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AGENCY FOR
INTERNATIONAL
DEVELOPMENT

SRI LANKA

COUNTRY DEVELOPMENT STRATEGY STATEMENT

FY 83

BEST AVAILABLE

January 1981

UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
WASHINGTON, D.C. 20523

UNCLASSIFIED

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THIS STRATEGY STATEMENT HAS BEEN PREPARED BY THE A.I.D. FIELD MISSION. IT IS PREPARED ANNUALLY AND USED FOR PLANNING PURPOSES IN THE FIELD AND IN WASHINGTON. IT DOES NOT REPRESENT OFFICIAL AGENCY POLICY.

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COUNTRY DEVELOPMENT STRATEGY STATEMENT

FY 1983 - 87

UNITED STATES AID MISSION TO SRI LANKA

Prepared January, 1981

This Sri Lanka Country Development Strategy Statement (CDSS) for FY 1983-87 is transmitted while the Ambassador is on vacation. His comments will be forwarded later.

UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D.C. 20523

February 10, 1981

MEMORANDUM FOR: FY 83 CDSS/SPS Distribution List I(14)-3

FROM: Rhonda M. Smith, PPC/PB RMS

SUBJECT: FY 83 Sri Lanka Transmittal Letter

Attached with this brief memorandum is the Ambassador's statement for the Sri Lanka CDSS which has already been printed and distributed. Please affix this to the Sri Lanka CDSS which you should have received 1/28/81.

Attachment: a/s

Department of State

INCOMING TELEGRAM

PAGE 01 COLOMB 00586 040738Z 069509 AID4738

ACTION NEA-07

INFO AAAS-01 ASEM-01 ASPM-02 ASDP-02 CH6-01 PPCE-01 PDPR-01
PPPB-03 GC-01 PPEA-01 GCAS-01 GCFL-01 PPIA-02 IDCA-01
FM-02 PDC-02 ASPD-03 AGTR-01 AADS-01 CHGT-02 CTR-02
DSAG-02 ENGR-02 FFP-03 OFP-01 CH6-01 ES-01 AAID-01
/043 A3 604

INFO OCT-01 ADS-00 AID-07 EB-08 /023 W

----------301200 040751Z /13

P 040710Z FEB 81
FM AMEMBASSY COLOMBO
TO SECSTATE WASHDC PRIORITY 9652

UNCLAS COLOMBO 0586

DEPT FOR NEA/INS

ALSO FOR AID

E.O.12065: N/A
TAGS: EAID, CE
SUBJ: US ECONOMIC ASSISTANCE; COUNTRY DEVELOPMENT STRATEGY STATEMENT (CDSS) FOR 1983-87

FOLLOWING IS AMBASSADOR'S STATEMENT WHICH SHOULD BE ATTACHED AS PREFACE TO CDSS FOR FY 83-87 ALREADY SUBMITTED TO AID WASHINGTON IN MID-JANUARY (WHILE AMBASSADOR ON VACATION):

THERE IS A LARGE ELEMENT OF UNREALITY IN THIS CDSS -- UNAVOIDABLE SINCE USAID/COLOMBO IS, IN EFFECT, REQUIRED TO MAKE A FIVE-YEAR PROJECTION OF ASSISTANCE LEVELS FOR A SINGLE COUNTRY BEFORE THE NEW ADMINISTRATION HAS MADE DECISIONS ABOUT WORLDWIDE ASSISTANCE LEVELS.

DESPITE THIS ELEMENT OF UNREALITY, THE CDSS FOR 1983-87 COMMANDS MY ENTHUSIASTIC SUPPORT -- FAR MORE SO THAN PREVIOUS CDSS'S OR ANNUAL BUDGET SUBMISSIONS HAVE COMMANDED FROM ME OR MY PREDECESSOR FOR THE FOLLOWING REASONS:

-- THIS CDSS WOULD FOCUS FUTURE US ASSISTANCE IN AREAS (MAHAWELI BASIN DEVELOPMENT, FOOD PRODUCTION, HUMAN PRODUCTIVITY AND NATURAL RESOURCE MANAGEMENT) WHERE OUR PROGRAMS WOULD REST ON A SOLID FOUNDATION OF PAST EXPERIENCE/COMPARATIVE ADVANTAGE, WOULD MEET URGENT AND GENUINE NEEDS OF POORER SEGMENTS OF SRI LANKAN POPULATION, AND WOULD COINCIDE WITH HIGH GSL PRIORITIES.

-- IT PROPOSES A TECHNIQUE FOR TRANSFERRING US RESOURCES TO SRI LANKA WHICH MEETS URGENT NEEDS FOR LARGER REVENUES AND BALANCE OF PAYMENTS SUPPORT WHICH HAVE ARISEN IN THIS ECONOMY. (THE REASONS ARE SET FORTH IN THE EXCELLENT MACRO-ECONOMIC ANALYSIS).

-- IT FORESEES, IN MARKED CONTRAST TO PAST PROJECTIONS, AT MOST A MINOR INCREASE IN US STAFF LEVELS - A CHANGE I WELCOME FOR REASONS OF COST, ADMINISTRATIVE SUPPORT LOAD AND POLITICAL PROFILE (NATIONAL ELECTIONS FOR PARLIAMENT AND THE PRESIDENCY ARE SCHEDULED FOR MID-1983 AND EARLY 1984, RESPECTIVELY).

DESPITE OVERALL ENTHUSIASTIC SUPPORT, I HAVE TWO SUBSTANTIVE POINTS OF DIFFERENCE WITH THE STRATEGY OUTLINED IN THIS CDSS:

-- IT CONTINUES TO PROPOSE ONE AREA OF ASSISTANCE -- MAHAWELI ENVIRONMENTAL PROTECTION -- ABOUT WHICH I AM DUBIOUS. SPECIFICALLY, I QUESTION WHETHER THIS PROPOSED ACTIVITY MEETS URGENT SRI LANKAN NEEDS, MAKES A CONTRIBUTION TO ECONOMIC PRODUCTIVITY AND IS BEST PROVIDED BY THE U.S. IN MY VIEW, RESOURCES PROJECTED FOR THIS ACTIVITY (SOME $3 MILLION) WOULD MAKE A GREATER CONTRIBUTION TO ECONOMIC PRODUCTIVITY IF THEY WERE INVESTED IN PROJECTS SUCH AS POTABLE WATER.

COLOMB 00586 040738Z 069509 AID4738

-- I ALSO BELIEVE FULFILLMENT OF THE AID MANDATE REQUIRES A MORE SUBSTANTIAL INVESTMENT OF US RESOURCES IN THE SARVODAYA MOVEMENT, A PURELY SRI LANKAN MOVEMENT FOR RURAL DEVELOPMENT WHICH COMMANDS UNPARALLELED RESPECT IN DEVELOPMENT CIRCLES, DOMESTIC AND INTERNATIONAL. (PRESENT US INVESTMENT IN SARVODAYA IS LIMITED TO AN AIT GRANT OF $95,000.)

IT IS IMPOSSIBLE TO ENDORSE OR QUESTION THE SPECIFIC PROPOSED LEVELS OF DEVELOPMENTAL OR PL 480 ASSISTANCE UNTIL THERE ARE REALISTIC OVERALL FIGURES TO RELATE TO. NEVERTHELESS, I WHOLEHEARTEDLY SUPPORT THE ANALYSIS AND REASONING BEHIND THE RECOMMENDATION FOR AN INCREASED PL 480 PROGRAM (BOTH TITLES I AND III) IN 1983-84. IN ADDITION, I URGE DECISIONS ABOUT DEVELOPMENT ASSISTANCE LEVELS FOR SRI LANKA TAKE INTO ACCOUNT THE STARTLING ANALYSIS THAT BECAUSE OF INFLATION, THE LEVELS OF FUTURE ASSISTANCE CALLED FOR IN THIS CDSS, ENTAIL A DECREASE IN REAL TERMS FROM THE CURRENT LEVELS.

TOUSSAINT

UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D.C. 20523

February 10, 1981

MEMORANDUM FOR: FY 83 CDSS/SPS Distribution List I(14)-3

FROM: Rhonda M. Smith, PPC/PB RMS

SUBJECT: FY 1983 Guinea SPS

Please attach this errata sheet and cable to the FY 1983 Guinea SPS.

Attachments: a/s

Errata Sheet

GUINEA SMALL PROGRAM STRATEGY STATEMENT UPDATE 1983-87

NOTE: The Guinea SPSS update was transmitted from the field by telegram, as authorized by AID/W. Since the cable was reproduced in small, compressed type-form that was not conducive to review of a fairly lengthy document, the SPSS was retyped and printed for distribution. However, in part because of telegraphic garbles, the typed version contains typos and omissions, the most important of which are listed below. It is hoped these corrections will clarify certain points. We regret the inconvenience to readers.

* * *

p. 1 - Insert introductory paragraph:

"The following SPSS update has been constructed to address specifically the issues raised in /80 State 075229 -- last year's SPSS review cable/ as well as the key concerns expressed in CDSS/SPSS guidance. Relevant material from the FY 82 SPSS is referenced, not repeated. Commitment data not integrated into the update is subject of septel."

p. 1, line 2 - "contiguous" lieu "continuous"

p. 5, Section 3, Faranah. line 2 - "kops" lieu "crops". Line 4 should read "...and substantial increases in production could be obtained through its further development. Lowland rice is cultivated near the river...."

p. 6, line 2 should read ". . . has generally been respected. A small amount of fertile land has been taken from farmers for use by collective farms . . . ."

p. 7, last paragraph, first line - "1976" lieu "1960". In third line from bottom, the second figure should read "1,600".

p. 10, second line from bottom - "ever poorer" lieu "even poor". Following the last paragraph on this page, insert following full paragraph:

"To break this circle requires a development strategy which takes account of each element and their interrelationships. Poor small-scale farmers constitute the vast majority of the population and contribute over 80% of the country's agricultural production. To increase both production and the welfare of the people, the basic strategy objective must be to enable the poor to meet their basic human needs through sustainable use of the dormant resource potential of the target zone. In pursuit of this objective it is necessary to improve agricultural practices, provide needed inputs, incentives and markets, protect and enhance soil, water and forest resources, and improve nutrition and health. As the productive quality of land and manpower improve, the quantity of the human and natural resources required for subsistence will diminish and the way will be opened for surplus production. This will create incentive to reduce the birth rate, permitting increased per capita consumption while limiting demand on the natural resource base."

p. 15, line 2 should read "... rate of exchange and $475 million at the unofficial rate. Since a portion — amount unknown -- is converted at the official rate for imports, the equivalent dollar value is somewhat above $475 million . . . ."

p. 15, second paragraph, line 3 - "Exhortation" lieu "Exportation"

p. 17, line 1 - "shops" lieu "shorts". Line 7 should read ". . . growing demand for food and the very low state of agricultural productivity in Guinea require that the donors . . ."

p. 22, line 1 - "1987" lieu "1976". Agricultural Research and Extension figure for 1987: "2.0" lieu "2.5". Title I and Housing Guaranty figures should be in parentheses to distinguish them from development grants.

Department of State

INCOMING TELEGRAM

ACTION AID-35

ACTION OFFICE PPPB-03
INFO AAAF-01 AFCW-03 AFDP-02 AFDR-06 CRS-01 PPCE-01 PDPR-01
PPEA-01 FM-02 AABS-01 BSAG-02 BSHE-01 ED-02 EHGR-02
POP-04 CHR-01 AGRI-01 REV-09 RELO-01 NAST-01 AFDA-01
/047 A4 828

INFO OCT-01 AF-10 /046 W
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P R 271200Z JAN 81
FM AMEMBASSY CONAKRY
TO SECSTATE WASHDC PRIORITY 0000
INFO AMEMBASSY ABIDJAN

UNCLAS SECTION 1 OF 3 CONAKRY 0272

AIDAC

FOR PPC/PB, AFR/CWA, AFR/DP, STATE AF/W

ABIDJAN FOR REDSO/WA

E.O. 12065: NA
SUBJECT: PROGRESS AND COMMITMENT: SUPPLEMENT TO GUINEA SMALL PROGRAM STRATEGY UPDATE, 1983-87

REF: (A) 80 STATE 309900, (B) CONAKRY 0148

1. THE FOLLOWING IS KEYED TO THE TOPICS UNDER PARAGRAPH 7 OF REF A. ADDITIONAL TOPICS REF A ARE SUBJECT OF SEPTEL SENT THIS DATE.

A. IMPACT OF MACROECONOMIC FACTORS ON THE POOR

(1) DOMESTIC ECONOMY: THE GUINEAN CURRENCY, THE SYLI, HAS ALWAYS BEEN TRADED ON THE PARALLEL MARKET AT A FRACTION OF ITS OFFICIAL VALUE. IN THE EARLY 70'S THE SYLI WAS OVERVALUED BY A FACTOR OF ABOUT TEN. AS A RESULT OF STRICT CONTROL OVER THE MONEY SUPPLY, THE PARALLEL MARKET VALUE OVER THE PAST TWO YEARS HAS STABILIZED AT 80-85 TO THE DOLLAR, SLIGHTLY MORE THAN FOUR TIMES THE OFFICIAL VALUE OF 19 TO THE DOLLAR. MONEY SUPPLY IN PROPORTION TO GDP HAS DROPPED FROM 39.4 PERCENT IN 1976 TO 33 PERCENT IN 1979. THIS REDUCTION, COUPLED WITH LESSENED RESTRICTIONS ON THE FREE MARKET AND THE INFLUEX OF PRIVATE FOREIGN EXCHANGE, HAS REDUCED INFLATION, INCREASED THE SUPPLY OF GOODS AND ENHANCED THE PURCHASING POWER OF THE POOR. THE GOVERNMENT IS NOW PURSUING A POLICY WHICH SEEKS TO STIMULATE DOMESTIC PRODUCTION AND ALLOWS FOR MODERATE GROWTH IN MONEY SUPPLY. GUINEAN AUTHORITIES SAY THEIR AIM OF MAKING THE SYLI FULLY CONVERTIBLE WILL COME ABOUT THROUGH A STRENGTHENED NATIONAL ECONOMY RESULTING FROM AND EXPANSION AND DIVERSIFICATION OF EXPORTS, AND FROM INCREASED PRODUCTIVITY, ESPECIALLY IN AGRICULTURE, TO EXPAND THE DOMESTIC SUPPLY OF GOODS. TO IMPROVE THE EFFICIENCY OF THE BANKING SYSTEM, INTEREST RATES HAVE BEEN RAISED TO MORE REALISTIC LEVELS, AND A NATIONAL SAVINGS BANK HAS BEEN CREATED TO MOBILIZE PRIVATE SAVINGS. AT THE SAME TIME, STEPS ARE BEING TAKEN TO IMPROVE THE CASH FLOW AND OPERATIONAL EFFICIENCY OF PUBLIC ENTERPRISES (SOME HAVE BEEN CLOSED DOWN, OTHERS ARE BEING REHABILITATED), AND CREDIT TO THE PRIBATE SECTOR IS BEING INCREASED FOR THE FIRST TIME IN SEVERAL YEARS. HOWEVER, PUBLIC SECTOR INVESTMENT CONTINUES TO RECEIVE PRIORITY, WITH EMPHASIS IN AGRICULTURE GIVEN TO MECHANIZED COLLECTIVE ENTERPRISES SUCH AS THE FAPA'S (DISTRICT FARMS). YET, IN SPITE OF GOVERNMENT ASSISTANCE, THE FAPAS' PRODUCTIVITY IS LOWER THAN THAT OF SMALL FARMERS WHO PROVIDE THE BULK OF AGRICULTURAL OUTPUT. (SEE ALSO DISCUSSION IN REF B.

(2) BALANCE OF PAYMENTS: GUINEA HAS HAD A TRADE SURPLUS OF $20 MILLION TO $30 MILLION OVER THE LAST THREE YEARS, BUT AS RUN A DEFICIT ON CURRENT ACCOUNT OF $76 MILLION TO $90 MILLION DURING THAT PERIOD

(EMBASSY STATISTICS). THE DEFICIT IS ATTRIBUTED TO FACTOR SERVICE PAYMENTS RELATED TO MINING OPERATIONS AND TO RELATIVELY LOW CAPITAL INFLOWS. FOREIGN EXCHANGE EARNINGS FROM EXPORTS FOR 1978, 1979 AND 1980 HAVE BEEN (IN $ MILLIONS) 330, 370 AND 410, RESPECTIVELY. BAUXITE AND ALUMINA EXPORTS CONSTITUTE OVER 95 PERCENT OF THESE EARNINGS. ABOUT 60 PERCENT OF GROSS EXPORT EARNINGS RETURNS TO THE MINING SECTOR FOR OPERATING COSTS AND DEBT SERVICE, LEAVING ONLY 40 PERCENT FOR OTHER DEBT SERVICE AND FOR INCREASINGLY COSTLY IMPORTS OF PETROLEUM, RAW MATERIALS, FOODSTUFFS AND CONSUMER GOODS. ALTHOUGH PRODUCTION OF BAUXITE AND ALUMINA HAVE LEVED OFF, DIVIDEND EARNINGS FROM MINING ARE EXPECTED TO RISE SHARPLY IN THE NEXT SEVERAL YEARS AS ORIGINAL CONSTRUCTION LOANS ARE PAID OFF. OVERALL DEBT SERVICE, HOWEVER, IS EXPECTED TO RISE BECAUSE OF THE VOLUME OF EXISTING SHORT AND MEDIUM-TERM CREDITS. THE RATIO OF ANNUAL DEBT PAYMENTS TO YEARLY FOREIGN EXCHANGE INCOME WILL REMAIN ABOUT 1:3. GUINEA HAS HANDLED ITS FOREIGN EXCHANGE SHORTAGES THROUGH ARREARAGES ON DEBT SERVICE, DELAYS IN PAYMENTS FOR CURRENT PURCHASES, AND A DECREASE IN FOREIGN EXCHANGE RESERVES (DOWN TO ONE MONTH'S WORTH OF IMPORTS AT THE END OF 1978: $29.2 MILLION). TO IMPROVE ITS DEBT AND BALANCE OF PAYMENTS POSITION, GUINEA HAS RESCHEDULED PART OF ITS DEBT, CREATED TWO NEW DEPARTMENTS WITHIN THE CENTRAL BANK TO PLAN FOREIGN EXCHANGE EXPENDITURES AND MANAGE FOREIGN DEBT, AND IS SEEKING LONGER MATURITIES (5-10 YEARS) AND CONCESSIONAL INTEREST RATES. EXTERNAL BORROWING TERMS ALREADY SHOWED A SOFTENING IN 1979. HOWEVER, THESE MEASURES WILL NEED TO BE SUPPLEMENTED BY LARGE AMOUNTS OF EXTERNAL ASSISTANCE OVER THE NEXT FEW YEARS IF DEVELOPMENT NEEDS ARE TO BE MET AND THE BALANCE OF PAYMENTS IS TO BE PLACED ON A SOUND FOOTING.

B. EMPLOYMENT GENERATION

RELIABLE DATA ON OVERALL EMPLOYMENT IN GUINEA ARE NOT AVAILABLE. THE NUMBER OF REGISTERED WAGE EARNERS IN 1978 WAS 134,330, ABOUT 6 PERCENT OF 2.3 MILLION ESTIMATED TO BE ECONOMICALLY ACTIVE. OF THE TOTAL WAGE EARNERS, 28 PERCENT WERE EMPLOYED IN PUBLIC ADMINISTRATION, THE REMAINDER IN STATE ENTERPRISES AND MIXED ECONOMY CORPORATIONS. THE GOG GUARANTEES EMPLOYMENT TO ALL SCHOOL GRADUATES. THREE-FOURTHS OF POST-SECONDARY STUDENTS, A TOTAL OF OVER 10,000, ARE ENROLLED IN THE 29 AGRICULTURAL SCHOOLS SPREAD THROUGHOUT THE COUNTRY. WHETHER ALL THE GRADUATES ARE IN FACT PLACED IN FAPA'S OR OR OTHER AGRICULTURAL INSTALLATIONS IS NOW KNOWN.

APPROXIMATELY 85 PERCENT OF THE LABOR FORCE IS AGRICULTURAL AND 6 PERCENT IS WAGE-EARNING, LEAVING 9 PERCENT OF WORKERS WHO ARE TRADERS, ARTISANS, OTHERWISE SELF-EMPLOYED OR UNEMPLOYED. STATISTICAL DATA ON UNEMPLOYMENT AND UNDEREMPLOYEMENT ARE LACKING. A PARTICULAR PROBLEM OF UN- AND UNDEREMPLOYMENT EXISTS IN THE FOUTA DJALLON, AN AREA OF CONSIDERABLE MALE OUTMIGRATION.

PUBLIC SECTOR WAGE INCREASES ARE GRANTED ONLY INFREQUENTLY AND DO NOT APPEAR TO MATCH THE RISE IN THE COST OF LIVING. GOVERNMENT EMPLOYEES RECEIVE FAMILY ALLOWANCES AND INDEMNITIES OF VARYING DEGREES FOR POSITIONS OF HIGHER RESPONSIBILITY. GUINEAN PERSONNEL OF MIXED ECONOMY COMPANIES ARE ON THE SAME WAGE SCALES BUT MAY RECEIVE ADDITIONAL REMUNERATION IN KIND.

Department of State

INCOMING TELEGRAM

ACTION AID-35

ACTION OFFICE PPPB-03
INFO AAAF-01 AFCW-03 AFDP-02 AFDR-06 CH6-01 PPCE-01 POPR-01
PPEA-01 FR-02 AADS-01 DSAG-02 DSBE-01 ED-02 ENGR-02
POP-04 CR6-01 AGRI-01 REV-00 RELO-01 MAST-01 AFDA-01
/047 A4 028

INFO OCT-01 AF-10 /046 V
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P R 271200Z JAN 81
FM AMEMBASSY CONAKRY
TO SECSTATE WASHDC PRIORITY 8179
INFO AMEMBASSY ABIDJAN

UNCLAS SECTION 2 OF 3 CONAKRY 0272

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WITH RESPECT TO CAPITAL VERSUS LABOR-INTENSIVE POLICIES: THE COST OF CAPITAL IS ARTIFICALLY LOW FOR GUINEAN ENTERPRISES BECAUSE OF THE OVERVALUED EXCHANGE RATE. BY THE SAME TOKE, LOCAL COSTS FINANCED BY FOREIGN INVESTORS WITH FOREIGN EXCHANGE ARE ARTIFICALLY HIGH. EMPLOYMENT IN MINING AND INDSUTRY REMAINED STEADY AT ABOUT 18,500 FROM 1975 TO 1978, THE LATEST YEARS FOR WHICH FIGURES ARE AVAILABLE. DURING THOSE YEARS, BAUXITE CONSTRUCTION (JOINT VENTURE OF GOG AND FOREIGN INVESTORS) ROSE BY 49 PERCENT, WHILE LOCAL INDUSTRY AS A WHOLE SAW LITTLE GROWTH OWING TO SHORTAGE OF FOREIGN EXCHANGE, A CUMBERSOME BUREAUCRACY, POOR MAINTENANCE AND SHORTAGES OF IMPORTED RAW MATERIALS AND SPARE PARTS. WE DO NOT KNOW TO WHAT EXTENT MORE LABOR-INTENSIVE METHODS MIGHT BE FEASIBLE IN THE MINING SECTOR OR IN THE VERY SMALL INDUSTRIAL SECTOR IN GUINEA, HENCE CANNOT JUDGE WHETHER EMPLOYMENT OPPORTUNITIES HAVE BEEN LIMITED OR ENHANCED BY CAPITAL IMPORTS. ONE CAPITAL IMPORT WHICH HAS NOT BEEN VERY PRODUCTIVE IS TRACTORS FOR COLLECTIVE FARM USE. MANY HAVE BROKEN DOWN FOR LACK OF SPARE PARTS AND MAINTENANCE, AND OTHER NEEDED FARM INPUTS HAVE BEEN IN SHORT SUPPLY. ALTERNATIVE USE OF THE FUNDS TO MEET SMALL-FARM NEEDS MIGHT HAVE YIELDED A GREATER RETURN IN PRODUCTION AND EMPLOYMENT.

