Chapter 3

ECONOMIC AND SOCIAL INFRASTRUCTURE

3.1 Overview

- **An efficient and developed economic and social infrastructure base across all geographic regions is vital for creating opportunities for rapid economic growth, employment generation and poverty alleviation.** Primary economic infrastructure facilities are transport, telecommunications, energy and other utilities such as water supply. The main social infrastructure services are education, health and safety nets.
- **The modern era is characterised by an intensification of demand for high quality infrastructure services by both domestic and international sectors.** Domestic demand arises from continuing economic growth and the renewed efforts at enhancing regional economic growth. Increasing globalisation and the rapid growth in the South Asian region have increased international demand for high quality infrastructure services from Sri Lanka. Furthermore, the gradual deepening of globalisation has raised demand for greater liberalisation of services, especially from countries seeking greater market access for the supply of services such as Business Process Outsourcing (BPOs), health, education and professional services.
- **Infrastructure facilities have been expanding in the country but they are not adequate or competitive yet, thereby constraining economic growth.** The adequacy and the quality of services provided by public enterprises in the areas of electricity generation, transmission and distribution, passenger transportation and water supply leave much to be desired. Many essential services, such as healthcare and education are to some extent, even obtained from abroad by Sri Lankans. The country has the potential to develop these service sectors and turn them around to be significant foreign exchange earners. Nevertheless, infrastructure facilities in the liberalised service sectors such as ports and telecommunications have demonstrated improved performance and an ability to face competition.
- **Many state owned infrastructure related institutions continue to incur large operational losses despite being monopolies in essential sectors.** Inability to implement realistic pricing policies, low productivity/efficiency, principal agent problems,[1] rent seeking, absence of effective regulatory systems and political interference are the major reasons for the lacklustre performance of state institutions. In the absence of proper pricing and regulatory systems, natural resources are being exploited in an unsustainable manner. Principal agent problems and rent seeking lead to lower quality and inadequate production of services. The ineffectiveness of regulations and undesirable political interference aggravate these problems. Therefore, a renewed effort has to be made to introduce the necessary reforms in the infrastructure service sector of the economy.
- **Recognising these weaknesses, the government has taken measures to enhance the supply of infrastructure services through the continuing liberalisation and strengthening of public sector institutions.** Accordingly, current reforms are focused on introducing institutional reforms, promoting public-private partnerships, improving competition, freeing public enterprises from political interference and enhancing their accountability, establishing appropriate pricing mechanisms and strengthening regulations. In line with this policy focus, the Strategic Enterprise Management Agency (SEMA) continued to monitor strategic public institutions.[2] Decisions have been taken to implement the Upper Kotmale hydropower plant and a coal power plant. Institutional changes have been introduced in the transport sector by re-establishing Sri Lanka Railways and the Sri Lanka Transport Board. *Maga Neguma* and *Gama Neguma* programmes have been introduced to improve rural infrastructure. The implementation of the key recommendations made by the Presidential Task Force (PTF) on Health in 1997 continued within the framework of the National Health Development Master Plan. The reforms introduced in relation to education in 1999 continued, aiming at improving education infrastructure, enhancing quality and reducing regional disparities. Further, under the National Council for Economic Development (NCED), clusters have been formed to look into issues pertaining to telecommunications, renewable energy, transportation, health and education, with a view to promoting development through collective and collaborative efforts by all stakeholders.

1. The Principal Agent Problem occurs when the managers in control (the agents) act in their own interest rather than the interest of the owners (the principals), due to different set of incentives

2. Ceylon Petroleum Corporation (CPC), Ceylon Electricity Board (CEB), Sri Lanka Ports Authority (SLPA), Sri Lanka Railways (SLR), Airport and Aviation Authority of Sri Lanka (AAASL), Sri Lanka Transport Board (SLCTB) and Cluster Bus Companies (CBCs) and the National Water Supply and Drainage Board (NWSDB) were the infrastructure related public enterprises brought under the purview of SEMA in 2004.

Table 3.1
Government Investment in Infrastructure

Year	Economic Services		Social Services		Total Services	
	Rs.bn.	% of GDP	Rs.bn.	% of GDP	Rs.bn.	% of GDP
1996	31.4	4.1	10.3	1.3	41.7	5.4
1997	32.5	3.6	11.6	1.3	44.0	4.9
1998	44.7	4.4	15.5	1.5	60.2	5.9
1999	44.9	4.1	17.5	1.6	62.4	5.6
2000	54.7	4.4	16.5	1.3	71.1	5.7
2001	54.9	3.9	14.6	1.0	69.5	4.9
2002	51.7	3.4	15.7	1.0	67.4	4.3
2003	58.7	3.3	19.2	1.1	77.9	4.4
2004	61.3	3.0	29.0	1.4	90.3	4.4
2005(a)	77.5	3.3	60.4(b)	2.5	137.9	5.8

(a) Provisional
(b) Inclusive of tsunami related capital expenditure
Source: Central Bank of Sri Lanka

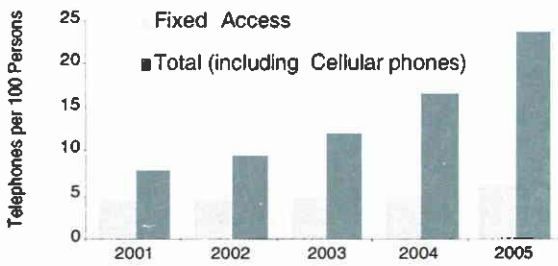
- **Performance of infrastructure services was mixed in 2005.** Telecommunication services grew remarkably in 2005 supported by the introduction of Code Division Multiple Access (CDMA) technology and the rapid expansion of mobile telephones. Port services recorded a significant growth with increased international trade, tsunami related imports and improved productivity. The electricity and petroleum sectors suffered from historically high oil prices. The passenger transportation services operated by the state owned bus companies have expanded marginally with the addition of a new fleet of buses, but the performance of Sri Lanka Railways indicated a setback during 2005. Air transportation has shown a modest growth amidst increasing fuel prices and a slow growth in tourism. Domestic air services expanded significantly. In the education sector, 15,000 university graduates and 3,706 students who had completed their education at National Colleges of Education were recruited as teachers. Two new state universities, the Uva Wellassa University and the University of the Visual and Performing Arts, were established in 2005. In the health sector, the number of hospital beds increased by about 3 per cent and the number of doctors in the public health service increased by 4 per cent in 2005. The housing market expanded further in response to developments in the real estate and financial markets and rising income levels.

3.2 Economic Infrastructure Policies, Institutional Set up and Performance

Communications Services

- **The telecommunications and postal services are the two major communications services operating in the country. These complement and compete with each other.** The telecommunications service has become one of the fastest growing sectors of the economy supported by strong reforms and healthy competition. In contrast, the postal services recorded a sluggish growth in the absence of reforms.
- **The reforms introduced since 1981 have made telecommunications one of the most liberal, competitive and fast growing infrastructure services in the country.** Vigorous competition was seen among 3 fixed access telephone operators, 4 mobile telephone operators, 32 external gateway operators, 29 data communication and Internet service providers, 4 paging operators, 2 payphone operators and 2 trunk radio operators. During the year, the sector continued to derive benefits from the opening of the external gateway operations in 2003. As a result, international connectivity improved remarkably and charges were reduced significantly, benefiting both domestic and corporate consumers. The subscriber network of the telecommunications sector expanded by 45 per cent in 2005 with the fixed access network growing by 26 per cent and mobile telephone subscribers growing by 54 per cent. The introduction of CDMA technology supported the growth in fixed access network. CDMA technology has narrowed the urban rural disparity in access to telephone services. Mobile telephone penetration (the share of mobile phones in the total number of telephones) in the telecommunications sector further increased to 73 per cent in 2005 from 71 per cent in 2004, benefiting from improved technology, aggressive competition, affordability, quick connectivity and large coverage. With these developments, the national telephone density (telephones per 100 persons) for fixed access telephones increased from 5.1 to 6.3, while total telephone density including cellular phones increased from 16.4 to 23.6 in 2005. Subscribers to Internet and e-mail services increased by 23 per cent in 2005.
- **Several telecommunications projects were in progress in 2005 to further expand telecommunication facilities in the country.** Construction of a submarine cable system between India and Sri Lanka was initiated in September 2005. Sri Lanka will be able to secure fast telecommunications connectivity at cheaper rates with India and other SAARC countries with the commissioning of this submarine cable system in 2006. The SEA-ME-WE-IV (South East Asia-Middle East - West Europe-IV) submarine cable project was commissioned in 2005 with 15 international partners. This would enhance the quality and bandwidth of Sri Lanka's telecommunication services. Sri Lanka Telecom (SLT) was the local partner of both these projects. In addition, mobile telephone operators implemented several projects to upgrade and expand their services.
- **Sri Lanka has the potential to further develop Information and Communication Technology (ICT) related services.** Given the high level of literacy in Sri Lanka, there is potential to further develop information technology based services for overseas and domestic clients such as BPOs, telemarketing, call centres, data processing and internet based products.

