	Value $m	% Satisfact.
1954-1982				
Adjustment Loans	1	100%	15.0	100%
Non-Adjustment Loans	33	79%	587.7	67%
Period Total	34	79%	602.7	67%
1983-1986				
Adjustment Loans	0	#DIV/0!	0.0	#DIV/0!
Non-Adjustment Loans	9	78%	198.2	76%
Period Total	9	78%	198.2	76%
1987-1990				
Adjustment Loans	1	100%	105.3	100%
Non-Adjustment Loans	10	80%	265.1	78%
Period Total	11	82%	370.4	84%
1991-1999				
Adjustment Loans	1	100%	125.0	100%
Non-Adjustment Loans	2	50%	92.6	48%
Period Total	3	67%	217.5	78%
All:1954-1999				
Adjustment Loans	3	100%	245.3	100%
Non-Adjustment Loans	54	78%	1143.5	69%
TOTAL RATED	57	79%	1388.8	75%

ARPP RATINGS OF ONGOING PROJECTS	Number	Percent	Value $m	Percent
Development Objectives				
Satisfactory	11	85%	393.0	79%
Unsatisfactory	2	15%	101.7	21%
TOTAL	13	100%	494.7	100%
Implementation Progress				
Satisfactory	12	92%	470.0	95%
Unsatisfactory	1	8%	24.7	5%
TOTAL	13	100%	494.7	100%

DISCONNECT FOR SRI LANKA				
No. of projects		*ARPP % Sat*	*OED % Sat*	*Net disc. at exit**
Since FY80:	47	94%	77%	17%
Last 5 FYs:	17	94%	70%	24%

(*) The net disconnect (based on ARPP FY exit) is an indication of the optimism in supervision ratings. The number of projects for which both the OED and ARPP ratings are available may differ from the total number of projects evaluated by OED.

*Through September 1998.
**Based on FY of Board approval.
Note: includes projects evaluated through August 26, 1998.
Sources: OED, FDB, OIS.

Table C.2: Development Effectiveness Indicator (DEI)

(Weighted by net disbursements, in FY96 US$, standard deviation in parentheses)

	ESSD	FPSI	HD	PREM	All Sectors
Sri Lanka (FY 92-95)	5.885	6.267	n/a	5.500	5.964
	(1.057)	(1.270)	n/a	n/a	(1.085)
Sri Lanka (FY96-98)	6.579	4.000	6.311	7.512	6.612
	(0.512)	n/a	(1.089)	(0.439)	(1.297)
Sri Lanka (all FYs)	5.825	6.059	6.311	6.729	6.218
	(1.073)	(1.397)	(1.089)	(1.039)	(1.231)
EAP	7.213	7.411	7.578	8.389	7.462
	(1.622)	(1.453)	(1.490)	(1.618)	(1.524)
SAR	5.684	6.575	6.345	6.801	6.351
	(1.620)	(1.879)	(1.355)	(1.052)	(1.797)
Bank	6.564	6.586	6.959	7.235	6.717
	(1.757)	(1.901)	(1.549)	(1.877)	(1.864)

Note: The Development Effectiveness Indicator (DEI) is a cardinal index, ranging from 2 to 10, which summarizes the project-specific ordinal ratings on Outcome, Sustainability and Institutional Development (ID) Impact (a score of 6.75 corresponds to a project with Satisfactory Outcome, Uncertain Sustainability and Modest ID impact). The average DEI in the Bank-wide portfolio (for all projects evaluated and rated since FY93) is 6.47, its standard deviation is 1.85. Projects are grouped by year of evaluation.

TABLE C.3: LIST OF EVALUATED AND ONGOING PROJECTS (FY 1989-98)

