



# Sri Lanka PPP Diagnostic Note

## Accelerating infrastructure investment through PPPs

### Key Findings

- **Fiscal constraints and limited budget resources will require the Government of Sri Lanka to explore and consider alternative financing options to address the country's infrastructure needs.** One option to address these constraints is to mobilize private sector financing through the use of Public Private Partnerships (PPPs). However, it is important to note that PPPs have direct and indirect fiscal and financial implications which need to be assessed on a case by case basis and fully understood by participating agencies and policy makers.
- **Overreliance on public finance.** In Sri Lanka today, many projects that are suitable candidates for PPP procurement are typically being financed through the public sector, with the public sector funds often being sourced through sovereign loans backed by sovereign guarantees. Private sector financing is only sought in cases where a project is unable to secure public funding. This practice is partly a result of the lack of a framework that can help line ministries determine the most appropriate method of procurement and financing (public sector versus PPP) at the project inception stage.
- **Lack of project prioritization.** The Government's Western Region Megapolis Program consists of over 160 individual projects with an estimated investment volume of US\$40 billion. In addition, there are a large number of other projects identified by various agencies at the national level. However, there is no framework to prioritize such projects and, more importantly, many of these projects are not being properly assessed for feasibility or readiness for implementation.
- **Multiple agencies with overlapping functions.** There is currently no clear assignment of responsibilities among the various government agencies engaged in promoting PPPs. As a result, different agencies are independently pursuing PPP projects. The absence of a cohesive framework to govern the institutional mandates, responsibilities and inter-agency decision making processes has created an environment of uncertainty and confusion that is difficult for potential domestic and foreign investors to navigate.
- **Limited institutional capacity.** Although in the past there have been several PPPs successfully transacted in the port and power sectors, the current institutional capacity with respect to structuring and procuring PPPs is severely limited.
- **Over reliance on unsolicited proposals.** In recent years, a substantial number of public sector projects have been procured on an unsolicited bid basis which is a practice that can have adverse implications with respect to transparency and value for money considerations.
- **Limited capacity in the debt markets to finance infrastructure projects.** There are liquidity (debt volumes and tenors) constraints in the domestic financial markets given the magnitude of investment required.
- **Land valuation issues.** A perceived lack of consistency with respect to the allocation and valuation of Government land for investment has implications for a successful PPP program.



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## **Key Actions**

- **Optimize public resources and prioritize investments.** To optimize the use of public resources a more systematic process of project prioritization should be adopted. In addition, instituting a mechanism for a detailed economic and financial analysis of each of the prioritized projects as well as having coordinated inter-agency discussions, will help better determine the nature of support (financial and/or non-financial) that may be required from Government.
- **Establish an ‘apex’ institutional framework.** A high-level committee, with representatives from key sectors, should be established. Such an apex institution would have the mandate to review all proposed investments and assess whether they should be financed publicly or be developed through a PPP. An inter-ministerial or cabinet level sub-committee could act as such an apex institution.
- **Institutionalize a PPP unit.** Based on the experience in other countries, a specialized PPP unit for the identification, preparation, evaluation and negotiation of PPPs should be considered for the development of PPPs in Sri Lanka. This PPP unit would also provide the necessary analytical support to the proposed apex institution referred to above.
- **Improve policy environment.** Clear and consensus-based policies and guidelines should be established around Public Investment Management and PPPs, with the objectives of enhancing coordination and optimizing the use of public finance.
- **Strengthen procurement guidelines.** Sri Lanka’s current public procurement guidelines for PPPs require review and revision, particularly with respect to managing unsolicited bids. Specifically, the mechanisms and procedures for handling unsolicited proposals need to be clarified and strengthened to ensure more effective adherence to the principles of competitive tendering and value for money.
- **Develop a liability management framework.** A liability management framework should be developed that will enable the Government to better manage and track the direct and contingent fiscal liabilities that arise from PPP arrangements.
- **Build PPP capacity and awareness.** A consistent understanding of PPPs should be ensured across the various line ministries and government agencies. This can be achieved through training and the use of PPP guide books. The Government should also actively reach out to external stakeholders to encourage an open dialogue about PPPs.
- **Mobilize long term infrastructure finance.** Once a sizeable project pipeline is identified, the Government could consider establishing an infrastructure development financing institution that can help mobilize long-term financing for infrastructure PPPs.