Chart 3.1
Telephone Density



- **The traditional postal services are increasingly challenged by rapid developments in ICT and emerging private postal and courier services.** The postal infrastructure in the country represents one of the largest networks in the services sector with over 4,000 state sector post offices located throughout the country. With appropriate reforms and the incorporation of developments in ICT, the postal sector has the potential for developing into a modern system to deliver a better service with a multitude of products such as agency functions relating to financial and insurance and data transfer. The delays in reforms required for modernisation will result in further weakening the quality of services, a loss of market share to other competing services and the continuation of operational losses. These losses would add to the already high fiscal burden. In 2005, the total operating expenditure of the Department of Posts (DOP) grew slightly to Rs 4,298 million. Its revenue collection was Rs. 2,644 million. Consequently, its operating loss amounted to Rs.1,654 million in 2005.

Table 3.2
Growth of Postal and Telecommunications Services

Item	2004	2005(a)	Growth Rate 2004	Growth Rate 2005(a)
1. Telecommunications services				
1.1 Fixed access services				
SLT Telephone lines in service (No.)('000)	860	954	5.1	10.9
New telephone connections given by SLT (No.)('000)	54	117	-14.3	116.7
Wireless local loop telephones ('000)	131	290	12.9	121.4
Telephone density (Telephones per 100 persons)	5.1	6.3	4.1	23.5
1.2 Other services				
Cellular phones ('000)	2,211	3,393	58.7	53.5
Public pay phones	6,095	6,285	-5.4	3.1
Radio paging services	828	-	71.0	-
Internet & e-mail	93,300	115,072	9.1	23.3
2. Postal service				
Delivery areas (No)	6,729	6,729	0.0	0.0
Post offices (No)	4,711	4,704	1.7	-0.1
Public	4,049	4,041	0.0	-0.2
Private	662	663	14.1	0.2
Area served by a post office (Sq.km)	13.9	13.9	-1.4	0.0
Population served by a post office	4,100	4,100	0.4	0.0
Letters per inhabitant	24	25	0.0	4.2

(a) Provisional

Sources: Sri Lanka Telecom Ltd.
Telecommunications Regulatory Commission of Sri Lanka
Department of Posts

Energy

- **Major energy sources in Sri Lanka are biomass, hydro electricity and petroleum.** Biomass contributes to 47 per cent of the total energy requirement, followed by petroleum (45 per cent) and hydro electricity (8 per cent). The contribution from alternate energy sources such as solar power and wind power is insignificant. The share of petroleum in the total energy supply has been rapidly increasing from 32 per cent in 1996 to around 45 per cent in 2005 as a result of the increasing demand, the slow growth in hydropower generation and slow adoption of alternate energy sources.
- **Electricity: The installed capacity for electricity generation increased moderately in 2005 but fell short of the demand for electricity, which is growing at 8-10 per cent annually.** The installed capacity, which expanded by 3 per cent to 2,407 MW was the combined effect of the commissioning of power plants by the private sector, the 100 MW thermal power plant at Embilipitiya and 5 mini hydropower plants with a total capacity of 7 MW. Consequently, the composition of the power system was as follows: 1,287 MW (54 per cent) of hydropower, 1,115 MW (46 per cent) of thermal power and 5 MW of other sources. To meet the growing demand, the electricity generating capacity has to be augmented by around 200 MW per annum. Although a serious power shortage is not expected in 2006, assuming normal weather conditions, the supply of electricity is at risk since there are no major power generating projects to be completed in 2006 and 2007. The demand for electricity is on the increase; both domestic and general purpose consumption grew by 11 per cent, while industrial sector consumption grew by 8 per cent.
- **Supply of electricity grew by 7.4 per cent to 8,766 GWh in 2005.** Hydro electricity generation grew by 17 per cent and thermal power generation grew by 16 per cent in 2005. The share of hydropower in total electricity generation increased to 39 per cent in 2005 from 37 per cent in 2004, due to higher rainfall in catchment areas, particularly during the latter part of the year. The share of thermal power generation declined to 61 per cent in 2005. The share of the private sector in power generation that has been rising, grew to 39 per cent in 2005 while the share of electricity generated by the CEB declined to 61 per cent.

- **The long-term sustainability of the electricity sector is being threatened by delays in implementing new low cost power plants, the non-implementation of necessary reforms and the delay in addressing the high system losses.** Considerable delays in the implementation of the already planned power projects such as the combined cycle power plant at Kerawalapitiya (300 MW), the first phase of the coal power plant (300 MW) and the Upper Kotmale hydropower plant (150 MW) could threaten the provision of an uninterrupted power supply in the future. The average fuel cost of the CEB increased by 19 per cent in 2005 due to the compounded effect of higher oil prices and heavy reliance on thermal power generation. This has led to the further erosion of the financial position of the CEB, burdening the government, as electricity tariffs remained unchanged in 2005. Electricity tariffs remain unchanged since April 2002 despite sharp increases in petroleum prices. Efforts to raise tariffs by 3.5 per cent in 2003 and increase the fixed charge by about 100 per cent in 2005 were unsuccessful due to protests by consumers. The proposed increase in the fixed charges is to be implemented from early 2006. In 2005, the average cost of production was Rs.10.35 per unit. However, the average tariff was Rs.7.70 per unit leading to a significant loss to the CEB. However, the existing tariff is high compared with tariff in other countries. The losses of the CEB have increased further due to the use of high cost short-term power plants operating in some parts of the country and high system losses of the CEB, which increased to 17.3 per cent from 17.1 per cent a year ago. According to provisional accounts, the net operating loss of the CEB increased by 49 per cent to Rs.16 billion during 2005. Short-term liabilities and payment arrears of the CEB have increased further. Short-term borrowings from commercial banks and payment arrears to the Ceylon Petroleum Corporation (CPC) and Independent Power Producers (IPP) amounted to Rs.26 billion at the end of 2005. In addition, payment arrears and future payment obligations on CEB's long-term loans, amounted to Rs.53 billion by end December 2005.

Chart 3.2

Average Tariff and Cost of Electricity

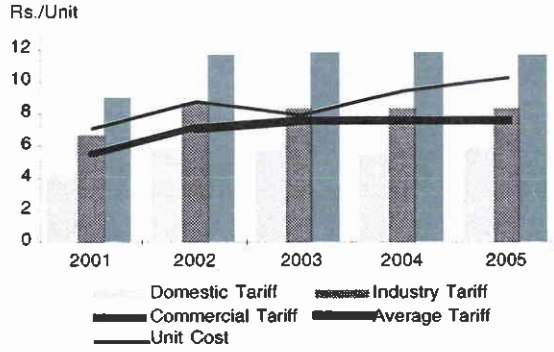


Table 3.3

Power Sector Performance

Item	2004	2005(a)	Growth Rate 2004	Growth Rate 2005(a)
Available capacity (MW)	2,378	2,427	6.0	2.1
Installed capacity	2,329	2,407	4.8	3.3
Hydro	1,280	1,287	2.6	0.5
Thermal	1,025	1,115	5.3	8.8
Wind	3	3	0.0	0.0
Hired private power	20(b)	–	0.0	–
Units generated (GWh)	8,159	8,766	7.2	7.4
Hydro	2,961	3,450	-10.5	16.5
Thermal	4,571	5,314	17.1	16.3
Wind	3	2	-11.5	-33.3
Hired private power	509	–	29.1	–
Total sales by CEB (GWh)				
Domestic and religious	2,204	2,444	8.6	10.9
Industrial	2,266	2,446	5.0	7.9
General Purpose	1,132	1,254	8.6	10.8
Bulk sales to LECO	981	1,027	9.7	4.7
Street lighting	83	83	0.0	0.0
LECO sales (GWh)	912	972	8.2	6.6
Domestic and religious	435	464	8.2	6.7
Industrial	225	241	5.1	7.1
General Purpose	191	210	13.7	9.9
Street lighting	23	24	4.5	4.3
Other	38	33	2.7	-13.2
Overall System loss of CEB (%)	17.1	17.3	-10.5	1.2
Number of Consumers (b) ('000)	3,597	3,802	6.4	5.7
Domestic and religious	3,182	3,361	6.3	5.6
Industrial	37	38	4.7	2.7
General Purpose	378	403	7.5	6.6

(a) Provisional
(b) Inclusive of LECO consumers

Sources: Ceylon Electricity Board
Lanka Electricity Co. (Pvt) Ltd.

