

AUSAID

LOCAL ECONOMIC INFRASTRUCTURE PROGRAM (LEIP)– SRI LANKA

CONCEPT DOCUMENT

September 2, 2011

The Draft Concept Report outlines a proposal for AusAID to establish Local Economic Infrastructure Program (LEIP) in the conflict and flood-affected northern and eastern areas of the Democratic Socialist Republic of Sri Lanka. The document sets out a proposed five-year program (2010-2015) with a total budget of up to A\$38.55 million. The program includes support for rehabilitation and construction of new infrastructure, capacity building for infrastructure development and management by public institutions and utilities at district and provincial level, aimed at improving the income and livelihoods of people living in some of the poorest regions of the country. It is proposed that the program be delivered through a partnership with the World Bank. AusAID would transfer funds to a World Bank Trust Fund to support an existing World Bank program operating in the conflict affected parts of the country as well as establishing a catalytic fund to be managed by the Bank for new and innovative infrastructure projects to be jointly agreed between the Bank and AusAID.

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ACRONYMS

ADB	Asian Development Bank
AusAID	Australian International Development Agency
CLICAAP	World Bank Community Livelihoods in Conflict Affect Areas Program
CPS	AusAID Country Program Strategy Sri Lanka
DCD	Draft Concept Development
DFID	UK Department for International Development
GoSL	Government of Sri Lanka
LEIP	Local Economic Infrastructure Program
MDG	Millennium Development Goals
NELSIP	World Bank North East Local Service Improvement Project
ODA	Official Development Assistance
SIDA	Swedish International Development Agency
UNDP	United Nations Development Program
WB	World Bank

SUMMARY ON A PAGE

The Concept Document outlines a proposal for AusAID to support a Local Economic Infrastructure Program (LEIP) in the conflict and flood-affected northern and eastern areas of the Democratic Socialist Republic of Sri Lanka. While Sri Lanka is a middle-income country, the northern and eastern regions of the country lag significantly behind the development of other regions.

The concept document was prepared following a mission by AusAID to Sri Lanka from the 20-30 June, 2011, which involved meetings with the Post, Government of Sri Lanka, multilateral agencies, NGOs and the private sector. The project would involve approximately A\$38.55 million over five years (2011-2015) to support the reconstruction and development of the essential economic infrastructure needed to improve the livelihoods of people in the most impoverished areas of the country. It includes provision of a Catalytic Fund to create opportunities that leverage the resources of the private and public sectors to develop key pieces of rural economic infrastructure.

The LEIP would be an important project for AusAID in Sri Lanka. The program would support the objectives of the Country Strategy for Sri Lanka, to support recovery and rehabilitation of conflict-affected areas, livelihoods and income generation. It also supports achievement of the Millennium Development Goals at the sub-national level, and the National policy objectives for the Government of Sri Lanka as set out in the *Mahinda Chintana*. The program involves an integrated approach to economic development in rural areas aimed at ensuring sustainability, equity, and value for money.

The Concept Design for the LEIP involves a multilateral partnership with the World Bank in Sri Lanka to support an expansion of the North East Local Services Improvement Project (NELSIP). It also includes the development of a Catalytic Fund to be managed by the World Bank to support innovative finance for local government or private sector partners. The program will involve the delivery of packages of assistance to district/provincial and local area levels. An example of the activities LIEP would support include: (i) restoration of infrastructure, including water supply systems, local roads and community facilities (ii) development of a major regional/district infrastructure project such as an inland inter-modal transport hub, industrial estate or solid and hazardous waste management (iii) land-use, social and infrastructure planning (iv) institutional human resource development and capacity building (v) enhancing the business enabling environment (vi) improving systems for financial planning and revenue collection of local government operations and maintenance support economic development.

The project would be executed under a donor trust fund arrangement with the World Bank. Specific programs of activity that support the Australian Aid Program's core strategic goals and development objectives will be identified with the Bank and the Government of Sri Lanka. Other modalities to develop and implement the LIEP with multilateral agencies were investigated, but the World Bank project provided the best fit with the AusAID Country Program Strategy, the needs assessment conducted by the Mission and priority areas and activities for aid assistance.

A partnership with the World Bank through NELSIP will result in more effective leveraging of AusAID funds, reduced administrative overhead costs compared with other multilateral agencies and lower political and fiduciary risk. A multilateral partnership with the World Bank also offers opportunities for AusAID to leverage off other World Bank related program activities in Sri Lanka. By targeting of AusAID funds to activities in two or three selected districts, the LEIP will ensure the Australian Aid program maintains a profile and ownership of the programs activities.

The Concept Document includes background material justifying the benefits of the project, an explanation of the design concept, analysis and benefits, sustainability and feasibility of the project.

CONCEPT DESIGN DOCUMENT FOR LOCAL ECONOMIC INFRASTRUCTURE (LEIP)-SRI LANKA

1. INTRODUCTION

AusAID is currently preparing a program of development assistance activities for Sri Lanka to support the implementation of its Country Strategy (CS) which runs from 2011-15. The Agency anticipates that a budget of \$5-7 million per year will be available over the life of the Country Strategy, starting in 2011-12, to support a local economic infrastructure program (LEIP) to support the development of lagging regions. At this level of funding, and with current resources, the program is modest compared to national infrastructure requirements and development objectives and the efforts of other large donors¹ such as China, Japan, India, ADB and World Bank. Within this context tight targeting of assistance, partnering with other large development partner(s) and efficient design/ implementation arrangements are necessary.

The concept document was prepared following a mission by AusAID to Sri Lanka from 20-30 June 2011. The Mission consulted with a range of bilateral and NGO partners to identify key priorities for AusAID in developing an infrastructure support program to Sri Lanka. The Mission confirmed the development of local economic infrastructure in lagging regions as a priority area offering opportunities for AusAID support in partnerships with other multi-lateral donors and NGOs.

The LEIP is expected to have an impact on the improving the economic livelihood of the rural and regional poor in lagging regions of Sri Lanka, and help to close the gap between vulnerable groups and national level achievements of the MDGs. The following report outlines a concept for the local economic infrastructure program. There are three elements to the report: a Contextual Analysis, Proposed Activity Description, and Design, Implementation and Resource Implications.

2. CONTEXT ANALYSIS

The following analysis provides context for matters to be considered in the preparation of a concept design for a proposed LEIP for conflict and disaster affected regions of Sri Lanka.

2.1 STRATEGIC CONTEXT

Sri Lanka is a middle-income country with a GDP per capita of \$US 5,057 (2010 PPP) and ranks 99 in the world in GDP per capita and 61 in terms of the world's largest economies. The country is close to achieving the MDGs at a national level. The Human Development Index ^[1] ranks Sri Lanka as 91 (See Annex 1: Statistical and Indicator Data). The country ranks 64 in terms of global competitiveness ^[2], but is being held back by the slowness of economic and governance reforms, and the lack of basic infrastructure. Direct foreign Investment flows in 2009 was US\$3.4.68 billion and has been rising rapidly since the cessation of the conflict ^[3].

The development of Sri Lanka has been impressive, despite the many setbacks caused by civil unrest and natural disaster. However, development has not been uniform across the country. The south-western part of Sri Lanka has enjoyed rapid economic growth and development while other regions of the country, especially those in the north and east, have had their economies and livelihoods devastated by civil war and natural disasters. Incomes per capita in the eastern and northern provinces are almost 50% less than that of the Western Province. Indicators on poverty, income, health, education and accessibility to economic infrastructures and services show significant disparities between the north, central, and eastern regions of the

¹ Annex 2 Targeted Areas of ODA Assistance, Sri Lanka 2010

country and the Southwest^[4, 5]. Rural areas are the most affected, with about 15.7% of the population living in poverty, compared to 6.7 % in urban settlements (World Bank 2011). Reducing the gap in regional disparities between regions is a high priority of the Government of Sri Lanka (GoSL) and official development assistance (ODA) agencies^[6].

The lack of access to basic infrastructure and services, private sector investment and employment opportunities are primary causes for many regions lagging behind the development of the rest of the country. There remains an urgent need for interventions by government and ODAs to support the recovery efforts in the post conflict-affected and flood devastated areas of the country.

2.2 GOVERNMENT OF SRI LANKA'S DEVELOPMENT PRIORITIES

The Government of Sri Lanka's (GoSL) policy document *Mahinda Chintana*^[7] outlines strategic directions for the recovery and development of the country over the next 5 years. The GoSL has signalled Infrastructure and private sector investment are the highest priorities for the investment and development in the country. Infrastructure is a priority area for current and future ODA assistance, with the scaling down of humanitarian activities. The GoSL has also given high priority to reconstruction in the north and eastern parts of the country following the cessation of hostilities in 2009 and the disastrous floods in January 2011. The government is also seeking to strengthen the capacity of local government and to support greater decentralization under Amendment 13 to the Constitution.

2.3 AUSTRALIA'S DEVELOPMENT PRIORITIES IN SRI LANKA

AusAID is a medium sized donor in Sri Lanka. Australia's aid program spiked in terms of total ODA immediately following the disruption caused by the 2004 Tsunami and the end of the civil war in May 2009. Most of this increase was made up of humanitarian assistance. Only a gradual increase occurred in the long-term development assistance part of the program. ODA in 2009-10 was \$79 million reducing to \$52 million in 2010-11. It is estimated to be \$43.5 million in the financial year 2011-12.

Looking forward a slight increase of total ODA can be expected during the next five years (A\$45 - 65 m by 2015). The goal of AusAID's Country Strategy for Sri Lanka (2011-2015)^{[8][8][8]} is for 'more inclusive development for vulnerable people in lagging regions.' The regions that lag behind in terms of social and economic development include the Northern, Eastern, Central, Sabaragamuwa and Uva Provinces². Severe pockets of poverty also exist in other Provinces^[5]. The key sectoral priorities under the strategy include: (i) recovery of conflict-affected areas and rehabilitation of infrastructure; (ii) sustainable livelihoods and (iii) improved access to services, and social protection. AusAID's Country Strategy^[8] is aligned to the Government of Sri Lanka's '*Mahinda Chintana - Vision for the Future*'^[7]. The GOSL is focused on overcoming regional imbalances through rural development, investment in economic infrastructure and better public service delivery.

