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**POVERTY TRENDS, CORRELATES AND POLICIES IN SRI LANKA:
1990-2002**

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1. Introduction

Sri Lanka's complementary mix of growth-oriented and welfare policies over the last three decades have seen average incomes rise across the board and more people in higher income ranges than ever before (Gunatilaka et al. 2006). But while the better-off have experienced faster income growth, a fifth of all Sri Lankans remain in poverty and the decline in poverty rates over the same period has been disappointingly modest (World Bank 2007).

This paper aims to summarise the current state of knowledge about why large numbers continue to be poor in Sri Lanka. It does not present any original research, but integrates the findings of a number of recent studies within a new conceptual framework that aims to enable a better understanding of the complex causal conditions that trap people in poverty. It is hoped that this would help policy makers identify gaps and potential areas for intervention more easily. Given this objective, the paper also includes some information about the policy background and discusses in particular the present government's approach to poverty reduction and the constraints it is likely to face.

While Sri Lanka's secessionist conflict is the principal driver of poverty in affected areas, it is impossible to do justice to its impact and ramifications in a paper that looks at poverty in the country as a whole. But attempts to deal with the issue separately always run the risk of marginalising it. This paper attempts to avoid these extremes by developing a conceptual framework that integrates and mainstreams the correlates of poverty in conflict-affected areas. But details about human development issues in these areas and current institutional arrangements to address them, can be found in a companion paper which tries to do justice to its subject and which will be presented

separately at a couple of fora in Canberra and Melbourne during September-October 2007.

The present paper is structured as follows: Section 2 sets out Sri Lanka's poverty profile in terms of consumption poverty, inequality and other non-income poverty indicators. Section 3 details the causal conditions that have given rise to this poverty situation. Section 4 sets out sins of omission and commission on the policy front associated with the phenomenon. It also discusses current policy initiatives to reduce poverty in Sri Lanka and assesses the institutional and macroeconomic constraints that these efforts are likely to come up against. Section 5 concludes.

2. Poverty Profile

A fifth of all Sri Lankans remain in consumption poverty and the decline in poverty rates between 1990 and 2002 has been slow. Growing sectoral and regional differences in poverty reduction rates are also apparent. Poverty reduced only marginally in Sri Lanka mainly because income inequality increased significantly. While mean incomes grew by 28 per cent during this period, the top quintile claimed half this consumption growth and the 4th quintile claimed a quarter. The 1st and 2nd quintiles were left with only 2 and 6 percent of growth. Inequality in access to infrastructure, education, occupation differences and spatial variables were the main drivers of inequality change and slow poverty reduction. Sri Lanka's performance in terms of non-income poverty indicators has been better and comparable to much richer countries like Malaysia and Thailand. Even so, national figures mask considerable gender-related, sectoral and regional variation. Western Province with the metropolitan hub of Colombo has forged ahead of the rest. The conflict-affected areas along with a few other backward regions bring up the rear in many indicators.

2.1 Income Poverty

Sri Lanka is on track to halving between 1990 and 2015, the proportion of people whose income is less than \$1/day (United Nations ESCAP et al. 2006). Nevertheless, a fifth of all Sri Lankans¹ remain in consumption poverty and the decline in poverty rates between 1990 and 2002 has been disappointingly modest (see Table 1). Widely fluctuating

poverty rates from one survey year to the next suggest that periodic shocks push vulnerable groups into poverty and their easing off reduces poverty rates again.

Growing sectoral and regional differences in poverty reduction rates are also apparent. Urban poverty halved, rural poverty declined by less than 5 percentage points and poverty incidence in the estates increased by roughly 50 per cent between 1990 and 2002. While poverty in Western Province more than halved, it declined only modestly in the North Central, Central and Southern Provinces, and actually increased in North Western Province, Sabaragamuwa and Uva (see Figure 1 for a Map of Sri Lanka's Administrative Provinces).

Consumption poverty in the Northern and Eastern Provinces is likely to be as bad as in the poorest districts elsewhere, with some areas rather worse off. The estimations in Table 1 are based on the Department of Census and Statistics' Household Income and Expenditure Surveys (HIES), which could not be conducted satisfactorily in the conflict zone. However, the Central Bank's Consumer Finance and Socio-economic Survey of 2003/04 was conducted in all the districts of the Northern and Eastern provinces other than Killinochchi, Mannar and Mullaitivu. A further limitation is that the survey has a Jaffna-urban bias and excludes internally displaced persons (IDPs) living in welfare centres. Nevertheless, the CFS data shows that significant private transfers to the populations of the North and East have shored up mean consumption expenditure to levels prevalent in the Central and Southern Provinces at least. Even so, higher commodity prices in the conflict zone means that food expenditures of Northern and Eastern households are similar to Uva and Sabragamuwa, the poorest provinces in the rest of the country (World Bank 2007). For example, in March 2007, the average prices of basic consumer goods in Jaffna were 70 percent above Colombo prices (RADA et al. 2007). The poverty situation is likely to be much worse in the predominantly rural districts in the North excluded from the survey.

Conditions are certainly bad for people displaced by conflict, by natural disasters, or by both. There are roughly 300,000 persons displaced by conflict alone living in different parts of the country, in welfare centres and with host families. Conflict-related IDPs in the districts of Mannar, Vavuniya, Anuradhapura, Polonnaruwa and Trincomalee have been found to be in most respects worse off than the average Sri

Lankan household and worse off than the typical residents of the districts and communities they currently live in. In terms of asset ownership, a geographically limited survey has shown that non-IDP households in the areas surveyed were commonly drawn from the second and third poorest income quintiles in the country while the IDPs were mostly concentrated in the poorest quintiles (Health Policy Research Associates (Pvt) Ltd 2006).

2.2 Income Inequality and Determinants

Poverty reduced only marginally in Sri Lanka between 1990 and 2002 mainly because income inequality increased significantly. Inequality in access to infrastructure, education, occupation differences and spatial variables were the main drivers of inequality during this period. In fact, the change in access to infrastructure and education over the longer period of 1985-2002 benefited mainly those in the lower to middle income ranges, enabling them to move up along the distribution.

While national mean per capita consumption increased by 29 percent in real terms during the period, the top quintile claimed half this consumption growth and the 4th quintile claimed a quarter. The 1st and 2nd quintiles were left with 2 and 6 percent of growth, respectively. The rise in inequality is reflected in the Gini coefficients set out in Table 1. For the country as a whole, excluding the North and East, the Gini coefficient rose from 0.32 to 0.40 during the period. This increase is mirrored in all three sectors, with inequality in rural areas actually growing much faster than in either the urban or estate sectors. While mean per capita income grew by 26 per cent between 1995 and 2002, compared with a modest increase of 3 percent in the period 1990-95, inequality also grew faster in the period of high income growth. Poverty reduction in the later period was entirely due to faster income growth rather than to any redistribution towards poorer segments (World Bank 2007).

The World Bank's (2007) analysis found that while intra-district inequality usually accounts for a much larger share of total inequality, inter-district inequality grew much faster than intra-district inequality during the period 1990-2002. Using the regression-based, Shapley value decomposition methodology, Gunatilaka and

Chotikapanich (2006) were able to decompose both inequality levels and their changes into several contributory factors. Table 2 sets out the findings of that analysis.

In the table, \hat{G}_{TOT} denotes the share of total inequality as measured by the Gini coefficient explained by the seven factors set out in the first column.² The last two columns set out the contribution of these factors to inequality change measures as the change in the Gini coefficient set out in the last row. The variables adult males and adult females refer to the proportion of adult male or female workers in a household. Infrastructure refers to access to vehicles, electricity and telephones. Spatial variables refer to administrative provinces. The residual is the amount of inequality which remains unexplained by these factors. A positive contribution by any factor to the change in inequality denotes that the factor or group of factors acted to intensify the positive change in inequality which took place between the given periods.

It can be seen that demographic variables such as the gender composition of household workers and ethnicity contributed relatively little to the level of total inequality. The largest contributor was access to infrastructure. The second was variations in educational attainment and the third, occupation categories of household workers. Of course, education attainments largely determine occupation outcomes.

From the table it is apparent that the main drivers of inequality increase over the period have been infrastructure and education. Note how the contribution to inequality of income from ethnic endowments has mitigated the rise in inequality, even weakly. Variation in income flows from occupation contributed towards the increase in inequality between 1990 and 1995 and worked to mitigate its rise in the later period. The number of adult male and female workers in the household contributed positively to the increase in inequality between 1990 and 1995 but served to restrain its rise in 1995-2002. Income from spatial endowments has contributed positively towards the rise in inequality throughout the period.

