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Midterm Evaluation of the Promotion of Private Infrastructure Project

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This report presents the independent findings and recommendations of the evaluation team. It does not necessarily represent the official views of the Government of Sri Lanka or the U.S. Agency for International Development.

TABLE OF CONTENTS

EXECUTIVE SUMMARY v

CHAPTER ONE
INTRODUCTION 1

CHAPTER TWO
PROJECT BACKGROUND 3

PROJECT DESCRIPTION 3
PROJECT ACCOMPLISHMENTS TO DATE 4

CHAPTER THREE
PROJECT DESIGN 7

APPROPRIATENESS OF THE PROJECT DESIGN 7
Project Goal and Its Contribution to Mission Strategic Objectives 7
Project Purpose 7
EFFECTIVENESS OF PROJECT STRUCTURE 9
THE HOUSING GUARANTEE PROGRAM 9
REQUIRED CHANGES IN PROJECT DESIGN 10
Project Purpose 10
Project Structure and Outputs 11
Sectors of Concentration 12
Project Inputs 13

CHAPTER FOUR
PROJECT IMPLEMENTATION 15

GSL PERFORMANCE AND SUPPORT 15
Overall Government Policy 15
Subsidies 16
Attitudes within the Relevant Ministries 17
Next Steps 18
SIDI PERFORMANCE AND NEEDS 19
Performance to Date 19
Needs for the Future 20

THE TECHNICAL ASSISTANCE CONTRACT 21
Past Performance 21
Next Steps 23
USAID MANAGEMENT 24

CHAPTER FIVE
SUMMARY OF RECOMMENDATIONS 27

ANNEXES

A. Logical Framework A-1
B. Infrastructure Priorities B-1
C. Evaluation of the PPI Power Sector Component C-1
D. Persons Interviewed D-1

ACRONYMS

BOI	Board of Investment
BOO	Build-Own-Operate
BOT	Build-Own-transfer
CEB	Ceylon Electricity Board
CFED	Center for Financial Engineering in Development
COP	Chief of Party
DG	Director General (SIDI)
EIU	Environmental Infrastructure Unit (SIDI)
GSL	Government of Sri Lanka
HG	Housing Guarantee
IMIC	Inter-ministerial Infrastructure Committee
M/FP	Ministry of Finance and Plan
M/PPI	Ministry of Policy Planning and Implementation
NWSDB	National Water Supply and Drainage Board
PACD	Project Assistance Completion Date
PPI	Promotion of Private Infrastructure
RFP	Request for Proposals
RTA	Resident Technical Advisor
SLT	Sri Lanka Telecommunications
SOE	State-Owned Enterprise
USAID	U.S. Agency for International Development Mission to Sri Lanka

EXECUTIVE SUMMARY

BACKGROUND

The Promotion of Private Infrastructure (PPI) project was initiated in early 1993 for the purpose of creating a market for the private financing and operation of economic infrastructure. The rationale for the project was that, although the lack of economic infrastructure had been identified by the GSL and donors as a major constraint to Sri Lanka's economic growth and development, government and donor resources were inadequate to finance the necessary investments. At the end of the project a government network was to have been established for the promotion and implementation of private infrastructure projects, a sizeable number were to have been tendered, and three were to have been approved for implementation. The five priority sectors were: power, telecommunications, transportation, water supply and treatment, and solid waste disposal.

The project had four components for achieving its objectives: 1) the creation of the private infrastructure network developing and approving projects; 2) the creation of public awareness of and support for private infrastructure; 2) the establishment of a project marketing system to maximize private investor interest and competition; and 4) the development of risk-minimizing and financing mechanisms to encourage increased private participation in infrastructure. The project was implemented by the Secretariat for Infrastructure Development and Investment (SIDI), a unit of the Ministry of Policy Planning and Implementation (M/PPI). PPI provided long-term and short-term technical assistance, training and funding for local operating costs. In late 1993, the project was amended to add support for an Environmental Infrastructure Unit (EIU) in SIDI. With this amendment, USAID project funding consisted of an $8 million development assistance grant and a $30 million housing guarantee (HG) loan.

PROJECT ACCOMPLISHMENTS TO DATE

These are best summarized by component.

Private Infrastructure Network. Although the objective was to create a network of government ministries and agencies for the purpose of developing and approving projects, the focus of activity was on the actual development of projects. The most work was done on two power plants and a transshipment port. The power projects reached the final negotiation stage and the port project has gone through two RFPs. Work on other projects was limited to the preparation of pre-feasibility studies and project profiles. None of these projects have been implemented (most have not advanced beyond the pre-feasibility stage), and the "network" has not been established. SIDI is functioning, but the interagency review and approval process is not. Within SIDI a core of expertise for the design, tendering, negotiating and approval of projects has not been developed.

Public Awareness. Most of the activity under this component has consisted of workshops and seminars aimed at the business community and line ministries. Both groups are now well informed about private sector approaches to infrastructure development, including "build-own-operate" and "build-own-transfer" (BOO.BOT). However, thus far, very little effort has been made to increase the understanding and support of the general public.

Marketing. There has been very little activity under this component, mainly because there have been no projects to market. Initially, materials were prepared to market the government's new policy of encouraging the private financing and operation of economic infrastructure, but in the absence of commercially viable projects and associated incentive packages, the marketing activities appropriately did not proceed beyond this initial stage.

Private Sector Window. Here again there has been relatively little activity. Procedures for treating unsolicited proposals have been established but only in a very preliminary form, and little progress has occurred in setting up a private sector credit facility for infrastructure investments, or in setting up a mechanism for co-financing feasibility studies.

The conclusion to be reached from the above is that the PPI project has made very little progress toward achieving its project purpose: the development of a market for private financing and operation of economic infrastructure. Thus far, no private infrastructure projects have been approved, none are close to being approved, and no significant progress has occurred in expanding the government's capacity develop commercially viable projects.

REASONS FOR THE POOR PERFORMANCE TO DATE

The project's lack of progress can be attributed to the following four reasons:

1) There has been a lack of government commitment to implementing its policy of private financing and operation of economic infrastructure. SIDI was not given much authority nor even a clearly defined role, and line ministries and public utilities were allowed to resist private participation in their sectors if they so wished. In most sectors, the line ministries and public utilities continued to look to donor funding or government-guaranteed supplier credits to finance new projects. The lack of government commitment also shows up in its unwillingness to change sector-level policies and regulations that are effectively preventing private infrastructure projects from being commercially viable.

2) SIDI, the line ministries and the public utilities have not built up the necessary expertise in the identification, design, tendering, negotiating and approval of private infrastructure projects. Requests for proposals were poorly prepared and, when proposals were received, the government response was slow and indecisive. Thus far, in the cases where RFPs have been issued and proposals received, all proposals

have been rejected, and either the RFPs were re-issued or the projects were put on hold.

3) The project design was too oriented toward the approval and implementation of specific infrastructure projects and not sufficiently oriented toward strengthening the government's commitment, bringing about the necessary sector-level policy reforms, and creating the institutional capacity for developing private infrastructure projects. The underlying assumption was that there were no major obstacles preventing the relatively quick approval and implementation of projects. As a result most of the PPI technical assistance was directed toward closing deals on specific projects, to the almost total exclusion of institution building. When these efforts failed, PPI and the GSL were left with no infrastructure projects and virtually no progress in terms of increased public support, improved policies, or increased institutional capacity for private infrastructure development.

4) Although most of the technical advisors and consultants provided by PPI had first hand experience in developing and implementing private infrastructure projects, they had very little experience in policy reform or institution building. By mid-1993 they were beginning to recognize that the conditions for the rapid development of commercially viable private infrastructure projects did not exist, but they had neither the qualifications nor the experience to propose or undertake the necessary corrective actions, including project re-design.

RECOMMENDATIONS FOR IMPROVING PROJECT PERFORMANCE

The actions necessary to achieve the PPI project purpose of bringing about the private financing and operation of economic infrastructure are summarized in Section V of the main report. These actions amount to a stronger government commitment to private infrastructure and an increased institutional capacity in government to develop private infrastructure projects.

The first step is for the GSL to reiterate its commitment to the private financing and operation of economic infrastructure. It should state unequivocally that the expansion of economic infrastructure is a top government priority and will have to be achieved almost exclusively through private investment. The GSL should then instruct line ministries and public utilities to begin the project identification, tendering and approval process.

Next the GSL should set up an Inter-ministerial Infrastructure Committee (IMIC) to oversee the implementation of its private infrastructure policy, and sub-committees for each sector where projects are being developed. The role of this committee would be to resolve the inevitable policy issues and move projects through the approval process. SIDI would be its secretariat and would be empowered, staffed and provided with the technical assistance necessary to prepare tendering documents, evaluate bids and negotiate purchase agreements.

Once its policy is made clear and the institutional structure for implementation is put in place, the government should take steps to create the necessary policy and regulatory framework in the priority sectors. This task should be jointly undertaken by SIDI and the line ministry concerned under the overall direction of the inter-ministerial committee. PPI should provide highly qualified technical assistance as needed. Because the policy reform process will be long and difficult, it should focus on only a few sectors — power, telecommunications and environmental infrastructure. Once the basic policy and regulatory analysis is completed, the main tasks will be to generate public and political support for change and systematically deal with the resistance that is certain to come from the public utilities. The objective in each sector is to change the policy and regulatory framework so that private projects can be commercially viable.

Next, SIDI and the line ministries should begin work on developing projects in each of the three priority sectors. This consists of preparing sectoral expansion plans, identifying priority projects, carrying out pre-feasibility studies, preparing project profiles, and putting together tendering documents, negotiating guidelines and purchase agreements. Here again, PPI should provide the necessary technical assistance. SIDI should report progress regularly to the IMIC where key issues should be discussed and resolved. The objective should be to build up the expertise in SIDI and the line ministries to design, tender, negotiate and approve commercially viable projects effectively, expeditiously and professionally.

The main point in all of this is that the initiative must come from the GSL. If the GSL does not take the first two actions on its own and specifically request PPI assistance in carrying out the third action, there is no point in proceeding with the fourth action. No matter how well staffed and organized it is, SIDI cannot bring about the private financing and operation of infrastructure projects if the conditions do not exist for those projects to be commercially viable or if the public utilities concerned can effectively prevent the projects from being implemented.

CHAPTER ONE
INTRODUCTION

In September 1992 an embarrassing thing happened in one of Asia's most rapidly developing countries: Electric lights went out across the whole of West Malaysia. Officials reacted quickly, by licensing five companies to be independent power producers, and two of them (with a combined capacity of 1212 MW) are already selling power to the state electricity company. Could a similar situation arise in Sri Lanka?

Policy makers in Sri Lanka believe that infrastructure deficiencies already limit economic growth in their country, and that there are indeed risks of failure of essential services. To this end the Government of Sri Lanka (GSL) created the Secretariat for Infrastructure Development and Investment (SIDI) to encourage the private sector to provide a significant portion of the infrastructure investment effort. The USAID supported this initiative by launching the Promotion of Private Infrastructure (PPI) project to assist SIDI.

Because of the limited financial resources available in Sri Lanka, the GSL and SIDI expect that most of the investments will have to come from abroad. Foreign private participation in Sri Lanka's infrastructure would be desirable, but it should not be taken for granted. Sri Lanka has to compete against many other countries for scarce capital, including countries with huge opportunities such as India, China, Eastern Europe, and the developed countries themselves. To attract the necessary funding, Sri Lanka has to pay the world market price for capital which, for any project, is affected by the investment environment of the host country.

A well-functioning SIDI could play a major role in attracting foreign investment Lanka by advising the government on how the investment climate can be improved without sacrificing the country's interests, and by providing the expertise required in the development and approval of specific projects. SIDI, however, cannot have a significant impact on private investment in infrastructure unless the GSL takes adequate measures to create the necessary investment climate.

In evaluating PPI project performance and impact to date, this report assesses: 1) the adequacy of measures being taken by the GSL to create the investment climate needed to attract foreign investment in infrastructure; 2) SIDI's capacity to carry out its role as promoter as facilitator of private investment in infrastructure; and 3) the PPI project's effectiveness in strengthening SIDI's capacity to perform these functions.

CHAPTER TWO
PROJECT BACKGROUND

PROJECT DESCRIPTION

The Promotion of Private Infrastructure Project (PPI) was authorized in September 1992 as a four-year $7 million project. The rationale for the project is that the lack of economic infrastructure is a major constraint to the country's economic growth and development, and traditional means of infrastructure financing (public resources and donor assistance) are far from adequate to meet the country's projected needs.

The project goal is to modernize economic infrastructure in five sectors: power, telecommunication, water supply and treatment, transportation, and solid waste disposal. The project purpose is to assist the Government of Sri Lanka (GSL) to develop a market for private financing and management of economic infrastructure through "build-own-operate, build-own-transfer" (BOO/BOT) or other joint public-private sector approaches. In August 1993, the project was amended to incorporate Housing Guarantee (HG) resources to support the development of urban environmental infrastructure. With this amendment, a $30 million housing guarantee loan and $1 million of technical assistance and training was added to the PPI project.

The project has four components:

- The Private Infrastructure Network Component to establish the GSL's policy and institutional framework to promote and implement public/private infrastructure activities. The main outputs of this component were to have been: a Secretariat for Infrastructure Development and Investment (SIDI) functioning as the GSL interface between the private business community and line agencies and municipalities; the preparation of project tender packages; and the actual signing of agreements for private sector infrastructure projects.

- The Public Awareness Component to inform and educate government officials, the business community and the public of the benefits of BOO/BOT and other public-private sector approaches.

- The Marketing Component to engender the participation of the maximum number of qualified private investors.

- The Private Sector Window Component to expand the role of the private sector in identifying, designing, and financing of infrastructure projects. The outputs of this component were to have included: a functioning private sector financing facility for channelling development assistance funds for private sector infrastructure projects; mechanisms for sharing costs of feasibility studies; and formal and effective procedures for treating unsolicited proposals for private infrastructure projects.

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The project design called for USAID to finance two long-term expatriate advisors, three Sri Lankan long-term advisors, and a large number of short-term technical experts to assist SIDI in carrying out the activities represented in the above four components. The project also funds local operating costs consisting mostly of support staff salaries, office rent, utilities, transportation and communication. In late 1993, a part-time (30 to 40 percent) resident technical advisor and four local staff were provided under personal services contracts to assist with implementing the environmental infrastructure activities. The project also financed in-country training and overseas tours to countries where private infrastructure projects had been successful.

