

SRI LANKA TITLE III & APAP

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CONSULTANT'S FINAL REPORT:  
SRI LANKA TITLE III EXTENSION  
and  
CONTINUATION OF  
AGRICULTURAL PLANNING AND ANALYSIS PROJECT (APAP)  
through inclusion in  
POLICY REFORM SUPPORT (PRS) PROJECT

A Report Prepared  
for:  
USAID/Sri Lanka  
by:  
International Science  
and Technology Institute

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December 11, 1993

TO: MR. GARY ALEX  
DIRECTOR ANR OFFICE  
USAID/SRI LANKA

FROM: PAUL N. WENGER  
TEAM LEADER  
DESIGN TEAM

I would first like to point out, for the record, that because of uncertainties as to expected levels of Title III and PRS funding, plus questions as to the position of the follow-on to APAP within PRS, oral agreement was reached between USAID/Sri Lanka and the

Evaluation Team on the need for operational modifications in the Scope of Work for Team activities. As a result, the attached documents have been submitted in Draft, rather than Final form. Nevertheless, they will provide a solid foundation that can readily be finalized once those uncertainties have been resolved.

Attached are:

1. Draft Annex A to the proposed Title III Extension (finalized before Gary/Goggin comments received).
2. Six Appendices to Draft Annex A, setting out in more detail the proposed Policy Reforms for the Title III Extension.
3. A Partial Draft Project Paper Outline for the proposed PRS Project - including an APAP extension and Central Project buy-in - leaving open matters that have not yet been resolved in the project design and funding.
4. Draft Justification for Title III Extension.
5. First Draft of Program Proposals for Completion and Extension of the Sri Lanka Title III Program.
6. PL-480: Policy & Nutrition Perspectives: Economic Analysis.
7. Land Title and Tenure Provisions of Prior FFP Programs.
8. List of Persons Contacted.
9. Bibliography of Documents Consulted.

We would like to express our appreciation for the warm reception and full cooperation on the part of everyone with whom we worked. Our special thanks are due to:

Jim Goggin

Gary Alex

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Tissa DeSoyza  
Seneka Abeyratne  
Cheryl Thangiah  
Henry Charles  
Mohamed Fallil

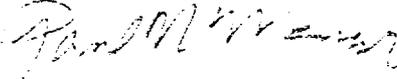
of the USAID/Sri Lanka ANR staff; and

Terry Liercke  
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who backstop ANR;

as well as the many non-USAID persons noted in # 8 above whose assistance was so useful.

Sincerely,



Paul N. Wenger

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POLICY REFORM MEASURE A: POVERTY RELIEF:

I. BACKGROUND:

Sri Lanka introduced the Food Stamp Program in September 1979 to replace a three-decade old universal food ration subsidy scheme. At its inception, the new program provided benefits to 1.55 million households (55% of all households). During the first year the number of beneficiaries increased steadily and a freeze on new entrants was put into effect from March 1980. The number of beneficiaries subsequently tended to decrease to 1.48 million households at the start of 1986. By then inflation had reduced the real value of food stamps by more than half.

The GSL launched a restructuring program in 1986 with the aim of reducing the number of beneficiaries by one-third, incorporating newly-poor households, and increasing the value of the benefits from savings realized. The program was moved to the Department of Social Services and renamed the Poor Relief Food Stamp Program (PRFSP). A new strategy for screening applicants was initiated under which committees of government officials and village residents reviewed applications and posted lists of selected households throughout each village. The public was asked to identify any households erroneously included or excluded from program rolls. Political intervention led to virtual abandonment of this retargeting. A large number of households were added, few removed, and participation rose to 1.84 million households.

In 1991 the Janasaviya Program (JSP) for poverty alleviation was launched. The JSP also relies on community-based screening and focuses on non-income criteria such as productive assets owned, sources of income, and durable goods consumed. It provides households with relatively large monthly payments over a two-year time-limited period to free them from the urgency of obtaining daily subsistence, thereby presumably enabling the household to engage in training, private investment projects and community infrastructure projects whereby its economic plight could be improved. JSP was to be implemented in seven rounds, the fourth of which would take place in 1994. Its original intent was also for the JSP to absorb food stamp recipient households, replacing food stamps with a more meaningful method to better the family's livelihood. This plan has since been abandoned, as discussed below.

The Household Income Survey, conducted in mid-1991 to restructure the PRFSP, identified four categories of poor: (1) Extreme poor: households with less than Rs 700 monthly income (901,877 families); (2) Moderately poor: households with monthly incomes between Rs 700 - 1500; (3) poor youth (as a special group among extremely and moderately poor); (4) old-aged and indigent. Close to 5.6 million people in the foregoing categories (roughly 33% of the Sri Lankan population) are entitled to receive food stamps.

Of the 901,877 families identified in the poorest category, 132,373 were not then receiving food stamps: these newly eligible households were added to the PRFSP. A total of 634,258 recipient households (or 45% of the total prior to screening) were found ineligible. However, as a result of political pressure and the drought that occurred during that period, ineligible households were not removed.

Using criteria similar to those developed for JSP, eligibility for PRFSP is based on household income, assets, and consumption, and therefore is not adjusted for family size or composition. There is a partial adjustment insofar as the number of household members eligible to receive food stamps varies according to household income level. In addition, the value of food stamps is adjusted by age in order to target benefits more effectively at households with young children. Following the doubling of benefits in 1988, the monthly food stamp values are currently:

Rs. 50 for children below 8 years; Rs. 40 for children between 8 and 12 years; and Rs. 30 for individuals above 12 years. There is also a Rs. 50 milk ration for infants under one year of age. Each beneficiary household also receives a monthly kerosene stamp valued at Rs. 44.

## II. PRESENT SITUATION:

Outlays on the PRFSP scheme represented 3.8% of total government expenditures in 1988. Since then, in the absence of indexing, this share has declined substantially in relative terms, reaching about 2% in 1993. The total budget allocation for PRFSP in 1993 is approximately Rs. 2.7 billion. The annual budget for the JSP is now Rs. 5 billion, and Rs. 600 million is allocated for the Mid-Day Meal Program for school children. Of total counterpart funds generated by Title III wheat sales, 43% in 1991 and 30% in 1992 were used to support PRFSP which amounted to approximately 5% of the PRFSP budgets during those years. JSP was not supported by Title III because of USAID doubts concerning its efficiency and effectiveness.

A clear understanding of the share of food stamps income in total household income is not possible because of the well known problems of enumerating household incomes. The share of food stamps (including the value of kerosene stamps) is estimated on the basis of average food stamp value of Rs. 167 per month. Accordingly, food stamps are believed to constitute about 25% of the total income of the households in the lowest 20%, and about 11% of total income of households in the next higher quintile (Based on information contained in the HIES 1990/91 and previous studies). Food stamps may be used to purchase both essential food or non-food items; however, evidence shows that 90% of the food stamp income is in fact used to purchase food, mostly rice.

The impact of the PRFSP on current consumption cannot be properly estimated because of the non-availability of data on quantities of food consumed by income class. While the nominal value of food stamps per capita doubled between 1981/82 and 1990/91, this was not sufficient to compensate for the Colombo Consumers Food Price Index increasing by a factor of 3.25 during that period. The nominal value of food stamps should have increased by 300

percent to compensate for the erosion of real value in this income transfer during that time. This has not taken place primarily because of budgetary constraints.

Until now the GSL conducted a nutritional survey only every five to six years. It has now agreed to put into place a survey mechanism devised under a USAID contract whereby nutritional data can be collected semi-annually. PRFSP recipients will be targeted in this new regular survey so that the contribution of food stamps to total calorie consumption can be better assessed.

The GSL has found that the JSP is not achieving its desired purpose of lifting households up from the poverty level they were at to qualify as entrants to the program. The accuracy of such an assessment may indeed be hindered by a recently enacted Rs 250 monthly stipend to households at the end of their two years in the JSP. Receiving this allotment may evoke an unwillingness to state that their economic status has improved for fear the Rs. 250 would be withdrawn. Whatever the circumstances, it is expected that the GSL will discontinue the JSP when it is politically opportune to do so; with elections coming up in 1994 and 1995, this probably means a two year postponement of such an action. The retargeting of the PRFSP will probably be delayed for the same reason. The fourth round of the JSP will probably be the last. The end of the JSP portends the opposite of what was originally envisaged. Instead of PRFSP recipients being absorbed into the JSP, many former JSP households, upon termination of their two-year program, may still qualify to receive food stamps. So the PRFSP will continue as the principal means of providing food security to the lowest echelons of Sri Lankan society, with the lowest 20% (1 million families) being the prime target group of this program.

The distribution of income gathered in 1986/87 by Statistics Department of the Central Bank of Sri Lanka showed the following pattern, still believed to be fairly accurate:

|                              |       |       |       |        |
|------------------------------|-------|-------|-------|--------|
| Lowest 20% Income Group..... | 3.5%  | Share | Total | Income |
| Second 20% " " .....         | 7.8%  | "     | "     | "      |
| Third 20% " " .....          | 12.5% | "     | "     | "      |
| Fourth 20% " " .....         | 19.4% | "     | "     | "      |
| Highest 20% " " .....        | 56.8% | "     | "     | "      |

## III. CONSIDERATIONS AND CONSTRAINTS:

A USAID-funded study by Kansas State University completed in October 1993 indicates that Sri Lanka's per capita income figure of US\$494 is highly skewed, with the majority of income earners in the urban, rural and estate sectors receiving considerably less than this average. The study also noted a widening disparity between lower income groups and the total population in calorie intake, a trend which continues as the percentage of disposable incomes of the poor spent on food increases. Its findings indicated that the lowest 20% of the population spends 65.9% of its total expenditures on food, and that any food price increase affects the lowest income group 33% more than the "average" consumer.

A USAID-funded study by the International Science & Technology Institute (ISTI), also completed in October 1993, indicates that households in the bottom 40% of the income range may be having per capita energy intake levels well below accepted norms. Recent data indicate that the bottom 20% of all households, whose nutritional welfare deteriorated from an already low level in the immediate aftermath of economic reforms, have consumption levels which represent only 60 to 70 percent of adequacy.

In 1993 a UNICEF survey gathered anthropometric data on 1159 children under 5 years-old in rural households. The study indicates that the incidence in young children of both stunting (low height-for-age, reflecting chronic malnutrition) and wasting (low weight-for-height, reflecting acute malnutrition) is still high, as had been found in more extensive studies in 1987/88. The UNICEF study found that 28.7% of these children were stunted and 20.7% suffered from wasting. 71.8% of the rural households involved stated they faced some form of food shortage lasting up to four months during the year.

During the period it was conducted, the UNICEF survey indicated that nearly 85% of the parents are undernourished in some degree, with a Body-Mass Index (BMI) below 18. Malnutrition of pregnant women appears widespread; 28% of all babies had low birth weight, higher than the corresponding figure for Pakistan (25%) and only somewhat lower than India (30%) and Bangladesh (31%). The high

level of newborns of low birth weight is related to maternal morbidity and malnutrition, including anemia (mainly caused by a serious iron deficiency)

A USAID-funded Nutrition and Health Survey (NHS) conducted in November and December 1993 provides information on the nutrition status of Sri Lankan children between the age of 3 and 60 months at the national, provincial, and sector (urban/rural) levels. It shows that 35 percent of Sri Lankan children age 3 to 60 months are underweight which is 15 times the level expected in a well-nourished population (2.2%). The results of the study indicate that the trend is toward increasing prevalence of underweight through the first 36 months, with the most critical period of nutritional vulnerability for children throughout Sri Lanka being the first 18 months of life.

The foregoing World Bank, UNICEF, GSL, and USAID-funded studies and data confirm that, at this stage of its structural adjustment program, poverty as acute as anywhere else in Asia persists among a sizeable element of Sri Lanka's population. This factor underscores the necessity of targeted food and other transfers to those who have not yet benefited from measures in the structural adjustments and economic reforms being implemented.

Because of the continuing civil war in the northern and eastern regions of the country, the GSL has also had to undertake a continuing relief effort for some 615,000 persons displaced by the conflict. This displaced populace lives inside and outside 463 government operated camps. A portion of the FY1993 PL 480, Title III generated local currencies is used for refugee relief.

Future budgetary requirements of the PRFSP will depend on three major factors: (i) adjustments in the value of food stamps to mitigate the cost of living increases; (ii) effectiveness of and adherence to the screening process in removing ineligible households; and (iii) entry of households in the North and East into the program as the security situation improves.

In keeping with both the Sri Lanka Constitution and USAID regulations, all actions taken in the selection of families and/or individuals for PRFS eligibility and/or in the specific levels of assistance to be provided shall be conducted without discrimin-

ation as to the sex or ethnic background of the persons involved. In addition, sex-disaggregated data shall be gathered concerning the numbers, composition, economic status and landholdings of the families and individuals considered for inclusion in the PRFS Program.

#### IV. PROPOSED POLICY REFORM MEASURES AND PERFORMANCE BENCHMARKS:

Policy Reform Measure A - 1.: Plan and implement a proposed program to eliminate ineligible households, estimated to be approximately 33% of recipients, from the PRFSP. (Existing criteria and administrative mechanisms in place should be sufficient to accomplish this reform)

##### Specific Outputs:

|    | <u>Target<br/>Benchmarks:</u>  | <u>Completion<br/>Dates:</u> | <u>Budgets<br/>\$ million:</u> |
|----|--|------------------------------|--------------------------------|
| 1. | Undertake studies to update data to target PRFSP on neediest households within lowest quintile and, depending on area, selected households in next lowest quintile.  | June 1994                    | 0.5                            |
| 2  | Draft Action Plan to implement results of studies completed under Benchmark # 1.   | Oct. 1994                    | 0.5                            |
| 3. | Under foregoing Action Plan, issue instructions to teams chosen by communities to select poorest 20 families, then next poorest 10 families, then identify other poor families eligible under existing PRFSP criteria. | Dec. 1994                    | 0.5                            |
| 4. | Implement refocusing of PRFSP based on results of  |                              |                                |

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| foregoing selection process.   | Dec. 1995 | 0.5 |
| 5. With savings realized from foregoing retargeting, implement changes required to increase income transfer to deserving households. | June 1996 | 0.5 |

Policy Reform Measure A - 2.: Implement simplified health and nutritional surveys semi-annually to capture seasonal variations in nutritional status and improve monitoring of existing programs for the poor.

Specific Outputs:

- | <u>Target<br/>Benchmarks:</u>  | <u>Completion<br/>Dates:</u> | <u>Budgets<br/>\$ million:</u> |
|--|------------------------------|--------------------------------|
| 1. On basis of the USAID-funded Nutrition and Health Survey (NHS) undertaken during November/December 1993, use NHS questionnaire to explore problem areas where further analysis is needed. | June 1994                    | 0.5                            |
| 2. Undertake second of semi-annual Nutrition & Health Surveys (NHS).   | Dec 1994                     | 0.5                            |

Policy Reform Measure A - 3.: All data gathered indicates that while accessibility and availability have been addressed in GSL food security undertakings, relatively little has been accomplished by way of interventions to address better utilization.

Specific Outputs

- | <u>Target<br/>Benchmarks:</u>   | <u>Completion<br/>Dates:</u> | <u>Budgets<br/>\$ million:</u> |
|---|------------------------------|--------------------------------|
| 1. Plan pilot food utilization interventions targeting women responsible for food preparation |                              |                                |

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| and survey results of such interventions periodically.       | Sept. 1994 | 0.5 |
| 2. Implement first interventions planned under Benchmark #1. | Nov. 1994  | 0.5 |

Policy Reform Measure A - 4.: USAID and GSL have, on occasion, discussed fortification of wheat flour to improve nutritional levels, especially for pregnant and lactating women. A decision to do so has never been arrived at for lack of a satisfactory demonstration of benefit:cost feasibility. Evidence is now at hand whereby such feasibility is expected to be established.

Specific Outputs

|    | <u>Target<br/>Benchmarks:</u>  | <u>Completion<br/>Dates:</u> | <u>Budgets<br/>\$ million:</u> |
|----|--|------------------------------|--------------------------------|
| 1. | Analyze data from USAID Nutrition Survey making preliminary showing of favorable benefit:cost ratio. | June 1994                    | 1.0                            |
| 2. | Conduct definitive survey proving favorable benefit:cost ratio.                                      | Sep. 1994                    | 1.0                            |
| 3. | Prepare action plan for wheat flour fortification.   | Dec. 1994                    | 1.0                            |
| 4. | Commence program of wheat flour fortification.   | Mar. 1995                    | 2.0                            |
| 5. | Wheat flour fortification program continuing in operation.   | Mar. 1996                    | 2.0                            |
| 6. | Wheat flour fortification program continuing in operation.   | Mar. 1997                    | 2.0                            |

PROGRAM PROPOSALS

for

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POLICY REFORM MEASURE B: CONTINUATION AND EXPANSION OF  
ACCELERATED LAND SURVEYING AND TITLING PROGRAM:

I. BACKGROUND:

1. Overall Agricultural Situation:

Farmland holdings in Sri Lanka fall into two general categories:

- Traditional villages (some 38% of the country's population), where titles - if any are held - tend to be freehold, with full power vested in the owner to sell his holding, with the possibility of either consolidation or fragmentation of landholdings. The practical result of traditional inheritance rights is that holdings are more often fragmented into uneconomically small parcels. There are also substantial numbers of landless. As a practical matter, it is impossible to engage in wholesale retitling exercises in this setting. However, due to the fact that conditions vary from upland to wet zone to mid-hill tree crop areas and individual small scale programs could be entered into to develop experience in all of these areas.
- "Settlement" areas, primarily on government land, cover some 28% of the population or close to 1 million families. Many of these are in Mahaweli, but a large number are elsewhere. These are the areas where few of the occupants have satisfactory title - most of them being on "limited use permits", leases or "encroachment on Crown lands" - and where the majority of titling programs are in process.

Because of the self-evident importance of furnishing farmers with satisfactory land titles, both to induce them to make investments in their land and to satisfy the need of lending institutions for loan collateral, the GSL and USAID have been seeking a mutually acceptable formula for granting titles in the settlement areas for a considerable period of time. A related problem is that here too there is a tendency toward uneconomically small parcels, a fragmentation inevitably exacerbated by uncertainties over what rights the occupant of the land might possess. Since the ongoing GSL titling program, although substantial, had extended over a seemingly excessive period of time, it was decided in the 1980s - partly as a result of findings of the USAID-supported National Agriculture, Food and Nutrition Study (NAFNS) - to include land titling as one of the subjects of the Food for Peace Program:

2. Self-help Measures (SHMs) under Title I Agreements:

The FY 1987 Title I Agreement included a SHM to improve the system of GSL processing and issuing of land titles to eligible settlers. In that SHM, priority attention was given to Mahaweli and other new schemes, and GSL was enjoined to issue some 225,000 new titles within a 3 year period.

The magnitude of the program, as proposed, was sufficient to insure that its effects would have been meaningful if it could have been carried out as planned. However, implementation was subject to force majeure, since subversive activities and ethnic disturbances not only affected large portions of the area where the land titles were to have been issued, but also reduced the resources available to GSL for processing and granting those titles. In addition, conditions imposed by the World Bank concerning allocation of land development costs served further to delay issuance of titles in the key Mahaweli region.

And finally, in a problem that persists to the present, there was a shortage of land surveyors, coupled with unsatisfactory legal procedures, the combination of which severely retarded the pace at which titles could be issued.

The FY 1987 Title I Agreement also included a SHM to carry out on a pilot basis two alternative land alienation models designed to encourage investment in agriculture, increase farmer productivity

and enhance farm-generated incomes. The provision was met by establishment of two-hectare model plots testing the viability of growing animal fodder under irrigated conditions in the one case, and pasture combined with coconuts under rainfed conditions in the other. If those models had been fully successful, they could have been replicated on a wider scale. However, in January 1991, USAID decided it would need to continue monitoring this activity and dialogue with the GSL on additional ways to expedite the program. It was subsequently decided to settle on a less complex plan of simply expediting titling activities.

As a follow-up to the above provisions - and in response to the lack of progress in their implementation - the FY 1990 Title I Agreement provided that GSL was to conduct a thorough policy review of land tenure problems and their impact on agricultural productivity and income in the food crop sector. The review was to focus on land fragmentation, lack of security of tenure, and titles unacceptable as collateral to lending agencies, among other problems. The agreed importance of this review, coupled with the time required for its completion, caused it also to be incorporated into the Action Plan aspects of Title III Policy Reform Measure B; it has since been completed as reported in Colombo \_\_\_\_\_.

### 3. Policy Reforms under the Title III Program:

The Title III program design did an excellent job of building on the lessons learned under Title I and avoiding its pitfalls. The cited Title III Policy Reform Measure B: "Implement an intensive land survey and titling program" enabled USAID to take advantage of the Title I SHM studies and pilots in the area of land titling and tenure to fashion a sweeping program of reform that is now beginning to bear fruit, as reported in Colombo \_\_\_\_\_, despite the fact that numerical targets have not yet been fully met.

The task of reform has not been easy, however, and is far from complete: there are still a great many bureaucrats in GSL who feel they have a duty to: "protect the peasant from himself." The job has been effectively begun and a considerable amount of momentum has been generated, but another two or three years of concentrated effort toward institutionalizing the program of land

titling will be required before one can be confident that the process has become irreversible.

## II. ECONOMIC AND SOCIAL JUSTIFICATION FOR REFORM:

It has been demonstrated through World Bank and other economic analyses, coupled with discussions with GSL officials and expatriate technicians, that the absence of satisfactory land title is one of the primary causes of both rural poverty and inadequate production and crop diversification. Rectification of the situation clearly requires a long-term program of land titling - whether freehold title, Swarnabhoomi grants, or some combination of the two - as a precondition to a range of needed improvements in the sector over the longer term.

