Project Information Document/ Integrated Safeguards Data Sheet (PID/ISDS)

Concept Stage | Date Prepared/Updated: 26-Sep-2017 | Report No: PIDISDSC23084

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Parent Project ID (if any)	Project Name
Sri Lanka	P163864		Framework Development and Infrastructure Financing to Support 3Ps (P163864)
Region	**Estimated Appraisal Date**	**Estimated Board Date**	**Practice Area (Lead)**
SOUTH ASIA	Jun 04, 2018	Sep 06, 2018	Transport & Digital Development
Financing Instrument	**Borrower(s)**	**Implementing Agency**	
Investment Project Financing	Ministry of Finance	National Agency for Public-Private Partnerships (NAPPPs)	

Proposed Development Objective(s)

The PDO is to improve the institutional, policy and legal framework conducive for structuring and financing of PPP projects.

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	26.34
Total Financing	26.34
of which IBRD/IDA	25.00
Financing Gap	0.00

DETAILS

World Bank Group Financing

International Development Association (IDA)	25.00
IDA Credit	25.00

Non-World Bank Group Financing

Counterpart Funding	0.64

Borrower	0.64

Environmental Assessment Category	Concept Review Decision
A - Full Assessment	Track II-The review did authorize the preparation to continue

Other Decision (as needed)

B. Introduction and Context

Country Context

1. **Overview.** Sri Lanka is a lower-middle-income country with a per capita gross domestic product (GDP) of US$3,835 in 2016. The economy grew at an average 6.2 percent during 2010–2016 following the end of the 30-year civil war in 2009, enjoying the benefits of a peace dividend and policy thrust toward reconstruction and growth. In 2016, it recorded a 4.4 percent GDP growth and is expected to reach 4.7 percent growth in 2017.[1] It ranks relatively high (73) on the United Nations Human Development Index compared to other developing economies and 110 on the World Bank Group's Doing Business Indicator in 2017 (up from 113 in 2015).

2. **High debt levels.** Over the past few years, Sri Lanka has been grappling with large fiscal deficits and public debt management issues. In 2015, it recorded a fiscal deficit of 7.6 percent of GDP with public debt levels of 77.6 percent of GDP. The corrective fiscal measures adopted following the International Monetary Fund (IMF) program in June 2016 saw the fiscal deficit reduce to 5.4 percent of GDP in 2016. However, public debt levels remained elevated at 79.3 percent of GDP at the end of the year. These high public debt levels have been exacerbated by weak foreign direct investment (FDI) flows over the past few years, leading the Government to rely more and more on domestic and foreign loans to bridge the fiscal deficit. Considering this, Sri Lanka still has a long way to go, to be able to meet its commitments of lowering the fiscal deficit to 3.5 percent of GDP by 2020.

3. **Low infrastructure investment.** Constrained by a large fiscal deficit and high debt levels, Sri Lanka's actual spending on infrastructure (both economic and social) as a percentage of GDP was only 4.6[2] percent in 2016. This compares unfavorably to other countries in the region, emphasizing the need for Sri Lanka to ramp up its infrastructure investment to strengthen its competitiveness.

[1] World Bank Sri Lanka Development Update - June 2017.
[2] US$3.71 billion against GDP of US$80.6 billion.

Sectoral and Institutional Context

4. **Growing infrastructure needs.** While infrastructure has been a key driver of economic growth in recent years, the country still has a large infrastructure deficit. With increased urbanization in the Colombo Metropolitan Region (CMR), connectivity and congestion have become severe productivity constraints. The country still has a lot to do in addressing economic and social infrastructure needs beyond the CMR.

5. **Infrastructure financing dominated by public funding.** Infrastructure financing in the country has so far been dominated by public funding, often supported by loans from international financial institutions and countries such as China and Japan that have typically lent to the Government/state-owned enterprises (SOEs). In addition, some of the infrastructure projects were also financed by SOE's by borrowing locally with the support of a sovereign guarantee. Private sector financing in infrastructure is often only sought in cases where a project is unable to secure public funding.