2.4 PROBLEM ANALYSIS

The Northern region, because of the former conflict, remains one of the most impoverished areas in the country^[9]. There are a number of reports and studies which show the severity of the problems facing the rehabilitation and development of the north^[4, 9-12]. These reports refer to the growing need of ODA and government support resettlement, reconstruction and development assistance. In May 2011, nearly US\$47 million (16.4%) had been received against the total requirement of US\$289 million in the Joint Plan of Assistance for the Northern Province^[10:2, 12, 13].

² Annex 2 Map of Sri Lanka Provinces

It is difficult to conceptualise the challenges and approaches necessary to resolve the complex development problems facing the northern and eastern regions of the country. Problem tree analysis is a useful technique to analyse the nature, cause and effect of complex development and post disaster problems. These problems can be depicted diagrammatically, and actions identified to help resolve them. The technique has proved useful in helping bilateral and multilateral agency partners to conceptualise and design aid projects.

Figure 1 Problem Tree Analysis Economic Infrastructure in Lagging Regions

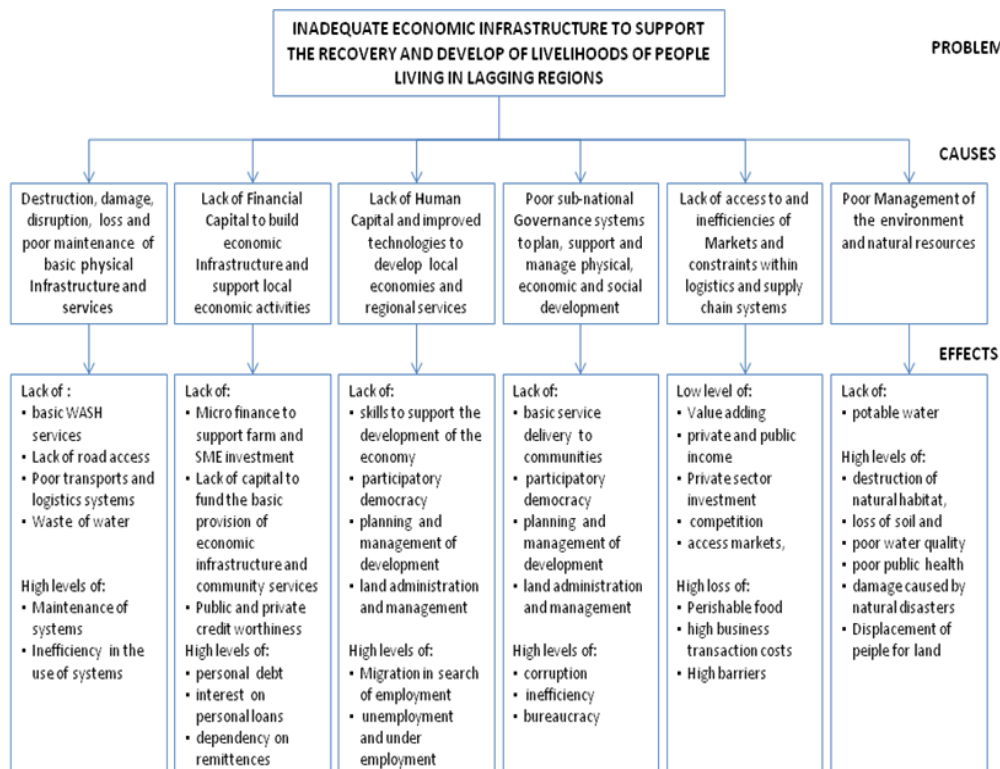


Figure 1 shows a problem tree analysis prepared by the Mission Team. It provides the background context for a proposed local economic infrastructure project for lagging regions. The primary problem to be addressed by the project is that there is inadequate economic infrastructure to support and value-add to local production and supply chain systems to enhance the livelihoods of people living in lagging regions. Without the capacity to produce food, trade goods and services, and attract capital investment necessary to fund the means of production, the prospects for economic recovery and development in lagging regions will remain poor. There are many causes and effects which result from the lack of economic infrastructure, some of which are shown in the figure. These factors severely constrain the capacity of local communities in lagging regions to develop and improve the livelihoods of people living in them.

2.5 NEEDS ASSESSMENT

The problem tree analysis is useful in identifying needs which can be filled by an Australian development assistance program supporting the economic infrastructure sector. There are, however, many ODA agencies working in the sector. It is important in developing a concept project for a program of activities in Sri Lanka that AusAID does not duplicate the efforts of other ODA agencies or support activities which it has limited capacity to deliver. In order to identify where AusAID could strategically position itself to ensure the most effective delivery of its aid program to Sri Lanka, the various sector activities in which ODA agencies and organisations have provided assistance to the country were mapped with an estimate of the total amount of funds (grants and loans) provided during 2010 (Annex 3). There are many common areas and needs of

assistance, particularly human resource development, humanitarian aid and infrastructure, which most of the major ODA is involved with. It is essential that any programme of assistance developed by AusAID is targeted to needs and priority areas of assistance.

To identify where AusAID might prioritise or target its program of activities for an economic infrastructure program, an assessment was made by the Mission Team of priority needs of assistance (See discussion Annex 4). The areas of potential assistance which could be targeted by AusAID in order of priority include:

1. Restoration and rehabilitation of damaged small-scale infrastructure
2. Preparation of economic development plans at a District and local government level
3. Supporting new economic infrastructure investments
4. Strengthening the Capacity of Local Government
5. Improved Access to Finance and Service Pricing
6. Asset Management and Land Information Systems

2.6 GO SL INFRASTRUCTURE PRIORITIES

The World Bank is currently undertaking an infrastructure needs assessment study for the country. The *Mahinda Chintana* ^[7] set out ports, roads, irrigation systems (including a national canal project to the north) and rehabilitation of the rail network as priorities for nation building infrastructure projects. Almost 30% of public investment is devoted to road infrastructure and 8% to ports. The GoSL is promoting public private sector partnerships for major infrastructure projects in the transport and water sectors. The *Mahinda Chintana* also recognizes the need to strengthen the provision of infrastructure at the local government level. Water and sanitation projects are a high priority area for urban settlements. There are other reports which set out key investments priorities and programs for infrastructure reconstruction and development in the conflict and disaster affected areas of the country ^[4, 9-11].

2.7 LESSONS LEARNED

There are many donors operating in the economic infrastructure sector. Meetings conducted with government agencies and potential ODA partners in Sri Lanka during the Mission reveal important lessons for AusAID in the delivery of a Local Economic Infrastructure Program in lagging regions. These are:

- There has been good cooperation between AusAID, UN agencies and development banks for the delivery of humanitarian aid; however, there is a general lack of coordination between ODA's when it comes to development assistance associated with local economic development projects.
- A very significant proportion of ODA has been targeted at humanitarian support and capacity building. ODA programs of infrastructure have been mainly small, dispersed and have involved significant management cost overheads.
- The GoSL is taking a more directive approach to ODA assistance and has requested that donors consult with the Ministry of Finance to seek in-principle agreement to proposed activities before undertaking detailed discussions with line Ministries.
- Many ODA agencies (eg DFID, SIDA) have pulled out of Sri Lanka as humanitarian projects finish. There has been an uneasy relationship with European and North American donors whose governments and civil society groups have been critical of GoSL human rights policies. GoSL political sensitivities to adverse comments in western media have made it difficult to deliver multilateral ODA.
- There is duplication of public administration activities occurring at the regional level. Central agencies responsible for developing infrastructure and providing services, are often conducted in parallel with provincial and local government with very poor coordination between levels of government.
- The GoSL is very suspicious of international or internationally supported local NGOs delivering ODA.

- Volunteer assistance programs by ODAs, especially like the one run by the Planning Institute of Australia, have been a very effective means of leveraging ODA and GoSL resources.

2.8 RATIONALE FOR A PROPOSED ECONOMIC INFRASTRUCTURE PROJECT

The widespread destruction of property and basic infrastructure in the northern and eastern regions of the country has severely undermined the capacity of people living in these areas to rebuild their lives and develop their local economies. Many have limited access to basic services available to people living in other parts of the country and market supply and value chains do not function efficiently. It will take many years to repair essential infrastructure such as roads, water supply and irrigation systems, community and government facilities in these regions to restore them to prosperity. The loss of skilled workers, weakness of local government, disrupted market supply chains, lack of access to capital, and the affects of trauma on afflicted populations have significantly disadvantaged the development of the northern and eastern regions. Without restoration and development of local economic infrastructure and human capital, these regions will continue to lag well behind the rest of the country in poverty, income, education and other MDG indicators.

The development problems facing lagging regions in Sri Lanka are complex and historic. Years of civil conflict and natural disasters have traumatized populations and settlements in some regions, resulting in a lack of trust, confidence, and despair in many communities. Nurturing community recovery efforts through modest programs of government and ODA to restore market value chains through basic local economic infrastructure and services in lagging regions to address these problems is currently going a long way towards the healing and restoring process going on in the country —especially in the former conflict areas of the north and east.

A new initiative to support economic infrastructure development, particularly one that is targeted at lagging regions of the country, is highly relevant to national development sector priorities and AusAID’s higher level goal of 'more inclusive development.' In addition, an economic infrastructure program also provides AusAID with an opportunity to deepen our engagement with multilateral partners who are already firmly entrenched in this sector. Deeper engagement with multilateral partners is a key feature of the new policy framework and one of the key recommendations of the Aid Effectiveness Review for how AusAID will work in South Asia. Economic infrastructure is one of the highest priority sectors for the Government of Sri Lanka, and provision of additional grant based funding in this sector will provide Australia with an opportunity to engage constructively with the Government around an issue of common interest and to deepen the bilateral relationship, possibly paving the way to engage with them on other issues down the track.