- **The initial proposal to restructure the power sector by unbundling of the CEB has been revised.** Unbundling of the CEB by creating two power generation companies, one transmission company and five distribution companies was proposed in the Electricity Sector Reforms Act No.28 of 2002. This structure was modified as per the Power Sector Concept Paper, presented to the Cabinet in July 2005, taking into consideration proposals made by trade unions. Under the proposed reforms, the power sector would be regulated by the Public Utilities Commission of Sri Lanka (PUCSL) established in 2003.
- **Petroleum: The domestic petroleum sector was seriously affected by the historically high oil prices in 2005.** Expenditure on petroleum imports increased by 37 per cent to US dollars 1,655 million in 2005 driven by an equal increase in prices. Domestic petroleum prices were not adjusted monthly as per the pricing formula, but some adjustments were made in May and June 2005 raising petrol, diesel and kerosene prices by 18 per cent, 19 per cent and 20 per cent, respectively. The delayed and inadequate adjustments in prices caused a significant financial strain on petroleum distributing companies, the CPC and Lanka IOC Ltd (LIOC), compelling them to claim subsidies amounting to Rs. 26 billion (about 1 per cent of GDP) in 2005 from the government. To limit its impact on the general

price level, the government removed the 15 per cent VAT on diesel with effect from August 2005.

- **The demand for major petroleum products (petrol, diesel and kerosene) increased by 3 per cent in 2005, in comparison to a 10 per cent increase in 2004.** The largest petroleum use in Sri Lanka is for transport (50 per cent), followed by power generation (25 per cent) and industries, households and other sectors (25 per cent). The growth of petrol consumption further decelerated to 6 per cent in 2005 from 11 per cent a year ago responding to the price increases during the year. Auto diesel sales dropped by 11 per cent mainly due to the increased use of furnace oil for power generation and increased hydropower generation, particularly during the latter part of the year. The demand for kerosene increased marginally in 2005.
- **The financial position of the CPC improved in 2005 due to progress made in financial management, internal control and external financial support, but its medium term liabilities have increased.** The establishment of a Treasury Management Unit in 2001 helped rationalise the loan portfolio of the CPC thereby reducing finance cost, facilitating the import of refined products on a more competitive basis and enabling the CPC to negotiate more favourable terms for suppliers' credit. The government arranged an extended suppliers credit facility from Iran for a period of six month; up to a maximum limit of US dollars 150 million in 2005. The CPC used this facility entirely during the first half of 2005 and commenced repayment during the second half. The government has also arranged a long-term credit facility of US dollars 150 million under the Indian Line of Credit to import refined petroleum products from India, which is repayable in seven years including a grace period of one year. The CPC used upto US dollars 144 million of this facility in 2005 and repayment is to commence from April 2006. These facilities improved the liquidity position of the CPC, reducing short-term advances taken from commercial banks to very low levels, but its long-term liabilities increased.

Table 3.4

Petroleum Sector Performance

Item		2004	2005(a)	Growth Rate	
				2004	2005(a)
Quantity imported (Mt '000)					
Crude oil		2,201	2,008	10	-9
Refined products		1,644	1,823	41	11
L.P. gas		148	149	5	1
Domestic L.P. gas production (Mt '000)		15	13	0	-13
Value of imports (c&f)					
Crude oil	(Rs. mn)	61,434	77,795	47	27
	(US dollars mn)	605	773	40	28
Refined products	(Rs. mn)	61,298	88,767	56	45
	(US dollars mn)	604	882	49	46
L.P. gas	(Rs. mn)	6,095	7,573	35	24
	(US dollars mn)	60	75	28	25
Average price of crude oil (c&f)(b)					
	(Rs./barrel)	3,811	5,184	35	36
	(US dollars/barrel)	37.40	50.92	28	36
Quantity of exports	(Mt '000)	292	274	30	-6
Value of exports	(Rs. mn)	10,133	13,170	61	30
(US dollars mn.)	100	100	131	178	31
Local sales (Mt '000)		3,747	3,803	10	1
Petrol (90 Octane)		417	443	11	6
Petrol (95 Octane)		20	20	25	0
Auto diesel		1,890	1,674	14	-11
Super diesel		36	16	-14	-56
Kerosene		204	209	-1	2
Furnace oil		748	973	5	30
Avtur		170	178	22	5
Naphtha		96	125	-6	30
L.P. gas		166	165	3	-1
Local Price (at period end) (Rs./litre)					
Petrol (90 Octane)		68.00	80.00	28	18
Petrol (95 Octane)		71.00	83.00	27	17
Auto diesel		42.00	50.00	31	19
Super diesel		47.30	55.30	27	17
Kerosene		25.50	30.50	0	20
Furnace Oil					
500 Seconds		26.30	33.30	6	27
800 Seconds		25.20	32.80	6	30
1,000 Seconds		24.70	31.40	6	27
1,500 Seconds		24.30	30.30	9	25
3,500 Seconds		22.00	28.00	6	27
L.P. Gas (Rs./kg)					
Shell gas		63.12	63.68	38	1
Laugfs gas		63.12	65.60	33	4

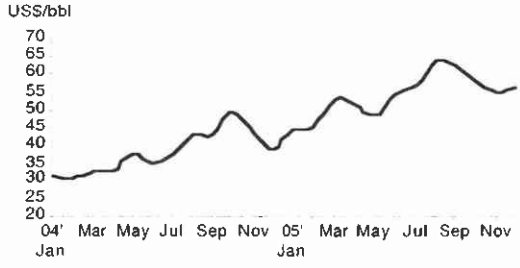
(a) Provisional
(b) As reported by Ceylon Petroleum Corporation

Sources: Ceylon Petroleum Corporation
Lanka IOC Ltd.
Shell Gas Lanka Ltd.
Laugfs Lanka Gas (pvt) Ltd.

Chart 3.3

International Crude Oil Prices: 2004-2005

(Brent-New York closing prices)



- **Since petroleum would become a very scarce resource in the future, a long-term strategy for the energy sector should be prepared.** In this respect, developing alternate energy sources such as coal power, as well as renewable energy sources such as wind power, solar power, dendro power and hydropower would be important. The government has recognised this need in its new energy policy, which is being drafted. At the same time, inefficient use of fuel should also be discouraged through proper pricing, introduction of fiscal measures, promotion of

mass transport systems and the development and maintenance of an efficient road network. Developing a mass transport system will not only reduce the use of private vehicles, thereby saving energy, but also assist environmental protection.

- **According to recent seismic surveys, there exists a high probability of Sri Lanka having oil in its off-shore areas in the Western and North-Western regions.** Sri Lanka has made several attempts at oil exploration since the 1970s. The current attempt at oil exploration commenced in 2001. Several hydro-carbon location surveys were carried out with donor assistance. These surveys disclose a high likelihood of finding hydro-carbon deposits in off-shore areas of the Western and North-Western regions. In view of rising oil prices in the international market, the Sri Lankan government has taken several steps to expedite oil exploration activities. The necessary legal and institutional framework has already been set up.

Transportation

- **Transportation is a vital component of economic infrastructure, having strong linkages to economic and social development by providing access to input and output markets as well as to public services throughout the country.** The transport network comprises highways, bus routes and railways, shipping network and air transportation. Air transport and maritime transport are used mostly for international and regional transport. In Sri Lanka, the transport sector contributes about 8 per cent to the GDP.

Road Transport

- **Road Development: Roads in Sri Lanka are in need of significant improvements in quality.** They are in a poor condition mainly due to the lack of regular maintenance, excessive delays in implementing planned projects of road construction and rehabilitation and insufficient funds. The Road Development Authority (RDA) is responsible for the development of the national road network. The RDA maintained 11,694 kilometres of trunk roads (A class) and main roads (B class) and 4,429 bridges in 2005. It has spent Rs.14 billion in 2005, a 26 per cent increase over 2004, for the maintenance, rehabilitation and reconstruction of national roads. Provincial and Local governments maintain about 15,000 kilometres of provincial roads (C and D classes) and 75,000 kilometres of local roads (E class). The lack of funds is more severe in the case of local and provincial governments. This has led to a low level of rural and provincial road maintenance.
- **During 2005 the RDA continued to implement several highway projects.** The Southern Highway, the Colombo Outer Circular road and the Colombo - Kandy expressway were the major road projects. The Southern expressway with a total length of 130 kilometres is funded by the ADB and the JBIC. The construction work of the ADB funded section (Kurundugahahetepma-Matara, Godagama) commenced in April 2003 and by end 2005 over 50 per cent of the construction work had been completed. This section of the road will be completed by September 2007. The construction work of the JBIC funded section (Kottawa-Kurundugahahetepma) commenced in August 2005 and is expected to be completed by August 2009. The Colombo Outer Circular Highway, with an estimated project cost of Rs. 33.5 billion, is expected to be implemented with financial assistance of JICA. The feasibility study of the Colombo-Kandy expressway has been completed with assistance from SIDA and is expected to be implemented on a BOT basis with the assistance of the Malaysian Government at an estimated cost of Rs. 29 billion. The Baseline Road Phase III extension project is to be implemented with financial assistance from the JBIC. The land acquisition for it is in progress. The estimated project cost is Rs.4.6 billion.
- **The RDA implemented several road rehabilitation, maintenance and improvement projects funded by foreign sources.** The Road Network Improvement Project funded by the ADB is in progress to rehabilitate 345 kilometres of roads and 47 bridges at a cost of US dollars 80 million. Further, the JBIC funded Road Sector Development Project, the World Bank funded Road Sector Assistance Project (RSAP) and Small Scale Infrastructure Rehabilitation and Upgrading Project (SSIRUP), the ADB funded Flood Damage Project and Conflict Affected Area Rehabilitation Project (CAARP) were in progress in 2005. The Kuwait Fund for Arab Economic Development provided a loan (Kuwait Dinar 5.1 million) to reconstruct 32 bridges. The rehabilitation and improvement of the Balangoda-Beragala-Bandarawela road with financial assistance from Korea, is also in progress.
- **The 'Maga Neguma' programme commenced in 2004 with the objective of developing feeder roads in rural areas.** The programme is funded through budgetary allocations and reimbursable foreign aid. The Ministry of Highways is the executing agency. Under the Maga Neguma programme, 731 kilometres of rural roads were improved through 1,299 projects at a cost of Rs.432 million in 2005.
- **The first phase of the rehabilitation of tsunami affected roads was completed.** The tsunami disaster damaged 415 kilometres of roads in four provinces. These roads were repaired to a passable condition in 2005 and are to be rehabilitated under the Sri Lanka Tsunami Affected Areas Recovery and Takeoff Project (STAART) funded by the JBIC.
- **In the absence of sufficient budgetary resources or donor funds, Sri Lanka needs to look at alternate models of road development.** Some development models advocate the establishment of a Road Development Fund for road maintenance, the raising of funds from the capital market for new construction and should encourage BOO/BOT arrangements for new road constructions.