6. **Fiscal constraints necessitate the need to attract more private investments**. However, with public debt levels close to 80 percent of GDP, continuing to rely on public debt financing to provide infrastructure is unlikely to be a sustainable approach for the Government, moving forward. Public-Private Partnerships (PPPs), although complex and time-consuming, are seen as one of the solutions that will provide value for money for projects that are well prepared and structured, where suitable. However, it will be important for the Government to realize that PPPs will not be the appropriate solution for all their infrastructure needs and that PPPs will also bring contingent liabilities that need to be quantified and managed.

7. **There are several constraints faced by the Government in executing a successful PPP program.** The diagnostic (September 2016) carried out by the World Bank and recent experiences indicate several constraints that need to be addressed to pave the way for a successful PPP program:

(a) **Over-reliance on unsolicited proposals.** In recent years, a substantial number of public sector projects have been procured on an unsolicited basis which is a practice that can have adverse implications with respect to transparency and value for money. Unfortunately, the absence of a guiding policy framework for PPPs together with a distinct lack of understanding based on limited institutional capacity to identify, assess, and prepare bankable PPPs has exacerbated the use of unsolicited proposals.

(b) **Multiple agencies with overlapping functions.** The absence of a cohesive framework to govern the institutional mandates, responsibilities, and interagency decision-making processes has created an environment of uncertainty and confusion for investors.

(c) **Poorly prepared projects have adversely affected recent PPP procurement.** More recently, the Government's attempts at developing key infrastructure projects on a PPP basis have brought mixed reaction from private developers with different Government agencies attempting to lead the path amidst political uncertainties. Several key infrastructure projects, mainly in the areas of ports, highways, and energy, have failed because of inadequate or nonexistent feasibility studies resulting in poorly structured transactions. The market has also seen political interference because of the ambiguity created by poorly structured transactions coupled with the absence of a clear procurement process.

Unfortunately, these failed attempts at PPPs pave a clear path for unsolicited proposals that attempt to meet the delivery time line of a Government under pressure to demonstrate results.

(d) **Limited long-term debt and liquidity.** There is lack of long-term debt in the domestic banking market for infrastructure loans that typically require longer repayment periods. In addition, the banking system does not have enough liquidity to support the amount of infrastructure investment required, particularly when it comes to large individual infrastructure projects. At the same time, the capital markets in Sri Lanka are significantly underdeveloped and ill-equipped to support the large amount of investment required in the infrastructure as well as other sectors. Therefore, it will be important for Sri Lanka to deepen and broaden its capital markets, encourage local banks to increase their infrastructure financing, and attract offshore banks (at least in the short term). However, to do this, Sri Lanka will need to establish an appropriate legal, regulatory, and institutional enabling environment together with a pipeline of well-structured PPP projects.

(e) **Legal framework not conducive for private sector investment.** Although Sri Lankan law relating to investments is not explicitly restrictive of foreign investment, there are obstacles to investment including the lack of clarity and scope, lack of information, and excessive discretion permitted by the legal framework. Unfortunately, Sri Lanka does not currently have one comprehensive 'Investment Law'.

(f) **Limited institutional capacity for PPPs.** There is currently very little understanding within the public sector of PPPs and little, if any, capacity to prioritize, structure, procure, and manage PPPs. In addition to this, the PPP-enabling environment is very weak and there is no clear policy on PPPs.

(g) **Limited ability to manage contingent liabilities.** Although much of the public-sector borrowing is guaranteed by the Government, the Government's capacity to manage contingent liabilities is very limited. The ability to manage liabilities is critical because it is likely that most PPPs will have some form of contingent liability associated with them.

8. **Sri Lanka's past successful experience in PPPs.** Sri Lanka has the potential to benefit immensely from a PPP program in addressing its infrastructure requirements given its past successful track record where private participation in infrastructure over 1995–2005 totaled US$2.1 billion across the transport, telecom, and energy sectors. Several of these projects procured over a decade ago have already completed successful implementation without any renegotiation. At the forefront of this success was the central, dedicated PPP Unit established under the Board of Investment that was tasked with the identification, structuring, evaluation, and negotiation of PPP projects. However, despite the success, this PPP Unit was wound up post 2005 by a Government that increasingly favored the development of infrastructure through the use of public finance, particularly with the assistance of bilateral development partners.

