PPA:SRI 18145

ASIAN DEVELOPMENT BANK

PROGRAM PERFORMANCE AUDIT REPORT

ON THE

AGRICULTURE PROGRAM LOAN
(Loan No. 994-SRI[SF])

IN

SRI LANKA

December 1996

CURRENCY EQUIVALENTS

Currency Unit — Sri Lanka Rupee/s (SLRe/SLRs)

		At Appraisal (August 1989)	At Program Completion (February 1992)	At Postevaluation (October 1996)
SLRe1.00	=	$0.0251	$0.0228	$0.0177
$1.00	=	SLRs39.88	SLRs43.7708	SLRs56.50
$1.00	=	SDR0.7948	SDR0.7496	SDR0.6944

ABBREVIATIONS

APL1	–	First Agriculture Program Loan
APL2	–	Second Agriculture Program Loan
ASA	–	Agrarian Services Act
CTC	–	Crush, Tear and Curl
DPL	–	Development Policy Letter
EA	–	Executing Agency
ERD	–	External Resources Department
FO	–	Farmer Organization
GDP	–	Gross Domestic Product
IMF	–	International Monetary Fund
INMAS	–	Integrated Management of Major Irrigation Schemes
IO	–	Irrigation Ordinance
ISF	–	Irrigation Service Fee
JEDB	–	Janatha Estates Development Board
JFE	–	Janatha Fertilizers Enterprise Limited
MOF	–	Ministry of Finance and Planning
NAFNS	–	National Agriculture, Food and Nutrition Strategy
NPD	–	National Planning Department
O&M	–	Operations and Maintenance
PCR	–	Program Completion Report
PEM	–	Postevaluation Mission
PMB	–	Paddy Marketing Board
PPAR	-	Program Performance Audit Report
R&D	–	Research and Development
SDP	-	Sector Development Program
SDR	–	Special Drawing Rights
SLSPC	–	Sri Lanka State Plantations Corporation
TPAR	–	Technical Assistance Performance Audit Report
WB	–	World Bank

NOTES

(i) The fiscal year (FY) of the Government and the Central Bank of Sri Lanka ends on 31 December.

(ii) In this Report, "$" refers to US$.

CONTENTS

BASIC PROGRAM DATA
Agriculture Program Loan [Loan No. 994-SRI(SF)]

KEY PROGRAM DATA ($ million):	As per Bank Loan Documents	Actual
Bank Loan Amount/Utilization	80.0[1]	83.9[1]
Bank Loan Amount/Cancellation	–	–

KEY DATES:	Expected	Actual
Identification/Fact-finding		28 Mar–12 Apr 1989
Appraisal		7–25 Aug 1989
Loan Negotiations		23–26 Oct 1989
Board Approval		28 Nov 1989
Loan Agreement		12 Dec 1989
Loan Effectiveness	12 Mar 1990	22 Dec 1989
First Disbursement		28 Dec 1989
Final Disbursement		14 Aug 1991
Loan Closing	30 Jun 1992	14 Aug 1991
Program Completion	31 Dec 1991	Nov 1992[2]

BORROWER: Democratic Socialist Republic of Sri Lanka

EXECUTING AGENCY: Ministry of Finance and Planning

MISSION DATA:

Type of Mission	No. of Missions	Person-days
Identification/Fact-finding	1	66
Appraisal	1	181
Program Administration		
– Review	4	65
– TA Review	2	4
– Program Completion	1	24
Postevaluation	1	24

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1 Equivalent to SDR 63.59 million. The increase in equivalent dollar amount at the time of Program completion was the result of a realignment of the SDR against the US dollar.

2 Refers to the date of accomplishment of the latest policy reform implemented. Some policy recommendations from the Program--sponsored studies made on crop production incentives and extension service have been carried over for implementation under APL2.

I. HIGHLIGHTS

1. **Objectives and Scope.** The main objective of the first Agricultural Program Loan (APL1)[1] was to revitalize the agriculture sector through improving overall productivity and growth in agriculture, achieving a high degree of self-reliance in rice, enhancing export earnings from tree and minor export crops, and promoting agro-industries. Major policy and institutional reform measures aimed at rationalizing the fertilizer sector, the plantation sector and the Paddy Marketing Board (PMB), improving production incentive through reducing tree crop taxation, developing rural credit markets, ensuring sustainability of irrigation facilities and recovering irrigation costs, improving agricultural extension services, and raising agricultural investment.

2. **Cost, Financing, and Schedule.** Bank assistance to the Government with a loan of Special Drawing Rights (SDR) 63.59 million ($80 million equivalent) from its Special Fund resources was released in two equal tranches: the first tranche, on 28 December 1989; the second, on 27 June 1991. The second disbursement was delayed due to legislative difficulties in processing amendments to the Agrarian Services Act (ASA) and the Irrigation Ordinance (IO) to enable Farmers Organizations (FOs) to collect irrigation service fees (ISF). Nevertheless, the Program loan was closed four months earlier than originally envisaged.

3. **Implementation.** All the policy measures were implemented during the Program period except for the enhanced collection of ISF. However, efforts aimed at encouraging participatory irrigation management instead were sustained. Additional irrigation areas were brought under the Integrated Management of Major Irrigation Scheme (INMAS). The role of FOs in irrigation maintenance was legally established though their responsibilities remained to be clarified. The most notable success achieved was in the reduction of tree crop export taxes, though measures aimed at reducing the losses of the State plantation companies were largely ineffective. These companies, however, were later split-up and progressively divested. Two major policy items, the removal of fertilizer subsidies and containment of PMB losses, were reversed in 1994. The policy of increasing rural interest rates remained ineffective due to the persistence of subsidized term lending and other inconsistent policy changes. Measures to strengthen rural financial market development and agricultural extension were not fully implemented.

4. **Institutional Aspects.** Years of detailed, preparatory policy analysis and consensus-building, led by the Ministry of Finance and Planning (MOF), the Executing Agency (EA), in the reform process, contributed to the relative success of APL1 despite the country's difficult conditions. While APL1 did not specifically provide for training, the agencies involved gained much experience in coordinating and keeping reforms on track. Notwithstanding severe staffing constraints, and limited familiarity with the Bank's disbursement procedures, the EA and implementing agencies were able to secure compliance with most of the reforms identified in the Development Policy Letter (DPL, see Appendix 1), and to secure disbursement and utilization of the loan proceeds within the Program period. That there were policy reversals, incomplete and ineffective reforms, can be attributed partly to design deficiency but more so to changes in the

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[1] A Second Agricultural Program Loan (APL2) for $60 million approved in October 1991 was under implementation at the time of the Postevaluation Mission. The objectives of APL2 were to (i) support Government's programs to increase agricultural productivity, (ii) help Government in introducing extensive agricultural reforms and sustain policy reforms and institutional strengthening implemented under APL1, and (iii) assist Government in meeting the continued need for imports of agricultural inputs. The second tranche of APL2 was recently cancelled as certain policy conditions were not fulfilled, amongst them was the withdrawal of fertilizer subsidies that were reintroduced.

external environment and the need of the Government to make mid–course corrections to the reform effort.

5. **Environmental Aspects**. Environmental impact of APL1 was positive. It discouraged overuse of chemical fertilizers, inspired the Government to promote the use of organic fertilizers, contributed to more participatory management of irrigation systems and complemented the Government's efforts to increase public investment in rural environmental management.

6. **Program Impact**. Overall impact had been mixed. Positive results were realized in those reforms that were sustained such as lowering the tax burden on the tree crops sector and developing a program to break–up and then privatize the public sector estates. Where measures were reversed or were generally ineffective, such as eliminating fertilizer subsidies, reducing PMB losses, strengthening agricultural extension, and deepening rural financial markets, negative impacts on the budget and the efficient use of agricultural resource resulted. The Program did pursue a broad and ambitious range of reforms.

7. **Overall Performance and Sustainability**. Overall, the Program is considered partly successful because of the mixed results achieved in the implementation of both policy and institutional reforms and the nonsustainability of some reforms. Nevertheless, the Government made significant progress in some areas of agricultural policy reform, particularly in the reduction of export taxes. Political and security developments had hampered full completion of APL1 reform efforts.

8. **Feedback**. Program lending can be an extremely effective instrument to introduce policy and institutional reforms provided that certain requirements are met; such as, having clear and focused objectives and performance indicators, adequate emphasis on credibility and consensus building, a proper balance between expenditure–reducing and growth–enhancing reforms and ensuring that the number and type of reforms pursued do not overwhelm limited policy–change capacity of the country.

II. BACKGROUND

A. Rationale

9. The Government began liberalizing the economy, including agriculture, in 1977 after years of interventionist policy. But progress in trade liberalization was slow and agricultural reforms were modest. In the mid–1980s, despite record commodity prices, agricultural production stagnated. Distortions in the economy persisted with strong implications for the budget. As public expenditures shifted to meet growing security requirements, the budget deficit grew and Government sought ways to contain public expenditure pressures. In September 1989, Sri Lanka's balance of payments deteriorated and the fiscal position eroded. The Government requested the support of the multilateral community for a set of macroeconomic and sectoral reform programs that would stabilize the macroeconomic environment while increasing the economy's capacity for efficient, export–oriented growth. The Bank responded with a program loan which would be the most suitable vehicle for pursuing the policy reforms in the agriculture sector given the sector's importance in the economy. APL1 was to support the implementation of policy and institutional reforms in agriculture aimed at expanding the influence of market–signals and improving the enabling environment for private sector participation. This was in keeping with the need to address broad–based policy and institutional constraints to

agricultural development as highlighted in the Bank's 1988 Country Operational Program Paper. The ultimate goal of the Program was to develop a competitive and sustainable agriculture sector.

B. Formulation

10. APL1 built upon the strategy for restoring high and sustained rates of agricultural growth laid out in the National Agriculture, Food and Nutrition Strategy (NAFNS) of 1984. It also followed on an earlier Agricultural Inputs Program[1] which was essentially a fertilizer import facility with a narrow range of policy reform measures aimed at improving fertilizer and irrigation use. The Government's commitment to further policy and institutional reform measures were outlined in the DPL. Its involvement in the formulation of the Program was strengthened by the various efforts of the officials to conduct preparatory policy analysis and build up consensus. Such efforts were further helped by the availability of various studies originating from external sources.[2]

11. A reasonably extensive sectoral analysis was undertaken when the Program was formulated by the Bank. Nevertheless, while APL1 was broad-based, key macroeconomic and sectoral policies that have a significant effect on agriculture, such as the exchange rate, fiscal balance, administrative wage rates, agricultural property rights, and public expenditures in agriculture were not part of the reform agenda, reflecting the lack of a comprehensive assessment of the policy environment surrounding the sector. Macroeconomic policies were, however, addressed contemporaneously under an International Monetary Fund (IMF) supported stabilization program and a World Bank (WB) economic reform and development program. These macroeconomic programs focused heavily on reducing public expenditures to stabilize financial markets. This emphasis on cost-saving measures was also reflected in APL1.

C. Objectives and Scope at Appraisal

12. The stated overall objective of APL1 was to revitalize the agriculture sector. It was intended to improve overall productivity and growth of the sector, achieve a high degree of self-reliance in rice, enhance export earnings from tree and minor export crops, and promote agro-industries. APL1 was also intended to prepare the groundwork for further market-oriented reforms in agriculture by emphasizing the use of market signals for resource allocation, encouraging a higher level of private sector participation in crop agriculture development and irrigation improvement schemes, and stimulating private investment and efficient financial intermediation in agriculture.

