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APPRAISAL REPORT

SRI LANKA

OPERATIONS APPRAISAL STAFF

BUREAU OF PROGRAM AND POLICY COORDINATION

September 27, 1978

REVIEW OF AID PROGRAM

SRI LANKA

Sri Lanka, as you know, is a country which is deeply committed to social welfare and social justice--the quality of life if you wish to use that term. The dilemma before us with our scarce resources of present is to evolve a proper mix between social welfare and social justice and development and growth, between consumption and subsidies and savings and investment.

Since 1956 we have been experimenting with piecemeal, patchwork, ad hoc solutions to our economic problems. The age of cosmetic solutions to economic problems is over and this Government is determined to offer real and long term solutions for the problems of our nation.

We should... place our emphasis on production, development, growth and employment.

Ronnie de Mel, Minister of Finance & Planning
Budget Speech 1978, Colombo, November 15, 1977

September 22, 1978

OPERATIONS APPRAISAL STAFF
BUREAU FOR PROGRAM AND POLICY COORDINATION
A.I.D.

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PREFACE

One of the objectives of OAL appraisals is to deal with controversial issues and spark interest, comment, and discussion of our conclusions and recommendations. Measured by this criterion, the Sri Lanka appraisal was a "smash hit." The report attracted an unusual amount of comment and criticism. While some of the criticisms tended to cancel each other out, others were very well taken and have led to modifications of our conclusions. In general, criticisms covered four areas:

(1) Interpretation of Basic Human Needs approaches, particularly AID's interpretation as contained in the recently issued "Strategy for a More Effective Bilateral Development Assistance Program;"

(2) The actual record of Sri Lanka - both with regard to its growth record and the effect of equity policies pursued by the GOSL and economic growth;

(3) Recommendations about AID program content and some proposed new methods of implementing programs; and

(4) Embassy-USAID relations.

A summary of the comments in each area is contained below. Many specific comments are taken into account in the body of the assessment - either through inclusion or through modification of our original conclusions and recommendations.

1. Basic Human Needs Policy - The appraisal was criticized for discussing BHN in overly narrow terms and drawing a dichotomy between BHN and growth. We continue to believe that many writers on BHN continue to place very heavy emphasis on speedy realization of difficult or impossible goals, i.e., elimination of poverty by the year 2000 and focus on improving living indicators, rather than focusing on how to achieve sustained growth with equity. The AID policy paper does indeed emphasize among other things that BHN is but an additional dimension to an AID policy which continues to emphasize both growth and equity.

Nevertheless, we continue to be concerned about the danger of seeming to "overpromise" to both the Congress and LDCs; the

failure to arrive at a clear consensus of the desirability or meaning of a BHN approach within AID and the apparent lack of enthusiasm about a BHN approach on the part of many LDC leaders. Because so much of our bilateral assistance program is intimately linked to U.S. political and strategic interests, it is also often difficult to link levels and programs to BHN or host country efforts. Therefore, we advocate a broad interpretation of BHN and a gradual shifting of rhetoric away from BHN, and an effort to ensure that statements on BHN emphasize support for increases in productive capacity to support continuing growth, productive employment, and provision of services as a way of achieving increased productivity and welfare for AID's target groups.

2. Sri Lanka's Record - We were justifiably criticized for being overly critical of Sri Lanka's growth record, particularly during the 1960s, and drawing too direct a relation between GSL equity policies and expenditures on social programs and poor growth record in the 1970s. An excellent IBRD staff paper on The Relationship of Basic Needs to Growth, Income Distribution and Employment: The Case of Sri Lanka concludes that it was poor growth policies and an accelerated decline in the terms of trade rather than excessive expenditure on social programs that caused growth to decline in the first half of the 1970s.

On balance, Sri Lanka's per capita growth record is not bad, and its standard of living is extremely high when compared with other low income LDCs. We continue to believe that Sri Lanka's record continues to raise doubts about a BHN approach, and that BHN improvement by pursuing better economic policies might have achieved greater growth and less unemployment than resulted in Sri Lanka. Indeed, the paper referred to above concludes that there were serious deficiencies in Sri Lanka's past growth efforts, particularly untargetted social programs, which mean that Sri Lanka can hardly be held out as a basic human needs model for other developing countries. In any event, we must be careful in generalizing from a single case about the feasibility of a BHN approach.

3. AID Program Content and Mechanisms - Our recommendation to diversify AID programs beyond agriculture and rural development was not enthusiastically received by either the USAID or the Asia Bureau, which sees the period through FY 1980 as a period of consolidation at slightly higher program levels. Similarly, there was little enthusiasm for sector loans, CIP procedures,

and support for the Mahaweli project by equipment financing. We continue to be concerned, however, about how larger AID programs can be successfully implemented (and we favor expanded programs in Sri Lanka) in the face of severe personnel constraints without seeking program mechanisms which are less demanding of AID manpower.

There was, however, general agreement that PL 480 Title I programs should be phased down and possibly out. It was also agreed that PL 480, Title III, as currently established, holds little appeal to the GSL.

Embassy - USAID Relations - The USAID's cable stated that it did not agree that the Embassy is over-controlling the USAID, while conceding that the Embassy has a strong concern over profile and has insisted that AID should remain in the compound. The USAID concluded "As long as we have the program we want and the people we need, the question of where AID is housed or who signs project agreements does not seem to merit the emotional energy displayed in the OAS report."

Our comments have been softened somewhat as a result of this counter-attack, but we continue to be concerned over MODE restrictions, interpretations of low profile, and Embassy-USAID relations worldwide insofar as they effect development and implementation of effective programs. Thus, we see the situation in Sri Lanka as part of a continuing worldwide pattern which AID has learned to live with at considerable cost.

COUNTRY APPRAISAL - SRI LANKA

I. INTRODUCTION

Sri Lanka was proposed as a country to be appraised by the Operations Appraisal Staff (OAS) because:

- (1) its development strategy seemed to place emphasis on meeting basic human needs (BHN) and a review of Sri Lanka's experience might provide insights relevant to AID's own interest in BHN; and
- (2) AID/W was recommending a rather substantial increase in the magnitude of AID assistance to Sri Lanka at a time when there was no approved program strategy statement.

This report looks to Sri Lanka's past for insights regarding development strategies in general, and to its future to suggest AID strategy options. There is a minimal look at AID's past in Sri Lanka because the program was reinstated only in 1975 and few projects have progressed far enough to evaluate. In the area of USAID management, the focus is on potential problems as the program and mission expands. The report also explores alternative techniques for program implementation. Following orientation and research conducted in Washington, the appraisal team visited Sri Lanka in April.

Since this report is designed to emphasize issues and options, general background information on Sri Lanka is included only as considered necessary to understand the issues and options. For a more complete picture of the current economic and social situation in Sri Lanka, the reader may refer to the March 1978 IBRD report 1/ and the USAID's May 1978 budget submission (ABS).

II. SRI LANKA - A BHN SHOWCASE?

As increased Agency attention has been focused on basic human needs and related development strategies, and on the importance of equity considerations, Sri Lanka frequently has been cited as an example for emulation. To appraise this thesis, we review briefly the Sri Lankan situation first at the time of independence in 1948, and then in 1977, approximately 30 years later.

A. Situation and Prospects at Independence (1948)

Governmental Structure: Sri Lanka (then known as Ceylon) had in being a working democracy with the executive/legislative structure patterned after the British parliamentary system. The civil service was competent, disciplined and generally free of political influence; however, it was made up largely of generalists who were not particularly well suited for undertaking major developmental activities. The Government Agent, a civil servant, was the chief administrative officer in the rural areas. Although there were elected local village councils with some powers, the system of local administration could be described as dominated by central government paternalism.

Economy: The British left behind a dual economy: a highly developed and efficient, but largely foreign-owned, agricultural plantation sector (primarily tea, rubber and coconuts) and an indigenous, largely subsistence food crop sector. The plantation sector provided a high level of exports easily capable of financing needed imports and sufficient budgetary revenues to finance a high level of governmental services. A good transportation network but little industry had been established. Although there was some underemployment in the rural areas, open unemployment was not a serious problem.

Education: Compulsory school attendance from age 5 to 14 had been the law since 1906. The Free Education Scheme of 1946-47 abolished fees and tuition in all government schools from kindergarten through university. The literacy rate in 1946, two years before independence, was already estimated at 58 percent. The educational system included government schools and private schools (mostly denominational schools: Christian, Buddhist, and some Hindu and Moslem). Christian mission and Buddhist temple schools received government assistance. The Christian mission schools, in which the language of instruction was English, provided most of the entrants to the universities and to the civil service.

Health: Public health, sanitation and some welfare services increasingly became the concern of the central government from 1866 when the first attempts were made to control communicable diseases. Since 1931 preventive as well as curative services were the responsibility of government at both the local and central level. An anti-malaria spraying campaign was initiated in 1946 and an anti-tuberculosis campaign in 1947. These contributed substantially to the accelerated decline in the death rate in the decade of the 40s and on into the 50s:

	<u>Death Rate</u> <u>(per 1,000)</u>
1910-1919	30.1
1920-1929	26.9
1930-1939	23.5
1940-1949	17.9
1950-1959	10.7

Social Problems: Two problems existed at independence that have continued to create difficulties in the post-independence period: the caste system and ethnic (with religious undertones) frictions. The latter were exacerbated by the British effort to deal with the former. In the caste system of Sri Lanka, which is different from that in India, the peasant is considered a high caste but the laborer (skilled or unskilled) is low caste. Thus, the Sri Lanka Sinhalese (generally Buddhist) were unwilling to work as laborers on the plantations and the British brought in Tamils (generally Hindu) from South India. Another group is the Sri Lankan Tamils, who had settled largely in the north and in coastal areas in earlier centuries, had taken advantage of Christian missionary schools to get an education and move into commerce, finance and the civil service from which they increasingly gained control over the means of livelihood of most of the Sinhalese (70 percent of the population). This situation had already created friction, including violence, between the two groups during the colonial period.

B. Developments from Independence to 1977

Government and Politics: The post-independence political environment has been characterized by the alternating of power between the two principal political parties -- the right-of-center United National Party (UNP) and the left-of-center Sri Lanka Freedom Party (SLFP), with the latter generally relying on the support of two smaller Marxist parties. In general, the UNP tended toward a private sector, market-economy approach to development, while the SLFP coalition threatened and eventually carried out nationalization of the plantations and other enterprises and established a heavily controlled economy. Since no government succeeded in being re-elected, abrupt policy shifts resulted which were very detrimental to the economy.

Given that the electorate was already accustomed to a high level of services being provided by government, politicians of both parties tended to focus more on increasing the level of services to the population than on establishing the conditions that could

promote the economic growth needed to sustain the level of services already being provided. In addition, Members of Parliament increasingly dominated the governmental decisions affecting their electoral area, thereby strengthening the paternalistic tendencies of the system and reducing the incentive for local initiative.

During its last administration (1970-77), the SLFP politicized the civil service and the management of the government corporations. In the civil service this led to deterioration of services and increased emigration of trained managers and technicians.

The election of July 1977 may well have ushered in a new era. With an overwhelming majority in the Assembly, the policy thrust of the new UNP government promises major change. According to the Budget Speech of the Minister of Finance last October, Sri Lanka must reverse a generation of stagnation and transform the economy, emphasizing growth in order to sustain social welfare programs.

Economy: As a direct result of the abrupt policy shifts between alternating governments, private investment declined -- particularly in the crucial plantation sector. Some plantations were abandoned and needed replanting. After nationalization, the management of the plantations deteriorated markedly as management jobs were used for patronage purposes by the SLFP; expatriate managers and trained Sri Lankans emigrated. This, coupled with the decline in export prices during the 60s and early 70s, meant that the plantation sector could no longer provide adequate foreign exchange earnings for the rest of the economy.

The balance of payments problem was exacerbated in the 70s with a further deterioration of the terms of trade resulting from the rise in the cost of petroleum imports (after 1973) and imported industrial goods. In addition, bad weather caused major shortfalls in rice production in all but one year between 1971 and 1976, thereby creating a need for an even higher level of food imports, at a time of declining levels of foreign exchange.

Non-plantation agriculture registered some gains, particularly in the late 1960s. Improved rice seeds were developed and distributed; the distribution of fertilizer, the provision of extension services and credit, and the collection of harvested paddy was expanded and institutionalized; some new areas were opened up to irrigation; and land reform was carried out. These gains were offset to a considerable extent during the 70s as the

quality and quantity of governmental services deteriorated. Politicians undermined the system of agricultural credit by encouraging farmers not to repay their loans from government agencies and by getting government to forgive debts.

Industrial development during the period consisted primarily of highly protected import substitution activities. With the balance of payments crisis during the mid-70s, exchange controls were tightened and many firms were forced to reduce output because they could not import spare parts -- even raw materials in some cases. With unrealistically low prices fixed by the government, most of the government industrial enterprises were operating at a substantial loss. Because of the anti-private sector bias of the SLFP government, there was disinvestment in industry by the private sector during the 70s.

The transportation system was expanded somewhat during the period. However, the most noticeable change during the period, particularly during the 70s, was the deterioration in the quality of services of the public-managed elements of the system, i.e., the buses, the railways, ports, and airlines. In addition, the maintenance of the road system has been inadequate.

Unemployment is the economic problem with the most substantial political impact. Unemployment has not occurred suddenly; rather, it is a problem that has been building all during the post-independence period as the increase in the labor force far outstripped the number of jobs created in the slow-growing economy. It has been exacerbated by structural problems such as the attitudes toward certain type of employment reflecting caste values and the inappropriateness of much of the education system to the development needs of the country. The system of food subsidies and subsidized education and health services also contributes to the level of unemployment by reducing the cost of remaining unemployed while waiting for the highly prized white collar job.

Education: The education system has also suffered from the abrupt shifts in governmental philosophy and policy. Before schools have integrated one "reform" it is being undone by a different "reform." In 1960 the denominational schools were nationalized and made a part of the state school system. In theory, the curriculum was standardized, but shortages of books and teachers meant that some subjects were not included in schools in some areas. Technical education has been slow to

to develop as plans to build and equip new schools have frequently been altered or dropped. Alternating governments have had differing philosophy on the emphasis to be placed on technical and scientific education in relation to liberal arts.

The language of instruction has also been an issue that has disrupted the schools. In 1945 a policy was issued stating that the language of instruction would be Sinhala or Tamil in primary schools and English in secondary schools. This policy has been altered several times since.

Health: Until about 1970 there was expansion of the health care system and continued improvements in health care. A resurgence of malaria occurred in the late 60s and intensified in the 70s. The number of persons per hospital bed, per dispensary and per nurse was higher in 1976 than in 1970, reflecting the inability of the government to keep pace with the population growth. In addition, the quality of the services available in health facilities declined, in part due to inadequate budgets and the loss of qualified personnel from the system -- particularly doctors, nurses and anesthesiologists. Reduced food availability (and higher prices) also had an adverse affect on the health standards during the 1970s. Thus the crude death rate, which had fallen to 7.6 per 1,000 by 1970 rose to 8.9 in 1974 and the 1976 rate was still above 1970. The infant mortality rate of 45 in 1971 rose to 64 the following year and was 51 in 1974. For more trend data on selected social indicators, see Table 1 on the following page.

Social problems: The so-called communal problems between Tamils and Sinhalese continued during the period with occasional violence -- twice very serious, the latest being in 1977 following the election. Issues have been the language of instruction in the schools, the language requirements for the civil service and the politicization of the civil service by the last SLFP administration -- all designed to diminish the influence and economic power of the Tamils. The economic policies of the SLFP (e.g., controls, State ownership) also had a more serious impact on the Tamils. This communal conflict has spilled over into the family planning program, with each group expressing concern that the program is designed to reduce the future size of its group.