9. **Given the combination of fiscal constraints and the need to invest in infrastructure, the Government is keen to relaunch the PPP program.** The Government approached the World Bank in 2016, seeking assistance in developing a robust PPP program in Sri Lanka. The work carried out by the World Bank to provide this assistance has received great appreciation indicating genuine commitment to the PPP

program. The immediate establishment of the PPP Unit based on these recommendations was a demonstration of this strong support.

10. **World Bank Group support and status.** To provide assistance to the PPP program, the World Bank has built upon the assistance already being provided to Sri Lanka in the areas of (a) introducing capital market reforms, (b) strengthening the investment climate and related legal framework, (c) supporting investment promotion, (d) improving the Doing Business indicators, (e) establishing a Debt Management Unit, (f) climate risk management, (g) public finance management, and (h) transaction advisory support being provided by the International Finance Corporation (IFC).

(a) **PPP Diagnostic and operational support.** The World Bank Group carried out a 'PPP Diagnostic' in May 2016 that assessed the current constraints in the enabling environment for PPPs in Sri Lanka and provided recommendations to address those constraints. Immediately after the presentation of this report to the Government, a central PPP Unit was established in January 2017. The World Bank (at the request of the Ministry of Finance [MoF]) has been engaged in providing support in operationalizing the PPP Unit by sharing the World Bank's experience from around the world, as well as arranging advice from a team of consultants who helped establish and strengthen the PPP Unit in the Philippines that is often held up as a good example of a professional and well-organized PPP Unit. This has helped establish the institutional structure around PPPs with a central PPP Unit overseen by a Board of Governors.

(b) **Supporting prioritization and procurement.** The World Bank has also taken steps to address some of the inherent weaknesses that prevail in investment prioritization by creating capacity within the National Planning Department that will ensure a sustainable approach to the prioritization of infrastructure projects. In addition, although being a task pursued under U.S. Agency for International Development (USAID) financing, the team has also been actively involved in shaping new procurement guidelines as these would help minimize several issues experienced by line agencies in the preparation of PPPs.

(c) **Transaction support.** In addition, IFC has been mandated to provide transaction advisory support on several transactions. Indeed, the transaction support being provided to the National Water Supply and Drainage Board (NWSDB) on the Weliwita Water Project is progressing well with a robust response being received from international investors in its first round of procurement.

(d) **Public-Private Infrastructure Advisory Facility (PPIAF) Grant.** In response to the request made by the Government of Sri Lanka (GoSL) for assistance in developing a suitable framework and enabling environment for PPPs, a grant of US$700,000 was approved in June this year. Procurement of necessary consultancies using grant financing is already under way and will equip the PPP Unit with the necessary start-up capacity.

11. **Maximizing Finance for Development (MFD).** In support of MFD (previously referred to as the 'Cascade'), Infrastructure Sector Assessment Programs (InfraSAPs) for both the transport (in progress) and energy (first scoping mission in October) sectors are also being carried out to assess the technical solutions and constraints for long-term finance with the objective of providing a road map of solutions and recommendations whereby the Government can establish a realistic way forward in achieving the

Government's objectives within these two sectors as well as mobilize private sector investment in support of the Government's investment plans. The analysis and recommendations arising from these two InfraSAPs will feed into and supplement the work that will be carried out under the project.

12. **The team is also working very closely with other groups within the World Bank.** The objective is to ensure that relevant knowledge and experience from other groups is also being applied to support the Government and meet the PDO, for example, PPIAF, Global Infrastructure Facility (GIF), Global Practice for Social, Urban, Rural, and Resilience (GSURR), Trade and Competitiveness (T&C), Finance and Markets (F&M), Governance, Environment and Natural Resources, Climate Change, and IFC.

