Country and Sector Background

1. Sri Lanka’s emergence from conflict in the North and East provides a basis for sound tourism growth. The tourism sector along with other productive sectors in the East was affected by the persistent insecurity and conflict, leading to the loss of investments and jobs in the sector. While a few locations could maintain a small presence in the market place, others were completely destroyed. The proposed project offers to support the achievement of two main outcomes: First, it supports the implementation of the Tourism Sector Strategy which aims to shift the industry’s growth trajectory from the current low value tourism growth, to a higher value and unique Sri Lanka based product. Second, the project will contribute to the rebuilding and reconstruction of the East by contributing to the re-investment in tourism activity by improving the investment climate, training of human resources in the East and supporting broad participation in the tourism supply chain (supply of local produce and services). Given the embedded knowledge, low barriers to entry and natural resources, the sector provides the opportunity to a rapid economic reconstruction in the East.

2. At present, the economic development is highly skewed towards the Western Province (WP). WP contributes almost 50 percent of the GDP while the rest of the eight regions in the country cumulatively account for the balance. In 2007, the WP contributed 48 percent while the Eastern Province (EP) contributed only 5 percent. During the period 2003 –
2009, the contribution to GDP from EP had ranged between 5-6 percent. In addition to the conflict, the EP was severely affected by the Tsunami in 2004.

3. The Eastern Province (EP) consists of 15 percent of the land mass of the country with the longest beach frontage out of the 9 provinces in the Country. It has three Districts (Ampara, Batticaloa and Trincomalee) with mixed ethnic and religious composition. This province is the most diverse in Sri Lanka, both ethnically and religiously (Tamils 42.6%, Muslims 36.3% and Sinhalese 21.1%). As a lagging Region, the socio economic indicators and infrastructure are poor. Poverty head count index is 10.8 percent while poor households recorded 9 percent (2006/07). The road density is a mere 0.8 km/km² but, the province is blessed with 3 domestic airports and one international harbor. The communities are mainly involved in agriculture, livestock breeding and fisheries for their subsistence. There is a small portion of individuals who are employed in the private or government sector. Many others are self-employed in the fields of small businesses and crafts or as skilled and unskilled daily wage earners.

4. The Province is rich in tourism assets and can boast of the best beaches in the country together with world class surfing sites, secluded lagoons, national parks/wildlife sanctuaries and a very large number of heritage sites dating back to over 2,000 years. The tourism sector is not new to the province. Tourism investments along the eastern coast, cultural heritage sites and national parks provided additional employment prior to the escalating conflict. For example, prior to the ethnic tensions, the Eastern province had three key tourism centers, namely Nilaveli, Passikudah and Arugam Bay that operated very successfully during the 1960s and 1970s. Currently two major resort project sites are being planned in two sites in Kucchavelli (Trincomalee) and Passikudah (Batticaloa).

5. Current occupancy rates, room capacity and hotels in the Eastern region are very low compared to other tourism regions. Tourism related manpower skills are not available in the region. In the Trincomalee district, the main beaches are in Nilaveli and Uppuveli. There is great potential for marine based activities such as diving, snorkeling, whale and dolphin watching and deep sea fishing. Trincomalee’s deep natural harbor is renowned for its size and is accessible to all types of vessels. In Ampara district, Arugam Bay has six surfing points known to be among the top 10 surfing beaches in the world. The area is in close proximity to two well known wildlife parks and a number of cultural heritage sites.

6. The sector issues and constraints were identified during focus group discussions with 150 participants consisting of investors, NGOs, community participants, and Government officials in two locations (Colombo and Arugam Bay). The issues are also noted in a value chain analysis completed in 2007, by IFC and a USAID funded competitiveness study in 2006. Some of the issues were also confirmed in a sector survey of 140 tourism firms which was conducted during project preparation.

7. The main constraints affecting tourism sector growth can be categorized into regulatory, infrastructure and market issues. as follows:
• **Regulation and licensing.** It currently takes 70 days on average to issue a license for a guest house, or 147 days for a hotel based upon a sample of approvals given in 2008. Entrepreneurs highlighted the need to review and streamline registration, licensing, and inspection procedures, etc in order to reduce and trim the time taken to obtain permits and transact with the public service. The Tourism Survey also confirmed the focus group discussions that business licensing and registration were serious problems in addition to the tax rates.

