

AGENCY FOR INTERNATIONAL DEVELOPMENT PROJECT DATA SHEET		1. TRANSACTION CODE A A = Add C = Change D = Delete	Amendment Number	DOCUMENT CODE 3
COUNTRY/ENTITY Sri Lanka		3. PROJECT NUMBER 383-0100		
4. BUREAU/OFFICE Asia		5. PROJECT TITLE (maximum 40 characters) Private Sector Policy Support		
6. PROJECT ASSISTANCE COMPLETION DATE (PACD) MM DD YY 07 31 96		7. ESTIMATED DATE OF OBLIGATION (Under 'B' below, enter 1, 2, 3, or 4) A. Initial FY 88 B. Quarter 4 C. Final FY 96		

8. COSTS (\$000 OR EQUIVALENT \$) =

A. FUNDING SOURCE	FIRST FY			LIFE OF PROJECT		
	B. FX	C. L/C	D. Total	E. FX	F. L/C	G. Total
AD Appropriated Total	2,450	800	3,250	10,544	11,456	22,000
(Grant)	(2,450)	(800)	(3,250)	(10,544)	(11,456)	(22,000)
(Loan)	(--)	(--)	(--)	(--)	(--)	(--)
Other U.S.	1. --	--	--	--	--	--
	2. --	--	--	--	--	--
Host Country				--	19,943	19,943
Other Donor(s)						
TOTALS	2,450	800	3,250	10,544	31,399	41,943

9. SCHEDULE OF AID FUNDING (\$000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH CODE		D. OBLIGATIONS TO DATE		E. AMOUNT APPROVED THIS ACTION		F. LIFE OF PROJECT	
		1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan
(1) PSEE				12,644	--	1,580	--	18,300	--
(2) EHR				--	--	550	--	2,700	--
(3) ARDN				--	--	1,000	--	1,000	--
(4)									
TOTALS				12,644	--	3,130	--	22,000	--

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each)

11. SECONDARY PURPOSE CODE

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

A. Code

B. Amount

13. PROJECT PURPOSE (maximum 480 characters)

"To strengthen the private sector's contribution to the formulation, appraisal and implementation of market-oriented economic policies; to assist the privatization of state-owned enterprises to a broad spectrum of private investors; to improve the operation of the Colombo Securities Exchange and broaden participation by small investors, and to demonstrate the viability of equity participation through venture capital companies.

14. SCHEDULED EVALUATIONS

Interim MM YY MM YY Final MM YY
1 2 9 1 0 7 9 3 0 7 9 6

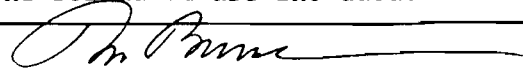
15. SOURCE/ORIGIN OF GOODS AND SERVICES
 000 941 Local Other (Specify)

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a 1 page PP Amendment.)

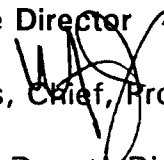
This amendment expands upon the original projects third component which is to further develop the capacity of the Sri Lankan capital market to broaden public equity and debt participation in the economy and increase capital investment resources.

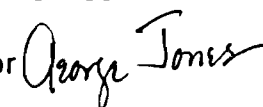
I concur with the methods of implementation and that adequate provisions for audit are included.

Clearance: WButler/CTR (J. Butler)

17. APPROVED BY	Signature 	Date Signed MM DD YY 06 03 92	18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION MM DD YY
	Title Richard Brown DIRECTOR		

Action Memorandum to the Director

From: William Jeffers, Chief, Projects Office 

Thru: George Jones, Deputy Director 

Subject: Project Paper Supplement to Amend the Private Sector
Policy Support Project -- (PSPS, 383-0100)

Action Requested: Your approval is requested to (1) amend the authorization of the Private Sector Policy Support (PSPS) project; (2) authorize an additional \$7.0 million in project grant funds; and (3) extend the project assistance completion date from July 1993 to July 1996.

Authority: The Assistant Administrator for the Bureau of Asia delegated authority to the Mission Director, USAID/Sri Lanka to authorize up to \$30 million in project amendments in Delegation of Authority No. 405, dated on April 22, 1991. This Delegation also authorizes project life amendments provided that total project life does not exceed 10 years. All actions requested in this memorandum fall within the authority delegated to the Mission Director.

Background: The Acting Director, USAID/Sri Lanka authorized the Private Sector Policy Support project (PSPS) in July 1988. LOP funding was established at \$15.0 million over five years. The Project Purposes were to: (1) strengthen the private sector's contribution in formulating, appraising and implementing market-oriented economic policies; (2) facilitate successful privatization of a significant number of state-owned enterprises through acquisitions by a broad spectrum of private investors; and (3) expand the capacity and volume of Sri Lanka's capital market by increasing the number of publicly traded equity securities thereby raising capital investment resources.

In December 1991, Price Waterhouse/Washington completed an extensive in-country evaluation of the PSPS project. The evaluation's overall assessment concludes that the project has accomplished a number of its objectives and is on target to achieve others. Accomplishments highlighted include: (1) catalyzing 9 Chamber and Business Associations to undertake 9 major policy research activities; (2) providing assistance to the Government of Sri Lanka (the Government) in meeting its privatization schedule and securing further commitments to increase the target number of state-owned enterprises for privatization from 24 to 43; (3) providing critical technical assistance to the Sri Lanka Security Exchange Commission (SEC); and (4) procuring an automated post-trade and market

information system for the Colombo Securities Exchange (CSE) in developing a more orderly, diversified, and efficiently functioning capital market.

Discussion: The PP Supplement presents a unique opportunity for USAID/Sri Lanka to build upon its past successes and to provide critical support to the Government in strengthening its financial institutions and markets. The PP Supplement requests an additional \$7.0 million in grant funds and would extend the PACD an additional 3 years, bringing the total LOP funding level to \$22.0 million over 8 years. The host country contribution will add an additional \$2.0 million in funding for a total of at least \$19.9 million over the LOP.

Future capital market interventions are based principally upon the evaluation's recommendations which are to: (1) continue to provide technical assistance to the SEC as vital pieces of securities legislation are created and to develop the CSE self-regulatory role in an expanding market-place; (2) assist these and other financial intermediaries in developing a supply of quoted securities; and (3) assist new forms of financial intermediation in the quoted securities market.

The PP Supplement builds upon the significant achievements attained under the existing scope of the project. The Project Goal remains unchanged which is to increase national employment and income by creating an economic policy environment conducive to private sector growth. The Project Purpose expands upon the original project's third objective which is to increase national capital investment resources by developing the capital markets capacity to broaden investor participation. The Project Outputs will expand the SEC and CSE's capacity to serve rapidly growing financial markets, increase the supply of quoted debt and equity securities, and encourage new forms of financial intermediation. The Project Inputs will primarily be technical assistance and overseas and in-country training, but will also include automated data processing equipment for the central depository system (CDS).


In sum, the PP Supplement capitalizes upon its successes and lessons learned from previous interventions and focusses additional resources to advance and sustain future capital market growth. Project implementation will require approximately 92 man-months of long-term technical assistance, 124 man-months of short-term technical assistance, and 27 man-months of program management technical assistance. The project also includes participant training and commodity procurement.

Legal Requirements: Congressional Notification (CN) is required to advise an increase in LOP funds and intentions to obligate funds from the Education and Human Resources Account. We have been informed by State 162120 that the CN

PSPS PP Supplement
Action Memorandum to the Director
Page 3 of 3

expired without objection on 5/20/92. A categorical exclusion for an Initial Environmental Evaluation was granted on March 25, 1992. FAA Section 611(a)(1) requirements have been met. New Conditions and Covenants added to the project is presented in Section 6E(1) and (2) of the PP Supplement. The Statutory Checklist appears in Annex C in the PP Supplement. Project obligation is subject to the availability of funds.

Recommendation: That you (1) amend the authorization of the Private Sector Policy Support (PSPS) project; (2) authorize an additional \$7.0 million in project grant funds; and (3) extend the project assistance completion date from July 1993 to July 1996.

Approve 
Disapprove _____
Date 6/3/92

Richard Brown
Mission Director
USAID/Sri Lanka

Attachments: _____

PP Supplement

Draft: PRJ:LHardy

Clearances:

PRJ:PBaldwin	<u>PB</u>	Date	<u>5/26/92</u>
CTR:WButler	<u>WB</u>	Date	<u>5/29/92</u>
PSD:MNanayakkara	<u>MN</u>	Date	<u>5/25/92</u>
PSD:TPenner	<u>TP</u>	Date	<u>6/2/92</u>
PRM:PCrowe	<u>PC</u>	Date	<u>6/2/92</u>
PRM:DGarms	<u>DG</u>	Date	<u>5/29/92</u>

Private Sector Policy Support

(PSPS, 383-0100)

Project Paper Supplement

May 25, 1992

PRIVATE SECTOR POLICY SUPPORT (383-0100) PROJECT

PROJECT PAPER SUPPLEMENT

Glossary

Project Paper Supplement Data Sheet	01
1. Executive Summary and Recommendations	02-09
A. Project Description	03-07
1. Project Supplement Objectives	
2. Project Strategy	
3. Relationship to USAID/Sri Lanka Strategic Framework	
4. Project Implementation	
B. Cost Estimates	07-08
C. Status of Negotiations	08-09
D. Project Review Committee Recommendations	09
2. Project Authorization Amendment No. 1	10-11
3. Background	12-15
A. Private Sector Policy Support Project	12-13
B. PSPS Performance To-date	13-15
C. Rationale for PP Supplement	15
4. Amended Project Description	16-29
A. Evaluation Recommendations and the Policy Environment	16-18
1. Evaluation Recommendations	
2. Other Donor Activities	
3. Premises underlying Project Strategy and Design	
B. Overview of Amended Project Goal, Purpose and LOP Funding	18-19
C. Overview of Amended Project Outputs	19
D. Overview of Amended Project Inputs	19-23
1. Technical Assistance (TA) Components	
2. Training	
3. Commodities	
E. Structure of Expanded Capital Markets Component	23-26
1. Regulation and Self Regulation	
2. Financial Reporting	
3. Post Trade Automation System (PTA)	
4. Development of a Second-Tier Market	
5. Development of a market for Quoted Debt Securities	
6. Certification of Securities Markets Professionals	
7. Assistance to Emerging Financial Institutions	
8. Program Management of Policy	
F. End of Project Status	26-28
G. Sustainability	28-29

5.	Project Analyses	30-41
A.	Environmental Analyses	30
B.	Social Soundness Analyses	30-33
C.	Institutional Analyses	33-38
	1. The Securities and Exchange Commission (SEC,SL)	
	2. Colombo Stock Exchange (CSE)	
	3. The Institute of Chartered Accountants (ICASL)	
D.	Economic Analyses	38-41
6.	Project Implementation	42-48
A.	Project Management	42-43
B.	Contracting Plans	43-45
	1. Technical Assistance Contract	
	2. Procurement of Computer Equipment	
	3. Cooperative Grant to ICASL	
	4. Evaluation	
C.	Monitoring, Evaluation and Audit	45
D.	Implementational Schedule	46-47
E.	Conditions Precedent and Covenants	47-48
	1. Conditions Precedent	
	2. Covenants	
7.	Cost Estimates and Financial Plan	49-55
A.	Illustrative Budget/Financial Plan	49-50
B.	Analysis of AID Funding	50-52
	1. Technical Assistance	
	2. Training	
	3. Commodities	
C.	Analysis of GSL and Private-Sector Counterpart Contributions	52
D.	Obligation Plan	53
E.	Buy-America Considerations	54
G.	Financial Plan by Source, Activity and Year	55

Annexures

- A. Technical Analysis of Project
- B. Revised Logframe
- C. Statutory checklist
- D. 611A Certification
- E. Environmental Assessment
- F. Evaluation Summary
- G. GSL letter of request
- H. Amended Project Description

G L O S S A R Y

ADB	Asian Development Bank
ADP	Automated Data Processing
CSE	Colombo Stock Exchange
CDS	Central Depository System
CBSL	Central Bank of Sri Lanka
CFA	Chartered Financial Analysts
CDSS	Country Development Strategy Statement
CDIC	Capital Development Investment Company
DFCC	Development Finance Corporation of Ceylon
DP	Data Processing
ERD	External Resources Division
EPF	Employees Provident Fund
ETF	Employees Trust Fund
EQUILL	Equity Investments Lanka Limited
ESAF	Extended Structural Adjustment Facility
GSL	Government of Sri Lanka
ICA SL	Institute of Chartered Accountants of Sri Lanka
ISTI	International Science and Technology Institute
IPOs	Initial Public Offering
IRM	Information Resource Management
ICASL	Institute of Chartered Accountants of Sri Lanka
IMF	International Monetary Fund
IAS	International Accounting Standards
ICFA	The Institute of Chartered Financial Analysts
IQC	Indefinite Quantity Contract
ICFA	Institute of Chartered Financial Analysts
IFC	International Finance Corporation
MBSL	Merchant Bank of Sri Lanka
NDB	National Development Bank
NAMAL	National Asset Management Company
NSB	National Savings Bank
OTC	Over the Counter Market
PSPS	Private Sector Policy Support
PSD	Office of Private Sector Development
PIO/T	Project Implementation Order, Technical
PQO	Post Qualifying Education
PTA	Post Trade Automation
RCO	Regional Contracting Officer
USAID	United States Agency for International Development
UNDP	United Nations Development Program

Executive Summary and Recommendations

In July 1988, USAID authorized \$15 million for the Private Sector Policy Support (PSPS) project which has a project assistance completion date (PACD) of July 31, 1993. The project involved (1) support of the Government of Sri Lanka (GSL) privatization effort; (2) strengthening of the private sector's contribution to market oriented economic policies through assistance to private sector chambers and associations; and (3) assistance to the Securities and Exchange Commission of Sri Lanka (SEC, SL), the Colombo Stock Exchange (CSE) and a pioneer venture capital company in a program of capital market development.

In an interim evaluation by a Price Waterhouse team in December 1991 the consultants reported that the ". . . (PSPS) project has already accomplished a number of activities, is on track to realize the remaining ones, and has demonstrated by progress to date that the activities supported will continue even after this project is completed."¹ Further, with reference to the Capital Market component, the team recommended that ". . . USAID has shown that this is a project area where it can clearly add value and that it should therefore follow-up the initial success". (page 6). The report identified specific areas of potential USAID activity.

Meanwhile, as a direct result of the expansion of the medium-term privatization program of the GSL, the implementation of its policy of private sector led growth, and its desire to increase the levels of private sector investment, the GSL has determined that the country's financial markets require further development. GSL has already undertaken some reforms as part of its policy realignment under the Extended Structural Adjustment Facility (ESAF) with the International Monetary Fund (IMF). They are also currently negotiating a detailed set of reforms under a proposed World Bank Financial Sector Project and an Asian Development Bank (ADB) financial markets program.

As a part of these much wider ranging reforms, GSL hopes to further develop the burgeoning capital market in Sri Lanka. Specifically, GSL wishes to improve the regulatory structure of the market, to increase the supply of quoted securities, and to develop new forms of financial intermediation in the market-place. Based upon its earlier experience and U.S.'s acknowledged excellence in the area the GSL has requested USAID assistance to meet its financial markets objectives through the provision of technical assistance (TA), training and U.S. equipment in support of the Government's capital market development program.

¹ Price Waterhouse: Evaluation of the Private Sector Policy (383-0100) Project, December 20, 1991. pp5

USAID, Sri Lanka has decided to incorporate these activities as a part of the PSPS project. The project supplement will authorize a further \$7 million in grant funds for the PSPS project, and extend the PACD by three years, to July 31, 1996.

A. Project Description

1. Project Supplement Objectives

The overall goal of the PSPS project will remain the same; that is, to assist the GSL to increase national employment and incomes by the creation of a policy environment conducive to private sector growth. The verifiable indicator, however, has been changed to the increase in private sector investments of 10% per annum in real terms over the project period. We feel that this measurement will be more directly attributable to and explained by the project outputs.

The purpose of the Capital Markets component of the Private Sector Policy Support (PSPS) Project is marginally modified to read: The project will *further* develop the capacity of the capital market to broaden public equity participation in the economy and increase capital resources for investment. We are proposing to expand the verifiable indicators to more comprehensively measure the role of the capital market in the economic landscape and overall financial market development. These will include measures of the relative size of the market, market liquidity, new investments facilitated by the market and the net inflow of foreign investment.

At current levels of investment, approximately \$50 million net has been invested in the Colombo Stock Exchange by overseas funds. This rate, now at approximately \$10 million per quarter, will not continue at these levels unless the market imperfections (slow processing, errors, tardy acknowledgement, poor financial reporting etc.) are improved. With the activities scheduled for this supplement, the flow of equity investment is likely to stabilize or increase. In addition, a new market for debt will be developed, and between the shares and the bonds, net foreign investment should double by the end of the Supplement, to \$80 million per annum.

2. Project Strategy

Relationship to AID Policy

The project is fully in compliance with Agency Policy Guidance contained in August 1988 "Financial Markets Development" which directs A.I.D. ". . . (to) promote a system of financial markets that is integrated and relatively undistorted, one that relies heavily on competitive financial institutions, and on policies to facilitate competition. This system should be capable of effectively mobilizing private savings, allocating that savings to investments yielding maximum returns, and maximizing the participation of the general populace". The proposed project supplement will assist the development of the quoted securities market, which has both the potential to grow very quickly and has proved most responsive to USAID/Sri Lanka's interventions in the capital market.

The activities described in this Project Paper Supplement will greatly strengthen U.S. - Sri Lankan business and investment ties. Of particular importance is the elevation of standards to an international level, which will facilitate U.S. investment in Sri Lanka (already, numerous U.S. fund managers have registered with the GSL, including General Motors Employees Pension Plan Fund, Fidelity, Merrill Lynch, and Boston Trust). The introduction of professional certification to the Colombo Stock Exchange of regulatory procedures standardized by the SEC, and the use of skilled U.S. financial experts to implement the program will increase U.S. investor confidence in the Sri Lankan market.

Relationship to USAID/Sri Lanka Strategic Framework

The development of the capital market will contribute to the program objective of the development of a sound investment climate and business performance. It is a component of a key program intervention in the area of designing and implementing financial market reforms, and will complement other activities in financial market undertaken by the Mission in housing finance and small business lending. Additionally, it will facilitate the provision of private sector investment to modernize economic infrastructure services a crucial area of activity targeted for future Mission interventions.

The influence of a developed capital market will be felt beyond narrow sectoral boundaries, and is supportive of the Mission's objectives of diversification and commercialization of agricultural systems, and a proposed intervention in assisting the devolution of land and water control. Finally,

by working together with the market regulators and the participants simultaneously, the program supports strategic goal of expanding opportunities through a new private-public partnership.

Implementation Strategy

The strategy adopted for this supplement is best described by the Price Waterhouse evaluation report of the PSPS project, which noted that "the success of (the Government's) Capital Markets program and the project to date suggest that the multi-faceted approach to developing a stock market -- public awareness, training, development of the regulatory structure and stock market operations, the efforts to promote the supply of and demand for shares, and the linkages to the privatization program -- lends itself to consideration by other countries" (page 13). This supplement continues this proven strategy.

3. Project Implementation

Project Elements

USAID/Colombo has determined that the most effective way to assist the GSL in its capital market development objective is to provide TA and training to support key financial institutions, including the SEC, SL, the CSE, the Institute of Chartered Accountants of Sri Lanka (ICASL), and a wide variety of other, private sector financial intermediaries. In addition, ~~this supplement~~ will provide computer hardware and software to the CSE. The program will support a series of specifically targetted activities, listed below:

Improve the reliability of market information by;

- strengthening market regulation capacity of the SEC SL, and the self regulation activities of the CSE;
- improving financial reporting of listed companies; and
- expanding and improving systems reliability of the Post Trade Automation system and its Central Depository (PTA/CDS).

Increase the availability of financial instruments by;

- the development of a second tier market; and
- developing a market for quoted debt securities, initially by supporting

a secondary market in GSL Treasury Bills and subsequently Corporate Bonds.

Improve the analytic capability of market participants by:

- establishing the U.S. certification program of Chartered Financial Analysts (CFA) as a formal certification program in Sri Lanka.
- Providing TA and training to selected emerging financial institutions -- to encourage innovative new activities in the field of financial markets and thereby improve its functioning.

Project Management

The implementation strategy is one of dealing with a wide range of institutions and market participants simultaneously, in an arena that is sensitive and heavily susceptible to both economic and political dynamics. This creates an unusual challenge. To deal with this complexity, the project supplement proposes a unique and supportive management structure.

The management risks will be greatly minimized by a clear, task oriented contract, with specific individuals made responsible for pre-determined results. There will be several long-term advisors who will be accountable for training, regulation, accounting and ~~audit standards, computer~~ hardware/systems and second-tier markets. Each of these individuals will be a specialist in their respective field and each will be responsible for clearly defined set of tasks. This is expected to considerably reduce the management burden.

Successful management of the program of assistance, however, will require responding to the dynamic changes in the market place by changing the mix of activities and inputs. It will also require that the project management be engaged in providing the policy makers with options on a variety of policy issues, thus improving their responsiveness to emergent issues in a rapidly growing market place. The project will be managed by a full-time chief-of-party whose terms of reference will include the development of annual work plans, deployment of project resources to achieve the objectives set out in the plan, development of a policy agenda, and advice to the SEC, other GSL counterparts and USAID.

Given the combination of the relatively short time frame for achievement of the tasks, the relative high opportunity costs of expatriate TA being in-situ

and the variety of institutions and participants, the consequent need for the chief-of-party to "hit-the-ground running" will become a key success factor for the program. As such, we propose that the position be staffed by a senior professional with international finance, macro-economic and research experience who would be widely accepted by a multiplicity of the clients. It need be noted that the COP, in contrast to the other long term specialists, will be a financial markets generalist, and be in effect the "General Manager" of the program.

The Chief-of-Party will report to the USAID/Colombo Project Officer in the Office of Private Sector Development (PSD).

B. Cost Estimates

The total cost of this project supplement is \$9.0 million, comprising of \$7.0 million in A.I.D. Grant Funds and host country contributions -- both GSL and the private sector entities -- of \$2.0 million. Therefore, the total budget for the PSPS project is now \$42 million, representing \$22 million in A.I.D. Grant funding and \$20 million in Sri Lanka contribution.

Table 1
Pre Amendment Budget by Component (\$000)

	USAID			Host Country			Project Total
	Cumulative Obligation	Future Years Anticipated	Total	GSL	Other	Total	
Policy Support	2,100	846	2,946		350	350	3,296
Privatization Support	7,450	412	7,862	13,720		13,720	21,582
Capital Markets Development	2,514		2,514	225	315	540	3,054
Venture Capital Company	400	100	500		3,333	3,333	3,833
Monitoring and Evaluation	180	120	300			0	300
Contingency and Inflation		878	878			0	878
Total	12,644	2,356	15,000	13,945	3,998	17,943	32,943

Table 2
Amendment Budget by Component

	USAID			Host Country			Project Total
	Cumulative Obligation	Future Years Anticipated	Total	GSL	Other	Total	
Policy Support			0			0	0
Privatization Support			0			0	0
Capital Markets Development		6,250	6,250	1,636	364	2,000	8,250
Venture Capital Company			0			0	0
Audit, Monitoring and Evaluation		125	125			0	125
Contingency and Inflation		625	625			0	625
Total	0	7,000	7,000	1,636	364	2,000	9,000

Table 3
Summary of Total Project funding by component

	USAID			Host Country			Project Total
	Cumulative Obligation	Future Years Anticipated	Total	GSL	Other	Total	
Policy Support	2,100	846	2,946	0	350	350	3,296
Privatization Support	7,450	412	7,862	13,720	0	13,720	21,582
Capital Markets Development	2,514	6,250	8,764	1,861	679	2,540	11,304
Venture Capital Company	400	100	500	0	3,333	3,333	3,833
Audit, Monitoring and Evaluation	180	245	425	0	0	0	425
Contingency and Inflation	0	1,503	1,503	0	0	0	1,503
Total	12,644	9,356	22,000	15,581	4,362	19,943	41,943

C. Status of Negotiations

We have received a formal request for assistance from the Securities and Exchange Commission of Sri Lanka (SEC, SL), which has been expanded upon by the CSE and the ICASL. This fully satisfies our requirements for a GSL formal request for assistance. Furthermore, the Chairman of the SEC has agreed in principle to all of the general terms and conditions of this project supplement. The scope of work of the long-term TA advisors will be

subsequently developed and will be used as input to prepare contracting documentation for the RCO's direct contract for technical assistance. It is anticipated that final negotiations with the GSL of the Project Grant Agreement Amendment will proceed rapidly upon USAID authorization for this Project Supplement.

The extension of time by three years to a total of eight, and the increase in the life of project funding of \$7.0 million from \$15.0 million to \$22.0 million, are both within the delegated authority of the Mission Director.

D. Project Review Committee Recommendations

The Project Committee recommends that an obligation of \$7.0 million be authorized under the terms and conditions described in the following Project Supplement Authorization.

16/

AUTHORIZATION AMENDMENT

Project Authorization Amendment No. 1

Name of Country/Entity: Government of Sri Lanka
Minister of Finance and Planning

Project Name: Private Sector Policy Support
Supplement to the Project Paper

Project Number: 383-0100

Pursuant to Section 106 of the Foreign Assistance Act of 1961, as amended, the Private Sector Policy Support project (383-0100) for the Government of Sri Lanka was authorized on July 20, 1988, involving planned obligations of not to exceed \$15,000,000 in grant funds over a five year period. The authorization is hereby amended as follows:

1. The total authorized life of project grant financing is hereby increased to \$22,000,000, over a year period subject to the availability of funds in accordance with the A.I.D. Operating Year Budget and allowance process, to help in financing foreign exchange and local currency costs for the project. The planned life of the project is increased to 8 years from the date of initial obligation.
2. The amended project is intended to assist the ~~GSL~~ in further developing its capital markets and regulatory framework by (1) further expanding the SEC and CSE's capacity to serve a rapidly growing capital market; (2) increasing the supply of quoted debt and equity securities; and (3) encourage new forms of financial intermediation in the market.
3. Except as amended herein, the Project Authorization is unchanged and remains in full force and effect.

Approved: _____



Disapproved: _____

Date: _____

6/3/92

Richard Brown
Mission Director
USAID/Sri Lanka

Clearances:

PSD: TPenner	<u>TPenner</u>	date	<u>6/2/92</u>
PRJ: PBaldwin	<u>PBaldwin</u>	date	<u>5/26/92</u>
PRJ: WJeffers	<u>WJeffers</u>	date	<u>4/27/92</u>
PRM: DGarms	<u>DGarms</u>	date	<u>5/29/92</u>
PRM: PCrowe	<u>PCrowe</u>	date	<u>6/2/92</u>
CTR: WButler	<u>WButler</u>	date	<u>5/29/92</u>
RLA: M Ward	<u>(d/aft)</u>	date	<u>4/9/92</u>
for DD: GJones	<u>GJones</u>	date	<u>5/29/92</u>

Background

A. Private Sector Policy Support Project

During the past two decades, the Government of Sri Lanka (the Government) has slowly moved away from an economic structure where government institutions and state-owned enterprises exert significant control over the country's commercial activities to an economic structure increasingly guided by market forces. The Government's initial strategy focussed on developing domestic industries and public enterprises to reduce dependence on foreign imports, thereby enriching national welfare and sovereignty. Though the ensuing economic policies provided some gains in select industries, the resulting market inefficiencies negatively affected overall economic growth.

The Government began economic liberalization in earnest in the late 1970s. The national elections of 1977 ushered in a new government committed to reducing market distortions, contracting government expenditures, and initiating privatization of state-owned enterprises. From 1977 to 1983, the gross domestic product grew from 2.9% to 6.0% annually. The intervening years since this period have produced positive but inconsistent growth rates. Several exogenous factors contributed to a mixed economic performance. Chief among them are declines in national productivity resulting from ethnic violence in the northern country. During this period, deficit spending ~~remained excessive~~, foreign investment and tourism declined, and indigenous private investment slowed markedly. Despite these impediments to growth, the Government maintained its commitment to economic liberalization.

The primary goal of the Government's liberalization strategy of the late 1980s and today is to raise Sri Lankans' standard of living by attaining and sustaining more broadly based economic development. The Government has pursued three primary objectives which are meant to (1) increase the privatization of state-owned enterprises; (2) create an investment climate that attracts foreign capital; and (3) develop a diversified financial market which can respond to the needs of a growth-oriented economy. Successful attainment of each objective is linked to the success of the other two. However, the development of a financial market is the key and the sine qua non to the realization of the other two objectives. Without a financial market, newly privatized firms would be without critical capital resources and few investment mechanisms would exist to productively employ domestic and foreign capital.

USAID/Sri Lanka developed the Private Sector Policy Support project (383-0100) in July, 1988 to encourage the Government to develop a market-led economy by undertaking difficult economic reforms. (USAID/Sri Lanka made this a cornerstone of its CDSS.) The project goal is to increase national employment and income by creating an economic policy environment conducive to private sector growth. The project purposes are to (1) strengthen the contribution of the private sector to the formulation, appraisal and implementation of market oriented economic policies; (2) contribute to the successful privatization of a significant number of state-owned enterprises to a broad spectrum of private investors; and (3) develop the capacity of the Sri Lankan capital market to broaden public equity participation in the economy and increase capital resources for investment.

USAID/Sri Lanka developed four interrelated component activities which support the project purposes. The first activity initiated a dialogue among private companies, business associations, and government entities in identifying policy issues affecting private sector development. The second activity encouraged the Government to continue its "medium term - privatization plan" by institutionalizing mechanisms to implement privatization activities. The third activity enhanced capital markets capacity and capabilities through institution building, expanding both private and institutional investor opportunities for equity participation, and developing greater transparency of and investor confidence in financial market operations. The final activity facilitated establishment of a venture capital ~~company whose purpose was to encourage entrepreneurship and provide a~~ financing mechanism for nascent enterprises or small companies interested in expanding.

The Life of Project (LOP) funding for PSPS is \$15,000,000 over five years. The Government's initial planned LOP contribution was \$17,943,000. To date, the Government has contributed approximately \$54,000,000, most of which was for redundancy costs incurred in privatizations.

