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Country Development Strategy Statement

FY 1987

Sri Lanka

Febuary 1985

Agency for International Development
Washington, D.C. 20523

BEST AVAILABLE

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THIS STRATEGY STATEMENT

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THE AMBASSADOR
OF THE
UNITED STATES OF AMERICA
Colombo, Sri Lanka

CHIEF OF MISSION COMMENTS

I am pleased to endorse the Country Development Strategy Statement prepared by the USAID Mission in Colombo. The Strategy emphasizes three major areas:

(1) Agricultural Productivity and Farm Incomes;

(2) Off-Farm Employment and Rural Enterprise;

(3) Development of the Mahaweli Region.

The strategy continues the shift of resources begun last year from major infrastructure to a program designed to build institutional capacity. This institutional capacity will be essential as Sri Lanka attempts to assure adequate levels of economic growth through effective utilization of available resources. The assistance levels presented in the strategy are lower than those of previous years; however, they reflect both the changed nature of the strategy itself and the U.S. budgetary considerations affecting A.I.D. I note with satisfaction that the strategy can be responsive to policy reform by the Government of Sri Lanka which would provide further opportunities for development assistance. Also noted is the possibility of a contingency program related to the political situation. While we all pray that such a program will not be necessary, realistic planning in Sri Lanka must take account of the possibility.

This strategy, in my judgment, then reflects a program of U.S. assistance that will be responsive to Sri Lanka's development needs and priorities. I am pleased to support it.

John H. Reed
Ambassador

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LIST OF ACRONYMS

AMP	Accelerated Mahaweli Program
BOP	Balance of Payments
CDSS	Country Development Strategy Statement
CY	Calendar Year
DA	Development Assistance
DARP	Diversified Agricultural Research Project
DWL	Department of Wild Life
ECT	Energy Coordinating Team
ESF	Economic Support Fund
FY	Fiscal Year
FTZ	Free Trade Zone
GDP	Gross Domestic Product
GNP	Gross National Product
GSL	Government of Sri Lanka
HG	Housing Guaranty
ICSM	Instant Corn and Soya Mix
MADR	Ministry of Agricultural Development and Research
MHP	Million Houses Program
NAFNS	National Agriculture, Food and Nutrition Strategy
PID	Project Implementation Document
PIP	Project Investment Plan
PP	Project Paper
PQLI	Physical Quality of Life Indicators
PVO	Private Voluntary Organization
SME	Small to Medium Enterprise
SLBDC	Sri Lanka Business Development Center
SLIDA	Sri Lankan Institute of Development Administration
TA	Technical Assistance
UNDP	United Nations Development Program
USAID	United States Agency for International Development
WS&SS	Water Supply and Sanitation Sector

I. EXECUTIVE SUMMARY

A. Background

Sri Lanka is currently an island in turmoil. It is a nation with a strong history of democratic government and commitment to equitable access to the benefits of development. However, despite impressive physical quality of life indicators, poverty persists and per capita income estimated at $ 320 in 1982 is comparable to some of the least developed countries of the world. Following six years of substantial economic growth, serious problems now threaten Sri Lanka's ability to sustain that growth. The ethnic tensions of the past two years have had a significant role in this changed developmental situation.

Agriculture remains the dominant productive sector throughout the country, providing 25% of GDP and 55% of employment. In 1984 over one half of export earnings were unprocessed and semi-processed agricultural goods. Agriculture has three distinct sub-sectors: 1) estate crops including tea, rubber and coconuts; and 2) rice; and 3) other crops. As a share of agricultural GDP, the estate crops make up 32%, rice 27% and all others 41%. Most of the employment in agriculture is related to rice, but the nature of employment is seasonal. Agriculture outside of the estate sector is predominently on small holdings: 96% of the rice holdings, for example, are less than 10 acres.

The industrial sector's share of GDP is 14%. It provides 12% of employment and about 35% of export earnings. Despite official Government of Sri Lanka (GSL) policies to encourage growth of the private sector, the GSL's share in the value of production still dominates at 52% versus 48% for the private sector.

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Industrial GDP has grown only 3% per annum since 1977, and this slow growth is due primarily to poor performance in the public sector. The entire industrial sector remains heavily dependent on imported raw materials (between 75 to 80%). Energy also continues to be a constraint to industrial development, accounting in 1983 for about 14% of total production costs.

Expansion of the private sector has occurred following the policy changes enacted by the GSL since 1977. The government's Public Investment program for 1984-1989 calls for the private sector to contribute 47% of total investment required. That contribution compares with 40% called for in the 1978 plan. However, the private sector still represents a minority share of the economy.

The country's mineral base is weak. There are no known reserves of petroleum, and known mineral deposits are heavily controlled by government mining corporations. The transportation network is badly in need of rehabilitation. Telecommunications are not adequate to support a growing economy. Tourism, the fourth largest source of foreign exchange, has fallen off considerably following the ethnic disturbances of mid-1983. The continuing unsettled security situation situation make any early revival of the tourist industry unlikely.

Sri Lanka's labor force of 5.6 million people is 37% of the total population. Official figures show over 14% unemployment. While a vast improvement over the 25% unemployment levels of the mid-1970s, it is still a serious problem. Without improvement in the ability to create jobs, the unemployment situation will turn for the worse with new entrants to the labor force greatly outnumbering the employment generation capacity. Underemployment is another serious problem, especially in agriculture where at least 40% of the workforce is underemployed.

One solution to the un- and underemployment prospects has been taking employment abroad. About 200,000 Sri Lankans are working abroad. Remittances from this overseas employment are second to tea exports in providing foreign exchange.

B. Recent Economic Performance

GDP growth averaged 7.6% during the 1976-80 period and a little over 5% during the 1981-83 span. Over the six years from 1978-83, GDP growth averaged 6.2%. For 1984 and 1985 GDP growths rates of 4.5% and 5.0% respectively are projected. The decline in real growth rates has been largely due to poor performance in agriculture and manufacturing, domestic financial constraints, balance of payments pressures, adverse weather and ethnic disturbances.

Agriculture and manufacturing, both dominated by public estates and corporations, had a combined contribution to GDP growth between 1976 and 1983 of only 27% against their 39% share of GDP sectorial composition. Low growth was to be expected in these areas when the public sector had virtually no capital investment during this period other than on irrigation.

Domestic savings proved inadequate to finance the irrigation and power schemes that have been the focus of the capital budget over the past seven years. In some years domestic revenues have not even covered recurrent expenditures in the annual budgets. The resultant imbalance led to heavy domestic borrowings, sharply increasing money supply and inflation. Development investments in the last few years, thus, have had to be less expansionary.

A sharp deterioration in the balance of payments brought on by growing external trade deficits has been another cause in slowing down GDP growth. This growing external trade deficit was caused by the sharp increase in both volume and value of imports following trade liberalization and expansionist development policies of the government. As a result the external trade deficit increased significantly and external debt increased from Rs.14.5 billion in 1978 to Rs.46.1 billion by the end of 1983.

Sri Lanka has long been plagued with ethnic problems, and since 1958 Tamil extremists of the northern and eastern parts of the country have sought first greater autonomy and now a separate state. Ethnic riots in July 1983 caused large numbers of casualties and heavy economic damage, but worse, considerably widened the gap between the two communities. Continuing terrorist and counter-terrorist actions further exacerbate the tensions, and cause the GSL to devote more attention and resources away from development to security.

C. Key Development Problems

The obstacles to Sri Lanka's ability to reach and sustain significant levels of real growth can be summarized as:

— A basic imbalance in the external accounts,

— Low or declining levels of productivity in agriculture,

— Low and slowly growing income levels caused in part by high unemployment and severe rural underemployment. (This obstacle also manifests itself in growing disparity in income distribution and deteriorating nutritional levels),

— Ethnic tensions polarizing Sri Lankan communities and distracting resources needed for development.

The Strategy presented in this CDSS centers on the constraints of low agricultural productivity and low income levels. At present the external accounts balance has benefitted from high tea prices. This situation masks the need for basic reform but allows time to focus on other critical issues.

In order to overcome these identified development constraints the GSL will need to make better use of available resources, and that will require some hard decisions. Opportunities for assistance will be based on the GSL's awareness of the need for such decisions and its willingness to make and support them. The recommended strategy proposes first a core program that is possible within the policy and administrative changes the GSL currently is willing to consider. In tandem with the core program, the Strategy provides that GSL willingness to consider a broader range of policy reform would warrant an expanded program from AID in support of these initiatives.

Within agriculture there are three divisions: estate crops, rice, and all others. Rice has been a success story in Sri Lanka because of a clear commitment to achieving rice self-sufficiency which resulted in adequate research and extension and free market policies on inputs and sale of production. The estate crops particularly tea and rubber have experienced declining production levels since 1979 because of insufficient investment and poor management practices. The Mission has not proposed working in this sector, however, because we believe that rehabilitation should be done under a clear policy which encourages private sector ownership and management and because AID has no comparative advantages in these crops.

Over 80% of Sri Lanka's population lives in rural areas. Most of the rural work force is engaged in agriculture although few are fully employed at it. Small farms predominate. Poverty is most extensive in the rural areas. The Strategy, therefore, has as an objective improving agricultural productivity and farm incomes. Priority attention will be given to the new settlement areas of the Accelerated Mahaweli Development Program where the GSL, AID and other donors have already made substantial investment. However, this attention will not be exclusive of other parts of the country where successful interventions can contribute to an equitable pattern of growth.

In Sri Lanka agricultural productivity is hampered by insufficient research, poor planning and policies, limited management capability and inadequate marketing and distribution. In the dry zone sufficient and timely delivery of water is also a priority need. Working through a time phased approach over the CDSS planning period, the Mission will work to improve the capability of both the GSL and the private sector to carry out appropriate research efforts, to utilize research findings to develop realistic plans and policies, to implement those plans and policies, to assure water for irrigation, and to provide better marketing and distribution services for the resultant increased production.

Efforts at improved agricultural productivity will be focussed at the field crop sub-sector (excluding rice) in the early years of the Strategy. In the course of carrying out the program, the Mission will be encouraging better coordination and integration of agricultural programs now spread over six separate ministries. Should opportunities for more rational management of agricultural programs develop, the focus of USAID assistance would expand beyond the field crop sub-sector.

Creating jobs continues as a top priority of the GSL, and the need for employment in the rural areas is evident in the fact that over 40% of the work force there works less than 100 days a year. More than increased farm labor is required as the number of landless within the agriculturally dependent population is increasing (7% in 1973 to 20% in 1981). In addition nutritional standards for low income groups, particularly the rural poor, have been deteriorating. Income generating opportunities must be created both on and off the farm.

The Mission views the creation of jobs off the farm to be a role of the private sector. However, the Strategy will focus on providing the environmental setting and support services necessary to stimulate off-farm employment and rural enterprise. Again, the Mahaweli region will receive priority but not exclusive attention. Agribusiness is expected to be a primary investment target.

The early stages of our involvement will be of an analytical and pilot nature. In private sector promotion work with the Sri Lankan Business Development Center, three areas of assistance have been identified which will improve the prospects for rural enterprise development policy and planning which will involve analytical work to identify further constraints and methods to overcome them; information development, such as market information; and the development of managerial skills must, therefore, rank high in priorities.

The USAID will work with both the GSL and selected private sector organizations to develop the analytical and planning skills necessary to encourage rural employment and business development. The Mission will also continue support for a professional information development and dissemination

capability to provide accurate and timely economic data and informational services for business decision making. Concurrently and in coordination with management development efforts directed at improved agricultural productivity, the Strategy calls for assistance to build a capacity for providing practical, high quality management education from which specialized rural enterprise management can be developed. The GSL policies, or lack of them will be an important concern of our assistance. Progress on improving the policy framework will determine how much more can be done to increase rural enterprise development.

The Mission will give high priority to development of the Mahaweli region. Over $1.5 billion has been invested in the Mahaweli program — $181 million of that is from AID — both to tap hydro-electric potential and to open sparsely populated lands to settlement and increased agricultural productivity. The Strategy envisions Mahaweli development as a special focus of our efforts in agricultural productivity and farm income and in off-farm employment and rural enterprises. In seeking to achieve these objectives the Mahaweli area will be used, when feasible, to develop program interventions and to serve as the testing ground for new activities which can be replicated in other parts of the island.

In addition, the Mission will work with the Mahaweli Development authority to improve their capacity to plan for continuing Mahaweli development. Program development will be centered on the opportunity to make previous investments more productive. Better inter-ministerial coordination will be an important factor in successfully developing the Mahaweli region, and Mission efforts for downstream work will feature this policy issue.

While the Mission is not planning major new initiatives in the fields of health and energy, they remain programs of interest as important aspects of rural development. At this time policy and management environments are not conducive to program development in either of these two fields. The Mission will continue attempts to alter that environment so that our assistance could play a meaningful role. If GSL decisions reorient policy direction in these and other development areas, the Mission would consider appropriate assistance.

Any long range development planning for Sri Lanka must take into consideration the destabilizing efforts of the terrorist campaign and the associated threat of ethnic violence. The situation could well deteriorate to a level which made normal development programs impossible. Efforts for a negotiated settlement have completely broken down and violent incidents continue almost daily.

While the outlook appears to be a continuation of the present situation, the Mission — as a contigency program — has anticipated the possibility of shifting assistance objectives to a combination of stabilization, humanitarian relief, and rehabilitation should violence reach a major disruptive scale. Stabilization would take the form of balance of payments or budgetary support. Humanitarian assistance would be intended to relieve the plight of displaced and destitute people. Rehabilitation would be designed to restore normal economic activity. In the event of a political settlement, the Mission foresees the need for contributing to ensuring progress and stability in addition to helping overcome the ravages of conflict. Inevitably, such assistance would be part of a multi-donor effort in support of massive GSL resource commitments.

II. ANALYSIS

A. RESOURCE BASE OF SRI LANKAN ECONOMY

Sri Lanka is an island nation with an area of 25,000 square miles, approximately the size of West Virginia, and an estimated current population of 15.4 million currently growing between 1.8 and 2% a year. Sri Lanka is also a socially segmented and complex nation in which ethnicity, religion, regionalism, caste, class and political affilication crosscut the society in ways that are significant for both social and economic policies. Most of the population lives in the rural areas, (rural 71% and estate 8%) with only 21% in urban areas. Rural based social patterns continue to dominate the structure of social and political relations.

While per capita income is low ($320 in 1982 based on World Bank figures), Sri Lanka's physical quality of life indicators (PQLI) are on par with southern Europe - literacy 86%, life expectancy of 68 years and infant mortality of 37 per 1,000. Regardless of political party, governmental commitment to equitable access to social services has been a cornerstone of the country's development. One of Sri Lanka's greatest assets has been its democratic tradition in which over 80% of the voting population participates in elections and governments have changed in every election since Independence with the exception of referendum of 1982.

The country's resource base is primarily agricultural. With substantial variations in rainfall, topography and soil, Sri Lanka offers a diversified resource base for agriculturally led economic development. Three-fourths of the country is a lowland in the dry zone receiving an annual rainfall of less than 75 inches concentrated mostly during the October-January period.

Relatively speaking, the dry zone is sparsely populated (about 128 per square kilometer compared with the national average of 230). The economic base supporting 6.3 million population is largely agricultural, both irrigated (with rice as the major crop) and non-irrigated dryland cultivation.

The economic base of the country, however, is currently the hilly wet zone, where the annual rainfall is more than 100 inches per year and the elevation rises to about 7000 feet above sea level. Most of the land in the upcountry area is utilized for monoculture tea which continues to be the single largest source of foreign exchange. In the lowland areas of the wet zone, the economy is diversified with manufacturing, trade and services together with mining and agriculture. Land utilization in agriculture in the wet lowlands is mixed, consisting of plantation crops (rubber, coconut, tea), minor cash crops (cocoa, coffee, spices) and food crops, principally rice. More than 50% of the population is concentrated in this area yielding a population density of 617 persons per square kilometer, nearing the average for Bangladesh.

The mineral base in the country is relatively weak and has not been well developed. Sri Lanka has no known reserves of petroleum although off-shore oil reserves are a possibility. Known minerals include graphite, mineral sands, gemstones, silica sands, cement, clays, dolomite and phosphate. The mineral industry is heavily controlled by government mining corporations.

While almost all villages in Sri Lanka are easily accessible by road (16,500 miles of road, 12,600 miles of which are paved), the roads are narrow, and the quality of the system is uneven but generally poor. Rapid growth in the number of vehicles following liberalized trade and import policies since 1977, low priority on road improvements, and inadequate maintenance of the road network (particularly the major roads), have caused serious deterioration of the system

during the last five to seven years. The road network, therefore, has been identified as an area of priority for future national development, receiving 6% of the 1985 capital budget and over 50% of the government's allocation to maintenance of capital assets. While not extensive, the railroad system serves most important cities and agricultural regions although most of the traffic is passengers, not freight.

Telecommunication networks and power supply are equally important priorities for national development. In both cases, the current level of development is not adequate to support the needs of a growing economy. Significant improvements are constrained by inadequate financial resources. Investment shortfalls also limit the development of full hydropower potential which, according to current estimates, is around 2,000 megawatts. About 25% of this potential has already been developed and another 25% will be added by the Accelerated Mahaweli Program (AMP) within the next few years. To accommodate this added capacity, the electrical transmission network needs to be upgraded and strengthened. The AMP hydropower additions will meet the country's needs only until about 1990 and the feasibility of a coal-fired electricity generation plant is being investigated.