PROJECT ACCOMPLISHMENTS TO DATE

These are best summarized by component.

Private Infrastructure Network. Although the objective was to create a network of government ministries and agencies for the purpose of developing and approving projects, the focus of activity was on the actual development of projects. The most work was done on two power plants (one 400 MW and one 40 MW) and the transshipment port in Galle. The power projects reached the final negotiation stage and the port project has gone through two RFPs. Work on other projects, for example, Southern Region Water Supply and the Colombo-Matara road was limited to the preparation of pre-feasibility studies and project profiles. None of these projects have been implemented (most have not advanced beyond the pre-feasibility stage), and the "network" has not been established.

SIDI is functioning, but the interagency review and approval process is not. Within SIDI a core of expertise for the design, tendering, negotiating and approval of projects has not been developed. The most progress has occurred in the Environmental Infrastructure Unit (EIU) which has had the strongest institution building focus. Although the EIU was only set up in early 1994, an ongoing dialogue has been established with municipalities relating to the private financing and operation of water supply systems, water treatment plants, and solid waste disposal and treatment. No projects have reached the RFP stage, but pre-feasibility studies have been very useful in identifying the key policy issues and prospects for eventual commercially viable projects.

Public Awareness. Most of the activity under this component has consisted of workshops and seminars aimed at the business community and line ministries. Both groups are now well informed about BOO/BOT approaches to infrastructure development. However, thus far, no effort has been made to increase the understanding and support of the general public. Because of the lack of transparency in dealings between the government and the private sector, the public view of private sector projects is highly negative. Through the press, the public has been made much more aware of the corruption in these dealings than of the benefits that would come

from the expansion of economic and environmental infrastructure through private investments.

Marketing. There has been very little activity under this component, mainly because there has been no product to market. Initially, materials were prepared to market the government's new policy of encouraging the private financing and operation of economic infrastructure, but in the absence of commercially viable projects and associated incentive packages, the marketing activities appropriately did not proceed beyond this initial stage.

Private Sector Window. Here again there has been relatively little activity. Progress is behind schedule on setting up the Environmental Account in the National Development Bank, procedures for treating unsolicited proposals have been established in a general form, and little progress has occurred in setting up a private sector credit facility for infrastructure investments or in setting up a mechanism for co-financing feasibility studies.

The conclusion to be reached from the above is that the PPI project has made very little progress toward achieving its project purpose: the development of a market for private financing and operation of economic infrastructure. The reasons are partly design related and partly implementation related. The major design flaws were, first, that the policy assumptions relating to the output-purpose link were overly optimistic, and, second, too little attention was given to the tasks of policy reform and institution building. The lack of attention to institution building was also partly an implementation problem. The remainder of this report will discuss the project design and implementation shortcomings and propose actions to improve project performance and impact.

CHAPTER THREE
PROJECT DESIGN

APPROPRIATENESS OF THE PROJECT DESIGN

Project Goal and Its Contribution to Mission Strategic Objectives

The project goal and purpose are clearly supportive of the Mission's strategic economic growth objective: the increased opportunity for people to participate in a growing market economy. The Mission's Program Performance Plan calls for this objective to be measured by the percent change in foreign and domestic investment and the change in total employment in target enterprises. The PPI goal is to modernize infrastructure in five sectors: power, water supply, telecommunications, transportation and waste management, with quantified targets set for each sector. If these targets are met, the infrastructure constraint to economic growth will be significantly alleviated. Conversely, if these targets are not met, economic growth will be much slower, thus adversely affecting the ability of the USAID program to meet one of its key strategic objectives.

An important design issue, of course, is whether achieving PPI's project purpose will contribute significantly to its stated goal. As is usually the case with development projects, the leap from achieving the project purpose to achieving the development goal is a large one, and links between the two in the project design are somewhat vague. The purpose-level targets, except for three actual infrastructure projects, amount to an improved environment for the private financing and operation of economic and environmental infrastructure. The key assumptions for this purpose to lead to the goal are: 1) political stability, 2) continued economic liberalization, and 3) increased government commitment to sustained market-led economic growth. It must be remembered that most of the private investment must come from abroad, and that Sri Lanka is competing with many other countries for scarce resources. The less attractive the investment climate the higher the profit opportunities will have to be before private investors will commit resources.

Project Purpose

A much more important design issue for the PPI project, however, is whether the project purpose will result from the project outputs. The three key assumptions are that:

- The political and institutional will exists to initiate and sustain a marriage between the public and private sectors over the long term;
- A technical unit (SIDI) could be established within the appropriate entity and that it would have sufficient political authority; and

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- The economic and investment climate in Sri Lanka would continue to provide an "enabling environment" for public/private partnerships.

These assumptions are in fact critical. If they are not valid, the project cannot succeed. At the time the project was designed, they appeared valid, but, even then, it was evident they would have to be closely monitored.

The political and institutional will probably existed, but only for a marriage in which the public sector had the dominant role. The relationship between the public and private sectors in market economies appears to have been imperfectly understood in Sri Lanka. The Public Awareness component of the project should have been designed to promote such understanding (e.g., by publicity/education drives targeting the media and other "opinion makers"), but its message was limited to the benefits of private investment as a source of funds to finance much needed infrastructure growth. Clearly, however, it is beyond the scope of this one project to change overall government and public attitudes regarding open markets and the private sector. The lack of political and institutional will to move aggressively toward free markets will inevitably limit PPI's impact on the country's economic infrastructure.

This lack of will and understanding also prevented the second assumption from being valid. SIDI was well designed and situated to carry out its role, but it was never given the necessary authority. The government should have set up an inter-ministerial body with the power and willingness to support SIDI's authority vis-a-vis line ministries and state-owned enterprises (SOE). It should be noted, however, that SIDI has yet to build up the expertise to carry out its responsibilities even if it had the authority, so the government may have inadvertently made the right decision in not giving it the full level of authority called for in the project design. This matter is discussed later in the section on SIDI performance.

Perhaps the least supported assumption at the time of the project design was that there existed an "enabling environment" for private investment in infrastructure. Public/private partnerships can be formed under most circumstances, but they cannot achieve their potential unless all the elements concerned wish to pursue them, and understand the issues. The experience of trying to create such partnerships in the power sector suggests that the SOEs are not anxious to give up their powers to make investments, and that they do not appreciate the interests and concerns of private investors. Furthermore, the GSL's policy of holding consumer tariff levels below production costs does nothing to encourage private investment.

In assessing the overall climate for private investment in infrastructure, it is important to note that progress in the privatization of state-owned enterprises is not a critical factor. In fact, privatizing the SOEs in the absence of open markets simply does no more than replace a government monopoly with a private monopoly, with the private monopoly often less subject to oversight than the government one. A more appropriate approach to privatization is to allow the public enterprises to continue operating but allow private providers to compete. The higher efficiency of the private providers will lead to increased efficiency of the public enterprises or to their privatization. For this reason, PPI should not become

directly involved in efforts to privatize SLT, CEB, and other SOEs, nor should the continuation of PPI be contingent on progress in these privatization efforts.

EFFECTIVENESS OF PROJECT STRUCTURE

Considerable care appears to have been devoted to the design of the project structure, and its first three components (the 'Network', 'Public awareness' and 'Marketing' components) produce a logical structure for achieving the project objectives. The 'Window' component does not appear to be part of this logical structure, but provides useful additions to it.

The output targets under each component, however, are too often stated in terms of the development of specific projects. This is consistent with the initial assumptions in the project paper, but, once it became evident that projects would not be implemented without important policy changes and capacity building in SIDI and the line ministries and agencies, USAID should have initiated a restatement of project output targets. The most important change would have been to set specific institution building targets in the Network component. The new targets would also have increased the priority of the Public Awareness component while lowering the priority of the Marketing component. These changes in turn should have been reflected in the SIDI and CFED workplans. Project records show that the need for these changes was recognized by USAID in late 1993, but a redesign was not undertaken. As will be discussed later, the overemphasis on project development that is evident in the design was even more acute in the implementation of the project components.

THE HOUSING GUARANTEE PROGRAM

In contrast to the activities called for in the original design, the Housing Guarantee Program took a more gradual and institution building approach to project development. The focus of the program is the development of urban water supply, wastewater treatment, and solid waste disposal. Previous analyses established, first, that municipalities were unable to meet the needs of urban populations for these services, and second, many of these services could be provided efficiently and profitably by private businesses under BOO/BOT or other forms of public/private sector partnerships.

The design was based on three critical assumptions: 1) municipalities were willing to enter into agreements with the private sector for the provision of environmental services, 2) laws, regulations and procedures could be changed when necessary to make private sector projects financially and operationally feasible, and 3) private businesses would respond to opportunities on terms that would not be excessively onerous to the municipalities. All three of these assumptions have proved to be partially valid, but only with strong support from the project. An Environmental Infrastructure Unit (EIU) was established in SIDI, and $1 million of technical assistance was made available, including one-third of the time of a Resident

Technical Advisor. This arrangement has proved effective in meeting the technical assistance and training needs of SIDI staff and the municipalities.

Advancing projects to the implementation stage, however, is likely to prove difficult, because, under existing cost recovery conditions, very few activities provide high enough returns to attract private investors. Residents of most cities and towns, for instance, have access to alternative sources of water. At existing rates they obtain their water from the municipal systems, but at the full cost of providing that water most users would shift to private wells and other traditional sources. Prospects are better for waste disposal, where the benefits are easily identified and the initial investment costs are low. It should be noted that, because of the low investment costs, the HG loan is unlikely to be used for solid waste disposal. Larger, more costly urban infrastructure projects will occur as the options for solid waste composting and waste water treatment are explored with the larger municipalities, including Colombo.

REQUIRED CHANGES IN PROJECT DESIGN

As previously noted, the project requires a major re-design, with a clearer statement of project purpose and a set of outputs that emphasize policy change and institution building.

Project Purpose

The project purpose should be re-worded slightly as follows: to enable Sri Lanka to successfully enter the market for private financing and operation of economic infrastructure. This would emphasize the fact that Sri Lanka is competing with other countries in an already existing international market. The objective is not only to allow the private sector to participate in infrastructure, but to create conditions that will attract this investment in competition with other countries. The end-of-project conditions that would indicate that this purpose has been achieved are:

- The necessary policy and regulatory framework will have been established in at least three sectors: power, telecommunications and environmental infrastructure.
- SIDI functions as the focal point for the effective, expeditious and transparent processing of private infrastructure projects.
- A marketing and incentive program for private infrastructure projects will have been established, including 1) a sustainable credit facility, 2) a mechanism for feasibility cost sharing, and 3) the capacity to produce marketing materials for individual projects.
- Financeable projects will have been developed as evidenced by RFPs issued, responded to, and approved.

It needs to be remembered that achieving the above targets entails mainly the implementation of policy reforms and strengthening of government institutions. These targets will be achieved only if the government has decided at the highest levels to move in this direction and looks to the PPI project as the source of technical expertise in this endeavor. If the policy analysis and institution building expertise to be provided under this project is not meeting explicitly expressed needs of the government, it will not achieve its objectives.

Project Structure and Outputs

To achieve the above purpose, PPI should have the following four components:

The Policy Analysis and Dialogue Component. This component would carry out studies of the policy and regulatory framework in three sectors: power, telecommunications, and environmental infrastructure. These studies would make recommendations to the government for policy changes that meet the needs of private investors, the interests of the country, and the economic and social priorities of the government. The purpose of each of these studies would be to tell the GSL: "these are the policy and regulatory changes that are needed for private infrastructure projects to be viable in this sector. With the changes, private investment will occur; without the changes, private investment will not occur." If the GSL chooses not to make the changes, there is no point building up institutional capacity and pursuing projects. (Although policy analysis and dialogue are needed in all of the infrastructure sectors, implementing significant policy changes is extremely complex and arduous. Without priorities and focus, PPI risks spreading itself too thin, and not achieving significant reform or progress in any sector.)

The Private Infrastructure Network Component. This component would be aimed primarily at strengthening SIDI to perform its role as the focal point in the design, tendering, evaluating, negotiating and approval of private infrastructure projects. Technical assistance would be provided to do pre-feasibility studies, prepare project profiles, and prepare generic RFPs, evaluation and negotiating procedures, and purchase agreements (e.g., contracts, concessions, BOO/BOT agreements). The objective would be to create a center of high level expertise able to move projects through the approval process in a context of agreed-upon sectoral policies fully supported by the government and SOEs. (See Annex C for details of how SIDI and CEB need to be strengthened in order to develop commercially viable private projects in the power sector.)

The Public Awareness Component. This component would remain as described in the existing project paper. However, in contrast to the first two years of the project, it would be aimed at the public and politicians as well as government officials and the business community. The first part of the message would be that the country's infrastructure base can only be expanded through private financing and operation. The second part would relate to the policy changes that are needed to attract the private investors, including laws assuring transparency and the decontrol of prices. This component should utilize the media more effectively than has been the case thus far.

The Marketing and Incentives Component. This component is aimed at maximizing the number of investors competing for infrastructure projects. It would have four sub-components: 1) the establishment of a credit facility for channelling development assistance to finance private infrastructure projects, 2) the development of a mechanism for sharing the costs of feasibility studies, and 3) the development of a marketing program for individual projects in conjunction with the issuance of RFPs. This component would be implemented in cooperation with the BOI.

Sectors of Concentration

Given the complexities involved in changing policies and developing actual projects, activities under the first two components should be focused on those sectors where tangible results are most likely. As discussed in Annex B, the highest priority sectors should be power and telecommunications. In both of these sectors, most of the users are prepared to pay the full cost of the services, thereby greatly alleviating the all important cost recovery problem.

Although the transportation sector is critical to Sri Lanka's economic growth, the issues related to private investment and operation are extremely complex and politically sensitive. This has particular implications for the priority that should be given to the Galle Port. Pre-feasibility analyses indicate that the port has a very low rate of return, and almost certainly cannot be commercially viable without an improved road link to Colombo. Since it is unlikely that issues related to the private financing and operation of roads in Sri Lanka can be resolved during the remaining life of the PPI project, the evaluation team recommends that SIDI assist in the Galle Port project only on an as requested basis. Another possible sector is municipal buses. Much work has been done on the privatization of these bus companies but, because the process has not been completed, the system is deteriorating rapidly. SIDI could possibly assist in completing the "peoplization" of the bus companies if the GSL were to release them from fare control and from obligations to provide loss-making services.

