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INTERAGENCY PRIVATE SECTOR BRIEFING

ON

SRI LANKA

A.I.D Program Activities

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Office of South Asia Affairs
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1. POLITICAL, ECONOMIC AND A.I.D. PROGRAM OVERVIEW

Political/Economic Overview: President Jayewardene was elected to a second term in late 1982. He then won a national referendum extending his majority in Parliament for six years. The market-oriented development policies instituted by the President in 1977 are expected to continue, although the country's insurgency problems have made Sri Lanka less attractive to domestic as well as foreign investment. Also, there are serious budget and balance of payments deficits, largely caused by major increases in defense spending. Poorly trained government forces have reacted to the insurgency in ways which have sometimes involved unnecessary civilian casualties, but the GSL has greatly improved the performance of its security forces through more rigorous training efforts.

U.S. Interests: The United States strongly supports Sri Lanka as a working democracy. We also appreciate Sri Lanka's moderate role in the non-aligned movement, its willingness to have U.S. Navy port visits, and its hosting of a regional VOA transmitter.

A.I.D. Relationship: USAID has close working relationships with GSL counterparts at policy and working levels, with the closest being in those sectoral areas where U.S. assistance is concentrated -- agriculture, health, nutrition, private sector development and housing. USAID is a major contributor to two of the GSL's three "lead" national development priorities - Mahaweli Basin development and housing. USAID's private enterprise project will indirectly benefit the third "lead" activity, the free trade zones.

<u>Resource Levels</u>	<u>1986 Actual</u>	<u>1987 Est.</u>	<u>1988 Proposed</u>
<u>Budget</u>			
DA (\$MM)	24.3	18.0	16.8
Title I (\$MM)	33.0*	17.0	16.0
Title II (\$MM)	2.7	2.0	.6
Housing Guaranty	(25.0)	(15.0)	(15.0)
TOTAL Aid	60.0	37.0	33.4
<u>Key Data</u>			
Population	16.3 million	Life expectancy	69.9
Literacy	86%	Pop. growth rate	1.3%
Per/Capita GNP	\$330		

* Includes \$7 million early programming

2. SRI LANKA--FULL CIRCLE ON ECONOMIC POLICIES?

Major Features of Sri Lanka Economic Policies, 1948-1987

<u>Period</u>	<u>Economic Policies</u>	<u>Average GDP Growth Rate</u>
1948-55	Economy remains open. No import restrictions or foreign exchange controls.	4.5
1956-60	Major nationalization efforts.	2.0
1961-65	Nationalization of oil companies and banks. Import controls.	4.0
1966-70	Partial trade liberalization and devaluation.	5.4
1971-77	Land Reform. Nationalization of plantation estates.	2.9
1978-87	Trade liberalization. Removal of most important foreign exchange controls. Privatization of state-owned enterprises. New industrialization policy promulgated.	5.6

3. SRI LANKA PRIVATIZATION INITIATIVES

a) Privatization Initiatives During 1985-1987

During the last two years, economic and political constraints have seriously impeded the GSL's ability to undertake reforms. Nevertheless, it has carried out significant new initiatives which clearly demonstrate its commitment to private sector development.

Legislation

The GSL has two bills before parliament to allow state-owned enterprises (SOE) to be turned into private companies. Also, a draft telecommunications privatization bill will be submitted to the cabinet for review in about a month and a securities exchange act to establish a regulatory environment for the stock market has been presented to parliament.

Privatization of State-Owned Enterprises

- Four textile factories have been turned over to private sector management and several joint stock companies were established.
- The GSL has completely withdrawn from the construction of middle and upper-middle class housing. A number of private companies are now involved.
- Private insurance companies are now allowed to compete with the two SOE insurance companies. Foreign companies can invest in reinsurance.
- A profitable SOE distillery has been sold to the private sector.
- Sugar importation and marketing is in private hands as of April, 1987.
- More than 50% of the government's bus transport system was sold to the private sector.

Financial Sector Reforms

The GSL has introduced a new treasury bill scheme which allows the Central Bank to sell the bills on auction to the highest bidders. Previously the Central Bank had fixed the price for the bills and only sold them to other Banks.