2.9 OPTIONS AND ALTERNATIVES

A number of ODA implementation approaches are available to address the problem and issues described earlier in lagging and conflict affected regions of the country. Annex 5 includes more detail discussion of these options and alternatives. Different implementation approaches include: (i) co or parallel-financed new or existing project (ii) partnership projects involving other ODA partners, business and government (iii) partnerships with an NGO or bilateral agency (iv) direct budget support program (v) Public Private Partnerships and (vi) mixed modality delivery programs. The preferred option is AusAID to partner with one or more established multi-lateral delivery partners.

In line with the Australian Government’s response to the Independent Review of Aid Effectiveness “Making real difference-Delivering real results”, the preferred option is for AusAID to partner with a multilateral agency. The preferred and least risk option is for AusAID to engage with a multilateral to support an existing project under a co or parallel financing arrangement. Other alternatives, although feasible, are likely to involve significant agency resources in the project design, administration, and management of the program of activities. Direct Budget Support is not favoured because of the limited capacity of GoSL agencies to execute programs and accountability issues. AusAID has no experience working in public private sector partnerships in

Sri Lanka; however, there are modalities including the World Bank’s Public Private Infrastructure Assistance Facility and the multi donor InfraCo that should be considered in the project design.

2.10 IDENTIFICATION OF POTENTIAL PARTNERSHIPS

A number of current or planned programs have been identified which address one or more of the issues identified in the 'needs assessment.' An assessment of these programs against the needs analysis is shown in the table below and Annex 3.

TABLE 1: EXISTING LOCAL ECONOMIC INFRASTRUCTURE ACTIVITIES IN SRI LANKA

PROJECT	Project (millions)	Timeframe	Risk Ranking	Geographic Alignment	NEEDS ASSESSMENT				
					Rehabilitation of Infrastructure	New Infrastructure	Improved planning	Finance and service charges	Local Government Capacity
World Bank Community Livelihoods in Conflict Areas Project (CLCAP)	US\$140	2011-15	Medium	*****	*****				**
World Bank North East Local Service Improvement Project (NELSIP)	US\$86	2010-15	Medium	*****	***** Irrigation not included	**	***	**	****
World Bank Warehouse Finance Facility	US\$6.5	2011-14	High	**		*****	**	**	
ADB Lagging Local Authorities Infrastructure Development Sri Lanka	US\$59	2012-15	Medium	** Project does not work in conflict areas.	*****	**	**	***	*****
ADB Conflict Affected Region Emergency Project	US\$150	2010-13	Medium	*****	*****				
European Union North and East Assistance Program	€72	2012-16	High Delays and political risk.	*****	*****	*****	***	***	*****
UN Agency Programs		Ongoing	Medium	*****	*****	**	**	**	***
Civil Society Programs		Ongoing	Medium	*****	*****		**	**	*
Domestic Private Sector		Ongoing	Medium	*****		*****	*****	*****	

Based on this assessment there are three viable alternatives open to AusAID to support an existing program based around economic infrastructure development program for lagging regions in Sri Lanka. The first is the proposed European Union Northern and Eastern Province Assistance Program. It aligns closely with the needs assessment. However, the program has a number of high risks. It is still in early design phase and an approval date is uncertain. Depending on political developments in Sri Lanka members of the European Union may even delay implementation of a new project or reduce funding.

The second option is to partner with the World Bank and support one or more existing programs. The World Bank has two large current loan programs that operate in the target area for AusAID assistance: (i) Community Livelihoods in Conflict Areas Project (CLICAAP) and (ii) North East Local Services Improvement Project (NELSIP). Both programs are focused on the issues identified in the needs assessment and are scheduled to continue throughout the next 5 years and possibly longer. Both have associated issues and require the clear identification of operational roles, risks and a management strategy at the design stage.

Another option for AusAID is to partner with the ADB Conflict Affected Region Emergency Project.. This option was evaluated and dismissed because the project is scheduled for completion mid 2013. By the time the AusAID economic infrastructure project is started, there would be less than 18 months remaining in the ADB project. The project targets lagging regions in the East and Southern provinces, which are not priority areas for assistance identified in the AusAID CPS. The ADB project also does not have the flexibility in design as the two World Bank projects discussed above.

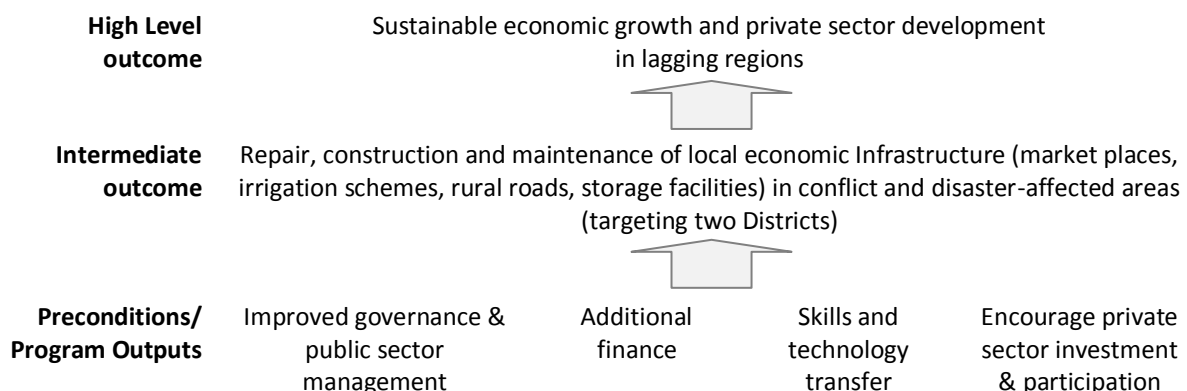
The preferred option, for reasons explained in more detail in Annex 6, is for AusAID to partner with the World Bank.

3. ACTIVITY DESCRIPTION

3.1 OVERALL PROGRAM FRAMEWORK

Table 2 shows a program framework for a local economic infrastructure program (LEIP) in Sri Lanka. The high level strategic outcome that the LEIP aims to support is 'sustainable economic growth and private sector development in lagging regions.' To support this high level outcome the project will work towards the intermediate outcome of 'repair, construction and maintenance of local economic infrastructure in conflict affected areas (market places, irrigation schemes, rural roads, storage facilities)'. The proposed outputs of the program include (i) improved governance and public sector capacity, (ii) additional finance, (iii) skills and technology transfer and (iv) private-sector investment and participation. Given the amount of available funding, the program will target three (3) districts in the Northern and/or Eastern Provinces, to ensure maximum targeting and visibility for Australia’s funding.

TABLE 2: PROGRAM FRAMEWORK: LOCAL ECONOMIC INFRASTRUCTURE PROGRAM (LEIP)



Delivery mechanisms

World Bank
CLICAAP



World Bank
NELSIP

Catalytic Fund

The LEIP would operate at two administrative levels: District and Local Area. If the local environment is right, as gaps are filled in local infrastructure needs, the program will transition to an activity that enables economic growth through government, private sector and community partnerships. A brief description of the types of development assistance that could be supported by an AusAID LEIP at each level is given below.

A program of district economic infrastructure development would support: (i) the development of a major regional/district infrastructure such as an inland inter-modal transport hub, industrial estate or water supply systems (ii) land-use, social and infrastructure planning (iii) institutional human resource development and capacity building (iv) enhancing the business enabling environment (v) improving systems for financial planning and revenue collection of local government operations and maintenance that support economic development.

Local area development assistance would support the reconstruction and rehabilitation of economic infrastructure in conflict areas, flood damaged areas, and local community infrastructure. A program of local area infrastructure would involve small packages of assistance of up to \$200,000 to repair or improve local community infrastructure and facilities such as: feeder roads, repairs to small scale-irrigation systems and tanks; repairs and improvements to water supply, sanitation and drainage systems, and community markets, healthcare, grain storage and transport facilities. Programs for community-based economic development could also be considered.

3.2 DELIVERY APPROACH

The proposed program will be delivered under a World Bank consolidated Trust fund and include two mechanisms:

- (1) North East Local Services Improvement Project (NELSIP)
- (2) Catalytic Fund

The first two delivery mechanisms have been selected because they are already closely aligned to the issues identified by AusAID’s Needs Assessment (Table 3 below). Annex 7 provides more detail on the components.

TABLE 3: FIT BETWEEN WORLD BANK PROGRAMS AND NEEDS ASSESSMENT

World Bank Projects	AUSAID Economic Infrastructure Identified Need for Assistance						
	Rehabilitation of Infrastructure	New infrastructure	Improved Planning	Financial Management	Local Government Capacity	Environmental and Land Management	Community and LED
NORTH EAST LOCAL SERVICES IMPROVEMENT PROJECT (NELSIP)							
1: Infrastructure Service Delivery	X	X					X
2: Institutionalising Accountabilities			X	X	X		X

3: Building Capacities			X	X	X		
4 Assessments and Evaluation	X	X				X	X
5: Project Implementation Support	X	X					X

The Delivery mechanisms allow for a phased approach to local economic infrastructure support and the transition from short-term recovery towards medium term development and longer term innovation. This will be reflected in the funding allocations for each delivery mechanism (see Table 4 below).

TABLE 4: PHASING STRATEGY FOR LEIP

LOCAL ECONOMIC INFRASTRUCTURE PROGRAM	Short-term		Medium-term		Long-term	
	2011	2012	2013	2014	2015	2016
North East Local Services Improvement Project (NELSIP)	*	***	***	***	***	**
Catalytic Fund			*	***	***	***

3.2.1 NORTH EAST LOCAL SERVICES IMPROVEMENT PROJECT (NELSIP)

The Aim of the North East Local Services Improvement Project (NELSIP)^[14] is to improve the delivery of local infrastructure services by local authorities in the Northern and Eastern provinces of Sri Lanka. The project covers five local authorities in the North (Jaffna, Mannar, Vavuniya, Killinochchi, Mullaitivu) and three local authorities in the East (Batticaloa, Ampara, Trincomalee). The project includes five components (See Annex 8). AusAID will work with the ADB and GOSL to select three districts for targeting the expenditure of AusAID funds. An annual program of Activities would be developed by the World Bank in consultation with the AusAID and the GoSL. The program would be reviewed every six months by a joint supervision mission.