Table 1

SELECTED SOCIAL INDICATORS ^{2/}

SRI LANKA:

	<u>1946</u>	<u>1953</u>	<u>1963</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>
EDUCATION										
Adult Literacy (%)	58	65	72	-	78	-	-	-	-	-
School Enrollment Ratio (ages 5-14)	41	58	65	99	100	89	86	-	-	-
HEALTH AND DEMOGRAPHY										
Life Expectancy	43	56	63	-	66	-	-	-	-	-
Infant Mortality (per '000)	141	71	56	48	45	64	46	51	-	-
Crude Birth Rate (per '000)	37.4	38.7	34.3	29.6	30.1	29.8	27.9	27.4	27.6	27.4
Crude Death Rate (per '000)	20.2	10.9	8.6	7.6	7.6	8.0	7.7	8.9	8.5	7.9
Rate of Natural Population Increase (%)	1.7	2.8	2.6	2.2	2.3	2.2	2.0	1.9	1.9	2.0
Net Migration (per '000)	5.2	5.2	-1.0	-0.8	-2.7	-3.2	-3.8	-4.0	-2.3	-3.7
Average Age at Marriage:										
Male	27.0	27.2	27.9	-	28.0	-	-	-	-	-
Female	20.7	20.9	22.1	-	23.5	-	-	-	-	-
Number of New Family Planning "Acceptors" (per '000)	-	-	-	55	49	71	96	-	-	-
Female (crude) Labor Force Participation Rate (all ages %)	-	-	15.5	19.5	19.1	-	-	-	20.3	20.6

Source: Central Bank of Ceylon.

Violence erupted in 1971 in an attempt by some 10,000 radical youth to take over the SLFP coalition government. The main strength of the 1971 insurgency was in the provinces. With increasing levels of education, small farms, little new land available for settlement, and few employment opportunities in industry or services, the frustrations in the countryside reached the breaking point. The problem continued to worsen with unemployment rising to around twenty percent by 1977.

C. The BHN Showcase is Not a Clear Case

1. The BHN Record

Given alternating government philosophies and policies described in the previous section, one cannot say that Sri Lanka has followed any consistent development strategy. The UNP has generally tried to emphasize growth while at the same time maintaining a high level of services and giving consideration to equity in its economic and social policies, albeit not as pronounced as the SLFP. The SLFP appears to have been concerned primarily with redistribution of productive assets and income, which led to economic policies, particularly in the 1970s, which were detrimental to achieving economic growth and to maintaining the quality of social services.

Neither party gave adequate support to local or individual self-reliance or group participation. The SLFP policies at times appeared to have had the objective of eliminating the cultural identity of the Tamils. The sense of purpose in work seems also to have been minimized, particularly by the SLFP.

We suggest that Sri Lanka certainly could not be said to have had a BHN strategy as defined in the March 1978 AID Policy Paper "A Strategy for a More Effective Bilateral Development Assistance Program."

Although definitions of BHN approaches have evolved considerably since initial formulations and there is still some lack of agreement on what are the essential elements of a BHN strategy, the approach appears to focus on such indicators of the physical quality of life as literacy, life expectancy and infant mortality.

The indicators of the physical quality of life for Sri Lanka are generally higher than in neighboring countries with comparable per capita income levels (see Table 2). In a number of indicators, Sri Lanka compares favorably with higher income countries. While

TABLE 2
SOCIAL INDICATORS

	<u>GNI Per Capita (1974)</u>	<u>Population Growth - 76 (%)</u>	<u>Literacy (%)</u>	<u>Student Enrollment (As percentage of 5-19 age group)</u>	<u>Infant Mortality (Per 1,000 live births)</u>	<u>Life Expectancy (Years)</u>	<u>People Per Physician (Number)</u>
Afghanistan	110	2.3	8	12	173	40	26,100
Bangladesh	100	2.7	25	32	130	47	9,780
India	140	2.0	34	42	134	51	4,240
Nepal	100	2.3	14	15	152	44	37,000
Pakistan	130	3.0	25	27	24	53	4,020
Sri Lanka	130	2.0	84	51	45	66	6,100

Source: Selected Economic Data for the Less Developed Countries, Statistics and Reports Division, PPC, A.I.D., May 1977, except Sri Lanka figure for People per Physician from IBRD Report No. 1937-CE, March 22, 1978, Statistical Appendix Table 10.5.

NOTE: Data are for most recent years up to 1976 and were drawn from various sources which may have adjusted country data to improve comparability. Hence there are some minor differences in Sri Lankan data from that used elsewhere in this report.

these results are commendable, focussing on the latest reported indicator is somewhat misleading and other factors should be noted.

First, it is important to recognize that many of these social indicators were already at a very high level at independence. Thus, progress has not been so spectacular as might be assumed. Furthermore a considerable portion of the post-independence growth can be attributed to merely continuing programs existing at the time of independence. In other words, some further improvements were to be expected if governments did nothing more than continue existing policies. Nevertheless, subsequent governments did expand the health network and expanded some of the services that have contributed to the post-independence quality of life improvements.

Second, it is important to look at the trend of the indicators as well as the absolute level. Some of these indicators have fallen in recent years (See Table 1 on page 10a). These setbacks can be attributed in large part to poor weather and international economic conditions which resulted in reduced food availabilities and higher food prices. However, other contributing factors included poor economic policies; politicization of the civil service, with a resultant decline in administrative efficiency; and an overly paternalistic system with inadequate attention to the development of local and individual self-reliance and participation.

Third, some of the indicators tell only part of the story, and the untold part is not so favorable. For example, the fall in the mortality is indeed impressive, but data on nutritional standards raise concern about the physical and mental well-being of many of those who have survived their infancy. A 1975-76 survey indicated that second and third degree malnutrition among rural children under six years of age was over 40 percent^{4/}. This may well reflect the previously mentioned deterioration of economic and social conditions during the 70s, but it illustrates, as a minimum, the vulnerability of the society to macroeconomic conditions.

Another example of the indicators telling only part of the story is literacy. The literacy rate is very high, but the percentage of children in school has fallen in recent years and a survey in low-income areas of Colombo in 1976-77 revealed that there was an extremely high rate of repeating of grades, usually

resulting in early drop-outs.^{5/} Thus, the quality of education is still unsatisfactory and the cost is excessive. This raises questions about the future.

In summary, Sri Lankan social indicators do indeed compare favorably with other countries and there are advantages that have accrued in Sri Lanka from an emphasis on improving the physical quality of life: (a) there is a potentially more productive population than has resulted in many countries which gave less emphasis to BHN considerations; (b) the early emphasis on basic services appears to have had a positive influence on an early reduction in the population growth rate -- although clearly other factors were also at work. However, it is unclear whether the gains achieved are being maintained, and equally serious, whether current levels of social services can be maintained. Further gains in the physical quality of life may require new policies and programs -- including a higher priority given to unemployment and productivity as well as a new approach to the provision of social services.

2. Equity

Sri Lanka is often held up as a shining example of a country that has given priority to matters of equity, and indeed it has. But the recent history of Sri Lankan development raises some interesting questions about how equity is defined, how much advance in equity has really taken place, the means of achieving equity and the costs of the advances achieved.

Equity considerations appear to have been the basis for the pre-independence establishment of free education and health care and free food distribution to disadvantaged groups and food subsidies. Given that the population was accustomed to these services, politicians vied to increase these services and thus, implicitly at least, they defined equity in terms of availability of such services. Providing meaningful employment for all apparently was not deemed to be a priority element of equity by the UNP until the last half of the 60s and by the SLFP until after the youth insurrection in 1971. However, conspicuous consumption was automatically considered by the SLFP and its more radical coalition members, as well as many of the electorate, as evidence of inequity and was therefore to be eliminated through very high income taxes, forced savings schemes and nationalization of the estates and larger enterprises.

Although the foregoing implies certain definitions of equity, in reality many of the issues of equity appear not to have been faced. Certainly the policies reflect inconsistency. For

example, the means of improving equity for the urban working class was to increase wages and salaries, while ignoring the effects on employment, and to hold prices down, while ignoring the effects on industrial profits, investment, production and employment. Equity in the rural areas meant improved land tenure and increased land distribution through land reform and opening new areas and maintaining a high level of social services. However, growth opportunities often were restricted by agricultural pricing policies and inefficient delivery of agricultural inputs. The laboring group in the plantation sector was largely ignored because Indian Tamils were largely without a vote; and the result has been one of the greatest inequities in Sri Lanka.

Moreover, the degree of improvement in equity is not clear cut. It is obvious that virtually everyone (with the exception of many plantation laborers) has access to free education and health care and the quantity of food needed for survival. But this was largely true at independence.

We accept the judgment of the Marga Institute^{6/} that there has been a leveling of income distribution. However, some data suggest that the reduction in the differences between the highest and lower income groups may have resulted from bringing the top down, not by bringing the bottom up. (If so, does that improve equity?) Income data are based on households. On a per capita income basis, lower income families may have experienced both an absolute and relative worsening of their situation because they have large families and are probably affected more by the high rate of unemployment.

Some of the actions or policies carried out in the name of equity have been costly. For example, the nationalization of the plantations has been very costly for the economy, with little (if any) gain in equity. The result has been a reduction in foreign exchange resources (causing declines in industrial production and employment) and in budgetary resources (reducing availabilities for financing welfare services). Increases in income tax rates on higher income brackets appear to have gone so far as to discourage investment in productive activities and contribute to the large scale emigration of managers and technicians^{7/} -- which has contributed to a decline in the quality and quantity of services, inter alia, in the health area.

In general, the over-emphasis on redistribution and inadequate attention to growth has given rise to inequities, particularly

in the form of the rapid rise in unemployment to its rate of about 20 percent in 1977. Certainly the young insurgents in 1971 seem to have seen the unemployment situation and the lack of economic opportunity as very inequitable -- in spite of a high level of welfare services available to them.^{8/}

D. Some General Conclusions

There follow a number of comments and observations on general development issues that flow from our appraisal of the Sri Lankan post-independence development experience. Based on the comments received on the draft report, some readers apparently felt that we were belaboring the obvious, while others felt that our criticisms of the BHN strategy (particularly AID's policy) were inappropriate. This section has been revised to take into account comments received on our draft report. We continue to believe that the issues surfaced deserve further study and discussion within the Agency, as well as more dialogue among Agency officers, host country officials, and other donors.

1. Equity Issues

a. Concepts of equity and equity goals are country specific, and probably culture specific within a country. It follows, therefore, that AID field documents should clearly identify the definitions of equity which apply in the host country (e.g., as perceived by government officials, the intended target group, etc.), and evaluate host country policies designed to deal with them. If the perceived equity issues are not recognized and dealt with (not necessarily resolved), AID programs may not reach the intended target group to the extent intended.

b. Providing for basic service is not necessarily synonymous with equity. In Sri Lanka at the time of independence there was already a high level of basic social services with easy access to them. Thus, equity concerns in Sri Lanka focused on other issues such as preservation of the Buddhist culture, access to the university and the civil service without having to know English, foreign ownership of resources, conspicuous living styles (particularly if the individuals were English-speaking Ceylonese or foreigners owning Sri Lankan resources). The lack of employment possibilities led to the youth insurrection in 1971 and a continuing sensitive political situation, even though the youth's basic physical needs were being provided.

c. Can equity for the disadvantaged be achieved without inequity to the advantaged? In Sri Lanka, the English-

speaking minority was an advantaged group. Was it possible to redress this advantage without the great upheavals that occurred in the schools and in the civil service? Under what conditions is redistribution of assets the best way to achieve equity? How much redistribution of income is equitable? How much is feasible without destroying incentive? What are some of the techniques that have been utilized successfully elsewhere to obtain greater equity for the disadvantaged concurrent with maintaining a high level of economic growth?

d. Equity without growth becomes inequitable. In the Sri Lankan case, the burden of one-fifth of the work force being idle is both financially unbearable and potentially explosive. The costs of caring for this unproductive group is straining resources and causing a reduction in the quantity, and a deterioration in the quality, of the basic services. Perhaps more important, the direct burden of unemployment falls more heavily on the low income family. The unemployed in the higher income family stands a better chance of being employed first and usually has the options of either waiting for a desirable employment opportunity or emigration.

2. BHN Issues

a. How much and what kind of BHN Rhetoric? In our draft report, we were critical of the BHN development strategy as we understood it. We were admonished by colleagues who stated that we were criticizing earlier versions of a BHN strategy rather than the current March 1978 AID policy paper "A Strategy for a More Effective Bilateral Development Assistance Program" (hereafter referred to as the "AID Strategy Paper"). While the AID Strategy Paper sets forth a policy for U.S. bilateral assistance, this should be distinguished from a development strategy per se. It advocates a BHN approach within a development strategy and rightly emphasizes the importance of growth as well as equity, the need to create productive employment. We have been told that these elements are integral parts of the current definition of a BHN strategy.

However, we find no advantage in using a term which is so frequently misunderstood and subject to misinterpretation. It certainly has not been helpful in discussions with many LDC officials -- as acknowledged in the AID Strategy Paper and reinforced by other reports and writings, including negative comments by LDC leaders. A recent article by Soedjatmoko attacks BHN as a strategy, points out the tremendous changes required in LDC political, economic, and social structures to have any chance of achieving BHN goals, and perhaps equally difficult changes in attitudes and approaches by donor countries.

We further believe that a continuation of BHN rhetoric by the Agency is not likely to be helpful in attaining AID objectives including increased Congressional support. At least for the present, Congress seems to understand and be content with the growth with equity emphasis of "New Directions." Indeed, many in Congress, with considerable justification, point to New Directions as its own preferred approach to development. Even though the AID Strategy Paper talks of the importance of macroeconomic policies, the physical quality of life indicators continue to be emphasized as the factors that will be used to judge performance. We are concerned, therefore, that inadequate attention will be paid to ensuring correct policies required for sustained improvement in living standards. As we have seen in the Sri Lanka case, correct economic policies are critical to achievement of BHN objectives. Sustainable progress towards meeting BHN depends ultimately on increasing growth while improving equity.

We are concerned that AID's urging LDCs to establish specific BHN goals, which are achievable at best only over a long time frame, would generate rising expectations and demands for services that cannot be fulfilled. This can lead to internal political problems and possibly also to a diversion of resources responsive to these immediate demands, but which will not further long-term social and economic development.

Emphasis on BHN goals also tends to focus on government-provided services and government responsibility. Participation of the poor in decisions affecting them is mentioned as part of AID's BHN approach, but as governments try to increase their services, they almost invariably reinforce the already predominant practice of top-down development. If governments are under pressure to provide services, local participation is generally given short shrift.

We recommended in our draft report that if a new term is needed to supplement "growth with equity" we should consider "participatory development." We continue to believe that the element of increasing local participation is extremely important -- even though there are no pat answers on how to achieve it and there are many pitfalls in including the poor in a meaningful way in the planning and execution of programs. Local participation has the potential of increasing the resources devoted to development, can assure that the target group(s) feel a part of the development effort, and can contribute thereby to political stability, an essential ingredient to development. Local participation can lead to increased political

rights over time. However, this does not mean that we should circumvent government organizations; rather, we should try to encourage their working more closely with target groups. Thus we are concerned that establishing national BHN goals decreases the chance of target group participation and may well detract from local efforts to establish locally meaningful goals and intermediate targets.