In a companion study, Gunatilaka et al. (2006) applied a semi-parametric method to investigate the impact of changes in three key variables on the entire distribution of income during the longer period 1985 to 2002. The variables considered were, (i) changes in the structure of educational attainment of principal income earners,

(ii) changes in the industrial structure in terms of the source of households' main income, and (iii) changes in household access to infrastructure.

The analysis found that the rise in inequality between 1985 and 2002 was accompanied by a shift in the concentration of people towards higher income ranges at every stage in the distribution. The shift, however, was mainly driven by changes in the structure of educational attainment and access to infrastructure. Higher levels of educational attainment of principal income earners around the lower to middle income ranges increased income density along the upper middle income range. Structural change in the composition of sectors from which households derived their main source of income showed little change, and as expected, there was little discernible impact on the distribution of income. In contrast, much of the rightward shift in the concentration of people at higher income ranges between 1985 and 2002 appears to have been caused by the change in access to infrastructure.

2.3 Regional Differences

Many of the determinants of inequality discussed in the preceding section have an impact on poverty. They are tied to space and operate within the spatial dimension: access to electricity is determined by the spread of the distribution system in terms of the laying out of power lines; access to education and the level of educational attainment is determined by the distance from one's home to the nearest school and the quality of education it provides. The local transport system also operates along the spatial dimension, determining whether one can get one's products to the market before they perish or whether one can get a better paying job in the next village or in the next town. Hence, reducing spatial and regional inequalities in access to infrastructure services appears fundamental to engendering more equitable growth and a faster rate of consumption poverty reduction in Sri Lanka.

Differential access to infrastructure has been the main driver of inequality increase and underlies much of regional economic inequality. Table 3 sets out indicators of access to infrastructure by province along with poverty ratios and the contribution of each province to GDP. It is a story of the West and the Rest: Western Province accounts for half of total output in the country while all other provinces contribute 10 percent or

less. Uva and North Central Province actually contribute less than even 5 percent. Also note that Western Province has the best access to business opportunities by any measure, whereas geographical isolation and high average travel time to Colombo seems to be most closely correlated with poverty in other provinces. Unsurprisingly, Western Province has the largest proportion of employed persons working in industry and services: the overwhelming majority of employed persons in Uva and Sabaragamuwa work in agriculture, forestry or fishing. The correlations of factors that constrain investment and growth in poorer provinces have been found to be even stronger at district level. When other factors are controlled, the probability of a household being poor falls by almost 3 percent with a unit increase in the accessibility index of the district the household is located in (World Bank 2007).

2.4 Non-Income Poverty Indicators

Even though the pace of consumption poverty reduction was slow, Sri Lanka has fared quite well in terms of non-income poverty indicators. The country is an early achiever with regard to several MDG indicators relating to non-income dimensions of human development such as universal primary school enrolment, gender parity in primary and secondary school enrolment, under five child mortality and infant mortality, universal provision of reproductive health services, TB prevalence and death rates and access to safe water and sanitation. And while Sri Lanka's achievements in GDP per capita growth and income poverty reduction have not been as spectacular as in East Asian countries (though significantly better than in the rest of South Asia), in non-income poverty indicators Sri Lanka's performance is comparable to much richer countries like Malaysia and Thailand (see Table 4). However, the large number of displaced persons in Sri Lanka, relative to its population is cause for serious concern. Note that while India's total population is 50 times the size of Sri Lanka's, Sri Lanka has half the number of IDPs that India has.

Malnutrition is prevalent especially among the poor even though levels have been declining significantly over time (World Bank 2005). In 2000, 13.5 percent of under fives were found to be stunted, 14 percent wasted, and 29 percent underweight (Department of Census and Statistics undated). High child malnutrition rates appear to be caused by

cultural practices such as denying new born infants colostrums, short duration of exclusive breast feeding, early introduction of solid foods in a child's diet and insufficiency and inadequacy of weaning diets (World Bank 2005).

National figures also mask considerable gender-related, sectoral and regional variation in terms of the other indicators. Table 5 sets out selected development indicators by sex, sector and province. It can be seen that while girls fare much better across the country in primary completion rates and under five mortality rates, malnutrition rates among boys and mortality rates among male infants are lower. The evidence suggests that even though there are no apparent gender disparities in schooling opportunities for children, there is intra-household discrimination against girls in the access to nutrition and health services. In terms of sector, the urban sector is the best off and the estate sector by far the worst off in terms of all indicators. Data on child nutrition (not shown in the table) reveal that 37 percent of estate children were stunted as against 8.3 percent in urban areas, and 14 percent in rural areas. Likewise, 46 percent of estate children were underweight compared with 18 percent in the urban sector and 31 percent in the rural sector (World Bank 2007). Maternal mortality rates in estates are also exceptionally high.

In terms of region, Western Province performs the best in all indicators other than in infant mortality. The Northern and Eastern Provinces fare the worst in terms of primary education completion rates, obviously due to the disruptive impact of the conflict and displacement on schooling. But the region fares well in terms of infant mortality. Under-five mortality is worst in North Central Province, but Uva and Sabaragamuwa are by far the worst off in terms of all remaining indicators other than in access to electricity. Here the worst off are Uva, North Central and Northern Province in that order. Access to electricity in the North is limited mainly due to the destruction of transmission lines through Killinochchi to the peninsula. Central Province performs poorly in terms of access to safe drinking water and improved sanitation probably due to the predominance of the poorly served estate sector in that province.

As in the case of consumption poverty, in terms of non-income poverty indicators too, internally displaced persons appear to fare the worst. A survey of IDPs in Mannar, Vavuniya, Anuradhapura, Polonnaruwa and Trincomalee in 2006 found that going by nutritional and anthropometric indicators, non-IDP households were found to be probably

modestly worse off than the national average but IDP children do even worse, with higher levels of stunting and wasting (Health Policy Research Associates (Pvt) Ltd 2006). In contrast, IDPs' access to education and health services – provided almost exclusively by the government - appeared good. Access to education for IDPs appears to be relatively high and comparable with non-IDP neighbours. In some respects access was even better for IDPs than non-IDPs. Primary school enrolment rates were found to be uniformly high and similar to national levels but literacy rates among young adults was lower than the national average, indicative of disrupted schooling due to conflict. Coverage of basic health services such as immunization in the IDP population is high at over 80 percent, but still 10-15 percent lower than in the non-IDP population surveyed. Access to antenatal care and skilled attendance at child birth was also high, but slightly worse than for non-IDP mothers. For example, 4 percent of IDP mothers give birth at home compared with 1-2 percent nationally wasting (Health Policy Research Associates (Pvt) Ltd 2006).

Even among IDPs the worst off in terms of access to services are probably the newly displaced. In March 2007, emergency relief services came under severe strain in Batticaloa District with the huge influx of displaced. Since then the situation has improved considerably, with humanitarian assistance services kicking in and the security situation improving to allow sizeable numbers of IDPs to be resettled in several areas in the district. Nevertheless, at the height of the crisis when the total number displaced in the district was around 140,000, the food security and nutrition situation, access to water and sanitation, shelter, education and health services were serious. A survey of 52 welfare camps found insufficient and irregular food supply in 60 percent of sites; inadequate shelter from weather in 75 percent of sites; a total of 101 persons per functioning toilet and open defecation in 71 percent of sites. In 15 percent of sites children were not attending schools and 40 percent of sites were without health clinics (UNOPS et al. 2007).

3. Correlates of Poverty

Poverty is the result of webs of different combinations of inter-dependent causal conditions operating at the level of each household. Therefore, any attempt to classify the correlates of poverty is bound to artificially simplify the phenomenon and thereby fail to

do justice to the different inter-locking conditions that make different people poor in different circumstances. Nevertheless, in what follows we approach the problem from the perspective of identifying and targeting policies that are likely to bring about a change in the causal conditions of poverty. Hence, we analyze the causes of poverty in terms of the following: location-specific, growth-related factors; economic sector-specific, growth-related factors; and, specific attributes of individuals and households. None of these categories is mutually exclusive and each factor is in turn dependent on other supporting conditions. The order in which they are described in what follows derives from the preceding analysis that drew attention to the regional differences in poverty incidence rather than from an acknowledgement that any one category of causal conditions is more important than the other.

The analysis in this section finds that location-specific factors that determine economic growth appear key to slow reduction of poverty. Western Province has benefited from geographical and infrastructure-related comparative advantages that enabled it to benefit from agglomeration forces unleashed by the macroeconomic liberalization of 1977. Under-served locations have correspondingly high poverty rates: poor transport facilities, infrastructure and connectivity contributing to the spatial segmentation of the labour market by inhibiting the movement of workers to areas and sectors which offer the best possible returns. In this growth-related spatial hierarchy, regions subject to natural and man-made disasters such as landslides, drought, Tsunami and conflict are the worst off. Meanwhile, certain economic sectors have been unable to respond to new challenges: low levels of productivity and competitiveness in the agriculture sector; infrastructure and other constraints on expansion of the non-farm sector; an education and skills-development system that has yet to be successfully geared to the world of work; and the high cost of electricity. At the same time, certain attributes of individuals and households have made them vulnerable to poverty and constrained their moving out it. Among these factors are ill-health and disability, old age, lack of social contacts and unequal power relations with the better-off, poor education attainments and occupation status of parents and low rates of inter-generational mobility.

