

USAID/SRI LANKA

COUNTRY PROGRAM STRATEGY 2001 - 2005

COLOMBO - APRIL 2000

1.0 ANALYSIS OF THE ASSISTANCE ENVIRONMENT

1.1 U.S. Foreign Policy

With an unbroken democratic tradition since independence in 1948, even as it conducts a war against a terrorist insurgent organization, Sri Lanka provides a unique environment in South Asia for promoting U.S. democratic values and economic interests. U.S. foreign policy interests center on promoting economic prosperity, greater respect for the rule of law, and humanitarian assistance.

In the period leading up to 2005, USAID programs will continue to be at the forefront of advancing U.S. foreign policy interests. USAID resources will focus on improving Sri Lanka's integration into the global marketplace, ensuring that citizens' rights are protected in law and practice, and bringing greater opportunities to disadvantaged groups.

1.2 Overview

Sri Lankans often repeat the story that when Lee Kwan Yew visited Sri Lanka shortly after its independence in 1948, he remarked that Singapore would have to work very hard to achieve Sri Lanka's level of development. Of course, the GNP per capita in Singapore is now around \$20,000 and in Sri Lanka, only about \$860. While great progress has been made in establishing an economic framework that could provide the basis for Singapore-like economic growth, the likelihood of that happening is uncertain. Sri Lanka faces two extremely difficult and inter-related problems. First, Sri Lanka is engaged in a lengthy war with the minority Tamil separatist group, the LTTE, which is fuelled in part by lack of economic opportunity. Second, Sri Lanka's economic growth rate of 4 to 5 percent per annum is too low to provide adequate employment for Sri Lanka's educated youth.

Sri Lanka's market economy is based on the export of textiles, tea, rubber, coconuts, and gems, and on earnings from tourism and repatriated earnings of citizens employed abroad. The annual value of exports, which is equal to about a third of GDP, has more than tripled in real terms over the last decade, but garment and textile exports, primarily to the United States, have been the leading edge of that growth. The quota system under the WTO Uruguay Round, which currently provides Sri Lankan exporters some protection from competition, expires in 2005. While predicting how Sri Lanka will fare in a much more competitive environment for garments and textiles with any precision is problematic, the consensus in the community is that the emerging situation holds more downside risk than upside opportunity for many in the industry. Given the uncertainty about the future of garments and textiles, the economy needs to diversify and move up the technological ladder to ensure competitiveness in world markets.

Without question, the future prosperity of Sri Lanka is linked to a political settlement of the war. In FY 99, 4.86% of its GDP was expended on conducting the war, keeping a high fiscal deficit of around 8.0%. The war not only squeezes Government of Sri Lanka (GSL) development expenditure, but also severely dampens investor confidence, especially

foreign direct investment in the economy. Domestic private investment and portfolio investment are also adversely affected. A widespread view exists that economic growth on the order of 7 percent per annum could be within reach once the war ends. This view, however, is conditional on additional reforms being made in the enabling environment facing business and Sri Lankan firms becoming more competitive.

There has been a tremendous response from the wide range of businesses, firms and associations who participated in USAID's Competitiveness Study in 1998. These firms, associations and their employees are the direct customers of USAID's economic growth program. Their analysis of problems and constraints helped shape the strategy towards its focus on better business strategies and public/private dialogue. Introduction of regular survey tools such as the business attitude survey will be used to keep the strategy and business needs aligned as much as possible.

The Asian Development Bank (ADB), the World Bank (WB), Japan and the UNDP are the largest donors of aid to the country. USAID is the lead donor working on competitiveness at the industry cluster level and developing policy reform through the private sector. Major donors supporting key infrastructure improvements are Japan, the WB and the ADB. The GSL receives funding from the WB and ADB for macro-economic reforms, including privatization of the plantation industries and telecommunications. In the area of legal and judicial reform, a WB loan will improve court infrastructure, administration and commercial law reform. USAID humanitarian activities complement efforts of the UN agencies such as UNICEF, WHO, UNHCR and international voluntary organizations, which are providing health care and shelter to the displaced.

1.3 Transitional Issues

Donor aid to Sri Lanka has been on a declining trend for the past decade. For some donors, including USAID, Sri Lanka's success in primary health care, education and gender equality, as well as its steady but slow economic growth trend, has been a factor in the decline in donor aid.

USAID proposes that the indicators and trends used to assess Sri Lanka's readiness to move to the next stage in the economic development relationship include its competitiveness ranking. An element of USAID's program is to help Sri Lanka meet the requirements to be ranked by the World Economic Forum Competitiveness Report beginning in 2001. USAID would also look for positive trends in income gap disparity based on its planned competitiveness activities with workforce development and secondary cities in Sri Lanka.