B. PSPS Performance To Date

In December 1991, Price Waterhouse completed an extensive project evaluation which assesses progress in implementation activities and recommends changes to help achieve project objectives. The evaluation's overall assessment concludes that "the project has already accomplished a number of its objectives, [it] is on track to realize the remaining ones, and has demonstrated by progress to date that the activities supported will continue even after this project is completed." A few highlighted

accomplishments at the purpose level include:

- strengthening the private sector's participation in developing market-oriented policies through grants to 13 business groups, assistance to the chambers of commerce and business associations in 9 major policy research activities, and organization of both nationally and internationally oriented workshops aimed at institutionalizing chamber activities;
- increasing the target number of state-owned enterprises for privatization from 24 to at least 43; privatizing 16 state-owned enterprises which transferred approximately \$165 million to the private sector while introducing more than \$130 million into the equity markets through the Colombo Stock Exchange;
- developing a more orderly, diversified, and efficiently functioning capital market that broadens and increases opportunities for investor participation by (1) providing technical assistance directly to the Securities Exchange Commission (which has passed critical market legislation) and the Colombo Securities Exchange of Sri Lanka (which establishes licensing requirements, broker training requirements and oversees the Colombo Stock Exchange); and (2) purchasing and installing the Central Depository System (CDS) which computerizes the critical function of recording and reporting equity transactions in a rapidly expanding stock exchange.

The Price Waterhouse evaluation made several recommendations to enhance the project's success. Chief among them are resolving contractor management issues in the program which supports Chamber activities; continuing to educate the public about the privatization process; continuing to assist the Government's privatization unit through additional technical assistance, marketing, and restructuring of privatization transactions; improving the supply of and demand for shares; and expanding the systems capacity of the CDS.

The evaluation identifies an important lesson learned based upon the project's contributions to the Government's successful capital markets program. The report notes that "the successes of [the Government's] capital markets program and the project to date suggest that the multi-faceted approach to developing a stock market -- public awareness, training, development of the regulatory structure and stock market operations, the efforts to promote the supply of and demand for shares, and the linkages to the privatization program -- lends itself to consideration by other countries."

The PP Supplement seeks to capitalize and expand upon these achievements as well as advance the sustainability of its capital market development activities to date.

C. Rationale for PP Supplement

Capital market development is a key ingredient in Sri Lanka's move from a largely government controlled economy to a more open-market approach, and is critical to the mobilization of increased investment in productive activity. As the economy develops towards the high growth rates of 7-8% of GDP per annum which is the GSL's current target, an increasingly proportions of productive assets must move to the private sector. The most efficient and transparent means of effecting this transfer is through the orderly operation of an equities market. Further investment is needed to fuel rapid growth, and this can more readily come about with the introduction of long term debt, which is more acceptable if there is a market which allows investor mobility.

The success of the Government's privatization program, financial markets development program, and capital markets regulatory program are inextricably linked. The amended project as defined in this PP Supplement presents a unique opportunity for USAID/Sri Lanka to build upon its past capital market development successes, strengthen the underlying financial market apparatus, and provide critical assistance and encouragement to the Government's on-going liberalization strategy.

097

Amended Project Description

A. Evaluation Recommendations and the Policy Environment

1. Evaluation Recommendations

The evaluation consultants reported that the ". . . project has already accomplished a number of activities, is on track to realize the remaining ones, and has demonstrated by progress to date that the activities supported will continue even after the project is completed." Further, with reference to the Capital Market component, the team recommended that ". . . USAID has shown that this is a project area where it can clearly add value and that it should therefore follow up on the initial success. In order for the momentum to be sustained, USAID should work towards such follow-on activities as increasing the supply of and demand for shares". The report makes the following recommendations that are specifically addressed in this PP supplement.

1. Improve the supply of and demand for shares

a) Supply (1) Initiate policy dialogue within the GSL to remedy debt/equity imbalances (while recognizing that equity is the highest cost source of finance). (2) Carry out measures to strengthen the privatization program and speed up privatization share offers. (3) ~~Provide technical assistance to members of the CSE and to the public~~ to develop the level of technological and financial skills required to enable companies to offer public shares. (4) As a related measure, implement recommendations of the IMF and the Banking Commission for the listing of government securities on the CSE.

b) Demand (1) Through policy dialogue, with the GSL, and with the support of domestic institutional investors, encourage change in investment policies of state controlled financial institutions to permit greater equity holdings, and relieve similar restrictions on private institutions. (2) Provide legal assistance to implement such changes. (3) Sponsor a Chartered Financial Analyst (CFA) program to develop investment research and management skills. (4) Provide technical assistance to work with institutional investors to improve their financial skills and expand their role in the stock-market.

2. Continue the Public Awareness program

The program has had its successes so far; it is now important to

undertake planned training programs in financial reporting and coverage of the stock market.

3. Continue to provide technical assistance to the SEC.

The SEC needs increased assistance as vital pieces of securities legislation are developed. The ADB's program with the SEC should be closely followed by USAID in order to effect a reasonable division of effort. Accounting standards should be improved and auditors' opinions should be made mandatory in annual reports for listed companies.

4. Continue to strengthen and expand the role of the Colombo Stock Exchange

USAID and its contractor should encourage and support enactment of needed organizational and structural changes in the area of broker licensing, reporting requirements, exchange surveillance and the creation of second tier exchange once the SEC structure is in place.

5. Maintain and expand the Central Depository System

While it is off to a good start, the CDS still has operational (e.g., processing delays) and staffing (lack of programmers) problems.

These recommendations are further strengthened by other reports and analyses funded by the PSPS project, and the three multilateral institutions -- the IMF, the World Bank and the ADB, and reinforced by Mission contact with policy makers and the general financial community.

2. Other Donor Activities

There is considerable amount of multilateral institutional activity in the general field of financial markets. The Policy Framework Paper prepared by the Government of Sri Lanka with the joint assistance of the staff of the Fund and the World Bank for IMF Extended Structural Adjustment Facility (ESAF) approved in September, 1991 indicates significant reforms undertaken by GSL. These reforms have contributed to the further development of the financial markets, and facilitate other liberalization reforms. The GSL is currently negotiating a series of reforms in the state controlled commercial banking sector, including commitments for greater commercialization and de-politicization, liberalizing the financial flows, and improving accounting information. Simultaneously, the Government is

24x

undertaking a series of capital market reforms which it is negotiating with the ADB. Policy reforms are being encouraged by the donors increasingly through balance of payments support. The proposed USAID assistance will effectively implement these policy reforms in an area where USAID has significant experience and competency. Close coordination with the ADB, IMF, World Bank and UNDP will be a feature of the implementation of this Supplement.

3. Premises underlying Project Strategy and Design

The premises that have guided the PP Supplement strategy are listed below.

- GSL is committed to a policy of private-sector led economic development. Consequently, it will provide an enabling environment and continue its programs of privatization and liberalization.
- GSL will continue reform of key macro-economic policy, including relative reduction of Government expenditures and refrain from supporting an over-valued currency.
- A sound financial market is viewed as important to carry out the GSL program.
- Private sector investment increases in response to policy changes and other PSPS stimuli.
- A relatively stable political/security environment is maintained during the project period.

B. Overview of Amended Project Goal, Purpose and LOP Funding

The Amended Project proposes additional interventions in the financial markets arena based upon the existing Capital Markets component of the PSPS project. LOP funding request of \$7 million will be included as a line item in the PSPS project. The Project's amended PACD will be July 1996.

The **Project Goal**, increasing national employment and income by the creating an economic policy environment conducive to private sector growth, remains unchanged. The amended **Project Purposes** expands upon the original project's third component which is to further develop the capacity of the Sri Lankan capital market to broaden public equity and debt participation in the economy and increase capital resources for investment.

25

C. Overview of Amended Project Outputs

The lessons learned from past PSPS Capital Markets interventions enables the Amended Project to productively focus its resources in strengthening, expanding, and sustaining Sri Lankan financial market growth. The objectives of the **Project Outputs** are to: (1) further expand the SEC SL and CSE's capacity to serve a rapidly growing capital market; (2) increase the supply of quoted debt and equity securities; and (3) encourage new forms of financial intermediation in the market.

Several significant changes in the financial markets must occur in order to meet these three objectives. These changes are identified as **Project Outputs**. The Outputs necessary to meet the first objective include: a SEC SL surveillance unit that is staffed and trained; enhanced self-regulation capability at the CSE; improved company reporting and disclosure requirements; adoption of more stringent accounting and auditing standards; and improved systems reliability and capacity to handle a greater volume and broader range of transactions by the Central Depository System (CDS).

Outputs necessary to meet the second objective include: a second-tier market with lower costs of entry, maintenance, and less stringent regulations; a secondary market in Government Securities; and a market to trade long-term corporate debt.

~~These activities will encourage new forms of financial intermediation in the market which is the third objective. A market driven securities industry with trained brokers, agents and analysts will be established. The new financial intermediaries will draw upon portfolio investment companies such as insurance companies, retirement funds, unit trusts, venture capital companies, and investment banks.~~

D. Overview of Amended Project Inputs

The Amended Project Inputs, detailed below, primarily require technical assistance interventions. The ability to develop, nurture and institutionalize the necessary regulatory and supporting entities of a capital market system has been a key to the PSPS project's success. The Price Waterhouse evaluation recommends both short and long-term technical assistance to help ensure market institutions are sustainable beyond the life of this project.

1. Technical Assistance (TA) Components

The project will provide the following long term technical advisors to assist the institutions indicated:

TA Contractor	Institution	MM	Principal Responsibility
Chief-of-Party	SEC SL and all other institutions/players located at the SEC SL	27	A widely respected Senior professional with finance, macro-economic and research experience, including Governmental experience. Overall responsibility for the development of annual work-plans, deployment of project resources to achieve the objectives set out in the plan, the development of a policy agenda and the management of a program of supporting policy research, and advice to the SEC, other GSL counterparts and USAID on these issues. The role is one of being the "General Manager" of the program.
Regulation Specialist	SEC SL and the CSE Located at the SEC SL	12	An expatriate specialist with experience in the regulation of a developed stock market whose principle task is to advise the Director General, SEC SL in implementing the recommendation arising from the Tang report on regulation. He/She will also be tasked with assisting the General Manager of the CSE in sequencing and implementing the Bishop report recommendations for self-regulation. The individual will also assist in on-the-job training of the regulatory personnel of the two institutions.
Computer Hardware/Systems Specialist	CSE Located at the CSE	24	A senior host country Data Processing (DP) consultant with international experience in systems hardware and computer operations in a large network environment. He/she will ensure smooth development during this critical period of systems development and operation. Responsibilities will include -- initially installing and operating the back-up system, and coordinating systems development in the implementation of the second-tier market and the Government debt securities markets link to the PTA/CDS. The individual will advise the CSE on the staff requirements and training needs of the system personnel.
Accounting and Audit Standards Specialist	ICASL Located at the ICASL	12	An expatriate specialist in accounting and auditing standards whose responsibilities will include the installation of the grants mechanism; developing an accounting research agenda driven by the market needs for information; developing syllabus, examination methodology, training modules and materials for seminars and public information; and developing a compliance and monitoring unit and advisory service.
Training Specialist	SEC, SL CSE, ICASL and other client institutions. Located at the SEC SL	32	An expatriate specialist with wide experience in training in financial institutions in the U.S. market. The individual's principal responsibility is for the promotion and the management of the CFA program. He/she will also be tasked with the coordination of other in country training programs identified under other sections of the project, and will be the principle point of contact for administering the contractor managed over-seas training. He/she will also critically assess the training plan once the project is underway, and be a catalyst in responding to changing market needs, as and when these emerge.

TA Contractor	Institution	MM	Principal Responsibility
Second-Tier Markets Specialist	SEC SL and the CSE	12	An expatriate specialist with extensive experience in an Over-the-counter (OTC) market, probably with screen based trading. The individual's responsibilities will include the initial definition of the entry regulations for both the main-board and the second-tier market, developing detailed feasibility and operational guidelines of the second-tier market, developing financial and other entry criteria for brokers and broker/dealers and assisting the SEC, SL to amend the restrictive provision in the Act against dual broker/dealer functions, obtaining institutional acceptance and implementation of an OTC system, supervision of the development of an electronic trading system and its implementation. He/she will also bear primary responsibility for the definition and management of the broker and broker/dealer training, training of the counterparts in the CSE and the SEC,SL who will supervise the system, and the guidance of the institutional players through its initial crop of flotations of companies in the market.

The project will also provide approximately 124 man months (including 64 host-country TA) of short-term technical assistance support for the activities defined in Section (E). The terms of reference for short term TA will be developed by the specific long-term specialists responsible for the tasks, and will be approved by the USAID Project Officer prior to commencement. An illustrative schedule of the anticipated expatriate short-term TA is given below.

Technical Assistance - Short Term Expatriate	FY93	FY94	FY95	Total
(1) Regulation and Self Regulation	2	4	0	6
(2) Financial Reporting	4	2	0	6
(3) Post Trade Automation	1	2	3	6
(4) Development of a Second-Tier Market	4	2	0	6
(5) Development of a Market for Quoted Debt Securities	4	5	0	9
(6) Certification of Securities Market Professionals	4	4	4	12
(7) Assistance to New Financial Institutions	6	6	3	15
Total	25	25	10	60

2. Training

There will be a major training program under this project comprising the following:

1. Introduction of Chartered Financial Analysts Certification Program

The program will launch, establish and gain official recognition of the widely recognized U.S. certification of The Institute of Chartered Financial Analysts (ICFA), an autonomous professional self-regulatory organization based in Virginia. This program, aimed at training securities analysts and portfolio managers in both the brokerage firms and institutional investors, involves three years of self directed study, with one examination per year. The project will promote the CFA program in-country and sponsor a batch of 45 students for the CFA program during the initial two years of the project, totalling 90 students. The project will also provide reference material and in-country training seminars for the participants

2. Local Workshops and Seminars

A series of local workshops and seminars will be held in-country in conjunction with other activities. These include seminars on; accounting standards and implementation to the members and ~~students of the ICASL~~; auditors role targeted at the public; second-tier market, targeted at company decision makers and financial institutions; screen-based trading including simulation games; trading of GSL and corporate bonds targeted at financial institutions, investors and companies; financial intermediation for staff of emerging financial institutions and of institutions; and policy analysis at various target audiences.

3. Short Term Overseas Training

Approximately 14 short-term overseas study tours are anticipated . These will be targeted at the regulators, data processing personnel and Central Bank officials responsible for supervising the secondary market in Government bills.

All training activities will be coordinated and supervised by the Training Specialist.

3. Commodities

There will be a relatively small commodity procurement program (approximately \$615,000) under the project supplement. Of this the larger component of approximately \$450,000 will be for the provision of computer hardware and operational software for the CSE PTA/CDS. This proprietary equipment will probably be procured using the GSA contract with UNISYS. The remainder will essentially be miscellaneous office equipment and one vehicle, for use by the team of consultants, and will be procured under the larger TA contract.

E. Structure of Expanded Capital Markets Component

USAID will provide TA, Training and Commodities (as outlined above) for a series of specifically defined activities. These are expanded below.

1. Regulation and Self Regulation

This amendment will assist the staff of SEC, SL to respond to the new regulatory obligations arising from a rapidly growing market and CSE's efforts at self-regulation to meet a wide variety of risks posed by the market. USAID will fund both long and short-term technical assistance to implement a series of recommendations arising from earlier reports. Other assistance will include on-the-job training and overseas training tours by the regulatory personnel of the two institutions. Specifically, placement at the Securities and Exchange Commission (SEC) of the U.S. will be considered to familiarize the individuals with the variety of techniques and practices in a developed, modern market that has a high degree of automation.

2. Financial Reporting

This amendment will, provide assistance for reforms in standard setting, standard implementation and monitoring of financial reporting which are market driven (ie. through the CSE, and the SEC, SL). The program will provide both long and short term TA for the above, a grant to stimulate and develop in-country research on standard setting, and extensive training on standards and their implementation for ICASL members and student accountants.

3. Post Trade Automation System (PTA)

The PP Supplement will further enhance the Post Trade Automation and the Central Depository System (PTA/CDS) which were successfully implemented under the original project. USAID will provide a back-up system and an additional communications processor for both improved network management and the ability to attach the terminal network to either existing or the back-up system (or a vendor back-up machine) if either of the two PTA/CDS modules fail. USAID will also provide a further long-term and short-term TA for systems management, systems audit and review and investigation of alternative "products" to be launched by the PTA/CDS. USAID will also fund overseas study tours by the CSE systems personnel which will include exposure to management of large real-time on-line, data networks overseas.

4. Development of a Second-Tier Market

USAID assistance will be provided to the CSE to establish a second-tier market, initially as an over-the-counter (OTC) market. Subsequently, the project will provide assistance to enhance the capacity of the existing PTA/CDS to link the brokers and broker/dealers to facilitate electronic trading. The PP Supplement will provide the CSE with long and short term TA to establish a second-tier market, program coding of the CDS and a series of in-country training programs for the brokers and broker/dealers, and short-term overseas placement in U.S. institution ~~for both the players and~~ the regulators. The latter will include training in a broad range of activities, from marketing the concept among target companies and institutions to actual dealing and trading in the electronic marketplace.

5. Development of a market for Quoted Debt Securities

The project will provide assistance to strengthen the secondary market in Treasury Bills being created by the Government. The project will finance expatriate short term TA to implement such a system, and provide funding for in-country training seminars in bond trading. Related short courses will also be provided for portfolio investors to utilize bonds as a part of their portfolio. Additionally, the project will finance overseas tours for Central Bank officials in the areas of public debt and open market operations to observe regulation and oversight activity in a developed market which utilizes screen based trading. A display terminal will also be provided the Central Bank officials to observe market performance on a real-time basis. With the establishment of an effective secondary market, the program objective of issuing longer term government securities will be taken up as a

part of the policy dialog. The introduction of corporate bonds is expected to be stimulated by the establishment of a longer term government interest rate.

6. Certification of Securities Markets Professionals

The program will launch, establish and gain official recognition of the widely recognized U.S. certification of The Institute of Chartered Financial Analysts (ICFA), an autonomous professional self-regulatory organization based in Virginia. Their program is aimed at training securities analysts and portfolio managers in both the brokerage firms and institutional investors. The certification program involves three years of self directed study, with one examination per year. USAID will sponsor approximately 30 students for the CFA program during each year of the project, totalling 90 students. The program will meet the costs of registration, fees, examinations and books totalling approximately \$2,500 per person on a cost sharing basis. In addition USAID will also meet costs of promotion of the CFA program, the one time costs of reference material that will be presented to the Securities and Exchange Commission's library, costs of short-term trainers (both expatriate and local) and development of teaching tools. USAID will also fund a long term-trainer who will co-ordinate this and other training programs.

7. Assistance to Emerging Financial Institutions

There is a need to assist the emerging financial institutions such as portfolio investment companies such as unit trust, insurance companies & retirement funds, venture capital companies, investment banks and brokers that are becoming active in fresh market segments. The project will provide expatriate technical assistance, long and short term TA, and in-country training for these institutions on the basis of demand and cost sharing. This assistance will be based on proposals for such services as and when forwarded by the institutions. These proposals will be reviewed and approved by the contractors, based on their contribution to the overall project purpose.

8. Program Management and Policy

The project will be managed by a full-time chief-of-party whose terms of reference will include the development of annual work-plans, deployment of project resources to achieve the objectives set out in the plan, the development of a policy agenda, the management of a program of supporting policy research, and advice to the SEC, other GSL counterparts

and USAID on. He/She will be supported by a staff of two Junior host country professionals to assist him in the research effort. It is anticipated that during the project period, the team will provide approximately 15 analytical studies, and related dissemination activities, in addition to responding to a variety of ad hoc requests by the client groups. The project management team will be rounded off by two office assistants and a driver. The project will also provide a vehicle and office equipment and recurrent expenses of the project office. The project office will be situated in the SEC, and will become part of the host country contribution to the project.

F. End of Project Status

By the end of this project, July 1996, we anticipate that the results set forth in the revised logical framework (Annex B) will have been achieved. The plan for evaluating progress made toward achieving these results can be found in section on Evaluation and Monitoring. The following table identifies the end-of-project status for each of the proposed activities, under the project and the means of verification.

Outputs:	Measurable Indicators	Means of Verification	End of Project Status
		(For all) Contractors reports, field inspection by USAID, evaluations, GSL reports, audits, and project monitoring system.	
Securities Exchange Commission operational; Colombo Stock Exchange playing expanded role in serving capital markets.	<i>Surveillance unit staffed, trained and functional at the SEC. Enhanced capability of the CSE for self-regulation.</i>	<i>Variety of market risks adequately addressed by the SEC and the CSE</i>	SEC will be fully functional, staffed by trained personnel, effectively supervising a market that encompasses listed securities -- both in the main-board and a second-tier market -- including both equities and debt, and several new financial intermediaries such as unit trusts. The CSE will have an effective self-regulatory unit in-place, addressing a wide range of risks of market participation.

Outputs:	Measurable Indicators	Means of Verification	End of Project Status
	<i>Improved Company reporting, disclosure and the development and implementation of more stringent accounting and auditing standards.</i>	<i>Accounting standards setting group established and functioning at ICASL. Compliance unit functioning at CSE.</i>	ICASL would have the capacity to respond to the needs of the market, as anticipated by the SEC, SL and CSE, for improved financial reporting. It would have developed linkages with the research community, have established a small core-staff of specialists to overlook the standard setting and monitoring and compliance unit. The existing members of ICASL would have been exposed to the new standards, and the private accounting training institute will have enhanced tools for the teaching of accounting and auditing standards to students.
	<i>Improved systems reliability and ability to handle greater volumes and broader range of transactions by the Central Depository System (CDS).</i>	<i>Response-time, down-time and error-rate of the CDS.</i>	CSE will have a more reliable PTA/CDS system, with better response time, less down time and a reduced error rate. The system will be poised to offer new information services to the market, and the staff will be adequately trained to manage the system. CDS will be continue as a financially viable going-concern.
<i>Increased supply of quoted securities.</i>	<i>A second-tier market established with lower costs of entry, lower costs of maintenance and less stringent regulations.</i>	<i>Small and medium companies using the second-tier market to access funds. Initial public offerings (IPOs) and rights issues.</i>	A second tier market will be established and functioning using electronic trading. Financial intermediaries will be working together with companies to access the market for capital. Venture capital companies will be exiting investments using the second-tier market. There will be an increase in the supply of available securities.
	<i>A secondary market in Government Securities established and functioning. Several quoted Corporate long term debt instruments floated.</i>		A secondary market in Government Securities will be established and functioning with participation by both the general public and institutions. Several Corporate Debentures will be quoted in the market.
<i>New forms of financial intermediation developed in the market-place</i>	<i>Proactive, market driven securities industry with trained brokers, agents and analysts.</i>	<i>Certified Financial Analysts Examinations being conducted in Sri Lanka. Other training courses being conducted.</i>	<i>the CFA program will be a well recognized point of entry for professionals in the securities industry in Colombo. The market will have at least 60 qualified professionals who would be active in a variety of financial market activities. There will be at least 40 privately funded students at various stages of obtaining certification and the training institutes will be servicing the needs of these students effectively.</i>

Outputs:	Measurable Indicators	Means of Verification	End of Project Status
	<i>New institutions active in fresh market segments; Portfolio investment companies such as Unit Trusts, Insurance companies & Retirement funds, Venture Capital companies and Investment Banks.</i>		<i>There will be new institutions active in fresh market segments; portfolio investment companies such as Unit Trusts, Insurance Companies and Retirement Funds, Venture Capital Companies and Merchant Banks. Existing institutions such as the brokers and banks will also be active in new market segments.</i>

G. Sustainability

Each of the individual outputs identified above are financially sustainable. The regulation and self-regulation activities will be sustainable, both due to the user tax ("cess") chargeable on the traded securities, and due to the increased levels of activities supported by the project. The financial reporting component will be sustained by user demand, and the linkage developed by the project between the users and the suppliers of information, through the intermediation of the SEC,SL and the ICASL. The "cess" will provide the user fees to support standard setting, implementation and monitoring. The CDS will be sustained through user fees (which are already being charged) on an increased base of transactions, and fees for new services which will be developed during the course of the project.

The financial sustainability of the second-tier market, and the secondary market for Government securities established by the project will be determined by the intermediation costs, and possible competing financial intermediation activity. Currently these aspects of the capital market are not being serviced and the project will establish these for the first time. Synergies between the existing securities market activities and the proposed new activities are expected to keep the "marginal" costs of intermediation low. If however, competitive forms of intermediation with lower costs and/or better service is caused consequent to project activity, spurred by the demonstration of the profitability of this market niche, the project *objectives* would have *in effect* achieved sustainability.

The sustainability of the CFA program will be achieved by three variables -- the *demonstrated* success of the initial batch of graduates, the demand for services generated by an expanding market, and the provision of training for new entrants. By training students already in on-the job-training situations who are sponsored by the financial institutions, the project has control over the first variable. The demand for skills in an expanding market is expected to in turn generate a demand for training by potential new entrants. The

private sector training institutions for business and accounting studies are expected to be responsive to the new entrants class room training requirements by the third year, by which time the institutions will be exposed to the teaching "packages", and a critical mass of potential new entrants are expected to make a new course financially attractive for the institutions.²

The newly emerging financial institutions are privately capitalized, and the TA and training is expected to facilitate the innovation process and reduce the risks of these activities. The thrust of this intervention is largely to increase the success potential of activities that may otherwise happen anyway. As such, there are no sustainability issues in this component.

² The training institutions are private profit-making bodies that provide classroom training for the certification examinations of the ICASL, the Chartered Institute of Management Accountants (CIMA) of the U.K., the Institute of Marketing of the U.K., the Institute of Chartered Secretaries of the U.K. etc. All these examinations have core business areas (such as Finance and Accounting, Planning) in their curriculum -- as do the CFA program -- but the specific syllabi and emphasis is unique, and the specialization areas differ. The addition of the CFA program will be a relatively modest effort for these institutions given these synergies, especially if the teaching packages are readily available, together with local trainers with exposure. The "critical mass" of students then need not be very large.

2/6

Project Analysis

A. Environmental Analysis

PSPS received a Categorical Exclusion to the Environmental Assessment. The decision to grant this waiver was based upon the project's implementational activities which were largely technical assistance, participant training, commodities, procurement and policy formulation. The activities proposed under the PP Supplement are consistent with those undertaken in the Capital Markets Development component of the original project.

The Supplement places additional resources and emphasis on developing Sri Lanka's capital markets, regulatory institutions and investor participation in financial market activities. Technical assistance, the primary input, will be provided to strengthen the analytical, management and regulatory capacity of key capital market institutions. The PP Supplement provides neither funds nor investment advice to public or private financial institutions. Based on the above, a Categorical Exclusion has been granted for the PP Supplement. This is attached in Annex E.

B. Social Soundness Analysis

Sri Lankan social values have traditionally been strongly oriented toward equity, poverty alleviation, preservation of village lifestyles and cultural values. With the advent of economic liberalization since 1977 -- and especially in the last three years -- these values have been explicitly incorporated in government policies that seek, at the same time, to promote economic growth, investment, an open trading regime and a market economy in which the private sector gradually supplants the state's role in productive activities. This combination requires a shift in emphasis away from welfare policies aimed at redistribution of income and toward economic policies that increase the economic opportunities of large numbers of people -- including the rural poor -- to participate in and enjoy the benefits of development. This, in turn, requires a delicate balance of policies and investments to avoid the emergence of a dual economy in which a limited number of elite urban participants in the formal economy benefit from accelerating economic growth while large numbers of rural, agriculturally-based people languish in a low-productivity poverty trap.

The policies of the current government seek to harmonize the two goals by

emphasizing broad citizen participation in privatization and in productive private investment and employment. One example of the GSL's commitment to these principles is its program of "people-ization", in which large numbers of small investors are encouraged or assisted to own shares of privatized companies. Employees of the previously state-owned enterprises are given shares in the companies amounting to 10% of total shares offered at the time of privatization, and another 30% of the shares are offered to the general public.

The Private Sector Policy Support Project is fully consistent with these objectives and values, and the activities proposed in this Supplement will strengthen their implementation. The Project has already supported the concept of broad participation in development by providing technical assistance with public stock offerings and financial support for the distribution of shares in privatized companies. Altogether, shares worth approximately \$17 million have been given to nearly 20,000 employees of privatized companies.

More significantly, in terms of sustainable impact, the Project is supporting the general development of capital markets that will continue to support the participation of large numbers of small investors. The total number of shareholders in the Colombo Stock Exchange has tripled during the life of the Project, from about 20,000 in 1989 to 60,000 in 1991. Most of these shareholders are quite small investors, averaging about Rs. 12,000 or \$285 in individual holdings. ~~Employee shareholders, however, average about Rs. 63,000 or \$1,500 in holdings of the companies for which they work.~~ This has given workers a stake in the productivity of their firms, and has greatly increased worker support for privatization.

While the average Sri Lankan -- and certainly the typical worker in Sri Lankan industry -- was totally unfamiliar with the concept of share ownership of companies when the "people-ization" program began, the above figures indicate that public awareness and acceptance of this concept have increased dramatically. The Project's support of public advertising and awareness campaigns has contributed significantly to this change. Extensive newspaper advertising heralding each of the new public offerings has reached large numbers of people in this high-literacy country and in response large numbers of people are investing in small blocks of equity shares.

Several of the activities planned for implementation under the Project Amendment will reinforce public confidence and participation in these new investment opportunities. Building on prior work, the Project will continue to

focus on ways to improve the transparency of privatizations and public offerings, thereby making it clear to all that these processes will be carried out on level playing fields where even the "little person" can expect a fair chance to play and win. Creation of the second-tier market and a market for new debt instruments, including corporate bonds, will increase the number and variety of opportunities available to the average citizen to share in the benefits of industrial growth and development.

The social impact of the Project will extend beyond the direct participants in capital markets. The development of the Sri Lankan equity market will substantially increase the pace of both foreign and indigenous investment in private enterprise in Sri Lanka, and that, in turn, will create new employment opportunities. A recent study on the causes of unemployment, co-authored by a consultant and an official of the Ministry of Policy Planning and Implementation, concluded that the Sri Lankan economy is simply not creating enough jobs to keep pace with the growth of the labor force, and that accelerating employment growth would require an increase of about 23% in annual foreign investment, compared with the 1990 level. Low demand for labor is a direct result of relatively low rates of economic growth in the 1980's, rather than -- as some earlier studies have argued -- a mismatch between the types of labor demanded and the types of jobs unemployed workers would accept or could perform.³ In other words, Sri Lanka's unemployment problem is demand-related rather than structural.