C. ACCESS TO PRODUCTIVE RESOURCES

(A) LAND: AVAILABLE INFORMATION INDICATES THAT LAND TENURE IN THE SENSE OF EQUITABLE ACCESS IS NOT NOW A SIGNIFICANT PROBELM. THE 500,000 TO 600,000 SMALL FAMILY FARMS AVERAGE APPROXIMATELY TWO HECTARES APIECES ALTHOUGH ALL LAND IS OFFICIALLY OWNED BY THE STATE, TENSURE AND GRAZING RIGHTS BASED ON CUSTOMARY USE HAVE GENERALLY BEEN RESPECTED. AUTHORITY TO REALLOCATE LAND AMONG FARMERS IS VESTED IN LOCAL PARTY COMMITTEES IN PLACE OF THE FORMER TRADITIONAL CHIEFS. THERE HAVE BEEN REPORTS OF LAND CULTIVATED OR LEFT FALLOW BY SMALL FARMERS BEING TAKEN OVER FOR SOME OF THE RECENTLY CREATED FAPA'S. HOWEVER, THIS PRACTICE HAS NOT TAKEN ON LARGE-SCALE PROPORTIONS, AS THE NUMBER OF FAPA'S TOTALS LESS THAN 250, THEIR AVERAGE SIZE IS STILL UNDER 100 HECTARES AND THE PROGRAM IS EXPANDING VERY SLOWLY DURING THE PRESENT "CONSOLIDATION PHASE." THE MORE SERIOUS THREAT TO AGRICULTURAL PROGRESS APPEARS TO BE SOIL DEGRADATION OWING TO DEFORESTATION, EROSION AND POOR AGRICULTURAL PRACTICES.

(2) ROADS: MANY OF THE TOWNS, PARTICULARLY IN WESTERN GUINEA, ARE CONNECTED BY PAVED ROADS. WITH WORLD BANK ASSISTANCE THE GOG HAS UNDERTAKEN AN EXTENSIVE UPGRADING AND MAINTENANCE PROGRAM. UNPAVED ROADS TO VILLAGES IN THE INTERIOR RANGE FROM GOOD TO BARELY PASSABLE. THERE IS NEED FOR ADDITIONAL FARM-TO MARKET ROADS, BUT WE DO NOT HAVE DETAILS ON MILEAGE AND LOCATION OF NEED. A LARGE FLEET OF PUBLICLY AND PRIVATELY OWNED TRUCKS SERVES THE TRANSPORT NEEDS OF BOTH THE OFFICIAL AND PARALLEL MARKETS, BUT DEMAND FOR TRANSPORT EXCEEDS SUPPLY AND BOTTLENECKS FREQUENTLY OCCUR. LACK OF SPARE PARTS AND MAINTENANCE ARE MAJOR PROBLEMS. A SINGLE-TRACK RAILROAD RUNS THE 410 MILES BETWENE CONAKRY AND THE EASTERN CITY OF KANKAN; THE ROUND TRIP TAKES TWO DAYS BECAUSE OF THE POOR CONDITION OF TRACK AND ROLLING STOCK.

(3) MARKETS: THERE ARE TWO DISTINCT MARKETING SYSTEMS: THE OFFICIAL AND THE PARALLEL. THE OFFICIAL MARKET SEEKS TO MAINTAIN MONOPOLY, IN STRATEGIC OR BASIC PRODUCTS (CEREALS, PEANUTS, PALM KERNELS, MARIOC, COFFEE, ETC.) PAYING ENERMLY LOW PRICES TO PRODUCERS. OFFICIAL MARKETING ENTERPRISES ALSO SELL BASIC ITEMS (CEREALS, COOKING OIL, SUGAR, SOAP, ETC) AT LOW OFFICIAL PRICES WITH RATION CARDS. HOWEVER, THE SHORTAGE OF LOCAL AND IMPORTED COMMODITIES ON THE OFFICIAL MARKET IS SUCH THAT EVEN CIVIL SERVANTS IN THE INTERIOR CANNOT RELY ON IT FOR BASIC NEEDS AND MUST TURN TO THE PARALLEL MARKET. THE RURAL POPULATION HAS TO RELY ALMOST ENTIRELY ON THE PARALLEL MARKET OR CONTIGUOUS FOREIGN MARKETS FOR BASIC CONSUMAR GOODS. PRICES ARE GENERALLY FOUR TIMES HIGHER THAN ON THE OFFICIAL MAREKT; HOWEVER, AS NOTED IN PARA A ABOVE, THIS IS A SUBSTANTIAL IMPROVEMENT OVER THE SITUATION IN THE EARLY 70'S WHEN PARALLEL MARKET PRICES WERE UP TO TEN TIMES AS HIGH. PRODUCTION GOODS AND INPUTS NEEDED FOR AGRICULURE ARE IN SHORT SUPPLY, WITH COLLECTIVE AND STATE-RUN AGRICULTURE RECEIVING PRIORITY FOR THE ITEMS IMPORTED.

(4) ELECTRICITY AND WATER: CITIES AND MAJOR TOWNS ARE SERVED BY ELECTRICITY AND WATER SUPPLIES: RENOVATION AND EXPANSIONOF THESE SYSTEMS IS UNDERWAY WITH EXTERNAL ASSISTANCE, CHIEFLY WORLD BANK AND EEC. MOST VILLAGES DO NOT HAVE ELECTRICITY. ACCESS TO SAFE WATER SUPPLIES IS LIMITED TO AN ESTIMATED AVERAGE 18 PERCENT OF THE POPULATION (27 PERCENT IN URBAN AREAS, 3 PERCENT IN RURAL AREAS). WITH EEC ASSISTANCE, THE GOG CREATED A NATIONAL WATER POINTS DEVELOPMENT SERVICE (SNAPE) WHICH HAS ESTABLISHED A SUCCESSFUL RECORD IN DEVELOPING VILLAGE WATER SUPPLIES IN THE FOUTA DJALLON (MIDDLE GUINEA) AND IS PLANNING TO EXPAND ITS OPERATIONS TO OTHER PARTS OF THE COUNTRY.

(5) IRRIGATION: CONSIDERABLE POTENTIAL EXISTS FOR DEVELOPMENT OF IRRIGATION IN GUINEA. THE INCREASE IN THE BUDGET FOR AGRICULTURE UNDER THE NEW PLAN (SEE REF B, PARA II.B.2) INCLUDES A FOCUS ON IRRIGATION DEVELOPMENT. EEC IS FINANCING IRRIGATION PROJECTS AND FAO IS PLANNING A SMALL DAMS PROJECT IN THE FOUTA DJALLON WHICH WILL FACILITATE IRRIGATION BY LOCAL FARMERS. AID IS PLANNING TO UNDERTAKE AN IRRIGATED VEGETABLE GRADENING PROJECT UTILIZ:NG WATER SOURCES DEVELOPED BY SNAPE.

(6) CREDIT: VERY LITTLE CREDIT HAS BEEN AVAILABLE TO SMALL FARMERS, PARTLY BECAUSE OF A POOR REPAYMENT RECORD EXPERIENCED IN CREDIT PROGRAMS DURING THE 60'S. THERE IS NOW RENEWED INTEREST IN AGRICULTURAL CREDIT: THE GOG SPONSORED AN INTERNATIONAL CONFERENCE ON THE SUBJECT IN DECEMBER 1980, AND AID MAY BE ASKED TO PROVIDE TRAIING FOR PERSONNEL OF THE AGRICULTURAL DEVELOPMENT BANK WHICH IS CONTEMPLATING THE EXTENSION OF CREDIT TO SMALL FARMERS.

(7) EXTENSION NETWORKS: SEE REF B, SECTIONS I.B.4 AND II.B.2 FOR DISCUSSION. IN BRIEF, THERE IS NO NATIONAL EXTENSION PROGRAM, BUT THE BASIS FOR ONE IS BEING LAID IN VARIOUS DONOR-SUPPORTED PRODUCTION, RESEARCH AND TRAINING PROJECTS, INCLUDING USAID'S.

D. HEALTH AND EDUCATION

AVAILABLE INFORMATION INDICATES THAT ALLOCATIONS FOR HEALTH AND EDUCATION HAVE REMAINED STEADY. OF THE 38 BILLION SYLI BUDGET FOR 1981-85, HEALTH AND SOCIAL AFFAIRS WILL RECEIVE 762 MILLION SYLIS (2 PERCENT) AND EDUCATION, CULUTRE AND INFORATMION, 2.286 MILLON (6 PERCENT).

Department of State

INCOMING TELEGRAM

ACTION AID-35

ACTION OFFICE PPPB-03
INFO AAAF-01 AFCW-03 AFDP-02 AFDR-06 CHG-01 PPCE-01 PDPR-01
PPEA-01 FM-02 AADS-01 DSAG-02 DSNE-01 ED-02 ENGR-02
POP-04 CIE-01 AGRI-01 HEV-09 RELO-01 NAST-01 AFDA-01
/047 A4 828

INFO OCT-01 AF-10 /046 V
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P R 271200Z JAN 81
FM AMEMBASSY CONAKRY
TO SECSTATE WASHDC PRIORITY 8188
INFO AMEMBASSY ABIDJAN

UNCLAS SECTION 3 OF 3 CONAKRY 0272

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WE DO NOT HAVE A BREAKDOWN FOR THESE FIGURES. HOWEVER, THE FOLLOWING OBSERVATIONS CAN BE MADE:

(1) HEALTH: HEALTH FACILITIES AND PERSONNEL ARE SPREAD THROUGHOUT THE COUNTRY AND HENCE AVAILABLE TO THE RURAL AS WELL AS THE URBAN POPULATION. THE RATIO OF POPULATION TO PHYSICIANS, NURSES AND HOSPITAL BEDS IS ABOUT HALF THE AVERAGE FOR LOW-INCOME COUNTRIES IN SUB-SAHARAN AFRICA AND IS COMPARABLE TO MIDDLE-INCOME COUNTRY RATIOS IN AFRICA. STUDENTS GRADUATING FROM MEDICAL SCHOOL ARE REQUIRED TO SERVE A MINIMUM OF TWO YEARS IN RURAL AREAS. THERE ARE 47 HOSPITALS OF VARIOUS CATEGORIES, 276 DISTRICT RURAL HEALTH CENTERS, 321 DISPENSARIES AND 2,442 LOCAL HEALTH POSTS, AMONG OTHER FACILITIES. THEY OPERATE AT VARIOUS LEVELS OF DEVELOPMENT AND ORGANIZATION, MANY BEING RUN DOWN AND POORLY EQUIPPED. DONORS INCLUDING EEC, WHO, UNICEF, AID AND COMMUNIST NATIONS PROVIDE EQUIPMENT, MEDICINES, VACCINES AND/OR PERSONNEL. AS NOTED IN SECTION I.E. OF REF B, THERE HAS BEEN SIGNIFICANT IMPROVEMENT IN MORTALITY RATES AND LIFE EXPECTANCY SINCE 1960, BUT IN THESE CATEGORIES GUINEA REMAINS SLIGHTLY BELOW THE AVERAGE FOR LOW-INCOME COUNTRIES IN AFRICA. LOWER NUTRITION LEVELS AND QUALITY OF HEALTH CARE AS WELL AS POOR ENVIRONMENTAL SANITATION MAY EXPLAIN THE DIFFERENCE.

(2) EDUCATION: THERE ARE NO UP-TO-DATE FIGURES ON LITERACY, BUT WE BELIEVE THE RATE IS HIGHER THAN THE 1972 RATE OF 18 PERCENT CITED IN AID'S ECONOMIC AND SOCIAL DATA. THE REASON IS THE GREAT EFFORT BEING MADE TO PROVIDE SCHOOLING THROUGHOUT THE COUNTRY, INCLUDING 25 POST SECONDARY AGRICULTURAL SCHOOLS WITH A TOTAL ENROLLMENT OF OVER 18,000 STUDENTS. THIS NUMBER IMPLIES A SUBSTANTIAL BASE OF PRIMARY AND SECONDARY STUDENTS. AS WITH HEALTH CARE, THE PROBLEM WITH EDUCATION IS LESS ONE OF ACCESS THAN QUALITY. THERE ARE SERIOUS DEFICIENCIES IN CURRICULA AND SHORTAGES OF QUALIFIED TEACHERS, BOOKS AND EQUIPMENT. THE WORLD BANK IS HELPING THE GOG UPGRADE TECHNICAL TRAINING, EDUCATION PLANNING AND PROJECT IMPLEMENTATION. AID IS ASSISTING WITH THE IMPROVEMENT OF AGRICULTURAL EDUCATION AT TWO OF THE LEADING INSTITUTES (FOULAYA AND FARANAH).

E. EFFECTIVENESS OF ADMINISTRATIVE SYSTEM

(1) STATISTICS: AS THE READER OF THIS MESSAGE AND REF B MAY HAVE GATHERED, ACCURATE AND UP-TO-DATE STATISTICS ARE HARD TO COME BY IN GUINEA. THIS IS DUE TO SHEER LACK OF DATA, TO SHORTAGE OF QUALIFIED STATISTICAL ORGANIZATIONS AND PERSONNEL, AND TO A RELUCTANCE TO FURNISH DATA, PARTICULARLY IN THE ECONOMIC SPHERE. HOWEVER, WITH THE CONTEXT OF SPECIFIC PROJECTS, MINISTRIES COOPERATE IN PROVIDING AVAILABLE DATA AND AGREEING TO DEVELOP MORE AS A FUNCTION OF THE PROJECT; AN EXAMPLE IS THE AID MOTHER-CHILD HEALTH PROJECT. THE GOG IS ALSO MAKING EFFORT

TO IMPROVE ITS OVERALL SOCIO-ECONOMIC DATA BASE; A GENERAL POPULATION CENSUS WILL BE UNDERTAKEN IN 1981 WITH UNFPA ASSISTANCE.

(2) PLANNING, IMPLEMENTATION AND LOCAL ADMINISTRATION: MANY BUDGETARY PLANS AND PROJECTS UNDERTAKEN BY GUINEA HAVE NOT SUCCEEDED. THE REASONS WERE FAILURE TO UNDERSTAND THE INSTITUTIONAL REQUIREMENTS FOR PROJECT SUCCESS, LACK OF TRAINED PEOPLE AND GOOD MANAGEMENT, INSUFFICIENT RESEARCH, LACK OF FUNDS WHEN NEEDED, AND IDEOLOGICAL CONCEPTIONS AT VARIANCE WITH ECONOMIC IMPERATIVES (E.G., THE NEED FOR INCENTIVES TO SPUR PRODUCTION). THE GOG GUARDS IT'S POLICY PREROGATIVES AND HAS NOT SHOWN RECEPTIVITY TO PROGRAM RECOMMENDATIONS INVOLVING RAPID, LARGE SCALE IDEOLOGICAL SHIFTS. ON THE OTHER HAND, IN THE LAST FEW YEARS THE GOG HAS SHOWN A READINESS TO EXPERIMENT WITH FRESH IDEAS ON A PILOT SCALE--WITNESS THE WORLD BANK AND IFAD RICE DEVELOPMENT PROJECTS WHICH INCLUDE INCENTIVES FOR SMALL FARMERS. THE GOG ALSO RESPONDS WELL TO CAREFULLY DRAWN PROJECT PLANS AND REQUIREMENTS FOR GOOD MANAGEMENT OF JOINT PROJECTS--AT LEAST THAT IS THE CURRENT AID EXPERIENCE. BY USING THESE POLICY AND MANAGEMENT OPENINGS, FOREIGN ASSISTANCE MAY HAVE A POSITIVE LONG-RANGE IMPACT ON DEVELOPMENT PLANNING AND ADMINISTRATION IN GUINEA.

LOCAL ADMINISTRATION HAS SUFFERED FROM POORLY DEVISED PROGRAMS IMPOSED FRO THE TOP. HOWEVER, LOCAL ORGANIZATIONS ARE STRONG, REPRESENTATIVE AND REASONABLY RESPONSIVE TO THE NEEDS OF THE PEOPLE. THUS A WELL-DESIGNED PROGRAM OPERATING AT THE LOCAL LEVELS STAND A GOOD CHANCE OF SUCCEEDING.

F. NATURAL RESOURCE DEPLETION

THE PROBLEMS OF SOIL AND FOREST DEPLETION, AND THE GOG/DONOR PROGRAMS TO COMBAT IT, ARE DETAILED IN LAST YEAR'S SPSS AND IN REF B. TO SUM UP: THE PROBLEMS ARE SEVERE; THE GOG HAS A STRONG CONSERVATION POLICY BUT WEAK AND INEFFECTIVE PROGRAMS; AND FAO AND AID ARE COOPERATING WITH GOG TO PROTECT AND ENHANCE FOREST AND SOIL RESOURCES IN THE REGION MOST AFFECTED, THE FOUTA DJALLON.

G. FERTILITY RATES

THIS QUESTION IS ADDRESSED IN SECTIONS I.E. AND II.B. OF REF B. AS SUCH, THE GOG, HAS A PRO-NATALIST POLICY BUT IS INTEREST IN BIRTH SPACING FOR MOTHER-CHILD HEALTH REASONS. UNFPA AND AID WISH TO BUILD ON THIS INTEREST IN DEVELOPING A FAMILY PLANNING PROGRAM.

2. CONCLUSION

DESPITE DATA GAPS, WE BELIEVE THE ABOVE INFORMATION, ALONG WITH THE DATA IN ABOVE-MENTIONED SEPTEL OF THIS DATE AND THE ANALYSIS IN REF B, PRESENTS A SUFFICIENTLY COMPLETE PICTURE OF GUINEA'S DEVELOPMENT PROGRESS AND COMMITMENT TO PERMIT A JUDGMENT ON WHETHER THE AID PROGRAM PROPOSED IN REF B IS APPROPRIATE. THE COMMITMENT PICTURE IS MIXED. AS A RESULT OF ITS POLICY FAVORING COLLECTIVE AND STATE RUN AGRICULTURE, THE GOG HAS UNTIL NOW PROVIDED NEITHER SUFFICIENT RESOURCES NOR INCENTIVES TO THE KEY SECTOR OF SMALL FARM AGRICULTURE. ON THE OTHER HAND, THE GOG HAS TAKEN STEPS TO IMPROVE PURCHASING POWER AND INCREASE THE SUPPLY OF GOODS ON THE MARKET; TO INCREASE BUDGETARY ALLOCATIONS TO RURAL DEVELOPMENT, WITH EMPHASIS ON CEREALS PRODUCTION AND IRRIGATION; AND, IN COOPERATION WITH DONORS, TO EXPERIMENT WITH WESTERN APPROACHES TO RURAL DEVELOPMENT AT THE LOCAL LEVEL AND TO IMPROVE INSTITUTIONAL CAPACITY TO SUPPORT AGRICULTURE. THE AID PROGRAM IS DESIGNED TO TAKE ADVANTAGE OF THESE OPENINGS THROUGH CAREFUL PROJECT SELECTION AND COMMITMENT OF A MODEST LEVEL OF RESOURCES CONSISTENT WITH ABSORPTIVE CAPACITY.

DAVIS

EXECUTIVE SUMMARY

The period of the CDSS, 1983-87, holds many uncertainties both for the GSL and USAID. In Sri Lanka, national elections will be held in 1983 and a change in governments could bring basic changes in development policies and programs. The new U.S. Administration may also alter U.S. aid strategies and the real possibility of substantial U.S. budget cuts make projecting of AID levels seven years in the future a somewhat risky business. Nevertheless, these projections, based on long-range assumptions and our current knowledge, are set forth in this document. This CDSS reflects changing conditions in 1980 and should be read in conjunction with the CDSS prepared in January, 1980.

Sri Lanka is a constitutional democracy dedicated to participatory government, social equality and economic well-being. Until 1977, Government of Sri Lanka (GSL) policies emphasized expenditures on health, education, food subsidies, and other social programs without a corresponding investment in economic productivity. As a result, Sri Lanka, since independence, has made impressive gains in social development. However, due to the insufficiency of productive investments, the economy stagnated and resources were not available to maintain these gains. During 1970-1977, GNP grew at an average annual rate of a little over 3% and agricultural production grew at only 1.2%. By the mid-70's, social gains were being undermined by a stagnant socialized economy and deteriorating public services. By 1977, the private sector was virtually dormant, over 20% of the labor force was unemployed, and about 50% of staple foods was imported.

After the present government was elected with an overwhelming majority in 1977, a far reaching program was launched to accelerate growth and employment. The main objectives of the GSL's development are to create a million jobs and achieve an annual GNP growth rate of 5.5%. These objectives are to be accomplished through a liberalized economy, freeing the private sector to expand production, and an ambitious public investment program which concentrates on agricultural production and job creation. Concurrently the GSL seeks to maintain and improve basic social services for the poorest until their incomes reach adequate levels.

The response of the economy has been remarkable, and substantial progress has been made on most fronts. The private sector has revived and its vitality is evident. GNP growth rates have been high: 8.2% in 1978, 6.2% in 1979, and about 5.4% for 1980; and private investment - both foreign and local - is increasing substantially. Data on employment is poor but the Central Bank estimates that up to 700,000 jobs have been created since 1977.