13. APL1 identified 22 major policy and institutional reform measures mainly in six major areas: fertilizer sector, tree crop taxation, State plantation sector, PMB restructuring, irrigation sector, and rural credit sector (see Appendix 2). Reforms in the fertilizer sector would promote more efficient use of fertilizers and liberalize fertilizer distribution. Measures in reducing tree crop taxation would improve crop production incentives. Lessening the burden on the budget and improve economic efficiency through privatization were the expected output from reforming public sector plantation companies and the PMB. Irrigation cost recovery and sustainability of the irrigation facilities were expected to be achieved with reform measures in the irrigation sector

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1 Loan No. 820 (SF)-SRI: *Agriculture Inputs Program*, for $29 million approved in December 1986 and closed in November 1989.

2 For example, *A Policy Framework Paper* (IMF, 1988); *The 1987-90 Program of Economic Reform and Adjustment* (World Bank, May 1988); and *A Strategy for Bank Operation in Sri Lanka* (ADB, March 1988).

while development of a viable rural credit market was expected from reforms at improving rural interest rates. Other measures in improving agricultural extension services and raising agricultural investment were to result in greater agriculture growth.

14. The reform measures could also be classified into three broad categories: (i) those reforms which were expected to have a broad and immediate impact on both the Government budget and the farm sector; such as, reductions in tree crop export taxes and fertilizer subsidies; (ii) those designed to start the process of policy and institutional reform in a given subsector; such as, the financial restructuring of the state plantation corporations and the PMB; and (iii) those aimed at assessing and setting the agenda for later reform efforts, such as, the technical assistance efforts in crop incentives and agricultural extension.

D. Financing Arrangements

15. The Bank provided the Government SDR63.59 million ($80 million equivalent) from its Special Funds resources. As a result of currency fluctuation, the actual amount disbursed was $83.9 million. The loan was released in two equal tranches; the first tranche, including retroactive financing, upon loan effectiveness and the second, after some delay, with the satisfactory fulfillment of six policy conditions. The proceeds of the loan were used to finance the foreign exchange costs of eligible items while the counterpart funds were used to finance the local currency cost requirements of agricultural development projects. The Borrower was the Democratic Socialist Republic of Sri Lanka. The Central Bank of Sri Lanka was the depository of the loan proceeds while MOF through its External Resources Department (ERD) in cooperation with the National Planning Department (NPD) was the EA.

16. The Program accounted for about 21 percent of total "program oriented" aid disbursements (excluding food aid) to the country during the Program period. Other major sources of Program finance were the WB (Small and Medium-Scale Enterprises Adjustment Credit of $61.3 million and the Economic Restructuring Credit of $61.2 million), and the Government of Japan (Economic Restructuring Credit Co-financing of $50 million).

E. Donor Coordination

17. Consultations with the IMF, the WB and the U.S. Agency for International Development were held during Program design. Concurrently, macroeconomic stabilization programs were mounted by IMF and WB while policy and institutional reform projects were supported by bilateral agencies. While the Bank assumed the lead role in agriculture sector reform, there is little evidence to suggest that coordination between the Bank and the IMF was used to forestall macroeconomic developments adversely affecting agriculture.

F. Program Completion Report

18. A Program Completion Report (PCR) prepared by the Bank dated 23 May 1994 discussed the design, scope, implementation and operational aspects as well as initial impacts of the Program. It did not examine the impact of changes in the external environment on agriculture and the expected sustainability of the reform effort. (Within six months after the PCR, two major Program-supported policy efforts were reversed.) At the time of approval by the Board, the Program was estimated to require 22 months, from 12 March 1990 to 31 December 1991. The loan became effective on 22 December 1989 and was closed about 18 months thereafter, on 14 August 1991.

G. Postevaluation

19. This Program Performance Audit Report (PPAR) focuses on key aspects of the Program and presents the findings of a Postevaluation Mission (PEM) that visited the country from 7 to 18 October 1996. The PPAR also presents an assessment of the effectiveness of the Program in achieving its objectives, in generating benefits, and in sustaining its impact.

20. The PPAR is based on a review of the PCR, the Report and Recommendation of the President, material in Bank files, Government reports, discussions with Bank staff, the EA, other agencies of the Borrower, and with representatives of multilateral agencies and the private sector. Copies of the draft PPAR were provided to the Borrower, the EA and other agencies concerned, and Bank staff for review and comment. Comments received have been taken into consideration in finalizing the Report.

III. IMPLEMENTATION PERFORMANCE

A. Policy Reform Measures

21. Policy reforms aiming at correcting major distortions in the pricing of agricultural inputs and products were implemented. Export taxes on tea and rubber were significantly lowered, interest-subsidies on rural credit significantly reduced, and fertilizer subsidies were removed. Support was also provided for the recovery of ISF (although this was later abandoned), the establishment of the legal framework for FOs, and the diffusion of the INMAS participatory irrigation management system in 32 major irrigation schemes (see Appendix 3).

22. Initial steps were taken to reduce the operating losses of agricultural parastatals, to liberalize access to fertilizer and rice markets, and to develop institutions supportive of a rejuvenated agricultural development effort. The number of storage and milling facilities of the PMB was reduced, and PMB's overdraft was converted to a term loan. Overdrafts amounting to SLRs4.7 billion of the two State plantation corporations were also converted to term loans. Other plantation-sector cost-saving measures, the reduction in mandatory work days and enhanced labor mobility, were not implemented due to opposition from labor unions. Imports and distribution of fertilizer were liberalized. Private sector participation in the rice market increased. The Rural Credit Board was not established and little tangible progress was made towards developing rural financial market institutions. The Program also called for increased public sector support for agricultural development. In the face of mounting fiscal pressures, however, public investment in agriculture was sharply reduced.

23. The emphasis on reforms aimed at reducing Government's fiscal burden in agriculture, while in line with ongoing stabilization efforts, would not be adequate in realizing the Program's stated objective of revitalizing agricultural growth. With rising costs and lower output prices, the net effect of reducing export taxes and removing input subsidies was to reduce producers' margins. The combination of political uncertainty, deteriorating world market and fiscal conditions constituted an external environment unfavorable to agricultural innovation. Given small and saturated domestic markets, revitalizing agriculture hinged on enhancing and diversifying the agricultural export effort. APL1 could have paid more attention to policies enhancing agro-export and export diversification as well as technological improvements through agricultural research and development (R&D).

24. A comprehensive assessment of the macroeconomic policy and institutional constraints affecting agriculture as opposed to a sectoral analysis was not carried out. Key policy constraints on efficient growth, such as import licensing, high and uneven tariffs, and ill-defined rural property rights were not addressed. More realistic performance indicators could have been established and the linkages between external conditions, sector reforms, and agricultural performance clearly analyzed. Little attention in Program design was accorded to public awareness or education of policy makers.

25. The proper sequencing of reforms appeared to be lacking. Liberalization of fertilizer marketing in the absence of a regulatory capacity for controlling fertilizer quality had made product adulteration easier. Liberalizing the rice trade, before producer marketing capacities were developed, resulted in widening trade margins. More generally, the reduction in subsidies and increase in capital costs, while correcting distortions, lowered the overall competitiveness of the sector. Given limited immobility of labor and shallow credit markets, the flow of agricultural resources into more competitive endeavors was limited.

26. Limited durability of policy reforms weakened the credibility of the Government's commitment to reform. The elimination of fertilizer subsidies and reduction in the operations of PMB were reversed in 1994. Limited progress was made in continuing other Program measures that were only partially implemented during the Program period, such as rural credit market development, agricultural extension reform, increased public investment in agriculture, and establishment of a clear legal framework for FOs in collecting ISF. Most significant progress made after APL1 was the elimination of tree crop export taxes and the break-up and privatization of the State plantation corporations.

B. Procurement and Disbursements

27. Procurement procedures were in accordance with the Loan Agreement and the Bank's *Guidelines for Procurement* entailing the use of a positive list of eligible imports subject to a prohibition list of harmful pesticides. As there was no single supply contract exceeding the equivalent of $3 million, award on the basis of international competitive bidding was not enforced. Loan proceeds were used to import goods for agriculture or agro-related industries from the Bank's member countries. About 59 percent of the loan proceeds were used to finance fertilizer imports of 262,000 metric tons (mt), equivalent to 34 percent of total fertilizer imports during the Program period. Other imports financed under the loan included petroleum (11.6 percent of total loan proceeds), jute bags (8.4 percent), and cement (10.6 percent).

28. The first tranche was disbursed according to schedule. Release of the second tranche was delayed five months because of difficulties in securing legislation to enable FOs to collect ISF. Despite these delays, and notwithstanding the limited experience of the executing agency in preparing withdrawal applications, implementation subsequently picked up momentum and the loan was closed on 14 August 1991, four months ahead of the schedule loan closing date.

C. Organization and Management

29. The leadership provided by the EA and the cooperation and coordination exhibited amongst the 12 Ministries involved in implementation were excellent. Despite severe staffing constraints, the EA and implementing agencies were able to secure compliance with many of the

reforms identified in the DPL, and to secure disbursement and utilization of the loan proceeds within the Program period.

30. The policy and institutional reforms supported in the Program were subjected to extended policy dialogue between the Bank and the Borrower. Six review missions were fielded between December 1989 and August 1991, during which time the Bank maintained regular discussions with local counterpart staff. The close working relationship between the Bank and the EA helped establish Government's Program management capacity, and ensured expeditious resolution of reform implementation delays.

D. Effectiveness of Technical Assistance

31. Technical assistance was provided for special studies on crop production incentives, agricultural extension, and the impact of APL1 reforms. The studies were undertaken by capable consultants, were well executed and fostered continuing dialogue amongst the concerned Ministries and between the EA and the Bank. The study on crop production incentives made a direct contribution to reforms pursued under APL2. However, many recommendations made in the study on agricultural extension were not adopted by the Government as the agricultural extension projects were funded by WB which adopted a different approach to agricultural extension.

32. The level of technical assistance provided under APL1 appears to be inadequate given the complex nature of many institutional reforms, the need to incorporate benefit monitoring as an ongoing part of the reform process, and the need to advance the reform agenda to generate follow-up and complementary reforms. The emphasis in APL1 was primarily on immediate accomplishment rather than preparing the groundwork for an extended reform process.

E. Compliance with Loan Covenants

33. The Government generally complied with the major loan covenants as detailed in the Loan Agreement. All conditions for loan effectiveness and for the second tranche release were met in full prior to loan closing. There were, however, two lapses in the conditions subsequently, namely the re-establishment of fertilizer subsidies, and the expansion of PMB's operations. The circumstances leading to the reversal of the policy on fertilizer subsidies in 1994 were political as a newly elected Government endeavored to fulfill part of its populist pledges made before the election but had its roots in the cost-price squeeze situation facing the farmers as fertilizer prices rose and output prices declined. Similarly, PMB was directed to implement support-price purchases of paddy when rice prices declined — a problem in part contributed by Government's decision to subsidize the import of wheat which lowered the demand for rice. While FOs were legally established and recognized as an entity to collect irrigation service fees, they did not have the power to enforce collection. Their role was further compromised when the Government decided not to collect the ISF. Further amendment to the ASA was under consideration during the time of the PEM to clarify the role and responsibilities of the FOs.

