8. INFRASTRUCTURE AND SERVICES

Energy

Electricity generation continued to be low during the first half of 2002. Consequently, the power cuts that began in July 2001 intensified and continued till mid May 2002, except for a few weeks in November and December. Meanwhile, the petroleum sector showed a gradual recovery with the adoption of a flexible pricing policy by the Ceylon Petroleum Corporation (CPC) and relatively stable oil prices in the world market during the first half of 2002. However, rising petroleum prices in the international market during the second half may increase import expediture and domestic prices of petroleum products.

Chart 8.1
Hydropower Generation

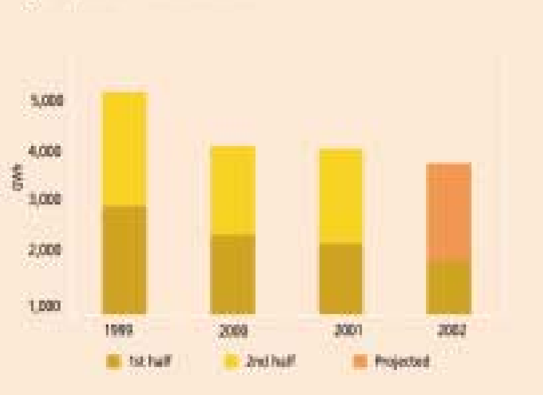
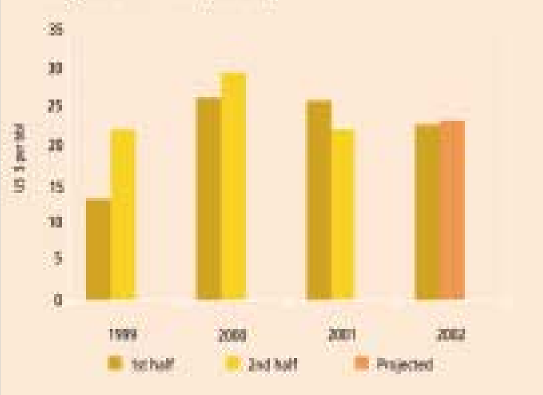


Chart 8.2
Average Oil Prices (Brent)



Electricity

- Electricity generation dropped by 6 per cent during the first half of 2002, owing to capacity constraints in both hydro and thermal power. Hydropower generation was severely affected by poor rainfall in the catchment areas, while delays in implementation of planned power projects and breakdown of some power plants reduced thermal power generation.

- The resultant power cuts led to an involuntary reduction of electricity consumption by about 420 GWh or about 25 per cent of the estimated electricity consumption, during January to May 2002.

- Power cuts were completely removed from mid May 2002 with the acquisition of additional thermal capacity of 197 GWh from the private sector on a short-term basis, restoration of existing thermal power capacity under the Ceylon Electricity Board (CEB) and a slight improvement in water storage in reservoirs.

- In the power generation mix, the share of hydropower further dropped to 33 per cent from 41 per cent during the first half of 2001, mainly due to lower water levels in reservoirs. In contrast, private power, including hired power, as a per cent of total power generation, increased to 31 per cent from 28 per cent.

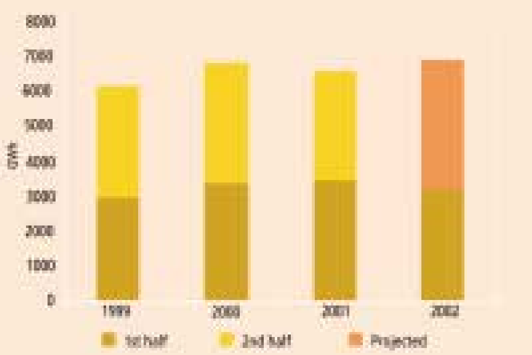
- The average cost of producing electricity increased sharply by 24 per cent to Rs. 8.97 per unit, further worsening the financial situation of the CEB.

- CEB's short-term bank borrowing increased to Rs. 13.6 billion at end June 2002 from Rs. 10.5 billion at end December 2001 despite the tariff increases in April 2002.

