The EC and Sri Lanka

Co-operation Strategy

2002 - 2006
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EXECUTIVE SUMMARY

Sri Lanka was one of the first Asian countries to sign a formal co-operation agreement with the EC in 1975. A third generation Co-operation Agreement on Partnership and Development was signed in 1995. The Commission opened a Delegation in Colombo in October 1995. The EU is Sri Lanka’s largest trading partner. 50% of Sri Lanka’s exports to EU are made-up garments.

The emphasis in cooperation between the EC and Sri Lanka has shifted over the years from traditional development aid to economic cooperation.

However, poverty, particularly in rural areas remains significant despite Sri Lanka’s social indicators which are generally impressive by South Asian standards, especially for education and health. The present government has indicated that it considers the private sector to be the engine for growth and that it will accordingly introduce a programme of further institutional and regulatory reform.

Although Sri Lankan governments have had ambitious policy agendas for the development of the country, they have been hampered by the protracted ethnic conflict, which has continued since 1983. The conflict, combined with internal structural and political problems as well as external reasons, reduced economic growth to below the average in the region. Efforts to bring the conflict to a negotiated settlement are now under way. The new government of Ranil Wickremesinghe, which came to power after elections in December 2001 made the resolution of the conflict its main priority. As a consequence, a permanent cease-fire agreement was reached on 23 February 2002 with the first round of peace talks being held in September 2002. Two further rounds have taken place and more are scheduled.

Sri Lanka’s development has also been affected by the unstable political situation. The previous government had only a small majority in the Parliament. The elections in October 2000 left the Government in an even weaker position, and led to the dissolution of the Parliament in October 2001. The decisive victory of the opposition led by UNP, the formation of the new UNF coalition Government in December 2001 and sweeping UNF victories in the March 2002 local elections have raised hopes of a more stable political situation.

The new government has made clear, both at home, as well as through high profile visits to Brussels during 2002 by the Prime Minister, the Foreign Minister, the Trade Minister and the Economic Affairs Minister, its desire to enhance its dialogue with the EU, in particular in the areas of increased trade and economic co-operation and also by enlisting EU assistance to the programme of rehabilitation, reconstruction and reconciliation which must accompany and follow up on progress in the peace process.

1 Regulation (EEC) 2410/75 of 16 September 1975  L247 of 23 September 1975
Due to the conflict, a large proportion of EC’s past and current assistance is through ECHO, for humanitarian relief operations, and from the Aid to Uprooted People budget line for assistance programmes in favour of the displaced people in the North and East. In the light of peace process progress, this assistance has been enhanced in 2002, 2003.

EU development aid to Sri Lanka, although never large in terms of annual commitments, has nevertheless also been a significant area of co-operation. From the mid-1980’s the Commission focused on the rural development sector where it has committed some €53 million. Programmes funded have directly addressed poverty alleviation in rural areas through projects aimed at improving irrigation and water management and through a series of projects to assist small farmers. A feature of these activities has been the promotion of off-farm co-operation activities to stimulate rural employment and added value income generation possibilities.

This CSP is based
- on the relatively modest level of existing funds under the multi-annual Asia budget for Sri Lanka. **Total allocation under B7-3000 and B7-3010 for Sri Lanka for 2002-2006 totals € 16.8 million.** However, in a scenario where the cease fire agreement between the government and the LTTE holds and the peace talks continue to show good progress, the EC has indicated that it would be prepared to support larger rehabilitation and reconstruction operations in the North and East, as pledged in the past Joint Commission meetings and reiterated this commitment at the February 2001 Joint Commission.
- on the fact that Sri Lanka will continue to benefit from a number of other co-operation instruments. At present, these contributions are as follows:
  - Aid to uprooted people: 11.7 M€ for period 2002 – 2004
  - ECHO: 8.3 M€ for 2002
  - Rehabilitation: 4 M€ - (proposed for 2002)
  - Human Rights: 0.5 M€ in 2002
  - JAI: 1.3 M€ in 2002
  - RRM : 1.8 M€ in 2002

In addition, EC Food Aid Counterpart Funds (FACF) to the value of some €20 million in rupee equivalent await disbursement from the National Bank. Further discussions are planned with GoSL on the means of disbursement, preferably along the lines of the proposal in the annex to the NIP.

In the future, the proportional share of other co-operation instruments will depend to a large degree on the further need for humanitarian assistance and aid to uprooted people vis-à-vis opportunities for reinforced co-operation assistance. The Commission will place particular emphasis on a proper phasing of these instruments in accordance with related Communications such as the “Communication on linking Relief, Rehabilitation and Development.” In the present strategy, this is being taken account of in particular by the following aspects:
1) The concerted utilisation of the Rapid Reaction Mechanism (RRM) in 2002.
2) The multi-annual programming of the Aid to Uprooted People budget line which is prepared to respond to a number of different peace related scenarios.
3) The types of interventions pursued by ECHO, focusing on immediate needs emanating from the civil conflict, and with its disaster preparedness programme.
4) The dialogue on migration and projects that could be financed under the budget line on Co-operation with third countries in the area of migration.
5) Support to civil society groups under the Promotion of Democracy and Human Rights budget.
6) A reserve in the development aid budget for RRM follow-up actions or to complement ECHO activities.
7) Extension of ongoing activities in the context of the peace process through the Rehabilitation budget line.

The National Indicative Programme for 2003 – 2005 proposes to use the full amount of €16.8 million available under the Asia budget with the following ventilation among main areas of co-operation:
- €5.3 million for economic co-operation,
- €7.5 million for development co-operation, and
- €4 million for post-conflict assistance.

These sums will also cater for the intended small project facility. This facility is expected to cover both economic activities (as a follow-up to EBIC) and civil society initiatives.

1 A description of the EU/EC co-operation objectives

The formal basis for EC-Sri Lanka co-operation is the Co-operation Agreement on Partnership and Development between the European Community and Sri Lanka, which came into force on 1 April 1995. Article I states that the co-operation is based on respect for democratic principles and human rights, which constitute an essential element of the Agreement.

The earlier Country Strategy for Sri Lanka to the year 2001 defined two broad criteria for co-operation:

- Support of activities and reform in both public and private sector which promote economic growth and improve opportunity for all,
- Poverty alleviation: interventions should be specifically targeted to the poorest and the most disadvantaged.

Furthermore, the impact of the then ongoing conflict was to be mitigated through the provision of humanitarian assistance to vulnerable groups within the population.

Thus, while there would be less emphasis on development co-operation, the priority in this sector would be for assistance towards poverty alleviation. Economic co-operation
was defined as a priority area for future co-operation; mutual benefit and mutual interest being the main principles. Activities should centre on private sector linkages, joint ventures and institution building. **Relief and rehabilitation activities** would continue to assist displaced people.

A larger scale rehabilitation programme would be considered in the case of a peaceful, negotiated solution to the conflict.

The EC-Sri Lanka Joint Commission meeting held in February 2001 broadly reconfirmed the above objectives, whilst also agreeing to work on programming of projects on agreed aspects for improving governance.

The general principles and priorities for the European Community’s development policy are contained in the statement by the Council and the Commission, issued in November 2000\(^3\). Community development policy is grounded on the principle of sustainable, equitable and participatory human and social development of which the promotion of human rights, democracy, the rule of law and good governance form an integral part. The main objective of Community development policy is to reduce and eventually eradicate poverty. While stating that in the allocation of resources the least developed countries and low-income countries will be given priority, it also encourages middle-income countries to draw up poverty reduction strategies where the proportion of poor people remains high.

The Commission’s revised Asia strategy, ‘Europe and Asia: A Strategic Framework for Enhanced Partnerships’\(^4\), sets out general objectives and priorities which apply to co-operation in Sri Lanka.

### 2 The Policy Agenda of the Government of Sri Lanka

The overall policy agenda of the former People’s Alliance (PA) coalition Government was set out on the occasion of its 5\(^{th}\) Anniversary in August 1999 in a document entitled “Vision for the 21\(^{st}\) Century - vision 21”. The expressed targets of ‘Vision 21’ were very optimistic and based on accelerating the then rate of economic growth of 4-5 percent to 7-8 percent on a sustainable basis. The aims included raising the per capita income of € 946 per year to € 2900 by the year 2010, reducing the budget deficit from 8 to 4 percent in the medium term and reducing defence expenditure to around 3 percent of the GDP. Development of modern infrastructure facilities was foreseen. The private sector was expected to take the lead in development. Further privatisation of public companies was planned. It was acknowledged that finding a peaceful solution to the ethnic conflict was essential if these goals were to be achieved.

The PA Government failed to carry out its policy agenda for reasons which can mainly be attributed to poor economic and financial management, the ethnic conflict and increased

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\(^3\) 2304\(^{th}\) Council Meeting 10 November 2000  12929/00 (Press 421)
\(^4\) Communication from the Commission COM (2001) 469 of 4 September 2001
defence expenditure, compounded by adverse global economic developments during the Government’s last two years in office.

The UNF Government has redefined new economic targets and policies, more favourable to further liberalisation and privatisation of the economy, which were presented at the end of March 2002 with the presentation of its first budget.

Regionally, the government is anxious to profit from and develop its generally good relations with its SAARC partners, promoting the idea (à la Singapore) of Sri Lanka as a regional economic hub and, where progress is not possible on a SAARC wide basis to proceed through a series of trade bilateral arrangements.

The principal development initiatives of GoSL have been: a Poverty Reduction Strategy Paper for Sri Lanka, a Framework for Relief, Rehabilitation and Reconciliation and the Tertiary Education Strategy. These were started by the previous Government.

2.1 Poverty Reduction Strategy Paper (PRSP)

The first draft of the PRSP was presented in December 2001. It is based on the earlier report, Framework for Poverty Reduction, which was presented to the Sri Lanka Development forum in Paris, December 2000. The framework advocated a three pronged strategy to achieve poverty reduction: 1) creating opportunities for pro-poor growth; 2) strengthening the social protection system; and 3) empowering the poor and strengthening governance.

The PRSP is intended to put into operation the visions, strategies and reforms identified in the Poverty Framework. It also incorporates lessons and recommendations prepared by several Sri Lanka’s development partners, the UN, World Bank and Asian Development Bank.

The Government is keen to have the Poverty Reduction Strategy available as soon as possible, to be able to draw on the financial support of the IMF and the World Bank. The revised draft was presented to the Local Donor Forum in June 2002 in Colombo. The strategy will be further discussed at the next Development Forum meeting.

2.2 Framework for Relief, Rehabilitation and Reconciliation

This framework was initiated by the Government in 1999, with World Bank help, to address issues related to policy and operational obstacles to the provision of relief and rehabilitation to the areas and people affected by the conflict in the North and East. The Framework was developed through a wide consultative mechanism, which brought together the Government, civil society and the donor community to identify ways in which Sri Lanka's development partners could best work together to promote improved relief, rehabilitation and reconciliation processes. The objectives of the Framework process are to help strengthen Sri Lanka's capacity to: (1) ensure the basic needs of
people affected by conflict; (2) rebuild productive lives where feasible; and (3) facilitate reconciliation and partnership across ethnic lines.

The expected outputs are common direction and a basis for effective assistance through the formulation of suitable policies, strategies, mechanisms and guidelines. Four main clusters of issues have been addressed through Working Groups: code of operations (aid modalities), co-ordination and institution building, programmatic priorities, and reconciliation and peace building.

At the Development Forum in Colombo in June 2002, the Government presented a revised document which takes account the changing situation on the ground. With the signing of the permanent cease-fire on 22 February 2002 and the removal of the economic embargo on the North, the situation on the ground has dramatically changed. The peace process appears to be moving ahead and the need for the Framework is now perceived as less urgent.

From the earliest stage, the Commission Delegation has actively participated in the preparation of the Framework at both Steering Committee and Working Group levels.

### 2.3 Tertiary Education

In a paper presented to the Development Forum in December 2000 the Government (together with ADB) set out a strategy and agenda for action in this sector. The priority challenges were seen as the introduction of policy reforms to enlarge quality, autonomy, resource mobilisation and capacity building; redefining the role of the state in a new regulatory framework for the sector; opening post-secondary education to the private sector and improving the quality and relevance of curricula inter alia through the introduction of market oriented courses, industry/university linkages, R&D and consultancy activities.

Reforms in the area of policy framework, quality improvement and finance and resource mobilisation and the greater participation and involvement of the private sector were foreseen.

### 2.4 South Asian hub

On the regional level, the Government has been keen to develop Sri Lanka as a South Asian hub in different sectors. Therefore, special efforts have been taken to develop Colombo port and Colombo Katunayake airport. Restrictions on foreign investments in the financial sector have been further relaxed in order to promote Sri Lanka as a regional centre. While Sri Lanka is the most open economy in South Asia, the ethnic conflict and unstable political situation undermine these efforts. The new Government is expected to pursue this policy, which was initiated by the previous UNP government in 1977.
2.5 South Asian Association for Regional Co-operation (SAARC)

The Government has actively supported efforts to create closer co-operation within the South Asian Association for Regional Co-operation (SAARC). In particular, Sri Lanka has worked for the establishment of the South Asia Free Trade Area (SAFTA). While the development of this regional body has been very slow, Sri Lanka and India have concluded a parallel Indo-Lanka Free Trade Agreement, which came into force in March 2000. A bilateral trade agreement is also under preparation with Pakistan, to be followed by an accord with Bangladesh.

3 ANALYSIS OF THE POLITICAL, ECONOMIC AND SOCIAL SITUATION IN SRI LANKA

3.1 Political situation

General

While Sri Lanka has a democratic multi-party system, political power has in practice been in the hands of two main political parties, the United National Party (UNP) and the Sri Lanka Freedom Party (SLFP). These two parties have in turn led Governments since the independence of Sri Lanka in 1948. The Peoples Alliance (PA) coalition (SLFP is the main party) was in power from 1994 but lost again power to the UNP led coalition in the elections held on 5 December 2001.

The 1978 Constitution introduced a very strong executive Presidency on the French model. The present President, Mrs. Chandrika Bandaranaike Kumaratunga, was first elected in 1994 and re-elected for a second six-year term in December 1999. The 1978 Constitution is still in force, with 17 amendments.

The PA Government, which came to power in 1994, had only a narrow majority in the Parliament and was dependent on the support of smaller minority parties. The elections held in October 2000 did not change this situation, and led to gradual deterioration of the political climate and internal divisions within the PA. With the defection of a number of PA Members of Parliament to the opposition, the Government lost its majority. The President decided to dissolve the Parliament and call for new elections on 5 December 2001. The UNP, strengthened by defections from the PA, won the elections decisively, despite widespread violence, election malpractices and misuse of state resources by the PA government. European Union Election Observation Missions were present to observe the elections in both October 2000 and December 2001 and the Mission reports made recommendations with regard to electoral violence, misuse of state resources and other related issues.