3.1 Location-Specific Growth-Related Factors

Location-specific characteristics are fundamental in explaining the uneven pattern of development and poverty reduction in Sri Lanka. Even when two households are identical in all characteristics but differ in location, with one having the average spatial characteristics of an advanced district and the other with those of a backward district, the household in the advanced district is significantly less likely to be poor than the other household (World Bank 2007).

Poverty reduced much faster in Western Province than elsewhere because the region had geographical comparative advantages that enabled it to benefit from agglomeration forces unleashed by the macroeconomic liberalization of 1977. The region had superior endowments of infrastructure facilities such as the port, international airport, the concentration of human capital resources, electricity and telecommunications services and proximity to large, diversified markets of consumers and firms. New industrial enterprises were therefore encouraged to locate close to the metropolitan hub, people followed jobs and jobs followed people, thereby setting in train a virtuous cycle. Increasing urban concentration raised rentals and wage rates but high transport costs between Western Province and most other regions and the lack of alternative, well-serviced urban hubs elsewhere, discouraged new industries from locating too far away from the growth centre. At the same time, high transport costs between hub and periphery and the high cost of housing in the urban centre constrained the flow of labour from surplus peripheral areas to metropolitan areas. Thus, regional imbalances between Western Province and the rest of Sri Lanka widened over the post-liberalization period.

The converse of this process has been that while Western Province, particularly the metropolitan hub surged ahead, locations with comparative disadvantages in terms of physical resource endowments, availability of infrastructure, and accessibility and distance from growth centres, lagged behind not only at the level of province, but also at the level of district and division. While access to services such as quality of education, health services, connectivity to markets and urban centres, quality and availability of infrastructure such as electricity, financing for micro-enterprises are factors that help people move out of poverty, their provision is invariably tied to the spatial dimension. For example, a recent survey of rural enterprises showed that poor road quality, access to

roads and absence of available transport were cited as major or severe constraints to doing business(World Bank and Asian Development Bank 2005).

Poor transport facilities and infrastructure also contribute to the spatial segmentation of the labour market by inhibiting the movement of workers to areas and sectors which offer the best possible returns. This perpetuates unemployment and poverty. For example, Gunatilaka's (2003) analysis of real wage trends of informal sector workers in Central Province suggests highly segmented regional labour markets, with possible spatial, skills-related and institutional barriers to the movement of labour within the province. Arunatilake and Jayawardena (2005) found that many informal sector workers are pushed into that sector by greater distance from commercial centres, lack of access to roads, electricity, schooling and health facilities, and by poverty which limits their investment opportunities (including investment in schooling and health). Informal sector workers were also found to be over-represented in communities with higher unemployment rates and in provinces other than Western province and the North and East. The authors show that the lack of equal opportunities underlies the decision to enter the informal sector.

Underserved locations have correspondingly high poverty rates. For example, the proportion of households without access to electricity was much higher than the national average of 36 percent in 101 out of 119 poorest DS divisions in the country, with at least 11 reporting non-access rates of more than 75 percent. Schools in such areas are small, ill-equipped, with few teachers, and most of them untrained (Department of Census and Statistics 2006). DS divisions that are better connected to markets are also likely to have a larger proportion of households with electricity and better educated household heads, while belonging to districts with lower unemployment rates and lower levels of agricultural wage employment. The higher the accessibility index of a DS division, the lower tends to be its poverty incidence (World Bank 2007).

The problem of geographic isolation from markets and employment opportunities is particularly acute for the estates sector with its labour enclaves, and within the sector, for women more than for men. Large numbers of the estate population have minimal links with networks and information sources in the outside world, often critical to migrate or find alternative employment. The Estate Survey conducted by the World Bank in 2005

found that households in estates where roads to town are passable all year tend to be better off (World Bank 2007). Estates located in poorer districts also had a higher incidence of poverty. Although many aspects of health, education and housing have improved in the estates in recent years due to government intervention, the estates still lag well behind the rest of the country and the rural sector on key indicators of health and education as is evident in Table 4.

In this growth-related spatial hierarchy, regions subject to natural and man-made disasters such as landslides, drought, Tsunami and conflict are the worst off in terms of geographical comparative advantages, with the crises actually destroying resource endowments such as economic and social infrastructure, eroding human capital, creating security crises and plunging people into poverty. For example, the economic growth process of the last twenty five years has completely by passed the Northern and Eastern Provinces, while the conflict itself has impoverished people trapped in these areas. The security situation has given rise to restrictions on the movement on goods in and out of conflict areas and depressed levels of economic activity translating into few employment opportunities and low incomes. Since both the LTTE and the breakaway Karuna faction are engaged in abducting children even as young as 9 years of age to be trained as cadres, parents live in constant fear for their children and cannot easily leave them to go looking for employment. When children are abducted, parents spend days walking miles looking for them, unable to undertake casual work and find the wherewithal to support their remaining children.

In 2002 it was found that among those displaced nation-wide due to conflict, displacement has been associated with a shift out of agriculture and fishing (35 percent to 20 percent) and plant and machine operators and assemblers (2.41 percent to 2.07 percent) and a corresponding increase in elementary occupations (44.71 percent to 61.41 percent). There was also an increase in the no-income group and decrease in the middle and high income groups economic activities such as farming, fishing, business, and labour (Hingst et al. 2002). In 2006, a survey of IDPs in Anuradhapura, Kurunegala and Colombo found that of a total of 3,427 individuals more than 18 years of age, 57 percent were unemployed (Ministry of Resettlement and UNHCR 2006). The same year found 61 percent of a total of 63,145 individuals more than 18 years of age in Puttalam

unemployed .(Ministry of Resettlement et al. 2006). Prospects for poverty reduction for such IDPs and those in the conflict areas depend on the security situation in place of settlement, resettlement or relocation; the ability to establish identity and reclaim property; access to input and output markets; the availability of credit and business development services; and the availability of skills. The human development situation in the conflict affected will be dealt with in more detail in Section 4.

3.2 Economic Sector-Specific, Growth-Related Factors

Higher rates of poverty incidence in the rural and estates sector plus high poverty rates among households whose head is employed in the agricultural sector suggest that agriculture does not afford an adequate living for large numbers engaged in it. As Table 7 shows, other than for those working in miscellaneous labour work that cannot be classified into industrial sectors, the highest poverty incidence – 40 percent - is among households whose head works in agriculture (World Bank 2005). Although not specified in the study, these are probably households whose main income derives from agriculture: 44 percent of households were found to derive their main income from agriculture in 2002 (Gunatilaka et al. 2006). Real wage trends associated with the rural informal agriculture sector show that while at national level female agricultural workers in the tea and coconut sectors experienced rising real wages, real wage rates in the residual paddy sector remained stagnant between 1980 and 1997 (Gunatilaka and Hewarathna 2002). But national trends mask regional differences: over the same period as real wages in the tea and paddy sectors in Central Province were largely stagnant other than for pockets of economic dynamism in some districts (Gunatilaka 2003).

Structural change in employment proceeded only slowly. Agriculture continues to employ large numbers of people: in 1996, it contributed to 37 percent of total employment; by 2006, this number declined marginally to 33 percent. The employment contribution of the manufacturing sector rose from 22 percent to 26 percent during the same period, while the share of the service sector has remained stable at 41 percent (Department of Census and Statistics 2007). Since these figures exclude the Northern and Eastern Province, the estimate for agriculture's contribution to total employment is likely to be biased downwards.

Agriculture's association with poverty derives from low levels of productivity and competitiveness, particularly in peasant agriculture (the export-oriented tree crops sector performs better). Low productivity in agriculture derives not from a pronounced urban bias in policy, but rather as the unintended fallout of government interventions implemented to protect the interests of the rural sector. Restrictive seed and phyto-sanitary policies have constrained farmers' access to productivity enhancing technologies. Agricultural research carried out almost exclusively by public sector organisations been pre-occupied with rice with little regard to the profitability of rice production for farmers. Private sector investment in agricultural research has been hampered by the absence of intellectual property rights protection and the same restrictive seed and phyto-sanitary policies, and the complicated procedures for accessing the grant research funding schemes established by the government itself. Agricultural extension services were weakened following devolution to the Provincial Councils and the reassignment of field-level agricultural extension workers as *grama niladharis* or village level officials of the Central Government. Existing land legislation which promoted more equity in land ownership had the unforeseen effect of fragmentation of landholdings, particularly when the urban industrial sector failed to take off sufficiently to ease pressure on the land (between 1982 and 2002 the proportion of holdings less than one acre in extent jumped from 42 percent to 63 percent) (World Bank 2007). Inadequate funding of operations and maintenance of irrigation systems has led to the rapid deterioration of canal systems and to poor quality of services. At the same time, agricultural tariffs have been subject to frequent change, driven by political imperatives to dampen the cost of living. This has increased price risks for farmers, consumers and local entrepreneurs (World Bank 2007).