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In spite of a serious drought in 1980, food production continues to increase and food imports continue to drop. Steadily increasing activity can be seen both in the urban and rural areas. The Public Investment Program is in full implementation and onsite construction of dams, irrigation systems, housing, and water systems is well underway. However, in spite of - or perhaps because of - progress, serious economic distortions have arisen. The high rate of economic activity, imposed on a formerly stagnant system, combined with escalating petroleum prices and worsening terms of trade, resulted in rates of inflation of up to 40%; these factors have caused a budgetary crisis and a sharp deterioration in the balance of payments. While real income for the employed has risen, inflation and the removal of many subsidies have reduced the well-being of the unemployed. In response to the inflation problem, the Government has cut the 1981 capital budget by 20% and plans to reduce the scope of the public investment program to attempt to maintain financial stability. Simultaneously, it is trying to find ways of reducing the harmful impact of inflation on the most disadvantaged groups.

The next few years will be very critical, until the development program yields substantial production. However, if the GSL can get through this pivotal period and can maintain the liberalized economy, as well as its emphasis on food production and employment generation, it has the potential of becoming an "AID graduate" within a short time-frame. In view of the GSL's severe current financial problems, the general soundness of its development policies (and the potential for self-sustaining growth), and its commitment to improving the lot of its citizens, the donor community should explore mechanisms which will provide flexibility in helping the GSL through this difficult period.

At the 1980 Aid Group Meeting in Paris, the U.S. did agree to move toward more flexible aid transfers. Therefore, while maintaining our basic objectives of food production, employment generation and human productivity, as set forth in earlier CDSS's, we propose to move away from the traditional AID project orientation to a system of broader program or sector loans and grants (Performance-Indexed Resource Transfers or PIRTs) wherever feasible. For instance, where the GSL has a well-defined longer term investment plan (as, for example, in irrigation), we and the GSL would agree on a multiyear program and the earmarking of AID funds. Funds would then be released to the GSL budget on an annual or biennual basis and, after the first allocation, further inputs would be on the basis of actual performance. Thus,

flexibility would be provided to both the GSL and AID to provide funding for those programs which are successful and provide greater production more quickly. This approach has several advantages:

- it provides needed flexibility;
- it stimulates the development of long range strategies in key areas;
- it should help improve the performance of line ministries;
- it will be much less staff intensive than a comparable program level composed only of projects; and
- it is quick disbursing and will support not only the development budget but the balance of payments.

As mentioned above, our basic objectives are the same as presented in earlier CDSS's but activities will be more sharply focused. Some proposed activities, such as rural enterprise, are being dropped in view of their low priority in the Public Investment Program. A slightly greater emphasis is being placed on human productivity and well-being in view of the heavy impact of inflation on the poorest elements of society.

Our major assistance categories are:

1. Mahaweli Basin Development

The GSL's overall Mahaweli program involves the construction of major dams and related downstream and settlement work and will, when completed, provide over 100,000 small farmer families with irrigated land, produce over 500,000 tons of rice and over 500 MW of power, and provide non-farmer employment activities for an estimated 175,000 people. During the CDSS period, our estimated contribution to this program will be $199.5 million in development assistance, primarily to: (1) finance downstream irrigation facilities in System B, and (2) provide targeted budgetary support for the GSL's construction of roads, schools, and related social infrastructure.

2. Food Production and Natural Resource Management

This category covers the provision of critical production inputs to the farmer and supports the development of a comprehensive national food sector strategy. Assistance will also be provided for the management of natural resources necessary for agricultural production and development of low cost energy sources for the rural poor. (Priority will be given to reforestation in watersheds and increased fuelwood production.) During the CDSS period our estimated contribution to this category would be $233.9 million in development assistance and PL 480.

3. Human Productivity and Well-Being

As health and nutrition improve, human productivity improves. This assistance category will focus on the improvement of environmental conditions and basic

services impacting on health (e.g., housing, water and sanitation, malaria, family planning and public health). We will also assist the Government to maintain or improve the health and nutrition status of children through the targeted maternal/child health (MCH) and school feeding programs supported by PL 480, Title II. During the CDSS period our estimated contribution to this category would be $107.3 million in development assistance and PL 480, in addition to $125 million in the Housing Guaranty Program.

Total U.S. assistance levels, composed of development assistance, PL 480 commodities and housing guarantees, increase steadily from $115.1 million in 1983 to $149.2 million in 1987. While such increases appear substantial, if adjustments are made for inflation, levels will actually decrease over the CDSS period. Assuming a U.S. inflation rate of 10%, by 1987 the U.S. assistance program will have a real value of $76.6 million as compared to a proposed level of $93.4 million in 1981 - an 18% decrease.

However, by focusing the program on fewer but larger priority programs and utilizing the proposed new delivery mode of PIRT, our assistance will have a greater development impact than the traditional AID project approach. In view of the GSL's financial constraints and probable AID manpower constraints, this CDSS strategy proposes the most efficient method of assisting the GSL's development efforts.

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ANNEXES

A. Macro-Economic Analysis

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I. DEVELOPMENT & ECONOMIC OVERVIEW

A. Development Perspective

Since the submission of the CDSS in January, 1980, additional vitality has been felt in the Sri Lankan economy as the economic liberalization policies continued to stimulate growth and the Public Investment Program moved off the drawing boards and into implementation. When analyzed in the context of development programs in other parts of the world, the results so far are remarkable. In 1980, GNP growth maintained a very respectable 5.4%, although less than 1978 (8.2%) or 1979 (6.2%).

Problems do exist, as later described in this CDSS. However, in concentrating on these problems, we do not want to lose sight of the very real accomplishments of the last few years. As stated by the World Bank in December, 1980: "A striking feature of the 78-80 performance has been the extent of the Government's success in shaking off the stagnation of the earlier period and in initiating a major investment program." A few examples of the real progress that has been made follow.

Food production, stimulated by government policies, has shown steady increases leading to optimism that the GSL target of food self-sufficiency can be met by the mid-80's. (Self-sufficiency is defined as producing enough food to meet national needs and provide for a surplus to cover imports of foods which cannot be grown here.) Paddy is perhaps the single most important crop influencing the overall performance of the economy. While the 1980 estimated production did not reach the target of 107 million bushels, largely due to drought, estimated production levels of 100 million bushels represent an 8% increase over the previous year. The GSL continues its supportive policies and recently (November, 1980) increased the guaranteed paddy price by 25%. Fertilizer continues to be subsidized at 85% of cost.

Manufacturing output (aside from tree crop processing) has grown at 8.4% as against 4.8% in 1979. Industrial investment has continued its rapid growth. The Greater Colombo Economic Commission has approved 123 projects with an investment of 3.5 billion rupees. In 1979-80 the Foreign Investment Advisory Committee approved 121 projects with a total investment of 2 billion rupees.

Employment has continued to increase substantially and there are more people working now than at any time in Sri Lanka's history. While hard data is not

available, there is anecdotal evidence that labor shortages are developing in the rural areas -- which also suggests that underemployment is on the wane.

The Public Investment Program is well underway. The Mahaweli Basin program - one of the three lead projects - is under construction. Work has started on three large dam systems (Victoria, Kotmale and Madura Oya) which will generate over 500 megawatts of power and provide irrigation water for 117,000 hectares (and eventually produce half a million tons of rice). About 100,000 families (over 500,000 people) will eventually be settled and jobs will be provided for up to 175,000 people. In System C, over 7,000 worker-settlers are in place and planning is proceeding for the worker-settler program in System B. Initial rainfed crops in those two areas should be harvested in 1982-83.

Low cost housing, another of the lead projects, has shown substantial progress toward its target of 108,000 units, with close to 11,000 units completed and 35,750 under construction.

In the overall food production sector, efforts are well underway to increase production of paddy and other coarse grains, both through policy and production incentive measures. In addition to the high fertilizer subsidy and guaranteed price for paddy, floor prices were recently introduced to stimulate production of 10 crops (black gram, green gram, cow pea, maize, sorghum, soya, chillies, ground nuts, gingelly and tumeric). The Paddy Marketing Board, formerly dealing only with paddy, has been given the responsibility for implementing the price support system for other grains.

The GSL has established a National Food Policy Committee, composed of representatives of all Ministries which have responsibilities in the food sector, to rationalize and coordinate all policies affecting food commodities. The GSL has also established a Marketing Research Unit in the Agricultural Training and Research Institute to collect and analyze data for policy formulation.

In addition to construction of the Mahaweli irrigation systems, the GSL is making a strong effort to rehabilitate the small and medium-sized reservoirs which have degenerated due to lack of maintenance. This will ensure almost immediate increases in crop production as more water becomes available to existing systems. At the same time, the GSL has accelerated its reforestation efforts in the denuded mountains to protect the watersheds which provide water for irrigation and it has started fuelwood plantations to provide low cost energy sources for the

rural population.

In the health and family planning field, the GSL is implementing a new program to significantly increase the training and utilization of paramedics (including upgrading of the National Institute of Health Sciences at Kalutara). An effective malaria control program has reduced this disease from over 400,000 cases in 1975 to about 50,000 in 1980. In short, measurable progress is being made on many fronts.

The high rate of activity has also, combined with factors over which the GSL has no control, created serious problems. 1980 was a sobering year for GSL economic planners and policy makers. The January, 1980 CDSS for Sri Lanka stated that ".. the main economic problem facing the GSL today is whether it's ambitious development objectives can be achieved in a four to five year time frame in the face of accelerating inflation ...". Now, one year later, the events of 1980 make it safe to say that in light of worldwide conditions, the investment plan was ambitious. The strain on both domestic and external resources reached critical thresholds during 1980 and exhibited itself through alarming increases in the government budget deficit, domestic credit, inflation and the balance of payments current account deficit. A clear illustration of the problem faced by the GSL, as well as other non-oil producing developing countries, is the increase in the cost of petroleum from $250 million in 1979 to a November, 1980 estimate of $603 million for 1981, to the most current estimate of the Ministry of Finance of $639 million, or a whopping 58% of export earnings and about 40% of the 1981 budget.

B. Economic Situation

1. General

In spite of increasing economic difficulties (see detailed macroeconomic analysis attached as Annex A), the GSL development objectives continue to be growth of income and employment obtained through liberalization of the economy and an ambitious development program. Progress has been steady on removing or reducing subsidies (food, transportation, petroleum) in order to channel resources to productive investment. Although subsidies still remain, the GSL's steady progress in this area is to be commended. However, action must also be gradual in this area, considering the possible adverse effect on the lower income groups and on agricultural production (in the case of fertilizer subsidies).

In recent years the GSL budget has been under increasing strain as expenditures have been increasing rapidly, accompanied by only moderate increases in revenue.

The capital (development) budget has been increasing very sharply -- from 8.9 billion rupees in 1979 to the initially estimated 1981 requirement of 14.9 billion rupees. Funding of that magnitude would have required domestic borrowing of about 6 billion rupees, a clearly unacceptable level in view of inflationary rates running at 30-40%. Consequently, in November, 1980, the GSL decided to reduce the 1981 capital budget by 20% thus decreasing the requirement for domestic borrowing to 3.7 billion rupees. These substantial cuts in the line ministries' estimates will commonly be met by reductions in the scope and extension of the timing of development projects.

The share of the budget deficit financed by domestic credit creation was 52% in 1979 and an estimated 51% in 1980 -- which contributed to an increase in the money supply of about 30% in 1979. The major concern that arises because of the budget deficits, domestic credit, and money supply is the consequent inflationary pressures. It is important to recognize, however, that deficit financing is only one of the factors causing inflation. The removal of subsidies on key consumer items (rice, flour, sugar, kerosene, milk powder, fresh coconuts, coconut oil, electricity, petrol, and bus fares) has accounted for a significant share of inflation. For example, consumer prices increased by 43.3% from March, 1979 to March, 1980 but only by 21.3% if subsidy removals are netted out. Similarly, from September, 1979 to September, 1980 the inflation rate is reduced from 33% to 19% if the same procedure is followed. The decontrol of energy related items (petroleum products, electricity and bus fares) was directly related to the rapidly increasing price of imported oil. Another important factor contributing to inflation has been the sharp increases in construction costs reflecting increasing scarcities of raw materials, skilled workers and construction capacity and increased reliance on imports (priced substantially above domestic items). The Sri Lanka private construction sector has been largely moribund over the last ten years, and trying to respond to the greatly expanded demands of the Public Investment Program has greatly exceeded its capacity. As a result, construction costs have been escalating at an annual rate of over 50% since 1978. The GSL is thus trapped in the classic tradeoff between increasing output, employment and incomes, and a high inflation rate - the latter may erode early gains and, if not controlled, push the Sri Lankan economy into a hyper-inflation situation.

The GSL has recently taken courageous steps to contain inflation while trying to maintain investments in priority elements of the development program. Large

cuts have been made in the 1981 budgets of the major ministries, including the lead projects: Mahaweli and Housing. As a result, the GSL deficit as a share of total expenditures will decrease from 53% in 1980 to 42% in 1981. For future budgets, 1982-85, the GSL has indicated it will maintain levels shown in the 1980-84 investment plan (prepared in early 1980) with no significant increases for inflation. Hence, the rate of real investment will be slowed by a percentage equivalent to the inflation rate. Even at this level of investment, substantial budget deficits are anticipated.

The GSL is planning further anti-inflation measures including a moratorium on new projects not already included in the investment program and serious moves to reduce waste and inefficiencies in the line ministries. The Minister of Finance estimates that a substantial portion of the 1980 budget increases could have been avoided if stricter standards of financial management had been observed. The GSL has also stated that priority for budget allocations will be provided for programs which have received or will receive substantial donor support.

2. Balance of Payments

Sri Lanka's balance of payments deteriorated sharply in 1980. The current account deficit (i.e. excess of imports of goods and services over export of goods and services) more than tripled to a level of $761 million. International reserves were depleted by $200 million during 1980. The major cause of the deteriorating current account balance has been the large increases in imports. About 75% of the increase in imports has been for intermediate investment goods primarily for the public sector investment program. Petroleum imports, of course, have been and will continue to be a serious problem, accounting for 54% of export earnings in 1980 and 58% in 1981. While conservation measures have been imposed, there will probably be steady increases in petroleum imports until the Mahaweli hydropower comes on stream in the mid-1980's. Poor performance of the plantation sector and worsening terms of trade have also contributed to the serious balance of payments situation. As suggested above, the situation will be much more critical in 1981 since the cushion of reserves has been drawn down to a dangerously low level.

Projecting Sri Lanka's balance of payments trends requires making many assumptions about quite uncertain events. However, it is clear that until the Public Investment Program and the new private investments produce substantial results, both for increasing exports and reducing imports, Sri Lanka will face serious balance of payments problems.

The Commitment of the GSL to a greater degree of financial discipline, while maintaining its objectives of employment and income generation, has been recognized by the World Bank in its December, 1980 Aide Memoire to the Sri Lanka Aid Group:

> " The courageous cuts in the capital budget and the firm resolve expressed at all levels of government to hold expenditures in 1981 reflect a clear recognition by the government of the need to trim its sails. These politically difficult decisions deserve commendation. During the probably harsh adjustment process, it is essential that the Aid Group continue to be responsive to Sri Lanka's complex needs."

3. Implications for Donor Financing

In light of the situation described above (and in more detail in Annex A), it is evident that external assistance should be fast disbursing and substantial enough to prevent erosion of the remarkable progress experienced to date, both in economic development and basic human needs areas. The USAID strategy proposed in Section III B does provide for a revised mode of assistance which would be directly responsive to Sri Lanka's critical financial needs while continuing to concentrate in priority areas of AID's legislative mandate.

C. Update of Analysis of Poverty

Since achieving political independence in 1948, most governments in Sri Lanka have been very concerned about promoting equitable economic and social policies. Until 1977, these policies emphasized expenditures on food, health, education and other social programs instead of investments in economic productivity. During the 30 years following independence, Sri Lankans did have a rather impressive overall performance in social development. They increased food consumption by about 15% to 2,200 calories per capita, increased life expectancy to 68 years, reduced infant mortality to 43 per 1,000, reduced net population growth to 1.8%, achieved an adult literacy rate of 79%, and achieved a modest redistribution of income to benefit the lowest 41% of the population.

However, the same policies and programs that helped produce these gains in social development meant that fewer resources were available for investment in economic productive capacity. Consequently, per capita income levels remained very low and the government continued to rely on traditional plantation crop exports to provide much of its revenue. By the mid-1970's, the social gains were being undermined by a stagnant socialized economy and deteriorating public services.

The GNP growth rate dropped as the overemphasis on welfare expenditures and increased reliance upon inefficient nationalized sectors of the economy combined with serious droughts and unfavorable prices for basic exports. The average GNP growth rate was about 3.2% per annum, while agricultural production grew at an annual rate of 1.2% -- or less than the population growth rate. By 1977, the private sector was virtually dormant, over 20% of the labor force were unemployed, and about 50% of the nation's staple foods had to be imported.

The Analysis of Poverty presented in last year's CDSS remains generally valid. The number of the island's households classified by the GSL as absolutely poor (i.e. those with a per capita income of less than US$58) has been reduced somewhat because of increases in employment and the percentage is now probably slightly below the 30% estimate shown in last year's analysis of poverty. However, the degree of poverty among the poorest households has worsened due to inflation. For example, the prices of basic items like kerosene, bread and rice increased sharply between 1977 and 1980. Kerosene soared from 3.48 rupees to 15.18 rupees per imperial gallon. Bread increased from 1.00 rupee to 2.15 rupees per loaf, while rice increased from 1.6 rupees to 2.5 rupees per pound. Such changes have significantly decreased the ability of low income families to buy food, cook meals, and light their homes.

Most of the poorer households are in the rural sector, although there are indications that substantial numbers may be in urban areas. The poorest rural areas are commonly in the more densely populated wet zones. Such areas usually have a severely limited land base for agriculture and few off-farm employment opportunities. Where land availability is not a major problem (i.e. much of the dry zone), the major constraint to increased farm production and incomes is inadequate water. Studies show that the shift to intensive agricultural practices in Sri Lanka (e.g. the increased use of transplanting, high yielding seed varieties, fertilizers and insecticides) occurs only after farmers feel assured of dependable supplies of water.

There is increasing evidence that several basic human needs (BHN) indicators dropped during the 1970's as a result of an inadequate resource base and governmental inefficiency. More recently, the new government's development strategy, emphasizing production and income growth over social services and welfare programs, has perhaps also adversely affected some indicators of well-being. Current problems include very high rates of infant mortality in selected areas, persistent malnutrition among children, rising urban poverty and the

continuing high rate of water-borne diseases.

While some of these conditions have existed for many years and deterioration in others was already well underway by the mid-1970's, some are a direct result of the inflation which has accompanied the country's recent increase in economic activity and the elimination of food and other consumer subsidies. Some of these undesirable conditions may reflect temporary dislocations which will improve as the benefits of the GSL's national development plan are more fully realized over the next several years. Additionally, the GSL's endeavor to establish a more productive resource base will eventually provide the resources required to develop and sustain the social service and other programs necessary to overcome some of these long-standing problems of human health and well-being.

II. POLICY COMMITMENT AND DEVELOPMENTAL PROBLEMS

A. Overall Objectives of the GSL

Sri Lanka is a constitutional democracy dedicated to participatory government, social equality and economic well-being. As described in earlier sections, this dedication and resultant policies have led to impressive gains in basic human needs indicators. However, the UNP government elected in 1977 realized that the social welfare policies implemented since independence could not be maintained without an increase in productive capacity.

After the present government was elected in 1977, a far-reaching program was launched to accelerate economic growth and employment. Major changes have included removing many government controls, providing incentives for increased private sector production and investment, and reducing welfare subsidies. The creation of productive employment opportunities for more than one million persons during the period 1979-83 is one of the main objectives of the present government's public investment strategy. The GSL plans to generate these jobs by expanding the economy at an annual growth rate of 5.5%. Growth of the private sector and the GSL's three "lead projects" (especially the Accelerated Mahaweli Program) are the main avenues selected to maintain economic growth and generate employment. At the same time, the Government seeks to maintain and improve basic social services for the poorest families, until their income reaches adequate levels.

While focusing on overall growth, policy makers remain concerned that the benefits of such growth be widely distributed and that there be active participation in the development process. Thus, in the Fall of 1980, legislation approving the District Development Councils (DDCs) was approved and elections to

these Councils will be held in the Spring of 1981. The purpose of the DDCs is to encourage local participation in the development process by providing a forum (in addition to the Parliament) for analyzing needs and determining priorities at the local level. The GSL has also instituted a series of area development programs which involve a high level of local participation and management.

The government has made substantial progress in meeting its overall objectives. As discussed earlier, GNP growth has been substantial. While data is incomplete, recent estimates of the Central Bank indicate that around 700,000 jobs may have been created, increases in real incomes for the employed have been generated, and the numbers of those in absolute poverty have declined.

B. Impact of the GSL's Development Strategy on Well-Being

The shift in 1977 from a welfare strategy to one of stressing production and income growth was perhaps the best alternative for improving the economic well being of the country's majority. Though it is still too early to make a full assessment, preliminary data from the Consumer and Socio-Economic Survey of 1979, together with GNP data for 1978 and 1979, support the GSL's claim that its development strategy has contributed substantially to the increase in real income and reduction of unemployment during the last three years. Unemployment was reduced from a high of 24% of the labor force in 1973 to about 15% in 1979 (according to the Public Investment Program dated May 1980). Recent estimates show that the share of total income for the bottom decile of income earners declined from 1.8% in 1973 to 1.5% in 1978, while the highest decile increased from 0.41% to 0.49%. This pattern of income distribution is not unusual for a country that has just begun to realize high growth rates and the equity situation should improve as the economy continues to grow. Moreover, incomes in real terms have risen for all segments of the employed labor force. Thus real per capita income increased by 49% between 1973 and 1978.

While essentially all categories of Sri Lanka's employed segments of society have benefitted from the GSL's new development strategy and the poor are now fewer in number, the poorest of the poor -- the currently unemployed -- have not yet gained any benefits. As a matter of fact, their well-being may have deteriorated severely due to inflation and the elimination of subsidies for food and basic consumer items. The total numbers of unemployed and those dependent upon them are estimated at about 2.9 million persons (20% of the population). While this is looked upon as a short-term dislocation which will improve as greater numbers are absorbed into the labor force, it is a matter that the GSL

will have to remain alert to. GSL policy makers are aware of such problems and have decreed that basic social services programs for the poorest groups must also receive attention in the national development plan.

We conclude that the GSL's income and growth-oriented development strategy will have a favorable overall impact on the economic well-being of most of Sri Lanka's people. However, during the CDSS period, the Government will face some extremely difficult choices in balancing off investments to accelerate economic growth and productivity against those needed to maintain the well-being of the majority of the people who remain very poor. If the present government is successful in doing this, Sri Lanka will have made a remarkable breakthrough, by reducing national poverty while preserving its past progress in providing basic human services to its people.

C. Resource Needs and Roles of Donors

The GSL's five-year Public Investment Program for 1980-84, prepared in the Spring of 1980, has already been overtaken by events. The program originally projected total expenditures of Rs.63.5 billion. Current estimates indicate that substantially increased resources would be necessary to completely implement that program. For 1980, actual capital expenditures are estimated to have exceeded planned expenditures by 24%. Consequently, the capital budget for 1981 was reduced by 20% to bring expenditures more in line with earlier projections.