World Bank data shows that landlessness, a lack of secure title for occupants of land, and uneconomically small land parcels are among the primary long term causes of rural poverty in Sri Lanka. Among the relevant data produced by the Bank are the following:

- The Government of Sri Lanka owns or otherwise controls 82% of all agricultural land.
- Tenancy on GSL land at present is sometimes by leasehold, but more often on some sort of an informal basis, such as encroachment, with attendant insecurity of tenure.
- Studies in Sri Lanka have shown that holdings under two acres are not sufficient to lift their owners above the poverty level.
- Nearly 11% of rural households are absolutely landless; 43% of agricultural holdings, formal or informal, are less than one acre; and another 22% range from one to two acres. That is to say, three-quarters of the country's farms are below the minimum size for making a decent living.
- Fragmentation and landlessness are especially prevalent in the "wet zone" where 91% of the occupiers have holdings of less than two acres and irrigation schemes, which tend to make small holdings more viable, are rare.

Additional factors adding to the inhibition of agricultural investment and production through inadequate farmer rights in the land under cultivation are:

- A dirigiste mentality on the part of many GSL officials, especially at the local level, has led to resistance to permitting "peasants" to obtain marketable title to land.
- This same type of official thinking has caused many local officials to pressure the land occupants into particular cropping patterns - especially rice in preference to higher value crops - which pressure the farmers are hesitant to resist because of their uncertainty of tenure.
- A persistent shortage of land surveyors is coupled with unsatisfactory legal procedures to severely retard the pace at which titles can be issued even when the will to do so is present.
- Although lack of title does not create an absolute inability to obtain credit, it generally serves to limit such credit to short-term crop-secured loans.
- Insecurity of tenure inhibits the occupants from making any sorts of investment other than those which bring immediate returns.

Questions have been raised over the GSL change from its original land tenure policy of granting freehold title to making "Special Program Grants" under the Swarnabhoomi program; these grants fall well short of constituting clear title in the English or American sense. Supporters of the Swarnabhoomi program contend that Sri Lankan economic and cultural conditions have required imposition of two restrictions on what would be considered "fee simple" or "freehold" land title in Anglo-American law: restriction upon fragmentation of holdings that would otherwise result from the culturally-dictated division of one's land among all the children upon death; and requirement of authorization before a farmer can sell paddy land to a large enterprise in defiance of social custom preferring holdings be kept smaller and more localized.

While these restrictions could be seen as less than ideal from the theoretical standpoint of full title, they do not appear to prevent the necessary economic and social gains inherent in land ownership from being realized in the Sri Lankan context, and have therefore been accepted for purposes of the Title III Program Policy Reform Measures.

The economic and social justification for reform has been well summarized in a recent GSL study of the land tenure problem:

"[T]he incidence of prosperity and poverty is determined upon the way access to ownership and use of the land is realized. Aspects such as the land holding structure, systems of tenure, the organization of agricultural production and the accumulation of surplus value therefore are said to largely determine the relative attainments in productivity, prosperity and poverty among those who depend upon access to agricultural land and its production for satisfaction of their needs."

In keeping with both the Sri Lanka Constitution and USAID regulations, all actions taken in the surveying of land, determination of eligibility for title and type of title, as well as quantity and quality of land granted will be conducted without discrimination as to the sex or ethnic background of the individuals involved. In addition, sex-disaggregated data shall be gathered concerning compliance with the above provisions.

### III. PROPOSED POLICY REFORM MEASURES AND PERFORMANCE BENCHMARKS:

Policy Reform Measure B: Continuation and Expansion of Accelerated Land Surveying and Titling Program:

#### Specific Outputs

|    | <u>Target<br/>Benchmarks:</u>   | <u>Completion<br/>Dates:</u> | <u>Budgets<br/>\$ million:</u> |
|----|---|------------------------------|--------------------------------|
| 1. | Preparation of an Action Plan for Simplification of Legal Procedures and Expansion of Surveying Capacity. | June 1994                    | 0.5                            |

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| 2.  | Selection of 3 Additional Districts (2 in "Wet Zone and 1 in "Dry Zone") for Accelerated Land Survey and Titling Programs. | June 1994 | 0.5 |
| 3.  | Preparation of Action Plan for Intensive Surveying and Titling Program in Initial District Selected under #2.              | Aug. 1994 | 0.5 |
| 4.  | Preparation of Action Plan for Intensive Surveying and Titling Program in Second District Selected under #2.               | Oct. 1994 | 0.5 |
| 5.  | Passage of Legislation to Carry out Legal Reforms and Authorize Expansion of Surveying Capacity.                           | Nov. 1994 | 1.0 |
| 6.  | Preparation of Action Plan for Intensive Surveying and Titling Program in Third District Selected under #2.                | Dec. 1994 | 0.5 |
| 7.  | Commence Implementation of Program in Initial District.  | Dec. 1994 | 1.0 |
| 8.  | Commence Implementation of Program in Second District.   | Feb. 1995 | 1.0 |
| 9.  | Commence Implementation of Program in Third District.  | Apr. 1995 | 1.0 |
| 10. | Submit Report on Completed Implementation of Program in Initial District.  | Dec. 1996 | 2.0 |
| 11. | Submit Report on Completed Implementation of Program in Second District.   | Feb. 1997 | 2.0 |

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12. Submit Report on Completed Implementation of Program in Third District.

Apr. 1997

2.0

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ANNEX A  
APPENDIX C

PROGRAM PROPOSALS

for

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POLICY REFORM MEASURE C: REFORMING THE MAHAWELI AUTHORITY:

I. BACKGROUND:

The Mahaweli Irrigation Scheme has been the centerpiece of Sri Lanka's agricultural development program for the last two decades, accounting in some years for up to 80% of all public investments in agriculture. The Mahaweli Project is implemented by the Mahaweli Authority of Sri Lanka (MASL), set up by act of Parliament with wide ranging powers. The Mahaweli Project has so far supplied water to 60,000 ha of unirrigated lands, improved irrigation supplies for another 66,500 ha, resettled over 70,000 families, and created 670 MW of electrical generating capacity. Major development work, which has been financed by the World Bank, USAID, and a number of other donors, is largely complete.

MASL has been successful in constructing irrigation and other infrastructure, and resettling farmers in the newly irrigated lands. However, the large investments made are not producing optimal returns. GSL recurrent costs remain high, and though MASL control over the system is near total, infrastructure facilities are not being properly maintained; water often is not used or controlled properly (water losses from main sluice to farm turnout are estimated at 55-60%); the farming system continues to be dominated by rice, with little diversification into higher value crops; and development of private agribusiness has been limited.

Many of these problems are related to the present structure of institutions and incentives. Maintenance is widely perceived to

be the responsibility of the authorities so the farmers have not been sufficiently involved in looking after their own systems. Financial allocations for operations and maintenance (O&M) have been inadequate and have been mostly spent on salaries of support staff. Farmers are not charged for water and hence use it wastefully; since 1989 almost no water charges have been collected. Extension services and the research system have mostly focussed on rice, with insufficient attention given to other crops. There are a number of constraints which have limited private sector involvement in marketing, input supply and credit.

The GSL realizes that a wholly new strategy is required to reduce recurrent costs and ensure proper utilization of the lands developed and infrastructure now in place in the Mahaweli irrigation scheme. Under Policy Reform Measure G of the Title III Agreement signed June 11, 1991, GSL completed a review of the operations, structure and size of the MASL early in 1993. The experience gained in USAID's Mahaweli Agricultural and Rural Development Project (MARD) in working with some 12,000 small farm families in farmer organizations, and efforts to promote their participatory management in irrigation and crop diversification, also serves as a basis for formulating a new strategy to move decision making and operations to a local level. USAID's Mahaweli Enterprise Development Project (MED) has provided invaluable groundwork to promote large and medium scale capital investments in agribusiness for the Employment, Investment and Enterprise Development Division of the MASL. In its work on a Commercialization Plan for the Mahaweli, MED also has redefined policies, procedures and regulations needed for the full involvement of small entrepreneurs to provide the support activities needed by small farmers to participate in agribusiness and cooperative undertakings.

Under USAID's Agricultural Planning & Analysis Project, a thorough study on the restructuring of MASL was undertaken with the GSL. A Benchmark under Policy Reform Measure G of the 1991 PL 480, Title III Agreement was for the GSL to complete a review of the operations, structure and size of the MASL by March 1993. In August 1993 a joint World Bank/FAO mission assisted in outlining a procedure for restructuring and rationalization of Mahaweli agencies, identified the repair and rehabilitation work to be undertaken, and made recommendations for improved support

services for agricultural development. The World Bank/FAO mission agreed that in order to address issues of such magnitude, particularly the transfer of functions to farmers and line agencies, it is essential to develop a new "Mahaweli Vision" which encompasses total organizational changes and addresses the major financial problems related to irrigation management.

## II. PRESENT SITUATION:

The World Bank's Mahaweli Restructuring Project, a seven year endeavor now scheduled to come on stream in 1994, is estimated to cost US\$37.7 million. Of this amount, 80% would be for repair and rehabilitation work; 11% for improved O&M; 7% for improved support services, and the remainder for technical assistance in restructuring MASL. Major components of the project are repair and rehabilitation of irrigation works; support for restructuring of MASL; improved O&M, including the strengthening of Farmer Organizations (FOs) to undertake this responsibility; training and demonstration units; repair of a small number of farm-to-market roads; and improved support service for agricultural and livestock development.

The estimated duration of the undertaking is 7 years. Its main benefits are to reform the present institutional set up in the Mahaweli area; effect a major reduction in recurrent budgetary costs by creating a more sustainable and cost-efficient system of irrigation management; and raise income and output. Its estimated beneficiaries are the 55,000 families on the 41,000 ha served by the irrigation systems to be rehabilitated. The cost averages \$690 per family.

There is a very wide range of estimated Economic Rate of Return, 7% - 35%, the higher return depending upon the extent of complementary policy reforms accompanying repair and rehabilitation of the existing irrigation system. The Bank estimates there is a tremendous scope for crop diversification and livestock development. The investment proposed under the project would be marginally viable (ERR = 7%) if the only benefit were reduced conveyance losses and a proportional increase in area cultivable. The project would be more viable (ERR = 12%) if increased water availability could be combined with better on-farm water

management and more effective O&M. The project becomes highly attractive (ERR = 35%) if farmers would adopt improved cropping practices and diversify into high value crops (maize, legumes, vegetables, chillies) and livestock along with the foregoing measures. Improved cropping practices and diversification would require improved extension services working with newly formed and motivated farmer organizations, and policy measures to encourage ever-expanding private sector participation.

The Mahaweli Restructuring Project will address various components in Systems C, H and G where much of the Bank's previous capital investment was made. The preparatory engineering work has been completed, and now cost estimates have to be reviewed, and detailed designs for the first year's work completed. However, little preliminary work has been done by the GSL on the institutional aspects, including restructuring of MASL, plans for privatization of commercial activities, and mergers between branches of MASL and various line agencies.

Six task forces are being formed, dealing with: Headworks; Irrigation Management; Agricultural Extension; Private Sector Enhancement; Business Promotion; and Infrastructure, Land, Local Government and Social Services. Under the supervision of a Senior Advisor appointed by the Ministry of Forestry, Irrigation and Mahaweli Development (MFIMD), all of these task forces are supposed to submit a detailed timebound action program for review by the Bank's Appraisal Team, tentatively scheduled to arrive in early 1994.

All of the task forces are to review, assess and make a range of recommendations regarding coordination with other donor efforts in these six activities. USAID and other donor projects in these fields have been cited by the Interim Preparation Mission, as well as the Bank's National Irrigation Rehabilitation Project, which is being conducted concurrently, and which addresses many of the same elements in irrigation schemes outside the Mahaweli. What is apparent in the preparatory materials for the Mahaweli Restructuring Project is that attitudes and practices prevailing among farmers make institutional changes and strengthening a more difficult undertaking there than elsewhere. This may be partly due to Mahaweli farmers having been resettled there and, in the process, losing the stronger cooperative spirit engendered in

traditional longer-settled communities. Also, only limited importance was initially accorded to the development of farmer organizations by the MASL staff.

As in the Bank's National Irrigation Rehabilitation Project, divestiture of MASL functions in the Mahaweli Restructuring Project includes turning over responsibility for O&M of Distributory and Field Canals to FOs. FOs in the Mahaweli Settlements are organized in a three tier system:

- a) Turn Out Group (TOG);
- b) Unit Level Farmer Organization (ULFO);
- c) Block Level Farmer Organization (BLFO).

In view of the variations in the length and area served by the distributory canals in Mahaweli, the main operational level of the FO program is the Unit Level Farmer Organization. The ULFO of Mahaweli closely resembles the DCFOs accepted as the operational tier of irrigated structure farmers' organizations elsewhere. The ULFO has clearly defined functions as a hydrological unit. It has a direct responsibility for water management, agricultural development, efficient supply and disbursement of inputs, and marketing of crops through cooperative ventures.

Progress in organizing FOs in the Mahaweli has been slow and lacking encouraging results to date. FOs there have not become sufficiently influential to guide or motivate farmers, and financially are very weak. Most farmers pay only a membership fee - 10Rp or so. Few FOs have undertaken any commercial activities to give them income, nor have they demonstrated much capability in handling responsibilities transferred to them. Meetings are infrequent, often not even quarterly. Lacking good leadership, Mahaweli FOs are viewed as informal organizations, ineffective in looking after farmers' concerns or problems.

In Farmer Organization Status Survey undertaken in 1991 by Unit Managers in System B, using criteria determined by the Mahaweli Economic Agency (MEA), only 7.3% of ULFOs were considered excellent; 60% of ULFOs no more than just functioning; and 33% of ULFOs almost defunct. Moreover, only 21% of eligible farmers were members of ULFOs. In the Field Canal/Turn Out Groups surveyed at the same time, 24% were classified excellent; 40% as somewhat

effective; and 28% as poor or defunct. Though there have been major improvements in ULFOs since that time, no Distributory Canals have actually been handed over to them. Accordingly, none of the FOs had organized to undertake repairs and maintenance of Distributory Canals.

### III. CONSIDERATIONS AND CONSTRAINTS:

As is the case in the Bank's National Irrigation Rehabilitation Project, likewise in the Mahaweli Restructuring Project the resources required by newly restructured farmer organizations to meet the financial requirements imposed by assuming O&M responsibilities for their Distributory Canal Systems cannot be easily assured through increased yields of paddy realized through better water management. Assumption of O&M costs should be accompanied by an increased cash flow generated through crop diversification. Where land is not suited for diversified cropping, then every two DCFOs should be provided with a small scale rice processing mill and warehouse space to store agricultural inputs purchased collectively as well as milled rice to be marketed collectively.

While this lack of current and uncertain future financial viability of the Mahaweli FOs is noted, the Bank's preparatory documents do not appear to give this fundamental consideration the emphasis it warrants. The responsibilities outlined for the six Task Forces now being formed do not address crop diversification or cooperative functions assumed at the outset by newly created DCFOs as being of critical importance. As in the National Irrigation Restructuring Project, unless equal emphasis is put on O&M responsibilities and income enhancing undertakings so that DCFOs undertake both of these activities in tandem, any newly formed FOs in the Mahaweli Restructuring Project could become as dysfunctional as the ULFOs in the MASL were found to be in the 1991 survey.

The Task Force on Agricultural Extension is given responsibilities which deal primarily with the transfer of functions to central government departments; no mention is made of adaptive research on crop diversification through field trials in existing individual land holdings. The responsibilities of the

Task Force on Irrigation Management deal mostly with issues of institutional frameworks to be devised, but its members are also tasked to review reforms in irrigation management being pursued outside the Mahaweli areas. The Task Force on Business Promotion does mention "private sector led diversification into higher value crop and livestock products" as well as a "set of new relationships where the private sector, non-governmental organizations and small farmers could join hands to reduce recurrent government expenditure". While no one can dispute this desirable goal, this Task Force should be required to produce more specifics as to how it can be achieved.

The Rationale & Design Considerations contained in the Main Report of the FAO/World Bank Team states: "it is critical that a more sustainable and cost efficient system of irrigation management be set up which involves private farmers as far as possible in O&M". It also recommends that water charges be based on flows from Branch Canals into Distributory Canals, and that all farmers drawing water from a Distributory Canal contribute equally toward water costs, all outlets from Branch to Distributory Canals already being fitted with measuring devices. In discussing improved crop production, the document recognizes the major constraints in a move to higher value crops are lack of extension, inputs and market. It then runs through the usual litany of steps to improve these factors, i.e. improved farmer training, extension programs, technical support, and setting up farm demonstrations to illustrate recommended cultivation, irrigation, agronomic and post-harvest management practices. There is no mention of relationships or synchronization of introducing new FO responsibilities for O&M management and costs along with crop diversification, much less that priority should be accorded the latter to provide the financial wherewithal for ULFOs to assume the former.

USAID should assure that the GSL preparatory Task Force on Irrigation Management for the Mahaweli Restructuring Project is well aware of the lessons learned in its Irrigation Systems Management Project (ISMP) and the work accomplished under the Mahaweli Agriculture and Rural Development Project (MARD). The Task Force should be furnished with the quarterly reports of these projects as well as the ISMP Project Assistance Close Out Report. Experience gained in formulation of the Bank's National

Irrigation Rehabilitation Project and its implementation thus far should be taken into account. It is assumed this Task Force will also review the ten IMPSA policy papers on irrigation management, particularly No. 10 dealing with participatory management.

The Private Sector Enhancement and Business Promotion Task Forces should review the accomplishments to date of USAID's Mahaweli Enterprise Development Project (MED). They should be fully aware of the constraints perceived in realizing the rate of progress and targets MED activities are attempting to accomplish. In particular, these Task Forces should deal with the lack of land policies to support the development of small enterprises in the Mahaweli region. Lack of land policies, i.e. freehold titles for Small Scale Enterprises (SSEs) and thirty-year leases to Medium and Large Scale Enterprises (MLEs), has inhibited the investments required for such entrepreneurs to provide the support services essential to FO's to function properly and market their crops.

In keeping with both the Sri Lanka Constitution and USAID regulations, all actions taken in the formation of and support for and granting of rights and authority to DCFOs, the surveying of land, determination of eligibility for lease or title and type of title, and access to credit and other economic services will be conducted without discrimination as to the sex or ethnic background of the persons involved. In addition, sex-disaggregated data shall be gathered concerning compliance with the above provisions.

In view of the foregoing considerations and constraints, the following policy reform measures are suggested to compliment implementation of the Mahaweli Restructuring Project:.

#### IV. PROPOSED POLICY REFORM MEASURES AND PERFORMANCE BENCHMARKS:

Policy Reform Measure C - 1.: In accordance with the Action Plan contained in the recommendations made by the Task Force on restructuring Irrigation Management, MASL should turn over to Line Agencies responsibilities for the rehabilitation of principal canal structures, headgates, tanks, spillways, outlet sluices, and diversion weirs.

Specific Outputs:

|    | <u>Target<br/>Benchmarks:</u>  | <u>Completion<br/>Dates:</u> | <u>Budgets<br/>\$ million:</u> |
|----|--|------------------------------|--------------------------------|
| 1. | Contingent upon merger of ID and IMD to be carried out concurrently with restructuring of MASL, MASL should transfer all responsibilities for new construction, operation and maintenance of irrigation facilities in the Mahaweli to new line agency. | March 1995                   | 0.5                            |

Policy Reform Measure C - 2.: Improvements in land policy implementation are a key requirement for there to be an increase in the flow of private investment into the Mahaweli areas by individual entrepreneurs or large companies. Outright land grants equivalent to freehold titles should be made to entrepreneurs (SSEs) who meet the following conditions: a) Were the original allottee; b) Have been on the land for 5 years; c) Have developed the site; d) Have lease payments up to date. Thirty-year leases should be granted to medium and large scale commercial agri-businesses (20 ha plus).

Specific Outputs:

|    | <u>Target<br/>Benchmarks:</u>                                  | <u>Completion<br/>Dates:</u> | <u>Budgets<br/>\$ million:</u> |
|----|--|------------------------------|--------------------------------|
| 1. | Issue 250 Land Grants (equivalent to freehold titles) to SSEs. | June 1994                    | 0.5                            |
| 2. | Issue another 250 Land Grants to SSEs.                         | Dec. 1994                    | 0.5                            |
| 3. | Issue 15 thirty-year leases to MLEs.                           | Jan. 1994                    | 0.5                            |
| 4. | Issue another 30 thirty-year leases to MLEs.                   | June, 1994                   | 0.5                            |

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| 5. | Issue an additional 30<br>thirty-year leases to MLEs. | Dec. 1994 | 0.5 |
|----|---|-----------|-----|

Policy Reform Measure C - 3.: Concurrent with or preceding formation of new Distributory Canal Farmer Organizations (DCFOs) in the Mahaweli Restructuring Project, implement an accelerated program of adaptive research in subsidiary and minor export crops designed for individual farm holdings.

Specific Outputs:

|    | <u>Target<br/>Benchmarks:</u>  | <u>Completion<br/>Dates:</u> | <u>Budgets<br/>\$ million:</u> |
|----|--|------------------------------|--------------------------------|
| 1. | Set up training courses for initial cadre of Agricultural Instructors (AIs) to allow them to accompany initial cadre of Institutional Development Officers (IDOs) to work with newly-formed FOs in Mahaweli Restructuring Project. | Oct. 1994                    | 0.5                            |
| 2. | Set up 100 on-farm adaptive research trials with vegetables and field crops other than rice on land cultivated by members of new DCFOs in Mahaweli areas.  | Jan. 1995                    | 0.5                            |
| 3. | Preparation of Action Plan to assure proper working relationships between producers of crops other than rice in DCFOs and private sector entrepreneurs capable of providing necessary inputs and marketing produce.                | Mar. 1995                    | 0.5                            |
| 4. | Begin implementing Action Plan prepared under Benchmark #3.  | June 1995                    | 0.5                            |

Policy Reform Measure C - 4.: Accelerate the turnover of O&M responsibilities for Systems and Distributory Canals to newly formed Distributory Canal Farmer Organizations (DCFOS) in the Mahaweli Restructuring Project.