In contrast, ownership of and employment in a rural non-farm enterprise are associated with higher welfare: poverty incidence among rural households owning and operating a non-farm enterprise is 13 percent compared to a poverty rate of 23 percent for households without one (World Bank 2007). The non-farm sector's importance as a source of income and employment has also grown (more than half of per capita income of the average rural household derives from non-farm sources). Note in Table 6 that the poverty ratio of households where the head is in construction is two thirds the value of

those in agriculture, but where the household head is employed in manufacturing or the services sector, the headcount ratio is at least half the value as that for households whose head is employed in agriculture.

Nevertheless, while the non-farm sector needs to expand in order to generate more productive employment opportunities for the majority of rural poor to move out of poverty, its potential to do is constrained. The poor quality and availability of transportation and lack of connectivity to urban hubs, poor access and high cost of finance, limited access and unreliable supply of electricity, marketing difficulties and poor coverage in telecommunications are identified as the main constraints to doing business in rural areas (World Bank and Asian Development Bank 2005). Few firms appear to be integrated into well-coordinated supply chains, and so have limited access to new technology, financing options and wider markets.

Low job creation rates in Sri Lanka's formal industrial and services sector is another reason for the slow pace of poverty reduction. Many of the infrastructure constraints which hamper non-farm sector growth have been found to affect the formal sector as well. For example, in the survey cited above, 40 per cent of urban firms cited electricity as a major constraint in terms of access, high cost and unreliability. A fifth held that transport was a severe constraint. They cited traffic congestion and absenteeism due to the unavailability of transport as being key reasons for low productivity (World Bank and Asian Development Bank 2005).

More importantly, the formal sector is subject to some of the most restrictive job protection legislation in the world. Wage determination mechanisms in the formal sector also ensure that wages are much higher here than anywhere else. This has ensured a dualistic labour market in Sri Lanka, made up of a well protected formal sector whose job creation rates are low, and a far less well protected informal sector which acts as the residual sector of employment for the majority of people. While the informal sector accounts for 61 per cent of total employment in Sri Lanka, in the agricultural sector this figure rises to 83 per cent of the labour force, while in the non-farm sector, half of all employment in the informal sector. Of all informal sector workers, 47 per cent are own account workers, 35 per cent are employees, and 15 per cent are unpaid family workers. Only 3 per cent are employers themselves (Department of Census and Statistics 2007).

The operation of the Termination of Employment of Workmen's Act (TEWA) requires high compensation to be paid to laid-off workers in enterprises with more than 15 workers. Its discretionary nature and lengthy procedures restrict the ability of employers to lay off workers (Heltberg and Vodopivec 2004; Rama 2003). In the early 2000s, Sri Lanka's job creation rate was 8 per cent and job destruction rate was 4 per cent, markedly behind the average job creation rate of 14 per cent and job destruction rate of 11 per cent in selected 17 developed, transition and developing countries (World Bank 2006). Collective bargaining by unions also ensures that wages and benefits are relatively higher in this sector. Government intervention in the wage setting process (through the Wages Boards mechanism and through periodic statutory directives to the private sector to raise the cost of living component in wages) also exerts upward pressure on remuneration in this sector (Rodrigo and Munasinghe undated). High wages in this sector and high retrenchment costs make it more costly for firms in the formal protected private sector to expand and hire workers. This has led to the rationing of jobs according to class and connections, which the majority of poor people lack, forcing them into the unprotected informal sector where wages are lower and working conditions poor.

Sri Lanka's education system is yet to be successfully oriented to the world of work. More emphasis is needed on the use of IT and technology in education, success in imparting mathematics and language skills, and engendering an enterprising culture. Students have only a weak grasp of their mother tongue (37 percent), English (10 percent) and mathematics (38 percent), essential for higher education and the job market (World Bank 2007). The formal education system has also long been based on rote learning, abstraction and authority which have inculcated attitudes that avoid challenges. Attitudes and values associated with hierarchy and conformity are deeply entrenched (Reinprecht and Weeratunge 2006). This has placed children from poor families at a disadvantage as they lack the means to obtain work-oriented skills from the fee levying sector. These problems have long been recognised along with the need to promote own observation, critical thinking and practical skills through the education system. But reforms have been long delayed and are only now beginning to bear fruit.

The technical and vocational training sector has performed poorly in terms of enhancing the employability of young jobseekers. The quality of the training programmes

has been variable with outdated study programmes, inadequate facilities, irrelevant industrial training and insufficient practical work. Employability of people who have received technical and vocational training is generally low with wide variations in employability across major public training providers (Chandrasiri 2005). Efforts to reform the sector began only two years ago and will take some time to have an impact.

A further constraint to investment in and the growth of the industrial and services sectors is the high cost of electricity. Sri Lanka has the highest electricity tariffs for businesses in the region due to delayed implementation of power projects in the past. This compelled the government to purchase emergency power at high cost from private power suppliers. Continued delays in bidding, financing and contracting of the Kerawalapitiya (300 MW) power plant has meant that the generating system is operating with a shortage of 200 MW in 2007 and a probable shortage of 405 MW in 2008. Sri Lanka's generating system has never had such low levels of reserve margin before. The energy sector also faces other problems of under-investment and delayed investments in the operation, reliability and quality of electricity supply, the high debt burden of the sector and high price of petroleum products on which a large proportion of the power generation capacity is dependent (Department of National Planning 2006a).

3.3 Attributes of Individuals and Households

Even if the conditions for poverty-reducing economic growth were present, there are many reasons why some people would remain in poverty or fall into poverty.

In the first place, poor people do not have inherited assets, or what they have is of too low quality to enable them to use it as investment capital or to provide them with an adequate safety net that protects sudden loss of entitlements due to shocks. These shocks may be individual such as the death of the principal income earner, illness or disability, loss of employment, or community-wide, such as natural disasters and the impact of conflict.

Poor people are also unable to save for their old age as they typically spend what they earn on keeping body and soul together. Hence poverty is also associated with old age. With a rapidly ageing population of whom only 16 percent have planned for their old age (World Bank 2006), poverty is likely to be increasingly associated with old age in the

future. Poverty is also associated with disability. Disability affects poor people the most as their bodies are invariably their only resource for earning any income. Employment rates among the disabled are much lower than for the rest of the population, varying from a low of 7 percent for those with psychiatric disability to a high of 26 percent with mobility disability. Of those employed, most live below the poverty line, varying from 43 percent for intellectual disability, to 88 percent with speech disability (Ministry of Social Welfare 2003). Meanwhile, the safety nets for the poor, for the elderly and the physically and mentally disabled currently provided by government are both inadequately funded and inefficiently targeted (World Bank 2006).

Those in poverty have low levels of education which depress their lifetime earning potential and in turn impact negatively on their children's education and earnings potential. Note the inverse correlation between the education level of household head and poverty ratios in Table 7. As education levels rise, poverty declines sharply: 45 percent of household heads with no schooling were found to be poor, whereas poverty incidence among those with GCE A' Levels or degrees was 2 percent and less. Poor households also tend to have more children with serious implications for the education of these children. The poverty of households with 2 children is 27 percent (about equal to the national average), but poverty incidence for households with 3 children is 38 percent and for those with 4 or more children it is 51 percent, nearly double the national average (World Bank 2006).

Low levels of educational attainment usually preclude children of poor families from accessing skills training that would yield higher returns. This also gives rise to low lifetime earning potential. Poorer individuals with low levels of formal education and English language skills, in particular, have less chance of obtaining the necessary formal and technical education as they cannot meet the qualifying criteria of most technical and vocational education courses (Arunatilake and Jayawardena 2006).

Low levels of education and vocational skills translate to low skilled occupations giving rise to low levels of earnings. Poverty rates are highest among individuals working in elementary occupations; agriculture, forestry and fisheries workers and craft and related workers (see Table 7). If the household head is engaged in a low skilled occupation, then she would have correspondingly weaker social networks and poorer

prospects of placing her child in a good job once the child has finished his education. This would lower the returns to her child's education, thereby encouraging her to invest less in it. Conversely, parents with more influential positions and thus better social networks may positively enhance returns to education by increasing the chances of accessing higher paying jobs (Arunatilake 2005).

