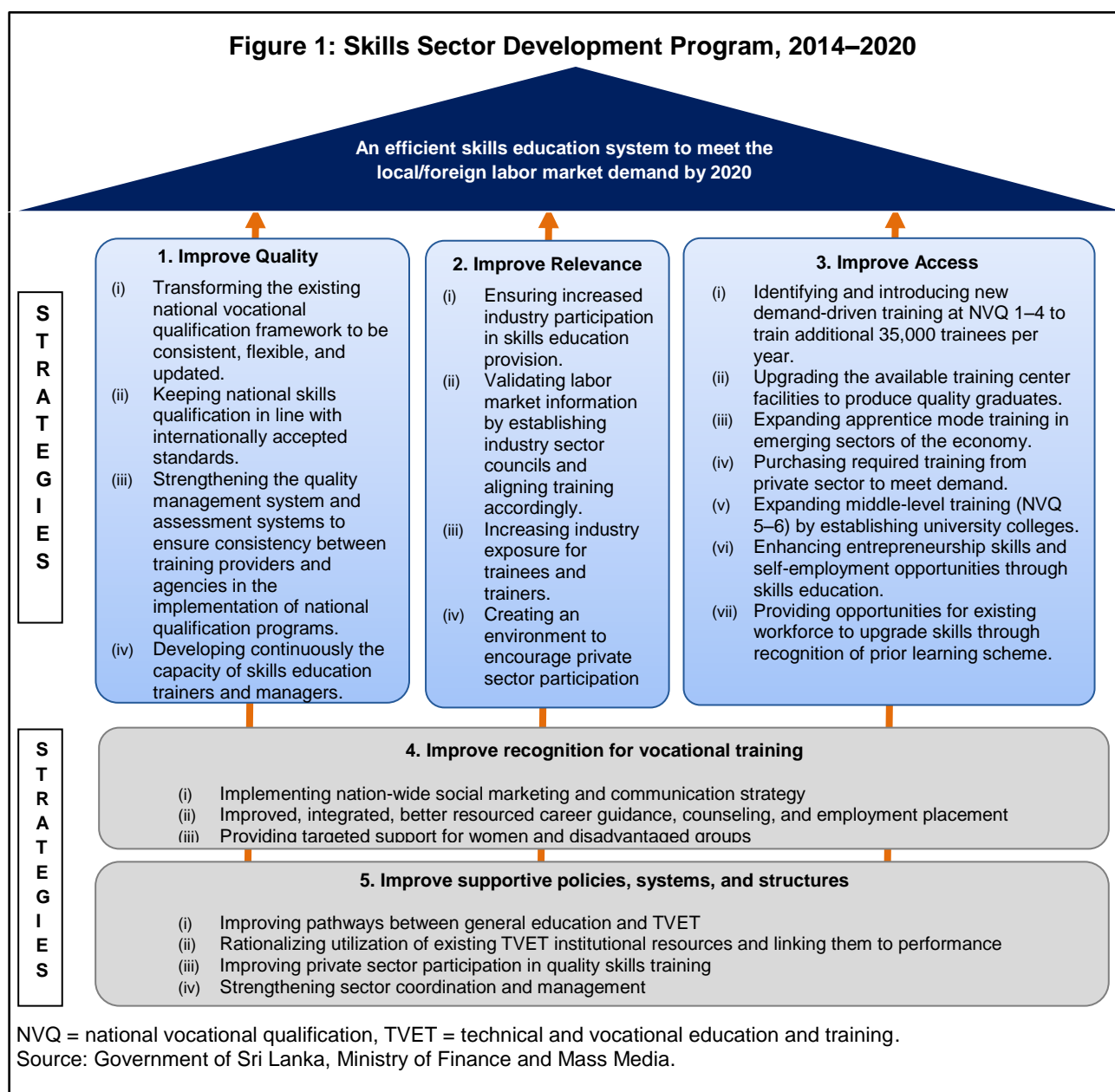


PROGRAM SOUNDNESS ASSESSMENT

A. Program Description

1. The Skills Sector Enhancement Program of the Asian Development Bank (ADB) supports the government's Skills Sector Development Program (SSDP),¹ 2014–2020, which is the first medium-term, sector-wide development program to include the government's priority skills development efforts across different ministries.²



¹ ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Results-Based Loans to the Democratic Socialist Republic of Sri Lanka for the Skills Sector Enhancement Program*. Manila (Loans 3119 and 3120(SF)-SRI).