In summary, we support the Congressionally-mandated "New Directions" approach which is designed to promote economic growth and insure that the benefits of U.S. aid accrue to the poor. We also support giving increasing attention to meeting basic physical needs, particularly where they are important to reducing the rate of population growth or increasing productivity and/or incomes of the poor. However, we believe that AID must give greater recognition to individual country economic and social situations and aspirations; and, to the extent possible, be responsive to the desires of AID's target group. Although the AID Strategy Paper does not preclude this, we are concerned that the emphasis on establishing and attempting to meet BHN goals, coupled with recent BHN rhetoric, will strain our credibility with the LDCs and lead to confusion and cynicism among Agency officials -- particularly those in our field missions.

b. How can we measure BHN progress? Whether BHN is the basis of a development strategy or just an additional element in a growth with equity strategy, measurement of progress will still be very important. The Sri Lankan experience indicates the need for reviewing trends in data, not just current magnitudes. But we should go farther than just collecting data and drawing conclusions therefrom; we should obtain the perceptions by various groups (including the intended target groups and policy officials). There also needs to be a review of the quality of the services provided, as well as the quantity. Access to services is basic, and it can be affected by the manner by which services are provided.

The particular indicators of progress used as proxies for the quality of life also need to be reviewed, e.g., the inclusion of specific nutrition measures would appear to be particularly important. Participation of the intended beneficiaries in the process of deciding on indicators and their method of measurement would also be desirable to insure the relevance of the indicators and to improve the reliability of the measurement data.

Recommendations:

1. The Agency should gradually shift its rhetoric away from BHN as a development strategy and speak instead of "growth with equity," with increased emphasis on participatory development.
2. In the further refinement of Section 102(d) country commitment criteria and factors, that:
 - (a) identification of country equity issues and evaluation of the recipient government's policies and actions be considered as a factor under criterion A; and
 - (b) the points made above regarding the measurement of BHN progress be incorporated more fully in the 102(d) factors, particularly with regard to Criteria E, F, G, and H.
3. The Agency should disseminate information on, and sponsor additional study of, successful and unsuccessful attempts to facilitate the participation of the poor in decision-making and programs affecting them. The information disseminated should pay particular attention to the apparent impact of different cultural values, including specifically religious beliefs.
4. The Agency should also find ways of creating an expanded dialogue on strategies of development and problems of development administration between the economic and social development planners and practitioners in the LDCs and the so-called development experts of the principal donor/lender countries and international development agencies.

One possibility might be a type of international Development Studies Program carried out by the planning affiliates of the UN regional economic commissions, with the attendees at each seminar/workshop representing a variety of disciplines. Perhaps two-thirds could be LDC representatives and one-third from contributing countries and international agencies. The workshop locations could be rotated within the region to enhance further the possibility of improving the quality of the development dialogue within the various countries of the region. Occasional inter-regional meetings also would be beneficial. We specifically recommend that IIA, which has indicated a willingness to do so, pursue this proposal.

III. CURRENT DEVELOPMENT ENVIRONMENT

A. The Situation Facing the GSL in 1977

Before looking at GSL policies and development strategy, it is useful to review briefly the economic situation in Sri Lanka when the UNP government took over in July 1977. There follows a summary by the IBRD of that situation.

"The inheritance of the Government that took office last July was, for the most part, clearly unenviable. Medium-term growth prospects were constrained by the severe neglect in the 1970s of the productive sector of the economy. Tree crop production and export prospects were depressed by past low replanting rates. Foodgrains production was handicapped by a severe deterioration in agricultural support services and a tolerance of wasteful water use practices. Manufacturing was characterized by demoralized and inefficient public and private sector firms, nurtured in a highly protected environment. Low and declining investment levels have led to a severe erosion of the capital stock. A large program of welfare expenditures, subsidies, and transfers, supported by the dwindling surpluses of the tree crop sector, left policymakers little scope to divert resources for development. Commitment to welfarism was also partly responsible for price distortions that prevailed throughout the economy both in the form of controlled prices and unrealistic relative prices. The dual exchange rate reinforced these distortions by artificially reducing the cost to the budget of the food subsidy, reducing returns to paddy farmers and shifting the budgetary burden to the main foreign exchange earner -- the tree crop sub-sector. A large pool of unemployed, with high expectations of the new Government, greatly reduced its freedom of maneuver. A run-down system of planning and administration and a demoralized bureaucracy were obstacles to the development of appropriate policy responses to the structural problems facing the economy.

"On the positive side of the balance sheet, the Government inherited a relatively strong external position, due to an unexpected improvement in world tea prices. Favorable weather, after years of successive drought, also provided a welcome respite. Further, there was considerable capacity throughout the economy waiting

to be utilized. Sri Lanka also remains a country rich in natural and human resources. The impressive gains noted above in the social fields provide a healthy, highly literate population, an asset that has been grossly neglected so far. Sri Lanka is also fortunate in that it is not required to divert large resources for internal or external security.

"The challenge for the new Government was how to take advantage of these positive elements to tackle the tasks of structural change. In the medium term, there are inevitably conflicts between the need to restore growth and the legitimate concern for equity and current consumption. Past experience suggests that these conflicts have been much less serious when the economy was growing rapidly, as in the 1960s, than when it was growing slowly. Further, the scope for cuts in transfers and subsidies is large, since explicit and implicit subsidies pervade the entire economy. These cuts need not, therefore, be focused entirely on politically sensitive social programs, nor need they affect poor target groups.

"The primary emphasis must lie on improving the quality and efficiency of investment. But an increase in investment is also inescapable and would involve a major effort at raising the level of domestic savings. This calls for a major shift in the direction of economic policies"10/

B. GSL Economic Policies

The GSL has taken a series of policy initiatives on the economic front designed to "free the economy." This involves a shift in emphasis from direct controls to reliance on the price mechanism, and a consequent realignment of relative prices. An increased role is envisaged for the private sector with a corresponding reduction in the dominance of the public sector, particularly in trade and distribution. The main thrust of the new policies is the dismantling of administrative controls over the allocation of resources, and the restoration of realistic relative prices.

This is being approached on the external front by a major liberalization and restructuring of the external trade and payments system, supported by a unification and readjustment of the exchange rate. Most public sector import monopolies have been terminated.

Prior licensing of imports has been reduced to a short list of items. Most exchange controls over invisible transactions have also been relaxed. The exchange rate has been unified and allowed to float. A new import tariff structure has been introduced, designed to provide less, but adequate, protection to domestic industry and to discourage luxury imports. Other indirect taxes have been adjusted to compensate for the reform of the exchange rate.

The unification of the exchange rate had the effect of sharply increasing the cost to the budget of the food subsidy, since food was previously imported at the official exchange rate. To reduce this drain on resources and to focus it more on the needy, the subsidy has been confined to households with a monthly income of up to RS 300 (\$19) -- one-half the population. To offset the adverse impact of the cuts in subsidy, wages and salaries have been increased across the board by 25 percent (subject to a ceiling of RS 50 per month). The provision of a dole of RS 50 per month for the unemployed has been announced -- although not yet implemented. The Guaranteed Price Scheme procurement price of paddy has been increased by the GSL 21 percent to RS 40 per bushel -- a step designed to increase paddy production. As an expression of concern over income distribution, the highest marginal rate of income tax has been raised from 50 to 70 percent, and a ceiling of RS 3,500 (\$220) on monthly salary incomes has been announced.

To check the inflationary impact of the new exchange rate and wage increases, price adjustments have been deferred in the case of wheat flour, fertilizer, petroleum, public transport and infants' milk food. Public corporations have been allowed more autonomy in pricing and distribution policies; their recourse to budgetary transfers has been correspondingly reduced. Their role in internal distribution has been curbed and the more inefficient firms are to be liquidated.

The fiscal implications of the new measures are a current account surplus of RS 651 million in the budget compared with a deficit of RS 88 million in 1977. The improved current account position, in turn, will facilitate a doubling of the capital budget, which in real terms amounts to a recovery to the high 1976 levels.

The fiscal package was complemented by major changes in interest policy introduced in the autumn of 1977. Deposit rates of the National Savings Bank and post offices have been raised from 7-8 percent to 12-18 percent for 6 to 18 month deposits. Long-term rates remain unchanged. Monetary policy currently is being used to

prevent a rise in speculative imports, and to keep inflation under control.

In essence, the reform program tries to find the right economic and political balance between:

- public investment and consumption expenditures;
- the need to reduce subsidies and the need to protect the poorest groups in the society;
- the need to raise farmers' incentives and the need to protect domestic consumers;
- adequate protection for domestic industry and import liberalization; and
- the need to check inflation and the need to provide an adequate expansion of money supply to finance the increased volume and value of economic activity.

Although the foregoing represents a good start, it is anticipated that some further steps will be necessary to ensure, over the next two or three years, the internal consistency of the program. In addition, some further measures are needed to increase the level of public savings -- through additional revenue efforts and through a phased reduction of subsidies, e.g., the price of wheat flour.

Employment Policy

The GSL has quite rightly placed employment generation high on its policy agenda. A million unemployed (20 percent of the labor force), most of them young and many vocal, not only constitute a serious threat to political stability, but also represent a vast pool of substantially unutilized resources. Furthermore, the problem will get worse in the next few years.

From 1977 to 1982, the labor force is expected to grow at an average rate of 2.6 percent annually. More than 70 percent of the new entrants will have at least some secondary education; about a third will be women. If employment grows as slowly in relation to output as was the case between 1963 and 1971 (1.7 percent growth in employment compared to 4.5 percent in GDP), then with a quite rapid 5.6 percent growth in output from 1977-1982 (IBRD's projection), employment would grow by 2.1 percent and the unemployment rate would continue to increase by 0.7 percent annually. Merely to avoid further increases in the number unemployed would require a 30 percent increase in the labor intensity of growth (ratio of employment to output growth). Realistically, therefore, unemployment is likely to be a continuing problem for years to come.

The new government has been moving with understandable haste to take ameliorative steps. There are three discernible elements in its approach. First, it has introduced change in the machinery for placement in public sector vacancies. Second, it is launching a number of short-term employment measures, primarily aimed at filling all existing "vacancies" in the public sector. Third, its choice of long-term development projects is, in part, dictated by the employment potential these appear to offer -- although not ameliorating the short-term situation, it can provide hope for eventual improvement.

The normal administrative machinery for placing the unemployed in public sector vacancies had ceased to function for all practical purposes. This was due mainly to the increasing degree of politicization in public sector appointments which caused the established machinery for placements to be short circuited. The new government has established a procedure which should improve on the situation, but it still involves Members of Parliament (MPs) in the initial screening of the unemployed in their electoral district to determine who will receive priority consideration for placement in government jobs.

There may well be pressure on the GSL to "find" vacancies to absorb the numbers identified by the MPs. This would have serious repercussions. For example, if the tea corporations are forced to hire the number of people calculated as "vacancies," the increased costs for the two public sector corporations would have disastrous financial implications. In general, if relatively unproductive employment expands as rapidly as is implied by the GSL's crash programs, it could eat into scarce budgetary resources for development.

As indicated earlier in this section, a rapid growth strategy would not in itself take care of unemployment. What is needed is a more careful choice of public sector investments and the establishment of incentives to make the growth process more labor-intensive through appropriate factor pricing, manpower training and improvements in the working of the labor market. Although recent GSL actions have somewhat reduced the subsidy to capital in new investments, it still is estimated at 20-30 percent. At the same time, other GSL actions have increased labor costs 10-25 percent. Therefore, additional action is needed to improve the profitability of labor-intensive investments. The IBRD recommends that the proposed Tax Commission, when established, review investment incentives in order to design a system that avoids unintentional

interference with employment growth. Consideration is also suggested of subsidies tied to increases in employment rather than to use of capital.

Another key determinant of employment growth is likely to be the pattern of sectoral investment. Because of the possibilities for increasing the acreage farmed and increasing cropping on existing lands, the agricultural sector appears to offer the most employment opportunities. Substantial employment opportunities lie in a more intensive utilization of existing irrigated paddyland. Improved cultural practices, such as weeding and transplanting, better water management, improved maintenance of irrigation schemes, and the increase in cropping intensity that would follow from these, are all highly labor-intensive. As for tree crops, tea is the most labor-intensive crop in Sri Lanka, and replanting, which was not maintained during the hiatus of the early 70s, badly needs to be accelerated. The cultivation of the vegetatively propagated high-yielding teas is particularly labor-intensive. There is also scope for rehabilitation of catchment areas under tea and reforestation of tea lands for timber and cover.

The extent to which the GSL succeeds in its efforts to shift from import substitution to export-induced growth will be a key determinant of employment growth in the industrial sector. IBRD recommends that the GSL also give greater attention in industry to: (1) the informal sector -- small-scale manufacturing and services -- through improved fiscal and credit policies and better coordination of government agencies, and (2) construction, which has been handicapped by the persistent low level of public and private investment.

The structural problem of educated unemployment further complicates the Sri Lankan employment problem. Many of the educated seek white collar jobs. Since there have been seasonal labor shortages in rice surplus areas, in spite of high unemployment levels, it is feared that increased investment in agriculture may not achieve the employment potential. The tendency to avoid agricultural labor may be modified, however, with higher wages that more realistic paddy pricing would permit and increased mechanization which is needed for other economic reasons.

The structural problem could be exacerbated by the proposed government supplementary doles to the unemployed and crash programs to fill government "vacancies" -- actions which could make unemployment more attractive than semi-skilled or unskilled employment for the educated young, i.e., they might believe that if they remained unemployed they would be rewarded with government help or prestigious government jobs. The GSL seems aware of the problem, and is working on a "development corps" proposal which would give

some status to its members and minimize the loss of dignity ascribed to manual work.

Education policies also could be used to tackle the structural problem. The GSL appointed an education commission to review the education system, but, unfortunately, it has proceeded to introduce a number of changes without waiting for the findings of the commission. Further, the actions taken to date are more likely to exacerbate the structural aspect of the employment problem than to alleviate it.

For example, the GSL has modified the secondary system to make it more comparable internationally, but this has meant adding a year and deemphasizing vocational subjects. This change was justified on the ground that the objective of the previous system, i.e., to equip pupils to pursue occupations traditionally followed in the area where they lived, was never achieved. However, sufficient resources were not made available to give content to the new forms of education and the system was introduced too abruptly, with little effort made to build support for it among parents. Achievement of the objective of the rejected system should have been pursued.

The GSL is also considering an expansion of post-secondary vocational and university education in an attempt to ease the employment problem by temporarily delaying entry into the labor market. Given the already existing budgetary constraints on education, this high cost measure is likely to cause an undesirable squeeze on funds required to make education at lower levels more relevant and to reduce the repeat and dropout rates. To the extent that this proposal expands the number of those with post-secondary qualifications, at a time when unemployment among that group is growing, it will only aggravate the problem in the medium term.

Another governmental action to alleviate the unemployment problem has been to encourage the emigration of skilled and semi-skilled Sri Lankans to the Middle East. Such a measure can provide a source of foreign exchange earnings and be an outlet for the trained unemployed. It will be necessary, however, to ensure that scarce skills are not lost to the country and guard against exploitation of the emigrant workers.

In summary, the GSL has given priority to the unemployment problem, but efforts to date have been primarily to establish some crash programs to ease the immediate situation. It is understandable that it feels it must respond in the short term to a crisis situation. However, real solutions will only be possible if the GSL:

- (1) adopts additional measures to create incentives for private

sector labor intensive activities; and (2) increases public investment, particularly in sectors with a large employment potential.

It is too soon to judge the adequacy of some of the GSL measures to increase employment, because they are still in a formative stage. Nevertheless, we are concerned that some of the crash measures will have detrimental long-term effects. Consistent and persistent reform measures are essential for long-term improvement.

C. GSL Development Strategy

The GSL is in the process of preparing a development strategy for the 1978-82 period, but its proposal is not expected to be available before late 1978. Nevertheless, the main elements of the GSL's strategy have been announced: (1) an acceleration of the implementation of the Mahaweli River Basin Development plan; (2) the establishment of an export processing, free trade zone north of Colombo; and (3) an urban renewal program for the Greater Colombo metropolitan area. While the GSL plans to continue other development measures, these three have been emphasized and presumably have the greatest political appeal.