Inevitably, the conflict has had a negative impact on the Sri Lankan economy. Successive governments have focussed on the resolution of the conflict by military means or by negotiation. Nevertheless, the budgetary burden of the conflict has drained resources
from other development and social priorities. The consequence of this can be seen in youth unemployment, political and ethnic unrest and violence.

Historical politicisation of the civil service has tended to distort the decision-making process. Low pay and a lack of transparency in job allocation and promotion in the civil service affect morale and efficiency.

The President called the UNP leader Ranil Wickremesinghe to form a new government. Sri Lanka is now governed through “cohabitation” between a strong Executive President and a Prime Minister from different parties.

The ethnic conflict and peace efforts

The tension between the majority Sinhalese and minority Tamils, which had been increasing since the independence of Sri Lanka in 1948, flared into an open armed conflict in 1983. The Liberation Tigers of Tamil Eelam (LTTE) at the time emerged as the leading armed Tamil group, claiming to be the sole representative of the Tamil population and fighting for the establishment of an independent Tamil state in the northern and eastern parts of the country. There are significant populations of Muslims in the country. Those living in conflict affected areas, particularly in the East, will need to be closely involved in peace efforts if these are to be successful.

The PA Government came to power in 1994 with a proposed programme to stop the conflict through a negotiated peaceful solution, to change the political culture, to eradicate bribery and corruption, to ensure the rule of law and to promote rapid and sustainable economic development. The Government quickly started negotiations with the LTTE but these failed when the LTTE unilaterally broke off negotiations in the spring of 1995 and restarted attacks against Government troops. The Government then adopted a two pronged approach to the conflict. The aim was to militarily weaken the LTTE, whilst preparing for a political solution in the form of a devolution package which would satisfy the political aspirations of the Tamil population within the framework of a united Sri Lanka.

The strategy did not succeed. Though the Government managed to regain control of the Jaffna Peninsula in 1995-96, other Northern Areas in Vanni and certain areas in the Eastern Province, South of Trincomalee and West of Batticaloa, remained under the LTTE control. Discussions on the devolution package and on the political solution led nowhere and the LTTE was not militarily weakened. This was clearly demonstrated on July 24, 2001, when LTTE attacked the Katunayke Air Force base and the adjoining international airport, destroying several military and civilian planes. This was followed by increased LTTE attacks in the eastern part of the country.

The UNF Government made the ending of the conflict its main priority. The peace efforts facilitated by Norway were revived, the economic embargo on the North was lifted and restrictions on movement of people were minimised immediately following the December 2001 elections. When the LTTE declared a unilateral cease-fire on 24 December 2001, the Government reciprocated. A formal cease-fire agreement was
negotiated with Norway’s help and came into force on 23 February 2002. The Sri Lanka Monitoring Mission, comprising of some 50 Nordic monitors, was set up to oversee the implementation of the agreement. Despite some violations of the agreement by both parties and delays in implementing some of the provisions, overall the cease-fire has been holding well and both parties have shown their interest in ensuring its implementation. The first round of substantive peace-talks took place in Thailand 16-18 September 2002. More sessions have since taken place and further rounds are scheduled. Observers have been encouraged by the outcomes of these early rounds of talks. The general view is that this is now the best opportunity to end and to find a peaceful negotiated solution to the ethnic conflict since 1995. Confidence in the process led to the organisation of a donors peace process support meeting in Oslo in November 2002 as a forerunner to a larger pledging conference in Tokyo in late Spring 2003.

**Human Rights**

On coming to power in 1994, the PA Government made efforts to improve the human rights situation in Sri Lanka. Sri Lanka has ratified thirteen international human rights conventions, including the Convention against Torture and the Optional Protocol to the International Covenant on Civil and Political Rights. A National Human Rights Commission was established in 1997. Several court cases on human rights violations were initiated and the human rights record of the armed forces improved.

This initially positive trend unfortunately slowed down, if not was reversed, towards the end of the administration of the previous Government. The court cases which were initiated did not bring results, except in a very few cases. Investigations and commission reports led nowhere. The Human Rights Commission, despite its seemingly wide and strong mandate, remained very passive and ineffective.

The UNF Government has already taken some measures to improve the human rights situation. More effective means have been taken to prosecute violators of human rights, and detainees held under the Prevention of Terrorism Act, have been released if no case has been brought against them. Previously, detainees could be held without charge for years if they were suspected of being LTTE supporters. However, it is still too early to say how far the situation will improve in the longer term.

At the same time, it should be noted that the LTTE has had a dismal human rights record and there have been very few positive developments in this respect. In 2001, reports of gross violations of human rights (summary executions, killings of political rivals) inside and outside the LTTE controlled areas continued. Attacks against civilians also continued in breach of the International Humanitarian Law and the Geneva Conventions. Some progress on the recruitment of child soldiers has been reported but this remains to be fully confirmed. The cease-fire agreement contains provisions forbidding attacks on civilians, abductions etc. It remains to be seen how well these provisions will be implemented by the LTTE and whether, with the new relative openness in LTTE controlled areas, the new situation will contribute to the better protection of human rights. The necessity to respect human rights has been raised by various delegations-including an EU delegation on
17 July 2002- which since the signing of the cease-fire agreement have gone to the LTTE controlled areas and met with the representatives of the LTTE political wing.

3.2 Economic and Social Situation of Sri Lanka

The Sri Lankan economy has been gradually diversifying, since the liberalisation which began in 1977. Agriculture, forestry and fishing declined from 30.3% of GDP in 1978 to 19.4% in 2000. The service sector has been the key beneficiary of this contraction, accounting for 54.6% of GDP in 2000. Manufacturing has not grown at the desired rate, and accounted for only 16.8% of GDP in 2000.

Sri Lanka’s GDP growth, at around 4.3% in 1999, was below the South Asian average of 5.5% for that year. Although Sri Lankan GDP growth improved to 6% in 2000, growth in 2001 for the first time since independence was negative, -1.3%. The slowdown was already apparent before the LTTE attack at the airport in July 2001. This attack had extremely serious consequences, not only on the tourist industry but also on the country’s economy as a whole, undermining the government’s economic policies. External factors (global economic slowdown, oil prices) are also partly responsible for the present economic crisis. However, the main reasons are internal: escalation of the conflict in 2001, structural constraints, lack of coherent economic policies and mismanagement. The economy also suffered since mid-2001 until May 2002 of daily several hours power cuts. Sri Lanka is largely dependent on hydropower and when the monsoon rains fail reservoirs do not have sufficient water to produce enough electricity. Though the problem has been recognised for years, mismanagement and non-implementation of agreed plans to build new power plants have led to the present crisis.

Annex 1 (a) shows key macro-economic indicators for Sri Lanka relating to output, savings and investment. From this it is clear that Sri Lanka’s domestic savings rate, at 15-20% in each of the last six years, has tended to be reasonable by SAARC standards. However, it was substantially below that of several ASEAN countries, such as Singapore (51.8% in 1998), Malaysia (48.5%) and Thailand (41.8%). This has constrained the country’s medium to long-term growth prospects. There has been an excessive reliance on migrant remittances (close to US$ 1 billion a year), which, until late 2000, helped sustain an overvalued exchange rate, undermining the potential of the manufacturing export sector.

Major structural problems in the Government’s fiscal position remain. Total interest payments rose from 27.5% of the Government’s current expenditure in 1998 to 28% in 2000. Given the privatisations of the 1990s, proceeds from which were designed to reduce the Government’s debt stock, the desired impact was not realised. In 2000, total debt service payments, at Rs. 175.7 billion, accounted for over 83% of the Government’s total revenue of Rs. 211.3 billion. Thus, the Government has very little capacity to spend on infrastructure facilities, which are essential as the foundations for private sector investment and overall growth.

The Budget 2000 envisaged an overall deficit of 7.6% of GDP that year. However, the intensification of the civil conflict in April/May 2000 necessitated emergency military
purchases and large expenditure over-runs. Certain revenue and expenditure measures were initiated to contain the deficit within the target 7.6% of GDP. Salary increases, subsidies etc., motivated by the October 2000 elections and December 2001 elections, were contrary to the government’s own policies and commitments to the IMF. The overall deficit rose to over 10% of GDP by the end of 2001.

The 2001 budget, although keeping to the prior action benchmarks of the IMF, was disappointing. Revenue proceeds, particularly from the expected proceeds of the divestiture of Sri Lanka Telecommunications (SLT) proved to be unrealistic.

The poor fiscal position, compounded by the adverse trade balance, led to speculation against the rupee from about the middle of the year 2000. In an attempt to defend the currency within certain parity bands, the Central Bank was forced to run down the country’s reserves. During 2000, Sri Lanka’s gross official reserves fell by as much as 36.4% in US dollar terms. After several step adjustments in the exchange rate band during 2000, the Central Bank was forced to abandon its defence of the currency, adopting a free float on 23 January 2001.

The Government also sought assistance from the IMF. On 23 April 2001, the IMF Executive Board approved a Stand-by Arrangement of US $253 million with Sri Lanka. Half of the loan was paid immediately with the rest to be paid in four instalments. However, the IMF did not agree to pay the following instalments due to concerns of the economic direction of the country. In February 2002 an IMF mission reviewed the situation with the new Government and released $ 60 million in April. It is expected that based on the Government’s new Poverty Reduction Strategy Paper, the Government will present to the IMF a request for structural assistance during the second half of 2002.

3.3 Social Indicators

Despite its relatively poor economic performance, Sri Lanka scores highly on several social indicators. This is especially so when compared to countries with similar per capita income levels and her SAARC neighbours. Annex 4 summarises some of Sri Lanka’s social indicators compared to those of some small to medium sized SAARC neighbours; Bangladesh, Pakistan and Nepal. Clearly, with respect to life expectancy at birth, infant and maternal mortality rates, literacy, educational enrolment Sri Lanka scores well in relation to these neighbours.

Moreover, Sri Lankan women enjoy a better social position than most of their South Asian counterparts. This is substantiated by several gender specific social indicators. For instance, gender specific life expectancy figures can be taken as one proxy for female infanticide, which is prevalent in parts of the subcontinent. As Annex 4 shows, in 1999, Sri Lankan female life expectancy at birth was 75 years, ahead of the male (69.3 years) by a larger margin than in the case of Bangladesh, India, Pakistan and Nepal. For the latter two male life expectancy at birth is greater than for females.

Similarly, in terms of access to educational facilities, Sri Lankan women appear to enjoy a comparatively privileged position. Adult female literacy in Sri Lanka in 1999, at 88.6%,
was close to the male figure of 94.3%, and substantially ahead of India (44.5%), Pakistan (30%), Bangladesh (29.3%), and Nepal (22.8%).

Although Sri Lanka tends to lead her SAARC neighbours on most social indicators, in terms of access to health and sanitation, the picture is more mixed. For instance, during 1992-95, Sri Lanka had only 23 doctors per 100,000 people; ahead of Bangladesh (18), but behind India (48) and Pakistan (52). As Annex 4 shows, Sri Lanka was ahead of certain SAARC neighbours in terms of access to sanitation but not to safe water.

Despite positive social indicators, poverty incidence remains high; between a fifth and a third of the population can be classified as being below the poverty line, depending on criteria. A positive sign has been that urban poverty seems to have declined. On the negative side are large and increasing regional and sectoral disparities. Most of the development has concentrated in the Western Province (Colombo and surroundings), which has increased disparities with all the other Provinces. Though there is not as much statistical information on the conflict areas than from other areas, it is considered that these areas in the North and East are the most badly affected. According to ADB reports, up to 70% of the population in these areas is below the poverty line. It should also be noted that in the official government statistics since the beginning of 1990s, these areas have been omitted (citing lack of statistical data). This means that some of the information does not fully reflect the overall situation in the country.

The health and education sectors have come under increasing pressure due to lack of funds. This has led to the deterioration of the quality of health and education services. The education sector as a whole needs urgent reform. It is widely accepted that the present system does not provide the kind of education that is relevant to today’s needs. This is reflected in the very high unemployment figures for university arts graduates. There is growing concern over the sustainability of these past achievements and on the reliability of some of figures for literacy and educational enrolment.

The ethnic conflict, human rights problems, economic crises and poverty have made Sri Lanka one of the major countries of origin for migrants and asylum seekers, almost 90% of whom are Tamils. There are close to 200,000 Sri Lankans living in EU Member States and each year thousands of new asylum seekers head for Europe. As a consequence, the Tampere Council in 1999 called for an Action Plan for Sri Lanka to address these migration flows. Negotiations are under way with Sri Lankan authorities on the implementation of the Action Plan. Related to this, the Commission hopes to sign a Readmission Agreement with the Sri Lankan Government following formal initialling in May 2002.

### 3.4 Privatisation and the Reform Process

The Government has declared the private sector to be the main engine of growth. In 2000, the private sector accounted for 94% of total industrial production. Fiscal incentives have been granted to so-called thrust industries; notably, electronics, components for electronic assembly, ceramics, glassware, mineral based products, rubber based industries and
certain engineering and advanced technology industries. Further incentives have been provided for the IT sector.

During the 1990s, plantations, telecommunications, the state airline, gas works, a major development bank (the National Development Bank [NDB]) were privatised. Colombo Port is now run as a BOT arrangement. Restructuring of the two state banks is also underway. Unfortunately, the motive for privatisation has mostly been need to raise capital rather than a real commitment and coherent privatisation policy. The PA coalition was mostly composed of leftist parties, and against privatisation in principle. Many privatisation exercises seem to have been insufficiently well prepared. This led to contradictory policy measures, confusing potential investors. Political interference in privatised entities pursuing legitimate activities further undermined investor confidence and caused concern amongst donors.

The telecommunications sector illustrates this situation. Conflicting commitments made in 2000 by the Government in the privatisation of Sri Lanka Telecommunications (SLT) led to complaints from private operators that the regulatory framework was not impartial. The Trade Commissioner intervened on behalf of a European operator in February 2000 and in a letter to the Sri Lankan authorities they were reminded of their international obligations under the WTO / GATS commitments. The private operator and GoSL then resolved the matter.

These issues raise questions about the efficiency and integrity of the privatisation process in Sri Lanka and point to the need for coherent competition policies and the need to take greater account of overseas investor sentiment. The coming into power of the UNP led Government was welcomed by the Sri Lankan business community. It is expected that economic reforms and privatisation will now be pursued with greater conviction although the government acknowledges that a great deal of reform is necessary before state owned enterprises can be sold off.

3.5 Sustainability of current policies

Although the previous Government confirmed its objectives of accelerated development for Sri Lanka, transforming it into a modern and prosperous economy, progress was restricted by the protracted ethnic conflict. Defence expenditure grew rapidly to 6% of GDP. This was meant that all longer-term development projects and infrastructure development has suffered and that the economic goals of the government were not attained.