~~The study notes a lack of data on the attitudes of entry-level workers about the attractiveness of various kinds of work opportunities, and cites evidence in support of the conclusion that given an opportunity -- any opportunity, including very poorly paid private-sector training positions with no promises of permanent employment attached, even university graduates previously presumed to prefer to wait for secure government jobs will apply in numbers that dwarf available slots. In short, the authors conclude -- if the jobs are there, workers will take them.~~

In some sectors, workers and their unions have expressed various levels of concern over the prospect of privatization for fear of losing their jobs. It is possible, of course -- even expected -- that corporate restructuring to improve competitiveness and profitability will require trimming and upgrading the work-force of many companies. In the privatizations completed so far, however, worker retrenchments have been considerably lower than expected because many of the newly-privatized firms have embarked immediately on

³ T.F. Kelly and H.M. Gunasekera, "A Critical Re-Assessment of the Mismatch Unemployment Hypothesis for Sri Lanka, unpublished paper, April 1992.

expansion programs. In addition, as implied in the figures for employee stock ownership, the "people-ization" approach has substantially alleviated many workers' concerns. This program has thus maximized "winners" and minimized "losers" from the development of an equity market in tandem with the privatization effort.

C. Institutional Analysis

1. The Securities and Exchange Commission (SEC)

The Commission was originally established as the Securities Council under the Securities Council Act of 1987, and has authority to oversee the securities market, including the Exchange and market participants (such as brokers and dealers) and to license Unit Trust. It has the power to:

- grant license to stock exchanges and ensure the proper conduct of exchange business
- grant licenses to operate as brokers or dealers and ensure the proper conduct of their business
- grant licenses to managing companies to operate unit trusts
- request the Registrar of Companies to call upon a private limited liability company to become a public limited company
- ~~give directions to a stock exchange or the trustees or managing companies of Unit Trusts~~
- grant compensation to any investor who suffers pecuniary loss from the failure of a broker or dealer to meet his contractual obligations
- advise the Government on development of the securities market
- employ officers to carry out the work of the commission
- frame rules required to be made under the Act
- suspend or cancel the listing of securities or the trading of given securities or of all securities for the protection of investors
- inquire into the business affairs of licensed exchanges, brokers, dealers, trustees and managers of unit trusts and companies listed on an exchange
- publish findings of malfeasance by any licensed broker, dealer or public company listed with an exchange
- implement policies and programs of the Government with respect to the securities market
- acquire properties and do other acts incidental to attainment of its objectives.

- develop and promote the growth of the securities market in particular and the capital market in general

The Commission is composed of 10 members, six of whom are appointed by the Minister of Finance and 3 ex-officio members who are the Deputy Governor of the Central Bank, the Deputy Secretary to the Treasury and the President of the Institute of Chartered Accountants. The nominees of the Finance Minister currently includes 3 private sector representatives.

The Commission staff consist of a Director-General, an accountant, an administrative assistant and some support staff. The Commission is in the process of hiring executives for a Licensing Section, a Legal Section and a Public Relations Section.

A government budgetary allocation is made through the vote for the Finance Ministry for financing of the operational costs of the SEC. As this budget is inadequate to effectively carry out the functions of the SEC, the SEC has proposed to the government that it be allowed to levy a tax (or "cess" based on the value of transactions on the trading floor to finance the costs of operations of the SEC. This would enable the SEC to carry out the regulatory functions that it has been mandated to perform.

2. Colombo Stock Exchange (CSE)

Since 1896, Sri Lanka has had a small share market which was serviced by the Colombo Brokers Association (CBA) and connected closely with the plantation sector. The new economic policies of 1977 and the re-emergence of the private sector as a dominant force in the economy resulted in the restructuring of the stock market with a trading floor open to the investing public from July 1984. This was named the Colombo Securities Exchange. In March 1990 it's name was changed to Colombo Stock Exchange to fall in line with internationally recognized nomenclature.

The Exchange is organized as a private limited liability (guarantee) company. The CSE is a nonprofit organization and has earned a reduced corporate tax rate of 20% by special exemption. It is owned and controlled by the private member firms who are the brokerage firms trading on the exchange. These firms which numbered eight when the Colombo Securities Exchange was set-up have increased to eleven as of March 1992. Applications have been made to increase

this number to 15 by September 1992.

The bulk of the transactions of the Exchange consists of buying and selling listed common stock. The Exchange trades new issues, some preference shares and a small amount of debentures. It does not support transactions in corporate bonds, syndicated partnerships, index features or commodities. During the period 1987 to 1991, the transaction volume of common stock increased from 9,700 to 65,100 trades while the value of shares traded increased from Rs 0.2 billion to Rs 3 billion. The primary objects of the Exchange as stated in it's Articles of Association are:

- to provide, regulate, control and maintain the facilities for conducting the business of a stock exchange in Sri Lanka
- to establish a stock exchange trading floor and to admit such floor members and such other class of members as the Executive Committee of the Exchange may in it's discretion determine to admit and to regulate and supervise their conduct and deal with any improper conduct
- to regulate and control the methods in which the business of Stock Brokers is to be carried on and to make and enforce rules and regulations for that purpose
- to promote and protect the interest and welfare of brokers and to promote and enforce honorable practices and to discourage and suppress malpractice
- to record transactions between brokers and to furnish reliable quotations of market prices
- to make and amend rules, regulations and by-laws for any of the above purposes and to make and from time to time to alter if necessary a scale of charges for brokerage and other standard charges in all transactions
- the CSE also establishes listing standards, approves securities for listing, reviews and approves prospectuses and provides facilities for clearance and settlement functions.

The main policy making body of the CSE is the Board of nine Directors, five being representatives of the brokers and four being members nominated by the Finance Minister on the recommendation of the SEC. They represent the listed companies, investing public, legal profession and the accounting profession. The activities of the CSE are regulated by the SEC.

The CSE's relationship with the broker firms is particularly complex.

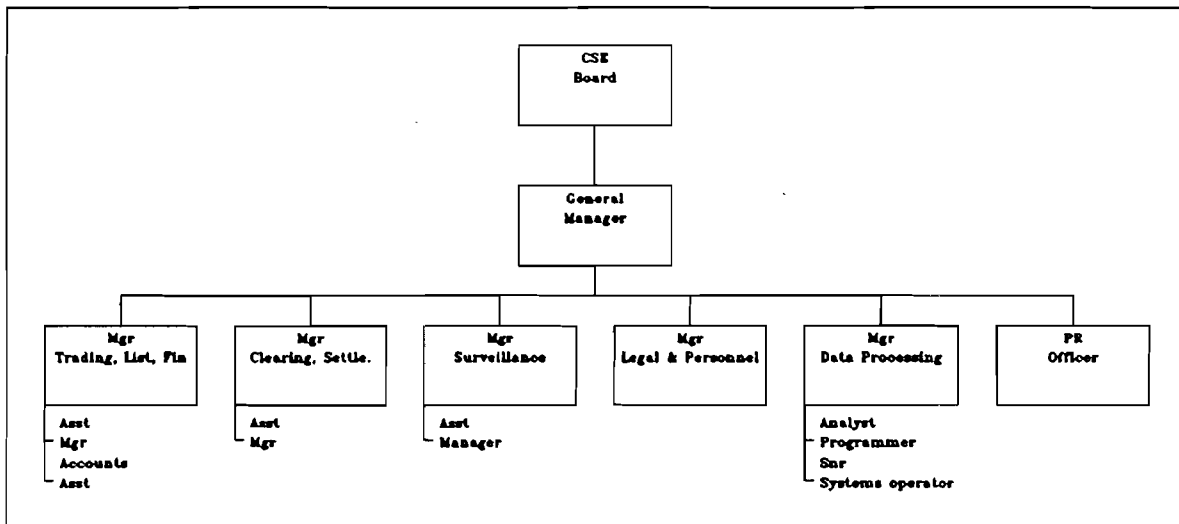


Figure 1: Organizational Chart of the CSE

The brokers are the owners and operators of the CSE, provide operating income (via fees) to the exchange and serve on its executive committee. They also provide the forum for deciding on the imposition of appropriate sanctions for brokers, for conduct contrary to the interests of the CSE and the market place; they are expected to be a self-policing body. The exchange and its member brokers provide a guarantee for limited contingent liability claims arising from inter broker defaults. (This guarantee is distinct from the investors compensation fund which when mandated by Parliament will be managed by the CSE).

The brokers firms are independent private limited liability companies. The average annual gross receipts of the member firms have increased from \$41,000 in 1987 to \$290,000 in 1991, an increase of over 600%.

The CSE has the following committees:

- Rules and By-laws Committee
- Disciplinary and Arbitration Committee
- Finance, Research and Development Committee

The Disciplinary and Arbitration Committee consists of all the non-broker board members.

The CSE publishes stock market information for the use of the general public and maintains a reference library of annual reports.

The capital issues committee of the CSE has since January 1, 1992 been made an independent body reporting to the SEC. This committee approves all new and subsequent share issues. It consists of four members, two nominated by the CSE, (one representative of the brokers and the other non-broker interests) and two nominated by the SEC.

3. The Institute of Chartered Accountants (ICASL)

The Institute of Chartered Accountants was incorporated by the ICA Act No. 23 of 1959 and amended by Act No. 16 of 1964 and Amendment Law No. 34 of 1975. The ICASL is the only recognized professional body which has legal recognition to directly authorize its members to audit accounts.

The main functions of the Institute are:

- To conduct qualifying examinations and to prescribe and approve courses of study therefor
- To supervise and regulate student education and training
- To maintain professional standards and acquaint members with the methods and practices necessary to maintain standards
- To encourage research in accountancy and related subjects
- To secure the well being and advancement of the profession

The membership of the ICASL is obtained by passing the qualifying examinations conducted by the Council and completing a course of practical training approved by the Council. Student members are those persons registered for the examinations of the Institute. The ICASL has a membership of about 1500 persons as at December 1991, and about 10,000 students registered under the examination schemes. While many members serve in positions of eminence, both in the private and public sector in Sri Lanka, about half it's membership work abroad.

The policy making board of the ICASL is the Council of Members which consist of 12 persons. The President and Vice President of the Council are elected by the members of the Institute. Six Council members are appointed by the Minister for Trade and Commerce and four members are elected by the members of the Institute. A member of the Council holds office for two years from date of election/appointment. 21 Committees look into specific areas of activity and make recommendations to the Council. The Institute has

an administrative staff of 72 of which 16 are executives.

The Institute's main source of income is from members subscriptions (50%) and from its business school (30%). While the government gave the initial grant to the Institute to construct its buildings, it continues to give a token grant on an annual basis.

The Institute consists of 4 lecture halls, auditorium, library, members lounge, computer room and administrative offices and is situated in a central location.

The ICASL operates a library, a computer center conducting courses for members and a Business School which provides training in Business and Financial Administration to senior executives. An annual conference is held to discuss matters of interest to the members and public lectures and seminars are held regularly. This forms a system of continuous professional education for the members. Publications include a bi-annual journal and other documents of professional interest. ICASL conducts an annual competition among companies, corporations and banks for the selection of the "Best Corporate Report and Accounts" and has recently embarked on a program of studying, modifying and adopting the International Accounting Standards.

D: Economic Analysis

The economic analysis of this amendment flows directly from the methodology employed in the original project paper (Annex E). The question addressed then was the likely nature and order of magnitude of benefits in each of four project component areas: 1. policy support (private sector organizations), 2. capital markets development (Securities Council and Colombo Stock Exchange), 3. privatization, and 4. a venture capital company.

The performance expectations for the capital markets strengthening elements of the initial project, described under "Securities Council and Colombo Stock Exchange" in Annex E, have been far exceeded in the event. The benefit stream, defined as the boost that the project would give to growth in both the number of shares traded and the average value, needed to be only about one-fourth of one percent to achieve an acceptable present value of the benefit stream. In 1987 the total value of shares traded was equivalent to U.S. \$11.1 million, four years later the comparable figure is ten fold higher, representing a compound annual nominal growth rate in

total turnover in excess of 80 percent. While it is not possible to say what portion of this growth was "boosted" by the project, there is no doubt that such phenomenal growth would have been impossible without the technical assistance and hardware made available on a timely basis through the project.

The original economic analysis may have been deficient in identifying benefits directly with rising turnover, although the project paper generally lays out the connection between improved market operations and increased economic efficiency. Sri Lankan economic output has increased an average of four percent annually since 1987, and the private sector, which is affected most by improved capital markets, has been even more robust. The linkage is far too complex, however, to say that this growth is a directly related benefit. Moving down the scale of aggregation one or two notches provides more acceptable evidence of positive economic benefits. The Central Bank of Sri Lanka's Annual Report states that,

"In the past, low levels of income, small size of firm and the desire of the government to retain control over investment inhibited the development of a capital market. However, this situation changed considerably during the period 1989 to 1991. With the expansion of financial markets, investment in such markets increased..... Capital market activities increased with the growth of companies in the private sector and the privatization of public sector enterprises. The stock market was seen to be an effective means of meeting the financial requirements of a growing private sector. This led to a progressive expansion of the stock market and a spectacular expansion in the demand for equity investments as reflected in large over-subscriptions to capital issues made in the recent past."

Later in the Report, the Bank attributes the sharp rise in the foreign direct investment in 1991 (from SDR 31 million in 1990 to SDR 74 million in 1991) to increases in activities of the Greater Colombo Economic Commission and portfolio investment through the Colombo Stock Exchange, a primary recipient of USAID assistance under the PSPS project. Collaborative evidence is found in the trend of domestic capital spending by private sector companies and public corporations, which doubled (from 34.5 to 68.6 billion rupees) from 1987 to 1991, twice the rate of increase in capital expenditures of Government and Public Enterprises. The relative inefficiency of the public sector in Sri Lanka (as elsewhere) is well documented in numerous studies; turning again to the Central Bank, they report that " *The majority of public sector industrial enterprises displayed*

*poor performance during the year."*⁴

Given the major deficiencies in Sri Lankan capital markets noted in the body of the amendment, and the surge in private sector capital spending (albeit from a low base) already being supported by project funds, there are strong reasons to expect achievement of the expanded capital markets amendment's goal of an increase in real private sector investment of ten percent per annum. As detailed above, the performance goals of PSPS relative to the capital markets already have been exceeded many fold. An increase of ten percent annually in private sector investment would produce economic benefits through employment of resources that otherwise would be idle, and by increasing the efficiency of all resources through use of market signals to determine production and distribution mixes and methods. In both cases, additional benefits are very probable given the high levels of labor unemployment, especially among well educated Sri Lankans, and the large residual role of Government enterprises in customarily "for profit" sectors of the economy.

This amendment adds U.S. and host country funding equal to about U.S. \$9 million to further capital market development, essentially through support of activities begun under this component of the original project. The expenditures, scheduled to take place over a period of approximately three years, have a present value of U.S. \$ 8.7 million (1993 dollars). To yield an internal rate of return of twenty five percent over the next ten years this level of expenditure should generate benefits ~~approximately equal to \$ 2 million per year (1993 dollars).~~⁵

The benefits are derived from sustaining a ten percent increase in real private investment. This increased private investment reduces the prevalence of idle resources (i.e. lowers unemployment) and increases economic efficiency through transferring resource allocation decisions from public command and control basis to market basis.

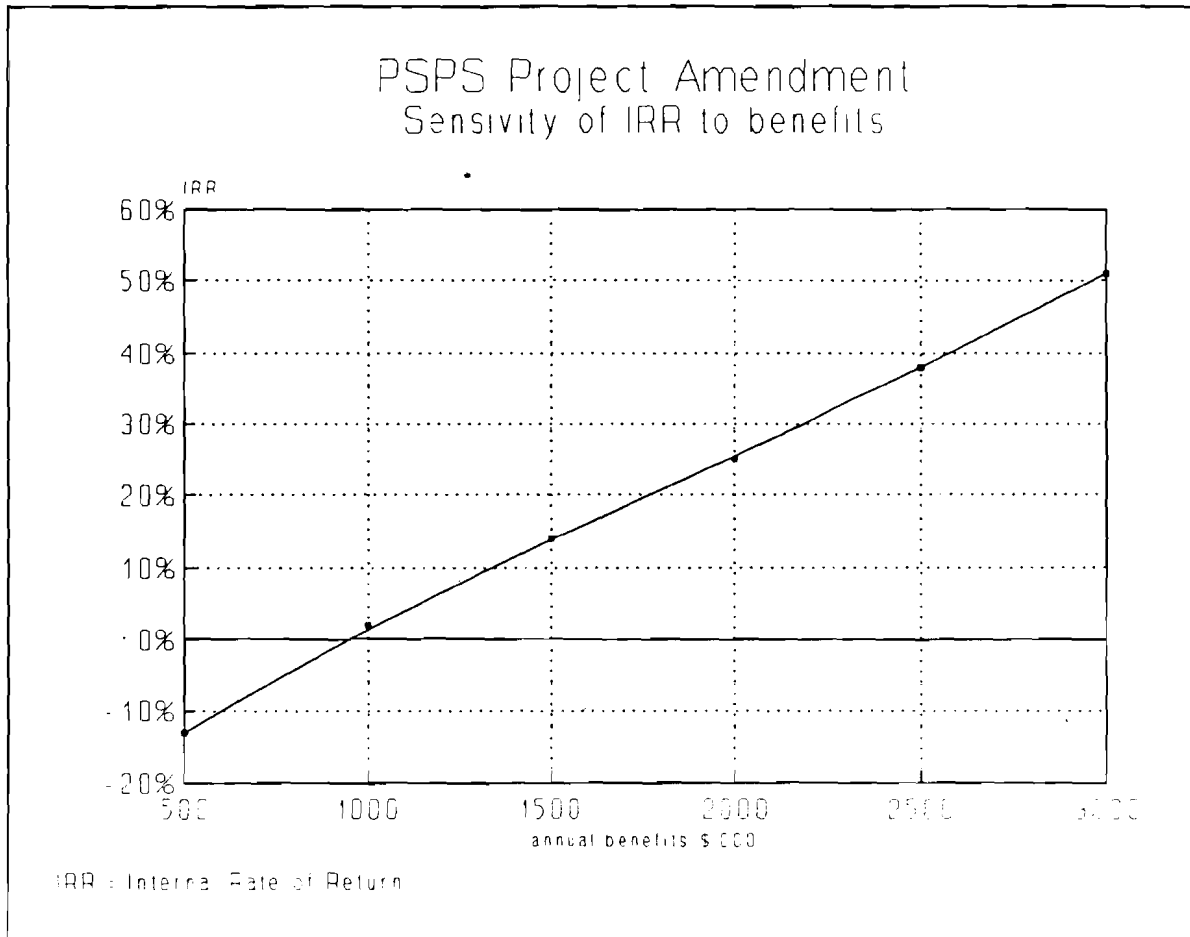
For a US \$2 million level of benefits to be generated from this project amendment on an annual basis would require an increase in the real return

⁴ Public sector industrial output actually decreased by 8 percent in 1991, while the real Gross Domestic Product increased by 4.8 percent.

⁵ The relatively high required rate of return and short time horizon seem appropriate to an investment designed to improve overall resource allocation efficiency through private markets, as opposed to a more traditional infrastructure project bringing basic services directly to the poor. More sophisticated analyses are available to address this issue, but are unnecessary given the minimal performance required to meet the stated rate of return criteria.

on additional private sector investment of only one percent. (This is calculated after allowing for some build up time for the benefits in the first two years). Experience to date with the PSPS project provides strong reason to believe that added benefits would greatly exceed one percent. The chart and table set out below show the sensitivity of project internal rate of return to various assumed levels of benefits.

Annual Benefits \$'000s	Internal Rate of Return to PSPS
3,000	51%
2,500	38%
2,000	25%
1,500	14%
1,000	2%
500	-13%



43x

Project Implementation

A. Project Management

The proposed program is both extensive and complex. It involves deploying six long term consultants and frequent short term assistance over a relatively short period of time. The project will have day-to-day contact with three major institutions (the SEC, SL, the CSE and the ICA,SL), over two dozen client institutions (such as the brokers, merchant banks, portfolio investors, and other financial intermediaries) and periodic interface with several governmental policy making bodies, such as the Central Bank, Ministry of Finance and the Monetary Board. The Economic environment is an additional variable that adds to the complexity of project management; clearly some of the proposed elements of the project are vulnerable to market conditions and others particularly sensitive to policy change. Successful management of the program of assistance will require responding to the dynamic changes in the market place by changing the mix of both the activities and the inputs. It will also require that the project management be engaged in providing the policy makers with options on a variety of policy issues, thus increasing their responsiveness to emergent issues in a rapidly growing market place.

The project will be managed by a full-time chief-of-party whose terms of reference will include the development of annual work-plans, deployment of project resources to achieve the objectives set out in the plan, the development of a policy agenda and the management of a program of supporting policy research, and advice to the SEC, other GSL counterparts and USAID. The position will ideally be staffed by a senior professional with international finance, macro-economic and research experience.

The various long-term consultants each of whom will be responsible for clearly defined tasks will include specialists who will develop close working relationships with institutions with which they are linked, as identified below.

The long term TA will be responsible for developing the terms of reference for the short term TA. While a greater portion of the short term technical assistance is tightly programmed at the PP Supplement stage, there is some provision for "targets of opportunity" that will arise in implementation. All such requests for short-term TA will be closely reviewed and approved by USAID. For overall coordination, administrative and project management purposes, the long-term consultants will report to the Chief-of-Party.

TA Contractor	Key Counterparts	Other Points of Contact
Chief-of-Party	The Chairman and Director General, SEC, the Chairman and General Manager of the CSE and the President, ICASL	Staff specialists in the SEC, CSE and ICASL. Private sector financial intermediaries, and both quoted and target companies for the quoted market.
Regulation Specialist	Director General, SEC and the General Manager, CSE	Staff specialists for corporate finance, market regulation, investment trust management, enforcement and accounting at the SEC. Floor Manager compliance and Deputy at the CSE.
Accounting and Audit Standards Specialist	ICASL	Chairman and Members of the Accounting Standards Committee, Audit Standards Committee, Private Sector tutoris etc.
Computer Hardware/Systems Specialist	General Manager, CSE	Manager, Data Processing, Software and hardware vendors
Second-Tier Markets Specialist	Director General, SEC and General Manager, CSE	Brokers, dealers and target companies for the second-tier market
Training Specialists	Director General, SEC and the General Manager, CSE	Client institutions and trainees

There will be significant amounts of short-term training needs for the various individuals in the host country institutions who are implementing the program, in addition to the more formal in-country longer-term training elements that are a part of the project outputs.

The Chief-of-Party will report to the USAID/Colombo Project Officer in the Office of Private Sector Development (PSD).

B. Contracting Plans

The program will be effected by the following contracting actions. Each of these are discussed below.

Action	Contracting Authority	Value	Timing
Competitively bid AID direct contract for short and long term technical assistance	RCO, New Delhi	\$6.25 Mil	11/92
GSA procurement of automation equipment from UNISYS	Contracting Officer, Washington	\$0.45 Mil	2/93
Cooperative Grant to the Institute of Chartered Accountants of Sri Lanka (ICASL)	RCO, New Delhi	\$0.10 Mil	4/92
Indefinite Quantity contract or Buy-in for evaluation	Contracting Officer, Washington	\$0.15 Mil	2/95

1. Technical Assistance Contract

The single largest procurement action will be the technical assistance contract which will provide for a total of 95 person months of expatriate long term assistance, 24 person months of host-country long term assistance, 60 man months of short-term expatriate technical assistance and 64 man-months of short-term host country technical assistance. All long term TA is for precisely defined tasks which are now known, while there is limited provision for "targets of opportunity" to be defined in implementation for some short term TA. All such requests for short term TA will be closely reviewed by USAID prior to approval. Training activities will be included under the same contract. More detailed information on training requirements is presented in Section 4 on "Amended Project Description", D2 and under Section 7 "Cost estimates and financial plans", B2. The contract will also incorporate small procurement such as office equipment. The details are presented in Section 7, B3.

2. Procurement of computer equipment

Code 000 Source and Origin computer equipment to be provided under this project supplement will be procured by A.I.D. direct contracting procedures. Due to the need to purchase proprietary equipment that is compatible with the existing hardware and software investment by the CSE and other market participants, USAID will try to procure UNISYS equipment under the existing GSA contract with UNISYS.

3. Cooperative Agreement with ICASL

A Cooperative Agreement will be funded by the Project Supplement which

will be primarily a vehicle for issuing sub-grants to domestic research institutions. The sub-grants are expected to be very small (under \$5,000) and will not require audits. The establishment by ICASL of grant selection criterion, and grant administration capability will be a pre-condition for the Cooperative Agreement. A justification for awarding the Cooperative Agreement to the ICASL without competition will be prepared based on their unique capability.

4. Evaluation

The final evaluation is expected to be contracted through the use of an appropriate indefinite quantity contract, or a buy-in.

C. Monitoring, Evaluation and Audit

The amended PSPS project will have three evaluations over the LOP. Each evaluation will focus on all four project components: policy support, privatization, capital markets development, and venture capital company. The first evaluation was completed, under a technical assistance contract, in December, 1991 (see Annexure H, Executive Summary). A second evaluation will occur in July, 1993. The primary objective of this evaluation is to ~~assess progress in project implementation and to~~ recommend any necessary changes to better achieve project objectives. A secondary objective is to re-examine the project's activities given the existing political and economic current in developing alternatives or additional activities needed.

The final evaluation will occur in July 1996 at the project's completion. The final evaluation will focus on whether the project's output- and purpose-level objectives have been met and will assess the project's overall impact on Sri Lankan private sector growth. The evaluation will include a complete financial audit. Data for project monitoring and evaluation will be gathered and maintained by the Chief of Party and the Office of Private Sector Development at USAID/Colombo. The remaining evaluations will be conducted under a technical assistance contract. Two non-federal audits are planned.

The project's large technical assistance component will provide a means of monitoring project performance between major evaluations.

D. Implementation Schedule

The composite implementation schedule of the capital markets amendment is given below. Implementation for the other three components will proceed according to the original schedule.

Milestone	Responsibility	Target Date
Project Agreement Amendment signed	External Resources Department (ERD) of the Ministry of Finance, USAID/Sri Lanka	May 92
PIO/T for technical assistance contract	Approved by ERD, USAID	June 92
Request for Proposals on TA Contract	USAID Regional Contracting Officer (RCO)	July 92
Receipt of TA Contract Proposals	Potential Contractors	September 92
AID Direct Contract for procurement of ADP equipment using the GSA Schedule contract	Contracting Officer, Washington	October 92
Technical Review of TA Proposals, negotiations and award	RCO, USAID Technical Officers, SEC and CSE and potential contractors	October 92
Departure of the ISTI Capital Markets team under the existing contract - close out	ISTI and USAID	October 92
Fielding of Chief of Party, and the Training Specialist	Contractor	November 92
Fielding of Regulation Specialist, Computer hardware/systems specialist and Second-Tier Market Specialist	Contractor	January 93
Development and approval of the commodity procurement	Procurement Officer and the Project Officer, USAID/Sri Lanka, Information Resource Management (IRM) of USAID/Washington, CSE, BC Computers (UNISYS local agents) and International Science and Technology Inst., existing USAID Capital Markets contractor	February 93
1st Year Workplan developed and approved	The Contractor, with assistance from SEC, CSE, ICASL and USAID	February 93
Field Accounting Standards Specialist	Contractor	April 93
Cooperative Grant with the Institute of Chartered Accountants signed	RCO and ICASL	April 93
Delivery and installation of Computer Hardware	UNISYS	May 93

Milestone	Responsibility	Target Date
2nd Interim Evaluation of the PSPS Project under IQC or buy-in	USAID/Sri Lanka, Contracting Officer/Washington and IQC/Buy in Contractor	July 93
Close out of the Policy Support Unit grant and the privatization elements of the existing project, and no cost extension of the Cooperative Grant to EQUILL, the Venture Capital Company	USAID, ERD, University of Maryland and Equill	August 93
Final Evaluation of the PSPS Project under IQC or buy-in	USAID/Sri Lanka, Contracting Officer/Washington and IQC/Buy in Contractor	May 95
Long Term Contractor Departs.	Contractor	July 95

An illustrative chart, identifying activities, milestones and target dates for completion is presented under Annexure A, "Technical Analysis of Project" F

E. Conditions Precedent and Covenants

1. Conditions Precedent

The following conditions precedent are proposed for the Private Sector Policy Support Grant Agreement Amendment No. 4.

1. Prior to the mobilization of the Chief-of-Party and the training specialist funded by A.I.D. technical support program for Capital Markets, a user tax ("cess") on equity securities being transacted in the secondary market, which is adequate to meet the costs of the Securities and Exchange Commission operations, should be in place.
2. Prior to the ordering of the automated data processing equipment for the Central Depository Company, a wholly owned subsidiary of the Colombo Stock Exchange, the A.I.D. Project Officer will be invited to attend all board meetings of the Depository Company, until the Project Assistance Completion Date (PACD).
3. Prior to the signing of the Cooperative Agreement between A.I.D. and the Institute of Chartered Accountants of Sri Lanka (ICASL), (a) the ICASL should form the accounting standards committee, the audit standards committee and the compliance committees of the institute; (b) a full time Senior technical person is recruited to manage the sub-grant mechanism and the overall program of support to the ICASL; and (c) ICASL invites CSE and SEC representatives to be ex-officio members of the Compliance Committee.

1244

4. The Securities and Exchange Commission senior staff members responsible for market regulation and financial reporting are recruited and in place prior to the mobilization of the technical assistance specialist on Regulation.

In addition, the standard conditions precedent and covenants, including GSL designation of authorized signatories which are now in force, will continue.

2. Covenants

In addition to the covenants in effect as per the Project Grant Agreement, the following special covenant is proposed for the Private Sector Policy Support Grant Agreement Amendment No. 4.

"The Securities and Exchange Commission will consider financing the continued monitoring of financial reporting and standards development for quoted public companies, by the Institute of Chartered Accountants of Sri Lanka."

Cost Estimates and Financial Plan

The total cost for this Project Supplement is \$9 million, comprising \$7 million in A.I.D. grant funds, and \$2 million in host country contributions. Therefore, the total budget for the Private Sector Policy Support is now \$42 million, \$22 million in A.I.D. grant funding and approximately \$20 million in host country contributions. A breakdown of utilization of A.I.D. funding activity by element is presented in Table 4. A discussion of the elements follow:

A. Illustrative Budget/Financial Plan

The following financial tables present estimates of total budgetary requirements to achieve the objectives of the Private Sector Policy Support project, including this project supplement.