F. Monitoring

34. Frequent consultation and second-tranche review were conducted to monitor policies, institutional developments, and changes in the agriculture sector. Although performance indicators were not clearly identified at appraisal, the NPD monitored the progress in the agreed

reforms, and in its annual publication on *Public Investment*, reviewed the impact of major reforms on the agriculture sector. Further monitoring was made under the study on policy impact of APL1 in 1993. Although a Technical Assistance Performance Audit Report (TPAR)[1] noted that quality of analysis in the impact assessment was mixed, study findings helped Government better understand the impact of reform measures on different categories of producers. This information was also used to fine–tune reform efforts supported under the APL2.

G. Use of Counterpart Funds

35. Counterpart funds generated from the loan proceeds were used to finance an equivalent of $83.9 million local cost requirements of Bank–financed and other agricultural projects. An amount of SLRs200 million (equivalent to $5 million) was used to finance cost–overruns in the Walawe Irrigation Development Project (Loan No. 695–SRI[SF]).[2] The balance of the funds were used to augment general revenues. Public capital expenditures in agriculture amounted to SLRs11.4 billion ($282 million) during 1990 and 1991, and the counterpart funds were deemed to have been spent on agricultural projects.

IV. PROGRAM RESULTS

A. Performance Indicators

36. Separating the effects of major changes in the external environment from those of agricultural policy reform is difficult. Performance evaluation of APL1 would have been simpler had there been a logical framework specifying quantitative performance indicators such as the changes in the effective protection rates of the commodity sector. The overall major performance indicators implied at the time of appraisal — an increase in overall productivity and growth in agriculture as well as agricultural exports, greater private sector involvement and reduction of Government activities in marketing — could well have been appropriate if conditions prevailing during the Program period had continued thereafter. External conditions for agriculture were relatively favorable when APL1 was implemented. Subsequently, Sri Lanka experienced sharp price increases in agro–inputs and food imports, inflation and wage pressures linked to expansionary fiscal policy, public investment cutbacks, high real interest rates, and in later years, a modest appreciation of the real exchange rate in addition to political and security upheavals. Changes in the external environment precipitated the slippage of some APL1 reforms.

1. Revitalization of Agricultural Sector

37. During 1989–1994, agriculture grew by 3.5 percent per annum (see Appendix 4, Table 1). Growth accelerated the most in paddy and tea production, with coconut, rubber, and other field crops stagnating or decreasing. But such agricultural growth was largely a reflection of past investments such as the coming into production from new Mahaweli irrigation schemes and smallholder tea replanting programs in the 1980s. Agricultural export volumes, as a result, increased by 2.4 percent per annum, and export values increased by 10.2 percent per annum during 1989–1994. But agricultural productivity changes had been mixed. Paddy yields stagnated

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1 TPA:SRI 26258: *Study on Policy Impact of the First Agricultural Program Loan*, December 1994.

2 This project continued to record further cost-overruns and implementation delays after the close of APL1. The 1996 Budget allocates additional financing to the Mahaweli Development Authority to accommodate these cost overruns.

at around 3,500 kg per hectare and tea, at 1.3 tons per hectare. Rubber yields fell from 850 kg per hectare during 1983–1988 to about 740 kg per hectare during 1989–1991 but have since recovered to 865 kg per hectare during 1993–1995.

2. Promotion of Agricultural Productivity and Growth

38. Direct policy measures to improve production incentives and contribute to productivity and growth took the form of reduction in export taxes and the promotion of high value added "crush, tear and curl" (CTC) tea technology. Less direct measures included fertilizer subsidy withdrawal to promote productivity through optimal use, implementation of ISF and measures aimed at sustainable irrigation operations and maintenance (O&M), policies to improve agricultural support services, and Government investments in agriculture.

39. With the reduction in export taxes for tea and rubber, the export tax burden for tea fell from 2 percent to 1.1 percent and for rubber, from 24.6 percent to 18.1 percent of their export prices during 1989–1991 (see Appendix 4, Table 2). By the end of 1993, export duties and sales taxes on tea and rubber were eliminated. The impact of lower export taxes on supply was difficult to estimate. A lack of competition in exporting tea appeared to have dampened the impact of the lower export tax burden on producers, with the benefits of the export tax reduction accruing largely to the wholesale trade. The reduction in the rubber export tax burden was more significant but was offset by falling real rubber prices. The initial impetus provided to tea factories for adopting CTC technology was sustained with increasing share of tea produced under this technology. Exports of such tea as a share of total tea exports increased from 10–15 percent in the late 1980s to 45 percent in 1995.

40. Evidence indicated that the removal of fertilizer subsidies had little impact on fertilizer demand after an initial fall in demand in 1990 (see Appendix 4, Table 3). Fertilizer consumption fully recovered by 1993, with total demand reaching a historical high of 548,000 mt. In 1994 fertilizer consumption in paddy was 8.4 percent higher than in 1989 due to a doubling of nominal producer paddy prices between 1989 and 1993. Conversely, even after the reintroduction of the subsidy in October 1994 in response to fertilizer price increases, total fertilizer demand fell from 532,000 mt in 1994 to 509,000 mt in 1995 as output prices declined (see Appendix 4, Table 4).

41. Efforts to ensure collection of ISF largely failed, due to Government's decision not to prosecute farmers in default. Irrigation O&M conducted through participatory farmer management of distributory and field canals appeared to be more successful. By mid-1994, about 7,270 field canal groups and 760 distributory canal organizations were formed and about 750 distributory canals were handed over to FOs. The INMAS program was in place in 32 major schemes, and Government policies continued to emphasize the transfer of irrigation management responsibilities to FOs. Nevertheless, the degree to which the handover of distributory and field canal responsibilities had improved efficiency in water resource use and extended the economic life of the irrigation systems was uncertain. In certain Mahaweli schemes, farmer management had improved distribution of water and facilitated crop diversification. In other areas, O&M continued to be neglected, water was not well distributed amongst paddy farmers, irrigation systems continued to deteriorate, many FOs were ill-prepared to undertake necessary canal maintenance, and the legal basis of the FOs remained uncertain.[1]

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[1] The Department of Irrigation recently formed a task force to develop necessary amendments to the Agrarian Services Act to define the rights and responsibilities of FOs as corporate bodies.

42. A number of recommendations (for example, unification of the different services, reduction in the administrative burden of extension officers, improvement in research–extension linkages, and others) from the study on agricultural extension were not followed by the Government as a different approach to extension was adopted in the Agriculture Extension projects funded by WB. The quality of agricultural extension suffered because of diversion of trained extension officers to public relations and other provincial administrative tasks, inadequate coordination between national agencies and provincial councils supervising the extension effort, deteriorating linkages between national research institutes and provincial extension services, poor performance incentives, and inadequate operating budgets. While budgetary constraints were a major reason, a more fundamental reason was the demand–based extension system promoted by WB which essentially asked what the farmer wanted to improve in their production. Such a system did not appear to have worked well according to Government sources because extension officers had to attend to tasks beyond their expertise.

43. The Government reduced, but did not eliminate, subsidized lending in the rural areas. Owing to earlier commitment, term loans under the Bank's perennial crops project,[1] for example, were provided at an interest rate of 16 percent per annum and with a six–year grace period, while short–term commercial loan rates were in the range of 24–28 percent per annum. Government guaranteed cultivation loans were still being provided at 18 percent per annum. The partial increase in rural lending rates had not led to any significant increase in credit supply and to rural financial market development. Access to rural credit provided by private institutional sources remained limited with no specialized products or private financial intermediaries catering specifically to rural credit requirements. Rural financial markets remained shallow, and the share of commercial lending to agriculture had fallen to historical lows. In the wake of the 1994 agricultural debt amnesty, rural credit discipline eroded resulting in very low collection ratios of rural credit.

44. Government capital expenditures reached 14 percent of GDP in 1989 and had fallen to an average of 6 percent of GDP during 1993–1995 (see Appendix 4, Table 5). As a result of the general decline in public investment, reflecting the diversion of resources to overcoming the security situation, the Government's public investment program in agriculture had been on a declining trend since 1985 (see Appendix 4, Table 6). Mahaweli investments (in irrigation and settlement) accounted for 40 percent of total investments in the agriculture sector during 1991–1995, with the larger portion used to finance the administrative costs of the institutions charged with implementing the Mahaweli development program. Subsidies and transfer payments continue to account for a large share of public expenditures in agriculture. During the period 1991–1995, the Government's expenditures on fertilizer subsidies, wheat import subsidies, agricultural debt relief, the restructuring of the State plantations, and producer credit–cum–subsidy schemes exceeded the total public investments in agriculture.

3. Government Cost Reduction and Privatization Measures

45. Policies aimed at greater private sector participation and reduced Government activities included measures aimed at improving access by private fertilizer traders to information and facilities, at lessening Government trading in fertilizers with the withdrawal of subsidies, and at restructuring PMB, the Janatha Estates Development Board (JEDB), and the Sri Lanka State Plantations Corporation (SLSPC).

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[1] Loan No. 899-SRI(SF): *Perennial Crops Development*, for $17.3 million approved in August 1988.

46. Private sector participation in agricultural marketing increased under the Program. The private sector accounted for almost 95 percent of all rice marketing activities during 1991–1993. In 1994 and 1995, with the resumption of large-scale PMB procurement, private sector activity still accounted for almost 80 percent of the market. The opening up of the fertilizer import market, combined with the later breakup and partial privatization of the two public sector fertilizer companies, heralded a sharp increase in private sector activities. By 1995, 16 private sector companies accounted for more than 60 percent of total fertilizer sales. However, concomitant with the increase in private fertilizer marketing was the prevalence of adulterated fertilizers. The National Fertilizer Secretariat reports that approximately one quarter of all fertilizer samples tested during 1991–1995 were adulterated (primarily at the retailers level). The Government's ability to monitor and enforce quality standards in the private trade was found deficient.

47. APL1 reforms contributed toward reducing the physical capacities of the PMB, JEDB and Sri Lanka State Plantations Corporation. PMB's operations were significantly reduced as a result of asset sales and staff reductions. However, following rapid growth in PMB procurement in 1994 and 1995, its overdraft rose to an estimated SLRs3 billion. Consequently, while PMB's capacity was reduced, there is little evidence that its financial performance and position improved.

48. Similarly, JEDB and SLSPC continued to incur accumulated losses of SLRs10 billion by 1992 that the Government had to bear when the two companies were merged and their assets hived off into 23 regional plantation companies. Although APL1 reforms did not lead to a significant improvement in performance of the State plantation companies, these reforms did help to identify the extent of the financial problem, the need to write-off bad debts, and introduce private management and ownership to put the plantations on a sound financial footing.

B. Institutional Development

49. APL1 did not specifically provide for institutional capacity building. But in the process of Program implementation, the ERD and the NPD gained much experience in coordinating the adoption of policy reforms and improved their capability to keep the policy reforms on track as far as possible in the face of challenging circumstances. Local counterparts involved in the TA studies benefited from their interaction with foreign consultants. The Study on Policy Impact of APL1, in particular, was undertaken by local consultants though the possibility of their bias was raised in the TPAR that evaluated the study.