- Total installed capacity stood at 1,944 MW at end June 2002 reflecting an increase of 43 MW since December 2001. A further 125 MW of capacity is to be added to the national grid during the second half of the year, increasing the installed capacity to 2,069 MW by end 2002. Installed capacity is expected to increase to 2,400 MW by end 2003.

- Total power generation, inclusive of registered self-generation, dropped by 6 per cent during the first six months of 2002. With the restoration of power supply and the expected recovery in the economy, power generation is expected to increase by 17 per cent during the second half of the year. Accordingly, annual power generation would increase by about 5 per cent in 2002 over the previous year.

Chart 8.3
Electricity Generation



- According to CEB sources, power generation is expected to increase by 17 per cent to 7,935 GWh in 2003. With the expected increase in installed capacity and on the assumption of favourable weather conditions, a power shortage is not expected in 2003.

- The hydro dependency of the power system is expected to drop to 56 per cent by end 2002 from 61 per cent in 2001. It would further drop to about 50 per cent by end 2003, reducing the vulnerability to weather vagaries.

- With a view to matching the cost of power generation, CEB raised electricity tariffs by about 37 per cent from April 2002. However, mainly due to the additional cost of hired power, CEB has projected a net loss of about Rs 5 billion for 2002, in comparison to a loss of Rs 9.5 billion in 2001. CEB has forecast an operating profit of Rs 9 billion for 2003 under normal weather conditions and with all hired power plants discontinued from early 2003.

- In view of the automatic pricing policy introduced for petroleum products and its direct link to thermal power generation, it is important to introduce a similar pricing policy for electricity as well, to pass on the additional costs or benefits arising from the variation of fuel prices to consumers.

- The systems losses in the power network still remain high, although they have declined by about 2 percentage points to 17 per cent during the first half of 2002, mainly due to power cuts. Fixing of electricity meters to some un-metered connections also contributed towards reducing the systems loss. However, it is imperative to take steps necessary to reduce systems losses to an acceptable level.

- According to the CEB's latest Long Term Generation Expansion Plan covering 2002 - 2016, capacity has to be increased by at least 855 MW by 2008 to meet the increasing demand, in addition to power plants that are presently being constructed. The expected capacity increase includes a 300 MW combined cycle power plant in 2005, a 105 MW gas turbine in 2007, a 300 MW coal fired power plant in 2008 and a 150 MW Upper Kotmale hydropower plant in 2008. Therefore, prompt action needs to be taken to have these planned power plants established as scheduled to avoid any power shortages in the near future.

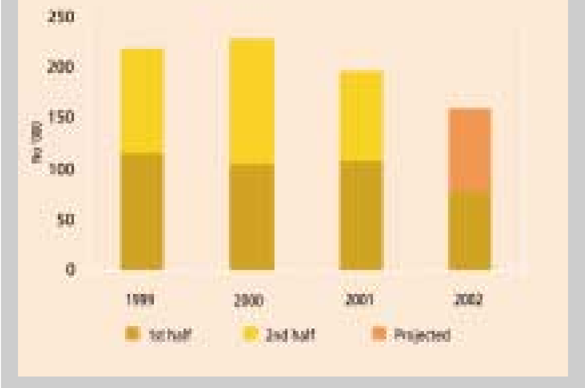


Chart 8.4
New Electricity Connections

- Implementation of the proposed reforms to the electricity sector with the passage of the Electricity Reforms Act would facilitate resolving major issues in the power sector such as insufficient capacity, organisational weaknesses, transmission and distribution inefficiencies and irrational pricing policy.

Petroleum

- The petroleum sector as a whole improved with the rationalisation of the pricing policy, initiatives to promote competition and somewhat stable world market prices.

- Consumption of major petroleum products dropped further by 2 per cent during the first six months of 2002 following a marginal drop in 2001. The drop in demand is mainly attributable to substantial increases in local prices of petroleum products and slower growth in economic activity.