² The SSDP covers the ministries of education, higher education, youth affairs and skills development, industry, agriculture, construction, economic development, environment, social services, ports, and foreign employment promotion.

2. The SSDP aims at an efficient skills education system to meet local and foreign labor market demand by 2020. It has five strategies: (i) improving quality; (ii) improving relevance; (iii) improving access; (iv) improving recognition for vocational training; and (v) improving supportive policies, systems, and structures to meet the needs of the skills sector.³

3. The ADB program supported SSDP activities during 2014–2017. The additional financing will continue this support until 2020. The executing agency is the Ministry of Skills Development and Vocational Training (MSDVT), successor of the Ministry of Youth Affairs and Skills Development since 2015. The initially identified implementing agencies are MSDVT as well as a department and six semiautonomous agencies under MSDVT.⁴ The Ceylon-German Technical Training Institute (since 2015) and the Sri Lanka Institute of Printing (since 2017) were added as implementing agencies. Using disbursement-linked indicators (DLIs) and the program action plan (PAP), the program design ensures that the SSDP implementation focuses on key reforms and critical actions to improve the relevance and inclusiveness of the technical and vocational education and training (TVET) system and to further enhance the country systems. The ADB program will excluding activities that involve high-value contracts and activities that would be classified as category A under ADB's Safeguard Policy Statement (2009). Table 1 describes the program actions aligned with SSDP strategies.

Table 1: Program Outputs and Actions Aligned with Government Strategies

SSDP Strategies	SSEP Outputs	SSEP Actions
1. Quality	Quality	(i) Updating and expanding the quality assurance system (DLI 2, PAP 1.2); (ii) adopting a vocational teacher development policy and plan to ensure the availability of qualified teaching staff (DLI 3); (iii) improving NVQ for multiple and flexible pathways (PAP 1.3); and (iv) strengthening skills assessment (PAP 1.4).
2. Relevance	Industry partnership	(i) Aligning TVET provision with industry-led sector-specific skills forecasting (DLI 4, PAP 1.6 and 1.8); (ii) strengthening private sector engagement in TVET through employment-linked training agreements (DLI 5); (iii) market-demanded mid-level skills through university colleges (PAP 1.5); (iv) more instructors with industry exposure training (DLI 3); and (v) skills upgrading for in-service workers (DLI 6).
3. Access	Participation and equity	(i) Expanding student enrollment with gender target (DLI 6); (ii) expansion of recognition of prior learning (PAP 1.4);
4. Recognition for vocational training		(iii) establishing a targeted stipend program (PAP 1.7, PAP 6.3); and (iv) adopting a TVET-system-wide gender equity and social inclusion framework (PAP 6).
5. Supportive policies, systems, and structures	Sector management capacity	(i) Increasing system efficiency by rationalizing existing resources and performance-based financing (PAP 1.8, DLI 7); (ii) strengthening sector coordination and implementation capacity (DLI 8, PAP 1.9 and 1.10); (iii) assuring predictable and adequate financing and effective spending (DLI 9); (iv) improving fiduciary capacity and reporting (DLI 8, PAP 1.10, PAP

³ Government of Sri Lanka, Ministry of Finance and Mass Media. 2013. *Public Investment Strategy*. Colombo.