The continued political instability, the devastating effects on the economy caused by the LTTE attack on the airport in July 2001, and by the global economic slowdown, further aggravated the situation. The Government has said that the country is in deep economic crisis. GDP growth for 2001 was negative for the first time since independence.

The former Government achieved some progress in structural reforms (tax reforms and private sector participation in key areas such as gas, telecommunications, plantations) but further efforts are necessary. The present Government appears to be determined to
address the serious structural issues impeding economic growth, such as the public sector reform, labour reform and further privatisation and liberalisation of the economy.

The conflict has not been the only reason for the slow development of Sri Lanka. Although the conflict is often used as an excuse for many problems, the problems related to a very polarised political culture, including lack of political consensus on major national issues, governance, corruption, politicisation of the very extensive public service, are further elements which have restricted the government from pursuing reform policies. The Government has committed itself to address these issues and the budget of March 2002 was an indication of its resolve.

4 External Environment, Trade Structure and Regional Integration

Sri Lanka has diversified its export base away from agriculture since the 1977. Whereas plantation agricultural commodities accounted for 74% of total exports in 1977, this share had fallen to 15% by 2000. Industrial export receipts rose from 14% of total export earnings in 1977 to around 75% during each of the five years 1996-2000. However, there is an excessive dependence on textile and garment exports, which accounted for 54% of total export earnings in 2000, and 70% of total industrial export earnings that year. Other important industrial exports were machinery and equipment (6%), rubber based products (5%), and diamonds and jewellery (4%). In line with this industrialisation, the import structure has also shifted away from consumer goods, and towards intermediate and investment goods. Consumer goods imports declined from 45% of total imports in 1977 (in value terms), to 19% in 2000. An increased domestic supply of rice and other food items also contributed to this. Investment goods imports as a proportion of total imports (in value terms) rose from 12% in 1977 to 24% in 2000, whilst intermediate goods increased from 42% to 52% over the same period.

The EU is one of Sri Lanka’s major trading partners. In 2001, it accounted for 27.1% of Sri Lanka’s exports: second only to the US, which accounted for 41.9%, according to unadjusted Customs data. The EU was also Sri Lanka’s largest source of imports, accounting for 15.7% of the total in 2001. Other important import sources were India (11.1%), Hong Kong (9.3%), Singapore (7.6%), Japan (6.2%), and South Korea (6.2%).

Sri Lanka continues to be active in various regional fora; notably, SAARC, the Bangkok Agreement (other members of which are India, Bangladesh, South Korea and Laos), BIMSTEC (also including Bangladesh, India, Myanmar and Thailand) and the Indian Ocean Rim Association for Regional Co-operation (IOR-ARC).

Co-operation within SAARC has been hampered by continuing Indo-Pakistan rivalries, though an agreement was reached to hold the SAARC Summit in Nepal in January 2002.

There have been some positive developments on SAARC. Sri Lanka’s exports under South Asia Preferential Trade Agreement (SAPTA) to the SAARC countries increased from 1.8% of her total exports in 1997, to 6.8% in 1999, pointing to increased utilisation
of this facility. As noted in 2.4 above, the Indo-Lanka Free Trade Agreement (ILFTA) came into effect in March 2000, after the negative lists of the two countries were finalised. Sri Lanka is also in the process of negotiating Free Trade Agreements with Pakistan and Bangladesh.

5  AN OVERVIEW OF PAST AND ONGOING EC CO-OPERATION

5.1  Results, lessons and experiences from the past and ongoing EC co-operation

*Development co-operation*

Development co-operation started after the first Agreement was signed in 1975. A large part of early aid was food aid through counterpart funds. The priority in development co-operation was agricultural diversification and the rehabilitation of medium and minor irrigation systems. While tea, rubber and coconut, the three plantation crops, are managed on a large scale, there remains a significant section of the agricultural economy which is based on small holdings. It is in areas where this type of agriculture is located that much of the rural poverty in Sri Lanka is to be found, as well as related problems of poor water management, communications and lack of adequate health and education facilities. There are still three ongoing projects in this “traditional” sector of EC co-operation. These are: the Dry Zone Agricultural Development Project, the Mahaweli Consolidation Project and the Monaragala Irrigation and Community Development Project.

Since 1997 the Commission has been aiming to place greater emphasis on economic co-operation. Since then only one new development project has been initiated. Two ongoing projects will end in 2002.

With the exception of the most recent project, other development aid projects suffered from start up delays, followed by slow implementation. There have also been cases of interference by local politicians trying to influence project implementation for the benefit of their supporters.

A significant amount of the food aid counterparts funds were not utilised. An independent audit carried out by the EC in 2000 on the Mahaweli Trust Funds and Food Aid Counterpart Funds identified unused funds in joint EC/GoSL bank accounts at the Sri Lankan Treasury. Remaining funds in the Mahaweli Trust Funds could be used within the ongoing Mahaweli Consolidation Project. Policy decisions, made between EC and GoSL will be required on the possible use of the residual Food Aid Counterpart Funds. These are largely under commitments to other, now completed projects, and with interest now amount to a rupee equivalent of some ₹20 million.

*Relief and rehabilitation assistance*

Since 1983, the conflict has made relief and rehabilitation assistance an important part of the Community aid to Sri Lanka. Large parts of UNHCR’s country budget is covered by
the EC from the budget line B73020 – Aid to Uprooted People. In addition, ICRC, GTZ and several NGOs such as MSF, Action Contre la Faim (ACF) and German Agro Action, have been funded by ECHO for their humanitarian activities in the North and East. Community aid has been essential in alleviating the plight of displaced people in the conflict areas. Even with a cease-fire in place, this assistance still needs to be continued, notably to support the resettlement of the internally displaced people and the Sri Lankan refugees in Tamil Nadu, India. At present the main emphasis remains on relief and low scale rehabilitation. However, in the longer term, if a peaceful solution to the conflict can be found, larger scale rehabilitation assistance to the North and East will be required.

The EC-financed assistance programmes (and others) to the North have in the past suffered particularly from logistical problems and restrictions placed on supplies to these areas by the Ministry of Defence (MOD). Although the security concerns of the MOD were generally understood by the agencies working in these areas and many have now been lifted, it was sometimes difficult to see the linkages between security needs and restrictions (e.g. for shipments of painkillers to government hospital in non-government controlled area) often imposed by the MOD in an ad hoc manner. To overcome these problems, the Government, together with donors, including EC, has been finalising a Framework for Relief, Rehabilitation and Reconciliation, although given the cease-fire and the general progress in the peace process this work is no longer considered to be urgent.

**Economic co-operation**

EC economic co-operation with Sri Lanka started at the end of 1980s. In its early stages this mainly consisted of trade promotional technical assistance to support Sri Lankan export industries (jewellery, printing) but later changed to concentrate on mutually beneficial forms of co-operation. Total volume of assistance has been € 2.7 million. In general terms, projects have been well received but have often not proceeded to further stages for internal policy reasons, unrelated to the Sri Lankan connection. Examples are the Regional South Asia Integrated Tourism Human Resources Development project 1995-1998 and the European Business Information Centre (EBIC), established in Colombo in 1998 which during its existence has enhanced the profile of EU and provided relevant information on EU-Sri Lanka markets to European and Sri Lanka companies. Similarly, a project to strengthen the Sri Lankan Standards Institute has not yet moved to a second phase. The European Community Investment Partners (ECIP) scheme made grants for part-financing of joint start-up ventures, pilot studies and further phases, via European development banks. Although its procedures were considered somewhat cumbersome, it was able to finance some 40 projects in Sri Lanka, with positive results. Equally, there has been interest in the newer instruments, Asia Invest and Asia Urbs. It is too early to evaluate what their full impact has been in Sri Lanka.

Since 1997 the EC's declared aim has been to put more emphasis on economic co-operation. This has not materialised, at least in part due to the highly uncertain investment climate resulting from the conflict. Past projects such as the South Asia Integrated Tourism Human Resources Development Project and the regional standards project which might have succeeded can now also be seen to have been too short term,
lacking impact because extensions were not considered appropriate or feasible by the Commission.

Of the various economic co-operation instruments, the experience in Sri Lanka has been that in volume terms, ECIP was the most productive. In general terms, the Commission's instruments were considered by Sri Lankan partners to be not sufficiently adapted to support private sector initiatives in the difficult Sri Lankan environment.

Contrary to the experience in many Asian countries, the European Business Information Centre (EBIC) in Colombo has been very well received both by the local business community and the Member States missions. An evaluation of EBIC was carried out in January 2001 confirming the positive view of the EBIC and, therefore, it has been extended until end of 2002. It is hoped that the absorption of some EBIC activities into the work programme of the Delegation following deconcentration will continue the positive results.

Sri Lanka is a partner in the € 15 million (total) regional civil aviation cooperation project open to 15 countries of South and South East Asia. It will be implemented by AECMA (European Association of Aerospace Industries). Sri Lanka signed a financing agreement for its component on 10 December 2001.

The project aims to establish a solid cooperation relationship and further business to business linkages between EU and (in this case) Sri Lanka. The project will increase Sri Lanka’s awareness of EU industry practises, including airworthiness, safety regulations, standards and will seek to improve standards of aviation safety in the region.

The project component will concentrate on a programme of cooperation between European industry and regulatory authorities, and Sri Lankan industry, operators and regulatory authorities in the field of aviation safety through the development of cooperation in the areas of air traffic management and air traffic control as well as product maintenance and customer support practises.

**NGO co-financing**

NGO financing has been an important channel for funds to different small scale development projects implemented by the local NGOs. Annually there have been around 10-15 projects. Care should be taken when funding NGO projects to ensure that funds are properly used and the Delegation is an important actor in approving and monitoring such projects.

**Evaluation**

Evaluation by outside consultants are mandatory for all EC development aid and economic co-operation projects. For Sri Lanka projects, the programme of evaluations has been as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>Final evaluation of NIRP</td>
</tr>
</tbody>
</table>
2001 Mid-term evaluation of Monaragala Consolidation Project
Late 2002/early 2003 Mid-term evaluation CARE Dry Zone Project
Late 2002/early 2003 Final evaluation Monaragala Consolidation Project
2001 Mid-term evaluation of EBIC project

EC assistance in 2002

In response to the positive developments in the peace process since Christmas 2001, the Commission has increased the level of its commitments to Sri Lanka in areas directly linked to the provision of humanitarian assistance and to activities which support the peace process.

The break down per source of funding is set out below:

<table>
<thead>
<tr>
<th>Budget line</th>
<th>2002 Budget € million</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Aid to Uprooted People</td>
<td>2.70</td>
</tr>
<tr>
<td>2. RRM</td>
<td>1.80</td>
</tr>
<tr>
<td>3. Rehabilitation</td>
<td>4.00</td>
</tr>
<tr>
<td>4. NGO co-financing</td>
<td>0.50</td>
</tr>
<tr>
<td>5. ECHO</td>
<td>8.30</td>
</tr>
<tr>
<td>Total EC assistance</td>
<td>17.30</td>
</tr>
</tbody>
</table>

6 PROGRAMMES OF EU MS AND OTHER DONORS

Only six of the fifteen EU Member States have a diplomatic presence in Sri Lanka: France, Germany, Italy, the Netherlands, Sweden and the UK. Germany, the Netherlands, Sweden and the UK have longer-term projects and programmes, using both grants and loans. France and Italy have had a more occasional involvement through loans.

It should be noted that the three main international donors, Japan, Asia Development Bank and World Bank account for about 80% of all aid to Sri Lanka. Other donors active in Sri Lanka include Australia, Canada, Kuwait, Norway and the United States.

6.1 EU Member states bilateral assistance

Until 1998 France focussed its aid on soft loans in the area of water treatment and energy. In 2000, Sri Lanka also benefited from specific food aid in kind which allowed GoSL to finance specific development programmes. Two French NGOs, MSF and ACF, are present in Sri Lanka. France puts the emphasis on cultural, technical and administrative co-operation, with the help of a network of three Alliance Française
Centres as well as through specific university to university co-operation activities and short-term training programmes.

Of note are a water resource management programme in Hambantota and a TV co-operation project.

**Germany's** 2-year assistance plan 2001 – 2002 is € 33.1 Mio, which confirms a decreasing trend from the previous plans of € 40.9 Mio and then € 35.3 Mio. € 16.5 of the current plan are earmarked for financial co-operation projects and loans, while € 16.6 Mio are earmarked for technical assistance and grants. The German Government’s intention is to enhance the significance and efficiency of German development co-operation by focusing on specific areas. For Sri Lanka “Promotion of a dynamic market economy and qualified employment” has been identified. This includes programmes promoting private sector, entrepreneurship training and enterprise information. Vocational training and promotion of a Higher National Institute of Applied Technology are also included. For the time being, the second main area of co-operation is conflict transformation and peace building, including rehabilitation works in North & East, conflict transformation projects throughout the country and basic education for children in conflict areas.

Bilateral assistance from **Italy** will end this year with the last € 457.000 for the support of the Don Bosco Vocational Training Centre in Negombo. In addition, € 571.000 has been channelled through UNICEF for the “Children in Armed Conflict” project.

**The Netherlands'** aid focuses on three main sectors: (1) environment including natural resources management, (2) rural development exclusively on social development in the plantation sector, and (3) relief, rehabilitation and reconciliation (in large part through international agencies like the UNHCR, ICRC, CARE International and MSF). With CARE International the Netherlands finances two long-term programmes in the LTTE controlled areas. The Netherlands hopes to address poverty in the conflict areas through the RRR Framework. The annual budget is € 11.3 Mio and the annual level of expenditure has been kept to € 9.1 Mio.

The **UK** has a three-year Country Strategy, published in September 1999, which outlines development programme priorities. There are three main objectives: 1. Promoting social harmony through improved quality of education, particularly at the primary level; 2. Improved livelihood security of the very poor in conflict areas; and 3. Processes for inter-communal reconciliation. The overall goal for the UK development programme is to contribute to a reduction in the proportion of Sri Lankans living in poverty by 2015, in line with the UN Millenium Development Goals.

The UK's programme expenditure has declined in recent years, from Euro 9.9 million in 1999/00 to Euro 7.8 million in 2001/02. No further reductions are currently planned.

**Sweden’s** current country strategy expires in December 2002 and work on developing a new strategy (2003-2008) is in process. Continued focus on peace, democracy and human rights and sustainable economic development for the benefit of the poor (including
private sector development), is envisaged. Swedish development co-operation also includes research co-operation between universities in Sweden and Sri Lanka and support to NGOs. Presently the country allocation is approx. EURO 10.0 million per year (excluding humanitarian assistance, soft loans and concessionary credits).