1. Mahaweli Development Program

Of the three principal elements proposed for inclusion in the GSL development strategy, by far the most important from the point of view of its claim on resources is the development of the Mahaweli Ganga (Ganga = River). The Mahaweli is Sri Lanka's most important river, draining an area of about 4,000 square miles. The river is the principal unexploited source of water for irrigating the dry zone -- potentially it could improve or bring irrigation to 900,000 acres, doubling the present irrigated acreage. It also has the potential for about 500 MW of hydropower development.

The original surveys and explorations of the Mahaweli area were financed by USOM in 1960-61. The UNDP subsequently financed the preparation of a "Master Plan" for developing the basis.

Implementation of the Master Plan, which called for completion over a period of thirty years, was initiated in 1970 and has been rather slow. The new government initially promised to complete the remaining works in 5 years. In response to skepticism by the members of the Sri Lanka Aid Group (donor consortium) that such a feat was either possible or desirable, the GSL has been talking more recently of completing only the four or five top priority projects within

five to ten years. However, it has insisted on the necessity of initiating the next phase program by early 1979. This also will not be easy because the Mahaweli Ganga implementation plan, which is being developed with the help of a Dutch consulting consortium (NEDECO), will not be finished before November 1978.

There is a consensus among the Aid Group members that the development of the Mahaweli Ganga Basin should be part of the GSL development strategy. There has been concern, however, that a too rapid acceleration of the plan could result in an over-extension by the GSL -- in terms of management and planning attention, budgetary resources and professional and middle-level technical personnel -- with minimal short and medium-term results. For example, there would be no output from the acceleration until the early or mid 1980s.

Earlier increases in output could be achieved by improving water management in a number of the already irrigated areas and by renovation of existing reservoirs and canals; however, these activities could easily be neglected in favor of the new construction. Even though labor absorption on new farms to be created in the next phase of the Mahaweli would be some years off, the project could provide considerable employment during its implementation. Some of this could be lost, however, if the GSL establishes such short deadlines for the construction of the dams and reservoirs that it becomes necessary to utilize capital intensive construction methods.*

Acceleration of the development of the Mahaweli is justified as a major element in the GSL's development strategy because of its potential to increase both employment and food production. Its large magnitude raises public expectation of solution to the pressing problems of slow output and employment growth and provides the GSL with a rationale for reducing some welfare expenditures in order to raise resources for development. It may also be that production gains through an expansion of irrigated acreage can be more easily achieved than through the enforcement of administrative and political discipline in such sensitive areas as water management and credit -- areas where it has been traditional not to enforce discipline. The Mahaweli Development Program was already being implemented by the previous government so it does not run the risk of being abandoned with a change of government.

Thus, the issue with regard to the Mahaweli is not whether, but how much and how fast. The IBRD believes that the GSL intends to allocate no more than RS 7,500 million in 1978 prices (about \$500 million) to Mahaweli over a five-year period and that such a level

*Recently an IBRD supervision team found very serious problems in implementation of Phase I of the Mahawela Ganga project, primarily because of efforts to accelerate construction and settlement while physical and human resources have been diverted to planning and implementation of Phase II. This underscores the need to avoid an over-ambitious or over-accelerated Phase II program.

is manageable if carefully phased. Nevertheless, the Bank warns that care would need to be exercised that non-financial resources such as experienced engineers and the energies of public officials were not overly concentrated on the Mahaweli program at the expense of other projects.

2. Free Trade Zone

The establishment of a Free Trade Zone is presented by the government as a cornerstone of its industrial policy. To understand the rationale for this proposal, as well as have a basis for judging it, it is necessary to have an understanding of the serious problems in the industrial sector at the time of the change of government.

First, industrial growth had slowed down in the 1970s to 2.3 percent, with an average capacity utilization of only 60 percent. This low growth rate and capacity utilization reflected import controls (for a sector that imported 70 percent of its raw material requirements), price controls, poor planning, low efficiency and the relatively small size of the domestic market. Second, many existing industries were not competitive, having been established behind a protective wall of quantitative restrictions and high tariffs. Third, the private sector had tended to shy away from sizable investments, given the frequent changes in the policy environment and the nationalization episodes. Foreign private investors kept away.

The new government's policy is to encourage export-led industrial development in preference to import-substitution, since the latter had proved to be both uneconomic and incapable of generating significant employment. The first steps to implement this new policy were in the area of dismantling the foreign exchange and import restrictions and initiating tariff reform. The Free Trade Zone enabling legislation has been passed as a further important element in implementing the export-oriented industrial policy.

The Zone is seen as a way of achieving in one cordoned-off corner of the country what the political climate probably would not permit in the country as a whole, i.e., launching a major effort to attract domestic and foreign investors by providing guarantees on repatriation of capital, placing restrictions on labor, etc. It might also be less likely to be immediately and completely reversed by a change of government, especially since the previous government proposed a similar arrangement for the east coast port of Trincomalee.

Given the foregoing context, the Free Trade Zone proposal would seem to be a good one. For it to be effective, however, it will be necessary for the government to clarify some of its ambivalence towards private investment. In addition, further export incentives will need to be established. Even if these steps are taken, the Free Trade Zone should not be seen as a panacea for the industrial sector's problems. The employment potential is estimated by IBRD at only about 12,000 jobs in five years and the net foreign exchange earnings may be quite modest in the first four or five years.

It is important, therefore, that the government not let the Free Trade Zone effort divert its attention from creating an incentive and institutional infrastructure for non-traditional exports irrespective of where these activities are located. Concurrently the government must give high priority to reform of the public sector enterprises which account for 66 percent of the current gross value of production in the "organized" industrial sector. Equally important is improved governmental support for small scale industry, particularly outside the Colombo area.

3. Greater Colombo Urban Renewal

While details of this proposal are not known, it apparently will have a very heavy component of housing as well as infrastructure for water supply and sanitation. It is counted upon to provide substantial employment, in addition to improving living standards. How much employment will result will depend upon the target completion dates established -- if they are short, capital intensity will be necessary and employment gains will be minimal. Furthermore, availability of semi-skilled and skilled workers and local construction materials may be a constraint if a large program is undertaken in a short time frame.

D. Absorptive Capacity

The most likely constraints to the GSL's development effort during the next two to three years are discussed briefly below.

1. GSL Administrative and Planning Capabilities

A major determinant of the success of the GSL's efforts will be the outcome of its current attempt to transform the system of planning and administration, machinery which has been neglected over the years. The bureaucracy had become excessively politicized

and used to merely responding to political directions rather than engaging in a process of identifying problems and designing solutions. There was little interministerial coordination, resulting in policies and promises that were often inconsistent or unrealistic. There was excessive interference by politicians and pressure groups in routine decisions at both national and local levels, causing routine micro-level decisions to end up at the ministerial level. The result was excessive delays in decision-making and implementation and neglect of policy evaluation and monitoring of progress. (Ambassador Marshall Green emphasized the need for both improved inter-ministerial cooperation and for better coordination with donors.)

The Government has taken a number of steps designed to respond to these challenges and problems. It has obtained legislative approval of constitutional amendments designed to increase the powers of the executive branch and partially to insulate it from the vicissitudes of the legislative process. A reorganization of local administration with similar objectives is also under way. The Ministry of Planning and Economic Affairs has been merged with the Ministry of Finance to streamline the machinery for planning and to ease the problems of coordinating the capital budget and foreign exchange management with the general budgetary process. A newly constituted Committee of Development Secretaries coordinates decisions on the capital budget and will review progress in the preparation of projects and sector plans. The Ministry of Plan Implementation has been given additional powers to coordinate and monitor implementation. The Mahaweli Development Board is being strengthened in view of the expected much larger program that it will have to administer; it has been moved from Colombo to Kandy where it will be closer to actual project activity.

The foregoing are sensible steps, yet to be institutionalized, but more remains to be done. The planning process remains greatly handicapped by the absence of policy planning capabilities in line ministries. There are few economists and technical specialists in line ministries and a lack of technical capabilities for project preparation. The latter problem is being addressed by technical assistance efforts of the UNDP, UK, Canada and the Netherlands, including the training of local personnel in project preparation. The IBRD has recommended that the GSL implement the recommendations of the UN Economic Commission for Asia and the Far East in its Report to the Government of Sri Lanka on the Development of Administrative Capability to Support the Five Year Plan (1972-76). In addition, the Bank recommends an upgrading of the salaries of the civil service and the institutionalization of a program to train and upgrade the planning skills of civil servants.

2. Professional and Technical Personnel

As indicated in the previous section, some of the ministries are short on technical professionals. This situation could well become aggravated with the substantial increase in development activity that is planned. Although there is a high rate of unemployment, the bulk of the job-seekers are not professionals and are without technical skills. There are unemployed college graduates, but not in the technical areas; furthermore, the technical specialists represent the largest share of the emigrees who have obtained employment outside the country.

The "brain drain" was taking over 600 professionals per year during 1973-75 and probably was at a higher level in 1976 and 1977. Doctors, anesthesiologists and other medical personnel, engineers, teachers and accountants were the most numerous of the professional emigrants. Ninety percent of the doctors and about half of the engineers and teachers who emigrated in 1973-75 went to developed countries, probably with the intent to stay. The others, plus over 70 percent of the accountants and probably substantial numbers of sub-professional technicians went to developing countries, particularly the oil-exporting nations of the Middle East. Members of the latter group generally are on specified fixed time contracts and hence probably expect to return. The GSL is concerned about the brain drain problem and reportedly has taken some steps to encourage repatriation of certain types of professionals; however, it is still not clear how successful this effort will be.

The government has indicated its willingness to use large numbers of expatriates, if necessary, to implement its development program because of the urgency to obtain economic growth to absorb the already unemployed and the high level of new entrants into the labor force. Specialized training programs for middle level personnel will also need to be emphasized and expedited.

3. Construction Industry

The Sri Lankan construction industry is unlikely to be able to cope with an acceleration of the Mahaweli Development Program, the construction of Free Trade Zone industries and the construction inherent in the Greater Colombo Urban Renewal Program. In addition to the likely shortage of skilled and semi-skilled personnel, there are management problems in many smaller firms plus an outright shortage of firms to undertake all the work. Waiting for imports of building materials could well be a problem early in an expanded construction phase. It probably will be necessary to rely on expatriate firms to satisfy the construction requirements of an accelerated development program. An early expansion of technical and trades training programs, some of which is already planned, will be essential.

4. Port and Internal Distribution Capabilities

Port handling capacity and the adequacy of the internal distribution network were not cited in the recent IBRD report as likely constraints to the implementation of the development program, although problems in these subsectors were cited in the Finance Minister's Budget Message of November 1977. We understand that the port of Colombo is operating at near capacity now, with occasional delays already occurring in ship unloading. The virtual elimination of exchange and import controls should lead to an increase in imports, even without the extra impetus of the proposed three major activities (Mahaweli, Free Trade Zone and Colombo Urban Renewal). Even if these activities emphasize labor-intensive methods, there will still be a need for a considerable quantity of imported equipment, building materials and supplies.

Presumably, port capacities will be reviewed by the NEDECO group as they prepare the detailed implementation plan for the Mahaweli Development Program. It is possible that the Colombo port capacity can be expanded somewhat through improved management. The ports of Trincomalee and Batticaloa on the east coast probably could handle some increase in traffic, and these ports might be convenient for off-loading some of the equipment for the Mahaweli program. It is likely, however, that this would entail some advanced planning for port management and perhaps the import of some additional equipment. It would probably also involve some additional access road construction -- or at least construction of a somewhat different network into the Mahaweli than if the port of Colombo were used.

The internal distribution network is already strained, particularly at harvest time (when the harvest is good) and when there is the need to move large quantities of fertilizer into the farming areas. The initial bottleneck will probably be in rolling stock, but increases in traffic that should result from the accelerated Mahaweli construction activity and anticipated gains in agricultural production will lead to an early requirement for an upgrading of a number of roads. Possibly rail transport can be increased to alleviate part of the strain that will be developing on road transport.

5. Budgetary Requirements

In its March 1978 report,^{11/} IBRD reviewed the growth potential of the principal economic sectors and concluded that a growth rate averaging about 5.5 percent in the medium term was possible, with a gradual acceleration by the early 1980s. However,

to achieve such a level of growth would require a marked increase in the level of investment from the 15-16 percent of GDP experienced in recent years to some 20 percent by 1982. In addition, the pattern of government investment outlays would have to shift away from some of the public industrial corporations to the agriculture sector. It might also be necessary to cut back on some of the crash unemployment programs that the government has initiated.

Raising sufficient resources to finance an enlarged capital program and the associated recurrent expenditures will not be easy. Private consumption is expected to rise sharply in 1978 as some accumulated savings are spent on imports under the liberalized trade regime. Consumption must decline thereafter, as a percent of GDP, either voluntarily or through increased taxation, to free resources for capital formation. Domestic savings will need to rise from 12 percent of GDP in recent years to 15.5 percent by 1982. The recent increase in interest rates paid to private savers should facilitate some increase. However, more strenuous tax efforts and a substantial reduction in the burden of transfers and subsidies will be necessary in the medium term.

The tax effort would focus on reducing the over-dependence on the tree crop sector by shifting the tax burden in favor of domestically based taxes, such as the business turnover tax, and eliminating or tightening the excessive number of exemptions and deductions that characterize existing taxes. Reducing transfers and subsidies would involve cutting the very expensive food subsidy, particularly for wheat flour (a partial first step was taken in early May) and sharply reducing or eliminating the transfers to the Ceylong Transport Board and the Ceylon Petroleum Corporation and to public corporations which have performed poorly.

Taking the necessary steps to augment government revenues, reduce current expenditures and reallocate capital expenditures along the lines described above will be crucial to achieving the government's development goals, but these steps will be very difficult politically, particularly reducing sharply the transfers and subsidies affecting low and middle income families.

Aid Group members could insist that the GSL take such measures to demonstrate its determination to achieve a growth level that has a chance of laying the groundwork for an eventual reduction in the level of unemployment. Alternatively, they could structure some of their assistance, particularly during 1978 and 1979, in such a way as

to absorb a higher level than usual of government expenditures. This could permit the GSL to defer some of the more severe politically sensitive measures, thereby increasing the chances that resources would be available for, and the GSL could devote its attention to, initiating and monitoring the new development activities. Furthermore, some improvements in the employment and income situation should begin to show up in 1979 from the economic liberalization measures and from the initiation of some of the new development activities. This could mean some automatic reductions in transfers (from increased employment), as well as result in a more suitable environment for reducing further some of the subsidies.

6. External Resources

External prospects are constrained by the anticipated modest growth in export earnings (IBRD estimates 9.6% in current dollars from 1977 to 1982). The over-dependence upon tree crops for export earnings also makes for an undesirable level of vulnerability. Nevertheless, IBRD anticipates that the medium-term balance of payments position is likely to be comfortable since export earnings are expected to be high for the next two years or so. However, implicit in the Bank's balance of payments estimates are a level of imports in 1978 of \$100 million less than estimated by the GSL, a sizable increase in coconut exports in 1979, no significant decline in the price of tea and a high level of foreign assistance.

Given the uncertainties attached to import liberalization, the Bank suggests that donors respond promptly to Sri Lanka's requests for increased levels of quick-disbursing non-project aid in the remaining months of 1978 and 1979. Such assistance will help the Sri Lankan authorities to discourage excessive speculative imports by ensuring continued import liberalization and enable Sri Lanka to restrict its recourse to more expensive forms of borrowing. The IBRD also suggests that donors will need to reach a high level of fresh commitments in 1978 to ensure an adequate level of aid disbursements in 1979 without a severe depletion of the aid pipeline -- about \$300 million in 1978 compared to \$269 million in 1977.

