



Investing in rural people

## Sri Lanka

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### Country strategy note 2023-2024

Main report and appendices

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## Currency equivalents

Currency Unit	=	Sri Lankan Rupees (LKR)
US\$1.0	=	LKR 368

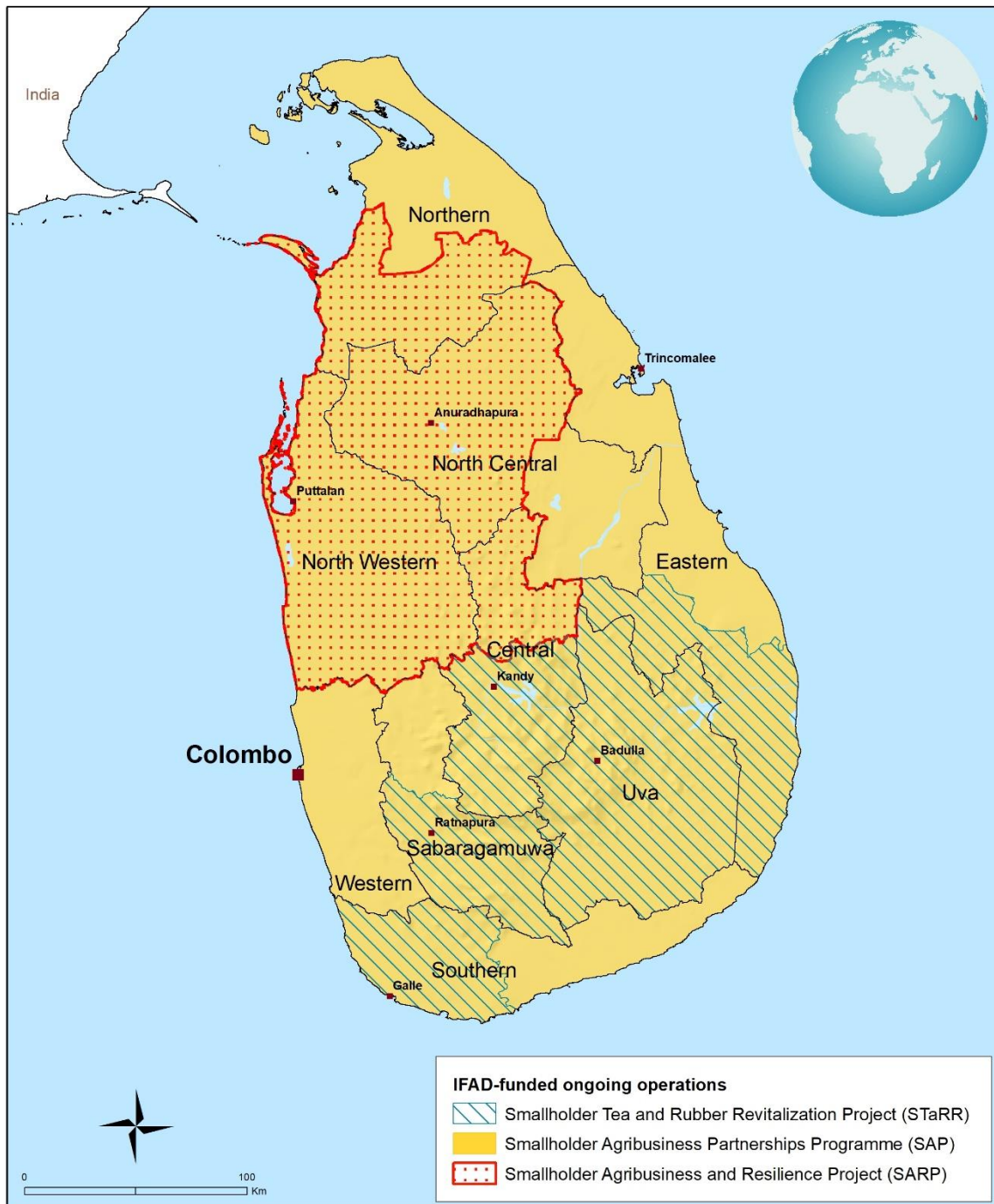
## Weights and measures

1 kilogram	=	1000 g
1 000 kg	=	2.204 lb.
1 kilometre (km)	=	0.62 mile
1 metre	=	1.09 yards
1 square metre	=	10.76 square feet
1 acre	=	0.405 hectare
1 hectare	=	2.47 acres