3.2.2 CATALYTIC FUND

The Catalytic Fund would be established to provide funds for specialised economic infrastructure, delivered through different modalities, such as partnerships with the private sector to develop cold and grain storage facilities, small manufacturing workshops or subsidies for local governments to construct community facilities not covered in the current NELSIP program. The Fund could also be used to support municipalities to improve infrastructure asset management, public records management, mass appraisal valuation of land and property tax collection which are needed to improve business competitiveness and public sector financial management. The Fund could be rolled into an extension of the recovery programs or into a separate program such as the Cold Storage project being developed by the World Bank or a partnership with an existing private sector facility like InfraCo Asia. The Catalytic Fund is intended to open up opportunities for leveraging capital and resources to develop critical economic infrastructure, facilities and services in locations that will build value chains in areas where local public financial capacity is weak or commercial risks are considered too high for the private sector to invest.

3.3 TARGETING OF ASSISTANCE AND VISIBILITY STRATEGY

Given AusAID resources to support the LEIP are limited, no more than three districts would be targeted for assistance. Vavuniya is a district and town centre worthy of development assistance support, but further investigations are required. It is the Gateway town to the North, and will become an important transport and market centre in the future. The two other targeted districts for development assistance, (depending on fund availability) would need to be identified in consultation with the World Bank and the GoSL.

A focus on three districts would help ensure that Australian visibility is maintained. The establishment of the Catalytic Fund may also support Australian visibility by providing flexibility to support innovative ideas from the private sector. Achieving recognition of Australia’s role in Sri Lanka’s development from the proposed LEIP is an important aspect of collaboration between the Government of Sri Lanka, World Bank and AusAID. AusAID will work with the Government of Sri Lanka and the World Bank to identify opportunities, which may include diplomatic or other representation at key program milestones such as openings of completed facilities or high-level meetings with the Government of Sri Lanka including supervision missions and joint program reviews.

3.4 ALLOCATION OF FUNDS AND POTENTIAL TO SCALE UP

Table 5 below shows a suggested allocation of AusAID LEIP funds for the period 2011-2015. The proposed budget over five years is \$38.55 million. AusAID will need to confirm the suggested budget for the project. Approximately 55% of LEIP funds would be allocated to infrastructure development. Provision has been made for project implementation support and monitoring and evaluation, including joint supervision missions. The table provides a basis for negotiating with the World Bank and the GoSL. There may be need for changing the balance of funds between the two projects during the discussions with the World Bank and GoSL. There may also be the potential for Australia to scale up assistance over time, if more funds become available and strong results are achieved.

TABLE 5: PROPOSED BUDGET LEIP

LOCAL ECONOMIC INFRASTRUCTURE PROGRAM*	2011-12	2012-13	2013-14	2014-15	2015-16	Total	%
	Costs are in AUD million						
North East Local Services Improvement Project (NELSIP)	\$3.90	\$7.20	\$8.20	\$7.45	\$4.50	\$31.25	81
Catalytic Fund	\$0.00	\$0.00	\$0.60	\$1.00	\$4.00	\$5.60	14.5
Project Supervision and Quality (AusAID)	\$0.50	\$0.10	\$0.10	\$0.50	\$0.50	\$1.70	4.5
LEIP TOTAL	\$4.40	\$7.30	\$8.90	\$8.95	\$9.00	\$38.55	100

* Australian Financial Year

3.5 ANTICIPATED RESULTS AND ENGAGEMENT WITH THE GO SL

The expected outcomes of the project will be improved livelihoods and a better quality of life for people in at least two districts of the northern and/or eastern provinces of the country. Approximately 37,000 people could benefit from the investment in infrastructure projects, based on \$60 per head invested in the infrastructure using the World Bank multipliers. Support for a minor roads project under NELSIP could improve 1200 km of road, with significant economic benefits to farm incomes. The institutional benefits of the projects, in terms of improved local economic infrastructure and services delivered effectively by more accountable and financially and technically strengthened local authorities will be much higher, depending on the districts selected. The economic rate of return (ERR) data is not available from the NELSIP project appraisal document, but is expected to be in the order of 18%-20%, based on the performance review of the CLCAAP.

Economic infrastructure is one of the highest priority sectors for the Government of Sri Lanka. If AusAID can effectively capture the results from this activity, and use it effectively to demonstrate our support for the Government’s priorities, we may be able to open up other lines of engagement to broaden AusAID’s development assistance program to local government in the country.

3.6 SOCIO-ECONOMIC ANALYSIS AND SUSTAINABILITY

The World Bank Implementation Status and Results Report ^[15] gave an overall satisfactory ranking to the NELSIP project for the achievement of project development objectives, overall implementation progress,

project management and counterpart funding. Financial management, procurement, and monitoring & evaluation are moderately satisfactory. Integrated Safeguards Datasheet Appraisal Stage ^[16] reports favourable progress on the Community Livelihoods in Conflict Affected Areas Project. Although there have been delays in procurement on the two projects, both are predicted to meet their social economic targets and economic rate of return estimated in the project appraisal documents ^[14, 17]. Projects supported by the catalytic fund will need to demonstrate both leverage and a positive financial rate of return and will need to meet World Bank social and environmental safeguard requirements.

The proposed program of activities is considered sustainable. The reviews of the CLCAAP and NELSIP projects currently being executed in the North-eastern region demonstrate that livelihoods have been improved and rehabilitated infrastructure systems are now functional. The provision of economic infrastructure, especially the restoration of irrigation systems is essential to build the value and supply chain system from farms to markets that will maintain the livelihood of local communities and food security in the country. The provision of basic infrastructure to improve water and sanitation will lead to improved public health and well-being, and reduce the potential impact of future disasters on human settlements in the North. Improvements to economic infrastructure will improve the efficiency of the transport, logistics, and governance systems which will have a beneficial impact on productivity in those areas targeted for assistance. Improved infrastructure will also result in better water quality and improvements to the environment. It will enable those areas given assistance to improve MDG indicators- especially access to better infrastructure, public health and education services.

3.7 MANAGEMENT ARRANGEMENTS

The management arrangements for the LEIP would involve AusAID entering into a Sri Lanka infrastructure trust fund agreement with the World Bank to finance the existing NELSIP project and catalytic project in Sri Lanka. World Bank will need to establish a management unit in Colombo to coordinate project funding and reporting for AusAID assistance to the two projects. This unit can also task consultants for analytical and project preparation work for investment by the trust fund. The approach will require a clear identification of operational roles, risks and a management strategy for implementing a range of project activities identified in the LEIP. AusAID involvement will be based around regular contact, involvement in supervision missions and six monthly coordination meetings with the WB management unit.

The Catalytic Fund will be a flexible mechanism to allow for engagement with the domestic private sector and joint funding of activity with others including InfraCoAsia, PPIAF, GPOBA and the Singapore based PPP unit. AusAID and the World Bank would agree on funding criteria with the World Bank Task Team Leaders for the way Sri Lanka infrastructure facilities would make a request for and utilise funds. The WB management group would then prioritise and prepare a schedule of activity and associated outcomes for AusAID's no objection. AusAID will need to play an active role in the establishment of the Fund to ensure that it meets the Agency's strategic objectives.

3.8 RESOURCE IMPLICATIONS FOR AUSAID

The resource and administration implications for AusAID of a \$38.55 million multilateral sub-national program for local economic infrastructure in lagging regions are not as significant as those if the Agency to develop a bilateral programme with the government of Sri Lanka. Colombo Post will need to hire specialist consultants to participate in project supervision missions and to prepare monitoring and evaluation reports for AusAID. AusAID Post will need to employ a local program manager with an infrastructure background would provide administrative support to manage AusAID inputs into the project; including, joint supervision mission arrangements, QAI reporting and a mid-term review of the program. The Colombo Counsellor and First Secretary will also need to participate in review missions and 6 monthly planning and program consultations with the Bank. There will also be need of technical advice and inputs from AusAID specialist staff or advisors

into program activities during — especially in discussions with the World Bank — and possible participation in supervision missions.

3.9 CONTRIBUTION TO MDGS

The proposed LEIP is strongly supportive of the millennium development goals 1, 7 and 8. The LIEP supports the target of Eradication of Extreme Poverty and Hunger (Goal 1), especially the provision of employment for people that have been displaced from their land due to conflict and flooding. Goal 7, Ensuring Environmental Sustainability, is supported through improved land management and provision of basic water supply and sanitation services. The project is highly supportive of Goal 8, Global Partnership for Development, and targeting good governance, special development needs, and incorporating the private sector to encourage investment and introduce new technologies into lagging regions.

3.10 LINKS TO OTHER AUSAID, GOSL AND DONOR ACTIVITIES AND PROGRAMS IN SRI LANKA

The LEIP offers opportunities for AusAID to leverage its resources with other multilateral ODA agency programs. There are opportunities for AusAID to utilize the Public Sector Linkages Program, to develop partnerships between Australian institutions and Sri Lankan public institutions in the north-eastern region to build capacity of local government administrations. The Australian volunteers and United Nations Young professionals programs also provide opportunities for supporting human resource development and institutional capacity in district and local government. The AusAID Cities Alliance Partnership offers opportunities for the Agency to engage with the World Bank on urban sector capacity building activities, especially the preparation of city development strategies to improve the delivery of infrastructure, economic development projects and utility services in larger urban centres.

3.11 Support for AusAID's cross-cutting policies

The LEIP should be developed and delivered as an integrated project in order to ensure that there are multiplier effects of that contribute to the achievement of crosscutting policies for development assistance specified in the agencies Corporate Plan^[18] and Making a real difference-Delivering real results the Australian Government's response to the Review of Aid Effectiveness. The project will strongly support gender inclusiveness, environment, transparency and accountability, poverty alleviation and livelihoods. Northern Sri Lanka has a high proportion of female headed and involvement of women in economic and human development is a key strategy in reducing poverty. Improved road networks will assist women with equitable access to health and education services, involving men and women in decision making will improve how resources are allocated and participation of women in political decision making and peace building will support their economic empowerment.