⁴ MSDVT is the main line ministry for skills development, responsible for (i) quality assurance of public and private TVET providers; (ii) an extensive network of public TVET providers, consisting of more than 600 training centers across the country; and (iii) implementation of more than 90% of SSDP financing, through its department and agencies such as Department of Technical Education and Training, National Apprenticeship and Industrial Training Authority, National Institute of Fisheries and Nautical Engineering, National Youth Services Council, Tertiary and Vocational Education Commission, University of Vocational Technology, and Vocational Training Authority. MSDVT will develop a purchasing model to finance other ministries' skills development activities under the SSDP.

SSDP Strategies	SSEP Outputs	SSEP Actions
		2, PAP 3, PAP 5); and (v) adopting a program-wide environmental and social management framework (PAP 4)

DLI = disbursement-linked indicator, NVQ = national vocational qualification, PAP = program action plan, SSDP = Skills Sector Development Program, SSEP = Skills Sector Enhancement Program, TVET = technical and vocational education and training.

Source: Asian Development Bank.

B. Program Soundness

4. The program soundness assessment is informed by project preparatory technical assistance (TA) completed in 2012, multiple policy dialogues with the government on the TA recommendations and developments in the sector in 2013, and several joint missions with the World Bank in 2013 to assess Sri Lanka's TVET system. As per the midterm review of the SSDP, the program remains relevant to the government strategy, adequately designed for effective and efficient delivery and sustainability of results. The original soundness assessment remains valid. Since updates on overall context, rationale, and the program performance or achievement so far are presented in the report and recommendation of the President and different linked documents, the original assessment is repeated in this section, except for some minor edits to ensure clarity.

1. Relevance and Justification

5. Sri Lanka is a middle-income country with a per capita gross domestic product of \$2,923 in 2012, and it aims at reaching \$4,000 by 2016. The poverty rate has been reduced to 8.9% in 2010, from 15.2% in 2007. The unemployment rate declined from 8% in 2003 to below 4% in 2012 as the economy rebounded with the end of a long civil conflict. The remarkable economic achievements coupled with a low dependency ratio of 50% in 2012 provides a significant opportunity for Sri Lanka to develop its human capital base to accelerate its economic development and transformation into a knowledge-based economy.

6. Sri Lanka's workforce has a higher education attainment than that of its neighbors in South Asia, but a high education attainment has not translated into high labor productivity. The key issue is relevance to the labor market requirements. An increasing number of graduates from secondary and higher education are unemployed, contributing to a youth unemployment rate four times higher than the overall unemployment rate. The majority of overseas Sri Lankan workers are unskilled workers while there is large demand for semi-skilled and skilled workers.⁵ The domestic labor market is also short of skilled workers, especially in (i) construction, (ii) tourism and hospitality, (iii) light engineering and manufacturing, and (iv) information technology.⁶ Market-relevant skills offer better opportunities for the poor and the disadvantaged to move out of poverty and obtain social recognition through gainful employment.

7. In most countries, TVET provision is publicly financed or subsidized to support various policy objectives such as industrial development, employment creation, and social protection. Sri Lanka has a long tradition of strong public provision at all levels of education, including TVET. A majority of private sector TVET providers offer courses in information technology, business management, and basic technical skills that do not require much capital investment. On the other hand, private companies have been engaged in skills development by participating in the national apprenticeship program and various on-the-job training schemes. The ADB program will help the government expand an improved quality assurance mechanism to both public and private training

⁵ Tertiary and Vocational Education Commission. 2012. *Labour Market Information Bulletin Vol. 02/11*. Colombo.

⁶ ADB. 2012. *Priority Sectors of the Economy* (unpublished consultant report).

providers, and engage private providers and private companies in TVET provision through a purchasing model and public–private partnerships.⁷ It will also increase the efficiency of public financing by (i) strengthening the links between TVET and national development priorities and market demand, (ii) rationalizing existing public providers, and (iii) introducing a performance-based financing pilot. These design aspects are incorporated as DLIs to ensure that the government gives them priority in implementation.