The revised 1981-85 investment program will be prepared in the forthcoming months. The GSL has indicated that it will attempt to maintain the total allocations for 1982-84 at the levels shown in the 1980-84 plan, making no substantial adjustments for inflation. If it can accomplish this, the costs of the Public Investment Program would increase only to Rs.69 billion. (It is unlikely, however, that in light of worldwide inflation this level can be maintained). It is projected that about two-thirds of this program will require external financing or about $600 million a year. Because of the high inflation experienced in 1980 and projected in future years, this would represent a substantial cutback in real investment.

The IBRD has noted that a substantial increase in new aid commitments will be required to reach projected disbursement levels over $600 million by 1984. ODA disbursements for commodity and project aid totalled about $307 million in 1979, and are estimated to have reached a level of about $348 million in 1980. They are expected to continue to increase in 1981 ($421 million projected) and 1982 with the implementation of major donor projects in the AMP. Thus, the substantial

shortfall between IBRD's 1980 estimate of disbursement needs and actual disbursement trends indicates a need for larger amounts of quick disbursing assistance.

Sri Lanka receives aid from a variety of sources, including the IBRD and the 13 DAC countries (including the U.S., which is one of the largest donors), as well as the UN, ADB, and OPEC countries plus a minor amount from Communist countries. Short-term balance of payments support is also provided from the IMF. The most substantial donors are the IBRD and the 13 DAC countries, which coordinate their development strategies through annual Aid Group meetings and regular contacts in Sri Lanka. DAC programs provide development assistance and balance of payments support across a wide range of fields. Estimated aid disbursements for 1980 and 1981 are shown in Annex B.

The IBRD's largest development activity in Sri Lanka to date is the Mahaweli Development Project (Systems H and C). Commitments by the IBRD/IDA in FY 1980 amounted to $151.5 million, more than twice that approved in the previous year. The IBRD/IDA is also involved in a wide range of other activities, such as integrated rural development, rehabilitation of irrigation facilities, small-scale enterprise, dairy development, roads and transport, tree crop rehabilitation and diversification, urban water supply and sewerage, and agricultural research and extension. Together, IBRD's and IDA's estimated 1980 level of disbursement was about $24.9 million. The ADB's program with estimated 1980 commitments of $35 million represents a substantial increase over the 1979 program and involves integrated area development and Mahaweli road development. The ADB is also involved in fishery development, rural credit and electrification, telecommunications, and hydro-electric power generation. The UN and its specialized agencies, with 1980 level of about $23.6 million, are engaged in a number of small disparate activities including village water supply (UNICEF), colonization and settlement schemes (WFP), varied technical assistance (UNDP), health care (WHO), and family planning (UNFPA).

As the US is the largest contributor to these organizations, the increasing programs of assistance to Sri Lanka can be considered as an additional substantial transfer of US resources to aid in Sri Lanka's development.

In view of the serious GSL budgetary and balance of payments problems described above, it is important that donors review their programs to ensure that disbursements are accelerated during the next few years. The IBRD has recently recommended that donors consider adjusting their programs to provide substantial

balance of payments support and less project (slow disbursing) assistance. It has also recommended that donors increase annual aid allocations to the full foreign exchange cost of the programs in the budget.

D. Employment Situation

As mentioned earlier, Central Bank estimates indicate that employment opportunities increased by almost 700,000 for the period 1978-1980. While these statistics may overestimate progress, there are increasing signs that the unemployment trend is decidedly down. Shortages have continued in a number of skilled occupational categories (such as masons, carpenters, mechanics, technicians, and engineers) as a result of substantial increases in construction and related activities. Shortages of clerks, stenographers and office supervisors are also becoming evident as a result of increasing activities in the private commercial and trading sectors. There is also anecdotal evidence of increasing labor shortages in the rural sector. However, available data indicates a continued high unemployment level.

While current labor shortages are mainly due to increased economic activity, especially construction in the private sector, they are also due to the continuing labor drain to the Middle East and elsewhere. The number of persons departing for more lucrative employment abroad probably reached over 10,000 in 1980. Although less than 24,000 are officially registered, the GSL estimates that there are now about 42,500 persons working abroad and that about half of these are skilled craftsmen, technicians and engineers.

The impact of growing shortages of skilled construction workers, technicians and engineers on the country's development program is a matter of increasing concern to the GSL and the donor community. The IBRD has estimated that a minimum of 14,000 additional skilled construction workers will need to be trained by 1984. The shortage of engineers, architects, surveyors and foremen is equally serious.

The current shortages, coupled with projected future needs for skilled manpower, lead to conclusions that the demands of the economy and the development program for skilled labor are far in excess of the country's formal training capacity. In recognition of this problem, the GSL has made the major construction ministries responsible for developing training programs to meet their own requirements. The universities are also changing their programs to accommodate the increased interests of students in entering engineering, scientific, and technical fields. Moreover, the increasingly attractive wages and salaries being

offered to skilled craftsmen (wages for some skilled workers have more than doubled) are beginning to attract more educated school leavers to these areas.

E. Food Production

Agriculture is clearly the most important sector in the Sri Lankan economy. It accounts for about 55% of employment, 30% of the country's gross domestic product, and between 60-70% of export earnings. Sri Lanka has traditionally been required to import several staple foods, including sugar, rice and flour. Rice imports ranged from 200,000 MT to 500,000 MT per year during the period 1970-79, while flour imports ranged from 300,000 MT to 600,000 MT in the same period. Consequently, a major goal of the present government is to achieve greater self-sufficiency in food, with first priority going to increased rice production. The GSL is striving to achieve self-sufficiency by 1985 by stressing both increased yields and expansion of cultivated area. Recently, attention has also been given to increased production of subsidiary crops for import substitution, exports and improved nutrition. The GSL production strategy includes efforts to improve and expand irrigation and water management systems, subsidize fertilizer, maintain floor prices for paddy and other grains, and improve plant varieties. In addition, efforts are being made to expand cultivated areas, particularly through the Acelerated Mahaweli Basin Development Program (designed to ultimately bring about 117,000 hectares under cultivation).

The GSL's efforts have increased rice yields, but a serious drought in 1980 prevented full achievement of current production targets. About 1.6 million acres (out of 5.2 million acres of arable land) are in paddy and about 45% of this is double cropped. Yields during the 1980 main (Maha) harvest were around 57 bushels per acre or about 5.5% above 1979. Total paddy production for 1980 was about 100 million bushels or about 8% above 1979. However, this was below the GSL's 1980 target of 107 million bushels. The 1980 harvest will provide about 1,426,000 MT of milled rice or about 90% of the estimated consumption requirements of 1,575,000 MT. The gains in rice production in recent years have permitted the GSL to reduce its rice imports to about 99,000 MT in 1980, from 542,000 MT in 1977.

The 1979 removal of the general consumer subsidy on rice resulted in the establishment of an open market for paddy. Paddy prices in 1980 thus increased to about Rs.55 per bushel in some areas, as compared to the support price of Rs.40. Consequently, the GSL's Paddy Marketing Board's purchases dropped sharply to about 10% of purchases. The GSL increased the support price to Rs.50 per bushel in November 1980.

The higher prices have had a negative impact on low-income consumers, while providing needed production incentives for the farmers. With continued increases in production costs and some discussion of decreasing the high fertilizer subsidy (now 85%), it is difficult to predict future trends. The country does not produce wheat, so will remain dependent on imports.

The government recently introduced support prices for such secondary crops as maize, cow peas, chillies and soya. Since many of the poorer farmers, particularly in the dry zone, depend on such crops, gains in this area will have a beneficial impact on the groups of greatest concern to AID. As indicated in Section III B., USAID programs will continue to support paddy production, while simultaneously moving to support increased production of selected dryland food crops.

The elimination of the wheat flour subsidy in early 1980 had an immediate effect on wheat flour consumption, with monthly sales dropping from 35,000 MT in February 1980 to 22,000 MT in March 1980. However, in the course of the year, monthly consumption gradually increased to reach a high of 43,000 MT in December. The GSL estimates that the increase in consumption is due to (a) convenience factor, (b) growing energy cost (affecting rice preparation), and (c) the increased price of rice. Projections are that the price of rice will remain high and that energy costs (for cooking) will continue to increase. While it is unlikely that the consumption level of wheat will increase to the 1979 level of 578,000 MT, the GSL predicts a minimum of 420,000 MT annual consumption.

It is still too early to judge the effect of the reduction of the subsidy on production and consumption of other grains. Data on production and marketing of such crops are weak, as is the fledgling marketing system itself. However, it is likely that production will be stimulated by the introduction of floor prices, as described above, and the attempts to improve the marketing system through GSL market interventions. If the GSL does design a comprehensive food strategy, it should include a detailed analysis of the preference/pricing relationships between various foods.

The GSL's fragmented approach to policy formulation and program planning in the food sector is not adequate to cope with the rapidly changing conditions of recent years. While a new National Food Policy Committee has been established, it is preoccupied with the more immediate crises. A new Marketing Research Unit (in the Ministry of Agricultural Development and Research) collects some trend data, but there is insufficient policy-oriented staff work being done to help the Food Policy Committee address longer term planning needs. USAID, and a few other

interested donors, are trying to support the policy research activities and organizational improvement needed to move toward more effective macro-planning. However, progress may be slow until enough policy level officials recognize the inefficiencies of the current piece-meal approach to food sector planning.

Thus, there are a number of major constraints which limit the pace and scope of efforts to increase Sri Lanka's food production. These include the need for a coherent agricultural policy, the impact of inflation on the access to essential production inputs, inadequate program budget allocations, insufficient numbers of trained personnel to implement agricultural development projects and marketing problems requiring government intervention. Any one of these constraints, if not alleviated, can seriously impede needed increases in food production. The GSL is already addressing many of these constraints within its Public Investment Program, especially the insufficient availability of irrigation water. However, other constraints, such as increased energy costs which impact heavily on the cost of inputs, can probably only be effectively addressed within the context of an overall food strategy. Such a strategy should not only cover the production of food (including livestock and fish) but also marketing, imports/exports, pricing of both inputs and food products, nutrition and food security.

F. Human Productivity and Well-Being

1. General Progress and Problems

By the mid-1970's, Sri Lanka had a Physical Quality of Life Index (PQLI) of 82, in spite of the fact that its per capita income was under $200. Since achieving independence in 1948, the country has been able to reduce its national infant mortality rate to about 43, increase the literacy rate to about 78, and increase life expectancy to around 68 years. However, such national level indicators or statistical averages tend to conceal serious regional or group problems. Thus infant mortality rates are twice the national average in some remote and estate areas. Similarly, the quality and availability of education and health services are often less in the rural areas.

Progress in several areas of social development had slowed down by the mid-1970's. The health delivery system began to deteriorate as public expenditures lagged and many medical personnel sought better jobs abroad. In spite of the government's food subsidy efforts, low family incomes still prevented many families from obtaining adequate food. While we do not have much reliable national data on recent trends, there are indications that serious problems persist in the health and nutrition areas and may be aggravated during the CDSS period if they do not

receive proper attention. In order to assess recent developments in health, population and nutrition, an AID/HEW sector review trip visited Sri Lanka in April 1980. The following sections draw on the Team's report of July 1980.

2. Nutrition

Undernutrition represents one of the apparently more intractable problems facing many low income nations like Sri Lanka. In 1975/76, the first national study of nutrition was conducted with assistance from the U.S. Center for Disease Control. This survey indicated that about 35% of rural pre-school children suffered from chronic under-nutrition (wasting). Some observers attributed these rather alarming results to poor crop conditions and other unique factors present in 1975. However, a six-district GSL nutrition survey made in 1980 suggests that chronic under-nutrition for pre-schoolers may still remain at about the same level as 1975/76, while acute under-nutrition may have increased. Further, a 1979 survey indicates that about 52% of primary school children suffer from both wasting and stunting, an increase over 1973 estimates of 41%. The nutrition situation illustrates some of the complex and difficult policy issues confronting the present government in its efforts to move from "equity without growth" to "growth with equity".

Prior to the election of the Jayawardene Government in 1977, most of the population were entitled to free food rations and food purchases were heavily subsidized. Since then, in the short period of about three years, no one remains on food rations and other subsidies have been largely eliminated. A food stamp program was started in 1979 to help the low income families (i.e. those with monthly family incomes below Rs.300($17). However, this low level of income still includes about half of the population. Unfortunately, the fixed monetary value of food stamps has eroded steadily as a result of rapid inflation. Consequently, nutritional status - already low - is probably being further reduced among the unemployed and low income groups.

The long term answer to under-nutrition and related health problems is higher incomes to permit families to purchase adequate food and basic services, and effective national programs for improving water supplies, environmental sanitation and health education. Since a top priority of the GSL's development program is to increase employment and accelerate economic growth, income levels should rise over time. However, the government is simultaneously concerned that basic services continue to be provided to low-income groups to maintain their well-being until their income reaches acceptable levels.

At present, there is no comprehensive national strategy for the food and nutrition sector. While such existing goals as achieving self-sufficiency in rice may have a positive long term impact on nutrition, this does not adequately address the complex short run problems. There are on-going GSL nutritional studies and program reviews which will lead to a more concerted attack on malnutrition, but the findings and recommendations may not be available until mid-1981. Preliminary indications are that the GSL nutrition review group will recommend such short or medium term actions as (1) indexing of food stamp values to inflation rates, (2) increasing fortification of foods, (3) expanding nutrition education and (4) improving the distribution of supplemental foods for malnourished groups. While the group is also examining the need for better policy and program coordination in the broader food and nutrition area, these changes will probably take considerably more time.

Progress has recently been made in some areas, including increased media coverage of nutrition issues, a legal prohibition against advertising of commercial products to replace breast-feeding, and increased involvement of district development groups in nutrition and population. The GSL has also appealed to USAID to maintain PL 480 support until some of the current reviews and resultant corrective actions begin to yield results. The continuation of PL 480 Title II foods is seen as being particularly crucial during the next few years, to help prevent any further deterioration in the nutritional status of low income children and pregnant or lactating mothers. The 1980 expansion of local production facilities for fortified food supplements (Thriposha) should permit CARE to increase the number of MCH program beneficiaries from 322,000 in 1979/80 to about 480,000 in 1980/81. A CARE biscuit program covers about 1,250,000 children in 7,500 schools. The GSL believes that the improved health and school attendance levels of the children merit expansion of the program, but AID and GSL resource constraints currently preclude this. Local ingredients now constitute 30% of Thriposha and by 1988 it should be composed entirely of local foods.

3. Health, Sanitation and Shelter

Since the 1978 World Health Assembly Meeting on primary health care, the GSL has cooperated with WHO and other donors to develop an action program for upgrading and expanding primary health services and education. Similarly, Sri Lanka has been a leader in the U.N. Water Supply and Sanitation (WSS) Decade. The GSL's WSS Decade plan, prepared with AID assistance, has been lauded by WHO as one of the most comprehensive plans prepared to date.

As a result of several recent reviews of health needs, GSL policies assign high priority to the: (1) on-going anti-malaria campaign, (2) new efforts to improve water supplies, environmental sanitation, and shelter for the poor and (3) expansion and upgrading of basic health services. Malaria is still regarded as the most serious public health threat, particularly in the new Mahaweli settlement areas and gemming areas. However, the GSL anti-malaria campaign, with USAID and other donor support, has succeeded in reducing the number of reported cases from over 400,000 in 1975 to about 50,000 by 1980. Nevertheless, these efforts must be sustained if Sri Lanka is to avoid a recurrence of the upsurges in malaria which followed relaxation of control activities in the past.

The shortage of adequate housing in both urban and rural areas is considered by the GSL to have deleterious effects on not only the well-being, but the health of low income people. Overcrowding, the lack of sanitation and flooding can lead to severe health problems, particularly in populations already at risk because of under-nutrition. Consequently, the low cost housing program is one of the three lead projects in the GSL's investment program.

By 1990, the GSL's WSS Decade Plan calls for providing safe and reasonable quantities of water to all of the urban population and about half of the rural population. The upgrading of sanitation facilities will proceed simultaneously with the expansion of water supplies. Since it is currently estimated that only about 10% of the population have access to regular supplies of safe water, many observers consider these goals to be quite ambitious. On the other hand, the Ministry of Local Government, Housing and Construction, headed by the Prime Minister, is a very efficient Ministry and will probably be able to make good progress if adequate financing is made available. This Ministry is also responsible for achieving the national goal of providing an additional 108,000 units of shelter under the Public Investment Program. The Housing Program has been hit hard by inflation and resultant budget cuts, so the GSL has been quickly moving to reduce expensive direct construction and to increase aided self-help housing and slum and shanty upgrading. The Government's housing efforts are focussed on low-income groups and it has encouraged the private sector to cover other groups. The GSL has also tried to establish linkages among its shelter, water, and health programs, particularly in new settlements, to maximize the impact on health and well-being.

The upgrading of rural primary health care has focussed on the upgrading and expansion of paramedical personnel (e.g. assistant medical practitioners,

midwives, and public health inspectors). However, progress in implementing objectives has been hampered by general budget reductions and the tendency of the Ministry of Health to give higher priority to the needs of existing curative institutions.

4. Population and Family Planning

Sri Lanka's annual population growth rate declined from a peak of 2.8% in 1953 to 1.8% in 1974. The decline in the growth rate is attributed to such factors as the availability of education, improved status and opportunities for women, declining infant mortality, and late age of marriage.

However, there is growing GSL concern about the recent increases in the birthrate and the long term projections of population size. The natural rate of annual increase has risen from 1.8% in 1974 to 2.2% in 1978. Recent projections indicate that the natural rate of population may have increased to 2.3% in 1980. If present fertility patterns continue, total population will increase from about 14 million in 1977 to 23 million by 2000, 27 million by 2010 and 36 million by 2025. GSL leaders have expressed their fear that population pressures will reduce the quality of life by increasing the demands being made on scarce natural resources, social services and the job market.

At the highest levels of this government strong support is being given to family spacing. However, additional attention to the administrative and organizational structure is needed before a strong national program can be implemented.

The AID health sector review team concluded that the GSL's assignment of high priority to malaria, water and sanitation, family planning, and primary health care were quite consistent with recent analyses of local needs and the priorities of AID, WHO and other health donors. However, the team observed that a key need was to accelerate the development and expansion of action programs to fully implement the GSL's positive policies. The team also recommended that more attention be given to the development of a national nutrition surveillance or monitoring system to assess the changing nutritional status of the population. In view of the serious overall financial problems now faced by the government, it is doubted that adequate funding will be provided to make needed improvements in preventive health programs.

G. Energy

Escalating petroleum prices have placed severe constraints on Sri Lanka's development program and have adversely affected the daily lives of people at all

levels. The fledgling industrial sector and the commercial transportation sector are almost completely dependent on oil. Similarly, kerosene is used for lighting in about 95% of rural households and 60% of urban households. The recent removal of the long-standing consumer subsidy on kerosene reportedly reduced the demand by about 25%. The regular price for an imperial gallon of kerosene increased from Rs.3.48 in 1977 to Rs.15.18 in 1980. Consequently, low income families have had to drastically curtain the use of kerosene for lighting and cooking. Estimates of energy consumption (excluding fuelwoods) show about 9% coming from electricity, 90% from oil products and 1% from coal.

While the GSL has encouraged energy conservation through various pricing and administrative decisions, it has not yet developed a national energy policy or an effective focal point for coordinating energy efforts. Some discrete programs for reforestation, fuel wood production, etc., will help and several energy research pilot project efforts will produce a longer term payoff. More substantive action, however, by GSL policymakers is needed in order to rationalize investments and to maximize foreign resources which may be devoted to this sector. Such policy analyses may be triggered by a recent disclosure by the Minister of Finance that 1981 expenditures for petroleum would soar to a level which equals about 40% of the government budget and 58% of export earnings.

H. Environment

The Government has become increasingly concerned about such major environmental problems as the loss of forest cover (from 44% of land area in 1956 to 20% in 1978) and erosion in watersheds and coastal areas. The 1980 USAID-financed environmental study of the GSL plans for the Mahaweli area is also stimulating increased interest in steps to protect the flora, fauna, and other natural assets as the Mahaweli development program proceeds. As discussed below, USAID has responded to a GSL request for assistance in revitalizing and expanding its forestry service and its reforestation efforts. The GSL has also established an Environmental Authority, under the Prime Minister, and a new Environmental Quality Act is now being drafted. These two steps should permit more concerted action to be taken on environmental problems in the future.

I. Effectiveness of the Administrative System

Sri Lanka's higher public service has been relatively efficient and responsive to the people's needs, but ambitious economic development efforts initiated since 1977 have strained both public and private sector systems. A shortage of trained people for development tasks has been aggravated by continued emigration,

particularly to the Middle East. GSL actions to expand skilled resources and make better use of existing resources include the following: (1) universities and other training institutions have altered programs to accommodate the increased demand for graduates in science, engineering, and the technical fields; (2)special GSL groups have been established to concentrate scarce technical and managerial skills on the review, approval, and implementation of priority projects (to expedite action, particularly on private sector and foreign investments); and (3) increased efforts have been made to decentralize development activities to local organizations (such as the new District Development Councils).

The top administrative leadership of most GSL agencies concerned with AID-supported activities is excellent. However, the quality and availability of staffs at the middle management and technical levels varies significantly among the ministries. Thus, administrative capacity does continue to constrain the timing and targeting of our assistance in some sectors.

J. Status of Women

The social, economic and legal status of women in Sri Lanka is relatively good. Women enjoy almost equal access to education at all levels and they have been moving increasingly into technical and vocational fields. Women constitute 26% of the labor force, about half of whom are married and live in rural areas. Moreover, the percentage of urban women in the labor force has been steadily increasing. In the new Free Trade Zone near Colombo, women have filled over 8,000 of the 11,200 factory jobs created since 1978.

Naturally, there is still much that can be done to improve opportunities for women. The 1979 USAID-financed study on women by the University of Colombo identified legal and other actions which should be taken over time. For our part, we have tried to identify specific areas in our general assistance efforts and in specific women-oriented activities where AID can help. At present, we are directly involved in the following special women's projects: (1) a DS&T-financed project to train women in 300 villages to improve their health and income earning capacities; (2) a project to provide agricultural skills to low-income and orphan girls; (3) a study of women's attitudes toward night work (since they are now legally prohibited from working between 10:00 p.m. and 5:00 a.m.); and (4) short training programs to increase the marketable skills of young, unemployed educated women.