Sri Lanka is also a leading tourist center in the east. Economically, the tourist industry had been the fourth leading source of foreign exchange until 1983 when it fell to sixth place. The industry provides approximately 60,000 jobs. Until the recent communal disturbances, the average annual growth rate of tourist receipts was about 31%. Tourist arrivals in 1984 were down 6% when compared to 1983 and down 22% when compared to 1982. The government is making concerted efforts to reverse this trend, but these efforts are proving difficult due to continued ethnic problems as well as air routing changes made by Air Lanka.

One of Sri Lanka's pricipal resources is its highly literate adult population which offers Sri Lanka a tremendous economic advantage over almost all other nations in the same per capita income group. Compared with other developing countries, Sri Lanka does not have a serious skilled labor shortage, although the exodus of trained employees following the July 1983 ethnic disturbances is beginning to result in shortages in certain managerial and technical fields. The country's main development priority is to create jobs to employ its people productively. Due to the persistent unemployment levels of around 15%, the government does not place restrictions on any technical or skilled labor leaving for employment abroad. About 200,000 Sri Lankans are currently working abroad and earning valuable foreign exchange. These remittances are the second major source of foreign exchange receipts behind tea. Workers are concentrated in the Middle East with approximately half working as housemaids.

B. CURRENT ECONOMIC SITUATION

1. Background

Economic policy in Sri Lanka shifted radically in 1977 when the newly elected government initiated an export-led, growth-oriented, open economic development strategy in contrast to the inward looking policies pursued by the socialist government during the 1970-77 period. Major reforms were trade liberalization, unification of the exchange rate together with the introduction of a flexible exchange rate policy, interest rate reforms, producer incentives and a greater role for the private sector.

While these policies were meant to open up the economy, which during the

1970-77 period remained near stagnation, the government took further steps to stimulate the economy by concentrating on three lead projects: (a) the Accelarated Mahaweli Program to bring 350,000 hectares under irrigated agriculture and to develop hydropower potential; (b) the Free Trade Zone (FTZ) to attract foreign investments and promote export diversification and employment; and (c) the housing and urban development program to provide improved housing facilities, particularly to low income households, while providing employment and stimulating the construction sector.

While the strategy of the government was to increase the role of market mechanisms and free trade, it retained for itself the primary responsibility for promoting growth and employment through massive public sector investment programs. The government embarked on capital-intensive infrastructure projects which had long gestation periods. The private sector and foreign investors were expected to engage in quick-yielding, surplus-generating agricultural, industrial and commercial activities by taking advantage of incentives provided by the government. The public sector share of national investment thus increased from 50% during the 1970-77 period to 60% in the 1978-83 period.

GDP growth averaged 6.8% during the 1978-80 period and a little over 5% during the 1981-84 period. Over the seven year period between 1978-84, the GDP growth averaged 5.9% compared with the 2.9% average growth rate during the 1971-77 period. A growth rate of over 5% is projected for 1985.

The relatively higher GDP growth rate during the 1978-80 period was primarily due to the economy responding positively to trade and economic liberalization and to the growth stimulus generated by increased public spending. Central Bank figures show that in terms of sectoral performance, about 75% of the GDP growth during the early phase of liberalization occured in

TABLE I

KEY ECONOMIC INDICATORS

	1978	1979	1980	1981	1982	1983	1984 a/
Real GDP Growth	8.2	6.3	5.8	5.8	5.1	4.9	5.5
Real GNP per capita	6.8	4.3	2.6	2.5	3.3	2.4	2.7
Implicit GNP deflater	7.5	15.8	18.2	20.6	10.2	16.1	15.0
Colombo Consumer Price Index	12.1	10.7	26.1	18.0	10.8	12.3	16.6
Budget Deficit as a % of GDP	17.7	17.7	26.1	18.7	21.9	19.4	13.0
Public Debt (net) as a % GDP	68.5	63.3	75.1	73.9	77.7	77.6	NA
Debt Service ration							
(i) Overall	15.5	12.4	11.2	14.4	15.3	17.8	17.0
(ii) Excluding IMF transactions	11.6	8.3	6.7	8.6	10.4	13.2	NA
Growth rate in money supply b/							
(i) Narrow Money (M1)	20.2	17.5	22.2	12.7	18.9	16.1	NA
(ii) Broad Money (M2)	34.4	31.7	27.5	30.7	29.3	16.9	NA
External Trade Deficit as a % GDP	5.9	14.6	26.2	19.7	22.2	18.2	9.0
Savings as a % GDP	15.3	13.8	11.2	11.7	11.8	13.8	NA
Investments as a % GDP	21.1	27.2	36.1	29.8	33.3	31.5	NA
Exchange rate	15.5	15.5	18.0	20.5	21.3	23.6	25.5

a/ USAID Projections (NA= not available)

b/ Annual Average growth rate

Note: All the figures shown in this table are computed from the Central Bank Annual Report. Due to definitional variations, the IMF and the World Bank figures on these indicators may be different from what is reported here.

trade, services and construction. The rapid increase in the demand for imported consumer goods after the long period of import restrictions was the major factor which caused a sharp rise in trading activities.

2. Factors in Recent Economic Performance:

The deceleration in real GDP growth in recent years has been largely due to (a) poor performance in some agricultural and manufacturing sub-sectors, (b) domestic financial resource constraints, (c) external trade deficits and balance of payments pressure, and (d) ethnic disturbances. As a result of the domestic financial resource constraints and balance of payments pressure, the GSL has recently followed development policies which are less expansionary and which have a greater focus on economic reforms and management policies.

a) Poor Performance in Agriculture and Manufacturing:

Apart from increased capital spending on irrigation related development projects such as the AMP and producer incentives in food related agriculture, there has been a limited focus on improved agricultural productivity. The plantation sector, which during the previous administration suffered from nationalization and lack of real investments, continued to be seriously neglected. In the manufacturing sector, the policy focus was primarily on the promotion of foreign investments in manufacturing for export markets.

Due to these policy shortcomings in these two leading sectors, both agriculture and manufacturing performed poorly and contributed considerably less than their share of GSP composition. Between 1978 and 1983, the combined contribution of agriculture and manufacturing to GDP growth averaged only 27% (agriculture 20%, manufacturing 7%), compared with their joint share of 39%

(agriculture 25%, manufacturing 14%) in the GDP sectoral compositions. Given this performance, a slowdown in the GDP growth had to be anticipated when the initial dynamism of economic liberalization on trade and services slowed down.

For several consecutive years, the Sri Lankan economy experienced adverse weather conditions. In 1981, 1982 and early 1983, a prolonged drought caused serious losses in food production and lowered the production of the tea, rubber and coconut export crops. Moreover, the drought also resulted in substantial shortfalls in hydropower supply, disrupting most factories and industrial plants. In addition, both producers and consumers were required to pay higher energy costs due to the use of thermal power to cope with the hydropower shortfall.

Between December 1983 and April 1984, the country experienced unprecedented rainfall. Rice and subsidiary crops suffered heavy production losses. However, both tea and coconuts recovered under continuous rainy conditions and hydropower generation improved to its full installed capacity.

b) Domestic Financial Resource Constraints:

A major limitation that the government had to overcome in pursuing a growth-oriented development strategy was inadequate financial resources. Due to factors such as a poorly diversified economic base, low per capita incomes and an increasing share of households with low incomes, domestic savings were inadequate to meet investment requirements necessitated by the ambitious development programs started after 1977. In some years, domestic revenue sources were not even sufficient to support the recurrent expenditures of the annual budget.

The investment program of the government after 1977 therefore led to a disproportionate growth in public investments, relative to its ability to mobilize domestic savings and caused a growing imbalance between investments and savings. This imbalance can be clearly seen from the increase in public investments as a ratio to GDP, from 12.0% in 1978 to 18.5% in 1980 while public sector savings as a ratio to GDP remained negative and declining from -1.9% in 1978 to -6.6% in 1980. Despite the substantial external support of grants and concessionary loans extended to the government, considerable unfinanced budgetary gaps still remained. This required domestic borrowings particularly from the banking system. Moreover, the situation was further exacerbated by the 1979 oil price rise and the subsequent world economic recession.

Clearly, the economy cannot cope with these developments on a sustained basis over the long run. According to the IMF, the combination of these factors led to an overheated economy with sharply increasing money supply and inflationary tendencies. While the money supply (M2) increase averaged 31% between 1978 and 1981, inflation ranged between 12% to 26% over the same period. Following these developments, the IMF began to exert strong pressures on the government to introduce measures for monetary and fiscal management. Accordingly, development policies since 1980 have been less expansionary.

c) Balance of Payments:

Another major reason for the slowdown in growth performance emerged from the growing external trade deficits followed by the sharp deterioration of the balance of payments position. Following the trade liberalization and expansionary development policies pursued by the government, the current account deficit of the balance of payments grew, resulting from sharp increases in both volume and value of imports without a corresponding increase in exports.

The doubling of oil prices in 1979 and the protectionist policies adopted by advanced countries since 1979 further intensified the economic difficulties. The terms of trade turned highly unfavourable and declined progressively from 100 in 1978 to 58 in 1980 and to 44 in 1983. As a result, the outflow of foreign exchange since 1978 has increased sharply. From only Rs 1.9 billion in 1978, the external trade deficit increased by massive proportions to Rs 16.3 billion in 1980 and to Rs 20.4 billion in 1983.

Given the increasing magnitude of external payment problems, the government was compelled to depend on short-term borrowings, suppliers credit and foreign exchange reserves as supplementary balance of payments support in addition to external borrowings and grants extended by the donor community. These developments in turn led to a steady build up of foreign debt and a dangerously low position of external assets barely sufficient to meet one month's imports. Despite economic reforms introduced after 1981, the external debt continued to increase to Rs 50.6 billion by mid 1984. However, net external assets and short-term liabilities improved by the third quarter of 1984 due to the overall improvement in the balance of payments resulting principally from higher export earnings from tea.

g) Ethnic Disturbances:

Since 1956, Sri Lanka has been confronted with worsening ethnic problems. Beginning in the mid 1970's, militants among the Tamil minority have sought a separate state in the north and east where Tamils are heavily concentrated. According to the latest census (1981), Sri Lanka's ethnic composition consists of 74.0% Sinhalese, 12.6% Sri Lankan Tamils, 5.5% Indian Tamils, 7.1% Muslims and 0.8% other ethnic communities. Of the 24 administrative districts, Sinhalese are the dominant population in 16 districts; Sri Lankan Tamils

dominate in 6 districts and Indian Tamils in one (plantation) district.

In July 1983, ethnic violence, on a scale not before witnessed in Sri Lanka, broke out between Sinhalese and Tamils resulting in heavy casualities and substantial damage to a number of factories and business concerns owned or operated by Tamils. The Central Bank survey of the damage in the industrial sector revealed that 122 industrial establishments were affected and 13,366 jobs were lost. The estimated cost for rehabilitation of affected industries alone will be around Rs 1,760 million in 1983 prices. Apart from reduced domestic production, lower export earnings, and loss of employment, the disturbances severely tarnished Sri Lanka's image abroad, discouraging both foreign investment and tourism.

While the economy appears to have recovered well from the July 1983 disturbances, increased terrorist activity in late 1984 and ever increasing allocations of resources to the security problem, lead to an increasingly pessimistic outlook vis-a-vis rapid economic development. Development projects in the northern part of the country have been suspended, the Ministries of Plan Implementation, Transport and Education have been tasked with heavy security burdens, vessels from the Ministry of Fisheries have been turned over to the Navy, curfews are in effect daily in the north and east and defense expenditures are rising. The polarization of the Tamil and Sinhalese communities is becoming more pronounced and will make future progress all the more difficult.

At the time of this writing, the prospects for a political settlement look remote. The proposals put to the All Party Conference in December 1984 were not satisfactory to either the Tamil or Sinhalese communities. While the immediate effect on GDP growth may be relatively minor (due largely to the fact

that problems at present are limited to the northern and eastern areas which contribute only a minor share of GDP), the picture could change dramatically in the future if violence were to spread to, for example, the tea estate areas. Probably the most significant effects of the continued security operations will be (1) diversion of resources to defense, (2) diversion of the attention of government from development to security related matters, (3) the continued emigration of trained personnel, both Sinhalese and Tamil and (4) a slow down in both local and foreign investment.

3. Highlights of Economic Reforms:

In 1981 the government imposed public spending cuts on the capital expenditure component of that year's budget, and increases in subsequent budgets have remained fairly moderate. The government has endeavoured to discourage new development proposals while focusing on the successful completion of ongoing projects. These capital spending restraints have been followed by restrictions on bank lending to the private sector with the exception of credit facilities for agricultural and industrial development and export financing. Other reforms have included (1) several increases in indirect taxes since 1980, (2) the removal of many consumer subsidies, (3) decreasing the real value of the Food Stamp Scheme and (4) rupee depreciation. The purpose of rupee depreciation was to contain the pressure on the balance of payments by reducing the demand for imports and promoting more exports. Since early 1980 the rupee had undergone periodic depreciation and in 1983 it was subject to two official devaluations. The current exchange rate ($1=Rs.26.5) indicates a 40% depreciation when compared with the exchange rate of Rs 15.50 to U.S. $1 in 1977. However, the effects of devaluation have been partially offset by the sharp rise of the U.S. dollar which has put the rupee at a greater disadvantage vis-a-vis the currencies of some of Sri Lanka's major

trading partners.

These measures produced encouraging developments on fiscal, monetary and balance of payment variables. The budget deficit moderated in 1983 to about 19% of the GDP compared with 26% in 1980, and in 1984 and 1985 the ratio is estimated to be 13% and 14%, respectively. Dependency on the banking system as a source of deficit financing was eliminated in 1985 budget proposals.

The external trade deficit improved appreciably in 1983 due principally to reduction of the volume of imports rather than improved export earnings. The 1984 balance of payments is expected to be in favor of Sri Lanka with a possible addition of $300 million to its external assets due largely to higher tea earnings. This improvement to a great extent has masked the necessity for additional economic reforms at the present time. At the time of the IMF negotiations in early 1983, the IMF recommended additional measures, including a 10-15% devaluation of the rupee against the U.S. dollar. However, because of the improved export earnings following on higher international tea prices, the government did not readily respond to the IMF recommendations. Of the SDR 100 million stand by agreement negotiated at the time, the government utilized only SDR 50 million before the agreement expired in June 1984.

4. Medium Term Outlook:

a) Investment Program:

The projected GDP growth rate during the medium term, as stated in the current Public Investment Plan (PIP, 1984-88), in 5.5%. In order to reach this growth target the Government of Sri Lanka (GSL) proposes a Rs 203 billion investment program (Rs 107 billion public and Rs 96 billion private) during the

1984-86 period. As the budgetary expenditures of the GSL continue to be supplemented by external sources, the level of foreign assistance will be a major determinant of actual public investments in the ensuing years. The World Bank projects the level of gross external assistance to increase from the current level of $540 million to about $800 million by 1990. However, this projected assistance would be subject to the GSL's continued focus on economic reforms which contribute to economic viability and, particularly, price stability. For the purpose of attaining economic stability during the medium term, the IMF has recommended that by 1987 capital spending be reduced to 10% and the budget deficit to 9% of GDP respectively and government revenue to increase to 25%, compared with the ratios of 19%, 19%, and 22%, respectively in 1983.

Although the government is conscious of the necessity to implement the stabilization package proposed by the IMF, the ability to fully commit on such reforms is constrained by a preoccupation with political factors and the continuing ethnic tensions. If terrorist activities persist over the medium term, the government will have to divert more resources for security operations. This tendency has already been demonstrated in the latest budget proposals (1985) where defence expenditure accounts for 5.7% of the total expenditures compared to about 3% in 1984. Such developments are likely to result in slower growth.

c) Balance of Payments:

A dramatic change in the short run balance of payments outlook emerged with the sharp upturn of international tea prices since late 1983. In 1984, tea prices registered an average increase of 45% in rupee terms and this, together with a 12% increase in the volume of tea exports, resulted in a 75%

increase in the rupee value of exports, compared with 1983. Assuming reasonable weather in Sri Lanka as well as the expectation that private remittance flows will stabilize, the current account deficit is expected to improve in the short run.

Tea analysts consider the developments in the international tea market to be more than a temporary or short run phenomenon. Colombo Tea brokers expect the short supply situation in world tea markets, which has been building up since 1982, to continue for a couple of years due largely to a 2.5 to 3% per annum growth in demand in traditional tea importing countries as well as substantial domestic demand growth in tea exporting countries, principally India. On the other hand, a change in India's tea export policy or the entry of non-traditional countries into the tea export market or a combination of both could result in a less promising balance of payment outlook in the medium term. In that event, as the World Bank notes, export volume growth in traditional as well as non-traditional goods will have to compensate for both an already substantial deficit plus possible future deterioration in the terms of trade beyond 1985, if the external deficit is to remain manageable. The country's exports at present only support slightly more than 55% of its annual import requirements due largely to the imbalance in the structure of external trade. Sri Lanka's agricultural products, which currently account for 60% of the total value of exports, are both demand and price inelastic. Even if international prices go up, there will not be a ready response from the supply side due to physical constraints. In fact, until 1984 the volume of exports had been continuously declining. In addition, Sri Lanka is a price taker for both its imports and exports.