The third sector of concentration should be environmental infrastructure — water supply, wastewater disposal, and solid waste disposal. Except for solid waste disposal, cost recovery is not easy in this sector. However, the social needs are great and are strongly felt by government leaders at both the national and local levels. Prospects for tangible results are therefore reasonably good, but will require strong policy analysis and persistent dialogue by SIDI staff and technical advisors. Policy makers must be convinced that the social and political benefits of expanding services through private financing outweigh the social and political costs of the policy and regulatory changes needed to make private projects commercially viable.

Project Inputs

The inputs for achieving these outputs will consist mostly of technical assistance. The project should continue to finance SIDI's operating costs, but on a declining scale. Specifically, the GSL should immediately begin assuming part of the costs of local support staff, office rent, utilities and transportation.

The remaining funds in the project are sufficient to achieve the project outputs and purpose, but, due to the delays described in this report, the PACD will have to be extended. In early 1995, USAID, SIDI and the senior technical advisor to SIDI should prepare a two year implementation plan for achieving the outputs. The evaluation team recommends that the PACD be extended to December 1996 or June 1997.

CHAPTER FOUR
PROJECT IMPLEMENTATION

GSL PERFORMANCE AND SUPPORT

Overall Government Policy

On September 13, 1994, the then Prime Minister (and current President and Minister of Finance) Chandrika Bandaranaike Kumaratunga delivered a speech defining the economic policy of the GSL. In it she declared that '[t]he principal engine of growth is expected to be the private sector, both domestic and foreign' and that '[t]he role of the State is to provide an institutional framework that is wholly supportive of rapid private sector development'. It is likely that the sentiments in the president's speech are shared by key officials, especially in the Ministry of Finance and Plan (M/FP), but it is not clear to what extent they are shared by officials at lower levels, especially in the line ministries and SOEs.

With regard to the financing of infrastructure, the Prime Minister referred specifically to 'a significant portion of the infrastructure investment effort' being 'undertaken by the private sector'. She said that '[p]rivate sector infrastructure investment would occur under arrangements such as BOT and BOO, which would be implemented within an evaluation and regulatory framework that would guarantee transparency and accountability'. We have understood this to mean that the private sector would be invited to finance elements of the GSL's infrastructure program, not that private firms are to be encouraged to invest in infrastructure in accordance with their own preferences.

In looking at the attitude of the GSL to the private sector, it has to be said, with much regret, that there appears to be but little understanding in government circles of the workings of market economies based on voluntary transactions. The GSL does not seem to appreciate how the private sector works, or what it seeks. This is evident from the obsession with micro-managing Sri Lanka's infrastructure, primarily through detailed control of investments and tariffs. For example:

- Despite the prospects of power shortages, private companies are prohibited from selling electric power to one another;
- Despite a six-year wait for telephone lines, private companies are not allowed to alleviate this shortage;
- Although they have no legal powers to do so, government agencies effectively control the levels of most bus fares;
- Residential charges for telecommunications (the lowest in Asia) and electricity are subsidized by commerce and industry.

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The project's second ('awareness') component should have been designed to counter these commonly-found attitudes, but much work to achieve this objective is yet to be done by SIDI and others. Similar attitudes are found in the sectoral ministries concerned with the project.

Subsidies

The Sri Lankan economy, based as it is on the principle of benevolence, is dotted with subsidies designed to keep down the costs of basic commodities and services. For example, many railway users obtain monthly season tickets getting 90 percent discounts on regular fares; water tariffs cover less than 30 percent of costs; and residential electricity rates are only a fraction of the rates paid by industrial users. These subsidies have the effect of discouraging private investment. When investors take equity in a company, and when financial institutions lend, they like to see the assets they finance earn more than sufficient to repay debt and remain financially viable, without having to depend on government guarantees that in practice can be rescinded at any time. This is the single most important constraint to private investment in infrastructure.

Although, the removal of subsidies should not be a requirement for SIDI's continuation, the government should be required to take actions that minimize the need for private investors to depend on government guarantees. The general rule should be that the purchasers of infrastructure services pay the full market price.

Even if subsidies are considered important to encourage consumption or to make the services accessible to low income consumers, it is possible to provide them without discouraging production. Examples can be given from the US food stamp programs, the 'GI Grants' for university education after the World War, and the issuance of bus tokens to students. In all these cases the recipients were assisted directly, without obliging the providers of the services to sell at less than full cost or depend on direct payments from the government for full cost recovery.

Another point is that there can be ways of splitting markets, and allowing improved service to be provided at an increased price, while retaining a base service at a lower, subsidized price. This is done successfully in Sri Lanka for inter-city bus travel, where air conditioned services are offered at premium prices, and with cellular phones which are being offered at full market cost. The essence of these arrangements is that private providers are allowed to identify and serve new markets that could not be served at the controlled prices.

Thus, while the existence of subsidies makes the private provision of infrastructure more difficult, a frontal assault on them might not be the most effective way of removing them. The GSL should, however, be encouraged to tackle the subsidy issue on a sector by sector basis. Two government actions would go a long way to addressing the subsidy issue:

1) Officially adopt the principle that all infrastructure services, whether they are provided by public or private entities, be fully funded, either by charging the full

market price to the users, or by earmarking the necessary funds from the government budget when subsidies are deemed necessary; and

2) Carry out studies (funded by PPI) that will identify cost recovery issues in the power, telecommunications and environmental infrastructure sectors and identify mechanisms that will, as much as possible, assure full cost recovery without government guarantees, and, on the basis of these studies, take appropriate policy action.

Attitudes within the Relevant Ministries

While it is difficult to generalize about ministerial attitudes, they have generally been less than enthusiastic about the involvement of private firms in their investment programs. At least one agency — Sri Lanka Telecommunications (SLT) — was excluded at its request from SIDI's efforts to find it private sector investors. According to Kenneth Lussier (See Annex C), the Ceylon Electricity Board (CEB) prefers to get its funds from donors, possibly because, not knowing its own cost structure with precision, it lacks confidence to negotiate with the private sector. The National Water Supply and Drainage Board (NWSDB) has decided not to proceed with private sector negotiators on a water project for the Southern Region when a pre-feasibility study indicated that the costs of water delivered by the private sector would exceed current tariff levels — an easy way out of dealing with a thorny problem.

We can only speculate about the reluctance of the line ministries to embrace SIDI. All of us are creatures of habit, and when we develop close relationships with our suppliers — even perfectly legitimate relationships — we do not like to have these disturbed by outsiders. But there are likely to be other reasons.

First, dependence on private finance may be seen as leading to wrenching institutional and policy reforms. This particularly applies to consumer tariffs, which are currently heavily subsidized. Subsidized consumers rely on the benevolence of their suppliers, a far easier way of life for suppliers than relationships based on contracts, with customers paying full price and demanding full service. If SLT, for example, were to lose its monopoly on long-distance and international calls, it would have to charge market rates for local calls and may have to struggle to stay in business and even to reduce its work force. (SLT employs 56 people per 1,000 lines, compared to 48 in Pakistan, 39 in Indonesia and 27 in the Philippines). Water and electric power suppliers are in a similar situation.

It is also likely that private investors will be seen as more demanding of good performance than bilateral aid agencies, who do not have private investors and lenders breathing down their necks. For example, in the case of a power project, private investors may actually insist that the BOT power plant earn the amounts stipulated in the project agreement. On the other hand, bilateral agencies such as (say) the World Bank, rarely insist on their covenants being complied with because it is so much easier to turn the blind eye.

To the line agencies, SIDI is seen not as a lifeline to additional financial resources but rather as an interloper and spoiler of existing arrangements that have worked tolerably well in the past. It is evident that the interests of these agencies are directly opposed to the interests of the Treasury, which has to find additional funds because of slackness in the line agencies. It follows that firm action by the Treasury would be an essential part of any reform.

Next Steps

The GSL needs to strengthen its public support for the private financing and operation of economic infrastructure. This requires two actions.

First, the GSL should specify in greater detail what it means by having the private sector undertake a "significant portion of the infrastructure investment effort." Specifically, it should: publicly reiterate that inadequate infrastructure is a critical constraint to rapid economic growth and development; identify those infrastructure needs that must be financed by the private sector because government and donor funds are not available; and instruct the responsible line ministries and public utilities that they should begin the project identification, design and tendering process as soon as possible. These pronouncements and instructions should be unequivocal. If they are not, the line ministries or public utilities will continue to resist successfully the transition to the private sector. This in turn will make it virtually impossible for PPI to achieve its purpose-level objectives.

Second, the GSL should set up a reliable process for moving projects from the identification stage to the implementation stage. One approach would be to establish an Inter-ministerial Infrastructure Committee for the purpose of resolving policy issues and facilitating cabinet-level approval of projects. Committees that are now dealing with projects at the sector level, e.g., the Committee on Power-related Issues and the committee dealing with the Galle Port, would become sub-committees of the Infrastructure Committee. SIDI would be this committee's secretariat. The committee should be given decision-making power over public utilities with respect to the development of private infrastructure projects, although in some cases it would be appropriate for final approval to be given at the Cabinet level. Under the guidance of this committee and its sub-committees, SIDI would analyze policy issues, participate in pre-feasibility studies, assist line ministries and public utilities in the preparation of tendering documents, and take the lead in evaluating bids and negotiating the final agreements. It is important that this committee and its secretariat have real authority and not be simply advisory bodies or "facilitators" utilized by line ministries and public utilities on a voluntary basis. The importance of infrastructure development to the economy and the country is greater than the interests of any one line ministry or public utility.

SIDI PERFORMANCE AND NEEDS

Performance to Date

SIDI staff give the impression of being hard-working, intelligent, officials, with a good understanding of their objectives and difficulties. Unfortunately, they have not proved to be effective, due mainly to the following reasons.

First, because their role was not defined clearly enough, they became involved in fights over 'turf' with some of the agencies they are trying to help, particularly the CEB.

Second, as mentioned above, SIDI's activities were seen as threats to vested interests and thus it increasingly found itself in adversarial relationships vis-a-vis the line ministries.

Third, SIDI staff had inadequate expertise of their own and PPI provided technical advisers whose experience and qualifications were more attuned to closing deals than developing institutions, policies and procedures.

Fourth, the PPI implementation arrangements made it difficult for SIDI to utilize PPI-funded advisors and consultants effectively in support of its program. The problem lay in the technical assistance contract, which placed most of the responsibility for project achievements on the contractor, not on SIDI. Instead of seeing itself as advisor in support of the SIDI program, CFED saw itself as the implementer of the PPI program for which it would be held accountable. The more appropriate organizational arrangement would have been to make SIDI the umbrella organization under which the objectives of the four PPI components should have been pursued. The role of the technical consultants would then have been to provide advice and support to SIDI rather than hold direct line positions within SIDI.

Fifth, there was inadequate communication between SIDI and other concerned ministries and agencies. SIDI staff appear to have had no formal mechanism of keeping other agencies aware of what they were doing. For example, officials dealing with roads in SIDI's own Ministry of Policy Planning and Implementation were given no opportunity to comment on the Southern Highway study done for SIDI, and did not even receive a copy of the final report. Such lack of communication is bound to breed suspicion and bad relations.

Sixth, and this is another aspect of inadequate communications, SIDI and CFED gave insufficient attention to the 'Public Awareness' component of the project, which was designed to 'educate Sri Lankans of the benefits of BOO/BOT and other joint sector approaches'. While seminars and study tours were arranged for the benefit of officials, very little seems to have been done to obtain media support, or to refute the general perception — based on some real Sri Lanka experiences — that privatization is designed to enrich the few at the expense of the many. SIDI may not be equipped to teach Colombo about market systems, but it should do more to persuade chambers of commerce and others to provide appropriate educational activities.

It is also important to note the effect that the political situation has had on project implementation. When the project was initiated, the Minister of Policy Planning and Implementation (M/PPI), the ministry where the SIDI is located, was President of the country. Until may 1993, the PPI project could move through the GSL bureaucracy without much friction due to the political leadership of the President and the M/PPI Secretary. However, with the assassination of the President, progress in moving infrastructure projects through the system slowed down considerably; the bureaucracy was allowed to resist openly. Subsequently, a M/PPI was headed by a new Secretary until the parliamentary election held in August 1994. During this transition period no policy decisions were made with regard to private infrastructure. In August 1994, M/PPI was absorbed into the Ministry of Finance and Planning, and a new Secretary was appointed. However, until the presidential election held in November 1994, again, all major policy decisions were put on hold. The question now is, will the new government be able to move sufficiently on policy matters to enable SIDI to carry out its responsibilities.

Needs for the Future

SIDI is well-placed in government to do its job, and its position will be strengthened if (as mentioned in section V below) it becomes the secretariat of a powerful GSL inter-ministerial committee on infrastructure. In that capacity it should have no difficulty in holding its own after the completion of the USAID project under review, and may not need to be given the status of an "authority". The key is to have a mechanism that brings pressure on the public utilities in a top-down arrangement through line ministries. An important indicator of adequate government support for private infrastructure will be the strength of the alliance between SIDI, M/FP, and the line ministries in overcoming the resistance that has occurred and will continue to occur in the public utilities.

Although strengthening SIDI's authority and clarifying its role in the project development and approval process is necessary, it is not sufficient. SIDI itself needs a vision of where it is headed. At present, the organization has neither a mission statement nor an annual workplan. Consequently, the organization is floundering. The mission statement should define SIDI's role in the development of Sri Lanka's economic infrastructure. Based on this mission statement, SIDI should set targets for what it hopes to have achieved at the end of one year, two years, and five years, and should prepare annual workplans for achieving these goals. At a minimum, SIDI's goals should be consistent with the PPI purpose-level targets as specified in Section III.E.1. Its workplan should indicate how these targets are to be achieved over the two-year period that coincides with the remaining life of this project.

