



CONGRESSIONAL NOTIFICATION TRANSMITTAL SHEET

We wish to notify you that the Millennium Challenge Corporation plans to negotiate a Millennium Challenge Compact with the Government of Sri Lanka.

If you or your staff would like to arrange a meeting to discuss the proposed negotiations with the Government of Sri Lanka, please contact Abigail Avery at averyat@mcc.gov or (202) 521-3880.

This notification is being sent to the Congress on August 13, 2018 and negotiations with the Government of Sri Lanka may be started on or after 15 days from the date of this notification.

In addition to the enclosed notification, we have included supplemental information regarding the planned compact.

Sincerely,

/s/

Karen Sessions
Vice President
Congressional and Public Affairs

Enclosure:

As stated

**MILLENNIUM CHALLENGE CORPORATION
CONGRESSIONAL NOTIFICATION**

August 13, 2018

Pursuant to section 515 of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 2006; the heading “Millennium Challenge Corporation (Including Transfer of Funds)” and section 7015(c) of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2010; the heading “Millennium Challenge Corporation (Including Transfer of Funds)” and section 7015(c) of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2010, as carried forward by the Full-Year Continuing Appropriations Act, 2011; the heading “Millennium Challenge Corporation” and section 7015(c) of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2012; the heading “Millennium Challenge Corporation” and section 7015(c) of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2014; the heading “Millennium Challenge Corporation” and section 7015(c) of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2015; the heading “Millennium Challenge Corporation” and section 7015(c) of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2016; the heading “Millennium Challenge Corporation” and section 7015(c) of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2017; and section 610(a) of the Millennium Challenge Act of 2003, as amended (the “Act”), this notification is to advise you that the Millennium Challenge Corporation (MCC) intends to commence negotiations with the Government of Sri Lanka for a Millennium Challenge Compact under section 605 of the Act.

The proposed Compact will seek to assist Sri Lanka in addressing two major constraints to economic growth: (1) inadequate transport logistics infrastructure and planning and (2) lack of access to land for agriculture, service sector, and industrial investors. It is planned that the Compact will address these constraints through two projects, the Transport Project and the Land Project.

Projected Economic Justification for the Compact

Transport Project: At the present stage, the estimated economic rate of return for the Transport Project is 19 percent over a period of 20 years. The project is expected to alleviate transport cost burdens on the profitability of a wide range of economic activity in a region of the country that has been and continues to be the locus of much of the economic growth that supported recent achievements in the reduction of poverty in Sri Lanka. Traffic congestion not only imposes direct costs on businesses, but as travel speeds decrease and trip times extend, market scope effectively shrinks; there are consequences for production at scale, just-in-time processing of goods, the management of inventories, and the sourcing of appropriate inputs and skills within the workforce. The Advanced Traffic Management System Activity and Bus Transport Service Modernization Activity are mutually supporting elements of a comprehensive strategy to manage congestion and to help safeguard continued economic growth in a rapidly urbanizing area that also is a principal logistics center for the rest of the country. The Central Ring Road Network Activity is expected to improve regional connectivity with markets and access to logistics facilities in the Western Province, boosting the rural economy and facilitating labor mobility. The beneficiary population

for the Advanced Traffic Management System Activity and Bus Transport Service Modernization Activity includes all residents of the Western Province. Assuming a provincial population growth rate of about 1.6 percent per year, there are expected to be 5,343,478 beneficiaries 20 years after Compact closeout. Estimates of beneficiaries for the Central Ring Road Network Activity are not yet available.

Land Project: The estimated economic rate of return for the Land Project is 30 percent over a period of 20 years. The primary benefits associated with the project come in the form of increased land values and decreased administrative and time costs associated with conducting land transactions. The Land Project will increase land values by improving tenure security through improved documentation of land rights and will ease the process of making land transactions through improved land information systems. The beneficiary pool includes individuals whose land plots will be affected by the projected activities in the Colombo-Trincomalee corridor and who will experience the gains from the project within the timeframe of the economic rate of return analysis. The number of beneficiaries at the end of the 20 year analytical period is thus an estimated 2.25 million households or 8.73 million individuals.

SUPPLEMENTAL INFORMATION – PROPOSED SRI LANKA COMPACT

Overview

The proposed Millennium Challenge Corporation (“MCC”) compact with the Government of Sri Lanka (the “Government”) seeks to assist the Government in addressing two major constraints to economic growth: inadequate transport logistics infrastructure and planning and lack of access to land for agriculture, service sector, and industrial investors. The proposed compact will address these constraints through two projects – a **Transport Project** and a **Land Project**.