13. **The World Bank is working in coordination with other development partners to help prepare a successful PPP program.** The team is working together with the Government and other development partners such as USAID, Asian Development Bank (ADB), Millennium Challenge Corporation (MCC), Japan International Cooperation Agency (JICA), and the Netherlands Embassy to ensure that collective resources are channeled to develop a single framework. Assistance from USAID (that has been the most active player in the PPP sector) will end in December 2017 and it has been agreed with the Government that the World Bank will take forward USAID's work in the sector, thereby providing seamless assistance. The development partners will be coordinated through the strong leadership under the PPP Unit.

14. **The World Bank is also working with other key stakeholders.** In addition to development partners, the team is also involved with other partners such as the Ceylon Chamber of Commerce through the participation of their National Advisory Committee on PPPs that reach out for wider support for the PPP program with several stakeholders, including both the Government and the private sector. The team has also engaged several think tanks, key journalists, media etc. to broaden the PPP program and insulate it from any political changes. Moreover, a concerted effort is being made to engage and sensitize the public on PPPs, particularly in demonstrating the past success of PPPs in the country.

15. **With the World Bank's support, the Government so far has shown strong and continued commitment to the PPP Agenda.** The new Finance Minister appointed in May 2017 has already secured approval of the Cabinet of Ministers to reconstitute the PPP Unit as the National Agency for Public-Private Partnerships (NAPPP). It is intended that the NAPPP will be formally established through an Act of Parliament or an alternative legal structure to ensure sustainability within the institutional structure. Furthermore, the Finance Minister has already appointed the Board of Governors who will have oversight over the NAPPP and its processes and will consist of members from the two main coalition partners. He has also brought in as the chairman of the Board of Governors and Chief Executive Officer (CEO), who has been the head of the previous successful PPP Unit in Sri Lanka. As the Government is keen to ensure that the NAPPP is the central unit for PPPs, it has formalized its position in the draft procurement guidelines that are expected to be approved by the Cabinet of Ministers. The Government will therefore need to build capacity within the NAPPP to win the confidence of ministries and line agencies in moving this program forward.

16. **The Government's recent economic policy framework (Vision 2025) features PPPs as an integral part.** Vision 2025 highlights the Government's commitment to encourage PPPs to strengthen the country's growth framework. It identifies the importance of empowering the private sector and reducing reliance on public sector borrowing in the provision of public assets and services. Furthermore, the Government envisions expanding PPPs beyond the current sectors of transport and energy into health care, leisure, tourism, and education.

17. **The World Bank will need to play a key supporting role.** The Government has identified the World Bank as the key player in assisting them with this PPP initiative. Therefore, the World Bank will need to play a crucial role in developing a successful PPP program in Sri Lanka that will, in turn, also help shape the landscape for the World Bank's future engagements in the country. In that context, the proposed project has been designed to address the critical constraints and provide seamless support in establishing a successful PPP program in Sri Lanka.

Relationship to CPF

18. The project ties in directly with the objective of scaling up infrastructure through PPPs (Objective 1.3) under the pillar to improve macro-fiscal stability and competitiveness (Pillar 1) of the Country Partnership Framework (CPF) for FY17–FY20. The CPF acknowledges the need to bring in more private sector investment in infrastructure, given the rising fiscal constraints in the country, and identifies PPPs as one of the most suitable delivery options. It indicates the World Bank's willingness to provide advisory and financing services to facilitate PPP approaches toward improving the quality of, increasing access to, and expanding infrastructure assets and services of the country. It further envisions providing the World Bank's support to the Government to build capacity to identify, assess, prepare, and oversee PPP projects, as well as review the existing regulatory and incentive framework for PPPs.

19. A successful PPP program also addresses the objective of improving public finance management (Objective 1.1) under Pillar 1 of the CPF by reducing the need for direct public financing of investment. It is also linked to the agenda on improving public debt management to manage the fiscal risks from PPPs. By creating opportunities for private sector involvement in the infrastructure sphere, it further complements the objective of improving the enabling environment for private investment and trade (Objective 1.2) under the same pillar of the CPF.