To effectively carry out this workplan, SIDI needs to have a full-time executive director. SIDI's workload as an advocate for sector-level policy reforms and as the focal point for project development and approval is too large and complex to be managed by a part-time director. This management role should be assumed either by SIDI's Director General or by the appointment of a deputy DG with wide powers. SIDI's staffing and organizational structure needs to reflect this workplan. Sector directors should have well

defined responsibilities and goals, and their sectoral workplans should be supported by the PPI-funded technical assistance as appropriate.

There also is an urgent need to establish clear communication channels between SIDI and line ministries and public utilities. At the very least, a person in each ministry and public utility affected by a SIDI study should be designated to receive copies of significant papers, and be given an opportunity to comment on them. Such openness could go a long way to reduce tensions and disarm criticism, and SIDI staff might often benefit from comments received.

As SIDI is likely to be required to continuously bring new ideas to the notice of government officials, it should set up a modern information-gathering unit, computer based, with the ability to search data bases in the World Bank and elsewhere and to produce up-to-the-minute reports on any aspect relating to the private provision of infrastructure. SIDI already has many of the requirements for such a communication center. Additional requirements would include: one full-time information specialist; subscriptions to publications dealing with private infrastructure issues ("Privatization International", "Public Works Financing"), and computer access by telephone to USAID, and World Bank information systems. The key will be to utilize these resources to keep interested ministries and agencies informed on SIDI activities and developments related to the market for private infrastructure both at home and abroad.

THE TECHNICAL ASSISTANCE CONTRACT

Past Performance

To what extent has SIDI's lack of impact been due to inadequacies in technical assistance? As noted above, the overriding reason for the lack of impact thus far has been the lack of government commitment to private sector infrastructure and the lack of interest of the line agencies. This was not clearly evident during the project design, but when it became evident soon after, the project implementers, including the technical assistance team should have shifted its focus from project development to public awareness, policy analysis, and capacity building in SIDI and the line ministries. In fact, the technical assistance team continued to focus of project development to the almost compete exclusion of institution building.

This should not be blamed entirely on CFED. SIDI staff, USAID staff, and CFED advisors were all in agreement that this was the proper focus of activity. The expectation was that project approvals were in fact possible and that the most effective way to build project development capacity in government and establish effective procedures was to approve actual projects. This remained the accepted approach until late 1993. By then, it was becoming clear that almost any private investment in infrastructure raised complex policy issues which the GSL and line agencies were unwilling to address head on. All, including CFED, were agreed that a change in project focus was necessary, and that the

initial advisors did not have the qualifications required to bring it about. The re-orientation of project activities, however, was slow in coming.

The four questions asked in the evaluation SOW regarding the technical assistance contract are:

- Has CFED provided the required leadership for the promotion of private infrastructure?
- Has CFED's support to GSL been responsive?
- Has CFED established strategic plans to achieve longer-term project goals?
- Does CFED adequately tap into other resources in implementing the contract?

The answer to all of these questions is a qualified yes — at least until late 1993. The CFED home office project director led the design team, established a strategy as presented in the Project Paper and reflected in the first year workplan, and backstopped two resident advisors who were selected on the basis of their first hand experience in developing and implementing private infrastructure projects. There was a high level of activity in the early months. The short-term technical assistance was generally qualified and focused almost exclusively on project development. This appeared appropriate at the time given the already growing flow of project proposals both solicited and unsolicited.

However, during this period, the contractor's performance fell short of the mark in three important respects. First, the resident advisors did not give enough attention to the policy and regulatory environment within which projects were being pursued. Second, they did not give enough attention to creating the capacity in SIDI to do what CFED advisors were doing. Finally, the advisors saw their role as aggressively moving projects to completion rather than as advisors to the GSL in this process. As a result that they were perceived as advocates of the project sponsors thus reducing their credibility and effectiveness as advisors to the line ministries. These shortcomings resulted to a large extent from the project design and the terms of the CFED contract, but an important responsibility of technical assistance contractors is to identify design shortcomings and propose corrective action.

In late 1993, the project entered a turbulent period from which it hasn't fully recovered. Between November 1993 and April 1994 CFED stumbled badly. There was a rapid and disorganized turnover of key personnel at the home office and in Colombo; a series of actions by CFED personnel, some at the direction of the home office, created personal animosities; and a critically important revised technical assistance workplan reflecting the shift in project emphasis away from project development to institution building was prepared only after a cure notice was sent to by USAID to CFED. The resulting delays and confusion generated serious conflicts between CFED, its local sub-contractor (Comintax), SIDI and USAID.

Relations between SIDI and CFED improved during May, June and July, but started deteriorating again in August. CFED was falling behind in the implementation of its 1994/95 workplan. From the DG's standpoint, this showed that CFED was being unresponsive to SIDI's needs. From CFED's standpoint, the SIDI DG, and to a lesser extent the USAID Mission, was preventing the firm from implementing its workplan by refusing to approve consultancies that had been previously approved by SIDI and USAID.

By the end of August, due more to the disagreements and perceptions described above than to any objective assessment of performance, the SIDI DG and CFED had lost all confidence in each other. Since then, SIDI has shown no interest in having CFED provide leadership or establish strategic plans; nor can CFED be responsive to SIDI's technical assistance needs because SIDI is in effect asking for very little. Specifically: discussions are ongoing with CEB with respect to power generation, important deliberations are occurring regarding how to proceed on Galle Port, a Cabinet Paper is being prepared on the setting up of an Inter-ministerial Infrastructure Committee, and a SIDI study of its organization and staffing is nearing completion, but the SIDI DG has rarely consulted the COP nor even kept him adequately informed on any of these activities. The 1994-95 CFED workplan has become largely inoperative, due as much to it's being ignored by the DG as to CFED's inability to deliver. This is not to say that CFED could necessarily be performing better now than they did during the first year of the contract, only that, since August, they have not really been given the chance.

Next Steps

Regardless of how the problems described above are resolved, changes are needed in the type of technical assistance to be provided and the objectives for which the technical assistance contractor will be held accountable. This will require a contract amendment or a new contract. The most important point to make with respect to future technical assistance needs is that this project is a policy reform and institution building project. It is not an infrastructure development project. The project purpose remains essentially the same — to enable Sri Lanka to enter the market for private financing and operation of private infrastructure — but the immediate tasks (over the next two years) are to create a greater appreciation in government and the line agencies for the benefits private investment in infrastructure, and to create the capacity in SIDI and the line agencies to design, tender, evaluate and negotiate private infrastructure projects. These should be SIDI's priority objectives as well as the technical assistance contractor's. The time has come for USAID and CFED to set the 1994/95 workplan aside and put together a new workplan based on the project redesign as described in Section II, above.

The experience of the last 18-months shows that the GSL needs technical assistance in formulating its private infrastructure policies and in establishing efficient and effective project development and approval procedures. Given the low level of project development activity, the most cost-effective way of providing this assistance is through short-term experts rather than long-term advisors. However, one long-term advisor is needed to coordinate the provision of these short-term experts and also to act as a senior advisor to the SIDI Director

General. This position can be either a Chief of Party (COP) as it is at present or a Resident Technical Advisor (RTA).

The basis for a technical assistance contract amendment or a new contract should be the project re-design but, for the technical assistance to have an impact, it must be closely tied in to SIDI's own workplan. The SIDI DG must sit down with his COP or RTA and say: "these are the objectives we want to achieve this year and this is our workplan for achieving them. Let's discuss this and decide on the technical assistance that we will be needing to carry out the workplan and achieve our objectives." One of the important responsibilities of the RTA will then be is to provide quarterly and annual progress reports to USAID based on the agreed upon workplan.

USAID MANAGEMENT

From a management standpoint the key indicators of project success are first, whether the intended project outputs were achieved and second, whether the project purpose, as measured by the targeted end-of-project status, was achieved. Although, as technical advisor to the project, the technical assistance contractor is responsible for advising SIDI and USAID on progress in achieving these objectives, final responsibility for their achievement lies with the USAID Mission.

The management task becomes more difficult as one moves up the logical framework. The project monitoring and management system is well suited for monitoring the delivery of inputs and the achievement of targeted outputs. The outputs result directly from the inputs. USAID project management is well informed about output achievement and has been well aware when changes were necessary. Specifically, USAID intervened when it became apparent that the 1993 workplan was overambitious and many of the activities were inappropriate. USAID project management also pays close attention to the quality of the outputs and makes efforts to correct shortcomings. There is reason to expect that this will continue under the project redesign.

The real management effort, however, has to occur at the purpose level. If Sri Lanka does not become competitive in the international market for private financing and operation of economic infrastructure, the project will not have succeeded. First, USAID has to be clear on what constitutes successful entry into the international market. Presumably, at a minimum, RFPs will have been issued and private investors will have responded with proposals that have a reasonable chance of being accepted. If this is not occurring, then all that will have been achieved is that some elements in government, the line agencies, and among the public will have a better understanding of and appreciation for private infrastructure, but successful entry into the market will not have occurred. USAID must ask itself if an actually functioning market is critical for the spending of $7 million to have been worthwhile.

If the answer is yes, then the focus of USAID's attention should be on the assumptions affecting the output to purpose link. If these assumptions were in place, PPI could in fact have been a private infrastructure development project as originally intended. SIDI and the technical assistance contractor could focus on creating technical expertise in SIDI and the line agencies and establishing an efficient, effective and transparent review and approval process. The market for private investment and operation of economic infrastructure would then be in place, projects would get underway, and Sri Lanka's economic infrastructure would grow.

However, as previously discussed, this is clearly not the case. The government has been inadequately supportive of private infrastructure; line agencies have not embraced private investment in their sectors; sector-level policies that prevent projects from being commercially viable are not being revised; and, as measured by progress in moving project proposals forward, the inter-ministerial approval process is barely functioning. USAID project management must focus on these issues. At a minimum, government support must increase sufficiently to make a few projects possible. Even this hasn't happened yet. For the project to be truly successful, however, government and line agency attitudes must change sufficiently for projects to continue being approved expeditiously after the end of the project.

The essence of a policy reform project is for the outputs to support and facilitate the desired policy change. The COP plays an important role in helping to bring this about, but the main responsibility lies with the USAID project manager. USAID's experience with policy reform projects in Sri Lanka and elsewhere shows that the Mission and the technical assistance team must make a constant effort to understand the issues from the government's standpoint and to address constructively, i.e., not dismiss, the strongly felt concerns of key high level officials. This requires very close teamwork between the senior government counterpart, in this case the SIDI DG, the USAID project manager, and the resident technical advisor or COP, all of whom must be highly qualified with previous experience in policy formulation. The key is to follow the lead of government, not take the lead. In the end, unless the project is perceived by key policy makers as meeting priority government needs it will not succeed.

It must also be recognized that progress will not be steady. It will be in fits and starts, with periodic setbacks that are beyond the control of those implementing the project. Frequently, coordination between donors will be a key element in bringing about the desired change. This requires a USAID project manager (and COP) with strong communication skills and the ability to stay focused on the final objective and keep day to day developments in perspective.

At the same time that policy reforms are being pursued, the USAID project manager must continue to focus on increasing the GSL's capability to design, tender, negotiate and approve private infrastructure projects. This increased capacity needs to occur in SIDI and in the line agencies. Benchmarks must be established with respect to this objective and the project manager must assess the progress. Progress will depend not only on the quality of technical assistance provided, but also on the use made of that assistance by SIDI and the

line agencies. The quality of the advice and training will be very important, but for this assistance to have its desired impact, the resulting project profiles, generic documents, and procedures must by seen by government agencies as theirs and not as the advisors'. The USAID project manager will be able to assess this impact only by monitoring the actions of SIDI and the line agencies in the consideration and development of private infrastructure projects.

CHAPTER FIVE
SUMMARY OF RECOMMENDATIONS

Government Support

- The GSL should clarify its policy regarding private investment in infrastructure. Specifically, it should: reiterate that inadequate economic infrastructure is the single most critical constraint to the country's growth and development; identify those infrastructure needs that must be financed by the private sector because government and donor funds are not available; and instruct the responsible line agencies that government funds or guarantees are no longer available and that they should begin the project design and tendering process as soon as possible.

- The GSL should establish an Inter-ministerial Infrastructure Committee for the purpose of dealing with policy issues that arise in the process of developing private sector infrastructure projects and facilitating the cabinet-level approval of these projects. Committees that are now dealing with projects at the sector level would become sub-committees of the Infrastructure Committee.

Project Design

- The project design should include conditions precedent that link the continuation of this project to adequate government support, line ministry cooperation, and sector-level policy reforms. Specifically, USAID should require that, prior to the decision to continue this project:

  — The GSL will announce to the line ministries and state-owned enterprises in power and telecommunications that no public funds will be made available nor will the government guarantee any loans for expansion projects in these sectors.

  — The GSL will establish a high level Inter-ministerial Infrastructure Committee (IMIC) with the power to resolve policy issues, approve project agreements and impose its decisions on the line ministries; and will officially designate SIDI as the secretariat of that committee.

  — The GSL will begin the process of removing all policy and regulatory obstacles to the entry of private investors in the power, telecommunications and environmental infrastructure sectors by carrying out a policy study in each of these sectors (to be financed by PPI) with appropriate policy actions to be taken by June 30, 1995. These studies and actions should include the subsidy and cost recovery issues discussed in Section IV.A.2.

- The project should be redesigned so that the purpose and output indicators relate to policies, institution building, and procedures rather than to the development, approval and completion of actual projects. (See Section III.E. and Annex A.)

SIDI Role, Organization, and Workplan

- SIDI's role should be redefined in light of the GSL's less than unequivocal support for private financing and operation of economic infrastructure. Specifically, it must be recognized that, for the foreseeable future, the issuance of RFPs, evaluation of bids, and negotiation of agreements will be a very small part of SIDI's responsibilities. Its main functions should be to interact with line ministries to identify possible projects, participate in pre-feasibility studies, prepare project profiles and generic tendering and contracting documents, and identify sector-level policy issues that need to be addressed in order for privately financed and operated projects to be commercially viable.

- SIDI's organization and staff must reflect the role described above. This implies a small but highly qualified staff with access to highly qualified short-term consultants. This staff should be organized by sector with each sector headed by a director who reports to the Office of the Director General. The number of professional staff should remain small at first (probably less than ten) and increased only as project development work increases.

- SIDI should have a workplan that has benchmarks for setting the groundwork for eventual private sector projects. Each sectoral director should have specific tasks to accomplish and objectives to achieve with respect to project profiles, generic documents, policy analyses and incentive packages.

