

## Ex-Ante Evaluation

### 1. Name of the Project

Country: The Democratic Socialist Republic of Sri Lanka

Project: Development Policy Loan (Private Sector Development, Governance Improvement, and Fiscal Consolidation)

Loan Agreement: October 10, 2016

Loan Amount: 10,000 million yen

Borrower: The Government of the Democratic Socialist Republic of Sri Lanka

### 2. Background and Necessity of the Project

#### (1) Current State and Issues of the Economic Development, Governance, and Private Sector in Sri Lanka

Due to the reconstruction efforts made since civil war ended in 2009, Sri Lanka achieved a real GDP growth of 8.0% to 9.0% from 2009 to 2012. While slowing down to 3.4% in the subsequent year 2013, it has maintained a steady growth of 4.9% and 4.8% in 2014 and 2015, respectively.

Although the Government of Sri Lanka has reduced its fiscal deficit (to GDP) to 5.3%, the deficit in 2014 slightly increased to 6.2% followed by the expansion to 6.9% after the new administration was inaugurated in 2015. The budget in FY 2016 is planned to maintain the deficit to 5.4% by promoting fiscal consolidation taking into considerations of growth and investment. At the same time, a goal of reducing the fiscal deficit to 3.5% in 2020 was set in the mid-term fiscal framework.

In view of the balance of payments, the current account balance suffers persistent deficit reflecting labor-intensive industry, such as tea, apparel and other export industries. In terms of the financial account, foreign reserves decreased from 8.2 billion USD (worth 4.3 months of import) to 7.3 billion USD (worth 3.8 months of the same), followed by the decrease to 5.6 billion USD in the end of May 2016 which was derived from the low level of foreign direct investment (FDI) as well as capital outflows arising from concerns over fiscal management and the interest rate raise by the US in 2015. In response to concerns over further reduction due to expected debt repayment, the Government of Sri Lanka requested support to IMF in 2016. In June 2016, IMF approved to provide the Extended Fund Facility (hereinafter referred to as "EFF") in which 1.5 billion USD will be provided over the next three years.

Regarding the industrial sectors, the recent economic growth has been led by construction and the tertiary industry such as retails. However, most of the tradable goods remains low value-added, which has hindered industrial advances. A large part of FDI is accounted for non-tradable industries such as infrastructure and services. Moreover, despite its good accessibility to the Indian market and geographical advantage as a hub of marine traffic between Asia and the Middle East, the openness to trade (ratio of goods and service exports and imports to the nominal GDP) has decreased due to the introduction of non-tariff measures; therefore, further trade

promotion has become one of the challenges of the country. In addition, the business environment of Sri Lanka is ranked 107<sup>th</sup> out of 189 countries in Doing Business 2016 published by the World Bank. While Sri Lanka has raised its rank from 113<sup>th</sup>, challenges remain in areas such as Registering Property (complicated and time-consuming registration procedures, etc.), and Paying Taxes (frequent changes in tax administration, etc.).

## (2) Development Policies for the Economic Development, Governance, and Private Sector in Sri Lanka and the Priority of the Project

In these circumstances, the Government of Sri Lanka makes efforts on raising the tax rates and repealing excessive tax incentives on the revenue side, and reducing expenditures by improving transparency and efficiency in the budget process on the expenditure side.

As mentioned in Prime Minister's Economic Statements in 2015 and 2016, the Government of Sri Lanka aims to attract FDI as a means to achieve growth in the private sector. Specifically, it aims at integration of global value chains and domestic industries as well as at fostering high value-added manufacturing industries. The Government of Sri Lanka is also undertaking reforms to improve investment climate for FDI, making efforts in the removal of investment obstacles. As a result, simplification of obtaining business visa has been achieved and One-Stop Shop for investment introduced. To promote trade, standardization of export and import procedures is being promoted through ratifying the World Trade Organization (hereinafter referred to as "WTO") Trade Facilitation Agreement.

Development Policy Loan (Private Sector Development, Governance Improvement, and Fiscal Consolidation) (hereinafter referred to as the Project) is to support such efforts of the Government of Sri Lanka in policy and institutional reforms towards enhancing industrial competitiveness and realizing sustainable economic growth.