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## Sri Lanka: As Things Stand Now

### 1. Sri Lanka is facing rising fiscal constraints which are likely to limit its capability to invest in public infrastructure.

Sri Lanka is a lower-middle-income country with a per capita GDP of USD 3,924 in 2015. It ranks relatively high (73<sup>rd</sup>) on the United Nations Human Development Index compared to other developing economies and 107 (up from 113 in 2015) on WBG's Doing Business Indicator. The banking sector has been strengthening with a 15.9% increase in total assets in 2015 and a 3.2% reduction in non-performing loans. However, Sri Lanka's credit rating was downgraded by Fitch and put on a negative outlook by S&P in early 2016, due to growing external and fiscal vulnerabilities. Sri Lanka is currently rated B+ (Fitch), B+ (S&P) and B1 by Moody's. Although Sri Lanka's GDP is expected to grow at a robust pace of 5.3% in the medium term with low inflation close to 4%, the fiscal deficit has been increasing and for 2015 it amounted to 7.4% of GDP, significantly exceeding the original budget target of 4.4%. The external current account balance has narrowed to an estimated 2.4% of GDP by end 2015 and public debt has risen to over 70% of GDP. However, despite the narrowing of the current account, the country experienced capital outflows in 2015 and the overall balance of payments has deteriorated.

Actual spending on infrastructure as a percentage of GDP has also been declining and was budgeted to be only 1.6% of GDP in 2015 (USD1.3 billion<sup>1</sup> against GDP of USD80.6 billion<sup>2</sup>). Estimations are that Sri Lanka will need to invest around 7%<sup>3</sup> annually to enable the country to achieve a high level of basic services similar to that experienced in more developed economies, or investment around 4% of GDP annually to achieve more modest standards in terms of access and quality of service. The spending of 1.6% of GDP in Sri Lanka for 2015 compares to actual 2015 infrastructure spending of 8% of GDP in Thailand, 9% of GDP in Indonesia and 13% of GDP in Vietnam - emphasizing the need for Sri Lanka to ramp up its infrastructure investment to strengthen its competitiveness.

As the Government has committed to reduce the fiscal deficit to 3.5% of GDP by 2020,<sup>4</sup> public budgets will

likely continue to be constrained to meet Sri Lanka's infrastructure development, upgrading and maintenance needs. Sri Lanka currently ranks 68<sup>th</sup> out of 140 countries in the World Economic Forum's Global Competitiveness Index for Infrastructure which highlights the urgent need to address the large gap in infrastructure. Addressing the gap will require greater efficiency in infrastructure planning and prioritization, provision and financing, as well as a greater inclusion of the private sector.

### 2. Over-reliance on donor/IFI funding of infrastructure has increased public debt levels.

Multiple international and bilateral financial institutions, including the Asian Development Bank (ADB), Japan International Cooperation Agency (JICA), and China EXIM Bank are funding infrastructure projects in Sri Lanka by providing debt financing directly to the Government or individual government agencies. China is currently Sri Lanka's biggest foreign investor with nearly 70% of the country's infrastructure projects being funded and built by China. Sri Lanka has 16 ongoing Chinese-backed infrastructure projects, including the USD 1.4 billion "Colombo Port City" FDI project. This public financing model is now facing possible sustainability issues given the high levels of public sector debt. Therefore, the Government will need to focus on alternative sources of infrastructure delivery and financing, in particular by attracting private sector investment through the use of Public Private Partnerships, which can leverage the comparative advantage of the private sector in areas such as enhanced service delivery, access to new sources of capital, better utilization of technology and know-how and improved risk management. However, it is important to note that not all public infrastructure projects will be suitable for procurement through a PPP and it is likely that a large portion of future investment into public infrastructure will still need to be publicly funded. In addition, procuring public infrastructure projects through PPPs does not necessarily eliminate the fiscal impact of these projects, as the Government may still be required to provide direct and/or contingent fiscal support e.g. providing availability payments or minimum revenue guarantees. It is important in this context that any direct