8. The primary target group is about 326,000 young people leaving school education each year. By 2020, the government aims to provide skills development opportunities for 250,000 youths per year, 70% of whom would be in quality-assured courses.⁸ The program will also benefit in-service workers who wish to upgrade their skills for better career progression. MSDVT also coordinates with successful youth programs of the government that help communicate the concerns of the young through various forums, and these are incorporated in the design. Demand is high for technical skills, as the quick take-up in 2013 of the technology stream at secondary schools proved.

9. The program will support a stipend program targeted at women and disadvantaged groups (e.g., the poor, differently abled people, rural residents) to participate in TVET or upgrade their skills to increase their chance for gainful employment or higher incomes. The stipend program will promote key gender goals such as equity in access to TVET, stronger female participation in nontraditional vocations, and greater awareness of the potential benefits of TVET through explicit gender targets in enrollment, stipend program, and job placement, as well as strengthened social marketing and career counseling.

2. Adequacy

10. **Effectiveness in achieving results.** The program design is technically sound, based on extensive sector assessments and studies, supported by ADB, Government of Korea, World Bank, and other agencies since 2011. Its results areas, performance targets, and activities are extensively debated among the representatives of MSDVT and TVET agencies for regulatory feasibility, cost effectiveness, implementation capacity, adequate sequencing, and attainability of results within the given time. The results areas and performance targets are adequate to achieve the overall sector goals, but detailed activities and their sequencing need further annual refinement for effective implementation. Capacity development in results-based planning and budgeting should be introduced to improve the planning and budgeting process. As the program will almost double TVET sector financing, MSDVT's and TVET agencies' implementation capacity would be enhanced. The government already established a dedicated implementation unit to manage new initiatives such as purchasing model, university colleges, and performance-based financing, and provide technical procurement support to TVET agencies as necessary to boost implementation capacity. The program includes DLIs in budgeting and implementation capacity enhancement, and PAP items in planning and budgeting.

11. **Efficiency and economy.** The program will introduce an allowance scheme to supplement the low salary of TVET instructors, and the allowance will be performance-based. It will also pilot performance-based financing for TVET training centers, which will use an annual business planning process where each center will set its own targets in a set of key performance indicators derived from the program results framework. The business plan achievement will trigger

⁷ The purchasing model will allow the government to flexibly source training services from any qualified training providers to meet the needs for a skilled workforce.

⁸ Government of Sri Lanka, Ministry of Finance and Mass Media. 2013. *Public Investment Strategy*. Colombo.

performance incentives for the center. The targeted stipend program will encourage women and disadvantaged groups to acquire skills in existing and emerging skills-shortage areas to increase job-placement success and minimize the skills mismatch in the labor market. The purchasing model (using performance-based agreements) will encourage private sector providers and employers to bridge skills shortages that existing public providers cannot address. These measures will increase the efficiency and economy of public financing and help the sector achieve incremental efficiency gains.

12. **Sustainability of results.** The program aims at system-wide change, introducing several mechanisms for incremental reform in TVET system effectiveness and efficiency to develop the skilled workforce required by the market. Most of the envisaged changes are within the existing regulatory and institutional framework, but emphasize (i) strengthening and expanding current good practices (e.g., apprenticeship programs, engagement of visiting instructors, carrier counseling); (ii) improving existing systems and practices (e.g., reviewing and updating the quality assurance system and the national vocational qualification framework, rationalizing TVET facilities, upgrading in-service instructors' qualifications, strengthening assessment, invigorating industry working groups, institutionalizing skills gap analysis, and improving planning and budgeting processes); and (iii) introducing new mechanisms (e.g., performance-based financing using business planning processes at TVET institutes, performance-based allowances for TVET staff and instructors, purchasing model, public-private partnerships, and university colleges). The likelihood of sustainability of the first group of activities is very high because they build on existing, well-running mechanisms, well understood by stakeholders, and proven to be successful. For the second group of activities, all stakeholders should be clear on the objectives and the envisaged benefits, and can therefore change the status quo. The program has some DLIs and PAP items to encourage and support the stakeholders. Also, development partners will provide TA to support the stakeholders in considering different delivery options (e.g., outsourcing to professional organizations, benchmarking of well-running systems in other countries, twinning of renowned TVET institutes for fast-tracking curricula development, and instructor training) to ensure successful outcomes. Once stakeholders are convinced by the positive outcomes, those activities are highly likely to continue beyond the program period. The third group of activities, consisting of new initiatives, would require careful planning of and consultation on detailed mechanisms to ensure high ownership by the stakeholders and successful implementation. The Skills Sector Development Division (SSDD) under MSDVT will be responsible for managing the new initiatives. Clear targets are set in DLIs and PAP to guide the incremental reforms.