C. Socioeconomic Impact

50. During 1988–1993, real agricultural wages increased by 19.4 percent, suggesting that living standards of the rural poor had been protected, if not improved. Higher rural wages occurred largely for reasons unrelated to agricultural policy reforms — most notably a 20 percent administrative increase in plantation sector wages in 1989, the Janasavia and then the Samurdhi income support schemes amongst low income families[1], rapid growth in labor-intensive garment production, and overseas migration of unskilled laborers. Nevertheless, the higher wages added

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1 In 1989, 1.9 million households participated in the Janasavya scheme and received a grant of SLRs2,500 per family per month. On 1 June 1995, the Samudhri program was extended to one third of all households and provided income transfers aimed at raising average incomes to between SLRs1,500–2,000.

to higher production costs, impacting on the net returns to the producers already affected by the withdrawal of fertilizer subsidies.

51. The price increase following the fertilizer subsidy withdrawal apparently adversely affected middle–sized rice producers in rainfed areas. Poor producers also suffered from a lack of access to fertilizer in the markets in 1991 and 1992 because of temporary disruptions in the fertilizer market as Government reduced its activity.

52. Generally, because limited progress was achieved in Program components where significant net socioeconomic benefits would have occurred (e.g., rural credit market development and increased public sector investment in agriculture), APL1 did not have a significant socioeconomic impact.

D. Women in Development

53. The role of women was not specifically addressed during Program formulation. Nevertheless, the reduction and subsequent elimination of export taxes for tea and rubber could have stimulated demand for female labor during bouts of higher commodity prices and provided an impetus for increased wages in traditionally female dominated tasks such as tea–plucking. Reduction of Government involvement in fertilizer and paddy marketing had widened opportunities for female participation in agricultural input and output marketing, particularly in village–level markets.

E. Environmental Impact and Control

54. The removal of fertilizer subsidies led to increased use of organic fertilizers and plant residues in rice and other fieldcrop production reinforced by the recommendation of the country's Agriculture Department to farmers to apply an equal mix of straight and organic fertilizers in field crop production. The handover of irrigation systems to farmer management made a significant contribution to the sustainability of the irrigation system, particularly in the Mahaweli schemes.

F. Gestation and Sustainability

55. While the Government remains committed to relying on market forces for agricultural development, the changing political environment continues to be a major constraint. Continuing dialogue between the Government and the Bank to put the reforms in regard to fertilizer subsidies and the PMB back on track is the best solution. But it may not be feasible to pursue such a solution immediately. Where the necessary conditions are not in place it may be advisable to pursue a second–best alternative and allow subsequent program assistance to continue towards the general direction of market–oriented policy reform.

56. The Program was followed closely by APL2 which continued and broadened reforms in the area of tree crop taxation. Policies under APL2 include reducing export crop subsidies; rationalizing sugar pricing, agricultural extension, fertilizer marketing systems, and the livestock subsector; privatizing public sugar, fertilizer and livestock companies; restructuring JEDB and SLSPC; and streamlining the agricultural seed subsector. While APL2 did deepen reforms in APL1, some of the key lessons of APL1 were not fully reflected in the design of APL2; such as, (i) the exclusion of irrigation O&M, irrigation and rural credit policies, from the scope of APL2

although reforms were only partly implemented in these areas under APL1; and (ii) lack of special studies and consensus-building activities in the privatization of the sugar and milk industries. The opportunity to build on progress in past reforms, however limited, was therefore not fully exploited.

V. KEY ISSUES FOR THE FUTURE

A. Program Design

57. The Bank's program loans have often been processed under conditions that require the redressing of a country's economic imbalances. APL1 was influenced by the need to support efforts to stabilize and solve the balance of payments crisis. Growth enhancing measures, such as R&D, and key policy distortions in the agricultural land market and in the import regime, were not addressed under the Program. Pursuing cost-saving measures in advance of measures to enhance growth and factor-mobility appears to have worked against the overall objectives and increased the risk of reversal of some of the reforms when the farm sector was caught in a cost-price squeeze. A comprehensive analysis of the policy and institutional barriers to improved agricultural performance (including barriers outside the agricultural sector) would have helped to identify the constraints and the inconsistencies likely to thwart the fulfillment of the ambitious objective of revitalizing agriculture. While a more thorough analysis may not necessarily have altered the set of measures that were pursued under APL1 — in fact, Government sources have argued that those measures that were "ready" were the ones pursued — it would have helped Government identify macroeconomic and sectoral measures complementary to Program reforms, establish clear priorities amongst those reforms, identify key areas where further policy research and review were required, and establish realistic performance criteria.

58. Acknowledging the importance of factoring in the broader macroeconomic policies in the pursuit of agricultural reforms poses the challenge of responding to the changes in the external environment. Where such changes do occur, the suitability of different agricultural reform measures may change as well. Provisions may have to be made for mid-course revisions in the Program and the phasing of conditions over a number of years.

B. Maintaining Reform Momentum

59. A balance-of-payments crisis provides a timely opportunity to introduce policy reforms. But the process of policy and institutional reform may take many years to complete. While balance-of-payments conditions may change, the need for agricultural policy reform continues. Policy and institutional reform measures must continue to be pursued both during periods of external imbalances and of more favorable balance-of-payments conditions.

60. An external payments crisis helps focus attention and speed-up reform approval. But the degree to which policy and institutional reform momentum will be maintained depends also on underlying processes of policy analysis, monitoring and consensus-building. Policy reforms under APL1 had their origin in many years of special studies, consultation and consensus-building exercises at the technocrat level, and had contributed to the speedy implementation of the reforms. Adequate attention to the institutional mechanisms for generating and managing agricultural policy and institutional reforms, particularly when the reforms need to be phased-in over many years, would help the development of Government's institutional capacity to effectively manage the reform process.

C. Policy Reversals

61. Policy reversals may occur and cannot be insured against. Such reversals should be carefully reviewed, and in some cases, may well be unavoidable under extenuating conditions as evidenced in the case of fertilizer subsidy reintroduction and reactivation of support-price purchases of paddy by PMB. These reversals, however, should not halt efforts toward achieving policy and institutional progress on the other fronts. Under the circumstances, it may be best for program assistance to pursue second-best solutions. When conditions are reversed, time-bound plans for the renewed elimination of the distortion may then be considered.

62. Other measures that were reversed, such as the collection of ISF, may no longer need to be pursued. The switch to a system of participatory management of distributory and field canals appeared to be appropriate, although further improvements in the legal framework for farmer organizations, strengthening the institutional capacity of FOs and providing farmer organizations with adequate incentives to maintain canals (e.g., why should they maintain canals if the Government will rehabilitate them), will be needed to advance reforms initiated under APL1.

D. Ineffectual Policy Results

63. Relatively few of the recommendations made under the Program-financed extension study were implemented. The World Bank's Second Agricultural Extension Project made only a minimal use of the study's findings and had limited success because of the difference in the basic orientation of extension services. More generally, the poor performance of agricultural research and extension services continues to be a major cause of low growth in agricultural productivity. As major externally sourced investments in agricultural R&D are coming to a close, it may be timely for the Bank to assist the Government in reviewing policy and institutional options in this area.

64. Few improvements had been made in terms of access to rural credit. Tight monetary policy, continued lack of specialized products and institutions to serve the agriculture sector, continued directed credit, and erosion of credit discipline in the wake of the 1994 debt forgiveness program, hindered rural financial market development. Raising rural lending rates alone has proved to be insufficient to inspire rural financial market development, particularly when most agricultural investments are long-gestating. The Government's efforts to inspire private sector investment in agriculture, to diversify, and to restructure the agriculture sector continue to be constrained by weaknesses in rural financial markets. A more thorough review of constraints and options for improvement in rural financial market development appears to be warranted.

E. Program Monitoring

65. Program monitoring was conducted in an ad-hoc manner, but the excellent communication between the Bank and the EA ensured that adequate information was assembled. This was helped with the Study on Policy Impact of APL1. However, a period of five years after the Program's closure was needed to obtain the country's Auditor General's qualified approval of Program expenditures, largely because of a lack of qualified accountants and book-keeping experience in ERD. It might have been more appropriate to delegate the Program's financial accounting responsibilities to a division of the MOF that was better qualified in these matters.

VI. CONCLUSIONS

A. Overall Assessment

66. The Government demonstrated its commitment to undertake a series of policy and institutional reform measures by establishing the necessary legislation, rules and guidelines, and by undertaking the studies and restructuring called for under APL1. Only a few, though important, measures were not fully implemented. Certain reforms have improved opportunities for private sector participation in the sector (fertilizer and paddy marketing), enhanced incentives for export agriculture and reduced the fiscal burden. On the other hand, the macroeconomic environment had become unfavorable to agriculture, aggravated by the need to devote greater resources to overcoming the security problems; major reforms were reversed, program measures were generally ineffective in improving extension, rural credit and irrigation O&M, and the Program was unable to revitalize agricultural investment. Overall, the Program is considered partly successful at this time in view of the mixed results achieved in policy and institutional reforms, and the nonsustainability of some of the reforms.

B. Lessons Learned

67. Program experience suggests that program lending can be an effective instrument to induce policy and institutional reforms provided that (i) the program is based on a locally defined and broadly supported set of reforms; (ii) the objectives of the program are clearly defined and the reforms are prioritized and limited to manageable proportions; (iii) intermediate and final performance indicators of policy and institutional reforms are clearly defined; (iv) adequate flexibility is provided for corrections to the program warranted by changes in the external environment; (v) policy and institutional reform is understood to be a lengthy and on–going process to be nurtured through continuous review of reform options and consensus–building amongst decision–makers; (vi) the political leadership and the population at large are educated on the purpose and expected impact of reforms; and (vii) a sound macroeconomic environment and supportive macroeconomic policies are recognized as an essential complement to sectoral reform efforts.

68. Striking the right balance among the three broad categories of reforms, namely, those having broad and immediate impact, those starting the process of reform, and those setting the agenda for later reforms, is a challenge. With limits to the Government's economic management capacity, this involves trade–offs between immediate actions and future initiatives, and underscores the need to carefully set priorities in Program design, to limit prior conditions to the major, immediate reforms, and to establish clearly the rationale and expected impact of each of the measures to be pursued. Measures that are of secondary importance should be pursued through policy dialogue, but not necessarily within a program framework. Special attention should be given to ensuring that policy conditions do not proliferate beyond the Government's administrative capacity to manage reforms, monitor change and prepare the groundwork for future efforts. Government sources did mention that the policy measures under APL1 were too many and unfocused.

69. Reforms that involve changes to major Parliamentary laws, such as the Agrarian Services Act, may take considerably more time to accomplish than is provided for in a Program period. The amount of time needed to introduce legislative changes was not fully appreciated in the design of APL1. Program covenants should not be made contingent on legal amendments

which may exceed the duration of the Program. The time required to effect changes to the legal environment in a functioning democracy characterized by political instability should be taken into consideration.