If the GSL's medium-term development program, due to be presented in the fall, and follow-on policy initiatives are a reasonable response to the structural problems facing the Sri Lankan economy, the Bank proposes a rise in gross aid disbursements in the medium

term of about 12 percent per annum in current dollars between 1977 and 1982. The Bank states that such aid levels on a per capita basis would not be unduly high in relation to the other aid recipients of a similar size and per capita income. Based on informal "pledges" given at the Aid Group meeting in Paris on May 5, 1978, it appears that the donors agree with the Bank -- their pledges were about \$340 million (this figure may not be fully comparable to the \$300 million cited above). The current account deficit could be as much as \$100 million higher from 1980 onward if the Mahaweli Development Program is implementing rapidly by then; the Bank assumes that much of the increased import level would be financed by increased project aid.

IV. A.I.D. STRATEGY ISSUES AND OPTIONS

A. Level of Support

Two political factors, as well as normal economic development issues, are relevant to decisions on the magnitude of the A.I.D. program in Sri Lanka. One of the political factors involves the potentially volatile future of Sri Lanka and the other relates to the past when U. S. aid programs have been a political issue in Sri Lanka.

Previous mention has been made of the youth insurrection of 1971, the deterioration of the economic situation subsequent to 1971, and the rising level of unemployment (about 20 percent in 1977). Leaders of the new UNP government elected in July 1977 believe, and we are inclined to agree, that this may be the last chance for a democratically elected government to prove that it can successfully cope with the basic economic and social problems that have undermined the confidence of the youth in their leaders and their system of government.

This has been cited as a reason why the U. S. should increase its support substantially to Sri Lanka. This could indeed be a strong argument for increased support if, 1) the new government is prepared to adopt and carry out appropriate policies and programs; 2) a large U. S. contribution would not make U. S. aid again a political issue and thus be counter-productive -- either to maintaining internal support for the GSL development effort or to maintaining good bilateral U. S. - Sri Lankan relations; and 3) a large increase in our aid would make a substantial difference.

Embassy officials in Colombo informed us how the U. S. aid program had been an issue in previous election campaigns and expressed their concern that it might become so again. However, their concern seemed much less with the possible magnitude of the program than with the number of AID people assigned to Sri Lanka, where the USAID had its office, and how much publicity was given to the program.

It is understandable that U. S. aid has been at times a political issue because the U. S. has terminated its program twice in Sri Lanka for essentially political reasons: first in 1953 under "trading with the enemy" provisions of the Battle Act because of Sri Lankan trade with the People's Republic of China; and second in 1963 under expropriation provisions (Section 620(e)) of the Foreign Assistance Act. Also, U. S. aid obligations generally have been much less during SLFP administrations, even when not formally terminated, than during UNP administrations. Given some of the SLFP's economic policies, this would have been justified on developmental grounds; however, political factors appear generally to have been important, if not decisive.

Sri Lankans queried by the OAS team acknowledged that U. S. aid had been a political issue earlier, but said that it had not been so in recent years. The fact that the U. S. had resumed aid to Sri Lanka in 1975 under the SLFP no doubt explains why U. S. aid was not a campaign issue in 1977.

We agree that U. S. aid could become a touchy issue once again, but believe that it is not so at the present time and that the A.I.D. program can be structured in a way to minimize the danger of it becoming an issue. In addition, the manner of conducting and publicizing the program can also affect its vulnerability to demagoguery; this is discussed further in the section below on relations with the Embassy. Therefore, we conclude that the developmental issues, not a possible political issue, should be the primary determinants of the level of U. S. assistance.

Section III.A. above presents the situation facing the new government and the principal policies adopted during its first nine months to remedy the situation. As previously indicated, we have concerns about some of the policies. However, we believe that the initial effort, on balance, is worthy of support; the GSL is pragmatic and will modify its policies further as the situation evolves; and the political restraints facing the GSL are such that some of the desired corrective actions in reducing subsidies and transfer payments will only become feasible when there is evidence of some positive results from some of the GSL's policies and programs and evidence of strong donor support for the principal elements of the GSL's development strategy.

As indicated previously, the principal elements of the GSL development strategy are accelerated development of the Mahaweli river basin; creation of a Free Trade Zone to foster export-oriented industry; and an urban renewal program for the Greater Colombo area. External donors might well suggest other activities that might produce more immediate results, particularly with regard to providing employment, e.g., reservoir renovation, investments in the plantations, rural industry and/or public works. However, it is the GSL which must establish its own political economic, and social priorities.

It is important to note the importance of the GSL strategy in terms of obtaining local public support for the program. The Mahaweli development program can be seen as a major national effort and particularly important to the rural sector; the free trade zone should garner support of the private sector and should increase employment possibilities in Colombo; and the Colombo urban renewal should be welcomed by a large part of those living in the Colombo area, including presumably the majority of organized labor.

All of the elements of the GSL strategy are long-term development projects which make sense in the Sri Lankan environment and are worthy of external support. An early start on these programs could provide a basis for hope in the future and help create a climate conducive to a discussion of other development policy issues on which consensus will be more difficult to achieve.

The foregoing proposed programs, however, are insufficient to make a dent in the unemployment problem. Furthermore, if these activities are pushed too rapidly, there will be inadequate human and financial resources available for other development activities which are less dramatic but which are likely to have a much greater impact on both production and employment in the medium term. There are increasing indications that GSL authorities realize this and are sufficiently pragmatic and adjust their plans as needed. It is important, therefore, that Aid Group members, including the U. S. offer support for the less dramatic programs and for activities designed to increase the country's capacity to plan for and monitor higher aid levels effectively.

Six different factors were discussed under Absorptive Capacity: (1) GSL planning and administrative capability; (2) professional and technical personnel; (3) construction industry capability; (4) port and internal distribution capabilities; (5) budgetary requirements; and (6) external resources. Steps are already being taken to improve the first two of these; furthermore, expatriate personnel can be used to alleviate these problems and the GSL has indicated its willingness to do so, particularly if necessary to carry out the major elements of its development strategy. The second two factors may not turn out to be bottlenecks, particularly if they are analyzed early and adequate plans are made to ameliorate potential problems.

The most crucial element is apt to be budgetary resources because, at the moment at least, the members of the Aid Group seem disposed to provide a reasonably high level of external resources. The form in which the external resources are provided can determine to a very considerable extent how serious the internal budgetary resource problem will turn out to be. For example, the budgetary problem can be exacerbated if the donors insist on a high level of GSL contribution to all projects and are unwilling to provide significant levels of local currency support. On the other hand, the external assistance could be provided in such a way as to reduce some of the budgetary requirements, not only by providing local currency support but also by financing imports of commodities that normally would be covered by ministry budgets, e.g., equipment and medical supplies for the health service.

In summary, we conclude that Sri Lankan conditions justify strong development support from the U. S. There is a desperate need, not only in terms of a low GNP per capita but in terms of the threat to the stability of this democracy -- a threat which has resulted primarily from the slowness of economic growth, particularly during the 1970s. Because of a high level of basic services and a strong concern for equity, education and health standards are relatively high. Unexploited natural resources, particularly in agriculture, are available. The GSL has adopted a number of needed economic policies designed to free personal initiative and take the shackles off the economy. At the same time, it evidences a concern for equity and basic human needs and will continue a high level of services--albeit somewhat reduced from the previous levels which were too high to be sustained. Economic and social planning and interministerial coordination have been improved--although further improvements are needed. The development program as it is evolving is worthy of support.

It is somewhat premature to recommend a particular dollar level before the Agency can review the NEDECO proposed implementation plan for the Mahaweli Development Program and the GSL development strategy promised for later this year. However, we could conceive of a development assistance program in Sri Lanka (excluding P. L. 480) rising within two years to a level up to \$40 to \$50 million. However, we do not recommend making a commitment of a certain level annually. Rather, there should be a willingness to offer strong support to certain elements of the GSL development effort, with the annual levels contingent on implementation progress, the maintenance of appropriate economic policies, and continued other donor activities.

The support for a relatively high level of aid to Sri Lanka is predicated on the assumption that USAID staffing will increase rapidly--it is under staffed now--and that certain Embassy/USAID relationship issues will be resolved (see Section V below). Our support for a higher aid level is also based on our proposals, set forth in the next section, on program content and structure.

U. S. bilateral aid should be examined in the context of total donor aid. When external assistance exceeds one-third of imports and investment, the danger of creating dependency arises--negating sustainable self-reliant development.

B. Program Content and Structure

1. P.L. 480 Food Assistance

a. Title I/III

During the 1970s, Sri Lanka has been importing about 50 percent of its food requirements. Rice has been the principal import during this time, largely due to extensive drought conditions in Sri Lanka. However, since 1976 rice production has been at record levels and rice imports have dropped substantially. Imports of wheat flour, however, have continued at a high level because the population has become accustomed to eating bread and other products from wheat flour, and wheat is not grown in Sri Lanka. In recent years P.L. 480, Title I has financed about 25 percent of wheat flour imports, i.e., 200,000 tons. At issue is whether this level of Title I should be continued and, if so, should it be converted to Title III.

Since agriculture is the sector with the greatest potential for providing badly needed income earning possibilities, an immediate question is the impact of Title I imports on local food production. In accordance with the latest Title I agreement, the GSL is to study this question. However, there are strong indications that the high level of flour imports and their subsidized distribution is a disincentive to the production of coarse grains and tubers (sorghum, soybeans, manioc and corn) which are potential substitutes for wheat flour. It may also serve as a disincentive to expanded rice production. It seems likely, therefore, that wheat flour imports should decline.

Given the recent bumper rice crops and the increase in wheat flour prices that are scheduled to be promulgated, the quantity of P.L. 480, Title I imports should decline substantially in FY 1979. Barring adverse weather conditions and assuming the implementation of improved agricultural policies, Title I quantities should continue to decline in subsequent years and it should be possible to look forward to a phase out of Title I, except in poor agricultural years. Assuming AID participates in an expanded agricultural development program, consideration should be given to discussing with the GSL within a year or two a gradual phase out of the Title I program.

The Asia Bureau has provided USAID/Sri Lanka with information on Title III and instructed it to encourage the GSL to convert from Title I to Title III. Title III would, however, involve the USAID in sensitive policy issues that presently can be dealt with best by the International Monetary Fund (IMF) or in the context of Aid Group discussions.

Furthermore, the GSL reporting responsibilities and the USAID's monitoring responsibilities would be substantially increased, neither of which would be appreciated by the GSL. GSL officials recently expressed an interest in Title III when they mistakenly thought that the debt forgiveness provisions would apply to past agreements, i.e., it would provide immediate debt relief. Up to that point, the GSL was most unenthusiastic about Title III.

The AID program has been a political issue in Sri Lanka in the past, and there are continuing sensitivities about having GSL policies dictated by external sources, particularly the U. S. For example, a member of the Sri Lankan parliament recently charged that the IMF, which was recommending some difficult-to-implement policies, was a lackey of the U. S. G. (It was denied by the spokesman.) Given this background, it does not seem appropriate to seek Sri Lankan agreement to a Title III agreement, with its additional requirements affecting Sri Lankan policymaking and program administration. We certainly should not be applying pressure on the Sri Lankans for a Title III agreement. The likelihood of a declining need for Title I supports this position. It would seem inconsistent to advocate a phase-out of Title I on a disincentive argument and then convert to Title III which would pose the same problem.

The Asia Bureau agrees with the possible disincentive efforts of high levels of flour imports and subsidized distribution. The Bureau now plans to reduce the levels of Title I wheat flour, and states that any phase out would depend on GSL import requirements and its food policies.

We also believe that the Agency should review the results to date of country discussions worldwide on Title III. We believe there is a need to take potential recipients' views into account. Based on those views, the Agency may wish to revise its internal procedures and/or seek legislative changes.

Recommendation No. 5: That the Agency review the results to date of progress in developing Title III agreements to be sure that the current policy and procedures are appropriate.

NOTE: AA/PDC responded to this recommendation in the draft report by stating that Title III had been under constant review by PDC/FFP and PPC and that no further review was needed. In the interim since the draft report was circulated, we have had additional conversations with the Agency about Title III. We found considerable uncertainty about how the program worked and under what conditions it is appropriate. We therefore reiterate our recommendation, and support, as a first step, the proposed meeting of the Policy Discussion Group session to explain and discuss Title III programs.

2. Title II

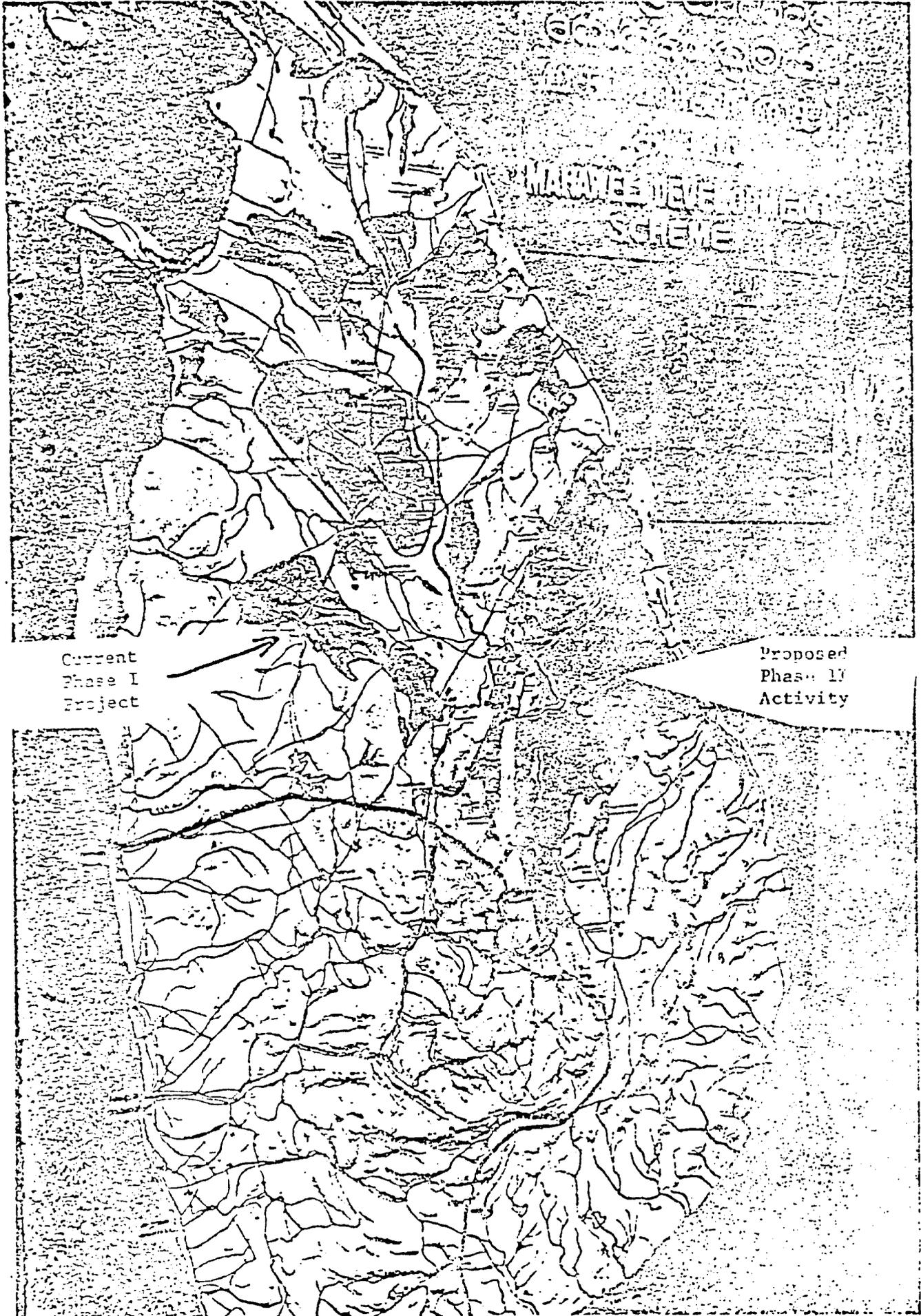
CARE works with the Ministry of Education to provide Title II support to the school feeding program and with the Ministry of Health to support maternal and child health programs. The Title II program has recently been audited by the General Accounting Office and evaluated by a contractor/direct hire team testing a new evaluation methodology. Both groups gave the program reasonably high marks. Given the foregoing circumstances, the OAS team did not do an in-depth study of the program. However, a meeting was held with the AID member of the evaluation team and the local director of CARE.

