

**PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE**

March 24, 2016

Report No.: AB7830

Operation Name	Sri Lanka Competitiveness DPC
Region	SOUTH ASIA
Country	Sri Lanka
Sector	General industry and trade sector (30%); Central government administration (30%); General finance sector (20%); Public administration- Industry and trade (20%)
Operation ID	P157804
Lending Instrument	Development Policy Lending
Borrower(s)	MINISTRY OF FINANCE
Implementing Agency	Ministry of Finance, Ministry of National Policies and Economic Affairs
Date PID Prepared	March 16, 2016
Estimated Date of Appraisal	May 6, 2016
Estimated Date of Board Approval	June 28, 2016
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation of the operation.

I. Key development issues and rationale for Bank involvement

The Government of Sri Lanka has articulated a commitment to strengthen competitiveness which will foster entrepreneurship and trade which in turn will yield more good jobs. The Government's reforms stem from the recognition that while the economy has grown rapidly in the last decade, the countries drivers of economic growth have been construction and non-tradables which are areas where sustaining growth over time is difficult. The Government is in the process of revising trade and investment policies to place greater emphasis on outward orientation of the economy and private sector development. The Government also seeks to establish the necessary conditions for a thriving knowledge economy, the integration of productive local companies in global value chains, and the attainment of higher value addition in the manufacturing sector. It has undertaken steps to improve the investment climate including the establishment of a one-stop shop for FDI and the elimination of minimum investment requirements for FDI in some sectors. It has approved the ratification of the WTO Trade Facilitation Agreement and has submitted legislation to enable the use of movable assets as collateral thereby facilitating credit, especially to smaller firms.

The Government has also taken steps to improve governance, a key enabler of the country's competitiveness. Sri Lanka remains the only country in South Asia without a right to information framework and in recent years has scored below regional peers on global indicators

of accountability of government. The Government has moved to address governance challenges through the passage of the 19th Constitutional amendment in 2015 which changed the basis for formation of the cabinet, strengthened or created new independent oversight commissions, and established a Constitutional right to information. At the same time, the Government has enacted reforms to address public financial management weaknesses, particularly in budget formulation, public investment planning, revenue administration, and control over treasury transactions. The Government is moving to operationalize a strengthened institutional framework, though drafting of bills on audit and right to information as well as execution of public financial management strategy. Implementation of these reforms are expected to improve the Government's capacity and responsiveness in carrying out its service delivery and regulatory functions.

While growth has been strong, Sri Lanka faces challenges in maintaining macroeconomic and fiscal sustainability. The country has suffered from chronic low revenues as a percentage of GDP over the past decade. Fiscal policy in recent years has not adequately addressed this structural challenge, raising concerns on the sustainability of the fiscal path and the level of public debt, particularly given the short-term risk of significant foreign exchange outflows. Over the past two years fiscal deficits have increased while the balance of payments has been under pressure owing to lower than expected foreign direct investment and a surge in non-oil imports. Meanwhile, having fallen from 2009 peak, public debt has started to rise again since 2013 due to slower growth, less favorable loan terms and a widening primary deficit. Measures to address the short-term risks as well as the adoption of medium-term commitments to address the fiscal vulnerabilities are critical to providing for a macroeconomic framework conducive to sustained, inclusive growth. An adequate macroeconomic framework is also a condition for proceeding with the planned operation. Consideration will be given to supporting policy measures to strengthening the macroeconomic and fiscal framework through the proposed lending operation.

Sri Lanka has witnessed strong declines in poverty over the past decade. Poverty, measured by per capita consumption, fell from 22.7 percent in 2002 to 6.7 percent in 2012/13 using the national poverty line, which is equivalent to about US\$1.50 in PPP terms. Most of the reduction in poverty was due to higher labor incomes, and, in particular, to increased earnings. At the same time, recent years have seen an increase in inequality, with the Gini coefficient increasing from 0.36 in 2009/10 to 0.39 in 2012/13; there are also differences in non-monetary measurements of poverty, such as access to public services, in certain districts. Facilitating more and better jobs is integral to continued progress in bringing more persons out of poverty and promoting prosperity among the bottom 40 percent of Sri Lanka's population.