Loan/Credit Nos.	Project Name	Commitment $m.	Net Commitment $m.	Approval FY	Exit FY	DEI	Outcome	Sustainability	ID	Bank Performance	Borrower Performance	QAG Rating	Last DO Rating	IP Rating	Completion Delay (in months)	Percentage Cancelled
	Agriculture					6.11										
Cr. 1079	SECOND RURAL DEVT.	33.50	48.22	1981	1990		S	UNC	SUB	S			1	2	48	11%
Cr. 1166	MAHAWELI GANGA III	90.00	117.04	1981	1992	5	U	LIK	MOD	S	S		2	2	48	19%
Cr. 1160	VILLAGE IRRIG. REHAB	30.00	34.71	1981	1991	4.5	U	UNC	MOD	S	S		1	2	48	28%
Cr. 1363	RURAL DEV III	23.00	3.90	1983	1990		NIMP		NEG	S			4	2		89%
Cr. 1317	FORESTY I	9.00	7.30	1983	1991		S	LIK	SUB	S			2	1	12	46%
Ln. 2437	MAHAWELI IV	12.10		1984												100%
Cr. 1494	MAHAWELI IV	30.00	0.04	1984	1990		NIMP		NEG	S			4	4		100%
Cr. 1537	IRRIG. REHAB	17.00	15.03	1985	1993	6	S	UNC	MOD	S	S		1	1	24	35%
Ln. 2576	DAIRY II	38.00	0.00	1985	1989		NRAT			U			2	2		100%
Cr. 1562	TREE CROPS IV	55.00	74.58	1985	1992	7.25	S	LIK	MOD	S	S		1	2	18	0%
Cr. 1776	AGRIC. RESEARCH	18.60	17.92	1987	1997	6	S	UNC	MOD	S	S		S	S		21%
Cr. 1909	SMALLHOLDER RUBBER	23.50	15.02	1988	1997	6.75	S	UNC	MOD	S	S		S	S		45%
Cr. 2043	FORESTRY II	19.90	11.61	1989	1997	7.25	S	LIK	MOD	S	S		S	S	12	49%
Cr. 2260	IRRIG. REHAB.	29.60	24.66	1991	ONGOING							ACTUAL	U	U	18	17%
Cr. 2380	SECOND AGRIC.EXTENSION	14.34	14.34	1992	1998								U	U		0%
Cr. 3058	MAHAWELI RESTRUCTURING	57.00	57.00	1998	ONGOING							NONRISKY	NR	NR		
	Environment															
N0140	ENVIRONMENTAL ACTION	14.80	14.80	1997	ONGOING							NONRISKY	S	S		0%
	Education					7.5										
Cr. 1698	VOCATIONAL TRAINING	15.00	14.73	1986	1996	7.75	S	UNC	SUB	S	S		S	S	12	23%
Cr. 2072	GENERAL EDUCATION	49.00	54.48	1990	1997	7.25	S	LIK	MOD	S	S		S	S	12	0%
Cr. 2881	TEACH ED &DEPLOYMENT	64.10	64.10	1996	ONGOING							NONRISKY	S	S		0%
Cr. 3014	GENERAL EDUCATION II	70.30	70.30	1998	ONGOING							NONRISKY	S	S		0%
	Health					5										
Cr. 1903	HEALTH & POPULATION	17.50	12.75	1988	1996	5	U	LIK	MOD	U	U		S	S	12	38%
Cr. 2928	HEALTH SERVICES DEV	18.80	18.80	1997	ONGOING							NONRISKY	S	S		0%
	Social Assistance					5.25										
Cr. 2231	POVERTY ALLEVIATION	57.50	52.44	1991	1998	5.25	U	UNC	MOD	U	U		S	S	12	16%

Note: DO/IP rating (1 = HS; 2 = S, 3 = U; 4 = HU) -- these ratings are applicable for projects completed on/before 1993 only.