6.2 Other major donors

The World Bank portfolio currently comprises twelve projects with total commitments totalling US $ 395 million, including for the first time a project targeting conflict affected areas: the North East irrigated agricultural project with the value of € 31.5 Mio. The IDA supported portfolio is designed to support the Country Assistance Strategy and achieve long term development outcomes that include (a) institutional capacity building; (b) improvement of the overall policy framework; (c) improved governance and efficient use of limited resources; (d) define new roles for the state.

In terms of commitments, about 60% of the current portfolio supports the social sectors and rural development. Support to the financial sector and private sector development account for about 13% of investments.

The Government of Sri Lanka also requested an IDA Structural Adjustment Loan in 2001 to support its private sector development reforms within the framework of an IMF Stand-by Arrangement. It was agreed that the envisaged reforms would include five thrust areas, namely (a) the creation of an enabling environment for private sector development; (b) the reform of land and labour markets; (c) the restructuring and promotion of private participation in loss-making state owned enterprises; (d) the increased private provision of infrastructure and (e) financial market reforms. The new Administration subsequently requested urgent IDA technical assistance to support its programme of economic reforms over the next few months.

The Asian Development Bank (ADB) has a substantial loan portfolio in Sri Lanka. As of end December 2001, there were 23 ongoing loan projects ($930 million from Asian Development Fund [ADF] and $15 million from Ordinary Capital Resources [OCR]) with total loan commitments of $ 945 million, of which $689.8 million (or 72 percent of the total) were undisbursed. In the past, poor disbursement was largely due to cumbersome contracting and procurement procedures, as well as non-compliance with major loan covenants. However, with the assistance from ADB, the Government to some extent has addressed some of these problems on procurement and project implementation.

The ADB now proposes a performance-based allocation (PBA) of funds. Under this, a country’s specific allocation will depend on its per capita GNP, the size of its population and the performance of its economy. In assessing Sri Lanka’s economic performance there will be a specific focus on (1) macro-economic management, (2) structural policies, (3) poverty reduction policies, (4) protection of the environment, (5) governance and public sector management, and (6) portfolio performance.

million ($480 million ADF and $200 million OCR) for 15 projects, 9 of them (60 percent of the total) which are classified as poverty intervention.

The sectoral distribution of the loan programme is agriculture and natural resource management (34 percent), transport (25 percent), social infrastructure (24 percent), industry and finance (11 percent), and energy (8 percent).

The TA programmes include 22 TAs with a total value of $13.8 million. The focus of the TA programme is on project preparation, institutional strengthening and capacity building to develop more effective sectoral institutions in the sectors where ADB's operations are centred.

In 2001, ADB provided a $25.0 million soft loan to the Government of Sri Lanka for the rehabilitation and assistance to displaced people in the North and East. The loan will be mainly used for improving the living conditions of people affected by the conflict, particularly those who have been displaced but also people who have remained in place and have accommodated displaced people. The project will undertake a wide variety of activities, including rehabilitation and expansion of base hospitals and the improvement of health care, improvement and rehabilitation of schools, as well as community based activities in housing, water supply and assistance to income generating activities such as agriculture and fisheries.

Japan is the largest bilateral donor to Sri Lanka, its share being over 50% of the total. Japan's priorities in her grant and loan programme in Sri Lanka are as follows: 1) In economic infrastructure; the modernisation of ports and airport, construction of power plants, improvement of roads and bridges, expansion of water supply and the development of a telecommunication system. 2) In the manufacturing sector, the improvement of equipment for industrial standardisation, transference of modern technology and the development of industrial estates. 3) In the agriculture, forestry and fishing sector, the provision of agricultural equipment and the expansion of the water management system. 4) In human resource, the improvement of junior schools and universities and the construction of libraries. 5) In health and medical services, the establishment of hospitals and the supply of medical equipment. 6) In the environmental sector, flood control.

Japan’s programme in Sri Lanka takes two major forms. First, there are grants, channelled chiefly through the Japan International Co-operation Agency (JICA). Certain training programmes are also implemented by JICA. Until fiscal year 1999, grants involved a cumulative commitment in current prices of $1.383 million. The second major form of Japanese involvement comprises special interest loans, channelled chiefly through the Overseas Economic Co-operation Fund (OECF), now the Japan Bank for International Co-operation (JBIC). Until fiscal year 1999, this involved a cumulative commitment in current prices of $2.162 million.

Although Japan’s loan commitments appear substantial, disbursements (at 10% in the year ending end March 2000 and 13% in the year ending end March 2001) have been
low. This has been attributed largely to ineffective local management of projects and, reportedly, to a lack of transparency in tender/procurement procedures, which are shared concerns among the donor community. Japan, together with ADB, has been advising the Sri Lankan Government to improve its disbursement ratio.

7 The EC response strategy

7.1 Principles and objectives for co-operation

The 1995 Co-operation Agreement between the European Community and Sri Lanka on Partnership and Development outlines the general objectives of co-operation. These have been discussed and refined in the Joint Commissions of 1997, 1998 and 2001 and are well understood and appreciated by GoSL. The Commission’s overall development policy and the Asia Strategy provide the general framework for the co-operation. Sri Lanka’s economic status, social indicators and development aims call for a change, emphasising greater priority to be given in future to economic co-operation.

EC is not a major donor to Sri Lanka. However, all its financial support is in grant form. This form of support is elsewhere in decline as major donors (Japan, ADB, World Bank) now mainly provide soft loans. European Investment Bank (EIB) concluded a Framework Agreement or MoU with the Government of Sri Lanka in March 2001. In the present stage of Sri Lanka’s economic development the possibility of EIB involvement in larger infrastructure projects could also support possible participation of European companies in the implementation of projects.

Despite, or indeed because of the recent positive developments in the peace process, the need for the humanitarian aid and support for displaced people will continue for some time to come. The political situation remains vulnerable and concerns about human rights and governance remain.

Gender and environment/sustainable development concerns will be cross-cutting issues, taken fully into account, forming an integral part of the EC’s development and economic co-operation activities.

Overall, in the present situation and the expected development of Sri Lanka, the main objectives of EC co-operation for the coming years should be to:

- provide support for the search for a peaceful negotiated solution to the conflict and in case of a peace settlement, engage in the rehabilitation and reconstruction activities in the North and East to provide a sustainable basis for a lasting peace;
- support Government efforts in rural poverty alleviation, based on the Framework for Poverty Reduction and the Poverty Reduction Strategy Paper;
- further development and diversification of trade and investments in the mutual interest of Sri Lanka and EC, especially by facilitating increasing private sector - business to business - contacts and links through the economic co-operation facilities;
- provide support to measures and actions aimed at improving democracy, good governance and human rights, and eventually community reconciliation activities through the various available budget lines;
- provide humanitarian assistance, food security, to the conflict areas to alleviate the effects of the conflict;
- provide support to efforts to provide practical solutions to the protection of Sri Lanka’s eco-system;
- provide support for government/municipal efforts towards the improvement of the urban environment;
- support sustainable solutions to overcome Sri Lanka’s energy problems;
- participation in regional co-operation activities;
- revise the CSP in 2004 in the light of progress and developments.

7.2 Priorities for co-operation

Taking into account that in the South Asian context, Sri Lanka is not a low income country, it is not expected that the overall level of commitments will significantly increase above recent annual average levels except to provide supplementary financing for assistance to peace process related rehabilitation and reconstruction.

In its positive approach to its WTO membership, its concrete support for market access improvement and its willingness to embrace imaginative use of the GSP system (labour rights clause) Sri Lanka has shown that it understands the need to grasp the opportunities offered by globalisation, to prepare for the challenges of the post-ATC world and to diversify its economy away from an over-dependence on the garment sector.

Sri Lanka’s further integration with the world economy and enhancing its trade performance should therefore be supported. This could include trade related technical assistance in terms of helping Sri Lanka implement existing WTO commitments and in particular building the necessary capabilities and capacities to take a full and effective part in the Doha Development Agenda negotiations, through, for example, training, seminars, studies, awareness building etc.

The Commission has expressed, in Joint Commissions and elsewhere, its readiness to contribute to the rehabilitation and reconstruction of the North and East, if and when a peace settlement takes shape. Early, small scale interventions involving the RRM budget and possibly including components for demining, food security would be possible pilots for additional EC commitments to Sri Lanka.

**Economic Co-operation**

Emphasis should continue to be on the development of **economic co-operation** to provide improved opportunities for the further increase and diversification of trade and investment for the mutual interest of the European Union and Sri Lanka drawing on lessons from the past. This should include technical assistance to Sri Lankan authorities for enabling activities to assist institution-building. This could take in public utilities, intellectual property rights, standards, redrafting and modernising of commercial
legislation. It is important to continue support for business to business linkages, provision of information to Sri Lanka and European business on EU regulations, commercial legislation, Sri Lanka investment and trading environment, building on the work done by the European Business Information Centre (EBIC). In support of this, an ALAT working on economic co-operation matters within the EC Delegation will take on selected activities previously undertaken by the EBIC. In the event that the peace process shows tangible progress then the economic co-operation activities can be more diversified and less restricted to enabling activities.

EC involvement in the institutional reform of Sri Lanka’s railway system was suggested by the Sri Lankan side during the 2001 Joint Commission, given the EU experience in recent years of various programmes of rail reform, particularly public/private partnership.

The Commission considers that there are significant internal policy issues to be resolved by GoSL before EU involvement in this sector can begin.

In the longer run this sector could possibly benefit from EIB and European private sector involvement in infrastructure renovation. It is clear that Sri Lanka’s transport infrastructure has suffered from decades of neglect and under investment and that if the country’s economy is to be revitalised in the context of successful peace talks then transport linkages must be a focus for significant investment. Given the limited amounts of EC development aid funding available, large infrastructure projects are not currently feasible.

A more realistic area for institution building in the transport sector could be in the civil aviation sphere. The EC has already agreed a regional civil aviation programme for which Sri Lanka has formally signed a financing agreement for its component.

The recent growth and commercial success of low-cost airline operations throughout Europe, developing a network of small regional airports has developed a depth of expertise by EU operators which could be transferred to the Sri Lankan context.

An economic co-operation programme to assist in the revitalisation of the country’s regional airports could be complementary to the Sri Lankan component of the Asia region civil aviation programme.

At present, internal civil aviation in Sri Lanka is severely restricted by the military situation. If progress is made in the peace process, the country’s airfields could once again be opened up to civilian traffic, with positive impacts on tourism, trade, regional regeneration. It could then become a priority for economic co-operation. The fact that the civil aviation sector has been obstructed by the civil conflict could be a positive factor with regard to reform and restructuring.

The need for an improved transport infrastructure in Sri Lanka is evident. The economy is heavily Colombo-centric. There is a clear need, particularly in the event of success in the peace negotiations, for the government to be able to demonstrate that there are peace
dividends in terms of economic progress – jobs, investment for Sri Lankans in all parts of the island.

Aside from the international airport in Colombo, there are eight regional airports around the country from Jaffna in the North to Trincomalee and Baticaloa in the East to Ambalantota in the South. These airports have effectively been unable to operate commercially during the civil conflict. They represent an important asset for the economic regeneration of the country. The revitalisation of internal/international civil aviation beyond Colombo can open up large parts of the country to international markets for products such as fresh fruit and vegetables, seafood and cut flowers as well as textiles and other high value products. The tourism industry would also benefit from the opening up of the country to civil aviation.

In effect, the country could be starting with a clean sheet in this sector. Similarly, tourism, which has suffered dramatically during the conflict period, could now take off again in a more relaxed security environment on the island. A recent international cricket competition held in Sri Lanka is said to have generated €25 million from expenditures by visiting teams and supporters. Sri Lanka has a wide range of cultural, sporting, environmental, wild life and leisure attractions, many of which are in need of refurbishment, remarketing. A programme in the tourism sector, involving economic co-operation and development co-operation elements could meet EU co-operation priorities in both areas.

As with all areas of co-operation with Sri Lanka the scope and prospects for success of co-operation activities will depend on the peace process. Co-operation priorities which can benefit from improved peace prospects are institution building to boost deregulation; promotion of measures aimed at increasing inward investment, particularly outside Colombo; working within the education system to make curricula more relevant in terms of technical and IT training accessibility across the country, and at all levels.

In this context, the proposed small project facility should also provide wider scope for support to economic co-operation activities and NGOs.

*Development Co-operation*

In the area of development co-operation, two of the ongoing projects (Mahaweli Consolidation Project and Moneragala Irrigation and Community Development Project) should be brought to a satisfactory conclusion by the end of 2002. The Care Dry Zone Project should end in 2005.

The Commission’s development co-operation focus has historically been on the rural sector. Other donors have been active in the social sectors – education, health (see 4.2 above), sanitation, infrastructure. The Commission will continue activities in the rural development sector, where there remains a real need to address poverty alleviation.
The GoSL/WB Framework for Poverty Reduction is a basis to define programmes that would effectively contribute to poverty reduction and be directed to regions where poverty levels are highest.

The general trend among donors now appears to be turning more directly to the reconstruction/rehabilitation phase of the peace process as a means of assisting Sri Lanka’s development.

Rural poverty remains a serious development issue in some areas of the country. In this climate it is appropriate to continue to work in this sector.

Sri Lanka also faces a number of environmental challenges including deforestation, soil erosion, increasing unplanned urbanisation, biodiversity depletion, coastal degradation, pollution, inadequate water management, solid waste management, air pollution. An increased level of contacts between the GoSL Environment Ministry and Commission services should lead to the exploration of effective means for Commission intervention through either the classic co-operation budget lines or through specific instruments, e.g. Asia-Urbs.

More effective exploitation of ecological tourism, sport and heritage tourism in a post-conflict scenario has abundant development cooperation possibilities and can be linked to economic cooperation (see above). Poverty alleviation through development of on-farm and down-stream activities related to freshwater fish farming and dairy production as natural follow on activities to the earlier irrigation and small farm development programmes can be considered for EC funding in the care of the former, possibly in collaboration with ADB. Both areas could be developed in collaboration with small tank (reservoir) rehabilitation and improved water management. The development of the independence of farmers from government extension service “nannying” would be an important element in programme technical assistance in such programmes.

Additionally, such programmes could meet real nutritional needs in rural areas for the supply of adequate and affordable dietary protein.

**Humanitarian Aid**

**Humanitarian aid and aid to displaced people** should be provided as long as the conflict situation lasts, in order to alleviate the plight of displaced people and other sections of the population suffering from the effects of conflict. In addition to ECHO, the budget line **Aid to Uprooted People** should continue to be used to channel funds through the UNHCR and other international agencies and NGOs. The EC should continue to provide its support in situ for the process of formulation of the Framework for Relief, Rehabilitation and Reconciliation and be prepared to provide support for the operational recommendations that are expected from the process.
**Asylum and Migration**

In tandem with the expected signing of an EC-Sri Lanka Readmission agreement, the EC’s budget for actions under the Action plan on Asylum and Migration for Sri Lanka will provide funds to implement measures agreed with the Sri Lankan Government in cooperation and coordination with the EU Member States. The return and reintegration of returnees would be a cross-cutting issue, where relevant, for EC-Sri Lanka co-operation.