Specific Outputs:

|    | <u>Target<br/>Benchmarks:</u>  | <u>Completion<br/>Dates:</u> | <u>Budgets<br/>\$ million:</u> |
|----|--|------------------------------|--------------------------------|
| 1. | Prepare Action Plan utilizing Institutional Development Officers, Agricultural Instructors, and Financial Management Assistants operating as a team to assist in formation of new DCFOS. | Oct. 1994                    | 0.5                            |
| 2. | Prepare Action Plan to assure prompt registration of newly created DCFOS to provide legal status to facilitate access to credit for start-up costs.                                      | Jan. 1995                    | 0.5                            |
| 3. | Begin implementation of Action Plan under Benchmark #1.  | Jan. 1995                    | 0.5                            |
| 4. | Begin implementation of Action Plan under Benchmark #2.  | Mar. 1995                    | 0.5                            |

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POLICY REFORM MEASURE D: PRIVATE SECTOR PLANTATION MANAGEMENT:

I. BACKGROUND:

For over a century, the privately owned and operated tea, rubber and coconut plantations of Ceylon/Sri Lanka were the country's primary foreign exchange earners and major contributors to GDP. Some 220,000 ha of tea is being grown, with the plantation sector covering around 160,000 ha and smallholders the rest; the Sri Lankan share of the world tea market peaked in 1977 with 23%. Rubber is grown on about 200,000 ha, two thirds on estates; Sri Lanka produced only about 4% of world output. Coconut has always been largely a smallholder crop, with 95% of an estimated 390,000 ha in the hands of producers with less than 20 ha, and is mostly consumed in the domestic market, along with specialty exports such as dessicated coconut, where it has held up to 1/3 of the world market.

Then, in the 1970s lurch toward socialism, the GSL nationalized the plantations and turned them over to public corporations, the Janatha Estates Development Board (JEDB) and Sri Lanka State Plantations Corporation (SLSPC), to operate. Inevitably, their costs began to rise, production to stagnate, maintenance and tree replacement and upgrading to be neglected. The once-profitable estates began to lose money and Sri Lanka found its market share in world commerce entering into a period of decline. Weaknesses in public management were particularly noticeable in the tea sector, where the JEDB and SLSPC, with almost 73% of the acreage produced only 55% of the output. As stated in the ADB "Report and Recommendation" for the Second Agriculture Program:

"The state plantation sector . . . is a major player in the economy of Sri Lanka. However, its less than satisfactory performance - productivity being 30 to 40 per cent lower than that of tea and rubber estates in other countries - has resulted in a declining contribution to the economy over the decade. In fact, it has been out-performed by the local private sector estates including the smallholdings."

Additionally, viewing the plantations as "cash cows" to finance Sri Lanka's extensive and expensive social services system, the GSL imposed heavy export taxes on the sector, causing a further erosion of the country's competitive position in world markets for its products.

By the late 1980s, it had become clear to the donor community and even to the somewhat-more-than-previously private-sector-oriented GSL that the plantation sector had gotten into serious trouble. A two-pronged effort was launched to rescue it:

- The export tax burden was squarely addressed by USAID in Policy Reform Measure D. of the Title III program: "Phase out export taxes on tea, rubber and coconuts" and by both the World Bank and ADB in their structural adjustment programs. The GSL has complied and taxes are now at a reduced level competitive with other exporting countries.
- The ownership/management question has been addressed by USAID through the Plantation Restructuring Unit and by the World Bank and the ADB, as discussed in detail below.

## II. TREE-CROP SECTOR REFORMS:

### 1. World Bank and ADB:

The World Bank and ADB have addressed the problems of the tea/rubber/coconut sector on two fronts: direct assistance to smallholder development programs and the requirement of management changes in the case of the large plantations.

- Smallholder loans by both Banks concentrated on the need for technical assistance to the minor producers for: production

increases; improvement of product quality; new planting and replanting; processing facilities; and institutional development.

- The leading role in the privatization/management improvement program for the JEDB and SLSPC has been undertaken by the ADB through its Second Agriculture Program Loan (APL II), following up on policies developed under APL I and the earlier Bank-assisted Plantation Sector Project.
- The World Bank has also supported the program, both through portions of its structural adjustment conditionality and with direct financing. As stated in the ADB "Report and Recommendation" for the Second Agriculture Program:

"The main objective of the restructuring program is to improve the performance of the plantation estates, initially by introducing private sector management . . . Considering the scope and magnitude of the tasks involved in the restructuring program, the Government has received from the World Bank a grant to finance a series of activities to support the restructuring program."

## 2. USAID Title III Program:

Although the Title III design did not focus specifically on the GSL program for privatizing management of the plantation sector, it aided immeasurably in that program by Policy Reform Measure D, cited above. By removing the competitive burden in international markets of excessive taxation, this reform helped to give the Sri Lankan plantation sector the promise of renewed profitability.

In addition, Policy Reform Measure G called on GSL to: "Review agricultural programs . . . with a view toward . . . expanding the role of the private sector . . . ." This review helped to lay the conceptual groundwork for more effective privatization of plantation management through Benchmark #1: "Completion of a study on commercialization of public estates." The successful completion of the study was reported in Colombo \_\_\_\_\_, placing USAID in a position to take advantage of its findings to help

fashion a more effective program of reform in conjunction with the programs of the IFIs.

### 3. Course of Reform Program to Date:

As the result of both its own realization of the need for reform and the leverage of the IFI programs, GSL entered into an overall management contract with a group of private companies to undertake management of all of the estates that were considered to be viable (the less viable ones are being dealt with separately) by way of a contract with a nominal term of 30 years, but which was subject to reopening by either party after only five years - thus making any long-term investments by the managers extremely risky! The parties are currently discussing renegotiation of the terms of the contract, including making it firm for the full 30 years, and the ADB is weighing in on the side of modification of the terms to encourage the long-term investment so desperately needed in the sector. Although both sides are presently engaged in the normal posturing attendant to economic/political negotiations, the likelihood of a successful conclusion appears good.

The task of plantation ownership/management reform has not been easy, however, and is far from complete: there are still a great many socialist inclinations among certain GSL bureaucrats, who distrust the profit motive and management methods of the private sector, especially rationalization of employment. The economic aspects of the reform are well under way through the present short-term management program and considerable momentum has been developed, but it will only be when longer term leases have been negotiated and government's interference in estate management reduced to a reasonable minimum that the privatization program can be considered irreversible.

### III. JUSTIFICATION FOR FURTHER REFORM:

It has been demonstrated in World Bank, ADB and other economic analyses, and confirmed by USAID consultants in their discussions with GSL officials and expatriate technicians, that the weakness of the plantation sector flowing from the shortcomings of public sector management constitute a major cause of both rural poverty and inadequate production and crop diversification. Without the

dynamism of the large plantations to lead the way in technology, systems and marketing, smallholder production - of tea and rubber in particular and coconuts to a lesser degree - has tended to stagnate.

Because of the long-term nature of tree crop growth cycles, the failure of the state plantations to carry out an adequate program of replacing and upgrading their ageing stock has cast a special burden upon the sector. The worst of the crisis was a long time coming and will not be fully remedied in the near future, even though such immediate measures as rationalization of employment and diversification of products can insure a degree of recovery in the shorter term.

The taking of economically necessary but frequently socially disruptive measures in the near future, however, faces two major hurdles: a) with elections coming up in late 1994 and early 1995, disrupting the guaranteed job security of substantial numbers of worker/voters is not in the cards; and b) most of the plantation workers are Tamils who have so far resisted the blandishments of the terrorist LTTE movement - but might be seen as vulnerable if they were to suffer severe economic dislocation.

Rectification of this situation clearly requires a program that goes beyond immediate rationalization of the plantations' labor requirements viewed solely in the light of their current product mix, and calls for innovative steps toward diversification in ways that will employ workers who would otherwise be rendered redundant in the face of more efficient production of the present crops.

## IV. PROPOSED POLICY REFORM MEASURES AND PERFORMANCE BENCHMARKS:

## Policy Reform Measure D: Expansion of Private Sector Plantation Management:

Specific Outputs

|    | <u>Target<br/>Benchmarks:</u>  | <u>Completion<br/>Dates:</u> | <u>Budgets<br/>\$ million:</u> |
|----|--|------------------------------|--------------------------------|
| 1. | Acceptance of ADB Plan for Non-Interference with Management Companies' Operation of Plantations.   | June 1994                    | 2.0                            |
| 2. | Begin Joint Development with Management Companies of Plan for Diversification of Agricultural Production on Plantations, Including Financing and Tax Incentives for Measures Alleviating any Unemployment Resulting from Production Rationalization. | June 1994                    | 1.0                            |
| 3. | Acceptance of Joint Plan Developed Under Benchmark # 2, Including Financing for Employment Generation.   | Sep. 1994                    | 5.0                            |

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## POLICY REFORM MEASURE E: NATIONAL IRRIGATION REFORMS:

## I. BACKGROUND:

Sri Lanka's greatest promise for concurrent economic and social progress is believed to lie in agricultural development-led industrialization. Overall agricultural production during the last decade has been mixed. During the past five years the agricultural sector has been lagging well behind manufacturing in comparative rates of growth, neither does the current pattern of Sri Lanka's industrial growth contain a large percentage of agricultural inputs.

At present the agriculture sector contributes 22% of GDP and is the main source of employment for some 2.2 million persons, about 45% of the active labor force. Moreover, with three-quarters of the population living in rural areas, agriculture is the single most important source of livelihood for most of Sri Lanka's population. What are being sought now are formulae which, in the context of maintaining food security, will provide steady and sustainable growth to all segments of the agricultural sector.

Sri Lanka has about 1.6 million ha of land in its dry, intermediate, and wet zones which are cultivated permanently. Tree crops account for about 900,000 ha of cultivated land; highland annual crops for about 100,000 ha, and paddy for about 600,000 ha. About 80% of all paddy land is under irrigation systems. Irrigation has been a major focus of investment since Sri Lanka's independence with goals of achieving self-sufficiency in food production and reducing unemployment through settlement of the dry zone.

To date, some 255,000 ha of irrigated land is served by some 75 major schemes (over 600 ha), including 45,000 ha under the Mahaweli Program. An additional 45,000 ha is irrigated by medium schemes (80 - 600 ha). Some 235,000 ha is served by about 22,000 minor schemes (less than 80 ha).

Most of the medium and major schemes are located in the dry zone and were built over the past 40 years. GSL has the responsibility for operation and maintenance (O & M) of these schemes. About 65% of the land under minor schemes is located in the dry zone and is mostly irrigated from tanks. Ostensibly, the minor schemes were to be operated and maintained by the farmers themselves. However, over the years and due in some degree to the proliferation of government agencies serving the irrigation sector, farmers have come to look increasingly to GSL to provide assistance for rehabilitation of structures such as tanks, spillways, outlet sluices, diversion weirs and distributory canals and turnouts.

Today, maintenance in minor irrigation schemes is not done regularly, causing deterioration of facilities as well as waste of scarce water. As a result, irrigation facilities in most of the 22,000 minor schemes have been allowed to deteriorate to the point where major rehabilitation is now required. Recent estimates indicate that over 10,000 minor schemes covering 110,000 ha require substantial rehabilitation work at an estimated cost of about US\$55 million.

## II. PRESENT SITUATION:

Both GSL and the donor community have recognized the inefficiencies brought about by the fragmentation of functions, overlapping of responsibilities, and seeming contradictions in policies among GSL agencies and ministries concerned with irrigated agriculture.

The Irrigation Department (ID) is the oldest among the irrigation sector institutions and is responsible for managing construction and O & M activities in medium/major schemes. ID also executes externally financed rehabilitation works in minor schemes. The Mahaweli Authority of Sri Lanka (MASL) operates through several inter-disciplinary sub-groups in planning, implementing and maintaining the Mahaweli Development Program in which most major

donors have participated and which has been the GSL's single largest investment scheme through the 1980s. The Irrigation Management Division (IMD) of the Ministry of Lands, Irrigation and Mahaweli Development has been responsible for managing some 35 major irrigation schemes, while the ID handles all technical matters related to rehabilitation and O & M of IMD-managed schemes. The IMD launched a Program for Integrated Management of Major Irrigation Schemes (INMAS) administered through national, district and project level committees and farmer organizations (FOs). Project managers are to coordinate the functions of all line agencies, but with budgets controlled by IMD headquarters in Colombo. Added to this equation is the Department of Agrarian Services (DAS), responsible for technical and institutional advisory services for minor irrigation schemes and for allocating and controlling the budget for repair works on minor schemes.

In 1988 GSL adopted a new management policy for the irrigation sector designed to increase the role of the farmers and reduce the role of the public sector. Its aim was to limit the role of the public sector to the O & M of major irrigation facilities such as headworks and main canals, and to provide technical and institutional advice to FOs. This policy was predicated on the presumption that eventually the FOs would assume the full O & M cost of the parts of the systems managed by them (Distribution Canals), and that the farmer members of the FO's would contribute their fair share in the form of labor and/or cash payments. Experience to date has not borne out this underlying presumption.

Provincial Councils (PCs) have recently taken over responsibility from central GSL agencies for providing services - construction, O & M of major schemes, technical advice - in all irrigation schemes located on provincial rivers. Following a decision by the Minister of Lands, Irrigation, and Mahaweli Development (MLIMD), the PCs also assumed responsibility for all schemes under 400 ha located on interprovincial rivers. Since 1990 the PCs have had responsibility for all minor schemes and about 40% of the area under medium/major schemes. However, in 1991 the GSL budget for minor irrigation schemes was again put under the control of the Department of Agrarian Services.

A number of the relationships and authorities between central government departments and PCs concerned with irrigation require clearer delineation. Some 1,725 staff, including about 90 engineers, were transferred from the central Irrigation

Department to the new provincial irrigation units. Nonetheless, the technical capabilities as well as the institutional structure and authority of the new provincial administrations remain areas of concern.

Along with GSL experience in its ongoing attempts to decentralize and move irrigation support services to the field, there have been two recently terminated activities which provide a wealth of pragmatic experience and policy research for future interventions in irrigated agriculture. The first of these was USAID's Irrigation Systems Management Project (ISMP - 1986-1993) in which valuable lessons were learned regarding farmer organizations, sustainability of O & M requirements, and overall organizational requirements for support services needed. The second is the Irrigation Management Policy Support Activity (IMPSA - 1990-1992), a two-year undertaking by the Ministry of Lands, Irrigation & Mahaweli Development in association with the Ministry of Agricultural Development & Research, to formulate appropriate strategies and policies for GSL consideration. IMPSA produced ten major policy papers. The main recommendations contained in these were incorporated in GSL Cabinet Papers for review and presentation to the Parliament for discussion and enactment.

The composite of the foregoing experiences, activities and accomplishments, accompanied by a World Bank funded National Irrigation Rehabilitation Project now getting underway, presents an opportune juncture for USAID to propose policy reform measures to the GSL in this sector.

### III. CONSIDERATIONS AND CONSTRAINTS:

The World Bank's National Irrigation Rehabilitation Project, scheduled to run through 1997, is a national program to improve the efficiency of public irrigation services within GSL central offices and in the provinces and promote increased participation in system management by FOs. Its major components include the rehabilitation and improvement of about 1000 minor, 42 medium/major tank schemes, and 26 medium/major diversion schemes providing irrigation to 37,500 ha in several provinces. Plans for improvement of these schemes have been prepared in all these provinces. Of the 42 medium/major tank schemes, 9 are to be implemented by the Irrigation Department; the remainder will be

under provincial management. Of the 26 medium/major diversion schemes, only 4 are to be under ID management and the remainder under provincial management.

The schemes appraised thus far in the following Districts indicate highly favorable economic rates of return:

|              |                        |                            |              |                           |              |
|--------------|------------------------|----------------------------|--------------|---------------------------|--------------|
| Kaltota      | Mahagal<br><u>wewa</u> | Dorakada<br><u>Liyadde</u> | Kobeigane    | Mahakiri<br><u>Ibbewa</u> | Nittewa      |
| <u>36.10</u> | 29.81                  | 30.40                      | <u>30.60</u> | 30.89                     | <u>21.51</u> |

As a result of this project, the average incomes of some 100,000 farm families would increase by 15 - 55% due to higher and more diversified crop production combined with more efficient water usage. Moreover their income would be better protected from losses arising from deterioration of scheme facilities. With diversification, the project is also expected to generate an additional annual labor demand for farm activities of about 2000 person years.

The greatest risks in completing this project on schedule and realizing its projected ERR are institutional. Inadequate staffing of the new provincial administrations could cause delays in implementation or sub-standard quality in major engineering works; to minimize this risk, the ID is to have a cadre of irrigation consultants ready to assist provincial administrations as needed. Secondly, if the establishment of FOs proceeds more slowly than expected, there would also be delays in project implementation and prolongation of the GSL undertaking costs it can no longer bear. For medium/major schemes (80 ha and over), FOs are to bear the full cost of O & M of distributory and field canals after completion of rehabilitation and improvement, and the cost of O & M of headworks and main canals two years after these are rehabilitated. For minor schemes (less than 80 ha), the FOs will bear the full cost of O & M after completion of rehabilitation and improvement.

The speed with which the Parliamentary enactment of the IMPSA Policy Papers takes place will lay the groundwork for and accelerate the pace of implementation of the foregoing IBRD intervention, particularly IMPSA Policy Paper No. 10, entitled: "Achieving High Productivity and Prosperity of Irrigated

Agriculture through Participatory Management". The Bank appears to be focusing on restructuring and reorientation of existing irrigation agencies as a preliminary phase in establishing a clearly understood line of engineering, funding, responsibilities and technical assistance to support PCs and facilitate increased FO participation in irrigation systems management. A number of the studies completed under USAID's Agricultural Planning and Analysis Project (APAP) to assist in development of an integrated national and provincial agricultural planning system and provide a framework for improved policies and a more rational framework for decision making can now be put to good use under in the GSL's responding to the Bank's concerns.

The Bank's National Irrigation Rehabilitation Project includes agricultural demonstration plots for high value field crops in the context of increasing the efficiency in the use of available water through improved cropping practices. However, it does not appear to concentrate upon crop diversification to the degree that the experience gained under USAID's ISMP indicates is warranted in assisting farmer's in the formation of Field Canal Groups, Distributory Canal Farmers' Organizations, and System Level Farmer Organizations. The resources required by such farmer organizations to meet the financial requirements imposed by assuming O & M responsibilities at these levels of irrigation systems cannot be met through the increased yields of paddy realized through better water management. It appears that the DCFOs and the SLFOs can only assume such costs with an increased cash flow generated through crop diversification.

The foregoing finding indicates the need for an intensified adaptive research effort on existing farm plots to determine possibilities for crop diversification between or during paddy seasons. It is estimated that some 60-70,000 ha of well-drained irrigated land seems potentially available for diversified cropping on major irrigation schemes. At least double this area is thought to be available on minor schemes. The FAO has estimated that some 39,000 ha are available in rainfed areas.

There has already been some successes in crop diversification. Subsidiary food crops are mostly grown under rainfed conditions, and have become increasingly prominent during the Yala (Southwest Monsoon Season - April to September) on the Dry Zone irrigation

schemes. Most are known to producers as subsistence crops and as part of mixed cropping, rather than as interplanted crops or as a specialized product. Much of their production is carried out on a miniscule basis. It is estimated that in 1990 subsidiary food crops were planted on 225-250,000 ha. High value crops - chillies, red onions, groundnuts, green gram, soybeans, potatoes, big onions and black gram - have all recorded a steady increase in production during the past two decades, especially under irrigation. The most successful crop diversification intervention in USAID's ISMP was the growing of mung beans between rice crops. This technique required no tillage or irrigation as seeds were sown on the paddy field just after harvest using residual soil moisture.

For unemployment in Sri Lanka to fall to 1981/82 levels (i.e. to 12%) at the end of 1995, some 300-400,000 new jobs will have to be created in agriculture, which has traditionally had to offset low rates of employment creation in other sectors. The majority of the country's poor (88%) still live in rural areas. The tree crop sector is now being divested of excess labor as estates are contracted to private corporate management. Demand for labor in the paddy sector remains seasonal. Prospects for increased agricultural employment and of higher incomes for marginal and small producers could improve with greater diversification into more labor-intensive, higher value crops. While irrigated yala paddy in the Mahaweli required on average 424 man-days/ha, the corresponding figures for red onion, chillies and potatoes (subsidiary food crops with the highest returns) were 758, 503, and 590 man-days/ha. The potential for such on-farm employment is especially attractive for the more economically depressed areas in southern Sri Lanka. Crop diversification should eventually reach that area as it progresses through richer farming areas just south of the Mahaweli Irrigation System.

In the mid-80s it was generally recognized that the concentration of Sri Lanka's agricultural programs on self-sufficiency in rice had left its research facilities ill-equipped to provide the necessary support for diversified agriculture in either subsidiary or minor export crops. USAID undertook its recently completed Diversified Agriculture Research Project (DARP) in response to this need. DARP ran concurrently with ISMP, and both have components which can reinforce the viability of FOs being

formed within the context of the IBRD Irrigation Rehabilitation Project. DARP organized and carried out Yala season demonstrations of vegetable and other crops in paddy lands during the Yala season. It has greatly furthered seed technology and availability for OFCs, as well as the horticulture and nursery management required for production of tropical fruits by small farmers. The DOA can utilize ISMP and DARP accomplishments as points of departure in expanding the scope of its adaptive research programs.

Within the context of reorganization of the DOA, now scheduled for January 1994, GSL agricultural research is widely considered to be in need of reorientation. The Sri Lanka Council for Agricultural Research (CARP) has the authority to shape national research policies and priorities and to allocate resources. However, irrigation and water resources related research are presently not part of its program. Therefore IMPSA proposes a Joint Research Committee for Irrigation Management as a CARP sub-committee, as well as a Research Management Unit within the reorganized Irrigation Department.