3.12 RISK ANALYSIS AND MANAGEMENT

Annex 8 shows a risk analysis and management strategy for the project. Categories of risk included in the assessment are: political; country and sector; technical design; financial management; and procurement, environmental and social risks in project implementation. The overall project risk, using the preferred modality of implementation, is considered moderate. By coupling the program to an existing World Bank program of activities, there is an existing framework for risk management in place, and significant political risks are considered to be minimized through this option. AusAID will undertake an initial assessment of public financial management systems as part of the design process, firstly using the World Bank assessment. If there are concerns then a further independent evaluation will be required.

The proposed program of activities is technically feasible and many of the problems which could arise if a new bilateral programme was developed have been ironed-out with the experience drawn from the current projects. The most difficult aspect of the project will be capacity-building support to district and provincial councils, given the lack of skills, weak governance and low level of IT technology used in these organizations. These matters can be addressed through training programs built into project activities, leveraging resources with other ODA program and NGO activities, and Australian aid volunteer support teams and institutional linkage programs.

3.14 CONCLUSION

The proposed LEIP targeting the north-eastern region of Sri Lanka will make a significant improvement to the livelihood of people living in this area who have been severely affected by conflict and natural disasters. The program can be justified on the grounds it supports the GoSL policies for National development and the AusAID country program strategy and priorities for recovery in conflict affected areas. The project outcomes are expected to be a reduction in poverty, improved health and well-being, improved value chains, new economic opportunities, more efficient and effective delivery of infrastructure and government services, new investment and employment opportunities. The program is expected to improve the MDG indicators for the poorest region of the country through supporting economic growth and social development.

The Concept Design piggybacks an existing World Bank program of activities involving partnerships with local government, the private sector and communities. These projects are likely to be extended beyond the AusAID current country program strategy, which finishes in 2015. The Design will not require extensive resources to develop a co-financing program by AusAID. It will give Australia exposure if LEIP is concentrated in a limited number of districts. The Concept Design is sufficiently flexible to enable the ODA executing agency to modify and change activities according to need. It will enable many people to benefit from the program through the leveraging of resources and the minimization of administrative costs, and the program could be replicated and scaled-up in other lagging regions if there is evidence that the program is effective and if more funds were available.

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ANNEX 1: STATISTICAL AND INDICATOR DATA

HUMAN RESOURCE DEVELOPMENT INDEX SRI LANKA	
Indicator	Value
Prevalence of under nourishment in total population (% of population)	21
Expenditure on health, public (% of GDP)	2
Under-five mortality (per 1,000 live births)	15
Life expectancy at birth (years)	74.4
Education	
Mean years of schooling (of adults) (years)	8.2
Adult literacy rate (both sexes) (% aged 15 and above)	90.8
Combined gross enrolment ratio in education (both sexes) (%)	68.7
Expenditure on education (% of GDP) (%)	2.7
Internet users (per100 people)	5.8
Mean years of schooling (of adults) (years)	8.2
Expected Years of schooling (of children) (years)	12
Income	
GNI per capita (2008 PPP US\$) LN	8.5
GDP per capita (2008 PPP US\$)	4,999
GNI per capita (2008 PPP US\$) LN	8.5
Household final consumption expenditure per capita PPP (constant 2005 international \$)	2,150
Inequality	
Inequality-adjusted HDI value	0.546
Income Gini coefficient	n.a.
Inequality-adjusted education index	0.519
Inequality-adjusted income index	0.414
Inequality-adjusted HDI value	0.546
Inequality-adjusted life expectancy	n.a.
Poverty	
Multidimensional poverty index (k greater than or equal to 3)	0.021
Multidimensional poverty index (k greater than or equal to 3)	0.021
Intensity of deprivation	38.7
MPI: Headcount (k greater than or equal to 3), population in poverty (% of population)	5.3
Population living below \$1.25 PPP per day (%)	n.a.

Gender	
Gender Inequality Index, value	0.599
Maternal mortality ratio (deaths of women per100,000 live births)	58
Population with at least secondary education, female/male ratio	0.973
Adolescent fertility rate (women aged 15-19 years) (births per 1,000 women aged 15-19)	29.8
Labour force participation rate, female/male ratio (Ratio of female to male shares)	n.a.
Gender Inequality Index, value	0.599
Shares in parliament, female-male ratio	0.061
Maternal mortality ratio (new estimates) (deaths of women per100,000 live births)	39
Gender Inequality Index (updated)	0.576
Sustainability	
Adjusted net savings (% of GNI)	10.4
Carbon dioxide emissions per capita (tonnes)	0.6
Protected area (percentage of terrestrial area)	20.8
Adjusted net savings (% of GNI)	10.4
Human Security	
Refugees (thousands)	137.8
Refugees (thousands)	137.8
Unemployment rate, total (%) (% of labour force)	5.2
Homicide rate (per 100,000)	7.4
Robbery rate (per 100,000)	n.a.
Population affected by natural disasters (average per year, per million) (average per year per million people)	31,444
Composite indices	
HDI value	0.658
Indicator	Value
Multidimensional poverty index (k greater than or equal to 3)	0.021
HDI value	0.658
Gender Inequality Index, value	0.599
Inequality-adjusted HDI value	0.546

HUMAN DEVELOPMENT INDEX: TRENDS 1980 - PRESENT

Rank	91		
Year	Sri Lanka	South Asia	World
1980	0.513	0.315	0.455
1985	n.a.	0.356	0.486
1990	0.558	0.387	0.526
1995	n.a.	0.415	0.554
2000	n.a.	0.440	0.570
2001	n.a.	0.445	0.575
2002	n.a.	0.451	0.581
2003	n.a.	0.459	0.587
2004	n.a.	0.470	0.594
2005	0.635	0.481	0.598
2006	0.640	0.489	0.604
2007	0.646	0.499	0.611
2008	0.650	0.504	0.615
2009	0.653	0.510	0.619
2010	0.658	0.516	0.624

Source: Human Development Index ^[1]

PROVINCIAL INDICATORS

Table 1.51 > Performance of Regionally Balanced Development 2009

Indicator	Region/Province								
	Ran Aruna	Wayamba Pubuduwa	Nagenahira Navodaya	Rajarata Udanaya	Uthuru Wasanathaya	Pubudamu Wellassa	Ruhunu Udawa	Sabaragamu Arunaikaya	Kadurata Udanaya
Covering Districts	Colombo, Kalutara, Gampaha	Kurunegala Puttalam	Ampara Baticcalo Trincomalee	Anuradapura Pollonnaruwa	Jaffna, Mullaitivu, Killinochchi, Mannar, Vavuniya	Badulla, Moneragala	Matara, Galle, Hambantota	Rathnapura, Kegalle	Kandy, Nuwara Eliya, Matale
GDP (Rs. Bn)	2,178	495	281	232	159	220	492	303	465
Per capita income (Rs. ' 000)	375	213	183	189	134	168	199	157	175
Poverty headcount index	4.00	7.00	5.00	7.00	N/A	9.3	9.00	9.3	9.5
Infant mortality rate per 1,000 births	9.3	8.7	10.7	8.5	3.00	5.5	8.6	5.5	11.1
Maternal Mortality Ratio per 1,000 live births	0.34	0.42	0.53	0.22	0.56	0.57	0.36	0.44	0.46
Access to Safe Water	94.4	86.2	89.1	82.7	N/A	78.3	85.0	72.9	72.1
Access to Electricity	98.1	92.0	70.6	82.3	48.2	75.5	95.6	83.5	89.6
Unemployment	6.5	5.4	7.7	4.7	N/A	4.6	9.4	5.7	6.5

Source: Department of National Planning

Table 1.52 > **Provincial Share of GDP and Mean Household Income**

Province	2007	2009	2016		
	Share of GDP %	Mean Household Income (Average Monthly) (2006/07) Rs.	Share of GDP %	Mean Household Income (Average Monthly) (2009/10) Rs.	Share of GDP %
Western	48.4	34493	45.1	44955	32.0
Central	8.9	20507	9.6	35100	10.0
Southern	10.5	24730	10.2	31940	14.0
Northern	2.9	N/A	3.3	N/A	7.0
Eastern	5.0	18876	5.8	19710	7.0
North Western	9.6	20631	10.3	32120	11.0
North Central	3.9	24548	4.8	35235	6.0
Uva	4.5	19757	4.6	27739	6.0
Sabaragamuwa	6.3	19698	6.3	33865	7.0

Source: Department of Census and Statistics

Source: ^[19]