• **Research, market strategy and promotion are inadequate** to cope with new and evolving market developments. As a result additional propositions heritage, sporting, culture, etc are not articulated. The tourism experience that Sri Lanka offers consists of distinct, diversified segments and can be extended beyond the sun and sand segment.

• **Lack of highly localized infrastructure.** Un-tapping existing potential requires basic infrastructure (rehabilitation of small air strips, roads and trails, etc.), especially to integrate rural areas. Inadequate waste water and solid waste management severely undermine the sustainability of the sector. Internal air access is difficult and road infrastructure with municipalities is poor particularly in the Eastern Province.

• **Difficulty in recruiting and retaining professionals.** The focus group discussion highlighted the need for trained professional staff. Adequately trained staff in general, but in particular in the east of Sri Lanka, is in short supply. This is partly due to a supply constraint but also due to loss of existing expertise to competitive locations. The overall sector survey also confirmed that professional hotel managers were difficult to find.

• **Enterprises in the supply chain need to improve productivity and quality of products.** Firms supplying goods and services to tourism firms such as hotels, restaurants, etc need to provide better quality inputs that can enable tourism firms deliver a better quality product. New market segments in tourism have emerged and MSMEs need to adapt to new market demands.

• **Access to finance.** Entrepreneurs at the focus group discussions indicated that access to investment capital and working capital is limited. Most entrepreneurs who had also received a Tsunami loan to rebuild their businesses found it difficult to repay these loans due to the subsequent surge in conflict. As a result, commercial banks had become extremely risk averse to the sector.

8. The Government of Sri Lanka Tourism Strategy aims at achieving 8 main targets: 1) Building a more diverse product range; 2) Make Sri Lanka more accessible; 3) Attracting 1.5 million tourists per annum - if peace prevails; 3) Increasing yield per tourist from US$80 to US$ 130/day; 4) Enabling the building of 7,000 additional rooms by 2016 with the right conditions; 5) Enabling new developments in the East and Northwest with further development of existing sites and cities (resorts and new resorts); 6) To grow traditional markets and open new markets; 7) Grow domestic tourism; and, 8) Grow the Micro, Small
and Medium Enterprise (MSME) sector. The Sri Lanka Tourism Strategy is in line with the country’s 10-year Development Framework which aims to accelerate growth from its historical average of about 5 percent to over 8 percent by the year 2010. The proposed scope of the project cannot address all these objectives of the Sri Lank Tourism Strategy however it. The project objective is to strengthen the institutional framework for the Tourism Sector to facilitate environmentally and socially sound investments, in particular in the East of Sri Lanka.

9. As a first step in implementing Tourism sector strategy, the Government enacted a new tourism act. The Tourism Act No.38 of 2005, which became effective on October 1, 2007, established a new structure for the implementation of policy for the tourism sector. Four institutions; (i) Sri Lanka Tourism Development Authority (SLTDA), (ii) Sri Lanka Tourism Development Bureau (SLTPB), (iii) Sri Lanka Institute of Tourism and Hotel Management (SLITHM), and (iv) Sri Lanka Convention Bureau (SLCB) were set up to manage the development of the industry with the common vision, “To establish Sri Lanka as Asia’s most treasured island, highlighting its beautiful beaches, warm and friendly people, with a strong nature, culture and adventure offering, raising its profile to that of an Asian tourism icon.”

Objectives

10. The project objective is to strengthen the institutional framework for the Tourism Sector to facilitate environmentally and socially sound investments, in particular in the East of Sri Lanka.

Description

11. Expanding tourism to under developed to the East of Sri Lanka through environmentally and socially sound investments will require systemic changes that can be summarized in three broad objectives:

a) improving the efficacy and efficiency of the institutional framework: This will require reviewing existing processes, practices and institutional arrangements in the policy environment at the national and the local government levels, making it more conducive to investment in sustainable tourism, for small and medium enterprises or communities;

b) providing highly localized tourism related infrastructure services: based on well defined, locally owned and community based tourism development plans, and investment in the provision of infrastructure services that will enable local tourism clusters to compete and extend their market outreach. These investments will be modeled along public private partnerships to ensure ownership and sustainability of these services, and

c) Improving and extending the product content and supply chains of SMEs. This will involve improving the mix and the quality of tourism products offered, in particular by small
medium and large enterprises (SMEs) as well as communities. The private sector will be encouraged to innovate and re-invest in products that are consistent with sustainable tourism development.