- **Road Passenger Transport: Passenger transportation continued to be dominated by bus passenger transportation but the share of private modes of transportation is on the increase.** Public road passenger transport, measured in terms of passenger kilometres, contributes 68 per cent of the total passenger transportation in Sri Lanka, while Sri Lanka Railways contribute 5 per cent and private and hired vehicle owners contribute the balance 27 per cent.
- **In 2005, there was a decline in the performance of passenger transportation, as indicated by the operated kilometres and passenger kilometres.** The total operated kilometres of the state and the private sector operators declined by 4 per cent, while passenger kilometres declined by 3 per cent, over 2004.
- **The quality of road passenger transportation showed no significant improvement in 2005.** Although Sri Lanka has a satisfactory bus transport network and vehicle fleets, shortcomings that have prevailed during the last few decades continued to loom large. Inadequate services, poor quality, an increasing number of accidents and weak enforcement of regulations were some of the weaknesses of the public road transport service. In addition, state owned bus services suffered from a shortage of operational buses, a deterioration of revenue, cost escalation due to the excessive work force, management deficiencies, a unionised labour force, inadequate working capital and low investment. As a result, state owned bus services are running at a large loss and are heavily dependent on government assistance.
- **The Sri Lanka Central Transport Board (SLCTB) was reestablished to strengthen the state owned passenger bus service**. Accordingly, the operations of all the Cluster Bus Companies (CBCs) have been brought under SLCTB, which manages a registered fleet of 8,649 buses though the actual average number of buses operated per day was only 3,808 (about 44 per cent). Steps have been taken to augment the operational bus fleet through new purchases under the Indian Line of Credit, donations received from Japan and by repairing non-operational buses.
- **In keeping with the national policy on fare revisions, bus fares were raised by 10 – 20 per cent from June 2005.** The increase in price of diesel by Rs. 6.00 per litre and the escalation of other operating costs were the main reasons for this fare increase. Consequently, the total revenue of SLCTB in 2005 increased by 37 per cent to Rs. 10,806 million. However, as total expenditure increased by 11 per cent to Rs. 12,682 million, SLCTB reported an operating loss of Rs. 1,876 million in 2005.
- **Railway Transportation: Sri Lanka Railways (SLR) operating with a number of limitations has not been able to offer high quality services and achieve financial sustainability.** The SLR operates on 1,200 kilometres of track out of the total length of 1,445 kilometres due to the closure of several sections in the war ravaged areas of the North and the East. However, about 50 per cent of the operational track remains below the minimum standards and 30 per cent is being operated under strict speed restrictions. A large part of the signalling and communication system is obsolete and subject to frequent failures thereby disrupting the services. The rolling stock position of SLR is inadequate to provide a satisfactory service, with only 119 locomotives as against the minimum requirement of 162 locomotives. SLR needs at least 900 coaches, but it possesses only 500 coaches, of which 75 per cent has been in operation for over 15 years. As a result, the share of SLR in passenger and freight traffic has declined to 5 per cent and 2 per cent, respectively, from 8 per cent and 4 per cent, respectively, a decade ago. The quality of services provided by SLR has suffered and its financial position has weakened due to several major drawbacks such as rigidities in pricing, institutional weaknesses and frequent labour disputes. The operational losses have hindered the development of railway tracks, not permitted the strengthening and maintenance of the rolling stock or the other operational systems and forced SLR to depend heavily on continued budgetary support of a large magnitude.
- **The performance of SLR showed a further setback in 2005.** The operated kilometerage dropped slightly to 7.6 million km in 2005, while passenger kilometres dropped by 7 per cent to 4,358 million km. The decline in operations is partly attributable to the closure of the Southern line for a few months after the tsunami. However, the revenue of SLR increased by 17 per cent to Rs.1, 958 million in 2005 due to the upward revision of rail fares in August 2005. The operating expenditure increased by 26 per cent to Rs.5,463 million, mainly due to the increased fuel cost, salaries and wages. Consequently, the increase in the operating loss by 32 per cent to Rs.3,505 million exerted a heavy burden on the budget.
- **The SLR prepared a strategic action plan in 2005 to overcome its limitations.**The Department of Sri Lanka Railways was re-established in January 2005, abandoning previously envisaged reforms under the Railway Authority. Accordingly, SLR prepared a strategic plan for 2005, highlighting cadre requirements and recruitment of consultancy services for cost accountancy, property management, marketing and sales. However, it is necessary to free SLR from prohibitive administrative and financial regulations and permit it to function as a commercial venture, as a prelude to any restructuring programme. It is proposed to extend the Kelani Valley railway line up to Hambantota via Ratnapura and Embilipitiya and the Southern coastal line up to Kataragama, and to built a new railway line linking Kurunagala and Habarana via Dambulla.

Table 3.5
Salient Features of the Transport Sector

Item	2004	2005(a)	Growth Rate 2004	Growth Rate 2005(a)
1. New registration of motor vehicles (No.)	223,842	229,665	23.3	2.6
Buses	2,167	2,069	11.2	-4.5
Private cars	19,116	17,283	-9.8	-9.6
Three wheelers	43,789	41,085	21.0	-6.2
Dual purpose vehicles	10,736	6,851	-19.1	-36.2
Motor cycles	124,474	130,696	43.3	5.0
Goods transport vehicles	10,703	14,262	-2.8	33.3
Land vehicles	12,857	17,423	16.8	35.5
2. Sri Lanka Railways (S L R)				
Operated kilometers ('000)	7,630	7,570	-8.1	-0.8
Passenger kilometers (mn)	4,684	4,358	1.2	-7.0
Freight ton kilometers (mn)	134	135	3.9	0.7
Total revenue (Rs.mn)	1,678	1,958	27.0	16.7
Current expenditure (Rs.mn)	4,328	5,463	27.9	26.2
Operating loss (Rs.mn)	2,650	3,505	-7.4	32.3
Capital expenditure (Rs.mn)	1,732	2,902	20.5	67.6
3. Regional Bus Companies				
Operated kilometers (mn)	296	257	-11.9	-13.2
Passenger kilometers (mn)	14,537	13,087	-16.7	-10.0
Total revenue (Rs.mn)	7,888	10,806	-6.5	37.0
Operating expenditure (Rs.mn)	11,403	12,682	4.7	11.2
Operating loss (Rs.mn)	3,515	1,876	42.7	-46.6
4 SriLankan Airlines				
Hours flown (hrs.)	61,790	63,700	25.7	3.1
Passenger kilometers flown (mn)	8,316	8,545	20.1	2.8
Passenger load factor (%)	73	74	-3.9	1.4
Weight load factor (%)	55	58	5.8	5.5
Freight (Mt. '000)	79	90	23.4	13.9
Employment (no.)	5,107	5,376	24.7	5.3

(a) Provisional

Sources: Department of Motor Traffic
Sri Lanka Railways
National Transport Commission
Civil Aviation Authority of Sri Lanka
SriLankan Airlines