Export Promotion Reforms

- A new tariff schedule was introduced in 1985 which involved over 2,000 changes in nominal tariffs. Very few developing countries have undertaken such a far-reaching change of the tariff structure. The GSL substantially reduced export duties on tea and almost eliminated duties on rubber and coconuts.

b) New Industrial Policy Promulgated

The GSL formally announced its new industrial policy in May, 1987. The new policy is significant on several levels; it is more far-reaching than anticipated, the final statement is a consensus document, objectives are specific, there is a detailed plan for implementation and oversight of the effort will be at the ministerial level.

The major features of the new policy are: (a) emphasis on reducing the country's dependence on a narrow range of exports; (b) better management of the exchange rate; (c) phasing out of remaining import controls, introduction of an improved tariff structure, and anti-dumping legislation; (d) special incentives to encourage regional dispersal of industry and incentives for export marketing of new products; (e) gradually spin-off state-owned enterprises; (f) interest rates will be determined by market forces, foreign investment and transfer of foreign technology will be encouraged, and (g) labor laws will be rationalized.

USAID/Sri Lanka held regular discussions with the Ministry of Finance and Planning during the development of the new policy. In fact, A.I.D.-funded technical assistance (Coopers and Lybrand) and studies (1983 - A.D. Little's private sector assessment) were helpful to the GSL during the policy formulation process. There are now increased opportunities for us to be of further assistance. Two new private sector projects are planned for 1988 that will directly support implementation of the new industrial policy. These include a project to expand or generate small and medium size private sector enterprises within the Mahaweli impact area and a second project to continue our macro level policy dialogue efforts and to support the GSL's nationwide program to privatize state-owned enterprises. We will also continue to provide technical assistance, training and feasibility study funds under the on-going Development Management and Training project for private sector policy options research and selected project development efforts.

4. IMPACT OF RECENT ETHNIC DISTURBANCES

The economic impact of the ethnic disturbances in Sri Lanka has been less than might be expected due largely to the subsistence agricultural nature of the economy. In addition, due to the limited contribution made to national GDP by the affected areas, the troubles have not had a major macroeconomic impact. They have brought on, however, such problems as a widening budget deficit due in part to increased defense expenditures, a steady decline in tourist arrivals and foreign investment, and an increasing number of displaced persons.

This insurgency has affected the A.I.D. assistance program both directly and indirectly. Over the last several years we had several projects underway or planned in Tamil dominated areas. These include a Jaffna water supply project, an additional component of our Mahaweli development program and a forestry institute. Unfortunately, due to the security situation in these areas, these projects had to be relocated or cancelled. Other programs we have supported, such as sanitation, malaria control and private sector development benefit all Sri Lankans, including Tamils in secure areas. On the other hand, P.L. 480 wheat assistance, which is added to the nations's commercially distributed flour supplies, reaches even the insecure areas. Additionally, P.L. 480 local currency generations from wheat sales are used for development programs in both secure and insecure areas.

5. USAID DEVELOPMENT STRATEGY

Responding to key development needs, the A.I.D. strategy for Sri Lanka has two main objectives: (a) improving agricultural productivity and farm incomes, and (b) increasing off-farm employment through private sector development. In pursuing these development objectives and in fashioning the overall portfolio, the A.I.D. strategy for Sri Lanka stresses four main themes: (a) reliance on market forces, (b) cost recovery and subsidy reduction, (c) expansion of the role and effectiveness of participatory local organizations, and (d) increased availability of investment capital. While not equally important in each project, these themes provide an embracing rationale for the different sectoral emphases in a coherent program.

The Accelerated Mahaweli Development Program will continue to get priority attention. The GSL, A.I.D. and other donors have made a considerable investment in the Mahaweli program. However, much remains to be done. A.I.D.'s emphasis in the Mahaweli will shift over the next several years from construction of the major irrigation works to assuring better utilization of available resources in order to develop economically viable settlements.