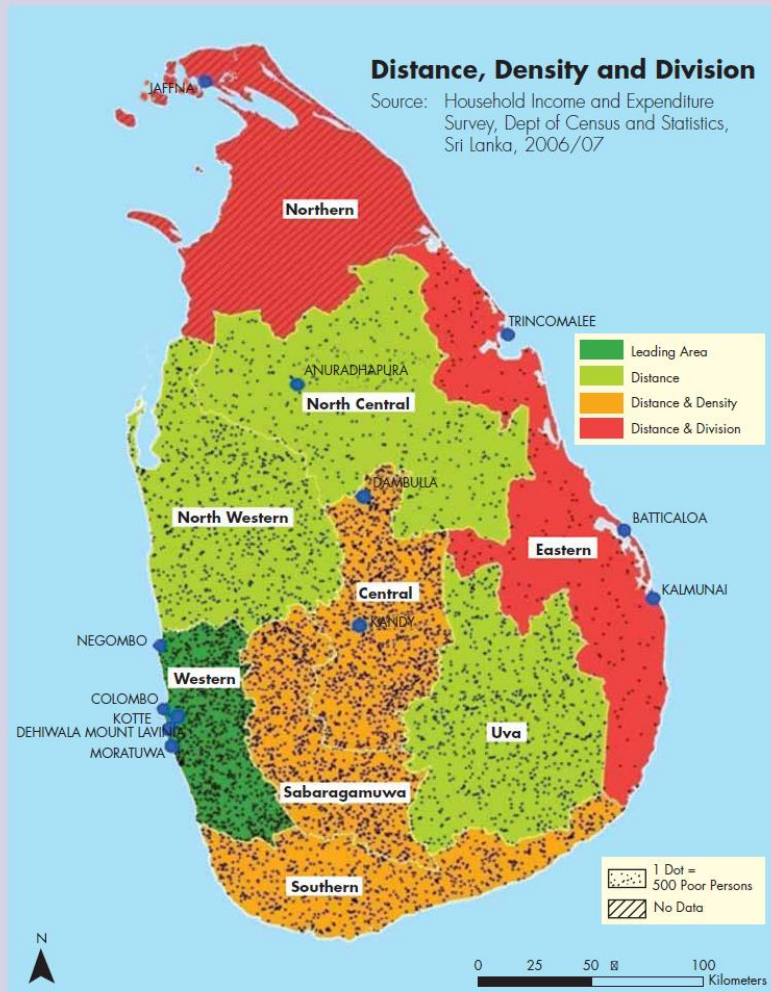
Table: 1.53 > **Gini Coefficient of Household Income and Per Capita Income - 2006/07, 2009/10**

Sector / Province	2006/07	2009/10	2006/07	2009/10
	Gini Coefficient of Household Income	Gini Coefficient of Household Income	Gini Coefficient of Per capita Income	Gini Coefficient of Per capita Income
Sri Lanka	0.49	0.47	0.49	0.46
Urban	0.54	0.45	0.55	0.47
Rural	0.46	0.46	0.46	0.46
Estate	0.41	0.44	0.46	0.43
Western	0.49	0.45	0.49	0.46
Central	0.48	0.51	0.48	0.51
Southern	0.44	0.43	0.43	0.42
Northern	N/A	N/A	N/A	N/A
Eastern	0.44	0.33	0.42	0.30
North Western	0.48	0.49	0.47	0.48
North Central	0.44	0.39	0.44	0.39
Uva	0.48	0.41	0.47	0.39
Sabaragamuwa	0.48	0.50	0.47	0.48

Source: Department of Senses and Statistics

Source: ^[19]

Figure 5: Connecting people to prosperity: identifying area-specific challenges



Source: CPP Team

Source: [6]

Table 1.7 > Public Investment by Sectors (Rs. Bn)

Item	2006	2007	2008	2009	2010
Public Investment	177.4	229.3	263.9	330.4	356.5
Economic Services					
Highways	35.0	46.9	82.7	100.6	108.0
Ports	5.8	0.6	7.8	28.1	29.0
Power and Energy	4.5	23.9	16.8	32.8	23.1
Water Supply	17.9	19.7	25.6	24.2	25.8
Agriculture*	16.1	16.4	29.5	29.5	25.5
Irrigation	7.3	7.5	10.7	14.3	10.6
Social Services					
Education	17.2	19.9	22.9	18.1	19.1
Health	11.0	12.0	11.0	10.0	13.0
Housing	4.0	4.5	4.8	5.3	5.5

*Including development subsidies

Source: Department of National Budget

Source: [19:44]

ANNEX 2: MAP OF PROVINCES

SRI LANKA: North East Local Services Improvement Project (NELSIP)



Source: [14]

ANNEX 3: NEEDS ASSESSMENT

There are gaps in existing ODA assistance programs which AusAID funds could help fill. In order to identify where AusAID could strategically position itself to ensure the most effective delivery of its aid program to Sri Lanka, the various sector activities in which ODA agencies and organisations have provided assistance to the country were mapped with an estimate of the total amount of funds (grants and loans) provided during 2010 (Annex 3). There are many common areas, particularly human resource development, humanitarian aid and infrastructure, which most of the major ODA is involved with. It is essential that any programme of assistance developed by AusAID is targeted to needs and priority areas of assistance. A prioritised list of areas of potential assistance for AusAID to support includes:

RESTORATION AND REHABILITATION OF DAMAGED SMALL-SCALE INFRASTRUCTURE:

The highest and most urgent priority is to restore small-scale infrastructure that has been damaged from human and natural disasters. In the Northern Province this includes damage from the conflict and in the Eastern Province and North-Central Province this includes damage from the February 2011 floods. In other lagging regions damage has been caused from neglect and lack of maintenance. The Government and the loan based donors are focused on the repair of large-scale infrastructure rehabilitation. Some examples of the small-scale physical assets that need to be repaired, and which contribute to economic development include: irrigation systems, local feeder roads, rural and town water supplies, public amenities, urban drainage, local markets, storage facilities for agricultural produce and community facilities such as schools and health clinics.

PREPARATION OF ECONOMIC DEVELOPMENT PLANS AT A DISTRICT AND LOCAL GOVERNMENT LEVEL

The second priority area of assistance is support for more integrated planning of infrastructure investments at the district and local government level. While provincial level development plans have been prepared by the National Planning Authority for all regions of the country, there is need for district and local government economic development plans to be prepared, that define local infrastructure needs, specific packages of investment and funding needed to build infrastructure. While there are other grant and loan based donors proposing to work in this area (EU, ADB, WB) there are still likely to be gaps across the country. Involvement of the private sector in this planning process will also ensure that infrastructure is linked into key value chain processes.

SUPPORTING NEW ECONOMIC INFRASTRUCTURE INVESTMENTS:

The third priority area for AusAID assistance is supporting new infrastructure investments at the District and local level. Increasing income levels in poorer rural areas will require increased levels of production efficiency and value adding. This includes product handling, shipment of farm products to markets and industrial food processing zones. Few major towns in regional centres have serviced industrial estates which are essential to attract manufacturing and food-processing industries. Vocational training centres are needed to develop skills required for new industries. Improved markets and transport hubs are required to support the development of local economies and improved logistics operations. The role for donors in this space needs to be carefully considered beforehand to ensure that the private sector and government are not crowded out.

STRENGTHENING THE CAPACITY OF LOCAL GOVERNMENT:

A fourth area priority area for AusAID assistance is strengthening District and local governments, in terms of governance and technical capacity and capability to deliver and maintain essential economic infrastructure services. There is a need for technical and continuing professional development training to local government organisations to ensure they have the necessary skills and competencies to provide essential economic infrastructure services at the local level. This includes:

Improved Access to Finance and Service Pricing: Financing the restoration and development of local economic infrastructure is challenging, because most funds have to come from government and limited ODA and NGO sources. Many services, such as water for irrigation, are provided at no or little costs to consumers, making it difficult to recover the cost of infrastructure improvement projects. There is a need for improved finance and cost-recovery funding mechanisms to provide critical economic infrastructure in provincial towns and cities. Mechanisms to improve the financing and cost recovery of basic economic infrastructure facilities and services need to be identified.

Asset Management and Land Information Systems: There is need to improve records management of public assets, especially infrastructure and property and land ownership in districts. Many provinces and districts have outdated records and no inventory of infrastructure assets. This makes it difficult to identify where infrastructure is located, its age and condition. Improved records management is needed to ensure that infrastructure is properly maintained and managed.

ANNEX 5: OPTIONS AND ALTERNATIVES

There are several options open to AusAID to deliver a program of activities to lagging regions to support the development of economic infrastructure. These options include:

1. **AusAID executed program of activities:** This would involve AusAID preparing a project design and executing the project using an in-house management team or a managing contractor. The project could operate as a facility for the allocation of small grants and programs of technical assistance, or it could specifically target infrastructure development and restoration in targeted areas of the North.
2. **AusAID co or parallel-financed project:** This option involves working with ODA partners to design a project that could be implemented by and executing agency appointed by the ODA partners. There are other variations which could be used for the design, funding and implementation arrangements for a project. Several alternatives to this option are discussed in detail in Annex 4.
3. **AusAID partnership projects with other ODAs, business and government:** This option would involve other ODAs, a government agency (ies) and the private sector partnering to develop and implement project.
4. **AusAID project executed under an existing program:** This option could involve budget support for a specific program of activities or execution of the project through an NGO or bilateral agency. This approach was successfully used for the delivery of humanitarian aid in conflict regions after hostilities had ceased.
5. **AusAID direct budget support program:** This option would involve direct support to the GoSL for a specific program of activities designed and implemented through a sector agency at a provincial and district level.
6. **Public Private Partnerships** offer a potential way to improve the funding, management delivery of lagging regions services. This option is similar to a partnership between USAID, World Bank, and private sector company to build regional cold store facilities. AusAID has limited experience of local and provincial governments engaging in public private sector partnerships, which will be essential to overcome the limitations of sub-national governments to provide and manage essential economic infrastructure services.
7. **Mixed Modality Delivery Program:** The final Concept Design for the program of activities may include a mix of the above.

There are alternatives within each of these options to develop a program of activities to support the development of economic infrastructure in lagging regions. The preferred and least risk option for AusAID is the development of the project involving co or parallel financing. Other options, although feasible, are likely to involve significant agency resources in the design, administration, and project management of the program of activities. Budget support is not favoured because of the limited capacity of public agencies to execute programs. And AusAID executed program is not preferred for similar reasons. AusAID has no experience of working in public private sector partnerships in Sri Lanka, but the option is worthy of inclusion in the project design.

ANNEX 6: CURRENT PROJECTS AND POTENTIAL PARTNERSHIPS

The Mission identified a list of current and proposed programs of other donors and multilateral development banks. All of these programs have some overlap with the key development needs that the mission has listed as a priority for economic growth in lagging regions. An assessment of programs against the needs analysis is shown in the table below A6.1. A brief summary is given of the programs below.