- **Component 1**: Institutional Framework: The component will reduce the time required to issue permits, approvals, etc, increase the number of registered hotels and increase the capability of public institutions.
- **Component 2**: The objective of this component to provide essential local tourism related infrastructure in the East.
- **Component 3**: The objective of this component is to Improve and extend the product content and supply chains of SMEs.

**Financing**

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<td><strong>Total</strong></td>
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**Implementation**

**A. Institutional and implementation arrangements**

1. The Ministry of Tourism (MoT) of Sri Lanka will be responsible for implementation of the project, supported by the services of a Project Facilitation Team (PFT), reporting to a Steering Committee (SC). The SC will be appointed by the Minister and chaired by the Secretary of the MoT. The SC will provide the oversight function, policy direction and guidance and will also monitor implementation. It will also act as a Grievance Mechanism and will co-opt additional members with technical expertise if needed (i.e. environmental, coastal, etc). The SC will consist of all chair persons from the boards of the four institutions (SLTDA, SLTPB, MICE, SLTHIM) and other public institutions. The other 50 percent of the SC members will be from private sector business associations and civil society.

2. The PFT will have a core staff including; Project Director, Project Coordinator, Finance Manager and a Procurement officer and will bring other technical expertise as and when needed for required durations. The Government and the IDA teams will jointly review (for example during the Mid Term Review mission), the possibility of phasing out or reduction of external staff from the PFT. In any event, the PFT will facilitate project implementation in close coordination with the existing staff of the respective organizations under MoT, thereby enhancing the capacity of those institutions as well.

**B. Sustainability**

3. The main elements of the new Tourism Act No. 38 of 2005 are to bring the public and private sectors together in a close working partnership, developing various boards for promotion, training, etc, providing an independence of the budget and sustainable funding,
making the institutions more responsive to sector needs. The reform process was based on an elaborate consultative process between Government and private sector participants and NGOs which finally resulted in making the Act effective in October 2007. The four dedicated institutions with representatives from various facets of the industry also developed a strategy document; --the Strategic Plan for Tourism (2009 – 2012) which further supported the shift from quantity to quality. The proposed project is based on the reform process started in 2006.

Lessons Learned from Past Operations in the Country/Sector

1. The key issues and lessons learned from a review of projects funded by the World Bank and other development agencies in tourism, coastal management and community based tourism, etc. were incorporated into the design of the project and can be summarized as follows:

2. **The importance of local (community) ownership and partnership**: Engaging local communities and local Government is a central part of the project design and a key factor in building the uniqueness of the tourism product in Sri Lanka. The project design entails building awareness among local communities.

3. **Establishing a clear consensus on the need for and relevance of strategic planning and programming**: Developing coherent strategies from the local cluster level, the community level where tourists form their impressions, to the provincial levels and at the national level is embedded in component 1. The project will develop a series of local tourism plans with local communities and ensure that the strategic visions are reflected in the provincial and national planning, marketing and investment strategies.

4. **Establish a better investment climate for sustainable tourism with effective coordination among Government agencies**: An enabling environment (policy, regulation and promotion) is important for the sustained success of a tourism destination. Clear and transparent application of regulations, rules and standards should be consistently implemented at all levels of Government to ensure equitable development.

5. A **Public Private Partnership framework based on transparent procurement and contractual procedures and managed professionally can contribute to job creation and investment**. PPP arrangements can generate large social benefits, as in the case of the Kingdom of Morocco where over 100,000 indirect and direct jobs from US$ 2.5 billion in private investment were generated in the Plan Azur program.

6. **Efficient and often highly localized infrastructure is required to develop a tourism destination**. Access (travel time) to destination, environmentally friendly infrastructure services (water, sewerage and power) and safety (access to hospitals and security) are the most important enabling factors for a competitive tourism destination.

7. **Encouraging firm level investments and innovation is essential for staying competitive**. Tourism is essentially a private sector led activity where firms compete for market share. Supporting and encouraging firms to innovate, improve services, to compete based on quality of their products, etc is an important element in implementing an overall sustainable tourism strategy. A Matching Grant Facility has been incorporated into the
project to encourage firm level behavioral change, taking into account the lessons learnt in using this instrument in Bangladesh, South Africa and Uganda.

Safeguard Policies (including public consultation)

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List of Factual Technical Documents

5. The Travel and Tourism Competitiveness Report 2007, World Economic Reform

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* By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas
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