Table 1
Pre Amendment Budget by Component (\$000)

	USAID			Host Country			Project Total
	Cumulative Obligation	Future Years Anticipated	Total	GSL	Other	Total	
Policy Support	2,100	846	2,946		350	350	3,296
Privatization Support	7,450	412	7,862	13,720		13,720	21,582
Capital Markets Development	2,514		2,514	225	315	540	3,054
Venture Capital Company	400	100	500		3,333	3,333	3,833
Monitoring and Evaluation	180	120	300			0	300
Contingency and Inflation		878	878			0	878
Total	12,644	2,356	15,000	13,945	3,998	17,943	32,943

56x

Table 2
Amendment Budget by Component

	USAID			Host Country			Project Total
	Cumulative Obligation	Future Years Anticipated	Total	GSL	Other	Total	
Policy Support			0			0	0
Privatization Support			0			0	0
Capital Markets Development		6,250	6,250	1,636	364	2,000	8,250
Venture Capital Company			0			0	0
Audit, Monitoring and Evaluation		125	125			0	125
Contingency and Inflation		625	625			0	625
Total	0	7,000	7,000	1,636	364	2,000	9,000

Table 3
Summary of Total Project funding by component

	USAID			Host Country			Project Total
	Cumulative Obligation	Future Years Anticipated	Total	GSL	Other	Total	
Policy Support	2,100	846	2,946	0	350	350	3,296
Privatization Support	7,450	412	7,862	13,720	0	13,720	21,582
Capital Markets Development	2,514	6,250	8,764	1,861	679	2,540	11,304
Venture Capital Company	400	100	500	0	3,333	3,333	3,833
Audit, Monitoring and Evaluation	180	245	425	0	0	0	425
Contingency and Inflation	0	1,503	1,503	0	0	0	1,503
Total	12,644	9,356	22,000	15,581	4,362	19,943	41,943

B. Analysis of AID Funding

A.I.D.'s total grant funding of \$7.0 million consist of the costs of long and short-term TA, local and overseas training and a modest amount of commodities for this Project Supplement. There will be no additional funding for the other activities of the existing project, which are expected to be completed on schedule. More detailed costing by activity is presented in the expanded project description.

1. Technical Assistance

The ongoing, Capital Markets contract assisting the SEC and the CSE (with International Science and Technology Institute, ISTI) was scheduled to end in July 1992 and is now expected to be extended to October 1992. A single new contractor, servicing all the proposed elements of the project is anticipated to field the personnel no later than November 1993, within the framework of a 3 year contract. Of the total \$7.0 million, approximately 69% (\$4.8 million) is expected to be expended on technical assistance personnel, both U.S. and host country.

2. Training

The project will provide for extensive in-country training including the promotion of a U.S. certification program, and will also fund approximately 14 tours of contractor managed overseas training. Overseas training will be short-term in nature and generally consists of attendance at relevant conferences, seminars and in-situ training. A.I.D. will pay for air fares and per-diem registration fees and incidental expenses in accordance with A.I.D. regulations. Local training will be implemented through the umbrella contract using local expatriate consultants. The non-personnel cost of training is approximately \$1.0 million. This includes short-term overseas training (19% of the training costs), subscription to the Chartered Financial Analysts (CFA) program on a cost-sharing basis (19%), and the balance representing expenses related to ~~other in country training costs~~, such as training materials, books, facilities, local transport etc.

3. Commodities

A limited amount of commodities for the CSE and the project office, estimated to total approximately \$0.6 million (9% of the total project) is estimated to be purchased. The largest single item (80% of the total) is expected to be the proprietary UNISYS computer equipment procured under the GSA, thereby meeting Code 000 source and origin requirement. The balance is primarily office and training equipment.

Table 4
Cost Estimates by Type and Activity

	Technical Assistance	Training	Equipment	Other	Total USAID
(1) Regulation and Self Regulation	451	96			547
(2) Financial Reporting	471	110	30	100	711
(3) Post Trade Automation	338	48	450	7	843
(4) Development of a Second-Tier Market	611	100		40	751
(5) Development of a Market for Quoted Debt Securities	182	124		40	346
(6) Certification of Securities Market Professionals	1,184	269		40	1,493
(7) Assistance to New Financial Institutions	305	90			395
(8) Program Management and Policy Audit, Monitoring and Evaluation	712	55	80	317	1,164
Contingencies (15%)	125				125
	429	87	55	53	625
Total	4,808	979	615	597	7,000

C. Analysis of Government of Sri Lanka (GSL) and Private Sector Counterpart Contributions

Total GSL and private sector funding is estimated at \$2 million. The funding essentially consist of in-cash contributions within the limited time-frame of the project. A significant component of this (\$1.64 million) will be raised by a new tax to be introduced by the SEC for transactions on listed securities. Of the \$0.36 million private sector contributions, \$0.15 million will result from financial institutions and CSE's expenditures on automation, communication, and site preparation expenses relating to the PTA/CDS system. The remainder relates to cost-sharing by the CFA and other training programs. Table 7 presents GSL and private sector contributions to the project, by fiscal year.

If one considers the host-country contributions both as reflecting the stream of cash commitments arising out of the new tax over a longer time-frame, and in-kind consideration by the private-sector, such as valuing the voluntary time by the Chartered Accountants on the standards and compliance

committees, the host country contributions will be significantly enhanced.

D. Obligation Plan

The obligation plan is presented below in table 5. Fiscal year expenditures are presented in Table 7. This is based on maintaining a minimum 6 months pipeline.

Table 5
Project Financial Analysis

	FY91	FY92	FY93	FY94	FY95	Total
Pipeline as at beginning of fiscal year	-	2,466	2,651	2,988	1,075	-
Obligations	10,944	4,830	5,500	726	-	22,000
Planned Expenditures						
PSPS Project	8,478	4,645	1,877	-	-	15,000
PP Supplement	-	-	3,286	2,639	1,075	7,000
Total	8,478	4,645	5,163	2,639	1,075	22,000
Pipeline as at end of fiscal year	2,466	2,651	2,988	1,075	-	-
Pipeline in months	05	07	07	05	-	-

E. Buy-America Considerations

Table 6 presents an illustrative source and origin analysis of services and commodities provided under the project. This is analyzed to the first level of subcontractors. The project is authorized for U.S. and host country expenditures.

60x

Table 6
Source and Origin of Services and Commodities

Source	US	US	Total	%
Origin	US	Sri Lanka		
Technical Assistance	3,753	1055	4,808	68.7
Training	371	611	982	14.0
Commodities	495	120	615	8.8
Other	107	490	597	8.5
Total	4,726	2,276	7,000	100.0
%	67.5	32.5	100.0	

The above analysis of expenditure is based on the following: approximately 10-15% of the cost relating to U.S. Consultants are anticipated to be expended on local subcontracts (housing allowances, lodging, utilities etc.) All overseas study tour expenditure are anticipated to originate from the U.S. commodities include the CDS computer systems which is anticipated to be procured under the GSA. Approximately \$120,000 of office equipment is expected to be purchased locally. The following is an illustrative list.

02 High Volume photocopiers @ \$7,000	14,000
01 Medium Volume photocopier	5,000
Printing equipment (Roneo machine)	20,000
04 Mobile Phones @ \$750	3,000
02 Fax Machines @ \$2,500	5,000
Micro computers and other related equipment	25,000
04 Air conditioners @ \$1,250	5,000
Other office equipment, partitioning etc.	20,000
Contingency	23,000
TOTAL	120,000

All equipment are anticipated to meet either the U.S. origin or "off-the-shelf" procurement regulations.

Table 7
Financial Plan by Source Activity and Year

Total Expenditure (\$'000)	93			94			95			Total			Grand Total
	USAID	GSL	Other	USAID	GSL	Other	USAID	GSL	Other	USAID	GSL	Other	
(1) Regulation and Self Regulation	335	500		211	536		0	600		547	1,636		2183
(2) Financial Reporting	316		32	335		34	60		6	711		72	783
(3) Post Trade Automation	582		100	173		25	88		25	843		150	993
(4) Development of a Second-Tier Market	416		19	335		19			19	751		57	808
(5) Development of a Market for Quoted Debt Securities	155			191						346			346
(6) Certification of Securities Market Professionals	520		19	526		19	442		19	1,493		57	1,550
(7) Assistance to New Financial Institutions	152		12	152		12	91		6	395		30	425
(8) Program Management and Policy	511			475			178			1,164			1,164
Audit, Monitoring and Evaluation							125			125			125
Contingencies (10%)	299			240			86			625			625
Total	3,286	500	182	2,638	536	109	1,075	600	75	7,000	1,636	366	9,000

Technical Analysis of Project

A. General Economic and Policy Background

During the past two decades, the Government of Sri Lanka (the Government) has slowly moved away from an economic structure where government institutions and state-owned enterprises exert significant control over the country's commercial activities to an economic structure increasingly guided by market forces. The Government's initial strategy focussed on developing domestic industries and public enterprises to reduce dependence on foreign imports, thereby enriching national welfare and sovereignty. Though the ensuing economic policies provided some gains in select industries, the resulting market inefficiencies negatively affected overall economic growth.

The Government began economic liberalization in earnest in the late 1970s. The national elections of 1977 ushered in a new government committed to reducing market distortions, contracting government expenditures, and initiating privatization of state-owned enterprises. From 1977 to 1983, the gross domestic product grew from 2.9% to 6.0% annually. The intervening years since this period have produced positive but inconsistent growth rates. Several exogenous factors contributed to a mixed economic performance. Chief among them are declines in national productivity resulting from ethnic violence in the northern country. During this period, deficit spending remained excessive, foreign investment ~~and tourism declined~~, and indigenous private investment slowed markedly. Despite these impediments to growth, the Government maintained its commitment to economic liberalization.

Monetary and financial regulatory policies in Sri Lanka, which distorted the financial system for many years, inhibited the development of an efficient financial market system. The liberalization measures introduced after mid 1970's to some extent corrected the distortionary monetary and financial policy framework. Nevertheless, inherent weaknesses in the financial market system have tended to limit their contribution to accelerated economic growth. Weaknesses of equity markets and enforcement limitations on debt recovery together created a situation of investors preferring debt over equity financing. The legal framework for financial market activities tended to suffer more from inadequate enforcement than from statutory shortcomings. Policy makers continue to rely on the financial system as an instrument of social policy, using subsidized interest rates and directed credit programs with consequent distortions.

The primary goal of the Government's liberalization strategy of the late 1980s and today is to raise Sri Lankans' standard of living by attaining and sustaining more broadly based economic development. The Government has pursued three primary objectives which are meant to (1) increase the privatization of state-owned enterprises; (2) create an investment climate that attracts foreign capital; and (3) develop a diversified financial market which can respond to the needs of a growth-oriented economy. Successful attainment of each objective is linked to the success of the other two.

However, the development of a financial market is the key and the sine qua non to the realization of the other two objectives. Without a financial market, newly privatized firms would be without critical capital resources and few investment mechanisms would exist to productively employ domestic and foreign capital. An efficient financial market system composed of both debt and equity instruments, is needed to mobilize financial resources from low productivity activities to investments with higher returns. Proper signals and opportunities emerging from the financial markets are of prime significance for a sound investment climate.

The domination of state institutions in the financial intermediary system and their internal management weaknesses, particularly in project and risk analysis, tend to impair the effective performance of financial institutions. Private banks, both foreign and domestic, have taken advantage of this inefficiency in the state banks to increase their own spreads, thus enhancing ~~profits rather than~~ gaining market share. The absence of long term money market instruments leads to the anomaly of a long term lending rates lower than the short term rates, unrelated to the element of risk involved. The policy outlook of the state and the domination of the state financial institutions in the financial system have acted adversely on the emergence of proper signals on investment opportunities.

Lending institutions in Sri Lanka are free to determine the rates payable on their deposits. Similarly, there is little direct interference by the authorities in the determination of bank lending rates, except the rates on Central Bank refinanced directed loans to some selected priority borrowers. Although there is no direct control, the market for commercial bank credit has long been dominated by the two state banks, People's Bank and Bank of Ceylon. Despite the competition from the entry of private foreign banks and local new banks, the rates on short term loans are determined largely by these two banks. On the otherhand, rates on medium and long term loans are determined primarily by the two Development Financing Institutions, National Development Bank (NDB) and Development Finance Corporation of Ceylon (DFCC) both of which are partly or wholly state owned and enjoy

access to low cost external resources or Central Bank refinancing facility. Although GSL is in the process of divesting its share holdings in these banks some residual distortionary issues may linger on.

Bank deposit and lending rates remain aligned largely to the Treasury Bill (TB) rates. Although TBs are publicly auctioned the rates are heavily influenced by the bids of a few captive state owned or Government sponsored institutions and the cut off rate is determined by the Central Bank of Sri Lanka (CBSL). The Government has taken some initial steps to reduce the consequent distortions by appointing primary dealers to service the captive institutions, among others. Currently, however, the market rates of interest in Sri Lanka still, does not reflect the true market-determined rate and does not respond fully to market conditions. After allowing for inflation, the net-of-tax real cost of debt has often been negative. Easy availability of debt coupled with poor debt recovery instruments favor debt financing as equity financing is relatively more expensive. Distortions in the debt equity cost relationship and the resultant tendency to seek loan in preference to equity financing have acted as major constraints to the development of a sound capital market structure in Sri Lanka. Sri Lanka's investment savings gap still represent a major constrain on economic development. As a consequence 35- 40% of Sri Lanka's investment is still financed from foreign assistance.

GSL is aware of most of the problems relating to the current distorted financial market system and has taken a number of steps to address them. Chief among these steps is a commitment to bring down the deficit to manageable levels. CBSL has imposed capital adequacy and accounting requirements on the banks. Detailed analysis of operation of the State Commercial Banks has been undertaken. A Banking Commission has been established to review the sector and make recommendations to the President. The GSL activities to develop a primary and a secondary capital market in Sri Lanka is a key strategy within its overall financial markets reform program. These activities have taken the form of the creation of the Securities and Exchange Commission of Sri Lanka (SEC, SL), the passing of supportive legislature and obtaining donor assistance (both by USAID, the World Bank and ADB) for these areas.

B. Colombo Listed Securities Market

1. Background

In 1985, Sri Lanka's stock market was reorganized as the Colombo Securities Exchange. (It is now called the Colombo Stock Exchange, or CSE). In 1987, the Securities Council Act created the first regulatory body charged with ensuring orderly markets and protecting buyers of listed equity and debt securities. The Securities Council (now called the Securities and Exchange Commission or SEC) also advises the Government on the development of the capital markets.

It has long been recognized that the Sri Lankan stock market has the potential to play an important role in channelling domestic savings into investments, productive capacity and growth. The economy has long term promise, the financial system is relatively sophisticated, the savings rate is above average compared with other countries at similar levels of national output and income, basic legislation for private corporations is in place, and accounting standards are above average.

However, there were some imposing constraints. Operations on the Colombo Stock Exchange were slow and cumbersome. The operations of the CSE were manual and paper-based, limiting the efficiency and timeliness of share transfers. Even before the recent rise in trading in 1990 and 1991, the CSE had experienced settlement difficulties. ~~For market trading to~~ continue to grow, an automated Central Depository System (CDS) was necessary to provide all post trade settlement services.

Other problems were of a structural nature. Many companies were unwilling to list, thus limiting the supply of shares on the market and reducing liquidity. Interest rate and tax policies actually encouraged companies to favor debt over equity financing. Most of the companies which did list did not trade actively and there was little float in the market. None of the brokers operated outside of Colombo and the services they provided clients were limited. Investment research and portfolio management skills were virtually non-existent.

The demand for shares was also severely limited. The Sri Lankan public was generally unaware of the possibilities and potential benefits of investing in shares. If aware, it frequently lacked confidence in the market and tended to prefer less risky, albeit lower-yielding, bank deposits. Institutional investors which could be a significant source of demand were typically government owned and used as captives for low yielding (in real terms)

government debt. Foreign portfolio investment was effectively eliminated by a 100 percent tax on purchased shares.

2. USAID's Project

One of the existing goals of the Private Sector Policy Support (PSPS) project is to develop the Sri Lankan capital market in order to broaden equity participation in the economy and increase resources for investment. With \$2.247 million in grant funds for capital market development, AID provided technical and financial assistance to:

- Help the Securities Council in its capital markets development and oversight functions.
- Develop specifications for, and procure, equipment to improve the operations of the Colombo Stock Exchange, and provide training and assistance to modernize exchange operations.
- Prepare educational materials, seminars, conferences and other events to improve public awareness of the securities market.

To this end, USAID entered into a long term technical assistance contract with the International Science and Technology Institute (ISTI) in May 1989. The long-term TA team arrived in Sri Lanka in July 1989. This team has been complemented by a number of shorter term consultancies looking at specific issues. The planned outputs of the Capital Market Development Project include:

- The promotion of public awareness of the possibilities and benefits of share ownership.
- The creation of an operative regulatory unit (the SEC) for the securities market.
- The development of more modern operations for the CSE in order to handle an increasing volume of transactions, including the installation of a computer-based Central Depository System (CDS) in the Colombo Stock Exchange.
- A significant increase in share trading activity.
- An increase in the number of listed companies and a broad-based ownership of companies.

67

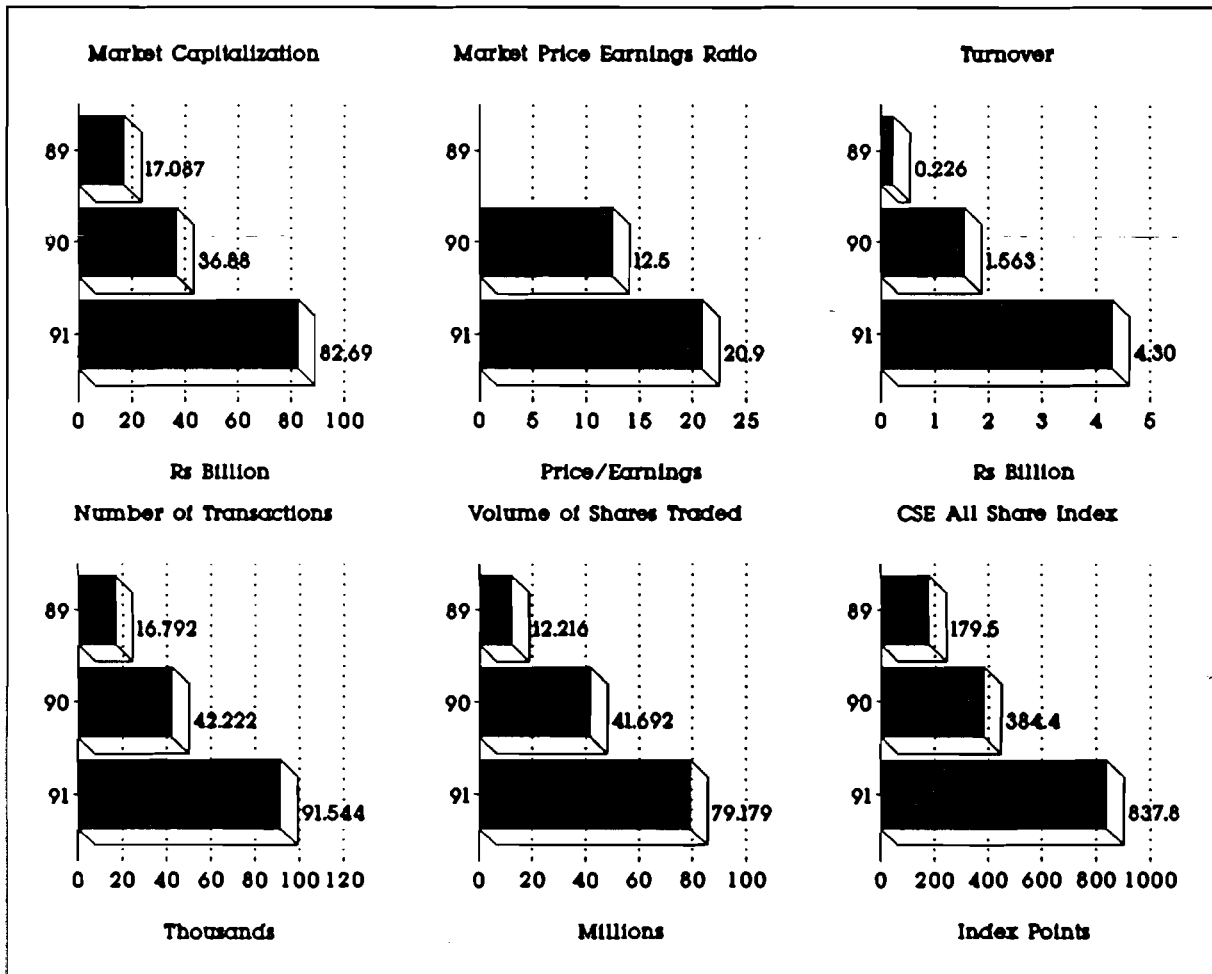


Figure 1: Colombo Stock Market Indicators, 1989 - 1991

3. Recent Market Performance

In the years 1990 and 1991, the CSE was the fastest growing stock market in the world. Figure 1 above presents key market indicators of the Colombo Stock Exchange and their movements during the project period. The growth in market capitalization, turnover, volume and the price index have been spectacular during these two years. The number of individual shareholders is estimated to have grown from around 18,000 to 60,000 by end 1991. These indicators demonstrate a robust market which appears sustainable at the current levels of activity, with potential for substantial further growth. The Securities Exchange and Stock Exchange are established and fully functional, awareness levels of quoted securities are high and the Central Depository System is functioning both profitably and with reasonable

68

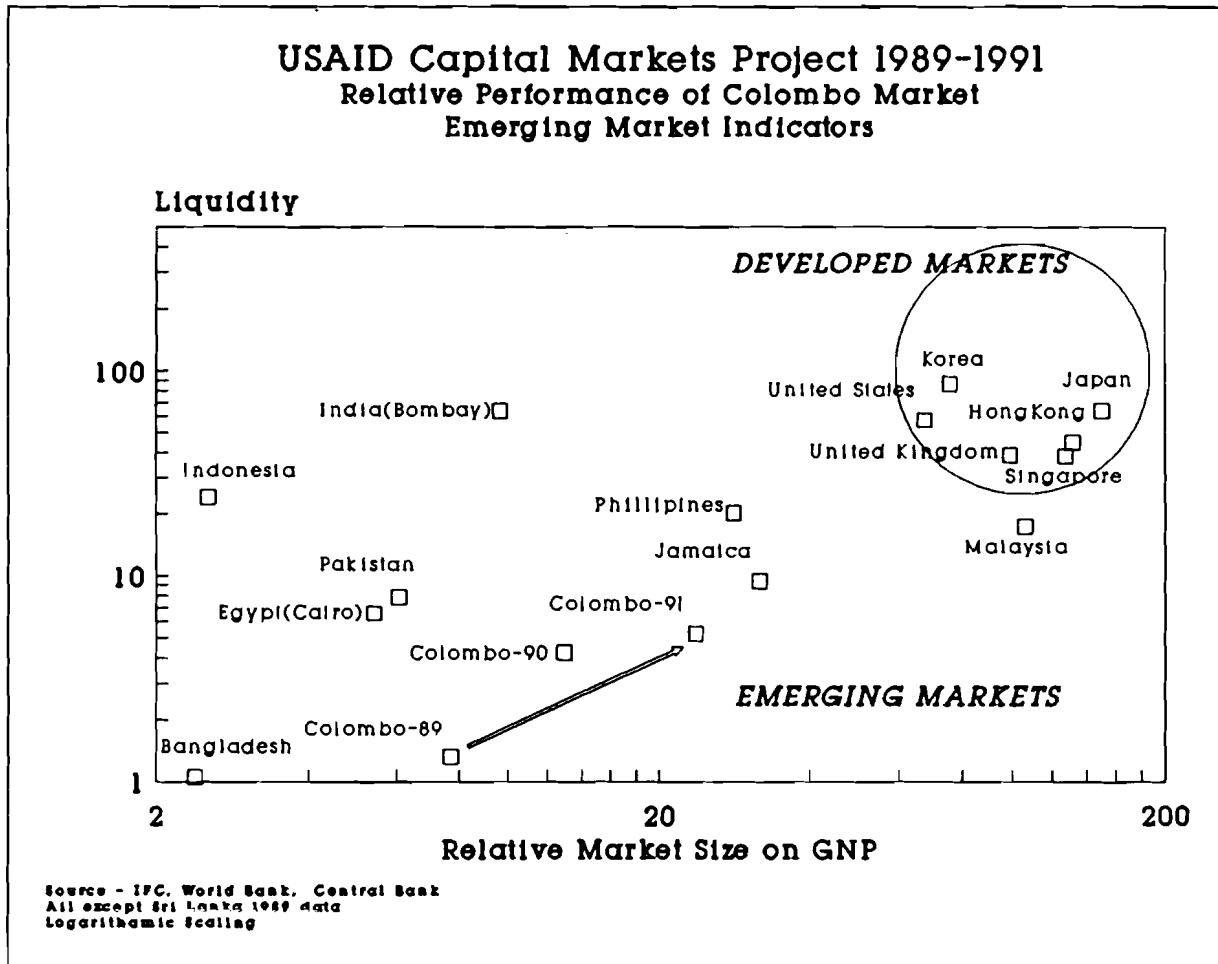


Figure 2: Relative Performance of the Colombo Market

success. However, success has brought the realization that the market can play a larger, more effective role in the economy, but this will require a greater degree of sophistication and reliability.

Figure 2 above indicates the movement of the Colombo market against two key variables that are indicative of the level of development of the market. One axis indicates the turnover in the market as a percentage of market capitalization and indicates a measure of liquidity -- or the ability of the investor to move in or out of a given investment position. The other axis measures the market capitalization as a percentage of the Gross National Product and is indicative of the size of the quoted securities market in relative terms. The outer circle is an arbitrary separation of developed and emerging securities markets. The progress of the Colombo market during

the project period has been most encouraging, and in independent evaluation

692

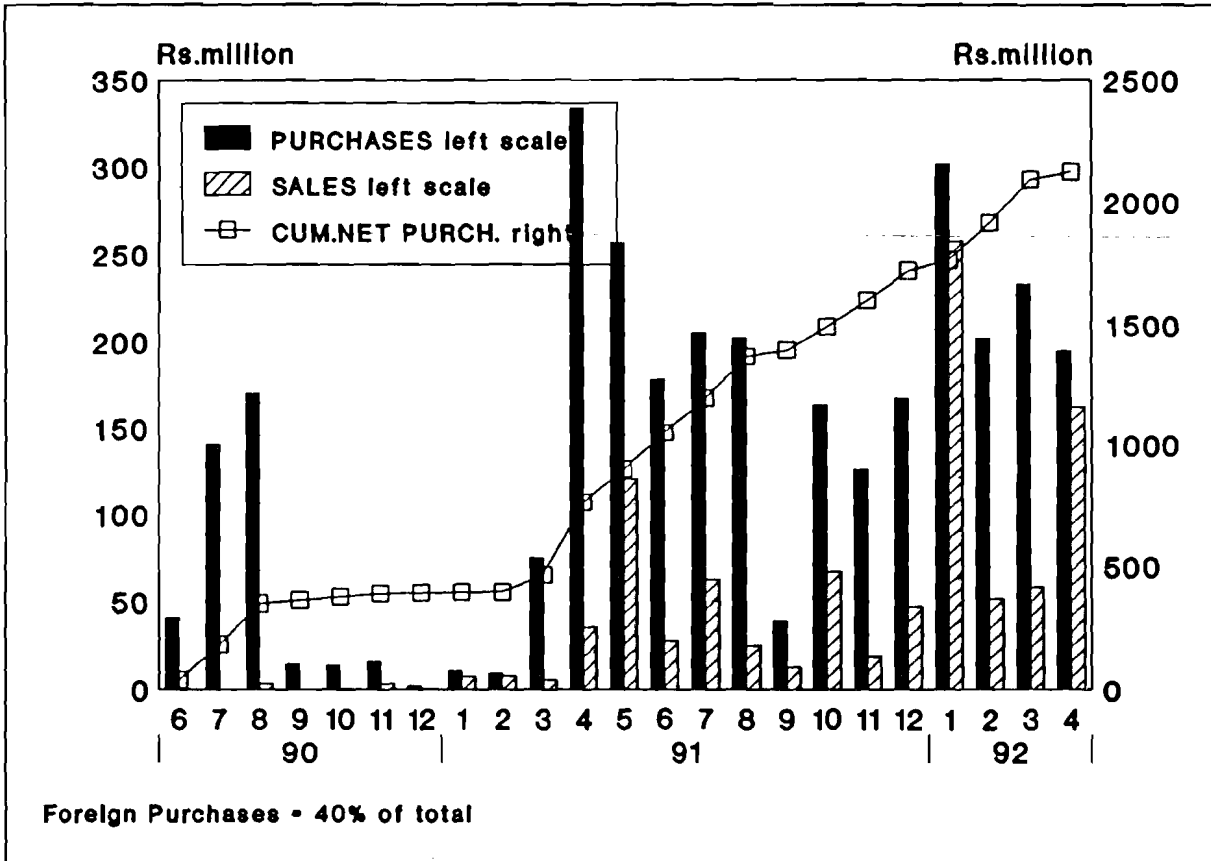


Figure 3: Foreign Investment through the CSE, April 1990 to April 1991

by Price Waterhouse has given USAID support high marks for effectiveness

While USAID has played an important role in the performance of the market over the last two years, several GSL decisions have been vital to the market's "takeoff". In June 1990, the GSL liberalized foreign portfolio investment by abolishing the 100 percent tax on share purchases by foreigners, subject to the limitation that their aggregate share holding not exceed 40 percent of the issued holding. This triggered an almost immediate surge in foreign interest in the market, which captured the attention of the CSE, the brokerage firms and the Sri Lankan investing public, and led to a rise in value of what had previously been undervalued shares. The GSL has also revised the capital gains tax on listed shares, abolished the advalorem stamp duty on shares, withdrawn the withholding

¹ Price Waterhouse: Evaluation of the Private Sector Policy Support (383-0100) Project, December 1991.

tax of 15 percent on dividends, and withdrawn the wealth tax on listed company shares.

The results to date of overseas investors can be seen by the accompanying figure 3, which shows net inflows of portfolio investment in excess of \$50 million.