C. Follow-up Actions

70. The most immediate follow-up actions should apply to the policy reversals and the need for an ongoing process of policy and institutional reforms. The Government appeared to be well aware that there was little economic justification for continued fertilizer subsidies, and was all too well aware of the eventual budgetary implications of mounting PMB financial losses. Both reversals had been subject to policy dialogue with other multilateral donors and with the Bank under APL2. At this juncture, an immediate and swift resolution of these policy reversals by the Bank and the Government is required. The costs of inaction are very high, particularly at a time when pressures on the budget are severe. However, the Government and the Bank had agreed to cancel the release of the second tranche under APL2 as, among others, the issue of fertilizer subsidy cannot be resolved currently. But the Bank still needs to assess whether these policy reversals should be allowed to deflect either Government's or the Bank's attention from the more urgent need to restore sustainable rates of agricultural growth and development.

71. Sri Lanka's agriculture sector requires substantial investment and policy reforms. These reforms are likely to imply large financial, fiscal and social costs.[1] An appropriate means for promoting both policy reform and sound investment lending is a sector development program (SDP) financed by the Bank, in which large sale funding of sectoral investment is linked to the adoption of high priority policy and institutional reforms. A program lending component of such an SDP could help defray the adjustment costs associated with the reforms, finance compensatory social measures, and help overcome possible political resistance of adversely affected groups. Sri Lanka's economic vulnerability to external developments should be taken into consideration through adoption of an extended time frame and flexible implementation procedures.

72. APL1 demonstrated the importance of local ownership, sound policy analysis, and consensus building to underpin an agricultural reform effort. A reassessment by the Bank and the Government of agricultural strategy, policy reform requirements and institutional needs is warranted in the light of changing external conditions and progress made in implementing policy reform. Local ownership (and leadership) of such an assessment is essential. Extending participatory policy analysis and consensus-building processes beyond the confines of concerned Government departments, to include representatives of both the private sector and the farm community, would enhance both the soundness and acceptability of the reform effort. As noted above, one of the shortcomings of the APL1 effort was the failure to conduct a comprehensive analysis of macroeconomic policy and institutional constraints and reform options, to clarify the sequence and expected impact of reforms, and to educate political leaders and the general public on the purposes and expected results of such reforms. If a sector development program is pursued, these should be addressed.

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[1] Particularly if the reforms involve, inter alia, measures such as harmonization and reduction in import duties, rural financial market development, establishment of an effective rural land market, consolidation and revitalization of key support services, and privatization of the remaining, more commercial agricultural parastatals.

APPENDIXES

CA75/196 B

16

DEVELOPMENT BANK

PRIVATE SECRETARY

PROGRAMS DEPT. (WEST)

MINISTRY OF FINANCE

The Secretariat, Colombo 1

Date 27 October, 1989

Mr. Masao Fujioka,
President,
Asian Development Bank,
P.O.Box.789,
1099 Manila,
Philippines.

Dear Mr. President,

This letter refers to the proposed assistance from the Asian Development Bank (ADB) to the Government of the Democratic Socialist Republic of Sri Lanka to support adjustments and development in the agriculture sector. The purpose of this letter is to set out the focus and objectives of the Government's development programme, the macro-economic framework, including the adjustment programme currently underway, and the Government's policies and programmes regarding the agriculture sector as well as the actions taken and to be taken to implement the policy reforms, strengthen institutions and improve investment programmes.

A. Development Objectives, Strategy and Performance

The development objectives of the Government have focused on: economic growth, employment creation, export promotion and macro-economic stability. While these objectives have been accorded different priorities at various times, there has been a consistent emphasis on welfare transfer to the poor and on the promotion of social and economic equity.

In support of these objectives, the country's development strategy has focused on economic restructuring from a controlled to a market-oriented environment, from public to private sector production, and from inward-looking to export-oriented development. The fundamental changes in policy, and the capital intensive investment programme initiated in 1977 succeeded in revitalising the economy: during 1978-1986 GDP growth averaged 5.6 per cent a year, almost twice the average GDP growth rate of 2.9 per cent during 1971-77. Despite this progress, however, a number of constraints on sustainable development have persisted, including insufficient domestic resource mobilisation, less rapid development of the private sector than envisioned, and sluggish development of new exports. Economic performance has been adversely affected by the ongoing civil disturbances and severe droughts in 1987 and 1988. Consequently, economic growth has faltered in recent years, and macroeconomic imbalances have emerged.

B. Macro-economic Stabilisation and Adjustment Programme

To counter declining economic performance, in mid - 1987 the Government began to formulate a comprehensive stabilisation and adjustment programme. This programme was formalised with the assistance of the IMF and World Bank in the Policy Framework Paper 1988-1990 and focuses on (i) setting quantitative targets for key performance indicators (principally GDP growth, inflation, fiscal deficit and balance of payments current account deficit) and (ii) a commitment to restructure key areas of the economy to remove the constraints on sustainable development. The principal structural reforms relate to reorganisation of the public sector to improve its administrative structure and to reduce overstaffing; to restructure public expenditure with a view to eliminating wasteful programmes and increasing the efficiency of the remaining programmes; and to establish industrial policies aimed at accelerating growth in the sector, reducing the role and increasing the efficiency of public enterprises, and increasing the export orientation of manufacturing.

Both the IMF and World Bank have supported this programme. In March 1988 the IMF disbursed an SDR 109 million Compensatory Finance Facility and released the first tranche (SDR 45 million) of a three-year SDR 142 million Structural Adjustment Facility. At the same time, the World Bank began processing several adjustment programmes for public enterprises restructuring, economic restructuring, and public sector restructuring programmes scheduled for implementation during 1990-1992.

Due to a combination of circumstances, the Government was unable to meet its economic performance targets for 1988, and results for 1989 also are likely to be less favourable than expected at the time the stabilisation and adjustment programme was formulated. The Government negotiated with the IMF and World Bank and finalised the medium-term Policy Framework Paper (1989-1994), allowing release of the second tranche from the SAF in October, 1989.

C. Agriculture Sector

Agriculture is a key sector of the economy contributing about 24 per cent of GDP, accounting for 43 per cent of the total merchandise export earnings and providing employment for about 50 percent of thelabour force. With a view to addressing policy and institutional weaknesses, and improving the sector's productivity and diversification, the Government prepared in 1984 the NationalAgriculture, Food and Nutrition Strategy (NAFNS). This strategy, among other things, calls for: (1) accelerated agriculture development outside the major irrigation schemes of the Mahaweli areas; (ii) adjustments to pricing policy (including fertilizer subsidy, export duty, ad valorem sales tax, irrigation service fee, and rural credit interest rates);

(iii) improved marketing, including deregulation of prices for agriculture output; (iv) increased participation of the private sector in import and trade of agriculture inputs and outputs; (v) improved research and extension services; (vi) improved credit delivery and recovery; (vii) improved operations of public sector estates; and (viii) emphasis on rehabilitation of existing irrigation schemes as well as improved irrigation management.

The major goals for the agriculture sector set out in the NAFNS are: (i) optimising the production of basic food items, namely rice, milk, sugar, fish and pulses so as to achieve a higher degree of self-reliance in these commodities; (ii) increasing productivity in tree crops especially in tea, rubber and coconut to expand and diversify agriculture export earnings and thus improve the balance of payments; (iii) increasing rural income levels and employment opportunities; and (iv) improving the nutritional status of the people.

The main policy measures to support above development objectives include; (i) policy adjustments and strengthening of such support services such as pricing policies, marketing, export promotion, research, extension and training as well as improved operations of public sector estates; (ii) a public sector investment programme in irrigation with emphasis on the rehabilitation and/or expansion of existing small and medium irrigation schemes as well as improved irrigation management; and (iii) improved credit delivery and recovery; and (iv) institutional strengthening of the Paddy Marketing Board.

D. Recent Policy Reforms in the Agriculture Sector

The Government has introduced the following reforms in accordance with the NAFNS and consistent with the policy dialogue conducted with the ADB: (i) reduction of fertilizer subsidy, export duty and ad valorem sales tax on tree crops; (ii) improvement of marketing of agriculture input and output (deregulation of sugar import, increased private sector participation in import and trade); (iii) consolidation of extension services for crops under two ministries instead of several ministries; (iv) establishment of integrated management of major irrigation schemes (INMAS) and establishment and upgrading of farmers' organisations to increase their participation in irrigation management with a view to recovering operation and management costs more effectively; (v) adoption of remedial measures to improve the commercial viability of public sector estates; and (vi) improvement of rural credit delivery and recovery.

E. The Proposed Agriculture Programme Loan

The proposed Agriculture Programme Loan (APL) will be an integral part of the Government's medium-term development programme and will assist the Government to implement its

agriculture sector development strategy by supporting further policy reforms, institutional strengthening and investments needed to improve the growth potential of the sector. The main objective of the APL is to support agricultural development over the medium term with a view to improving the overall productivity and growth of the sector, achieving a higher degree of self-reliance in rice production, enhancing export earnings from tree and other crops, promoting agro-industries, and encouraging a higher level of private sector participation in development schemes.

F. Specific Policy and Institutional Measures to be Implemented Under the Agriculture Programme Loan

1. Policy Changes

Fertilizer Subsidies

The Government shall completely remove all fertilizer subsidies by 31st December 1989.

Irrigation Cost Recovery

Given the financial constraints facing Sri Lanka, the Government is continuing, as a matter of urgency, to rehabilitate existing irrigation schemes, to improve water management, to achieve more efficient irrigation methods, and to encourage more active participation of farmers in the management of irrigation schemes to make it possible to optimise productivity, achieve greater financial self-sufficiency and to recover a higher level of operation and maintenance costs. A study of Procedures for the Collection of Operation and Maintenance fees, financed under an IDA-assisted Major Irrigation Rehabilitation Project (1984), was completed in April 1989. A major finding of the study is that irrigation service-fee recovery is a very narrow concept because it represents only one aspect of the operation and maintenance system of the irrigation schemes. The study recommends a more active participation by farmers in the O & M system through the development of legally constituted farmer organisations and provision of education and training to farmers and office bearers. The study's recommendations are in line with the initiatives already taken by the Government when it adopted the Integrated Management of Major Irrigation Schemes (INMAS) in 1984. In this respect, the Government conducted a workshop in September 1989 to review the findings and recommendations of the IDA study, and has agreed to the following: (i) to conduct a policy dialogue with the Bank by 31st January 1990 regarding the findings and recommendations of the study. Based on the results of this dialogue, an administrative system for recovery of operation and maintenance costs, and implementable procedures will be established by the Government on or before 30th September 1990; and (ii) to amend the Irrigation Ordinance Chap. 453 and any other legislation necessary (the Legislation) to enable the Government to

quickly prosecute wilful defaulters on operation and maintenance fee payment through civil courts rather than through magistrate courts as currently stipulated in the Legislation. These amendments shall be completed by 30th September 1990.

Rural Credit

Despite the efforts of the Government to develop rural credit through refinancing and guarantee schemes as well as promotion of the Regional Rural Development Banks, the present rural credit situation is characterised by a low volume of institutional lending, a backlog of past due loans (over the last ten years, the recovery rate of cultivation loans for Bank of Ceylon (BOC), People's Bank (PB) and Hatton National Bank (HNB) has been about 72 per cent), low interest rates and a reluctance on the part of the commercial banks to engage in this activity beyond a limited level.