## (3) Japan and JICA's Policy and Operations in the Economic Development, Governance, and Private Sector

The Country Assistance Policy to Sri Lanka (June 2012) stated that "Japan supports the development of basics for promoting further development and stabilization of Sri Lanka's steadily growing economy." The Project is therefore consistent with this policy as the Project aims at stable macro economy including fiscal consolidation and governance improvement. In addition, the policy listed "Promotion of economic growth" as one of the priority areas and stated "Japan's assistance to Sri Lanka not only promotes Sri Lanka's economic growth, but also contributes to the improvement of business environment for Foreign Direct Investments including those from Japan." From this viewpoint, too, the Project is in line with the policy.

JICA has provided Grant Aid and ODA Loan for infrastructure improvement in sectors such as transportation, electricity, and water supply, which contribute to the

investment climate improvement. In addition, JICA has provided its support for FDI promotion by dispatching investment promotion advisors to the Board of Investment (hereinafter referred to as “BOI”) since 2014.

#### (4) Other Donors’ Activity

For fiscal consolidation, IMF and the Government of Sri Lanka have agreed in the EFF to broadening of the tax bases, elimination of tax holidays, strengthening of management of state enterprises and other measures. The World Bank provides technical assistance for public financial management, audit. Also, it provided support for trade promotion and strengthening of the financial sector based on the findings of its report “Sri Lanka: A Systematic Country Diagnostic” (2015), which analyzed challenges and opportunities in the private sector development. The World Bank co-financed the Project and showed its willingness to continue providing supports related to these sectors. The Asian Development Bank is formulating its development policy loan for fostering the financial market.

#### (5) Necessity of the Project

The Project is consistent with the policies of the Government of Sri Lanka as well as assistance policy and analysis of Japan and JICA. It is also expected to contribute to the achievement of the Sustainable Development Goals in “Goal 8: Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all,” and in “Goal 16: Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels.” Therefore, the necessity of the Project is high.

### **3. Project Description**

#### (1) Project Objective

The Project will provide support to policy and institutional reforms by the Government of Sri Lanka with a focus on the three pillars of private sector development, governance improvement and fiscal consolidation, which will strengthen economic and industrial competitiveness; thereby contributing to sustainable economic growth in Sri Lanka.

#### (2) Project Site / Target Area

Throughout Sri Lanka

#### (3) Project Components

The Project is to provide budget support after evaluating the achievement status of defined policy actions under the three pillars of reforms: i) private sector development, ii) governance improvement, and iii) financial consolidation. The evaluation was conducted to those reforms carried out between May 2015 and June 2016.

Reform items	
Policy actions	
1) Private sector development (enhancing private sector competitiveness)	<p>1. Increasing the efficiency of trade facilitation The Government of Sri Lanka has: (a) ratified the Protocol annexing the World Trade Organization Trade Facilitation Agreement to the WTO Agreement; and (b) created a National Trade Facilitation Committee (NCTF).</p> <p>2. Removing obstacles to foreign investment entry and establishment The Cabinet of Ministers has approved the establishment of an One-Stop Shop (OSS) for foreign investors aimed at reducing the processing time for investment approval.</p> <p>3. Enhancing access to finance The Cabinet of Ministers has authorized the drafting of a new Secured Transactions Bill that will include provisions to facilitate the use of movable assets as collateral for bank loans, and to repeal the Secured Transactions Act 49 of 2009.</p>
2) Governance improvement (enhancing transparency and public management)	<p>4. Establishing a Right to Information Framework The Government of Sri Lanka submitted to Parliament a Right to Information (RTI) Bill.</p> <p>5. Strengthening Audit Oversight The National Audit Bill has been submitted to the Cabinet of Ministers.</p> <p>6. Strengthening Public Financial Management The Cabinet of Ministers has authorized the Ministry of Finance to draft a Public Finance Bill strengthening preparation, execution and oversight of the budget, as well as oversight of public enterprises.</p>
3) Fiscal consolidation (improvement of fiscal sustainability)	<p>7. Reducing granting of new tax holidays and clarifying investment regime The Cabinet of Ministers has decided to submit to Parliament a proposal to repeal the Strategic Development Project Act of 2008.</p> <p>8. Increasing the efficiency of debt management The Cabinet of Ministers has approved setting up a debt management unit in the Ministry of Finance.</p>

(4) Project Cost

10,000 million yen

(5) Schedule

The budget support of the Project will cover payments made for budget expenditures on or after January 1, 2016. All the policy actions shall be achieved by June 2016. Since all the policy actions were achieved, the project completion is defined as the timing of loan disbursement (scheduled to be in October 2016).