3. Financial and Economic Analysis

13. The economic rationale for public investment in human capital development is well founded in the macroeconomic growth theory, whereby human capital accumulation is a key driver of economic growth.⁹ Public investment in TVET has larger externalities than just the increase in income of the graduates through foreign direct investment or an overall productivity increase through shared learning within the workplace. TVET often serves the poor more than the rich, thus creating an equity effect. Public provision can be justified where private provision is weak.¹⁰

14. The government fully recognizes the importance of skills development for the economy,

⁹ Given that the original economic analysis for the SSDP covered the years 2014 to 2020 and used an overall expenditure framework for the program costs, the results are still valid for the additional financing.

¹⁰ ADB. 2009. *Good Practices in Technical and Vocational Education and Training*. Manila.

as expressed in the President's 2014 budget speech: "... [the] country needs to implement a fast-track skills development program to meet market demands by gearing [Sri Lankan] youth to be able to secure high paid jobs and also to improve productivity in industries and services in the next decades."¹¹ The government will increase sector financing by mobilizing internal and external resources to support implementation of the program.¹² The fiscal affordability analysis indicates that resources may become too tight to meet the program expenditure framework if economic growth slows down and the government prioritizes other sectors. The program would increase efficiency of spending through performance-based financing and by leveraging private sector contribution (employers' in-kind contribution for apprenticeship or on-the-job training, cost sharing for the purchasing model, and public-private partnership university colleges), which is expected to grow as the TVET system starts delivering more relevantly skilled workers, especially in the emerging or fast-growing economic sectors.

15. As the ADB program intends to contribute to the first phase of the SSDP, ensuring that the overall objective of the SSDP is met, an economic analysis of the overall SSDP was carried out to assess the economic impact using the economic internal rate of return (EIRR) analysis. The analysis used the program's medium-term expenditure framework as the costs and two incremental benefit streams: (i) improvement in the employability of graduates, who will get a 17% wage premium,¹³ and (ii) a modest 2 percentage point increase of this wage premium from employers' recognition of job-relevant skills and increased proportion of mid-level skills among TVET graduates. The latter assumption is based on the cost saving for retraining of newly recruited workers at workplace and increase in productivity. The SSDP emphasizes mid-level skills, which have a higher wage premium than the average skills.¹⁴ After 2020, it was assumed that 50% of total costs in 2020 will continue to accrue as recurrent expenditures to support system-wide TVET operations. The inflation rate is assumed to be the current rate of 7.5%. Standard discounting techniques are applied and a conservative period of 20 years (until 2034) is assumed for both the benefit and cost streams.

16. The EIRR analysis reveals that the SSDP has a moderate rate of return of 15.3% and a net present value of \$53.1 million when using the standard 12% discount rate. A sensitivity analysis indicates that the EIRR remains reasonably robust under different sets of assumptions. The rate of return is not very sensitive to different graduation and employment rates, varying from a low of 12.9% to a high of 17.5%. However, changing the additional wage premium for high-relevance and mid-level skills has a larger impact on the EIRR. A conservative 1.5 percentage point increase of the wage premium yields a lower rate of return of 9.9% and a negative net present value. This analysis illustrates that narrowing the skills mismatch to increase productivity and increasing number of graduates in mid-level skills will increase the wage premium and could substantially raise the rate of return of skills development. The economic analysis is accessible from the list of linked documents in Appendix 2 of the original report and recommendation of the President (footnote 1).