C. Proposed Development Objective(s)

20. The PDO is to improve the institutional, policy, and legal framework conducive to the financing of PPP projects.

Key Results (From PCN)

21. The PDO will be measured through the following key indicators:

(a) PPP Policy approved by the Cabinet of Ministers

(b) PPP Procurement Guidelines approved by the Cabinet of Ministers

(c) Communications strategy established and approved by the Board of Governors

(d) Feasibility studies completed for up to four PPPs with the assistance of the project

(e) Concession Agreements signed for one pilot PPP project by the NAPPP

D. Concept Description

22. The project supported through assistance from IDA and the PPIAF Grant will create the enabling framework for PPPs by improving the institutional, policy, and legal framework and building the necessary capacity within the country to develop PPPs. It will help develop a robust pipeline of PPP projects that will receive assistance under the project for carrying out feasibility studies and structuring of bankable transactions with appropriate risk mitigation and financing instruments that will lead to a credible PPP program in Sri Lanka. It will test the robustness of the framework and instruments by developing one pilot transaction.

23. The project is well-timed, given the World Bank Group's focus on MFD by helping governments (a) leverage their limited fiscal resources and (b) attract greater private participation in infrastructure investment. With the disappearance of low-cost concessional funding, Sri Lanka needs private sector financing to bridge its infrastructure needs. Therefore, this project will play a significant role in developing the foundation necessary for future World Bank programs.

24. **PPIAF Grant (July 2017–March 2019):** The ongoing PPIAF Grant of US$700,000 will be an integral part of the project and the grant together with IDA finance of US$5 million will provide assistance in creating the necessary institutional and policy framework and an enabling environment to support the development of a successful PPP program. The grant will therefore be used to part finance Component A as detailed in the following paragraphs. IDA finance will also be used to support Component A as the amount and the time span of the grant will be insufficient to meet the total requirement over the period of the project in improving the enabling environment. The primary support to the NAPPP under the PPIAF Grant will be provided by engaging a firm of consultants that will assist in addressing the weaknesses in the institutional, policy, and legal framework. The immediate weaknesses in capacity will be addressed through engaging a resident adviser who will handhold the NAPPP through its day-to-day activities and help provide an overall capacity-building program.

Description

25. The project design discussed in the following paragraphs is based on a single Investment Project Financing (IPF)

Component A: Improving the Enabling Environment (US$5 million from IDA and US$700,000 from PPIAF)

26. This component will be supported by a combination of the grant (up to March 2019) and IDA credit to provide support to meet the time lines and deliverables within this component.

A.1: Policy Framework

27. This subcomponent will support strengthening of the policy framework and will support the development of the following:

(a) **PPP policy.** A clear, transparent, and consistent PPP policy that will standardize the Government approach across sectors and remove any ambiguity in the treatment of PPPs. More importantly, it will also set out the treatment of unsolicited proposals. The policy will

encompass areas necessary to be included in a PPP project that will reflect the Government's position related to sovereign guarantees, Government risks, contingent liabilities, climate resilience etc. The specific role played by the MoF and the Board of Governors of the NAPPP in the PPP process will be clearly defined.

(b) **Procurement Guidelines.** The project will assist with further revisions to the procurement guidelines that are currently being finalized. It will set out clear processes on how proposals should be evaluated, monitored, and assessed. Establishing a clear process will help avoid interference from institutions external to the process and provide much-needed confidence to investors who would otherwise be deterred from bidding. The guidelines will also provide clarity on how the Government will address unsolicited proposals.

(c) **Communication strategy.** An effective communication strategy will reach out to various stakeholders to help address some of the concerns/misconceptions that prevail over PPPs. The community/stakeholder engagement strategy would be developed by stakeholder mapping and needs assessment and would focus on full transparency through periodic release of information on the status of projects. This would allow the Government to deal with issues proactively and broad base the PPP program for increased sustainability. Furthermore, a platform will be created in order to engage the public and various interest groups to inform the approach to be adopted for the PPPs and address sensitive issues.

A.2: Institutional Framework

28. This subcomponent will support strengthening of the institutional framework in relation to the NAPPP and the Board of Governors and the transitioning to a formalized institution following an Act of Parliament. It will also support the establishment of required institutions that will assist the sustainability of the PPP programs such as those providing oversight, arbitration, project development facilities, and long-term finance such as an infrastructure fund.