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<sup>1</sup> Source: Oxford Business Group Publication at <http://www.oxfordbusinessgroup.com/news/sri-lanka-looks-turn-page>

<sup>2</sup> Source: World Bank Source cited on Wikipedia at [https://en.wikipedia.org/wiki/Economy\\_of\\_Sri\\_Lanka](https://en.wikipedia.org/wiki/Economy_of_Sri_Lanka)

<sup>3</sup> Source: World Bank publication on Investing In Infrastructure- Harnessing Its Potential for Growth In Sri Lanka By Dan Biller and Ijaz Nabi

<sup>4</sup>Supported by the Extended Fund Facility arrangement with the IMF



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and contingent fiscal liabilities associated with PPPs are appropriately managed and recorded.

To date, donor/IFI funding has often been viewed as a ‘quick and easy’ financing solution, even if it would have been possible to fund the project through the private sector. However, as donor funding is becoming more limited, it is advisable to rationalize and optimize its use by leveraging additional financing from the private sector wherever possible. Improving central coordination and analysis to better prioritize projects and determine the best method of procurement (i.e. public sector vs PPP) could be of great help in this context.

### **3. Some infrastructure sectors have a successful PPP track record which can potentially be replicated in other sectors.**

The first PPP, Queen Elizabeth Quay, was executed in the **port** sector in 1999 as a Build-Own-Operate-Transfer (BOOT) PPP at a total cost of USD 240 million. The sponsors included domestic and international investors, with the Sri Lanka Port Authority (SLPA) holding 15% of the shares. Financing was provided by the Asian Development Bank (ADB), International Finance Corporation (IFC), and Commonwealth Development Corporation together with the Private Sector Infrastructure Development Company (PSIDC). This successful transaction led to the second port PPP, namely CICT’s South Container Terminal in 201, with a total investment of around USD500 million. This PPP was implemented as joint venture between China Harbor Engineering Company and SLPA. The initial private sector entry into the port sector and the creation of a competitive environment through the South Container Terminal transaction acted as a catalyst for growth and expansion in the port sector and helped to increase overall port sector efficiencies as well as contributed to the growth in port related ancillary services. It also paved the way for structural reforms encompassing the landlord model<sup>5</sup> with SLPA now in the process of planning the third PPP concession for the East Container Terminal.

In the **railway** sector, private participation has been much more limited in the form of lease of carriages by Sri Lanka Railways to a private operator, resulting in refurbished carriages and market based fares.

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<sup>5</sup> The Landlord Port Model is one where a public authority regulates the operations of the port (i.e. acts as a landlord) while the private sector actually operates the port on a day to day basis under some form of concession agreement.

In the **power** sector, a number of Independent Power Producer (“IPPs”) projects have been implemented mostly on a Build Own Operate (BOO)<sup>6</sup> basis. Initially, large thermal plants were procured (e.g. Kelanitissa), followed by smaller scale renewable energy power plants (wind, mini hydro and solar) more recently. The entry of IPPs into the power sector via several large thermal power projects, provided CEB with greater transparency with respect to generation costs and power tariff structures, whilst at the same time helped reduce the overdependence on expensive oil-based emergency power plants for short-term power generation. More importantly, it allowed the Government to reallocate public funds from the power sector into other sectors. Sectoral reforms in the energy sector which were initiated as result of the introduction of the private sector into power generation, led to the establishment of the Public Utilities Commission of Sri Lanka (PUCSL) as the regulatory body for the power sector. This body helped to ensure transparency in the consumer tariff setting process as well as formalized the long term generation plan of CEB based on a single buyer model with separate subsidiaries of CEB being set up to cover generation and distribution under a holding company structure.

Overall, from 1995-2015, private sector investment in Sri Lanka totaled USD 4.0 billion<sup>7</sup> across the transport, telecom and energy sectors. Although limited, the experience and successes of PPP transactions in these sectors can be used to pilot and roll out PPPs in other sectors such as roads, water, waste management, water supply etc. As announced in the 2015 budget, opportunities for PPPs are also being pursued in the airports, rail (light rail), hospitals and renewable energy sectors as well as under the Western Region Megapolis Program.