TABLE III

MEDIUM TERM BALANCE OF PAYMENTS OUTLOOK

(Million of U.S. $ at Current Prices)

	1984	1985	1986	1990
Trade & Service Balance	- 617	- 723	- 742	- 1,037
Net Factor Income	- 168	- 151	- 163	- 262
(Interest on Foreign Debt)	(- 88)	(- 99)	(- 113)	(- 209)
Transfers	282	305	334	481
Current Balance	- 503	- 569	- 571	- 818
Debt Amortization	- 127	- 151	- 188	- 284
Resource Gap	- 630	- 720	- 759	- 1,102
Financing:				
Grants	166	160	176	258
Direct Investment	50	55	60	89
Loan Disbursement a/	524	555	573	805
Reserves (- = increase)	- 110	- 50	- 50	- 50
Debt Service Ration	16.8	18.2	19.6	16.7

a/ Includes concessionary loans, commercial loans and IMF credit.

Source: World Bank

Examining the medium-term outlook, particularly from the balance of payments perspective, Sri Lanka's major development constraints are likely to emerge from its external debt situation. As of end 1983, Sri Lanka's total external debt stood at $2,672 million, and it was composed of (1) government and government guaranteed debt $1,620.6 million; (2) International Monetary Fund credit, $333.0 million; (3) short-term borrowings by the public sector, $115.9 million; and (4) commercial borrowings by public sector corporations and the private sector, $604.9 million. Between 1979 and 1983, the total outstanding external debt more than doubled, reflecting excessive dependency on foreign borrowings.

World Bank estimates show the external debt servicing requirement (amortization and interest payments) more than doubling from 1984 to 1990 and absorbing almost the entire annual concessionary loans expected during the same period. To avoid adverse developments arising from increasing external commitments, efforts must be made to diversify the export base and to give priority to quick-yielding, export-oriented projects. In addition, the government will need to renew its efforts to mobilize the private sector.

C. STRUCTURAL PROBLEMS

1. Poverty:

Poverty continues to be a leading socio-economic issue of the Sri Lankan economy, reflecting both low per capita incomes and unequal income and wealth distribution. A comprehensive explanation of poverty requires the consideration of a variety of complex factors but includes as primary causes: (1) relatively high unemployment and underemployment levels, (2) the inability of the agricultural sector to support an increasing population and (3) unequal

income and wealth distribution.

As a subsequent section shows, Sri Lanka's unemployment and underemployment levels are relatively high, denying adequate regular income to a large segment of the population, with poverty most extreme among the occupational categories where underemployment is prevalent. Both landlessness in the agricultural sector and uneconomical agricultural land holdings are important causes of poverty. Households belonging to this category are the most vulnerable to extreme poverty, particularly in the rural sector. About 9% of the farmers in the paddy sector and 12% in the subsidiary food crop sector live in extreme poverty either due to no land or uneconomical land holdings.

TABLE IV

INCOME DISTRIBUTION

Ranked Income	Percentage of Income Received			
	1963	1973	1978/79	1981/82
Lowest 20%	3.87	4.97	3.76	3.70
Second 20%	8.13	10.08	8.36	8.05
Third 20%	12.37	15.85	13.27	12.50
Fourth 20%	20.44	23.21	20.35	19.20
Highest 20%	55.25	45.89	54.31	56.52
Gini Coefficient	0.49	0.41	0.49	0.52

Source: Report on Consumer Finances and Socio-Economic Survey 1981/82 - Central Bank of Ceylon

After a significant improvement in income distribution between 1963 and

1973, the lowest 80% experienced a drop in their respective income shares between 1973 and 1981/82 while the income share of the upper 20% appreciably gained. These developments are clearly reflected in the Gini Coefficient which reflects the degree of income inequality. Between 1963 and 1973, the Gini ratio declined from 0.49 to 0.41, implying improvement in income distribution, but between 1973 and 1981/82, this trend reversed itself showing signs of increasing inequality. In terms of sectoral classification, both urban and rural sectors follow the national trends in income distribution, but in the estate sector income distribution has been becoming more equal.

The Central Bank analysis of trends in income distribution identifies a relationship between trends in income distribution and changes in economic policies and inter-temporal growth trends. During the 1963-73 period, the economy grew slowly. However, because of the provision of subsidies on consumer goods such as food (rice, flour, sugar, pulses, milk and milk powder), bus fares, petroleum products and rents, aimed at improving the living standards of low income groups, the inequality in income distribution narrowed. Under the development oriented strategy pursued after 1977, the priority has been on development and growth requiring the removal of many forms of subsidies in order to transfer resources from consumption to investment.

Recent studies carried out to assess the nutritional status of the Sri Lankan population and develop strategies to improve upon nutritional standards, clearly show indications of a growing poverty situation. The most startling discovery is that even after spending more than 70% of household income on food-related expenditure in 1980/81, (compared with 52% in 1969/70), a larger proportion of households still failed to meet the necessary calorie requirements. About 50% of urban households, 43% of rural households and 33% of estate sector households in the 1980/81 period failed to achieve minimum

caloric (2,161) requirements. A comparison of respective shares between the two time periods show that households with nutritional inadequacy increased by 66% in the urban sector, 34% in the rural sector and 65% in the estate sector. In 1980/81, food accounted for 74% of total expenditures for the entire population. Low wages prevailing in the estate sector during the 1970's help explain the deterioration in nutritional status in this sector. In the rural sector, low per capita calorie intake is closely correlated with small size of land holdings.

As stated by the Minister of Finance & Planning during his 1985 budget speech, the government is becoming increasingly concerned with the deterioration of nutritional standards of the low income groups. The most appropriate strategy at the present time is a revision of the food stamp scheme by increasing the value of the stamps while limiting the assistance to the most needy. It is estimated that 30% of the population, rather than the current 50%, should be receiving the stamps. The real value of the stamps has declined by 50% since 1979. Another proposed policy is to dispose of the possible rice surplus to food stamp recipients. While these strategies are currently being considered by the GSL, the likelihood of any quick change in the food stamp program is hampered by the political ramifications of eliminating any current recipients.

Although important means of preventing further deterioration of nutritional standards, these measures will not help to sustain adequate nutritional status over the long run. That can only occur through reduced unemployment and underemployment or simply improved household incomes. Such objectives will require that policy makers pay greater attention to programs and policies with the highest potentials for employment generation and where low income and nutritionally at risk groups become direct beneficiaries of the

development process. There are several districts where the households are at high nutritional risk and development strategies particularly aimed at these target groups could prove very effective both at regional and national levels.

2. Employment

Sri Lanka's labour force consists of about 5.6 million people or about 37% of its total population. Current estimates show 4.8 million employed. Employment in the public sector is currently estimated at 1.3 million, 37% of which are government employees. The balance is in the public sector corporations and state owned plantations. Estimates indicate formal employment in the private sector to be around 850,000 accounting for 18% of the total employed, with nearly half of this figure in manufacturing related employment. The latter includes about 30,000 in free trade zone employment. The balance, about 425,000, in the formal private sector is in construction, trade, transport and services. This accounting leaves employment in the informal sector at about around 2.7 million including farm employment.

Despite major improvements, the high level of unemployment is still a vital issue facing the Sri Lankan economy. It is estimated by the Central Bank that the unemployment rate fell from nearly 25% in 1977, to about 15% in 1978/79 and to about 12% in 1981/82. In the urban sector, the rate of unemployment in 1981/82 was around 14%, rural 12% and estate 5%. However, these estimates are not very reliable and are often manipulated for political advantage.

A significant improvement in the employment situation was evidently clear during the first few years after economic liberalization due to an opening up

of employment in retail and wholesale trade, services, construction, manufacturing and tourism. Additionally, the government's three lead projects created direct employment on a substantial scale while having equally significant indirect employment effects. However, the situation appears to have changed since the early 1980s. The Central Bank's estimate for example, shows that compared with an estimated creation of 35,000 new jobs per year between 1978 and 1980, the employment generation capacity in the private sector has now declined to about 20,000 per annum. In the public sector, in both 1981 and 1982 there were only 3,000 new jobs per year compared with 8,300 jobs per year between 1978 and 1980.

With about 150,000 new job seekers entering the market every year, there is growing concern about the adequacy of the current level of employment generation. If the employment generation capacity is not stepped up considerably, the country is likely to experience a large scale increase in unemployment in the short run continuing as well through the medium term. According to some observers, unemployment was an important underlying element of the 1983 communal violence.

Underemployment is another problem which persists in the Sri Lankan economy. This problem is particularly significant in the informal sector where nearly 55% of the currently employed labor force find their main source of livelihood. The proportion of underemployment is largest in agriculture, animal husbandry and trade and services. According to the Central Bank, in the agricultural sector, only about 40% of the workforce work for more than 100 days per year. The situation is even more significant with regard to the female population as the Central Bank survey includes 2.6 million female workers in a category of "own house work". Given increasing female school

attendence, only a small proportion would be truly confined to this category, if they could find alternative employment. The main conclusion of this information is that underemployment is fairly widespread in the rural agricultural sector, despite a relatively low reported unemployment rate in the same sector. This high underemployment rate is another major factor relevant in the explanation of poverty and malnutrition.

3. Agriculture:

Agriculture is Sri Lanka's major economic activity. It accounts for about 25% of GDP, between 50% to 60% of total export earnings, 40% government revenue and 55% of employment. The agricultural sector has two distinct categories: (a) rice and subsidiary food crops and (b) plantation agriculture: tea, rubber and coconuts, grown mainly for export. As a share of agricultural GDP, plantations account for 32%, rice for 27% and all others for 41%. Rice accounts for about 1.7 million acres of the total 3.85 million acres under cultivation, followed by coconut with about 1.0 million acres, tea with about 530,000 acres and rubber 430,000 acres. Rice lands are often planted in other agricultural crops, particularly in the dry zone, during the minor rainy season, when irrigation water is inadequate for rice cultivation. The coconut and rubber lands are also inter-cropped with coffee, cocoa, cinnamon, spices, fruits and vegetables. Most of the employment in agriculture is related to rice — over a million cultivators — but the nature of employment is seasonal. A substantial proportion of permanent agricultural employment is related to tea and rubber (550,000 jobs) and coconuts (27,000 jobs).

Between 1980 and 1983, the annual growth in agriculture has been about 4.7%, much higher than the average annual growth of 3% during the seventies. Rice production grew by an annual average rate of 8.2% between 1977 and 1983,

largely due to more effective pricing and incentive policies as well as the effected research, extension and seed supply program resulting in a 7.9% average annual increase in per acre yields. The main elements of this performance have been the widespread adoption of improved seed (90% of the acreage in 1983 compared with 60% in 1977) and cultural practices combined with improved delivery of inputs and free market pricing policies. Sri Lanka required no rice imports in 1984. In 1977 rice accounted for 15% of the total value of imports.

The area planted under coarse grains, pulses, spices and oil seeds has on the whole increased steadily with a corresponding increase in production. However, due to the continued use of traditional agricultural practices, unstable and inefficient markets, and lack of producer incentives, per acre yields have shown no significant improvements. While the production of coffee, cloves and cashews appears to have increased, other export crops — cinnamon, seasame and cardamom — suffered setbacks.

a) Plantation Agriculture

Since 1979, tea and rubber production have fallen while coconut production has stagnated. As demonstrated by a negative growth rate of 3.3% in value added, the production loss in tea was pronounced. Lower tea production in turn, produced adverse developments in agro-processing, agricultural marketing, government revenue and export earnings. Fortunately, tea production turned around in 1984 increasing by 16% over 1983.

Most of the problems in the plantation sector result from the nationalization policies of the previous administrations. From entirely private ownership before 1971, the public sector now owns about 70% of tea, 30%

of rubber and 2% of coconuts. The balance in each is accounted for by small private holdings of less than 50 acres. With this shift from private to public ownership, the production performance, management efficiency and crop maintenance in the plantation sector rapidly deteriorated. The skilled and experienced managerial cadre was replaced with people selected on the basis of political affiliation. The most serious production problem caused by nationalization was the substantial shortfall in replanting of tea and rubber.

The problems in the plantation sector were intensified since the latter half of the 1970s, due to lack of investments in infrastructure (such as factories, machinery and buildings), high taxes, increasing production costs and low international prices. Between 1978 and 1983, the plantation sector directly contributed Rs 21 billion to government revenue, but it received only Rs 1.5 billion in return from the GSL capital budget during the same period. Plantation revenues have been used by all Sri Lankan governments to support social programs. A five year investment plan of Rs 5 billion for the plantation sector has now been finalized by the government with World Bank assistance, and particular attention is being given to the tea sector.

b) Domestic Agriculture

The large size of the agriculturally dependent population relative to the land resources available in this sector has led to relatively small land holdings, increased fragmentation and a growing problem of landlessness. According to a recent survey, 82% of the land area in the paddy sector and 96% of the number of holdings consisted of units of less than 10 acres (66% are less than two acres). This difference in proportions between the number of holdings and the area of holdings implies a serious land fragmentation problem. While farms smaller than two acres accounted for 14% of the total paddy area,

they accounted for 39% of total land holdings.

Marketing problems also have considerable implications for agricultural development. They appear to be more serious in the subsidiary field crop (SFC) sector than in rice due to the limited market and widely scattered, small-scale production. There is a serious lack of knowledge regarding the structure and dynamics of the SFC market, which hinders effective planning. Market information is improving, but still not adequate for reliable market projections. The institutional mechanisms for carrying out market research and analysis are largely absent in the country though the technical capabilities exist.

Agricultural marketing is also constrained by poor quality standards and inadequate incentives (except for rice). In addition to improved varieties, the need for better quality standards through improved methods of handling, storage and processing is paramount, since the search is on for potential export markets. Inadequate market facilities (e.g. transport, storage) also result in significant losses, especially for the more perishable products.

Credit availability is another serious problem that confronts the agriculture sector. It has grave implications for production and household incomes of the agricultural population. Institutional credit currently accounts for only 25% of total rural credit. To a great extent this phenomenon has its roots in high default rates associated with past subsidized rural credit schemes. State banks, therefore, have largely withdrawn from credit facilities in domestic agriculture. In 1983, for example, the level of bank lending for paddy production by the two state banks declined 47% compared to 1978. The banking community considers rural lending an activity of great risks and an area where advances are not well secured. Among other factors, strict

collateral and administrative procedures limit bank lending. With declining credit facilities from the formal banking system, farmers are compelled to secure advances from private sources at much higher interest rates.

4. Industrial Development:

The industrial sector's share in the GDP is around 14%. It accounts for 12% of formal employment and about 35% of export earnings. The latter excludes the value of semi-processed plantation products. Export processing industries, including the Free Trade Zone (FTZ), account for 25% of industrial output; factory industries, including the processing industries in the plantation sector, account for 60%; the remaining 15% is attributed to small scale industries. On the basis of value of production, the public sector accounts for 52% and the private sector 48%. However, the production of one state corporation, petroleum, accounts for a large percentage of overall production. Excluding petroleum products, production shares for the public and private sectors are 38% and 62%, respectively.

Industrial GDP grew only 3% a year between 1978 and 1983, despite an environment more conducive to industrial promotion since 1977. Slow growth performance in the public sector industries has been a significant factor in the overall slow growth of the manufacturing sector. In real terms, the value of public sector industrial production declined by 9% since 1977 in contrast to an increase of 68% in the private sector. The private sector accounts for a leading share of production in both food, beverages and tobacco (70%) and textile, weaving apparel and leather products (80%). In chemicals, petroleum, coal, rubber and plastic products, the private sector accounts for 15% of production but the exclusion of petroleum and tire manufacturing increases the

private sector share to about 80%.

Sri Lanka's most successful industrial export has been garments, which have grown at an annual rate of 44% between 1979 and 1984, and which now account for 19% of total exports. Despite trade restrictions in the west, including a recent 2.79% countervailing duty imposed by the U.S., exports in 1984 grew 41%.

FTZ production accounts for nearly 20% of the value of industrial production of the private sector. At the end of 1983, there were 66 factories in commercial production employing 29,000 workers and representing a total equity investment of about U.S. $80 million at current exchange rates. Gross export earnings amounted to $90 million in 1983, and the value of export earnings in current prices is expected to grow by 20% (annually) during the next few years.

The industrial sector continues to depend heavily on imported raw materials, and in some industries the import content is almost 100%. On average, the industrial sector as a whole imports between 75% to 80% of its total raw materials, largely due to the absence of domestically available industrial raw materials.

The second major structural problem in industry relates to energy constraints as well as high energy costs. Since hydropower is the main source of energy, the frequent interruptions in 1981-83 due to droughts exerted serious strain on industrial production, especially for small and medium scale industries which depend almost exclusively on hydropower. Moreover, hydropower shortages also contributed to the increased use of thermal power generation, which during the 1981-83 period grew by 54% compared with an

increase of only 10% in hydropower. The increased use of thermal power also resulted in high energy costs in industry.