- Diesel and furnace oil consumption dropped by 2 per cent and 4 per cent, respectively, during the first half of 2002, mainly due to lower demand from industrial and thermal power sectors. Meanwhile, petrol and kerosene consumption increased by 12 per cent and 11 per cent, respectively, due to higher demand from the transport and domestic sectors.

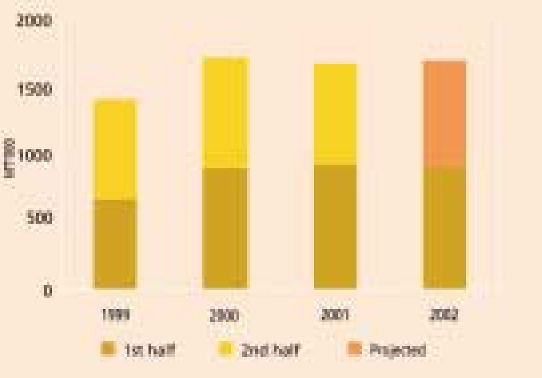
- With the higher demand from the thermal power sector and expected recovery in the economy, coupled with a significant reduction in local prices in July 2002 due to the removal of the debt recovery component from the pricing formula, petroleum consumption is expected to increase marginally in 2002 over the preceding year.

- CPC imported 1.1 million MT of crude oil and 0.7 million MT of refined products to meet local demand during the first half of 2002. The total cost of petroleum imports amounted to US dollars 353 million or 12 per cent of the total value of imports during the first six months of the year.

- Total cost of petroleum imports in 2002 and 2003 has been forecast to be US dollars 737 million and US dollars 770 million, respectively.

- The average crude oil import price (c&f), which was around US dollars 20 per barrel in January 2002, gradually increased to around US dollars 26 per barrel by June mainly due to political tensions in the Middle East. It is expected that the average crude oil import price (c&f) would remain at current levels during the balance of the year.

Chart 8.5
Diesel Sales



- The financial situation of the CPC reflected a noticeable recovery during the first half of 2002 with the introduction of the flexible pricing policy in January 2002. With the new pricing policy, CPC was able to pass on additional costs or benefits arising from the variation of oil prices to consumers.

- The debt recovery component (Rs 6.00 per litre of petrol and Rs. 2.50 per litre of diesel) in the pricing formula enabled CPC to reduce its debt from Rs. 18.7 billion at end 2001 to about Rs 15.5 billion by end August 2002. However, debt recovery charges were abolished from July 15, 2002. Therefore, it is essential to find alternative means to settle CPC's debt, as the carrying cost of these is very high.

- With a view to creating a competitive market for the supply of bunker fuel and to harness the opportunities available in this sector, steps were taken to broaden private sector participation. Accordingly, Lanka Marine Services Ltd (LMS), which held a monopoly in bunker fuel supply in the country, was privatised in July 2002.

- The government entered into an agreement with Indian Oil Company (IOC) to lease out a part of the oil tanks located in Trincomalee. IOC is expected to enter the local petroleum market shortly, ending the monopoly of CPC. Permitting a third supplier to enter the market will further fuel competition in the local petroleum market.

- The local consumption of LP gas increased by 6 per cent during the first half of 2002 over the same period of the previous year. The competition in the LP gas market is increasing following the end of the monopoly status held by Shell Gas Lanka Ltd (SGLL) from December 2000.

- A third entrant to the LP gas market is also expected shortly. With improved competition, consumers will benefit from increased choices, competitive prices, expanded distribution etc. However, it is essential to set up a regulatory mechanism for the LP gas sector to ensure that rules and regulations, especially safety and quality standards, are maintained and also to prevent any unfair competition in the industry.

- Action has also been taken to broadbase the ownership of SGLL by divesting government ownership through an initial public offering (IPO).

Transportation

Road Passenger Transportation

- In terms of the scale of operations, neither public sector passenger transportation managed by Regional Transport Companies (RTCs) nor private bus operations have shown significant improvements during the first half of 2002.

- Both operated kilometerage and passenger kilometerage remained almost at the same level at 469 million and 24,274 million, respectively. A significant improvement is not expected during the second half of the year. The positive impact of the proposed private sector participation in RTCs is expected to be realised only in 2003.