The existence of alternative approaches to crop diversification on traditional paddy lands may or may not clarify the choices as to what crops are appropriate. Two other considerations should be taken into account. First, it is necessary to link this research closer with the needs of Sri Lankan industry, both for domestic and export markets. Guidance and advice from entrepreneurs familiar with all the facets of marketing subsidiary crops or minor export crops should be sought from the outset. Secondly, there is an overriding need for adaptive on-farm (as opposed to demonstration plot) research, examining ways of improving the mix and yields of crops (and livestock & ruminants) on individual small farm holdings in the existing agrarian situation since the size of these is not likely to change. And, as previously noted, most production of subsidiary crops now takes place on plots of from 1 - 2 ha.

Under IMSP, annual maintenance plans for some 60,000 ha were completed and turned over to DCFOs. One Hundred and Eighty (180) DCFOs and Two Thousand One Hundred and Sixty-Eight (2168) Field Canal Groups (FCFOs) were formed in the eight irrigation schemes covered by this project. Each FCFO has a representative with the

DCFO serving it. These Farmers Organizations obtained legal recognition under the Agrarian Services Act No. 4 of 1991 and by September 1992 138 DCFOs had registered with the Commissioner of Agrarian Services Department. Registration under this Act allows them to become legal entities.

Farmer organizations developed under the ISMP are recognized as being much further advanced than any others. Some 150 DCFOs, including all forty (40) which have recently signed the Standard Memorandum of Understanding for Taking Over The Management of Distributory Canals, have opened bank accounts in the State Banks and in Cooperative Rural Banks to retain control of their Development Funds. Under ISMP it was demonstrated over a two year period that DCFOs could develop the capability to address all required aspects of accounting to plan budgets, collect and maintain capital for system improvements, and make payments in a transparent system that was readily understood by its members.

Many DCFOs have taken significant steps in serving their membership in areas outside of the originally-envisaged area of O & M. DCFOs have become involved in agro-input supply, including seeds and fertilizer; Crop Production Plans which have reduced water use per unit of area irrigated or per unit of production to almost half the pre-project figure; marketing paddy; and assuming mortgages. Five DCFOs were approved for loans from the National Development Bank for the establishment of DCFO-owned and managed rice mills. From what is known these new activities have been undertaken successfully.

Adaptive research with new technical packages can probably make significant inroads in increasing production. However, the most fundamental problem that will need to be tackled by diversification strategy is that of marketing, including collection, transport, storage, processing, packaging and distribution. As the ISMP project has shown, once the Distributory Canal Farmer Organizations have signed their Memorandum of Understanding with the DI defining rights and responsibilities of these FOs upon turnover of irrigation systems, they can be duly chartered as a legal entities. It is this legal charter which gives these FOs the capability of receiving loans from banks or cooperatives to purchase and store inputs and to process, package, store and market their harvest collectively. These latter functions in

expanding subsidiary field crop or minor export crop cultivation are the best assurance of putting DCFOs on a sustained renewal basis from year to year.

This testing of the means to inaugurate and sustain economically viable DCFOs coincides with budgetary constraints so severe within GSL that it must confine its future O & M undertakings in irrigation rehabilitation to principal canal structures and headgates, leaving the O & M of distributary canals and the remainder of irrigation systems to DCFOs and SLFOs. We are now at a point of departure in applying lessons learned from USAID's ISMP, DARP and APAP activities in a broader sectoral context to achieve this objective.

In keeping with both the Sri Lanka Constitution and USAID regulations, all actions taken in the formation of and support for and granting of rights and authority to the DCFOs will be conducted without discrimination as to the sex or ethnic background of the individuals involved. In addition, sex-disaggregated data shall be gathered concerning the membership, leadership, and land-holdings of the individual DCFOs and their constituencies.

#### IV. PROPOSED POLICY REFORM MEASURES AND PERFORMANCE BENCHMARKS:

Policy Reform Measure E - 1.: Implement accelerated program of adaptive research in subsidiary and minor export crops in irrigation schemes where newly-created DCFOs are registered as legal entities.

##### Specific Outputs

|    | <u>Target<br/>Benchmarks:</u>   | <u>Completion<br/>Dates:</u> | <u>Budgets<br/>\$ million:</u> |
|----|---|------------------------------|--------------------------------|
| 1. | Establish Research Management Unit in Irrigation Department focusing on adaptive research in subsidiary/minor export crops in irrigation schemes. | April 1994                   | 0.5                            |

## SRI LANKA TITLE III

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- |    |  |            |     |
|----|--|------------|-----|
| 2. | Preparation of Action Plan to accelerate adaptive research in subsidiary/minor export crops on irrigation schemes where DCFOs have been registered as legal entities.              | June 1994  | 0.5 |
| 3. | Preparation of Action Plan to facilitate DCFO access to credit or grants for start-up capital using PVO/NGO resources such as ACDI, VOCA, etc. as needed.                          | June 1994  | 0.5 |
| 4. | Preparation of Action Plan to assist DCFOs entering income generating activities using services available under Agro Enterprises Project and other private sector oriented groups. | June 1994  | 0.5 |
| 5. | Preparation of strategy to assure adequate and continuous liaison between DCFOs and local enterprises with demonstrated capacities marketing subsidiary and/or minor export crops. | Sept. 1994 | 0.5 |
| 6. | Begin Implementation of Action Plans prepared under Benchmarks #2, #3, and #4.   | Sept. 1994 | 0.5 |
| 7. | Begin Implementation of marketing liaison strategy under Benchmark #5.   | Oct. 1994  | 0.5 |

Policy Reform Measure E - 2.: Accelerate turnover of O & M responsibilities for tertiary irrigation systems to Distributory Canal Farmer Organizations (DCFOs).

Specific Outputs

|    | <u>Target<br/>Benchmarks:</u>  | <u>Completion<br/>Dates:</u> | <u>Budgets<br/>\$ million:</u> |
|----|--|------------------------------|--------------------------------|
| 1. | Prepare Action Plan utilizing Institutional Development Officers, Agricultural Instructors, and Financial Management Assistants operating as a team to assist in formation of DCFOs. | Oct. 1994                    | 0.5                            |
| 2. | Prepare Action Plan under which the Irrigation Dept. will continue to provide technical support to DCFOs by assigning a full time ID official to each irrigation scheme.             | Dec. 1994                    | 0.5                            |
| 3. | Begin Implementation of Action Plan under Benchmark #1.  | Jan. 1995                    | 0.5                            |
| 4. | Begin Implementation of Action Plan under Benchmark #2.  | Mar. 1995                    | 0.5                            |

Policy Reform Measure E - 3.: As borne out by working papers and policy studies undertaken during the past three years, a single agency for irrigation management is a highly desirable goal to avoid future confusion or overlapping of responsibilities re engineering, construction, operation and maintenance of major and minor irrigation schemes; such an agency should now be created.

Specific Outputs

|    | <u>Target<br/>Benchmarks:</u>  | <u>Completion<br/>Dates:</u> | <u>Budgets<br/>\$ million:</u> |
|----|--|------------------------------|--------------------------------|
| 1. | Prepare Action Plan under which responsibilities and functions of Irrigation Department (ID) and Irrigation Management Division (IMD) of MLIMD would |                              |                                |

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- |  |           |     |
|--|-----------|-----|
| be consolidated and merged<br>into a single agency.        | June 1994 | 1.0 |
| 2. Implement Action Plan drafted<br>under Benchmark No. 1. | Dec. 1994 | 1.0 |

Policy Reform Measure E - 4.: Review agricultural programs and structure of state agencies and corporations with a view toward reducing Government expenditures, increasing efficiency, and expanding the role of the private sector in all areas of agricultural support, production and marketing.

Specific Outputs

- | <u>Target<br/>Benchmarks:</u>  | <u>Completion<br/>Dates:</u> | <u>Budgets<br/>\$ million:</u> |
|--|------------------------------|--------------------------------|
| 1. Implement Action Plan to reform Agrarian Services Department (ASD) program as indicated in study under Benchmark #4 of Policy Reform Measure G of Title III Agreement signed June 11, 1991. | Jan . 1995                   | 0.5                            |

[NOTE PAGE 5]

ANNEX A  
APPENDIX F

PROGRAM PROPOSALS  
for  
TITLE III EXTENSION

POLICY REFORM MEASURE F: PRIVATIZATION OF FERTILIZER INDUSTRY:

I. BACKGROUND:

Until recently the fertilizer industry in Sri Lank was controlled predominantly by the public sector. In 1990 three state-owned fertilizer mixing, manufacturing and marketing companies, the Ceylon Fertilizer Corporation (CFC), the fertilizer division of the Janatha Estates Development Board (JEDB), and the Colombo Commerical (Fertilizer) Company (CCFL) controlled 83% of the market.

In 1990, as part of the reform measures set forth in the Asian Development Bank's (ADB) 1st Agricultural Program Loan (APL I), the GSL undertook the first steps to rationalize and privatize the fertilizer industry. First, subsidies on fertilizer were removed. Other measures were then taken to reduce existing barriers and facilitate entry by the private sector into the fertilizer industry. The GSL announced that it was trying to create an environment in which private sector fertilizer whole-salers could compete on equal terms with their public sector competitors.

In February 1991, the ADB financed a study of Rationalization of the Sri Lankan Fertilizer Marketing System to: (a) assess the existing fertilizer procurement procedures, the marketing system and the operations of the CFC, the JEDB, the CCFL, as well as the National Fertilizer Secretariat (NFS). Following the recommendations of this study, as part of the package of reform measures specified in the ADB's \$60 million 2nd Agricultural Program Loan

(APL II), the GSL agreed to undertake the following with regard to fertilizer:

- i) Privatize the Ceylon Fertilizer Corporation by December 31, 1992, including:
  - a. divestiture of CFC district fertilizer stores;
  - b. divestiture of CFC regional warehouse complexes;
  - c. divestiture of at least 51% of the CFC Hunupitiya complex and head office.
- ii) Privatize the Colombo Commercial Fertilizers, Ltd. by December 31, 1992 with divestiture of at least 51% equity.
- iii) Privatize the Janatha Fertilizer Enterprise, Ltd. by March 31, 1993 with divestiture of at least 51% equity.
- iv) Streamline the National Fertilizer Secretariat through:
  - a. redefinition of its role by November 30, 1991;
  - b. staff redeployment, starting June 30, 1992.
- v) Establish a bulk fertilizer handling facility at the Port of Colombo on the following principles:
  - a. to avoid possible conflict of interest, the operator shall not be a fertilizer importer;
  - b. the port will continue to provide service to importers of bagged fertilizers;
  - c. port handling charges shall be structured appropriately for the import of bulk fertilizers;
  - d. port handling charges shall remain the same for bagged fertilizers as for other bagged cargo.

By 1992 the three public sector companies, the CFC, JEDB and the CCFL, were incorporated as wholly owned public limited liability companies. Although they were still wholly owned by the GSL, the conversion to limited liability companies was to facilitate the privatization process. The CFC was, at the time of its incorporation, separated from its five regional entities: the Wyamaba Agro Fertilizer Co., Ltd.; the Ruhunu Agro Fertilizer Co., Ltd., the Rajarata Agro Fertilizer Co., Ltd.; and the Thamankaduwa Agro Fertilizer Co., Ltd., which are now listed separately as regional agro-fertilizer companies.

The opening up of the fertilizer industry with the removal of subsidies, proposed divestiture of public sector companies, and equal treatment of private companies, resulted in six new private companies entering the market. Intense pricing competition brought about the amalgamation of four of these, with the two remaining ceasing operations in 1992 and 1993 respectively.

The restructuring of the state-owned plantation sector in 1992 resulted in the management of 449 of the 502 tea, rubber and coconut estates being handed over to 22 private sector companies. Of the 476,000 metric tons of fertilizer utilized in 1992, 157,000 m/tons (or about 33%) were used on plantations, with 208,000 metric tons (44%) being used on paddy. Estate companies are now free to purchase their fertilizer requirements from any wholesaler, as are individual farmers and farmer organizations, so the public sector share of the market declined to 63% in 1992.

## II. PRESENT SITUATION:

The issued share value of the public sector fertilizer companies are based on asset valuations (land, buildings, machinery), not potential earnings. The valuations were placed by the Chief Government Valuer during the years 1989-91, and since that time these assets are believed to have appreciated considerably. All of the share capital of these companies is held by the GSL Secretary of the Treasury until they are sold. The title to the land on which the blending facilities are located is vested in the GSL and will likewise be transferred to the purchaser of the company shares.

Profiles have been prepared for all of the fertilizer companies by an independent Sri Lankan firm of chartered accountants. They reported that the buildings and machinery of these companies are in good condition and well maintained. Further details, including profit and loss statements for previous years can be obtained by any prospective purchaser.

The sale of shares of public sector fertilizer companies have been by tender invitation advertised in the newspapers. Thus far in calling for tenders the offers received have been well below par value, with one exception. Therefore the GSL believes that calls for tenders for the others will have to be readvertised in order to obtain what it feels is the required price. The tender for the purchase of 60% of the shares of JFE was closed on March 10, 1993. The successful bidders were Ceylon & Foreign Trades, Ltd. in collaboration with Helm-Dungemittel of Germany. The latter company withdrew its offer, so the tender will have to be readvertised.

The Jayagiri Transporters, Ltd. offered the highest bid for the purchase of 90% of the shares of CCFL, and was the only offeror represented at a meeting on November 2, 1993 to examine payment proposals. It appears this company will win the award.

Tenders for the regional agro-fertilizer companies were closed on October 22, 1993 and are still in the process of being examined.

### III. CONSIDERATIONS AND CONSTRAINTS:

For reasons not clear, the GSL has decided that tenders for the purchase of a majority shareholding of the the largest fertilizer company, CFC, will be invited only after the privatization of JFE and CCFL. As noted, the GSL plans to readvertise for tenders for JFE.

Mr. Maurice D. De Zylva, Managing Director of Janatha Fertilizer Enterprise, Ltd., represented GSL at the Asia/Pacific Meeting of the International Fertilizer Association in Manila the first week of December, 1993. At this meeting he hoped to rekindle the interest of Helm-Dungemittel in the purchase of JFE; he also made a presentation and distributed descriptive literature on the

fertilizer industry in Sri Lanka in the hope of soliciting other multinational firms' interest in future bidding. He feels strongly about having the participation of some multinational firm in the local fertilizer industry to assure having a channel for transferring the latest technology to Sri Lanka.

[MISSION SHOULD FOLLOW UP ON RESULTS WITH DE ZYLVA]

CFC and JFE are the largest firms here, and their value and the nature of their operations will probably require participation of some multinational and/or access to foreign investment capital. The recent fighting in the north and the publicity it received may make it more difficult to attract major foreign investment in Sri Lanka.

IV. PROPOSED POLICY REFORM MEASURES AND PERFORMANCE BENCHMARKS:

Policy Reform Measure F: Draft and implement an Action Plan to accelerate divestiture of the fertilizer companies remaining in the GSL public sector; appoint a Task Force to work with international financial institutions, capable of assisting multinational firms, and with the firms themselves that might be interested in acquiring controlling shares in any of the Sri Lankan fertilizer companies.

Specific Outputs:

|    | <u>Target<br/>Benchmarks:</u>   | <u>Completion<br/>Dates:</u> | <u>Budgets<br/>\$ million:</u> |
|----|---|------------------------------|--------------------------------|
| 1. | Draft Action Plan to accelerate sale of fertilizer companies in public sector to private firms. | April 1994                   | 0.5                            |
| 2. | Implement Action Plan under Benchmark #1.   | July 1994                    | 0.5                            |
| 3. | Advertise invitations for tenders for fertilizer companies still in public sector.              | Oct. 1994                    | 0.5                            |
| 4. | Make awards of all final tenders.   | Dec. 1994                    | 0.5                            |

PROGRAM PROPOSALS  
for  
TITLE III EXTENSION

POLICY REFORM MEASURE G: REFORM OF SEED INDUSTRY:

I. BACKGROUND:

Organized seed production and distribution in Sri Lanka was initiated by the Department of Agriculture (DOA) after selection and breeding of improved paddy varieties in the late 1950s. Between 1960 to 1980 the industry matured within the public sector, and in the late 1970s the national Seed Certification Service began functioning. Today the DOA produces, processes, stores, packs and distributes virtually all local seeds through its Seeds and Planting Materials Division. Using the land of its own farms as well as contract growers, it handles about 70 varieties of seeds for more than 20 crops. In addition, grafts and seedlings of various horticultural fruit crops are produced and distributed by the DOA.

The major components for an effective seed program such as varietal development, seed production, quality control and distribution have been developed in Sri Lanka during the past forty years. Most of the infrastructure and personnel involved in the seed development program exist today in the DOA. Despite its recognized shortcomings, whatever planting materials DOA produced were at a price affordable to farmers. However, DOA's commercial activities often conflict with the service role of a government agency and have produced some endemic inefficiencies as well. Such a dominance by the public sector has not allowed a private seed industry in Sri Lanka to develop to desired levels.

Enhancing private sector participation in the seed industry is the declared policy of the GSL. The National Agriculture, Food and Nutrition Strategy states: "since 1983 it is the policy of the Government to privatize those aspects of the seed program which are commercial in nature". The Ministry of Agriculture's Crop Agriculture Development Strategy of 1984 further elaborated upon this policy as follows:

"To commercialize the seed industry, both public and private participation (jointly or individually) will be encouraged, with positive steps taken to hand over seed production, distribution and sale functions to public and private companies, with the Department of Agriculture (DOA) retaining the functions of plant quarantine, seed certification and quality control, varietal research, basic seed production, provision of technical know-how and implementation of the Seeds Act."

In its 1992-96 Public Investment Program (PIP), GSL states that it will continue to follow strictly the policy of not investing in ventures which are directly production oriented and which are suitable for private ownership. In keeping with that policy, and to promote seed industry development at the rate now required for crop diversification, private sector involvement in the seed industry should be actively canvassed and supported. To accelerate private sector participation, policy guidelines must detail an Action Plan for divestiture of the public sector seed program components, infrastructure and manpower.

The crops that interest the seed companies are those not easily produced or saved by the farmer. This creates a marketplace where the farmer must purchase most of his requirements. Experience in other countries indicates that the initial investment in a seed enterprise is considered to be a risky business and frequently no profits are generated in the first few years of operation. Many investors prefer safer options. A number of Sri Lankan companies have indicated their interest in local seed production, but few have actually prepared plans to implement activities. Several reasons have been cited, including the dominance of the government program and a lack of tax and credit incentives for private entrepreneurs in the seed industry.

## II. PRESENT SITUATION:

It has become increasingly evident that the quantities of seed and planting materials distributed by the DOA are low compared to the national demand. Except in a few crops such as chillies and potatoes, the use of high quality seed by farmers is also low, perhaps about 2% of the national seed requirements. The use of hybrid seeds in particular is close to zero in subsidiary food crops and rice, but high in exotic vegetables. (The importation and distribution of vegetable seeds are handled by the private sector.)

In October 1991, to encourage and foster the private sector in the importation, production and marketing of high-yielding varieties of agricultural seeds and planting materials, GSL stated it would take the following steps during 1992: (i) prepare and publish an expanded list of approved varieties of high-yielding seeds/planting materials that can be imported by private or public companies; (ii) prepare a program for the divestiture of at least five of the agricultural seed farms run by the DOA, such divestiture to be completed by December 31, 1992.

GSL has also published its intention to: (a) review the permit system for imports of seeds and planting materials administered by the DOA with a view to facilitating and accelerating the procedures for import certification and quarantine; and, (b) prepare a detailed development program for the Sri Lankan seed industry which clearly defines the role of the public sector in promoting increased and vigorous participation by the private sector, including whatever draft legislation is required to define and delineate the respective roles of each.

Legislation for a National Seeds Act was drafted by DOA in 1991. Under USAID's Diversified Agriculture Project (DARP), a contract was let for this draft to be reviewed by a legal consultant. The legal comments and suggestions for clarification and changes were submitted to the DOA for its consideration in August 1992.

Under DARP sponsorship a national workshop was held to evaluate the current status of the seed industry and chart directions for its future development; cost-of-production studies were undertaken; a Seed Development Unit within the DOA was established

to provide technical assistance to new seed companies; a Seed Association of all seed importers was launched; public sector seed farms were reduced from 37 to 19; seed packaging was improved; and seed certification services increased.

Among its many activities in Sri Lankan seed production and marketing, DARP sent six ranking GSL officials from the DOA's Seeds & Planting Materials Division and its Seed Certification & Plant Protection Division on a Seed Policy Study Tour to Thailand, Indonesia, the U.S.A., Bolivia, and Colombia. Upon its return in October 1992 the group drafted a new seed policy statement for Sri Lanka. Based on this document and the draft National Seeds Act, the DOA has drafted legislation for enactment of a comprehensive seeds policy for Sri Lanka which refocuses DOA seed programs to take a pro-active industry promotion approach and to place responsibility for commercial seed production entirely with the private sector. Elements of this draft policy include:

- The Ministry of Agricultural Development and Research (MADR) will explore new ways to foster collaboration between government crop improvement programs and the private sector;
- The commercial seed production/distribution program of the DOA will be refocused towards the provision of basic seeds to seed producing enterprises;
- The private sector will be encouraged to carry out production, processing, distribution and marketing of commercial seed with technical and quality promotion services from the DOA;
- The private sector will continue to import seeds and planting materials while strictly observing the plant quarantine policies of MADR;
- A National Seed Development Committee will be formed to help coordinate and develop the seed industry in Sri Lanka;
- Seed Certification programs will adopt a proactive stance in the promotion of quality seeds. Quality standards attained

by the seed industry will lend prestige to the seed industry and will enhance farmer confidence.

Both the National Seeds Act and the National Seeds Policy are in the legislative approval process and should be published shortly.

### III. CONSIDERATIONS AND CONSTRAINTS:

70% of Sri Lankan farmers have secondary education, and 98% have basic skills of reading and writing. They readily recognize the importance of using high quality seed in almost all crops which suggests great potential for expansion of the seed market. Poor germination is the most serious existing problem in Sri Lankan seed, even in varieties purchased from formal sources.

Though still to be formalized, current policy permits private sector imports of seed and encourages formation of non-government seed enterprises (private sector; cooperatives; NGOs). For its part in such encouragement, the DOA now provides to the private sector basic seed, technical assistance, certification services, leasing of its seed production and processing facilities, and custom cleaning of seed at its processing centers.