- **Civil Aviation: The civil aviation sector has grown significantly in recent years, owing to reforms, the benign economic environment and the ceasefire agreement.** The Civil Aviation Authority of Sri Lanka (CAASL) was established in 2002 in order to give greater flexibility for decision making, in place of the Department of Civil Aviation. Vital changes were made in the civil aviation sector thereafter, leading to deregulation, and the adoption of bilateral liberalisation agreements to attract more international carriers and tourists to the country. As a result, the number of international passenger airlines operating in Sri Lanka increased to 33 by 2005 from 27 in 2000. In 2005, three domestic airlines were permitted to operate services to India while Indian domestic private carriers were permitted to operate services to Sri Lanka.
- **International air passenger and freight transportation continued to improve despite the slow down in tourist arrivals.** During 2005, 33 international airlines, including 3 cargo airlines, operated in Sri Lanka, compared to 32 airlines and 3 cargo airlines operating in the previous year. The number of air passengers passing through the Bandanaike International Airport (BIA) increased by 5 per cent compared to the 25 per cent increase in 2004. Freight transportation, excluding tsunami related freight, increased by 9 per cent compared to the 18 per cent increase in the previous year. The share of the national carrier, SriLankan Airlines, in terms of passengers and freight transportation, increased by 16 per cent and 14 per cent respectively, in 2005. The new passenger terminals and bridges at the BIA facilitated the handling of an increased number of passengers and provided an improved service to passengers.
- **The performance of domestic air transportation also improved in 2005.** The number of passengers transported by the three domestic airlines increased by 10 per cent to 63,673. The domestic air services operated mainly to Jaffna. Air taxi or water aerodromes operated by SriLankan airlines expanded further in 2005, providing services to new destinations such as Benthota, Nuwara-Eliya and Kandy during the year. The CAASL is considering permitting aviation related recreational activities such as Ballooning, Para Gliding and the operation of Ultra Light aircraft in the country.
- **Sri Lanka faces several challenges to harness its strategic geographical advantage to become a hub in the region.** Insufficient infrastructure, inadequate ancillary services, poor road transportation, insufficient accommodation, the lack of an alternate airport and policy deficiencies are among the major constraints. Unless those weaknesses are addressed, there is a risk of losing a considerable share of air traffic to other airports in the region. To further develop infrastructure, the government has decided to build a second international airport at Weerawila with a view to providing another major airport as per international aviation norms.
- **Port Services: Port services continued to expand benefiting from increased international trade, capacity expansion and productivity improvements.** The performance of all four ports, at Colombo, Galle, Trincomalee and Kankasanturei, increased in 2005. Total cargo handling, including container handling, recorded a 10 per cent growth in 2005, following the 11 per cent growth in 2004. Total container handling increased by 11 per cent to 2.5 million Twenty-foot Equivalent Container Units (TEUs) in 2005. Of the total container handling, about 70 per cent was transhipments, which grew by 12 per cent in 2005. The container handling capacity at the Port of Colombo increased by 250,000 TEUs per year with the opening of the Unity Container Terminal (UCT) in June 2004. Productivity in respect of cargo handling at the Port of Colombo also improved to around 25-30 gantry moves per hour from around 20-25 a few years ago, due to the use of better technology and equipment and improved human resources management.

- **The number of ships arriving at Sri Lanka's ports increased by 7 per cent to 4,140 in 2005.** The number of main vessels carrying containers increased by 4 per cent, while the number of feeder vessels increased by 34 per cent. The number of conventional ships arriving at Sri Lanka's ports in 2005 declined as cargo transportation is increasingly done in containerised form, as the latter method is more economical, faster and safer.
- **Steps are being taken to further expand the capacity and efficiency of the Port of Colombo to meet increasing demand and to face emerging regional competition.** The expansion of the Jaye Container Terminal (JCT) was initiated by the Sri Lanka Port Authority (SLPA) in 2005 to enhance the capacity of the Port of Colombo to accommodate mega container ships. The completion of this project, will facilitate handling of two 8,000 TEUs container ships simultaneously at JCT III and IV. The implementation of the proposed Colombo South harbour, without further delay, is crucial to face regional competition. The initial cost of constructing the three kilometre long breakwater has been estimated to be US dollars 300 million. The ADB has committed US dollars 150 million for this purpose. The Colombo South Harbour will accommodate bigger container vessels with a draft of 16 metres and will have three terminals each of 1,200 metres in length, which are to be developed by the private sector. Construction work has to be commence this year (2006) for the port to be ready to handle mega ships that are expected by 2009.
- **Regional port development has also been given priority in the context of the government effort to reduce regional disparities.** Under the regional port development programme, the Port of Galle would be developed with a 12 metre deep multi-purpose berth and an outer port to facilitate tourism, with financial assistance from JBIC. The proposed Port of Hambanthota is to be developed as a bunkering centre. The Port of Trincomalee will be developed as a 'port city', focusing on the development of tourism, as well as providing services to regional industries.

Chart 3.4

Volume of Container Handling and Transshipments

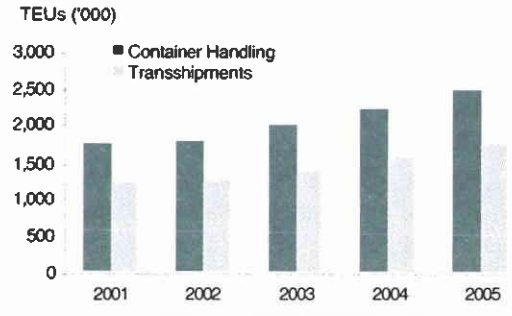


Table 3.6

Performance of Port Services

Item	2004	2005(a)	Growth Rate 2004	Growth Rate 2005(a)
1. Vessels arrived (No.)	3,883	4,140	-4	7
Colombo	3,688	3,929	-4	7
Galle	88	114	21	30
Trincomalee	107	97	-12	-9
2. Total cargo handled (Mt '000)	33,959	37,301	11	10
Colombo	31,299	34,523	11	10
Galle	578	655	20	13
Trincomalee	2,082	2,123	14	2
3. Total container traffic (TEUs '000)	2,221	2,455	13	11
4. Transshipment container (TEUs '000)	1,531	1,717	12	12
5. Employment (no.) (b)	13,233	13,527	-5	2
Colombo	11,888	12,217	-5	3
Galle	634	622	-1	-2
Trincomalee	711	688	-8	-3

(a) Provisional
(b) Only for Sri Lanka Ports Authority
TEUs = Twenty-foot equivalent container units

Sources: Sri Lanka Ports Authority
South Asia Gateway Terminals Ltd.

- **The Port of Colombo has satisfied US security requirements under the Container Security Initiative (CSI).** The Port of Colombo became the 42nd port to comply with the CSI, which facilitates US bound containers to be scanned for weapons of mass destruction. The port also complies with the Mega port initiative to detect nuclear or radioactive material in shipments to the USA. These measures were required as the USA is planning to deal only with CSI compliant ports. Further, this will improve efficiency of cargo clearing, and preclude the need for re-examination.
- **Port services continued to face new challenges due to emerging regional competition, mainly from the new ports developed in the Middle East and South India.** The technological advancements that contribute to the efficiency of port services are taking place at a rapid pace and any port that is oblivious to those developments is bound to be pushed back by competitors. Hence, any plan to develop port services should take cognisance of the future requirements rather than concentrate on current issues.

Water Supply and Irrigation

- **The provision of water for drinking and irrigation on a sustainable basis is a national priority.** Achieving sustainability requires economising on the usage, appropriate pricing to prevent wastage and over exploitation and attaining public consensus through awareness on the need for reaching sustainability. Two major factors threatening the long-term sustainability of water resources in Sri Lanka are improper pricing and deficiencies in regulation. Pipe borne drinking water is subject to a price, with a subsidy segment, but other forms of water supply are not subject to any pricing, leading to possible over exploitation and inefficient utilisation. In this

Table 3.7
Water Supply by National Water Supply and Drainage Board

	2004	2005(a)	Growth Rate	
			2004	2005(a)
Total number of water supply schemes	287	291	2.5	1.4
Total number of new connections given during the period	58,781	66,117	18.1	12.5
Total number of connections (as at end year)	841,505	907,662	7.5	7.9
Total water production (Mn. Cu. Mtr.)	368	383	3.1	4.1
Unaccounted water (%)				
Greater Colombo	36.5	35.9	-1.2	-1.7
Regions	29.6	30.9	-4.7	4.3

(a) Provisional Source: National Water Supply and Drainage Board

connection, only a few regulations exist in respect of the use of natural aquifers and other forms of water resources, threatening their long-term sustainability.