C. Overview of Project Paper Supplement

Examples of successful capital market development, e.g. Korea and Taiwan, indicate that the process takes a long time. The three year capital market component of the PSPS project has been successful in assisting the GSL to put in place initial and critical factors necessary for a functioning market. However, as the market begins to play a more dominant role in the economic landscape of the country, it becomes necessary to build-on and follow-up these initial successes. The PP Supplement will provide approximately \$7 million in technical and financial assistance, to further develop the quoted securities market, over a period extended by 3 years.

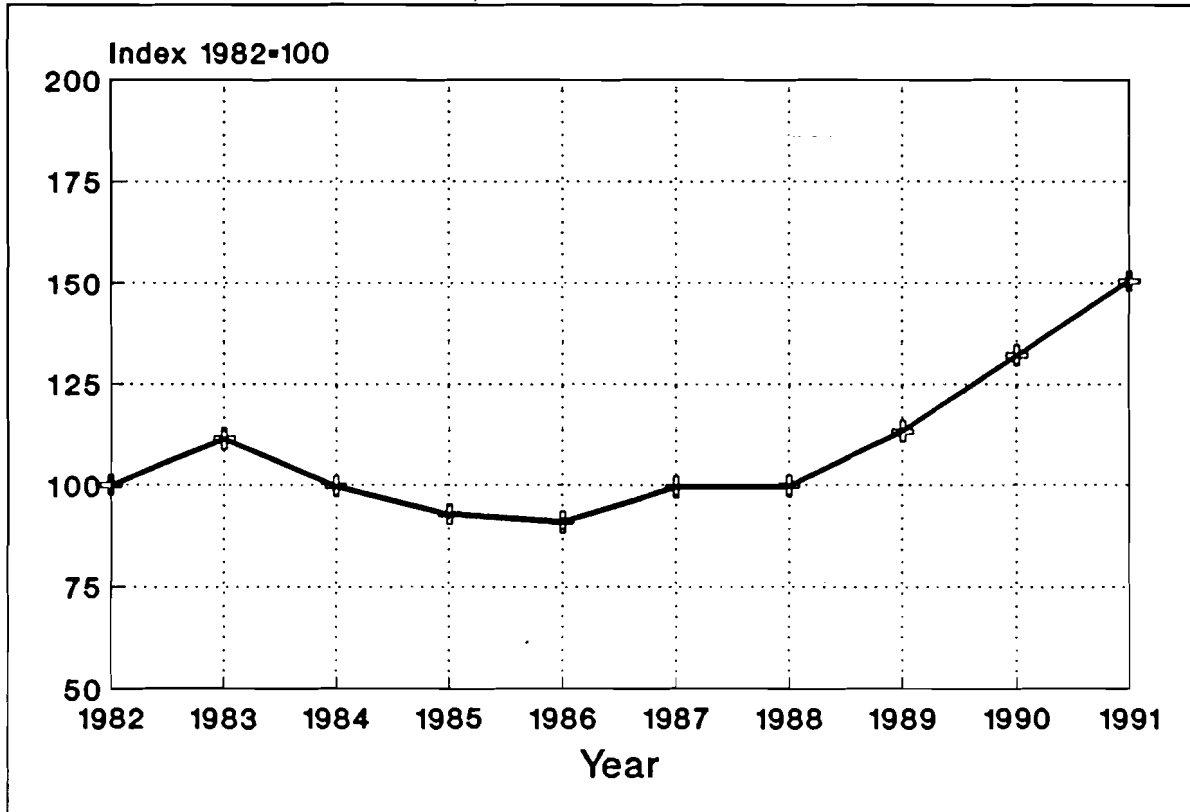


Figure 4: Private Sector Real Investment Index (1982 = 100)

7/1x

The project purpose is to further develop the capacity of the Sri Lankan capital market, to broaden public equity and debt participation in the economy, and increase capital resources for investment. This is expected to contribute to Sri Lanka's goal increased national employment and income through private sector investment. During the three years of project activities, private sector investment has dramatically increased from zero growth through the early and mid 1980s to more than 10% per year. (See figure 4 which illustrates the private sector real investment indexed with 1982 as the base year).

The lessons learned from our past PSPS Capital Markets intervention enables the Amended Project to productively focus its resources in strengthening, expanding, and sustaining Sri Lankan financial market growth. The objectives of the **Project Outputs** are to: (1) further expand the SEC, SL and CSE's capacity to serve a rapidly growing capital market; (2) increase the supply of quoted debt and equity securities; and (3) encourage new forms of financial intermediation in the market.

Several significant changes in the financial markets must occur in order to meet these three objectives. These changes are identified as **Project Outputs**. The Outputs necessary to meet the first objective include: a SEC surveillance unit that is staffed and trained; enhanced self-regulation capability at the CSE; improved company reporting and disclosure requirements with the; adoption of more stringent accounting and auditing standards; and improved ~~systems~~ reliability and capacity to handle a greater volume and broader range of transactions by the Central Depository System (CDS).

Outputs necessary to meet the second objective include: a second-tier market with lower costs of entry, maintenance, and less stringent regulations; a secondary market in Government Securities; and a market to trade long-term corporate debt.

These activities will encourage new forms of financial intermediation in the market which is the third objective. The new financial intermediaries will draw up on portfolio investment companies, insurance companies, retirement fund trusts, venture capital companies, and investment banks.

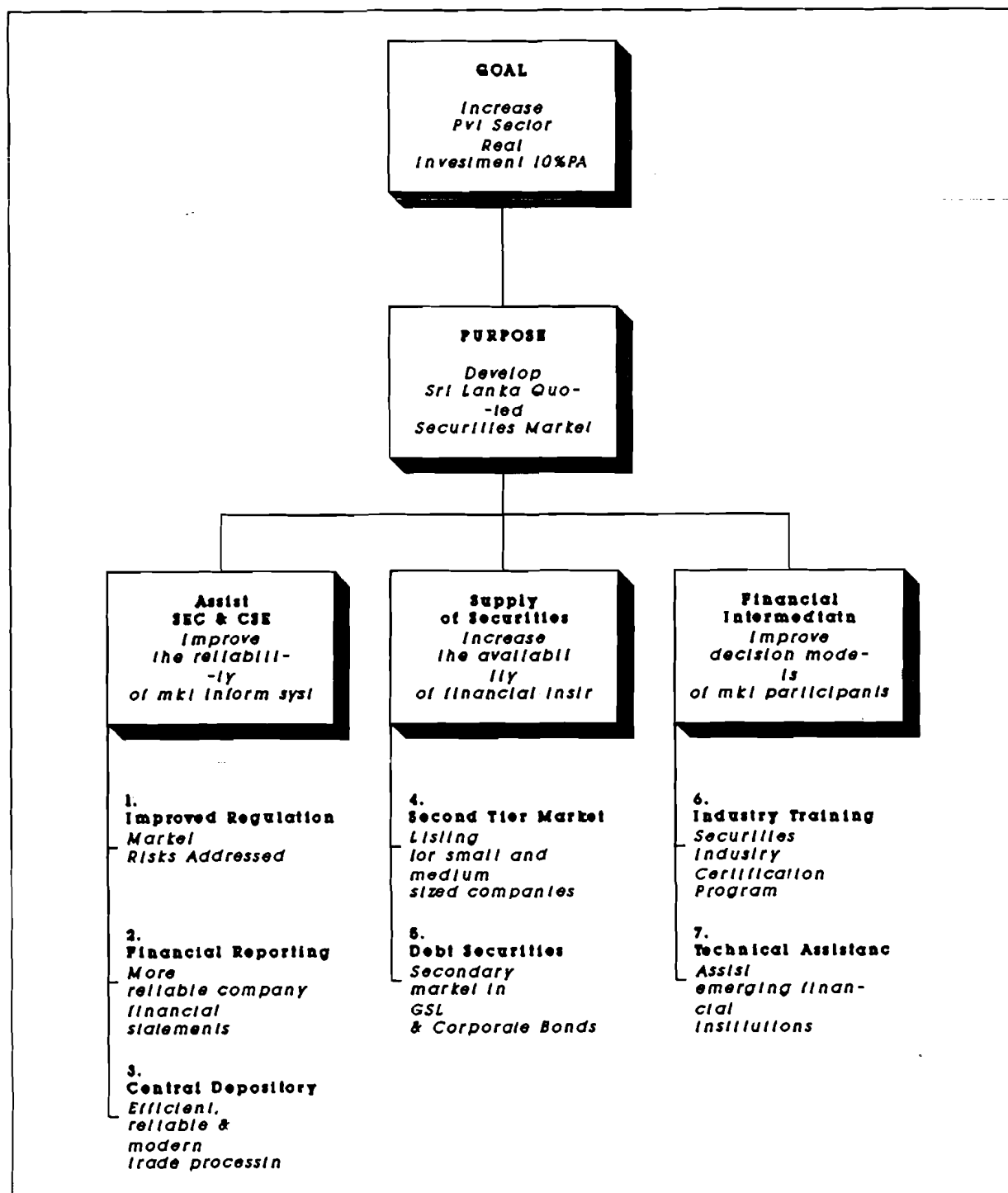


Figure 5: Structure of the Expanded Capital Markets Component

D. Technical Analysis of Project Elements

1. Sueveillance Unit and Self-Regulation

The Colombo market is regulated by the Securities and Exchange Commission of Sri Lanka (SEC, SL), the Governmental body tasked this responsibility by statute and, through self-regulations, the Colombo Stock Exchange (CSE), the institutions that directly manages the trading. Improved regulation is needed to address a number of imperfections in the present system, which have been identified and high lighted under the existing project, and through the Price Waterhouse evaluation.

The current Capital Markets component of the project provided significant assistance to both the SEC, SL and the CSE in regulatory issues. The long term advisors attached to these institutions were consulted on a variety of ad-hoc issues. Two reports by short-term consultants have mapped out in comprehensive detail specific courses of action for the implementation of regulation by the SEC, SL and self-regulation by the CSE². An Asian Development Bank (ADB) funded study has also addressed regulatory issues³. All three studies call for a significant strengthening of staff to fulfill SEC, SL's new regulatory obligations arising from a rapidly growing market. These include staff specialists for corporation finance, market regulation, investment trust management, enforcement, and accounting. Precise recommendations have been made for meeting risks posed by the levels of profitability of the brokers, regulation personnel, conflict of interest, capital adequacy, customer frauds, conditions of sale, credit extension and theft, and employee and agent fidelity. In addition the reports offer CSE a blueprint for action over the next several years.

Further support to these two institutions by USAID is justified on the basis of the costs of installation of a regulatory regime being an essential "infrastructure" cost that cannot, during this particular stage of market development, be readily recovered by users. The reduction in risks caused by USAID intervention will, over the medium term, assist in expanding the market size, thus enabling these costs to be fully met by user fees at the end of the project intervention.

² International Science and Technology Institute, Inc. (ISTI) "Improving Colombo Stock Exchange Regulation" supplemented by the book "Consolidated Sri Lanka Securities Regulation" by Robert M. Bishop and "The Role of the Securities Council in the Regulation of Market Intermediaries" by Estella Tang. 1990.

³ The Aries Group/Price Waterhouse, "A Study of the Regulation of Securities Markets in Sri Lanka, 1991.

**PSPS PP Supplement: Annex A
Technical Analysis of Project: Page 13**

Table 1: Budget for Regulation and Self Regulation

	Rate/unit	93	94	95	Total
Level of Effort - man months					
Regulation specialists - person months	\$27,422	9	3		12
Short term specialists - person months	\$20,297	2	4		6
Total		11	7	0	18
Overseas Study Tours - Average	\$12,000	4	4		8
Cost (\$ '000s)					
Technical Assistance		287	163		451
Study tours		48	48		96
Total Contract		335	211	0	547
Sub-total USAID		335	211	0	547
Sub-total GSL		500	536	600	1,636
Total		835	747	600	2,183
Appropriation					
PSEE		287	163	0	451
EHR		48	48	0	96

USAID will fund a long term Securities Market regulation specialist for a period of 12 months. His/her principal task will be to advise the Director General in implementing the recommendation arising from the Tang report. He/She will be located at the SEC, SL, and will also be required to assist the General Manager of the CSE in sequencing and implementing the Bishop recommendations as well as assist in on-the-job training of the regulatory personnel of the two institutions. In addition, six expatriate short term consultancies of one month each will be provided for specialized activities relating to regulation -- such as setting up a system of monitoring brokers capital adequacy and profits, and training the regulatory personnel.

The project will also finance eight overseas training tours by the regulatory personnel of the two institutions. Specifically, placement at the Securities and Exchange Commission (SEC) of the U.S. should be considered for a period of up-to one month, to familiarize the individuals with the variety of techniques and practices in a developed, modern market with a high degree of automation.

The long term specialist is expected to be in-country by January 1993. The short term specialists will be required in 1993 and 94, as will the study tours. Estimated fiscal year expenditure is presented in Table 1. The host country contribution will be in the form of incremental funding provided to the SEC, SL, which will be through a fee (known locally as a "cess") on traded securities now estimated at 0.3% of the value of the transaction.

At the end of the project, the SEC SL will be fully functional, staffed by trained personnel, effectively supervising a market that encompasses listed securities -- both in the main-board and a second-tier market -- including both equities and debt, and several new financial intermediaries such as unit trusts. The CSE will have an effective self-regulatory unit in-place, addressing a wide range of issues associated with a substantially expanded market.

In the past, the SEC SL has found it difficult to recruit staff to fill up its professional cadre. This was due to its inability to pay technical staff competitive salaries because of Governmental budgetary constraints and salary ceilings. However, GSL has recently approved recruitment of new staff outside the salary ceilings, and the SEC, SL is currently in the process of recruiting key staff members and reallocating operations. Additionally, GSL has approved in principle, the introduction of a user fee on turnover to fund its SEC, SL's operation. The project amendment will require the following conditions precedent: (a) prior to the mobilization of the Chief-of-Party, the legal and regulatory changes ~~required to effect the~~ user fee is approved by the GSL cabinet of ministers; and (b) certain key members of the SEC, SL staff are recruited and in place prior to any expenditure financed by this project.

2. Financial Reporting

Financial information is the primary tool of a securities market. Investors and analysts rely on financial information to make investment decisions. If the information is unavailable or unreliable the operation of the market is hampered. To the extent that inaccurate, missing or out-of-date information form the basis for investment decisions, there can be a mis-allocation of capital with consequent market inefficiencies. If such weaknesses are endemic to a particular market, it will reduce participation in the market-place given the consequent lack of an "objective" measure of company performance. Inaccurate or incomplete financial data can also contribute to insider trading and other abuses, further compromising market efficiency. The development of the capital market has created the need for better accounting information to improve the credibility and information content of published financial statements.

There is widespread evidence of the format and content of the financial reporting by the listed companies having limited use for market participants. A recent study by the World Bank spoke of late, unreliable and non-existent financial statements, unqualified accountants and lack of enforcement as the most important problems affecting the securities industry. Subsequent to the study, the Institute of Chartered Accountants of Sri Lanka (ICASL) was assisted by the World Bank to update the Accounting Standards and to bring them in line with the current developments in the International Accounting Standards (IAS). This is a ~~useful first step in improving~~ the information flow to the investor, and these efforts need to be assisted to facilitate the development of a vibrant capital market.

The Price Waterhouse evaluation recommended that USAID work with listed companies in order to get them to move towards using internationally accepted accounting standards. USAID will, through this amendment, provide assistance for reforms in financial reporting that are market driven (ie. through the CSE, and the SEC, SL). These reforms can be broadly classified into three areas; setting standards, implementing of standards, and monitoring compliance with the standards.

Setting standards: The Institute of Chartered Accountants of Sri Lanka (ICASL) issues accounting standards which govern the presentation of the financial statements and the auditing guidelines which govern the field work of the auditor. Three institutions have interests in the setting of standards. The CSE which will reflect the needs of the capital market, the SEC, SL which will overlook the operations of the market and the ICASL which will be responsible for developing, adopting and implementing the standards.

Standards setting will involve developing the following: (a) a mechanism where ICASL will have dialogue with the SEC, SL and CSE in order to respond to their needs; (b) a system whereby there is continuous development and update of accounting and auditing standards including formats for specific sectors; (c) linkages with the IFAC and the IAS to keep in touch with worldwide developments; and (d) a mechanism to encourage research into standards and their usage. This can be achieved through a system of grants to research organizations that have an accounting specialty such as the Universities.

Implementing Standards: The recent adoption of the IAS and the increasing public scrutiny of the professional standards maintained by auditors of quoted companies would require the Institute to undertake a program of education of students, members and the public. Standard implementation will involve: (a) developing case study based materials for post qualifying education (PQE) seminars on standards; (b) developing training modules for students; (c) developing objective methods of examination setting and systems of periodic review of syllabus; (d) development of financial markets audit methodology; and (e) a public education series on the role of the auditor.

Monitoring Compliance: Failure to adopt the standards set by the ICASL have been due to the lack of legislative authority for the standards, ICASL's failure to introduce sanctions on members for non-compliance and the lack of policing to monitor observance of the standards. While the SEC listing rules require compliance with accounting standards, it does not have the capacity to monitor compliance with this requirement. The company law reform committee is presently considering legislation for granting legal status to accounting and auditing standards issued by the ICASL. The amendments to the Institute of Chartered Accountants Act to empower ICASL to enforce technical standards on members is also under consideration. The Institute therefore needs to establish a compliance unit which will serve as an advisory body on the adoption of standards. It is anticipated that the unit will be funded through user fees, including transfers from the SEC, SL.

The Financial Institutions study (1991) conducted by the World Bank and the draft reports resulting from TA funded by UNDP recommended several far reaching changes for the ICASL. It is therefore necessary that the Institute examine the role it has to take in the context of its many stakeholder and interest groups, and chart its course over the next several years to best fulfill its functions. The Institute recognizes its responsibility in generating investor confidence and improving the standards of training. USAID will be providing assistance to develop a strategic plan for the

PSPS PP Supplement: Annex A
Technical Analysis of Project: Page 17

Institute and for developmental activities in the areas of standards setting, implementing and monitoring for a period of 2 years which will thereafter be funded through the revenues of the Institute. Assistance is anticipated to include two years of funding for research on accounting standards, 12 months of technical assistance for installing the grants mechanism, developing a research agenda driven by the market needs for information, developing syllabus, examination methodology, training modules and materials for seminars and public information, and two two month consultancies for developing a compliance and monitoring unit and advisory service. The institute will contribute a minimum of 10% of the costs, including volunteer time of the members and staffing and administrative costs. The training will be coordinated by the long-term training specialist (See Section 6) provided under the project.

Table 2 Budget for Financial Reporting

	Rate/unit	93	94	95	Total
Level of Effort - man months					
Accounting Standards Specialist	29,082	6	6		12
Compliance/monitoring Specialist	20,297	2	2		4
Strategic Planning Specialist	20,297	2			2
Total		8	8	0	16
Cost (\$ '000s)					
Technical Assistance		256	215	0	471
Seminars/dissemination			30	30	60
Public awareness on auditors role			50		50
Total Contract		256	295	30	581
Grant to ICA,SL		60	40	30	130
Sub-total USAID		316	335	60	711
Sub-total Private Sector		32	34	6	71
Total		347	369	66	782
Appropriation					
PSEE		153	129	0	282
EHR		162	206	60	428

79x

Table 2 presents the phasing and costs of inputs, by fiscal year. The Technical Assistance specialist is expected to be in country by April 1993. The short-term tours are expected to be in June 1993 with a repeat visit in January 1994. The seminars and other dissemination activities are expected to be completed during January to June 1994. A separate Cooperative Agreement will be entered with ICASL to enable it to make sub-grants to researchers. This will be done by April 1993, and is expected to expend evenly over a two year period. There will also be a provision for certain office equipment that will be funded under the technical assistance contract, which will revert to the ICASL at the end of the project.

At the end of the project, ICASL will have the capacity to respond to the needs of the market, as anticipated by the SEC, SL and CSE, for improved financial reporting. It will have developed linkages with the research community, have established a small core-staff of specialists to overlook the standard setting, monitoring and compliance unit. The existing members of ICASL will have been exposed to the new standards, and the private accounting training institute will have enhanced tools for the teaching of accounting and auditing standards to students.

As a pre-condition for support, USAID will require the ICASL to set in place within the Institute the formal administrative structure to co-ordinate the standard setting and implementation process, including managing the sub-grant program, training and monitoring. This will require ICASL nominating a full-time staff person with the appropriate qualifications ~~to be the overall~~ administrator for this activity. In addition, ICASL has agreed to provide the office space and administrative support for the long term specialist.

3. Central Depository System (CDS) and Post Trade Automation System (PTA)

One of the key activities of the capital markets component of the PSPS project was to provide the CSE with a computer system to handle post-trade automation which included a computer based central depository. The system is designed to record bids and offers off the trading floor, and to provide both the market participants (including those at remote terminals) and the market regulators (both at the SEC, SL and the CSE) access to real-time information. The system also provides contract documentation subsequent to the completion of the trades, generates market reports for monitoring and for the public, and maintains a central depository system (CDS) which facilitates paper-less trading. With the increase in both the number of transactions and the volume of shares traded in the Exchange by a factor of six during the project period, the introduction of automation was

timely, with the market being able to process trades without systems breakdown.

The demand for automation has surged far in excess of the relatively modest growth that was anticipated during the design of the PSPS project. Not only has trading activity grown substantially but, other ancillary activities that determine system requirements -- such as the number of brokers and other users including investment companies that rely on the system -- have grown as well. Consequently, the degree of reliance placed by the market on the PTA/CDS has increased well beyond the that originally envisioned. This has resulted in some concern regarding possible system failure.

The Price Waterhouse evaluation team identified this risk and recommended that USAID consider further assistance to the PTA/CDS to ensure that the very significant achievements made to date are effectively protected and further developed. Specifically, they proposed that an independent back up processor -- which is both offsite, and under the control of the CSE -- be provided to that organization. A senior systems analyst representing one of the world's leading market information systems, subsequently reviewed the PTA/CDS and made similar recommendations⁴.

Further enhancing the PTA/CDS provides other opportunities for the development of the financial market that was not contemplated during the design of the original project. For example, investment in an on-line, backup processor and the consequent improvement in systems reliability will enable the linking of the brokers and broker/dealers in a second-tier market, and also link dealers in Government Treasury bills. These linkages will both improve the market's ability to process information and enable speedy execution of trades. Additionally, the synergies inherent in linking these different markets will result in improvement in market efficiencies and, over the medium term, increase competition to ensure a reduction in intermediation costs. The CDS will provide a collective "storage" facility; offer composite software modules which will enable order-taking and recording of trades; enable financial intermediaries to operate simultaneously in several of these markets; and provide customers with the option of switching between alternate securities with only a modest effort.

Unifying the information system with all major institutions linked to a common database may also provide significant market efficiencies over the long run. The PTA/CDS system has the potential to keep adding other financial "products" to its range. For example, all initial public offerings

⁴ William Gorman, Quotron Corp.;

(IPOs) may be computerized in the first instance, thus eliminating the need for duplication of entry when the securities are traded in the secondary market; the CDS can act as an electronic "share-register", further reducing costs of intermediation; brokers may be served by common computer systems for processing customer accounts, a data base for securities analysis, a mailing facility etc.; the trading floor itself may be eliminated with all transactions being carried out at the brokers office through remote terminals, thereby further reducing broker costs; options and derivatives may be facilitated and marketed through the system, enhancing the stability of the market; and foreign exchange options may be "listed" in the CDS, improving predictability and facilitating the reduction of risk in export/import institutions and sectors. Each of these innovations will require relatively little investment once a stable, reliable system is in place.

Further USAID investment is also justified on the basis of the inability of the CSE, at current levels of operation, to obtain reasonable financial returns on the expenditures required for improving systems reliability through increasing system redundancy. While the enhanced system will have a significant potential to benefit the entire financial markets community, the costs of such a system will be borne by a relatively narrow segment of the market-- those existing players of the Colombo Stock Exchange -- at least in the short term. As such, USAID intervention to assist the CSE is both appropriate and justified.

USAID will finance proprietary computer ~~equipment totalling \$450,000 in~~ value. The system is expected to have approximately 130 on-line terminals by end-December 1993, which is an increase of approximately 100 terminals over its current usage. The proposed back up system also caters to the expansion planned over the period of the project in terms of memory, storage, back-up, printing capacity and terminal connectivity. It will provide additional hardware/data redundancy for CSE by almost duplicating all the hardware at different locations. The project will also provide an additional communications processor for both improved network management and the ability to attach the terminal network to either existing or back-up system (or a vendor back-up machine) if either of the two PTA/CDS modules fail. This will be achieved without any disruption in trading. These elements, and the users, will be connected together by using leased lines and the public data network, which will also enable low-cost international connectivity.

**PSPS PP Supplement: Annex A
Technical Analysis of Project: Page 21**

Table 3: Budget for Post Trade Automation/Central Depository System

	Rate/unit	93	94	95	Total
Level of Effort - man months					
Senior DP Consultant	9,000	9	12	3	24
Systems Audit	20,297	1	2		3
Product Investigation	20,297			3	3
Total		10	14	6	30
Overseas Study Tours	12,000	2	2		4
Cost (\$ '000s)					
Technical Assistance		101	149	88	338
Overseas Study Tours		24	24	0	48
IRM Evaluation		7			7
Equipment - GSA		450			450
Sub-total USAID		582	173	88	843
Sub-total GSL		100	25	25	150
Total		682	198	113	993
Appropriation					
PSEE		558	149	88	795
EHR		24	24	0	48

USAID will also provide a further 24 month consultancy in systems management, to ensure smooth development during this critical period of systems expansion and operation. The individual is expected to be a senior host country Data Processing (DP) consultant with international experience in systems hardware and computer operations in a large network environment. The individual will be responsible for initially installing and operating the back-up system, and coordinating systems development in the implementation of the second-tier market and the Government debt securities markets link to the PTA/CDS. In addition he/she will advise the CSE on the staff requirements and training needs of the system personnel. three tours of one month each of expatriate short term consultancy is planned to review the overall system including system audit. A further three tours of one month each are anticipated to investigate alternative "products" to be launched by the PTA/CDS. The project will also provide for a 2 week review by AID Information Resource Management (IRM) division, who will review and approve the procurement.

PSPS PP Supplement: Annex A
Technical Analysis of Project: Page 22

USAID will also fund approximately four overseas study tours by the CSE systems personnel. Specific content of training will be defined by the Senior DP Consultant in implementation, but will include exposure to management of large real-time on-line, data networks overseas.

USAID will need to purchase UNISYS proprietary equipment that complements CSE and the financial market community's existing investment in hardware and software. As such, it will attempt to use the GSA contract which is pre-competed. In this case, CSE will enter into an extension of the existing maintenance agreement with the vendor, who is an agent of UNISYS. Host country contributions to the project are expected to be approximately \$150,000 and will include costs of terminals by users, cost of premises and preparation of the back-up site, and present value costs of maintenance over a five year period. CSE has undertaken to provide these resources. The equipment is expected to be in-situ by May 1993 and operational in June of that year.

The Senior DP Consultant will start his term in January 1993. The short term review tours are phased at the end of the initial installation (August 93) during the pilot phase of the second tier market and automation of the Government Treasury Bill dealers (May 94) and once the systems are fully operational (September 94). Short term consultancies to investigate new "products" are planned for at the end of the initial development period (October 94, to April 95). USAID/IRM personnel will visit the country in February 1993 and will be funded independently of the technical assistance contract. The study tours will be phased evenly in 1993 and 1994.

USAID has reviewed the published financial statements of the CSE, and has determined that the CDS is financially sustainable. The additional activities to improve systems reliability will result in incremental costs, over and above the capital costs of equipment and costs of installation met by the project. These will include the costs of maintenance, personnel and other operational costs. Due to the increase in activities forecasted for the exchange over the project period, and consequently the increase in revenues, the financial viability of the CDS is not expected to be impaired due to these incremental costs.

In order to monitor this critical aspect of the project more carefully, USAID has requested, and CSE has agreed to invite a USAID representative to attend all board meetings of the Central Depository Company (a fully owned subsidiary of the CSE) which manages the PTA/CDS system. USAID project management will thus be fully informed of potentially problematic areas, and also serve in a more pro-active agent of change. This will be a condition

precedent in the Project Grant Amendment to further procurement of hardware in the PTA/CDS system.

At the end of the project, CSE will have a more reliable PTA/CDS system, with better response time, less down time and a reduced error rate. The system will be poised to offer new information services to the market, and the staff will be adequately trained to manage the system. CDS will be continue as a financially viable going-concern.

4. Development of a Second-Tier Market

One aspect of the market that has lagged behind the general trend of development of the Colombo Stock Market is the listing of new companies. For example, the number of companies listed on the main board in 1988 (at the beginning of the project period) was 177. By January 1992, despite the booming market conditions the number was only 179. While there is some evidence that the companies already listed have made use of the boom market conditions to increase their capital through rights issues, there have been few initial public offerings (IPOs). Of the seven IPOs during the period, four have been due to privatization. Apparently, there are system constraints to private sector companies using the Colombo Stock Exchange to increase their equity base. The lack of securities has resulted in several obstacles in developing the capital market. Liquidity levels -- although improving -- is still very low, even by emerging market standards, and the market price to earnings ratio is, given the other macro-economic indicators, unreasonably high according to several knowledgeable observers. Table 4 provides information on the supply of securities to the Colombo Stock Exchange (CSE) during the project period and the market liquidity rate.

Table 4 - Flow of New Securities to the Colombo Stock Exchange 1988-91

	1988	1989	1990	1991
Total No. of Companies Listed	176	176	175	180
New Listings	8	1	1	5
(Of which privatization issues)	0	1	0	3
Delistings	0	2	2	0
Price to Earnings Ratio	N/A	N/A	12.5	20.9
Funds raised by new issues Rs Mil	80	50	9	238
Funds raised by privatization Rs Mil	0	90	0	1,214
Funds raised by rights issues Rs Mil	339	91	303 ⁶	543
Total raised in share offerings	419	231	312	1,995
Liquidity (Turnover/Market Capital)	2.4%	1.3% ⁵	4.2	5.3%

A survey of forty Companies on their attitudes towards going public was conducted by the technical assistance contractors under the existing project⁷. The surveyed companies included companies both listed in the Exchange already, as well as those with potential of going public. The survey concluded that the benefits -- such as ability to support growth, access to capital and liquidity for the shareholders -- were widely recognized. However, the survey identified that the costs of market entry was relatively too high, especially for smaller companies. The costs of maintenance of the quoted status, due to disclosure requirements that result in an additional cost burden to the company, and costs of printing and despatching annual reports were also considered by some to be excessive.