As the hydropower projects of the AMP are now beginning to generate power, the power situation is expected to improve vastly over the medium term. The Victoria project has already been commissioned and Kotmale and Randenigala are scheduled to be completed in 1985 and 1986 respectively. These three projects will have the installed capacity of about 466 MW (Victoria 210 MW, Kotmale 134 MW, Randenigala 122 MW) which will enable the doubling of hydropower supply. According to current forecasts this added hydropower generation capacity of the AMP will be adequate to meet the increasing power demand unti the mid 1990's without the excessive use of thermal power.

The continued poor performance of public sector industries is a burden to the national economy and also creates structural imbalances in the overall economy. In a number of cases, budgetary support is necessary for operation and maintenance. In other cases, the investment focus is primarily on fixed capital assets such as land and buildings rather than focusing on improvements in production as well as operation and management. Consequently, while overall production in the public sector industries is declining, the capital labor ratio is appreciably increasing. If Sri Lankan policy makers are serious about industrial development, efforts must be made to eliminate such imbalances. The adoption of the recommendations of the tariff reform commission in November 1984, and changes in the Ministry of Industries are positive signs that the government is addressing these issues.

5. The Private Sector

The private sector will continue to play a crucial role in the achievement of GSL development objectives. Indeed, Sri Lanka's long-term economic growth will depend heavily on the ability and the willingness of the private sector to expand and develop the productive sectors of the economy, particularly via investments in labor-intensive, resource-based and export-oriented enterprises which add maximum value to local production.

The GSL explicitly recognizes the role which the private sector will have to play in accomplishing its overall economic objectives. With regard to investment levels, the Public Investment Program for 1984-1986 calls for the private sector to contribute 47% of total investment during the period, entailing a large increase in real terms and a substantial increase in percentage terms vis-a-vis public sector investment. Similarly, in setting export expansion targets, the national Export Development Plan issued in 1984 calls for an 11% average annual increase in real value of exports if a positive trend in the balance of trade is to be achieved. However, the targets set for both investment and exports have yet to be translated into sector-specific strategies clearly demarcating the desired role of the private sector, particularly in comparison with existing or future state-owned enterprises.

Several recent studies by USAID, UNDP, and the World Bank have addressed the advantages to be gained through various privatization moves, ranging from outright divestiture to rationalization of state corporations on a truly equal competitive footing with the private sector. To date there has been verbal commitment to act on recommendations made in these studies, and a special

GSL-appointed Committee on Public Enterprises (COPE) has been established to guide the government's decisions. As a start, the Ministry of Finance and Planning is insisting on greater accountability by the state corporations for the management of assets at their disposal and proposes to end reliance on government funds to cover operating losses.

In this environment it is essential that the government decide upon and implement an overall privatization plan that sets the terms for continued operation of the state-owned enterprises and the advantages (ideally none) which they are to have in competing with the private sector. At a minimum, the private sector community must be convinced that vested interests committed to protecting the state's role per se will be contained, that new state enterprises are unlikely to start up, and that a future wave of nationalizations will not occur. The signal to the private sector, however, will be strongest if the government joins with the private sector to spell out very specific sector-by-subsector industrial development plans, indicating the roles for both the private and the public sectors. There is some movement now toward the formulation of such industrial sector plans. The USAID supported Sri Lanka Business Development Centre established in 1984 may assume a leading private sector coordination role in such a process, and privatization moves are a major focus of the SLBDC's business policy unit.

D. DEVELOPMENT PLANNING AND FINANCING

Sri Lanka's development planning is contained in its rolling five year public investment plan. The current 1984-88 plan envisages a slowing of capital expenditure and a reorientation of new expenditures towards directly productive areas and the maintenance of existing assets. Total budgetary

allocations for the 1984-88 program amount to Rs 99 billion at 1984 prices, compared to Rs 111 billion at 1983 prices for the 1983-87 plan. Approximately 40% of the plan is expected to be financed by foreign aid.

According to the plan, the government's first priority will be operations and maintenance. Rehabilitation and maintenance has become a line item in the capital budget for the first time amounting to 7% in 1985. The investment plan also stresses that the government will not undertake activities which could be more efficiently handled by the private sector. Public investment over the next five years will concentrate on projects which will strengthen the balance of payments (i.e., quick-yielding production-oriented projects) and meet the country's essential infrastructure needs. In line with these priorities the GSL has decided that one of its major programs will be rehabilitation of the plantations. Agriculture remains the dominant sector although investments decline throughout the period. Mahaweli remains the single largest activity accounting for 21% of the total 1984-88 planned budget, followed by power at 9%, transport at 6%, airport and port expansion at 5%, plantations at 5% and field and minor crops at 4%.

The government has recognized that the burden of such large scale development activities cannot be sustained indefinitely. The 1985 budget revenues cover recurrent expenditures and provide approximately 25% of the financing for the capital budget. Donors have been generous to Sri Lanka in the past, and the expectation is that, barring major political change, this support will continue. While it had been expected that aid levels might fall after the July 1983 ethnic disturbances, levels in fact rose in 1984 to $ 541 million. Foreign assistance between 1980 and 1985 has averaged 10% of GDP.

E. CONCLUSIONS

The preceding analysis leads to a number of conclusions about Sri Lankan development which should provide guidance to the development of a strategy. The first is that Sri Lanka's bold entry to the world of open economics has met with mixed success. While real per capita GNP increased by approximately 3.5% per year since 1978, nutrition indicators have fallen, and the equity of income distribution has worsened. The safety net for the poor has weakened through the elimination of various subsidies and the lack of indexing of the food stamps. The rapid economic growth of the post-1977 period has not reached the majority of the poor.

Secondly, one of the country's major assets, political stability, is being severely threatened by the current unrest over the ethnic issues. The potential for severe social, political and economic disruption is high. Government's ability to focus attention on development is being overshadowed by defense and security concerns. The ability of the economy to create additional jobs (apart from recruiting for the security forces) has diminished, and the potential exists for future unrest to revolve around the rich/poor dichotomy in addition to the ethnic differences.

Third, the ability to translate the huge investment in Mahaweli into increased productive output will become more and more difficult as time goes on. The expected early arrival of rice self sufficiency leads to the question of what to grow on these new Mahaweli lands. Huge increases in rice production would disrupt the domestic rice market, yet neither the research and extension capacity nor the marketing system are available to guide and support crop diversification. Export of rice to cope with any surpluses is not likely given

the low quality of Sri Lankan rice and tough international competition. The continued security problems highlight the question of the ethnic balance in the Mahaweli settlement areas and will make the allocation of these lands an extremely sensitive political issue.

Fourth, the present improvement in the balance of payments picture rests largely on high tea prices. The underlying economic imbalances continue and government's ability to take the tough decisions necessary to deal with these issues is questionable. It is unlikely that the tourism sector will recover quickly. Should the security problem spread to the tea areas for any length of time, the economic foundation of the country would be threatened.

Fifth, ineffective management of resources is becoming recognized as a serious problem in Sri Lanka. The proliferation of ministries to deal with development or security issues, the lack of coordination among ministries, and the fragmentation of responsibility are major aspects of this problem.

Sixth, the GSL's record in promoting a more extensive role for private enterprise and rationalization of the large portfolio of public enterprises has been uneven. There remains a wide disparity between rhetoric and action.

III. STRATEGY

A. OVERVIEW

The foregoing analysis concludes that despite impressive PQLI figures, Sri Lanka remains a poor country as yet unready to graduate to middle income status. While growth rates have been substantial over this decade to date, Sri Lanka could have difficulty sustaining them. Unemployment has declined but not

enough. Food production has improved, but for Sri Lanka this may cause new concerns if rice, the primary food crop, becomes a surplus commodity with no export market. Nutrition levels have deteriorated among the at risk population despite improvements in food production. Ethnic tensions and the associated terrorist campaign are increasingly diverting attention and resources away from development issues. The favorable aspects of the macro-economic picture rest on tenuous factors that could change quickly to constrain further Sri Lanka's ability to deal with its development problems. Can Sri Lanka reach the growth rate targets set in the 1984-88 Plan (GDP increases of 5% annually)? Achievement will depend on improving the productivity of available resources.

The Strategy presented here is intended to contribute to Sri Lanka's ability to reach and maintain significant levels of real growth through enhancement and better utilization of available resources. The level of resources of such a strategy is largely dependent on choices to be made by the Government of Sri Lanka (GSL). In the current policy setting, opportunities specific for major initiatives are necessarily circumscribed. However, given GSL willingness to execute major policy reforms a larger, more comprehensive program would be appropriate. Still a third alternative — a contingency program — exists should ethnic tensions erupt to a scale which necessitates relief and rehabilitation or economic stabilization efforts.

Section II of this paper, the analysis, identified several key factors inhibiting Sri Lanka's development:

— A basic imbalance in the external accounts (currently masked by high tea prices) and an over dependence on a limited set of exports for which Sri Lanka is a price taker.

— Seriously declining productive capacity in the major (estate) agriculture sector.

— Concentration of non-estate agriculture in a single food crop (rice) which may soon be in surplus with limited export potential.

— Low productivity levels in non-estate agriculture other than rice.

— Slow growth in real per-capita GNP coupled with continuing disparity in income distribution.

— Already unacceptable high un- and underemployment figures likely to grow as job creation lags considerably behind labor force entrants.

— Deteriorating nutritional levels among the at-risk population.

— Ethnic tensions polarizing Sri Lankan communities, distracting resources and attention needed for development and threatening to erupt to a degree which could threaten the nations stability.

These are all problems recognized by the Sri Lankans. Coping will require assistance from the donor community, and donors have developed programs around one or more of these constraints.

The Mission in selecting this Strategy has identified those constraints which best match AID's experience and expertise. The Strategy is intent on maximizing the development impact of the USAID's recent experience in Sri Lanka. Thus, the strategy is designed to address those key development problems with which the Mission is best prepared to work by following through

on initiatives now underway. The active project portfolio includes 14 projects in agriculture research and education, reforestation, irrigation, health, community participation, development of the Mahaweli region, and private enterprise promotion. The attempt to improve the productivity of available resources is the common theme which links these efforts into a cohesive program to be built upon over the planning period.

People are a primary and abundant resource of Sri Lanka. Literacy rates are over 80%; health statistics show a better than average health status for a country at this stage of per capita income; 80% of the population is rural, and over half the labor force is employed in agriculture. Land is a primary but limited resource in Sri Lanka resulting in relatively small land holdings, increasing land fragmentation and "atomization" and a growing problem of landlessness. Therefore, the Strategy presented here is focussed on the productive relationship of land to people. Its principal objectives will be improving the productivity of the small farm, employing those without land or whose labor is not fully occupied on the farm, and completing the work begun in the Mahaweli (really a special focus of the first two objectives). These are objectives where AID has a "comparative advantage", and past AID efforts can be reinforced and extended to address urgent current needs.

The Strategy calls for the development of local institutional capacity, in both the public and private sectors, in order to make the development process self-sustaining. In addition, the Strategy includes activities designed to demonstrate alternative development approaches and technologies which can be continued or replicated with non-AID resources.

B. AGRICULTURAL PRODUCTIVITY & FARM INCOMES

Sri Lanka is still an overwhelmingly rural country. Over 80% of the population lives in the rural areas (including the estates) and over 50% depend on agriculture for their livelihood. Small farms predominate in non-estate agriculture where, for example, 66% of rice holdings are smaller than two and a half acres. Recent studies for the National Agriculture, Food and Nutrition Strategy show that poverty is most extreme in those areas where underemployment is most prevalent. Other studies indicate that underemployment is widespread in the rural, agricultural areas where, according to the Central Bank, only about 40% of the workforce is employed more than 100 days per year.

Rice remains the dominant crop in the small farm sector accounting for about three-fourths of the non-estate land under cultivation, but Sri Lanka may soon be self sufficient in rice. Improvements in agricultural productivity, therefore, should be directed at alternative crops and farming systems with special attention given to those that provide exports, employment and better nutrition.

The principal constraints to development of alternative farm systems are insufficient research and extension, poor planning and policies, limited management capability and inadequate marketing and distribution. The Strategy proposes to address these constraints in a time phased approach over the planning period, 1986-90. The Strategy, recognizing the private sector nature of the farmer, will seek private sector means of dealing with these constraints (particularly marketing and distribution) wherever possible.

1. Agricultural Research

In keeping with the emphasis placed on agricultural research in the Asia Regional Strategy, the Mission believes that the key to increasing small farm productivity will be found in technological innovation. Research is essential to such innovation. Sri Lanka has developed a successful research capability in rice, and the improved varieties resulting from that research have made an important contribution to achieving rice self-sufficiency. Little in the way of research has been undertaken for other crops or livestock. The Strategy proposes to assist Sri Lanka in developing an effective, self-sustaining institutional base to carry on diversified crop research. In agricultural research, Sri Lanka has achieved considerable success with respect to rice as attested by the rapidly increasing per acre yields. However, the research base to support the proposed diversification program needs considerable strengthening to develop technologies for the sustained, productive cultivation of upland, rainfed areas as well as for irrigated production of crops other than rice.

To encourage diversified crop research, the Mission will support the development of a coordinated research effort to develop and test diversified crop technologies and to provide the empirical base for concerned decision making. In addition, the Strategy calls for developing the managerial expertise to coordinate and administer adequate research programs and for providing training and special opportunities to further develop individual research talent. We will also encourage linkages with appropriate international research institutions and take advantage of centrally funded science and technology programs. Nutrition is expected to be a concern of research on diversified crops.

At a higher level, research effectiveness and potential is seriously constrained by the prevailing excessive institutional fragmentation, wherein ten distinct research programs and/or institutes are in operation in six different ministries. Such an arrangement seriously constrains opportunities in such key areas as agro-forestry, coconut intercropping, farming systems research, forage agronomy. Further, the costs of maintaining so many distinct programs are outdistancing available resources, with consequent stagnation or decline in standards.

Because of the fractionalized authority for agricultural activities in the GSL, the Mission will limit its involvement in research development primarily to those areas under the direct responsibility of the Ministry of Agricultural Development and Research (MADR): field crops, horticulture and minor export crops. If the GSL reduces the bureaucratic labyrinth of split responsibilities (a major point in our policy dialog), the research effort could be expanded to cover forage crops, livestock, forestry and small farmer holdings in the estate sector. In policy discussions the Mission will push for a coordinated research program which crosses organizational lines, such as coconut intercropping, which is not carried out at present because the crops involved are the responsibility of separate ministries. These "bureaucratic turf" problems represent lost opportunities to improve on agricultural productivity and extend to the macro-level when, for example, the lack of coordination prevents logical decisions on where Sri Lanka's comparative advantage exists relative to agricultural imports and exports.

Agricultural research goes hand in hand with an extension effort to deliver the technology to the small farmer. However, agricultural extension is now being addressed by the GSL with other donor assistance and no major AID

involvement is anticipated. Should the situation change, the Mission would consider additional work in this area.

2. Agriculture Policy and Planning

Recently, with AID support, the GSL has prepared a National Agricultural Food and Nutrition Strategy (NAFNS), and it is a good beginning. A sustainable, effective planning capability must have adequate research to back it up and must set priorities and policies which are adopted and implemented. Despite the NAFNS effort, planning throughout the GSL is still perceived as Project preparation often in response to donor initiatives. Priority is given to developing new ideas into projects rather than careful management of limited resources.

The Mission plans to build upon the NAFNS to foster institutionalization of the planning and policy formulation capacity within the relevant organizations. Since effective planning should be on a broadly based approach, the Mission will encourage and support better coordination between all six GSL ministries involved in agriculture. If the GSL were to foster better inter-ministerial communication and decision making regarding integrated agriculture systems, the Mission would be prepared to expand the scope of the planning assistance effort to provide a more multi-disciplinary approach.

The strategy envisions support for upgrading staff skills and facilities at the respective planning units. Technical assistance, training and support for activities to provide applied experience in planning and analysis, will be the primary means to upgrade staff skills; modest commodity support will upgrade facilities. In developing practical analytical experience, specific areas important to sustainable agricultural productivity will be examined.

These areas will include the role of energy in the entire farming system (e.g., animal-power versus a tractor, small-scale farm mechanization, farm fuelwood needs, optimum use of human labor, etc.), protection of the environment, farming to agribusiness links and how health affects productivity. Funding will also provide for including the private sector in special task forces to develop policy options in the development program.

Policy dialog, as discussed below, will be an intregal part of the Mission's efforts to improve agricultural planning and policy formulation to increase awareness and support for policy changes necessary to improve agricultural productivity. While the Mission's emphasis will be on the role of small farmers, skills developed under AID assistance should be relevant to planning in other agricultural sectors as well.

3. Agricultural Management

Since improving agricultural productivity will be dependent on the efficiency of the utilization of available resources, assistance efforts must be directed beyond the research and planning stages to the management and mechanisms of implementation. The WARNS cites the inability to design properly and manage the development of a responsive agricultural support service and a viable agricultural development program as major limitations to national development. Several factors contribute to low managerial skill levels in the public sector: low salaries, few incentives for better management and limited training opportunities. In addition, the public sector manager is often saddled with implementation of policy decisions made on a political basis rather than sound management. The emphasis is on meeting financial rather than programmatic targets — spending rather than returns. While some excellent managerial talent can be found in the private sector, very little is devoted to

rural development related activities primarily because of the uncertainty caused by government policies.