Loan/Credit Nos.	Project Name	Commitment $m.	Net Commitment $m.	Approval FY	Exit FY	DEI	Outcome	Sustainability	ID	Bank Performance	Borrower Performance	QAG Rating	Last DO Rating	IP Rating	Completion Delay (in months)	Percentage Cancelled
	Economic Management					5.5										
Cr. 2128	ECO. RESTRUCT. CREDI	106.60	117.12	1990	1995	5.5	S	UNC	NEG	U	U		S	S	6	1%
	Pub. Sec. Management And Privatization					7.25										
Cr. 2250	SMI IV	45.00	48.06	1991	1997	8.25	S	LIK	SUB	S	S		S	S	8	2%
Cr. 2185	PUBLIC MANUF. ENT AD	125.76	135.70	1991	1997	7.25	S	LIK	MOD	S	S		S	S	25	1%
Cr. 2880	PVT SECT INFRAS DEV	77.00	77.00	1996	ONGOING							ACTUAL	S	U		0%
Cr. 2837	TELECOM REG & PUBL..	15.00	15.00	1996	ONGOING							NONRISKY	S	HS		0%
	Financial Sector Development					7.25										
Cr. 1401	INDUSTRIAL DEVELOPME	25.00	35.90	1984	1989		S	LIK	SUB	S			2	2		0%
Cr. 1948	IDP III	43.80	47.03	1989	1995	7.25	S	LIK	MOD	S	S		S	S		6%
Cr. 2484	PRIVATE FINANCE DEVE	60.00	60.00	1993	ONGOING							NONRISKY	S	S		0%
	Small and Medium Industry					7.5										
Cr. 1692	IND. DEVELOP. II	20.00	25.07	1986	1994	8.25	S	LIK	SUB	S	S		S	S	6	2%
Cr. 1860	SMI III	20.00	22.42	1988	1993	6.75	S	UNC	MOD	S	S		1	2		4%
	Power & Energy					6.5										
Cr. 1736	POWER - DISTRIBUTION	52.00	49.35	1987	1994	6.5	S	LIK	MOD	U	U		S	S	24	22%
Cr. 1933	POWER DIST.& TRANSMI	40.50	22.23	1988	1995	6.5	S	LIK	MOD	S	S		S	S		53%
Cr. 2297	POWER DISTRIBUTION	50.00	50.00	1992	1998								S	U		0%
Cr. 2938	ENERGY SERVICES DLVY	24.20	24.20	1997	ONGOING							NONRISKY	S	S		0%
	Telecommunication															
Cr. 2249	TELECOMS. II	57.00	57.00	1991	1998								HS	S	24	0%
	Transportation and Highways					6.50										
Ln. 2517	SECOND ROADS PROJECT	24.00	32.54	1985	1991	6.5	S	LIK	MOD	S	S		2	2		0%
Cr. 2183	3RD ROADS	42.50	42.50	1991	ONGOING							NONRISKY	S	S	6	0%
Cr. 2495	COLOMBO URB TRANSPOR	20.00	20.00	1993	ONGOING							NONRISKY	S	S		0%
	Urban Development					4.38										
Cr. 1697	MUNICIPAL MANAGEMENT	13.00	12.91	1986	1995	4.25	U	UNL	MOD	S	S		S	S	12	22%
Cr. 1883	EMERGENCY RECONSTRUC	78.00	55.14	1988	1994	4.5	U	UNL	NEG	S	S		U	S	36	40%
Cr. 2757	COL. ENV. IMPROV.	39.00	39.00	1995	ONGOING							NONRISKY	S	S		0%
	Urban Water Supply					4										
Cr. 1700	WATER SUP.& SANITATI	37.00	47.24	1986	1996	4	U	UNC	NEG	U	U		U	S	12	0%
Cr. 2442	COMMUNITY WAT SUPP/S	24.30	24.30	1993	ONGOING							NONRISKY	S	S		0%

TABLE C.4: COUNTRY ASSISTANCE COST INDICATORS - 1994-97 Average

									Client Services (Admin. Budget)		
	Projects Supervised [% of Total]	Disbursement Ratio (inv.)	Average Completion Costs - Staff Years per Projects	Average Completion Costs - $ per Projects	Supervision Intensity - Staff Weeks per Project	Supervision Intensity - $ per Project	Dropped SWs per ESW Report	Dropped SWs per Sector Report	Lending	Supervision	Economic & Sector Work
Sri Lanka	1.3	17.7	2.4	313,906	16.1	47,564	28.9	9.6	1.0%	1.1%	1.1%
Pakistan	2.6	18.8	2.4	355,730	23.7	57,339	23.4	22.3	2.0%	3.2%	2.2%
Philippines	1.7	20.5	2.4	412,296	15.5	47,800	11.3	0	1.4%	1.4%	1.1%
SAR	12.3	16.8	3.1	447,374	23.9	57,471	24.5	111.6	11.3%	15.7%	13.9%
EAP	17.2	22.7	2.3	375,294	14.5	44,564	10.8	10.8	14.6%	13.5%	14.0%
Bank-wide	100	18.5	2.3	344,518	18.5	53,707	30.7	28.7	100%	100%	100%

Table C.5: List of Economic and Sector Work (ESW)