### **4. Lack of clarity and limited government support for PPPs has led to skepticism amongst investors.**

PPPs are commonly understood as partnership arrangements between the public and private sector in which both parties gain a mutual benefit by focusing on what each party does best and by allocating risk to the party best able to manage it. In Sri Lanka today, there is not only a lack of understanding of PPPs as a concept but also a lack of clarity in terms of which sectors are

<sup>6</sup> Based on data from World Banks’s PPI database

<sup>7</sup> Source: PPI database maintained by World Bank

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open to PPPs. Given this and the absence of a guiding PPP policy framework, the private sector has often sought to ‘kick start’ projects themselves by initiating unsolicited proposals. However, at the same time, the lack of predictability and consistency in government policy with respect to private sector participation in infrastructure investments has often constrained private sector appetite to pursue investments. A good example of the uncertain business environment is the passing of the Revival of Underperforming Enterprises and Unutilized Assets Act 43 of 2011 which has led to some private sector led projects being taken back by the Government.

Limited land availability has emerged as another important issue that has often deterred private sector from investing. Most of the land in Sri Lanka is state owned. The perceived lack of transparency in the allocation and valuation of state land have become important issues. Since land will likely be required for most PPP projects, it is important that land alienation and land values are dealt with in a consistent and transparent manner. It is also important that the private sector has full and legally transferable rights to use the land whether through a direct sell or lease.

#### **5. Government capacity in managing PPPs is limited.**

It has been almost a decade since several PPP projects were successfully procured through the support of the Bureau of Infrastructure Investment (BII). The BII was essentially a PPP unit that was slowly wound down as Government policy shifted towards financing major infrastructure through public funds. As a result of this shift to public financing, there is currently limited capacity within the Government to prioritize, structure, procure, implement and manage PPP projects. Moving forward, capacity constraints will likely be a significant constraint in the Government’s ability to develop a successful PPP program. Therefore, PPP capacity building will be critically important moving forward.

#### **6. Coordination among line ministries and institutions is limited and complicated by overlapping mandates.**

At present, coordination and cooperation mechanisms between line ministries and between the Ministry of Finance and the line ministries are limited. For example, the highways portfolio is attached to the Ministry of Higher Education instead of Ministry of Transport. In

addition, decision-making tends to be fragmented and inefficient as the various line ministries typically tackle their own challenges and problems in isolation. Such a fragmented structure is likely to impede a rational and efficient allocation of resources and investments.

Overlapping functions add to inefficiency and confusion. The Western Region Megapolis Planning Authority (WRMPA), for example, is in charge of implementing projects in the Western Region across various sectors, including transport, water, energy etc. However, this mandate conflicts with the mandates and functions of the specific sector ministries creating confusion about the responsibilities of WRMPA vis a vis the individual line ministries. Another example is the National Procurement Commission and the Procurement Appeals Board which are both mandated to monitor transparency in the procurement process. Therefore, going forward, it is important that the roles and functions of all the relevant institutions are reviewed carefully, redundancies identified and that a consolidation of overlapping functions is undertaken.

#### **7. Procurement guidelines need updating, particularly with respect to unsolicited proposals.**

Sri Lanka’s Public *Procurement Guidelines for the Development of Infrastructure Projects on a PPP Basis* (1998) and the *Procurement Guidelines for Goods and Works* (2006) cover the Government’s policy with respect to PPPs and these guidelines have since been recognized as law by the Sri Lankan Supreme Court. However, these guidelines were issued more than a decade ago and will likely require review and updating to remain relevant. For example, the Bureau of Infrastructure Investment (BII), which is referenced in the guidelines, is not operational any more. In addition, the use of Supplement 23 to the Procurement Guidelines Part II, relating to unsolicited proposals, will also require a revision. Indeed, the whole concept of unsolicited bids has important governance and transparency implications. Encouragingly, the new guidelines on *Swiss Challenge* procedures are transforming unsolicited proposals into a competitive procurement process whereby competitive counter proposals are invited to benchmark the original unsolicited proposal. However, the success of the guidelines based on implementation remains to be tested.