(a) **NAPPP and the Board of Governors.** Assistance will be provided to strengthen the structure and governance of the NAPPP and its Board of Governors to improve the quality of PPP project identification, preparation, evaluation, and negotiation. It will provide the necessary technical assistance and incremental operating cost for the efficient functioning of the NAPPP. It will also include assistance to employ a strategy that would ensure financial sustainability of the NAPPP and reduce reliance on budgetary contributions.

(b) **Establishment of other Institutions/arrangements.** Assistance will be provided in establishing institutions or arrangements that are integral to the smooth operation of the project cycle such as the apex organization that will be responsible for determining the procurement route for infrastructure projects, i.e. public sector, or PPPs. The project would also provide support in establishing institutions that will complement the objective of the project. This could include institutions providing long-term financing for infrastructure projects, project development funds for feasibility studies, strengthening the Arbitration Center, and any institutional support to agencies involved in the PPP process such as sector ministries, line agencies, Attorney General's Department, National Planning Division, Central Environment Authority, Chief Valuer's office, Surveyor General's Department, and so on. Furthermore, assistance will be provided for the development of PPP nodes within the

relevant line agencies to liaise with the NAPPP in the project development process. The nodes would also be responsible for the monitoring of the PPP contracts under their responsibility.

A.3: Legal Framework

29. Assistance will be provided to assess any weaknesses in the investment climate, where necessary, to supplement the work already being carried out by the World Bank. In addition, it will also assess the legal framework in each of the sectors being identified for PPPs to ensure their applicability and to recommend changes to the legislative framework where necessary. The assessments will also review the land acquisition regulations given the complexity that would be faced when implementing most of the PPP transactions. Furthermore, it may also focus on the changes to the legal and regulatory framework that may be necessary if project finance products were required.

A.4: Development of a PPP Pipeline

30. Given the existence of several project lists established by different institutions such as the Prime Minister's office, Western Region Megapolis Project, the 2017 budget, the Government's Public Investment Plan, etc. a single pipeline supported by a preliminary analysis and agreed by the relevant Government agencies is key to the successful development of a PPP program. This pipeline of transactions will use the results of the prioritization work that has already been carried out by the World Bank for the water sector. Similarly, the results of the analysis carried out through the InfraSAP for both the transport and energy sectors will inform the prioritization of the projects in these sectors. Guided by the financing and funding instruments recommended by the InfraSAPs the prioritized lists of projects in these sectors will then be used to identify suitable PPP projects. It is imperative for the NAPPP to be engaged in developing a PPP pipeline that has a good mix of easy wins and more complex PPP projects that would provide a wider impact. Therefore, the project will support the NAPPP to manage the existing pipeline and develop a new pipeline while considering the readiness and time line for implementation.

A.5: Capacity Building

31. Proposed activities will build on the capacity building that USAID has carried out and will include training for Government agencies that are currently involved in the PPP process as well as potential users such as the provincial councils. It will also include capacity building for senior politicians and Government staff at central and provincial levels. It will have more specialized training for project specific staff. Activities could include building preliminary business cases, preparation of feasibility studies with PPP options analysis, preparation of safeguards instruments, calculation of value for money and affordability, determining fiscal impact, and procurement and management of contracts. It will include a more advanced training with PPP certification for the staff of the NAPPP. Furthermore, it will also include the formulation of standard documents and templates such as terms of reference (TOR), bid documents, contracts, and so on, for less complex projects that can be easily replicated.

Component B: Transaction Support (US$20 million from IDA only)

32. This component will encompass assistance that will be provided exclusively through IDA support for specific transactions.

B.1: Project Development Assistance

33. Recent failed attempts to engage developers for PPP projects have demonstrated the dire need for the projects to be supported through well-prepared feasibility studies and properly structured transactions reflected in robust risk allocation and contract documentation. Due to several failed attempts to procure PPP projects, there is likely to be an increased demand from sector ministries and line agencies for their projects to be properly prepared to be able to attract private sector investors and finance.