- The number of buses operated per day by RTCs and private operators increased marginally to 16,546. This, as a percentage of the total bus fleet, is about 67 per cent.

- Total revenue of RTCs increased by 6 per cent during the first half of 2002. As operating expenses soared, mainly due to increased fuel and utility expenses, the total operating loss of RTCs rose by 47 per cent to Rs. 1,134 million during this period. The total loss in 2002 is expected to exceed Rs. 2 billion.

- A new bus fares policy was introduced by the National Transport Commission (NTC). The first fare revision under the new fares policy was announced in July 2002 and bus fares were increased by an average of 15 per cent. However, this fare revision was not adopted by RTCs, even though they were operating at a huge loss. If RTCs are to be financially sustainable, bus fares need to be adjusted to reflect the cost of operations.

- The NTC has authorised Government Agents in Vavunia, Jaffna and Mannar to issue route permits to operate private buses in their respective districts. The Central Transport Board (CTB) is also operating bus services in the Jaffna Peninsula.

- PERC has invited expressions of interest from private investors to acquire 39 per cent of the government holdings of RTCs by investing an equal amount and taking over the management.

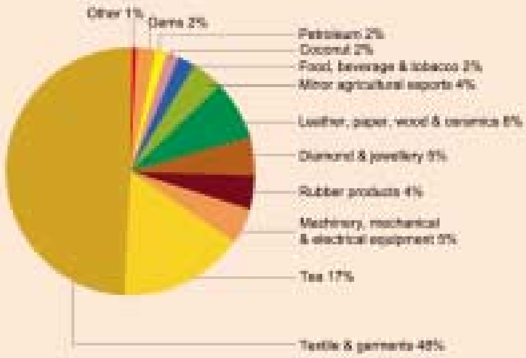
- With the expected expansion in investment, efficient management and quality improvements under private management, road passenger transportation operated by RTCs is expected to grow in 2003. At the same time, with the new fare policy in place, private investment in road passenger transportation is also expected to expand in 2003.

- New registration of motor vehicles declined by 8 per cent during the first half of 2002. The decline was prominent in the registration of buses and private cars. However, registration of three wheelers increased by 35 per cent.

Rail Transportation

- There was no noticeable improvement in rail transport services during the first half of 2002, except in goods transportation. A significant improvement is also not expected during the second half of the year owing to the short supply of essential transport equipment and the obsolete nature of a large part of the rail track and most of the existing rolling stock of Sri Lanka Railways (SLR).

Chart 10.1
Composition of Exports
Jan-Jun 2002



- SLR has 129 locomotives and power sets available for daily operations; it needs 154 to meet the demand and to keep to timetables. Similarly, SLR has 520 carriages, whereas it needs at least 809 carriages to provide a satisfactory service.

- In the absence of new investments and reforms, notable improvement in the rail services cannot be expected even in 2003.

- The total revenue of SLR increased by 9 per cent to Rs. 621 million during the first half of 2002, mainly due to a 52 per cent increase in revenue from goods transportation. SLR raised freight charges by 50 to 250 per cent with effect from September 2001. Even with the increase in freight charges, goods transportation rose by 29 per cent. However, SLR's passenger fares have remained unchanged since 1996.

- The operating expenditure of SLR increased sharply by 33 per cent to Rs. 1,650 million during the first half of 2002, mainly due to increases in fuel cost, salaries and maintenance expenses. The cost of fuel increased by 30 per cent as diesel prices rose during the period.

- SLR's operating loss increased by 53 per cent to Rs. 1,029 million. The operating loss in 2002 is likely to exceed Rs. 2 billion, exerting heavy pressure on the fiscal budget. The need for reforms is both urgent and compelling.

Port Services

- Port services recovered gradually after the removal of the war risk insurance surcharge on ships calling at Sri Lankan ports. The war risk insurance surcharge was imposed in August 2001 and was completely removed by most shipping lines serving Colombo by April 2002.