Report Title	Report Type	Date	Report No.
Agriculture (3)			
Nonplantation crop sector policy alternatives	SR	03/20/96	14564
Tree crops strategy	SR	07/05/94	12356
Strategic issues in the development of Sri Lanka's agricultural sector	SR	02/01/91	8229
Education (1)			
Education and training sector strategy review	SR	06/27/94	12460
Environment (1)			
Environmental management for Sri Lanka : an action plan	SR	06/01/91	9649
Finance (3)			
Financial Sector Reforms	SR	07/31/98	17236
Financial institutions study	SR	02/01/91	9339
Regional financial sector report : lessons of financial liberalization in Asia : a comparative study	SR	11/23/88	7512
Multi Sector (6)			
Recent economic developments and prospects	ER	05/01/98	17761
Social Services: A review of recent trends and issues	ER	04/28/98	17748
In the year 2000 : an agenda for action	ER	03/14/96	15455
Sri Lanka in the year 2000 : an agenda for action	ER	06/23/95	14531
Sustaining the adjustment process	ER	09/26/90	8951
Recent macro-economic developments and adjustment policies	ER	12/18/89	8193
Poverty (2)			
Poverty assessment	ER	01/11/95	13431
Strengthened adjustment for growth and poverty reduction	ER	01/01/92	10079
Private Sector Development (1)			
Private sector assessment	SR	03/13/95	12514
Public Sector Management (3)			
Public expenditure review	SR	11/05/96	15940
Public expenditure review	ER	12/22/93	12337
Country economic update FY93 : public sector rationalization for private sector development and poverty alleviation	ER	06/01/93	11862
Public Health (1)			
Nutrition review	SR	07/01/89	7575
Telecommunications Sector (1)			
Strategic options for the telecommunications sector	SR	03/01/94	12464
Transport Sector (2)			
Transport Sector Strategy Study	SR	01/01/97	16269
Transport sector memorandum	SR	06/28/91	8962

Table C.6: Bank Management Sri Lanka 1989-1998

YEAR	VICE PRESIDENTS	COUNTRY DIRECTORS
1989	Attila Karaosmanoglu	Shinji Asanuma
1990	Attila Karaosmanoglu	Shinji Asanuma
1991	Attila Karaosmanoglu	Jochen Kraske
1992	D.Joseph Wood	Paul Isenman
1993	D.Joseph Wood	Paul Isenman
1994	D.Joseph Wood	Paul Isenman
1995	D.Joseph Wood	Mieko Nishimizu
1996	D.Joseph Wood	Mieko Nishimizu
1997	Mieko Nishimizu	Roberto Bentjerodt
1998	Mieko Nishimizu	Roberto Bentjerodt

Annex D

Sri Lanka CAE - Government's Formal Comments

OED received by electronic mail on December 11, 1998 the following comments of the Government of Sri Lanka on the draft CAE dated November 23 (an earlier version than the one distributed to the Executive Directors). They were conveyed by Mr. Faiz Mohideen, the Director General of the External Resources Department, Ministry of Finance and Planning.

Government's Comments	OED's comments
We note that the overall tone of the CAE is rather negative regarding the performance of the Bank and the government in the 1990s. Since the late 1989, when political violence in the South dwindled, the implementation of a a second phase of adjustment program intensified with the support of the Bank. The highest sustained period of growth of 5.4% was achieved during 1990-1997 compared to 4.4% in the initial adjustment period of 1978-1982 and 2.1% during 1983-1989, when the reform effort faltered. This performance of 1990s was despite the impact of intensified civil conflict and, at times, an unfavorable external environment. We believe the Bank's strong support for structural reforms and a changed focus of lending in the 1990s made a substantial impact on the government's efforts to steer the economy on a sustained growth path.	We agree that the Bank assistance achieved substantial successes within a difficult political and security environment (as summarized in para 2.27 of the CAE). The section on structural adjustment, in particular, praises the Government for implementing and the Bank for supporting, far reaching reforms (paras. 2.4-2.6). Nonetheless, the CAE also notes the insufficiencies and oscillations on the part of the Bank and the Government, which reduced the payoffs of Bank assistance (para. 2.7). In fact, the country's growth rate in recent years (at 4.9 percent during 1990-97 according to the WDI database) was good, but less than that achieved in the initial adjustment period (6.1 percent during 1978-82 according to the same source).
The CAE makes repeated references to the proactive role that the Bank could have played in building national cohesion. The initial efforts of the Bank on economic analysis of the devolution package and the reaction of the government are not spelt out in the report. The Bank cannot be found at fault with its late entry in policy dialogue on higher education since we understand that the Bank's worldwide emphasis was on primary and secondary education until recently; also, higher education is an area in which the government has been working with ADB support.	The CAE acknowledges in para. 2.18 the Bank analysis of the devolution package conducted in 1995 by a one-week, one-man mission, which remained confidential and received no follow-up. The Bank also analyzed the higher education system in three major sectoral reports in 1986, 1994 and 1998 (see footnotes 8 and 10 of the CAE) and offered recommendations as to cost recovery and private sector participation. But in neither of these reports the Bank explored the implications of the admission policies for the composition of the student body.
The CAS tends to look one-sidedly and at certain length at areas where institutional development was weak in the last few years, such as under the poverty alleviation project, while giving insufficient weight to areas where deep institutional change, implemented with	The success story of privatization in telecommunications is recognized in para 2.21, which also praises the recent approach by the Bank to institutional development in other infrastructure sectors. Positive achievements in institutional development are also acknowledged in para. 2.4 and