A large number of seed dealers are registered in most of the agricultural regions of Sri Lanka. Nine private seed companies now provide 10% of the current volume of seed marketed, going from virtually zero to about 1000 M/Tons during the past year. This includes 100% of commercial chilli seed, some 20% of paddy seed, and about 15% of bean seed. Okra is the next crop to be encouraged in the private sector, followed by other vegetables.

As far as is known, all parties in the public and private sector concerned with the seed industry agree that the National Seed Development Committee (NSDC), prescribed in the National Seed Policy Paper now pending, should be created without further delay. All agree that its composition should be 50/50 from the public and private sectors, with an initial membership of ten persons representing each of the following:

Public Sector:

1. DOA/Seed Development Unit;
2. Researchers/Breeders;
3. Seed Certification Service;
4. Department of Cooperatives;
5. Universities.

Private Sector:

1. Seed Enterprises in CP and NWP;
2. Seed Enterprises in NCP and EP;
3. Seed Enterprises in Uva and SP;
4. Nurserymen;
5. Seed Importers.

The NSDC should be convened immediately and meet thereafter at least four times (quarterly) per year. By-laws would be developed by the NSDC membership and approved by the Minister of Agricultural Development and Research.

## IV. PROPOSED POLICY REFORM MEASURE AND PERFORMANCE BENCHMARKS:

Policy Reform Measure G: Implement an accelerated program to capitalize upon the research, activities underway, legislation drafted, and momentum already achieved in encouraging and assisting private and non-governmental enterprises in seed production and marketing.

Specific Outputs:

|    | <u>Target<br/>Benchmarks:</u>   | <u>Completion<br/>Dates:</u> | <u>Budgets<br/>\$ million:</u> |
|----|---|------------------------------|--------------------------------|
| 1. | Appoint and convene National Seed Development Committee (NSDC) as described in National Seed Policy Paper now under review. | June 1994                    | 0.5                            |
| 2. | Have National Seed Development Committee obtain GSL approval  |                              |                                |

SRI LANKA TITLE III

ISTI

|    |  |           |     |
|----|--|-----------|-----|
|    | and implementation of National Seed Development Policy limiting GSL role to: supplying basic seed; maintaining security stocks; assuring quality control and seed certification, while promoting: private sector in seed production and marketing; liberalization of seed imports to enhance crop varieties; private sector development of crop improvement capabilities; and commercial orientation of seed industry. | Dec. 1994 | 0.5 |
| 3. | Divestiture of at least 10 more public sector seed farms to private enterprises.   | Dec. 1994 | 1.0 |
| 4. | Implement the National Seeds Act.  | June 1995 | 0.5 |

D - R - A - F - T

PROJECT PAPER

POLICY REFORM SUPPORT (PRS) PROJECT

(383-00\_\_)

including

AGRICULTURAL PLANNING & ANALYSIS PROJECT (APAP)

EXTENSION

ISTI Design Team:  
Harry Petrequin  
Paul N. Wenger

D - R - A - F - T

PROJECT PAPER

O - U - T - L - I - N - E

POLICY REFORM SUPPORT (PRS) PROJECT

(383-00\_\_)

including

AGRICULTURAL PLANNING & ANALYSIS PROJECT (APAP)  
EXTENSION

I. SUMMARY AND RECOMMENDATIONS:

A. The Problem:

Although the excellent Sri Lankan educational system has resulted in levels of literacy unparalleled among developing countries and permitted the country to have a government of well educated and, generally, dedicated civil servants, there remain gaps in GSL analytical capabilities that limit the levels of planning and analysis that can be performed using totally indigenous human resources. A portion of the gap, in the agricultural sector, had been filled by the recently completed USAID Agricultural Planning and Analysis Project (APAP). However, in addition to capabilities in the agricultural sector being in need of further support to insure full sustainability of the APAP reforms, other areas of government planning and analysis also require the same type of assistance.

B. Brief Description of the Project:

This Project Paper [Outline] provides the rationale for authorization of a project designed to improve the policy reform process in Sri Lanka by increasing opportunities for dialogue, exchange and the development of linkages with international expertise and experience. It will focus on providing analytical resources and technical assistance aimed at addressing: (1) public service and legal/regulatory functions; (2) land and other natural resource policy issues; (3) financial sector reform and liberalization; (4) divestiture and privatization of government assets; and (5) trade, food, nutrition and agricultural policy issues..

## II. PROJECT BACKGROUND:

A. Overview:

The Policy Reform Support (PRS) Project is a combination of the highly productive Agricultural Planning and Analysis Project (APAP) and the Non-Agricultural Policy Analysis Component (NAPAC) a proposal for a range of similar activities in other fields of importance to Sri Lankan economic development.

Through the serendipitous combination of a talented and culturally sensitive technical advisor, receptive and well-prepared Government of Sri Lanka (GSL) officials and active encouragement by USAID/Sri Lanka, APAP was able to achieve a unique measure of success in providing intellectual leadership and analytical support for a number of key policies actually implemented by GSL.

It is important to be able to replicate that record in the broader field of overall policy formulation. To conceive and frame essential economic and related social policies properly and to be able to explain their importance to the political decision makers, it is vital that GSL have a strong analytical capability. Clearly, where possible, it is best that the necessary analyses be carried out by GSL study groups or working parties; a goal toward which APAP directed much of its effort and PRS will seek to emulate. Even to the extent that independent studies calling for specialized expertise not available in Sri Lanka are required in various areas where relevant problems have been identified, the need remains for indigenous analytical capability to frame terms of reference for such studies, to oversee them as they are carried out, to assess their quality and to frame plans of action on the basis of their recommendations. The need also remains for the capacity to assess the relative merits of various proposed policy reforms in order to choose between them, and to determine realistically what effects they may have.

And, most meaningful, given the inextricable linkage between the economic, social and political effects of governmental policies, it is vital to have a strong indigenous input into their design and formulation.

B. The Agricultural Planning and Analysis Project (APAP):

The Sri Lanka Agricultural Planning and Analysis Project was signed in August 1986, for a seven year period with \$ 6.6 million in USAID financing, supported by a GSL contribution of \$ 2.7 million for a project total of \$ 9.3 million. The objectives of the Project were, and are, to support analyses for the undertaking of policy reform initiatives and to assist in making necessary institutional changes.

The TA contract under APAP provided assistance to counterpart agencies both in implementing the GSL reform agenda and in increasing their own institutional capacities. It funded: long/short term TA; short- and long-term training; and limited commodities. The Contractor's long-term technical advisors ~~were~~ <sup>was</sup> located in the Ministry of Planning with their counterparts. This arrangement, coupled with the capabilities of the team at working with and training their counterparts facilitated the transfer of skills that is essential for the establishment of long term sustainability, as well as developing excellent working relationships.

The final evaluation of the APAP Project confirmed that the combination of active GSL interest and the project's technical assistance formed an effective means to promote and develop GSL capacity to review, design, monitor and implement sectoral policy reforms and to develop the institutions necessary for sustainability of those reforms. The technical assistance and training inputs of the APAP Project were found to be of high quantity and quality, timely and appropriate.

As a result, the evaluation team recommended extension of the TA contract beyond the Project period and provision of additional funds for training and monitoring to strengthen implementation, so as to enhance the institutional capacity of the Planning Office to implement the project after the TA contract ends. In addition, the evaluation recommended that due to the depth and complexity of the policy reforms and institutional development requirements, additional time should be allowed to carry the program to maturity and put reforms and institutions alike on a self-sustaining basis.

C. Analytical Limitations of Other GSL Ministries:

Analyses of GSL analytical capabilities have shown that most of the operating ministries do not have adequate analytical capacity in-house. Too often, moreover, the staff members possessing the greatest analytical capability in such ministries are burdened with other responsibilities and cannot devote adequate attention to the more analytical policy oriented tasks.

The department that has the necessary analytical capability to help compensate for these shortfalls is the Planning Department, which has been supported by APAP with its special expatriate advisors, extensive training and support staff. It is to avoid the weakening of this essential department now that the support provided by APAP has come to an end that the follow-on activity of PRS is being designed; including an APAP-extension component both to continue its own uniquely valuable activities and to serve as the model in other sectors, which will be assisted under the NAPAC of the Policy Reform Support Project.

D. Other Donors:

From the beginning of its design activities, the other donor agencies have recognized the APAP Project as a key element in the improvement and rationalization of GSL planning capabilities and, as a result, an important potential element in the proper design and operations of their own projects.

The World Bank is currently funding, under its \_\_\_ and \_\_\_ projects, studies to assess other potential areas of reforms for additional investment program. In addition, disbursement of funds under World Bank Projects are generally affected by CPs related to overall GSL macroeconomic performance. In addition to World Bank assistance programs, the Asian Development Bank (ADB) is also engaged in a range of development activities involving appropriate GSL planning capabilities.

### III. PROJECT RATIONALE AND DESCRIPTION

#### A. Project Goal and Purpose:

The Goal is to help create an economic environment in Sri Lanka characterized by efficient agricultural production and marketing systems, improvement in the non-agricultural spheres of financial and productive activity, increased privatization of all sectors of the economy, increased employment opportunities and a more effective social service sector.

The Purpose is to assist Sri Lankan decision-makers in identifying issues and resolving problems inhibiting progress toward goal attainment through an improved capacity to analyze problems, opportunities, and potential solutions to those problems. Means for fulfilling this purpose will be: technical assistance for policy analysis; comparative policy analyses and research; long and short term training; and information on internationally tested and accepted means of problem resolution.

The End of Project Status is projected to be as follows:

By October 2000, the efforts of policy planning bodies supported by this Project should have resulted in GSL policies laying the foundations for the following:

- A major expansion of private sector productive enterprises.
- A meaningful increase in new employment opportunities.
- The development of local resource management plans.
- A significant strengthening of the capacities of local, democratic institutions, including PCs, to design and implement community-initiated development activities.

#### B. Relationship of Project to GSL Strategy

This Project reflects and responds to the GSL's strong interest in providing both improved economic growth and revitalizing the country's private sector institutions to meet the needs of:

- Employment Generation: GSL development planning documents note the need for attaining a prompt and major reduction of unemployment.
- Private enterprises: GSL has noted the need for policy reforms to assist a wide range of private enterprises to improve their businesses, increase productivity and generate additional employment.
- Environment: The GSL has an enlightened Natural Resource Strategy. Its objectives include an effective land use planning and management system; the promotion of rational and sustainable use of renewable natural resources; control and management of watersheds; preservation of the country's system of natural reserves and parks; control and prevention of environmental contamination; and effective environmental education. Planning activities supported by the Project in this sector will be consistent with and supportive of these GSL objectives.

### C. Relationship of Project to USAID Strategy

The PRS Project will contribute to meeting USAID objectives at the Congressional, Bureau, and Mission levels.

- Congressional Mandate: The Project will assist GSL in its development activities, and will strengthen its human and institutional resources. It thus responds to Congressional mandate, and is consistent with the Agency's [and the Asia Bureau's if it still exists] strategy and policies.
- Bureau Objectives: The Project will contribute to the Bureau objectives of support for broadly-based, sustainable economic growth; assistance in meeting critical social needs; supporting the evolution of stable, democratic societies; and advancing the Agency agenda on natural resources management. The Project will move toward these objectives as follows:
  - Achievement of broadly based, sustainable economic growth: The Project will assist planning exercises that encourage increased economic participation by the

private sector and support conservation and sustainable use of the natural resource base. Planning activities will support such activities as generation of employment in productive activities, development of private enterprises, and environmental sanitation and conservation.

- Assistance in meeting critical social needs: The Project will support planning in support of overcoming constraints to development as they become perceived [a fancy way of saying "targets of opportunity".]
- Supporting the evolution of stable democratic societies: The Project will strengthen grass-roots democratic organizations through assisting GSL in promoting development activities through the Provincial Councils (PCs) which are becoming the vehicles for decentralization of governance.
- Advancing the agenda set forth in the A.I.D. Initiative on the Environment to guide future natural resource and environmental interventions by financing planning activities in tropical forests and biodiversity; watershed management; and coastal zone management.
- USAID/Sri Lanka Strategy: The current Country Strategy Statement affirms that: "[find a quote]" This Project gives substance to this USAID vision of the role of planning. Additionally, the Project will address Mission concerns in the employment, environment, and private sectors in the following ways:
  - Employment: The Project is expected to fund planning studies that will help generate employment, including the strengthening of private enterprises.
  - Democratic Initiatives: A critical portion of the policy planning work to be carried out under the project will deal with empowerment of the PCs, thus fulfilling the Mission's strategy of promoting "expanded participation by decentralized organizations."

- Natural Resources and Conservation: The USAID Strategy sets forth a program for the conservation and rational utilization of renewable natural resources based on a number of reforms such as private sector institutional development and technology transfer. The activities covered in the policy planning exercises under the project will support these objectives in a manner consistent with this approach.

*get quote* ←

- Private Sector: The Project will contribute to the Mission's objective of strengthening institutions helping to move the country toward greater private sector activity.

} *strengthen*

D. Project Description: .

1. APAP Extension Component:

The agricultural planning activity to be continued in the APAP Extension Component has been functioning as a segment of Sri Lanka's macro-level national planning exercise, with the purpose of developing policies, procedures and projects to improve growth and productivity to develop a sustainable agricultural economy. Agricultural planning particularly aims to optimize the use of investment resources in agriculture, remove market distortions and restructure the sector, so as to promote and expand private sector enterprise and create opportunities for diversification of the export base *and increased employment.*

There is a special case for continuing to strengthen the analytical capability of GSL in agricultural policy. This is necessary for the formulation and assessment of policy measures and for their effective implementation. The contributions of APAP to improvements in agricultural policy underline the importance of such strengthening. Even though this appears to reinforce the role of government in the agricultural sector, such strengthening is, in fact, needed in the various ministries concerned directly with agriculture and allied activities to provide a counterpart to the analytical capabilities of the macro ministries concerned with industry and finance, which might otherwise tend to downplay the vital importance of agriculture in the Sri Lankan economy.

} *re-write*

APAP has demonstrated that agricultural planning in Sri Lanka has certain important aspects needing serious attention which must be fulfilled in order to derive maximum benefit from the plans:

- ~~In the area of policy analysis and planning activity,~~ there must be real contact between analyst and decision-makers, since lack of such contact can alter the focus in the design and implementation of projects.
- Flexibility should be an integral part of project design and programs must have the mechanism to address this factor.
- ~~It is also necessary that~~ <sup>spared</sup> technical personnel involved in projects be ~~kept away~~ from those administrative demands that would otherwise sap their time and attention.
- Setting the policy agenda must be a joint process involving both political decision-makers and technocratic analysts.
- Effective planning requires leadership and continuity of technically capable personnel.

Perhaps the most beneficial recent experience in planning, for which APAP can claim a measure of credit, has been Sri Lanka's move from a policy of ~~food self-sufficiency~~ in agriculture to one of ~~food self-reliance~~, a policy which includes export-based commercialization. The strategy of encouraging commercialization, coupled with increased emphasis on stable land tenure is designed to help attract needed foreign investment and technology to revitalize not only agriculture itself but also such agricultural/~~related~~ value-added sectors as food processing and fisheries.

The Project Committee has devoted considerable thought to how the APAP follow-on component should be handled. Creating or strengthening analytical capability in the several departments handling agricultural activities remains as one of the key requirements. Likewise, institutional reforms that enable analytical staff in these departments to concentrate on policy related issues without having to bear routine administrative responsibilities appears desirable.

2. NAPAC Component:

Implementation of the NAPAC portion of the PRS Project will have to take into account the ways in which the agricultural planning systems dealt with under APAP differ from the more generalized system of national planning prevalent in Sri Lanka:

- Agricultural planning concentrates on production and the institutional aspects of sub-sectoral constraints.
- National plans focus more on inter-sectoral issues, such as general systemic restructuring, and are thus more broadly based in their outlook.
- Agricultural planning begins with grass-root-level agrarian service units, which form the basis of a bottom-up approach to develop higher level plans at the regional levels.
- National planning, by its nature, tends to be top-down.
- Strategic linkages with the provincial councils (PCs) to implement agricultural development programs at the provincial level are important and will become even more so in the future - if and when the PCs assume control of local resource allocation and budgeting.
- Strategists engaged in national planning will need to develop a range of methodologies for dealing with the PCs, varying with the needs and local impact of each particular sector of economic activity.
- Agricultural planning suffers from an absence of private sector input in the discussion and development process - an absence that must be corrected.
- In the national planning picture, private sector linkages are already relatively strong, although they need to be built up further.

3. Types of Assistance to be Furnished Under PRS:

a. Long-Term Technical Advisors:

[TO BE FILLED IN AS PROJECT THINKING DEVELOPS]

b. Short-Term Technical Assistance:

[TO BE FILLED IN AS PROJECT THINKING DEVELOPS]

c. Special Studies for :

[TO BE FILLED IN AS PROJECT THINKING DEVELOPS]

d. Training:

As with the original APAP project, training activities for both components will concentrate on multiplying the efforts of the TA team through emphasis on working closely with counterparts and on training trainers to insure project sustainability. The APAP extension period and additional funds will help finance follow-up training costs related to [TO BE FILLED IN] and the NAPAC training activities will follow the same general pattern.

Macro-planning activity at a national level requires quality cadres of manpower in order to develop, implement and monitor effective progress. A planned manpower development and training program, therefore, must be implemented to ensure that the personnel involved in planning are equipped with the required skills. To accomplish this purpose, planning structures must be evaluated and programs for training and development identified to obtain the best benefits from such an effort. It is essential that the training be a structured ongoing process rather than just a "one off" exercise. Furthermore it is also essential that the process of recruitment and selection to positions in the planning structure be made after careful development of job profiles and personnel profiles. Personnel so selected for recruitment should have clear career paths and performance appraisal systems developed in the planning organizations in order to motivate the cadres and get the best contribution from their services. This will minimize employee turnover to ensure continuity of policies and programs associated with planning.

This system, therefore, calls for a set of personnel policies that will address the human resources development needs of the staff in the planning divisions.

Agricultural planning is a segment of macro-level national plans and is intended to develop policies, procedures and projects to improve growth and productivity to develop a sustainable agricultural economy. Agricultural plans in Sri Lanka are developed to improve inter-institutional policy analysis and planning capability. The aim is to optimize the use of investment resources in agriculture, to remove market distortions and restructure the sector in a manner that promotes and expands private sector enterprise and also creates diversification of the export base. The overall goal of agricultural plans is to enhance the contribution of the agricultural sector to economic development.

e. Institutional Development:

It is necessary that macro planners mobilize appropriate research institutions and universities to develop a long-term perspective as an integral part of the national planning system in the country. The work required to reflect the long-term perspective should be directed in a manner having relevance for the medium-term plan. This can then provide signals to key policy makers on issues such as emerging structural problems, environmental issues affecting quality of life, and emerging technological and scientific developments in the global scenario, many of which will have an impact and influence future planning directions.

A related requirement is the necessity for planners and planning organizations to effectively mobilize the professional expertise and intellectual resources available outside the framework of the nation's public sector. Their contribution on a regular basis in a carefully structured manner could provide a new dimension to national plans by being able to fill gaps that cannot be satisfied by public sector planners due to lack of exposure and appreciation to related issues. Such a multi-dimensional planning process is receptive to the needs of the environment. It has the capacity and capability to provide the necessary feedback on vital issues such as unemployment, discrimination and political favoritism from a tight network that will assist the

planning process and permit a meaningful response. This promotes constructive criticism and objective appraisal of government policies and programs, which might not be readily available when the planning activity is exclusively limited to the government system.

f. Other Direct Costs:

A limited amount of additional funds will be required to finance other direct costs, such as reproduction of materials, petrol and vehicle maintenance, travel per diems, office supplies, etc., to support TA team and

4. USAID Project Management Location:

The APAP component of the project will continue to be managed by USAID/Sri Lanka's Office of Agriculture and Natural Resources.

The NAPAC component will be managed by ??

As required by USAID regulations, funding for audit and evaluation will be provided from project funds.

5. PP Approval Authority:

Based on the general delegation of approval authority to USAID/Sri Lanka, it is concluded that authority to approve this PP rests with USAID/Sri Lanka. There are no policy issues in the development or implementation of the project that require AID/W resolution.

IV. REVISED FINANCIAL PLAN:

[TO BE INSERTED WHEN BUDGET INFORMATION AVAILABLE].

V. EVALUATION, MONITORING AND AUDIT:

The APAP component of the Project and its related technical assistance contracts will continue to be monitored on an ongoing basis by USAID's Agriculture and Natural Resources (ANR) Office. The NAPAC component will be monitored by the \_\_\_\_\_

and \_\_\_\_\_ Offices of USAID. In the case of both components, monitoring will be carried out through semi-annual progress reports to assess progress against jointly agreed-upon annual work plans. USAID/Sri Lanka will use these reports as the basis for semi-annual project reviews with GSL on the progress towards achievement of Project goals. Quarterly financial reports will also continue to be reviewed by USAID and Mission Project Implementation Reviews (PIRs) are held semi-annually to review progress against objectives and address issues that arise. In addition, periodic scheduled and unscheduled meetings will be held among USAID, GSL/\_\_\_\_ and \_\_\_\_\_ and TA Team personnel, both to verify the formal reports and to deal with any unanticipated situations as they arise.

An external Project-financed mid-term evaluation of the total PRS Project, including the APAP component, will be scheduled for October 1997. A final evaluation will be scheduled for May 2000, to determine the degree to which program objectives were met and what was the overall impact of the program.

Financial audits will be the responsibility of RIG/Singapore.

Pursuant to the Standard Provision in A.I.D. HB 3, the Project Agreement will include language requiring the GSL to have a NFA audit in accordance with IG's Guideline for Financial Audits contracted by foreign recipients.

#### VI. IMPLEMENTATION PLAN:

##### A. APAP Extension:

The basic method of implementation for the APAP Extension Component of the PRS Project is expected to be through a series of buy-ins to the Central AID APAP III Project as particular needs are seen to arise. These buy-ins will be carried out through standard procedures and are expected to result in considerable savings of both USAID/Sri Lanka staff time and start-up time insofar as actual project activities are concerned.