Background and Context

In December 2015, MCC’s Board of Directors selected Sri Lanka to develop a threshold program. Sri Lanka failed to pass MCC’s policy indicators in fiscal year (FY) 2016. Sri Lanka’s performance on the indicators has steadily increased in parallel with the reforms undertaken by the Government since January 2015. In FY 2017, Sri Lanka passed more than half of the indicators including both democratic rights indicators: political rights and civil liberties and control of corruption. MCC’s Board of Directors selected Sri Lanka to develop a compact in December 2016.

With MCC’s assistance, the Government conducted a constraints-to-growth analysis in November 2016 identifying the following three binding constraints to economic growth: (1) policy uncertainty, especially regarding revenue collection and tax policy; (2) transport bottlenecks resulting in traffic congestion in the Western Province and the slow movement of people, goods and services between the Western Province and other regions; and (3) the difficulty of the private sector in accessing state-owned land for commercial purposes.

Sri Lanka has made impressive economic headway over the past few decades, but significant challenges remain. Economic growth dipped to 3.1 percent in 2017 from 4.4 percent in 2016, due mainly to droughts that badly affected agricultural output. GDP growth is expected to rebound to 4.5 percent in 2018. During the same period, the country made significant strides to reduce poverty. Excluding the Northern and Eastern Provinces (for which 2002/2003 data was not available), the poverty rate fell from 22.7 percent in 2003 to 6.1 percent in 2014. The national poverty rate, including the Northern and Eastern Provinces, fell further to 4.1 percent in 2016.

Despite this encouraging reduction in poverty, living standards remain modest for most of the country and pockets of severe poverty persist. Around 40 percent of the population subsists on less than twice the poverty line, which was \$2.75 per capita per day in 2005 purchasing power parity terms. Living standards of the near-poor – those above the national poverty line but below the 40th percentile -- are similar to those of the poor. Significant pockets of poverty remain in the central region and former conflict areas in the north and east.

The current coalition government, elected in 2015 on a platform of political and economic reform, has developed an agenda to accelerate economic growth and continue to reduce poverty in Sri Lanka. The Government’s goal is to increase per capita income to \$5,000 per year by 2025,

increase foreign direct investment to \$5 billion per year from its current \$1 billion, and further reduce poverty. To help achieve these goals and advance compact development, the Government has established a project management unit to design and lead bus reform in the transportation sector and the Surveyor General's Department has begun digitizing land data as a first step to providing title registration.

Program Overview and Budget

The proposed compact aims to reduce poverty through economic growth in both the Western Province of Sri Lanka, which accounts for 42 percent of the country's GDP, and economically lagging and post-conflict regions with high rates of poverty.

In a country with a total population of 21 million people with approximately two million person-trips a day in the Colombo Metropolitan Region alone, traffic congestion is fast approaching a tipping point from which it will be difficult to recover if remedial action is postponed. The root causes of urban traffic congestion, which defy quick, easy solutions, are largely rising population growth, urbanization, the attractiveness of private transport, and sub-optimal public transport. Additionally, poor inter-regional transport infrastructure and services are diminishing prospects for economic expansion in other regions of the country. The Transport Project is designed to address the root causes of the transport problem in Sri Lanka.

In Sri Lanka, the process of acquiring rights to develop land is slow and unclear, resulting in unmet private sector demand for land that could be put to productive use, affecting the growth of manufacturing, agriculture, construction, residential and commercial development, and tourism, among other sectors. Restrictions on land parcel size, the absence of land titles, and longstanding laws affecting rural land use also reduce agricultural productivity and rural well-being. Existing laws disadvantage the property rights of women, further restricting the scope of women's participation in domestic investment. The Land Project is designed to increase the amount of publicly available land rights information, strengthen land rights and tenure security, and improve the regulatory environment so that investors can more easily acquire land. The project builds on the commitment the Government has made to improve access to land in the public and private sectors through a series of ongoing initiatives.

Below is a summary describing the components of the proposed compact with the Government. The budget and expected impacts are preliminary based on initial due diligence and project appraisal and are subject to change following compact negotiations. The anticipated budget for the proposed compact is up to \$480,000,000.