6. INVENTORY OF A.I.D.-FUNDED PRIVATE ENTERPRISE INITIATIVE PROJECTS
IN SRI LANKA

ONGOING

1. Private Enterprise Promotion-383-0082; \$4.0 million (G);
1983-1988

The objective is to help improve the investment climate and increase domestic and foreign investment. Project supports preparation of pre-feasibility studies and investment profiles, investment promotion, management training, entrepreneur development, and business consultant services, analyses of government policies affecting the private sector, and establishment of a Sri Lanka Business Development Center.

2. Diversified Agricultural Research Project-383-0058; 11.4 million
(L/G); 1984-1992

This project is designed to broaden the agricultural food production base of Sri Lanka by strengthening the Department of Agriculture's capability to produce subsidiary field crops. The private sector involvement will include private production of seed and marketing channels for the crops.

3. Mahaweli Basin Development Phase I/EIED Component Project
383-0056; \$1.0 million (L); 1986-1988

This is a 2-year bridge finance program to establish the institutional capacity of the Employment, Investment and Enterprise Development (EIED) Division of the Mahaweli Authority to assist and promote rural private enterprise development. Funding is for policy development, training, technical assistance and special projects aimed at the promotion of commercial and manufacturing enterprises. Activities are linked to the follow-on REDS project.

4. PL 480 Title I:

USAID/Sri Lanka is maintaining a private sector lending program under Section 108 of PL 480 Title I in FY 1987, with the intention to repeat this program annually pending GSL concurrence. In FY 1987, the equivalent of \$1.2 million in rupees will be available for medium-term project lending to the private sector.

5. PL 480 Title II:

USAID/Sri Lanka has supported a weaning food program under PL 480 Title II since 1973. The weaning food manufacturing plant is now being examined as a candidate for privatization through either an improved performance-based management contract with the private sector or the lease/sale of assets to private parties. A privatization feasibility study will be carried out in June-July 1987 by the center for privatization under a pre-funded IQC.

6. PVO Co-Financing Project 383-0050; \$6.539 million (G); 1979-1989

This project was amended in 1983 to include promotion of private enterprise as one of its major objectives. Since then most of the sub-projects approved for co-financing provide for promotion of small enterprise among other activities and provide a package of critical inputs to enterprises appropriate to the beneficiaries and their setting, which would advance small enterprise development, and such that changes can be sustained and have advance widening impact.

PLANNED PROJECTS

1. Private Sector Development Project 383-0108; \$15 million (G); 1988-1993

This project will seek to enhance and increase the private sector's participation in the economy and to correspondingly reduce the role of state-owned enterprises. Planned components are formulation/implementation of industrial development policy; privatization assistance, including performance-based disbursements; capital markets development; private sector training; and export/investment promotion via linkages to U.S. and other foreign markets, technology and capital.

2. Rural Enterprise Development Project 383-0050; \$15 million (G); 1988-1993

This project will support the expansion of farm-based and off-farm enterprise in the Mahaweli area and possibly other rural areas. Planned components and policy formulation/implementation, small-scale enterprise development, infrastructure for private enterprise promotion, domestic/export market information/development, cost-share feasibility studies/pilot projects with private sector, and possible capitalization of credit lines and/or equity finance.

3. Development Studies and Training Project 383-0085; \$6.0 million (G); 1987-1992

This project will focus on relevant policy options for the Government of Sri Lanka. Major areas of attention would be macro-economic management and policies supportive of private sector development.

4. PVO Co-Financing II Project 383-0101; \$5.046 million (G); 1987-1993

This project is a follow-on to the PVO Co-Financing I project (383-0060) and the initial obligation for this will be in FY 87. It provides for the increase of off-farm employment through private enterprise development and private enterprise development.

5. Mahaweli Agricultural and Rural Development Project 383-0086; \$14.0 million (G); 1987-1995

This project will focus on improving household incomes for new settler families on the left bank of System B through introduction of new agricultural technology, improvement in the management of the main irrigation system and on-farm water management and strengthening of farm support service. Policy elements will foster private sector participation in managing the irrigation system and providing farm service.

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