We conclude that the Title II program is useful and effective in alleviating the malnutrition problem. CARE is developing plans for the eventual phase out of Title II support to the school feedings program. This can contribute to a strengthening of the agricultural program as CARE works to get Triposha, a nutritious flour which it developed using imported corn and soya, manufactured from locally produced grains. CARE is studying the possibility of commercial marketing of Triposha -- it currently is used only in school and MCH feeding programs.

3. Mahaweli - How Much and What Type of Assistance?

One of the principal issues facing the USAID is the level and form of support to provide for the Mahaweli Development Program. (Note: The USAID already has a project in support of an earlier stage (Phase I, Stage II) of the Mahaweli Development Program; however, discussion here relates to support to the new government's proposed accelerated Phases II and III program which is in the process of being defined -- see map on following page.) Although a recommended implementation plan identifying priority projects and their phasing is not expected to be available until December 1978, an accelerated Mahaweli program is clearly part of the GSL strategy and AID support to the program will need to be addressed in the FY 1980 budget reviews.

Given the importance the GSL attachés to the Mahaweli, virtually all members of the Aid Group have indicated their willingness to support Mahaweli development, even though the specifics of such assistance are yet to come. Thus far, financing has been offered only for detailed feasibility surveys. The U. S. has indicated a general willingness to support the program, but has specifically only offered to finance an environmental impact study. Some have argued that the U. S. should provide a high level of support to the Mahaweli to enhance the chances that the GSL would focus on some of the less glamorous but important aspects of the program such as environmental factors (e.g. endangered species) and farm level water management.



Current
Phase I
Project

Proposed
Phase II
Activity

The degree of U.S. influence on GSL decisions on environmental and water management issues also entered into the discussion of the form of any U.S. assistance to the Mahaweli program. Both a direct and an indirect approach have been proposed, with each of these broad categorizations having several variations.

One indirect approach would be for AID to make its contribution through IBRD to the total project -- mingling U.S. bilateral assistance with IBRD assistance. This assumes that IBRD would play an implementing role and that any U.S. influence on the program will be through the Aid Group rather than bilaterally.* A variation on this theme would be to offer to finance specific commodity imports from the United States for the overall Mahaweli project. This could be handled on a yearly basis based on projected import requirements.** The U.S. could also offer to finance the costs of some discreet portion of one of the major projects with one or more other donors, as is the case with the current Mahaweli II Project.

The direct bilateral approach has a "vertical" and a "horizontal" version. Under the "vertical" version, the U.S. would provide complete financing for one of the four or five priority projects, including detailed feasibility and engineering studies, the construction of a reservoir (possibly a dam), and subsidiary canals (and possibly the land development and settlement that would flow therefrom). It has been argued that this would permit the U.S. to encourage a maximum use of labor-intensive construction methods in constructing the reservoir and canals and to make a demonstration water management project in the new area -- a task that is apt to be much easier in a new area than in an already settled area.

Under the "horizontal" approach, the U.S. would not finance head-works or major distribution canals but would consider secondary and tertiary canals and downstream land development (including resettlement, social infrastructure, farm services, etc.). The U.S. offer could apply to all of the land settlement that flows from the four or five priority projects. It is argued that this would avoid having to defend to Congress A.I.D. support to infrastructure development, would involve the U.S. heavily in an area in which we have much expertise (water management) and be such a major contribution to the success of the program that the GSL would be willing to heed our advice on environmental and water management matters.

* Assistance was channeled this way in a major river development project in Laos some years ago; however, this method of aid raises some legal problems regarding 50-50 shipping, Congressional notification, etc.

** This assumes that some donor-financed procurement would normally be done in the U.S. because of U.S. competitiveness or uniqueness in certain types of equipment.

If the U. S. is going to contribute significantly to Sri Lankan development, which we support, we believe that an important portion of that contribution should be to programs of highest priority to the GSL -- with priority attention to GSL requests which conform to New Directions criteria. There seems to be little A.I.D. support that could be provided to the Export Processing/Free Trade Zone. The greater Colombo urban renewal program is likely to involve some politically sensitive issues, such as which group will benefit first from the program, what charges will be made and under what terms, etc. Thus, the only top priority element left in the GSL development strategy, as currently formulated, is the Mahaweli Development Program. Therefore, we support the Bureau and USAID proposal to make a significant contribution to the Mahaweli program.

What would be considered by the GSL as a "significant" contribution may well depend not only on the ratio of the U. S. contribution to the total cost of the next phase, as finally determined late this year, but also on the timing and form of the U. S. contribution. Therefore, we suggest an early U. S. contribution and use of one of the indirect approaches. Contributing early will be favorably received by the GSL and may also help arrange the additional funding needed from other sources.

We do not favor the vertical approach (finance one of the big projects) because it would likely entail a much larger U. S. contribution, thereby making it less likely that A.I.D. could also contribute significantly elsewhere in the agriculture sector where the payoff is apt to be more immediate. Furthermore, it appears that adequate other donor assistance will be available for the large infrastructure projects, particularly if the U. S. picks up some of the equipment costs as recommended below.

We wish to emphasize that we did not rule out the vertical approach because it would involve financing a large infrastructure project, although some Congressional opposition may be anticipated. The Sri Lankan conditions would clearly justify A.I.D. financing of this type of infrastructure, i.e., (1) the country is already committed to meeting (and has been doing so to a large extent) its people's basic physical needs; (2) the project is essential to expanding the area under cultivation; (3) it is one of the few activities that has the potential to absorb a large number of the disillusioned unemployed youth from the over-populated rural areas; and (4) poor people will benefit directly from the project, with jobs during construction and as settlers when the project is finished --

the settlers will be largely the unemployed youth from families generally now living on 2½ acre farms.

We do not favor the horizontal approach (take land development only of the new projects, with all its components) because it would be a number of years (probably three to five) before any significant input would be needed. Admittedly, some planning will need to start sooner, but that would not be considered a major contribution to the project. Resettlement programs can be very sensitive politically in any country. It is likely to be particularly so in Sri Lanka because the two parties are likely to have different concepts of how to carry out resettlement. Implementation of the resettlement activities would be likely to coincide with the next Sri Lankan national elections.

The approach we prefer and recommend for consideration is financing in FY 1979 and 1980, using non-project assistance procedures, earth-moving and other equipment for which U.S. prices are competitive and which will be needed for the large-scale construction phase of the Mahaweli program. This permits association with the front end of the project without being bogged down in the detailed planning and project documentation and approval process. It should also permit AID to maintain a much smaller pipeline for the project. For many types of heavy construction, U.S. equipment is competitive; therefore, there should be no objection to this procedure from either the GSL or other donors. Although other donors, and possibly the GSL, might be hoping for direct project assistance from USAID because it would entail some local currency support, the willingness to pick up some budgetary costs and to provide extensive local currency support in other parts of the AID program (see next section) should allay their concern.

We are less inclined toward the other two indirect approaches to supporting the Mahaweli Program (i.e., channeling the money through IBRD or sharing the costs of a major project with another donor) because we believe that we would get less credit for our assistance and have less chance to affect policy discussions of such issues as environmental protection and water management, as well as because of the possible legal obstacles involved. As fallback alternatives to our proposal we would prefer assistance to Mahaweli (even front end) as part of an agriculture sector project (discussed below). We would prefer the cofinancing approach as a fallback position to either the vertical or horizontal approach described below.

The Asia Bureau objected to the above OAS proposal characterizing it as an "equipment drop" which precludes involvement in the "people" part of the program. The Bureau tends to favor support

for downstream development involving resettlement, organizing people for agricultural production, and providing several infrastructural services. We believe that it is not appropriate to be making a commitment in 1979 (when Mahaweli commitments will be sought) for downstream land development (including resettlement) in the Mahaweli when the timing (and probably the magnitude) of AID inputs to downstream development will be unknown. Furthermore, it is very unclear what the political conditions will be at the time of downstream project implementation. We believe, therefore, it is prudent to make commitments at this time only for support of the front end of the project -- which is what the GSL will be primarily concerned with in any case. The foregoing position is not meant to rule out eventual support to land development, even resettlement, in the new Mahaweli areas.

Implicit in the Asia Bureau comments also was a concern that using non-project assistance procedures somehow strayed from the Congressional mandate. While it is true that non-project assistance has generally been used in recent years only in countries receiving Security Supporting Assistance, it previously was used very effectively for supporting development, e.g., in Europe under the Marshall Plan and in Latin America during the Alliance for Progress. Such assistance would seem to be quite appropriate for Sri Lanka under present circumstances because the GSL is committed to the welfare of its poor; the GSL has introduced new, appropriate economic policies and practices; and the budget and balance of payments are likely to be the most important constraints on development in the next few years.

Several questions were also raised about the propriety of utilizing a commodity import program. Apparently these people feel commodities provided as project assistance are consistent with the Congressional mandate, but not when provided as non-project assistance -- a position we believe is too narrow. It is also generally assumed that a non-project commodity import program has to be a commercial import program. The Handbook is silent on the latter point, but we believe that both commercial and non-commercial import programs are appropriate under varying circumstances. In the case of Sri Lanka, there are already some commercial import programs funded by other aid donors. Our proposal was for a non-commercial government commodity import program in the health area to maximize budgetary support as well as balance of payments support. Equipment for the Mahaweli program could be handled either as a commercial or non-commercial import program depending upon the implementation plan adopted.

Recommendation No. 6: That PPC review, in conjunction with the regional bureaus, current policies, procedures and practices with regard to non-project assistance and commodity imports with a view to expanding (and legitimizing) the use of non-project assistance in development assistance programs in situations such as that found in Sri Lanka.

Recommendation No. 7: That Handbook 4 be revised to delete the requirement for the PARD, the PRP equivalent, from non-project assistance approval procedures.

4. How Much Concentration?

Except for the Malaria Control project, the USAID program has concentrated on agriculture and rural development (see Table 3 on the next page). The USAID, with strong encouragement from the Embassy, plans to continue this concentration. Although agriculture is a pivotal sector, and there is much to be done, agriculture alone cannot absorb all of the unemployed -- to say nothing of the 2.6 percent annual increase in the labor force. Furthermore, there has been a deterioration in recent years in public administration in general, in the educational system and in health services. Should, therefore, the AID consider providing assistance in these other fields?

Could a Housing Guaranty program fit in with the Greater Colombo Urban Renewal program and also serve as a vehicle for promoting both employment and better housing in the district capitals? The Office of Housing would be pleased to co-operate with the USAID and Bureau to provide any additional information regarding a possible Housing Guarantee program in Sri Lanka. A more integrated rural development approach has also been suggested as a possible vehicle for increasing local self-reliance and the mobilization of local resources.

The USAID Director's argument against a broader-based AID program is based primarily on the fact that his staff is small and already overloaded; thus, it is incapable of developing a broader program or even managing the TDY visits that could be used to develop a broader program. He is also not sure that AID has the necessary expertise in integrated rural development, and believes the education sector could well be sensitive politically. The Embassy officials argue for concentration because they wish to keep the USAID small;

TABLE 3
USAID/SRI LANKA PROJECT PROGRAM
(since resumption in FY 75)

PROJECT TITLE	FY of Obligating Authority	Loan or Grant	Amount (SMillion)
Agricultural Inputs	1975	L	8.0
Rice Research	1976	L	3.8
Paddy Storage and Processing	1977	L	5.4
*Mahaweli Ganga Irrigation and Area Development	1977	L	5.2
*On-Farm Water Management	1977	G	0.8
Agriculture Base Mapping	1977	L	
Malaria Control	1977	L	5.0

*Authorized as a single project but the grant project was separately obligated.

also, they argue that a program concentrated in one sector permits the Director of the USAID to be fully conversant with the details of the program. (In commenting on the draft report, the USAID and Bureau reiterated their intention of "consolidating" the program by restricting it to agriculture, rural development, and malaria control over the near term.)

We concur that support to the agriculture sector should be the primary focus of the AID program, but not necessarily the exclusive focus. We agree with the USAID Director, however, that he must have more staff to implement the program signed up and planned for FY 1978, let alone develop new initiatives. Assuming staffing can and will be provided, we suggest consideration of a few activities outside of agriculture -- on the assumption that the proposed investments will have a high payoff and that we will not be competing with other donors.

It is suggested that the import element in the 1979 health budget be reviewed to determine the feasibility of including in a commodity import program early in FY 1979 a health equipment and supplies component. Such a program element would serve two purposes: (1) to alleviate the GSL budget -- the most serious of the potential constraints on expanding GSL investments; and (2) help bring about a rapid improvement in the deteriorated situation in the health centers and hospitals. This latter improvement is very important for health reasons and to maintain support for the GSL development program; it may be essential to reverse the recent downward turn in voluntary sterilizations, and thus to achieving further significant declines in the birth rate.

This suggestion, if feasible, is proposed for one to two years maximum and no further investment in health is implied. The USAID contribution should only be offered if it would be consistent with and help the GSL to implement the principal recommendations of a recent major health planning analysis. ^{12/} AID should not need to get involved in second-guessing the recommendations or establishing conditions -- other than the reasonableness of the quantities to be included under the program and a commitment by the GSL to provide resources to maintain the equipment. Grant funding should be considered. (As indicated above, the USAID and Bureau do not favor support in the health field, although PPC's comments favored giving further consideration to a possible AID role in this field.)

The OAS Team concurs with the USAID position of not becoming involved at this time in the education sector with the following two exceptions: (1) support to agricultural education, some of which is already planned; and (2) vocational education and skills training if AID financing was requested by a Private Voluntary Organization (PVO). We favor support also to any PVO program (U. S. or local) that results in increased employment, including the promotion of small-scale enterprise. A specific case for USAID review is the Samagi Fund which provides loans to young men to start their own small business. Another might be OICI, which has conducted successful programs in English speaking West Africa.

In addition to alleviating the deplorable housing situation and providing employment, a HIG loan would also provide some balance of payments support. However, we would not pursue a HIG possibility unless it were established that (1) there is an adequate local financial system to work with or the GSL is interested in establishing such a system and (2) the GSL seeks U. S. assistance.

Some small-scale activities are currently being carried on in the labor sector and we believe there may be the basis for a small expansion. Given the high unemployment levels and the IBRD recommendation for improving the working of the labor market, we commend the Labor Attaché for his efforts to inform appropriate GSL and union officials of AID centrally-funded labor training opportunities and to facilitate their participation in the activities. We suggest AID sponsor, either as an AID/W regional or inter-regional project, one or more seminars/workshops in Sri Lanka on labor-intensive construction methods and appropriate technology. The seminars/workshops should be designed in a modular fashion so that they could be presented separately to different groups, e.g., governmental planners, government and non-governmental engineering and construction managers, industrial groups and organized labor. We believe that the Labor Attaché would welcome such a program and could handle any local arrangements, minimizing the workload on the USAID.

The GSL is in the process of formulating labor reform policies, in part to reduce the politicization of labor. Many unions are run by politicians, not the workers, and political strikes have been common. Given the presently fluid and sensitive situation, we support the Embassy position that an AAFLI official presence in Sri Lanka, even in the form of a regional office, should be deferred. On the other hand, AAFLI union-to-union support for education, training and welfare-related activities, if low key, could be beneficial.