4. Implementation Arrangements

17. MSDVT will continue to be the executing agency and also one of the 10 implementing agencies (along with one government department and nine semiautonomous institutions under

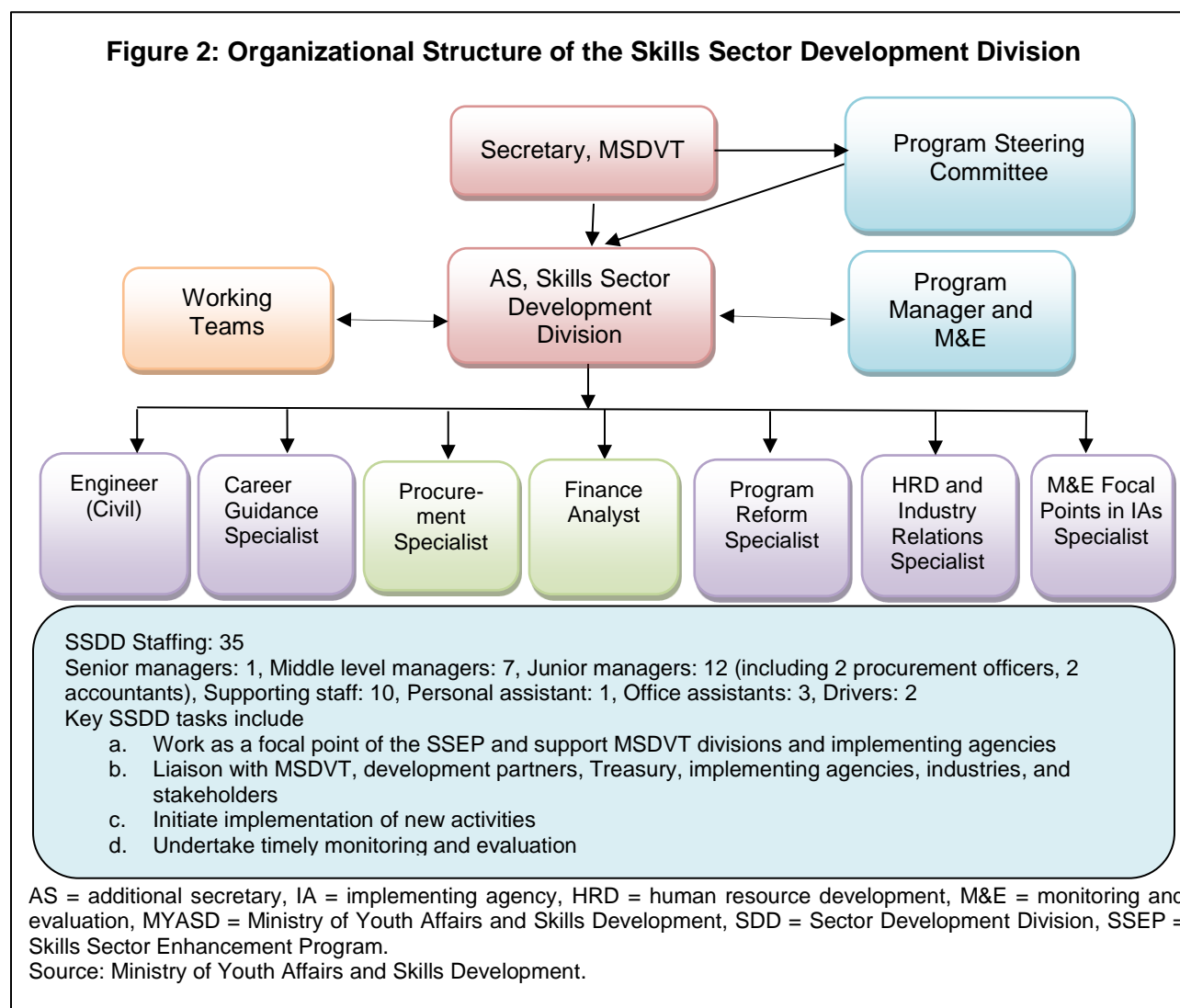
¹¹ Government of Sri Lanka. 2013. *Budget Speech 2014*. Colombo.