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## 8. There is inadequate liability management, particularly with respect to Government guarantees.

To date, many of Sri Lanka's PPP transactions are backed by full sovereign guarantees which have important fiscal implications for the Government, because these guarantees typically give rise to contingent liabilities on the public balance sheet. However, no policy guidance or decision frameworks seem to exist to determine whether a sovereign guarantee should be provided for a particular project and what form this guarantee should take. Currently, the amount of sovereign guarantees issued is equivalent to 5.7% of GDP, although the Government has recently announced its intention to increase the overall cap to 10% in the recent budget discussions. In this context, it is important to note that the volume of sovereign guarantees issued does not fully capture the risk, because in addition to an increasing number of sovereign guarantees, there has also been a shift towards issuing guarantees to state-owned enterprises ("SOE") that typically have insufficient underlying revenue sources. The implication of this is that these SOE guarantees are more likely to be called and therefore become direct public liabilities of the Government. Given that PPPs are likely to carry more complex forms of guarantees, it is important that GOSL considers strengthening its risk monitoring and risk management capacity.

## 9. The private sector appears keen to invest in PPP projects but there is limited domestic liquidity in the market.

Most of the recent infrastructure projects have been funded by the public sector and there have been limited opportunities for private sector investments. While private sector sponsors are keen to be involved in PPP projects in Sri Lanka, the lack of opportunities has forced many of the larger firms to look at overseas markets such as India, Pakistan, Bangladesh and the Maldives. While there is appetite for PPPs by domestic investors, there are indications of some significant liquidity constraints in the domestic market in terms of debt amounts and tenors available. One of the main

reasons for the liquidity constraint has been the crowding out effect of high levels of public borrowing. In addition, commercial banks typically have limited capabilities to hedge their interest rate risk as swap markets are currently limited in Sri Lanka. Finally, given the limited amount of capital that many banks have in Sri Lanka, there is also the possibility that Single Borrower Limits will prevent many domestic investors from raising the amounts of debt they would require to finance some of the larger PPPs. Therefore, ensuring the availability of long-term local financing at a reasonable cost will be critical for financing those PPP projects that will have local currency earnings.

## 10. Increasing "Climate-Smart" Infrastructure.

The Government has submitted its "Intended Nationally Determined Contributions (INDCs)" to the UNFCCC on April 25, 2016. This document highlights Sri Lanka's commitments to the international community on how the country plans to reduce emissions by developing climate-smart infrastructure. Sri Lanka's INDCs specify indicative targets within critical infrastructure sectors, including energy<sup>8</sup>, transport<sup>9</sup>, industry and the waste sector. The Government is seeking to develop many of these climate smart initiatives through private sector participation. These INDC infrastructure commitments can help Government leverage potential climate finance to de-risk potential climate-smart infrastructure PPP projects and engage private sector/developers (e.g. climate finance can be used to cover first-tranche losses and/or provide subordinated debt at concessional rates etc.). Upfront climate finance for priority climate-smart PPP projects can also help Government reduce the amount of viability gap funding (VGF) that it may have to provide from its own balance sheet.

## How Can Sri Lanka Develop a Sustainable PPP Program to Address its Future Infrastructure Needs?

### Immediate Priorities

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<sup>8</sup> 1. Establishment of large scale wind power farms of 514 MW to replace thermal power plants.  
2. Solar power plants with the capacity of 115 MW will be established, with participation of private sector  
3. Promote use of biomass (fuel wood) and waste (municipal waste, industrial and agricultural waste) by elevating its use in the power generation, which will be adding 104.62 MW in 2025.

<sup>9</sup> 1. Sustainable transport systems by 2030: a. Launching of Electric Buses as a Pilot Project. b. Introduction of BRT system to encourage public transport.  
4. Shifting of passengers from private to public transport modes: a. Introduce Park & Ride system b. Introduce the BRT system for Galle Road Corridor c. Rehabilitation of Kalani valley Railway line  
5. Enhancing the efficiency and quality of public transport and Economic instruments to environment friendly transport modes: a. Electrify railway from Weyangoda to Panadura.