34. This component will provide assistance for the preparation of feasibility studies and transaction advisory support for some of the prioritized projects included in the pipeline. It will include due diligence work to assess the technical, economic, and financial feasibility of a project (technical scoping, concept design, economic and financial analysis); further assessments required such as environmental and social assessments, gender impacts, traffic surveys, willingness-to-pay surveys; value for money analysis, market sounding and so on, and structuring of specific transactions considering the risk allocation and revenue structure. It will include the necessary financial and legal advice during procurement with respect to structuring of transactions and preparation of the necessary contractual documentation while supplementing the technical skills of the line agencies where necessary. It will help supplement the skills of the Government in the evaluation and negotiation of the transactions. The screening criteria for projects that seek assistance from the proposed project will also be established during the preparation of the proposed project.

35. However, it is recognized that the limited funding available under this component may not be sufficient to support the entire pipeline and, as such, a more sustainable and long-term arrangement needs to be established to encourage the development of well-structured projects. Therefore, the project could also help establish a long-term revolving project development fund (with assistance from other development partners), depending on the demand and appetite for funding under this component. The team will also work very closely with the GIF to source project development funds for applicable projects.

B.2: Investment Support and Risk Mitigation

36. Experience with PPP projects around the world has shown that some projects that are assessed as economically viable may require additional support to ensure financial viability to attract private investors. In such a case, financial viability can be achieved through the Government providing an up-front subsidy to cover a portion of the capital costs or an ongoing subsidy (for example, backstopping initial availability payments) to be paid over the lifetime of a project. However, any decision to provide Viability Gap Funding (VGF) should always be based on a detailed financial assessment of the project, particularly as VGF may create financial liabilities for the Government. The proposed project has been structured to provide limited VGF on one pilot transaction with a view to developing the capacity of the Government to undertake the necessary project assessment to determine whether VGF is required and the method to best deliver such VGF.

37. Furthermore, it seems that several PPP transactions have recently failed in procurement because a number of key risks were not properly mitigated to the satisfaction of private sector investors. Therefore, in addition to VGF, the project could also leverage the World Bank Group's various guarantee instruments provided by IBRD, IDA, and the Multilateral Investment Guarantee Agency (MIGA) to help mitigate payment and/or political risks.

38. The provision of such support under the project is expected to help increase the participation of existing and new private sector sponsors and lenders, especially for large infrastructure projects.

39. Once the pipeline of projects to be developed as PPPs is identified (under Component A), the feasibility studies are completed, and the transaction has been appropriately structured (under Component B1), the project will prioritize one of the PPP projects as a 'pilot' transaction for which a portion of the US$20 million will be earmarked to provide VGF and/or other risk mitigation instrument to ensure bankability. The need for VGF and/or risk mitigation instruments will be determined during the preparation of the project and upon the identification of the project pipeline.

SAFEGUARDS

A. Project location and salient physical characteristics relevant to the safeguard analysis (if known)

Currently the locations of the PPP projects that would be supported by the project are unknown.

B. Borrower's Institutional Capacity for Safeguard Policies

A comprehensive policy and regulatory framework for environmental safeguards is in existence in Sri Lanka. The Central Environmental Authority (CEA) is the key regulatory body that is mandated by the National Environmental Act (NEA) to implement all regulatory provisions outlined in its statutes. All development projects, that fall in to a set of prescribed categories (majority of the long-listed PPP projects fall within these categories) are required to conduct a comprehensive environmental screening and mitigation planning process through Environmental Impact Assessment or Initial Environmental Examination. These processes are largely consistent with the Bank's safeguard policy on Environmental Assessment. With over three decades of experience the CEA demonstrates the technical expertise in evaluating environmental impacts of development projects. However even with an enabling legal environment, the enforcement of legal instruments and subsequent monitoring of environmental management activities has been very low. Likewise, in terms of social safeguards, regulations governing land acquisition and resettlement are considered comprehensive, and consistent with Bank's OP 4.12 requirements with the exception of few gaps. In the past, through various WB-financed projects, GoSL has the experience in complying with WB's requirements. However, due to capacity constraints as well as lengthy procedures, land acquisition has often been leading to delays in project implementation.