**Rehabilitation and reconstruction**

As indicated above, Rehabilitation and reconstruction activities would become a greater priority, initially through the RRM, if the peace process makes significant progress. In line with the commitments made in Joint Commission meetings, the EC should then be prepared to allocate further funds within a multi-donor programme (e.g. WB, ADB, MS and others). Major donors have indicated their willingness to allocate funds for this purpose. In the context, provisions are being made to make use of inallocated funds for 2002 under the Rehabilitation Budget line (€ 4 million).

**Good governance, human rights**

The fact that the EU has fielded two Electoral Observation Missions to cover the Sri Lankan parliamentary elections in 2000 and 2001 has given the EU an additional opportunity, through the Chief Observer’s reports to comment on related governance and human rights issues. The Other Co-operation Issues Working Group set up at the February 2001 Joint Commission, and which had its first meeting in May 2002, is another platform for an EC-Sri Lanka dialogue on these issues and for discussion on how best EC can assist Sri Lanka in this area. Responses from Sri Lankan NGOs can be expected to the Commission’s latest call for proposals for funding under the Promotion of Democracy and Human Rights budget.

8 **COHERENCE**

Emphasis on economic cooperation is in line with the overall Community development policy and the new Asia strategy, as Sri Lanka graduates to the group of lower middle income countries.

At the political level, the EU has strongly supported efforts to solve the ongoing conflict through peaceful means, i.e. via negotiations. The cooperation strategy also stresses practical support for peace efforts and post conflict assistance.

In trade, the decision, in 2000, to improve market access for Sri Lankan garments by removing quotas and the tariff reductions by Sri Lanka for European products is in line with efforts to increase economic cooperation. Sri Lanka has also applied to benefit from the labour incentive scheme of the GSP regulation. This is under active consideration by the Commission. In May 2002 the Sri Lankan Commerce Minister wrote to Commissioner Lamy to request negotiations on an EU-Sri Lanka Free Trade Agreement.
Commissioner Lamy replied that it was not Commission policy to consider FTA’s with any partner until the Doha Round had been successfully completed.

Likewise, Sri Lanka is also to be included on the permanent list of countries allowed to export seafood products to Europe after the successful inspection visit of the Veterinary Services to Sri Lanka in 2000.

In a regional context, Sri Lanka has been an active player in trying to advance SAARC cooperation. Sri Lanka, during its most recent presidency of SAARC, was also instrumental in reviving the EC/SAARC MOU\textsuperscript{5}, looking to provide technical assistance to the SAARC General Secretariat.

9 COMPLEMENTARITY WITHIN EU AND WITH OTHER DONORS

There exists a good exchange of information between both the Commission and the EU Member States Missions present in Sri Lanka as well as between Commission and other donors. In this way, it is possible to avoid overlapping and duplication of effort. However, there have been only a few examples of co-financing or joint actions. Nevertheless, the donors have generally convergent views on aid policies, and these are also reflected in this strategy. There is particular scope for co-operative and complementary actions with Member States and other donors in such areas as agriculture and rural development, humanitarian assistance, assistance to displaced people, private sector linkages and privatisation.

The aid officers of the EC Delegation and the EU Member States Missions have monthly meetings. In addition, the EC Delegation maintains a database on projects carried out by the EC and the Member States. To date at the EU level, coordination has been limited to the exchange of information. More should and could be done in this respect. If rehabilitation and reconstruction efforts in the North and East can begin this would provide further possibilities for joint actions. This would apply not only to MS but also to other donors. Since 1998, GTZ has been implementing projects in the Jaffna Peninsula with funding from the German, British and the Netherlands Governments as well as ECHO. However, these are separate, complementary projects, and not initiated or funded as part of a joint effort.

EC and Sweden have recognised the possibility for greater co-operation on institution building projects in the economic co-operation sector and have agreed on the need for closer information sharing in this area.

A wider local donor group meets approximately four times a year and includes all major donor countries, international financial institutions and the UN system. Meetings are chaired by the World Bank. These meetings are very open and provide an opportunity for donor dialogue, which is useful in preparing for events such as the Sri Lanka

\textsuperscript{5} Signed in Brussels on 10 July 1996
Development Forum. A Local Donor forum was held early June 2002 and will be followed by a regular Donor Forum.

The only co-financing project that the EC has undertaken has been with the World Bank; National Irrigation Rehabilitation Project.
Annex 1

SRI LANKA AT A GLANCE

Official name : Democratic Socialist Republic of Sri Lanka
Form of state : Executive presidency on the French model
Population : 18.9 million
Annual population growth : 1.3 %
Life expectancy : 73.1 years
Literacy rate : 91.1 %
Male : 94.1 %
Female : 88.3 %
Unemployment : 8.4 %
GDP per capita (USD) : 825
GDP growth : 5.6 % 2001
Consumer price inflation : 7.3 % 2001
7.7 % 2002 (forecast)
External debt (USD bio) : 10.8 2001
11.5 2002 (forecast)
Debt service ratio : 7.7 %
Origins of GNP %
Services 52.0
Agriculture 20.7
Manufacturing 16.4
Construction 7.6
Mining 1.8
Utilities 1.5
100
### A Output, Savings and Investment

<table>
<thead>
<tr>
<th></th>
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<th></th>
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<th></th>
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</thead>
<tbody>
<tr>
<td>GDP per capita (at current market price in US $)</td>
<td>719</td>
<td>759</td>
<td>814</td>
<td>839</td>
<td>825</td>
<td>856</td>
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<tr>
<td>Real GDP Growth (%)</td>
<td>5.5</td>
<td>3.8</td>
<td>6.3</td>
<td>4.7</td>
<td>4.3</td>
<td>6.0</td>
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<tr>
<td>Agriculture Forestry and Fishing</td>
<td>3.3</td>
<td>-4.6</td>
<td>3.0</td>
<td>2.5</td>
<td>4.5</td>
<td>1.8</td>
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<td>Mining and Quarrying</td>
<td>3.4</td>
<td>8.9</td>
<td>3.8</td>
<td>-5.4</td>
<td>4.1</td>
<td>4.8</td>
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<tr>
<td>Manufacturing</td>
<td>9.2</td>
<td>6.5</td>
<td>9.1</td>
<td>6.3</td>
<td>4.4</td>
<td>9.2</td>
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<td>Construction</td>
<td>4.9</td>
<td>3.4</td>
<td>5.4</td>
<td>7.1</td>
<td>4.8</td>
<td>4.8</td>
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<tr>
<td>Services (as a % of GDP)</td>
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<td>5.8</td>
<td>7.1</td>
<td>5.2</td>
<td>4.2</td>
<td>6.9</td>
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<tr>
<td>Investment</td>
<td>25.7</td>
<td>24.2</td>
<td>24.4</td>
<td>25.1</td>
<td>27.3</td>
<td>28.0</td>
</tr>
<tr>
<td>Government and Public Corp.</td>
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<td>6.2</td>
<td>6.3</td>
<td>6.3</td>
<td>6.7</td>
<td>6.6</td>
</tr>
<tr>
<td>Private</td>
<td>17.8</td>
<td>18.0</td>
<td>18.1</td>
<td>18.7</td>
<td>20.6</td>
<td>21.5</td>
</tr>
<tr>
<td>Domestic Savings</td>
<td>15.3</td>
<td>15.3</td>
<td>17.3</td>
<td>19.1</td>
<td>19.5</td>
<td>17.3</td>
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<td>Net Factor Income</td>
<td>4.2</td>
<td>3.7</td>
<td>4.2</td>
<td>4.3</td>
<td>4.0</td>
<td>4.1</td>
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<td>National Savings</td>
<td>19.5</td>
<td>19.0</td>
<td>21.5</td>
<td>23.4</td>
<td>23.5</td>
<td>21.4</td>
</tr>
</tbody>
</table>

### B Money, Interest Rates, Prices and the Colombo Stock Exchange (CSE)

| Monetary Aggregate (% change, Dec - Dec) | 21.1  | 11.3  | 15.6  | 13.2  | 13.4  | 12.9 |
| Dom. Credit from the banking system to:  |       |       |       |       |       |      |
| Govt.(net) and Public Corps.            | 39.9  | 38.3  | -9.8  | 11.5  | 75.4  | 250.0|
| Private Sector                          | 29.0  | 9.0   | 14.5  | 12.0  | 10.5  | 11.8 |
| T-bill rate (12 months) %, end year      | 18.97 | 17.38 | 10.21 | 12.59 | 12.4  | 18.22|
| Reverse Repo                            | 20.00 | 18.58 | 12.85 | 15.0  | 13.48 | 20.00|
| Commercial banks weighted avg. deposit rate | 12.4  | 12.3  | 10.0  | 9.2   | 9.1   | 9.9  |
| Commercial banks weighted avg. prime lending rate | 20.1  | 20.2  | 15.2  | 14.9  | 15.9  | 21.46|
| CCPI (% change)                         | 7.7   | 15.9  | 9.6   | 9.4   | 4.7   | 6.2  |
| All Share Prices Index, 1985 = 100      | 663.7 | 603.0 | 702.2 | 597.0 | 573.0 | 447.6|
| Net purchase by non-nationals (Rs. Mn.) | -89.7 | 351.6 | 716.0 | -1517 | -902  | -3364|

### C Government Finance (as a% of GDP)

| Revenue                                | 20.4  | 19    | 18.5  | 17.2  | 17.7  | 16.8 |
| Expenditure and Net Lending            | 30.5  | 28.5  | 26.4  | 26.3  | 25.2  | 26.7 |
| Current                                | 23.1  | 22.8  | 20.8  | 19.6  | 18.7  | 20.3 |
| Public Investment                      | 7.9   | 6.0   | 5.8   | 6.7   | 6.5   | 6.4  |
| Current Account Balance                | -2.7  | -3.8  | -2.2  | -2.4  | -1.0  | -3.4 |
| Overall Balance                        | -10.1 | -9.4  | -7.9  | -9.2  | -7.5  | -9.9 |
| Deficit Financing                      | 10.1  | 9.4   | 7.9   | 9.2   | 7.5   | 9.9  |
| Foreign                                | 4.5   | 2.3   | 1.9   | 1.7   | 0.7   | 0.4  |
| Domestic                               | 5.1   | 6.5   | 3.4   | 7.0   | 6.8   | 9.4  |
| Privatisation Proceeds                 | 0.4   | 0.6   | 2.5   | 0.4   | 0     | 0    |
| Government Dept                        | 93.3  | 93.3  | 85.8  | 90.8  | 95.1  | 97.1 |
D External Trade and Payments (as a % of GDP, unless otherwise stated)

<table>
<thead>
<tr>
<th></th>
<th>Foreign</th>
<th>Domestic</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>46.8</td>
<td>46.4</td>
</tr>
<tr>
<td></td>
<td>46.8</td>
<td>46.4</td>
</tr>
<tr>
<td></td>
<td>42.3</td>
<td>43.5</td>
</tr>
<tr>
<td></td>
<td>45.3</td>
<td>45.5</td>
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<tr>
<td></td>
<td>45.9</td>
<td>49.1</td>
</tr>
<tr>
<td></td>
<td>43.1</td>
<td>53.9</td>
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</table>

<table>
<thead>
<tr>
<th></th>
<th>-11.5</th>
<th>-9.7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade Balance</td>
<td>-8.1</td>
<td>-6.9</td>
</tr>
<tr>
<td></td>
<td>-6.9</td>
<td>-8.7</td>
</tr>
<tr>
<td></td>
<td>-10.7</td>
<td></td>
</tr>
<tr>
<td>Current Account Balance</td>
<td>-6.0</td>
<td>-4.9</td>
</tr>
<tr>
<td></td>
<td>-2.6</td>
<td>-1.4</td>
</tr>
<tr>
<td></td>
<td>-3.6</td>
<td>-6.3</td>
</tr>
<tr>
<td>Export Growth(i)</td>
<td>18.6</td>
<td>7.6</td>
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<tr>
<td>Import Growth(i)</td>
<td>11.4</td>
<td>2.4</td>
</tr>
<tr>
<td></td>
<td>7.6</td>
<td>0.4</td>
</tr>
<tr>
<td></td>
<td>1.5</td>
<td>22.4</td>
</tr>
<tr>
<td>Gross Official Reserves(ii)</td>
<td>2063</td>
<td>1937</td>
</tr>
<tr>
<td></td>
<td>2029</td>
<td>1984</td>
</tr>
<tr>
<td></td>
<td>1639</td>
<td>1043</td>
</tr>
<tr>
<td>Debt Service Ratio(iv)</td>
<td>16.5</td>
<td>15.3</td>
</tr>
<tr>
<td>Total External Debt(and Liabilities v)</td>
<td>75.0</td>
<td>68.6</td>
</tr>
<tr>
<td></td>
<td>62.3</td>
<td>61.6</td>
</tr>
<tr>
<td></td>
<td>63.5</td>
<td>60.0</td>
</tr>
</tbody>
</table>

% change over previous year in US $ terms(ii) in US $ mn. At end year(iii) in months of same year imports of goods and services(iv) % of export of goods and services(v) includes banking sector external liabilities.