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### **1. Establish a clear and consistent PPP policy.**

It will be important to put in place a clear and consistent policy on the procurement of infrastructure projects through the use of PPPs. Such PPP policy should be binding on all ministries and public agencies and help harmonize how the Government perceives and pursues PPPs. The policy framework will help to improve and align understanding of PPPs within Government. Together with establishing a PPP policy, a review of the current legal framework needs to be undertaken (together with necessary amendments) to align policy and the regulatory framework.

### **2. Review and update PPP procurement guidelines.**

A review of the current public sector procurement guidelines should be undertaken to ensure that the guidelines remain sufficient, relevant and effective to support PPP procurement. To the extent that the guidelines are deficient or not reflective of the envisaged policy and institutional framework for PPP procurement, they need to be revised and updated. Of critical importance will be the need to provide clarity and guidelines around unsolicited proposals and negotiated bids. Finally, once the procurement guidelines have been updated and amended, it is important to ensure that all stakeholders understand and are familiar with the guidelines.

### **3. Establish an institutional structure that supports the procurement of PPPs.**

A critical component in ensuring a successful PPP program will be the establishment of a supporting institutional structure that has the capacity, capability and decision making authority to ‘push’ PPP projects through the system. This diagnostic recommends the establishment of a **PPP Unit**<sup>10</sup>. It is recommended that such unit reports directly to the Prime Minister or the President, clarifying to all stakeholders the importance of PPPs in the Government’s investment policy and strategy, and be mandated to supervise and direct ministries and agencies as well as the private sector with regard to PPPs. It is also recommended to establish an **inter-ministerial/Cabinet-level Subcommittee** that would be chaired by the Prime Minister and be comprised of representatives from all the relevant ministries, as well as from MOF, the PPP unit and Attorney General’s office. The role of the Sub-

committee would be to act as the final decision making authority on the procurement route to be followed for each investment as well as to make decisions as to how best to leverage sovereign guarantees and funding from the various IFIs. Irrespective of the institutional set up, a key element for success will be that the various institutions have the necessary resources, capacity, capability and authority to carry out their designated functions in a coordinated manner.

### **4. Devise a PPP communication strategy.**

A general communications program should be devised that targets a broad range of internal and external stakeholders with the objective of conveying the objectives and scope of the Government’s PPP strategy and policy. In addition, as individual projects are developed as PPPs, these projects should be accompanied with appropriate project specific stakeholder consultations, outreach and communication programs.

### **5. Institute a guiding framework for prioritizing public infrastructure projects and for determining the appropriate procurement approach.**

It will be critical for the success of a PPP program to institute an infrastructure procurement framework that provides decision making guidelines for ministries and agencies with responsibility for infrastructure development. A first step could include developing criteria and procedures for prioritizing projects and consolidating the master plans for the individual sectors as a basis for project selection. When a ministry brings a project forward for procurement, the project should initially be assessed and evaluated against the master plan to see if it is in accordance with such plan. It is also important to determine the basis for procurement of the project, i.e. should it be procured as a public investment project or as a PPP taking into account that not all projects will be suitable for procurement through a PPP. However, if the appropriate feasibility studies support procurement through a PPP, then the Government should consider using PPP as a basis of procurement for the project. The final key decision will be the nature and level of government support required for the project. Depending on the type of project and the nature of the underlying risks being transferred to the private sector,

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<sup>10</sup> In many countries the PPP unit typically reports into the Ministry of Finance given the direct and indirect financial and fiscal implications of PPPs.

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some form of Government support may still be required. Decisions on the type and level of support need to be addressed in a coordinated and consistent manner.