III. AID ASSISTANCE STRATEGY AND PROGRAM

A. AID Objectives and Rationale

It is in the U.S. national interest that the countries of South Asia and the Indian Ocean region remain independent and politically and socially stable states. Sri Lanka is a functioning constitutional democracy with a multi-party system, a parliament, an executive presidency and an independent judiciary. The country has a strong record of free elections, human rights and social equity. It is a moderate, non-aligned country which values good relations with all countries, keeps its ports open to the navies of all nations, and is very active in international forums. As the Government of Sri Lanka recognizes, the continued independence and stability of Sri Lanka depend largely upon a viable economy and realistic, effective development programs to improve the well-being of its citizens, most of whom are very poor. Thus, U.S. interests are well served by the rapid socio-economic development of Sri Lanka.

While Sri Lanka's standing according to various social indicators is high as compared to other developing countries, its per capita income ($200) is relatively low. Consequently, the increasing of productive capacity, employment and income growth is the primary thrust of Sri Lanka's current development strategy. In fact, unless production and incomes increase, Sri Lanka's capacity to protect its achievements in health and education will be jeopardized. As resources are being redirected to productive activities and away from subsidies, a potentially severe impact on the health status of poorer elements of society may be felt.

Incomes of the poorest elements of Sri Lankan society are not increasing in step with inflation and the recent removal of subsidies on food, kerosene, transportation, etc., has had a further adverse effect on their quality of life. The GSL believes that this hardship is a temporary phenomenon, and as the results of the development program are felt (e.g., higher productivity, greater employment and increases in food production), incomes will rise to help offset the very sharp increases in consumer prices of the last few years. During this critical transition period before substantial benefits of investments in the productive sector are fully realized, it is essential that the GSL act to maintain, if not improve, the impressive gains in health and the quality of life made over the past thirty years. Thus, in this CDSS, the USAID, while continuing its primary objectives of food production and employment generation, is also placing greater emphasis on increasing human well-being and quality of life. Such activities are carefully selected to be in line with GSL priorities as well as AID's legislative mandate.

While substantial progress has been made over the past three years in economic growth, the process has produced significant dislocations within the economy, as noted in Section I.B. and Annex A. It is likely that financial strains will continue until substantial increases in production are achieved. Given these problems and a background of deteriorating world economic conditions and worsening terms of trade, the GSL has taken courageous measures to reduce inflation and domestic borrowing. The severe economic problems highlight the GSL's need for increased financial help from the donor community, especially in the near-term, if it is to succeed in its efforts to promote economic growth and to reduce its still very high rate of unemployment. The failure of the present liberalized economic system to increase per capita income levels above the extremely low $200 could lead to a return to central socialistic controls or more radical options.

AID is increasingly structuring its assistance program to be more responsive to Sri Lanka's critical budgetary shortfalls while continuing to support priority development goals. The strategy is to further concentrate support in priority sectors of the Public Investment Program, where additional assistance is urgently needed and where AID has both a legislative mandate and comparative advantage. These are: (1) Mahaweli Basin Development, (2) food production and natural resource management, and (3) human productivity and well-being. This CDSS proposes an innovative assistance delivery mode which can provide substantial increases in effective, quick-disbursing aid while imposing minimal burdens on the GSL administrative system and on USAID staffing requirements.

B. Assistance Strategy and Program

The serious GSL financial situation described in Section I.B. and Annex A, as well as current and future constraints on AID staff resources, required that USAID re-assess the strategy proposed in previous CDSS's. The overall USAID objectives set forth in those earlier documents remain valid and continue to correspond closely to GSL priorities, but new implementation strategies are needed if AID is to be responsible to the changed economic conditions and constraints placed on the GSL's medium-term investment plan.

The 1982-86 CDSS proposed a gradual move towards sector lending in selected areas. Since that document was prepared in January 1980, the magnitude of the severe balance of payments problems and budget deficits is more evident. In late 1980, the GSL reduced the scope of its development program in a manner which still places priority on the critical overall objectives of increased food production and employment, while reducing inflation and maintaining financial stability. Since the GSL has demonstrated its political will to maintain both financial discipline

and its pronounced commitment to equitable growth, donors must identify more effective methods of providing assistance, particularly over the CDSS period, when the financial strains will be the greatest. The U.S. thus announced at the July, 1980, Consultative Group Meeting in Paris that it would look for more flexible means of providing assistance to Sri Lanka.

In Sri Lanka, as elsewhere, there is a growing frustration with the current conventional styles of assistance. Countries like Sri Lanka are literally choked by a plethora of small projects funded by a variety of donors, most of which have their own peculiar constraints and detailed regulations with which the host government must try to cope.

The new assistance delivery mode proposed below is based on what we feel are valid assumptions about the current situation in Sri Lanka: (1) the GSL is highly committed to improving the well-being of its poor people and possesses a high level of administrative competence for a developing country, (2) the GSL's current efforts to introduce rather radical changes to accelerate economic growth and employment are generally sound and deserve full donor support, particularly during the next few critical years of transition, (3) AID strategies must be sufficiently flexible to permit the shifting of assistance to match changes in the GSL's needs and implementing capacities, (4) USAID cannot expect any significant U.S. direct-hire staff augmentation and must therefore design a program which is less labor-intensive, and (5) the new delivery modes must also be responsive to changing levels of U.S. assistance.

The first step in the direction of increased program lending was taken in the Mahaweli Sector Support Program Paper (the December, 1980 PAAD). We will refine and build on the cash transfer mechanism described in that paper to develop a system for performance-indexed resource transfers (PIRT).

Under the PIRT system, USAID and the GSL would agree on rather specific policies and performance goals in a given economic sector over, say, a five-year period. Project or program papers would be prepared for selected sectors identifying the types of activities that are appropriate for AID assistance. In these sectors, assistance would be directed to developmental activities which meet most of the following criteria: the activities would (1) be important for development and within AID's New Direction Policies; (2) be capable of being administered by the GSL with minimum monitoring or involvement by AID; (3) have identifiable standards or yardsticks of performance; (4) have performance outputs which are easily measured or evaluated; and (5) preferably consist of several small activities rather than one large monolithic endeavor. After the project or program papers are approved by the appropriate authorities, the GSL would provide agreed on amounts of local currency and

foreign exchange to the program through its normal sector budgeting process. AID funds would then be provided directly through the cash transfer mechanism to the GSL.

The targeting of our assistance to existing GSL budgets would be made according to AID and GSL priority concerns and a joint assessment of the needs and capacity of the concerned GSL implementing agencies. After an initial allocation, AID funds would then be released on an annual or biennual basis, with levels and uses being determined by prior progress toward goals. This approach would permit both the GSL and USAID to have more flexibility in shifting funds among programs according to actual performance levels. At present, the system of providing life-of-project funding sometimes provides too much security for implementing agencies, so that less pressure exists to meet program goals. The GSL Ministry of Finance and Planning and the Ministry of Plan Implementation would be deeply involved in the assistance programming exercises. For them, the new approach would also have the appeal of providing flexible funding, within the existing budgetary and fiscal system, to meet changing economic conditions and ministry performance levels. Where the cash transfer mechanism is used, the GSL would also receive much needed help for its critical balance of payments problems. In return, the GSL would agree to encourage the importation of U.S. goods by amounts equal to the dollar transfers.

While the initial or design phase of such resource transfer programs might be labor intensive, the implementation and monitoring phases should certainly require much less detailed USAID staff involvement than the project approach, since more responsibility is shifted to the GSL.

PIRT will allow USAID personnel to: (1) concentrate their efforts on monitoring and evaluating performance, after the design stage is completed, rather than being involved in the details of implementation; (2) have greater flexibility to adjust funding to performance, needs, and changing conditions; and (3) carry out a program at higher funding levels with minimal staff increases.

The broader program or PIRT strategy would be concentrated in areas where the GSL has or is developing an acceptable longer term national strategy and investment plan (e.g., Water and Sanitation Decade Plan, Housing and Shelter, Irrigation, and Reforestation). In areas where such comprehensive planning is not available, we will continue to use project assistance as a means of stimulating more comprehensive planning (e.g., in such areas as food and agriculture and population). USAID will also continue to use project assistance in cases where: (a) the technical requirements are high and require detailed AID monitoring (e.g., Mahaweli System B), or (b) it is more effective for USAID to manage or be significantly involved in GSL management

of the assistance (e.g., training and small demonstration or pilot activities). This new assistance strategy (i.e., moving away from a project orientation to the sectoral programs or PIRT system) has not yet been discussed with the GSL. However, based on the immediate favorable response to the Mahaweli Sector Support Program, we are confident that the GSL will be fully supportive.

In line with our new approach, slight adjustments in the presentation of our major categories have been made. We will consolidate our assistance into three general categories: (1) Accelerated Mahaweli basin development, (2) food production and natural resource management, and (3) human productivity and well-being.

1. Accelerated Mahaweli Basin Development

The GSL's Accelerated Mahaweli Program (AMP), assisted by the IBRD and other donors, continues to be Sri Lanka's top priority effort and represents the largest single investment of the USAID. The AMP includes all aspects of an area development program: increased irrigation for food production, employment generation, providing land to the landless, increased agricultural productivity and incomes, improvement in human well-being, hydro-electric energy production, protection of the environment, etc. By the late 1980's, the overall AMP will provide irrigation to about 117,000 hectares of new land, provide for the settlement of 100,000 farm families (about 500,000 persons), provide employment - direct and indirect - for up to 175,000 persons, increase rice production by over 500,000 tons annually, and provide an additional 500 megawatts of hydro-electric power generating capacity.

AID-assisted activities will concentrate on canal construction and other downstream development activities in System B of the Mahaweli basin. Support will also be provided for environmental protection and enhancement and selected farm level production activities. The bulk of AID resources will be provided through flexible programs and PIRT instruments and is estimated at $199.5 million during the CDSS period. While the AMP will not achieve optimal production before the late 1980's, it will begin producing results in 1983 as the initial group of the 11,200 worker-settlers allocated to Systems B and C harvest their first rainfed crops. During the implementation period, this program will have a major impact on unemployment by providing thousands of jobs in construction, farming and administrative activities. In addition, it is expected that indirect employment will become available to those who will settle in the project area to service and support the farming population. Over the longer term, System B alone is expected to contribute about 8% of Sri Lanka's total projected rice production and a significant volume of dryland crops. When completed by 1990, System B should also provide incomes

substantially above the poverty level to over 32,000 land-poor settler families and provide off-farm jobs for over 30,000 people.

The Mahaweli Authority of Sri Lanka (MASL) is charged with planning for settlement and post settlement activities in the Accelerated Mahaweli Program (AMP). The bulk of this planning is done by the Mahaweli Economic Agency (MEA), a department within the Authority, with some assistance on infrastructure planning from the Mahaweli Development Board (MDB) which reports to the Authority. Current planning focuses on the settlement and support of settlers who will be brought onto an area of about 45,000 net irrigable hectares in Systems B and C in the near term (1982-1987). MEA's structure, functions, and capability are addressed in the Project Paper for the Mahaweli Basin Development, Phase II Project, submitted to AID/W in January, 1981. The paper noted that GSL plans call for the eventual establishment of MEA as a semi-independent public/private sector corporation. This has not yet occurred nor is it necessary, at least in the near-term.

MEA's planning capability is augmented by technical assistance from the British consultants, Hunting Technical Services Limited, for System C and by AID through the joint association of the U.S. firms of Louis Berger, Inc. and the International Engineering Company. This technical assistance was used in part to assist MEA and MDB to develop an implementation plan for System B,which is set forth as Annex D to the Mahaweli Basin Development Phase II Project Paper. The Mahaweli Sector Support PAAD (Project Assistance Approval Document),submitted to AID-Washington in December 1980, is the first activity to be funded under the new PIRT system. If approved, it will provide substantial assistance in meeting the costs of infrastructure essential to the settlement program. This flexible quick-disbursing assistance will also reduce the need for domestic borrowing and will provide some relief to the balance of payments.

2. Food Production and Natural Resource Management

We are concentrating assistance in this category on the critical need to expand staple food production and to protect the country's natural resource base (particularly watersheds, fuelwood lots, and other areas critical to food production and consumption). Our primary concern is to increase the small farmer's access to critical production resources (particularly water, fertilizer, improved seeds, and extension assistance). At the same time, if increased agricultural production is to be maintained, greater attention must be given to the protection of the rapidly deteriorating natural resource base. In addition, both our development and PL 480 assistance will be aimed at stimulating the design of a comprehensive long-range GSL food and nutrition strategy.

Under this assistance category, USAID is concentrating on three sub-categories: (a) irrigation and water management, (b) agriculture production inputs and services, and (c) environmental enhancement and renewable energy. During the CDSS period, an estimated $233.9 million will be provided to this category through development assistance and PL 480 Title I support.

a. Irrigation and Water Management

The first sub-category involves the expansion and improved management of irrigation water, the lack of which continues to be the most critical constraint on agriculture production. Given the important implications for agricultural production of improved access to water and water use efficiency, this sub-category continues to have high priority (as it did in last year's CDSS). USAID's current efforts in water management will continue well into the CDSS period. Additional activities using the PIRT system would support the rehabilitation and modernization of irrigation schemes not covered by the current USAID effort, the irrigation sector loan proposed for 1982, or other donors. Much of this work could be accomplished by using relatively labor-intensive methods and local contractors -- thus making a significant contribution to increased employment and income. The lessons learned about water-use efficiency and farmer organization in our current water management project will be applied to the sector loan and future programs.

b. Agriculture Production Inputs and Services

Between FY 1977 and FY 1981, we provided various types of assistance to help remove or reduce some of the key constraints on food production. Our agricultural inputs loans concentrated on such immdiate needs as fertilizers, while other projects concentrated on such longer term production needs as higher yielding seeds, more effective water management techniques, and strengthening of agricultural education, research and extension services. We also assisted the GSL to improve selected food

marketing, processing and storage operations and facilities.

During the CDSS period, we will build on these earlier efforts and continue to work toward increasing farm income through greater crop yields, crop diversification and more stable pricing and marketing schemes. We will thus move beyond rice to support increased production of rainfed or dryland crops, especially major grains and pulses. As shown in the Analysis of Poverty (CDSS dated January, 1980), farmers limited to rainfed crops are among the poorest. Increased production of rainfed crops could, therefore, provide important increases in nutrition and income to these farmers.

The Mission is exploring the possibility of including within the self-help provisions of future PL 480 Title I agreements, a GSL agreement to develop an effective food and nutrition strategy. Thus, PL 480 wheat would be provided during the early CDSS period when the Sri Lankan balance of payments is undergoing severe erosion and such assistance is required from a macro-economic view.* As food production increases, and Sri Lanka approaches food self-sufficiency, PL 480 Title I will gradually be phased out. At the same time, the GSL would be developing a macro strategy which would involve all the various elements of the food sector, e.g., pricing, agricultural production, nutrition, food imports and exports, etc. We would be prepared to assist in the efforts needed to produce such a strategy (through technical assistance, observation training, etc.) After the GSL develops a more coherent food and nutrition strategy, we will undertake to develop an agriculture sector loan program designed to support that strategy (particularly where it provides small farmers with better access to the resources required to increase their production, income and well-being).

c. Environmental Enhancement and Energy

The third assistance sub-category concentrates on some of the more critical rural energy and environment problems. Resolution of these problems is vital to maintaining and improving the resource base for agriculture as well as the real income levels in the rural areas.

The recently concluded environmental assessment of the Mahaweli Program states that, in the upper catchment, annual soil losses range from .3 to 7 MT per hectare on well managed land. On poorly managed land, it ranges from 21-570 MT per hectare. Annual aggregate soil loss from mapped portions of the catchment is estimated at 11.3 million tons per year. This is the equivalent of a 4,800 hectare annual productivity loss. The natural forests in the upper catchment system have been reduced far

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* The CDSS dated January, 1980, and the ABS dated May, 1980, each provided a full description and rationale for PL 480. A copy of the rationale included in the ABS is annexed for ready reference.

below the minimum required for the control of run-off. Therefore, to minimize losses to the productive base and to ensure adequate supplies of water to the irrigation systems fed by the upper catchment, it is essential to implement measures to stabilize exposed slopes and poorly managed lands. The current USAID-assisted effort to strengthen the Forest Department's capability to reforest denuded areas in vital watersheds and to establish fuelwood plantations will provide the base for a much more extensive forestry program. Follow-on assistance programs using the PIRT mode will be directed to increasing substantially the GSL forestry program. This will have growing importance as the Mahaweli and other schemes are implemented, both to protect the watershed and to provide low-cost fuel for the new settler families.

The dependence on kerosene and firewood for lighting and cooking by a large segment of the rural population is a serious and growing problem, as fuelwood becomes more scarce and the cost of kerosene continues to rise. Evidence is developing that consumption levels may be declining because the poor cannot afford fuel for cooking. In addition to on-going and proposed financing of fuelwood plantations, AID will give increasing attention to research and pilot activities designed to provide alternative sources of renewable energy for domestic use. This endeavor would include assisting the GSL in the development and diffusion of locally produced rural energy technologies.

3. Human Productivity and Well-Being

To alleviate some of the more critical problems of health and well-being, the GSL Public Investment Plan for 1981-84 gives priority to its Water and Sanitation Decade Plan and its housing and shelter program. These programs will solve some of the longer term environmental problems affecting health and nutrition, but will require considerable external aid for full implementation. Similarly, over the long term, current proposals to improve national food and agricultual policies will have a favorable impact on health and nutrition.

However, over the short and medium term (the CDSS period), other specific action programs are essential to help prevent further deterioration in the health and nutritional status of the poorer families. During this critical transition period, USAID can play a significant role by targeting assistance on the activities most likely to benefit low income families. The AID Health, Population and Nutrition (HPN) Sector Review Team concluded that USAID should give priority to: (1) continued support for malaria control and paramedical training, (2) a sector loan for health, water and environmental sanitation, (3) selective assistance on population planning, and (4) support for the establishment of a national nutrition surveillance system. During the CDSS period, $107.3 million of development assistance and PL 480 Title II goods will be provided, plus housing guarantees of $125 million.

USAID agrees in principle with the HPN Review Team's recommendations, but we will have to phase our assistance according to: (1) GSL actions and resource constraints and (2) prevailing USAID staff limitations. Consequently, first priority will be given to support for the GSL's own higher priority concerns: (1) water, sanitation and health education, and (2) shelter for low income groups. The GSL has already done considerable planning in these areas and has an adequate program implementation capacity. In the water and health sector program, we will also build on the practical experience gained in our Market Town Water Supply Project (Jaffna).

Current GSL trends indicate that we should support improvements in primary health care and family planning/population through a Performance-Indexed Resource Transfer (PIRT) program in the CDSS Period. This will also allow us to build on our current paramedical training activities under the multi-donor National Institute of Health Sciences Project. The timing will also allow the GSL to complete some of the ongoing planning and organizational changes needed to expand the rural health delivery system.

In the food and nutrition area, we will cooperate with other donors to assist the GSL to develop a needed national strategy which addresses the rapidly changing conditions in both the private and public sectors. At the same time, we will give high priority to improving the nutritional impact of existing programs. In 1980, the GSL initiated a review of nutrition and food distribution programs in order to increase their effectiveness. New initiatives will be designed and tested, including soya fortification of rice and wheat flour, expansion of home gardening, and increased nutrition education. Consideration is also being given to indexing the value of food stamps to inflation rates. PL 480 assistance will be critical during this period to help Sri Lanka maintain or improve its infant and child mortality and morbidity rates. The CARE PL 480, Title II Maternal and Child Health (MCH) and School Feeding Programs are the only country-wide efforts which directly address the basic problem that many children and lactating mothers simply do not have enough to eat. These programs differ from the broader food stamp program in that they directly affect those among the lower income groups who are most vulnerable to undernutrition. They therefore complement the food stamp program which, while ensuring an opportunity for families below a minimum monthly income to have access to a minimally adeqate food supply, does not focus on those most likely to suffer from under-nutrition. Both the food stamp and the Title II programs have important roles to play until families do have the incomes needed to purchase adequate supplies of food.

At the same time, steps are being taken to: (a) improve the targeting and delivery of PL 480 food and (b) continue the development and utilization of more local foods in weaning formulations and targeted feeding operations. The impact

study of the Title II program, planned by USAID for early CY 1981, should help identify additional ways of improving the use of PL 480 and local resources to improve nutrition.

Support to the GSL shelter program will be provided through the Housing Guaranty Program. Assistance will be concentrated on low-cost, aided self-help housing and on improvement of shelter policies and institutional capacity.

Since local health conditions and programs are rapidly evolving, we must be flexible in programming our assistance, so that it will produce the most benefits for the most needy groups. A Performance-Indexed Resource Transfer (PIRT) strategy will therefore allow us to encourage greater GSL effort in the expansion of preventive community health, population and nutrition services in the rural areas. Moreover, our targeted program and sector strategies will permit us to tailor support to the commitment level and delivery capacity of the various implementing institutions. Funds can thus be shifted as needed to support improved performance. In areas where policy and program options are not clear, we can provide limited grant and loan support to encourage the following: (1) improved program and organizational planning at the macro level, and (2) design and field testing of better action projects at the micro level.

Our assistance in this category will be concentrated on the following:

- a PIRT loan to support the GSL's long term plan for potable water, environmental sanitation, and health education;
- Continuation of the Housing Guaranty Program's support for Aided Self-help Housing and slum and shanty upgrading;
- Continued PL 480 Title II support for targeted maternal and child health and school feeding programs;
- Limited grant support for design and pilot testing of new population, nutrition and health interventions (largely via the PVO co-financing and Development Services and Training projects); and
- A targeted program loan for expansion of rural health and population services and, if necessary, continuation of the malaria control campaign.

It is recognized that the economic productivity of people is also influenced by education and training. USAID will provide limited grant support for the education and training of key technical and professional personnel, primarily through the DS&T and the Agricultural Education Projects. Vocationally-related training for rural community leaders, women, and out-of-school youths will be supported through our PVO Co-financing Project. In addition, there are inservice training components in several of our other projects (e.g., Water Management, Reforestation, Jaffna Water and Kalutara Institute). At present, we do not anticipate making investments in the formal school system. Sri Lanka's high literacy rate and satisfactory school enrollment ratios (77% at primary and 54% at secondary level) have resulted

in generally well-educated men and women. While there is probably a need for additional external assistance to increase vocational and technical training, we prefer to leave this to other donors which have a greater comparative advantage.

C. Assistance Levels and Staff

Total U.S. assistance levels proposed in this CDSS reflect an orderly increase from $115.1 million in FY 1983 to $149.2 million in FY 1987. These levels are predicated on Sri Lanka's need for external assistance, the availability of AID funding and the erosive effects of inflation on the value of AID assistance. These levels are comprised of development assistance, PL 480 commodities, and Housing Guarantees.

The largest part of these program levels (63.5% on the average) consists of development assistance (as described in Section III B). Of particular note in this category of assistance is the need for more effective and efficient modes of delivery, without which the program would be difficult to implement -- unless there are commensurate increases in U.S. direct hire staffing.