In view of these circumstances, interest rates for short-term agriculture production loans under the New Comprehensive Rural Credit Scheme shall be adjusted in a phased manner to reflect market rates. The Government shall increase the end user interest rate to a minimum of 12 per cent per annum. This will be done in two stages: the first adjustment shall be made on or before 30th April 1990 and the second on or before 30th April 1991. The interest rate spread given to the participating banks shall remain at the prevailing rate of 7.5 per cent. In addition, interest rates on medium and long-term loans refinanced by the Central Bank of Sri Lanka (CBSL) from internal sources, currently at 12 per cent per annum, shall be adjusted toward market rates in two stages to a minimum of 14 per cent per annum. The two adjustments in interest rates for medium and long-term loans shall take effect on or before 30th April 1990 and 30th April 1991, respectively, and shall bring these rates on loans financed internally by CBSL in line with loans of similar terms funded externally. The interest rate spread provided to the participating banks will be 7 per cent for term loans.

Crop Production Incentives

The Government recognises that adequate producer margins is an important factor in sustaining the long-term viability of the tree crop subsector. As part of the Medium-Term Investment Programme for the state-owned plantations, the Government established in July 1984 a 12-member Working Group on Tree Crop Taxes and Producer Margins. The primary objective of the Working Group is to monitor tax levels in relation to the export prices of tree crops (tea, rubber and coconut) and to recommend tax adjustments that will ensure adequate margins for the producers. In 1980, tree crop taxation contributed about 26 per cent of the total Government revenue with tea,

rubber and coconut being the principal contributors. As a result of reductions in tax rates, in 1984 the export duties and other taxes as a percentage of Government revenue declined to 19 per cent and in 1988 they further decreased to 4 per cent.

Recognising the importance of crop production incentives, the Government has undertaken a study supported by the ADB (an Advisory Technical Assistance, No. 962: Review of Crop Production Incentives, approved on 10th March 1988) with the following objectives: (i) to undertake a systematic and coordinated review of the entire crop production incentive system; and (ii) to prepare a comprehensive report and recommendations on the crop-related subsidy schemes, including a policy framework for the future and identifying action-oriented programmes to rationalise and improve the schemes. The study, which will provide analytical material for policy dialogue between the Government and the Bank, is expected to be completed in June 1990. The agreed recommendations shall be implemented commencing in the first half of 1991.

2. Institutional Enhancement

Fertilizer

Fertilizers are currently being imported by both public and private companies. The public sector dominates fertilizer imports, and accounts for about 85 - 90 per cent of the market. To increase the participation of the private companies in the importation and wholesaling of fertilizers, the Government will adopt the following measures. (i) before 31 December 1989, ensure quarterly publication by the National Fertilizer Secretariat of up-to-date target prices for fertilizer to keep the private companies informed of the import price range and of opportunities for the import of fertilizer financed under assistance from multilateral financial institutions, bilateral grants, trade agreements and the Government's own foreign exchange resources; (ii) provide for equal treatment of private and public sector companies with regard to the terms of payment for fertilizer imports. This equality of treatment will require, inter-alia, liquidation of the outstanding accounts relating to both private and public sector companies in respect of receipt of subsidy payments from the Government and payment for imports by the private and public sector companies, and establishment of bank guarantees by both private and public sector companies prior to clearance of future shipments of fertilizer imports (with regard to this, on 24th October 1989 the Government provided to the ADB a programme for liquidation of these arrears); and (iii) encouragement of the private sector to further increase its share of retail trade from the current 60 per cent to 80 per cent through provision of credit by the banking system for financing of storage facilities and inventory as appropriate.

Irrigation Management

With regard to irrigation management, the Government has adopted a new policy initiative, namely, participatory management, which is based on the following principles: farmer participation in irrigation system management will be further developed through village level institutions; the present system of committees and farmer organisations to be found within the irrigation schemes will be strengthened to provide for active farmer involvement and to give greater responsibility for decision making to farmers with a view to handing over the management of distribution canals and field channels to farmer organisations on a pilot basis; farmers will be encouraged to contribute their labour and other resources toward defraying operation and management charges rather than simply paying a cash service fee to the central authority. A Paper submitted to the Cabinet and approved on 11th January 1989 set out the legal framework needed to formalise the rights and obligations of farmer organisations through amendments to the Legislation. The necessary amendments to the Agrarian Services Act, 1979 shall be made before 30th September 1990. Training programmes for farmers and strengthening of institutions within the Ministry of Lands, Irrigation and Mahaweli Development will commence before 31st August 1990, and establishment of INMAS in three additional irrigated areas will be completed before 31st December 1990, and INMAS will also be established in seven additional irrigated areas before 31st December 1991.

Rural Credit

The Government shall upgrade the existing Rural Credit Advisory Board to Rural Credit Board (RCB) and strengthen the authority of the existing RCB by providing it with statutory status to formulate national rural credit policy and priority as well as issue directions to ensure that rural credit provided by the banking system is consistent with national objectives. A preliminary draft Act for this statutory status was completed in August 1989. Approval of the draft by the Cabinet will be undertaken before 30th June 1990. Enactment by the Parliament shall be before 31st March 1991.

Agriculture Extension Services

The Government has requested the Bank to provide an advisory Technical Assistance for an agriculture extension rationalisation project. The objectives of the Technical Assistance are to: (i) formulate a suitable approach to strengthen, modernise and consolidate the agricultural extension services; (ii) design a strategic plan to

modernise the extension function; and (iii) formulate a project which will implement priority area identified in the strategic plan. The findings and recommendations of the proposed study, which is expected to be completed by December 1990, will be discussed between the Bank and the Government. Implementation of the mutually agreed recommendations shall commence by July 1991.

Plantation Sector

With regard to the plantation subsector, under the Bank-financed Plantation Sector Project (Loan No. 712-SRI (SF), approved in 1984), the Government is taking measures to improve the operating performance and financial conditions of the Sri Lanka State Plantation Corporation (SPC) and the Janatha Estates Development Board (JEDB). Measures already taken included: (i) appointment of Directors of Finance for JEDB and SPC in May 1989; (ii) revocation of ad valorem sales tax on tea effective 13th August 1989; and (iii) effective 30th September 1989 implementation of a more flexible six-day week policy so that remuneration reflects the time worked.

In addition, measures to be taken will include: (i) a change in export duty structure for natural rubber so that the producers receive 60 per cent of the excess of the FOB price over the base price of Rs. 1/kg before 31st December 1990; and reduction of export duty on tea from Rs. 1.50/kg. to Rs. 1.00/kg before 31st December 1990); (ii) commencing 31st October 1989, transfer of labourers from one estate to another in accordance with actual requirements for labour on each estate; (iii) appointment (on 31st July 1989) by the Ministry of Plantation Industries of a task force to assess and recommend appropriate use of marginal estates owned and operated by JEDB and SPC. Completion of the report of the task force as well as commencement of the implementation of recommendations shall be before, 31st December 1989; (iv) before 31st December 1989, completion of an action plan by the task force appointed by the MPI for conversion of orthodox tea factories to Crush, Tear and Curl tea factories, and commencement of implementation of the action plan; and (v) effective 31st July 1990, conversion of Rs 400 million each of the existing overdrafts of JEDB and SPC with BOC and PB respectively to term loans repayable within 5 years and each carrying interest rates at 2 per cent less than the prevailing interest rate on overdrafts or arrange for repayment of these overdrafts each by JEDB and SPC respectively.

Paddy Marketing Board

With regard to the Paddy Marketing Board (PMB), the Government is reviewing the constraints and formulating an

action plan to strengthen the organisational capability and operational performance of the PMB. The rationalisation to be undertaken will, among other things, include staff reduction, leasing or sales of redundant rice mills, selling paddy direct to private millers instead of having it milled on contract and efficient use of stores. The rationalisation will commence by 1st April 1990.

3. The Agriculture Sector Investment Programme

Within the agriculture sector, the Government will make investments in irrigation outside the Mahaweli area, annual crops, tree crops and minor export crops. The Government will substantially increase its investment in agriculture research and extension activities.

Measures taken or to be taken to deregulate the fertilizer market will facilitate private sector investment in the fertilizer subsector. These investments will include: mechanical bulk handling and bagging facilities in the port of Colombo, modernisation of blending machines; upgrading of processing technology and mechanisation of in-warehouse handling and transport.

Use of Counterpart Funds

The local counterpart funds to be generated from the Loan proceeds will be used for financing the local cost requirement of ADB assisted agricultural development projects (including the equivalent of $ 5 million for Walawe Irrigation Project, Loan No. 695-SRI/SF), agricultural development projects assisted by other donors and other agricultural development activities.

G. Conclusion

In conclusion, Mr. President, may I say that the Government has already taken significant steps, and proposes to take other measures as outlined above, to improve and sustain growth in the agriculture sector. I wish to record that the recent policy dialogue with ADB staff during formulation of the Agriculture Programme Loan has been harmonious, fruitful, and constructive.

I trust, therefore, that you will consider the proposed Agriculture Programme Loan favourably and I look forward to continued assistance from, and co-operation with, the ADB as our country vigorously pursues its development objectives.

Yours truly,

(Harold Herath)

Acting Minister of Finance

OVERVIEW: LOAN POLICY BASE

I. POLICY FRAMEWORK AND ACTIONS

A. Fertilizer Subsidies

- o Remove all fertilizer subsidies

B. Irrigation Cost Recovery

- Conduct policy dialogue with the Bank regarding the findings and recommendations of the WB study on Procedures for the Collection of O&M Fees, and establish an administrative system and implementable procedures for the recovery of O&M costs.
- o Amend the Irrigation Ordinance Chap 453 and any other legislations to enable the Government to quickly prosecute willful defaulters on O&M fee payment through the civil courts instead of the magistrate courts.

C. Incentives for More Rural Credit

- Increase end-user interest rates under the New Comprehensive Rural Credit Scheme to a minimum of 12 percent per annum for short-term cultivation loan.
- Increase interest rates on medium and long-term loans refinanced by the Central Bank from internal sources to a minimum of 14 percent per annum, with a spread of 5 percent provided to participating banks.

D. Crop Production Incentives

- Undertake a systematic and coordinated review of the country's crop production incentive system and recommend on the policy framework and programs needed to rationalize and improve the system.

II. INSTITUTIONAL MEASURES

A. Private Sector Participation

- National Fertilizer Secretariat to publish quarterly up-to-date fertilizer target prices and notice of opportunities for the importation of fertilizers financed by multilateral financial institutions, bilateral grants, trade agreement, and the Government's own foreign exchange resources.
- Provide equal treatment to private and public sector companies on terms of payment to the Government for fertilizer imports.
- Encourage the private sector to increase its retail fertilizer trade from 60 percent to 80 percent through the provision of credit by the banking system for financing of storage facilities and inventory, as appropriate.

B. Farmer Participation in Irrigation Management

- Amend the Agrarian Services Act, 1979, to enable farmer participation in irrigation system management through FOs.
- Provide training for farmers and measures to strengthen institutions within the Ministry of Lands, Irrigation and Mahaweli Development.
- Establish INMAS initially in three additional areas, and subsequently in another seven.

C. Rural Credit Policy and Administration

- Cabinet to approve and subsequently Parliament to enact on Act enabling the Rural Credit Board to formulate a national rural credit policy and priority, as well as to issue directions for ensuring that rural credit provided by the banking system was consistent with national objectives.

