**Economic restructuring and public manufacturing enterprises adjustment credits**

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 Sri Lanka: Economic Restructuring Credit (Credit 2128-CE) and Public Manufacturing Enterprises Adjustments Credit (Credit 2185-CE)

The Implementation Completion Report (ICR) for the Sri Lanka Economic Restructuring Credit (Credit 2128-CE, approved in FY90) and Public Manufacturing Enterprises Adjustments Credit (Credit 2185-CE, approved in FY91) was prepared by the South Asia Regional Office. The Borrower's evaluation of Credit 2185 is included in Annex 1 and the cofinancier's (OECF) evaluation of Credit 2128 in Annex 3. The Borrower did not comment on Credit 2128.

The Economic Reconstruction Credit (ERC) was a US$90 million adjustment credit implemented during a period of considerable civil and economic turmoil. ERC's objectives were to help stabilize and open the economy, and target resources more efficiently on the poor. It also began a fundamental reorientation and reduction of the public sector that was to be carried further by the Public Manufacturing Enterprises Adjustment Credit (PMEAC). The second credit was for US$120 million, and focused on the commercialization and privatization of state-owned manufacturing enterprises.

Significant adjustment has taken place. Sustained growth has been realized, foreign investment and private investment have significantly increased. The privatization process has gathered momentum, as many firms not identified in the credit were also privatized. The process of opening up the economy to the forces of competition has firmly taken root. However, little progress was made on improving fiscal discipline, and many of ERC's covenants were reversed. Indeed, the civil service actions enacted under the project have made the situation worse. In sum, many of the most basic problems addressed by ERC are changing much less rapidly than agreed in loan covenants, and one important problem (civil service reform) has not been tackled. For PMEAC, the Government has exceeded the targets set, and continues to act in the spirit of the agreement. The ICR rates the outcome of both credits as satisfactory, and rates sustainability as likely. Institutional development is rated as partially achieved in ERC and substantially achieved under PMEAC. OED agrees with these ratings, except for (i) institutional development which is rated as negligible and modest, for ERC and PMEAC respectively; and (ii) outcome for the ERC which OED rates as marginally satisfactory. The lower rankings are due to the failure of civil service reform and broad slippage on other reform measures. Bank performance is rated as satisfactory on both credits.

The ICR is of satisfactory quality. The most important lesson drawn is that adjustment efforts should focus on a limited number of policy measures rather than on so broad an agenda that their focus is dissipated. Another lesson is that civil service retrenchment should have been more selectively done and that the generous retirement package used to reduce employment could have been better designed. For example, generous retirement provisions to reduce employment should be employed only with careful constraints on their use. An audit of both credits is planned.