(6) Project Implementation Structure

- 1) Borrower: The Government of the Democratic Socialist Republic of Sri Lanka
- 2) Executing agency: Ministry of National Policies and Economic Affairs
- 3) Operation and management: The Ministry of National Policies and Economic

Affairs facilitates coordination with relevant ministries of the Government of Sri Lanka.

(7) Environmental and Social Consideration/Poverty Reduction/Social Development

1) Environmental and social consideration

(i) Category: C

(ii) Reason for categorization:

The Project is likely to have minimal adverse impact on the environment as provided under the JICA Guidelines for Environmental and Social Considerations (April 2010).

2) Promotion of Poverty Reduction

None in particular.

3) Promotion of Social Development (e.g. Gender Perspective, Measure for Infectious Diseases Including HIV/AIDS, Participatory Development, Consideration for the Person with Disability etc.): None in particular.

(8) Collaboration with Other Donors

The Project is co-financed with the World Bank, and the World Bank made formal decision to provide 100 million USD at its Board of Directors in July 2016.

**4. Project Effect**

(1) Quantitative Effects

1) Outcome (Operation and Effect Indicators)

Reform items		
Outcome indicators	Baseline (Jun. 2016)	Target (Sept. 2017)
<b>1) Private sector development (enhancing private sector competitiveness)</b>		
1. Increasing the efficiency of trade facilitation Adoption of national action plan for the implementation of the WTO Trade Facilitation Agreement including specific roles and responsibilities, timeframe for implementation, and required human and financial resources	No	Yes
2. Removing obstacles to foreign investment entry and establishment Average time required for foreign investment approval	63 days on average	50 days on average
3. Enhancing access to finance Enactment of the new Secured Transactions Act repealing the Secured Transactions Act 49 of 2009, facilitating the use of movable assets as collateral for bank loans	No	Yes
<b>2) Governance improvement (enhancing transparency and public management)</b>		
4. Establishing a Right to Information Framework Share of ministries that proactively disclose information as required by the RTI Act on websites	0%	50%

Reform items		
Outcome indicators	Baseline (Jun. 2016)	Target (Sept. 2017)
5. Strengthening of the authority of National Audit Office Establishment of a National Audit Office with administrative and financial independence	No	Yes
6. Strengthening of public financial management Submission of the Public Finance Bill to the parliament	No	Yes
3) Fiscal consolidation (improvement of fiscal sustainability)		
7. Reducing granting of new tax holidays and clarifying investment regime No new projects with associated tax incentives approved under SDP Act	18 (between 2008 and 2015)	0 (from January 1, 2016)
8. Increasing the efficiency of debt management Approval and publication of a medium term debt management strategy (MTDS) covering domestic and external debt and defining measures to develop the domestic debt market	No	Yes

(2) Qualitative Effects

Sustainable economic growth in Sri Lanka is promoted.

(3) Internal Rate of Return

Not calculated.

## 5. External Factors and Risk Control

None in particular.

## 6. Lessons Learned from Past Projects

(1) Results of Evaluation of Similar Past Projects

In the ex-post evaluation of Development Policy Loan (I to IV) in the Republic of Indonesia (evaluated in FY 2009), it was pointed out that the activity of investment climate improvement was not recognized well by Japanese enterprises in Indonesia. Therefore, it was recommended to disseminate information to the private sectors including local Japanese enterprises from the perspective of further facilitation of collaboration between public and private sectors. Meanwhile, the ex-post evaluation of Development Policy Support Program (II) and (III) in the Republic of the Philippines (evaluated in FY 2011) indicated that proactive overseas information dissemination about the activities in the private sector development was expected to enhance and improve effectiveness of the program loan for investment climate and infrastructure improvement.

(2) Lessons for the Project

In the Project, observations of Japanese enterprises on investment climate in Sri Lanka were collected through hearings and reflected to policy matrix. Information

about the private sector development activities supported through the Project will be shared.

## **7. Plan for Future Evaluation**

### (1) Indicators to be Used

As described in 1) Outcome (Operational and Effect Indicators), (1) Quantitative Effect, in 4. Project Effect.

### (2) Timing

One year after project completion.