⁵ The drop in 1989 is explained by the civil commotion during most of that year when the market was not only inactive, but at times, physically closed down.

⁶ This excludes approximately Rs. 821 Million in a debt/equity swap for Trans Asia Hotels Ltd. The company, who had a large debt owing to its parent, converted some of the debt to equity to remain solvent.

⁷ Ernst and Young, Sri Lanka: "Survey of Issues Attitudes to Going Public", November 1991

There are no clear guidelines nor policies denoting which qualify for companies listing on the CSE board. To a certain extent, rules have evolved with experience. However, given the closer scrutiny to which the market is subject to due to its newly gained prominence in the economic life of the country, and the increasing levels of participation by foreign investors in the market place, entry will continue to become relatively more restricted. Similarly, with increasing pressure from the investing public, the disclosure requirements will become more exacting, in terms of the degree and the frequency of disclosure. Both of these areas will be further facilitated by the project amendment through tighter regulation and by activities to improve financial reporting. The impact of these changes will be to increase the costs of entry and the costs of compliance, thus effectively shutting out the medium sized business from accessing the quoted market for capital. Consequently, these companies may become constrained in their growth, or become dangerously over leveraged.

A similar problem is faced by EQUILL, the USAID assisted pioneer venture capital company, and other portfolio investors -- such as the Development Finance Corporation of Sri Lanka (DFCC) and the Capital Development Investment Company (CDIC) -- who take up minority positions in medium sized companies. The investee companies are reluctant to be listed on the CSE due to the associated high costs, and consequently the portfolio investor is locked into their position. With the introduction of several new venture capital companies, the limitations posed by exit mechanisms may become a major constraint in suitably developing this form of financial intermediation.

The Price Waterhouse Evaluation makes several recommendations regarding the increase in the supply of shares. These include continuation of support to the privatization program under the existing project, skill development, listing of government securities, and policy studies, all of which are dealt with in the other element of the project amendment. Under Section C.2 (page 33) Price Waterhouse recommends that ". . . the CSE should develop into a self regulatory organization and plans should be continued for setting up a second-tier exchange once the SEC structure is in place".

The development of a second-tier market will effectively facilitate several reforms in the stock market. The key objective is to reduce the costs of entry and maintenance in the quoted securities market for medium sized companies thereby increasing the supply of securities. Table 5 presents a summary of the current requirements by the CSE, planned requirements in the medium term, and possible requirements for a second-tier market.

Table 5: Comparative Summary of CSE Requirements with Probable 2nd Tier

Criterion	Current Practice	Anticipated Practice	Possible 2nd Tier Practice
Economic size of offering	Rs 5 Million	Rs 25 Million	Rs 5 Million
Profit Record of Company	None - on a case by case basis	Minimum of a three year profit record	None
Number of Shareholders	None	Minimum of 300	No restrictions
Financial Reporting	Half Yearly to every shareholder - with detailed disclosure	Quarterly to every shareholder - with detailed disclosure	Annual Report to be filed as a public document and disclosure less detail
Market Entry	Full Prospectus and formal advertising	Full prospectus with greater detail, and formal advertising	Limited prospectus and offered through dealers

USAID assistance will be provided to the CSE to establish this second-tier market. In implementation, it will initially be set-up as an over-the-counter market using brokers and broker/dealers. There will be no trading floor and the participants will communicate using telephones, faxes etc.

Subsequently, the project will provide assistance to enhance the capacity of the existing PTA/CDS (See Section 3) to link the brokers and broker/dealers to facilitate electronic trading. This development is expected to significantly reduce the costs of financial intermediation, and facilitate efficient trading.

The project amendment will provide the CSE approximately 18 man-months of expatriate technical assistance to develop a second-tier market. This will be through the provision of a long term expatriate consultant for 14 months. During the initial two short term tours of one month each, he/she will be responsible for the initial definition of the entry regulations for both the main-board and the second-tier market, detailed feasibility and operational guidelines of the second-tier market, financial and other entry criteria for brokers and broker/dealers, and amendment to the restrictive provision in the Act against dual broker/dealer functions. Obtaining institutional acceptance and implementation of an over-the-counter system, supervision of the development of an electronic trading system, and its implementation will be managed subsequently during the long-term tour of 12 months. The Consultant will also bear primary responsibility for the definition and management of broker and broker/dealer training, training of the

counterparts in the CSE and the SEC,SL who will supervise the system, and the guidance of the institutional players through initial flotations of companies in the market.

Table 6: Budget for the Development of a Second-Tier Market

	Rate/unit	93	94	95	Total
Level of Effort - man months					
Second-tier market Specialist	27,422	6	6		12
Expatriate Short Term Trainers	20,297	4	2		6
Preperation of companies	4,000	20	20		40
Total		30	28	0	58
Overseas Training	12,000	4	4		8
Cost (\$ '000s)					
Technical Assistance		326	285	0	611
Program coding		40			40
Training Seminars		50	50		100
Total Contract		416	335	0	751
Sub-total USAID		416	335	0	751
Sub-total Private Sector		19	19	19	56
Total		434	354	19	807
Appropriation					
SDA		366	285	0	651
EHR		50	50	0	100

The project will also provide a further 4 man-months of short-term technical assistance to accomplish specialized tasks, such as information systems design of the electronic trading system. 40 months technical assistance by host country professionals will be provided in the field of accounting, valuations, legal assistance etc. to successfully launch the initial 20 companies in the market. In addition, the project will provide funding for the program coding of the CDS and a series of in-country training programs for the brokers and broker/dealers, and short-term overseas placement in U.S. institution for both the players and the regulators. The latter will include training in a broad range of activities, from marketing the concept among target companies and institutions to actual dealing and trading in the electronic marketplace.

Estimated fiscal year expenditure, based on the anticipated work plan beginning in November 1992 is presented in Table 6. The long-term consultant is expected to have in operation an over-the counter market by September 1993, by which time the initial training efforts will be completed and the coding of the programs should begin. A second round of training is expected around May 1994, by which time the coding of the program and the pilot is expected to be completed.

At the end of the project period, a second tier market will be established and functioning using electronic trading. Financial intermediaries will be working together with companies to access the market for capital. Venture capital companies will be exiting investments using the second-tier market. There will be an increase in the supply of available securities.

5. Development of a Market for Quoted Debt Securities

The Colombo market has only one debt instrument listed on its Stock Exchange. The lack of long term debt instruments causes several problems in a financial market, especially one dominated by two large, relatively inefficient state banks who between them control over 75% of the deposit base in the commercial banking sector. First, the non-deposit taking financial intermediaries, like leasing and finance companies, have to either borrow short for their term lending, or pay higher intermediation costs to the Commercial Bank, consequently increasing risks of mismatch in funding, and costs. Second, industry does not have access to long term capital (other than funds available under a variety of re-finance schemes) and may be discouraged or incur avoidable risks in long-term capital investment. Third, the institutional investors, and the shareholding public do not have recourse to a critical financial instrument in building their portfolios. Finally, the Government management of the money supply through the use of Treasury Bills become possible only by radical variations in interest rates, which result in both relatively higher and unusually volatile short term interest rates.

This problem has been a critical one for domestic entrepreneurs in privatization transactions. In one instance the MBSL developed a debenture issue to be privately placed among the financial institutions, programmed to be listed at a later date. Even then, they had considerable trouble in determining an offer rate, given the lack of an appropriate bench-mark to set price. With this background, it seems unlikely that a corporate debt instrument, which is vital in developing an efficient quoted securities market, could be developed over the medium term without some form of intervention.

GSL has taken an initial step in developing a secondary market in Government Treasury Bills by appointing primary dealers who could then trade among themselves and the public, thus establishing a secondary market in these securities with maturities of upto 1 year. The development of an efficient after market in Treasury Bills will result in the GSL being encouraged to use this market to channel funds from the very large captive institutions, (such as the retirement funds like Employees Provident Fund (EPF) and Employees Trust Fund (ETF), and the National Savings Bank (NSB) and thereby to establish a market-driven short term interest rate structure. It will also be the first step in creating a secondary market for the longer term (that is beyond 1 year) Government securities. Once these are accomplished, the market will be in a position to absorb Corporate debt issues.

The project will provide assistance to strengthen the secondary market in Treasury Bills now being created by the Government. Essentially, the project will exploit the synergies created by the further developments in the PTA/CDS system (described in section 3) and the automation of the second-tier market (described in section 4). The provision of the network to improve information flow among the dealers, other financial intermediaries and the public, and the provision of a Central Depository facility is expected to improve efficiencies in trading, reduce intermediation costs, and over the medium term, provide information to the GSL to further refine a tool of monetary policy.

The project will finance two tours by an expatriate short term consultant. The first, a visit of three months will enable the consultant to develop the feasibility and operational guidelines for the bond trading system, to obtain institutional acceptance for the program and to coordinate his/her proposal with the project activity of developing a second-tier market. This is programmed for July 1993. A common software module is anticipated to be used for both these activities with relatively minor modifications. The second visit of three months beginning in March 1994 will enable the consultant to implement the system and to arrange training of the dealers in March 1994.

The project will also provide funding for two in-country training seminars in bond trading with approximately 15 participants each. There are several commercially available programs used to train bond dealers, and the contractor is expected to use one of these. This is programmed for May 1994 and May 1995. Related short courses will also be provided for portfolio investors to utilize bonds as a part of their portfolio. This is programmed for August 1994. Additionally, the project will finance

917

overseas tours funded for the Central Bank officials in the divisions of public debt and open market operations to observe regulation and oversight activity in a developed market which utilizes electronic trading. A display terminal will be provided for the Central Bank officials to observe market performance on a real-time basis. Estimated fiscal year expenditure for the component of the project is presented in Table 7.

Table 7: Budget for the Development of a Market for Quoted Debt Securities

	Rate/unit	93	94	95	Total
Level of Effort - man months					
Bond Trading Syst Specialist	20,297	3	3		6
Systems Audit	20,297	1	2		3
Total		4	5	0	9
Overseas Study Tours	12,000	2			2
Cost (\$ '000s)					
Technical Assistance Contract		81	101	0	183
Overseas Study Tours		24	0	0	24
Training Seminars		50	50		100
Software Amendments			40		40
Contract Total		155	191	0	347
Sub-total USAID		155	191	0	347
Total		155	191	0	347
Appropriation					
SDA		81	141	0	223
EHR		74	50	0	124

With the establishment of effective secondary market, the program objective of issuing longer term government securities will be taken up as a part of the policy dialog (described in section 8). The introduction of corporate bonds is then expected to be market driven and occur as a part of the project activity of assisting the emerging financial institutions (described in section 7).

At the end of the project a secondary market in government securities will be established and functioning with participation by both the general public and institutions. Several corporate debentures will be quoted in the market.

6. Industry Training: Certification of Securities Markets Professionals

With the rapid growth of the market in recent years, the lack of skilled professionals in corporate finance is increasingly a constraint in the development of the Colombo market. For example, until recently there was little or no analytical services provided by brokers to their clients. Lately, some larger brokers have attempted to remedy this situation, but they are hampered due to the lack of trained personnel. USAID's experience in privatization during the 1989-91 period indicated that the market did not fully appreciate the earnings basis of valuation -- the foundation for securities analysis -- with the valuers relying heavily on both revaluations or net assets basis. While the accounting profession is strong and well entrenched, there is less appreciation of corporate finance skills. The latter is essential for companies wishing to utilize the opportunities provided in a rapidly developing quoted securities market. This is considered to be a critical factor that has resulted in companies being slow to exploit the buoyant market experienced in 1991, which has resulted in a shortage of the supply of securities (See Section 4).

Currently the market lacks any form of certification. For example, there is no investor advisor act to discourage unqualified persons from giving advice, thus protecting investors from potentially poor counsel. Brokers do not require any formal training. The lack of certification may be viewed as an additional market risk that could be diminished through project intervention.

The Price Waterhouse team recognized the need for professional investment skills to maintain the long term development of the capital market. They identified the Chartered Financial Analysts (CFA) program -- a widely recognized professional certification originating in the U.S. -- as an appropriate, cost effective program to promote much needed investment research and management skills.

The Institute of Chartered Financial Analysts (ICFA) is an autonomous professional self-regulatory organization based in Virginia. Their program is aimed at training securities analysts and portfolio managers in both brokerage firms and institutional investors. The CFA designation focuses on equity, fixed income securities analysis and portfolio management. It involves three years of self directed study, with one examination per year. The CFA designation is a widely known credential in the investment research and management field. Introduction of the CFA program will meet a vital need in the market, and result in the popularization and acceptance of a U.S. certification program.

PSPS PP Supplement: Annex A
Technical Analysis of Project: Page 32

USAID will sponsor a batch of 45 students for the CFA program during the initial two years of the project, totalling 90 students over the remainder of the project life. These students will be nominated by the various financial institutions, which ensure on-the-job training of the candidates. USAID will meet the costs of registration, fees, examinations and books totalling approximately \$2,500 per person on a cost sharing basis. Students will be sponsored by the brokers, portfolio investors and other financial institutions, and these host country institutions will meet 25% of the costs of the program. In addition USAID will meet the promotional costs of introducing the CFA program to Sri Lanka, and meet one time costs of reference material that will be presented to the Securities and Exchange Commission's library for use by the candidates and others in the industry.

Table 8: Budget for Certification of Securities Markets Professionals

	Rate/unit	93	94	95	Total
Level of Effort - man months					
Long Term Trainer	26,409	11	12	9	32
Expatriate Short Term Trainers	20,297	4	4	4	12
Local Short Term Trainers	4,000	8	8	8	24
Total		23	24	21	68
Cost (\$ '000s)					
Technical Assistance		404	430	351	1,185
CFA Subscription		56	56	56	169
Promotion		20	10	10	40
Seminars		30	30	30	90
Reference Material		10			10
Total Contract		520	526	447	1,493
Sub-total USAID		520	526	447	1,493
Sub-total Private Sector		19	19	19	56
Total		539	545	466	1,550
Appropriation					
EHR		520	526	447	1,493

Additionally, USAID will meet the costs of 12 tours of 1 month each by the short-term trainers over the project life. They will conduct a series of seminars for the candidates in country. Each of these instructors will develop additional teaching tools such as cases and exercises which -- taken together with the CFA material -- form a "package" of learning material suitable for training future CFA candidates. Each of the expatriate trainers will work together with a local trainer, who (during the subsequent years of the project) will continue to provide the training courses at that level. Additionally, the "packages" will be made available to the private "tutoring" that train candidates for the various business and accounting examinations. Together with the anticipated market demand for these services, and the "demonstrated" success of the graduates of the program, these measures are expected to sustain the certification program in Sri Lanka.

USAID will also fund a long term trainer for a period of 32 months. One of his principle tasks will be the promotion and management of the CFA program. Additionally, he will co-ordinate the other in country training programs identified under other sections of the project, and will be the principle point of contact for administering the contractor managed overseas training. He will also critically assess the training plan once the project is underway, and be a catalyst in responding to changing market needs, as and when these emerge. Table 4 presents the information regarding inputs and estimated fiscal year expenditure.

At the end of the project period, the CFA program ~~will be a well recognized~~ point of entry for professionals in the securities industry in Colombo. The market will have at least 60 qualified professionals who would be active in a variety of financial institutions. There will be at least 40 other privately funded students at various stages of obtaining certification and the training institutes will be servicing the needs of these students effectively.

7. Assistance to Emerging Financial Institutions

As a part of the program of post-privatization management assistance, the PSPS project provided an 18 month, long term, technical assistance consultant to the Merchant Bank of Sri Lanka (MBSL). The objective of this assignment was to provide MBSL with much needed skills to develop revenues from fee-based services -- a segment of the financial services market not being attended to by the other financial intermediaries. Subsequently, the Merchant Bank has been extremely aggressive in marketing these services. For example, between February 1991 -- the beginning of the consultancy -- and January 1992, MBSL has been

responsible for successfully providing fee based services to no fewer than four (of the 16) privatizations completed by Government, and have successfully bid for at least two others. MBSL pioneered the introduction of a new financial instrument in the Colombo market during that time. It has also been observed that the private sector company clients who require innovative financial services such as financial restructuring are looking to MBSL. It may be concluded that the placement of technical assistance at MBSL during its crucial formative year has resulted not only in significantly strengthening MBSL, but also enabled it to spearhead innovation in financial technologies and increase in awareness levels of the Colombo market regarding a variety of financial products.

The positioning of two expatriate financial professionals, with extensive U.S. and other international experience at the SEC, SL and CSE, also played a catalytic role in developing linkages with international investors. During the initial period of opening the market to foreign investors in June 1990, the technical assistance team was invariably an initial point of contact for visiting foreign fund managers and investors. They played a crucial role both in inspiring confidence in the Colombo market among the foreign investors, as well as being instrumental in actively promoting the Colombo market among the relatively tightly-knit international financial community.

The Price Waterhouse evaluation, under the heading of critical issues learnt from the project (Page 13) has summarized these observations in the following manner: "Experienced financial professionals (such as those advising the SEC and the Merchant Bank) can help seize opportunities to promote and develop linkages with the international market, which is a critical aspect of capital market development". The project amendment proposes to exploit this strategy to strengthen the new financial institutions that are emerging as a result of the initial developments in the Colombo market during the first three years of the project.

USAID have had several requests for long term technical assistance by newly created private financial institutions. These include the Peoples Merchant Bank, slated to be privatized in May 1992, National Asset Management Company (NAMAL); and CKN Fund Management Ltd, the pioneering mutual funds in Sri Lanka, launched in early 1992, and two other large Venture Capital Companies that are being promoted by the Sri Lanka private sector, one with International Finance Corporation (IFC) assistance and the other with the Asian Development Bank (ADB) collaboration. In addition there are several other mutual funds and venture capital companies being floated. We also expect existing financial institutions such as share brokers, portfolio investors such as the private insurance companies, and the

Commercial Banks to discover new market segments to operate in, and consequently needing assistance in their initial efforts on these pioneering activities.

USAID assistance to these private sector institutions may be justified on several basis. Primarily USAID is providing a cost subsidy to these institutions to innovate new activities in the field of financial markets and thereby improve the functioning of the market. Second, the costs of such management technology may be considered prohibitive by the institutions in relation to their perceived benefits at this time and the project will demonstrate the need to acquire these technologies. Third, the technologies, once embraced by the institutions will, through emulation and staff turnover, be adopted by the larger financial community in the Colombo market and the benefits will effectively pass beyond the initial target institutions. Finally, having experienced professionals in key decision making slots in these organizations will effectively reduce the risk levels associated with these new financial instruments, avoiding costly errors during their introduction stage, and ensure that the experience of these instruments by the general public are positive, thereby assuring sustainability of these concepts.

USAID will provide up to 15 additional man months of expatriate technical assistance over the project period to these various financial institutions, based on proposals for such services as and when forwarded by the institutions. ~~These proposals will be reviewed and approved by the~~ contractors, to determine their contribution to the overall project purpose. The assistance will be provided on a basis of cost sharing, with a minimum of 10% of the total costs of the TA being met by the institution concerned. While it is difficult to anticipate the precise mix of TA, the budget is estimated on the average costs of 15 months short term TA. The assistance will be made available to the institution on a first come first-serve basis.

Additionally, USAID will provide funding for a series of incountry training seminars for more general skills, for a mixed group of staff from all interested financial institutions. For example, one such need that is already being felt is the training of broker agents. Approximately 12 seminars for 30 participants each is planned for under the project. The institutions will bear 20% of the costs of the program. The program will be coordinated by the long term training specialist (See Section 6) who will identify the generic needs, develop the course content and manage the resource persons and programming. Estimated fiscal year expenditure, based on the anticipated work plan is given below in Table 8.

**PSPS PP Supplement: Annex A
Technical Analysis of Project: Page 36**

Table 9: Budget for Assistance to Emerging Financial Institutions

	Rate/unit	93	94	95	Total
Level of Effort - man months					
Short Term Consultancies	20,297	6	6	3	15
Total		6	6	3	15
Cost (\$ '000s)					
Technical Assistance		122	122	61	304
Training Seminars		30	30	30	90
Total Contract		152	152	91	394
Sub-total USAID		152	152	91	394
Sub-total Private Sector		12	12	6	30
Total		134	134	67	335
Appropriation					
SDA		122	122	61	304

At the end of the project period, there will be new institutions active in fresh market segments such as unit trusts, insurance companies and retirement funds, venture capital companies and merchant banks. Existing institutions such as the brokers and banks will also be active in new market segments.

8. Program Management and Policy

The proposed program is both extensive and complex. It involves deploying over 119 man months of six long term consultants and 124 man months of short term assistance over a relatively short period of time. The project will have day-to-day contact with three major institutions (the SEC, SL, the CSE and the ICA,SL), over two dozen client institutions (including share brokers, merchant banks, portfolio investors, and other financial intermediaries) and periodic interface with several governmental policy making bodies, including the Central Bank, Ministry of Finance and the Monetary Board. The economic environment is an additional variable that adds to the complexity of project management; clearly some of the proposed elements of the project are extremely vulnerable to market conditions and others particularly sensitive to policy change. Successful management of the program of assistance will require responding to the dynamics of the market place by changing the mix of both activities and inputs. It will also require that project management in provide policy makers with options on a variety of

policy issues, thus increasing their responsiveness to emergent issues in a rapidly changing environment.

The Price Waterhouse evaluation report identifies several such policy issues, including continued distortions that favor debt over equity in the capital structure of the company; rules governing investments by private sector insurance companies and the various pension funds; various taxation issues including consolidation of tax returns and the feasibility of permitting dividends to be paid out of pre-tax earnings; and the need for an investment advisor's act. Other issues will emerge as the market develops.

The project will be managed by a full-time chief-of-party whose terms of reference will include the development of annual work-plans, deployment of project resources to achieve the objectives set out in the plan, the development of a policy agenda and the management of a program of supporting policy research and advice to the SEC, other GSL counterparts and USAID. The position will be ideally be staffed by a senior professional with finance, macro-economic and research experience, including governmental experience. He/She will be supported by a staff of two host country professionals to assist in the research effort. It is anticipated that during the project period, the team will provide approximately 15 analytical studies, and related dissemination activities, in addition to responding to a variety of ad hoc requests by the client groups.

The project management team ~~will be rounded off~~ by two office assistants and a driver. The time duration for all these positions are 27 months. The project will also provide a vehicle and office equipment and recurrent expenses of the project office. The project office will be situated in the SEC, and will become part of the host country contribution to the project. Table 10 presents Fiscal year expenditure based on the anticipated work plan.

Title to project team equipment and vehicle will revert to the SEC at the end of the contract; title to other equipment for the SEC, SL and the ICASL will be vested in their respective organizations.

**PSPS PP Supplement: Annex A
Technical Analysis of Project: Page 38**

Table 10: Budget for Program Management and Policy

	Rate/unit	93	94	95	Total
Level of Effort - man months					
Chief of Party	26,409	11	12	4	27
Total		11	12	4	27
Cost (\$ '000s)					
Technical Assistance		290	317	106	713
Support staff		55	60	20	135
Research Dissemination		15	20	20	55
Office Equipment		80			80
Communication and utilities		72	78	32	182
Contract Total		511	475	178	1,164
Sub-total USAID		511	475	178	1,164
Total		511	475	178	1,164
Appropriation					
SDA		389	340	127	857
EHR		122	135	50	307

E. Project Cost

Estimated costs of individual activities are presented in Section C, under the description of each activity. A consolidated budget, by activity, is presented in Table 11. This includes costs of approximately \$125,000 for monitoring and evaluation, and a further 10% for inflation and price contingency.

PSPS PP Supplement: Annex A
Technical Analysis of Project: Page 39

Table 11: Illustrative Project Budget

	93	94	95	Total
Total Expenditure				
(1) Regulation and Self Regulation	335	211	0	547
(2) Post Trade Automation	582	173	88	843
(3) Financial Reporting	316	335	60	711
(4) Certification of Securities Market Professionals	520	526	447	1,493
(5) Development of a Supply of Securities	416	335	0	751
(6) Assistance to New Financial Institutions	152	152	91	394
(7) Development of a Market for Quoted Debt Securities	155	191	0	347
(8) Program Management and Policy	511	475	178	1,164
Monitoring and Evaluation			125	125
Contingencies (10%)	299	240	86	625
Total	3,286	2,639	1,075	7,000
GSL Contribution				
(1) Regulation and Self Regulation	500	536	600	1,636
Total	500	536	600	1,636
Private Sector Contribution				
(2) Post Trade Automation	100	25	25	150
(3) Financial Reporting	32	34	6	71
(4) Certification of Securities Market Professionals	19	19	19	56
(5) Development of a Supply of Securities	19	19	19	56
(6) Assistance to New Financial Institutions	12	12	6	30
Total	181	108	75	364
Project Total				
(1) Regulation and Self Regulation	835	747	600	2,183
(2) Post Trade Automation	682	198	113	993
(3) Financial Reporting	347	369	66	782
(4) Certification of Securities Market Professionals	539	545	466	1,550
(5) Development of a Supply of Securities	434	354	19	807

101x

**PSPS PP Supplement: Annex A
Technical Analysis of Project: Page 40**

	93	94	95	Total
(6) Assistance to New Financial Institutions	164	164	97	425
(7) Development of a Market for Quoted Debt Securities	155	191	0	347
(8) Program Management and Policy	511	475	178	1,164
Audit, Monitoring and Evaluation	0	0	125	125
Contingencies (15%)	299	240	86	625
Total	3,967	3,283	1,749	9,000
SDA	2,153	1,463	429	4,044
EHR	1,133	1,176	646	2,956
Total	3,286	2,639	1,075	7,000

F. Anticipated Schedule of Work

Table 12 presents the anticipated schedule of work. It should be noted that several of the activities are interlinked, and a delay in one activity may result in a corresponding delay in another activity. For example, a delay in the procurement of computer hardware will result not only in a delay in the implementation of the back-up, but also a delay in the implementation of the second-tier market. Activities are grouped around long-term consultants, who will take the lead role in each of the activities.

REVISED LOGFRAME FOR THE PRIVATE SECTOR POLICY SUPPORT PROJECT

Narrative Summary	Verifiable Indicators		Means of Verification	Assumptions
<p>Goal: To assist the GSL to increase national employment and incomes by the creation of a policy environment conducive to private sector growth.</p>	<p><i>Increase in private sector investments of 10% per annum in real terms over the project period.</i></p>		<p>Central Bank reports and statistics on national accounts and trade.</p>	<p>Private sector investment increases in response to policy changes and other PSPS stimuli. <i>Relatively stable political/security environment.</i></p>
<p>Purpose: To develop the capacity of the Sri Lankan capital market to broaden public equity participation in the economy and increase capital resources for investment.</p>			<p>Central Bank reports, Colombo Securities Exchange reports, and project evaluations.</p>	<p>Political climate continues to improve, and private sector actively participates. <i>Real effective exchange rate not overvalued. GSL expenditure propotion of the GDP reduced.</i></p>
	a	<p><i>Growth in relative size of the market</i></p>		
	b	<p><i>Growth in market liquidity</i></p>		
	c	<p><i>New investments facilitated by the market</i></p>		
	d	<p><i>Growth in net inflows of foreign investments through the market</i></p>		
<p>Outputs: Securities Exchange Commission operational; Colombo Stock Exchange playing expanded role in serving capital markets.</p>			<p>(For all) Contractors reports, field inspection by USAID, evaluations, GSL reports, audits, and project monitoring system.</p>	
	a	<p><i>Surveillance unit staffed, trained and functional at the SEC. Enhanced capability of the CSE for self-regulation.</i></p>	<p><i>Variety of market risks adequately addressed by the SEC and the CSE</i></p>	
	b	<p><i>Improved Company reporting, disclosure and the development and implementation of more stringent accounting and auditing standards.</i></p>	<p><i>Accounting standards setting group established and functioning at ICASL. Compliance unit functioning at CSE.</i></p>	
	c	<p><i>Improved systems reliability and ability to handle greater volumes and broader range of transactions by the Central Depository System (CDS).</i></p>	<p><i>Response-time, down-time and error-rate of the CDS.</i></p>	

**PSPS PP Supplement: Annex B
Revised Logframe: Page 2**

<i>Increased supply of quoted securities.</i>	<i>d</i>	<i>A second-tier market established with lower costs of entry, lower costs of maintenance and less stringent regulations.</i>	<i>Small and medium companies using the second-tier market to access funds. Initial public offerings (IPOs) and rights issues.</i>	<i>Demand for securities remain strong due to increased availability of funds, through participation by foreign investors and reduction of GSL expenditure.</i>
	<i>e</i>	<i>A secondary market in Government Securities established and functioning. Several quoted Corporate long term debt instruments floated.</i>		
<i>New forms of financial intermediation developed in the market-place.</i>	<i>f</i>	<i>Proactive, market driven securities industry with trained brokers, agents and analysts.</i>	<i>Certified Financial Analysts Examinations being conducted in Sri Lanka. Other training courses being conducted.</i>	
	<i>g</i>	<i>New institutions active in fresh market segments; Portfolio investment companies such as Unit Trusts, Insurance companies & Retirement funds, Venture Capital companies and Investments Banks.</i>		

**PSPS PP Supplement: Annex C
Statutory Checklist: Page 1**

5C(1) - COUNTRY CHECKLIST

Listed below are statutory criteria applicable to the eligibility of countries to receive the following categories of assistance: (A) both Development Assistance and Economic Support Funds; (B) Development Assistance funds only; or (C) Economic Support Funds only.

A. COUNTRY ELIGIBILITY CRITERIA APPLICABLE TO BOTH DEVELOPMENT ASSISTANCE AND ECONOMIC SUPPORT FUND ASSISTANCE

1. Narcotics

a. Negative Certification (FY1991 Appropriations Act Sec. 559(b)):

Has the President certified to the Congress that the government of the recipient country is failing to take adequate measures to prevent narcotic drugs or other controlled substances which are cultivated, produced or processed illicitly, in whole or in part, in such country or transported through such country, from being sold illegally within the jurisdiction of such country to United States Government personnel or their dependents or from entering the United States unlawfully?

No

b. Positive Certification (FAA Sec. 481(h)): (This provision applies to assistance of any kind provided by grant, sale, loan, lease, credit, guaranty, or insurance, except assistance from the Child Survival Fund or relating to international narcotics control, disaster and refugee relief, narcotics education and awareness, or the provision of food or medicine.) If the recipient is a "major illicit drug producing country" (defined as a country producing during a fiscal year at least five metric tons of opium or 500 metric tons of coca or marijuana) or a "major drug-transit country" (defined as a country that is a significant direct source of illicit drugs significantly affecting the United States, through which such drugs are transported, or through which significant sums of drug-related profits are laundered with the knowledge or complicity of the government):

(1) Does the country have in place a bilateral narcotics agreement with the United States, or a multilateral narcotics agreement?