E Memorandum Items

<table>
<thead>
<tr>
<th></th>
<th>GDP(i)</th>
<th>GNP(i)</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP(i)</td>
<td>668</td>
<td>768</td>
</tr>
<tr>
<td>GNP(i)</td>
<td>659</td>
<td>757</td>
</tr>
<tr>
<td>Exchange Rate (ii)</td>
<td>51.25</td>
<td>55.27</td>
</tr>
<tr>
<td></td>
<td>58.99</td>
<td>64.559</td>
</tr>
<tr>
<td>Population (millions)(iii)</td>
<td>18.14</td>
<td>18.34</td>
</tr>
<tr>
<td></td>
<td>18.55</td>
<td>18.77</td>
</tr>
<tr>
<td></td>
<td>19.04</td>
<td>19.36</td>
</tr>
</tbody>
</table>

(i) at current market price in Rs. Billion (ii) Rs. Per US $, annual average (iii) Mid year estimate

Source : Central Bank of Sri Lanka

* Provisional
Annex 4

SRI LANKA: SOCIAL INDICATORS IN A REGIONAL CONTEXT

<table>
<thead>
<tr>
<th></th>
<th>Sri Lanka</th>
<th>India</th>
<th>Bangladesh</th>
<th>Pakistan</th>
<th>Nepal</th>
<th>Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population (millions)</td>
<td>18.9</td>
<td>1014</td>
<td>129</td>
<td>138</td>
<td>24</td>
<td>2000</td>
</tr>
<tr>
<td>Annual Pop. Growth (%)</td>
<td>1.1</td>
<td>1.7</td>
<td>1.6</td>
<td>2.6</td>
<td>2.7</td>
<td>(1995-2000)</td>
</tr>
<tr>
<td>Urban (%)</td>
<td>23.3</td>
<td>28.1</td>
<td>23.9</td>
<td>36.5</td>
<td>11.6</td>
<td>1999</td>
</tr>
<tr>
<td>MMR(i)</td>
<td>60</td>
<td>410</td>
<td>440</td>
<td>340</td>
<td>540</td>
<td>(1990-1999)</td>
</tr>
<tr>
<td>IMR(ii)</td>
<td>17</td>
<td>70</td>
<td>58</td>
<td>84</td>
<td>75</td>
<td>1999</td>
</tr>
<tr>
<td>Overall Life Expectancy</td>
<td>74</td>
<td>63</td>
<td>59</td>
<td>65</td>
<td>58</td>
<td>1999</td>
</tr>
<tr>
<td>at birth (yrs)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Male</td>
<td>69.3</td>
<td>62.4</td>
<td>58.9</td>
<td>59.8</td>
<td>58.3</td>
<td>1999</td>
</tr>
<tr>
<td>Female</td>
<td>75</td>
<td>63.3</td>
<td>59</td>
<td>59.5</td>
<td>57.8</td>
<td>1999</td>
</tr>
<tr>
<td>Literacy(iii)</td>
<td>91.4</td>
<td>56.5</td>
<td>40.8</td>
<td>45</td>
<td>40.4</td>
<td>1999</td>
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<tr>
<td>Male</td>
<td>94.3</td>
<td>67.8</td>
<td>51.7</td>
<td>58.9</td>
<td>58</td>
<td>1999</td>
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<tr>
<td>Female</td>
<td>88.6</td>
<td>44.5</td>
<td>29.3</td>
<td>30</td>
<td>22.8</td>
<td>1999</td>
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<tr>
<td>Enrolment (iv)</td>
<td>70</td>
<td>55</td>
<td>37</td>
<td>40</td>
<td>60</td>
<td>1999</td>
</tr>
<tr>
<td>Male</td>
<td>71</td>
<td>49</td>
<td>33</td>
<td>28</td>
<td>52</td>
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<tr>
<td>Female</td>
<td>68</td>
<td>62</td>
<td>41</td>
<td>51</td>
<td>67</td>
<td>2000</td>
</tr>
<tr>
<td>Malnutrition (v)</td>
<td>34</td>
<td>53</td>
<td>56</td>
<td>38</td>
<td>47</td>
<td>(1990-1998)</td>
</tr>
<tr>
<td>Income Distribution (vi)</td>
<td>5.4</td>
<td>5.7</td>
<td>4.9</td>
<td>4.3</td>
<td>5.9</td>
<td>(1987-1998)</td>
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<tr>
<td>Pop. without access to</td>
<td>17</td>
<td>12</td>
<td>3</td>
<td>12</td>
<td>19</td>
<td>2000</td>
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<td>safe water (%)</td>
<td></td>
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<td></td>
<td></td>
<td></td>
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<tr>
<td>Pop. without access to</td>
<td>17</td>
<td>69</td>
<td>47</td>
<td>39</td>
<td>73</td>
<td>2000</td>
</tr>
<tr>
<td>sanitation (%)</td>
<td></td>
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<td></td>
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<tr>
<td>Public Education Expenditure</td>
<td>3.4</td>
<td>3.2</td>
<td>2.2</td>
<td>2.7</td>
<td>3.2</td>
<td>(1995-1997)</td>
</tr>
<tr>
<td>(% of GNP)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Maternal Mortality Rate (per hundred thousand live births). (ii) Infant Mortality Rate (per thousand live births). (iii) % of the population aged 15 years and above, literate. (iv) Combined primary, secondary and tertiary gross enrolment ratio. (V) % of children aged under five years, underweight. (vi) Share of income or consumption of the richest 20% to the poorest 20%.

### SRI LANKA TRADE WITH THE WORLD (Mio ecu/euro and %)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Imports</td>
<td>1.438</td>
<td>1.946</td>
<td>6.984</td>
<td>Exports</td>
<td>646</td>
<td>1.482</td>
</tr>
<tr>
<td>world* share (%)</td>
<td>0,1</td>
<td>0,1</td>
<td>0,1</td>
<td>world* share (%)</td>
<td>0,1</td>
<td>0,1</td>
</tr>
<tr>
<td>Trade balance</td>
<td>-792</td>
<td>-464</td>
<td>-1.373</td>
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</table>

### EU TRADE WITH SRI LANKA (Mio ecu/euro and %)

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>62</td>
<td>239</td>
<td>479</td>
<td>1.533</td>
<td>82</td>
<td>298</td>
<td>368</td>
<td>961</td>
<td></td>
</tr>
<tr>
<td>Share of EU Total (%)</td>
<td>0,1</td>
<td>0,1</td>
<td>0,2</td>
<td>Share of EU Total (%)</td>
<td>0,1</td>
<td>0,1</td>
<td>0,1</td>
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</tr>
<tr>
<td>Trade balance</td>
<td>-570</td>
<td>-977</td>
<td>-573</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tbody>
</table>

### MAIN PRODUCTS IN 2001** (Mio euro and %)

<table>
<thead>
<tr>
<th>Products</th>
<th>EU Imports</th>
<th>Value</th>
<th>EU exports</th>
<th>Value</th>
<th>EU total</th>
<th>Balance</th>
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<tbody>
<tr>
<td>Agricultural products</td>
<td>175</td>
<td>0,2</td>
<td>Agricultural products</td>
<td>74</td>
<td>0,1</td>
<td>-100</td>
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<tr>
<td>Energy</td>
<td>0</td>
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<td>Energy</td>
<td>1</td>
<td>0,0</td>
<td>1</td>
</tr>
<tr>
<td>Machinery</td>
<td>55</td>
<td>0,0</td>
<td>Machinery</td>
<td>258</td>
<td>0,1</td>
<td>203</td>
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<tr>
<td>Transport. Material</td>
<td>88</td>
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<td>Transport. Material</td>
<td>136</td>
<td>0,1</td>
<td>47</td>
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<tr>
<td>Chemical products</td>
<td>7</td>
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<td>Chemical products</td>
<td>87</td>
<td>0,1</td>
<td>80</td>
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<tr>
<td>Textiles and clothings</td>
<td>806</td>
<td>1.1</td>
<td>Textiles and clothings</td>
<td>105</td>
<td>0.3</td>
<td>-731</td>
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<tr>
<td>------------------------</td>
<td>-----</td>
<td>-----</td>
<td>------------------------</td>
<td>-----</td>
<td>-----</td>
<td>------</td>
</tr>
<tr>
<td>Total</td>
<td>1.130</td>
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**2001: Lux data missing for Dec. 2001**
## Annex 6

**Donor Matrix: Sectoral focus of EU Member States and other major donors: ADB, IDA, Japan**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Germany</th>
<th>Sweden</th>
<th>Netherlands</th>
<th>UK</th>
<th>France</th>
<th>Italy</th>
<th>ADB</th>
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<tr>
<td>Agriculture and rural development</td>
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<tr>
<td>Energy, power, infrastructure</td>
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<td>x</td>
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National Indicative Programme

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Annex
The National Indicative Programme for 2003 – 2005 proposes to use the full amount of 16.8 M€ available under the Asia budget with the following ventilation among main areas of co-operation:

- € 5.3 million for economic co-operation,
- € 7.5 million for development co-operation, and
- € 4 million for post-conflict assistance.

These sums will also cater for the intended small project facility. This facility is expected to cover mostly economic co-operation activities (as a follow-up to EBIC) and some civil society initiatives.

1. **Economic Co-operation**

Proposed approach and rationale

The following intervention concepts have been formulated within the framework of the 1995 EC-Sri Lanka Co-operation Agreement on Partnership and Development\(^1\), the draft EU Country Strategy Paper and the priorities of the Government of Sri Lanka. They reflect a strategy which, in this area, aims to target the limited resources available within the Economic Co-operation envelope for Sri Lanka in the most mutually beneficial and effective way by:

* assisting the GoSL to modernise the regulatory framework for trade and investment; encouraging wider EU-Sri Lanka business linkages, investment.

* in the light of positive progress towards peace in Sri Lanka, supporting economic development by encouraging market led investment in the area of domestic civil aviation, promoting the reestablishment of the sector, modernisation and extending socially sensitive public private partnership-based reform.

1.1 **Areas of intervention**

1.1.1 Promotion of economic co-operation through trade, investment and institutional reform

Strategy Context and Justification

The promotion of trade and investment is central to addressing the underlying problems identified above and has the potential to bring immediate and longer term benefits both to partners in Sri Lanka and in the EU. At the EC-Sri Lanka Working Group on 28 June 2002 the partners agreed on the need to look at means to enhance bilateral trade. This should include Trade Related Technical Assistance (TRTA), institutional strengthening to underpin improved economic performance, competition and trade policy in particular as it relates to implementing WTO Agreements and the

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\(^1\) Council Decision (95/129/EC) of 27 March 1995  L85 19 April 1995
Doha Development Agenda. These are areas where the EU has enormous experience and expertise and where, in the present circumstances, there is a good prospect that relatively modest resources may bring about important beneficial changes of long term value. A joint study agreed between PM Wickremesinghe and Commissioner Lamy on 27 May 2002, is proposed, to look at issues such as the targeted use of technical assistance in the trade sphere, identifying possibilities for trade diversification in both goods and services, increasing investment from.

Furthermore, a modest initiative is proposed which aims to promote mutual advantage between EU and Sri Lankan enterprises by building on, and continuing, the work of the Colombo EBIC. Its aim is to support efforts to increase trade and other business contacts between the EU and Sri Lanka. It thus contributes directly to the trade and investment promotion objectives embodied in the CSP.

Financial envelope

An indicative amount of 2 M€ is foreseen for the activities described in detail below. Activities listed in 1.1.1.1, 1.1.1.2, 1.1.1.3 and 1.1.1.4, whilst all capable of being implemented individually, could also be combined flexibly under a single heading say, Programme for EC-Sri Lanka Trade Development.

1.1.1.1 Outreach business networking for companies in the EU and in Sri Lanka

Description of Action

The action would provide funding for a contract to enable the development of business links between enterprises in Sri Lanka and in the EU, with a particular emphasis on SMEs and on businesses located outside of Colombo.

Objectives

Current funding for the Colombo European Business Information Centre (EBIC) is due to run out at the end of December 2002. The Colombo EBIC not only provides the usual range of services and information, but also currently acts as the secretariat of the European Chamber of Commerce (ECCSL).

In the light of a EC Delegation reorganisation², an option for the work of the EBIC would be:

- That EBIC EU information services be transferred to the EU Delegation. It is suggested that this function be accommodated through a modest strengthening of the local staff resources available in the Delegation. A system of logging all contacts, including telephone contacts, should be introduced to make it possible to accurately measure the level of resources required to maintain an appropriate level of service.

Expected Results

* New and improved commercial links between businesses in Sri Lanka and the EU, including SMEs and businesses based outside of Colombo.
* Establishment of stronger links with Chambers both in and outside of Colombo.
* Cost effective, responsive and potentially more sustainable basis for trade promotion activities involving EU and Sri Lankan companies that avoids the problems involved in the EU being directly involved in trade promotion activities;
* possibility of building on, and sustaining, contacts and lessons learned by EBIC and the Chambers of Commerce in Sri Lanka.

Activities

The activities could include seminars, trade missions and a variety of partnership building initiatives.

Implementation

To maintain continuity, the project would need to start as soon as possible after the termination of the current EBIC contract.

The issue of the future of the services currently provided by EBIC was discussed by the programming mission with a number of parties including the representatives of EU based private sector enterprises operating in Sri Lanka and of four member States recommended by the EU Delegation. Differing views were expressed and it was recognised that no ideal cost-effective solution was available. This project concept represents one component of a broader strategy for addressing the problem of how to maintain services currently provided by EBIC after the end of the current contract. It is intended to complement the proposal that EBIC’s information functions should be transferred to the EU Delegation.

Risks and Assumptions

* the continued support of the Member States representations in Sri Lanka would be important to its success;
* special provisions would be needed to ensure that enterprises outside of the Colombo area were sufficiently involved;
* it would be important to retain the active support of larger EU based firms.

Performance/Output indicators

Records of activities undertaken.
Records of participation.
Donor context

The Embassy of one Member State indicated that it might be willing to consider providing some support for EBIC or a successor body by involving it in the running of a data management project. The scale of the resources involved, however, would be likely to be modest.

Cross cutting issues

* support for the development of SME business activities in Sri Lanka through new and improved links with EU business partners.
* Support for business development outside of Colombo, contributing to more balanced and equitable economic development.

Co-operation potential

The aim of the initiative would be to encourage business contacts of mutual benefit between enterprises in Sri Lanka and in the EU and to promote better understanding and increased commerce.

1.1.1.2 Joint market access study – Follow-up

Prime Minister Wickremesinghe, President Prodi and Commissioner Lamy agreed in May 2002 to carry out a study to examine the reasons behind the recent drop in Sri Lankan exports to the EU [believed to be caused in large part to the effects and aftermath of the LTTE attack on Colombo International Airport in July 2001], particularly in the textiles and clothing sector, to look into ways and means to improve the GSP utilisation rate by Sri Lanka, as well as identifying areas where carefully targeted technical assistance could be of greatest benefit. Although the textiles and clothing sector is critical, as it represents a substantial proportion of EU-Sri Lankan trade, it was resolved that it is also important to consider other sectors which may offer prospects to expand trade and investment in the future and support trade diversification and investment flows for Sri Lanka.

Objectives

The global objective of the study is to examine the evolution of EU – Sri Lanka trade, taking into account both recent and expected future developments pertaining to the relevant trade regimes as well as regional and global trends, such as the liberalisation of textiles under the ATC agreement foreseen for 2005 and the ongoing DDA negotiations.

The study should identify opportunities for co-operation through the provision of appropriate technical assistance to GoSL, to eliminate or reduce the effect of key factors and possible barriers which have negative influences on EU-Sri Lankan trade. Inputs would focus particularly on the textiles and clothing sector but would also address a wider range of trade and investment flows.
The programme would also respond positively and in a timely manner to ad hoc disruptions to EU-Sri Lanka trade, for example in the area of phyto-sanitary regulation and control.

**Expected results**

- improved EU-Sri Lanka trade flows, particularly in the textile and garment sectors;
- increased trade diversification in Sri Lanka into the service sector;
- increased inward investment into Sri Lanka from EU and other partners;
- greater transparency in Sri Lanka government procedures and regulations relating to inward investment, competition.

**Implementation**

Timing depends on the successful completion of the joint study and agreement on findings and proposed actions.

