Sri Lanka was one of the first developing nations to understand the importance of investing in human resources and promoting gender equality. It made advances in health and education on par with those of high-income countries and has maintained healthy economic growth despite a devastating 20-year civil conflict. However, the Asian tsunami of December 2004, which destroyed much of the country’s coastline, has threatened some of these advances, and Sri Lankans now must balance the difficult task of rebuilding their country but without its vulnerabilities and poverty. (For more on the tsunami and its impact on Sri Lanka, see Box 1)

In 1970, 48 out of every 1,000 infants died at birth. By 2000, that number had been reduced to 16. Over this same period, average life expectancy at birth climbed from 67 to 74 years. Between 1980 and 2003, fertility rates declined from 3.5 to 2.0 births per woman. Primary school completion rates are at 100 percent, and Sri Lanka’s literacy rates are on par with the more developed countries of the world.

In the late 1970s, Sri Lanka began the transformation from an inward-looking socialist system to a market economy based on liberalized trade, foreign exchange and investment. Gross domestic product (GDP) has been growing at around 5 percent annually for over two decades even during the conflict years. In 2001, Sri Lanka experienced negative growth for the first time since independence, though growth resumed the following year. The economy is currently growing at an annual rate of 5.9 percent and per capita GDP is currently estimated at US$1,030.

CURRENT CHALLENGES

In Sri Lanka, social exclusion, driven by ethnicity, language, religion, and conflict, has been deeply ingrained for decades, resulting in reduced opportunities and extreme tensions among different groups. More than 64,000 lives were lost, and an estimated 800,000 people were displaced in the conflict between the Liberation Tigers of Tamil Eelam (LTTE), and the Government of Sri Lanka. Reducing these social
and economic disparities will be critical to rebuilding trust and moving towards peace. At the same time, new economic benefits, equitably distributed throughout the country, will be essential for maintaining the level of social and political stability needed for lasting peace.

A cease-fire agreement was signed in February 2002 between the Government of Sri Lanka and the LTTE, putting a temporary end to hostilities and opening the way for peace negotiations and hopefully for a durable peace. Although peace talks have been stalled since April 2003, the cease-fire has been holding for the third consecutive year—the longest period without open hostilities since the outbreak of conflict in 1983.

Moreover, Sri Lanka has undergone two general elections in a period of four years. The last election led to a change in government leadership and a shift in the policy stance in certain reform areas, including privatization. The current government does not have a majority in the Parliament.

In 2004, real GDP grew by 5.4 percent, reflecting the economy’s resilience to adverse shocks—i.e., the surge in international oil prices, the severe drought followed by floods, and the tsunami. This expansion was largely driven by the strong performance in exports, consumption and investment, and the resurgence of economic activities benefiting from the continuation of the cease-fire. Economic activity in 2005 has been affected by the tsunami that devastated over two-thirds of the country’s coastal belt, seriously affecting fishing, hotel and restaurant sub-sectors, and dampening the growth prospects of banking, small industry, domestic trade and transport sub-sectors. Nevertheless, industry and services are growing and the agriculture sector has rebounded, thanks to improved weather conditions.

**Box 1: The Asian tsunami in Sri Lanka and the World Bank’s response**

The tsunami caused widespread devastation along Sri Lanka’s eastern, southern and western coasts, damaging about 87,000 houses and affecting about a million people, out of a total population of approximately 19 million. An estimated 31,000 people were killed, about another 4,000 remain missing, and around 418,000 people remain displaced by the disaster. Of those killed, 27,000 belonged to fishing families. Around 65 percent of the country’s fishing fleet—29,700 boats—has been completely destroyed or damaged. Although the tsunami struck indiscriminately, the worst hit inhabitants included poor coastal fishermen, people in conflict areas, and other vulnerable groups (e.g., the elderly, single parents).

The Asian Development Bank (ADB), the Japan Bank for International Cooperation (JBIC) and the World Bank conducted an early joint needs assessment which estimated recovery and reconstruction costs at approximately US$1.5 billion. The Government’s Reconstruction Strategy recently estimated the total reconstruction costs to be US$2.2 billion. This strategy takes into account all costs such as welfare, land acquisition, and ongoing relief which the initial joint needs assessment excluded.

The World Bank has stressed that post-tsunami reconstruction efforts not detract from the poverty reduction agenda for the country as a whole.

The assessment, prepared in close cooperation with the Government of Sri Lanka, sets out clear guiding principles (see below) for the reconstruction strategy, with a clear emphasis on the inclusion of affected communities in the planning and implementation of the rebuilding process. It estimates the overall damage/losses at US$1 billion (about 4.4 percent of GDP) with a large proportion of losses concentrated in housing, tourism, fisheries and transportation. The guiding principles for reconstruction state that:

- The allocation of resources both domestic and international should be strictly guided by the identified needs and local priorities, without discrimination on the basis of political, religious, ethnic or gender considerations.
- Reconstruction activities are carried out by the appropriate level of government, with an emphasis on decentralization where feasible;
- Communities are empowered to make their own decisions during recovery;
- Communication and transparency are present in decision-making and implementation;
- Reconstruction avoids rebuilding existing vulnerability to natural hazards; and
- A coordinated approach is used to prevent duplication in activities.

To translate these principles into reality, the assessment team recommends active public consultations, along with a communications program, and development of district-based reconstruction plans for the affected areas.