The Mission's PL 480 program is justified and examined in detail in our FY 82 Annual Budget Submission (sections attached as Annex C). While certain elements in that submission have changed (e.g. increased wheat off-takes, evidence of worsening nutrition due to inflation, and a somewhat more serious GSL financial situation) its justification and conclusions remain valid. PL 480 is an integral element of our program strategy because it provides quick disbursing aid which assists the GSL with the country's continuing nutrition problem, growing balance of payments problem, and increasing budgetary deficits. Although demand for wheat flour fell from 578,490 MT in 1979 to 371,494 MT in 1980 (a 36% drop) following elimination of GSL subsidies, demand recovered to a monthly off-take average of 39,190 MT during the last quarter of 1980. The GSL estimates that demand will stabilize at a monthly off-take level of 35,000 MT for a total minimum annual overall requirement of 420,000 MT of wheat flour (both because of the convenience factor of bread as well as the continuing high price of rice). In view of these developments, it is proposed that PL 480 Title I wheat imports be continued at a level of 135,000 metric tons (MT) of unmilled wheat (the equivalent of 100,000 MT of wheat flour) through FY 1984 and then be reduced at a rate of 20% annually of this level through FY 1987. This constitutes a decrease from 23.8% of total requirements in FY 1983-84 to 9.5% in FY 1987.

It is proposed that PL 480 Title II commodities also be scaled down both in terms of cost and numbers of recipients. The school feeding program, while straightlined at 1,250,000 recipients, will be substantially reduced in cost by

shifting from 12% soy-fortified flour to unmilled bulk wheat and soy flour in FY 1983 -- perhaps as early as FY 1982. The Maternal/Child Health program will be gradually reduced in cost, although not in numbers of recipients, through phase out in FY 1988. This is being accomplished by using progressively larger amounts of local inputs.

The Mission is proposing to continue the Housing Guarantee Program initiated in 1981 through the CDSS period. This program, financed by non-appropriated funds, can have a substantial impact on rationalizing the GSL's program to provide adequate, if modest, housing for its low-income citizens. Assistance provided on a long-term basis will assist the GSL to attain its goal of a financially self-sustaining housing program.

In addition to official U.S. Government assistance proposed in this CDSS, other U.S. resources have been steadily increasing and, if trends continue, trade and investment will play a substantial role in meeting Sri Lanka's resources gap. Increasing trade between the U.S. and Sri Lanka and U.S. private investments in Sri Lanka are also developmental resources. The U.S. is now Sri Lanka's first export market and fifth largest source of imports. Sri Lanka's trade with the U.S. has increased substantially over the past several years, reaching a level of $102 million in exports and $78 million in imports in 1979. As a result of recent economic reforms and private sector incentives, U.S. investment in Sri Lanka has risen from $0.5 million in 1978 to an estimated $6.0 million in 1980. Motorola International's recent commitment to invest $22 million in a semi-conductor assembly and testing plant in the Free Trade Zone makes the U.S. one of the largest foreign investors in Sri Lanka. The 1980 OPIC Investment Mission to Sri Lanka is also expected to lead to additional U.S. investment.

Whether Sri Lanka, in terms of U.S. interest, warrants this share of the AID budget will, of course, require a policy level determination. However, in terms of the financial resources required to maintain basic momentum of the GSL's development program and meet the basic human needs of its people, these program levels are justifiable. The IBRD estimates that net external assistance disbursements will need to increase from about $500 million in FY 1981 to $660 million in FY 1984. Extrapolating from these estimates, the USAID expects the GSL's annual external financial resource requirements to exceed $800 million by 1987.

The total AID assistance program (including development assistance, PL 480 and Housing Guarantees) will remain more or less constant in terms of percentage of GSL requirements (18-19%) throughout the CDSS period. With adjustments for

inflation, however, AID assistance will become increasingly modest in real terms and will, in fact, diminish over the CDSS period. Assuming a U.S. inflation rate of 10%, the U.S. assistance level of $149.2 million in FY 1987 will have a value of only $76.6 million in terms of constant 1981 dollar value, as compared to $93.4 million in FY 1981 -- a decrease of 18%.

The Mission is making no U.S. direct hire staffing projections at this time, given the numerous unknown factors cited earlier in this CDSS. Acceptance of the proposed PIRT or a similar mode of assistance delivery, along with increased ceilings and better remuneration policies for foreign national employees, will certainly minimize the need for additional U.S. direct hire staff. With less staff-intensive delivery modes, an adequate number and quality of foreign national employees, and some restructuring of U.S. direct hire positions, the Mission should be able to implement the requested assistance levels with only nominal increases in U.S. direct hire staff.

The USAID has seriously considered the possibility of co-financing with other donors in addition to the two projects now being co-financed; Mahaweli - System H and Kalutara Institute of Health Sciences. However, the proposed mode of delivery (PIRT) in which support is provided for sectors within the government's investment plan rather than for discrete projects would seem to preclude a substantial increase in direct co-financing. The USAID will remain alert to identify areas in which greater efficiencies could be achieved by joint funding of projects.

PROPOSED ASSISTANCE PROGRAM

FY 1983-1987 - $ Millions

Categories	1983	1984	1985	1986	1987	Total
1. Mahaweli Basin Development						
System B - Left Bank	25.0	10.0	-	-	-	35.0
Special Mahaweli Sector Support	25.0	20.0	12.0	29.5	-	86.5
Mahaweli Environmental Protection	-	3.0	-	-	-	3.0
System B - Right Bank	-	-	25.0	25.0	25.0	75.0
2. Food Production and Natural Resources Mgt.						
Irrigation and Water Management	-	10.0	20.0	-	27.5	57.5
Agricultural Production Inputs & Services	5.0	5.0	9.5	10.0	10.0	39.5
Environmental Enhancement & Energy	-	9.5	-	15.0	25.0	49.5
PL 480 Title I (non-add)	(23.0)	(23.0)	(18.4)	(13.8)	(9.2)	(87.4)
3. Human Productivity and Well-Being						
Health, Population, Nutrition & Human Resources	4.5	10.0	15.0	20.0	20.0	69.5
Housing Guarantees (non-add)	(25.0)	(25.0)	(25.0)	(25.0)	(25.0)	(125.0)
PL 480 Title II (non-add)	(7.1)	(6.6)	(6.1)	(5.5)	(5.0)	(30.3)
Private & Voluntary Organizations	0.5	0.5	0.5	0.5	0.5	2.5
Development Services & Training	-	2.0	1.0	-	2.0	5.0
Development Assistance	60.0	70.0	83.0	100.0	110.0	423.0
Housing Guarantees	25.0	25.0	25.0	25.0	25.0	125.0
PL 480 Title I	23.0	23.0	18.4	13.8	9.2	87.4
PL 480 Title II	7.1	6.6	6.1	5.5	5.0	30.3
Total U.S. Assistance	115.1	124.6	132.5	144.3	149.2	665.7

ANNEX A

MACRO-ECONOMIC ANALYSIS

I. Introduction

The year 1980 has been a sobering one for GSL economic planners and policymakers. The 1980 CDSS for Sri Lanka stated that "the main economic problem facing the GSL today is whether its ambitious development objectives can be achieved in a 4 to 5 year time frame in the face of accelerating inflation in the prices of vital imports, especially petroleum which has been predicted to consume 45% of 1980 foreign exchange earnings, as well as emerging domestic resource shortages, especially of cement and skilled labor." Now, one year later, the events of 1980 make it safe to say that there is no longer a question that the GSL's investment plan was too ambitious. The strain on both domestic and external resources reached critical thresholds during 1980 and exhibited themselves through alarming increases in the government budget deficit, domestic credit, inflation, and the balance of payments current account deficit. The GSL should be commended, however, in that it maintained and even increased its liberalized economic policy stance in 1980.

This macroeconomic update will analyze recent trends and policy developments in the government budget situation and inflation, in the balance of payments situation, and finally the implications for the AID program strategy.

II. Economic Policy Framework

In spite of increasing economic difficulties, the GSL is consistently maintaining its overall development objectives established in 1977 and the liberalized policy framework to support them. The major development objectives continue to be growth of income and employment to be attained

through a liberalization of the economy and an ambitious public sector investment program. Increased incentives for the production sectors, particularly exporters, are to be emphasized. Liberalized economic policies have been maintained and even increased in some cases during 1980. Subsidies continued to be reduced on a number of consumer items, such as milk, transportation, and petroleum products. Although subsidies still remain, the GSL's steady progress in this area is to be commended. Gradual but steady progress in this sensitive area is the appropriate approach, especially considering the possible adverse effects on the lower income groups.

Interest rates have continued to be raised to order to attract greater savings. Table I shows the interest rate changes that have occurred in 1980, which have been substantial in most cases and probably now closely reflect the real cost of capital.

The other most significant policy developments are in the areas of fiscal policy and trade policies. These are covered in the following two sections.

III. The Government Budget and Inflation

A. Recent trends in the Government Budget:

In recent years the GSL government budget has been under increasing strain as expenditures have been accelerating rapidly in response to the ambitious development program accompanied by only moderate increases in revenue. Table II presents the budget figures for 1979, estimates for 1980, and recently revised GSL projections for 1981.

The capital expenditure budget has been increasing very rapidly; 1978 represented a 143% increase over 1977, as compared to a 70% increase in

TABLE I

Interest Rate Changes in 1980

	Previous rate	Current rate
Savings	%	%
1. Government Treasury Bills	9.0	13.0
2. Central Bank rate	10.0	12.0
3. Commercial Banks		
Short term Fixed Deposits	8.5	14.0
Long term Fixed Deposits	15.0	22.0
Saving Deposits	5.0 to 9.0	10.0 to 13.5
4. Saving Institution		
Short term Fixed	12.0	15.0
Long term Fixed	18.0	20.0
Lending		
5. Commercial Banks	10 - 22	21 - 30
6. Other Lending Agencies		
State Mortgage Bank	5 - 18	5 - 20
Development Finance	10.5 - 16.0	10.5 - 17.0
National Housing	6.0 - 9.0	9.0 - 13.0

Source

Central Bank of Ceylon

recurrent expenditures. Starting from this higher base, capital expenditure increased by 36% in 1979 over 1978 to a new total of Rs. 8,991 million (above $580 million). In 1980, it is expected to increase again by approximately 38% to a level of Rs. 12,392 million (about $700 million). The initial budget estimates for 1981 projected a further increase of 20% to Rs. 14,923 (about $840 million).

On the revenue side, there was a dramatic increase of 74% in 1978 over 1977, but this slowed down to 9% in 1979 over 1978 for a total of Rs. 12,730 million (about $820 million). In 1980, the estimated increase over 1979 will only be 3.6%, for a new total of Rs. 13,194 million (about $740 million). The Minister of Finance's latest projects for 1981 (November 5, 1980) show a reversal of this trend and anticipate a 23% increase over 1980 to Rs. 16,225 million (about $910 million). This might appear overly optimistic. The 1981 receipts, however, include some new taxes and a recuperation of funds advanced in 1980 to purchase wheat flour. Netting out these two elements, the increase over 1980 on the same tax base is only 14.6%. In a situation where inflation is running well over 20%, this may not be unreasonable.

As indicated above, recurrent expenditures increased sharply by 70% in 1978 over 1977. However, recurrent expenditures increased only 2% in 1979 over 1978, and these are projected to increase by 26.2% in 1980 over 1979 (almost 40% of the increase was a one-time advance to purchase wheat flour). For 1981, a 3% decrease is programmed. If the wheat flour advance is netted out, 1981 represents a 4% increase over 1980.

TABLE II

SUMMARY BUDGET DATA 1979 - 81[1]

	(millions of rupees)		
	1979	1980	1981
Recurrent Expenditure	12,530	15,811	15,332
Revenue	12,730	13,194	16,225
Current Acct. Surplus/Deficit	+200	-2,617	+893
Capital Expenditure	8,991	12,392	12,739[2]
Overall Deficit	8,791	15,009	11,846
Financing of Deficit			
Domestic borrowing	4,554	7,579	3,750
External Loans & Grants	4,237	7,430	8,100

[1] Source: Minister of Finance, Nov. 5, 1980, Budget Presentation

[2] Includes Loan Repayments

The GSL uses a rolling, five-year deve-opment program instrument. Its initial capital expenditure estimates were Rs. 47 billion ($3.0 billion) for the 1979-83 period. The 1980-84 program called for an increase to Rs. 63.5 billion, on the basis of a reduced level of real investment. (The cost of fully executing the work included in the 1979-83 plan is now estimated at over Rs. 100 billion. As indicated in the 1981 adjustments discussed above, the GSL plans to cut back even more on the pace of development spending. The 1981-85 investment plan will not be prepared for some months. However, the strategy which will probably be used is the one followed in 1981, i.e., to maintain - at least 1982, 83, and 84 - the levels shown in current rupees for these years in the 1980-84 plan and to make no significant upward adjustments for price increases and inflation, except those which relate to donor financing and changes in the exchange rate. Tuus, the rate of real investment will be slowed down by a percentage equivalent to the rate of inflation. Even at this level of investment, and even if external

financing at projected levels is available, continued budget deficits of substantial magnitude are anticipated.

It is the judgement of the GSL that any further reduction of investment would seriously compromise the objectives of the development program. Thus, the government finds itself with a need for careful balancing between the extremes of inadequate levels of investment - with all that implies in the way of social and economic development - and excessive budgetary deficits with inflationary consequences.

B. The Government Budget and Inflation:

Increased spending pressures resulting from the accelerated GSL public investment program initiated in 1977 have led to increasing budget deficits that have reached 41% of government expenditures in 1979 and an estimated 53% in 1980. Actual expenditures have substantially exceeded planned expenditures because of significant original underestimation of many investments, partially due to unanticipated inflation in critical areas like construction costs. Rather than reducing the real levels of investments, line ministries responded by requesting and obtaining substantial supplemental budgetary allocations. The result was that actual capital expenditures exceeded planned capital expenditures by 22% in 1979 and an estimated 24% in 1980.

The share of the government budget deficit financed by domestic credit creation was 52% in 1979 and an estimated 51% in 1980. This increased domestic credit contributed to an increase in the money supply of about 30% in 1979. The money supply would have increased by more than 40% in 1980, except that the impact of increased domestic credit was offset by a $200 million decrease in international reserves that reduced the actual increase in the money supply in 1980 to 10%.

The increased domestic credit and consequent increase in the money supply led the IMF to suspend its External Fund Facility (EFF) agreement with Sri Lanka in August, 1980. The GSL is therefore not eligible for the remaining $78 million that it could have drawn in 1980. If the EFF is resumed in 1981, the GSL would be eligible for this $78 million plus another $122 million in that year.

The major concern that arises because of the increased budget deficits, domestic credit, and money supply is the consequent inflationary pressures. Increased inflation would be troublesome for the GSL's plans for the country's future economic growth and development. Government budget deficits tend to widen with inflation, which could lead to a vicious circle of deficits contributing to inflation which in turn contributes to increased deficits. Inflation will tend to reduce the real levels of planned investments that can be achieved. It also may endanger the liberalized exchange rate and trade policy reforms depending on how far the GSL is willing to let its currency depreciate. Finally, inflation could have serious distributional impacts, causing a further deterioration in the living standards of the low-income groups.

It is important to recognize, however, that deficit financing has not been the only, and perhaps not even the major, factor causing inflation in Sri Lanka. Price decontrol (i.e., subsidy removal) on some key consumer items has accounted for a significant share of inflation.* For example, consumer prices increased by 43.3% from March, 1979, to March, 1980, but by only 21.3% if the quantum jumps in decontrolled prices are netted out. Similarly, from September, 1979 to September, 1980, the inflation rate is

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* These items include rice, flour, sugar, kerosene, milk powder, fresh coconuts, coconut oil, electricity, petrol, and transportation.

reduced from 33% to 19% if the same netting out procedure is applied. The underlying inflation rate, therefore, is significantly less when these once-and-for-all quantum jumps in prices are excluded. The decontrol of energy-related items (e.g., petrol, electricity, and transportation) has been directly related to the rapidly increasing price of imported oil.

Although the direct impact of subsidy reductions is to increase prices, the indirect impact through its effect on the government budget should serve to lessen inflationary pressures since requirements for deficit financing should be reduced. This makes the high government budget deficits of 1979 and 1980 appear even more alarming.

Another important factor contributing to inflation has been the sharp increases in construction costs reflecting increasing scarcities of raw materials, skilled workers, and construction capacity in relation to the greatly expanded demands of the public sector investment program. In addition, increased reliance on imports has further worsened inflationary pressures since the prices of imported construction materials are substantially above domestic prices. The result has been that construction costs have been increasing at an annual rate of over 50% since 1978. It is unlikely that these inflationary pressures will ease, and they may actually increase in the construction-intensive phase of the GSL investment program over the next five years.

In summary, inflation until now has been mostly caused by price decontrol, worsening external terms of trade, and increasing domestic resource shortages, particularly in the construction industry. These factors are either uncontrollable or, in the case of price decontrol, desirable from an overall economic policy viewpoint. The impact of increasing levels of domestic credit on inflationary increases in the money supply has been largely offset by

declining levels of international reserves. The currently very low level of international reserves, however, would not allow such an offset in 1981.

C. Inplications for GSL Economic Policy:

The GSL has responded to the worsening fiscal situation by announcing in November, 1980, major cuts in 1981 planned capital expenditures and some minor revenue increases in order to reduce the deficit to manageable proportions. As a result, the government deficit as a share of total expenditures will decrease from 53% in 1980 to 42% in 1981, and the share of the deficit financed by domestic credit creation will decrease from over 50% in 1979 and 1980 to 32% in 1981.

The 1981 budgets for most major ministries were cut by 25%, including the Mahaweli program. Although these severe budget cuts demonstrate courage and a commitment by the GSL to reverse the deteriorating fiscal situation, the need for quick action led to the levels and allocation of cuts being somewhat arbitrary. Great care will have to be taken in implementing these directives to mitigate their adverse effects. For example, to the extent possible cuts should be avoided that would result in delays or cancellations of foreign aid disbursements. This would be self-defeating to the extent that expenditure cuts are offset by reductions in revenue due to foreign aid reductions.

Additional subsidy removals would also serve to reduce the pressure on the government budget. Subsidies to items like fertilizer and food still represent significant drains on the government budget. Adjusting subsidies that affect the living standards of the low-income groups, however, must be accomplished with great care.

The GSL is now facing the classic economic trade-off between increased output and employment on the one hand and inflation on the other. Many

signs are pointing to the fact that the public investment program initiated in 1977 has become too ambitious in relation to available resources, even considering the large amount of foreign aid commitments that have been made. If the revised 1981 budget is exceeded in a way similar to the 1980 excesses, the results could be disastrous for the economy of Sri Lanka. International reserves are too low to be drawn down any further as an offset to increased domestic credit creation, and a 40 to 50% increase in the money supply on top of an already heated economy could easily push Sri Lanka into a hyper-inflation situation.

It is also important that in revising its investment program the GSL provide a balance between the long-gestation lead projects and projects with shorter term productive outputs. Too great a share of government spending that does not result in real output in the short-run can also lead to inflationary pressures. The GSL must also try to balance private sector needs with public sector needs.

IV. Balance of Payments Analysis

A. Current Situation and Projections:

Sri Lanka's balance of payments deteriorated sharply in 1980. Table III shows that the current amount deficit more than tripled from $228 million to $761 million. International reserves have been depleted by $200 million during 1980, and at the end of 1980 it is estimated that net international reserves will be reduced to a level of $78 million, equal only to about two weeks' worth of imports.

This deterioration in the balance of payments continues the trend that began last year when the current account deficit almost doubled from 1978 to 1979, while imports increased by 42%. Imports in 1980 have increased by 45% over 1979 (See Table IV).

TABLE III

Balance of Payments

(millions US$)

	1979 (Provisional)	1980 (Estimated)	1981 (Projected)
MERCHANDISE	-467	-1087	-1220
Exports	979	1017	1135
Imports	-1446	-2104	-2355
SERVICES	48	52	63
Receipts	192	257	299
Payments	-144	-205	-236
GOODS AND SERVICES	-419	-1035	-1157
TRANSFERS	191	274	324
Private	48	117	157
Official	143	157	167
CURRENT ACCOUNT	-228	-761	-833
NON-MONETARY CAPITAL	212	576	418
Private	56	307	181
Public	156	269	237
ERRORS AND OMISSIONS	46	-26	-46
SDR ALLOCATIONS	16	16	16
OVERALL BALANCE	46	-195	-353

TABLE IV

Major Exports and Imports

(Millions US $)

	1979	1980 (EST)	1981 (EST)
EXPORTS	979	1017	1155
Tea	366	359	373
Rubber	160	146	189
Coconut	108	46	64
Minor Agric. Crops	54	78	98
Industrial Products	239	316	346
Textiles/Garments	(71)	(111)	(111)
Petroleum	(124)	(166)	(176)
Other	(44)	(39)	(59)
Gems	31	47	46
Other	21	25	39
IMPORTS	1446	2090	2223
Rice	57	56	20
Flour/Wheat	108	150	97
Sugar	59	133	174
Petroleum	250	549	603
Fertilizer	43	75	73
Other Consumer Goods	277	325	325
Other Intermediate Goods	223	306	363
Investment Goods	350	484	563
Other	79	12	5

The large increases in imports have been the major cause of the deteriorating current account balance. About 75% of the increase in imports in 1980 has been in intermediate and investment goods, mostly due to the increased imports generated by the public sector investment program and primarily financed by foreign aid. The remaining 25% of the increase in imports was in consumer goods. Intermediate and investment goods are expected to increase their share of total imports from 65% in 1979 to 68% in 1980 and 72% in 1981.

Another factor increasing the current account deficit has been the worsening terms of trade that Sri Lanka has been experiencing. During 1979-84, the prices of merchandise imports are expected to increase at an annual average of 12% which export prices are anticipated to increase by only 9% annually. These projections imply a deterioration of Sri Lanka's terms of trade by almost 13% between 1979 and 1984. The most significant import price development during 1980 was the more than doubling of oil import prices which resulted in oil imports also more than doubling, and accounting for 54% of export earnings in 1980 compared to 25% in 1979.

Although imports are expected to grow at a less rapid rate of 11% in 1981, and exports rebound to an 11% growth rate, the current account deficit will still increase by 9% to a level of $833 million. With current account deficits at these unprecedented high levels, it is necessary to assess very carefully the financing implications.

Table V estimates the external financing gaps for 1980 and 1981. In 1980 the gap was largely financed by drawing down international reserves by $200 million, which will not be possible in 1981 as net reserves are now at a precariously low level. There was also a substantial increase in the use of short-term trade credits in 1980, especially to finance petroleum imports. Continued heavy use of trade credits would begin to have an

TABLE V

External Financing Gap

(millions US$)

		1980	1981
A.	CURRENT ACCOUNT BALANCE	-761	-833
B.	Debt Repayments	-64	-66
C.	Gross Foreign Exchange Requirements (A+B)	-825	-899
	To be Financed from:		
	Net Direct Foreign Investment	60	70
	Loans and Grants	406	541
	SDR Allocations	16	16
D.	Total Non-Monetary Capital	482	627
	Unfinanced Gap (C+D)	-343	-272

adverse impact on Sri Lanka's credit worthiness and debt service situation. Sri Lanka was also to draw a $50 million Eurodollar loan in 1980, which will also worsen the debt service picture.