##### B. NAPAC Component:

Implementation plans for NAPAC have not yet been worked out.

C. Draft Implementation Timetable:

| ACTIONS:   | DATES:                                   |
|--|--|
| Project Authorized   | April 1994                               |
| Project CPs Met  | June 1994                                |
| NACAP Consultant Selection Process Begun                         | July 1994                                |
| APAP Buy-ins   | September 1994 [etc]                     |
| NAPAC Consultant Selected  | November 1994                            |
| NAPAC Consultant Mobilized                                       | February 1995                            |
| Semi-annual Progress Reports submitted by Contractor             | September 30 1995<br>March 31 1996 [etc] |
| NFA of PRS Project:  | December 1997 & 2000                     |
| Each Year's Contractor's Work/ Implementation Plan to ANR & ___: | November 1994 [etc]                      |
| USAID Semi-Annual Project PIRs:                                  | April/Oct 1995 [etc]                     |
| Semi-annual Joint Project Reviews                                | May/Nov. 1995 [etc]                      |
| Mid-Term Evaluation  | October 1997                             |
| Final Evaluation:  | May 2000                                 |
| Final Policy Review/Review of Final Evaluation:                  | July 2000                                |
| Final TA Consultant's Report:                                    | August 2000                              |
| PACD:  | September 2000                           |
| Close-Out Action by ANR & ___:                                   | October 2000                             |

## VII. SUMMARIES OF TECHNICAL ANALYSES:

A. Analysis of Planning Process:

Planning could be defined by varying types of definitions but one that deals with economic development activity could be the most meaningful particularly within the context of a developing economy such as in Sri Lanka. Therefore it could be described as: "a process involving the measurement and evaluation of economic performance, articulating a strategy for improving that performance, and pinpointing the investment and related activities by which the strategy can be implemented over time." Although this definition tends to give an economic bias it is appropriate under current circumstances, where the country has consistently performed better in the social sectors than in its economic performance.

The overall objective of economic planning is to improve the performance of an economy, a sector of an economy, such as agriculture, or a particular enterprise. The means of bringing about this improvement in Sri Lanka involves the monitoring and analysis of current and future conditions, identification of problems that tend to constrain performance, assessment of alternative options for solving the issues at hand and then clear articulation of strategy or series of steps such as changes in policy, legislation or investment to improve performance. In the current context, the government's proposed change in policy on land commercialization needs to be built into the planning process for optimum benefits. It is important that these activities are ongoing and continuous, since planning is a dynamic process that needs revision and evaluation against the background of the ever changing macro and micro environment.

Successful planning articulates different strategies and proposes specific activities and tactics to carry out these strategies. It is not planners who normally make the final decisions on their implementation. In government, most critical decisions are made by politicians and senior officials, while in the private sector, such key decisions falls under the purview of company executives. Planners usually inform decision makers but normally do not take the decision themselves. Most often, planners become involved in the function of performance measuring and monitoring, problem

identification, formulation of strategy, and in identification of alternative policies, programs, and investment projects. Rarely do they get involved in decision making and implementation. However, for the process of planning to be meaningful in Sri Lanka, planners must be in a position to obtain the required feedback to their plans after implementation and also, where necessary, develop mechanisms for testing out their plans in before final implementation.

There are two factors that are critical to the success of the function of planning: capacity for planning and direct access to decision makers. To be able to identify and find solutions to decision makers' problems, planners cannot afford to be purely engaged in academic research or be isolated from the decision makers: planners inevitably lose credibility by providing problem "solutions" that are politically, economically or administratively infeasible. Therefore, it is imperative that the decision making process is suited to the needs of the current environment.

The planning system is also closely linked to the budgetary system in the country. This has definite advantages in that the planning system then is driven by a realistic appraisal of resources while, on the other hand, it requires state agencies to place their entire range of budgetary exercises into a planning perspective. This coordination is vital for the development of a sound macro-economic framework for medium-term management of the economy.

There are several other characteristics that are an integral part of a macro planning system with special reference to Sri Lanka in order to make it a guiding force in the country's development:

The Public Investment Program (PIP), which reflects the economy's medium term investment strategy, is the instrument by which the government involves itself with both investment and development, in the public as well as the private sector. This is all the more crucial when the private sector is currently viewed as the engine of growth, particularly against the current developments concerning privatization of sectors of the economy. In Sri Lanka, this linkage could be further strengthened in many sectors of the economy where the private sector plays a dominant role.

This phenomenon becomes all the more crucial against the background of change in land commercialization and developments in agribusiness.

Analysis of the economy, reveals the disparity in growth patterns between the public sector and the private sector. This is all the more revealing in the areas of non-traditional agriculture. Therefore, it is imperative that national plans reflect private sector thinking and investment requirements in order to create the necessary linkages in the macro-economy. However, in such instances, it is important that government provides private investors and farmers with the stability and security they need to encourage optimal investments.

The time frames of planning in Sri Lanka are largely limited to the medium-term. However, the current status of some of the key sectors in the economy, such as agriculture, tree crops, energy, and education, demand a longer time horizon in planning. The current planning scenario also raises legitimate concerns on the environmental, ecological and social aspects of private sector related planning, where longer term consequences also need to be addressed. Hence medium-term planning by itself may leave a vacuum in the problems that needs to be looked in the country's development needs. This would refer particularly to major structural adjustments that have to be made to address chronic problems such as unemployment and deficiencies in the education system. Furthermore, project design must also take into consideration this long-term dimension and establish realistic time frames for expecting positive results. A good example in this context would be Singapore, now into the second phase of its long term development plan.

Long-term planning, and the resultant investment programs, requires the establishment of comprehensive information systems not only from the public sector but also more from the private sector. This permits meaningful bottom up planning and the involvement of all levels of activity in the planning process. If this takes place, it provides for more detailed analysis and appraisal of performance, policies and trends in the economy. The use of a computerized information system and the operation of a Planning information system is vital.

- B. Economic Analysis:  
[to be filled in later]
- C. Institutional Analysis:  
[to be filled in later]
- D. Detailed Cost Estimates and Budget Analysis:  
[to be filled in later]
- E. Administrative/Implementation Analysis:  
[to be filled in later]
- F. Social Soundness Analysis:  
[to be filled in later]
- G. Environmental Analysis:  
[to be filled in later]

VIII. NEGOTIATING STATUS, CONDITIONS & COVENANTS

The project has been discussed with and requested by GSL on an informal basis, but formal negotiations await project authorization.

## JUSTIFICATION FOR TITLE III EXTENSION

The proposal for an additional three years Title III programming in Sri Lanka (the two remaining years under the existing program plus a one year extension) meets the requirements for approval for 5 primary reasons:

- 1) The food is required to meet the basic nutritional needs of the poorest segments of the population in a sustainable manner.
- 2) The program constitutes a direct response to the Congressional mandate that USAID Food Aid programs be used to promote Food Security.
- 3) The program complies with the overall USAID policy of coordination with the programs of the International Financial Institutions.
- 4) Should the Title III program not be extended after FY 1994, such action, coupled with projected cuts in the DA level, would result in a draconian reduction in the overall USAID program.
- 5) Elimination or drastic downsizing of the Title III program would cause loss of momentum in implementation of the reforms so carefully designed and painstakingly nurtured under previous food aid programs and result in a severe diminution of their sustainability.

## I. BASIC NUTRITIONAL NEEDS OF THE POOR:

The following data was extracted from a series of documents including recent consultant (ISTI, KSU, Devres), World Bank, UNICEF, and GSL reports, surveys and evaluations. The findings and observations are in general agreement on the composite of information concerning overall performance, characteristics and trends of the Sri Lankan economy at this stage of its evolution, as well as the effects its present structure and the restructur-

ing it is now undergoing are having on Sri Lankan society. These findings and observations are:

- USAID's PL 480, Title III program is an integral part of the larger IBRD/IMF comprehensive stabilization and structural adjustment program. Macroeconomic objectives of the GSL's policy framework for 1992/95 are targeted within the context of the IMF's Enhanced Structural Adjustment Facility. Both the PL 480, Title III and the IBRD/IMF program it supports are designed to support policy reforms and programs promoting broad-based sustainable economic progress relying primarily on the private sector to raise people out of income and food insecurity. All concerned in these programs recognize the importance of the ongoing Title III program as one of the principal instruments for targeting food and other transfers to those who lack resources and sufficient income or other means of food security during the period of structural readjustment.

- Though Sri Lanka's program of economic reforms during the past year continues its encouraging trend, overall economic performance midway in this multi-year structural adjustment program is still behind most other Asian nations and at a critical juncture. There is an element of reversibility in the country's achievements to date; any faltering in the reform process underway could lead to the re-emergence of serious macroeconomic imbalances; undermining confidence in the private sector of the economy; frustrating hopes of higher growth in the immediate future; and limiting the possibility of achieving a growth rate of even 5%, the minimum required to keep unemployment at its current level of 14 - 15%.

- Progress made in reducing the GSL's budgetary deficit to 7.4% of GDP in 1992 was made by major reductions in government expenditures. The current principal burden on government finance is accumulated debt and servicing, with the GSL's debt to GDP ratio now exceeding 100%. In this context grant aid becomes all the more important. Local currency generated by the PL 480, Title III program in the last two years amounted to more than 16% of total grant aid received and about 4% of the budget deficit. Availability of Title III-generated local currencies has obviated the need to have mobilized such resources from domestic borrowing or higher taxes, either of which would affect the country's

growth performance adversely. While at some future date PL 480, Title I sales may be considered for Sri Lanka for balance of payments support, at present the Title III local currency generations are needed to reduce GSL expenditures in carrying out critical components of the ongoing structural adjustment program. This requirement does not allow such an evolution of this PL 480 program for at least the next 2 - 3 years.

- Private sector expansion has accounted for most of the growth which has taken place in the economy with the manufacturing sector accounting for 18.9% of national income in 1992. Agriculture still accounts for 22% of GDP though a severe drought in 1992 caused a decline of 1.3% in agricultural production. 82% of agricultural land is still government-owned; 43% of individual family holdings are less than one acre; 22% are two acres or less. Holdings of less than two acres are not considered viable so rural poverty remains high. Most of the Title III policy reform measures are concentrated in the agricultural sector and are designed, in conjunction with World Bank undertakings, to correct these inefficiencies and impart sustainable levels of production for both food staples and cash crops.

- A Household Income Survey, conducted in mid-1991 to restructure the Poor Relief Food Stamp Program (PRFSP), identified four categories of poor: (1) Extreme poor, households with less than Rs 700 (US\$14) monthly income (901,877 families); (2) Moderately poor, households with monthly incomes between Rs 700 - 1500 (US\$30); (3) poor youth among extremely and moderately poor; (4) old-aged and indigent. Close to 5.6 million people in the foregoing categories (roughly 33% of the Sri Lankan population) are entitled to receive food stamps.

- Because of the continuing civil war in the east and northern regions of the country, much agricultural land is not presently being cultivated nor can any other developmental activities take place in contested areas. It has required the GSL to mount a continuing relief effort for some 615,000 persons displaced by the conflict who continue to live inside and outside 463 government operated camps. A portion of PL 480, Title III generated local currencies are being used to defray some of this financial burden.

- A USAID-funded study by Kansas State University completed in October 1993 indicates that Sri Lanka's per capita income figure of US\$494 is highly skewed, with 80.7% of income earners in the urban sector, 63.2% in the rural sector, and 54.4% in the estate sector receiving less than average incomes. This study noted a widening disparity between the lower income groups and the total population in calorie intake, a trend which continues as the percentage of disposable incomes of the poor spent on food increases. The lowest 20% of the population spends 65.9% of its total expenditures on food. The KSU study found that any food price increase affects the lowest-income group 33% more than the "average" consumer.

- A USAID-funded study by the International Science & Technology Institute (ISTI), also completed in October 1993, indicates that households in the bottom 40% of the income range may be having per capita energy intake levels well below accepted norms of 2300 - 2530 calories per day. In the lowest 20%, the estimated daily calorie consumption is: 1,298 in the urban sector; 1,555 in the rural sector; and 1,714 in the estate sector. In the 20 - 40% quintile, these levels are: 1,670 for the urban sector; 1,994 for the rural sector; and 2,178 for the estate sector.

- The same ISTI study found that food stamp program (PRFSP), partially supported by Title III local currency generations, now constitutes about 25% of the total income of the households in the lowest 20%, and about 11% of total income of households in the next higher quintile. The contribution of food stamps to these families disposable income was 10% for the poorest quintile and about 6% for the next quintile, given the higher expenditures now required for essentials. These incremental incomes are believed to bring about 115 additional calories per capita per day which reflects a 30% reduction relative to the calorie contribution food stamps made in 1981/82. Since that time there should have been a 325% increase in food stamp value to compensate for the erosion of real value of this income transfer caused by inflation. This has not taken place largely because of budgetary constraints.

- In 1993 a UNICEF survey gathered anthropometric data on

1159 children under 5 years-old in rural households. The study confirmed that the incidence in young children of both stunting (low height-for-age, reflecting chronic malnutrition) and wasting (low weight-for-height, reflecting acute malnutrition) is still high, as had been found in more extensive studies in 1987/88. The UNICEF study found that 28.7% of these children were stunted and 20.7% suffered from wasting. 71.8% of these households stated they faced some form of food shortage lasting up to four months during the year.

- During the period it was conducted, the UNICEF survey indicated that nearly 85% of the parents are undernourished, with a Body-Mass Index (BMI) below 18. Malnutrition of pregnant women appears widespread; 28% of all babies had low birth weight, higher than the corresponding figure for Pakistan (25%) and only somewhat lower than India (30%) and Bangladesh (31%). The high level of newborns of low birth weight is related to maternal morbidity and malnutrition, including anemia (mainly caused by a serious iron deficiency)

- The foregoing World Bank, UNICEF, GSL, and USAID-funded consultant studies confirm that, at this stage of its structural adjustment program, poverty as acute as anywhere else in Asia persists among a sizeable element of Sri Lanka's population. This factor underscores the necessity of targeted food and other transfers to those who have not yet benefited from measures to improve their economic well being in the reforms now being implemented in this multi-year, multi-donor endeavor.

## II. NATIONAL FOOD SECURITY:

The Sri Lanka Title III Program, both ongoing and proposed, meets the Congressional mandate to focus USAID assistance programs on, inter alia, Food Security, as the term is analyzed in the May 1992 FOOD SECURITY DISCUSSION PAPER (FSDP), in the following ways:

"Use Title III food aid . . . to encourage policy reform. Such aid can provide incentives to governments . . . In the long-term, the poor are major beneficiaries of policy reform." [FSDP p.44]

The essence of Sri Lanka Title III conditionality, in keeping with the Program Objectives of the "USAID/Sri Lanka Strategic Framework FY 1992-1996", is the promotion of "diversified and commercialized agricultural systems" leading to food security, in its many manifestations, through policy reforms.

"USAID's special emphasis on private sector development is critical to a food security framework . . . Private sector activities and resulting economic development must furnish the domestic food supply, the foreign exchange needed to buy remaining food requirements, and the effective demand needed for food access. Private sector activity can be complemented by the Agency's skills in designing food aid and other targetted interventions for helping vulnerable populations." [FSDP p.45]

In keeping with the mandate of the Strategic Framework, the major thrust of the Sri Lanka Title III Program has been encouragement of food security-related activities in such areas as extension services, land titling, privatization of agriculturally related input and marketing activities, reduction of import and export taxes, downsizing of agricultural bureaucracies and privatization of agri-business industries related to food security.

"Targetted interventions for helping vulnerable populations" are discussed in Section I. above.

"It is important for Missions to look for constraints or 'bottlenecks' to food security not addressed by others, but whose removal would especially facilitate food security." [FSDP p.46]

While remaining within the context of other donor cooperation (see Section III. below) the Sri Lanka Title III program has been especially creative in its use of both USAID staff capabilities and the results of APAP policy reforms in seeking out previously unrecognized constraints to food security, such as [Jim ? ? ?].

## III. COORDINATION WITH OTHER DONOR PROGRAMS:

In "Sri Lanka: Country Economic Update FY93" dated June 2, 1993, the World Bank discusses the causes of food insecurity and rural poverty, with a major focus on farmer landlessness caused by the control of some 82% of all land by the national government.

In "Sri Lanka: Policy Framework Paper, 1992-1995" the World Bank further cites a range of harmful GSL interventions in the sector, most of which the Bank feels can and should be removed during the period covered by the paper. The document goes on to list a number of specific actions that the GSL should take to fulfil the requirements for Bank assistance.

And in "Mahaweli Restructuring Project: Interim Preparation Mission" FAO, in a joint exercise with the World Bank, treats extensively the need for major reforms in the present regime, including privatization of a wide range of functions now being carried out by the Mahaweli Authority of Sri Lanka.

As "USAID/Sri Lanka's PL-480 Title III Proposal (FY94-FY96)" demonstrates, the policy conditionality and performance-based disbursement program to be carried out under the extension will address several of the above-cited constraints in a manner fully consonant with the policies of the other donors.

## IV. DRACONIAN REDUCTION IN USAID PROGRAM:

For the last 5 years, the USAID Program in Sri Lanka has averaged roughly \$ \_\_\_ million per year, with relatively limited variations from year to year (except for \_\_\_\_\_). Of this aid level, some 3/4 has been Title III. With DA being subject to suggested reduction from the proposed \$ \_\_\_ million to \$ \_\_\_ million, failure to maintain the Title III level at a minimum of \$ \_\_\_ per year for FYs 1994-96 would result in a reduction of up to eighty percent (80%!) in the USAID Program in a country that is: a) in the forefront of LDC social development; b) making substantial progress moving toward sustainable economic development; and c) complying with virtually all of the requirements attached to the USAID assistance programs.

The vital role played by food aid in the USAID/Sri Lanka program is set out in the Strategic Framework:

"The PL-480 program has been an important assistance resource for Sri Lanka. Food aid has encouraged useful policy changes through self-help measures that have complemented and reinforced project-level interventions. The recently developed multi-year food program and the planned Title III program provide new opportunities to structure a longer-term policy agenda relating closely to the Mission's policy focus."

Thus, funding cuts in the Title III program have the same harmful effects upon Sri Lankan development and the USAID program to aid in that development as would an equivalent cut in DA funding.

#### V. DIMINUTION OF SUSTAINABILITY:

The question of sustainability of both the nutritional effects of the Title III program and the reforms being carried out as a part of that program were examined in the "SRI LANKA TITLE III MID-TERM EVALUATION" in October 1992. The conclusions reached therein remain equally valid today:

"Insofar as Sri Lankan ability to maintain essential wheat import levels in the absence of an AID program is concerned, they would clearly have to do so even if it meant turning to commercial imports, since it is a natural first priority to prevent food insecurity and social disruption. This is especially true in the political sense that one of the main wheat-eating populations is the so-called Estate Tamils. However, in light of Sri Lanka's low GDP and marginal Balance of Payments situation, the cost of such commercial imports would just as clearly come at the expense of other development programs.

"Some of the programs that would have to be sacrificed if the country were forced to turn to commercial imports in replacement of Title III would probably be those presently financed from the local currency generated by the wheat

sales; however no such projection could be considered firm when made on a hypothetical basis.

"The program policy reforms, once put in place, would not easily be turned back. Those reforms are the product of intensive GSL/USAID discussion and mutual agreement, and would be likely to continue more or less intact, at least insofar as those already negotiated are concerned. New reforms might also continue to be put into place, but probably at a considerably slower pace. One critical caveat would have to be noted, however: any reform in any institution will face a certain amount of opposition from supporters of the status quo. Absence of the PL-480 leverage would undoubtedly weaken the reformers and strengthen the old guard, so the possibility of some policy backsliding could not be ruled out. Experience to date and discussions with GSL officials indicate that the backsliding would most likely take the form of delays in implementation of reforms, rather than their outright abandonment, but the urgency of Sri Lanka's need for the proposed reforms would make any major delays socially and economically dangerous."

FIRST DRAFT of PROGRAM PROPOSALS for COMPLETION and EXTENSION of the SRI LANKA TITLE III PROGRAM

I. PURPOSES:

The purposes of the proposed continuation and extension of the Sri Lanka Title III Program are to:

- Furnish wheat imports essential to Food Security for Sri Lanka as a country;
- Assist in funding the Poor Relief Food Stamp Program which provides food security directly to the malnourished poor;
- Foster sustainable reforms in economic systems related to the creation of longer term food security;
- Complete to the point of full self-sustainability policy reforms begun under prior USAID Food for Peace programs.

II. BACKGROUND:

A) TITLE I - 1956-1990:

The Sri Lanka Title I Food for Peace program commenced in 1956 and provided virtually continuous food and development support to the country until 1990, as of which time the level of assistance had reached US\$ 477 million. By comparison, during the same time period Development Assistance was approximately US\$ 300 million.

During this period, the primary thrust of the PL-480 program was support for the development of Sri Lankan agriculture on private sector lines, along with the promotion of modern agricultural techniques and provision of necessary institutional and physical infrastructure, primarily the former.

As a result of the FY 1987 CDSS, emphasis was placed in the Self-Help Measures for the FY 1987-90 programs on:

- Support for programs designed to improve agricultural productivity through reforms in land title, tenure and alienability;.
- Assistance to private sector entities in agricultural production, marketing and distribution; and
- Development of a program to determine cost-effective rehabilitation, maintenance and management systems for Sri Lanka's deteriorated irrigation network.

Particular self-help measures were:

- GSL was to improve its processing and issuance of land titles to eligible settlers, with priority to Mahaweli and the other new resettlement areas.
- GSL was to try two alternative land alienation models designed to encourage investment, increase productivity and enhance income among settler families.
- GSL was to make a policy review of impacts of land tenure problems in the food crop sector as they inhibit productivity and diminish incomes.
- A pilot program in development of Farmer Organizations would be carried out, including full operation and maintenance responsibilities plus the right to collect and utilize water use fees.
- GSL was to promote private sector participation in production and marketing paddy seeds to farmers.
- GSL was to undertake a policy study covering a wide range of irrigation-related subjects.