## Abbreviations and acronyms

4P	Public-private-producer partnerships (IFAD)
CO <sub>2</sub>	Carbon dioxide
COSOP	Country Strategic Opportunities Programme (IFAD)
CPI	Corruption Perception Index
GDI	Gender Development Index
GDP	Gross Domestic Product
GII	Gender Inequality Index
GNI	Gross National Income
IFAD	International Fund for Agriculture Development
IMF	International Monetary Fund
LPA	Lead Project Agency
NDC	Nationally Determined Contribution
NGO	Non-governmental organization
PBAS	Performance Based Allocation System (IFAD)
PPP	Purchasing Power Parity
SAP	Smallholder Agribusiness Partnerships Programme (IFAD)
SARP	Smallholder Agribusiness Resilience Project (IFAD)
SO	Strategic Objective (IFAD)
STaRR	Smallholder Tea and Rubber Revitalization Project (IFAD)
UN	United Nations
UNDP	United Nations Development Programme

## Map of IFAD-funded operations in the country



The designations employed and the presentation of the material in this map do not imply the expression of any opinion whatsoever on the part of IFAD concerning the delimitation of the frontiers or boundaries, or the authorities thereof.

Map compiled by IFAD | 30-06-2022





## I. Country diagnosis

### Economy

1. Since 2019, Sri Lanka has been facing its worst economic crisis in over 70 years. By 2022 this had triggered a deep political crisis with widespread protests starting in March 2022 and the resignation of the President and Prime Minister amid unprecedented inflation, widespread blackouts and shortages of food, fuel and medical supplies. A new president was appointed in July 2022 but the situation remains volatile despite the formation of another unity government. There is a very high risk that parliamentary and presidential elections could be brought forward to 2023, particularly if the economic situation fails to improve in the coming months.<sup>1</sup>
2. The crisis is having a negative impact on growth and poverty. The country declared its first ever sovereign debt default in April 2022 and was cut-off from international financial markets and faces an unsustainable debt and severe balance of payments crisis. Year-on-year inflation reached an unprecedented 64.3 percent in August 2022, due largely to high food inflation of 93.7 percent<sup>2</sup>.
3. Gross National Income per capita reached a high of US\$4040 in 2018 before stalling prior to the COVID-19 pandemic<sup>3</sup>. The Easter Sunday Attacks contributed to GDP growth slowing to 2.3 percent in 2019, the lowest in two decades. The economy contracted by 4.0 percent in 2020, grew by 3.0 percent in 2021 and is expected to fall by 9.2 percent in 2022 and a further 4.2 percent in 2023<sup>2</sup>.
4. Prior to COVID-19, structural reforms to shift the growth model towards wider private sector participation, export-orientation, and integration into global value chains progressed slowly and, in addition, frequent macroeconomic shocks disrupted economic activity. COVID-19 manifested a new economic shock with unparalleled economic consequences that magnified pre-existing economic weaknesses largely driven by previous policy decisions.<sup>4</sup> The subsequent collapse of the economy has further broadened and deepened these impacts. Unprecedentedly high inflation has adversely affected real incomes, food security and living standards. Limited fiscal space is a severe constraint to an effective public response.<sup>2</sup>
5. Sri Lanka reached a Staff Level Agreement with the International Monetary Fund (IMF) in September 2022 for about US\$ 2.9 billion, which requires IMF board approval before actual support can begin. However, IMF Board approval would require financing assurances from official creditors, good progress on a collaborative agreement with private creditors, and the completion of prior actions.
6. **Poverty** is projected to have *doubled* in 2022 to around 25.6% of the population. A further 11.3% are vulnerable, living within 20% of the poverty line. The dramatic increase in poverty is widespread across different socio-economic groups and across rural, urban and estate areas of the country. Yet the crisis has not fundamentally changed the spatial and demographic profile of the poor, 80 percent of the poor live in rural areas with a further 10 percent in estate areas. Poorest households have been hardest hit by the crisis due to the unprecedented inflation in costs of essential food, energy, fertilizer and medicines combined with loss of income and remittances. The poorest 20% of households are estimated to have seen consumption drop by around 30% since 2019.
7. Before the COVID-19 pandemic, the poverty rate at \$3.65 per day (in 2011 purchasing power parity) had declined to 11.3 percent in 2019. The sharp economic slowdown due to the pandemic had already increased the poverty rate to 13.1 percent in 2021, all but reversing gains since 2016. In 2022, poverty is expected to have increased further due to the deepening crisis.
8. **Policy** has been fluid in recent years. The change of president and government in the elections of 2019 and 2020, respectively, led to a shift in policy. The political crisis in 2022 led to the resignation of the President and Prime Minister and a policy hiatus as the government struggled to deal with the economic crisis. The government's short-lived policy to ban imports and use of chemical fertilizer and pesticides introduced in 2019 and reversed in 2020 led to widespread falls in production and rural