Table 1: Sri Lanka Compact Budget

Component	Total (in millions)
1. Transport Project	
1.1 Advanced Traffic Management System Activity	\$159.9
1.2 Bus Transport Service Modernization Activity	\$50.0
1.3 Central Ring Road Network Activity	\$140.10
Subtotal	\$350.0
2. Land Project	
2.1 Parcel Fabric Map and State Land Inventory Activity	\$23.4
2.2 Deeds Registry Improvement Activity	\$11.4
2.3 Land Valuation System Improvement Activity	\$6.5
2.4 Land Grants Registration and Deed Conversion Activity	\$19.3
2.5 Land Policy and Legal Governance Improvement Activity	\$6.7
Subtotal	\$67.3
3. Monitoring and Evaluation	
3.1 Monitoring and Evaluation	\$12.7
Subtotal	\$12.7
4. Program Administration and Oversight	
4.1 Program Administration and Oversight	\$50.0
Subtotal	\$50.0
Total Program Budget	\$480.0

Proposed Projects

The **Transport Project** aims to increase throughput for passengers and commuters by modernizing urban transport infrastructure and networks and providing citizens with safe, reliable public transportation (particularly in the bus sector); and to reduce the time and vehicle operating costs required to move people and goods from lagging regions to markets and ports in the Western Province through three proposed activities:

- The **Advanced Traffic Management System Activity** aims to decrease relative travel time by reducing traffic delays and stops and improve road safety in the eight, most heavily congested arterial corridors in the Colombo Metropolitan Region, along which approximately two million people travel every day. The activity involves roadway and junction improvements spanning over approximately 205 kilometers of roads and the installation of a real-time-based traffic management system that deploys state-of-the-art sensing, communications, and data-processing and control system technology. The critical pillars of the activity include incident management, automated enforcement, motorist

information, and bus priority systems. These are integrated through a Traffic Management Center where command and control actions implementing optimal traffic control strategies would take place.

- The **Bus Transport Service Modernization Activity** aims to improve service and profitability and arrest the current, steady decline in bus ridership in the Colombo Metropolitan Region through institutional and regulatory reforms and by increasing the reliability, comfort, service quality, and safety of the bus system. The activity would introduce bus reforms such as route rationalization, enforced timetables, and smart payment systems on select bus routes along or connected to the heavily traveled corridors targeted by the Advanced Traffic Management System Activity. Bus regulators and operators will be incentivized to change the current farebox compensation model to a performance-based system with payments based on kilometers traveled and schedule adherence. An oversight agency for monitoring and compensating drivers based on this new regime will also be established. The activity would introduce closed-circuit television cameras to improve passenger safety and design interventions to decrease the harassment of female passengers. Service and safety improvements aim to incentivize the use of public transport.
- The **Central Ring Road Network Activity** in the Central Region would upgrade five sections of the road network (approximately 131 kilometers) that connects the Central, Sabaragamuwa, Uva, and Eastern Provinces with markets and ports in the Western Province. The activity would benefit some of the poorest, most agriculturally productive and ethnically diverse areas of the country. As part of this activity, a sustainable financing plan will be developed to maintain these and other interprovincial roads.

The **Land Project** aims to increase the availability of underutilized state and private lands for investment purposes, by increasing the amount of spatial data and land rights information available to investors and by improving the regulatory environment so that underutilized state lands can be more easily provided to companies for investment purposes. The project would also increase tenure security and tradability of land for smallholders, women, and firms through policy and legal reforms through five proposed activities:

- The **Parcel Fabric Map and State Land Inventory Activity** in seven districts along the Colombo-Trincomalee economic corridor aims to assist the Surveyor General's Department and the proposed State Land Bank Commission in preparing a comprehensive map of all land in Sri Lanka that would serve as the base layer for all digital cadastral and topical maps. The activity would also support the Ministry of Lands in identifying the state institution(s) in control of these lands and include them in the parcel fabric map. This would help the Government define the rights and restrictions that state institutions have in each land parcel.
- The **Deeds Registry Improvement Activity** would allow the Land Commissioner's Office to convert paper-based records to a digital format, aiming to protect them from damage, theft, and alteration, and preventing fraud in property transactions. Scanning, indexing, and

entry of records into the Government's existing electronic registry system would make the records more easily available to the public and legal practitioners for completing property transactions and improve the security of records. The records would also be linked to the digital parcel fabric map, further facilitating land-dependent economic activity.