B) TITLE III - 1991-93:

USAID's Title III food aid program for Sri Lanka was initiated in 1991. The program was authorized for an initial term of three years but was expected from the beginning to be extended for a

further period of two years, for a full term of five years like Title III programs in other countries at similar income levels. This extension would also bring the program in line with the USAID/Sri Lanka Multi-Year Food Assistance Plan (MYFAP).

As indicated in the "Food for Development Program - Plan of Operations" set out in Annex A of the Title III Agreement, the program pursued four major objectives:

- Contributing to Food Security for Sri Lanka;
- Promoting development of free, private sector dominated agricultural markets and private sector farmer organizations to promote rural development;
- Maximizing the developmental impact of the assistance by using it to promote economic and agricultural policy reform; and
- Providing critical balance of payment support during a period expected to be characterized by major efforts toward stabilization and structural adjustment.

The policy reform measures and performance-based disbursement benchmarks incorporated in the Agreement were designed to reduce the role of the state and to increase that of the private sector in Sri Lanka's food and agricultural systems, thereby increasing the efficiency and productivity of those systems and contributing directly to the USAID strategy of agriculturally led industrialization. In the joint development of policy reform measures, GSL and USAID relied on experience under the Title I program, current DA project experience, on-going policy dialogue and studies by both AID and the GSL. Similarly, the local currency uses were designed to support the GSL policy reform agenda and contribute to broad-based, sustainable growth in the agricultural sector.

These policy conditions were consistent with the policy framework set out in the overall development guidelines of the IMF/IBRD: "Policy Framework Paper" (PFP).

In addition to Title III, Sri Lanka has other agreements subject to policy conditionality, including agreements with the World

Bank, the International Monetary Fund, and the Asian Development Bank, coordinated pursuant to the PFP. The range of policy conditionality included in the programs of these institutions is wide compared to the policy conditions contained in USAID's agreement with Sri Lanka.

The Mid-Term Evaluation team therefore examined the possibility of overlaps between the USAID policy conditions and those of the other institutions. In particular, the team sought to determine whether the USAID conditions were reinforcing or duplicative of those of the other donor agencies. The team's finding was that the Title III policy conditions were more specific in nature and narrower in scope but also more tightly focussed. They were also sectoral in nature, being concerned with agriculture and allied activities and aimed at creating more competitive conditions in the sector by bringing about appropriate changes in specific institutions or arrangements that inhibit efficient resource utilization in the sector.

The team's conclusion was that the USAID program was complementary and reinforcing rather than duplicative.

The specific policy reform measures and performance-based disbursement benchmarks under the initial Title III Agreement, and progress in meeting them, are set out in the "Sri Lanka PL-480 Title III Program: Annual Progress Report" (Colombo \_\_\_\_\_).

III. PROPOSED POLICY REFORMS FOR COMPLETION AND EXTENSION OF TITLE III PROGRAM:

A) CRITERIA FOR SELECTION:

- Consistency: with USAID and GSL strategies;
- Continuity: with measures already undertaken;
- Complementarity: with other USAID and other donor programs and projects;
- Feasibility: in terms of prospects of implementation in the Sri Lankan political and economic situation;

- **Additionality:** in that the reform must not be one which would have been implemented expeditiously in the absence of the Agreement; and
- **Expected Benefits:** estimates should be made of expected economic and budgetary impacts.

**B) POLICY REFORMS AND USAID STRATEGY:**

The policy reforms presented below flow from one of the primary objectives proposed in the "Strategic Framework FY 1992 -1996": to promote development of free private sector dominated agricultural markets and of private sector farmer organizations to promote rural interests.

**C) SPECIFIC REFORMS:**

**1. Measure A: Reforming the Poor Relief Food Stamp Program:**

Due to its importance and complexity, this program is discussed in detail in Section V. below.

**2. Measure B: Restructuring the Mahaweli Authority:**

One of the four studies incorporated in the Agricultural Sector Review agreed to be implemented under the original Title III Agreement covered the Mahaweli Authority. The task of developing irrigation resources and creating new agricultural settlements in the area is nearing completion. The Mahaweli Authority should, therefore, begin to phase out its activities and release the substantial resources of the region for development by the private sector. The Mahaweli Authority should be restructured and its resources privatized along the lines recommended by the study. The suggested restructuring plan should be implemented as should the plan for commercialization of the area.

**3. Measure C: Privatization of Seed Industry.**

Considerable progress has been made on gradually privatizing the seed sector over a period of time, with the support of Title I

programs, the DARP Project and Title III PVO funds. Seed production on government farms has been nearly eliminated and a beginning has been made in extending support to farmer seed producer groups. Both these processes need to be completed and carried forward to strengthen the market orientation of the entire system. In particular a number of redundant GSL seed farms need to be turned over to the private sector.

4. Measure D: Privatization of Fertilizer Distribution:

Along the same lines, the privatization of fertilizer distribution has to be completed and carried forward. Attention needs to be paid in this connection to the improvement of the existing agricultural extension system through greater privatization of extension operations. This may be achieved by linking extension with private sector fertilizer distribution or other commercial operations subject to oversight by farmer groups in the private sector. Appropriate USAID policies would complement programs that the World Bank is devising for agricultural extension need consideration.

5. Measure E: Follow-up to APAP:

There is a case for strengthening the analytical capability of GSL in the agricultural policy field. This is necessary for the formulation and assessment of policy measure and for their effective implementation. The contributions made by APAP to improvements in agricultural policy underline the importance of such strengthening. Even though this appears to strengthen the role of government in the agricultural sector. Such strengthening is particularly needed in the various ministries concerned directly with agriculture and allied activities to provide a needed counterpart to the analytical capability at the disposal of the more macro ministries concerned with finance and planning.

6. Further Possible Measures:

Other measures for consideration include: (a) Continuation and enlargement of land titling efforts. (b) Rationalization of government agencies within the agricultural sector at the higher level and by devolution to farmer organizations at the lower

level. (c) Divestiture by the Livestock Department of land holdings not necessary for government livestock development purposes. (d) Promotion of commodity markets along the lines of the capital markets project. And (e) Supporting private sector agricultural projects through venture capital and financing institutions.

#### IV. OTHER RELEVANT ISSUES:

**Sustainability:** Is the program financially sustainable in the sense of GSL ability to continue both program activities and essential wheat import levels after the program terminates? Would the program policy reforms also be continued?

There is clear evidence that Sri Lanka's food supply policies have been driven by the key objective of ensuring an average per capita availability that would be in the region of the energy intake levels required to sustain a healthy and active life. Policy implementation has occurred through a mix of instruments, including commercial and concessional imports, promotion of domestic production and provision of a food safety net to assist the vulnerable. Food aid, particularly PL-480 imports which account for the bulk of food aid, has contributed significantly towards ensuring an adequate total food supply. The absence of external assistance would have had two important detrimental effects on food security in Sri Lanka. First, reduced food availability would have caused disproportionate hardships to the poor due to their relatively high price elasticities of demand for food. Second, scarce foreign exchange resources needed to finance other development activities would have been used to meet at least part of the food supply shortfall.

Insofar as Sri Lankan ability to maintain essential wheat import levels in the absence of an AID program is concerned, they would clearly have to do so even if it meant turning to commercial imports, since it is a natural first priority to prevent food insecurity and social disruption. This is especially true in the political sense that one of the main wheat-eating populations is the so-called Estate Tamils. However, in light of Sri Lanka's low GDP and marginal Balance of Payments situation, the cost of such

commercial imports would just as clearly come at the expense of other development programs.

Some of the programs that would have to be sacrificed if the country were forced to turn to commercial imports in replacement of Title III would probably be those presently financed from the local currency generated by the wheat sales; however no such projection could be considered firm when made on a hypothetical basis.

The program policy reforms, once put in place, would not easily be turned back. Those reforms are the product of intensive GSL/USAID discussion and mutual agreement, and would be likely to continue more or less intact, at least insofar as those already negotiated are concerned. New reforms might also continue to be put into place, but probably as a considerably slower pace. One critical caveat would have to be noted, however: any reform in any institution will face a certain amount of opposition from supporters of the status quo. Absence of the PL-480 leverage would undoubtedly weaken the reformers and strengthen the old guard, so the possibility of some policy backsliding could not be ruled out. Experience to date and discussions with GSL officials indicate that the backsliding would most likely take the form of delays in implementation of reforms, rather than their outright abandonment, but the urgency of Sri Lanka's need for the proposed reforms would make any major delays socially and economically dangerous.

V. THE POOR RELIEF FOOD STAMP PROGRAM (PRFSP):

Availability of a public safety net is particularly important in countries, such as Sri Lanka, where the poor are made more acutely disadvantaged by austerity measures adopted during periods of structural adjustment. Structural adjustment reforms may indeed cause transitory food insecurity even as they contribute to long-term food security by placing emphasis on sound economic policies for sustainable growth. For this reason, targeted food assistance can play a major role in alleviating food insecurity while reform is in progress.

A striking feature of Sri Lanka's structural adjustment program launched in the late 1970s is its emphasis on minimizing the negative impact of economic reform on the poor. Sri Lanka has already had a history of providing comprehensive social welfare programs that required relatively large public expenditures. One such program was the provision of universal food subsidies, especially rice. Market liberalization, together with the need to increase domestic savings for use in the productive sectors, necessitated a transfer program that would least interfere with the objectives of structural adjustment while providing a public safety net to protect the more vulnerable groups. A food stamp scheme was seen as the most appropriate response to these questions.

#### Program Operation

Sri Lanka introduced the food stamp program in September 1979 to replace a three-decade old universal food ration subsidy scheme. At its inception, the new program provided benefits to 1.55 million households (or 55 percent of all households). During the first year, the number of beneficiaries steadily increased and a freeze on new entrants was put in effect from March 1980. The number of beneficiaries subsequently tended to decrease, so that there were 1.48 million beneficiary households at the start of 1986. By that time, several major problems had become apparent. While there were sizeable "leakages" of program benefits to the non-poor, the opportunities for the newly-poor to enter the program became more limited. In addition, inflation had reduced the real value of food stamps by more than half. To remove these and other constraints, the government launched a restructuring program in 1986 with the aim of reducing the number of beneficiaries by almost one-third, incorporating the newly-poor households, and increasing the value of the benefits from the savings.

The new approach had several important features. First, the program was moved to the Department of Social Services and renamed the Poor Relief Food Stamp Program (PRFSP). By housing the program in this department and by explicitly so naming it, the government hoped that a certain amount of self-screening would take place. Second, the PRFSP implemented a new strategy for screening that allowed the community to participate in the

selection process. Committees of government officials and village residents reviewed applications and posted lists of selected households throughout each village. The public was then asked to assist in identifying any households that were erroneously included or excluded from program rolls.

The retargeting effort was nearing completion when political intervention led to its virtual abandonment and the adoption of less stringent procedures. A large number of households were added to program rolls, but few were removed. As a result, participation rose to 1.84 million households.

A second targeting effort was undertaken in 1991. The 1991 re-screening was essentially based on the procedures adopted for selection of beneficiaries under the newly-formed poverty alleviation project called the Janasaviya Program (JSP). One important element of the JSP approach is that it focuses on non-income criteria, such as productive assets owned, sources of income, and durable goods consumed. In addition, the JSP approach relies on community-based screening even more heavily than the 1986 PRFSP.

The 1991 survey identified 901,877 families in the poorest category, of which 132,373 were not receiving food stamps. A total of 634,258 households (or 45 percent of total recipients prior to screening) were found ineligible. The survey did not include the North and the East. If a similar pattern were to exist in the two regions, an island-wide survey might have reduced the number of eligible households to about 1.13 million. However, as a result of political pressure and the drought that occurred during that period, the newly eligible households were added to the PRFSP, but ineligible households were not removed.

Eligibility for PRFSP is based on household income, assets, and consumption, and therefore is not adjusted for family size or composition. However, there is a partial adjustment insofar as the number of household members eligible to receive food stamps varies according to household income level. In addition, the value of food stamps is adjusted by age in order to target benefits more effectively at households with young children. Following the doubling of benefits in 1988, the monthly stamp values are currently: Rs. 50 for children below 8 years; Rs. 40

for children between 8 and 12 years; and Rs. 30 for individuals above 12 years. Each beneficiary household also receives a monthly kerosene stamp valued at Rs. 44.

#### PRFSP's Budgetary Implications

Outlays on the PRSFP scheme represented 3.8 percent of total government expenditure in 1988. Since then, in the absence of indexing this share has declined substantially, probably reaching about 2 percent in 1993. The total budget allocation for PRFSP in 1993 is approximately Rs. 2.7 billion, accounting for about 14 percent of all transfers to households.

Of total counterpart funds generated by Title III wheat sales, 43 percent in 1991 and 30 percent in 1992 were used to support the PRFSP. These contributions represented approximately 5 percent of the PRFSP budget during those two years.

Future PRFSP budgetary requirements will depend on four major factors: adjustments in the value of food stamps to mitigate the cost of living increases; transfer of households from PRFSP to JSP; effectiveness of the JSP screening process in removing ineligible households; and entry of households in the North and the East to JSP.

#### Program Effectiveness

**Contribution to Incomes.** In 1990-91, income from food stamps contributed about 10 percent of the disposable income (total expenditure) of the poorest quintile and about 6 percent of total expenditure in the next higher quintile. In 1981-82, the contributions of food stamps to the expenditure of the poorest 20 percent and the next higher 20 percent of households were 14 percent and 9 percent, respectively.

**Contribution to Nutrition.** The contribution of food stamp incomes to calorie consumption of the poorest households has likely declined by about 30 percent relative to the contribution in 1981/82. While the nominal value of food stamps per capita doubled between 1981-82 and 1990-91, this was not sufficient to compensate for inflation. Assuming somewhat lower rates of inflation in the rural sector, where the bulk of the poor reside,

and some degree of commodity substitution, the nominal value of food stamps should have increased by at least 300 percent to compensate for inflation.

### Conclusions

The support given by the Sri Lanka Title III program to the food stamps scheme is well placed and is in direct compatibility with the food security mandate of the Title III legislation. In addition, there is justification for strengthening this public safety net. After many years of economic reforms leading to relatively high rates of economic growth, about 20 to 25 percent of the households have not been able to fully participate in the new income-enhancement opportunities. Earlier data from a survey conducted in 1981-82 indicated that the poorest 20 percent of the households had experienced a substantial deterioration in nutritional status due to reduced real income. Recent data seem to indicate that the nutritional status of the bottom 20 percent has begun to recover, but that consumption in this group still represents less than 80 percent of recommended adequacy. Due to its importance in assisting the poor during the present transitory period of economic adjustment, the PRFSP may deserve a higher focus than at present.

There is scope for improving the efficiency of PRFSP. Future support from the Title III program may in fact be used to promote such an objective. From the point of view of minimizing the error of not including deserving households, the present PRFSP could be regarded as a successful endeavor. It appears that the 1991 screening effort has ensured the inclusion of virtually all those who deserved PRFSP assistance. The program, however, has been less successful in minimizing the number of households who do not deserve to be included. If leakages were eliminated and the savings transferred to deserving households, it would be possible to increase the average transfer to such households. Ideally, food stamp incomes should ensure at least 80 percent of the recommended levels of energy intake. Budgetary constraints as well as concerns over "poverty traps" that may arise out of relatively large income transfers may not permit increased budgetary allocations to PRFSP. Hence, improving efficiency of the existing program appears to be a logical first step toward provision of more effective assistance to the poor. Elimination

of ineligible households (for which the administrative mechanisms are already in place) is the most appropriate initial measure to be undertaken. The Sri Lanka Title III program can provide useful assistance in this regard. For example, administrative measures required to remove ineligible households could be brought in as benchmarks to be achieved prior to release of funds from the Title III program.

#### VI. JUSTIFICATION FOR TITLE III EXTENSION

The proposal for an additional three years Title III programming in Sri Lanka (the two remaining years under the existing program plus a one year extension) meets the requirements for approval for 5 primary reasons:

- 1) The food is required to meet the basic nutritional needs of the poorest segments of the population in a sustainable manner.
- 2) The program constitutes a direct response to the Congressional mandate that USAID Food Aid programs be used to promote Food Security.
- 3) The program complies with the overall USAID policy of coordination with the programs of the International Financial Institutions.
- 4) Should the Title III program not be extended after FY 1994, such action, coupled with projected cuts in the DA level, would result in a draconian reduction in the overall USAID program.
- 5) Elimination or drastic downsizing of the Title III program would cause loss of momentum in implementation of the reforms so carefully designed and painstakingly nurtured under previous food aid programs and result in a severe diminution of their sustainability.

## VII. BASIC NUTRITIONAL NEEDS OF THE POOR:

USAID's PL 480, Title III program is an integral part of the larger IBRD/IMF comprehensive stabilization and structural adjustment program. Macroeconomic objectives of the GSL's policy framework for 1992/95 are targeted within the context of the IMF's Enhanced Structural Adjustment Facility. Both the PL 480, Title III and the IBRD/IMF program it supports are designed to support policy reforms and programs promoting broad-based sustainable economic progress relying primarily on the private sector to raise people out of income and food insecurity. All concerned in these programs recognize the importance of the ongoing Title III program as one of the principal instruments for targeting food and other transfers to those who lack resources and sufficient income or other means of food security during the period of structural readjustment.

Agriculture presently accounts for 22% of GDP. However, an astonishing 82% of all agricultural land is government-owned; while 43% of individual family holdings are less than one acre; 22% are two acres or less. Holdings of less than two acres are not considered viable so rural poverty remains high. Most of the Title III policy reform measures are concentrated in the agricultural sector and are designed, in conjunction with World Bank undertakings, to correct these inefficiencies and impart sustainable levels of production for both food staples and cash crops.

A Household Income Survey, conducted in mid-1991 to restructure the Poor Relief Food Stamp Program (PRFSP), identified four categories of poor: (1) Extreme poor, households with less than Rs 700 (US\$14) monthly income (901,877 families); (2) Moderately poor, households with monthly incomes between Rs 700 - 1500 (US\$30); (3) poor youth among extremely and moderately poor; (4) old-aged and indigent. Close to 5.6 million people in the foregoing categories (roughly 33% of the Sri Lankan population) are entitled to receive food stamps.

Because of the continuing civil war in the east and northern regions of the country, much agricultural land is not presently being cultivated nor can any other developmental activities take place in contested areas. It has required the GSL to mount a

continuing relief effort for some 615,000 persons displaced by the conflict who continue to live inside and outside 463 government operated camps. A portion of PL 480, Title III generated local currencies are being used to defray some of this financial burden.

A USAID-funded study completed in October 1993 indicates that Sri Lanka's per capita income figure of US\$494 is highly skewed, with 80.7% of income earners in the urban sector, 63.2% in the rural sector, and 54.4% in the estate sector receiving less than average incomes. This study noted a widening disparity between the lower income groups and the total population in calorie intake, a trend which continues as the percentage of disposable incomes of the poor spent on food increases. The lowest 20% of the population spends 65.9% of its total expenditures on food. The study found that any food price increase affects the lowest-income group 33% more than the "average" consumer.

Another USAID-funded study, also completed in October 1993, indicates that households in the bottom 40% of the income range may actually have per capita energy intake levels well below accepted norms. In the lowest 20%, the estimated daily calorie consumption is: 1,298 in the urban sector; 1,555 in the rural sector; and 1,714 in the estate sector. In the 20 - 40% quintile, these levels are: 1,670 for the urban sector; 1,994 for the rural sector; and 2,178 for the estate sector.

The same study found that the Poor Relier Food Stamp Program (PRFSP), partially supported by Title III local currency, now constitutes about 25% of the total income of the households in the lowest 20%, and about 11% of total income of households in the next higher quintile. The contribution of food stamps to these families disposable income was 10% for the poorest quintile and about 6% for the next quintile, given the higher expenditures now required for essentials. These incremental incomes are believed to bring about 115 additional calories per capita per day which reflects a 30% reduction relative to the calorie contribution food stamps made in 1981/82. Since that time there should have been a 325% increase in food stamp value to compensate for the erosion of real value of this income transfer caused by inflation. This has not taken place largely because of budgetary constraints.

In 1993 a UNICEF survey gathered anthropometric data on 1159 children under 5 years-old in rural households. The study confirmed that the incidence in young children of both stunting (low height-for-age, reflecting chronic malnutrition) and wasting (low weight-for-height, reflecting acute malnutrition) is still high, as had been found in more extensive studies in 1987/88. The UNICEF study found that 28.7% of these children were stunted and 20.7% suffered from wasting. 71.8% of these households stated they faced some form of food shortage lasting up to four months during the year.

During the period it was conducted, the UNICEF survey indicated that nearly 85% of the parents are undernourished, with a Body-Mass Index (BMI) below 18. Malnutrition of pregnant women appears widespread; 28% of all babies had low birth weight, higher than the corresponding figure for Pakistan (25%) and only somewhat lower than India (30%) and Bangladesh (31%). The high level of newborns of low birth weight is related to maternal morbidity and malnutrition, including anemia (mainly caused by a serious iron deficiency)

These studies confirm that, at this stage of its structural adjustment program, poverty as acute as anywhere else in Asia persists among a sizeable element of Sri Lanka's population. This factor underscores the necessity of targeted food and other transfers to those who have not yet benefited from measures to improve their economic well being in the reforms now being implemented in this multi-year, multi-donor endeavor.

#### VIII. NATIONAL FOOD SECURITY:

The Sri Lanka Title III Program, both ongoing and proposed, meets the Congressional mandate to focus USAID assistance programs on, inter alia, Food Security, as the term is analyzed in the May 1992 FOOD SECURITY DISCUSSION PAPER (FSDP), in the following ways:

"Use Title III food aid . . . to encourage policy reform. Such aid can provide incentives to governments . . . In the long-term, the poor are major beneficiaries of policy reform." [FSDP p.44]

The essence of Sri Lanka Title III conditionality, in keeping with the Program Objectives of the "USAID/Sri Lanka Strategic Framework FY 1992-1996", is the promotion of "diversified and commercialized agricultural systems" leading to food security, in its many manifestations, through policy reforms.