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<sup>1</sup> Economist Intelligence Unit, Sri Lanka Country Report – 3<sup>rd</sup> Quarter 2022

<sup>2</sup> World Bank, Sri Lanka Development Update October 2022

<sup>3</sup> DataBank, World Bank

<sup>4</sup> World Bank Development Update, 2021

livelihoods and negative impacts on agricultural trade. Rice production is reported to have fallen by around 20% in the first 6 months after the ban moving the country from being largely self-sufficient in rice, with imports of only around 25,000 tonnes in 2019, to being heavily dependent on rice imports which jumped to over 220,000 tonnes in 2021 (comtrade.un.org). Tea, Sri Lanka's largest export earner, has also been badly affected, with a year on year drop in production of 20% in the first half of 2022 according to the Sri Lanka Tea Board. This is primarily attributed to the ban on chemical fertilizers and the subsequent rise in fertilizer prices leading to large numbers of tea producers stopping using chemical fertilizers, and the production and quality of raw tea leaves then having decreased.

9. **Gender** Sri Lanka provides a mixed picture on gender equality and empowerment. It was ranked 73<sup>rd</sup> in the gender development index (GDI) of the UNDP Human Development Report 2021/22 – with a score of 0.949 – indicating that women achieve almost 95% of the Human Development Index score achieved by men in Sri Lanka. In terms of GDI, this places Sri Lanka closer to the regional average for Europe and Central Asia (0.961) than to South Asia (0.852). There are significant achievements in health and education for women, with women's life expectancy of 79.5 years compared to 73.1 years for men. Expected years in schooling are higher for women at 14.5 years compared to men of 13.8 years. Yet there remain significant inequalities in political and economic engagement. The UNDP Gender Inequality Index for 2021/22, also ranks Sri Lanka 73<sup>rd</sup> but with a score of just 0.383. GII measures inequality between women and men in three dimensions: reproductive health, empowerment (political participation and education), and labour market participation. Women's labour force participation rate of just 30.9% is less than half that of men (68.5%) and women hold only 5.4% of seats in parliament. Consequently, women's estimated Gross National Income per capita of US\$7,005 (2017 PPP \$) is just over a third of men's (US\$18,573). (UNDP, 2022)