- **One of the Millennium Development Goals (MDGs) set by the United Nations requires that all citizens in a country should access safe drinking water and adequate sanitation facilities by 2015.** In Sri Lanka, 92 per cent of the population had access to safe drinking water in 2005, of which only 39 per cent had access to pipe borne water. The National Water Supply and Drainage Board (NWSDB) has estimated that the investment requirements of the water supply sector up to 2010 would be Rs.140 billion. However, the average annual investment by the government in the water supply sector in the last five years was around Rs.8 billion. This indicates that alternative funding sources need to be tapped in order to reach the targets set with regard to the supply of water.
- **The NWSDB further expanded its activities in 2005. The water tariff was raised in 2005 after three years.** Total water production by NWSDB increased by 4 per cent to 383 million cubic metres. The number of water supply projects managed by NWSDB increased marginally to 291 during the year, while the number of new water connections increased by 13 per cent to 66,117. In view of the considerable growth in the cost of water production and distribution in recent years, a tariff revision was made effective from March 2005. The main objective of the revision was to recover the increased cost of water production.[3] The tariff increase is also aimed at reducing existing cross subsidies and motivating people to conserve water.
- **The NWSDB earned an operating profit in 2005 and implemented several water projects using both local and foreign funds.** The total revenue of NWSDB increased by 27 per cent to Rs.6,218 million in 2005, largely driven by the expansion of the consumer network and the upward revision of tariff. Its operating expenses increased by 11 per cent to Rs.5,850 million, resulting in an operating profit of Rs.368 million in 2005 against an operating loss of Rs.383 million in 2004. It invested Rs.12,647 million in 73 local funded projects and 14 foreign funded projects. The Secondary Towns Water Supply and Sanitation Project, Water Treatment Plant Project on the right bank of the Kelani river and the Third Water Supply and Sanitation Project are Some of the major foreign funded water supply projects implemented in 2005.
- **The NWSDB faces a serious loss from unaccounted water.** In distributing water, the Board faces a total loss of about 31 per cent while the loss is more acute in the Greater Colombo Area (36 per cent). This situation impacts adversely on its revenue and investment.
- **The Department of Irrigation is responsible for the implementation and maintenance of irrigation systems.** During 2005, the Department of Irrigation spent Rs.750 million on the rehabilitation of existing irrigation projects and canal systems. In 2005, the Department carried out two major foreign funded projects, Deduruoya and Weheragala reservoirs. The Department continued to implement the '10,000 tank programme' (Dahasak Maha Wew programme) in 2005 and 246 tanks were renovated at a cost of Rs.205 million in 2005.
- **The maintenance of large reservoirs requires urgent attention.** Although successive governments have invested large amounts of funds in the construction of reservoirs, major irrigation networks and in land development, attention paid to maintenance has not been adequate in the past. The lack of proper maintenance will not only results in an increase in the cost of maintenance in the future substantially, but would also lead to underutilisation and the potential risk of structural failures.

3.3 Social Infrastructure Policies, Institutional Set up and Performance

- **Sri Lanka has already achieved the Millennium Development Goals in several social development areas, but further progress in this respect is urgently required.** Sri Lanka's key social indicators stand well above those in comparable developing countries and are on par with many developed countries. As the World Bank has recently indicated, Sri Lanka has already achieved the Millennium Development Goals in the areas of universal net primary enrolment, gender equality and infant and maternal mortality. Sri Lanka achieved the rank of 96 out of 177 countries in the latest Human Development Index (HDI) in 2004. However, the social infrastructure has not yet been developed up to an internationally competitive standard to uplift Sri Lanka's growth and development.
- **Developing economies are gaining greater comparative advantage in the production and export of social**

3 Major components of expenditure of NWSDB are labour (40%), electricity (30%), chemicals (6%) and maintenance (10%).

infrastructure services, especially healthcare and education services. Sri Lanka could benefit by providing such services if the necessary reforms are undertaken. The high quality professionals in countries like Sri Lanka coupled with the physical environment which is attractive for tourism enhance the opportunities for developing a sound services industry. However, the two major sectors, i.e., health and education, are not sufficiently liberalised to produce high quality services at an affordable price both for the domestic population and to meet foreign demand. Instead, Sri Lankans even resort to obtaining these services abroad, while a significant proportion of the highly skilled population remains unemployed. Hence, the health and education sectors in Sri Lanka need to concentrate on resolving deep-rooted problems that hinder their progress.

Health

- **The broad aim of Sri Lanka's health policy is to increase life expectancy and to improve the quality of life by controlling preventable diseases through health promotion activities.** Five strategic objectives have been set to achieve the mission of the Ministry of Healthcare and Nutrition. These strategic objectives are: to ensure the delivery of comprehensive health services, which reduce the disease burden and promote health; to empower communities to actively participate in maintaining their health; to improve human resources for health development and management; to improve health financing, resource allocation and utilization and to strengthen stewardship and management functions of the health system. In attempting to achieve these objectives, the government provides healthcare free of charge to the entire population, whereas the private sector operates a fee-based system.
- **The achievements in Sri Lanka's health sector are considered highly commendable when compared with comparable per capita income developing countries.** With a life expectancy of 73 years, an infant mortality rate of 11.1 per 1,000 live births (2003) and a maternal mortality rate of 0.1 per 1,000 live births (2002), Sri Lanka's health standards are considered satisfactory. Sri Lanka has achieved the goal of universal child immunization and contained the spread of communicable diseases. The availability of free healthcare due to the emphasis placed on social welfare since independence and other interventions aimed at improving nutrition and family health were responsible for these achievements. As a consequence, Sri Lanka enjoys lower infant and maternal mortality rates when compared with most other developing countries, especially SAARC countries.
- **Although the government continues to play a major role in the country's healthcare system, maintaining public health sector achievements has now become a challenge.** Of the total expenditure on health, expenditure by the government accounted for approximately 43 per cent, while private sources accounted for the balance. Government expenditure on healthcare was 1.9 per cent of GDP in 2005. The continuing difficulties in maintaining the heavy public funding for government healthcare programmes provided to all without targeting are a strain on maintaining the quality of the public health service. The deterioration in some aspects of the public sector health services was to some extent, mitigated by the increased private sector investments, mainly in curative health care. However, preventive care, which is mostly of the nature of a public good, suffered due to inadequate funding and other typical state sector inefficiencies, threatening the erosion of Sri Lanka's historical achievements. Therefore, the introduction of a proper targeting system could save public funds for enhancing preventive healthcare, thus elevating Sri Lanka's health performance. This is especially relevant since private sector investors have minimal incentive for promoting preventive healthcare.
- **The sustainability of health sector achievements is threatened by several developments.** The major problems include untargeted spending by the government, insufficient investment in health infrastructure and equipment, budgetary constraints, labour disputes, insufficient trained health personnel and weak preventive healthcare services. These have caused a series of problems ranging from a high level of malnutrition among children and pregnant women, the resurgence of communicable diseases such as malaria and dengue, and an increase in non-communicable diseases such as heart diseases, diabetes and hypertension. Mental illness, substance abuse, depression, suicides and accident are also on the increase. Emerging issues include aging problems and deteriorating healthcare for the elderly and the disabled.

Table 3.8

Salient Features of Health Services

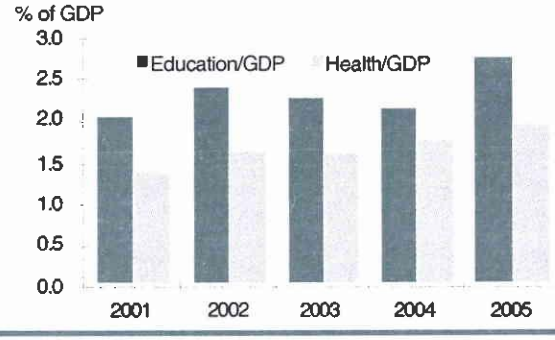
Item	2004	2005(a)
Government		
Hospitals (practicing Western medicine) (No.)	598	606
No. of beds	60,328	61,835
Central dispensaries (No.)	375	397
Total No. of doctors	8,749	9,070
Total No. of Assistant Medical Practitioners	1,276	1,260
Total No. of nurses	17,316	20,332
Total No. of attendants	6,696	6,701
Total No. of Ayurvedic Physicians (b)	17,038	17,503
Private		
Hospitals (practicing Western medicine) (No.)	174	190
No. of beds	8,650	9,000
Total health expenditure (Rs.bn)	34.4	44.9
Current expenditure (Rs.bn)	25.9	34.1
Capital expenditure (Rs.bn)	8.5	10.7

(a) Provisional
(b) Registered with the Department of Ayurvedic Commissioner

Sources: Ministry of Healthcare and Nutrition
Central Bank of Sri Lanka

- **Reforms proposed to address major issues in the health sector have been implemented to a certain extent.** The Presidential Task Force set up in 1997 recommended a series of measures to overcome major problems in the health sector. Out of these recommendations five thrust recommendations have been identified for immediate implementation. These are improving at least one hospital in each district, expanding services to areas of special needs, developing health promotional programmes, reforming the organisational structure including alternative financing mechanisms and promoting resource sharing with the private sector. Accordingly, 36 hospitals have been identified across the country and steps have been taken for their phased out development. Twenty-two estate hospitals have been developed and action has been taken to establish at least one mental rehabilitation centre in each district. Staff strength of the public hospitals has been improved and progress has been made on amending the Private Medical Ordinance. The Health Cluster of the NCED was involved in reviewing the National Health Development Master Plan, inter alia, developing other policies.
- **Private investments in the health sector continued to increase.** Private health institutions providing curative healthcare increased to 190 in 2005 from 174 in 2004, reflecting the increasing demand for high quality healthcare services. As a tradeable service, Sri Lanka's health services are gradually gaining competitiveness with increased investments by the private sector. This is especially relevant to Sri Lanka's efforts to attract tourists by providing the necessary infrastructure, and promoting tourism in niche areas such as health tourism. Of the total health expenditure of 3.5 per cent of GDP in 2004, contribution of the private sector was 2.0 per cent of GDP. With the increasing participation of the private sector in healthcare provision, it is essential to develop a market based regulatory framework to ensure that quality and standards are maintained.