Government's Comments	OED's comments
Bank's help, have generated visible positive development outcomes. We can mention, for example, reforms which we understand the Bank's own operations evaluation teams consider best practice such as those in telecommunications, community water supply and plantations, the latter being one of the largest and politically most sensitive sectors in Sri Lanka. All these reforms cut much deeper in their institutional and structural impact than has been described in passing in the CAE under the privatization heading.	para. 2.5 with regard to privatization (including that of the tea plantations), devolution of irrigation facilities, financial sector reform, tax reform, performance contracts for the state banks, and the strengthening of banking supervision. With respect to water supply, an ongoing project appears to be proceeding well, but another project implemented during 1986-96 had poor completion ratings across the board (unsatisfactory outcome; uncertain sustainability, negligible ID). The only available countrywide indicator of impact, access to safe water, remains below both South Asian and lower - middle-income countries' levels.
The government's view is that the CAE, in its present form, lacks a balanced approach in regard to assessing the performance of the government and the Bank in the 1990s, both with reference to macro-economic as well as structural results.	OED's ratings of marginally satisfactory Bank and Borrower performance derive from weighing successes (para. 2.28) and insufficiencies (para. 2.29) of Bank assistance, while considering the role of exogenous factors. The difficult political, security and institutional environment was a constant during the 1990s. it should have been better addressed in the Bank assistance strategy. Government's commitment and implementation could also have been stronger and steadier.

OED's judgment remains that the institutional development impact of the Government's reforms and Bank assistance was weak overall, at both the country and the project level, although it was certainly substantial in some sectors, including those indicated above.

December 14, 1998

Report from CODE

Committee on Development Effectiveness

Sri Lanka Country Assistance Note

On December 16, 1998, the Committee on Development Effectiveness (CODE) reviewed a Country Assistance Note (CAN) for Sri Lanka (CODE98-72), prepared by the Operations Evaluation Department (OED), and the Government's comments on the CAN together with OED's observations (CODE98-72/1). The Committee expressed its appreciation for the excellent report, and for the opportunity to discuss the Bank's lending strategy for Sri Lanka prior to the upcoming Board consideration of the CAS Progress Report on Tuesday, January 19, 1999.

The CAN reported that overall, the Bank's assistance in the 1990s had a satisfactory outcome and likely sustainability. However, development effectiveness was rated as marginally satisfactory as its institutional development impact, while substantial in some sectors, was weak overall. The CAN noted that Management could be seen to have sought too much to align their priorities with those of the existing authorities. The report also rated the Borrower's performance as marginally satisfactory.

OED found that the 1996 CAS priorities and scenarios remain valid. Specifically, the Bank should continue to assist the Government in completing the structural reform agenda, and to support the Government in its efforts at fostering peace and strengthening ethnic harmony without overstepping the Bank's mandate. Management stressed that the CAS Progress Report will describe a strategy which will be in full accord with OED's recommendations; the Bank's assistance is expected to remain in the base case, taking into account the uncertainties with respect to the political and security situation, fiscal discipline, progress of reforms, and the impact of external economic developments.

Management, in their response, shared OED's assessments and frustration that Sri Lanka could and should have done better. However, Management felt a certain disconnect with the CAN as it felt the report failed to capture and appreciate the often difficult conditions and atmosphere the Bank had to work in - the recent military setbacks, political tensions in the country to name a few. Some members characterized the disconnect between OED on the one hand, and the Government and Management on the other, as a question of whether the glass is half full or half empty.

Committee members stressed the importance of ethnic harmony to the successful implementation of Sri Lanka's reform and economic programs, and noted the references in the CAN to strengthen the limited Bank activities in education, and small-scale irrigation in conflict areas and to offer assistance in municipal development. The Committee asked Management to explore additional steps the Bank could take to help overcome ethnic differences and conflict without overstepping its mandate. A member thought this was a precarious area for the Bank to get involved in.

On partnerships, the Committee was pleased to hear that Management intended to make the next CAS for Sri Lanka more participatory by including the voices of segments outside of the government. One member asked how the Bank was going to implement this in light of the fact that the country is still very much in conflict.

The Committee also noted in the report that some donors, despite agreeing that stabilization, structural reforms and peace were of the highest priority to put economic growth and poverty reduction on a more rapid and sustainable path, continued to provide large sums of financial assistance without requiring the necessary institutional changes being encouraged by the multilateral banks. A member commented that this has brought to the fore the whole question of donor coordination, and the Bank's role in such coordination.

Jan Piercy
Chairperson