Although the financing gap in 1981 is not as large as 1980, mostly due to increased levels of foreign assistance, Sri Lanka will not have the cushion of reserves that existed in 1980. A resumption of the IMF Extended Fund Facility, which could amount to about $200 million for Sri Lanka in 1981, appears to be the most likely way by which excessive reliance on short-term trade credits could be avoided.

The prospects of a resumption of the EFF are fairly good, considering the strong budgetary steps that the GSL has recently taken. The danger, however, is that a repeat of last year's performance may occur. After drawing the first tranche, the GSL may find it increasingly difficult to restrain expenditures below the revised ceilings. If the ceilings are exceeded, the EFF will probably be suspended again, and the GSL will have to scramble again for whatever foreign exchange financing it can find, probably short term trade credits. The basic economic trade-off that the GSL would face would be the unpleasant one of a reduction of ambitious development plans on the one hand and the assumption of an increasing and probably unsustainable debt burden on the other.

Contributing to the worsening balance of payments situation has been the disappointing performance of exports in the face of large increases in imports. The 45% increase in imports in 1980 was accompanied by only a 3% increase in exports. Most disappointing has been the performance of the plantation crop exports which have fallen by 14% in 1980, causing their share in total exports to decline from 65% in 1979 to 54%. This poor performance was cuased both by drought weather conditions and reportedly ineffective management of plantations.

The performance of minor agricultural exports and industrial exports was encouraging in 1980, growing at 44% and 32% respectively. Petroleum product exports increased by 32% in 1980 mainly because of higher prices and now account for about 50% of industrial exports. Garment and textile exports grew at 56% in 1980 and represent 35% of industrial exports.

The projection in Table III that exports will rebound in 1981 to an 11% growth rate may be optimistic. It assumes favorable weather conditions and adequate producer incentives. To the extent that these conditions do not hold, the balance of payments situation could be significantly worse than projected.

The import projections may also be optimistic. Petroleum imports, after more than doubling in 1980, are projected to increase by only 10% in 1981. This is based on the assumption that subsidy removals and conservation measures will succeed in keeping the volume ofpetroleum imports constant in 1981 (15 million barrels). The price of oil is projected to increase from $32/barrel in 1980 to $36/barrel in 1981. Imports of oil will represent well over 50% of 1981 total export earnings. Holding "other consumer" imports steady at $325 million after a 17% increase in 1980 may also be difficult.

Projecting Sri Lanka's balance of payments even through 1981, therefore, requires making many assumptions about quite uncertain events. Projecting past 1981 through 1985 may have little validity. It is not unreasonable, however, to speculate on the range of the current account deficit under varying circumstances over the next five. years.

The World Bank's 1980 economic report on Sri Lanka provided a range of the annual average current account deficit over 1980-84 of between $712 million (official GSL estimate) and $956 million (IBRD adjustments with less favorable assumption). The main assumptions that were adjusted are regarding the behavior of exports, private remittances and factor service payments.

The events of 1980, however, have shown that even the IBRD projections with less favorable assumptions may be optimistic. For example, the IBRD's adjusted current account deficit figures for 1980 and 1981 of $620 million and $725 million respectively are significantly lower than our more recent estimates of $761 million and $833 million. With greater than expected import pressures and poorer export performance, it is not inconceivable that the average annual current account deficit over 1981-85 could be between $1.2 and $1.5 billion. The greater the current account deficit tends to increase over this period, the more likely it is that cutbacks in growth and investment will have to occur along with a reimposition of import restrictions. The balance of payments situation, therefore, could threaten to undermine the basic development strategy of the current government.

B. Implications for GSL Economic Policy:

The trade and exchange rate policies that the GSL has adopted since 1977 have in many ways been favorable to an improved balance of payments situation. The devaluation and unification of the exchange rate system replaced an inefficient system of import controls and provided increased incentives to exports, particularly industrial exporters. The GSL policy of letting the exchange rate float has maintained these favorable incentives. The reduction or elimination of subsidies on many imported consumer goods has discouraged excessive imports of these commodities, and has succeeded in achieving significant reductions in certain areas. The GSL has also embarked on a strong export promotion strategy, establishing special incentives for exporters and a Free Zone program to attract processing and re-export activities. Despite these favorable policies, however, several other factors

have contributed to the recent deterioration in the balance of trade. Although the poor performance in plantation crop exports in 1980 was partly due to weather conditions, it is clear that greater attention must be given to improving management of this sector and increasing producer incentives. Increases in the replanting subsidies in 1979-80 may help to strengthen performance. With these crops representing between 55% and 65% of total export earnings, Sri Lanka cannot afford many years like 1980 when plantation crop exports decreased by 14%.

An important GSL economic policy issue that affects the balance of payments is the level of economic growth and investment that it decides to maintain. High levels of investment imply high levels of imports, and to the extent that these imports are not covered by the country's own foreign exchange resources or foreign aid, large financing gaps will emerge as occurred in 1980. The GSL must carefully plan its investment programs so that desired growth rates are balanced with maintaining external financing gaps as sustainable levels.

The GSL has done an excellent job of obtaining donor support for its investment program. Over half of the current account deficit is accounted for by foreign flows. High levels of donor support can be expected to continue barring any unforeseen circumstances.

The GSL should also ensure that the managed floating exchange rate be allowed to adjust adequately to domestic vs. world inflation rates. Although the GSL seems to have achieved this so far, if high inflation rates continue, the maintenance of a realistic exchange rate may become endangered. In other words, the GSL may resist a continual depreciation of the rupee at the 17% annual rate of this past year. The alternative, however, is a resumption of import restrictions and disincentives to exporters.

V. Implications of the Macro-economic Situation for the AID Program

The major implication of the worsening macro-economic situation in Sri Lanka for the AID program is that project implementation may be delayed or stretched out, although priority in budget allocations is being given to projects which have donor support. This may occur because of insufficient counterpart financing, either local cost or external, and/or because of shortages of local materials or manpower.

With regard to future AID commitments, the macro-economic situation would support the following arguments for appropriate types of assistance for Sri Lanka:

1. As it appears certain that Sri Lanka will have great difficulty in securing both the domestic and external resource requirements to implement its current project portfolio as planned, fast-disbursing non-project assistance should be preferred to new projects except for very special cases. Most new projects will only further strain the shortage of local resources and skilled manpower, and add to the already unsustainable recurrent cost problem of the GSL.

2. Fast-disbursing non-project assistance is needed to support Sri Lanka's balance of payments.

3. Fast-disbursing non-project assistance can also be employed to generate local currency in a non-inflationary way to relieve the government budget deficit.

4. Non-project assistance should be designed to relieve both the balance of payments and local financing gaps of the current development budget.

ANNEX B

ESTIMATED AID DISBURSEMENTS 1980 ($ MILLIONS)

Donors	Project Assistance		Commodity Assistance		Total
	Loans	Grants	Loans	Grants	
1. Multilateral					
ADB	9.70				9.70
IBRD/IDA	24.90				24.90
IFAD	4.00				4.00
EEC	3.00	1.50		1.00	5.50
UN Group		5.00			5.00
WFP		2.50			2.50
Others		1.00			1.00
Sub Total	41.60	10.00		1.00	52.60
2. DAC					
Australia		1.00		3.60	4.60
Canada	13.00	.50	9.60	3.50	26.60
Denmark	2.00		.50 a/		2.50
France			8.50		8.50
Germany (FRG)	1.50	3.50	6.60 a/	4.70	16.30
India	1.50		11.20 a/		12.70
Japan	1.00	10.50	19.30 a/	11.75	42.55
Netherlands		1.50	15.10 a/	9.00	25.60
Norway		2.59		3.60	6.19
Sweden		22.75			22.75
UK		51.10		6.30	57.40
USA	8.75	2.00	41.20	6.10	58.05
Sub Total	27.75	95.44	112.00	48.55	283.74
3. Communist					
China	1.00				1.00
USSR	.25				.25
Sub Total	1.25				1.25
4. Other					
Kuwait	2.00				2.00
OPEC	1.15				1.15
UAE	.55				.55
Switzerland		.50			.50
Iraq			5.50		5.50
Finland				.50	.50
Sub Total	3.70	.50	5.50	.50	10.20
Totals	74.30	105.94	117.50	50.05	347.79

Note: a/- Commercial Credits

Source: External Resources Division, Ministry of Finance and Planning.

ANNEX B

PROJECTED AID DISBURSEMENTS 1981 ($ MILLIONS)

Donors	Project Assistance		Commodity Assistance		Total
	Loans	Grants	Loans	Grants	
1. Multilateral					
ADB	17.67				17.67
IBRD/IDA	68.95				68.95
IFAD	3.00				3.00
EEC	4.25	1.60		5.00	10.85
UN Group		5.00			5.00
WFP		.86			.86
Others		1.05		1.50	2.55
Sub-Total	93.87	8.51		6.50	108.88
2. DAC					
Australia		.50		2.65	3.15
Canada	15.21	1.05	6.00	4.00	26.26
Denmark	1.80	.80			2.60
France	7.00		20.00	1.50	28.50
Germany (FRG)	1.70	.20			1.90
India	1.00		10.00 a/	2.00	13.00
Japan	4.50	2.50	12.00 a/	14.30	33.30
Netherlands	1.80	.75	12.00 a/	17.00	31.55
Norway		1.55		8.50	10.05
Sweden		24.30			24.30
UK		52.00		3.00	55.00
USA	17.20	1.40	44.70	7.90	61.20
Sub-Total	50.21	85.05	104.70	60.85	300.81
3. Communist					
China	.30				.30
USSR	.15				.15
Sub-Total	.45				.45
4. Other					
Kuwait	2.00				2.00
OPEC	1.00				1.00
UAE	1.20				1.20
Other	.50	2.80	2.50 a/	.50	6.30
Sub-Total	4.70	2.80	2.50	.50	10.50
Totals	149.23	96.36	107.20	67.85	420.64

Note: a/- Commercial Credits

Source: External Resources Division, Ministry of Finance and Planning.

ANNEX C

P.L. 480 NARRATIVE

A. Introduction

In response to the AID/W CDSS issues cable (State 067409) the following PL 480 narrative presents a more extensive analysis than in previous years. Significant changes in the policy and program environment for PL 480 assistance to Sri Lanka over the last year have also highlighted the need for a more extensive analysis. This analysis endeavors to demonstrate the Mission's belief that a strong developmental case can be made for sustained, relatively high levels of PL 480 assistance over the next three years (FY81-83). These levels form part of a reasonable plan that will complement the GSL's goal of becoming self-sufficient in basic food grains. After FY 1983, it is proposed that PL 480 levels decline with Title I phasing out entirely by 1987-88 when development efforts now getting underway should yield self-sufficiency in basic food grains.

A major determinant of the kind and amount of commodity most appropriate for Title I assistance is the demand for imported rice and wheat (all wheat must be imported). Current consumption of imported rice and wheat flour has apparently dropped sharply owing to a current bumper rice crop and recent major policy changes, such as elimination of the food ration system and the domestic subsidy on wheat flour and bread. Therefore, while a range of other factors favor a high level of PL 480 Title I assistance, the recommendations of this narrative must be viewed as tentative and subject to revision, based on changes in consumer demand over the next few months.

Title II programs, which are intended to reduce directly malnutrition of mothers, infants and children, will remain at about the same levels (adjusted for cost changes). The Mission recommends further analysis and assessment of the nutritional impact, cost effectiveness, and logistical aspects of Title II programs in Sri Lanka.

B. Rationale

There are four basic rationale for PL 480 food aid to Sri Lanka: (1) to support employment and equity-oriented development at the local level; (2) to meet a continuing nutritional gap; (3) to reduce the economic burden of food import requirements; and (4) to help cover serious near-term balance of payment deficits.

The first Sri Lanka PL 480 rationale is to support employment and equity-oriented development at the local level. The local currency generated by the sale of Title I wheat flour through the GSL Food Commission

goes into a GSL Counterpart Fund Account from which the local cost component of the GSL's capital expenditure budget is financed.[1] Title I proceeds are, according to the Title I agreement with the GSL of March 18, 1980, to be used fo finance the agreement's self-help measures to: (1) improve agricultural production and consumption forecasting; (2) improve storage and warehouse facilities for food commodities; and (3) upgrade reforestation, dryland and watershed management programs. Proceeds are also to finance development efforts in the agriculture, water resources and population planning sectors, emphasizing "directly improving the lives of the poorest of the recipient country's people and their capacity to participate in the development of their country." A major share of proceeds under previous agreements has gone for such activities as: construction and maintenance of farm-to-market roads, rehabilitation of minor irrigation tanks and associated canal and drainage systems, and construction of village and town agricultural market places. This Counterpart Fund has become critical to the continued pursuit of small-scale, quick-yielding rural development projects at the local level, given the fact that inflationary pressures are forcing regular budgetary resources to be increasingly focussed on major, but longer-gestation projects, such as the Accelerated Mahaweli Development Program. A shortfall of $65 to $100 million a year is estimated to still exist in the Capital Development Budget for the 1980-84 period.

The second rationale is to meet a continuing nutritional gap. The recent ASIA Bureau Health/Population/Nutrition (HPN) Sector Review Team to Sri Lanka concluded that under-nutrition and malnutrition remain at significant and in some cases serious levels (see Sri Lanka HPN Sector Review Draft Report, April 1980). One study reviewed by the team finds that the gap between recommended and available calorie levels widened between 1959/60 and 1973, particularly at lower income levels.[2] The most serious problem exists among children. The roughly 41% of primary school children who suffer from some degree of Protein Calorie Malnutrition (PCM) experience a shortfall estimated at 300-400 calories and 5-10 grams of protein a day. About 43% of pre-school children in 1975-76 suffered from second and third degree PCM.[3] While more recent systematic evidence is not available, spot

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1 See Canadian International Development Agency (CIDA), A Review of Canadian Food Aid and Commodity Loans to Sri Lanka (Ottawa: draft, April 1980), p.20, -- and Colombo 2885, of June 6, 1979. The CIDA study recommends that CIDA approve in advance the projects to be financed from local currency proceeds. CIDA is in a strong position to do this, as all Canadian food aid, including shipping costs, is on a grant basis.

2 James Gavan and Indrani Sri Chandrasekera (Monograph on Food Production and Consumption Policies in Sri Lanka), International Food Policy Research Institute, Washington, D.C, 1979.

3 GSL, Ministry of Health, Sri Lanka Nutrition Status Survey, 1975-76, prepared with assistance of U.S. Center for Disease Control, Atlanta, Georgia.

checks and other evidence suggest the problem has not significantly improved and may have become worse.[4] Wheat flour and such other food aid commodities as corn and soybean can fill these nutritional gaps.[5] Moreover, wheat flour has been consumed over the last 30 years by an increasingly broad segment of the population, both in terms of income level and geographical locations.[6] The convenience of wheat flour for baking and widespread availability of commercial bakery-produced bread have been cited as factors encouraging wheat flour consumption.[7]

A third rationale for PL 480 to Sri Lanka is to reduce the economic burden of its substantial food imports, which during the years 1972-79 averaged about 40% of the annual value of total imports (unweighted annual average; see Table A at the end of PL 480 narrative). In 1979 total food imports amounted to about $310 million or about 21% of total 1979 imports. Rice, wheat, and wheat flour, which have constituted the bulk of grain imports, averaged about 68% of the value of total food imports during 1972-79. In 1979 total imports of these 3 commodities amounted to about $166 million or 54% of total 1979 food imports.

In physical terms, rice, wheat and wheat flour imports during 1970-79 averaged about 872,000 metric tons (MT) a year or about 46% of the total availability of these commodities (see Table B). Given difficult growing conditions in Sri Lanka, all wheat grain has been and continues to be imported; however, with the completion of the new Prima flour mill

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4 See Nutrition section of draft HPN Report as cited in text above.

5 The recent USAID supported Kansas State University report, "Recommended Support for Grain Policy Development and Implementation in Sri Lanka," Food and Food Grain Institute Report No.78, March 1979, indicates: "A pound of milled rice has about 99% as many calories as a pound of wheat flour and approximately half as much crude protein" (p.37).

6 The Survey of Sri Lanka's Consumer Finances, 1973 prepared by the Central Bank of Ceylon indicates that during the two sampled months in 1973 expenditure on wheat flour in rural areas at Rs.1.86 per capita exceeded that in urban areas at Rs.1.53 per capita. Even more striking, rural expenditure per capita for the lower middle income categories of Rs.100-200 and 200-400 monthly income per spending unit exceeded the overall rural average. Even at Rs.50-100 monthly income, per capita spending on flour was Rs.1.68. While expenditure on bread in urban areas at Rs.4.12 per capita exceeded that in rural areas at Rs.2.38 per capita, expenditure in lower income categories was significant (Rs.2.18 per capita for the Rs.50-100 monthly income rural spending unit.) See tables S609 and S610, pp. 518-19, Part II. Also see CIDA Review, op. cit., (Ottawa: draft, April 1980), pp.15&17.

7 See CIDA op. cit., p.14.

in Trincomalee during the latter half of 1980, no more wheat flour will be imported. Wheat flour and wheat (measured in terms of wheat flour equivalent) averaged 506,000 MT a year (1970-79) or 58% of total rice and wheat flour (and wheat) imports; in 1979 wheat flour and wheat imports were 590,000 MT or 68% of total rice and wheat flour (and wheat) imports. Rice imports averaged 346,000 MT a year during 1970-79 or 26% of total rice availability; in 1979 rice imports were 273,000 MT or 17% of total rice availability.

It will be noted from Table B that wheat and wheat flour imports declined in 1979 from 1978 and that rice in 1978 and 1979 were significantly lower than in most previous years of the decade. Owing to a bumper "Maha" (major season) paddy harvest and plentiful domestic rice available at a reasonable price in the local open market, the monthly draw-down of imported rice stocks in 1980 has declined to a level which, if continued through 1980, would indicate a significantly lower level of rice imports than the previous low point of 169,000 MT reached in 1978. This same factor plus the elimination of the domestic subsidy on wheat flour and bread in February 1980, has resulted in a significant decline thus far in the monthly wheat flour off-take (see further discussions below in Sections D and F). The third major food import, sugar, has continued to increase, reaching 177,000 MT in 1979 or 92% of total availability.

A range of coarse grains, pulses and root crops have served as partial substitutes in varying degree in human consumption for rice and wheat flour (with the latter two commoditeis in turn being partial substitutes for each other). Table C (at the end of PL 480 narrative) groups the major crops into 3 categories: (1) coarse grains -- maize, sorghum, kurakkan or finger millet and meneri --; (2) pulses -- green gram, black gram, dhal, cowpea, soya beans, and ground nuts --; (3) and root crops -- manioc or cassava (as well as sweet potatoes, not shown in the table). Some of these crops, such as the grams, cowpea and dhal, are widely used with curries; soya has only recently been intorduced into Sri Lanka; maize is used more for animal than human consumption; finally, such crops as sorghum, finger millet, cowpea, manioc and sweet potatoes are generally viewed as "poor man's" foods or elements in the diet of low income families, particularly when they cannot afford rice or wheat flour (or bread). There is no systematic analysis of consumption patterns of these crops by income group of which the Mission is aware. A comparison of Tables B and C (end of PL 480 Narrative Section) shows that the production of coarse grains and pulses in 1978 at 56,000 MT and 51,000 MT, respectively, were each about 4% of rice production at 1,288,000 MT and 10% of wheat flour imports at 664,000 MT. Manioc production, largely home consumed, has been estimated at much higher levels -- 637,000 MT in 1978 or about 49% of rice production and 96% of wheat flour imports.

A final rationale for PL 480 assistance is widening balance of payments deficits which are expected to remain serious over the next three to four years. The current account deficit more than trippled between 1978 and

1979, from $97 to $320 million, and is expected to almost double again in 1980 (to $438 million), notwithstanding continued expected growth in export earnings from such "traditional" exports as rubber, gems and minor export crops, as well as a doubling of industrial exports, including garments (to $184 million) and over a 20% growth in earnings from tourism. This situation continues to reflect a massive increase in import expenditures (with about two-thirds of the increase being for capital and intermediate goods) stemming from import liberalization, accelerated economic growth and development programs, and world inflation of the prices of petroleum and other imported raw materials. In fact, even with an expected increase by over 30% in official loans and grants (to about $480 million in 1980) and similar relative increases in foreign private investment and worker remittances (to $65 million and $78 million, respectively), the overall balance of payments in 1980 could, in the absence of additional capital inflows, reverse from a 1979 surplus (of $46 million) to a deficit ranging from $65 to $125 million.[8] This situation is expected to prevail during the next 3 to 4 years when the major expenditures for the 1980-84 public investment plan are scheduled but before their contributions to domestic production and foreign exchange saving and earning are fully realized. PL 480 food aid, in addition to AID development assistance, can make a significant contribution to covering these near-term balance of payments gaps. The fact that the share of investment and intermediate goods in total imports has increased from 48% in 1975 to 65% in 1979 suggests that foreign exchange released by financing through PL 480 the importation of food commodities will be used primarily to support Sri Lanka's development efforts. In the absence of additional balance of payments assitance, Sri Lanka's development programs could be curtailed and accomplishment of development objectives, as detailed in the FY 82 CDSS, jeopardized.

C. Instrument Mix

The Mission recommends a combination of Title I and Title II to meet the above objectives. Title I food aid contributes to all 4 objectives: (1) support of rural development and employment at the local level; (2) improved nutrition; (3) reduced economic burden of food import requirements; and (4) coverage of balance of payments gaps. Wheat flour milled from PL 480 Title I is distributed by the Food Commission to cooperatives, bakeries and other registered retail outlets. These outlets are the sole sources of commodities, including wheat flour and bread, covered under the GSL's Food Stamp Plan which is restricted to families in the lower half of the income distribution. For further discussion of future likely levels of demand for wheat flour, see Section F.

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8 Based on discussions with GSL officials and joint Embassy/AID assessments.

Although the subject has not been raised in recent months, the GSL is presumably still interested in a Title III program. The Mission is continuing to consider possibilities, but has simply not been able to devote the considerable staff time required to develop and obtain approval for a Title III program that might have a reasonable chance for acceptance by all parties involved in the review process. An expanded version of the "Village Low-End Poverty Program" described elsewhere in the ABS as a pilot DA project for FY 82 could be developed into a Title III program beginning in FY 83. This program should lend itself to Title III in view of the fact that it seeks to generate increased income and employment among the poorest rural families who have a high income elasticity of demand for food. But implementation of this program even on a DA pilot basis by FY 82 depends, as discussed elsewhere, on the Mission being able to expand its DH staff.