**6. Identify sectors ready for PPPs such as power generation, roads and ports.**

The Government should begin to identify those sectors in which PPPs can readily be implemented. For example, there have been many successful PPPs in the power sector and it may be advisable for the Government to consider pursuing new power generation projects through Independent Power Producers (“IPPs”) while focusing limited public resources on investments in transmission and distribution. Another suitable sector for PPPs would be the road sector. Historically, roads and highways have been built by the Road Development Authority (RDA) and several of these are tolled. Since the tolling concept has already been introduced by RDA and broadly accepted by road users, it is likely that new road projects can be developed through a PPP as long as there is a reasonable sharing of risk and that the underlying traffic studies support the project. The port sector is another possible sector given the two highly successful PPPs and a third currently under procurement in that sector.

**7. Build PPP capacity and understanding within the public sector.**

To build a common understanding of the PPP concept and the basic principles of PPP management, it will be important to implement a series of workshops and study sessions across the public sector.

**8. Hire transaction advisors to develop detailed project feasibility studies with PPP options analysis.**

The Government should consider hiring experienced transaction advisors for PPP projects. The transaction advisory exercises will help provide an opportunity for public sector officials to experience the rigors of developing a PPP project. It will also be important for these transaction advisors to help build local capacity in the market to ensure sustainability in the system and avoid the legacy left by the Secretariat for Infrastructure Development and Investment (SIDI), which failed to sufficiently build sustainable PPP capacity amongst public sector officials.

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**Short Term Priorities**

**1. Develop a pipeline of PPP projects that will attract interest and support from the private sector.**

The sustainability and credibility of Sri Lanka’s PPP program is best ensured by developing a pipeline of well-structured PPPs that will be attractive to both investors and lenders (i.e. create a pipeline of “bankable” projects). The initial focus of the PPP program should be on demonstrating a track record of success via the careful selection of a small number of PPP projects. In this context, it may make sense to initially focus on PPP projects in those sectors which have either already transacted PPPs (e.g. the port and power sectors) or where robust project feasibility studies have already been carried out. The main objective is to ensure that the first few projects are successfully procured so that the Government builds credibility and trust with the private sector.

**2. Increase awareness and understanding of PPPs across all stakeholders through the creation of a PPP Forum.**

To facilitate an exchange of ideas, solicit private sector feedback and build consensus, awareness and capacity across all stakeholders, it may be useful to consider establishing a PPP Forum. The purpose of the forum would be to regularly bring together the public sector, the private sector, NGOs, civil society and all other relevant stakeholders to discuss issues related to the PPP program.

**3. Develop a centrally coordinated liability management framework.**

A Fiscal Commitments and Contingent Liabilities framework should be developed in order to assess and manage PPPs on a programmatic basis with clear criteria for the approval and recording of all the Government’s financial commitments. Responsibility for monitoring and managing these liabilities should be clearly assigned to a single unit or department. The Debt Management Unit that GOSL has decided to set up within the Ministry of Finance could be appropriate for this role.

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**Medium-term priorities**

**1. Establish a PPP project preparation fund.**

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Moving to a systemized PPP program will require a long term source of sustainable funding to enable proper project development and preparation. Therefore, GOSL may wish to consider establishing a fund (or some other such structure) that the PPP unit can use to hire specialized transaction advisors. This fund can be financed through a combination of GOSL funds and donor funds. In addition to this fund, it is likely that GOSL will also be able to access project preparation funds from third party donors e.g. the World Bank's Global Infrastructure Facility and ADB's Asia Pacific Project Preparation Facility, amongst others.

## **2. Consider establishing an institution to help mobilize and provide long term financing.**

Given the liquidity constraints that currently exist in the Sri Lankan debt markets for private sector companies, the establishment of an institution that can provide long term financing should be explored. The purpose of this institution, would be to provide long term funding (both debt and equity) to eligible infrastructure projects being procured by GOSL under its PPP program. Given the typically long term nature of the underlying assets being procured through PPPs, there could be interest from institutional investors (pension funds and insurance companies) to invest in such an institution, as these investors typically have long term liabilities which they would like to match with long term assets. Other sources of funding would of course include multilaterals and other financial institutions. The Government could also explore the possibility of injecting finance through the issue of infrastructure bonds or through regional funds like the Mauritius based South Asia Clean Energy Fund. However, it only makes sense to consider establishing such an institution after several PPP projects have successfully reached financial close and a sizeable PPP project pipeline identified.