¹² According to the budget speech, the external financing would be \$350 million from the World Bank and ADB.

¹³ World Bank. 2013. *Sri Lanka: Building the Skills for Economic Growth and Competitiveness*. Washington, DC.

¹⁴ In Sri Lanka, those who have technology-related skills have a higher wage premium—38% (technology), 25% (mechanical), and 21% (computer skills)—than the average 17% across different TVET qualifications.

MSDVT).¹⁵ Other agencies included in the SSDP may be considered as additional implementing agencies or partner agencies once (i) adequate fiduciary capacity assessment is completed, (ii) the inclusion of additional implementing agency is endorsed by the high level interministerial committee; and (iii) a formal agreement made between MSDVT and the agency for specific activities. The ADB program has been implemented using the existing institutional structure with necessary institutional enhancement. To boost MSDVT's implementation capacity, the Department of Management Services in 2013 approved the establishment of the SSDD at the Ministry of Youth Affairs and Skills Development, led by an additional secretary, and this new division will have cadre staff and professionals deployed from both the public and private sectors. The SSDD (i) coordinates and support implementing agencies to plan, manage, and monitor SSDP activities; (ii) initiates implementation of new activities in the sector; and (iii) undertakes timely monitoring and evaluation of program activities. The SSDD's organizational structure is in Figure 2.



¹⁵ Ceylon-German Technical Training Institute, Department of Technical Education and Training, National Apprenticeship and Industrial Training Authority, Ocean University, National Youth Services Council, Sri Lanka Institute of Printing, Tertiary and Vocational Education Commission, University of Vocational Technology, and VTA.

18. The implementation committee structure for the SSDP has three levels. At the highest level, an interministerial sector coordination committee has been established at the Ministry of National Policy and Economic Affairs to guide SSDP implementation and coordinate with other ministries for the overall SSDP implementation. The second level of oversight will be within the executing agency. A program steering committee (PSC) chaired by the secretary of MSDVT has been established to oversee the implementation of the ADB program, approve annual work plan and budget, take timely decisions relating to policy and implementing matters, review progress, and endorse DLI verification report. The PSC will include representatives from all implementing agencies, four industry sector skills councils, External Resources Department, National Planning Department, and National Budget Department. The additional secretary for SSDD–MSDVT will act as the PSC member secretary. The third level of facilitation is a working team led by the additional secretary, SSDD, and will consist of members from respective implementing agencies. This team will support the day-to-day implementation of each implementing agency. Table 2 summarizes the program implementation arrangements.