Intergenerational schooling mobility is low in Sri Lanka by international standards implying only limited social and economic progress made across generations (World Bank 2006). Comparing educational attainment across three generations (that is, children, parents and grandparents), Ranasinghe (2004) found that an additional year of parental education for the older generation implies an increase of nearly 0.6 years of schooling for children, in comparison to only about 0.3 years for the youngest generation

Location is an important determinant of educational attainment. If children are living in an underserved location (see Section 2.1 above), the poor quality of education they have access to prevents them from succeeding in the qualifying examinations to proceed further in education. While the better-off may compensate for poor quality education with private tuition, poor people have no means of doing so. Low birth weight and malnutrition also affect educational performance.

In conflict areas, children do not have a secure environment in which to attend school. Regular school attendance is curbed due to the fear of being abducted and recruited as child soldiers. In September 2005, UNICEF reported that the number of children recruited as LTTE soldiers was 5,198 (World Bank 2006). Frequent displacement also disrupts schooling and leads to dropping out of school.

School drop-out rates are also highest among the poor as the opportunity costs of education are much higher for children of poor households. Staying in school means expenditure on books and transport (text books and school uniforms are provided free by the government), and foregoing labour earnings. Seventeen percent of children who enrol in school do not complete compulsory secondary education (5-14 years) (Department of National Planning 2006a). Overall there are about 38,000 children of school-going age in Sri Lanka excluding the North and East who do not attend school, of whom the majority (56 per cent) are girls (Department of Census and Statistics 2000). The incidence of child labour in Sri Lanka is very low relative to other South Asian countries: 2 per cent of

children were economically active in Sri Lanka, in comparison to 27.8 per cent in Bangladesh, 12 per cent in India, 15 per cent in Pakistan, 51 per cent in Bhutan and 42 per cent in Nepal (World Bank 2006). A little more than half of all working children were under 15 years of age, and 95 per cent worked in rural areas (Department of Census and Statistics 2000). Dropping out of school too early is a cause of poverty during the lifetime and is an issue that needs to be addressed in any poverty reduction strategy.

The poor lack powerful and widely dispersed social networks that determine access to food, shelter, finance, moral support, tacit 'cultural knowledge', access to education/training, information and employment, status and identity. While these relationships of reciprocity provide some safety net and help mitigate risk, they can also maintain the poor in social structures that perpetuate poverty (Weeratunge 2001). For example, poor people can rarely hold corrupt local officials accountable for the services they are supposed to provide as they are dependent on them for survival. A poor casual labourer is unlikely to question the site of a rural access road that benefits the corrupt local landowner or local government politician (who are often one and the same) and not the poor, if the landowner owns the only vehicle in the village that can take his sick child to hospital.

Certain cultural factors such as male dominance, alcoholism and high tolerance levels for domestic abuse make for poverty in some communities. Alcoholism is a particular problem in the estates sector (World Bank 2007), while male dominance and geographic isolation prevent women from finding better paid employment and a greater level of economic independence. In contrast, in certain rural areas where husbands settle in their wives' parental villages, women are more empowered and less vulnerable to male dominance and domestic abuse. They are active members of local self-help organizations and savings and credit groups and have contrived to improve their families' earnings and living standards (Gunatilaka 2000). In certain urban slums, an environment of violence, alcoholism and petty criminality trap families in poverty and prevent their emerging from their predicament.

4. Government's Policies and Initiatives

While political economy considerations have ensured that successive Sri Lankan governments have been concerned with issues of poverty, inequality and welfare, for many decades after independence, public policy was geared towards universal subsidies and welfare services rather than market-oriented development. However, over the last decade, the government's approach to poverty reduction has undergone a significant change. Policy now recognises that there are many dimensions and correlates of poverty which require an integrated development policy framework to address it. The current government's strong emphasis on infrastructure development to reduce regional inequalities and enable lagging regions and localities to link up with the growth process is noteworthy.

However, both institutional and macroeconomic constraints are likely to impede the effective realisation of policy goals. The culture of political patronage and revenge at the level of grass-roots in particular, make pro-poor development and safety net programmes vulnerable to capture and subversion at local level. The Sri Lankan economy performed well in 2006, posting its highest ever growth rate of 7.4 percent in the last three decades. Vigorous private sector activity, strong export growth and a resurgent agricultural sector powered GDP growth. But renewed conflict has dampened future growth forecasts and increased pressure on government finances. Rising oil prices and tighter monetary controls will also cool economic growth rates. These developments will make it hard to achieve a marked reduction in poverty levels. However, if the security situation in the conflict-affected areas improves enabling investment and development to take place in those areas as well as in the rest of the country on the lines envisaged in the ten-year development framework, then economic growth rates will pick up and help reduce poverty significantly.

4.1 Policy History

Political economy considerations have ensured that successive Sri Lankan governments have been concerned with issues of poverty, inequality and welfare even since before independence in 1948. This resulted in a mixed bag of social welfare and development policies implemented throughout the 1950s, 1960s and 1970s. Policies included universal

subsidies in health, education and consumption support on the one hand, and rural development initiatives based on rural access roads, land settlement schemes and irrigation works on the other.

Economic liberalization in 1977 paved the way for export-oriented economic growth and employment generation. The government of the day largely looked to higher economic growth in both urban and rural areas to translate into greater social welfare. However, in hindsight it is clear that the government's policy framework over the next two decades was characterized by a spatial and sectoral dualism that failed to integrate the urban and rural sectors, industry and agriculture, and product and factor markets between regions. While macro-economic growth rates picked up as expected, light industrial goods began to claim a bigger share of the country's exports, and unemployment rates began to decline.

But the post-liberalization era of higher economic growth and lower unemployment levels also saw continuing social conflict and greater political instability related to distributional issues (Abeyratne 2004). The political crisis triggered macroeconomic growth and balance of payments crises which necessitated a second wave of economic reform. The crisis also catalysed a significant turnaround in the government's welfare policy in tacit recognition that the economic growth process had failed to reach large sections of the population. A targeted income support programme was introduced, expenditure on health and education was increased and incentives provided to industries that located in rural areas. But these efforts invariably ran against constraints imposed by infrastructure bottlenecks in power and road transport as the military demands of the secessionist conflict crowded out public expenditure on urgently needed infrastructure. The conflict took its own toll on investor confidence.

The targeted income support programme – particularly the Samurdhi Programme which succeeded the previous Janasaviya Programme - also failed in its objectives due to inefficient targeting, minimal impact and high administrative costs. In contrast, the Grameen-style small group savings and credit programme known as the Samurdhi Bank programme fared much better even though it too remains vulnerable to political capture. The system appears to be reaching large numbers of the poor excluded by other programmes. Moreover, if the system is successfully insulated from capture, it has the

potential to be far more sustainable than most other micro-finance programmes as it is not donor dependent and is based entirely on members' savings for capital. (Gant et al. 2002; Gunatilaka and Salih 1999).

By the mid-1990s, policy makers realized that it was necessary to create a big push in investment, integrate markets and develop infrastructure and service systems on a functional regional basis if poverty were to be reduced in a meaningful and sustainable way. Consequently, the government's approach to poverty reduction has undergone a significant change. Policy now recognises that there are many dimensions and correlates of poverty which require an integrated development policy framework to address it.

The present government intends addressing the problem of poverty and regional inequalities by implementing a ten-year development plan consisting of policies, programmes and projects formulated by the Department of National Planning with substantive contributions from the line ministries and various stakeholders (Department of National Planning 2006a). Known as *Mahinda Chintana*, the document has yet to be finalized. Nevertheless, some broad themes are evident and will be assessed in the next section.

4.2 Current Approach

Concern with issues of inequality and poverty pervades *Mahinda Chintana* and is its strength. Even if the analysis and programming related to the stronger line ministries (education, health, power) are of much better quality than those of others (agriculture, livelihood and social protection), the integrated approach to development presented is to be welcomed. It is clearly the culmination of the policy formulation process begun in the mid 1990s and its over-riding emphasis on reducing poverty and inequality is its strength.

Policies and programmes proposed in the health and education sectors are oriented towards reducing regional inequalities and addressing poverty. In the health sector, this takes the form of upgrading facilities in the base hospitals of several districts; providing residential facilities for doctors, particularly in rural areas; and developing hospitals in the estate sector and recruiting and training necessary staff. It is also proposed to extend nutritional programmes for expectant mothers and strengthen the mid-day meal programme targeted at malnourished school children. Reducing regional

inequalities in healthcare provision has invaluable positive implications for poverty reduction. Poor people's only resource is their bodies, and ill-health and disability caused by ill-health severely impair the income-earning capacity of not only the person affected, but also that of family members who have to look after him. Pro-poor education policies include achieving 100 percent participation by reducing the number of out-of school children and introducing special measures to provide education to children from low-income neighbourhoods, remote villages, plantations, and conflict-affected areas, as well as to working children, street children, destitute and abandoned children. For example, the Ministry of Education has recruited teachers from estate areas who are required to serve in the estate areas for the next ten years. It is also proposed to develop high quality secondary schools in the 100 poorest DS divisions, extending opportunities for science education especially in rural areas, and expanding opportunities for learning English at primary and secondary level in all schools.