- The SIDI workplan should give top priority to the sectors where the prospects for commercially viable private sector projects are greatest. These are telecommunications and power. Adding telecommunications will require that the GSL instruct the appropriate line ministries and SOEs that SIDI will take the lead in proposing policy and regulatory changes that will enable greater private sector participation in that sector. (See Annex B.)

- SIDI should have a full-time director responsible for setting priorities, maintaining contact with line agencies, serving the needs of the Inter-ministerial Infrastructure Committee and its sub-committees (see recommendation 1 above) and monitoring the implementation of the workplan. There are two options for meeting this need. The first is to have a full-time Director General. The second is to keep a senior civil servant as a part-time Director General and add a full-time Deputy Director General who is responsible for day-to-day SIDI operations.

Technical Assistance

- There should be a full time technical advisor to SIDI DG and Deputy DG who will 1) provide high level expertise related to private financing and operation of economic infrastructure projects, and 2) oversee the provision of short-term technical experts. This individual should be selected on the basis of his knowledge and experience in private sector infrastructure projects, but he should also be familiar with the process

and complexities of policy reform and have had prior institution building experience in developing countries.

- PPI should have a technical assistance plan that fits into the SIDI workplan. It is not enough for the DG to merely approve this plan. The DG and senior SIDI staff should prepare a SIDI workplan and, in consultation with the senior technical advisor, identify the technical assistance that will be needed to carry it out.

Project Management

- USAID should inform SIDI and CFED that the project is to be re-designed and the 1994/95 workplan is no longer operative. USAID should then ask SIDI and the Resident Technical Advisor to prepare a two-year SIDI workplan and a technical assistance workplan based on the SIDI workplan. This task should be initiated as soon as possible and completed by the end of March 1995.

- In addition to the normal monitoring of project activities, the USAID project manager should focus on two concerns critical to the success of this project: 1) the policy assumptions that are critical to the achievement of the project purpose, and 2) the increase in the GSL's ability to design, tender, evaluate, negotiate and approve private sector infrastructure projects. Benchmarks can and should be set with respect to the second concern. Project outputs should be managed to maximize their contribution to policy reform.

ANNEX A

REVISED LOGICAL FRAMEWORK

LOGICAL FRAMEWORK			
	Verifiable Indicators	Means of Verification	Assumptions
<u>Goal:</u> Modernize economic infrastructure in 3 sectors: power, telecomm. and environmenntal infrastructure	__ addit. MW of electricity __ addit. phone lines __ addit. persons with access to potable water __ ton incr. in capacity to dispose of munic. solic waste	1. Govt. records 2. SLT records 3. Municipal records 4. Municipal records	1. Continued political stability. 2. Continued economic liberalization. 3. Increased GSL commitment to sustained market-led growth.

Purpose: To assist Sri lanka to successfully enter the international market for private financing and operation of economic and environemntal infrastructure.	End-of-project status: 1. The necessary policy and regul. framework will have been established in at least 3 sectors: power, telecomm. and environmental infra. 2. SIDI functions as the focal point for the effective, expeditious and transparent processing of private infra. projects. 3. A marketing and incentive program for private infra. projects will have be operational. 4. Financeable projects will have been developed in power, telecomm, and solid waste as evidenced by RFPs issued, responded to and approved.	1. SIDI records. 2. Project records. 3. SIDI records. 4. SIDI records.	1. The political will exists to open the economic and environmental infra. sectors to private investors. 2. SIDI will be given the necessary authority, staffing and funding. 3. The public utilities will not obstruct efforts to increase the private financing and operation of econ. and environ. infra. 4. Municipalities will give a high priority to attracting private participation in the provision of urban environmental services. 5. Other donors support the PPI project purpose. 6. The investment climate will not be an obstacle to Sri Lanka becoming competitive in the international market for private infrastructure projects.
Outputs:	Verifiable Indicators	Means of Verification	Assumptions

1. Identify policy and regulatory changes necessary for private infrasructure projects to be commercially viable.	Recommendations presented by SIDI to the IMIC concerning necessary policy and regulatory changes in: - the power sector - the telecomm. sector. - the environmental infra. sector	SIDI records.	1. A well defined, well organized, and well staffed SIDI. 2. Highly qualified technical assistance experienced in policy reform and insitutional development.. 3. GSL willing and able to allocate budgetary resources to SIDI operations and private infra-structure marketing and incentive programs.
2. Formal networks established to promote, develop, approve and implement private infra-structure projects.	- A functioning IMIC supported by a strengthened SIDI with access to qualified tech. assist. as needed. - Generic RFPs for power, telecomm and environ. infra. projects. - Generic purchase agreements (contracts, concessions, BOO/BOT agreements). - Pre-feasibility studies and project profiles. - Guidelines for reviewing and approving unsolicited proposals	SIDI and project records.	
3 . Increased understanding of and support for private financing and operation of econ. and environ. infrastructure.	- political awareness and support - public awareness and support - understanding and support at all levels of government - understanding and support in municipalities	- media reports - project surveys - SIDI and project records - SIDI and project records	
4. A marketing and incentive program in place for private infrastructure projects	- a credit facility to channel donor assistance to private infrastructure - a cost sharing mechanism for feasibility studies - the capacity to prepare and distribute marketing materials for specific projects	- SIDI records - SIDI records - SIDI records	
Inputs:	Verifiable Indicators	Means of Verification	Assumptions

1. l-t tech. assist 2. s-t tech. assist 3. GSL civil servants 4. GSL local cost funding		- project records - project records - project records - project records	

34

ANNEX B

INFRASTRUCTURE PRIORITIES

Gabriel Roth, Infrastructure Specialist

All infrastructure sectors are important, but not all merit equal priority at this time in the USAID SIDI program, if it is to produce tangible results in the time remaining in the project. The purpose of this annex is to list some of the issues in Sri Lanka's infrastructure sectors and to assess sector priority in the light of the following criteria:

- financial viability
- ease of implementation
- potential impact on employment
- political acceptability

The following discussion also covers some institutional issues, specifically ways of organizing the sectors to ensure fair competition between private and government suppliers. It is particularly difficult to attract the private sector to provide public infrastructure if it has to compete against the public sector on unequal terms.

A. Electricity Generation

The agency responsible for generating and selling electric power in Sri Lanka is the Ceylon Electricity Board (CEB). Private firms are allowed to generate electricity for their own use, but not to sell it without a license from the CEB. The CEB is thus responsible for meeting Sri Lanka's growing needs for electric power.

Because of the financial constraints facing the GSL, CEB was requested to explore the possibility of meeting its power needs by inviting private generators to supply power on a BOO or BOT basis. The additional capacity being sought is 400 MW to be available by the year 2000. Unlike the distribution and transmission of electricity, power generation is not considered to be a 'natural monopoly', and the GSL has indicated its willingness to involve the private sector in power provision, subject to the contractual processes being transparent.

SIDI devoted considerable efforts to identify potential suppliers, but failed to win the confidence of CEB's management, which complains that SIDI's intervention lost it two valuable years. It is evident from Kenneth Lussier's report that SIDI could have helped CEB to identify potential suppliers and to assist in negotiations. But there is no agreement on SIDI's precise role in the process, and the consequent misunderstandings have led to personality conflicts and disputes over 'turf'. Resolution of these conflicts over process and personality should not pose a major problem to a determined government.

In terms of the priority criteria, financial viability might have been expected because the sector serves the better-off. However, CEB's residential tariff is not high enough to cover costs. Implementation speed is critical, in view of the risk of 'brown-outs' which would lead to unemployment and loss of earnings. Conclusion of some BOO/BOT projects would demonstrate both to Sri Lankans and to overseas investors that Sri Lanka offers a good investment climate. In view of the risk of 'brown outs' there do not appear to be significant political objections to private power generation so long as a unit such as SIDI ensures that government is properly advised and that contracts are fairly awarded.

B. Telecommunications

Telecommunications is the easiest infrastructure sector for private sector development, and potentially the most beneficial to the country. Unfortunately, Sri Lanka Telecom (SLT), the state monopoly, has little incentive for privatization. Its own investments are financed by suppliers' credits, the costs of which can be passed on to consumers. SLT also licenses suppliers of cellular and card systems, and thus earns fees without even having to provide service.

The costs of this comfortable monopoly are 6-year waiting lists for telephone lines; poor service levels; and US$2 a minute charges for international calls. The benefits include low charges for domestic users: 2 US cents per local call (the lowest in Asia), plus a monthly subscription charge of only US$1.90. And the 6-year waiting list gives the authorities many opportunities to reward favored customers by giving them priority status to enable them to jump the queue.

The privatization of the of the SLT monopoly is an option that SIDI may have examined, but the transformation of a public monopoly into a private one may do more harm than good (because it would allow private monopolists to exploit the public) and cannot be recommended. However, deregulation of the sector, which would allow the establishment of new companies, both local and long-distance, may be a more fruitful option. Under a deregulated system (such as in New Zealand) many small local companies could be formed within a framework that would allow both competition and inter-connectability. The design of such a framework could be undertaken by SIDI-retained consultants. Should an acceptable framework be devised (which would establish technical standards and rules for interconnection) US telecom companies could either invest themselves in some of the companies, or provide equipment and training for newly-established small companies.

Using modern equipment, telephone lines provided by the new companies could carry not only voice and data services but also cable television programs for education and entertainment. The establishment of such companies could create immediate benefits in all areas, including direct employment in telecommunications (a key modern sector) and in services, such as mail order and data entry, dependent on telecommunications. The effect would be particularly beneficial if the new companies were allowed to provide long-distance and international services

A World Bank mission reviewed the sector in 1993. Its report: 'Sri Lanka: Strategic options for the communications sector' (Report 1 2464-CE, dated March 16 1994) included the following recommendations (p. 40):

"Improve Market Access and Competition:"

"* allow qualified private companies to provide wireless basic telephone services [in addition to mobile cellular service, already allowed] in competition with SLT as well as wired services in areas not served by SLT;"

"* study the feasibility of the establishment of local telephone companies and cooperatives and how they could be funded and provided with the necessary technical assistance."

SIDI is well-placed to follow up these recommendations, and others in the World Bank report, and thus help all of Sri Lanka's people to benefit from modern, low-cost communications. The main difficulty would be overcoming the objections of SLT, which may prefer the quiet life of the monopolist to constant struggle inherent in competition.

In terms of the priority criteria, telecommunication services are so much in demand that their financial viability would be achievable. Early implementation should not be a problem, given the many suppliers keen to enter the market. The potential for employment creation would be substantial. The demonstration effect of telecommunication deregulation would be significant - it would also send a loud and clear signal to the whole world that Sri Lanka's economy offers opportunities - and modern communication services - to all investors. Opening up the telecommunications market should be politically acceptable, although competition in long-distance rates could force up local tariffs.

C. Transportation

SIDI has been actively seeking investors for the port, railway and road sub-sectors. These three sectors will be considered in turn, followed by bus companies, which are also in urgent need of private management and investment.

1. Ports

Sri Lanka is situated on the main shipping route connecting Europe to Asia and is geographically ideally situated to provide trans-shipment and other services for shipping serving India's growing markets. Sri Lanka's main port, Colombo, is reported to be operating at full capacity. Additional capacity could be provided either at Colombo itself, or by expanding the small port at Galle, which would have the additional advantage of bringing employment to an under-developed part of Sri Lanka. Studies financed by the JICA indicate that development of a container port at Galle was likely to be economically justified but financially unattractive, due to the heavy costs of providing a new breakwater and continuous dredging. The GSL agreed to make the project financially viable by taking responsibility for these infrastructural elements.

In March 1994 The Ministry of Ports and Shipping, with some assistance from SIDI, invited proposals for the private developments of a new container terminal at Galle. Six bids were received and are being evaluated by the Ministry. In the event that at least one of the bids is found to be acceptable, there is likely to be a role for SIDI in the subsequent negotiations.

In terms of the priority criteria, the Galle port expansion would not be financially viable, but could be put in hand without delay and could have a significant effect on local employment. Its implementation would have a significant demonstration effect - as would its non-implementation, which would signify the GSL's indifference to the trans-shipment trade - and it would score well politically.

2. Railways

Sri Lanka Railways (SLR), which has a total route length of some 1600 km, carries about one tenth of the country's land transportation load, and receives about forty five per cent of land transportation budgetary allocations. It has been losing traffic and money ever since Sri Lanka's independence. The financial losses are due in part to the government's policy of holding down railway fares: subsidies reach 90 per cent of costs for season ticket holders, civil servants and school children. Much of the country's freight, including the carriage of plantation produce, has been transferred to trucks, because of their quicker and more reliable service. Nevertheless, the railway authorities have identified four projects for extending its network by 376 km, and two for the electrification of 116 km of its existing system.

While SLR's losses have been attributed to poor management and low fares, it is not obvious that the system could be made viable at any fare level, even with good management, especially if Sri Lanka's roads are upgraded. Railways are at their best carrying heavy loads over long distances, and viable railways exist in large countries such as the US, Canada, India, China and Russia. It is not obvious that Sri Lanka has either the distances or the traffics that are suitable for railways.

It is possible that, if fares were raised, viable routes could be established to serve commuters in the Colombo region. This possibility merits study. However, 'busways' offering exclusive rights of way to public transportation (such as the Shirley Highway busway in the Washington DC area) may provide better service at less cost, and need to be studied also.

In terms of priority criteria, railway projects are unlikely to be financially viable nor, because of the studies required, quick to implement. They would create more employment in the railway sector, which could ease over-staffing problems. The main demonstration effect would be that the GSL is interested in reducing reliance on motorized transportation. As most people like railways - though not strongly enough to pay their full costs - railway investments would probably be deemed politically correct and acceptable.

3. Roads

Sri Lanka has an extensive road network of some 100,000 km, a third of which is paved. Road density is 1,200 km per 1,000 sq.km of land, and 4.7 km per 1,000 people - one of the highest in Asia. But not one of its roads is dedicated exclusively to the use of motor vehicles, and over 90 per cent of the main road network was considered in 1990 by a World Bank appraisal team to be "too narrow for current traffic volumes". Could the private sector strengthen this network?