- The number of ships arriving at the Port of Colombo declined by 7 per cent during the first half of 2002, in comparison with the corresponding period of 2001. However, in comparison with the second half of 2001, during which period port services were badly affected by the war risk insurance surcharge, the number of ships calling at the Port of Colombo grew by 8 per cent.

Chart 8.7
Ship Arrivals

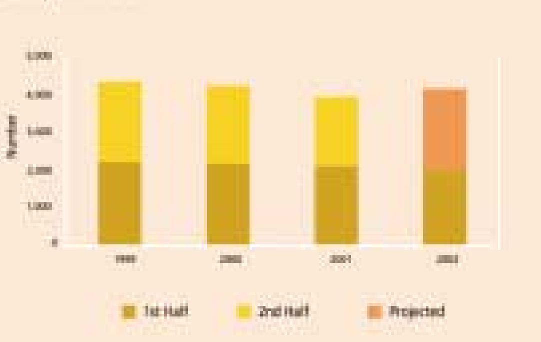
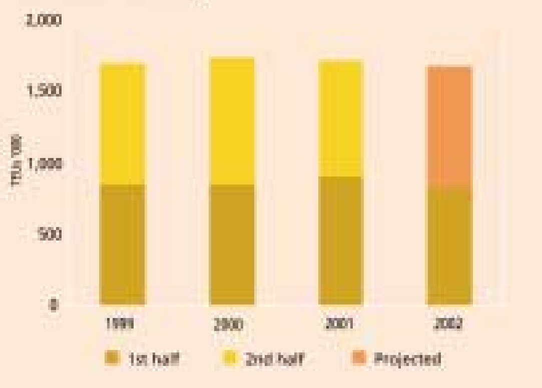


Chart 8.8
Container Handling



- Total cargo handled at the Port of Colombo dropped by 5 per cent during the first half of 2002. In addition to the war risk surcharge, a drop in trade volume, in both imports and exports, and the non-availability of two berths at JCT for several months due to dredging affected this decline. However, in comparison with the last six months of 2001, cargo handling increased by 2 per cent.

- Total container handling declined by 8 per cent and transhipment handling fell by 10 per cent during the first half of 2002 over the same period in 2001. As in the case of other port services, container handling has also improved gradually in recent months.

- With the expected recovery in the domestic and global economy during the latter part of 2002, port services are expected to recover completely by the end of the year and record a slight improvement over the previous year's level. With improving efficiency and productivity and the expansion of capacity, port services are expected to record an attractive growth in 2003.

- With the opening of a new berth at the South Asia Gateway Terminals (SAGT) and with higher productivity, total container handling at SAGT increased by 42 per cent during the first half of

2002 compared with the same period of the previous year. SAGT is expected to be operational at full capacity of one million TEUs per annum by end 2003.

- Sri Lanka Ports Authority (SLPA) also took several steps to improve cargo handling efficiency at its terminals. SLPA introduced a special incentive scheme for employees and an attractive discount scheme based on volumes for shipping lines.

- Gross berth productivity at the Jaye Container Terminal (JCT) at around 32 moves per hour in respect of main shipping lines, increased to about 36 during the first half of 2002. Gross gantry moves per hour also increased to 18 from 15 between the same periods.

Chart 8.9
New Connections (Fixed Access Phones)

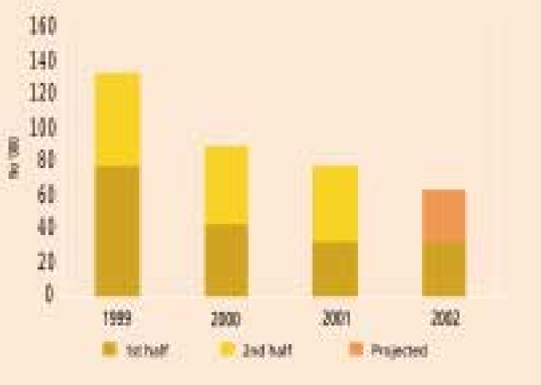
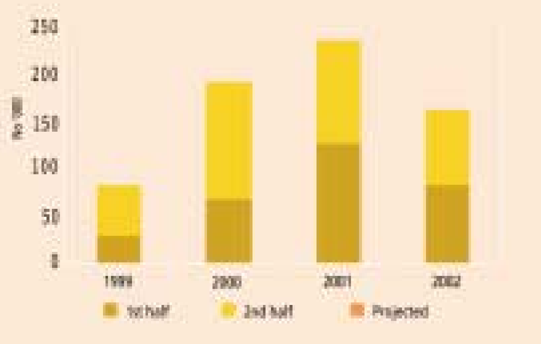