The Strategy includes management improvements throughout the program which are at the heart of AID institution building activities in Sri Lanka. In this regard, the Mission will work with the planning units of the Ministry of Finance and Planning and the MADR to identify those areas where the greatest inefficiencies exist and to develop appropriate managerial, institutional and/or technological responses. The Strategy anticipates the need to develop, through specialized training, a cadre of management expertise to work on both the analysis and resolution of management bottlenecks to development programs. Efforts will be made to link the work of other donors in extension services to the research and planning assisted by AID.

Any real efforts at management improvement in the public institutions will require policy decisions on salaries, incentives and managerial environment which will be difficult to make. These issues will be highlighted in our ongoing policy dialog, and our assistance will be tied to those changes both necessary and possible. Training, however, can make improvements even in the public sector and will be offered where it can better development programs.

An effective way to improve the management of rural development in Sri Lanka will be to increase the involvement of the private sector, but this in turn may require institutional and legal changes (e.g., there is no legal basis for a private seed industry). This means may be quite effective for field and minor export crops where price supports and publicly-managed input and marketing systems are less entrenched. As stated above, little private sector management capability is focussed on such programs now, but with improvements generated through AID and other donor efforts bearing fruit,

profits and private sector involvement can be expected to grow.

4. Water Management

Because of the agro-climatic nature of Sri Lankan geography, the Mission has chosen to devote particular attention to the specific area of water management. The dry zone of Sri Lanka covers almost 70% of the total land area but accounts for less than 45% of the land under cultivation. This zone also provides nearly 70% of total rice production and produces over 80% of the field crops. Further, the dry zone represents the greatest potential for increasing agricultural production as it is relatively underutilized in comparison with the more heavily settled wet zone. In addition to those applicable to farms island wide, the major constraints to greater agricultural production in the dry zone are irregular rainfall and limited water holding capacity in the soils. For these reasons irrigation has long been practised in this region of the country.

The Mission is developing a program for determining cost-effective rehabilitation and maintenance systems for the extensive but badly deteriorated irrigation network now in place. An important part of that program is farmer involvement. Farmers' associations are being formed which allow and promote participation of the small farmer in the management of water resources. Both farmers and Irrigation Department personnel have expressed satisfaction with the communication improvement. Another aspect of this program is to upgrade management and technical skills in the Irrigation Department which has responsibility for all the irrigation systems in the country.

GSL plans, including the NAFNS, call for shifting the emphasis in irrigation from large scale construction projects such as the Mahaweli to

rehabilitation of small scale village tanks which will generally be less capital intensive and quicker to complete. These plans also recognize the need for management improvement and systematized operations and maintenance. The NAFNS lists irrigation rehabilitation/management improvement as its top investment priority.

The Mission also considers water to be a top priority which must be developed in close coordination with agriculture to make the most effective use of available land. In support of GSL efforts the Mission intends to continue those water management activities which comprise stages two (water delivery) and three (community management) of irrigation development as described in the Asia Regional Strategy. Management and technological improvements will be introduced in order to assure adequate water delivery to all users on a system. Operations and maintenance will become institutionalized as standard procedures. Expansion of the farmers' associations to all major irrigation schemes will also be a target. The Mission expects to continue assistance with systems rehabilitation directly related to the effort of determining the most cost-effective means to do so. Major new construction work will be left for other donors.

5. Marketing and Distribution

The NAFNS identifies the lack of adequate marketing facilities as a formidable barrier to the development and expansion of new cropping systems. There are four constraints to marketing which are particularly acute and which the Strategy proposes to address: lack of market information and analysis; limited credit; inadequate facilities such as transport and storage; and post-harvest technology, including food processing.

The Mission believes that in general, marketing and distribution are areas best suited to private sector control. Therefore, the Strategy calls for AID involvement at the market information stage where technical assistance and training can be of value to improve the collection, analysis, and dissemination of relevant information at all levels of the marketing systems. Coupled with this would be exploratory work in the areas of post-harvest technologies and food processing, as well as support for activities to stimulate increased private sector participation in marketing, such as improved grades and standards and improved quality control associated with differential pricing.

If the GSL shows active support for market development/promotion as evinced by effective steps to upgrade the market information system, improve and enforce grades and standards, or implement an effective price stabilization program, USAID would consider a more active role in the sector. Credit may be an area that the Mission will want to include in the latter part of this planning period should AID funding be necessary to leverage private sector financing. The Mission will be developing more data on the credit situation in the rural areas in order to assess the need for our involvement. Another area for more active participation would be private sector commodities arbitrage which could significantly increase marketing efficiency.

One of the primary support elements necessary to an effective marketing system is transportation. In Sri Lanka transport is by road, rail or ship, each of which is the responsibility of a separate ministry. There is little coordination of effort and no overall transport system planning. All these transport systems are in need of rehabilitation, but the road network is in the worst state of deterioration. Other donors are extensively involved in rehabilitating and improving the road system, but poor maintenance — the primary cause for the deterioration — will continue to be a problem. The

USAID may work with the Ministry of Highways to improve the maintenance program especially for farm to market networks. PL 480 Title I/III counterpart generations will be considered as a means to assist the GSL in improving and implementing a cost effective maintenance program.

6. Policy Dialog

In relation to improving agricultural productivity, assistance will be linked to those policy changes necessary to sustain long term growth. Specific issues will include land tenure, input and support prices, management incentives, coordinated research, integration of planning into decision making and increasing the participation of the private sector.

Land tenure is particularly important to increasing the small farmer's productivity — especially in field and minor export crops — as he will be less willing to undertake innovations and, in most cases, incur the debt necessary to be innovative without secure title to his land. GSL policy supports the "regularization" of tenure on public lands, but bureaucratic practice lags far behind. Improvements in the process of land titling must be made together with a policy decision to grant clear title. The second and perhaps more important issue of land tenure is the size of holdings. Recent years have seen an increasing fractionalization and "atomization" of land parcels as already small plots are divided and subdivided. While generally unenforced regulations against sub-division exist, GSL policy concurrently limits the size of individual holdings and thus contributes to this problem. Mahaweli settlers, for example, are allotted only two and a half acres, the economic viability of which seems increasingly questionable. Island wide private land holdings are limited by law to 10 acres for irrigated land and 50 acres for non-irrigated land. A comprehensive analysis of this situation must

be undertaken soon to develop a specific set of policies to resolve the problem.

The GSL now subsidizes certain inputs and provides floor prices for the diversified crops that are of interest to the Mission. These policies have not been effective in stimulating production. While the long range goal will be to eliminate both subsidized inputs and support prices, more information is needed to determine the optimum schedule and mode for doing so. The Mission will seek a commitment on the part of the GSL to remove subsidies and support prices through a joint analysis of their real effect on improved production. In addition, the USAID will encourage the involvement of the private sector as the primary means of both delivering inputs and processing and marketing output.

As mentioned previously, management is a serious constraint to any development effort in Sri Lanka. The Mission will carry on a continuing discussion with the GSL and appropriate private sector institutions to instill the need for improved incentives. The more sweeping changes of adequate salaries and consolidation of authority in the public sector are unlikely to occur anytime soon, but we will keep up the drumbeat. What can be accomplished now is a commitment to training for all management levels.

A commitment to use effectively the results of enhanced research and planning will be necessary to make any efforts in those areas worthwhile. The research program must be coordinated to the needs of planning and decision making. Planning must likewise be integrated into the process of decision making. Planning must be viewed as the rational selection among alternative uses of scarce resources rather than "wish list" making. At present, Sri Lankan attitudes toward research and planning do not reflect these roles. The policy issue to be dealt with is to assure the appropriate utilization of

improved research and planning capabilities.

The USAID plans to encourage private sector participation wherever it can effectively do so. As indicated above, the private sector could logically be expected to play a greater role in the delivery of inputs and the processing, marketing and distribution of production. The Mission will work with the private sector through such service organizations as the Sri Lanka Business Development Center to encourage the private sector to invest its resources in agricultural activities. Private sector enterprises or service organizations could also transfer technology directly to the farmer. In policy formulation the Mission expects the private sector to participate actively with the GSL on special task forces to select among various development options.

In addition a host of project-specific policy issues, which will contribute to the broader policy objectives, will be identified as program implementation progresses. The Mission will raise them in the dialog whenever the opportunity presents itself to demonstrate the cost to Sri Lankan development if necessary reforms don't get made.

7. PL 480 Title I/III

With rice expected to surpass the self-sufficiency point during this planning period there is likely to be a modest decline in the need for wheat as some flour consumption is switched to rice. However, the GSL is expected to request continuation of the Title I/III program through this planning period as the balance of payments remains tenuous. The Mission will support that request, but at levels slightly lower than current ones.

The Title I/III program will be more closely integrated with DA objectives than has been the case in the past. Title I/III will be considered together with DA in the policy dialog carried on with GSL. Also, self help measures carried on with the local currency proceeds will be planned with the specific objective of improving agriculture productivity. Local currency could be utilized for support in research and planning, for enhancing farmer associations (being formed under water management), to leverage private sector involvement, to establish a cost-effective road maintenance system, rationalize the food stamp program and for other activities related to the program objectives. This Mission has initiated a dialog with the Ministry of Finance and Planning on the utilization of Title I/III which we believe will lead to better planning in the use of this development resource.

C. OFF FARM EMPLOYMENT AND RURAL ENTERPRISE

Studies done for the National Agriculture, Food and Nutrition Strategy show that underemployment is prevalent in the rural areas and that the number of landless of the agriculturally dependent population is increasing (7% in 1973 to 20% in 1980/81). The Minister of Finance and Planning noted in his presentation of the GSL 1985 Budget that nutritional standards for low income groups, including the rural under and unemployed, have been deteriorating. The GSL has proposed a series of short-term measures to deal with this problem, but the long-term solution is adequate incomes. On-farm opportunities will not grow significantly over the planning period even with rapid improvement in small farm productivity. Therefore, off-farm employment must increase.

The Mission views the creation of jobs off-the-farm to be a role of the private sector. Employment programs could be mounted by the GSL, but such

employment would be only short to medium-term at best and, given budgetary constraints, very limited in numbers. The Strategy envisions the creation of long-term employment opportunities in the private sector as a more attractive alternative.

To minimize rural to urban migration, the strategy will give priority to those employment creating investments which are in the rural areas. Agribusiness would appear to offer the best possibilities both to create employment in the rural areas and to stimulate production. Thus, the principal (but not exclusive) focus of attention is expected to be on agribusiness development.

The early stages of our involvement will be of an analytical and pilot nature. Activities undertaken by the Sri Lanka Business Development Center (SLBDC) will serve as an initial departure point. We will also continue to encourage the work of the Joint Agricultural Consultative Committee which has been promoting U.S. Sri Lankan agribusiness joint ventures for the past two years.

1. Policy and Planning:

Since the Sri Lankan business community still has not fully thrown off the attitudinal shackles of the socialist era, and AID lacks significant experience in developing a program of this type, policy and planning will be critical factors in achieving off-farm employment objectives. The Mission will work through the Ministry of Finance and Planning to institutionalize, in both the private and public sectors, a planning and policy formulation capacity to deal with rural employment and business development.

First efforts will have to be data collection and analytical studies. Work should be directed at clearly defining the current state of affairs and identifying major constraints to rural enterprise expansion. Attention will be directed to analyzing enterprise activity at the micro-enterprise (informal sector) level, the small to medium size enterprise (SME) level and the large enterprise level, including foreign investor participation. Analysis should not only identify the constraints but provide recommended options for overcoming them. GSL policies, or the lack of them, together with the legal environment will be areas for special review as work to date indicates that the government's policy framework is an inhibiting factor. Progress on improving that framework will determine how much more assistance is warranted.

Based on this analytical work, the Strategy calls for consideration of a variety of potential USAID assistance activities. These include project identification, feasibility studies, credit, market development and entrepreneurial development. The USAID will also test methods to invigorate private sector interest in rural business investment. More analysis is needed, but the Mission will explore the possibility of making project identification and feasibility study financing repayable if an investment is successful.

Donor coordination will be an important aspect of this planning stage. Certain infrastructure — such as roads, telecommunications and rural electrification — will be necessary to attract investment, and the GSL is negotiating with other donors, particularly the multi-national development banks for financing that infrastructure. It is anticipated that USAID financed planning activities will contribute to improved coordination of donor programs on the part of the GSL.

2. Information Development

Recent studies such as the AID financed A.D.Little Private Sector Assessment and others by the UNDP and World Bank identify the lack of information as a serious handicap to private sector development in Sri Lanka. Commercial banks, for example, cite a lack of sufficient market information to judge the value of potential investments. Would be entrepreneurs do not have access to the economic data necessary to make accurate assessments of return on investment.

The Mission anticipates continuing support for the development of information services as appropriate adjuncts to the data collection and analysis done in support of the planning and policy formulation activities above. Through its support of the SLBDC, AID assistance will help to establish a professional information development and dissemination capability to provide accurate economic data and informational services for business decision making.

3. Management Development

As highlighted above, Sri Lanka is deficient in the management skills necessary to successfully operate business concerns and implement new initiatives. Entrepreneurial talent is also severely limited. Many Sri Lankans who possess these skills or talent find greener pastures abroad. The private sector studies done by A.D. Little and others have indicated some of the reasons good managers don't stay in Sri Lanka. They include government taxation policies, low remuneration and little prospect for promotion.

The GSL policy problems can be addressed to some extent, if not completely, in the planning and policy side of this program objective. The remuneration and promotion issues are directly related to taxation and skill levels. With relief on the taxation issue training will be paramount. There are very few management training programs here and only one that offers entrepreneurial development at the small to medium enterprise level.

Management education must be improved and expanded. The Mission through the support of the SLBDC and the Sri Lankan Institute of Development Administration will build a capacity for providing practical, high quality management education from which specialized rural enterprise management training can be developed. Short-term courses in specific areas of interest to the private sector will need to be developed. These courses should be designed for classroom settings and for taking directly to the individual enterprises. They will also need to be linked to analytical and problem solving consultancies in order to create truly changed management approaches. Program intensity and correspondent funding levels will be responsive to GSL policy reforms. Developing top-level management talent will have little lasting impact if taxation policies continue to stimulate out-migration, for example.

D. MAHAWELI DEVELOPMENT

The Accelerated Mahaweli Development Program (AMP) is now nearing the end of its major construction phase. The Victoria and Kotmale headworks are basically completed, work on the Maduru Oya tank and headworks is completed and the AID financed canals in system B of the Maduru Oya Left Bank will be finished early in this planning period. To date over $ 1.5 billion has been committed to the AMP by the GSL and donors; $181 million of that is AID

financed. The AMP was planned with a dual purpose; both to tap hydro-electric potential for power generation and to open up sparsely populated lands to settlement and increased agricultural productivity. With completion of the dams and the follow on Asian Development Bank power distribution project, the first purpose will largely be achieved. Much remains to be done to achieve the second.

AID's major involvement in the AMP has been with System B on the left bank of the Maduru Oya. System B is the largest single area within the AMP, and AID has financed main and branch canal construction as well as social infrastructure needs. When fully developed, System B will support over 350,000 people on 75,000 hectares of irrigated land. But System B will not soon be fully developed; AID funded canals will irrigate only 23,000 hectares supporting 145,000 people. Agricultural inputs and services, social infrastructure and services, and housing lag far behind construction in development of the area. In order to capitalize on the large investment already made in the Mahaweli region and to assure that these lands reach suitable levels of productivity, more investment in the Mahaweli is needed.

The Mahaweli region is part of the dry zone and, as such, has the same constraints to development of agricultural productivity. The Mission, therefore, is interested in research, extension, planning, management and marketing as much in the Mahaweli as elsewhere. Likewise, the Mission is concerned with the need for off-farm employment since evidence indicates a serious underemployment problem already in the Mahaweli. At the same time, the Mahaweli as a settlement scheme opening new lands to agricultural production offers a means to alleviate the poverty of landlessness.

AID's emphasis in the Mahaweli region will shift over this planning period from construction to assuring better utilization of available resources for developing economically viable settlements. The main focus of the Strategy will be on research, planning and interministerial coordination with resource support to improve production and incomes.

1. Interministerial Coordination

Since the bureaucratic structure of the GSL has put full responsibility for development of the Mahaweli region in the hands of a separate ministry — the Ministry of Mahaweli Development — the Mission plans to work with this ministry to resolve problems identical or similar to those being addressed in other parts of Sri Lanka. The GSL intends to phase out the Mahaweli Ministry at an appropriate point in the future, therefore coordination is an issue that must be dealt with. The Mission also would like to see the Ministry of Mahaweli Development pull back from an operational role into that of planning and coordination once other ministries, such as Agriculture, demonstrate that they can be responsive to the needs of the Mahaweli. However experience tells us that coordination will be a difficult objective to achieve. This point will be a principal area for policy dialog, but the Mission, in the beginning, will be content to assure that appropriate mechanisms are being developed so that information generated in one program is available to another. The Mission will finance studies and analytical work that cross ministerial boundaries in expectation that the relationships developed in the analytical stage will lead to better coordination in both planning and implementation.

2. Policy and Planning

Like other development efforts in Sri Lanka, the Mahaweli Program suffers from a lack of planning expertise. The planning unit of the Mahaweli Authority of Sri Lanka (MASL) is really primarily a project monitoring unit. The GSL has recognized this deficiency and is attempting to resolve the problem. The Mission has been approached for assistance in this regard.