Project implementation will be the responsibility of the PPP Unit established under the Ministry of Finance. As a newly established unit, it currently lacks the capacity to effectively screen and process PPP projects, and will therefore benefit from the Component A focused on developing the enabling environment including capacity building. In addition, it will also benefit from the processes that will be introduced to the preparation of selected PPPs under Component B. The PPP Unit is expected to bring on board qualified and experienced environmental and social safeguard specialists to ensure due diligence required by the safeguard policies of the World Bank and the Government of Sri Lanka are met.

C. Environmental and Social Safeguards Specialists on the Team

Darshani De Silva, Environmental Safeguards Specialist
Bandita Sijapati, Social Safeguards Specialist

D. Policies that might apply

Safeguard Policies	Triggered?	Explanation (Optional)
Environmental Assessment OP/BP 4.01	Yes	This policy is applicable because the project will include support to undertake feasibility for infrastructure projects that will included improvements/rehabilitation to existing structures or construction of new infrastructure. As projects that will be supported through this investment are unknown, an Environmental and Social Management Framework (ESMF) will be prepared and publicly disclosed locally and in the Bank InfoShop.
Performance Standards for Private Sector Activities OP/BP 4.03	No	
Natural Habitats OP/BP 4.04	Yes	Based on the experience of the establishment of new infrastructure in the country in the recent past, it is expected that the potential infrastructure projects will have potential threats to significant natural habitats or designated areas of natural importance. Therefore, this policy is applicable. The ESMF will include appropriate screening as part of the environmental assessment (EA) process and necessary guidelines on avoidance/mitigation measures to address potential impacts.
Forests OP/BP 4.36	Yes	Based on the experience of the establishment of new infrastructure in the country in the recent past, it is expected that the potential infrastructure projects will have potential threats to forests as in many instances raw material such as metal, sand and gravel have been extracted from forest reserves. Therefore, this policy is applicable. The ESMF will include appropriate screening as part of the EA process and necessary guidelines on avoidance/mitigation measures to address potential impacts.
Pest Management OP 4.09	No	The potential infrastructure projects do not include purchase of pesticides or pesticide application. Therefore, this policy is not applicable. However, as a precautionary measure, these types of activities will be identified in the negative list with appropriate screening as part of the ESMF.
Physical Cultural Resources OP/BP 4.11	No	The potential infrastructure projects are unlikely to impact physical cultural resources. However, the ESMF

		will include appropriate screening as part of the EA process and chance-find procedures.
Indigenous Peoples OP/BP 4.10	No	There are no conclusive evidence pointing to indigenous people living within the potential project area.
Involuntary Resettlement OP/BP 4.12	Yes	Past experiences of infrastructure financing suggests that the potential infrastructure projects will require land acquisition for the rehabilitation of existing structures or construction of new infrastructure. As the precise nature of the projects are unknown, an Environmental and Social Management Framework (ESMF) will be prepared alongside a separate Resettlement Policy Framework. These will be publicly disclosed locally and in the Bank InfoShop.
Safety of Dams OP/BP 4.37	No	This policy is not applicable as the project does not include potential infrastructure projects that involve new construction/rehabilitation of any dams or impacts to the functionality of existing dams.
Projects on International Waterways OP/BP 7.50	No	The policy is not applicable because the project does not include potential infrastructure projects located in international waterways
Projects in Disputed Areas OP/BP 7.60	No	The policy is not applicable because there are no disputed areas in Sri Lanka.

E. Safeguard Preparation Plan

Tentative target date for preparing the Appraisal Stage PID/ISDS

Feb 12, 2018

Time frame for launching and completing the safeguard-related studies that may be needed. The specific studies and their timing should be specified in the Appraisal Stage PID/ISDS

The ESMF and RPF is expected to be cleared by the Bank and disclosed to public both in country and in the Bank InfoShop by January 31, 2018.

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APPROVAL

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Approved By

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Practice Manager/Manager:	Karla Gonzalez Carvajal	11-Jan-2018
Country Director:	Idah Z. Pswarayi-Riddihough	11-May-2018