**Risks and assumptions**

a. That the joint study results in recommendations that can be agreed by both partners;
b. That the recommendations can be formulated into agreed co-operation actions;
c. That the Sri Lankan economy continues to grow;
d. That GoSL maintains its positive approach towards encouraging inward investment particularly in the service sector.

**Performance indicators**

Indicators will be based on:

a. Increased EU-Sri Lanka trade
b. Increased investment flows into Sri Lanka from EU investors and other partners
c. Timely resolution of ad hoc disruptions to EC-Sri Lanka trade flows.

**1.1.1.3 WTO assistance programme**

**Background**

As early as 1998, Sri Lanka was invited to participate in a regional programme aimed at assisting countries in the South Asia region to develop the means to integrate into
the global trading system, to enhance trade efficiency and to meet WTO commitments.

It has not been possible for Sri Lanka to agree modalities for its participation in a regional programme. Consequently, since GoSL has indicated that it would wish to benefit from a country specific programme, and that it will develop a list of priority subjects for consideration within the scope of such an assistance programme, it has been decided to maintain this project in the NIP 2003-2005.

Description of action

- Identify relevant areas within the Sri Lanka administration where the information flow relating to WTO rules/procedures can be improved.

- Deliver technical assistance to bring about greater capacity and expertise to enable Sri Lankan officials in specific ministries to negotiate and manage WTO regulations.

- Specific areas such as customs valuation, implications of bilateral free trade agreements could be considered for assistance if Sri Lanka indicates that these are indeed priorities for the country.

Activities

In-house training, seminars, conferences.

Implementation

To be programmed following the receipt by the Commission of the EC-Sri Lanka Joint Trade Study and of a probable project specific identification mission.

Risks and assumptions

That GoSL delivers its priority list.

Performance/output indicators

To be decided in the light of study/mission findings.

1.1.1.4 Small Project Facility

Experience in China has shown that Small Project Facilities (SPF) are particularly useful in providing Delegations with enough flexibility to respond to local initiatives and to provide seed money for pilot schemes. In a country which has a well developed SME sector as well as voluntary NGO sector and a vibrant and diverse political culture in those parts of the country currently under government control, an SPF should provide an ideal instrument to provide small scale project finance to follow up specific economic co-operation activities initiated under EBIC and for rehabilitation and reconciliation activities by NGOs as well as eventually stimulating and diversifying the development of NGOs and other voluntary groups in areas presently under the control of LTTE.
In the new deconcentrated framework, the Colombo Delegation (with support from the regional Delegation in New Delhi) should be able successfully to operate such a facility. It is proposed that the size, scope and focus of the SPF are determined in further discussions between Commission services (RELEX and AIDCO) and the GoSL. These discussions should take account of the general principles currently being developed between these services for the setting up of SPFs as well as future human resources available at the Delegation. Although set out in the NIP as being financed through B7-3010, it is recognised that this facility would complement both economic and development activities and would need to be funded proportionally from the funds allocated to these two subsectors. For reference purposes, it is assumed that an indicative amount of ± € 0.5 million for the period 2003-2005 would be adequate.

1.1.2 Support to the development of domestic civil air transport

Background

The Government has asked the EC to consider a number of loosely interrelated actions in this context, namely in the railway sector and the support to tourism development and air transport.

Of those, the support to domestic civil air transport is considered the most suited for inclusion in the NIP.

Description of Action

In the air transport sectors, there are several different inter-related components. The proposed intervention is designed to help capitalise on the new GoSL initiatives including the proposed, more liberal, Civil Aviation Policy Framework. Domestic air transport movement is limited and exists at present only under the auspices of the Sri Lankan Air Force. There is no domestic civil aviation industry, due to the war and assistance with the proposed Civil Aviation Policy Framework would have a wide range of benefits, both national and local.

Financial envelope

An indicative amount of 3.3 M € has been earmarked for the initiative described in more detail below:

Aviation Sector development

Objectives

There is a significant opportunity to increase the contribution of aviation to GDP by assisting the development of the civil aviation sector after a long period of war when domestic aviation ceased. The objectives of the intervention would be to assist in the development of civil aviation policy through assistance with the preparation/revision of the Civil Aviation Development Plan and for related physical infrastructure and equipment.
Expected Results

The results of the programme would be seen in the development of the civil aviation in Sri Lanka resulting in

a. Higher safety and security levels;
b. Expanded air travel and expenditure for domestic and tourism purposes;
c. Greater economic impact from deregulated air travel (both international and domestic);
d. Higher and wider distribution of economic impacts from tourism
e. Development of domestic and international cargo traffic;
f. Opportunities for EU suppliers;
g. Significantly extended PPP in the sector;
h. Small scale, but significant, local impacts in terms of income and employment generation;
i. Environmental protection, mitigation and improvement in targeted areas.

Activities

Subject to an appropriate identification mission, the proposed activities could include the following:

a. Advisory support to the Department of Civil Aviation;
b. Assistance with Regulatory Institutions;
c. Specific studies with safety and deregulation/PPP as major considerations:
   1. Civil Aviation Development Plan
   2. Domestic air travel and national airports plan, including infrastructure and equipment needs
   3. Tourism Development and Aviation Requirements
   4. Colombo as an Aviation Hub
   5. Airline Planning inc. licensing, certification
   6. Air Cargo development
   7. PPP
   8. International Air Traffic Rights inc. Charter
   9. Air side and Land side Services
   10. Tariffs
   11. Training Needs
   12. Security;
d. Training Provision.

Implications

The needs of these proposed components are clear. However, given the lead-time between the programming and implementation, it is essential that the detailed activities reflect actual requirements at that time. There is little or no overlap between the regional EU project and the proposed project (which is predominantly domestic aviation) at this conceptual stage. However, at the formulation stage, the detailed
activities should be drawn up taking into account the ToR of the regional project and progress and outputs of that programme. The GoSL is preparing a draft development plan, which is a policy document. There needs to be assistance as soon as possible to detail and refine policies, based on the recommended studies and to follow up on urgently required physical infrastructure and equipment in order for the Government of Sri Lanka to respond to the potential increase in domestic flights throughout the country. The assistance is extendable but not replicable.

**Risks and Assumptions**

a. There are significant risks, and especially conflict related risks, in this sub sector but they can be managed and minimised by appropriate action.
b. Risks include delay or non-implementation of the peace process
c. Implementing agency can ensure progress is made with PPP and that all EU funded work is consistent with economic reform and the necessity for PPP.

**Performance Indicators**

There is some overlap between tourism and aviation. Hence, indicators will be based on:

a. Tourist arrivals at regional airports;
b. The extent of Civil Aviation deregulation;
c. Domestic movements and passenger volumes;
d. Trade and production impacts including freight movements and volumes;
e. Domestic flight operations-airlines, safety, aircraft, schedules/frequencies etc.

**Related Activity by other Donors**

Civil aviation is an area in which other donors have not participated, although JBIC has financed terminal development at Colombo International Airport. The EU is funding a regional aviation project (see page 19 of CSP) whose main aspects are safety and air traffic management. There are no overlaps between the proposed programme and the regional project at this conceptual stage. The proposed programme is also designed to support the sector reform process by the multi-lateral agencies in general and encourage further deregulation and PPP into the civil aviation sector.

**Cross cutting Issues**

a. Poverty alleviation is indirectly supported by this proposed programme. Macro economic development is encouraged and private sector investment and sustainable employment is also generated. Domestic airport development is designed to encourage a wider distribution of income and employment outside the Colombo area;
b. Governance reform is supported and promoted directly by this programme;

c. Conflict resolution is indirectly supported and efforts to improve conditions in the South, and subsequently the East and North;

d. Institution building is directly supported by the reform promoting activities;

e. Environmental concerns would be addressed in airport development

Co-operation Potential

The proposed programme is multi-faceted. It is designed to enhance economic development, draw on major EU experience in aviation and tourism including in low cost airlines, and assist in economic co-operation between EU and Sri Lankan companies. The opportunities for EU Member States will be considerable.

2. Development Co-operation

Proposed approach and rationale

While gradually shifting emphasis to economic co-operation, the EC Country Strategy for 2002 – 2006 maintains a rural development sector programme. It aims at poverty alleviation involving agricultural extension, development of off-farm, private sector led activities. In many ways this range of components is very similar to the traditional Sri Lankan Integrated Rural Development.

The Commission proposes to continue to support activities which have already shown good results, with the main emphasis on support to policy development: notably, improvement of the enabling environment of small farmers in order to assist them to raise their incomes which will have positive economic, commercial and social benefits in the rural economy.

Furthermore, the Commission’s proposed strategy also takes account of the opportunity to assist the rehabilitation and reconstruction efforts as well as looking to give support to the new government’s reform initiatives.

The government’s poverty reduction strategy should be the framework to identify and define rural development programmes and projects which should be directed to regions where poverty levels are at their highest and to former conflict affected areas. In agreement with GoSL, the Food aid counterpart projects will be used to support the Unified Assistance Scheme which provides funds for the resettlement of IDPs.

An indicative amount of 7.5 M € has been earmarked for the activities described in more detail below.
2.1 Support to policy development

2.1.1 Support to the ADB Aquatic Resource Development and Quality Improvement Project

Components:

Subject to the ADB project being able to include an EU stand alone component, institutional strengthening, capacity building of farmer organisations, improvement of fish marketing, improved fish storage, appropriate post harvest technology development and European TA.

Justification:

With the growing demand for fresh water fish both in the country and for export, fish farming could play a major role in supplementing the incomes of dry zone farming families living close to permanent reservoirs and seasonal tanks. There are about 50 large reservoirs and more than 20000 medium and small tanks in the country indicating the potential for inland fishery. Also, a very large number of small scale farmers in the dry zone are living below the poverty line. Their incomes can be supplemented through inland fishery. In addition, availability of fish as a protein source will improve nutritional standards in rural areas. EU funding can assist in improving the product quality and prices paid for the fish by strengthening farmer’s organisations, improving markets sites and storage facilities, developing local, national and international marketing outlets and increasing post-harvest expertise.

Objectives:

The overall objective is to increase income levels of small-scale farmers in the dry zone and to improve the quality of inland fish produced and improve food security.

Expected Results:

The main result will be increased production of fresh water fish and prawns, improvement in fish quality and marketing, increased access to credit and institutional strengthening. The outcome will be increased production of freshwater fish and other aquatic products for domestic and export sale and increased consumption of inland fish.

Activities:

Subject to an appropriate identification mission, these could include community based fisheries, capacity building of farmer organisations, improved fish marketing and storage; introduction of new technologies to increase volumes and fish varieties, export of fish, private enterprise development, improved quality of fish and increased credit facilities.
Implementation:

As discussed at the EC-Sri Lanka Working Group on Development Co-operation on 17 October 2002, the GoSL will inform EC on its discussion with ADB regarding a separate EC component within the project. Subject to the results of these contacts EU would provide financial support to implement part of this project in conjunction with the ADB. The ADB project feasibility study has been completed. The main objective is to develop aquatic resources and quality improvement. EU funding would focus on assisting in improving the quality and prices paid for fish by strengthening farmer organisations, improved markets, storage facilities, developing market outlets and increasing post harvest expertise. With continuing progress in the peace process, the area covered by this activity could be extended to include former conflict zones in the North and East.

Risks and assumptions:

There is a need to get the approval from local religious groups to cultivate fish for consumption. Agreement will have to be reached as to how funding and project management can best be handled.

Performance/Outcome Indicators:

Increased freshwater fish production, number of minor reservoirs and seasonal tanks stocked, mini-hatcheries established, community based fisheries established, improvement in fish quality, marketing outlets established, improved storage and post harvest processing units established.

2.1.2 Support to the Smallholder Dairy Farmer Poverty Reduction Programme

Components:

Increased dairy productivity, enhanced farmers co-operatives and producer organisations, youth employment, farmer owned collection points, improved breeding stock, efficient milk collection system and more liberalised commercial milk marketing system.

Justification:

With the increasing demand in Sri Lanka for milk products, this project will be able to pilot a small farmer milk production system in different key areas of the country to demonstrate how rural incomes and employment can be increased through strengthened farmer’s organisations. A detailed Project appraisal report has been prepared with assistance of FAO showing how a cost-effective project can benefit small farmers. At the EC-Sri Lanka Working Group of 17 October 2002, it was agreed that the EU intervention would be based on the recent GoSL/FAO action plan, with particular emphasis given to intervention in former conflict affected areas.
Objectives:

The main objectives are, where possible within the context of the ongoing peace process, to increase dairy productivity, develop farmer organisations, improved feeding stock, and/or established farmer owned milk collection points and/or develop other marketing services.

Expected Results:

Increased farmer profitability, increased milk production, improved collection system, strengthened farmer organisations, enhanced livestock nutrition and breeding, effective extension service, participation of unemployed youths and improved marketing of milk will be some of the expected results.

Activities:

Type of activities (illustrative only and subject to an appropriate identification mission):
Development and strengthening of farmer organisations and farmer owned milk collection points and introduction of new technologies like the improved breeds AI, improved cattle nutrition, and improved marketing of quality milk, farmer paid for extension service, improved collection system and better input supplies through farmer organisations.

Implementation:

Project appraisal report has already been prepared but will need verification and updating in particular in view of the latest GoSL/FAO Action Plan and the intention to design the project around the needs of the evolving peace process. EU funds will partly support this project in liberalising the milk marketing system in conjunction with other aid donors. The activities of this project could also be extended into the North and East if progress continues to be made in the Sri Lanka peace process.

Risks and assumptions:

Risk will be reduced by the full participation and involvement of the farming community to ensure sustainability.

Performance/Outcome Indicators:

15% increase in smallholder produced milk collected by commercial milk processors, increased membership in farmer organisations, increase in income from milk production, increase involvement by private entrepreneurs, improved gross margins of milk producers, number of farmer organisations arranging the supply of their own inputs, extension service, AI service and breed improvement.

2.1.3 Controlled Expenditure of the Food Aid Counterpart Funds

Components:
Visiting TA and the EC Delegation in Colombo to work with Treasury officials to prepare modalities for procedures and internal controls for the correct expenditure within a predetermined period of time of all the remaining Food Aid Counterpart Funds. This will include the remaining Mahaweli Food Aid Counterpart Trust Funds.

Justification:

At present the Euro 20 million remain unused in the Sri Lankan Treasury and are accruing interest (see Annexe for details). The original intention was to use the funds for their intended purpose of poverty alleviation by budgetisation in support of sectoral rural economic development but during the EC-Sri Lanka Working of 17 October 2002, it was agreed that in consultation with GoSL, these funds could be primarily used in favour of the Unified Assistance Scheme put in place by GoSL to fund the return of IDPs.

Objectives:

To prepare, with Treasury officials, rules, regulations and guidelines for procedures, internal controls, for the budgetisation of EC Food Aid Counterpart Funds within a predetermined period of time; monitor fund expenditure.