Given the historical lack of coordination between ministries and the role the Mission would prefer to see the Mahaweli Ministry take should better coordination become a reality, we propose to work on planning and policy formulation within the Ministry and its constituent operating agencies (Mahaweli Authority of Sri Lanka, Mahaweli Economic Agency, and Mahaweli Engineering and Construction Agency) while concurrently dealing with similar problems elsewhere. Planning here will be more comprehensive, however, as the full scope of the settlement scheme rather than just agricultural productivity will be appropriate for planning activity. For example, pilot activities may be undertaken in health which is of concern to Mahaweli authorities but is not an area in which AID currently plans to work outside the Mahaweli region. The Strategy presumes that AID assisted planning efforts will give priority attention to System B as a model for developing effective interventions which can be replicated not only in other parts of the AMP but throughout the country.

Again, the means of assisting the GSL to establish an effective planning and policy formulation capability will be through technical assistance, training, modest commodity support and financing for special studies and pilot projects.

3. Infrastructure Development

While major construction activities will no longer be the primary purpose of the Mission's participation in the AMP, some construction work will continue to be necessary. The criteria for including construction projects will be whether they are essential to productive use of infrastructure completed or near completion, bearing in mind the objectives of improved agricultural productivity and off-farm employment. In order to take full advantage of the work done by AID and others, limited additional infrastructure development may need to be considered in such areas as tertiary canals, roads, market centers, etc. (Minor construction such as small schools or health posts will be appropriate if it is related to a project purpose in support of the program objectives.)

4. Policy Dialog

The policy dialog regarding the Mahaweli programs will initially parallel the dialog for improving agricultural productivity and creating off-farm employment opportunities. Secondly the Mission will look for relevant areas such as health where some innovative intervention developed for the Mahaweli program could serve as the basis for an effective dialog with other GSL organizations. Another area of interest to the Mission is enhancing the coordination between government operating bodies. The Mahaweli program offers a unique opportunity to increase and improve what little cooperation now takes place. These efforts will be done in perspective with the larger policy issue of rationalization of the GSL bureaucratic structure. We hope that the Mahaweli program will be used to demonstrate ways of reducing the need for elaborate procedures and huge staffs.

E. ADDITIONAL PROGRAMS OF INTEREST

Throughout the preceding pages the possibilities of going beyond a basic strategy have been discussed. If the proper environment can be set, additional assistance can have a significant impact on development. The Mission has taken that possibility into consideration in developing this Strategy. Most of an expanded, more intensive program would come in areas in which the Mission would already be involved such as agricultural research, but there are additional areas in which we are not planning any major activity unless the policy environment changes.

1. Health and Population:

One of these areas is the health field. Despite impressive health statistics — crude birth rate of 27, infant mortality of 37 and child mortality of under four, each per 1,000 respectively — there remains much to do. Health programs are not adequate in all geographic regions, nutrition levels are declining in certain groups, and trained medical personnel are not available at all health facilities. These are a few of the problems which AID could address. However, the priorities of the Ministry of Health (MOH) and AID must coincide in order to assure a program of more than marginal impact.

Sri Lanka's health status does not warrant a high-risk program with relatively moderate chances for success. The USAID has determined that important policy and institutional problems exist which lower the feasibility of possible health assistance options. These problems include, the MOH's still curative orientation, GSL financing, management, community participation and

the operational aspects of the MOH's primary health care scheme. Despite a continuing dialog on these issues the Mission has not seen sufficiency change to warrant a major new initiative.

Because of the questions concerning coordination, operational commitment and policy consensus, we feel the health and population sector needs increased GSL attention more than large donor assistance. Therefore, under the current policy setting, the USAID will limit its involvement in the health sector to continuing ongoing projects, including PL 480 Title II, and to selective technical assistance and training opportunities that complement our continuing efforts to bring about the policy and institutional changes necessary for a sustainable program. Ongoing projects include our assistance in malaria control, construction of the National Institute of Health Sciences and provision of safe drinking water, together with education on health and sanitation. USAID support for the Malaria Control project will be ending in late 1987. Much progress remains to be made in institutionalizing an effective system of Malaria Control; specifically, the GSL needs to continue to focus on solving logistical problems, as well as those of coordination and management. The GSL will need to avoid any relaxation of efforts in this area given the recent appearance of chloroquine resistant falciparum malaria, communal disturbances which have set back control efforts, and the resettlement of populations in potentially malarious areas of the Mahaweli. If the GSL evidences a commitment to reorient policy direction and provide the required financial and personnel support, the USAID would be interested in additional programs such as family planning, health manpower development, health systems planning and management, and selective primary health care.

U.S.-financed commodity support for PL 480 Title II programs will decline over the planning period as the phase-out of U.S. assistance for the

school-feeding program continues, and the GSL assumes responsibility for the entire program in FY 1988. No further expansion of U.S. commodity support for the maternal/child feeding program is expected as the GSL continues its efforts to improve targetting in the program and to continue substituting locally grown soya, maize and rice for imported Instant Corn and Soya Mix (ICSM). U.S. efforts in the planning period will concentrate more on the use of Title III as a development tool. complemented by grant-financed technical assistance to help the GSL to improve the effectiveness of its supplementary feeding programs. AID will continue its efforts to encourage the GSL to address the root causes of malnutrition e.g. by promoting less frequent childbirth through family planning programs, by reducing both the causes and effects of diarrheal diseases through health, nutrition and sanitation education programs, and greater use of oral rehydration therapy.

2. Micro-Energy:

Energy is another area of interest to AID. Like other sectors, GSL responsibility for energy matters is highly fragmented and little coordinated. Some progress on coordination has been made on major power programs which are being handled by the National Energy Coordinating Team (ECT) which functions through three task forces to coordinate planning and policy analysis; energy effeciency, demand management and conservation; and alternative sources of energy. The GSL, through the ECT, has many active programs underway to address major development needs. However, little priority has been given to the largest source of energy: biomass and other renewable resources which are the basis of the USAID's interest in micro-energy.

Biomass is by far the most important source of domestic energy in Sri Lanka, accounting for some 55% of the total energy used in 1982 and providing

94% of the nation's household cooking requirements. A recent study estimated the total consumption of biomass fuel by the household sector at 7.5 million tons per year, consisting of fuelwood (53.2%), agricultural crop wastes (mainly coconut residues, 28.8%) and rubber wood (18.0%). The majority of biomass used for these purposes (81%) is obtained by individuals gathering their own supplies from home gardens, nearby estates and plantations and from "waste lands" and forests. The remainder (chiefly rubber wood) is purchased from local vendors. Thus, apart from its importance as a domestic energy source, biomass also has significant implications for both the agricultural plantation sector and the environmental status of the nation's forests and watersheds.

To avoid excessive deforestation while meeting the country's growing fuelwood requirements, the GSL estimates that over 500,000 acres of forest will have to be replanted during the period 1983-90 and 10,000 acres per year thereafter at an estimated cost of Rs 3-4,000 billion. It should be noted that these figures pertain solely to the nation's fuelwood needs, and do not include national construction timber requirements. Current GSL plans call for accelerated reforestation activities combined with the development and implementation of more efficient domestic cooking technologies. Unfortunately little real priority has been assigned to these reforestation efforts, and they have been seriously underfunded and understaffed. The Bank will complete projects underway but thereafter will limit our involvement to improve GSL consideration for policy changes before financing follow-on activities.

If the GSL assigns sufficient operating priority to a reforestation program the Mission would be interested in offering assistance in such areas as social forestry to develop the small farm/rural sector fuelwood needs and addressing soil erosion conditions in catchment zones of the irrigation schemes.

F. CONTINGENCY PROGRAM

Sri Lankan society has long been divided on the communal issue. This division has reached a very serious stage over the last several years with the ethnic disturbances of July 1983 and the terroist campaign now raging. The July 1983 riots were the worst outbreak of ethnic violence in recent history and seriously disrupted the course of economic development. The economy appears to have recovered to a large extent (except for the loss of managerial talent), but the society has not recovered. Communal lines are even more sharply drawn, and a return to harmonious relations between Sinhalese and Tamil is not a forecast for the near future. The terrorist campaign to establish a separate state of Eelam for Tamils in the North and East of the island, of course, exacerbates the tensions. While terrorist attempts in the past few months to create a backlash of the sort that occurred in July 1983 have failed to date, a shift in tactics may be taking place. Some evidence indicates that the target of terrorist activity may change from the police and military to economic production. The Mission's assessment of the economic effect of the terrorist campaign is that while the economy has been disrupted in certain locations, it has not lost its ability to recover quickly once the violence ceases. The Mission is not optimistic at this writing, however, that a political solution to these troubles will be soon forthcoming. The All Party Conference did not have real support among either Sinhalese or Tamils and has collapsed, leaving both communities without a forum for resolving their differences through negotiations.

The outlook, then, appears to be a continuation of the present situation which is increasingly drawing both attention and resources away from the development effort. There remains the possibility that violence could very

quickly erupt on a major scale. Such an occurence could be expected to disrupt economic activity seriously again, and destroy vital infrastructure.

The AID Strategy must be cognizant of this possibility within the planning period under review. The Strategy presented earlier will not be possible if terrorist and counter-terrorist activity creates an environment where farmers and the business community are unwilling to innovate and invest, where security becomes an overriding concern. At the same time, it would not be in the United States' interest to have Sri Lanka, a country with strong democratic roots and a growing private sector development orientation, slide into economic chaos. Should such a scenario develop, the Mission believes that program assistance - balance of payments and/or budgetary support — should be considered. In addition, humanitarian assistance to help relieve the plight of those displaced and destitute due to the violence would be a program in which the U.S. would want to participate. The U.S. should also be prepared, together with other donors, to offer a program of economic rehabilitation should it be necessary following a peaceful resolution to the current tensions.

G. SPECIAL CONCERNS:

The Mission views these special concerns as integral parts of our overall program. Each of the first three programs is a contributor to the Mission's objectives in improving agricultural productivity and farm incomes and in creating off-farm employment and rural enterprises. The fourth, the Peace Corps clearly could be a contributor if its own operating in Sri Lanka were expanded.

1. Women In Development

The women of Sri Lanka have made great strides during the past 50 years. Their life expectancy has more than doubled to 68 years. The average marriage age rose from 12 years to 24 years. Maternal mortality dropped from 21 to only 0.6 per thousand. Fertility rates were reduced from 2.6% to 1.7% in 35 years. Today 90% of young girls attend primary school. Over 42% go to school through grade 12. Female literacy is nearly 83% while the rate for males is 91%.

In large part, such dramatic social changes are due to the country's system of free education established in 1945. The access to education, the ability to vote and increased economic activity have changed, however, not the way women are perceived. The patriarchal family still views the man as bread-winner and woman as homemaker. The arranged marriage and dowry are still common. The dowry, though, has a new twist. It has been modernized. Education and employment can be parlayed now as legitimate alternatives to the customary dowry. However, while women do contribute to the family income, families consider such employment as a secondary activity.

Women earn money in a variety of ways. Approximately 16% of the formal labor force are women. Urban women tend to work in the service areas such as nurses, clerks, telephone operators, hotel housekeepers, receptionists, travel agents and domestics. Women workers dominate the large textile industry and 90% of the garment workers in the Free Trade Zone are women. But overall women work principally in agriculture and agriculture-related activities. At least 50% or agricultural workers are women. They are also active in producing handicrafts. In general, women do not receive technical training. Most governmental and private organizations have offered women training in tailoring, weaving, needlework, batiking, flower making, lace-making and coir-making. The National Apprenticeship Board and the Women's Bureau were innovative in introducing training in radio mechnaics, carpentry, masonry and

electrical wiring for women, as have voluntary agencies, some with AID financial support. However, these remain overwhelmingly areas of employment for men, and training is not widespread.

As part of program objectives of increasing productivity and raising incomes, the strategy takes into account the need for interventions to overcome development constraints particular to women. We are especially concerned with the access of women to productive resources, women's role in small-scale agriculture, off-farm income earning opportunities which fit time and work schedules of women, and the women as entrepreneur. The program of this CDSS planning period will stress the analytical capability needed to adequately address the full integration of women into development programs. As part of our policy dialog we will pursue an increased commitment by the GSL to take into account the needs and potential contributions of women.

The USAID does not view concern for the role of women as separate from our efforts to improve agricultural productivity or create off-farm employment opportunities. Women will be both participants and beneficiaries in these efforts. We do anticipate specific project activities being directed exclusively at women. In this regard the Mission is now developing a study which will delineate the role of women in irrigation and water management. This study will recommend both ways that women can have a more active voice in managing water resources and how they can benefit from its availability. Using this study as a pilot, the Mission will incorporate a rigorous analysis of the role of and effect on women of new projects being developed. Such an approach will require collection of data on a sex-disaggregated basis, a methodology not practiced here as yet, and will be incorporated into social soundness, technical and economic analyses.

2. Low Income Housing

During the planning period, the Mission will continue to place emphasis on assisting private and public entities to develop and finance affordable, low cost housing and related services as a means of enhancing the productive relationship of people to the land.

Through the Housing Guaranty Program, the Mission has developed a rural centered housing and infrastructure program which has had a significant impact on off-farm employment creation in hundreds of small villages throughout the country. During CY 1984, the Mission-supported housing program made approximately 40,000 small loans (up to $300) to villages for housing or infrastructure improvements (commonly new roofs, wells or latrines) as well as for new construction. All work was carried out by individuals themselves or by private sector small builders. The Mission has found that this program has generated considerable secondary employment in the areas of furniture making, brick and tile making, metal fabrication, transport as well as retail trade. All materials used in the Sri Lanka program are locally produced — often within the same district. In this fashion, employment creation in these rural areas helps to increase employment levels.

During the planning period, the Mission will expand its housing and related infrastructure program to the Mahaweli areas to assist with the financing of modest, affordable housing and facilities for settlers and towns people. It is anticipated that Mahaweli housing loans will be provided by Sri Lanka's specialized housing bank, the State Mortgage & Investment Bank, which has been a pioneer in spreading the concept of market rate lending to lower income households.

The Mission will also continue to support the innovating shelter program established by the Prime Minister known as the Million Houses Program (MHP). This ambitious, primarily rural, program targets the agricultural smallholder as one of its principal clients. The Mission will assist the GSL resolve problems of loan administration and repayment through a pilot MHP activity which seeks to channel housing funds through village credit unions ("thrift societies") which have functioned effectively, in some cases for nearly 50 years.

Through its shelter sector assistance, the Mission has entered into a dialog with the Ministry of Lands and Land Development with regard to land tenure issues. Early in 1985 the GSL Cabinet authorized the establishment of a National Land Commission to review a number of issues which relate to land use and transfer. Some existing governmental measures have severely restricted use and sale of land which has contributed to the country's housing problems as well as having profound agricultural consequences. These measures will be a principal subject in our continuing policy dialog.

3. Private and Voluntary Organizations

In recent years the GSL has shown increasing interest in marshalling the considerable resources of its PVOs towards assisting local communities in self-development. This interest is evident in the GSL program for the devolution of administrative power from the center to the villages through the establishment of village level organizations known as Gramodaya Mandalayas, to which representatives of all private and voluntary organizations in the area are nominated. The GSL believes "that the voluntary grouping of the people for a specific or general activity is an essential feature of a democratic society". It was this interest which provided the background for USAID's

initiation in August 1979 of a PVO Co-financing Project which will run to August 1989.

The twenty-five sub-projects approved to date include community-based integrated rural development, increased agricultural production, increased employment and incomes through promotion of small private enterprise, improved quality of life including health and nutrition, and increased participation of women and disadvantaged groups in developmental activities. All provide opportunity for the rural poor to participate in their own development. The Mission will continue to assist the PVOs in carrying out similar activities in the coming years taking advantage of the ability of PVOs to motivate people at the grass roots level to make effective use of the resources available to them. However, the Mission's original plan to maintain balanced support for indigenous PVOs and U.S. PVOs is gradually changing. As more and more indigenous PVOs prove their capability to manage projects on their own and with the dwindling contributions that the U.S. PVOs are prepared to make towards the cost of project activities there is a growing tendency to support an increased number of indigenous PVOs. While the Mission considers a number of the indigenous PVOs to be competent to manage implementation, it will be necessary to improve PVO capabilities to conduct evaluation of their projects, and arrangements are being made to conduct a workshop/seminar during 1985.

The indigenous PVOs are experimenting and conducting research on various approaches to development with varying success. They are working in areas of common concern and complementarity, and where they contribute to improving agricultural productivity and farm incomes and/or creating off-farm employment and rural enterprises they will be considered for USAID financing. The Mission maintains a continuing dialog with most of the active PVOs in Sri Lanka, and through this dialog PVO experiences and perceptions have benefited this CDSS.

4. The Peace Corps:

The Peace Corps program in Sri Lanka has only recently been restarted, and there are 30 volunteers in country at the present time. All of the volunteers are involved in teaching English at the local school level which is not a sector of AID assistance. AID and the Peace Corps have determined, therefore, that program coordination/integration is not a priority issue at this time. PCVs are being made aware of the USAID's PVO activities or how local PVOs can submit project proposals requesting USAID financing. Peace Corps and the USAID maintain a continuous liason, and should the Peace Corps be requested to expand its program into areas of interest to AID, the USAID and Peace Corps staff are prepared to discuss how to coordinate programs for mutual benefit.