Sri Lanka's Road Development Authority (RDA) has identified over 400 km of new roads as being required to support the island's economy and the needs of motorized traffic. At least two of these roads, a 24-km link from Colombo to its airport at Katunayake, and the 145-km 'Southern Highway' from Colombo to Galle and Matara, have been identified by SIDI as possible toll roads which the private sector could provide on a BOT basis.

The potential for developing the Southern Highway as a conventional toll facility was explored for SIDI by foreign consultants financed under the project. The consultants concluded that a conventional toll road would not generate sufficient toll revenues to cover costs and recommended that a full feasibility study be carried out which would also take into account the possibilities of the road provider being allowed to benefit from real estate development arising from the new road.

While this main conclusion was valuable, the consultants might have considered more options, such as building the road on the right-of-way of the existing railway line, which is grossly under-used and a major financial liability to the GSL. A big advantage of using rail rights-of-way for roads would be that land acquisition and displacement of land uses would be minimized. A precedent for such a conversion exists in Trinidad, where the main railway line into Port of Spain was successfully converted into a 'busway' some twenty years ago.

Another option not considered was building the road in stages. The report stated that a traffic volume of 5,000 vehicles a day can make a toll road viable, and that existing volumes exceeded 10,000 a day on the northern section between Colombo and Kalutara. The possibilities of giving early relief to that section do not seem to have been considered. Furthermore, the consultants considered only conventional toll collection (at toll rates as high as those prevailing in the US!) and did not consider the possibilities of 'shadow tolls', which are described below. These gaps should have been noticed by SIDI or CFED staff.

Toll roads have been criticized on the grounds that the tolls are costly to collect and divert traffic to congested 'free' roads. A better way of achieving the government's objective might be to use the 'shadow toll', a device currently being introduced in the UK. Private syndicates have been invited to build, operate and maintain roads, and to be paid by the government an agreed amount for each vehicle-km 'produced' on the roads they provide. Other things being equal, the contracts are to be awarded to the bidders offering to provide and maintain the roads at the lowest 'shadow toll'. Another advantage of this system is that

the traffic risk is shouldered by the private contractor. To ensure that the RDA has the funds to pay 'shadow tolls' to private providers, it would need a reliable source of income. This could be done by dedicating a proportion of road use taxes (e.g. surcharges on fuel, or 'distance licenses' for heavy vehicles), to the RDA which could distribute these revenues to all road providers, governmental or private, in accordance with the same rules, without discrimination.

The importance to private investors of stable, dedicated, predictable, income streams is generally recognized in revenue-earning sectors such as electric power, water supply and telecommunications. If the private sector is to participate widely in the provision of roads (for which it already provides the vehicles) ways have to be found to organize them, also, as revenue-earning entities, and to do this without the disadvantages of conventional toll roads. Most road users are prepared to pay for roads - in Sri Lanka total revenues form road user charges (fuel tax, license fees) in recent years have been four times the expenditures on roads. The use of dedicated road funds and "shadow tolls" could give the roads sector a stable financial structure that could attract wide private sector participation.

In terms of priority criteria, roads could be made financially viable, but only following studies and/or policy changes that would take considerable time to implement. Improved roads would create some additional direct employment, unless they were built on railway rights-of-way, in which case they could result in reduced railway employment. However, improved roads would generate additional employment through the enhanced mobility arising from their provision. Provision of roads dedicated to motorized transport would demonstrate the government's commitment to increasing travel opportunities; also to reducing accidents and improving the environment by separating motorized from non-motorized traffic. Road improvement would be popular with road users but could create political difficulties if people had to be displaced to make way for new construction. Such displacement would, of course, be minimized to the extent that railway right-of-way could be used.

4. Buses

The GSL embarked, with the assistance of the World Bank, on an ambitious program of transferring its publicly-owned bus operations to private hands. The process was called 'peoplisation'. Ninety-three peoplized buses were set up, based on existing depots. The peoplisation strategy was to value the assets of the 93 companies and issue shares in them. Half of the shares were given to the employees of the bus companies, and half were retained by the Treasury, with a view to selling them to private investors. Buildings and land were retained by the government.

As part of the peoplisation process, the GSL undertook to deregulate bus fares (in theory already deregulated, as government has no legal authority over them), and to ensure that bus companies were compensated for providing loss-making services provided at the request of central or provincial government. The GSL failed to live up to these obligation

and, to the surprise of nobody, was unable to find buyers for the shares it still holds in the peoplised companies.

If, and only if, the GSL were to confirm (a) that bus fares are not subject to price control and (b) that bus operators cannot be required to provide loss-making services without compensation, there could be an immediate role for SIDI to advance the peoplisation process by acting as a broker to introduce capital and management to peoplised companies seeking such inputs. It would not have to put all 93 companies on their feet: progress would be useful even if only a few companies were successfully relaunched as 'demonstration projects'. No other governmental decisions would be required as the decision to peoplise the bus companies was made by the previous government and accepted in principle by the present one.

D. Water supply and Sewerage

As in many other countries in South Asia, the quality of water available to the people of Sri Lanka needs to be improved, and SIDI explored some of the opportunities open to the private sector. But a study prepared for SIDI to determine BOO/BOT possibilities to develop potable water in the Southern Province failed to address many of the relevant issues.

The difficulties of involving the private sector in the supply of water and sewerage are well known. Many are due to the monopoly characteristics inherent in the sector, which preclude users being offered a choice between competing suppliers. But this problem has been solved by institutional arrangements that require suppliers to compete for the privilege of holding a monopoly concession. In many cities in France, private suppliers are required to bid the lowest water rate that they are prepared to accept to provide a specified service. The system works well in France, and French companies (some working with US associates) have pioneered them in the Ivory Coast and elsewhere. (Water rates in Ivory Coast are high compared to other water rates in Africa, but this could be due to the fact that the contract was awarded without the benefits of transparent bidding.)

The costs of water provision vary with locality, water quality and other factors. Willingness to pay also depends on different factors, including disposable income, water usage etc. A rational approach to private sector involvement would, first, seek to find areas where costs of provision can be covered by willingness to pay. It would also look at the different stages of water supply (ownership, extraction, purification, distribution, sale) and consider which activities might be contracted out to the private sector, even if subsidies are to persist. Policy and institutional changes to encourage private participation in water supply should also have been investigated, if only as part of the 'public awareness' component of the SIDI project.

But the report prepared for SIDI does not address any of these considerations. It examined some of the costs of providing water in the Southern Province and found that they

would not be covered by the approved GSL water rate. SIDI appears to have abandoned the sector after being advised of this finding. Is it possible that the sector was dropped because it was apparent that a quick deal was not on the cards? But the SIDI 'public awareness' component was designed to have basic issues such as these discussed with GSL officials and it appears unfortunate that they were not. Certainly SIDI staff should have been alerted by CFED about the importance of these issues.

In the sector priority ratings water supply does not score particularly well on any of the criteria, which might explain why it does not appear to have been pushed by SIDI and its consultants.

E. Solid Waste Disposal

One of SIDI's projects was the construction of a demonstration plant to produce compost from Colombo's solid waste. The project was designed by staff of the Metropolitan Environmental Improvement Program (MEIP) of the Ministry of Policy Planning & Implementation and was USAID funded. SIDI also commissioned marketing studies to help develop sales for this compost, and other studies relating to the composition of urban domestic solid waste in Sri Lanka.

This achievement is positive but, as in the case of water supply and sewerage, one searches in vain for work on the fundamental issues. Solid waste has traditionally been collected for profit in cities such as Cairo and Calcutta, and in New York City it was so profitable that it reportedly attracted the interest of Mafia elements. What have been the constraints (if any) on waste collection by the private sector in Sri Lanka? And what are the disposal problems? Can solid waste be used economically to produce energy? Or as safe landfill? What are the roles already undertaken by the private sector? What should government do if it wishes for these roles to be expanded? Until answers to these questions are obtained, progress in the sector is unlikely to be rapid.

The sector could be rated quite highly on the scores of financial viability, implementation speed, potential for employment creation and political acceptability. It may be of particular interest to Colombo and other local governments.

Conclusions

The conclusions of the above discussion are summarized in the following chart.

Infrastructure Priorities for SIDI								
	Elect. Power	Tele-comm	Galle Port	Rail-ways	Roads	Buses	Water Sewer	Solid Waste
Financial Viability	M	H	P	P	?	M	P	H
Ease of Implementation	H	H	M	P	P	H	M	H
Employment Creation	M	H	H	M	H	M	M	M
Political Acceptability	H	M	H	M	M	M	H	H

H= High
M = Medium
P = Poor

It may be concluded that, in terms of financial viability, quick returns, employment creation and political acceptability, it is the telecommunications sector that merits the highest priority. There could also be a major role Electric power projects, which are also urgently needed, should also score well and enable SIDI to play important roles in the preparation and negotiation of contracts with the private sector.

In the transportation sector, completing even a few bus peoplisation projects would score high marks on all the above criteria, except political acceptability. The political hurdle is that private capital cannot be attracted to buses unless government confirms the 'liberation' of bus fares and assures operators that they would not be forced to provide loss-making services. The Galle port development also merits high priority. It is urgently required if Sri Lanka is to remain a serious player in the maritime trans-shipment trade, and the government has agreed to bear some of the infrastructure costs.

The road and rail projects identified by SIDI need additional studies, including some relating to sector management. A major issue to be determined is the role of the railways in a modernized Sri Lanka transportation system. Such studies need to be put in hand quickly, possibly under SIDI aegis, but early results in terms of investment are unlikely. If land is to be acquired for road or rail improvement, further delays would be inevitable. So these sectors will score less well on implementation speed and political acceptability.

Water and sewerage projects will also take time to implement with private investment, given the reluctance of the GSL to allow users to pay the full costs of required facilities. Solid waste disposal has already produced a solid demonstration project, and further results would seem to be obtainable quickly if the relevant issues are identified and addressed.

ANNEX C

EVALUATION OF THE POWER SECTOR COMPONENT

Kenneth Lussier, Consultant

November 1994

Note: Mr . Lussier was not a member of the evaluation team, but the USAID Mission requested that he assess PPI activities in the development of power projects as part of the evaluation.

EXECUTIVE SUMMARY

The Scope of Work identified eight issues for study. My mandate is directed towards the power sector but the power sector can not be looked at without discussing the PPI project as a whole.

1. Review the validity of the assumptions made during the design stage in so far as the power sector is concerned.

COMMENT: The assumptions have yet to be fully tested: that there was political and institutional will in the Government of Sri Lanka (GSL) to encourage private sector investment into what had been reserved for the government, infrastructure; that a technical unit would be established and supported by the government with sufficient authority to implement this will; that the investment climate for the private sector was favourable; that the private sector would react to this favourable environment by investing.

Given this setting, project design, through broad in scope, remains valid. The Ceylon Electricity Board (CEB) was forecasting 800MW of new power by 2002. More than 400MW was being reserved for the private sector. That 400MW of new power would be at least under construction by the September 1996 project completion date, was reasonable.

2. Evaluate the effectiveness of the structure of the project in promoting private power projects.

COMMENT: The project structure does not address power as such. It is structured so as to allow the Secretariat for Infrastructure Development and Investment (SIDI) to develop and implement infrastructure projects in general, including power projects. The Private Sector Infrastructure Network, with SIDI as the focal point, was conceptually good but fell short in implementation to date as it did not start by creating basic guidelines, procedures and core documents. The "Window" concept was too broad.

The structure allows for effective implementation of power projects although the currently ambiguous role of SIDI must be clarified.

3. Evaluate the GSL and the CEB's performance in supporting the project.

Knowledge of the concept of Build Own Operate/Build Own Transfer (BOO/BOT) is widespread in the government but understanding its complexities is not and commitment to the implementation of such projects is uncertain.

The CEB is the government agency currently most involved in BOO/BOT negotiations but appears to be against private sector involvement in power generation. This attitude is probably as much due to lack of understanding and confidence in their ability to negotiate agreements that protect the governments interests as it is against the private sector entering their fiefdom.

4. Evaluate the role played by SIDI in promoting BOO/BOT power projects and recommend the appropriate role for SIDI.

At the moment SIDI is a shell. It has limited technical and no legal staff or experienced consultants to develop and assist in negotiation of power or any other infrastructure projects. Its mandate, according to its brochure, is to support the GSL's "renewed commitment to private enterprise by creating opportunities for both foreign and local investment in infrastructure development." Until it can pursue that mandate confident of its performance, it will remain moribund. A continuing USAID role in permitting SIDI to achieve its mandate is all important.

5. Evaluate the effectiveness of the Centre for Financial Engineering in Development (CFED) in providing technical leadership to SIDI and the CEB through SIDI.

In retrospect, the choice of CFED without competitive bidding was a mistake. The mistake was compounded by their consultants lack of experience with BOO/BOT projects and in working with USAID. They also appeared to lack management experience, otherwise the three tiered staffing of SIDI should not have happened: if it had to happen, their inability to create a team out of the group made it unworkable. USAID and the GSL should have intervened much sooner when it was realised that things were going wrong.

6. Assess the feasibility of SIDI's private power project pipeline for private sector financing and comment on the evaluation criteria adopted by SIDI and the CEB.

SIDI does not have its own pipeline of power projects as it does not have the technical staff to analyse such projects. The CEB maintains SIDI's pipeline.

SIDI has not adopted a separate criteria for evaluating power projects. Regarding the CEB's criteria, as CFED consultant Steve Thompson points out in his May, 1994 paper, the CEB has no approved generation expansions plan nor does it have an "accurate and realistic long-range marginal cost comparison as an indicator of CEB's ability to justify ... unsolicited proposals." Given this situation, it is not likely that CEB yet has a separate criteria to analyse private sector proposals.

7. Assess the capacity of the local finance industry in arranging financing for private power and recommending ways of overcoming limitations.

A technically and financially viable project supported by a Power Purchase Agreement from the CEB will have no trouble in raising funds for Sri Lanka unless there is a reversal in the current political situation.

The limitations are not in availability of funds. They are from the Government and, in the case of power, the CEB, in not expeditiously negotiating and signing the underlying agreements that move a project to financial close.