Expected Results:

Controlled and agreed expenditure of all the remaining Food Aid Counterpart Funds in sectors mutually agreed to by EC and GoSL.

Activities

Visiting TA together with EC Delegation in Colombo to work with Treasury officials in preparing modalities acceptable to the EC Delegation for handling the Food Aid Counterpart Funds. Then to begin a programme of fund allocation and expenditure over a pre-determined period of time on agreed activities.

Implementation:

Preparation of detailed rules, guidelines, and regulations for procedures, internal controls agreed to by the EC Delegation and the Treasury. Selection of suitable sectors and agreed monitoring system.

Risks and Assumptions:

Agreement can be reached on fund management procedures, funds can be budgetised quickly enough and good monitoring systems established. By having a visiting TA together with EC Delegation personnel close supervision can be established and use of the funds closely monitored.
Performance/Outcome Indicators:

Detailed guidelines prepared and approved. Funds expended and monitoring procedures show funds spent on planned activities.

Indicative Timeframe:

Start in 2002 and lasting for two years maximum.

2.2 Peace process and post conflict related development activities:

Financial envelope: € 4 million

Components

EC assistance to Sri Lanka has until now been rather compartmentalised, with ECHO and Aid to Uprooted People funding relief and rehabilitation in the North and East, while traditional development co-operation and, more recently, economic co-operation, have been confined to the South and the capital.

The signature of the CFA and progress in the peace process now opens possibilities to extend the geographic coverage of current programmes into conflict affected areas and to explore closer linkages between relief, rehabilitation and development through consultation with implementing partners.

Some ongoing projects may be susceptible to extension into areas currently controlled by LTTE. The CARE dry zone project is an example of this. Proposed RRM projects, notably the project to rehabilitate schools could be extended in the form of development projects to include rehabilitation of hospitals, other schools and other public buildings.

Justification

The prospects for successful progress in the peace process are considered sufficiently favourable to justify the setting aside of the sum indicated in order for the Commission to make prompt commitments to rehabilitation, reconstruction activities and with sufficient impact and visibility in the conflict affected areas.

With regard to political conditionality for the provision of extended assistance to the peace process, it should be noted that RRM funding for 2002 provides for assistance to the Peace Secretariat and the independent Human Rights Commission. Both of these projects focus to a greater or lesser degree on progress in the human rights field. It should also be remembered that the treatment of, and political arrangements for, minorities or regional minorities and the provision of political safeguards for them in a to be negotiated political framework in Sri Lanka will take up much of the negotiations between the partners to the ongoing peace talks GoSL and LTTE. It is to be assumed that a successful conclusion would provide an arrangement where there were no winners or losers.
Activities

To be finalised when the peace process is more advanced.

Risks and assumptions

* That the cease-fire continues
* That substantive peace talks between GoSL and LTTE take place and make progress.

3. OTHER CO-OPERATION INSTRUMENTS

3.1 ECHO

The 23 February 2002 cease-fire and the consequent easing of security restrictions, particularly in the north and east of the country has increased the trend of IDP return to areas of origin. Whilst the cease-fire holds and the peace process progresses these moments can be expected to continue and to expand. To facilitate this return ECHO will, in 2002, concentrate its activities on mine awareness, verification, mapping and demining training; provision of basic resettlement packages for families, including agricultural and fishing kits, distribution of seeds, provision of shelters, rehabilitation of agricultural infrastructure and construction and rehabilitation of water and sanitation facilities at community level; continued support of the ICRC cargo boat and patient services from Jaffna to Trincomalee will end in June 2002, given the reopening of the A9 road; health care provision through targeted assistance to hospitals. The ECHO envelope for 2002 Sri Lanka is € 8.3 million.

3.2 Rapid Reaction Mechanism

The current positive peace process environment in Sri Lanka provides an opportunity for the EC Rapid Reaction Mechanism to respond quickly to the needs of the country across a broad spectrum of activities. The envelope that can be foreseen for such a package of actions could be of the order of € 1.8 million for 2002. Activities that can be included are support to crisis management measures, post-conflict reconciliation, post-crisis reconstruction as a spearhead for long-term Community co-operation programme. Principal areas for intervention would be: reconciliation; reestablishment of the rule of law and civil administration, rehabilitation and reconstruction; high level economic reconstruction advisory mechanisms; demobilisation; disarmament; reintegration of fighters/military. A Decision covering the 2002 activities was signed in September and contracts for the four activities are being finalised.

RRM activities in Sri Lanka beyond 2002 will depend on the size of the future RRM budget and the rate of progress in the peace process.

For 2002 it is proposed that projects financed under this heading in Sri Lanka should address core actions aimed at confidence building and at assisting GoSL to implement requirements set out in the Cease Fire Agreement (CFA) of 22 February. Specific proposals are:
Refurbishment of schools and some public buildings vacated by either Party

Components:

The rehabilitation, including desks and chairs of schools, currently occupied by both sides.

Justification:

According to the CFA, “school buildings occupied by either party shall be vacated and returned to their intended use” while this “activity shall be completed by D-Day (the date of the Agreement) plus 160 at the latest”. All other public buildings were to be returned by D day plus 30. The re-opening of such schools would be a confidence boosting measure while it would also help people that are returning since the signature of the CFA to resettle. The vast majority of the schools in question are occupied by the SLA while the repair of public buildings, particularly town halls, would benefit the local authorities and give civilians a sense of normalcy.

Budget:

A Government estimate gives 132 schools occupied by the Sri Lankan Army and a figure for rehabilitation costs of 500,000 rupees per school. The mission proposes that 100 schools are selected in areas where people have returned for a total amount of € 1.0 million.

Support to the Human Rights Commission of Sri Lanka

Components:

Development of a series of dialogues on the issue of minority rights at different levels of society and in different parts of the country; production of a supportive media programme; programme of promotion of human rights and minority rights in the Eastern province.

Justification:

Much of the work of the Human Rights Commission relates to the violation of human rights arising out of the conditions created by the long-standing ethnic conflict in the country. The cease-fire and ongoing negotiations between the LTTE and the government have created space for an initiative around minority rights in the country. The conflict erupted as a result of the denial of minority rights. If the country is to evolve a sustainable and long-term peace then the human rights of all minorities, ethnic and other, would need to be respected, promoted and realised. A climate of inclusiveness would need to be created that would facilitate the participation of all groups in the processes decision-making and development in all parts of the country. A majoritarian approach to democracy by the majority community led to a denial of the rights of ethnic and political minorities and violent suppression of democratic protest and struggle. Equally, the minorities, in asserting their rights have tended towards exclusiveness and resorted to violent suppression of the rights of opponents and other ethnic groups.
**Budget:**

The budget for EC support to the programme is € 250,000, representing 100 % of total project cost.

**A Communications Programme to Support the Work of the Peace Secretariat**

**Components:**

The establishment of a communications team within the Peace Secretariat, the creation of a Peace Web-site and the development of an e-mail campaign, video and audio materials, a series of advertising campaigns, other marketing campaigns, a correspondence campaign and briefings, receptions and seminars.

**Justification:**

The critical importance of informing and educating the general public of the facts behind the peace process has been made clear both by key individuals within the GOSL and by the Norwegian Ambassador. Ordinary citizens are unaware of the full provisions of the CFA and know only about the obvious elements. A targeted campaign to the English speaking urban middle class, who have been identified as being the most critical of the process, is also a priority. Developing the capacity of the Peace Secretariat to run such a campaign would counter some very real threats to the process. At present, in the absence of a sustained public information strategy, hostile parties are filling the gap with misinformation.

Budget: The total cost of the project is € 210,000 for which we are proposing the RRM takes up the whole amount.

**Facilitating the movement of goods and civilians to and from the LTTE controlled areas.**

**Components:**

The rehabilitation of the electricity pylons up along the A9 to the GOSL checkpoint at Omanthai and beyond to the LTTE checkpoint of Puliyankulam.

**Justification:**

Freedom of movement is a key provision of the CFA. The checkpoints are currently only operational during daytime and not on Sunday. This is impeding the smooth flow of goods and people back and forth across the cease-fire lines. Powering these two checkpoints as well as villages along the A9 would allow the check points to remain open 24 hours a day while some villagers in the LTTE controlled Vanni, who have been deprived of electricity because of the fighting, would also benefit. Apart from easing the flow of traffic, the rehabilitation of the power lines would also create linkages between the North and South, as the power would come from the National
Ceylon Electricity Board. The LTTE political wing has also indicated their support for this idea and their willingness to keep all of their checkpoints open permanently and accept electricity from the GOSL.

**Risks:**

It is unclear at this stage if the SLA will accept the round the clock opening of checkpoints. To be consistent, all the checkpoints on the other side of the LTTE controlled areas, i.e. the Jaffna peninsula, should also be powered and kept opened while the implementation arrangements have also not yet been finalised.

**Budget:** € 340,000.

**Peace process**

A feature of the RRM budget is that it can act as a precursor for larger projects and EC will therefore maintain a reserve of € ± 4 million in the NIP to programme more extensive rehabilitation and reconstruction programmes, possibly as a direct follow-up to the above RRM activities.

### 3.3 Aid to Uprooted People – B7-3020

Following on from commitments in 2001 worth € 3.35 million for projects through UNHCR (€ 1.95 million) and CARE (€ 1.4 million) the Commission is preparing a project for implementation in 2002 through the NGO Action Contre la Faim (ACF) with a value of € 2.7 million. This 2 year project will assist IDPs in the East of the country.

Programming for 2003 and 2004 is for € 4.5 million each year for Sri Lanka. The hypothesis behind this increased funding level is that the cease-fire will hold and that larger scale resettlement and reintegration activities will then be possible.

### 3.4 Rehabilitation Budget line – B7-703

A proposal has been made by RELEX to AIDCO that the € 4 million available on this budget line for 2002 should be allocated to Sri Lanka for rehabilitation actions related to the peace process: demining surveys € 1 million; further rehabilitation to the Batticaloa railway €1-2 million; and extension of Aid to Uprooted People programmes € 1-2 million.

### 3.5 On Promotion of Democracy and Human Rights – B7-702

The Commission is engaged in finalising a project to increase the constructive participation of civil society in the peace process. This project with a value of € 0.5 million will be implemented through the Sri Lankan NGO National Peace Council and will last for three years. A second set of calls for proposals has been published in 2002 for projects on this budget line and will enable other NGOs in Sri Lanka to seek funding for their activities.
The civil conflict in Sri Lanka has, in particular, caused Tamils from the North and East to seek asylum elsewhere. Almost 90% of all migrants from Sri Lanka are Tamils.

The mostly male asylum seekers claim that, as Tamils, they are at risk of persecution in Sri Lanka from the authorities, or claim that they cannot stay in the North or East of the country as they risk being forcibly recruited by the LTTE.

The EU and Sri Lanka have started a dialogue on how best to address the asylum and migration issues and related activities using the Action Plan on migration adopted by the Council in October 1999 as an important source. Meetings on the issue took place between the partners in May 2002. The approach needs to be a comprehensive one in which targeted socio-economic assistance, development policy can be combined with measures in the area of freedom, security and justice. Two projects financed by the Commission are expected to be implemented in 2002. These are € 1.3 million to IOM for a project aimed at capacity building in migration management and preparatory actions to facilitate return and reintegration; and € 0.8 million to ICMPD for the establishment of field based country of origin information systems. Sri Lanka and the EU agree that the fight against illegal migration, in particular by preventing and combating trafficking in human beings and the return, in an orderly manner, of illegal migrants – for which the signing of EC-Sri Lanka Readmission Agreement will be an important step – is among the priorities for co-operation.

After nearly twenty years of conflict, much of it with relatively static front lines, Sri Lanka has serious problem with land mines, particularly in the Jaffna peninsular and Vanni.

Sri Lanka has not signed or ratified the Ottawa Convention on land mines although PM Wickremesinghe has indicated that Sri Lanka will sign the Convention before December 2002.

US funded demining activities have now begun in the Jaffna peninsular, allowing IDPs to return to their home villages. ECHO’s programming for 2002 includes financing for mine mapping and verification through specialised NGOs and for UNICEF’s mine awareness programme in both Jaffna and the Vanni.

Firm progress towards peace could override the EU’s principled position on the Ottawa Convention, with support for humanitarian needs provision and meeting rehabilitation priorities for IDP returns being prime means for donors to assist in driving the peace process forward through concrete demonstrations of peace dividends to inhabitants on both sides of the conflict zones.

Lack of adequate rains, particularly in the dry zone areas of Southern Sri Lanka, first identified by an ECHO mission in September 2001, had led to decreased harvests,
lowered water tables and lack of adequate locally available drinking water. Official health indicators do not show that. The lack of water resources has caused health or nutritional problems. However, ECHO during a subsequent 2002 programming mission, considered that its intervention should focus on the consequences of the conflict. The major portion of a € 3.8 million decision approved during Summer 2002 aims at improving the food security needs of IDPs and particularly returnees. The water situation in Sri Lanka is nevertheless precarious, as is shown from the daily power cuts in Colombo. If annual rainfall continues to be insufficient to reduce the rate of depletion of water resources, and to meet the public and agricultural needs of parts of the country, then recourse to provision of localised food security/food aid inputs may become necessary during the period under reference.

3.9 Discussions on the use of the remaining Food Aid Counterpart Funds

Unused funds from completed projects, amounting to around €20 million in rupee equivalent are awaiting disbursement from the Sri Lankan Treasury, preferably in support of the Unified Assistance Scheme as discussed during the EC-Sri Lanka Working Group on 17 October 2002. Given the nature of these funds, it may be appropriate that EC provides “light” technical assistance to oversee their disbursement. See annexe for details.

Annex 1

A proposal for the use of Food Aid Counterpart Funds in Sri- Lanka.

In order to ensure an adequate use of existing CPF originating from past Food Aid to Sri-Lanka a Memorandum of Understanding should be prepared for the signature of the EC and GoSL. The level of this signature is to be decided.

The memorandum should propose the budgetisation of all CPF originated from past food aid operations, to be spent over a limited period of time.

The memorandum should define clearly amounts, tranches and conditions for the disbursement of CPF. Provided that there are sufficient elements of trust for budgetary management in Sri-Lanka, CPF should be spent respecting local procedures.

The initial intention had been that the Food Aid CPF should be budgetised in favour of general agricultural programmes. However, at the EC-Sri Lanka Working Group on 17 October 2002 it was decided that the funds would be used in favour of the Unified Assistance Scheme in order to fund the return of IDPs.

The memorandum of understanding should be prepared in close coordination with the Food Aid responsible units. The EC Delegation should be providing an opinion on the quality of public finances and adequacy of government’s agricultural policy.

The memorandum should be providing as well an indication on the needs for monitoring. A light temporary Technical Assistance coupled with follow up from the EC Delegation could be sufficient.