(2) Has the President in the March 1 International Narcotics Control Strategy Report (INSCR) determined and certified to the Congress (without Congressional enactment, within 45 days of continuous session, of a resolution disapproving such a certification), or has the President determined and certified to the Congress on any other date (with enactment by Congress of a resolution approving such certification), that (a) during the previous year the country has cooperated fully with the United States or taken adequate steps on its own to satisfy the goals agreed to in a bilateral narcotics agreement with the United States or in a multilateral agreement, to prevent illicit drugs produced or processed in

or transported through such country from being transported into the United States, to prevent and punish drug profit laundering in the country, and to prevent and punish bribery and other forms of public corruption which facilitate production or shipment of illicit drugs or discourage prosecution of such acts, or that (b) the vital national interests of the United States require the provision of such assistance?

Not Applicable

c. Government Policy (1986 Anti-Drug Abuse Act Sec. 2013(b)):

(This section applies to the same categories of assistance subject to the restrictions in FAA Sec. 481(h), above.) If recipient country is a "major illicit drug producing country" or "major drug-transit country" (as defined for the purpose of FAA Sec. 481(h)), has the President submitted a report to Congress listing such country as one: (a) which, as a matter of government policy, encourages or facilitates the production or distribution of illicit drugs; (b) in which any senior official of the government engages in, encourages, or facilitates the production or distribution of illegal drugs; (c) in which any member of a U.S. Government agency has suffered or been threatened with violence inflicted by or with the complicity of any government officer; or (d) which fails to provide reasonable cooperation to lawful activities of U.S. drug enforcement agents, unless the President has provided the required certification to Congress pertaining to U.S. national interests and the drug control and criminal prosecution efforts of that country?

Not Applicable

2. Indebtedness to U.S. Citizens (FAA Sec. 620(c)): If assistance is to a government, is the government indebted to any U.S. citizen for goods or services furnished or ordered where: (a) such citizen has exhausted available legal remedies; (b) the debt is not denied or contested by such government; or (c) the indebtedness arises under an unconditional guaranty of payment given by such government or controlled entity?

No

3. Seizure of U.S. Property (FAA Sec. 620(e)(1)): If assistance is to a government, has it (including any government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities?

No

4. Communist Countries (FAA Secs. 620(a), 620(f), 620D; FY

106x

**PSPS PP Supplement: Annex C
Statutory Checklist: Page 2**

1991 Appropriations Act Secs. 512, 545: Is recipient country a Communist country? If so, has the President: (a) determined that assistance to the country is vital to the security of the United States, that the recipient country is not controlled by the international Communist conspiracy, and that such assistance will further promote the independence of the recipient country from international communism, or (b) removed a country from applicable restriction on assistance to Communist countries upon a determination and report to Congress that such action is important to the national interest of the United States? Will assistance be provided either directly or indirectly to Angola, Cambodia, Cuba, Iraq, Libya, Vietnam, Iran or Syria? Will assistance be provided to Afghanistan without a certification, or will assistance be provided inside Afghanistan through the Soviet-controlled government of Afghanistan?

*(a) Not Applicable
(b) Not Applicable*

5. Mob Action (FAA Sec. 620(j)): Has the country permitted or failed to take adequate measures to prevent damage or destruction by mob action of U.S. property?

No

6. OPIC Investment Guaranty (FAA Sec. 620(l)): Has the country failed to enter into an investment guaranty agreement with OPIC?

No

7. Seizure of U.S. Fishing Vessels (FAA Sec. 620(o); Fishermen's Protective Act of 1967, as amended, Sec. 5): (a) Has the country seized, or imposed any penalty or sanction against, any U.S. fishing vessel because of fishing activities in international waters? (b) If so, has any deduction required by the Fishermen's Protective Act been made?

No

8. Loan Default (FAA Sec. 620(q); FY 1991 Appropriations Act Sec. 518 (Brooke Amendment)): (a) Has the government of the recipient country been in default for more than six months on interest or principal of any loan to the country under FAA? (b) Has the country been in default for more than one year on interest or principal on any U.S. loan under a program for which the FY 1991 Appropriations Act appropriates funds?

*(a) No
(b) No*

9. Military Equipment (FAA Sec. 620(s)): If contemplated

assistance is development loan or to come from Economic Support Fund, has the Administrator taken into account the percent of the country's budget and amount of the country's foreign exchange or other resources spent on military equipment? (Reference may be made to the annual "Taking Into Consideration" memo: "Yes, taken into account by the Administrator at time of approval of Agency OYB." This approval by the Administrator of the Operational Year Budget can be the basis for an affirmative answer during the fiscal year unless significant changes in circumstances occur.)

Not Applicable

10. Diplomatic Relations with U.S. (FAA Sec. 620(t)): Has the country severed diplomatic relations with the United States? If so, have relations been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption?

No

11. U.N. Obligations (FAA Sec. 620(u)): What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the AID Administrator in determining the current AID Operational Year Budget? (Reference may be made to the "Taking into Consideration" memo.)

Sri Lanka is in arrears; however, this has been taken into account by the Administrator at time of approval of Agency OYB.

12. International Terrorism

a. Sanctuary and Support (FY 1991 Appropriations Act Sec. 556; FAA Sec. 620A): Has the country been determined by the President to: (a) grant sanctuary from prosecution to any individual or group which has committed an act of international terrorism, or (b) otherwise supports international terrorism, unless the President has waived this restriction on grounds of national security or for humanitarian reasons?

No

b. Airport Security (ISDCA of 1985 Sec. 552(b)): Has the Secretary of State determined that the country is a high terrorist threat country after the Secretary of Transportation has determined, pursuant to section 1115(e)(2) of the Federal Aviation Act of 1958, that an airport in the country does not maintain and administer effective security measures?

No

13. Discrimination (FAA Sec. 666(b)): Does the country object,

**PSPS PP Supplement: Annex C
Statutory Checklist: Page 3**

on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA?

No

Sec. 599D, amending FAA Sec. 116: Does the recipient government fail to take appropriate and adequate measures, within its means, to protect children from exploitation, abuse or forced conscription into military or paramilitary services?

No

14. Nuclear Technology (FAA Secs. 669, 670): Has the country, after August 3, 1977, delivered to any other country or received nuclear enrichment or reprocessing equipment, materials or technology, without specified arrangements or safeguards, and without special certification by the President? Has it transferred a nuclear explosive device to a non-nuclear weapon state, or if such a state, either received or detonated a nuclear explosive device? If the country is a non-nuclear weapon state, has it, on or after August 8, 1985, exported (or attempted to export) illegally from the United States any material, equipment, or technology which would contribute significantly to the ability of a country to manufacture a nuclear explosive device? (FAA Section 620E permits a special waiver of Section 669 for Pakistan.)

No

15. Algiers Meeting (ISDCA of 1981 Sec. 720): Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned Countries to the 36th General Assembly of the U.N. on September 25 and 28, 1981, and did it fail to disassociate itself from the communique issued? If so, has the President taken it into account? (Reference may be made to the "Taking into Consideration" memo.)

Sri Lanka was not represented at the meeting and entered a written reservation subsequently.

16. Military Coup (FY 1991 Appropriations Act Sec. 513): Has the duly elected Head of Government of the country been deposed by military coup or decree? If assistance has been terminated, has the President notified Congress that a democratically elected government has taken office prior to the resumption of assistance?

No

17. Refugee Cooperation (FY 1991 Appropriations Act Sec. 539): Does the recipient country fully cooperate with the international refugee assistance organizations, the United States, and other governments in facilitating lasting solutions to refugee situations, including resettlement without respect to race, sex, religion, or national origin?

No

18. Exploitation of Children (FY 1991 Appropriations Act

B. COUNTRY ELIGIBILITY CRITERIA APPLICABLE ONLY TO DEVELOPMENT ASSISTANCE ("DA")

1. Human Rights Violations (FAA Sec. 116): Has the Department of State determined that this government has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can it be demonstrated that contemplated assistance will directly benefit the needy?

No

2. Abortions (FY 1991 Appropriations Act Sec. 535): Has the President certified that use of DA funds by this country would violate any of the prohibitions against use of funds to pay for the performance of abortions as a method of family planning, to motivate or coerce any person to practice abortions, to pay for the performance of involuntary sterilization as a method of family planning, to coerce or provide any financial incentive to any person to undergo sterilizations, to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning?

No

C. COUNTRY ELIGIBILITY CRITERIA APPLICABLE ONLY TO ECONOMIC SUPPORT FUNDS ("ESF")

1. Human Rights Violations (FAA Sec. 502B): Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, has the President found that the country made such significant improvement in its human rights record that furnishing such assistance is in the U.S. national interest?

Not Applicable

1084

**PSPS PP Supplement: Annex C
Statutory Checklist: Page 4**

5C(2) ASSISTANCE CHECKLIST

Listed below are statutory criteria applicable to the assistance resources themselves, rather than to the eligibility of a country to receive assistance. This section is divided into three parts. Part A includes criteria applicable to both Development Assistance and Economic Support Fund resources. Part B includes criteria applicable only to Development Assistance resources. Part C includes criteria applicable only to Economic Support Funds.

CROSS REFERENCE: IS COUNTRY CHECKLIST UP-TO-DATE?

YES

A. CRITERIA APPLICABLE TO BOTH DEVELOPMENT ASSISTANCE AND ECONOMIC SUPPORT FUNDS

1. **Host Country Development Efforts (FAA Sec. 601(a):** Information and conclusions on whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry agriculture, and commerce; and (f) strengthen free labor unions.

Project activities directly support private sector growth by expanding financial markets, investment opportunities, and capital availability. It also fosters greater competition in the financial markets and directly strengthens the technical efficiency of financial market institutions and regulatory bodies.

2. **U.S. Private Trade and Investment (FAA Sec. 610(b)):** Information and conclusions on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

The use of U.S. technical assistance will grow capital markets and market efficiency creating a dramatically improved and more familiar investment climate for U.S. trade and investment activities.

3. **Congressional Notification**

a. **General Requirement (FY 1991 Appropriations Act Secs. 523 and 591; FAA Sec. 634A):** If money is to be obligated for an activity not previously justified to Congress, or for an amount in excess of amount previously justified to Congress, has Congress been properly notified (unless the notification requirement has been waived

because of substantial risk to human health or welfare)?

Yes

- b. **Notice of New Account Obligation (FY 1991 Appropriations Act Sec.514):** If funds are being obligated under an appropriation account to which they were not appropriated, has the President consulted with and provided a written justification to the House and Senate Appropriations Committees and has such obligation been subject to regular notification procedures?

Not Applicable

- c. **Cash Transfers and Nonproject Sector Assistance (FY 1991 Appropriations Act Sec. 575(b)(3)):** If funds are to be made available in the form of cash transfer or nonproject sector assistance, has the Congressional notice included a detailed description of how the funds will be used, with a discussion of U.S. interests to be served and a description of any economic policy reforms to be promoted?

Not Applicable

4. **Engineering and Financial Plans FAA Sec. 611(a):** Prior to an obligation in excess of \$500,000, will there be: (a) engineering, financial or other plans necessary to carry out the assistance; and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?

Yes

5. **Legislative Action (FAA Sec.611(a)(2)):** If legislative action is required within recipient country with respect to an obligation in excess of \$500,000, what is the basis for a reasonable expectation that such action will be completed in time to permit orderly accomplishment of the purpose of the assistance?

Not Applicable

6. **Water Resources (FAA Sec. 611(b); FY 1991 Appropriations Act Sec. 501):** If project is for water or water related land resource construction, have benefits and costs been computed to the extent practicable in accordance with the principles, standards, and procedures established pursuant to the Water Resources Planning Act (42 U.S.C. 1962, et seq.)? (See A.I.D. Handbook 3 for guidelines.)

Not Applicable

7. **Cash Transfer and Sector Assistance (FY 1991 Appropriations Act Sec. 575(b)):** Will cash transfer or nonproject sector assistance be maintained in a separate

**PSPS PP Supplement: Annex C
Statutory Checklist: Page 5**

account and not commingled with other funds (unless such requirements are waived by Congressional notice for nonproject sector assistance)?

Not Applicable

8. Capital Assistance (FAA Sec. 611(e)): If project is capital assistance (e.g., construction), and total U.S. assistance for it will exceed \$1 million, has the Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability to maintain and utilize the project effectively?

Not Applicable

9. Multiple Country Objectives (FAA Sec. 601(a)): Information and conclusions whether project will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of, industry, agriculture and commerce; and (f) strengthen free labor unions.

Project activities directly support private sector growth by expanding financial markets, investment opportunities, and capital availability. It also fosters greater competition in the financial markets and directly strengthens the technical efficiency of financial market institutions and regulatory bodies.

10. U.S. Private Trade (FAA Sec. 601(b)): Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

The use of U.S. technical assistance will grow capital markets and market efficiency creating a dramatically improved and familiar investment climate for U.S. trade and investment activities.

11. Local Currencies

a. Recipient Contributions (FAA Secs. 612(b), 636(h)): Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.

The GSL is contributing at least 25% of the cost of project implementation.

b. U.S.-Owned Currency (FAA Sec. 612(d)): Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

No

c. Separate Account (FY 1991 Appropriations Act Sec. 575): If assistance is furnished to a foreign government under arrangements which result in the generation of local currencies:

Not Applicable

(1) Has A.I.D. (a) required that local currencies be deposited in a separate account established by the recipient government, (b) entered into an agreement with that government providing the amount of local currencies to be generated and the terms and conditions under which the currencies so deposited may be utilized, and (c) established by agreement the responsibilities of A.I.D. and that government to monitor and account for deposits into and disbursements from the separate account?

(2) Will such local currencies, or an equivalent amount of local currencies, be used only to carry out the purposes of the DA or ESF chapters of the FAA (depending on which chapter is the source of the assistance) or for the administrative requirements of the United States Government?

(3) Has A.I.D. taken all appropriate steps to ensure that the equivalent of local currencies disbursed from the separate account are used for the agreed purposes?

(4) If assistance is terminated to a country, will any unencumbered balances of funds remaining in a separate account be disposed of for purposes agreed to by the recipient government and the United States Government?

12. Trade Restrictions

a. Surplus Commodities (FY 1991 Appropriations Act Sec. 521(a)): If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity?

Not Applicable

b. Textiles (Lautenberg Amendment) (FY 1991 Appropriations Act Sec. 521(c)): Will the assistance (except for programs in Caribbean Basin Initiative countries under U.S. Tariff Schedule "Section 807", which allows reduced tariffs on articles assembled abroad from U.S.-made components) be used directly to procure feasibility studies, prefeasibility studies, or project profiles

110x

PSPS PP Supplement: Annex C
Statutory Checklist: Page 6

of potential investment in, or to assist the establishment of facilities specifically designed for, the manufacture for export to the United States or to third country markets indirect competition with U.S. exports, of textiles, apparel, footwear, handbags, flat goods (such as wallets or coin purses worn on the person), work gloves or leather wearing apparel?

Not Applicable

13. Tropical Forests (FY 1991 Appropriations Act Sec. 533(c)(3)): Will funds be used for any program, project or activity which would (a) result in any significant loss of tropical forests, or (b) involve industrial timber extraction in primary tropical forest areas?

No

14. PVO Assistance

a. Auditing and Registration (FY 1991 Appropriations Act Sec. 537): If assistance is being made available to a PVO, has that organization provided upon timely request any document, file, or record necessary to the auditing requirements of A.I.D., and is the PVO registered with A.I.D.?

Not Applicable

b. Funding Sources (FY 1991 Appropriations Act, Title II, under heading "Private and Voluntary Organizations"): If assistance is to be made to a United States PVO (other than a cooperative development organization), does it obtain at least 20 percent of its total annual funding for international activities from sources other than the United States Government?

Not Applicable

15. Project Agreement Documentation (State Authorization Sec. 139 (as interpreted by conference report)): Has confirmation of the date of signing of the project agreement, including the amount involved, been cabled to State L/T and A.I.D. LEG within 60 days of the agreement's entry into force with respect to the United States, and has the full text of the agreement been pouched to those same offices? (See Handbook 3, Appendix 6G for agreements covered by this provision.)

Not Applicable

16. Metric System (Omnibus Trade and Competitiveness Act of 1988 Sec. 5164, as interpreted by conference report, amending Metric Conversion Act of 1975 Sec. 2, and as implemented through A.I.D. policy): Does the assistance activity use the metric system of measurement in its procurements, grants, and other business-related activities, except to the extent that such use is impractical or is likely to cause significant inefficiencies or loss of markets to United States firms? Are bulk purchases usually to be made in metric and are components, sub-assemblies, and semifabricated materials to be specified in metric units when economically available and technically adequate? Will A.I.D. specifications use metric units of measure from the earliest programmatic stages, and from the earliest documentation of the assistance processes (for example, project papers) involving quantifiable measurements length, area, volume, capacity, mass and weight), through the implementation stage?

Yes

17. Women in Development (FY 1991 Appropriations Act, Title II under heading "Women in Development"): Will assistance be designed so that the percentage of women participants will be demonstrably increased?
The project is designed to promote private sector growth and spread economic growth benefits across all population strata.

18. Regional and Multilateral Assistance (FAA Sec. 209): Is assistance more efficiently and effectively provided through regional or multilateral organizations? If so, why is assistance not so provided? Information and conclusions on whether assistance will encourage developing countries to cooperate in regional development programs.

No

19. Abortions (FY 1991 Appropriations Act, Title II, under heading "Population, DA," and Sec. 525):

a. Will assistance be made available to any organization or program which, as determined by the President, supports or participates in the management of a program of coercive abortion or involuntary sterilization?

No

b. Will any funds be used to lobby for abortion?

No

20. Cooperatives (FAA Sec. 111): Will assistance help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward a better life?

**PSPS PP Supplement: Annex C
Statutory Checklist: Page 7**

No

21. U.S.-Owned Foreign Currencies

a. Use of Currencies (FAA Secs. 612(b), 636(h); FY 1991 Appropriations Act Secs. 507, 509): Describe steps taken to assure that, to the maximum extent possible, foreign currencies owned by the U.S. are utilized in lieu of dollars to meet the cost of contractual and other services.

Not Applicable

b. Release of Currencies (FAA Sec. 612(d)): Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

No

22. Procurement

a. Small Business (FAA Sec. 602(a)): Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed?

Yes. Project will utilize standard A.I.D. procurement processes.

b. U.S. Procurement (FAA Sec. 604(a)): Will all procurement be from the U.S. except as otherwise determined by the President or determined under delegation from him?

Yes

c. Marine Insurance (FAA Sec. 604(d)): If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company?

Not Applicable

d. Non-U.S. Agricultural Procurement (FAA Sec. 604(e)): If non U.S. procurement of agricultural commodity or product thereof is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.)

Not Applicable

e. Construction or Engineering Services (FAA Sec. 604(g)): Will construction or engineering services be procured from firms of advanced developing countries which are otherwise eligible under Code 941 and which have attained a competitive capability in international markets in one of these areas? (Exception for those countries which receive direct economic assistance under the FAA and permit United States firms to compete for construction or engineering services financed from assistance programs of these countries.)

No

f. Cargo Preference Shipping (FAA Sec. 603): Is the shipping excluded from compliance with the requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 percent of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent such vessels are available at fair and reasonable rates?

Not Applicable

g. Technical Assistance (FAA Sec. 621(a)): If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? Will the facilities and resources of other Federal agencies be utilized, when they are particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs?

Yes

h. U.S. Air Carriers (Inter-national Air Transportation Fair Competitive Practices Act, 1974): If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available?

Yes

i. Termination for Convenience of U.S. Government (FY 1991 Appropriations Act Sec. 504): If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States?

Yes

j. Consulting Services (FY 1991 Appropriations Act Sec. 524): If assistance is for consulting service through procurement contract pursuant to 5 U.S.C. 3109, are contract expenditures a matter of public record and available for public inspection (unless otherwise provided

**PSPS PP Supplement: Annex C
Statutory Checklist: Page 8**

by law or Executive order)?

Yes

k. Metric Conversion (Omnibus Trade and Competitiveness Act of 1988, as interpreted by conference report, amending Metric Conversion Act of 1975 Sec. 2, and as implemented through A.I.D. policy): Does the assistance program use the metric system of measurement in its procurements, grants, and other business related activities, except to the extent that such use is impractical or is likely to cause significant inefficiencies or loss of markets to United States firms? Are bulk purchases usually to be made in metric, and are components, subassemblies, and semifabricated materials to be specified in metric units when economically available and technically adequate? Will A.I.D. specifications use metric units of measure from the earliest programmatic stages, and from the earliest documentation of the assistance processes (for example, project papers) involving quantifiable measurements (length, area, volume, capacity, mass and weight), through the implementation stage?

Yes

l. Competitive Selection Procedures (FAA Sec. 601(e)): Will the assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?

Yes

23. Construction

a. Capital Project (FAA Sec. 601(d)): If capital (e.g., construction) project, will U.S. engineering and professional services be used?

Not Applicable

b. Construction Contract (FAA Sec. 611(c)): If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable?

Not Applicable

c. Large Projects, Congressional Approval (FAA Sec. 620(k)): If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed \$100 million (except for productive enterprises in Egypt that were described in the Congressional Presentation), or does assistance have the express approval of Congress?

Not Applicable

24. U.S. Audit Rights (FAA Sec. 301(d)): If fund is established solely by U.S. contributions and administered by an international organization, does Controller General have

audit rights?

Not Applicable

25. Communist Assistance (FAA Sec. 620(h)): Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist bloc countries?

Yes

26. Narcotics

a. Cash Reimbursements (FAA Sec. 483): Will arrangements preclude use of financing to make reimbursements, in the form of cash payments, to persons whose illicit drug crops are eradicated?

Not Applicable

b. Assistance to Narcotics Traffickers (FAA Section 487): Will arrangements take "all reasonable steps" to preclude use of financing to or through individuals or entities which we know or have reason to believe have either: (1) been convicted of a violation of any law or regulation of the United States or a foreign country relating to narcotics (or other controlled substances); or (2) been an illicit trafficker in, or otherwise involved in the illicit trafficking of, any such controlled substance?

Yes

27. Expropriation and Land Reform (FAA Sec. 620(g)): Will assistance preclude use of financing to compensate owners for expropriated or nationalized property, except to compensate foreign nationals in accordance with a land reform program certified by the President?

Not Applicable

28. Police and Prisons (FAA Sec. 660): Will assistance preclude use of financing to provide training, advice, or any financial support for police, prisons, or other law enforcement forces, except for narcotics programs?

Yes

29. CIA Activities (FAA Sec. 662): Will assistance preclude use of financing for CIA activities?

Yes

30. Motor Vehicles (FAA Sec. 636(i)): Will assistance preclude

**PSPS PP Supplement: Annex C
Statutory Checklist: Page 9**

use of financing to provide for purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained?

Yes

31. **Military Personnel (FY 1991 Appropriations Act Sec. 503):** Will assistance preclude use of financing to pay pensions, annuities, retirement pay, or adjusted service compensation for prior or current military personnel?

Yes

32. **Payment of U.N. Assessments (FY 1991 Appropriations Act Sec. 505):** Will assistance preclude use of financing to pay U.N. assessments, arrearages or dues?

Yes

33. **Multilateral Organization Lending (FY 1991 Appropriations Act Sec. 506):** Will arrangements preclude use of financing to carry out provisions of FAA section 209(d) (transfer of FAA funds to multilateral organizations for lending)?

Yes

34. **Export of Nuclear Resources (FY 1991 Appropriations Act Sec. 510):** Will assistance preclude use of financing to finance the export of nuclear equipment, fuel, or technology?

Yes

35. **Repression of Population (FY 1991 Appropriations Act Sec. 511):** Will assistance preclude use of financing for the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights?

Yes

36. **Publicity or Propaganda (FY 1991 Appropriations Act Sec. 516):** Will assistance be used for publicity or propaganda purposes designed to support or defeat legislation pending before Congress, to influence in any way the outcome of a political election in the United States, or for any publicity or propaganda purposes not authorized by Congress?

No

37. **Marine Insurance (FY 1991 Appropriations Act Sec. 563):** Will any A.I.D. contract and solicitation, and subcontract entered into under such contract, include a clause requiring that U.S. marine insurance companies have a fair opportunity to bid for marine insurance when such insurance is necessary or appropriate?

Yes

38. **Exchange for Prohibited Act (FY 1991 Appropriations Act Sec. 569):** Will any assistance be provided to any foreign government (including any instrumentality or agency thereof), foreign person, or United States person in exchange for that foreign government or person undertaking any action which is, if carried out by the United States Government, a United States official or employee, expressly prohibited by a provision of United States law?

No

B. CRITERIA APPLICABLE TO DEVELOPMENT ASSISTANCE ONLY

1. **Agricultural Exports (Bumpers Amendment) (FY 1991 Appropriations Act Sec. 521(b), as interpreted by conference report for original enactment):** If assistance is for agricultural development activities (specifically, any testing or breeding feasibility study, variety improvement or introduction, consultancy, publication, conference, or training), are such activities: (1) specifically and principally designed to increase agricultural exports by the host country to a country other than the United States, where the export would lead to direct competition in that third country with exports of a similar commodity grown or produced in the United States, and can the activities reasonably be expected to cause substantial injury to U.S. exporters of a similar agricultural commodity; or (2) in support of research that is intended primarily to benefit U.S. producers?

Not Applicable

2. **Tied Aid Credits (FY 1991 Appropriations Act, Title II, under heading "Economic Support Fund"):** Will DA funds be used for tied aid credits?

Not Applicable

3. **Appropriate Technology (FAA Sec. 107):** Is special emphasis placed on use of appropriate technology (defined as relatively smaller, cost saving, labor using technologies that are generally most appropriate for the small farms, small business, and small incomes of the poor)?

Not Applicable

114x

**PSPS PP Supplement: Annex C
Statutory Checklist: Page 10**

4. **Indigenous Needs and Resources (FAA Sec. 281(b)):** Describe extent to which the activity recognizes the particular needs, desires and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civic education and training in skills required for effective participation in governmental processes essential to self government.

The Project will assist in developing and strengthening the institutional capability of Sri Lankan stock market and regulatory institutions. Emphasis is placed on providing technical assistance to these institutions which will enable them to expand and regulate new financial market segments.

5. **Economic Development (FAA Sec. 101(a)):** Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

Yes

6. **Special Development Emphasis (FAA Secs. 102(b), 113, 281(a)):** Describe extent to which activity will: (a) effectively involve the poor in development by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, dispersing investment from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using appropriate U.S. institutions; (b) encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries.

The project will, in part, create opportunities for rural populations to participate in capital market opportunities as brokerage institutions develop branches and branch activities outside of urban centers. Moreover, broad, sustainable economic growth benefits all strata of Sri Lankan society.

7. **Recipient Country Contribution (FAA Sec. 110, 124(d)):** Will the recipient country provide at least 25 percent of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)?

Yes

8. **Benefit to Poor Majority (FAA Sec. 128(b)):** If the

activity attempts to increase the institutional capabilities of private organizations or the government of the country, or if it attempts to stimulate scientific and technological research, has it been designed and will it be monitored to ensure that the ultimate beneficiaries are the poor majority?

Economic benefits accrued from strengthening economic performance, will be shared by the poor majority.

9. **Abortions (FAA Section 104(f); FY 1991 Appropriations Act, Title II under heading "Population, DA," and Sec. 535):**

a. Are any of the funds to be used for the performance of abortions as a method of family planning or to motivate or coerce any person to practice abortions?

No

b. Are any of the funds to be used to pay for the performance of involuntary sterilization as a method of family planning or to coerce or provide any financial incentive to any person to undergo sterilizations?

No

c. Are any of the funds to be made available to any organization or program which, as determined by the President, supports or participates in the management of a program of coercive abortion or involuntary sterilization?

No

d. Will funds be made available only to voluntary family planning projects which offer, either directly or through referral to, or information about access to, a broad range of family planning methods and services?

Not Applicable

e. In awarding grants for natural family planning, will any applicant be discriminated against because of such applicant's religious or conscientious commitment to offer only natural family planning?

Not Applicable

f. Are any of the funds to be used to pay for any bio medical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning?

No

g. Are any of the funds to be made available to any organization if the President certifies that the use of these funds by such organization would violate any of

**PSPS PP Supplement: Annex C
Statutory Checklist: Page 11**

the above provisions related to abortions and involuntary sterilization?

No

10. **Contract Awards (FAA Sec.601(e)):** Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?

Yes

11. **Disadvantaged Enterprise (FY1991 Appropriations Act Sec. 567):** What portion of the funds will be available only for activities of economically and socially disadvantaged enterprises, historically black colleges and universities, colleges and universities having a student body in which more than 40 percent of the students are Hispanic Americans, and private and voluntary organizations which are controlled by individuals who are black Americans, Hispanic Americans, or Native Americans, or who are economically or socially disadvantaged (including women)?

To comply with the statutory requirements, all solicitations for contracts in excess of \$500,000 will include a requirement that the contractor sub-contract not less than 10% of the gross value of the contract with entities described in the statute.

12. **Biological Diversity (FAA Sec.119(g)):** Will the assistance: (a) support training and education efforts which improve the capacity of recipient countries to prevent loss of biological diversity; (b) be provided under a long-term agreement in which the recipient country agrees to protect ecosystems or other wildlife habitats; (c) support efforts to identify and survey ecosystems in recipient countries worthy of protection; or (d) by any direct or indirect means significantly degrade national parks or similar protected areas or introduce exotic plants or animals into such areas?

- (a) No
(b) No
(c) No
(d) No*

13. **Tropical Forests (FAA Sec.118; FY 1991 Appropriations Act Sec.533(c)-(e) and (g)):**

a. **A.I.D. Regulation 16:** Does the assistance comply with the environmental procedures set forth in A.I.D. Regulation 16?