The strong emphasis on infrastructure development to generate regionally balanced economic growth is long overdue and most welcome. Sri Lanka has a huge backlog of infrastructure development that it needs to catch up on, and as discussed in Section 2.1 above, a massive infrastructure push is necessary if regions other than Western Province are to link up with the growth process and reduce poverty. This is particularly true of areas affected by conflict which have virtually fallen off the economic development map over the last two decades. The emphasis on infrastructure marks a welcome shift away from conceptualizing development simplistically merely as self-sufficient villages with sedentary populations as was the case in earlier times. The government has clearly reoriented its development vision towards regionally dispersed, urban growth centres and small and medium townships that are integrated with well-serviced rural hinterlands as well as with domestic and international markets through provincial and rural access roads, highways, railways and ports. The government also envisages providing near universal access to safe water and sanitation by 2016.

The infrastructure development plans of *Mahinda Chintana* are not over-ambitious in terms of what the country urgently needs. However, they may be over-ambitious in relation to the government's financial capacity, given the increasing demands that the most recent outbreak of conflict are making on the budget. While some

donors (e.g. JBIC) may be willing to shoulder a large part of the costs for large infrastructure projects such as highways, the government must still find the counterpart funding to make good donor assistance. Moreover, the precise amount of funding needed for certain infrastructure projects are dependent on other supporting conditions. For example, many of the proposed policies and programmes in the energy sector are contingent on the timely commissioning of certain power projects. If the projects do not materialize when expected, many of the proposed reforms such as debt restructuring of the Ceylon Electricity Board and tariff rationalization will not be feasible.

Financial constraints are also likely to affect the implementation of projects and programmes in agriculture. The chapter on agriculture sets out detailed sector plans to increase productivity primarily through the introduction of technology. But the proposed fund allocation for the sector devotes half the budget for credit (22 percent) and fertilizer (33 percent) subsidies, and relatively little on technology research (2 percent) and extension and education (4 percent). The *Bim Saviya* programme to register land titles along with the establishment of a Digital Land Information System – vital to establish a land market may also face financial constraints as it is to be funded from the Consolidated Fund (Department of National Planning 2006b). However, the Dry Zone Livelihood Support and Partnership Programme aiming to establish integrated rain-fed upland agricultural development systems and rehabilitation of village level tanks in the districts of Anuradhapura, Kurunegala, Monaragala and Badulla may fare better as it is jointly funded by IFAD and the Government of Sri Lanka.

In the non-farm sector, further reform of TEWA to make the labour market more flexible is also likely to be stymied by the lack of funds to establish an unemployment benefit insurance scheme. But greater private sector involvement is likely to make for more regionally balanced industrial development. The government seeks to construct industrial export zones, techno parks and industrial estates on BOT/BOO basis. Industrial incubators, mini industrial estates will also be established through public-private partnerships to cater to the specific needs of start-ups and SMEs which account for 70 percent of all industrial establishments. To provide quality assurance for business development services and to coordinate SME activities of provincial and central governments, *Mahinda Chintana* aims to establish an Apex Authority for SMEs. While

support from the World Bank, the ADB and the government itself has enabled the provision of concessionary financing schemes for SMEs, government policy aims to devote a little less than half of total investment during the next ten year period to financial assistance programmes to the sector. To provide business development services (managerial, accounting and technical skills) along with credit, the Small and Micro Industries Leader and entrepreneur Promotion Project (SMILE II) has been proposed.

However, it should be noted that the sustainability of credit lines to the SME sector will be entirely dependent on donor and/or government support. This is cause for concern. It should be recalled that financial institutions such as the NDB and DFCC were also set up many years ago to serve the SME sector. As concessionary financing dried up, these organizations were compelled to serve the higher end of the market and abandon the clientele they were set up to serve. Currently, the SME bank set up to serve the sector, as well as the Lankaputhra Bank, set up with the same objective, are facing liquidity constraints due to the lack of concessionary finance. They are also facing competition from private commercial banks and financial institutions which promote their own SME lending instruments, often with donor support. For example, Lanka Orix Leasing Ltd. is providing credit lines for the SME sector in partnership with USAID which is providing credit guarantees. Even HSBC is operating an SME credit arm as part of its Corporate Social Responsibility activities.

A more sustainable path to providing credit and BDS support for SME entrepreneurs who do not have collateral would be to further develop the Samurdhi Bank system and provide credit plus services to members who have proved their credit worthiness. The programme was very successful in generating a vast volume of investible funds and providing members with secure savings instruments and a reliable source of consumption and other loans (Gant et al. 2002; Gunatilaka and Salih 1999). At least half the total number of Samurdhi Banks was breaking even by 2003 and able to meet the staff costs of the banking programme (verbal communication, S. Liyanwala, Samurdhi Banking Division, 2003). While membership of the Samurdhi Bank system was for many years confined to those who received the income transfer, Bank officials changed criteria and procedures to accommodate those who did not receive the transfer so long as they progressed through the savings group system and proved their credit worthiness. The

change was partly motivated by the low absorption capacity of many poor for loans to fund anything more than survival strategies, and partly in recognition of targeting errors in the income transfer component which excluded many deserving poor from the system. Thus, the Samurdhi Bank system was gradually positioning itself to provide credit plus services for sustainable micro, small and medium enterprise development among members. Meanwhile, the large volume of savings generated was invested in government bonds. But this caused widespread discontentment among local politicians who argued that savings generated in a certain locality should be used for the development of that locality rather than diverted through the government's fiscal operations to develop other areas. They also criticized Samurdhi Bank officials' loan approval procedures, alleging that they are discriminatory.

The government appears to be responding to these pressures by looking for ways to increase loan disbursement rates in a certain area to be commensurate with the amount of savings generated in that area. This approach misses the fundamental point that loan disbursement rates have been low in most rural areas because other inputs necessary for enterprise development (demand, infrastructure, etc.) have been lacking, making few project proposals viable. Rather than interfere with the loan disbursement process, it may make more sense for the government to undertake to spend an equivalent amount of funds generated by the Samurdhi Bank system in a district on infrastructure development in that district and be transparent about such expenditure. District Development Bonds which name the district and the volume of funds generated by the Samurdhi system in that district may be an appropriate instrument. There is an urgent need to build on the Samurdhi Banking system's proven strengths, dispel the doubt and policy uncertainty that currently relates to the future of the system, and make it autonomous in order to prevent political capture of the programme. Failure to do so will jeopardize the sustainability of the system and discredit all such government-led poverty alleviation efforts in the future.

There also has to be more emphasis on entrepreneurship training beginning with the school curriculum, than current government policy provides for. For example, the Small Enterprise Development division (SEDD) of the Ministry of Youth Affairs and Sports and the Industrial Development Board (IDB) provide successful entrepreneurship training programmes. These efforts are currently supported by donors and NGOs such as

ILO/SIYB and GTZ/CEFE; microfinance programmes such as Sarvodaya Economic Enterprise and Development Services (SEEDS) and Agromart, and private sector programmes such as Young Entrepreneurs Sri Lanka (YESL) and Shell LiveWIRE. The government programme SEDD in particular, has a wide outreach to rural areas, long experience in implementation, well-trained trainers from within the same districts, and a well established network of linkages with banks and other technical service providers. While enterprising attitudes must be inculcated among all school children, only those who are interested in and have an aptitude for business need full-scale entrepreneurship training. This needs to take the form of an enabling environment that integrates career guidance, training, and business support services (Weeratunge 2006).

Despite its laudable aims to reduce poverty, many *Mahinda Chintana* programmes intended to reach the poor are extremely vulnerable to political capture by local elites. This problem derives from the institution of *Jana Sabhas* in rural communities to propose community-based rural infrastructure projects under the *Gama Neguma* or village re-awakening programme, to receive loans for enterprise development under the same programme, and to provide community screening for the effective targeting of the Samurdhi income transfer programme. The membership of the *Jana Sabhas* are to be made up by all members of a village under the guidance of five individuals – three of them government officers - the *Grama Niladhari*, the Samurdhi Development Officer and the Agriculture Extension Officer – plus two community leaders. The *Sabha* itself is expected to have legal status and act like a cooperative.