Chart 8.10
New connections (Cellular Phones)



- In a bid to improve productivity and reduce operating expenses, the SLPA initiated a long awaited voluntary retirement scheme (VRS) to reduce its redundant staff by about 6,000.

Communications Services

- The demand for telecommunication services continued to expand, particularly outside the Colombo metropolitan area. On the supply side, mobile telecommunication services expanded faster than fixed access telephones.

- In terms of the subscriber base, the telecommunications sector grew by 7 per cent in the first half of 2002. The same growth momentum is expected during the second half of the year.

- The number of fixed access telephones grew by about 4 per cent, while the number of mobile telephones grew by 12 per cent during this period. As a result, telephone density (telephones including cellular phones per 100 persons) increased from 8.02 to 8.47.

- The subscriber network of Sri Lanka Telecom (SLT) increased by 4 per cent to 738,250 as SLT provided 32,297 new telephone connections during the first half of 2002. The subscriber network of SLT is expected to increase by 10 per cent, to about 776,000, during 2002.

- The waiting list for SLT telephones rose by 15 per cent to 296,816 during the fist half of 2002.

- Subscribers to Internet and e-mail services rose by 3 per cent to 63,390. There were 32 companies providing Internet and e-mail services at end June 2002.

- The monopoly held by SLT for fixed line telephones and international telecommun ications expired in August 2002, and competitive markets for these services are expected in the future. The management contract awarded to NTT also expired in August.

- The government is planning to sell 15 per cent of SLT shares currently held by it through the Colombo Stock Exchange during the latter part of the year.

- The post office network expanded by 46 to 4,602, mainly due to the expansion of agency post offices, rural agency post offices and estate agency post offices.

- The Postal Department has taken steps to increase the number of postal shops, as they are relatively profitable and are gaining popularity among the public. There were 30 postal shops operating in the country at end June 2002.

- Handling of inland mail articles by public sector post offices increased marginally to 226 million articles, while handling of foreign mail articles decreased by 20 per cent to 29 million during the first six months of 2002.

- Restructuring of the Department of Posts was further delayed as the required legislation is yet to be passed by Parliament.

The Samurdhi Programme

- Several key steps have been initiated during the first half of 2002 to improve targetting and to rationalise welfare programmes aimed at poverty alleviation.

- A long felt need for a formal procedure to select needy households to receive welfare benefits was fulfilled with the enactment of the Welfare Benefit Law in August 2002. According to this law, Prospective recipients of welfare benefits should be selected independently by a committee appointed for that purpose, in terms of pre-determined selection criteria.

- The total budgetary provision for the Samurdhi Programme has been reduced by Rs 2 billion in 2002. Consequently, action has been initiated to reduce the number of families receiving Samurdhi benefits by removing ineligible receipients.

- The Samurdhi empowerment programme helped reduce the number of Samurdhi recipient families by about 1 per cent to 1.96 million during the first four months of 2002. The total estimated cost of the Samurdhi relief programme during the first half of 2002 was Rs. 5,921 million.

- The number of dry ration recipient families dropped by 24 percent during the first six months of 2002 mainly due to non-distribution of dry ration cards in certain districts. The estimated cost for the first six months was Rs. 685 million.

- Under the Nutrition Programme, 17,300 families received benefits to the value of Rs. 150 per month per family.

- The Samurdhi Compulsory Savings fund expanded by 7 per cent to Rs. 7,892 millions during the first half of 2002.

- Voluntary savings increased by 14 per cent to Rs. 1,300 millions by end June 2002. There were 989 Samurdhi Banking Societies in operation at end June 2002.