5. Structuring the Agriculture Program

The agriculture sector is the most important sector in Sri Lanka and is apt to continue so for the indefinite future. Further, additional industrial development and services expansion could flow from an expanded agriculture sector. Therefore, it deserves high priority in terms of GSL development activities and is a sector in which the U. S. could be particularly helpful. We share the USAID's view that it would be best to leave the plantation sector to others and concentrate the USAID effort on water management and so-called dry land agriculture.

a. Sector Loan Approach

We propose that the sector loan approach be utilized beginning in FY 1979 for channeling USAID assistance to the agriculture sector. This would permit greater flexibility in administration and greater flexibility in the type and form of assistance that could be provided. It would permit a more rapid response to changing situations. Adequate funding could be assured in all contributing sub-sectors, something that is generally very important, but apt to be even more so in the Sri Lankan context given the possible budgetary restraints and the GSL concentration on the Mahaweli development program.

Although, as indicated above, water management and dry land agriculture would be the priority sub-sectors for USAID support, developments in these sectors are dependent upon other sub-sectors and activities, not all of which are in the Ministry of Agriculture or the Ministry of Irrigation. Furthermore, private sector activities financed by the banking system and promoted by semi-autonomous GSL agencies are very important to the agriculture sector. Therefore, the sector loan should be structured to permit support to research and development of simplified agricultural machinery and other technological innovation; to credit programs for agriculture and agro-industry and other rural industries; to agricultural education, research and extension; to some small-scale public works projects supportive of rural development in the principal agricultural zones, etc.

The sector loan mechanism could also reduce the documentation workload by requiring one project paper, perhaps biannually, in place of the three or four per year that are anticipated for the next few years under the present procedure. The sector approach can also be used to cover operating, as well as investment, costs (including local costs) in a particularly crucial sub-sector.

b. Project versus Non-Project Support

We noted that a large share of the current program was in the form of projectized commodity support. For example, one of the five agricultural projects in the USAID's portfolio is totally commodities -- Agricultural Inputs (fertilizer) -- and two more are almost exclusively commodities -- Paddy Storage and Processing and Mahaweli Ganga Irrigation and Area Development. Furthermore, similar type follow-on loans are proposed for Agricultural Inputs in FY 1978-80 and Paddy Storage and Processing in FY 1979.

The rationale for this type of loan is the importance of the imported inputs to crucial programs and the balance of payments problem. Furthermore, loan documentation can be prepared more easily and quickly and the monitoring requirements by the USAID would be less than for the usual project loans. It is understandable that the USAID is proposing follow-on loans of this type because: (1) the IBRD is recommending fast-disbursing assistance to insure that the GSL can maintain its import liberalization policies; (2) maintaining an adequate supply of fertilizer and increasing the milling and storage capacity are essential to further increases in rice production; and (3) the benefits of the program accrue primarily to the small farmer.

Primarily to simplify program administration, it is proposed that a commodity import program be initiated (in FY 1978 if possible), using non-project assistance procedures, and be composed initially of the commodities that are being planned for the two follow-on projects in agriculture: Agriculture Inputs (fertilizer) and Rice Storage and Processing (rice storage and milling equipment). Even if some technical services were proposed for the latter project, this could be provided in the import program if the services are to be provided by the equipment manufacturers. Otherwise, the services could be incorporated in the Development Services and Training project proposed by the USAID for FY 1978.

Utilizing non-project assistance implementation procedures could simplify the documentation requirements and the AID approval process. It could also permit the funds to be obligated annually as needed, probably resulting in a lower pipeline. Any needed GSL commitments could be made a part of a non-project assistance agreement as well as in a project agreement. In fact, non-project assistance is an appropriate mechanism when, as in Sri Lanka, AID is interested in reform policy measures. Procurement could still be handled by AID/W if deemed necessary.

In addition to the agricultural projects cited, the non-project commodity assistance procedures could be used for any follow-on Malaria Control Assistance (Malathion) as well as the other activities proposed above: equipment for the Mahaweli Development Program and Health Commodity Assistance.

c. Technical Assistance

Most of the current and planned projects provide for some form of technical assistance, either an institutional contract or consultants. In some cases, it appears that the GSL did not feel the need for the technical assistance, but AID apparently insisted upon it. In any case, the GSL feels its technical assistance needs are limited and wants to select carefully and control its contractors. In relation to one project now being developed, the GSL recognizes its need for technical assistance, but does not want to be tied to a single university contractor. The GSL has also been very critical of high overheads in some contracts, particularly when it did not see significant benefits to Sri Lanka from the home office back-stopping. Given the foregoing, it seemed appropriate to explore alternatives that might provide the necessary technical inputs.

One suggestion for general consideration, as well as in the Sri Lankan case, is to dispense with "technical assistance" terminology in project agreements, implementation letters and other documentation to be signed by, or sent to the host government. Furthermore, a distinction should be made by AID between those technical inputs which the host country recognizes as needed and those which AID feels are necessary to insure success of the project. Then project documents should refer to "technical services" inputs for those inputs desired by the host government; other technical inputs should be described as AID's "technical collaboration" in the project. The latter definitely should be grant funded and contracted for by AID; the former could be loan-funded if part of a loan project. Whether loan or grant, they should be contracted by the host government whenever possible.

In commenting on the foregoing, the Asia Bureau felt that our suggestion missed "the central problem which is if the GSL collaborating organizations do not want technical services provided in the conduct of our assistance program, simply re-titling such assistance will not make it work." We agree that AID should not "force" a country to take our technical assistance, but in the real world we have seen many cases in which those designing projects simply were not satisfied that the cooperating country had sufficient expertise.

to carry out the project. Frequently those with direct operating responsibility in the host government agreed but their superiors at the ministerial level or in other more politically oriented ministries objected for reasons of "sovereignty" or "face." In such cases, AID would be derelict in not assuring the availability of adequate technical expertise. Our suggestions were designed to make this more palatable by distinguishing between technical assistance the Host Country feels is essential and is willing to borrow money for, and that technical assistance which AID believes is necessary.

Another possibility worth considering in the Sri Lankan context is to incorporate an activity in the proposed Agricultural Sector Loan or establish a new project that could be utilized for financing U. S. technical inputs -- either across the board or to cover a specific sector. This would provide the flexibility sought by the GSL and could also simplify the implementation of on-going and planned projects. Whether as a part of a sector loan or as a separate project, it is suggested that it encompass agriculture and rural development, nutrition, and activities which could help alleviate or facilitate grappling with the unemployment problem -- such as the seminar/workshop on appropriate technology proposed above.

The project could be made with an organization such as the Marga Institute, if the GSL concurred, or a governmental organization such as the Agricultural Research and Training Institute -- which is seeking a professional relationship with a number of U. S. institutions. This would permit operating directorates to state their needs and let a single GSL-sponsored organization specialize in contracting and/or recruiting expatriate services needed. The GSL could even be permitted to recruit personnel under the project for operational type jobs, e.g., in water management with AID financing only topping off costs when the position being filled was not a temporary one. The project could also be used to fund; (a) training in the U. S.; (b) seminars and workshops in Sri Lanka in the fields specified in the project agreement; (c) attendance of Sri Lankans at seminars and workshops held in other countries; and (d) provide research grants to Sri Lankans or expatriates to meet agreed upon needs.

Given the situation cited in the first paragraph of this section, some consideration was given to proposing contracting by AID rather than the host country. However, the preceding suggestions seem preferable because the host country involvement generally has been salutary -- more services have been obtained at less cost. Furthermore, it is clear both to the Sri Lankans and the contractor that they are working on a Sri Lankan project, not an AID project.

AID should not assume that host country contracting will entail less work by the USAID; on the contrary, the mission workload may at times be greater and more difficult with host country contracting. However, the AID/W workload should be less and the quality of implementation of the project should more than make up for any loss of time in the initial contracting.

6. Population Program

One of the questions which the appraisal team wanted to review in Sri Lanka was whether it was possible for the USAID to do something directly to support the GSL's efforts to control its population growth. With an unemployment rate of 20 percent, a labor force growing at 2.6 percent annually and the population growth rate at between 1.6 and 1.8 percent, there clearly is a need for high priority to be given to obtaining further decreases in the population growth rate as rapidly as possible. Furthermore, there is some evidence to indicate that the birth rate may have stabilized (at least temporarily) and that a special effort may be necessary to re-initiate the downward trend of the early 1970s. Given the potential importance of population programs, recent trends and the current situation are discussed below in some detail.

Trends during the early 70s were encouraging. The population growth rate, which rose from 1.4 percent in 1945 to 3 percent in 1950, fell in recent years to 1.6 to 1.8 percent (there are conflicting views on the current figure). The rise in the late forties was due principally to the fall in the death rate as a result of massive increases in public health expenditures, particularly for control of malaria which was practically eliminated by the early 1950s (although there has been a resurgence in the mid-1970s). The high level of health services and the government food distribution and subsidy programs, while very expensive, did result during the 1950s and 1960s in a feeling of relative well-being which in turn contributed to a willingness to reduce the size of families.

The limitation of land holdings to 2½ acres under the land distribution program may also have contributed to smaller families. The widespread availability of education for women as well as men has resulted in an increasing number of young women postponing marriage and entering the job market. The high rate of unemployment among the younger segment of the labor force may also have contributed to later marriages. The family planning program (called family health in Sri Lanka), also has contributed toward the lower birth rate. Sterilization has been a frequently used method of reducing fertility.

The favorable trends of the late 60s and the early 70s were not maintained during the last two years. The family planning program became a political issue. This may have been exacerbated by the scandals about the sterilization program in India. Both the Sinhalese and the Tamils see the family planning program as an effort by the other group to gain numerical advantage. The deterioration of health services during the last few years, particularly in 1977, has also contributed to a slow-down in sterilizations. For example, there has been an increasing shortage of doctors and anesthesiologists and increasingly frequent breakdown of equipment (e.g., for sterilization of surgical instruments).

The current situation, like the past, has both positive and negative aspects. On the positive side, the GSL is continuing a government family planning program through its extensive health facilities under the direction of Family Health Bureau of the Ministry of Health. The Family Planning Association of Sri Lanka (FPASL), with IPPF funding, continues a family planning information program, distributes condoms and operates two clinics. In addition, it is working with two other AID/W-supported programs: the International Fertility Research Program and the International Project for Voluntary Sterilization. The latter potentially could be very important in the Sri Lankan context because its mini-lap method for female sterilization can be accomplished with a local anesthetic (by-passing the anesthesiologist shortage problem) and the patient can return home the same day as the operation (in contrast to a three-day stay in the hospital under the more traditional method). This is still just a pilot program at this time.

FPASL is also supporting, in conjunction with the Family Health Bureau and the Ayurvedic Bureau, a program to provide family planning information to "ayurvedic" doctors -- the traditional folk doctors -- including training in the dispensing of orals. This program is especially important because of the greater dispersion of the ayurvedics, their continued influence on many rural and slum families and their previous antipathy to family planning programs. Orals can only be issued by prescription in Sri Lanka, and the training being provided will permit the ayurvedics to qualify to dispense orals.

Again this is a relatively new program, reaching to date perhaps 500-700 out of a total of some 10,000 ayurvedics in the country. It needs to be expanded, but it will need to be done so very carefully, taking into account the numbers of ayurvedics that can be made available for training at any one time and the sensitivities of the ayurvedics about both their status and family planning. There is a danger that

a recent power struggle within the FPASL is going to spill over into a struggle between two local organizations (one having been recently formed by a dissident from FPASL), each backed by different ministries of the government. The result can only be detrimental to the family planning program and the country.

No doubt because of political sensitivities, the new GSL has been very quiet publicly about family planning programs. Internally, however, coordination for population activities was assigned in November 1977 to Dr. Weerasooria, a senior official in the Ministry of Plan Implementation. Dr. Weerasooria has spoken of plans to establish a National Population Council, which could help get a broader focus on the population problem and ways to combat it. 10/ He has established a joint consultative group, which he chairs, with membership from the Ministry of Health and perhaps other ministries, plus the principal donors in the population field, e.g., the UN Fund for Population Activities and Sweden. Perhaps in part to prepare a GSL decision regarding the possible 3-year extension of Swedish assistance, Dr. Weerasooria requested the preparation of a planning and evaluation report on population activities. This was prepared (at least covering the family planning program) by the Family Health Bureau in January 1978, but neither it nor any other report had been issued by the Ministry of Plan Implementation by the end of April.

There are no sex education programs in primary or secondary schools in Sri Lanka, but a course in "human sexuality" has been introduced into the Medical School. In addition, "population awareness" has been introduced into the regular school curricula. According to the Executive Director of the FPASL, there is an 80 percent awareness of the possibilities of fertility control and some 45 percent are practicing some form of control; however, he estimates that only 20 percent are users of modern techniques.

Given the political undercurrents already affecting the family health program and the fact that U. S. aid has previously been a political issue in Sri Lanka, we support the Embassy/USAID position that AID should not provide direct support to the population program. Direct support could entangle the program even more in local politics to the detriment of the entire population program.

On the other hand, we support the indirect assistance being provided through PVOs and hope that it can be increased. Possible expansions of the program would include the wider use of the mini-lap technique

for sterilization and vasectomy, including the use of mobile units to reach communities with less ready access to health centers. An expansion of the ayurvedic program discussed above is desirable -- if feasible without undermining the existing program.

(The Asia Bureau agrees with these conclusions, but the Development Support Bureau also urges that the Embassy and the USAID look for ways to raise the level of understanding within the U. S. community and of Sri Lankan planners of the importance of population growth on development and on the achievement of objectives of other elements of the AID program.) The Embassy and USAID should also maintain close contact with donors of direct assistance in the population area (e.g., Sweden, UNFPA) with a view to providing informal support to their efforts and to seeking additional ways in which centrally funded contractors might help strengthen the internal Sri Lankan support for a strong population program.

V. USAID STAFFING AND MANAGEMENT

A. Relations and Relationships with the Embassy

Relations between the USAID and the Embassy are good in the sense that the Ambassador is supportive of the AID program. At his direction, his staff is making a conscientious effort to meet USAID's needs on a timely basis.

In some other respects, however, the present situation could lead to poor relations as the program expands. The AID program has been a political issue in the past; therefore, the Embassy maintains strong control over the program. "Low profile" is the order of the day -- which means keep the number of USAID personnel down, keep the USAID located in the Embassy compound, etc.

The situation in Sri Lanka is analogous to the situation in many Embassies. Although personal relations are smooth, the desire to minimize the USAID's size and profile represents a serious problem for AID, particularly as AID looks to the possibility of increasing worldwide aid levels. Therefore, considerable attention is devoted below to general Embassy/USAID relationships.

Our purpose is not just to affect thinking in Sri Lanka, but to support discussions with the State Department in the hopes that it will help improve Embassy-USAID relationships worldwide.

The most familiar Ambassadorial direction to USAID Directors worldwide is to maintain a "low profile," a term used to justify inter alia keeping AID staffing low (sometimes the program, too, but usually not), for keeping USAID offices housed with Embassy offices, and for not publicizing the AID program. Such is the situation in Sri Lanka. In the case of Sri Lanka, the argument for low profile is more valid than in many countries where we have AID programs. Some of the OAS recommendations above, particularly regarding program structure, are designed to reflect this. However, let us look at "profile" and how the usual use of it is really inconsistent with resolving the problem that was the reason for adopting a low profile, i.e., to avoid having U.S. aid become an issue in local politics.

First, the number of USAID personnel. We submit that the number of personnel is rarely the significant factor when an aid program becomes a political issue -- a particular individual might occasionally become a problem. Much more important will be:
(1) differences between the host country and AID over a specific

host country development policy or policy change; or (2) the general knowledge in the country of the AID program and the perception of the program's value, particularly in a country like Sri Lanka which has election campaigns.