Take the case of the *Gama Neguma* Programme first. The initiative was originally formulated to upgrade social and economic infrastructure and services in the 119 poorest DS divisions with the involvement of the line ministries. But in 2006, the programme was expanded to 4000 villages. Proposals for development projects under the programme were first submitted by elected members of the local governments, the *Pradeshiya Sabhas*, belonging to the ruling party. In subsequent efforts to ensure that the poor benefit from the programme, the community was required to provide a fifth of the labour cost of the project, while the Divisional Secretary was required to display detailed estimates of project costs. This was based on the premise that if the poor did not benefit from the project they would refuse to work on it. In a further effort to insulate the programme and

increase community participation, the mechanism of *Jana Sabha* was proposed to provide a forum for to discuss and select development projects and to develop cooperative-type enterprise development projects.

Progress made thus far on developing eligibility criteria for the Samurdhi income transfer through provisions of the Welfare Board Act and the institution of the proxy means test formula (PMTF) have also been abandoned in favour of community screening through the *Jana Sabha*. A perception that the weights assigned to certain household characteristics such as ownership of land were based on size rather than on productivity, appears to have encouraged policy makers to throw the baby out with the bath water instead of refining the formula and backing it up with community screening and procedures for appeal. Nevertheless, eligibility for Samurdhi in the north and the east continue to be determined by the PMTF.

The government's confidence in the *Jana Sabha* as a mechanism to provide the poor with a voice and ensure that benefits reach them is likely to be misplaced. As illustrated in Section 2.3 above, the poor cannot afford to antagonize village level elites by questioning the latter's decision-making or conduct. This is because of the patron-client dependency structures that provide the poor with informal safety nets in times of individual or community-wide shocks, but which also tilt the balance of power in favour of patrons the rest of the time.

While the beneficiary selection process for income transfer programmes for the poor remains unsatisfactory, it becomes difficult to increase the size of the grant in any meaningful way. Certainly, in 2006 Samurdhi cash grants were increased by 50 per cent (Central Bank of Sri Lanka 2007). Nevertheless, this one-off increase ten years into the life of the programme is hardly sufficient when inflation has increased by 142 percent (CCPI) over the same period. Meanwhile, other vulnerable groups such as the disabled and the aged are inadequately covered (World Bank 2006). A survey of disabled persons shows that only 41 percent of persons suffering from intellectual, mobility, psychiatric, hearing, or speech disability receive any sort of income transfer (including the disability allowance) from the government (Ministry of Social Welfare 2003).

4.3 Institutional Constraints

Endemic weaknesses in Sri Lanka's public administration system are likely to impede the effective implementation of pro-poor development policies and programmes. Some also perpetuate poverty. The system is vast (employing 1.1 million workers) and amorphous, characterized by a proliferation of institutions, uncertain lines of command, confusion about responsibilities and lack of accountability. It is highly politicized and a culture of patronage and revenge subvert many projects and programmes at grassroots level (Gunatilaka and Williams 1999). Ad hoc efforts at decentralization and devolution have only made matters worse by fragmenting implementing capacity on the one hand, while encouraging further centralization of decision-making on the other to overcome problems of coordination. The advent of coalition politics in recent years has exacerbated existing ills exponentially by necessitating the creation of ministries out of former ministry projects in order to provide ministerial berths for coalition partners. Sri Lanka currently has 56 ministries with considerable overlaps in functions between them.

The proliferation of institutions and confusion about responsibilities has meant that diverse institutions are involved in doing the same thing. Consequently, there is overlap and duplication of effort and lack of coordination with few in government knowing exactly who is responsible for what and who else is involved in doing what they are doing.

Efforts at political empowerment through devolution have not yielded significant results. The devolution exercise itself was badly designed and poorly executed. The lack of both financial and administrative capacity at provincial and local government level have made things worse. Political tribalism has also made the political party a centralizing force in an arguably 'devolved' structure of government and undermined the objectives of devolution. And as the more able politicians move to the national arena, the quality of those remaining at local level is often very poor. In many ways, devolution has facilitated the spread to the local level of existing ills at the centre such as political control, electoral power manipulation and personal aggrandizement, with more harmful effects on the poor and powerless.

Politics in Sri Lanka, particularly at the level of the grass-roots, is characterized by a culture of patronage and revenge, making pro-poor development programmes

vulnerable to capture and subversion at local level. Inability to insulate administrative decision-making from political capture also works against the equitable provision of key services. For example, large numbers of schools in rural areas lack teachers in mathematics, science and English because teachers who are posted to such areas bring political influence to bear to change the appointments to postings in less difficult areas. But at the same time, teachers remain vulnerable to punishment transfers if they do not comply with the demands of influential politicians.

There appear to be few internal systems in place to ensure accountability, to identify programme objectives and targets, and to monitor progress in achieving those targets. Even so, the Ministry of Plan Implementation has recently initiated Results Based Monitoring in four key ministries – highways, health, education and agriculture and agrarian services – with a view to demonstrating its success to other ministries as well. There has also been an encouraging trend in recent times for individuals to file violation of fundamental rights cases in the Supreme Court in order to redress discriminatory action by government agencies and hold them accountable.

While issues of proliferation and fragmentation abound and make the system slow to respond and to implement policies, the recent transformation of the Ministry of Nation Building into a mega clearing house for all development projects is likely to do more harm than good. In January this year, the Ministry of Nation Building and Estate Infrastructure Development was transformed into a mega ministry with 29 development-related functions including initiating and coordinating foreign aided projects, rehabilitation in the North and East, providing social safety nets and microcredit, all matters pertaining to rural revival through the *Gama Neguma* and *Maga Neguma* rural road development programmes, and implementation of regional development programmes. The ministry is to be the apex ministry for development by acting as a clearing house for all development-related projects while the Ministry of Finance acts as the financial clearing house. The Ministry of Nation Building has been allocated a budget of Rs. 53 billion or 65 percent of the total government budget. Its only cabinet minister is the President of Sri Lanka himself, while the ministry has, in addition, six non-cabinet ministers and a deputy minister. Thus, the Ministry of Nation Building looks to be a government within a government, centralizing all development decision-making within it

and reducing other government institutions to implementing functions only. If the central government is so highly centralized within itself, it augurs ill for more participatory decision-making, motivation and accountability at all levels of government.

4.4 Macroeconomic Prospects

The Sri Lankan economy performed well in 2006, posting its highest ever growth rate of 7.4 percent in the last three decades. Vigorous private sector activity, strong export growth and a resurgent agricultural sector powered GDP growth, helped by expansionary macroeconomic policies. But this in turn helped fuel inflation (already affected by high oil prices) and eroded real wages in the private sector even if unemployment continued to decline. However, the trade deficit expanded as the doubling of oil prices since 2004 made the import bill exceed receipts from exports. Expanded earnings on the services account and higher workers' remittances helped mitigate the inevitable widening of the current account deficit. High levels of FDI and grants and loans to government on the capital account helped balance the country's external payments. Some fiscal consolidation was achieved despite overruns on recurrent expenditure fuelled by increased defence expenditure, a higher wage bill and fuel subsidies.

Certain fundamentals in Sri Lanka's external trade performance have continued during the first five months of 2007.³ Exports grew by 14.4 per cent, faster than imports which grew by 7.5 percent. Workers' remittances grew by 17 percent. But the adverse impact of renewed conflict and higher oil prices are likely to constrain future growth prospects. FDI is likely to be lower this year; tourism was badly hit by the LTTE's air raids but has since recovered; and greater defence expenditure may crowd out much needed public investment. Tighter monetary policy to cool the economy is also likely to help moderate growth over the next two years. These developments will make it hard to achieve a marked reduction in poverty levels. However, if the security situation in the conflict-affected areas improves, enabling investment and development to take place in those areas as well as the rest of the country on the lines envisaged in the ten-year development framework, then economic growth rates will pick up and help reduce poverty significantly.

5. Conclusions

Sri Lanka is on track to halving between 1990 and 2015, the proportion of people whose income is less than \$1/day. Even so, a fifth of all Sri Lankans remain in consumption poverty and the decline in poverty rates between 1990 and 2002 has been disappointingly modest. Poverty reduction in terms of non-income poverty indicators has been better, but national figures mask considerable gender-related, sectoral and regional variation.

Location-specific factors that determine economic growth appear key to slow reduction of poverty. Western Province has benefited from geographical and infrastructure-related comparative advantages that enabled it to benefit from agglomeration forces unleashed by the macroeconomic liberalization of 1977. Under-served locations have correspondingly high poverty rates: poor transport facilities, infrastructure and connectivity contributing to the spatial segmentation of the labour market by inhibiting the movement of workers to areas and sectors which offer the best possible returns. In this growth-related spatial hierarchy, regions subject to natural and man-made disasters such as landslides, drought, Tsunami and conflict are the worst off. Meanwhile, certain economic sectors have been unable to respond to new challenges: low levels of productivity and competitiveness in the agriculture sector; infrastructure and other constraints on expansion of the non-farm sector; an education and skills-development system that has yet to be successfully geared to the world of work; and the high cost of electricity. At the same time, certain attributes of individuals and households have made them vulnerable to poverty and constrained their moving out of it. Among these factors are ill-health and disability, old age, lack of social contacts and unequal power relations with the better-off, poor education attainments and occupation status of parents and low rates of inter-generational mobility.