8. Suggest ways the project can improve its impact on the power sector.

(a) reorganise SIDI so that it becomes a cohesive, action oriented organisation and give it the tools to support the CEB in negotiating power plant proposals with the private sector;

(b) request government to make a full-time Director General available to SIDI and give him a strong mandate and clear instructions to the line ministries as to the role of SIDI and the obligation SIDI has in successfully implementing BOO/BOT power projects. Included in the mandate should be an acknowledgement of the role USAID financed consultants will play and guarantees that they will be allowed to play that role;

(c) make a decision as to whether the project consultant, CFED, has the capability to provide the following consultancy needs and, if not, make other arrangements;

(d) provide highly qualified, experienced consultants to develop the legal and technical core documents upon which BOO/BOT negotiations are based;

(e) bring in a short-term consultant with private power and USAID experience in project implementation to write the Scope of Work and technical qualifications to implement (d) above;

(f) provide qualified and experienced consultants to assist the CEB and GSL in writing an Energy Policy and Policy Framework and Package of Incentives for power and other infrastructure projects under the mandate of SIDI;

(g) bring in a qualified consultant to assist the CEB in costing and pricing its power, preparing its long-range forecasting and developing a policy for the purchase of power from small industrial producers and co-generators.

MAIN REPORT

The consultant is requested to address the following issues:

1. A short review of the validity of the assumptions made during the design stage in so far as the power sector is concerned.

The general project assumptions have yet to be fully tested: that there was a political and institutional will in the Government of Sri Lanka to encourage private sector investment into what had been reserved for the government, infrastructure; that a technical unit would be established and supported by the government with sufficient authority to implement this will; that the investment climate for the private sector was favourable; that the private sector would react to this favourable environment by investing.

Given this setting, the PPI Project;

> "then offers The United States Agency for International Development (USAID) a unique opportunity to provide pivotal support to the Government of Sri Lanka (GSL) to encourage public/private partnerships which will result in significant improvements in water management facilities for safe water and sanitary waste disposal, rural roads, transportation, power plants, telecommunications facilities, industrial land, and environmental infrastructure." This was to be accomplished through a $7.0 million grant (subsequently increased to $8.0 in August, 1993) the funds to be used for "strategic technical assistance, training and logistical support to the GSL Ministry of Plan and Implementation."

The specific goal for the power sector was to increase generation by 400MW in five years.

COMMENT: In my view the project design, though broad in scope, was good. All of the areas of concentration were needed if Sri Lanka were to develop the essential infrastructure to support continued economic and social development. GSL support was by creating the Secretariat for Infrastructure Development and Investment (SIDI) as a counterpart organisation to USAID involvement. To start-up, SIDI required technical assistance of the kind USAID could offer.

A recent history of power shortages due to low rainfall and increased demand made the need for more power and a different mix of energy source vividly apparent. The Ministry of Power and Energy was talking about the need of 800MW in new power by 2002. The Ceylon Electricity Board (CEB) acknowledged the need for the private sector to become involved in power generation. More than 400MW of power was already being looked at by the private sector. That 400MW of new power would be at least under construction by the private sector at the time of project completion date (PACD), September, 1996, was a reasonable assumption.

SUMMARY: The GSL had shown apparent understanding of the need for private sector

investment in infrastructure by creating SIDI. The CEB acknowledged the need for private involvement in power generation. Some 400MW of power generation was already being considered for investment by the private sector. That this would at least be under construction by PACD was a valid assumption.

2. Evaluate the effectiveness of the structure of the project in promoting private power projects.

The project structure did not address power as such. It addressed the need to introduce the private sector into infrastructure development, including power.

The project consists of four components: a) Private Infrastructure Network Component. b) Public Awareness Component. c) Marketing Component. d) Private Sector Window Component.

COMMENT: The key to success of the project is the Private Sector Infrastructure Network Component. Its primary objective is to "establish a formal network to promote and support the development of private infrastructure in Sri Lanka." SIDI is the "designated focal point" in promoting private infrastructure projects and is supported by $5.2 million in USAID technical assistance through October, 1996. To November, 1994, the project has failed to start meeting this objective.

The structure was especially innovative in its Public Awareness Component given the past socialist element in public policy in Sri Lanka.

The first three components were essential to establishing a positive environment through which to implement private investment in infrastructure. Where the structure was weak was in the Private Sector Window Component. It had too many goals, ie:

> (a) "Enhance the private sector's ability to attract long-term financial support, defray or mitigate the costs and risk of developing feasibility studies ... and engage in developing unsolicited proposals...". (b) Design a feasibility study or cost-sharing mechanism. (c) Develop and implement a Private Sector Infrastructure Fund PSIDF). (d) Channel overseas development assistance funds to the private sector. (e) Formalise procedures for treating unsolicited proposals for private infrastructure projects. (f) Design a long-term debit instrument. g) Develop cooperation between central and local government. (h) Prepare a model RFP for urban environmental projects.

A more conventional use of the term "Window" implies a "one-stop shop" where potential sponsors go to negotiate their projects.

The "Window" concept, as emerging in other countries in the area, (a) Consolidates the acceptance of a project, both solicited and unsolicited, as meeting government requirements by issuing a Letter of Intent (LOI) or Letter of Support (LOS). (b) Reviews the legal,

technical and financial agreements. (c) Approves these by issuing the Implementation Agreement (IA), Power Purchase Agreement (PPA) Fuel Supply Agreement (FSA) for power projects.

It coordinates negotiations with other agencies and line Ministries and has the power to commit the government based on approved guidelines. It also ensures final government clearance, usually at Cabinet level.

It should be noted however, that the agreements, once fully approved, are executed between the government ministry concerned and the sponsor. They are not executed by the "Window" authority.

The "Window" is also the point for introducing subordinated debt and long-term funding into a project but usually through intermediary banks and Development Finance Institutions (DFI's) who participate in negotiations when appropriate. Commercial debt and equity is handled outside the "Window" by the Sponsors.

This would be the ideal role for SIDI to eventually assume.

SUMMARY: The project is structured so as to allow SIDI to develop and implement infrastructure projects in general, including power projects. The Private Sector Infrastructure Network, with SIDI as the focal point, was conceptually good but fell short in implementation as it did not start by creating basic guidelines, procedures and core documents. The "Window" component scoops up tasks that should be included in the infrastructure network component. As usually understood, the "Window" is the place that consolidates, reviews, approves. The financial needs of project development and the setting aside of funds that could be tapped for co-financing feasibility studies were addressed only generally.

ACTION: to be covered in the following sections.

3. Evaluate the GSL and the CEB's performance in launching and supporting the project.

COMMENT:

The role of the Government of Sri Lanka.

Knowledge of the concept of Build, Own, Operate (BOO) and Build, Own, Transfer (BOT) is widespread in the government but understanding its complexities is not. Prime Minister Kumaratunga, in her 13th September Economic Policy Statement, acknowledged that a significant portion of the infrastructure investment effort will have to be undertaken by the private sector on a BOO/BOT basis "which would be implemented within an evaluation

and regulatory framework that would guarantee transparency and accountability. The present SIDI will be strengthened and will work closely in cooperation with the Board of Investment (BOI)."

Only when we see implementation of the Prime Minister's statement can we learn how supportive the GSL role will continue to be. USAID and SIDI have a very important role to play by backing-up and guiding the GSL efforts to finance infrastructure through the private sector.

The Ceylon Electricity Board.

The CEB is the government agency currently most involved in BOO/BOT negotiations but appears to be against private sector involvement in power generation. This stance could be as much due to lack of understanding and confidence in their ability to negotiate agreements that protect the governments' interest as it is against the private sector entering their fiefdom.

It would be at a regrettable economic cost but perhaps, as happened in the Philippines and Pakistan, only a crisis will force the government to force the utility to start negotiating seriously with the private sector.

Does the CEB not want private power or are they uncomfortable as to committing themselves to such a new field?

Some of the problem areas came out when reviewing the SIDI files on the Klockner-Humbolt-Deutsche (KHD) 40MW oil-fired project, especially the price to be paid for power and the "take or pay" agreement. These broke down in October because there was no middle party, no mediator between buyer and seller. The professional support that should have been provided by SIDI was not present, even though the SIDI consultants were. SIDI is nominally on the government side. It's role and that of the consultants should have been to offer quality professional advice to both sides so as to build the CEB's self-confidence in negotiating with the private sector sponsor. Rather, in their effort to make a deal, the consultants, I am informed, stood on the side of the sponsor and appeared to be advocating the interests of the sponsor over those of the government.

The right noises are being made by the CEB. Statements in the newspapers on the 25th Anniversary of the CEB by the Chairman, Vice Chairman and Additional General Manager (Projects) all mention the need to involve the private sector in power generation. The Additional General Manager, Projects pointed out the need for "development of regulatory structures to allow privately owned co-generation plants to sell surplus power at agreed prices. He adds that, "in order to consider such options seriously,(BOO/BOT and co-gen) necessary laws, rules and regulations must be developed and put into place that encourage private sector participation in the power sector."

These gentlemen, I am sure, are looking to the CEB as the implementing agency for private

power but the understanding, self-confidence and core negotiating documents are not with them. These must come from SIDI which is, at present, empty handed.

SUMMARY: In the government knowledge of BOO/BOT is widespread, understanding its complexities not so widespread, and commitment to implementation of such projects is uncertain. In the CEB there is a natural reluctance to bring the private sector into their work. This resistance is normal and was the case in all countries, including the United States, when private generation of power to be purchased by a utility became government policy. However, economic and financial realities eventually overcome this reluctance.

ACTION:

(a) the CEB and GSL must be provided with highly qualified technical assistance in the drafting of basic generic documents required in negotiating with the private sector. These are the Letter of Support or Letter of Intent, the Power Purchase Agreement, the Implementation Agreement, and the Fuel Supply Agreement.

(b) technical consultants experienced in negotiating these agreements must be made available to the CEB, through SIDI, when needed, to give them confidence in their negotiations.

(c) the CEB should be provided legal and technical assistance in pricing and negotiation of co-generation agreements with private sector self-generators of power to enable the utility to buy excess capacity, especially in times of emergency.

(d) the CEB must release its generation expansion plan and qualified technical assistance must be provided to assist it in developing its long-range cost forecasts, including the cost of buying power from the private sector.

Ideally, the GSL should issue an Energy Policy which offers a price at which it will purchase power from the private sector and its parameters for negotiation. This could be done in parallel with negotiating the first private power agreements. See Action recommended Section Four.

4. Evaluate the role played by SIDI in promoting BOO/BOT power projects and recommend the appropriate role for SIDI.

COMMENT: The GSL recognised that it needed to supplement public sector resources, institutionally and financially, by drawing on private sector sources. The Government also realised that there was no single institutional organisation responsible for promoting and managing private sector participation in infrastructure. In an effort to articulate this need, in the summer of 1992 it adopted a new policy to promote public-private partnerships for infrastructure development and established SIDI as a focal point for development of

BOO/BOT projects by line agencies.

SIDI was given no powers to negotiate on behalf of or commit the GSL.

SIDI has performed well in publicising the receptiveness of the GSL towards private investment and in educating the line ministries in the BOO/BOT concept.

It has made progress in promoting interest in private investment in the energy sector. Its Director General serves as convenor of an inter- governmental committee on power related issues and SIDI consultants and officers have participated in negotiations between sponsors and the CEB on a 300MW and 40MW power plant. SIDI has also received 29 unsolicited projects, in various stages of development, which it passed to the CEB for comment as it does not have in-house capability to technically analyse such projects.

It has not done so well in implementing the Public Awareness Component of the project: in promoting its image in the local private business and financial sector. There are complaints of lack of follow-up. It is viewed as a "post office", receiving proposals and passing them to the line ministry and then dropping out of sight.

It has yet to complete a single infrastructure project either in power or any other area. Why?

(a) BOO/BOT projects are complex and take a lot of time to negotiate.
(b) Given past economic thinking in Sri Lanka, the concept is difficult to put across and is politically sensitive.
(c) There is a natural reluctance in the line ministries to accept the private sector approach, especially when it means giving up authority in offering jobs and the award of contracts.

These problems were faced, and overcome to the extent that BOO/BOT private sector power projects have been successfully negotiated in Indonesia, Malaysia, The Philippines, India and now Pakistan. The process would be further along in Sri Lanka had SIDI started out on a sounder footing. It will happen in Sri Lanka if the actions recommended in this paper are taken.

There is talk of making SIDI into a statutory authority and giving it specific powers to commit the government. As this would require an act of the legislature it would be time consuming and probably politically difficult. Even if its role is strengthened and it is made an Authority, without specific "authority" it will not be taken seriously by the ministries, the CEB or the public. It will be only another step in the bureaucratic process and will duplicate a lot of the responsibilities assigned to the BOI.

SIDI needs to be given strength and capacity now, not after a long legislative process.

SUMMARY: At the moment SIDI is a shell. It has limited technical and no legal staff or

experienced consultants to develop and assist in the negotiation of power or any other infrastructure projects. Its mandate, according to its brochure, is to support the GSL's "renewed commitment to private enterprise by creating opportunities for both foreign and local investment in infrastructure development." Until it can pursue that mandate confident of its performance, it will remain moribund.

ACTION:

Two levels of action are needed and they should be put in place in parallel.

First: The GSL must renew its commitment to private sector BOO/BOT projects in a tangible and monitorable manner. Though it may evolve into an authority at a later date, SIDI's current role, its ability to become the "one-stop Window" discussed in paragraph two, must be strengthened. This can only be done from the highest level of government to the line ministries and the CEB, confirming the role of SIDI and insisting that it be allowed to play that role: making it clear that the Director General of SIDI reports direct to the Prime Minister and receives his authority direct from the Prime Minister. The Director General appointment must be full time.

USAID should help SIDI prepare an issues paper to the Minister of Finance recommending how this can be structured and enforced. Direct support for this action should come from the U. S. Ambassador and the World Bank Representative as the two Missions having the most interest in the success of SIDI. Second: There must be a review of existing legislation and regulations to ensure that the private sector can become involved in infrastructure as envisaged by the project. Then SIDI must be given the basic tools with which to operate. These are the core legal documents necessary in negotiating and implementing private power projects; reliable and timely technical financial consultants, when needed, to support negotiations with project sponsors; professional and financial assistance in management of the SIDI office in such a way that all feel they are participating in a joint effort to implement the mandate of SIDI.