IV. RESOURCE REQUIREMENTS

The Program Strategy as elaborated in the previous sections details the need for Sri Lanka to reach and sustain significant levels of real growth through enhancement and better utilization of available resources. In support of that goal the USAID will concentrate on the objectives of increasing agricultural productivity and farm incomes, stimulating off-farm employment and rural enterprise, and further developing the Mahaweli region.

The Mission has proposed two program alternatives. The first is our basic program and represents what we believe can be accomplished within the current policy framework, absorptive capacity and resource commitments of the GSL. The second alternative represents a program that could be responsive to GSL initiative in policy reform and priority changes. The second alternative, the responsive program, would flow out of a productive policy dialog begun under the basic program.

The basic program calls for $183.5 million in Development Assistance (DA) financing over the FY 1986-90 period. PL 480 resources of $130.3 million and Housing Guarantees (HG) of $40.0 million are also planned. No Economic Support Fund (ESF) financing is contemplated at this time.

Sri Lanka has had an historical commitment to equitable sharing of the benefits of growth. Extensive social services and high PQLI ratings testify to that commitment. However, GSL policies and practices have not always been conducive to achieving high levels of economic growth. Donor assistance programs, then are usefully directed at stimulating needed economic growth.

Mindful of the need for limited resources elsewhere, the Mission has directed the basic program to those opportunities where our assistance can reasonably be expected to overcome identified constraints and contribute to the desired economic growth. GSL priority and AID interest converge on the three program objectives detailed in the Strategy: agricultural productivity and farm incomes, off-farm employment and rural enterprise, and Mahaweli development. The basic program is, a statement of development objectives that can be addressed within the policy framework that the GSL is willing to consider for attention and appropriate reform.

The basic program has a research, analysis and planning emphasis which the Mission anticipates will provide recognition for reforms beyond that presently contemplated by the GSL. When the GSL indicates interest in making some of these difficult changes the Mission would be prepared to be responsive with additional assistance to help the GSL in implementing these reforms.

An example of the difference between the two program levels is in the area

of agricultural research. At present agricultural research is spread across six different ministries with varying responsibilities for agricultural programs. Field crops all are within the scope of the Department of Agriculture in the Ministry of Agricultural Development and Research, but livestock falls under the Ministry for Rural Industrial Development. Under the basic program the USAID will work with the Department of Agriculture to carry out research on field crops; however, farming systems research on livestock integration will have to be ignored at this time because of inadequate coordination between the two ministries. Should these two areas become better integrated the USAID assisted research program should be expanded to respond to that change.

The basic program does not include any major activity in the fields of health or family planning. Given the state of Sri Lanka's progress in these two areas and the critical need for these resources in other countries, health or population assistance here could be justified only by the prospects of very significant improvement in public health programs. Despite Sri Lanka's successes in the health sector, the Ministry of Health (MOH) continues a curative orientation and has not been willing to commit adequate resources — both human and financial — to a reorientation of health priorities. The same situation holds for family planning programs. The Mission plans to pursue this issue possibly through pilot experimental programs and in continuing policy dialog. If the MOH can be convinced to make the commitment to a reoriented health and family planning program, the Strategy should be responsive to that possibility.

The Mission's intent in presenting its two tiered program approach is to differentiate between the basic program we expect to implement and an enhanced program responsive to Sri Lankan performance in making hard development

choices. The Mission believes that Sri Lanka, by failing to tackle these choices is paying a substantial cost in development assistance foregone. At the same time the Mission realizes that if policy dialog indeed results in change, it must be prepared to modify the Strategy to take note of any reforms that follow from that effort. At this time we do not seek approval for the higher funding levels indicated for a "responsive" program but rather to signal the possible need for modification of the strategy.

As discussed previously, the possibility exists for terrorist activity and/or communal violence to disrupt development efforts. The Mission has not attempted to associate a resource level with this contingency, but any long range planning in Sri Lanka today must take this uncertainty into consideration. Should such a situation develop, the Mission would propose appropriate program and funding changes. The resource tables following provide a breakdown of the funding for the program as proposed in the Strategy. The tables present both funding by source (DA, PL 480, HG) and year (FY 1986-90). Levels and breakdowns for the responsive program are illustrative as the activities developed will depend on the types of reforms undertaken by the GSL. No loan/grant breakout has been proposed, but the emphasis on institution building and technology transfer would indicate a large grant component.

TABLE V

ASSISTANCE PLANNING LEVELS
(Millions of U.S. Dollars)

FUNDING SOURCE	FY 86	FY 87	FY 88	FY 89	FY 90
BASIC PROGRAM LEVEL					
Development Assistance (DA)	32.0	34.5	37.0	40.0	40.0
Economic Support Funds (ESF)	-	-	-	-	-
PL 480 Title I/III	26.0	25.0	25.0	23.0	22.0
PL 480 Title II	3.5	2.5	1.5	1.1	0.7
Housing Guarantees (HG)	-	20.0	-	20.0	-
TOTALS	61.5	82.0	63.5	84.1	62.7
RESPONSIVE PROGRAM LEVEL					
DA	32.0	39.0	48.5	57.0	60.0
ESF	-	-	-	-	-
PL 480 Title I/III	26.0	25.0	25.0	23.0	22.0
PL 480 Title II	3.5	2.5	1.5	1.1	0.7
HG	-	20.0	-	20.0	-
TOTALS	61.5	86.5	75.0	101.1	82.7

TABLE VI

RESOURCE TABLE
(Millions of U.S. Dollars)

OBJECTIVE/Funding Source	FY 86	FY 87	FY 88	FY 89	FY 90
AGRICULTURAL PRODUCTIVITY AND FARM INCOMES					
DA	19.7	18.8	14.0	28.0	25.0
ESF	-	-	-	-	-
PL 480 Title I/III	26.0	25.0	25.0	23.0	22.0
PL 480 Title II	-	-	-	-	-
HG	-	-	-	-	-
OFF-FARM EMPLOYMENT AND RURAL ENTERPRISE					
DA	0.4	8.9	13.6	4.8	15.0
ESF	-	-	-	-	-
PL 480 Title I/III	-	-	-	-	-
PL 480 Title II	-	-	-	-	-
HG	-	15.0	-	15.0	-
MAHAWELI DEVELOPMENT					
DA	9.8	4.8	9.4	7.2	-
ESF	-	-	-	-	-
PL 480 Title I/III	-	-	-	-	-
PL 480 Title II	-	-	-	-	-
HG	-	5.0	-	5.0	-
CONTINUING ACTIVITIES					
DA	2.1	2.0	-	-	-
ESF	-	-	-	-	-
PL 480 Title I/III	-	-	-	-	-
PL 480 Title II	3.5	2.5	1.5	1.1	0.7
HG	-	-	-	-	-
(The following objectives are part of the Responsive Program Levels and are additional to the Basic Program Levels)					
AGRICULTURAL PRODUCTIVE AND FARM INCOMES					
DA	-	-	4.5	5.5	9.0
ESF	-	-	-	-	-
PL 480 Title I/III	-	-	-	-	-
PL 480 Title II	-	-	-	-	-
HG	-	-	-	-	-
HEALTH AND FAMILY PLANNING OUTREACH					
DA	-	4.5	7.0	11.5	11.0
ESF	-	-	-	-	-
PL 480 Title I/III	-	-	-	-	-
PL 480 Title II	-	-	-	-	-
HG	-	-	-	-	-

TABLE VII

DA PROGRAM ALLOCATIONS
($ 000s)

OBJECTIVE	FY 86	FY 87	FY 88	FY 89	FY 90
AGRICULTURAL PRODUCTIVITY AND FARM INCOMES :					
Agricultural Research	2,110	3,010	1,650	2,800	4,000
Agricultural Policy and Planning	1,850	3,950	1,000	2,500	2,000
Agricultural Management	400	2,550	2,050	3,250	1,000
Water Management	14,700	8,400	3,000	10,500	8,000
Marketing and Distribution	650	900	6,330	9,000	10,000
Sub-Total:	19,710	18,810	14,030	28,050	25,000
OFF-FARM EMPLOYMENT AND RURAL ENTERPRISE :					
Policy and Planning	100	3,550	5,000	1,500	800
Information Development	-	1,700	2,600	200	200
Management Development	300	2,650	4,820	1,250	500
Rural Enterprise Promotion	-	1,000	1,200	1,800	13,500
Sub-Total:	400	8,900	13,620	4,750	15,000
MAHAWELI DEVELOPMENT :					
Inter-Ministerial Coordination	1,650	1,047	1,250	800	-
Policy and Planning	1,300	1,300	1,300	1,000	-
Infrastructure Development	6,883	2,400	6,800	5,400	-
Sub-Total:	9,833	4,747	9,350	7,200	-
CONTINUING PROJECTS :					
Activities not directly related to the Strategy above	2,057	2,043	-	-	-
TOTAL DA FUNDING:	32,000	34,500	37,000	40,000	40,000

TABLE VIII

STAFFING LEVELS

(BASIC PROGRAM LEVEL)

U.S, Direct Hire Positions at the end of the Fiscal Year

SECTOR	FY 86 1/	FY 87	FY 88	FY 89	FY 90
Director	3	3	3	3	3
Program	3	3	3	3	3
Proj. Dev.	4 2/	3	3	3	3
ARD	3	3	3	4	4
Health/Pop.	1	1	1	-	-
Eng/Env/Energy	3	3	3	3	3
EXO	1	1	1	1	1
CONT	2	2	2	2	2
Legal	1	1	1	1	1
Housing	1	1	1	1	1
Private Enterprise	-	1	1	1	1
TOTAL	22	22	22	22	22

N.B. At the Responsive Program level, an additional two positions would be required. Health Population and Nutrition Officer in FY 89 and an Agricultural Credit and Marketing Specialist in FY 88.

1/ Represents a reduction of two positions from FY 1985

2/ Includes private enterprise function.

V. WORK PLAN FY 1985-86

This Work Plan is the first required for USAID Sri Lanka; thus there is no prior plan against which to measure accomplishments. The Mission has used the program benchmarks from the FY 1986 CDSS as representative of a prior work plan, and progress is reported for those benchmarks. The Work Plan proposed here includes targets from mid FY 1985 through the end of FY 1986. The Plan presents the specific targets and management actions expected relative to the objectives of the Strategy.

A. PROGRESS AGAINST PRIOR PLAN:

1. Accelerated Mahaweli Development

-- 13,500 farm families settled on the Left Bank

PROGRESS: Over 2,500 farm families have been settled. Settlement has been delayed because of slow progress on infrastructure and support services.

-- 160 kilometers of truck and market roads in service

PROGRESS: 100 kilometers of road have been completed or are nearing completion.

-- 13,500 hectares of new lands under paddy

PROGRESS: Over 2,500 hectares have been put into production (one hectare per family), but further work may stress alternative crops as rice production nears self-sufficiency.

-- Wildlife reserve established and Department of Wildlife Conservation strengthened.

PROGRESS: 400,000 acres of park land have been legally set aside and 620 acres of park habitat have been approved. The TA contract to strengthen the Department has begun, professional staff have been hired by the Department and training programs have been initiated.

2. Irrigation and Water Managerment

-- Gal Oya irrigated acreage increased by 18,000 acres

PROGRESS: Over 9,000 acres have been irrigated.

-- Replicable technology for both operations and maintenance and farmers' organizations will be developed.

PROGRESS: A computer model for water management is now in operation at Gal Oya, and an Irrigation Department staff reorganization has been proposed to improve operations and maintenance. Farmers' organizations have been established on 90% of the Sinhala speaking area. The program has been adopted for use in other irrigation areas. In addition, the GSL has established a fee

for irrigated water — a major policy change — to cover the cost of operations and maintenance.

3. Agriculture Research, Production, Processing and Marketing

— Begin implementation of the Diversified Agricultural Research Project (DARP).

PROGRESS: DARP is expected to actually begin implementation during the third quarter of FY 1985.

— Begin implementation of a multi-year PL 480 Title III program.

PROGRESS: The Title III program has been reprogrammed as an FY 1986 start. Negotiations are currently underway with the GSL and should lead to a PID in the third quarter of FY 1985.

— Complete analyses related to possible new projects in agricultural export development and agricultural marketing and food processing.

PROGRESS: Some preliminary studies have been undertaken to provide a better understanding of constraints hindering increased production in minor export crops and the marketing of agricultural produce. Additional study of these two areas and of food processing is planned.

4. Agricultural Policy, Planning and Analysis

-- (No specific targets were set)

PROGRESS: The National Agriculture, Food and Nutrition Strategy was completed. The drafting of the Strategy brought together all the major line ministries with agriculture development responsibilities and as such fostered a strong sense of coordination not seen previously.

5. Energy and Natural Resource Conservation and Management

-- Critical preparatory steps completed for the Reforestation and Watershed Management Project.

PROGRESS: Long-term trainees have returned to the Forestry Department; 52 short-term training programs have been approved for CY 1985; and the integration of village fuelwood plots, fire control and wood utilization research will begin as expected in mid-1985.

-- Completion of initial AID assistance for the development and implementation of sound policies and plans in energy, environment and natural resource management and conservation.

PROGRESS: The GSL formally adopted national environmental impact assessment policies and procedures promulgated through an AID-assisted workshop activity and, pending final drafting and gazetting into law, has begun initial implementation of the procedures on an interim basis. Work has begun on

preparation of a National Conservation Strategy for Sri Lanka with some 25 local officials and academicians currently drafting natural resources and development sectoral papers for use as background material in Strategy compilation. Preliminary planning and design arrangements were completed for AID's assistance to the GSL in the development of a comprehensive national Coastal Resources Management Plan.

-- Continue support to research, training and pilot efforts involving mini-hydro and other alternative energy resources and conservation of non-renewable energy resources.

PROGRESS: AID's planned workshop, training and pilot feasibility study program in Conventional Energy Conservation Principles and Practices was successfully completed for some 45 plant managers and engineers, representing most of the country's major industrial/commercial energy consumers. Other donors are now working with this trained cadre within their respective institutions on various energy conservation programs and projects to further cost-effective economic development of the nation. Due to a perceived lack of GSL commitment, work was curtailed on research, training and pilot efforts involving alternative energy resources development in Sri Lanka.

6. Health, Family Planning and Nutrition

-- Begin implementation of the Water Supply and Sanitation Project.

PROGRESS: Following completion of project development, the project was

authorized on August 21, 1984 and the PROAG was signed on August 24, 1984. The FY 85 Amendment to the PROAG was subsequently signed on December 28, 1984, completing total project obligations to date of $2.5 million AID grant and $6.4 million AID loan funds, 50% and 88% of total planned project obligations, respectively. Accomplishments to date have largely been administrative consisting of meeting the initial conditions precedent to disbursement, establishing the project management organization, initiating facilities design and completing the required documentation and support equipment procurement for timely mobilization of the long-term technical assistance advisory team.

— Begin implementation of the Preventive Health and Family Planning Services Project.

PROGRESS: This project has been shelved because of lack of interest on the part of the GSL and the resultant reorientation in the Mission Strategy regarding assistance in the health field.

— Begin the phase out of AID's involvement in the school feeding program under PL 480 Title II.

PROGRESS: The phase out progress has begun and the school feeding program will terminate in FY 1987.

7. Low Cost Housing Program

— Successfully complete the Phase II Housing Guarantee Program.

PROGRESS: The Implementation Agreement for Phase II ($14.0 million) was signed by the GSL and AID. A loan contract with a U.S. lender has not been negotiated at this point. Approximately 19,000 low cost dwellings were completed under Phase I which is now completed. An evaluation was completed on Phase I.

8. Education and Training

— Assist the GSL in undertaking an assessment of the future demand for agricultural graduates in both the Public and Private sectors.

PROGRESS: The study is underway and progressing satisfactorily. It is expected to be finished by mid-1985.

-- Give priority to upgrading human resources in key development agencies, public and private, through both long and short-term training conducted overseas and in Sri Lanka.

PROGRESS: 300 participant have received training.

9. Private Enterprise Promotion

— An Action Plan for the private sector adopted by the GSL.

PROGRESS: The action plan was adopted as a condition precedent to the

Private Enterprise Promotion project now under way.

-- Legal status established for the Sri Lanka Business Development Center.

PROGRESS: The SLBDC is legally established and operational.

-- Initial pre-feasibility studies completed.

PROGRESS: No pre-feasibility studies have been completed, but initial policy studies and entrepreneur development work is underway.

-- Technical assistance team in place.

PROGRESS: The TA contract will be signed in February 1985. The team should arrive by mid-1985.

-- In addition, the Private Enterprise Project was significantly expanded and more precisely defined while the role of the SLBDC was expanded to include responsibility for the TA contract and for managing the remainder of project funds.

B. WORK PLAN FY 1985-86

1. AGRICULTURAL PRODUCTIVITY AND FARM INCOMES

a) Agricultural Research

(Under the Diversified Agriculture Research project (DARP)

- The TA contract signed and the team in place
- Base line surveys completed
- Construction of facilities initiated

- 20 long-term participant training programs started
- 60 person months of short-term training completed
- Recommendations developed for field crop research

b) Agricultural Policy and Planning

-- Drafting work completed on a Sri Lanka National Conservation Strategy and follow-up activities initiated to ensure that the Strategy is effectively integrated into the national development planning process for conservation of limited natural resources and environmentally-sound and sustainable national economic development.