10. In agriculture, there are large gender disparities in access to and control over resources (e.g. land, water and inputs), access to markets and access to skills training. Sri Lanka's constitution is non-discriminatory regarding land ownership. Yet only 16 percent of all privately owned land in the country belongs to women due to gender biases in Sri Lanka's Land Development Ordinance and other customary laws. Lack of land ownership limits women's ability to obtain agricultural assets, services and benefits (e.g. subsidies, credit and irrigation water). (FAO, 2018)

11. **Youth** of 15-29 years represent almost of quarter of the population (23.2%) and almost half the population is under 30. While Sri Lanka's youth are generally well educated, they face major challenges in translating this education into suitable employment and livelihoods. Youth unemployment has been a persistent problem and was high before the COVID-19 pandemic and has increased sharply since. Youth unemployment declined from highs of 24%-28% in the early 2000's to a low of 16.9% in 2011. It had risen steadily to 21.3% in 2019 and 23.8% in December 2021 (vs 4.6% for the population overall) – before the full economic crisis hit. Limited economic opportunities are a major source of discontent among youth.

12. **Climate and environment:** In September 2021, Sri Lanka submitted an Updated Nationally Determined Contribution which brings forward when it expects to achieve carbon neutrality to 2050 (previously 2060). The Updated NDC notes, "Sri Lanka is ranked among the countries that are most vulnerable to climate change-induced hazards. Being a tropical island in the Indian Ocean, Sri Lanka has consistently been placed among the top ten countries at risk of extreme weather events by the Global Climate Risk Index. Sectors that contribute significantly to Sri Lanka's economy tourism, fisheries, tea plantations and agriculture are climate-sensitive and impacted by the disruption of monsoons and altered rainfall." It highlights key vulnerabilities in the agriculture and water resources sectors, as well as significant risks to human health and in coastal zones. Climate change projections predict long-term changes to the monsoon pattern and shifting of ecological regions. (Ministry of Environment, 2021)

13. Sri Lanka is a low carbon emitting country with per capita emissions of around 1.02 tonnes/per person, and its development pathway has remained low-carbon-intensive. A recent analysis of the interplay between per capita emissions and human development picks out Sri Lanka as a rare

example of a country that has achieved both high human development and managed to keep CO2 emissions well below the long-term average needed to contain global warming targets of the Paris Agreement.” The country’s focus is on “building the resilience of Agriculture, Fisheries, Livestock, Health, Water, Biodiversity, Coastal and Marine, Tourism, Urban Planning and Human Settlement sectors.” Despite this low carbon footprint and highly vulnerable status, Sri Lanka has committed to “increase 32% forest cover by 2030 and reduce greenhouse gas emissions by 14.5% for the period of 2021-2030 from Power (electricity generation), Transport, Industry, Waste, Forestry, and Agriculture.”

14. The Government of Sri Lanka (GoSL) has expressed strong interest to IFAD to access climate financing for developing climate change sensitive and environment protection programmes. In the upcoming investments, IFAD will explore the possibilities to support GoSL leverage climate financing and for explicitly targeting a more climate and biodiversity focused programming to align with the priorities of the GoSL to tackle issues, such as, soil and land degradation, loss of forest cover, and greenhouse gas (GHG) emissions. Existing projects, such as STaRR, has already demonstrated good practices for GHG mitigation and protection of biodiversity. This CSN recommends exploring options for scale up of these practices in upcoming investments.

15. **Nutrition:** Before the economic crisis and the pandemic, malnutrition rates across Sri Lanka were already high. Before the COVID-19 pandemic, Sri Lankan women and children suffered far higher rates of malnutrition than most other middle-income countries with 17 percent of children aged under 5 too short because of stunting. Anemia also remains a major concern. The current economic crisis will likely aggravate this further.