D. Improvement of Agriculture Extension Services

- Prepare TA for an agriculture extension rationalization project aimed at strengthening, modernizing, and consolidating agriculture extension services; and implement the relevant recommendations to be agreed upon by the Bank and the Government.

E. Plantation Sector Operations

- o Revise export duty structure for natural rubber to enable producers to receive 60 percent of the amount in excess of the FOB price of SLRs 17/kg.
- o Reduce the export duty on tea to SLRs 1.00/kg.
- Reassign estate laborers according to the manpower needs of the estates.
- o Ministry of Plantation Industries to appoint a task force that will assess and recommend appropriate use of marginal estates owned and operated by JEDB and SLSPC, and subsequently implement its recommendations.
- Complete and subsequently implement an action plan for the conversion of orthodox tea factories to CTC tea factories.
- Reduce existing overdrafts of JEDB and SLSPC with the Bank of Ceylon and People's Bank, respectively, by SLRs 400 million each either through repayment, or conversion to term loans repayable within 5 years, at 2 per cent less than the prevailing interest rate on overdrafts.

F. Strengthen Paddy Marketing Board

- Complete and subsequently implement action plan to strengthen the organizational capability and operational performance of PMB particularly in the areas of staffing and efficient utilization or disposal of mills and warehouses.

G. Agriculture Sector Investment Program

- Promote public investments on irrigation outside the Mahaweli area, and on production of annual crops, tree crops and minor export crops.
- Increase public investments in agriculture research and extension services.
- Institute measures to facilitate private sector investment in the fertilizer subsector; including investments in mechanical bulk handling and bagging facilities in the port of Colombo, modernization of blending machines, upgrading of processing technology, and mechanization of in-warehouse handling and transport.

Legend:
o Conditionality for release of the Second Tranche.

POLICY MATRIX - STATUS OF IMPLEMENTATION

POLICY AREA AND POLICY ACTION	STATUS OF IMPLEMENTATION PER PCR	IMPLEMENTATION DATE		EXPECTED EFFECTS/ IMPACTS AT APPRAISAL	ACTUAL IMPACT PER PCR	STATUS PER PROGRAM PERFORMANCE AUDIT REPORT
		TARGET	ACTUAL			
I. POLICY ADJUSTMENTS						
A. Fertilizer Subsidies						
1. Remove all fertilizer subsidies.	Implemented.	31 Dec 1989	1 Jan 1990	Reduce the budgetary deficit of Government. Promote optimal use of fertilizer by farmers.	There was substantial diversification towards the cultivation of other food crops. Average farmers with a marketable surplus of 60 percent were financially better off in real terms after subsidy removal; average farmers with marketable surplus of 20 percent did not enjoy any improvement.	Budget deficit was not reduced. Fertilizer subsidy was reintroduced in 1994. Fertilizer usage increased in subsequent years.
B. Irrigation Cost Recovery						
2a. Conduct policy dialogue with the Bank on the findings and recommendations of WB study on Procedures for the Collection of O&M Fees.	Implemented. The discussion was held between the Government, World Bank and the Bank.	Before 31 Jan 1990	Nov 1989	Increase the portion of O&M cost contributed by farmers. Reduce the budgetary cost to Government, and improve the efficiency of O&M and delivery of irrigation water.	The O&M fee SLRs100/acre was collected. World Bank study on Procedures on Collection of O&M Fees recommended a system of participatory/joint management as an alternative. The Government established FOs entrusted with O&M of distributory/field canals. By the end of December 1990, management of more than 600 distributory channels had been handed over to FOs.	No collection of fees because of the Government's decision not to. O&M system is operated through participatory approach where farmers contribute in kind to the FOs.
2b. Establish an administrative system and implementable procedures for the recovery of O&M costs.	Partial implementation.	30 Sep 1990				
3. Amend Irrigation Ordinance Chapter 453 to enable the Government to quickly prosecute willful defaulters on O&M fee payment through civil courts instead of magistrate courts.	Implemented.	30 Sep 1990	10 Sep 1990	Facilitate cost recovery processing.	The Small Claims Court is now empowered to recover the O&M fees from willful defaulters.	

POLICY AREA AND POLICY ACTION	STATUS OF IMPLEMENTATION PER PCR	IMPLEMENTATION DATE		EXPECTED EFFECTS/ IMPACTS AT APPRAISAL	ACTUAL IMPACT PER PCR	STATUS PER PROGRAM PERFORMANCE AUDIT REPORT
		TARGET	ACTUAL			
C. Incentives for More Rural Credit						
4. Increase the end-user interest rates under New Comprehensive Rural Credit Scheme to a minimum of 12 percent per annum for short-term cultivation loan.	Implemented. Short-term interest rates were increased from 9 percent to 16 percent per annum.	Phase 1: 30 Sep 1990 Phase 2: 30 Apr 1991	Phase 1: 1 Apr 1990 Phase 2: 1 Apr 1991	Increase the supply of short, medium, and long-term institutional rural credit from Government and private banks. Increase the use of credit by farmers.	No significant negative impact on the demand for agricultural credit in both the New Comprehensive Rural Credit Scheme or the Medium and Long Term Credit Fund.	Interest increase did not improve availability of credit. Interest subsidies continued under other schemes such as term lending.
5. Increase medium and long-term loans interest rates refinanced by Central Bank from internal sources to a minimum of 14 percent per annum, with a spread of 5 percent provided to participating banks.	Implemented. Medium and long term interest rates increased from 12.5 percent to 18 percent per annum	Phase 1: 30 Apr 1990 Phase 2: 30 Apr 1991	Phase 1: 1 Apr 1990 Phase 2: 1 Apr 1991		Short-term borrowing from non-institutional sources for cultivation purposes increased over time for paddy farmers but could not be directly linked to interest rate changes.	
D. Crop Production Incentives						
6. Undertake systematic and coordinated review of crop production incentive system and recommend the policy framework and programs.	Implemented.	Jun 1990	Jun 1990	Improve profit margins for producers. Increase the production and productivity of tree crops or minor export crops.		No evidence of increase in producers' profit margins. Instead, marketing margins increased. No increases in yield.
II. INSTITUTIONAL MEASURES						
A. Private Sector Participation						
7. National Fertilizer Secretariat to publish quarterly up-to-date fertilizer target prices and notice of opportunities for the importation of fertilizers financed by the multilateral financial institutions, bilateral grants, trade agreement, and Government's own foreign exchange resources.	Implemented.	1 Jan 1990	1 Jan 1990	Reduced handling and transportation costs for importers and wholesalers of fertilizers. Improved marketing efficiency for fertilizers. Increased private sector participation in fertilizer marketing.	Private sector participation in the fertilizer business increased. A part of this outcome was attributed to the handing over of state-owned and state-managed plantations to private sector managers in mid-1992.	Greater participation of private sector in the fertilizer distribution.

POLICY AREA AND POLICY ACTION	STATUS OF IMPLEMENTATION PER PCR	IMPLEMENTATION DATE		EXPECTED EFFECTS/ IMPACTS AT APPRAISAL	ACTUAL IMPACT PER PCR	STATUS PER PROGRAM PERFORMANCE AUDIT REPORT
		TARGET	ACTUAL			
8. Provide equal treatment to private and public sector companies on terms of payment to Government for fertilizer imports.	Implemented. There are now seven private fertilizer import firms compared with three before the Program.	1 Jan 1990	1 Jan 1990			
9. Encourage an increase in private sector retail fertilizer trade share from 60 percent to 80 percent by providing through the banking system the financing of storage facilities and inventory.	Implemented.	1 Jan 1990	1 Jan 1990			
B. Farmer Participation in Irrigation Management						
10. Amendment of the Agrarian Services Act, 1979, in line with the Government's thrust for farmer participation in irrigation system management.	Implemented.	30 Sep 1990	23 Feb 1991	Promote measurable improvements in the operation of irrigation systems and in their O&M.	The FOs demonstrated their capacity to take over ownership and full responsibility for the irrigation network below the distributory canals. The following conditions must be satisfied in order to obtain maximum benefits: (i) existence of a suitable legal framework to allow FOs to effectively meet their responsibilities; and (ii) only canals which have been adequately rehabilitated should be handed over.	Further amendments to ASA, 1979 are being considered to clarify and strengthen FOs' responsibilities.
11. Provision of farmer training and institutional strengthening of the Ministry of Lands, Irrigation and Mahaweli Development.	Not mentioned.	Starting 31 Aug 1990		Increase in cultivated areas and land use intensity.		Increase in cultivated tea area was at the expense of land use in rubber and other crops.
				Improve yields and crop profit margins.		Yield improvements were mixed. Replanting was coming into harvest in the case of tea.
12. Establishment of INMAS initially in three additional areas, and subsequently in another seven.	Partly implemented. Only 3 INMAS have been established. Establishment of the other 7 has been constrained due to peace and order problems.					INMAS extended to 32 major schemes.

POLICY AREA AND POLICY ACTION	STATUS OF IMPLEMENTATION PER PCR	IMPLEMENTATION DATE		EXPECTED EFFECTS/ IMPACTS AT APPRAISAL	ACTUAL IMPACT PER PCR	STATUS PER PROGRAM PERFORMANCE AUDIT REPORT
		TARGET	ACTUAL			
C. Rural Credit Policy and Administration						
13. Cabinet to approve and enact Parliament Act enabling the Rural Credit Board to formulate national rural credit policy and priority, and issue directions for ensuring that rural credit provided by the banking system is consistent with national objectives.	Not implemented. The draft bill was approved by the Cabinet but not enacted by the Parliament.	Cabinet Approval: 30 Jun 1990 Parliament Approval: 30 Sep 1990	28 Mar 1990	More consistent and coordinated rural credit initiatives reflective of the national goals and objectives.	No significant negative impact on the agriculture sector has been found.	Rural Credit Board was not established. Rural Credit Market remains undeveloped.
D. Improvement of Agriculture Extension Services						
14. Undertake a study on agriculture extension rationalization to strengthen, modernize, and consolidate agriculture extension services.	Implemented. The study under a Bank-assisted TA for Agricultural Extension Rationalization was completed.	31 Dec 1990	Jul 1991	Rationalization of the agriculture extension system. Improvement in the delivery of extension services. Increase in crop yield.		The study provided important findings but they were not fully incorporated into WB's project on extension, due to basic philosophical differences.
15. Implementation of the relevant recommendations which will be agreed to by the Bank and the Government.	Not implemented. Implementation being addressed under APLII.	31 Jul 1991				
E. Plantation Sector Operations						
16. Revise export duty structure for natural rubber to enable producers to receive 60 percent of the amount in excess of base price of SLRs 17/kg.	Implemented. Base price was increased to SLRs 21/kg. in September 1990. The export duty was reduced to 30 percent of the value above the threshold price of SLRs 21/kg. The tax was completely abolished on 1 December 1993.	31 Dec 1990	8 Mar 1991	Improvement in the operating performance and financial conditions of SLSPC and JEDB. Increase in production, productivity and earnings from the tree crops sector.	Total additional revenues of JEDB and SLSPC resulting from duty reductions in tea and rubber products were SLRs 71.24 million and SLRs 84.02 million, respectively.	No more export tax.