USAID expects to phase out its economic growth support to Sri Lanka in the final year of the strategy period. To ensure that Sri Lanka can pursue and develop competitiveness and growth strategies without further economic assistance from USAID at that time, USAID will use the first few years of the strategy period to transfer ideas, technology and expertise to a wide range of individuals and organizations in Sri Lanka. In addition to the clusters

formed by the program, these could include, among others, linkages between a proposed Sri Lankan trade policy institute and partner institute in the United States, between universities, economic policy research organizations and agricultural councils. Linkages already underway include a partnership between a U.S. utility company and the Ceylon Electricity Board with the assistance of USAID and USEA.

While it would be foolhardy to predict the timing of a politically negotiated settlement of the war, there have been some signs of progress in this direction. Whereas five years ago public discussion of a politically negotiated rather than a military solution to the conflict was seldom heard, today the need to end the war because the economic, social, environmental and human costs are so high is broadly discussed in public fora. A negotiated settlement is seen by many groups as the only way to resolve the war. U.S. foreign policy interests and USAID objectives in democracy and human rights and in humanitarian assistance are largely based on problems created by the ongoing war in the north and the east. If there were significant progress towards a negotiated political settlement during the strategic plan period, USAID would request assistance of USAID/OTI in formulating a strategy for USAID assistance to affected areas. Progress on improving competitiveness would be critical in ensuring that all regions of the country benefit from economic growth. Competitiveness activities could be extended to areas in the north and east if conditions in those areas, and funding, made it possible to do so.

II. THE STRATEGIC PLAN, FY2001 - FY2005

USAID's strategic plan for 2001-2005 would improve Sri Lanka's ability to compete in global markets, protect citizens' rights in law and practice, and bring greater economic opportunities to those affected by the conflict. These objectives contribute to Agency objectives of expanded and strengthened private markets, respect for law and human rights, and humanitarian assistance.

The strategic plan is directly in line with GSL priorities. In her budget and Independence Day speeches in February 2000, President Kumaratunga declared her intention to bring an end to the war and put the country on a path to increase incomes, reduce unemployment and raise domestic savings. She pointed out that for Sri Lanka to integrate with and benefit from the global economy, it demands "vast changes in the way we live, the way we educate ourselves, and the way we work." Most importantly, she noted, these benefits must reach all the people of Sri Lanka.

2.1 Economic Growth Strategic Objective (SO4): Increased Sri Lankan Competitiveness in the Global Marketplace

USAID's economic growth objective is to increase Sri Lankan competitiveness in the global marketplace. USAID's competitiveness assessment of Sri Lanka, conducted in the summer of 1998, made a number of important findings, including:

- Although there is still room for improvement, the Sri Lankan government scores fairly well relative to other countries on its macroeconomic framework, based on work of previous governments and continued improvements made by the current coalition government.
- The government has also performed relatively well in the active and creative use of fiscal policy to mobilize investment and boost exports. Continuing to rely on incentives, however, is not a sustainable source of competitive advantage for Sri Lanka. Other countries can easily replicate the strategy. Also, it leads businesses to look to government to solve their problems when it would be better to focus their time and resources on customers and competitors.
- Unlike the stage set for reform of macroeconomic policies, which are proceeding relatively well, the policy and regulatory framework facing the individual firm is quite weak.
- In addition, weak business strategies and minimal understanding of competitive position characterizes much of Sri Lankan industries studied, including tourism, toys, gems and jewelry and floriculture.

- While the war is currently the major single factor discouraging economic expansion, the “peace dividend” for the economy will be disappointing if the enabling environment for business is not improved.

USAID’s economic growth resources will continue to focus on measures to improve Sri Lankan competitiveness in the global economy. In addition to supporting a national consensus on a competitiveness strategy for Sri Lanka, other initiatives include benchmarking country performance in key areas by public and private sector and assistance to industry clusters.

In response to the high level of demand from industries, USAID technical assistance will help them form competitiveness clusters. To be effective, such industry clusters require participation of all entities involved in getting a product to the customer: from producer to manufacturer, packer, shipper, vendor, the government that creates the platform upon which all these entities work, as well as research and development organizations. The methodology applied by USAID’s program avoids picking winners and losers. Success of the competitiveness process ultimately depends on the participants’ commitment to developing and implementing a strategy, including committing necessary resources. To ensure they have the necessary commitment, clusters receiving specific technical assistance will use their own resources to assign or hire a cluster coordinator to work with USAID’s technical advisors. Potential clusters include financial sector and banking industry, information technology, education, garments, tea, rubber, tourism, eco-tourism, horticulture, gems and jewelry.