16. Food price inflation year-on-year reached and unprecedented 93.7% in August 2022. Combined with loss of income and reduced production – due to a combination of inflated fertilizer costs as well as earlier disruption from the short-lived ban on chemical fertilizers – the impacts on nutrition are severe and widespread. It is estimated that more than 6 million people – nearly 30 percent of the population – are currently food-insecure and require humanitarian assistance. An estimated 500,000 people were pushed into poverty due to the pandemic. The economic crisis will push many more families into hunger and poverty – some for the first time. (World Food Programme, 2022)

## II. Rationale and time frame

17. IFAD has supported a total of 19 projects in Sri Lanka since 1978, with financing commitments of US\$340.5 million and a total value of about US\$650 million impacting around 650,000 households. These investments have been to support government policies to achieve food security, ensure higher and sustainable incomes for farmers, improve production and productivity, and sustainably manage the environment. Three projects are currently ongoing: Smallholder Tea and Rubber Revitalization Project (STaRR) 2016 -2023 (\$65.4 million); Smallholder Agribusiness Partnerships Programme (SAPP) 2018 – 2023 (\$105.0 million); Smallholder Agribusiness and Resilience Project (SARP) 2020 – 2025 (\$82.1 million).

18. IFAD’s strategy in Sri Lanka has evolved over time, in keeping with the country’s rapid economic development and rise from its status as a low-income country in 2004 to upper middle income status in 2019, before falling back to lower-middle income in 2020. Most recently the strategy has focused on promoting deep involvement of the private sector, and of small and medium-sized industries related to the agriculture, fisheries, livestock and plantation sectors in support of inclusive rural economic growth.

19. IFAD’s comparative advantage in Sri Lanka is, firstly, its experience in expanding decent economic opportunities for rural communities, especially linking smallholders to buyers via public-private-producer partnerships (4Ps) and joint ownership models. Secondly IFAD projects have extensive experience of delivering such investments in relatively remote and poor areas. These remain highly relevant in the current economic crisis as 80% of the poor live in rural areas and the poorest households have been hardest hit by the crisis.

20. This Country Strategy Note defines IFAD’s strategic engagement in Sri Lanka for the period of 2023 to 2024 and has been prepared instead of a full COSOP due to the current fluid situation in the country and that there is currently no PBAS allocation for the coming period.

### III. Strategic objectives

21. Reflecting the evolving short- and longer-term development challenges facing the rural poor, the strategic objectives are:

22. **SO1: Rural communities gain greater resilience to shocks and longer-term changes in the climate and economy as they recover from the current economic crisis.** This objective is intended to directly contribute accelerating the recovery and increasing the resilience of poor rural household livelihoods and the capacity of individuals and their communities to adapt and recover from shocks. This requires that ongoing projects take recovery and resilience considerations as central elements in adapting planned investments to the evolving economic situation and expected climate scenarios.

23. **SO2: Smallholders benefit from sustainable productivity enhancement in more resilient livelihood systems which are effectively connected to markets.**

This objective is intended to contribute directly to addressing the causes of rural poverty that relate to inefficient factors of production, low productivity due to degradation of natural resources (mainly land), adoption of harmful agricultural technologies, and lack of off-farm opportunities. To translate this into inclusive economic growth, the objective also entails further scaling up experiences from IFAD's ongoing projects in value chain development linked to urban consumers, enhancing market connectivity through effective private and public-sector partnerships, and mobilizing innovative financial products.

24. **Target groups** include: (i) smallholder producers and their organizations in domestic crop, livestock and other product value chains and plantation crops; (ii) landless labourers, particularly in the plantation sector; (iii) rural youth; and (iv) women, especially woman-headed households.

25. In the short term (1-6 months), the objective of this CSN is to complete the two active projects and consolidate its results. In the medium-term (6-24 months), the objective is to disseminate projects' results, explore potential partnerships and write a COSOP for Sri Lanka for the new period. The possible inclusion of Sri Lanka in IFAD13 will allow new projects to be designed.