Table 2: Summary of Implementation Arrangements

	Description	Functions
ISCC	ISCC will be headed by the secretary, Ministry of National Policy and Economic Affairs. The member secretary will be the additional secretary for SSDD under MSDVT. Members will be ex-officio members from the ministries participating in the SSDP.	<ul style="list-style-type: none"> (i) guide the overall SSDP implementation; (ii) coordinate with concerned ministries for the overall SSDP implementation; (iii) help solve planning and financing issues; and (iv) ensure that the activities implemented are in accordance with SSDP
PSC	<p>The PSC will be headed by the secretary, MSDVT. The member secretary of PSC will be the additional secretary for SSDD. The PSC will be represented by implementing agencies. Representatives from industry sector skills councils, and External Resources Department, National Planning Department, and National Budget Department will also be included in the PSC. Other members will be co-opted as appropriate.</p> <p>The PSC would meet at least once every quarter.</p>	<ul style="list-style-type: none"> (i) oversee the SSDP implementation; (ii) help solve policy-related issues that arise; (iii) provide guidance to the SSDD/MSDVT; (iv) approve annual work plan and budget; (v) ensure timely budget release and disbursement of funds; (vi) approve of all reports, including disbursement-linked indicators monitoring; (vii) ensure compliance with fiduciary oversight arrangements; (viii) ensure oversight and guidance of public–private partnership activities; (ix) monitor the implementation status of gender action plan; and (x) ensure that the activities implemented are in accordance with environmental assessment review framework, resettlement framework, and resettlement framework
SSDD/ MSDVT	SSDD/MSDVT comprises the cadre staff and professions team led by the additional secretary to coordinate program implementation and monitoring and support implementing agencies.	<ul style="list-style-type: none"> (i) work as the focal point for the program; (ii) liaise between MSDVT, development, partners, Treasury, implementing agencies, TVET agencies, industry, and other stakeholders; (iii) serve as program support, coordination, and monitoring agency for SSDP; (iv) initiate implementation of new activities in the sector; and (v) undertake timely monitoring and evaluation
Working	Working team is led by the additional	Support SSDD/MSDVT to carry out its technical

	Description	Functions
Team	secretary, SSDD under MSDVT and consists of members from implementing agencies. Working team would meet weekly or as needed.	functions in the areas of planning, and monitoring and evaluation
Implementing Agencies	MSDVT divisions, DTET, Tertiary and Vocational Education Commission, Vocational Training Authority, National Apprenticeship and Industrial Training Authority, University of Vocational Technology, Ocean University, Ceylon-German Technical Training Institute, Sri Lanka Institute of Printing, and National Youth Services Council. Additional implementing agencies may be added from the participating agencies in SSDP	Implement the program as per SSEP

DTET = Department of Technical Education and Training, ISCC = interministerial sector coordination committee, MSDVT = Ministry of Skills Development and Vocational Training, PSC = program steering committee, SSDD = Skills Sector Development Division, SSDP = Skills Sector Development Program, SSEP = Skills Sector Enhancement Program.
Source: Government of Sri Lanka.

C. Managing Risks and Improving Capacity

19. The program soundness assessment shows that the ADB program is well justified for its envisaged impact on economic and social development; adequacy measured by effectiveness, efficiency, and economy; as well as sustainability of the results in the medium term.

20. Successful implementation, however, will require a high level of stakeholder commitment and stronger capacity, as elaborated in paras. 9–11. Major risk mitigation measures are: (i) planning and budgeting to ensure that the detailed annual work plan and budget are fully integrated with MSDVT and TVET agencies' regular work program, with emphasis on the achievement of DLIs; (ii) adequate number of qualified instructors and assessors to scale up training; (iii) procurement capacity in MSDVT and implementing agencies; and (iv) technical inputs for new reform initiatives and successful engagement of the private sector to ensure relevance.¹⁶ DLIs and PAP incorporate most of these risk mitigation measures, but the capacities of MSDVT and the implementing agencies need significant boosting. The government took the first step by establishing the SSDD, and development partners have been providing TA to strengthen the SSDD's and other stakeholders' capacity.¹⁷ ADB has an ongoing TA to support human capital development initiatives in Sri Lanka, and it will continue providing technical inputs required by the SSDD to ensure annual DLI and PAP achievements.¹⁸ It will also provide consultant inputs for ADB's independent verification activities and annual fiduciary review, as described in the DLI verification protocol.

¹⁶ Integrated Risk Assessment and Mitigating Measures (accessible from the list of linked documents in Appendix 2).

¹⁷ Development Coordination (accessible from the list of linked documents in Appendix 2).

¹⁸ ADB. 2012. *Technical Assistance to Sri Lanka for Human Capital Development Capacity and Implementation Support*. Manila.