WORLD BANK

Community Livelihoods in Conflict Areas Project ^[17] – **Third Additional Financing** :The objective of the Community Livelihoods in Conflict Affected Areas (CLICAAP) or 'Awakening Project' is to help the conflict-affected communities and villages in the Northern Province of Sri Lanka by: (i) restoring their livelihood; (ii) enhancing agricultural production and income; and (iii) building their capacity for sustainable social and economic reintegration. The project began as the North-East Irrigated Agriculture Project (NEIAP) in 1999 with a \$27 m WB/IDA Credit. It was extended in 2004 with a \$64 m with an added a focus on community development. In 2009 the program was extended —partly because the budget was not spent due to increased hostilities during 2008 -2009. The program was extended in 2011 is scheduled for completion in 2015. Total program value is US\$ 140 million which included the additional financing component of US 48 million with disbursements over FY 2011-2015.

North East Local Service Improvement Project (NELSIP) ^[14]: Project objective is to improve the delivery of local infrastructure services by local authorities in the northern and eastern provinces of Sri Lanka. Components of the projects include Infrastructure Service Delivery, Institutional Accountability, Building local authority capacity, monitoring and evaluation and project management. Activities include rehabilitation of infrastructure managed by local authorities, including rural roads, drains, public buildings, markets, rural water supplies. Project is under implementation with a total program value is US\$ 86 million IDA financing with disbursements over FY 2010-2015.

Warehouse Finance Development ^[20]: Project objective is to introduce financing system that will improve market chains for dry agricultural products. Components of the project include construction of 6 grain warehouses around Sri Lanka which will be operated by the private sector for proof of concept. World Bank would like to explore development of the concept into multi purpose facility including cold storage for fruits and vegetables. Expected outcomes are a 25% increase in farm income for beneficiaries using the system. Pilot project is under design with a total value of US\$ 6.5 million over FY 2011-2014.

ASIAN DEVELOPMENT BANK

Conflict Affected Region Emergency Project ^[21]: Project objective is to expand and strengthen the reconstruction of urgently needed essential infrastructure and administrative services to meet basic human needs and create employment in conflict affected areas of Northern and Eastern Province and adjoining areas of North Central Province. Components of the projects include re-establishing connectivity, restoring utilities and improving basic social services. Activities include rehabilitation of national, provincial and rural roads, restoration of electricity and water supplies, and restoration of small to medium sized irrigations schemes, construction of administrative centres and rehabilitation of vocational training centres. Project is under implementation with a total program value is US\$ 168 million with US\$150 million for ADB loan financing with disbursements over FY 2010-2013.

Lagging Local Authorities Infrastructure Development Sri Lanka ^[22]: Project focus is on the poorest performing local government areas in Sri Lanka. It will work throughout Sri Lanka but not including the conflict affected northern and eastern provinces. ADB will work in 7 provinces to expand small scale infrastructure and build the capacity of local

government. Components of the project include water supply, roads, markets, solid waste management, governance and local government revenue. Project is under design with a total program value is US\$ 59 million with ADB loan financing of \$50 m with disbursements over FY 2012-2013.

EUROPEAN UNION:

EU is developing a new country strategy program for 2012-2016 which will have a greater focus on sustainability and working more closely with government in 4 northern districts. (Ampara, Batticalda, Vavunya and Manar) They have a strategy of better coordination of UN agencies through a one UN approach rather than dealing with separate institutions. Components of the project include delivery of pro poor services, support for local economic growth including agro industry, SME's and vocation training as well as local government capacity building. Activity will include irrigation systems, tanks, rice mills, fisheries, market places, small business development, public buildings and support for farmer organisations and local government. Project is under design with a total program value is €72 million with disbursements over FY 2012-2016.

UN AGENCIES:

UN Agencies currently work separately implementing small infrastructure and rural livelihoods projects. Agencies include UN Habitat (Housing), UNDP, FAO, UNICEF and ILO. Development of new programs will be subject to available funding from donors, in particular the EU.

CIVIL SOCIETY

Domestic Private Sector

There is an active private sector operating in rural areas to improve their own supply chains. Cargill's has developed a number of storage areas in the north and has programs which focus on improving on farm production, food processing, vocational training, community development and micro finance. Interest rates through the Cargill's loan guarantee program are only 8% per annum through commercial banks compared to 5-6% per month charged by farmer groups and small lenders. USAID and the Gates Foundation are involved in some of this work.

DISCUSSION ON PREFERRED MULTILATERAL PARTNER

There is three viable program options. One is the proposed European Union Northern and Eastern Province Assistance Program. It aligns closely with the needs assessment. However, the program has a number of quite high risks, it is in the design phase and an approval date is uncertain. Depending on political developments in Sri Lanka members of the European may even delay implementation of a new project.

The second option is to work with World Bank through a Sri Lanka infrastructure thematic trust fund. A Trust Fund would support the two existing WB programs in the north and east and other programs including engagement with the domestic private sector and joint funding of activity with others including PPIAF, GPOBA and the Singapore based PPP unit. It would operate as a facility in a similar way to the current AusAID WB SAR IFGI Trust Fund. WB and AusAID would agree on funding criteria and then the WB management group would prepare a schedule of activity and associated outcomes for AusAID's no objection. Both approaches have associated issues and the clear identification of operational roles, risks and a management strategy will be necessary elements of the Concept Note.

The third option, the Community livelihoods project and ADB's conflict affected regions programs mostly focus on rehabilitation of basic services to restore the functionality of rural production systems. NELSIP and ADB Lagging regions project focus more on local government services but do not have a strategic approach to

economic growth and development. ADB lagging regions will only work 'outside' the conflict affected areas to avoid overlap with World Bank programs.

The World Bank Warehouse Finance Facility, while strategic, does not deal with the rehabilitation of damaged infrastructure and has a number of timing and commercial risks. However development of the multi functional concept could be a useful subject for an analytical technical assistance project.

Civil Society and UN Agencies in Sri Lanka are currently implementing donor funded activity in conflict affected areas. These agencies do not have a pipeline of projects but operate within broad strategic frameworks. They have spare capacity to implement but will only develop activity specific programs when donor criteria or funding availability is known.

There is also an active private sector operating in rural areas to improve their own supply chains. Cargill's has developed a number of storage areas in the north and has programs which focus on improving on farm production, food processing, vocational training, community development and micro finance. USAID and the Gates Foundation are involved in activity with the private sector.

PREFERRED PARTNER

The EU and World Bank partnership offer the two best options to support an LEIP for Sri Lanka. Both partners programs would include rehabilitation of infrastructure, new infrastructure, improved planning and financial management, local government capacity, environmental and land management. These are all essential elements of building blocks needed to develop and maintain economic infrastructure. The EU program, however, is still at the development stage and there are much higher levels of political risk and administrative costs associated with it, than with the NELSIP project. It is unlikely the project would be fully operational before 2013. AusAID is seeking to disburse funds in the 2012. The preferred partners for the LEIP is the World Bank.

SELECTION OF A PREFERRED PROJECT

The Community Livelihoods in Conflict Affected Areas Project (CLICAAP) North East Local Services Improvement Project (NELSIP) both offer opportunities to fund project activities that will satisfy a range of needs for assistance identified in the tree problem analysis. However, with a budget averaging around A\$8 million a year, the administrative overheads for AusAID in servicing the two projects will be high. An evaluation of how well the two projects responded to the needs assessment identified in the problem tree analysis was undertaken (See tableA6.1). It showed the NELSIP project provided the best spread of activities in response to needs, and in addressing the key performance outcomes of the AusAID Country Program Strategy for Sri Lanka. Value for money, the NELSIP project offers the most effective approach to the delivery of a local economic infrastructure project for Sri Lanka.

NELSIP also offers greater opportunities to target and leverage AusAID funds through the Catalytic project. The Activities supported by AusAID are expected to identify issues and opportunities to leverage funds through partnerships with the private sector and local governments. These may include small grant funds to develop improved valuation or management information systems that will enhance the revenue collection and competitiveness of district economies. Opportunities for leveraging private sector funds to reduce risks involving the development of improved logistics facilities, information and energy efficiencies in districts may be possible under the Catalytic Fund.

TABLE A6.1: FIT BETWEEN AUSAID NEEDS ASSESSMENTS FOR COMPONENTS OF CLICAAP AND NELSIP PROJECTS

World Bank Projects Aligned to AusAID CPS	AUSAID Identified Need for Assistance						
	Rehabilitation of Infrastructure	New infrastructure	Improved Planning	Financial Management	Local Government Capacity	Environmental and Land Management	Community and LED
COMMUNITY LIVELIHOODS IN CONFLICT AFFECTED AREAS PROJECT							
Component 1: Village Rehabilitation and Development							
• Agriculture roads	X	X					
• Housing		X					
• Education		X					
• Village Water Supply and Sanitation	X	X					
• Health & Sanitation	X	X					
Component 2: Rehabilitation of major Irrigations Schemes							
• Small-scale Irrigation	X						
Component 3: Farmer Organizations and Cluster Development							
• Livelihoods							X
• Community development							X
Component 4: Project Implementation Support							
• Procurement	X	X					X
NORTH EAST LOCAL SERVICES IMPROVEMENT PROJECT (NELSIP)							
Component 1: Infrastructure Service Delivery							
• Infrastructure (roads, water supply, sanitation services)	X	X					
• Community facilities (markets, health clinics, libraries)	X	X					X
Component 2: Institutionalising Accountabilities							
• Financial audits of local Authorities				X	X		
• Social and technical audits of public expenditures				X	X		
• Participatory planning, budgeting and monitoring.			X	X	X		
• Community Education and Learning							X
• Strengthen in demand-side approaches to local governance				X	X		
Component 3: Building Capacities							
• planning, budgeting, financial, revenue and procurement			X				
• Improving internal and external audits of LAs				X	X		
• Training financial, procurement and project management				X	X		
• Developing a long-term capacity building LA Departments				X	X		
• Capacity building of national and provincial institutions				X	X		
Component 4 Assessments and Evaluation							
• Monitoring and Evaluation					X		
• Evaluating technical and social audits for score cards					X		X
• Other needed analysis	X	X	X	X	X	X	X
Component 5: Project Implementation Support							
• Procurement	X	X					X

ANNEX 7: DESCRIPTION OF WORLD BANK PROJECTS COMPONENTS

The following summarises briefly the components of the World Bank North East Local Services Improvement Project. This information draws upon material taken from the World Bank project website.