### IV. Planned IFAD engagement

26. The Strategic Objectives will be achieved through the three ongoing projects:

27. **Smallholder Tea and Rubber Revitalization Project (STaRR)** is an on-going project with completion extended to June 2023. The project supports improved production and replanting in the smallholder tea and rubber sectors and inclusive rural finance. Project activities are in eight neighbouring districts in Central and Southern Sri Lanka: Southern Province (Galle and Matara Districts), Sabaragamuwa Province (Ratnapura District), Uva Province (Badulla and Moneragala Districts), Central province (Kandy and Nuwara Eliya Districts), Eastern Province (Ampara District). The Lead Project Agency (LPA) is the Ministry of Plantation Industries. As part of the project closure, STaRR is planning to conduct a KM forum on project results in the tea and rubber sector and possible policy adoption.

28. **Smallholder Agribusiness Partnerships Programme (SAPP)** is an on-going project, with completion due in June 2023. It aims to contribute to Sri Lanka's smallholders' poverty reduction and competitiveness and targets poor rural households with the potential to become active economic players in a diverse array of value chains and under the framework of public-private-producer partnerships (4Ps) schemes. Project activities focus on (a) access to commercial partnerships, establishing 4Ps, institutional strengthening and capacity building of producer groups, access to rural finance, financing of 4Ps; and (b) institutional strengthening for the financial services sector. The LPA was the Presidential Secretariat, but the Ministry of Agriculture took it over in February 2020.

29. **Smallholder Agribusiness and Resilience Project (SARP)** is expected to run for six years from 2020. The goal is to contribute to smallholder poverty reduction and food security in the Dry Zone region building resilience and market participation of rural smallholder households in the project

area. SARP will focus on three river basins identified as most vulnerable ecologically and socially – the Malwathu Oya, Mi Oya and Deduru Oya. SARP targets the extreme rural poor, poor with potential to sell in local markets and more commercially oriented smallholder farmers. Activities focus on 1) capacity building for climate resilience and inclusive value chains and 2) climate sensitive investments for climate resilience and inclusive value chains including last mile infrastructure. The project will be executed by Presidential Secretariat and the various departments of the Ministry of Agriculture. The main project implementation activities will be undertaken at district levels with Technical Implementation Units in district hubs having executive and technical responsibility for implementation.

30. The IFAD country programme will continue to work with other development partners to support the government's emerging strategies and policies to manage the current crisis and subsequent recovery.

31. As the situation in Sri Lanka is gradually stabilizing, during the CSN period, the Sri Lanka country programme would actively look for cross-country knowledge exchange to ensure that best practices from other countries, such as, private sector engagement, are captured in Sri Lanka and vice versa. In addition, lessons learned from the policy work being undertaken under ongoing projects, such as, STaRR and SAPP, should be incorporated in future designs, either in the form of scaling up or introducing innovation in the portfolio.

32. The 2022 COSOP Completion Review highlighted the following lessons to be learned from previous engagements in Sri Lanka:

- a. IFAD-supported operations should aim at better "value for money" based on a more focused programme and a clear scaling-up pathway. For this, IFAD will invest more in analytical work, knowledge management and policy engagement at the country programme level and beyond the project-level, which may be supported through the investment projects, by more effective use of grants and/or working with other like-minded partners.
- b. Effective linkages between the country programmes and associated regional networks are key to deliver tangible benefits from effective south-south co-operation.
- c. **Increasing co-operation with other development partners active in the agribusiness sector in the country will increase productivity and gain competitive advantage.** Synergy created by partners through communication networks and systems, strategic and participative planning, and mutually beneficial alliances would result in scaling-up effective models.
- d. In addition, in order to increase the sustainability potential, the borrower has proposed to **utilize existing government structures** for project management, rather than setting up separate project management units. This proposal needs to be carefully considered during the next COSOP and project designs so that the best efficiency may be obtained without compromising the quality of project management.
- e. The borrower has also requested IFAD to explore the possibility of financing development projects that the government has already identified