To attract additional investment needed for development of new products and expansion into new markets, clusters need a competitiveness strategy. USAID’s technical assistance will help clusters formulate strategies to maximize a given cluster’s participation in international markets, while delivering sustained increases in productivity and income gains in the domestic economy. USAID will also fund studies and technical assistance to develop and support cluster strategy implementation, workforce development, public/private dialogue and public sector policy change. Other types of assistance might include study tours to countries or areas that have developed their competitive advantage, participation at international trade fairs, and attendance at seminars or workshops on competitiveness. USAID may provide limited funding for the purchase of necessary equipment.

Improving competitiveness of Sri Lanka is essential for the GSL to achieve its goals of integrating and benefiting from the global economy. To ensure that the benefits of improved competitiveness are broad-based, the program will implement competitiveness activities in secondary cities and regions of Sri Lanka. It will also increase local value-addition and lead to the upgrading of skills and competitiveness of low-value exporters.

Expected results of the objective is progress towards Sri Lanka reaching a national consensus on a competitive strategy, making the necessary policy and regulatory reforms that will improve the enabling environment for firms, and on the firms, themselves, implementing better business strategies. Proposed performance measures are an increase

in value-added exports of 20 targeted clusters, relative to their industries as a whole. The target is a 10% increase in value-added exports above 2000 levels by 2005.

2.2 Democracy & Human Rights Strategic Objective (SO2): Citizens' Rights Better Protected in Law and Practice

USAID plans to continue the important efforts underway to address human rights abuses and provide support for legal aid through 2005. Many of the human rights abuses are related to the ongoing war. Even if the war ends within the strategic plan period, the need for human rights abuse reporting and legal aid will continue. There has been a shift in the past few years in the type of human rights abuses being reported, with fewer cases of disappearances and extra-judicial killings by the military, but many more allegations of torture by police. These cases do not necessarily involve ethnic issues but point to serious problems with police investigative techniques and higher levels of violence in the society as a whole. USAID anticipates need for continued support to human rights organizations, the judiciary, the Human Rights Commission, and for public awareness.

USAID provided critical support to the GSL and the forensic community for the investigation into mass graves in Chemmani, an area in the Jaffna peninsula. The GSL appears to be interested in pursuing further investigations into mass human rights abuses. USAID would provide continued support for these investigations so perpetrators of human rights abuses are brought to justice.

Sri Lanka has become a magnet for the international exploitation of children through the sex tourism industry and more recently, through materials conveyed through the internet. USAID would provide funding to assist the recently formed Sri Lanka National Child Protection Authority to prevent child trafficking. A component of the human rights program may continue to improve the working condition of women in areas where they are subject to abuse.

Violence continued to be a problem in the presidential elections held in December 2000, in which the President was re-elected for a second six-year term. USAID anticipates that the parliamentary elections are expected in August 2000 will create an opportunity during the early years of the plan for continued work on election reform and the problem of election violence.

Expected results of the objective during the strategy period are an increase in a total of 9,700 human rights cases reported to authorities and 84,750 legal aid clients receiving assistance. Continuous assessment of the service providers is planned through random sample surveys of clients by an independent monitoring group.

2.3 Humanitarian Assistance Strategic Objective (SO3): Enhanced Economic and Social Opportunities for Disadvantaged Groups

The 16-year ethnic conflict in the north and east has disabled thousands of people and displaced a large population including children. Providing short-term relief and resettlement assistance to disabled and/or displaced groups is a high priority of the GSL. Another serious threat to the well being of children in Sri Lanka is sexual exploitation and abuse of mostly boys in the western and southwestern coasts. USAID plans to continue providing assistance to these groups to recover from adverse circumstances and provide them an opportunity to return to a normal life. Activities would include support for NGOs providing prosthetic devices to war victims and other amputees, for assisting displaced children and families, and orphans and youth exploited by the sex trade.

USAID expects the need for prosthetic devices to continue through the strategic plan period, even if there were an end to the war. Many of the current victims from the northeast are farmers who have moved back into areas under government control and have been injured from mines hidden in their fields. Given the duration and intensity of the conflict in Sri Lanka, the need for assistance for amputees can be anticipated for some time to come. NGOs working with displaced children and families would play a valuable role in helping these groups with reconciliation and reintegration into normal community life. Expected results of the objective are an increase of 6,000 children participating in community-based activities and prosthetic services provided to 7,200 amputees during the strategy period.

2.4 Global and Regional Activities

Better environmental practices are an important factor in advanced competitive strategies of countries. U.S. Asian Environmental Partnership (USAEP) activities in Sri Lanka will sponsor several key studies on air quality, solid waste, wastewater, noise and energy use efficiency. Direct consultations, trade shows in the U.S. and in the region, workshops, training, environmental exchanges and specific studies will be employed to introduce new concepts and promote technology transfer. Regional Urban Development Office (RUDO) activities focus on expanding and improving delivery of urban environmental services, including such as water supply, sanitation and solid/liquid waste management. In addition to addressing technical and policy issues on access to services, the activities help mobilize financial resources for urban environmental infrastructure investments.