- The **Land Valuation System Improvement Activity** with the Valuation Department would enhance and standardize the system for land valuation for calculating lease payments for state land, stamp duties in land transfers, and property taxes. The Government is not collecting rents and taxes based on the true value of its land holdings, depriving the Treasury of millions of rupees annually. The activity will introduce innovative methods of valuation tested in other countries, such as South Korea, to provide more rapid valuation with less discretion and error.
- The **Land Grants Registration and Deed Conversion Activity** aims to strengthen tenure security by registering rights to state land in the title registration system and providing a state guarantee of ownership in the land. MCC funding would be contingent on the Government providing joint titles through this process so that women have equal access to MCC programs and land tenure security for women and men is improved. The activity would accelerate the conversion of deeds to titles with a state guarantee in seven districts along the Colombo-Trincomalee economic corridor by streamlining title settlement procedures and expanding outreach programs that raise public awareness of the activity and its benefits.
- The **Land Policy and Legal Governance Improvement Activity** aims to support reforms in the land sector by conducting policy studies and research, preparing policy papers to inform decision making, supporting preparation of legislation in support of new land policy, and promoting consultation and outreach to stakeholders and the public on key land and land-related women's rights issues.

Policy Reform and the Compact

Transport Project: Policy, legal, regulatory, and institutional reforms undergirds the Transport Project. The success of the Advanced Traffic Management System Activity, for instance, will require the accomplishment of several key policy milestones, including identifying an operations and maintenance strategy; agreeing on data management and sharing; integrating bus-modernization principles and pedestrian safety; and drafting a legal framework to operate the traffic management center, given multiple stakeholders and jurisdictions.

For the Bus Transport Service Modernization Activity, the most critical reform is to institutionalize private bus operators' revenue incentives away from competitive single-bus profit maximization to performance-based revenue sharing. This will require outreach to bus drivers and operators to communicate anticipated benefits and is a high priority for the bus reform project management unit that will convene government stakeholders to develop a clear strategy and timetable for implementation by the end of 2018. The unit will also facilitate the deployment and adoption of

an automated farecard system and performance-based operations. An automated farecard system is key to facilitating performance-based revenue sharing amongst private operators, which will reduce the current profit incentive of buses to drive dangerously to maximize passenger counts.

The proposed compact will also support reforms that address the incentives facing transport regulators, which may entail restructuring these regulators. Provincial transport authorities—and the provincial councils that oversee them—derive revenue from issuing and renewing private bus permits for intra-provincial transport. As a result, too many permits are issued, causing an oversupply of buses and a decline in per-bus profitability. To address this, MCC will collaborate with provincial transport authorities to realign their incentives toward providing quality service and deriving revenue from competitive bidding for bus routes. Once these incentives are realigned, the Government would work with provincial authorities to enforce performance standards and optimize route networks and schedules according to passenger demand forecasts.

Land Project: The Government has recently prepared two draft legislative acts that seek to convert permits and grants to state land to absolute land grants given for the use of households to marketable and bankable titles and to establish an authority that gathers information on state lands and facilitates investment in underutilized state land. MCC believes that the acts, as written, will not achieve these objectives and suggests revisions before the acts are sent to Parliament. The substance of these suggested revisions center on decentralizing authority for the approval of absolute land grants, simplifying procedures, and ensuring gender equality in the issuance of absolute land grants, among other factors. MCC will also include two conditions precedent to the disbursement of compact funds to address legislative gaps that will inhibit the success and sustainability of the Registration of Land Grants and Deeds Conversion Activity.

There are other land sector reforms of importance that MCC has raised with the Government, which MCC plans to address through conditions precedent to the disbursement of compact funds. Briefly, these include the following:

- Gender issues – There is substantial discrimination against women in the provision of state land to households. A distinct bias toward males exists among government officials who provide title in the name of males when providing state land for family use and in the inheritance of state land, placing women at risk when there is divorce, abandonment, death, or discord within the family. Inclusion of joint titling provisions related to alienation of state and private land in the title registration system is needed to address these concerns.
- Registration of Title Act revisions – This act was hurriedly passed in 1998 in anticipation of a World Bank project to convert deeds to the title registration system. The act has many deficiencies that have frustrated past efforts to convert deeds to the title system and move to more secure land rights and a streamlined system for the completion of land transactions. MCC proposes adding amendments to the draft revisions of the act to allow the relaxation of land survey requirements for registration of titles that will permit less expensive and less accurate land mapping to be the basis for the registration of title. Such revision would allow the activity to register many more titles using the same budget.