"USAID's special emphasis on private sector development is critical to a food security framework . . . Private sector activities and resulting economic development must furnish the domestic food supply, the foreign exchange needed to buy remaining food requirements, and the effective demand needed for food access. Private sector activity can be complemented by the Agency's skills in designing food aid and other targetted interventions for helping vulnerable populations."  
[FSDP p.45]

In keeping with the mandate of the Strategic Framework, the major thrust of the Sri Lanka Title III Program has been encouragement of food security-related activities in such areas as extension services, land titling, privatization of agriculturally related input and marketing activities, reduction of import and export taxes, downsizing of agricultural bureaucracies and privatization of agri-business industries related to food security.

"Targetted interventions for helping vulnerable populations" are discussed in Section I. above.

"It is important for Missions to look for constraints or 'bottlenecks' to food security not addressed by others, but whose removal would especially facilitate food security."  
[FSDP p.46]

While remaining within the context of other donor cooperation (see Section III. below) the Sri Lanka Title III program has been especially creative in its use of both USAID staff capabilities and the results of APAP policy reforms in seeking out previously unrecognized constraints to food security, such as [Jim ? ? ?].

## IX. COORDINATION WITH OTHER DONOR PROGRAMS:

In "Sri Lanka: Country Economic Update FY93" dated June 2, 1993, the World Bank discusses the causes of food insecurity and rural poverty, with a major focus on farmer landlessness caused by the control of some 82% of all land by the national government.

In "Sri Lanka: Policy Framework Paper, 1992-1995" the World Bank further cites a range of harmful GSL interventions in the sector, most of which the Bank feels can and should be removed during the period covered by the paper. The document goes on to list a number of specific actions that the GSL should take to fulfil the requirements for Bank assistance.

And in "Mahaweli Restructuring Project: Interim Preparation Mission" FAO, in a joint exercise with the World Bank, treats extensively the need for major reforms in the present regime, including privatization of a wide range of functions now being carried out by the Mahaweli Authority of Sri Lanka.

As "USAID/Sri Lanka's PL-480 Title III Proposal (FY94-FY96)" demonstrates, the policy conditionality and performance-based disbursement program to be carried out under the extension will address several of the above-cited constraints in a manner fully consonant with the policies of the other donors.

## ECONOMIC ANALYSIS

## PL 480: POLICY &amp; NUTRITION PERSPECTIVES

FRAGILITY OF ECONOMIC REFORMS AND UNCERTAINTY OF GAINS:

The PL 480, Title III program in Sri Lanka is an integral part of a comprehensive stabilization and structural adjustment program in Sri Lanka conducted under the aegis of IMF/IBRD requirements which incorporates the principal components outlined in A.I.D.'s Food Security Discussion Paper (PN-ABK-883):

- (1) Broad-based, sustainable economic progress relying on private sector under supportive public policies to raise most people out of income and food insecurity;
- (2) targeted food and other transfers to those who lack resources and income or other means of food security.

Satisfactory results achieved thus far on the macroeconomic front:

- an average annual growth rate of GDP of 5% since 1989;
- the government's budget deficit reduced from 9.9% of GDP in 1990 to 7.4% in 1992 (though a current account deficit persists for the 5th year running);
- the country has recorded an overall balance of payments surplus for the last three years;
- the rate of monetary expansion, which had risen after 1989, was pegged back markedly in 1992;
- official foreign reserves rose to the equivalent of 3.1 months of imports.

Significant areas of concern in macroeconomic management include the interest burden from public debt, the size of the country's budget deficit, double digit inflation, high interest rates, and the level of unemployment. There is an element of reversibility

in the country's achievements to date. Any faltering in the reform process underway could lead to:

- the re-emergence of serious macroeconomic imbalances;
- undermining confidence within the economy;
- frustrating hopes of higher growth in the immediate future;
- limiting the possibility of achieving a growth rate of even 5%, the minimum required to keep unemployment at its current level of 14 - 15%.

Sri Lanka's stabilization and structural adjustment program aims at increasing the country's growth rate, reducing the budgetary deficit, stabilizing prices, reducing unemployment and alleviating poverty. The program is supported by the multilateral (IMF/IBRD/ADB) and bilateral donor community, with Japanese aid being the largest single component. Two thirds of the annual level of U. S. contributions to this program is now comprised of P.L. 480, Title III wheat, considered an essential component in annual balance of payments support, especially now when for the first time in many years the GSL has managed to build its foreign exchange reserves a fraction over requirements for three months of imports. (Considered minimal by IMF) As importantly, local currency generations under PL 480, Title III have figured prominently in allowing the GSL the wherewithal to finance the requirements of critical policy reforms while continuing program of annual reductions in its budget deficit.

Local currency generated by the Title III program<sup>1</sup> in the last two years amounted to more than 16% of total grants and about 4% of the budget deficit. Availability of such funds has obviated the need for additional resources that would otherwise have been mobilized through foreign sources, domestic borrowing and/or higher taxes to reduce the deficit.

Financing any additional deficit through higher taxes may create inefficiencies and affect the country's growth performance, which is already lagging behind most other nations in the Asian region.

Obtaining such an amount from foreign sources is extremely problematical given the trends and levels of commitments in the donor consortia. Even allowing that it were obtainable, it would probably be on loan rather than grant basis thereby exacerbating the GSL's debt servicing.

Financing the deficit through higher taxes may create inefficiencies and affect the country's growth performance. Financing the deficit through advances from the Central Bank (i.e., an increase in the money supply) would increase an already significant inflationary pressure (21.5% in 1990; 12.2% in 1991; 11.4% in 1992). Domestic borrowing usually increases interest rates, crowding out non-public borrowing and private investment.

The current principal burden on government finance is accumulated debt and its servicing. Sri Lanka's debt to GDP ratio now exceeds 100% and interest payments (currently 6% of GDP) place a considerable strain on government expenditure. In order to stop the ratio rising still further, the budget deficit will have to be kept below 6% of GDP.

It should be noted that the progress made in reducing the budgetary deficit to 7.4% of GDP in 1992 - the best result recorded over the past five years of the government's stabilization program - was made on the side of budgetary expenditure which was reduced from 32.1% to 27.8% of GDP. In this context, grant aid becomes all the more important.

Agreed benchmarks mutually set between the GSL and USAID must be attained before each successive release of Title III-generated local currencies required to achieve the next phase of a given reform program is made. This performance-based disbursement system has served as an effective mechanism to expedite policy reform in Sri Lanka, thus enabling the country to maintain its commitment to the structural adjustment program. The nature of many of these policy reforms is such that the momentum currently imparted in achieving incremental advances during the past three years has to be maintained if they are to be successfully completed. Any hiatus or major reduction in financing the next successive phase would in all likelihood induce an erosion of the gains already made. Moreover, the reforms financed by local currencies generated under the PL 480, Title III program are in

large part synchronized to concurrent policy reforms undertaken in the same or other sectors by the IBRD and other donors, and have a synergistic relationship to a number of these. Such relationships portend that these reform measures, once initiated, cannot be abandoned midstream without undermining others still in the course of their realization.

The list of reform measures being supported by the current PL 480, Title III agreement includes:

- (1) implementation of a plan to restructure and privatize the Ceylon Fisheries Harbors Corporations;
- (2) implementation of an extensive survey and land titling program;
- (3) improving plant quarantine procedures;
- (4) phasing out export taxes on tea, rubber and coconut;
- (5) liberalization of food imports and trade;
- (6) restructuring the Agricultural Insurance Board to reduce operating deficits and improve services to farmers;
- (7) expanding private sector participation in the agricultural sector.

As noted, these policy reforms negotiated by USAID are an integral part of the overall package of stabilization and structural adjustment measures addressed by the donor consortia. Targets are updated annually in line with progress, and the achievement of agreed targets in the overall program has been the basis for disbursement of IMF loans under its Enhanced Structural Adjustment Facility (ESAF). Macroeconomic objectives of the GSL's policy framework for 1992/95, worked out in the context of the IMF's ESAF -- a sustained 6% growth rate, single digit inflation and a budget deficit (before grants) of 6-7% -- required, and still require, hard decisions by the GSL. PL 480, Title III induced reforms are an integral part of this multi-year framework.

Recent economic performance by the GSL has shown these macro-targets to be within Sri Lanka's reach. An abrupt termination or drastic reduction of grant support by any one donor at this mid-way point in the program would send a signal of no confidence to the GSL and other donors, a measure not at all warranted by results to date.

The series of achievements at the national level completed and being implemented under the IMF/IBRD structural adjustment program are impressive; these include:

- initiating an ambitious privatization program while concurrently restructuring and raising the efficiency of remaining public enterprises and the machinery of government.
- the management of a large part of the state-owned plantation sector was privatized in July 1992.
- restructuring and commercialization of the two state banks has been initiated and made a priority for reform in financial markets.
- fiscal and tariff structures have been lowered and rationalized.
- exchange controls on current account transactions have been liberalized and compulsory surrender requirements for exporters abolished.

Priority has been given to expansion of the private sector, and the response has been significant. Total investment rose sharply in 1992 to the equivalent of 23.7% of GDP (up from 22.6% in 1990). Private sector expansion has accounted for most of the growth that has taken place in the economy.

The manufacturing sector accounted for 18.9% of national income in 1992. However, the main area of manufacturing growth is becoming more and more concentrated in textiles and garments. A sizeable portion of investments in garment manufacture came from East Asian entrepreneurs whose countries were filling their import quotas in North America and the European Community (Korea;

Taiwan; Hong Kong). What this has given rise to in Sri Lanka is a garments industry which is highly import dependent for intermediate inputs. The domestic value-added component in garment exports in 1992 was on 27% of gross output. Moreover garment and textiles are exports which are highly susceptible to new rounds of quotas, tariffs or other restrictions should domestic politics in the United States or EC members dictate new measures to protect their own industries during periods of slow economic growth. The GSL recognizes that garments and textiles are a rather fragile foundation for major growth in exports and foreign exchange earnings.

The agriculture sector, where the PL 480, Title III-supported policy reform measures are concentrated, was hard hit by a severe drought in the first six months of 1992. Overall agricultural output declined by 1.3%. Given the large size of Sri Lanka's agricultural sector (22% of GDP in 1992), this was significant.

Agricultural growth has lagged for several reasons, and rural poverty remains high in Sri Lanka. 43% of individual family agricultural holdings are less than one acre; 22% range from one to two acres (holdings under two acres cannot be considered viable). 80% of all agricultural land is still government-owned. Land titling is being addressed in reform measures currently supported by PL 480, Title III local currencies. Also, the GSL has continued policies which demonstrate an understandable ambivalence regarding food self-reliance vs. food self-sufficiency, and so domestic production of dietary staples has been encouraged. Such uncertainty is dictated in part by Sri Lanka's geographic position and in part by an unhealthy dependency on foreign exchange earnings from exports which are highly vulnerable to price fluctuations and possibly some restrictions. Even a 10% deterioration in the price of garment exports would be sufficient to increase the current account deficit in the balance of payments by 1% of GDP.

So rice cultivation has been continued almost exclusively in such capital-intensive irrigation schemes as Mahaweli where, even with respectable yields of 3.5 M/Tons per hectare, only a 4% rate of return is realized. In conjunction with a new World Bank initiative beginning early in 1994, PL 480, Title III local currency generations will support efforts in crop diversification

in the Mahaweli irrigation system with the goal of increasing incomes of the small farmers working through newly-created producer and marketing cooperatives. There is still only a limited domestic market to absorb cash crops, and the GSL realizes that the export of these faces stiff competition in markets being exploited by Thailand, Malaysia, Indonesia, and very soon, Viet Nam.

Sri Lanka's growth performance should always be assessed in relation to developments in the fast-growing Asian economies, for these will be her competitors as her economy becomes more and more export oriented. In 1992, developing Asia was the fastest growing region of the world economy. It expanded by 7%. The average growth rate of East Asian countries was 6.4%. Sri Lanka's growth performance was poor in comparison. Instead of gaining on these countries, Sri Lanka lagged further behind. Moreover a higher growth rate is required to raise the country's income level significantly and generate adequate employment. In this perspective, Sri Lanka's 1992 GDP growth rate of 4.3% was inadequate. For Sri Lanka, a growth rate of under 6 -7% poses serious questions about the rate of employment creation and the amelioration of poverty.

Sri Lanka's pattern of growth to date has shown that the poor engage themselves in activities of low marginal productivity of labor, and real earnings seem to have been declining bringing more of the "employed" into the ranks of the poor. Households with main income earners falling within the category of the "unemployed and not in the labor force" comprise around 10% of the total poverty group so that the poor, for the most part, are working poor. The latest Consumer Finance Survey conducted by the GSL indicated that the bottom 40% of the population received only 14.1% of total income.

The relatively low average annual per capita income figure of US\$494 for Sri Lanka is highly skewed and weighted toward the low side of the income range in all three sectors of the economy, as follows:

- 80.7% of income receivers in the urban sector have an average income less than the average for the urban sector;

- 63.2% of income receivers in the rural sector have an average income less than the average for the rural sector;
- 54.3% of income receivers in the estate sector have an average income less than average for the estate sector.

As these statistics indicate, acute poverty as found elsewhere in Asia persists in Sri Lanka among a sizeable segment of Sri Lanka's population and, as has been found to be the case in the early and intermediate stages of structural adjustment and stabilization programs elsewhere, has even intensified in certain sectors by the austerity measures adopted.

Accordingly, availability of a public safety net is extremely important. In a survey conducted in mid-1991 to restructure the Poor Relief Food Stamp Program (PRFSP), four categories of the poor were identified:

- (a) the extremely poor, classified as those households with less than Rs 700 (US\$14) monthly income; 901,877 families were found in this category.
- (b) moderately poor, classified as those households with monthly incomes between Rs 700 and Rs 1500 (US\$30); 343,110 families were found in this category.
- (c) poor youth among extremely poor and moderately poor households.
- (d) the old-aged and indigent with no income-earning potential.

Close to 5.6 million people in the foregoing categories (roughly 33% of the Sri Lankan population) are entitled to receive food stamps under the PRFSP, costs of which accounted for 0.7% of GDP in 1992. In addition, the GSL has had to undertake relief programs for some 615,000 registered persons displaced by the civil conflict in the North and East who live inside and outside 463 government operated camps.

Food stamps constitute about 25% of total income of the households in the lowest 20%, and about 11% of total income in the

next higher quintile. The contribution of food stamps to these families disposable income was 10% for the poorest quintile and about 6% for the next quintile given the higher expenditures now required for essentials. In 1981/82 the contributions of food stamps to expenditures of the poorest 20 percent and the next higher 20 percent of households were 14% and 9% respectively.

#### NUTRITIONAL DEFICIENCIES IN THE LOWEST 40% OF THE POPULACE

In having done extrardinarily well in terms of improving its health, education and fertility indicators, Sri Lanka's excellent record in social development challenges the often-aired opinion that a developing country cannot afford expenditures for health care and education until it is richer and more financially sound. Sri Lanka recognized that education and health care are labor intensive, and these services cost much less in a cheap labor economy than they do in a wealthier country. Hence, although still classified as a low-income country (\$470 per capita GNP) by the World Bank, it has achieved a life expectancy of 71 years; an adult illiteracy rate of 12%; and an infant mortality rate of 19/1000 live births, statistics which are better than many middle-income countries. The low infant mortality rates among undernourished children is attributed to a a combination of a generally good level of education among mothers and good coverage of government provided, free basic health services. Sri Lanka should not be penalized because of its relatively high PQLI, particularly when taking into account that after birth the nutrition status of children in families in the lower 20 - 30% of the economic pyramid does not fare very well. Evidence from several major surveys conducted during the eighties indicates that, when Sri Lankan children are compared to the standard international reference group for the measurement of anthropometric nutrition indices (the standards developed by the U. S. National Center for Health Statistics and endorsed by WHO and UNICEF), the incidence in young children in the critical age bracket of 6-36 months of both stunting (low height-for-age, reflecting chronic malnutrition) and wasting (low weight -for-height, reflecting acute malnutrition) is high. A 1987 Sri Lanka Demographic and Health Survey found that 15.2% of the children aged 6-11 months; 31.1% of those aged 12-23 months, and 34.1% of

those aged 24-36 months were stunted. For wasting, the corresponding percentages were 3.9%, 19.3% and 13.3%. In 1993 a UNICEF study was conducted in Mahiyangana, an administrative unit of Badulla District in Uva Province. It found that 90% of the rural families sampled spent less than Rs 500 (US\$10) per week for food. 55% of the total households interviewed were eligible to receive food stamps issued by the government. 71.8% responded that they had faced some form of food shortage during the year, the four food deficit months in this particular area being February - May. The anthropometric data gathered (1159 under 5 year-old children used in this analysis) shows that 28.7% of the children in this survey were stunted and that 20.2% of the children suffered from wasting. Though a single sampling, it shows a 1.9% increase in stunting and an 8.1% increase in wasting in children. This latter survey indicates such faltering in the growth of children usually begins during the weaning age, i.e. 6 to 12 months. The survey also indicated that nearly 85% of the parents are undernourished, with a Body Mass Index (BMI) below 18.

Malnutrition of pregnant women appears to be widespread; 28% of all babies had low birth weight, higher than the corresponding figure for Pakistan (25%) and only somewhat lower than India (30%) and Bangladesh (31%). The practical nutrition problem concerning undernourished, stunted, and poor (40%) pregnant women in Sri Lanka is usually attributed to food insufficiency for the household, priority ordering in the eating habits and lack of knowledge about the special needs of mothers. The high level of newborns of low birth weight is related to maternal morbidity and malnutrition including anemia (mainly caused by a serious iron deficiency).

Along with increasing disparity in incomes, the disparity in calorie intake between the low-income consumer group and the total population appears to be widening. The pattern of food supplies indicates that average availability has been falling, as have donor-supported food supplies. In addition, data from a recent household survey indicate that households in the bottom 40% of the income range may be having per capita energy intake levels that are well below recommended norms (WHO daily norms of 2530 calories per adult male, age 20-39, and proportionately less for other age and sex groups). In the lowest 20% the

estimated daily consumption of calories (per capita) are: 1,298 calories per day in the urban sector; 1,555 calories per day in the rural sector, and 1,714 calories per day in the estate sector. In the 20% - 40% quintile these levels are: 1,670 calories per day for the urban sector; 1,994 calories per day for the rural sector, and 2,178 calories per day for the estate sector.

The real income effects of food supply shortages working through price increases affect the poor much more seriously than the relatively better-off segments of the population. It is estimated that food price increases affect the 20% lowest income group in Sri Lanka 33% more than the "average" consumer.

As noted, estimates are that food stamps contributed about 10% of the disposable incomes of the poorest 20% and about 6% in the next poorest 20 - 40% of households in 1990/91. The impact of the PRFSP concurrent consumption cannot be properly estimated because of non-availability of data on quantities of food consumed by income class. However, based on information given in previous studies, a rough approximation of calorie consumption can be made. In terms of possible calorie purchases, these incremental incomes are believed to bring about 115 additional calories per capita per day, contributing about 8% of total calorie consumption by the lowest 20% of households in 1990/91. This amount of calorie contribution reflects a 30% reduction relative to the contribution food stamps made in 1981/82. While the nominal value of food stamps was doubled between 1981/82 and 1991/92, the increase has not been sufficient to compensate for inflation. There should have been at least a 325 percent increase in the food stamps value to compensate for the erosion of real value of this income transfer. With no indexing to inflation, the budgetary allocation for the food stamp program has declined from 3.8% of the budget in 1988 to 1.5% of the budget in 1993.

In these programs children are given higher valued food stamps with the expectation that they would derive greater benefits from these transfers. However, a recent sampling, albeit limited, indicates this may not be the case. These transfers are viewed usually as additional income to the household and the benefits to the children are guided by the intrahousehold allocation practices of the households which tend to favor adults when

allocating relatively low calorie supplies. An earlier study indicated that income transfers may have a greater effect on small children if the transfers are large enough to ensure that a reasonable amount of calories, such as 80% of the recommended allowance, is consumed by the more productive members of the household. The current Food Stamp Program does not provide a transfer of this dimension to the poorest 20% of the population, and the 1993 survey conducted by UNICEF indicates a higher prevalence of stunting and wasting than previous surveys among children in this percentile.

Donor grants in food assistance can play a major role in a greater degree of food security while reforms are in progress. The total budget of the GSL Food Stamp Program (PRFSP) was about Rs 3 billion in 1991 and 1992. In 1993, it may be in the region of Rd 2.7 billion and may account for about 14% of all transfers to the household sector and about 2% of total government expenditure. Projections for the next three years show that the PRFSP may decrease to Rs 2 billion in 1994 and Rs 1.7 billion in 1996. This program would require about Rs 2.7 billion each year during this period if food stamps were now to be indexed to the rate of inflation.

Food aid, particularly PL 480 imports which account for the bulk of food aid, has contributed significantly towards ensuring an adequate total food supply. The absence of PL 480 food assistance would have had two important detrimental effects on food security in Sri Lanka. First, reduced food availability would have caused disproportionate hardships to the poor due to their relatively large price elasticities of demand for food. Second, scarce foreign exchange resources needed to finance other development activities would have been used to meet at least part of the food supply shortfall.

#### CONCLUSIONS

Sri Lanka's economic and social goals can only be achieved if the economy's growth rate is significantly above that of 1992 and if it is sustained until the end of the decade.

The recent economic growth has been dragged down by the poor performance in agriculture.

The continuing high budget deficit (though reduced in 1992) to 7.4% of GDP) remains the fundamental weakness in the economy.

Inflation remains high, at over 10% per annum, and tight monetary policies to combat inflationary pressures are curbing private investment, especially those of a long term nature.

While many features of economic performance in 1992 are encouraging, a much better performance will be required to raise the economy to a stage of high self-sustaining growth.

The Sri Lankan economy is expected to grow at around 5.5% in 1993.

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