Chart 3.5
Government Expenditure on Health and Education



Education

- **Progressive improvement in the education system is a pre-requisite for rapid economic growth and development.** This is particularly relevant for a country aiming at developing an increasingly knowledge-based economy. Successive governments in Sri Lanka have attempted to improve the education system by introducing reforms in general education, technical and vocational education and higher education. These reforms have resulted in some progress but are inadequate to address the growing needs of the economy. During the past decade, despite significant limitations, private sector involvement in education has shown remarkable expansion, filling the gaps in Sri Lanka's public sector educational system.
- **The education sector is subject to a major reform programme, which was initiated in 1998.** The main objectives of the reforms introduced in the general education sector were to promote access and equity and improve the quality of education. The key elements of the reforms were strengthening service delivery, upgrading selected regional schools, the revision of curricula in all stages of education, changing the methodology of teaching and learning, providing inputs of good quality to schools and improving school management. Reforms in university education and vocational training focused on expansion, improving relevance and the creation of opportunities in tertiary education within public ownership.
- **Steps have been taken to improve the infrastructure facilities of schools in rural and semi urban areas.** This was accomplished by introducing the Navodya Schools Programme, introducing activity based learning approaches, inclusion of ICT Education in the curriculum, the establishment of student counselling and career guidance programmes and the promotion of English education. To further buttress these efforts, steps have been taken to implement the new Education Sector Development Framework Programme (ESDFP) during 2006 – 2010. The ESDFP envisages promoting equity by enabling all children in the country to access and complete basic and secondary education, enhancing the quality, improving economic and social relevance, strengthening the capacity of the education system to allocate and distribute public resources efficiently and equitably within the school system and improving the governance and institutional capacity of central and provincial agencies to deliver high quality services. The General Education Project funded by the World Bank for improving quality, equity and efficiency of general education, the Teacher Education and Deployment Project funded by the World Bank for improving effectiveness of teacher services, the Secondary Education Modernisation Project funded by the ADB for improving equity and efficiency of secondary education as well as access to quality secondary education were

concluded in 2005. Under this latter project, 1,000 computer learning centres, 2,300 multi media centres, 36 science laboratories and on-site environmental laboratories and 30 additional computer resource centres at zonal level were established while 54 Central Colleges were rehabilitated.

- **Regional disparities in the general education continue to loom large.** A Recent survey on skills in the first language, mathematics and the English language shows high provincial disparity when compared with the Western province. The students' participation rate in the junior secondary level was 87 per cent in the Western province, whereas it was 78 per cent and 73 per cent in the North West and the North East provinces, respectively. There is a severe shortage of qualified and competent teachers in regional schools. To address these issues, a total of 15,000 unemployed graduates were recruited as teachers in 2005. However, it is essential to provide comprehensive training in teaching methods and educational psychology to those chosen to make them competent teachers for effective delivery of services. During 2005, a total of 3,706 students trained in 17 National Colleges of Education were also recruited as teachers to schools.
- **The tsunami of December 2004 had a severe impact on education infrastructure.** A total of 182 schools in 10 districts were destroyed completely or partially by the tsunami. Action has been taken to reconstruct all these schools, largely with foreign assistance. The total estimated cost to rebuild these schools has been estimated at Rs.10 billion. Action has also been taken to renovate 442 schools, which were used to shelter displaced persons in the aftermath of the tsunami.
- **The public sector monopoly of university education in Sri Lanka suffers from both an inability to meet the demand for university education and a failure to supply high quality education in many fields, compatible with global trends.** In 2005, although 111,725 students were eligible for university education, only 14,520 placements were available in universities. The recent drive to recruit unemployed graduates to public institutions revealed that over 40,000 graduates were seeking employment. The failure of university education were manifested in many indicators: a large number of students entering the labour force at an early age, a significant number choosing vocational training instead of university education, students going abroad for education and foreign education institutes making a commercial presence in Sri Lanka to attract local students. Agitation against the establishment of private universities has kept the government postponing the much-needed decision of deregulating higher education. This is akin to regulating domestic service provision in favour of the import of services.
- **At the end of 2005 Sri Lanka had 15 universities that enrolled 66,386 students, excluding the students of the Open University.** In 2005, the Uva-Wellassa University was established to enhance the intake of students as well as to ensure a regional balance in the provision of higher education opportunities. In addition, the University of Visual and Performing Arts was established by amalgamating institutions, which were providing aesthetic studies.
- **International studies show that the social rate of return of primary and secondary education is significantly higher than the private rate of return.** This justifies the continuation of public investment in primary and secondary education. However, the private rate of return is higher in tertiary education, thus indicating that it is reasonable to charge individuals for their tertiary education. Considering the inability of the state universities to absorb a reasonable number of students who seek entrance to university due to the inability to expand the public university system, owing to fiscal constraints, it is essential to provide alternative higher education opportunities. International experiences show that deregulation of university education has brought in promising results. However, the deregulation has to be accompanied by a set of

Table 3.9

General and University Education

Item	2004	2005(a)
A. General education		
a. Total schools	10,501	10,464
Government schools	9,765	9,727
o/w National schools	324	324
Other schools	736	737
Private	85	85
Pirivena	651	652
b. Students ('000)	4,028	4,102
c. New admissions ('000) (b)	303	318
d. Teachers ('000)	198	198(c)
e. Student/Teacher ratio (government schools)	21	21
f. Total expenditure on education (Rs. bn) (d)	42	64
Current	34	51
Capital	9	13
B. University education		
a. Universities	13	15
b. Students (d)	64,801	66,386
c. Lecturers (e)	3,725	3,875
d. Number graduating	10,525(f)	n.a.
Arts and Oriental studies	3,366	n.a.
Commerce & Management studies	3,091	n.a.
Law	166	n.a.
Engineering	984	n.a.
Medicine	964	n.a.
Science	1,323	n.a.
Other	631	n.a.
e. New admissions for first degrees	13,396	14,520

(a) Provisional
(b) Government schools only
(c) This include 1,935 teachers paid by other than the government
(d) Includes government expenditure on higher education
(e) In all Universities, excluding the Open University of Sri Lanka
(f) Include Ayurvedic / Unani / Sidda medicine (48)

Sources: Ministry of Education
University Grants Commission
Central Bank of Sri Lanka

comprehensive rules and guidelines, which ensure that private universities maintain the required standards in line with the changing global trends.

- **There are several other public and private institutions providing higher education and professional education.** Amongst those institutions are the Sri Lanka Institute of Information Technology, Institute of Chartered Accountants of Sri Lanka, Sri Lanka Law College, National Institute of Business Management and the Institute of Bankers of Sri Lanka.
- **A large number of public and private institutions are involved in technical and vocational education and training (TVET).** Tertiary and Vocational Education Commission as the central planning, development and coordinating body for the TVET sector, and the Ministry of Vocational and Technical Training are implementing competency-based training (CBT) programmes through a number of public and private institutions. These public institutions include the Department of Technical Education and Training (DTET), Vocational Training Authority of Sri Lanka (VTA) and National Apprenticeship and Industrial Training Authority (NAITA). There are 365 CBT courses identified to be provided through these institutions. The Ministry of Vocational and Technical Training in association with relevant training institutions envisages the setting up of a University of Technology to conduct higher diploma and degree programmes on TVET with initial financial assistance from the ADB.

Housing and Urban Development

- **The demand for houses and the expansion of the urban sector increases with continuing population growth and economic development.** The demand for new houses in Sri Lanka is rising at around 100,000 units per year. In addition, there is a need for meeting a large pent up demand and a large number of sub-standard houses require upgrading. As per the latest Census of Housing and Population survey conducted in 2001, the shortage of housing was 218,295 units with an additional 1,325,880 sub-standard units requiring improvements. Further, the tsunami disaster of December 2004 completely destroyed 70,637 houses while another 30,839 units were partially damaged.
- **The Government plays a facilitator role in the housing sector.** The Ministry of Housing and Construction pays attention to issues such as land for housing, resource mobilization for housing finance, developing infrastructure and other services, cost effective technology development and simplification of approval procedures. The government is also implementing special housing programmes for targeted groups. The government, in its Budget for 2005 proposed to provide housing loans at a concessionary rate of interest to government servants through commercial banks. The National Housing Development Authority (NHDA) is the main public institution that implements housing programmes targeted at low-income households. Other key government institutions that play a key role in the provision of public sector housing are Ministry of Fisheries and Aquatic Resources (MFAR) and the Plantation Human Development Trust (PHDT). The NHDA has planned to build 175,000 housing units during the three year period 2005-2007. It has commenced building 5,040 housing units in 2005 under the 'Sustainable Village' programme initiated by the Ministry of Housing and Construction. The NHDA has also identified 9,545 housing units for redevelopment in 2005 and another 19,200 units for redevelopment by end 2007. Roofing materials were distributed among 43,625 families under the Roofing Sheets Assistance Programme financed by way of an Indian Line of Credit. Housing programmes of the MFAR were affected by the tsunami. The PHDT continued with implementing several housing construction and upgrading programmes in the estate sector under the Plantation Development Support Programme (PDSP) in 2005. The Real Estate Exchange (Pvt.) Ltd., (REEL), which is the implementing arm of the Sustainable Townships Programme, provides shelter for the urban poor in the city of Colombo. The REEL commenced the construction of 3,000 housing units under this programme in 2005.
- **The private sector has emerged as the major supplier of houses, especially to middle and high-income households.** The private sector is playing a vital role in housing through the direct construction of houses as well as by developing lands, providing inputs and finance. Condominium development by corporate property developers in urban and suburban areas has shown a significant growth in recent years. Housing loans granted by financial institutions also increased in 2005. Commercial banks have granted 89,335 housing loans to the value of Rs.22,803 million during 2005. The three housing banks, namely, State Mortgage and Investment Bank (SMIB), Housing Development Finance Corporation Bank (HDFC Bank) and NDB Housing Bank and the National Savings Bank (NSB) have together granted 23,305 housing loans to the value of Rs. 8,607 million in 2005, in comparison to 18,741 loans in 2004.
- **The housing finance market faces several issues, which inhibit its growth.** These include, the lack of long-term vision on housing development, the absence of long-term sources of funds, a mismatch of cash flows in lending institutions for housing, legal and institutional issues, problems relating to land tenure and land titles and lack of new housing finance instruments. In addition, sharp rises in land prices, high salaries and wages in the construction industry, high cost of major building materials and the lack of skilled labour also restrain the