In some countries, an Embassy's concern about the numbers of USAID personnel has arisen because Embassy counterparts in the Foreign Ministry, who are automatically informed of each U.S. arrival -- we doubt they note the departures -- comment on the numbers of U.S. (or possibly AID) personnel in country. Generally, LDC foreign ministry personnel consider themselves the guardians of their country's sovereignty and frequently resent having to take anything referred to as technical assistance. Understandably, they generally have little knowledge of the details of their country's development program and external assistance needs. Where foreign ministry personnel have gotten involved in aid negotiations, protracted discussions of form rather than substance have frequently resulted.

Implications from the foregoing are numerous. First, if Embassies want to minimize political difficulties, they should help the USAID keep aid negotiations (other than the general umbrella bilateral agreement) away from the Foreign Ministry, and in the hands of the planning office or economics/finance ministry. This implies also that the Embassy try to stay in the background; otherwise, the Foreign Ministry will have an excuse to get involved.

Second, it implies that Embassy personnel who deal with host country ministries, but particularly with the Foreign Ministry, should be knowledgeable about the AID program, including the jobs of USAID personnel and who their principal contacts are. This also implies a more intensive effort by USAIDs than is frequently the case to keep their Embassy colleagues (including all elements of the U.S. Mission) informed of the AID program and staffing.

Third, the USAID has an obligation to keep the Embassy informed of any negotiations that it anticipates may be touchy so that all members of the Country Team can know the situation and the Ambassador can decide how best to be supportive of the USAID and still minimize the chances that politics (either internal or international) will become overly involved. We say "overly involved" because internal politics is usually inherent in development decisions and we should never kid ourselves into believing otherwise.

Fourth, the likely profile of an activity or project and the personnel needed to implement it should be analyzed by the Embassy

prior to its submission to Washington for program review (at the budget submission or project identification stage, not the project development stage). This implies that USAID give the Embassy sufficient time to perform its analysis; this can be facilitated by the USAID focusing on such issues early and presenting them to the Embassy while documentation is still in an early draft stage.

It was stated above that one of the most relevant factors affecting whether an AID program becomes a political issue, for example, in an election campaign, is the knowledge in the country of the program and how it is perceived by the general public. This suggests that publicity of the program may be more helpful than keeping a low profile -- assuming that we have something worthwhile to talk about. The type of publicity can be very important.

Frequently the only publicity given the AID program is when agreements are signed, and usually Ambassadors want to do the signing. If one really wants to minimize the political content of the AID program, why does the chief U.S. political officer in the country do the signing? Admittedly, if the President or Prime Minister wants to sign because of perceived internal political significance, then the Ambassador is the logical U.S. signatory. But if the USAID's counterpart minister is signing (usually Ministry of Plan or Finance), then why not keep the U.S. profile down by letting the USAID Director sign -- and let people know why that one person at least is in the country!

But, let's not just publicize the signing of agreements. Let's have some publicity when equipment arrives, or when work commences, or when the first (and maybe the 1,000th) farmer gets a loan from an AID-supported program, when a health clinic opens or begins undertaking a new program, when a project is completed and AID participation terminated. In other words, publicity should be carried out at appropriate times throughout project implementation in order to show progress and to highlight particularly when people (hopefully poor people) are receiving benefits.

If there is a reluctance on the part of counterpart personnel to publicize activities, the U.S. Information Service (USIS -- or whatever its new field name will be) can do so with exhibits in its centers including binational centers, and other lower profile means. This implies that the USAID become more public relations minded than is the norm and that USIS take a stronger role than usual in seeking opportunities to publicize the AID program. Periodic meetings between the AID and USIS directors could facilitate coordination and help insure that USIS would have the necessary lead time to organize the most effective program. This is not a plea for saturation

publicity for the AID program; it is a plea to consider how publicity can forestall political problems more effectively than low profile silence.

One element of staffing that can be important is the mix of overhead vs. project personnel and the numbers of U.S. personnel vs. local personnel. Host government officials may legitimately complain when the overhead-to-project proportion is high. A lack of local personnel may be viewed with suspicion and possibly used by radicals to charge that the USAID includes personnel carrying on clandestine activities. Perhaps more importantly, the use of local professionals by a USAID enhances the chances that it will have an early warning signal when trouble is brewing over an issue. In addition, the local professional can be used to make informal proposals or to feel out the extent of opposition to a proposal, thereby facilitating less formal negotiations and minimizing the use of written position papers than can be used to create problems by dissident elements within a ministry. Specific staffing recommendations for USAID Sri Lanka are made in Section B. below.

As indicated earlier, low profile is also used to justify an insistence that the USAID must be co-located with the Embassy. We submit that being co-located emphasizes the political role of the USAID -- which hardly seems consistent with the rationale for low profile. USAIDs do not need to fly flags and be high profile; rather they can and should be located in non-ostentatious, but business-like quarters, close to the Embassy if possible for convenience and efficiency. Just to avoid the over-association with day-to-day diplomacy, the Peace Corps fought for and obtained the right to have its offices apart from the Embassy. To be consistent with the Humphrey Bill and to minimize the perceived "politicalness" of AID, USAIDs also should be housed outside of Embassies.

One additional argument given in Embassy/Sri Lanka for co-location was that the USAID in a previous post was not co-located and it did not receive (or heed if it did receive) adequate Embassy political guidance. This is a problem of personnel (possibly Embassy as well as USAID), not a question of location. We know of many instances of separately located USAIDs where Ambassadors have been satisfied with relationships.

Another reason given for keeping USAID in the Embassy compound was security. Again, this argument seems inconsistent, when the USIS, which is a far more likely target, is located outside the Embassy. AID personnel have very, very seldom been targets of terrorist attack and then usually because of mistaken identity. The chances of mistaken identity are enhanced when USAID personnel are located with

the Embassy. We suggest that the security agencies of AID and the State Department review the situation with regard to AID and the security situations abroad, because we believe that they would conclude that only in a handful of countries, excluding Sri Lanka, is colocation essential for security reasons. Certainly most AID personnel will feel more secure if they are subject to fewer high profile security precautions.

USAID effectiveness can be enhanced by being located outside of the Embassy compound, particularly because of the security precautions. For example, government officials coming to the USAID in Colombo must now pass through a screening procedure which they find humiliating -- hence annoying and insulting. The result has been statements to USAID officers by GSL officials that they will no longer come to the Embassy for meetings. This hardly makes for a non-political environment for the USAID program.

To reiterate the point made at the beginning of this section, the extensive discussion of Embassy-USAID relationships is not meant to imply that there is currently a difficult situation in Sri Lanka. However, the situation could deteriorate if some of the current conceptions and guidelines are maintained. Furthermore, the problems and the supposed solutions discussed above are found in many missions. Therefore, we hope that the foregoing can contribute to a dialogue between State and AID on this matter, possibly resulting in some norms and guidelines for each set of officers which would permit USAIDs to become more effective and operate more in line with the apparent Congressional intent, yet meeting the Ambassadors' legitimate concerns about the political ramifications of an AID program.

AID/W managers should also not lose sight of the fact that the results of understaffing, at best, are critical reports by AG and GAO which require valuable time to respond to; at worst, there will be serious deficiencies in monitoring or errors in judgment that bring discredit not only on AID in the individual country but on the aid program in general as viewed by the U.S. Congress and public. Thus, it is AID that pays for Ambassadorial decisions on USAID staffing that are not consistent with decisions on program levels and content. Therefore, AID/W must resist increasing programs until Ambassadors are prepared to accept the necessary staffing to administer the program.

USAID/Sri Lanka commented as follows:

". . . We do not agree that the Embassy is over-controlling the AID program. It is true that the

present Ambassador takes a strong, supportive interest in AID's comings and goings, but all judgments about the size and direction of the program have been made by AID. The Embassy has a strong concern with profile -- an admittedly elusive concept -- but has agreed to a significant increase in staff. Our current understaffing is due to lags in recruiting, not Embassy policy. It is true that the Embassy has said AID should stay in the compound, and we have not disputed this judgment. As long as we have the program we want and the people need, the question of where AID is housed or who signs project agreements does not seem to merit the emotional energy displayed in the OAS report."

OAS Response:

We concur with the USAID that the program is not currently over-controlled -- we did not say that it was; nevertheless, we have modified our text, to make clear our concerns over the future with the proposed expansion of the program. Our intention is to encourage some reflection on the issues now to avoid tensions later. As indicated in the report, we were addressing an issue that is broader than the situation in Sri Lanka.

Recommendation No. 8: That AID management seek to encourage a meaningful State-AID dialogue on Embassy-USAID relationships, using the foregoing as a basis for some of the issues to be discussed. As an interim step, we propose that State encourage Ambassadors to attend future sessions of the Administrator's Development Seminar and two or three more junior officers the Development Studies Program. Hopefully this will result in a greater understanding by both State and AID of the constraints which impinge on USAID/Embassy relations.

B. USAID Staffing

At the time of the OAS team's visit, the USAID was understaffed. The on-board U.S. direct hire strength was four officers (Director, Program Officer, Agriculture Development Officer, Capital Resources Development Officer) and an Executive Assistant/Secretary. A Regional Malaria Advisor had recently arrived but was on TDY in the region.

Some normal housekeeping functions had not been attended to, field trips had to be postponed, too little time was available to spend with counterparts, and implementation monitoring had to be postponed in favor of program development. Approved positions need to be filled urgently.

Although the USAID is currently understaffed, the Ambassador's approval of 17 U.S. direct hire positions for the end of FY 1979 should provide adequate relief if AID/W moves rapidly to fill the positions. If the FY 1980 program is approved as submitted in the ABS, the USAID proposal of 21 is probably about right. However, we have suggested in the previous section some alternatives for structuring the program which should increase the likelihood of staying within the FY 1979 approved level. The alternatives were suggested as a means of making the program more effective, but they should have the added effect of requiring fewer U.S. direct hire.

Whether it will be possible to maintain a lean mission (in terms of U.S. direct hire) will depend to a considerable extent on the USAID's success in hiring Sri Lankan professionals. At the time of our visit, USAID had only one professional Sri Lankan on its staff. USAID personnel acknowledged the need to increase the number of locals, but felt that recruitment was not as easy as might be expected where unemployment levels among the highly educated are so high. However, the most important factor in not recruiting has been the fact that the officers had no time to work up job descriptions, to interview a number of candidates or to train anyone recruited.

In time this situation will be eased, but we believe that the USAID cannot afford to wait until its U.S. staffing is substantially increased before getting on with local hiring. To do so will likely result in higher than necessary U.S. staffing. We urge early action, therefore, including the provision of short-term TDY help to the Embassy/USAID if desired to expedite recruitment.

To minimize the training load on the USAID and to make the new hires effective more quickly, the latter (after a brief orientation

at post) should (in some cases) be sent to AID/W and/or to a fully staffed USAID for on-the-job training. An immediate target might be four to six new local hires, but twice that number should be the target for end FY 1979.

Given the current under-staffing of the USAID, the likely problem of finding adequate housing as the USAID builds up, and the Embassy concern over USAID staffing levels, we question the desirability of maintaining the Regional Malaria Advisor position in Sri Lanka. Given the number of programs to service (from Pakistan to Indonesia) the advisor will not be able to spend much time in Colombo. Thus, someone in the USAID will have to continue to handle any day-to-day action required. It would appear that the USAID would be as well served by the Advisor with periodic visits from another post as it would be with him headquartered in Colombo. We suggest, therefore, that AID/W and the USAID review the decision to place the Regional Malaria Advisor in Sri Lanka.

C. USAID Administration

As indicated above, some internal USAID housekeeping has not been carried out on time. This is understandable since the responsibility for most such matters has been assigned to the Program Officer who already has a full platter of regular Program Office functions plus serving as Project Monitor for two or three projects. He received help on last year's Operating Expense budget from the Embassy Budget and Fiscal Office but had to redo the work; this year he was planning to do it himself -- this normally would be done by the USAID Controller (in conjunction with others).

The USAID requested the TDY of an executive officer and was able to get one for a week. He left an outline of actions to be taken and the Embassy GSO was prepared to assist in carrying out the actions. However, he needed to have some time and information from the Program Officer which the latter could not make available because of the pressure of more urgent items. Hopefully, the TDY of a local employee of USAID/India, which was recently arranged by the Director of SER/MO, will alleviate the situation; unfortunately, however, the Program Officer will have departed for home leave in the meantime.

The Embassy has been very forthcoming in providing space for the USAID, but this is creating some inconvenience for Embassy personnel. The situation will deteriorate further unless steps are taken soon to find space for in-coming personnel. The Embassy, wishing to keep

the USAID in the Embassy compound, has proposed that a third floor be added to a building in the rear of the compound. It is questionable whether FBO will approve the outlay since it plans to build a new chancery within the next two or three years. If FBO does not finance it, the Embassy wants AID to.

We believe that a USAID with the size of program projected should not be co-located with the Embassy -- for reasons discussed above. The space situation would be easier for both the Embassy and the USAID if the decision were taken now to find appropriate space for AID outside but as near as possible to the Embassy. If that is not done, consideration should be given to moving the GSO operation out of the compound, either to an existing FBO house or to new quarters constructed on the new chancery grounds. This would permit the USAID to occupy all of the building in the rear of the compound.

Consideration should be given to establishing a branch office in Kandy and assigning two or three officers there. The Mahaweli Development Board recently has moved its headquarters from Colombo to Kandy. The Directorate of Agriculture is located in Kandy, as is the Agricultural Faculty of the University. An IRRI team working on the Rice Research project is already located in Kandy. The current Mahaweli project could be visited in one day from Kandy, while it would take two from Colombo. Such a move would make sense for reasons of program administration and would also ease the space and upcoming housing problems in Colombo.

FOOTNOTES

1. IBRD, Report No. 1937-CE, Development in Sri Lanka: Issues and Prospects, March 22, 1978.
2. Ibid., Statistical Appendix, Table 10.1.
3. Streeter, Paul, "Distinctive Features of a Basic Needs Approach to Development," AID Development Digest, January 1978, pp. 119-128. The article was extracted from International Development Review, Vol. 19, No. 3, 1977, Society for International Development, Washington, D. C., pp. 8-15.
4. Actually 42% according to Gomez weight-for-age classification, Sri Lanka Nutrition Status Survey (September 1975-March 1976) prepared by Center for Disease Control, PHS, HEW, in cooperation with GSL Ministry of Health, CARE and USAID, June 1976.
5. Kariyawasam, Dr. (Mrs.) T., A Report on a Study of Early School Drop-Outs in the Secondary Schools of Under-Privileged Areas in the City of Colombo (Sri Lanka), National Council of YMCAs in Sri Lanka, Colombo, 1977.
6. Welfare and Growth, Marga Institute, Colombo, Sri Lanka, 1974, p. 32.
7. For an analysis of the "brain drain" in Sri Lanka, see UNCTAD Document TD/B/C.6/AC-4/4, Case Studies in reverse transfer of technology (brain drain): A survey of problems and policies in Sri Lanka (prepared by Marga Institute), 19 December 1977.
8. For a detailed analysis of the causes of the insurrection, see W. Howard Wriggins and C.H.S. Jayewardene, "Youth Protest in Sri Lanka (Ceylon)" -- Chapter 10 of Population, Politics and the Future of Southern Asia, Wriggins and James F. Guyet, Columbia University Press, New York, 1973.
9. Agency for International Development, A Strategy for a More Effective Bilateral Development Assistance Program: An A.I.D. Policy Paper, Washington, D. C., March 1978.
10. IBRD, op. cit., pp. 11-12. Sections B. and C. also draw heavily on the IBRD Report.
11. Ibid., pp. 44-52.
12. Ibid., p. 43.
13. See Attachment to memorandum of Ambassador Marshall Green, OES/CP dated April 6, 1978. Subject: The Population Problems of Sri Lanka and Kerale - Where Social Development Has Far Outstripped Economic Development.