To start implementing the second level, USAID should:

(a) engage the short-term services of someone experienced in implementing a BOO/BOT private power project from the USAID side to write Scopes of Work for top quality lawyers (probably a senior for two weeks and a junior for up to a month) to work with local lawyers, the GSL Attorney Generals office, SIDI and the CEB in drafting agreed to standard letters of support/intent, power purchase agreements and implementation agreements. Mian Shahid Ahmad, Project Manager of the $140 million Private Sector Power Project at USAID, Islambad is suggested;

(b) the same short-term consultant should also prepare standard Scopes of Work for the various types of technical assistance required by SIDI to support it and the CEB in negotiations of power projects with sponsors. This should include expert advice in

small power and co-generation sales to the utility;

(d) USAID should also bring in an expert to help the GSL and CEB draft an energy policy and establish a policy framework and package of incentives for private power generation and other private sector infrastructure investment sectors.

The current SIDI needs pruning and some reorganisation, but it must be well watered and fertilised to start growing again. At the moment, USAID is its only "life-giving" source.

5. Evaluate the effectiveness of the Centre for Financial Engineering in Development (CFED) in providing technical leadership and direction to SIDI and the CEB through SIDI.

COMMENT: The key to success in a complex project such as this lies in the quality and experience of the consultants involved in its implementation. Using people of conventional background, unless mixed with others who understand BOO/BOT projects, can lead to problems. Unfortunately, this is what has happened. The experience was not there, not with CFED, USAID or the GSL.

CFED, a Gray amendment company, was awarded the contract in November, 1992, on a sole-source basis, justified by its proported experience with such projects and the professional impression made by the man marketing the company and the SIDI concept to the GSL and USAID. He left CFED after a falling out with the company president just as the Sri Lanka contract started to go really wrong.

Things seem to have started well. An agreeable office was created, staff hired, equipment put in place. In retrospect, there were problems from the beginning.

In addition to the two CFED expatriate consultants there was a government appointed Director General and other senior staff and staff hired by a local sub-contractor to CFED who, it appears, was given responsibility for running the office. The Director General was part time. The consultants became involved in negotiations on two power projects and in trying to put together the Galle Port project. Getting the project up and running and preparing Quarterly Reports to USAID was left to the sub-contractor. He was without sufficient experience in this kind of management and was not supervised properly by the consultants. There was no team spirit or common sense of purpose. Soon there was little communication between these three groups. This became obvious when reading the Quarterly Reports and draft Annual Work Plan. There was no apparent input from the prime counterparts, the GSL appointed senior staff.

At the outset there should have been a review of the existing legal situation to see if there were restrictions on the private sector financing infrastructure projects. Next, there should have been an inventory of core documentation required to enable the government, through

SIDI, to bid, negotiate and award BOO/BOT projects, ie, LOI/LOS, draft Requests for Proposals (RFP's), Power Purchase Agreements, Implementation Agreements. In order to assure transparency, work should have started on regulatory legislation which would have laid out the roles, rewards and responsibilities needed to protect both the public and private sector.

With the inventory completed lawyers and private power experts should have been brought in to work with SIDI and their government counterparts in drafting these documents.

What the project got was a broad brush marketing approach with the goal to make a quick deal! Such an approach was encouraged in the CFED contract which laid out the number of projects in each area expected to be approved during the life of the contract, with a financial reward if they were accomplished.

As mentioned earlier, BOO/BOT projects are agonisingly slow to put together, especially the first one. For such a project to be successfully implemented, an overall strategy is required to create sustainable conditions to attract private sector interest, including an effective SIDI operating in a supportive legal and regulatory environment.

This has yet to happen in the PPI Project.

As these problems emerged early in project implementation,
USAID must also be taken to task over its supervision of CFED. Some tension between the USAID project officer and the consultants he supervises is normal. It puts issues out on the table and results, later, in smoother management. The line between micro-managing a project by USAID and USAID exercising its obligation to make sure the consultants produce the expected results is broad enough that it should not have become an implied issue in USAID's management of CFED. The fact that the relations between the consultants and their Sri Lanken counterparts became strained early on in the project, and that this was sensed by USAID, should also have been a trigger for much earlier action on the part of USAID.

Definitive action was taken in April, 1994 when a "cure notice" was issued by the Regional Contracts Officer after a prolonged delay by the consultants in delivering their 1994 Annual Work Plan. This resulted in the removal by CFED of the Chief of Party, the non-renewal of the Financial Analysts contract and the appointment of a new Head Office back-stop.

A new Chief of Party has been in place for less than three months.

SUMMARY: In retrospect, the choice of CFED without competitive bidding was a mistake. The mistake was compounded by their consultants lack of experience with BOO/BOT projects and in working with USAID. They also appeared to lack management experience, otherwise the three tiered staffing of SIDI should not have happened: if it had to happen, their inability to create a team out of the group made it unworkable. USAID and the GSL

should have intervened much sooner, when it was realised that things were going wrong. In view of these management and implementation problems, CFED was unable to provide technical leadership and direction to SIDI and through SIDI to the CEB. On the contrary, the CFED consultants participation in negotiation on two private sector power projects is reported to have been a setback to these negotiations.

ACTION: To provide SIDI with a foundation on which to build a reputation for accomplishment its staffing structure must be reorganised, its capacity to provide timely professional consultants to assist in negotiation of projects must be assured, and it must have the core legal documents required to implement such projects.

Can CFED quickly redesign its 1994-95 Annual Work Plan to identify those actions most essential to putting SIDI on its feet and then, implement those actions in the eleven months remaining in their contract? Can CFED guarantee that it has the quality professional consultants available, or can contract them, to perform the work required? They are expensive, considerably more than the AID maximum. Can it fund this work with what is left in the project? Can it sort out its current problems with its sub-contractor and with its GSL counterparts, and provide quality management to the SIDI office?

USAID must pose these questions and obtain satisfactory answers. In addition, it has to decide as to whether the project consultant, CFED, has the capability to provide the following consultancy needs and, if not, make other arrangements.

(a) to provide highly qualified and experienced consultants to review the existing legal situation related to private sector investment in infrastructure and to develop the legal and technical core documents upon which BOO/BOT negotiations are based;

(b) to bring in a short-term consultant with private power and USAID experience in project implementation to write the Scopes of Work and technical qualifications to implement (b) above;

(c) to provide qualified and experienced consultants to assist the CEB and GSL in writing an Energy Policy;

(d) to bring in a qualified consultant to help the CEB develop a policy for the purchase of power from small industrial producers and co-generators.

6. Assess the feasibility of SIDI's private power project pipeline for private sector financing and comment on the evaluation criteria adopted by SIDI and the CEB.

COMMENT: SIDI does not have a pipeline of projects as it does not have a technical staff able to analyse and make recommendations to the appropriate Ministry. Nor does it have the qualified in-house personnel to assist the government or sponsors in negotiating BOO/BOT projects. It receives projects and passes them, in the case of power, to the CEB pipeline.

SIDI's role has been as marketer for unsolicited projects and conduit of these projects to the line ministries.

The Director General of SIDI is the convener of the Committee in on Power Related Issues. This is Chaired by the Secretary, Ministry of Finance, and is made up of government officials and senior management of the CEB. It has no private sector representatives.

The minutes of the 20th October meeting of the Committee shed an interesting light on decision making in the power sector. Three major power projects are under current review.

(a). Regarding the 300MW Tricomalee coal fired plant, the decision was that as the sponsors (Mihaly) has had some 20 months since the first LOI without reaching financial closure: the GSL could no longer waste time and the project should be re-offered to the private sector, the current sponsor also being able to bid. The new project should consider additional sites on the Western and Southern coasts. The issue would be referred back to cabinet and, once a decision was obtained, SIDI would issues a new RFP. (CFED is bringing in consultants to help prepare the RFP)

(The 575MW Pakistan Uch low btu gas fired project has taken five years to reach finalisation of the IA, PPA, FSA and other major agreements. It is still a good year away from financial close. It is a very viable project and will probably move ahead. What is missing in Sri Lanka are advocates of private power within SIDI and the CEB, technically able to defend the prolonged negotiations required to bring such a project to fruition. Good consultants play that role.)

(b). Regarding the 40MW Asian Development Bank (ADB) sponsored project, it was decided to go ahead and a paper to this effect was to be sent to cabinet. This would be in the public sector. The CEB said it could finance the difference between the ADB loan and the total required. The finance secretary pointed out the availability of funds from the Asia Capital Company and the proposed PSIDF, but did not make it a requirement that such private sector funding be used.

(c). Regarding the KHD project, negotiations fell apart here because of price and a proposed 20% discount offered by the sponsors in the early stage of negotiation that was subsequently withdrawn. The Prime Minister has decided to call for fresh bids. (As of November 7, 1994 there was some talk that the KHD project had come back to life).

SIDI has also received 29 unsolicited proposals. Most of these are in the conceptual stage or involve using untried sources of energy. As mentioned above, they are passed to the CEB

for review.

SIDI has not adopted a separate criteria for evaluating power projects.

Regarding the CEB's criteria, as the CFED consultant Steve Thompson pointed out in his May, 1994 paper, the CEB has no approved generation expansion plan nor does it have an "accurate and realistic long-range marginal cost comparison as an indicator of CEB's ability to justify ... unsolicited proposals." Given this situation the CEB must accept assistance from professional consultants to develop a criteria to analyse private sector proposals.

SUMMARY: SIDI does not have its own pipeline of power projects as it does not have the technical staff to analyse such projects. Solicited proposals are already with the CEB. Unsolicited proposals are forwarded to the CEB. It is convenor of the high level Committee on Power Related Issues and is looked upon by that committee as taking an active role in preparing RFP's and being involved in the processing of sponsors applications in the power sector. SIDI has not adopted a separate criteria for evaluating power projects. The CEB does not appear to have such a criteria.

ACTION: Give SIDI and through SIDI, the CEB, the tools with which to analyse, approve and implement private sector power projects.

7. Assess the capacity of the local finance industry in arranging financing for private power and recommend ways of overcoming limitations.

COMMENT: This is the least developed part of project design. It is included in the Private Sector Window Component as a responsibility of the consultants to design "a feasibility study fund or cost-sharing mechanism, developing and implementing a Private Sector Infrastructure Development Fund (PSIDF) ... ."

Interestingly, the World Bank has taken up the PSIDF. It will provide long-term subordinated loans at near market rates of interest to partially finance infrastructure projects along with funds to come from commercial sources. The first tranche of $50 million should be available within a year.

A projects ability to raise funds depends first on financial and technical feasibility but, almost equally, on the strength of the sponsors. What is especially important is bringing in a strong local partner. A John Keells or Atkin Spence has the ability to leverage its financial strength and reputation into attracting foreign investment in power plants.

In financing private sector power projects, local debt and equity are required. It is estimated that the local market, under current conditions, could raise up to $25 million in a mixture of debt and equity. The bulk of the financing comes from abroad. A technically and financially viable project supported by a Power Purchase Agreement from the CEB will have no trouble

in raising funds for Sri Lanka unless there is a reversal in the political situation.

The limitations are not in availability of funds. They are from the Government and, in the case of power, the CEB, in not expeditiously negotiating and signing the underlying agreements that move a project to financial close and start-up of construction.

SUMMARY: A good project showing tangible support by the GSL and the CEB and having strong local partners, can raise local and foreign funds under current political and financial conditions in Sri Lanka.

ACTION: Again, give SIDI and the CEB the self-confidence to negotiate with sponsors by having the necessary legal and financial documents in place and the ability to call on specialised technical assistance when needed.

8. Suggest ways the project can improve its impact on the power sector.

USAID should:

(i) request that the GSL reorganise SIDI so that it becomes a cohesive, action oriented organisation and give it the tools to support the CEB in negotiating power plant proposals with the private sector;

(ii) request the GSL to make a full-time Director General available to SIDI with a strong mandate and clear instructions to the concerned line ministries as to the role and obligation SIDI has in successfully implementing BOO/BOT projects. Included in the mandate should be a clear explanation of the role that USAID financed consultants would play and guarantees that they would be allowed to play that role;

(iii) make a decision as to whether the project consultant, CFED, has the capability to provide the following consultancy needs and, if not, make other arrangements;

(iv) provide highly qualified, experienced consultants to develop the legal and technical core documents upon which BOO/BOT negotiations are based;

(v) bring in a short-term consultant with private power and USAID experience in project implementation to write the Scopes of Work and technical qualifications to implement (iv) above;

(vi) provide qualified and experienced consultants to assist the CEB and GSL in writing an Energy Policy; and

(vii) bring in a qualified consultant to help the CEB develop a policy for the purchase of power from small industrial producers and co-generators.

ANNEX D

PERSONS INTERVIEWED

Secretariat for Infrastructure Development and Investment

Dr. P. Ramanujam, Director General
Mrs. S. Kanendran, Director
Mr. B.H. Dissanayake, Director
Mrs. Lalitha Jayaraman, Director, Environmental Infrastructure Unit (EIU)

U.S. Agency for International Development

Mr. William Jeffers, Chief, Office of Projects
Mr. Glenn Whaley, Office of Projects
Mr. Leel Wickremarachchi, Office of Projects
Mr. Jon Lindborg, Chief, Office of Private Sector Development
Mr. William Foederer, Office of Private Sector Development
Mrs. Kamilini fernando, Mission Housing Advisor (PSD)
Mr. Earl Kessler, Regional Housing and Urban Development Office, New Delhi

Government of Sri Lanka

Dr. A.S. Jayawardene, Secretary, Ministry of Finance and Planning (M/FP)
Dr. Lal Jayawardene, Economic Advisor to the Prime Minister
Mr. M. Nabavi Junaid, Secretary, Ministry of Shipping and Ports
Mr. Nihal Amarasekera, Advisor to the Finance Minister, and former Counterpart Director, SIDI (Comintax)
Mr. K. Jegarajasingham, Director, Transport Infrastructure, Department of National Planning, M/FP
Mr. M. Vamadevan, Director, Department of National Planning, M/FP
Mr. Wijeratne, Additional General Manager (Planning), CEB

Center for Financial Engineering in Development

Jon Wegge, Chief-of-Party, PPI Project
Randolph Lintz, Home Office Project Director (by phone)

Other

Mr. Patrick Amarasinghe, President, Federation of Chambers of Commerce and Industry of Sri Lanka
Dr. Saman Kelegama, Fellow, Insitute of Policy Studies