growth of the housing sector. The development of a secondary mortgage market would resolve funding issues to a great extent. Therefore, it is essential that a secondary mortgage system be established for primary mortgage lenders along with the necessary legal and regulatory framework. It is expected that primary mortgage lending could increase by as much as 75 per cent if an efficient secondary mortgage market is available.

- **The Urban Development Authority (UDA) plays a key role in planning and executing urban development projects in the country.** The UDA gave priority to the development of tsunami-ravaged urban areas in 2005. It engaged in facilitating the permanent relocation of affected families, the identification of lands for relocation, the reconstruction of damaged houses, the enforcement of planning and building regulations, and the reconstruction of tsunami affected townships. For this purpose, the UDA established 52 project offices in the affected areas. It has identified 62 towns, (12 large towns, 20 medium towns and 30 small towns), which were affected by the tsunami, for development. Initially, 15 townships have been selected for development on a priority basis at an estimated cost of US dollars 250 million.
- **The main operational activities of the UDA continued.** These included the construction of administrative complexes and commercial complexes, and implementing town improvement projects, industrial projects and integrated projects.

Safety Nets

- **The Samurdhi programme is aimed at improving the nutritional status of poor communities by providing direct financial assistance and implementing programmes to enhance their income levels.** About 2 million families benefited directly from the Samurdhi income supplementary programme in 2005. The total expenditure on food stamps provided under the income supplementary programme was Rs.9,244 million in 2005 compared to Rs 8,591 million in 2004. The Samurdhi Authority of Sri Lanka (SASL) implemented various programmes to enhance the living standards and income levels of the Samurdhi beneficiaries. The main programmes implemented by the SASL in 2005 were 'Janapubudu' programme to establish 100,000 income generating projects for the benefit of Samurdhi beneficiary families, the Social Mobilization Programme aimed at empowering rural communities, the 'Gamipubudu' programme to provide basic infrastructure facilities to remote villages and the housing programme to support the construction of houses for poor families.
- **The Welfare Benefit Act (WBA) passed in 2002 provides the legal framework for improving the targeting of Smurdhi benefits in a transparent manner.** The implementation of the Act will ensure an improvement of the selection process, the identification of eligible families, the removal of overlap with other welfare programmes and ultimately increase benefits to poor families. As per data released by the Department of Census and Statistics, the population living below the poverty line (Rs. 1,423 per month in 2002) was only 22.7 per cent, though nearly half of the total population received Samurdhi benefits. This indicates the need for better targeting of social welfare programmes, which would result in an increase in benefits to needy households.
- **The performance of the Samurdhi Savings Schemes continued to expand.** The Samurdhi compulsory savings fund increased by 5 per cent to Rs.6,950 million in 2005, while

Table 3.10

Samurdhi Welfare Programme

Number of Beneficiary Families and Value of Grants 2004 - 2005

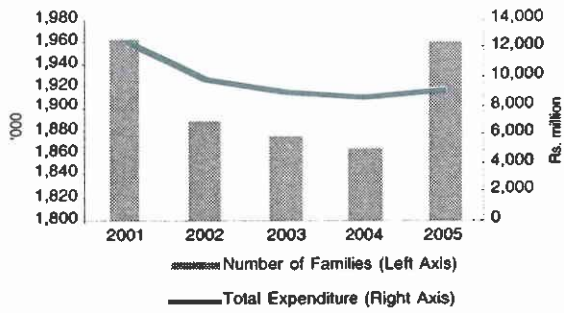
Cash Grants Amount (Rs.)	2004		2005 (a)	
	No. of Families	Value (Rs.Mn)	No. of Families	Value (Rs.Mn)
Samurdhi Income Supplementary Programme				
Rs.1,000	3,616	44	7,115	85
Rs. 600	584,635	4,211	655,092	4,717
Rs. 400	334,672	1,608	330,725	1,587
Rs. 350	327,168	1,369	347,323	1,459
Rs. 250	249,022	742	267,843	804
Rs. 140	364,945	617	352,566	592
Total	**1,864,058**	**8,591**	**1,960,664**	**9,244**
Dry Ration Programme	155,048(b)	2,226	222,662(c)	649
Nutrition Programme Rs. 200 (with effect from June 2004)	103,967	127	112,960	271

(a) Provisional.
(b) Rs. 336 – 1,260 per household
(c) Rs. 168 – 830 per household

Source: Department of the Commissioner General of Samurdhi
Samurdhi Authority of Sri Lanka

Chart 3.6

Samurdhi Receipiants and Expenditure



Samurdhi voluntary savings of the Samurdhi banking societies grew by 26 per cent to Rs.10,000 million and the number of these accounts increased by 5 per cent to 7,647,043 in 2005. Total outstanding loan disbursements by Samurdhi banking societies for various purposes such as self-employment, cultivation and fisheries amounted to Rs 20 billion by end 2005.

Environment

- **Maintaining an appropriate balance between economic development and the utilisation of natural resources is vital to ensure long-term sustainable development.** Negative externalities arising from economic activities could have an adverse impact on the natural environment. Regulation, effective enforcement and increasing awareness among the general public play an important role in protecting the environment. The Ministry of Environment and Natural Resources (MENR), being the apex institution for the management of natural resources of the country, continued the formulation of environmental policies in 2005, while the Central Environment Authority bore primary responsibility for the enforcement of regulations.
- **MENR introduced several policy measures in 2005 for the protection of the environment.** Cabinet approval was granted for the National Cleaner Production Policy and Strategies, and the National Bio-safety Policy in 2005. The Bio-safety Policy ensures the enforcement of regulations in respect of genetically modified food. The draft National Policy on Sand was prepared in 2005 incorporating comments received from the general public.
- **The MENR continued monitoring, coordinating and implementing international conventions and treaties in 2005.** Major international treaties include the Global Environment Management Project, United Nation's Convention to combat desertification, the Vienna Convention and the Montreal Protocol, Stockholm Convention on persistent organic pollutants, the Convention on biological diversity and the Cartegena protocol in bio-safety.
- **The Ministry introduced new regulations to the National Watershed Management Policy.** The new regulations aim at reducing the degradation of steep slopes in upper watershed areas through prohibiting cultivation activities and implementing the Upper Watershed Management Project, which includes forest rehabilitation activities such as buffer zone plantation, home-gardening, conservation oriented farming, awareness and media programmes and conservation of landslide proven areas.
- **In addition to designing policies and formulating regulations, the MENR implemented several other programmes aimed at improving the natural environment.** Unsatisfactory management of solid and liquid waste is a critical issue particularly in urban areas and poses serious risks to the health of the public. Local government authorities, which bear the responsibility for waste management, lack adequate resources and technology for the purpose. The MENR updated the database on Municipal Solid Waste in Sri Lanka published in 1999. This data base would be useful in taking strategic action on waste disposal, prevention, reduction, reuses and recycling in an environmentally sound manner. Regarding waste disposal the MENR initiated a project to identify final disposal facilities/sanitary landfill sites for solid waste. However, a number of environmental issues such as land degradation due to soil erosion, depletion of coastal resources, loss of biodiversity, solid waste disposal, and inland water pollution that continue to exist require urgent attention of the authorities.
- **The Central Environment Authority (CEA) as the regulator of the national environment, continued to regulate and promote environmental activities.** The CEA processed 127 Environmental Impact Assessments (EIA) in 2005 and granted approval for 21 projects. During the year, the CEA issued 160 Environmental Protection Licenses (EPL), while 134 applications were recommended for the setting up of new factories. The CEA received 1,965 public complaints on environmental matters in 2005 (1,350 complaints were from the Western Province) and action was taken in respect of most complaints during the year.