NORTH EAST LOCAL SERVICES IMPROVEMENT PROJECT (NELSIP)

The Aim of the North East Local Services Improvement Project (NELSIP)^[14] is to improve the delivery of local infrastructure services by local authorities in the Northern and Eastern provinces of Sri Lanka. The project covers five local authorities in the North (Jaffna, Mannar, Vavuniya, Killinochchi, Mullaitivu) and three local authorities in the East (Batticaloa, Ampara, Trincomalee). There are five components of the project described briefly below.

Component 1: Infrastructure Service Delivery (\$US76m). The objective of this component is to improve the quantity and quality of public goods delivered and maintained by local authorities (LAs). These may include rural roads, drains, culverts and bridges, public buildings, markets and fairs, waste disposal, rural water supply, parks, recreation facilities and libraries, nursery schools, playgrounds and dispensaries and similar public utility services. This component is intended to ensure predictable and transparent resource transfers in the form of Capital Grants from the central government to the LAs, to enable them to plan and deliver these services in accordance with the GOSL's guidelines for participatory planning.

Component 2: Institutionalising Accountabilities (US\$ 2 million). This component has five objectives to assist LAs to be responsible for public expenditures and deliver local services in a transparent and accountable manner. It will strengthen upward and downward accountability systems at the LAs to support:

- i. Transparent and independent annual financial audits of LAs to ensure their financial accountability;
- ii. Social and technical audits of public expenditures undertaken by LAs to ensure effective use of funds in line with citizen expectations; and
- iii. Systems and processes to bring greater transparency in LA affairs and strengthen citizen voice in planning, budgeting and monitoring.
- iv. Information, education & communication campaign aimed at disseminating project related information to different stakeholders at all levels.
- v. Facilitate working with other civil society stakeholders to strengthen demand-side approaches to local governance.

Component 3: Building Capacities (US\$ 4 million): This component is intended to strengthen the service delivery systems and building capacities of the LAs to deliver a range of services as well as strengthening the monitoring capacities of the provincial and national level institutions. Five areas are targeted for support:

- i. Improving the efficiency of current systems and procedures relating to planning, budgeting, financial management, revenue management and procurement at the LA level
- ii. Improving the efficiency, timeliness and follow up of the internal and external audits of LAs
- iii. Training elected representatives and staff of LAs on financial management, procurement and project management
- iv. Providing effective hand holding support to LAs by the district local government staff on day to day basis; and developing a long-term capacity building strategy for LAs including the Organizational Development Unit (ODU) of the local government departments
- v. Strengthening of the capacities of the national and provincial level institutions that play a critical role in the support and oversight of local government functions

Component 4 Assessments and Evaluation (US\$ 1 million): This component will finance:

- i. activities pertaining to establishing a comprehensive monitoring system, including baseline assessment, repeater surveys of social assessments, social accountability assessment, and capacity assessments;
- ii. evaluating technical and social audits and preparation of citizens' score cards; and
- iii. Other needed analysis as and when they are needed.

Component 5: Project Management (US\$ 3 million): This component supports the key agencies at the central, provincial and local levels involved in the project in the day to day management of the project procurement necessary consultant, equipment and operational support for the smooth implementation of the project.

ANNEX 8: PROJECT RISK ASSESSMENT PROPOSED LOCAL ECONOMIC INFRASTRUCTURE PROJECT

Risk	Likelihood	Impact	Risk Level	Impact	Mitigation Strategies
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EXTERNAL RISKS

Civil Hostilities in the North and East break out again	C	5	M	Project activities may need to be rescheduled to areas where there is a higher level of security	Strategies to be developed to switch assistance to areas with better security
Political bilateral relations between Sri Lanka and Australia deteriorate	C	3	M	As program would be run through World Bank, the risks of the program being stopped is reduced greatly	Beyond the project to manage, but will involve steps to improve bilateral relationships between the two countries
Political Disruption caused to project by Tamil International Community	B	3	L	Questions may arise of specific project activities requiring reporting to Tamil community locally and in Australia	Program is targeted to support rehabilitation in a mainly Tamil area of the country. Need to keep Tamil community in Australia informed
Currency exchange rate risks which will affect AusAIDs CPS budget and capacity deliver on the program	B	3	H	The exchange rate may have positive or negative impacts depending on appreciation or depreciation of \$AUS to SLR and \$US	Monitor and evaluate carefully the exchange rate and its impact on the project annually basis. Scale up or down forward program according to expected exchange rate.
Financial Cost rise caused by delays, inflation and other operational factors	B	3	H	Periods when there will be disruptions	Sufficient cash kept in account to cover expect cash flow. Sub consultants to be paid after stage payments made to company by clients.

Project Risk

Stakeholder management – relationship with partner and other GOSL stakeholders deteriorate	D	5	H	Blow out in project costs and time lines	Ensure relations between, AusAID, World Bank and the government of Sri Lanka agencies maintain through meetings and information sharing so WB and GoSL partners are well-informed.
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Political Support for Project: The GOSL, Provincial and local district government withdraws its support for the project.

Operational – covers the planning, daily operational activities, resources (including people) and support required within the business that results in the successful development and delivery of products/services.

Security information, intellectual property, and technology stolen.

Fraud and Corruption – covers the misappropriation or fraudulent use of AusAID funds

Procurement Delays: delays occurred to procurement of essential equipment and contractor's to ensure effective delivery of targeted program activities.

Financial – Failure of ODA partner to make pay on invoices

C	4	H	Project fails to meet its development objectives	Ensure relations between, AusAID, World Bank and the government of Sri Lanka agencies maintain through meetings and information sharing so all partners are well-informed.
B	3	M	Blow out in project costs and time lines	All projects to be included in PERT systems for monitoring and evaluation of progress on project tasks and activities. All projects over \$50,000 to have Project risk Management Plan.
E	2	L	Catalytic Fund may require AusAID to ensure commercial, technology, information or grant bidding interests are confidential or secure.	Ensure security of IT and confidential information and data during the life of the project.
			AusAID funds are not spent efficiently reducing the outputs and outcomes of the project	Ensure transparent accounting for procurement, project delivery and monitoring and evaluation of expenditure on the project.
B	3	H	Delays in implementation, cash flow and project overrun problems	Ensure financial accounting systems are in place for monitoring and evaluation of progress on project tasks and activities. All projects over \$50,000 in contract value to have Project risk Management Plan. Ensure procurement processes are open and transparent, and staff responsible for procurement are well trained in WB procurement processes.
C	3	M	Cash flow problems	Contract, where possible, to include stage payments to minimise cash flow risk exposure. Risk relatively low as client predominantly international development agencies and well established business enterprises.

Project Management – includes the management of equipment, finances, resources, technology, timeframes and people involved in the management of projects. Extends to internal operational projects, business development and external projects such as those undertaken with international partners

Lack Institution Cooperation: difficulty in working relationships between sub National levels of government caused delays for and other problems with the implementation of projects

Loss of Productivity and Staff Support: lack of skills, competencies and human capital lead to delays in implementation of projects

Loss of Corporate Knowledge: officials training to undertake responsibilities to improve the operations and management of infrastructure leave the region for higher pay employment elsewhere

Sustainability: many of the program activities fail to generate value adding, improve maintenance and operations and increased livelihoods.

Safety – including everyone associated with the business: individual, workplace and public safety as well as travel

C	2	L	Delays in implementation, cash flow and project overrun problems	All projects to PERT systems for monitoring and evaluation of progress on project tasks and activities. All projects over \$50,000 in contract value to have Project risk Management Plan.
D	4	H	Limited capacity building takes place within provincial and district institutions	Introduce programs of change management to make sure public agencies involved with projects fully understand the need for change and how to motivate staff to embrace it.
D	4	H	Delays will occur in project implementation	Ensure human resource management development programmes public agencies are targeted to meet skills and management deficiencies gaps in public agencies
E	4	E	Underperformance of provincial and district institutions	Introduce programs of change management to make sure public agencies involved with projects fully understand the need for change and how to motivate staff to embrace it.
D	3	M	Project fails to meet its development outcomes	Ensure the monitoring and evaluation systems put in place track the performance of projects against desired development outcomes.
C	3	M	Risk to personal safety of staff is high when working in developing countries. Risk to personal health, Kidnapping, and security would affect business operations.	Travel will not be undertaken to regions of the country where Department of Foreign Affairs warns it is unsafe for Australians to travel. A travel evacuation plan has been put in place for personal travelling outside Australia

RISK ASSESSMENT CRITERIA

Measures of Impact

Level	Descriptor	Example detail description of Impacts
1	Insignificant	No injuries, low financial loss
2	Minor	Basic emergency treatment, on-site release immediately contained, medium financial loss
3	Moderate	Medical treatment required, on-site release contained with outside assistance, high financial loss
4	Major	Extensive injuries, loss of production capability, off-site release with no detrimental effects, major financial loss
5	Catastrophic	Death, toxic release off-site with detrimental effect, huge financial loss

Measures of Likelihood

Level	Descriptor	Description of Likelihood
A	Almost certain	Is expected to occur in most circumstances
B	Likely	Will probably occur in most circumstances
C	Possible	Might occur at some time
D	Unlikely	Could occur at some time
E	Rare	May occur only in exceptional circumstances

Measures of Consequence

Likelihood	Insignificant	Minor	Moderate	Major	Catastrophic
	1	2	3	4	5
A (almost certain)	H	H	E	E	E
B (likely)	M	H	H	E	E
C (moderate)	L	M	H	E	E
D (unlikely)	L	L	M	H	E
E (rare)	L	L	M	H	H

Note: The number of categories should reflect the needs of the study.

E: extreme risk, immediate action required by relevant authorities

H: high risk, senior management attention needed

M: moderate risk, management responsibility must be specified

L: low risk, manage by routine procedures

ANNEX 9: CONTACTS LIST: CONCEPT DESIGN MISSION, 20-30 JUNE, 2011

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