— An agreement signed and work initiated in all phases of the development of a comprehensive national Coastal Resources Management Plan for Sri Lanka. (A centrally funded activity).

-- Detailed analytical research and feasibility work completed regarding the liabilities and constraints to increased agricultural productivity in Sri Lanka, with emphasis on those areas which show the greatest promise for improving the energy efficiency of the small farmer and agri-businessman.

-- The NAFNS continuing to serve as a forum for inter-ministerial policy dialog.

-- Project development work for the new Agriculture Policy and Planning project completed and a Project Agreement signed.

-- A second environmental impact assessment workshop undertaken to discuss problems encountered in initial procedures implementation and provide guidance for further implementation and monitoring.

c) Agricultural Management

-- Project development work for the new Development Training and Services project completed and a Project Agreement signed.

-- 15 specific agriculture/rural development management improvement training programs initiated.

-- The Agriculture Education Development project completed having created a functional capability to provide graduate level education in agriculture.

-- An analysis and strategy for agriculture education completed based on the Agriculture Manpower Study.

d) Water Management

-- The Water Management Project completed with the Gal Oya Left Bank fully rehabilitated.

— Project development work for the new Irrigation Systems Management (ISM) project completed and a Project Agreement signed.

— Long term diagnostic analyses completed on four irrigation systems to be included in the new ISM project.

— Final evaluation of the Water Management project completed.

e) Marketing and Distribution

-- A study undertaken to identify the critical constraints to the marketing of rice, coarse grains and vegetables.

f) PL 480 Title I/III

— Project design work for a new PL 480 Title III program completed and a Project Agreement signed.

-- Better integration of the PL 480 resource into strategic objectives.

— A comprehensive report on self-help measures undertaken and a waiver of repayment (conversion to Title III) authorized.

2. OFF-FARM EMPLOYMENT AND RURAL ENTREPRISE

-- Project development work for a new project to promote rural enterprises completed for an FY 1987 start.

a) Policy and Planning

— A mid-term evaluation of the Private Enterprise Promotion project completed.

-- A study completed on the feasibility of developing a food technology industry in Sri Lanka.

— SLBDC financially self-sufficient and able to cover its basic "core budget" operating costs.

-- The private sector more actively engaged in macro-economic development strategy formulation, and specifically in industrial development policy formulation, and actively supported in these endeavors by the SLBDC.

b) Information Development

-- Investor services (market studies, pre-feasibility studies, promotion

activities) provided to business clients and contributing to increased investment by the private sector.

c) Management Development

-- A program of rural entrepreneur development and related business promotion services introduced in ten or more interior districts.

-- A program of management training and development initiated and geared to the specific needs of the private sector.

-- 15 specific management improvement training programs initiated.

3. MAHAWELI DEVELOPMENT

-- 7,000 farm families settled

-- Project development work for the New Mahaweli Agriculture and Rural Development (MARD) project completed and a Project Agreement signed.

a) Inter-Ministerial Coordination

-- An assessment of the health status and needs of the Mahaweli settlement areas completed.

-- Two additional studies or pilot activities designed to foster

inter-ministerial coordination.

b) Policy and Planning

-- Evaluation of the Mahaweli I, II and Sector Support projects completed.

-- Project redesign authorized to include additional work in Section 4 of System B and assistance in planning and budgeting.

-- An assessment undertaken on planning and financial management capabilities within the Mahaweli Authority and recommendations on means to improve them.

-- A ground water feasibility study carried out for System B.

-- A study of employment generation potential in the Mahaweli region completed.

— Three workshops, undertaken to develop (a) a policy handbook for the Department of Wildlife, (b) resource base maps for the four parks, and (c) a management plan for one of the four parks

-- An evaluation of the Mahaweli Environment project completed.

c) Infrastructure Development

— 1400 acres of park habitat improved.

— 20 miles of road, a bridge and 20,000 sq.ft. of buildings for the national park completed.

— 100 additional kilometers of market roads completed.

— 53 kms of main canal and 87 kms of branch canals constructed.

4. OTHER PROGRAMS

a) Health and Family Planning

— AID's participation in the school feeding program reduced by 50%.

— An evaluation of the National Institute of Health Sciences completed.

— Deobligation/reobligation made from the cancelled Market Town Water Supply project.

— Develop a plan for the Information and Education Campaign of the Malaria Control Project.

— Develop workplans for Management and Evaluation components of the Malaria Control Project.

-- Initiate arrangements for overseas training of staff in specialized/newer malaria control techniques especially where relevant for monitoring and management of resistant falciparum.

For the Water Supply and Sanitation project:

-- Technical assistance contract awarded, contractor fully mobilized and initial TA requirements fulfilled for project management, technical assistance, consulting, participant training and commodity procurement services.

-- Construction/renovation designs completed, contracts awarded and work initiated on Central, Regional Support Center and Regional Office workshop, training, laboratory, office and associated supportive facilities, including commodity procurement actions required for equipping said facilities.

-- water supply and latrine construction/rehabilitation sub project selection, pre-feasibility, feasibility, design and cost estimates completed.

-- Initial two year health education training completed.

b) Micro-Energy Development

-- Forestry extension service division established

-- Construction of AID financed forestry college facilities completed.

5. SPECIAL CONCERNS

a) Women In Development

-- An assessment of the role of women in irrigation and water management completed.

-- Rigorous analysis of the role of and effect on women included in all project design work carried out.

-- Collection of sex-disaggregated data done as an integral part of data gathering activities under all AID funded projects.

b) Low-Income Housing

-- A draft national housing policy paper

-- Revise and update Subsidy Reduction Study demonstrating the real cost to GSL of existing housing sector subsidies

-- Update the Shelter Strategy Statement

-- Formulate savings and lending procedure and strategies for the private and public housing financing institutions, including expansion to rural housing in the Mahaweli Settlement Area

-- Development of plans to rationalize urban low income housing and basic infrastructure services

-- Assist the newly created Land Commission in revising legialation adversely impacting on housing sector

-- Design the Phase III Housing Guaranty Program

c) Private and Voluntary Organizations

-- PVO grants valued at $2,250,000 signed for new activities under the PVO Co-financing project.

-- A selective reorientation of PVO grants to more closely integrate PVO programs into the Mission's strategic objectives put into practice.

-- An evaluation of the PVO Co-financing project completed.

6. MISSION MANAGEMENT ISSUES

-- Reduction of 2 positions completed

-- MACS put into fully operational status

-- 6 computer work stations brought on line throughout the USAID.

OBLIGATION SCHEDULE

($ 000)

PROJECT NUMBER	PROJECT TITLE	APPRO ACCOUNT	OBLIGATED AMOUNT LOAN	GRANT	MONTH OF OBLIGATION
	FY 1985				
383-0043	Malaria Control	HE	2,000	2,000	December '84
383-0058	Diversified Ag. Research	FN	1,540	3,040	December '84
383-0060	PVO Co-Financing	FN	-	402	December '84
383-0060	PVO Co-Financing	HE	-	100	December '84
383-0060	PVO Co-Financing	EH	-	200	December '84
383-0060	PVO Co-Financing	SD	-	250	December '84
383-0073	Mahaweli Basin Dev. Phase II	FN	11,706	2,000	December '84
383-0088	Water Supply & Sanitation Sec.	HE	4,100	2,000	December '84
383-0055	Reforestation & Watershed Mgmt	FN	2,157	200	April '85
383-0073	Mahaweli Basin Dev. Phase II	FN	3,710	960	June '85
383-0085	Development Training & Support	FN	-	500	July '85
	TOTAL OBLIGATIONS		25,213	11,652	
	FY 1986				
383-0043	Malaria Control	HE	-	1,000	December '85
383-0058	Diversified Ag. Research	FN	-	1,460	December '85
383-0060	PVO Co-Financing	FN	-	498	December '85
383-0060	PVO Co-Financing	HE	-	100	December '85
383-0060	PVO Co-Financing	EH	-	100	December '85
383-0060	PVO Co-Financing	SD	-	359	December '85
383-0080	Irrigation Systems Mgmt.	FN	10,000	1,500	December '85
383-0085	Development Training & Support	FN	-	1,000	December '85
383-0088	Water Supply & Sanitation Sec.	HE	900	1,000	December '85
383-0083	Agriculture Planning	FN	-	1,000	March '86
383-0086	Mahaweli Agriculture	FN	11,033	2,050	June '86
	TOTAL OBLIGATIONS		21,933	10,067	

WORKPLAN ANNEX "B"

PIPELINE ISSUES

Following are the current pipeline issues:

DEVELOPMENT SERVICES AND TRAINING (383-0044) -

The project had accrued expenditures of $4.6 million as of December 31, 1984. This figure represents 70.8% of total life of project (LOP) costs of $6.5 million. Of the balance of $1.9 million, $1.13 million will be utilized by ongoing projects due to be completed by the PACD of August 1985.

Our review of proposed uses of the remaining funds indicates that at least $500,000 will not be expended by the end of the project. We will deobligate any such monies.

REFORESTATION AND WATERSHED MANAGEMENT (383-0055) -

Only $1.8 million in expenditures had been accrued as of December 31, 1984. That expenditure level represents only 17% of LOP obligations both loan and grant, and with more than half the LOP now elapsed, this project will require special attention.

Under Sri Lankan law, both loan and grant funds which are to be expended through a department of the government must appear in the Government of Sri Lanka (GSL) budget. This project has been hampered by this requirement. Proposed project activities, particularly construction and the planting activities, have been seriously delayed or reduced by budgetary constraints. In addition special provisions of the budget, such as no new buildings (1983) or no new vehicles (1981) in a particular year, have delayed project funding

entering the GSL budget. The result has been that only $50,000 worth of construction (2 hostels at China Bay) has been completed out of $1.1 million planned. Our review indicates that AID financing of construction at the Forest College will need to be reduced by approximately $350,000 because some of the planned facilities were financed by other donors. The planting program will likewise be reduced by a possible $1 million due to the lower total plantings possible by the PACD.

Another implementation problem has been in short-term participant training. The Forestry Department has simply not been able to identify enough candidates both qualified and available for training. The July 1983 disturbances are one cause of this trouble as many Tamils selected for training left the country. Less than 15% of the proposed short-term training has taken place. A more realistic training plan has now been drawn up, and expenditures are expected to reflect that over the next three years. However, there will be over $500,000 in the training line item which will not be used.

We are now finalizing a mid-term evaluation of this project. When the evaluation is finished in February the Mission will further restructure the project based on the evaluation recommendations and will make decisions regarding possible deauthorization of funds.

MAHAWELI BASIN DEVELOPMENT I (383-0056) -

As of December 31, 1984, $4.9 million had been accrued for expenditures from a LOP amount of $10.0 million. The major purpose of this project is the design and supervision of the construction taking place under the Mahaweli Basin

Development Phase II (383-0073) project, and progress in Phase I is dependent on progress in the second. An extension of the Phase II effort is within the authority of the Mission. However, the extension of Phase I must be approved in AID/W.

The GSL will submit a proposal to us for adding a study on ground water within System B of the Accelerated Mahaweli Development area. The ground water proposal will cost approximately $1.5 million and could be included within the current funding authorization. However, it would require an extension of time up to 12 months. The Mission is interested in the ground water study as additional information is needed on water sources for a scarce-water region. We will review the proposal, when received, in conjunction with the need to extend the PACD to provide the necessary construction supervision on Phase II.

WATER MANAGEMENT (383-0057) -

As of December 31, 1984, accrued expenditures were $6.1 million for loan funds and $4.8 million for grant funds. These expenditures represent 56.5% and 74.5% of obligated funds, respectively. With only five quarters left to the PACD, it is unlikely that all canal rehabilitation work will be completed within the current life of project.

Construction activity was slowed over the past year by the exceptionally long rainy season, the need to extend the irrigation period, and to a greater extent by GSL budget allocations. The rainy season extended through April this year, a full three months longer than normal, thus rehabilitation work was limited during those three months. Unsure of adequate water supplies, many farmers in

the area planted that Yala season late and over a wider time range. This change in the planting cycle necessitated extending the irrigation period an extra month through the end of August, also limiting the amount of physical rehabilitation that could be done.

Budget cutting resulted in a reduced 1984 budget for the Irrigation Department which, consequently, was unable to plan work for all rehabilitation and construction targets previously proposed for 1984. Sufficient budget has been provided to meet planned 1985 targets, and discussions have been held with appropriate GSL offices including the Irrigation Department, Ministry of Lands and Land Development and Ministry of Finance and Planning to assure that funds will actually be available. The Mission has also been assured that additional funds will be available if the planned targets can be exceeded. If the targets are not exceeded the project will not be completed by the PACD.

It appears at this point that approximately $1.9 million in loan funding will not be utilized by the end of project. The Mission will wait and see what GSL funding is officially allocated to this project in 1985 and how rehabilitation work progesses against new realistic quarterly targets before deciding to request a PACD extension or deobligate.

Grant expenditures are not unreasonable when you consider that activity actually began in 1982 rather than when funding was first provided (1979). Expenditure targets by quarter have also been established for grant financing and are not expected to be a problem.

NATIONAL INSTITUTE OF HEALTH SCIENCES (383-0062) -

As of December 31, 1984 only $170,000 worth of expenditures have been accrued under this project or 8% of total LOP obligations.

The PACD extension approved last June was predicated on the GSL moving quickly on a retender of the construction bid in order to have a contract signed by March 1985. On January 31, 1985, the Mission approved the contract award decision.

MAHAWELI BASIN DEVELOPMENT II (383-0073) -

Accrued expenditures totaled $55.8 million in this $110.0 million project as of December 31, 1984. The project at that point was 51% complete.

Construction has been delayed by several unforeseen problems that have arisen as construction progressed: including heavier concentrations of rock in the path of the canal; quality of the dirt fill for the canal embankments; delayed shipments of cement, blasting caps and like materials; three additional months of heavy rain, and communal violence of mid-1983. The contractor is preparing a request for a cost overrun and additional time to complete the work which will carry activity right to the PACD of September 30, 1986.

Our estimate is that construction will need to continue beyond that date into the first quarter of FY 1987. The contractor has been unable to reach the planned average expenditure level of $3.6 million per month, and it is unlikely that that level can be reached over the remainder of the contract. The contractor is attempting to bring in additional equipment to increase the rate

of completion. Under current assumptions, $4.0 million from contingency and inflation would be unutilized at the completion of the work.

The Mission has submitted a proposal to amend this project to include work in Section 4 of System B. An extension of the project and utilization of any available funding will be considered as part of the review of that proposal.

MAHAWELI ENVIRONMENT (383-0075) -

This project had accrued expenditures of only $458 thousand as of December 31, 1984, out of the programmed amount of $5.0 million for this five year project. Despite the low expenditure level, several important activities have now been undertaken.

The major project delays have come in construction. In 1984 the proposed construction activities were not all included in the GSL budget, and the Department of Wildlife was thus limited in spending the AID funds in this category. The Mahaweli authority has assured the Mission that the $810,000 programmed for construction has been included in the 1985 budget. The GSL is now moving quickly to a contract award to complete all construction work. One contract for $280,000 for bridge construction has been awarded. Prequalification of firms for construction of buildings will be completed shortly.

While construction makes up close to half of project costs and is important to the end of project status, the other components can continue and have significant results even if the construction is slow to completion. With the

TA PASA advisors' arrival in February 1984, we expect the other project components to move at an adequate pace to finish by the PACD.

MAHAWELI SECTOR SUPPORT (383-0078) -

As of December 31, 1984, accrued expenditures reached a level of $37.5 million leaving a pipeline of $12.5 million or 26% of total obligations.

Following our latest discussions with the Mahaweli Authority, attention is being given to timely completion of eligible activities by the PACD with total utilization of remaining funds. The Minister of Mahaweli Development has taken a strong personal interest in having the loan fully utilized and understands this must be accomplished prior to the PACD.

WORK PLAN ANNEX "C"

EVALUATION SCHEDULE

FY 1985

Mahaweli Basin Development I (383-0056) Interim	March 1985
Mahaweli Basin Development II (383-0073) Mid-term	March 1985
Mahaweli Sector Support (383-0078) End-of-Project	March 1985
Mahaweli Environment (383-0075) Mid-term	August 1985

FY 1986

Water Management (383-0057) End-of-Project	November 1985
Private Enterprise Promotion (383-0082) Mid-term	March 1986
PVO Co-Financing (383-0060) Mid-term	June 1986
National Institute of Health Sciences (383-0062) End-of-Project	August 1986

Work Plan Annex "D"

PROJECT DEVELOPMENT SCHEDULE

PROJECT NUMBER	PROJECT TITLE	DESIGN DOCUMENT	SUBMISSION DATE
383-0085	Development Training & Support	PID	January 1985
		PP	July 1985
383-0073	Mahaweli Basin Development II	PID -Like) Cable)	February 1985
		PP Amend.	May 1985
--	PL 480 Title III	PID	April 1985
		PP	September '85
383-0083	Agriculture Planning & Analysis	PID	June 1985
		PP	October 1985
383-0080	Irrigation Systems Management	PP	July 1985
383-0086	Mahaweli Agriculture & Rural Development	PID	September '85
		PP	March 1986
383-00	Rural Enterprise Development	PID	May 1985
		PP	September '85