No

b. **Conservation:** Does the assistance place a high priority on conservation and sustainable management of tropical forests? Specifically, does the assistance, to the fullest extent feasible: (1) stress the importance of conserving and sustainably managing forest resources; (2) support activities which offer employment and income alternatives to those who otherwise would cause destruction and loss of forests, and help countries identify and implement alternatives to colonizing forested areas; (3) support training programs, educational efforts, and the establishment or strengthening of institutions to improve forest management; (4) help end destructive slash-and-burn agriculture by supporting stable and productive farming practices; (5) help conserve forests which have not yet been degraded by helping to increase production on lands already cleared or degraded; (6) conserve forested watersheds and rehabilitate those which have been deforested; (7) support training, research, and other actions which lead to sustainable and more environmentally sound practices for timber harvesting, removal and processing; (8) support research to expand knowledge of tropical forests and identify alternatives which will prevent forest destruction, loss, or degradation; (9) conserve biological diversity in forest areas by supporting efforts to identify, establish, and maintain a representative network of protected tropical forest eco-systems on a world wide basis, by making the establishment of protected areas a condition of support for activities involving forest clearance or degradation, and by helping to identify tropical forest ecosystems and species in need of protection and establish and maintain appropriate protected areas; (10) seek to increase the awareness of U.S. government agencies and other donors of the immediate and long-term value of tropical forests; (11) utilize the resources and abilities of all relevant U.S. government agencies; (12) be based upon careful analysis of the alternatives available to achieve the best sustainable use of land; and (13) take full account of the environmental impacts of the proposed activities on biological diversity.

Not Applicable

c. **Forest Degradation:** Will assistance be used for: (1) the procurement or use of logging equipment, unless an environmental assessment indicates that all timber harvesting operations involved will be conducted in an environmentally sound manner and that the proposed activity will produce positive economic benefits and sustainable forest management systems; (2) actions which will significantly degrade national parks or similar protected areas which contain tropical forests, or introduce exotic plants or animals in to such areas; (3) activities which would result in the conversion of forest lands to the rearing of livestock; (4) the construction, upgrading, or maintenance of roads (including temporary haul roads for logging or other extractive industries) which pass through

116x

**PSPS PP Supplement: Annex C
Statutory Checklist: Page 12**

relatively undegraded forest lands; (5) the colonization of forest lands; or (6) the construction of dams or other water control structures which flood relatively undegraded forest lands, unless with respect to each such activity an environmental assessment indicates that the activity will contribute significantly and directly to improving the livelihood of the rural poor and will be conducted in an environmentally sound manner which supports sustainable development?

- (1) No
- (2) No
- (3) No
- (4) No
- (5) No
- (6) No

d. **Sustainable Forestry:** If assistance relates to tropical forests, will project assist countries in developing a systematic analysis of the appropriate use of their total tropical forest resources, with the goal of developing a national program for sustainable forestry?

Not Applicable

e. **Environmental Impact Statements:** Will funds be made available in accordance with provisions of FAA Section 117(c) and applicable A.I.D. regulations requiring an environmental impact statement for activities significantly affecting the environment?

An EA Waiver has been granted

14. **Energy (FY 1991 Appropriations Act Sec. 533(c)):** If assistance relates to energy, will such assistance focus on: (a) end-use energy efficiency, least-cost energy planning, and renewable energy resources, and (b) the key countries where assistance would have the greatest impact on reducing emissions from greenhouse gases?

Not Applicable

15. **Sub-Saharan Africa Assistance (FY 1991 Appropriations Act Sec. 562, adding a new FAA chapter 10 (FAA Sec. 496)):** If assistance will come from the Sub-Saharan Africa DA account, is it: (a) to be used to help the poor majority in Sub-Saharan Africa through a process of long-term development and economic growth that is equitable, participatory, environmentally sustainable, and self-reliant; (b) to be used to promote sustained economic growth, encourage private sector development, promote individual initiatives, and help to reduce the role of central governments in areas more appropriate for the private sector; (c) to be provided in a manner that takes into account, during the planning process the local-level perspectives of the rural and urban poor, including women, through close consultation with African, United States and other PVOs that have demonstrated effectiveness in the promotion of local

grassroots activities on behalf of long-term development in Sub-Saharan Africa; (d) to be implemented in a manner that requires local people, including women, to be closely consulted and involved, if the assistance has a local focus; (e) being used primarily to promote reform of critical sectoral economic policies, or to support the critical sector priorities of agricultural production and natural resources, health, voluntary family planning services, education, and income generating opportunities; and (f) to be provided in a manner that, if policy reforms are to be effected, contains provisions to protect vulnerable groups and the environment from possible negative consequences of the reforms?

Not Applicable

16. **Debt-for-Nature Exchange (FAA Sec. 463):** If project will finance a debt-for-nature exchange, describe how the exchange will support protection of: (a) the world's oceans and atmosphere, (b) animal and plant species, and (c) parks and reserves; or describe how the exchange will promote: (d) natural resource management, (e) local conservation programs, (f) conservation training programs, (g) public commitment to conservation, (h) land and ecosystem management, and (i) regenerative approaches in farming, forestry, fishing and watershed management.

Not Applicable

17. **Deobligation/Reobligation (FY 1991 Appropriations Act Sec. 515):** If deob/reob authority is sought to be exercised in the provision of DA assistance, are the funds being obligated for the same general purpose, and for countries within the same region as originally obligated, and have the House and Senate Appropriations Committees been properly notified?

Yes

18. **Loans**

a. **Repayment Capacity (FAA Sec. 122(b)):** Information and conclusion on capacity of the country to repay the loan at a reasonable rate of interest.

Sri Lanka maintains a good debt service record.

b. **Long-range Plans (FAA Sec. 122(b)):** Does the activity give reasonable promise of assisting long-range plans and programs designed to develop economic resources and increase productive capacities?

Yes

c. **Interest Rate (FAA Sec. 122(b)):** If development loan is repayable in dollars, is interest rate at least 2 percent per annum during a grace period which is not to exceed

**PSPS PP Supplement: Annex C
Statutory Checklist: Page 13**

ten years, and at least 3 percent per annum thereafter?

Not Applicable

d. Exports to United States (FAA Sec. 620(d)): If assistance is for any productive enterprise which will compete with U.S. enterprises, is there an agreement by the recipient country to prevent export to the U.S. of more than 20 percent of the enterprise's annual production during the life of the loan or has the requirement to enter into such an agreement been waived by the President because of a national security interest?

Not Applicable

19. Development Objectives (FAA Secs. 102(a), 111, 113, 281(a)): Extent to which activity will: (1) effectively involve the poor in development, by expanding access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (2) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (3) support the self-help efforts of developing countries; (4) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (5) utilize and encourage regional cooperation by developing countries?

Second-tier markets, for example, increasingly make capital available to the poorer strata as well as increase opportunities for non-urban populations to participate in capital market activities.

20. Agriculture, Rural Development and Nutrition, and Agricultural Research (FAA Secs. 103 and 103A):

a. Rural Poor and Small Farmers: If assistance is being made available for agriculture, rural development or nutrition, describe extent to which activity is specifically designed to increase productivity and income of rural poor; or if assistance is being made available for agricultural research, has account been taken of the needs of small farmers, and extensive use of field testing to adapt basic research of local conditions shall be made.

Not Applicable

b. Nutrition: Describe extent to which assistance is used in coordination with efforts carried out under FAA Section 104 (Population and Health) to help improve nutrition of the people of developing countries through

encouragement of increased production of crops with greater nutritional value; improvement of planning, research, and education with respect to nutrition, particularly with reference to improvement and expanded use of indigenously produced foodstuffs; and the undertaking of pilot or demonstration programs explicitly addressing the problem of malnutrition of poor and vulnerable people.

Not Applicable

c. Food Security: Describe extent to which activity increases national food security by improving food policies and management and by strengthening national food reserves, with particular concern for the needs of the poor, through measures encouraging domestic production, building national food reserves, expanding available storage facilities, reducing post harvest food losses, and improving food distribution.

Not Applicable

21. Population and Health (FAA Secs. 104(b) and (c)): If assistance is being made available for population or health activities, describe extent to which activity emphasizes low-cost, integrated delivery systems for health, nutrition and family planning for the poorest people, with particular attention to the needs of mothers and children, using paramedicals and auxiliary medical personnel, clinics and health posts, commercial distribution systems, and other modes of community outreach.

Not Applicable

22. Education and Human Resources Development (FAA Sec. 105): If assistance is being made available for education, public administration, or human resource development, describe (a) extent to which activity strengthens non formal education, makes formal education more relevant, especially for rural families and urban poor, and strengthens management capability of institutions enabling the poor to participate in development; and (b) extent to which assistance provides advanced education and training of people of developing countries in such disciplines as are required for planning and implementation of public and private development activities.

Project provides technical training to support economic development.

23. Energy, Private Voluntary Organizations, and Selected Development Activities (FAA Sec. 106): If assistance is being made available for energy, private voluntary organizations, and selected development problems, describe extent to which activity is:

**PSPS PP Supplement: Annex C
Statutory Checklist: Page 14**

Not Applicable

a. concerned with data collection and analysis, the training of skilled personnel, research on and development of suitable energy sources, and pilot projects to test new methods of energy production; and facilitative of research on and development and use of small-scale, decentralized, renewable energy sources for rural areas, emphasizing development of energy resources which are environmentally acceptable and require minimum capital investment;

Not Applicable

b. concerned with technical cooperation and development, especially with U.S. private and voluntary, or regional and international development organizations;

Not Applicable

c. research into, and evaluation of, economic development processes and techniques;

Not Applicable

d. reconstruction after natural or man made disaster and programs of disaster preparedness;

Not Applicable

e. for special development problems, and to enable proper utilization of infrastructure and related projects funded with earlier U.S. assistance;

Not Applicable

f. for urban development, especially small, labor-intensive enterprises, marketing systems for small producers, and financial or other institutions to help urban poor participate in economic and social development.

Not Applicable

C. CRITERIA APPLICABLE TO ECONOMIC SUPPORT FUNDS ONLY

Not Applicable

1. **Economic and Political Stability (FAA Sec. 531(a)):** Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of Part I of the FAA?
2. **Military Purposes (FAA Sec. 531(e)):** Will this assistance be used for military or paramilitary purposes?

3. **Commodity Grants/Separate Accounts (FAA Sec. 609):** If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counter-part) arrangements been made? (For FY1991, this provision is superseded by the separate account requirements of FY1991 Appropriations Act Sec. 575(a), see 575(a)(5).)

4. **Generation and Use of Local Currencies (FAA Sec. 531(d)):** Will ESF funds made available for commodity import programs or other program assistance be used to generate local currencies? If so, will at least 50 percent of such local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106? (For FY 1991, this provision is superseded by the separate account requirement of FY 1991 Appropriations Act Sec. 575(a), see Sec. 575(a)(5).)

5. **Cash Transfer Requirements (FY1991 Appropriations Act, Title II, under heading "Economic Support Fund," and Sec. 575 (b)):** If assistance is in the form of a cash transfer:

a. **Separate Account:** Are all such cash payments to be maintained by the country in a separate account and not to be commingled with any other funds?

b. **Local Currencies:** Will all local currencies that may be generated with funds provided as a cash transfer to such a country also be deposited in a special account, and has A.I.D. entered into an agreement with that government setting forth the amount of the local currencies to be generated, the terms and conditions under which they are to be used, and the responsibilities of A.I.D. and that government to monitor and account for deposits and disbursements?

c. **U.S. Government Use of Local Currencies:** Will all such local currencies also be used in accordance with FAA Section 609, which requires such local currencies to be made available to the U.S. Government as the U.S. determines necessary for the requirements of the U.S. Government, and which requires the remainder to be used for programs agreed to by the U.S. Government to carry out the purposes for which new funds authorized by the FAA would themselves be available?

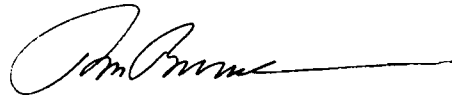
d. **Congressional Notice:** Has Congress received prior notification providing in detail how the funds will be used, including the U.S. interests that will be served by the assistance, and, as appropriate, the economic policy reforms that will be promoted by the cash transfer assistance?

**PSPS PP Supplement: Annex D
611 A Certification**

**Certification Pursuant to Section 611 (a)
of the Foreign Assistance Act of 1961, as amended**

I, Richard Brown, Mission Director of the Agency for International Development in Sri Lanka, having taken into account among other things, that the project design includes adequate financial analysis and planning to properly estimate the costs of project technical assistance, commodity purchases, and training activities to be funded, and do hereby certify that, in my judgement, Sri Lanka has both the financial capability and adequate human resources to effectively utilize the inputs provided by this project.

This judgement which is fully detailed in the project budget and analysis presented in the PP Supplement to the Private Sector Policy Support project, is based upon historical cost of similar projects, and is subject to the conditions imposed therein.



Richard M. Brown
Mission Director
USAID/Sri Lanka

6/3/92

Date

ENVIRONMENTAL ASSESSMENT
Request for Categorical Exclusion

Project: Capital Markets Development -- PP Supplement
to the Private Sector Policy Support
Project - 383-0100

Funding: \$7.0 million

FACD: July, 1996

Previous Action: The PSPS project received categorical
exclusion from the procedures set forth
in 22 C.F.R. 216.3, in accordance with
22 C.F.R. 216.2(c)(1) and (2)

Recommended Action: Grant categorical exclusion to the
PP Supplement under 22 C.F.R. 216.2(c)

**Basis for
Recommendation:**

The PP Supplement places additional resources and emphasis on developing Sri Lanka's capital markets, regulatory institutions, and investor participation in financial market activities. Technical assistance, the primary input, will be provided to strengthen the analytical, management, and regulatory capacity of key capital market institutions. The PP Supplement provides neither funds nor investment advice to public or private financial institutions. Therefore, a categorical exclusion is recommended since the scope of the technical assistance provided focusses on capital markets institutional development.

**Asia Bureau
Environmental
Officer Action:**

Approve

M. Kux

Disapprove

Date

3-26-92

Molly Kux

12/1x

USAID/Sri Lanka
Environmental
Officer Action:

Approve Stanley C. Stalla
Disapprove _____
Date April 27, 1992
Stan Stalla

USAID/Sri Lanka
Mission Director:

Approve Richard Brown
Disapprove _____
Date April 27, 1992
Richard Brown

Summary of Evaluation Findings, Conclusions and Recommendations

In July 1988, USAID authorized \$15 million for the Private Sector Policy Support (PSPS) project. This grant was authorized on July 20, 1988, and has a project assistance completion date (PACD) of July 31, 1993. The project aims to:

- promote capital market development
- establish a privately owned venture capital company
- support the GSL privatization effort
- strengthen the private sector's contribution to market-oriented economic policies.

The primary objective of this first report to USAID/Colombo and the Government of Sri Lanka (GSL) is to assess progress in project implementation and to recommend any necessary changes to better achieve project objectives. A secondary purpose is to examine original project assumptions in light of recent political and economic changes in Sri Lanka and, on this basis, to recommend alternative or additional activities which should be considered for project support.

Capital Markets/Venture Capital

A. Findings & Conclusions - Sri Lanka

- ~~The stock market has boomed in almost every respect, though there are still~~ relatively few stock holders.
- The Sri Lankan public's awareness of the possibilities and potential benefits of investing in shares has grown.
- The Securities Exchange Commission (SEC) has been strengthened through the passage of important legislation. There is however a lack of well-paid staff and a need for increased enforcement of the stock exchange.
- The Central Depository System (CDS) came on stream in September and its operations are being constantly improved, though operational and staffing issues remain unresolved.

B. Findings and Conclusions - Project

- The Project played a large role in building up public awareness of the stock market.
- USAID funded the Central Depository System at a very minimal cost and it is up and running.

C. Recommendations

We specifically recommend that the appropriate parties:

1. Improve the supply of and demand for shares.
2. Continue the Public Awareness program and undertake planned training programs in financial reporting and coverage of the stock market.
3. Continue to provide technical assistance to the SEC as vital pieces of securities legislation are developed.
4. Continue to strengthen and expand the role of the Colombo Stock Exchange and encourage and support enactment of needed organizational and structural changes.
5. Maintain and expand the Central Depository System.

The venture capital firm, EQUILL, has made investments in four companies and will shortly include a fifth. At this point, it is too early to assess EQUILL's investment performance, but it has nevertheless fulfilled USAID's major objective of being up and running and actively searching for investment opportunities.

Privatization

A. Findings & Conclusions - Sri Lanka

- The last two years have seen a significant movement in preparing and privatizing companies.
- Efforts to privatize are hindered by a lack of public awareness of the privatization process and by operational and staffing difficulties.

B. Findings and Conclusions - Project

- USAID-supported privatizations are on schedule and more companies will be privatized in 1992.
- The TA contractor has been helpful in many respects, though his role has been marginal in many others.

C. Recommendations

1. Improve Public Awareness of the Privatization Process.
2. Address a Number of Operational Issues including a greater role for the Technical Assistance Contractor, the need for additional GSL staffing for privatizations, more care towards structuring transactions and marketing privatizations.

3. AID should support the above two recommendations.

Policy Support Unit

A. Findings & Conclusions - Sri Lanka

- The institutional base of the private sector organizations is being strengthened through better research, technical skills and relations between individual groups and other institutions.
- Private sector groups and interests have become more aggressive in the last couple of years in formulating policies and making representations to the public sector on behalf of these interests.

B. Findings and Conclusions - Project

- The AID-assisted program has achieved impressive results during its first year, especially in research activities, working with private sector organizations and hosting conferences. In addition, thirteen grants have been approved representing 66 percent of the budgeted amount, 15 percent of which has already been disbursed.
- These results were achieved in spite of problems between the Colombo and U.S. offices of the subcontractor.

C. Recommendations

1. Find a suitable new Chief of Party for the subcontractor.
2. Delegate authority to the Colombo office of the subcontractor away from the U.S. office. The U.S. office should focus more on mapping out long term strategy.

Lessons Learned

- Multi-faceted approaches to developing a stock market -- public awareness, training, developing of the regulatory structure and stock market operations, the efforts to promote the supply of and demand for shares, and the linkages to the privatization program -- appear to work well.
- Experienced financial professionals can help seize opportunities to promote and develop linkages with the international market.
- A strong synergy can be created through simultaneous support for the capital market and privatization.
- Public awareness of how privatization works and proper marketing of these transactions are essential.



**SECURITIES AND
EXCHANGE COMMISSION
OF SRI LANKA**

(Incorporated under Act No. 36 of 1987)

2nd Floor, Mackinnons Building York Street Colombo 1. Telephone: 437086 Fax: 447603

MAY 21 1992

OFFICE	ACT	INFO
DIR/DO		
MSG		
PRM		
EXO		
CTA		
PRJ		
ANR		
PER	X	W/A
CLERK		
DATE DATE	6/2	
ACT. TAKEN		
FILE STA		
MAN		
INITIALS		

19 May 1992

OFFICIAL FILE COPY

Mr. Richard M. Brown
Director
United States Agency for International Development
356, Galle Road
Colombo 3.

Dear Mr. Brown,

The Securities & Exchange Commission, on behalf of the Government of Sri Lanka, wishes to express its interest in participating with the United States Agency for International Development in a program to substantially increase the activity of the financial markets in Sri Lanka. We see this as critical to raising the necessary quantum of new investment which will be required if Sri Lanka is to grow at the rate of seven to eight percent of GDP per annum.

The Securities & Exchange Commission seeks the assistance of USAID in developing a regulatory environment which will ensure the investing public of an orderly, well managed, and fair market. The Securities & Exchange Commission sees the current market expanding beyond the trading of equity issues, to include long and medium term government and private sector debt securities. To this end, the Government of Sri Lanka is in the process of transferring the trading of Treasury Bills to competent private sector establishments, and has asked the Securities & Exchange Commission to help with the regulation of trading of these Bills also through the Stock Exchange in order to widen the secondary market for these Bills.

In addition to monitoring and regulatory assistance, the Colombo Stock Exchange needs assistance in further developing the post trade automation system and their central depository system, to be able to process in an accurate and timely fashion the fast developing market for equity investments, and to prepare to take on the additional task of making a market for debt investments.

And, finally, the financial community as a whole requires training and standards to achieve the level of professionalism which will be required if the Sri Lankan financial markets are going to be effective on an international level.

Yours truly,

L. Stanley Jayawardena
Chairman

REFERENCE NO.	92/1101
DATE RECEIVED	05.01.92
ACT. TAKEN	

Copies: Secretary, M/F
Director General

L. S. JAYAWARDENA (Chairman)
H. B. DIANAYAKE
B. MAHADEVA
S. T. G. FERNANDO
A. C. DE ALWIS

M. PASUPATI
S. K. WICKREMESINGHE
G. L. PEIRIS
G. C. B. WUEYESINGHE
N. A. L. CABRAAL

LSJ/LSJ

Amplified Project Description

I. General Project Description

The Amended Project proposes additional interventions in the financial markets arena based upon the existing Capital Markets component of the PSPS project. The amended **Project Purposes** expands upon the original project's third component which is to further develop the capacity of the Sri Lankan capital market to broaden public equity and debt participation in the economy and increase capital resources for investment. Several significant changes in the financial markets must occur in order to meet this purpose. These changes are identified as **Project Outputs** and are detailed in I(A) to (C).

A. Improve the reliability of market information by further expanding the Securities and Exchange Commission of Sri Lanka (SEC,SL) and the Colombo Stock Exchange (CSE) capacity to serve a rapidly growing capital market. These will be achieved by the following activities;

1. Regulation and Self Regulation

This amendment will assist the staff of SEC,SL to respond to the new regulatory obligations arising from a rapidly growing market and CSE's efforts at ~~self-regulation to meet a wide~~ variety of market risks. A.I.D. will provide technical assistance and on-the-job and overseas training tours by the regulatory personnel of the two institutions to implement a series of recommendations arising from earlier reports.

By the end of the project period SEC,SL will be fully functional, staffed by trained personnel, effectively supervising a market that encompasses listed securities -- both in the main-board and a second-tier market -- including both equities and debt, and several new financial intermediaries such as unit trusts. The CSE will have an effective self-regulatory unit in-place, addressing a wide range of market risks.

2. Financial Reporting

A.I.D. will provide for reforms in accounting standards setting, standard implementation and monitoring of financial reporting. The program will establish a linkage between the users and the

providers of financial information, through the intermediation of SEC,SL and the CSE. The program will provide technical assistance, in-country training and a program of grants to stimulate and develop in-country research on standard setting, training on standards and their implementation for members and student accountants of the Institute of Chartered Accountants of Sri Lanka (ICASL), and establish a mechanism for monitoring of compliance on standards by the listed companies.

By the end of the project period, ICASL would have the capacity to respond to market needs as anticipated by the SEC,SL and CSE for improved financial reporting. ICASL would have developed linkages with the research community, and have established a core staff of specialists to overlook the standard setting, monitoring and compliance. The existing members of ICASL would have been exposed to the new standards, and the private accounting training institute will have enhanced tools for the teaching of accounting and auditing standards to students.

3. Post Trade Automation System (PTA)

The Amendment will further enhance the Post Trade Automation and the Central Depository System (PTA/CDS).

~~A.I.D.~~ will provide commodities for a back-up system to improve systems reliability, and technical assistance for systems management, systems audit and review and investigation of alternative "products" to be launched by the PTA/CDS. The assistance will include overseas training for the CSE systems personnel.

By the end of the project period, CSE will have a more reliable PTA/CDS system, with better response time, less down time and a reduced error rate. The system will be poised to offer new information services to the market, and the staff will be adequately trained to manage the system. The CDS will be continue as a financially viable going-concern.

- B. Increase the availability of financial instruments by the following activities:

1. Development of a Second-Tier Market

The amendment will assist the SEC, SL and the CSE to establish a second-tier market and enhance the capacity of the existing PTA/CDS to link the brokers and broker/dealers to facilitate screen-based trading. The Amendment will provide technical assistance to establish a second-tier market, program coding of the CDS and a series of in-country training programs for private sector market intermediaries, and short-term overseas placement in U.S. institution for both the players and the regulators.

The Government will implement the necessary enabling regulation to implement the Second-tier market.

By the end of the project period, a second tier market will be established and functioning using electronic trading. Financial intermediaries will be working together with companies to access the market for capital. Venture capital companies will be exiting investments using the second-tier market. There will be an increase in the supply of available securities.

2. Development of a market for Quoted Debt Securities

~~The project will provide assistance to strengthen the secondary~~
market in Treasury Bills being created by the Government. A.I.D. will finance technical assistance to implement a screen based trading system for bonds, and provide funding for in-country training seminars in bond trading. Related short courses will also be provided for portfolio investors to utilize bonds as a part of their portfolio. Additionally, the project will finance overseas tours for Central Bank officials in the areas of public debt and open market operations to observe regulation and oversight activity in a developed market which utilizes screen based trading. A display terminal will also be provided the Central Bank officials to observe market performance on a real-time basis.

With the establishment of an effective secondary market in short-term bills, the Government will consider establishing a secondary market in the longer term government securities.

By the end of the project period, a secondary market in

Government Securities will be established and functioning with participation by both the general public and institutions. Several Corporate Debentures will be quoted in the market.

- c. Assist the development of new forms of financial intermediation in the capital market by enhancing the analytic capability of market participants by the following activities;

1. Certification of Securities Markets Professionals

The program will launch, establish and gain official recognition of the widely recognized U.S. certification of The Institute of Chartered Financial Analysts (ICFA), an autonomous professional self-regulatory organization based in Virginia. Their program is aimed at training securities analysts and portfolio managers in both the brokerage firms and institutional investors. USAID will sponsor approximately 45 students for the CFA program during the initial two years of the project, totalling 90 students. The program will meet the costs of registration, fees, examinations and books. In addition USAID will also meet costs of promotion of the CFA program, the one time costs of reference material that will be presented to the Securities and Exchange Commission's library, costs of short-term trainers (both expatriate and local) and development of teaching tools. USAID will also fund a long-term trainer who will co-ordinate this and other training programs.

The Government will take the necessary steps to create the enabling environment for the establishment of this certification program including formal recognition of the program by the SEC,SL.

By the end of the project period, the CFA program will be a well recognized point of entry for professionals in the securities industry in Colombo. The market will have at least 60 qualified professionals who would be active in a variety of financial market activities. There will be at least 40 other privately funded students at various stages of obtaining certification and the training institutes will be servicing the needs of these students effectively.

2. Assistance to Emerging Financial Institutions

The project will provide technical assistance and in-country training for the emerging financial institutions including unit trust, insurance companies, retirement funds, venture capital companies, investment banks and brokers that are becoming active in fresh market segments. The assistance will be based on proposals for such services as and when forwarded by the institutions. These proposals will be reviewed and approved by the contractors, based on their contribution to the overall project purpose.

By the end of the project period, there will be new institutions -- such as Unit Trusts, Insurance Companies, Retirement Funds, Venture Capital Companies and Merchant Banks -- active in fresh market segments. Existing institutions such as the brokers and commercial banks will also be active in new market segments.

II. Responsibilities of the Parties

Prior to the mobilization of the Chief-of-Party and the training specialist funded by A.I.D. technical support program for Capital Markets, the Government will ensure that a user tax ("cess") on equity securities being transacted in the secondary market, which is adequate to meet the costs of the Securities and Exchange Commission (SEC,SL) operations, is in place.

The Government will also ensure that the SEC,SL senior staff members responsible for market regulation and financial reporting are recruited and in place prior to the mobilization of the technical assistance specialist on Regulation. In addition, the Government will take all reasonable steps to hire and maintain an adequate staff cadre to discharge its regulatory functions.

The Government, through its regulatory body, the SEC,SL, will consider using a portion of the funds raised by the "cess" on traded securities to finance the continued monitoring of financial reporting and standards development for quoted public companies by the Institute of Chartered Accountants of Sri Lanka.

The Government will also provide office space for the project-funded technical assistance contractors at the SEC,SL.

A.I.D. will enter into a direct contract for technical assistance to the SEC,SL,

the CSE and the ICASL. The contractors will be responsible for providing the long and short-term consultants, overseas and local training, and equipment and services related to the certification program.

A.I.D. will enter into a direct contract to provide automated data processing equipment to the CDS.

A.I.D. will enter into a Cooperative Agreement with the ICASL, to manage a program of sub-grants.

III. Illustrative Financial Plan

The financial plan, attached to this Amplified Project Description as Attachment 1, is illustrative. Changes may be made to the plan by representatives of the parties named in the text of the Agreement without formal amendment to the Agreement if such changes do not cause (1) A.I.D.'s contribution to exceed the amount specified in the text of the Agreement, or (2) the Grantee's contribution to be less than the amount specified in the text of the Agreement. Adjustments between line items which exceed 15% must be agreed in writing. Future A.I.D. obligations are subject to the availability of funds and mutual agreement of parties to proceed.

IV. Financing Method

A.I.D. will make direct payments to the technical assistance contractors, commodity procurement contractors and cooperative agreement recipients on receipt of appropriate documentation.

V. Evaluation

Two further evaluations are scheduled. A final evaluation on the activities undertaken under the original project will be concluded in July 1993. A final evaluation scheduled to be completed near the end of the project will evaluate the above activities undertaken under the Amended Project. The focus of this final evaluation will be on (i) the project's achievement of its purposes, (ii) identification of significant successes and failures and the factors which contributed to them, and (iii) identification of the next steps (if any) that A.I.D. and host country institutions should take to consolidate gains made during the life of the project.

F. Special Considerations

The CSE will have title to the equipment provided under the project, including the CDS.

The ICASL will have title to the equipment provided under the project.

**PSPS PP Supplement: Annex H
Amplified Project Description: Page 8**

A.I.D. Project No.383-0100

Annex G
Attachment 1

PRIVATE SECTOR POLICY SUPPORT

PROJECT FINANCIAL PLAN

(Source and Application of Funding - \$000s)

PROJECT INPUTS	A	I	D	T	O	T	A	L	PROJECT
	Cumulative Oblig.	Add'l Oblig., Amendment No.4 FY 1992	Future Years Anticipated*	AID		GSL**	OTHER***		
1. Policy Support	2,100	846	-	2,946		-	350		3,296
2. Privatization Support	7,450	1,266	-	8,716		13,720	-		22,436
3. Capital Markets Development	2,514	924	5,476	8,914		1,861	679		11,454
4. Venture Capital Company	400	44	-	444		-	3,333		3,777
5. Audit, Monitoring & Evaluation	180	50	125	355		-	-		355
6. Contingency & Inflation	-	-	625	625		-	-		625
TOTAL	12,644	3,130	6,226	22,000		15,581	4,362		41,943

* All future obligations are subject to the availability of funds and the mutual agreement of the Parties to proceed.

** The GSL total includes in kind contribution and staff salaries.

The GSL contribution for this project is based on an exchange rate of Rs.40.00 to US \$1.00.

*** Contributions anticipated from the private sector in Sri Lanka.