USAID's strategic plan will also complement and benefit from the South Asia Regional Initiative (SARI). SARI/Energy activities will help improve utility management in Sri Lanka and increase private sector participation in energy generation, transmission and distribution through training and capacity building activities. Activities to prevent child trafficking in Sri Lanka will be supported through SARI/Trafficking as well as USAID's human rights and humanitarian assistance program. USAID's competitiveness program may form the basis for regional business development programs. These global and regional activities will be managed by USAID staff in Sri Lanka.

3.0 RESOURCE REQUIREMENTS

3.1 Program Funds

USAID assumes continuation of program funds at FY 1998-2000 levels for the first four years of the strategic plan period. For the period FY 2001- FY 2004, USAID requests approximately \$12 million in Economic Growth funds, along with \$1.5 million annually in Economic Support Funds and from \$500,000-\$700,000 in DCOF/WVF per year. In addition, USAID/OTI resources would be requested for assistance to affected areas in the north and east if significant progress were made in reaching a negotiated political settlement of the war.

By the end of FY2004, USAID expects to have established a sustainable process for public/private dialogue on competitiveness and economic growth in Sri Lanka. USAID also expects to have in place sustainable linkages between local organizations and partner organizations in the United States, between universities, economic policy research organizations and agricultural councils to support such dialogue. This will enable USAID to phase out its bilateral funding support for economic growth activities in FY 2005.

As of September 30, 2000, USAID's economic growth pipeline is expected to be around \$4.1 million, which represents about 13 months of forward funding. Expenditures for FY2001 are expected to be around \$3.7 million, and the resulting pipeline after obligating FY2001 funds will be around \$3.4 million (12 months of forward funding). Expenditures for FY2002 to FY2004 are expected to be around \$3.0 million. At these low levels of funding, a marginal increase or decrease of funds would have a significant impact on program results.

As of March 31, 2000 the local currency special account (from previous PL 480 III programs) pipeline was US\$3.80 million. In addition \$4.38 million in local currency had not been programmed and is available to support NGO programs in all three objectives of the strategy, including support for linkages between Sri Lankan and U.S. institutions.

Program Funds (\$000's)

| Funding Category | FY 2001 | FY 2002 | FY 2003 | FY 2004 | FY2005 | Total |
|--|--------------|--------------|--------------|--------------|--------------|---------------|
| Economic Growth SO (Discretionary funds) | 3,000 | 3,000 | 3,000 | 3,000 | 0 | 12,000 |
| Democracy/Human Rights SO (ESF funds) | 1,500 | 1,500 | 1,500 | 1,500 | 1,500 | 7,500 |
| Humanitarian Assistance SO (WVF & DCOF) | <u>700</u> | <u>500</u> | <u>500</u> | <u>500</u> | <u>500</u> | <u>2,700</u> |
| Total | <u>5,200</u> | <u>5,000</u> | <u>5,000</u> | <u>5,000</u> | <u>2,000</u> | <u>22,200</u> |

3.2 Staffing Requirements

With the closeout of several large activities continuing into FY 2002, USAID will continue to require 2 USDH through until the end of FY 2002, when it will reduce the staffing level to 1 USDH. By mid FY 2002, program and activity implementation units will have been

significantly reduced and replaced by global mechanisms or umbrella grantees in order to reduce the direct management burden.

A staffing assessment was conducted with USAID/Washington support in September 1999. Based on the recommendations of that report, USAID will continue to consolidate staff functions where feasible. Operating expense funds requested for the plan are approximately \$900,000 per year.

USAID will continue to require the financial management and accounting services of USAID/New Delhi during the strategic plan period. In addition, USAID will require periodic support from USAID/New Delhi's Executive Officer and Program Officer for general oversight and expert assistance, and for regional contracting officer services. USAID will also require legal services from USAID/Jakarta.

GLOSSARY OF ACRONYMS

| | |
|---------------|--|
| DA | Development Assistance Funds |
| DCOF | Displaced Children and Orphans Fund |
| ESF | Economic Support Fund |
| GDP | Gross Domestic Product |
| GNP | Gross National Product |
| GSL | Government of Sri Lanka |
| LTTE | Liberation Tigers for Tamil Ealam |
| NGO | Non-governmental Organizations |
| OE | Operating Expense |
| OTI | Office of Transition Initiatives |
| RUDO | Regional Urban Development Office |
| SARI | South Asia Regional Initiative |
| SO | Strategic Objective |
| TAF | The Asia Foundation |
| UNHCR | United Nations High Commission for Refugees |
| UNICEF | United Nations International Children's Education Fund |
| USDH | U.S. Direct Hire |
| USEA | United States Energy Association |
| WB | World Bank |
| WHO | World Health Organization |
| WTO | World Trade Organization |
| WVF | War Victims Fund |