## **3. Develop standardized guides, tools and templates to support the preparation of projects.**

To promote adoption of international best practice in project preparation and encourage focus on achieving value-for-money in PPP deals, the preparation of guides, tools and templates will benefit contracting agencies in the development and implementation of projects, as well as facilitate the oversight role of the PPP unit. The PPP Unit should lead the development of a comprehensive set of guides, tools and templates for use and reference in the procurement process. An indicative list of areas to focus on is presented below:

- Needs analysis, project identification and planning
- Developing preliminary business cases
- Feasibility studies and risk analysis
- Value for Money assessments
- Affordability and fiscal impact assessments
- Procurement and contract management
- Performance management
- Dispute resolution

## **The World Bank Group (WBG) can assist in developing a strategic approach to infrastructure and PPPs**

The World Bank Group (WBG) can provide customized technical advice and financial assistance to meet Sri Lanka's future infrastructure needs, including:

### **1. Technical assistance to build institutional capacity in support of a sustainable PPP program.**

The WBG can provide technical assistance to strengthen institutional PPP capacity within the Government including project selection, preparation, procurement, and management. Such technical assistance could specifically include:

- a) Providing a series of PPP workshops to relevant ministries and agencies to introduce the benefits of PPPs, as well as the importance of proper project preparation and risk allocation;
- b) Developing a PPP guidebook for policy makers and PPP practitioners explaining all aspects of PPPs, including the rationale for undertaking PPPs and how best to approach PPP procurement;
- c) Developing operational guidance manuals covering the PPP project cycle, including project feasibility, procurement, implementation and management; and
- d) Developing an appropriate framework for managing fiscal commitments and contingent liabilities.

### **2. Technical assistance for project prioritization.**

The WBG can assist the Government in developing a framework for project prioritization that can help Government in building a pipeline of prioritized projects in line with national objectives and available budgets. Such a pipeline can be further developed to select projects suitable for PPPs. A well-structured prioritization framework can not only help the Government improve investment planning at both the

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national and sector levels but also help achieve a broader consensus on key national priorities. The WBG has developed a Project Prioritization Tool that can be applied in Sri Lanka.

### **3. Design, establishment and operationalization of a PPP Unit.**

The WBG can provide technical assistance (e.g. through its Public Private Infrastructure Advisory Facility) to help design and operationalize a PPP unit based on the WBG's global experience.

### **4. Project development and transaction advisory services.**

The WBG, through IFC's PPP Transaction Advisory Department, can provide assistance to develop, structure, and tender individual PPP projects. IFC has significant global experience in providing infrastructure advisory services and is currently involved in several potential projects in Sri Lanka including in the water and solar power sectors. While IFC's advisory services cannot be directly funded by the WBG, these advisory services can potentially be funded through the Global Infrastructure Facility or by third party donor funding. Funds from the Global Infrastructure Facility can also be used to fund project preparation advice from third party consultants as well as helping the Government devise broad sector strategies for PPP procurement.

### **5. Financing and guarantee support for PPPs.**

To ensure the financial viability and bankability of PPP projects in Sri Lanka, a broad range of financial instruments and products are available from the WBG in coordination with other multilateral and bi-lateral agencies. Specific support from the WBG can include: (i) guarantee instruments, such as credit and/or political risk guarantees from either IDA/IBRD or MIGA; and (ii) equity and/or debt financing from IFC, including balance sheet financing as well as syndicated financing with commercial banks and other development finance institutions.

### **6. WBG Assistance for long term financing.**

The WBG can provide technical support to assist in mobilizing long-term infrastructure financing based on the WBGs international experience. One way of mobilizing such financing would be through the establishment of an infrastructure development fund

and, in this context, the WBG can provide financial support in the form of seed capital and assistance in bringing in investors, including institutional investors, financial institutions, and non-financial institutions.

*The World Bank Group looks forward to a continuing dialogue with the GOSL to determine how best to develop a successful PPP program in Sri Lanka that will benefit the people of Sri Lanka and meet the country's future infrastructure needs.*