## **Appendix 1: Social Environment and Climate Assessment Procedures Background Study**

*Attached.*

## Appendix 2: Integrated Country Risk Matrix (ICRM)

Risks	Rating (Inherent risk)	Mitigation measures
<b>Political / governance:</b> Political situation remains volatile despite the formation of another unity government with a very high risk that parliamentary and presidential elections could be brought forward to 2023, particularly if the economic situation fails to improve in the coming months.	Severe	IFAD to closely monitor the evolving situation and prepare contingency plans for projects.
<b>Macro economic:</b> Debt restructuring and fiscal support packages from IMF and others are not yet approved. Painful structural reforms are likely to also be a required part of any support package. There could be prolonged economic turmoil.	Severe	IFAD to closely monitor the evolving situation and prepare contingency plans for projects.
<b>Sector strategies and policies:</b> Sector strategy and policy environment remains highly uncertain given the volatile political situation. Extreme policy changes of the previous government, including ban on inorganic fertilizer and chemicals, created widespread problems and lasting damage to the sector. Painful reforms to investments in public goods and services are likely to be required part of government bail-out package.	Severe	IFAD to closely monitor the evolving situation and prepare contingency plans for projects.
<b>Institutional capacity:</b> Weak institutional capacity, especially in the areas of support services, social mobilization, building resilience to climate variability and facilitating market linkages amongst implementing partners and support service providers.	High	By projects: strengthen capacities through technical assistance, training, management tools; diversify and support service delivery, including through the private sector and specialized government entities support from NGOs and technical assistance to work with service provider organizations By IFAD: Constant dialogue and follow-up with lead project ministries to ensure the appointment of competent project management personnel and to minimize staff turnover; proactive implementation support from the country office and; integrating project management processes into project structures and seconding government staff.
<b>Portfolio:</b> All projects in the portfolio may be impacted by limited government funds or other disruptions to government operations. STaRR and SAP are mature projects nearing completion were considered not at risk in their 2021 supervisions. SARP has recently launched and is likely to be more vulnerable to disruption to government teams, budgets and policies.	Substantial	Focus on ongoing projects only. Closely monitor the evolving impacts on project operations with government counterparts and adjust strategies as required.
<b>Fiduciary:</b> Fiduciary management and process issues have negatively affected the efficiency of past projects. Sri Lanka is ranked in medium risk bracket with the score of CPI index of 38 and RSP rating 3.7.	Substantial	Ensure capable financial management teams and systems in all programmes, with necessary training and capacity building as required.



		To mitigate inherent country risks government authorities have taken a series of measures during the recent past. Among them, main reforms are: establishment of a National Procurement Commission; release of a comprehensive set of Public Procurement Guidelines covering all aspects of public procurements; widening the scope of the “Commission to Investigate Allegations of Bribery or Corruption” and; strengthening the Public Audit function by establishment of National Audit Commission to ensure independency of the Auditor General Department responsible for all public audits that include public procurement
<b>Environment:</b> The strategy may lead to the potential increase in unsustainable use of chemicals, medicines and inputs leading to contamination of local environments.	Substantial	Investment programmes and policies that promote good farming practices, including water use efficiency and limited use of chemical and other inputs e.g. through use of integrated pest management and net houses where appropriate to reduce pest and disease loads
<b>Climate:</b> Sri Lanka ranks among the countries most vulnerable to climate change with key vulnerabilities in agriculture and water resources. Climate events may cause significant negative impacts to affected communities.	High	Support: <ul style="list-style-type: none"> <li>• set up of system for climate smart information collection and</li> <li>• dissemination to provide climate change adaptation options</li> <li>• invest in climate smart technologies (solar pumps, irrigation, water harvesting);</li> <li>• training to increase smallholder and public-/private sector capacities to adapt to the effects of climate change.</li> </ul>
<b>Overall</b>	<b>Severe</b>	

## **Appendix 3: 2015-2022 COSOP Completion Review**

*Attached*