II. Proposed Objective

The proposed Development Policy Credit (DPC) will support the long-term competitiveness of the Sri Lankan economy through a first package of structural reforms that remove constraints to private investment and enhance transparency and public sector effectiveness. The actions supported by the proposed DPC represent an important initial set of reforms that represent achievable actions that can be expected to be part of longer-term reform packages

under consideration. Government policy statements have set objectives of facilitating the generation of one million job opportunities in the private sector, enhancing income levels, development of rural economies, and creating a wide and a strong middle class. Achieving this goal will require reversing underperformance of Sri Lanka versus peers on areas including exports, competitiveness and innovation in the private sector. In addition, the Government has prioritized fundamental institutional reforms to strengthen the system of checks and balances to forestall abuse of power, provide for greater accountability, and increase the effectiveness of government. The proposed DPC corresponds to the objective of promoting investment and competitiveness set out in the present World Bank Group country Partnership Strategy and addresses some of the key priorities identified in the recently completed Systematic Country Diagnostic for Sri Lanka.

As of the concept stage, key expected results are:

- *Trade facilitation:* the articulation of a medium-term agenda of reforms to eliminate regulatory obstacles to trade and the establishment of an institutional framework to guide and implement those reform;
- *Promoting FDI:* an increase in capital investments by foreign investors through the elimination of current regulatory obstacles;
- *Access to finance:* an increase in ability of firms to access finance through the establishment of key pieces of legislation aimed at fostering sustainable access to finance for entrepreneurs and SMEs;
- *Enhanced transparency:* establishment of an institutional framework for a Right to Information regime, including standards of disclosure and an administrative apparatus to enforce these standards as well as a strengthened audit function to provide for greater accountability of public authorities for their use of resources.
- *Increased public sector effectiveness:* development of a coherent reform package to improve budget preparation and harmonize sector planning with the budget process.

III. Preliminary Description

The proposed DPC is a stand-alone operation supporting Government reforms through two pillars: Enabling Private Sector Competitiveness and Enhancing Transparency and Public Sector Effectiveness. The two pillars support immediate actions within the framework of evolving sets of reforms to promote competitiveness and good governance. The operation may also include policy reforms to strengthen the country's macroeconomic and fiscal framework.

Pillar 1. Enabling Private Sector Competitiveness. This pillar covers trade facilitation reforms, particularly in the context of expected ratification of the WTO Trade Facilitation Agreement, which should provide for simple, transparent trade procedures to streamline the flow of trade and address inefficiencies. It will also revise policies which may hinder foreign investment, particularly in the conditions around acquisition of land by investors. Finally, it will

support reforms to make financing easier, particularly in the legislative framework for the use of assets as collateral.

Pillar 2. Enhancing Transparency and Public Sector Effectiveness. This pillar will cover actions that help to operationalize governance reforms that have been initiated, notably through the 19th Constitutional Amendment. It will support the development of a Right to Information framework, steps to enhance the capacity and scope of coverage carried out by Sri Lanka’s supreme audit institution, and harmonization of a range of actions to strengthen public financial management practices.

IV. Poverty and Social Impacts and Environment Aspects

The proposed actions to support competitiveness and improve governance either are assessed to have either no adverse impact or lead to positive impacts on the poor. Efforts to increase FDI should positively impact the poor, as FDI are generally associated with increased technology transfers, improved productivity, and poverty reduction. Trade facilitation work is primarily aimed at reducing costs of conducting trade rather than tariff reductions. Providing for more flexibility in collateral requirements should ease access to credit, enabling smaller borrows to access credit from formal institutions, thereby reducing reliance on informal credit sources which usually carry higher cost of credit and pose concerns on consumer protection. Increased government transparency and a right to information empowers all citizens which in turn should prompt greater accountability and responsiveness in public service provision. Similarly, improvements in public sector effectiveness should lead to more resources for delivery of public services.

The proposed operation has been screened against Bank policies concerning the environment and none of the policy reforms to be supported by the DPC are expected to result in significant negative environmental impacts. The actions under this DPC are expected to have neutral environmental impacts. Sri Lanka has a strong regulatory framework to ensure investments and developments are environmentally sustainable.

V. Tentative financing

Source:	(\$m.)
BORROWER/RECIPIENT	0.00
International Development Association (IDA)	100.00
	Total
	100.00

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