The Mission proposes continuation of a Title II grant program to address the nutritional improvement objective. The program is administered through CARE which acts as the cooperating sponsor in collaboration with the Ministry of Education for the School Feeding (SF) program and the Ministry of Health for the Maternal Child Health (MCH) program and other smaller programs (Thriposha Commercial Market and Other Child Feeding). The MCH program addresses the three predominant nutritional problems in Sri Lanka: Protein Calorie Malnutrition (PCM), Nutritional Anemia and Vitamin A deficiency. Through the monthly issuing of a nutritional food supplement (through some 2,000 social service units) to medically selected pregnant and lactating mothers and pre-schoolers, the MCH program seeks to reduce third degree malnutrition by 75% and second degree malnutrition by 50%. It is estimated that a 4 month Thriposha program for pregnant women should result in a 20 lb. gain and babies with a "normal" 5-1/2 lb. birth weight. The nutritious food supplement provided through this program is a blend of instant corn soy milk (70%) and local cereals (30%) called "Thriposha".[9] A factory constructed under this program began production of Thriposha in January 1980 and is now producing 42 tons per day. Thriposha (under the Thriposha Commercial Market Program) is being market tested for sale commercially at low cost.

Approximately 41% of Sri Lanka's primary school children suffer from PCM. The nutritional shortfall for primary school children is estimated at 300-400 calories and 5-10 grams of protein per day. The primary school feeding program, through the delivery of a daily 50 gram (238 calories and 7.5 grams of protein) nutritious ration to primary school children in some 8,000 targeted schools, seeks to maintain and improve the nutritional status of primary school children in these schools. Nutrition education and a primary school nutritional surveillance system are integral parts of this program.

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9 Beginning in March 1981 the proportions will change to 60% ICSM and 40% local cereals; in FY 1983, to 50-50; and in FY 84 to 40% ICSM and 60% local cereals.

D. Food Self-Reliance

Sri Lanka's historically high food import requirements have been described in Section B. However, with the expansion of irrigated acreage, the development and spread of high-yielding varieties and other inputs, and the increasing effectiveness of the Guaranteed Price Scheme, domestic rice production has accelerated from an annual growth rate of 3.5% over the last 10 years to 5.25% over the last five years.[10] The share of rice imports in total availability declined markedly to 12% and 17% in 1978 and 1979, respectively, compared to an annual average of 29% for the 1970-77 period. The GSL's policy is to reach self-sufficiency in rice production as soon as possible. The Ministry of Agricultural Development and Research has suggested a 1981 or 1982 target. This could be achieved if the Ministry's "high projection" for yield growth and a relatively low growth of demand are assumed. More conservative (and probably more realistic) Mission assumptions would result in self-sufficiency being achieved between 1985 and 1990.[11] It is during this period that increases in rice production from the country's major development schemes, including those receiving substantial USAID assistance, should be realized (see discussion in Sri Lanka FY 82 CDSS, pp.26-27).

At least one GSL official has defined "total" basic food self-sufficiency as the point at which Sri Lanka will earn enough foreign exchange from the export of surplus rice to pay for its wheat requirements. Achievement of so-called "total" self-sufficiency, as defined above, will thus depend not only on the growth of rice production and demand, but also on projections of Sri Lankan demand for wheat flour and the international prices of rice and wheat flour (or the wheat grain equivalent). Utilizing a range

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10 These compound annual growth rates are based on 5-year average initial and terminal production for the 10-year comparison (1965-69 and 1975-79, respectively) and 3-year averages for the 5-year comparison (1972-74 and 1977-79, respectively). Averages were employed in order to smooth out the effects of such annual influences as variations in weather.

11 "Low" demand growth is the 2.17% compound annual growth of total availability of rice (production plus imports) between 1965/69 and 1975/79. In the less optimistic projections, a higher rate of demand growth (3.35%) is assumed, based on the growth of population (1.7%), and per capita income (3.3%) as well as the income elasticity of demand for rice (0.5). A lower growth of production (5.25%), based on compound annual growth from 1972/74 to 1977/79, is also assumed in one of the projections.

of reasonable assumptions about these parameters, the Mission estimates that "total" self-sufficiency might be achieved sometime between 1987 and the year 2000.[12]

The GSL has no quantified production targets for coarse grains, pulses or root crops. The current Dryland Agriculture Production/Marketing I project proposed for USAID support and currently in preparation may lead to the GSL's adopting targets for eight commodities. The project aims to double yields by 1990 of each of the folloiwng commodities: maize, sorghum, finger millet, meneri, black gram, green gram, cowpeas and groundnuts. The GSL has recently increased floor prices for several of these crops. Proposed USAID assistance to the GSL Marketing Research Unit and for Dryland Production/Marketing I and II will further improve marketing of these crops.

E. Other Policy Considerations

The domestic price of wheat flour, which less than three years ago was pegged at 40% of landed cost, has been progressively raised until, on February 23, 1980, it was increased by 58% to Rs.2.37 a pound. The price of bread was raised accordingly. This bold and politically risky measure completely eliminated the domestic subsidy to wheat flour and in the Mission's judgement greatly weakens any disincentive the importation of wheat/wheat flour might have on domestic production of rice and subsidiary coarse grains and pulses (in fact the new price was set slightly above the landed cost of imported wheat flour in order to anticipate possible world price increases during 1980).[13] The announced policy of the GSL is to permit the domestic price of wheat flour to move with the world price.

The Mission believes the receiving, storage and distribution capacity of Sri Lanka are adequate to handle the levels of PL480 imports recommended in the following section. See also Colombo 1935 (April 22, 1980) for

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12 It was assumed that wheat flour consumption will either remain constant from 1981 at 420,000 metric tons a year, or increase as a result of per capita income and population growth at about 3 percent a year. It was also assumed that the ratio of international rice to wheat (wheat flour equivalent) price ratios (c.i.f. Colombo) will range between the values experienced between 1970 and 1978, 0.60 to 0.85 (see Kansas State University, op.cit., p.55). These assumptions yield amounts of rice exports ranging from 250 to 500,000 metric tons by 1990 required to pay for estimated wheat import requirements.

13 In fact, the February action brought the retail price ratio between rice and wheat flour below 1 for the first time. For an earlier study which concluded that the 60% subsidy on wheat flour which prevailed in 1977 and earlier did have a disincentive effect on coarse grains and yam production, see P.A.S. Dahanayake, "Disincentive Effects of Food Aid on Food Production in Sri Lanka", Central Bank of Ceylon, August 1978.

additional information and judgement on Sri Lankan storage and handling capacity. The recent CIDA Review of Canadian Food Aid and Commodity Loans to Sri Lanka (see note 5) found GSL performance in unloading, storage and distribution to be adequate, with losses reported between one and two percent. The CIDA review team also concluded that the GSL National Food Policy Committee (NFPC), established in early 1979, should result in an improvement of demand forecasting.[14] The recently established GSL Marketing Research and Assessment Unit, which is about to receive technical assistance from the Mission's Development Services & Training Grant, will provide the NFPC with analytical support in coordinating grain production, import and distribution policies.

F. Recommended Levels of Title I Assistance

The U.S. is providing the wheat equivalent of 107,300 MT of wheat flour (145,000 MT of wheat) under PL 480 Title I to Sri Lanka in FY 1980. This level includes an amendment for an additional 28,100 MT of wheat flour (38,000 MT of wheat) authorized in April for negotiation in response to the Mission's request, which was in turn based on the GSL's urgent need for additional balance of payments financing in support of its development efforts beset with inflation, in the cost of imported raw materials and capital goods and in view of its steps to eliminate the subsidy on wheat flour as well as to reduce other subsidies. The Mission believes the foregoing analysis of needs and objectives of food aid to Sri Lanka, as well as the discussion of self-sufficiency efforts and pricing and other policy measures, justify a continuation of Title I assistance at a level of 100,000 MT of wheat flour, or 135,000 MT of wheat, a year for the fiscal years 1981-83. If total demand for wheat flour in Sri Lanka remains constant at 420,000 MT a year, this level of Title I support would provide about 24% of total wheat imports (see Table D at end of PL 480 narrative).

The Mission further believes that particularly in view of the large balance of payments deficits which are expected to continue over the next three to four years when the import requirements of the GSL's development programs will be particularly heavy (see "Rationale" section above), additional annual Title I support above 135,000 MT of wheat could be justified. Therefore, a total of 180,000 MT of wheat, or 133,200 MT of wheat flour, a year is recommended for 1981-83. This would represent slightly less than a third (31.7%) of total wheat flour demand if the latter remains at 420,000 MT a year (see discussion below on this point). For the ABS year, FY 82, Tables I and V rank the first 135,000 MT of wheat in the "Minimum" category and the next 45,000 MT in the "Current" category.

As indicated in previous sections, by 1984 Sri Lanka's need for extraordinary balance of payments support should begin tapering off. Self-sufficiency in rice production should also be imminent if not already achieved.

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14 CIDA, op. cit., pp. 15-19.

Over the years 1984-87, as major agricultural development projects assisted by AID and other donors for the Accelerated Mahaweli Program, Rice Research, Water Management, Paddy Processing & Storage, and Dryland Agricultural Production/Marketing continue or begin to make substantial contributions to food production (see FY 82 CDSS, pp.26-27), and as Sri Lanka approaches the point of earning enough foreign exchange through rice exports to pay for its wheat imports ("total" self-sufficiency), Title I assistance is projected to decline, as shown in Table 1. By 1986, Title I is projected to decline to about 14,000 MT of wheat flour equivalent or slightly less than 10% of 420,000 MT estimated total flour demand. By 1987 a further decline to about 11,000 MT or about 2-1/2% of total demand is projected. (See Table D) Unanticipated adverse circumstances, such as drought or external (world market) shocks beyond GSL control, would force reconsideration of these projections.

One important consideration in recommending Title I levels is the likely effect on the demand for wheat flour and bread following the February 1980 flour price increase of 58%, which eliminated the domestic subsidy. The flour off-take from Food Commission stocks declined to 22,000 MT in March from the monthly average of about 45,000 MT during the previous six months. As reported in Colombo 1935 (April 22, 1980), this decline was believed to somewhat overstate the true decline in consumption, owing to release of private stocks hoarded in anticipation of the price increase. Poor quality of then available EEC wheat and seasonally low rice prices reflecting the record "Maha" paddy harvest were also believed responsible. While official figures have not been released, the Food Commission indicates that the April off-take remained, at least in part for the two last-mentioned factors, near the March level. Although Mission assessment of the elasticity of consumer substitution between wheat flour and domestically produced grains suggests a low responsiveness to relative price changes, the current existing price ratios between rice and other domestic grains on the one hand, and wheat flour on the other, are lower than ever before experienced.[15] Thus, while wheat flour consumption may recover from the March and April lows, it is not likely to return to pre-1980 levels. The Food Commission estimates that a new "normal" consumption level of 35,000 MT a month will be reached over the next few months, resulting in an annual consumption of 420,000 MT beginning in 1981. Other GSL officials believe it will not increase much above 25,000 MT a month or 300,000 MT a year.

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15 Assessment of low substitution elasticity based on review of KSU report, op. cit., p.57, and on Mission regression analysis of rice-flour price and consumption ratios for the 1961-77 period. The latter analysis showed a statistically insignificant degree of association between the two ratios.

It is even more difficult to project what might happen to flour demand in the longer run. The rice-flour price ratio might decrease even further over the long run, if -- as it seems plausible -- the growth of world-wide demand for wheat outstrips supply at a faster pace than will occur for rice. On the other hand, increasing population and per capita income would, other things being equal, increase the demand for flour. In the absence of information on world-wide long-run commodity price projections, the Mission assumes a constant level of flour demand of 420,000 MT a year. A more definitive projection cannot be made until flour off-take is observed for the next few months. As rice stocks are worked down the resulting increase in price may shift some consumption towards wheat flour. If flour consumption were to remain as low as 300,000 MT a year, the recommended "Current" Title I annual level of 133,000 MT of wheat flour would amount to 44% of total demand. It could be difficult to negotiate a UMR ("Usual Marketing Requirement") in circumstances that would permit 133,000 MT of Title I plus another 15 to 30,000 MT of concessional wheat flour equivalent from other countries, given that the FY 1980 UMR alone requires 300,000 MT to be purchased on commercial terms.[16] At a total annual demand level of 330,000 MT, it may not be possible to negotiate a level of Title I wheat in excess of 100,000 MT. In these circumstances additional Title I assistance would have to consist of another commodity, such as, cotton. Sri Lanka imports most of its cotton with about 15 to 20 % coming from the U.S. in recent years, so this could be a possibility. In the absence of firmer information on future wheat flour demand, the Mission has not pursued this possibility further.

A related issue concerns the impact of elimination of the wheat flour subsidy on the consumption of flour and bread by low income groups. Rations of rice, paddy, sugar and milk foods restricted to the lower half of the income distribution in 1977 were in turn eliminated completely in October 1979 when the food stamp plan took the place of the ration program. An authorized holder of stamps may exchange them at market prices at outlets authorized by the Food Commission for any combination of the above commodities as well as for wheat flour, bread, and available pulses (a few stamps are ear-marked for kerosene also). The stamps are denominated in monetary terms, so that when market prices of the covered commodities increase, purchasing power of the food stamps declines -- unless additional food stamps per capita are issued. The latter does not yet appear to be in the offing. Casual reports from the countryside (e.g., field trip discussions held by the AID/W HPN Review Team) suggest that rural families with access to food stamps reduced substantially their use of stamps for flour and bread after the February price increase. On the other hand, it should be noted that the total rupee amount of the food stamp allocation per family was designed to be larger than the prevailing value of the ration by an amount calculated to compensate for the anticipated elimination

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16 Non-U.S. concessional figures based on recent experience and GSL projections. The major non-U.S. source of food aid is Canada.

of subsidies on covered commodities, including flour and bread. Moreover, stamp allocations vary by family member, with a larger amount for children. As in the case of the 1977 ration reform, food stamps are restricted to the lower half of the income distribution. Plans to restirct coverage further appear to have been shelved in view of concern over hardship caused by inflation. Families recently forced below the median income because of unemployment or other hardship have reportedly not been able to get access to stamps, however. Finally, the cost of fuel has been cited as a factor encouraging bread rather than flour or grain consumption.[17] A study of how food stamps are being allocated would provide valuable information for planning related to food production and imports as well as assessment of the impact of inflation on the nutrition of lower income groups. The GSL Food Commission is considering such a study towards the end of 1980, after, according to the Food Commissioner, "Adjustments to the new price structure have been made."

Although the Mission believes the foregoing, which draws on recent studies such as the KSU Report, CIDA Review, and HPN Review, represents a fairly comprehensive analysis, there are refinements which should be made. These include more thorough investigation of possible production dis-incentive effects and consumption substitution between wheat flour and domestically produced grains, pulses and root crops; improved world commodity price projections, drawing on work done by the World Bank and elsewhere; and at least a sample survey of the allocation of food stamps by families. The GSL Ministry of Finance and Planning, with the assistance this summer of consultants from the Harvard Institute for International Development has initiated studies on basic food production and consumption policies as well as on improving the food stamp program. A study of the nutritional impact of food stamps may also be done as part of a June-July 1980 AID/W-funded consultancy by Dr. James Levinson to the GSL's Food and Nutrition Policy Planning Unit. The Mission is therefore recommending three to four person months of consultancy during summer or early fall 1980 from PD&S funds to conduct further analysis of Title I assistance, drawing on recent studies.

G. Recommended Levels of Title II Assistance

In accordance with the approved CARE Multi-Year Plan, Title II assistance having an estimated cost of $9.4 million is proposed for FY 1982 (see Table I). This represents an increase from $7.5 million in FY 81, reflecting both an increase in cost factors and a relatively small net increase in Title II-funded recipients of 26,000 -- from 1,712,000 to 1,738,000.

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17 See CIDA Review, op. cit., p.14. Although the baking of bread in commercial bakeries also requires fuel, larger operations may be able to take advantage of economies of scale.

There are four components of the CARE FY 82 Title II program proposed for Sri Lanka: (1) School Feeding with 1.35 million recipients; (2) Maternal/Child Health with 354,000 recipients; (3) Thriposha Commercial Market program with 24,000 recipients; and (4) Other Child Feeding with 10,000 recipients.[18]

The entire Title II request is placed in the minimum cateogry in Table I. The Mission believes the overall Title II program, or at least certain elements of it, has potential (see p.10 on intended Thriposha impact on birth weights) for a significant positive impact on the problems of maternal and child malnutrition in Sri Lanka. However, in the absence of comprehensive nutritional impact evaluation data which do not exist for the CARE/Sri Lanka programs, the Mission is not able to rank the various components and place them into different ZBB categories.

The nutritional impact of school feeding (SF) programs has been the subject of continued debate among experts, as noted by the HPN Review team. The team observed that CARE/Sri Lanka believed the SF program at least stabilized deterioration in children's nutritional status. However, since it was believed not feasible to select children for feeding from within a given school, entire schools were selected instead, based on the criterion of greater than 40% prevalance of malnutrition in 1973. The HPN team questioned the continued validity of this approach which discriminates against malnourished children in non-participating schools.

Under the MCH-Thriposha program 80% of the recipients have received a take-home portion. The HPN Review team noted that maximum nutritional impact has been prevented by the "common practice of recipients sharing the Thriposha with non-target family members". To redress this problem the GSL has recently decided to shift where feasible to an on-site program. For a number of reasons based on negative experience elsewhere, including strain on administrative capacity, difficulty of food preparation, and inter-cultural barriers to common feeding, the HPN team advises a scaled down pilot test for this new approach. A number of logistic problems in the existing MCH-Thriposha program, including inadequate storage, handling, inspection and monitoring, which prevent Thriposha from reaching its intended beneficiaries were observed by the team. Concern over the cost-effectiveness of the MCH program in reaching its intended beneficiaries was expressed by health officials to team members on several occasions during their visit.

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18 The MCH and Thriposha Commercial Market programs will use 40% local cereals in FY 82, a proportion expected to increase over the next few years. Thus, the total number of FY 82 MCH recipients will be 600,000 compared to 354,000 Title II recipients and the total number of Thriposha recipients will be 40,000 compared to 24,000 Title II recipients.

In view of these concerns, the Mission recognizes the need for an intensive review of these problems with CARE, as well as the initiation of systematic impact evaluations with the objective of improving the cost-effectiveness of Title II-assisted programs. Unfortunately, as noted in the long-range plan narrative section of the ABS, the Mission is in an extremely poor position to devote the USDH staff time required to initiate and guide such a review process.[19] The Mission has just received a draft summary of a 1979 Nutrition Status Survey of the School Feeding Program undertaken with the assistance of CARE but has not yet been able to review the survey or its implications.

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19 Dr. James Levinson, AID/W-funded consultant to the GSL's Food and Nutrition Policy Planning Unit, has proposed a GSL impact evaluation of the Thriposha program. This would help, but is only one element of a comprehensive review of the Title II program.

Table A

Value of Major Food Imports into Sri Lanka, 1972-79
$ Million 1/

	Rice	Wheat Flour 2/	Sugar	Total Food	Total Imports
1972	9.2	14.1	16.5	9.2	133.2
1973	20.8	29.5	21.5	91.9	175.2
1974	51.5	60.5	14.9	137.9	293.9
1975	62.2	66.1	17.3	171.0	338.8
1976	46.7	50.4	8.3	111.7	300.3
1977	59.2	55.4	12.8	140.7	387.5
1978	44.5	133.8	40.0	266.3	947.5
1979	57.0	109.1	59.9	310.1	1455.5

1/ Converted from rupee figures at 1979 exchange rate RS 15.5 = $1.00

2/ Includes imported wheat converted into wheat flour equivalent.

Source: GSL, Central Bank, Customs Department

Availability of Major Food Grains, Sri Lanka 1970-79
(000 Metric Tons)

	Rice (milled) production	Rice Imports	Wheat Flour Imports[1]	Total Availability[2]
1970	1106	534	432	2072
1971	956	339	437	1735
1972	896	266	400	1562
1973	899	343	436	1678
1974	1097	308	488	1893
1975	790	459	528	1777
1976	857	425	476	1758
1977	1140	542	610	2292
1978	1288	169	664	2121
1979	1308	273	590	2171

[1] Includes wheat flour equivalent of wheat grain imports.

[2] Sum of first 3 columns.

Sources: GSL Food Commission, Ministry of Agricultural Development and Research

Table C

Production of Major Coarse Grains, Pulses

and Root Crops, Sri Lanka, 1973-78
(000 metric tons)

Coarse Grains

	Maize	Sorghum	Meneri	Finger Millet	Total
1973	13.6	1.1	0.2 a/	19.4 a/	34.3
1974	23.8	3.1	0.5	15.6	43.0
1975	34.5	6.5	0.5	20.6	62.1
1976	31.0	1.7	0.9	15.6	49.2
1977	41.9	2.0	1.1	22.7	67.7
1978	36.8	1.4	1.0	17.1	56.3

Pulses

	Green Gram	Black Gram	Dhal	Cowpea	Soyabeans
1973	3.2	0.4	0.1	0.6	0.2
1974	5.9	0.7	0.8	2.0	1.3
1975	6.3	1.1	0.2	7.6	1.2
1976	4.6	2.3	0.1	11.9	0.8
1977	7.8	11.7	--	21.1	1.1
1978	10.8	7.9	0.4	21.4	2.1 b/

a/ Yala (minor) season only
b/ Maha (major) season only

Table C (cont'd)

(ooo metric tons)

	Pulses, continued		Root Crops
	Ground Nuts	Total Pulses	Manioc (Cassava)
1973	9.2	13.7	661.5
1974	7.4	18.1	849.6
1975	7.6	24.0	766.7
1976	6.1	25.8	682.8
1977	6.6	48.3	547.3
1978	8.4	51.0	636.8

Sources: GSL Central Bank, Ministry of Agricultural Development and Research, Department of Census and Statistics

TABLE D

PL 480 Title I Projections Employed in ABS Narrative

	Wheat (000 MT)	Wheat Flour (74% of Wheat) (000 MT)	Dollars[a/] ($ 000)	Total Demand (000 MT)	Title I % of Dem.
FY79	-	78.7	17,000	500	15.7
FY80	145	107.3	25,000	454	23.6
FY81	180	133.2	29,700	420	31.7
FY82 minimum	135	100.0	22,950	420	23.8
FY82 current (additive)	45	33.2	7,650	420	7.9
FY83	180	133.2	30,600	420	31.7
FY84	140	103.6	23,800	420	24.6
FY85	100	74.0	17,000	420	17.6
FY86	55	40.7	9,350	420	9.7
FY87	15	11.1	2,550	420	2.6

a/ Per STATE 110974, cost of wheat is to be computed at $165 per MT for FY81 and at $170 for FY82 and out years.