The World Bank moved quickly following the tsunami, and in February 2005 announced a total of US$150 million in financial support for tsunami-related reconstruction and recovery. A new emergency credit/grant of US$75 million supplements the US$75 million made available as an immediate response to the tragedy. The emergency projects will finance housing, roads, water supply and other infrastructure. It will also support livelihood and capacity building for implementation. (For more information visit [http://www.worldbank.org/tsunami](http://www.worldbank.org/tsunami))
Besides the toll of the civil conflict, Sri Lanka's lagging progress can in part be explained by a gradual weakening of public institutions and governance since the early 1970s and by the country's heavy dependence on the public sector for the creation of jobs. Despite relatively healthy economic growth, recently released estimates show that poverty, although declining slightly since the early 1990s, still affects nearly one in four Sri Lankans.

Ninety percent of Sri Lanka's poor live in rural areas, where access to basic services is limited. Among the poorest households, only 38 percent have electricity, 55 percent sanitation, and 61 percent access to safe drinking water. These conditions discourage economic growth in poorer areas and exacerbate inequality within the country.

The Government's efforts to fight poverty on a grand scale are frustrated by a number of factors, including design and implementation troubles. Meanwhile, large and ineffective government institutions, and poor physical infrastructure hamper private sector activity - crucial for boosting growth and employment.

While health and education services are widely available, the quality remains inadequate in many places. The school repetition rate is high, while availability of teachers and modern learning materials in remote areas is low. Health services will also need to adapt to meet new challenges posed by an aging population, as well as to meet emerging threats like HIV/AIDS.

The United People's Freedom Alliance, which took office in April, released its draft Framework for Economic Growth and Poverty Reduction in May, 2005. This new strategy aims at accelerating economic growth and is premised on pro-poor, pro-growth,

**Box 2: Results: Helping Communities Improve their Quality of Life**

**Re-establishing Communities in Conflict-Affected Areas**

Agricultural communities in Sri Lanka's North and East were traditionally among the most productive in the country. However, during 20 years of civil conflict, a large number of families fled their lands, and social and physical infrastructure has fallen into a state of disrepair.

The World Bank-financed North East Irrigated Agriculture Project (NEIAP)—and the follow-on operation, NEIAP II, approved in June 2004—is helping to rebuild village organizations, rehabilitate infrastructure, and provide employment opportunities while transferring organizational, managerial, and technical skills to local communities.

The project has helped rehabilitate 86 small irrigation schemes, enabled farmers to recommence agriculture, and increased the land area farmed with assured water supply in 5,400 hectares of land.

It has supported rebuilding and repair of 275 km of roads and provided over 200 wells for drinking water. Local labor is being used for repairs and public works, creating jobs and supporting livelihoods.

132 village community centers have also been constructed and more than 6,500 women have been given small-scale, repayable funds to start up income-generating activities.

Around 35,000 families have benefited from the project activities so far.

NEIAP is a partnership between the Government, World Bank, UN High Commission for Refugees, International Committee for the Red Cross, NGOs, and local community-based organizations.

**Revitalizing Rural Communities**

The Community Development and Livelihood Improvement ‘Gemi Diriya’ Project is enabling local communities to lead the design and implementation of rural development programs.

Under the Mahaweli Restructuring and Rehabilitation Project, the Village Self-Help Learning Initiative pilot project in the Polonnaruwa district in the North-Central province, has helped rural communities develop their own village development plans. The local communities have also set up village level organizations for implementation and management of programs such as water supply and irrigation.

This pilot has demonstrated the effectiveness of community participation and its empowerment as essential principles for development. Learning from this experiment, a full-scale Community Development and Livelihood Improvement ‘Gemi Diriya’ Project loan (2004, US$ 51 million) focuses on expanding the participatory approach to other communities, so as to enable them to take the lead and implement development initiatives such as rural infrastructure, and income-generating activities. The initial focus will be on the poorest communities in the South.
income improvement and redistribution policies with joint participation of the private and the public sector.

THE WORLD BANK IN SRI LANKA

The World Bank's assistance is aimed at helping Sri Lanka reach its development goals and provides financing and technical help for both economic and human development.

In April 2003, the World Bank produced a new Country Assistance Strategy for Sri Lanka, outlining a program that includes US$800 million of assistance, to be provided in the form of grants and interest-free loans (known as credits) from the World Bank's International Development Association (IDA), over a four-year period.

The strategy is built around three pillars of peace, growth, and equity. With regards to peace, the World Bank is working to support resettlement and revival of livelihoods in the conflict-affected North and East of the country, through restoration of health services, irrigation, and water supply, as well as monetary support to displaced people who are returning home.

In order to support growth, the World Bank is supporting efforts to create an environment conducive to improved private sector functioning, including improvements in the financial sector, utilities, infrastructure, and regulatory capacity.

To support equity in development, the World Bank augments Sri Lanka's efforts to improve access to and quality of public services in education, health, electricity, water supply, and sanitation, as well as focusing on empowering communities to address their own development needs. The Bank's support places great importance on balanced development of the island, with interventions explicitly targeting poor areas in the North, East and the South. These efforts will help Sri Lanka make progress towards meeting its own development objectives and also the Millennium Development Goals (MDGs) - i.e. development objectives that have been endorsed by nearly 150 heads of state at the United Nations' Millennium Summit in September 2000.

CURRENT LENDING

Since joining the World Bank in 1950, Sri Lanka has received 108 development loans, credits, and grants totaling more than US$3 billion. Most assistance has been provided in the form of interest-free loans through IDA. In fiscal year 2005, the World Bank approved US$173 million in credits and US$30 million in grants for three operations—(i) E-Sri Lanka: ICT for Development; (ii) North East Housing Reconstruction; and (iii) Tsunami Emergency Reconstruction Project (TERP) Phase II. Additionally, ten ongoing projects (six credits and four grants) were restructured in February 2005, to provide financing for TERP Phase I.