POLICY AREA AND POLICY ACTION	STATUS OF IMPLEMENTATION PER PCR	IMPLEMENTATION DATE		EXPECTED EFFECTS/ IMPACTS AT APPRAISAL	ACTUAL IMPACT PER PCR	STATUS PER PROGRAM PERFORMANCE AUDIT REPORT
		TARGET	ACTUAL			
17. Reduction of the export duty on tea to SLRs 1.00/kg.	Implemented. Export duty on tea was removed on 1 December 1992.	31 Dec 1990	31 Jul 1990			
18. Reassignment of estate laborers according to the manpower needs of the estates.	Partly implemented. Because of the privatization in estate plantation management, this issue will have to be addressed by the new private sector managers.	Starting 31 Oct 1989	31 Oct 1989		Steps taken to reduce the offer of six work days per week and to increase the mobility of labor had not been very successful.	With legislation change in citizenship status of plantation workers, greater mobility is now assured. Also, as plantation is experiencing labor shortage, the measure is no longer relevant.
19. Ministry of Plantation Industries to appoint of a task force to assess and recommend appropriate use of marginal estates owned and operated by JEDB and SLSPC, to implement the recommendations.	Partly implemented. The task force assigned to formulate a restructuring program for JEDB and SLSPC completed its report in April 1991.	31 Dec 1989	Jun 1990			Marginal estates still managed by merged body of JEDB and SLSPC.
20. Complete and implement action plan to convert orthodox tea factories to Crush, Tea, and Curl tea factories.	Partly implemented. Fourteen factories were converted while the conversion of 8 more is underway.	31 Dec 1989			There was demonstration effect towards the expansion of CTC teas in Sri Lanka.	Greater market share of CTC/manufactured tea. Greater value added as a result.
21. Reduce the existing overdrafts of JEDB and SPC with the Bank of Ceylon and People's Bank, respectively, by SLRs 400 million each either through repayment, or conversion to term loans repayable within 5 years, at 2 percent less than the prevailing interest rate on overdrafts.	Implemented. The conversion for JEDB was effected in September 1990, while for SLSPC, conversion was in December 1990.	31 Jul 1990	Sep/Dec 1990		No significant improvements in the performance of JEDB and SLSPC. Paved the way for a more comprehensive restructuring program which included privatization of plantation management.	JEDB and SLSPC merged into one body to manage the marginal estates. Other estates broken into smaller units for privatized management.

POLICY AREA AND POLICY ACTION	STATUS OF IMPLEMENTATION PER PCR	IMPLEMENTATION DATE		EXPECTED EFFECTS/ IMPACTS AT APPRAISAL	ACTUAL IMPACT PER PCR	STATUS PER PROGRAM PERFORMANCE AUDIT REPORT
		TARGET	ACTUAL			
F. Strengthen Paddy Marketing Board						
22. Complete and implement action plan to strengthen the organizational capability and operational performance of the PMB particularly in the areas of staffing and utilization or disposal of mills and warehouses.	Partly implemented. Staff was reduced from 1,528 to 560. Disposal of surplus stores and paddy mills has not gone smoothly. 90 out of 212 stores and 2 out of 26 mills have been disposed.	1 Apr 1990		Reduction in operating costs that will correspond with its scope of operations.	Financial performance of the Paddy Marketing Board did not improve. Dissolution of the Board was seriously being considered as there was no perceived justification for its continued operation.	Renewed activity of PMB in purchasing in support of farm price. High losses incurred as debt stood at SLRs 3 billion in overdraft.
G. Agriculture Sector Investment Program						
23. Institute measures to facilitate private sector investment in fertilizer subsector, which includes the lease of space in the port of Colombo to promote investments in mechanical bulk handling and bagging facilities by the private sector.	Implemented.	31 Jul 1990	Nov 1992	Reduction in fertilizer handling and transportation costs for importers and wholesalers. Increase in producer margins for tree crops and minor export crops farmers.		No increase in producers margin due to market rigidities.

STATISTICAL TABLES

Table 1: Sri Lanka - Performance of the Agricultural Sector Before and After Reform

(percent)

Item	1984-94	Before Reforms 1984-88	After Reforms 1989-94	1995
Growth				
Real GDP at factor cost	2.3	1.8	3.5	5.5
Tea	3.7	1.7	2.4	5.2
Rubber	-1.9	-1.2	-0.1	0.3
Coconut	3.2	2.7	2.2	0.5
Paddy	1.3	0.3	5.4	4.6
Other	3.5	3.8	3.4	n.a.
Export value[a]	7.0	9.6	10.2	11.9
Traditional	6.1	9.6	9.2	12.2
Other	16.8	13.1	17.7	-2.4
Export volume	0.6	-1.3	2.4	8.9
Role in Economy				
Share in GDP	19.7	21.1	18.5	20.0
Tea	11.4	11.7	11.1	11.3
Rubber	3.0	3.5	2.7	2.4
Coconut	12.5	13.2	12.0	12.4
Paddy	24.9	26.4	23.7	24.7
Other	48.1	45.3	50.5	49.2
Share in export value[a]				
Traditional	34.2	44.6	25.5	21.8
Tea	24.4	30.9	18.9	12.6
Rubber	5.3	7.7	3.3	n.a.
Coconut	4.5	5.9	3.3	n.a.
Other	4.3	4.3	4.2	3.5
Share of agricultural export duties in total trade taxes	9.7[b]	15.4	4.0[b]	

[a] In SDR terms.

[b] Covers the period 1989-92; export duties were eliminated in December 1992.

Source: IMF, Sri Lanka - Selected Issues, 1996 and Central Bank of Sri Lanka, Annual Report, 1995.

Table 2: Tree Crop Export Taxation, 1989-1994
(SLRs per kg unless indicated otherwise)

Item	1989	1990	1991	Year 1992	1993	1994
Tea Export Taxes	4.58	8.91	3.81	3.97	2.00	2.00
(as % of fob export price)	6.80	9.70	4.50	4.80	2.10	2.20
Export duty		3.08	7.41	2.31	1.97	-
Specific	1.34	1.34	0.91	0.74	-	-
Ad valorem	1.74	6.07	1.40	1.24	-	-
Cess	1.50	1.50	1.50	2.00	2.00	2.00
FOB Export Price	66.90	91.80	84.10	81.90	91.60	91.30
in constant 1989 terms	66.90	75.50	61.70	53.90	54.00	49.60
Tea Supply ('000 MT)	207.00	233.00	241.00	179.00	232.00	242.00
Rubber Export Taxes	10.36	10.05	7.68	5.81	2.21	2.21
(as % of fob export price)	28.60	28.30	22.20	15.40	4.90	4.30
Export duty		8.91	8.60	6.23	4.10	-
Cess	1.45	1.45	1.45	1.71	2.21	2.21
FOB Export Price	36.20	35.50	34.50	37.60	44.30	51.80
in constant 1989 terms	36.20	29.20	25.30	24.70	26.20	28.10
Rubber Supply ('000 MT)	111.00	113.00	104.00	106.00	104.00	105.00

Source: IMF (1996) and Central Bank of Sri Lanka.

Table 3: Fertilizer Consumption by Crop: 1987-1995
(metric tons)

Crop	1987	1988	1989	1990	1991	1992	1993	1994	1995
Paddy	217,120	226,196	238,105	161,230	179,306	207,793	247,973	269,738	256,756
Tea	136,653	138,006	127,902	134,125	118,933	110,254	147,195	126,404	120,288
Rubber	23,249	25,056	22,598	22,246	13,686	13,106	17,883	17,160	14,947
Coconut	42,173	41,983	38,842	23,581	28,842	34,270	35,094	31,218	33,607
Other Food Crops	22,201	26,123	28,690	46,246	50,702	49,522	44,300	40,611	39,736
Minor Export Crops	3,190	4,658	5,559	7,622	11,092	7,117	7,021	5,610	5,163
Tobacco	7,735	6,125	6,484	6,243	5,310	2,162	9,824	4,331	4,714
Others*	52,948	57,014	54,452	35,638	45,899	51,598	38,830	36,588	34,191
Total	595,269	525,170	522,272	436,949	453,770	475,882	548,120	532,660	509,402

* Includes unspecified sales.
Source: National Fertilizer Secretariat

Table 4: Average Retail Price of Major Fertilizers
(SLRs per metric ton)

Fertilizer	Jun 89	Jan 90	Jan 91	Feb 92	Feb 93	Oct 94	Feb 95	Dec 95	Jun 96
Urea	3,650	8,000	9,600	9,850	9,850	6,850	11,800	9,600	11,000
SA	3,300	5,900	6,300	6,300	7,100	5,440	9,920	5,000	7,500
NPK	3,550	8,000	10,000	10,400	10,400	7,300	10,400	12,500	12,500

Source: National Fertilizer Secretariat

Table 5: Central Government Revenues and Expenditures
(percent of GDP)

Item	1985-89[a]	1990	1991	1992	1993	1994	1995*	1996[f]
Total Revenue	20.9	21.1	20.4	20.3	19.7	19.0	20.5	19.8
Total Expenditures and net lending	33.3	31.0	32.3	28.3	28.3	29.5	30.8	30.4
Current Expenditures	20.5	22.3	22.5	21.2	20.5	22.0	23.3	23.3
of which: Wages and salaries[b]	3.9	4.1	3.6	3.1	3.3	3.3	3.5	3.3
Pensions	1.7	1.4	2.4	1.9	2.1	2.3	2.3	2.3
Defence	2.4	2.0	2.8	3.7	4.1	4.7	6.4	6.3
Interest payments	5.2	6.4	5.9	6.1	6.0	6.6	5.8	5.9
Social Transfer	2.7	2.7	2.1	1.9	1.8	2.2	3.3	5.5
Programs Capital Expenditures[d]	12.8	8.8	9.8	7.1	7.9	7.5	6.3	5.4
Overall budget deficit (excluding grants)[e]	-12.4	-9.9	-11.9	-8.0	-8.6	-10.5	-10.3	-10.6
Primary Deficit before grants	-7.2	-3.5	-6.0	-1.9	-2.6	-3.9	-4.5	-4.6
Grants	2.4	2.1	2.0	2.0	1.6	1.4	1.3	1.2
Primary Deficit after grants	-4.8	-1.4	-4.0	0.1	-0.1	-2.5	-3.2	-3.2
Financing in domestic borrowing	6.4	6.3	4.1	3.0	4.9	6.5	5.6	7.8

* Estimate.
[a] Annual average.
[b] These numbers include expenditure on defence until 1992 only.
[c] Including wheat and fertilizer subsidy.
[d] Including net-lending and excluding privatization proceeds.
[e] Excluding privatization proceeds.
[f] Projected out-turn for the year based on IMF estimates.

Source: World Bank, Sri Lanka – Public Expenditure Report, 1996

Table 6: Public Investment in Agriculture, 1985-1994
(percent of GDP)

Year	Public Investment	Public Investment in Agriculture
1985	12.5	4.9
1986	14.2	4.3
1987	14.0	4.1
1988	12.9	3.1
1989	10.6	2.9
1990	8.8	2.0
1991	9.8	1.8
1992	7.1	1.2
1993	7.8	1.2
1994	7.6	1.1

Source: Department of National Planning, Public Investment, (various issues).