Political economy considerations have ensured that successive Sri Lankan governments have been concerned with issues of poverty, inequality and welfare. For many decades after independence public policy was geared towards providing universal subsidies and welfare services rather than market-oriented development. However, over the last decade, the government's approach to poverty reduction has undergone a significant change. Policy now recognizes that there are many dimensions and correlates of poverty which require an integrated development policy framework to address it. The

current government's strong emphasis on infrastructure development to reduce regional inequalities and enable lagging regions and localities to link up with the growth process is noteworthy. However, both institutional and macroeconomic constraints are likely to impede the effective realization of policy goals. The culture of political patronage and revenge at the level of grass-roots in particular, make pro-poor development and safety net programmes vulnerable to capture and subversion at local level. Proliferation of institutions in the public sector and fragmentation of the system make it difficult to coordinate initiatives on the one hand, and make it slow to respond and to implement pro-poor policies on the other. Ad hoc attempts at devolution have been ill-designed, poorly executed and have actually made matters worse.

The Sri Lankan economy performed well in 2006, posting its highest ever growth rate of 7.4 percent in the last three decades. Vigorous private sector activity, strong export growth and a resurgent agricultural sector powered GDP growth. But renewed conflict has dampened future growth forecasts and increased pressure on government finances. Rising oil prices and tighter monetary controls to hold back inflation will also cool economic growth rates. These developments will make it hard to achieve a marked reduction in poverty levels. However, if the security situation in the conflict-affected areas improves enabling investment and development to take place in those areas as well as the rest of the country on the lines envisaged in the ten-year development framework, then economic growth rates will pick up and help reduce poverty significantly.

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**Table 1: Poverty and inequality in Sri Lanka
(as percent of total population)**

Poverty Indicators	1990-91	1995-96	2002
Poverty Incidence	26.1	28.8	22.7
Poverty Gap	0.056	0.066	0.051
Poverty Severity	0.018	0.022	0.016
Poverty Incidence by sector			
Urban Poverty	16.3	14	7.9
Rural Poverty	29.4	30.9	24.7
Estate Poverty	20.5	38.4	30.0
Poverty Incidence by region			
Western	21	18	11
North Central	24	24	21
Central	28	37	25
Northwest	25	29	27
Southern	30	33	28
Sabaragamuwa	31	41	34
Uva	33	49	37
Inequality: Gini coefficient by per capita expenditure			
National	0.32	0.35	0.40
Urban	0.37	0.38	0.42
Rural	0.29	0.33	0.39
Estates	0.22	0.20	0.26

Source: World Bank (2007). Data excludes Northern and Eastern Provinces

Table 2: Factor Contribution to Levels and Changes in Inequality Using Shapley Value Decomposition (percent)

	Contribution to level of inequality			Contribution to change in inequality	
	1990	1995	2002	1995-1990	2002-1995
Adult males	3.44	3.39	1.34	2.05	-11.83
Adult females	3.03	3.65	1.07	4.76	-15.33
Ethnicity	1.83	0.88	0.28	-2.98	-3.52
Education	16.88	17.33	20.99	13.15	37.74
Occupation	8.73	8.73	6.70	5.80	-7.88
Infrastructure	23.50	22.72	36.59	12.04	112.38
Spatial	1.27	3.73	4.38	11.75	7.20
\hat{G}_{TOT}	58.68	60.43	71.36		
Residual	41.32	39.57	28.64	19.54	-47.62
Change in G				8.17	5.39

Source: Gunatilaka and Chotikapanich (2006). Data excludes Northern and Eastern Provinces

Table 3: Poverty indices and access to infrastructure by province

	Employment by Industrial Sector (percent of employed)						Average travel time to Colombo (min)	Enterprises using electricity (percent)	Enterprises with landline or mobile phone	Enterprises located in a community with a bank (percent)	
	Poverty headcount ratio (percent)	Contribution to GDP (percent)	Agriculture forestry fishing	Industry	Services	Average accessibility index					
	2002	2002	2003/04	2003/04	2003/04	2004					
Western	11	48.1	9.3	35.9	54.8	3.8	73	79	24	70	
Central	25	9.4	43.8	19.1	37.1	3.1	200	80	7	47	
Southern	28	9.7	39.8	24.1	36.1	3.1	229	68	18	62	
Northwest	27	10.1	28.5	32.5	39.0	3.1	177	61	15	70	
North Central	21	3.9	50.0	15.6	33.5	2.9	304	61	8	75	
Uva	37	4.3	63.7	9.2	27.2	2.8	295	62	23	78	
Sabaragamuwa	35	6.9	44.9	27.4	27.8	3.3	152	76	15	70	
Correlation with headcount							-0.62	0.47	-0.32	0.2	0.14

Source: Central Bank of Sri Lanka (2007) for data on employment by industrial sector. Other indicators from World Bank (2007).

Notes:

Accessibility index calculated for every point as the sum of the population totals of surrounding cities and towns, inversely weighted by the road network travel time to each town. The numbers show the mean of the access values for all points that fall into a given province.

Average travel time to Colombo city is estimated travel time to each town based on geographical information of road network. The numbers show the mean travel time for all points that fall into a given province.

Table 5: Human Development Indicators of Selected Asian Countries

Indicators		Malaysia	Thailand	Philippines	Sri Lanka	Indonesia	India	Pakistan	Bangladesh	Nepal
HDI	2004	0.805	0.784	0.763	0.755	0.711	0.611	0.539	0.53	0.527
GDP per capita (PPP US\$)	2004	10,276	8,090	4,614	4,390	3,609	3,139 u	2,225	1,870	1,490
Population living below \$1 a day	1990-2004a	2	2	15.5	5.6	7.5	34.7	17	36	24.1
Ratio of richest 20% to poorest 20%	j	12.4	7.7	9.7	5.1	5.2	4.9	4.3	4.6	9.1
Gini index	k	49.2	42	46.1	33.2	34.3	32.5	30.6	31.8	47.2
Adult literacy female (aged 15+)	2004n	85.4	90.5	92.7	89.1	86.8	47.8	36	.. w	34.9
Adult literacy male (aged 15+)	2004n	92	94.9	92.5	92.3	94	73.4	63	.. x	62.7
Net primary enrolment ratio	1991f	..	76 p	96 p	..	97	..	33 p	..	..
	2004f,g	93 q	..	94	97 p	94	90 p	66 r	94 r	78 r,q
Net secondary enrolment ratio	1991f,h	..	..	..	..	39	..	..	..	..
	2004f,g,h	76 q	..	61	..	57	..	..	48 q	..
Children reaching grade 5	1991g,i	97	..	..	92	84	..	..	..	51
(% of grade 1 students)	2003g,i	98 s	..	75	..	92	79	70 t	65	67 p
Children underweight for age	1996-2004c	11	19 o	28	29	28	49	38	48	48
(% under age 5)										
Infant mortality rate	1970	46	74	56	65	104	127	120	145	165
(per 100 live births)	2004	10	18	26	12	30	62	80	56	59
Maternal mortality rate (per 100,000 live births)	1990-2004d,e	30	24	170	92	310	540	530	380	540
Internally displaced persons (thousands)	2005l,m	..	..	60	325	342-600	600	20 v	500	100-200

Notes:

- a.Data refer to the most recent year available during the period specified.
- b.Data refer to the most recent year available during the period specified.
- c.Data refer to the most recent year available during the period specified.
- d.Data reported by national authorities.
- e.Data refer to the most recent year available during the period specified.
- f.The net enrolment ratio is the ratio of enrolled children of the official age for the education level indicated to the total population of that age. Net enrolment ratios exceeding 100% reflect discrepancies between these two data sets.
- g.In 2006 UNESCO Institute for Statistics changed its convention for citing the reference year of education data to the calendar year in which the academic or financial year ends – from 2003/04, for example, to 2004. Data for some countries may refer to national or UNESCO Institute for Statistics estimates.
- h.Enrolment ratios are based on the new International Standard Classification of Education, adopted in 1997 UNESCO (United Nations Educational, Scientific and Cultural Organization). 1997. “International Standard Classification of Education 1997.” Paris. [www.uis.unesco.org/TEMPLATE/pdf/isced/ISCED_A.pdf]. Accessed May 2006. . and so may not be strictly comparable with those for earlier years.
- i.Calculated on the basis of survival rates that may exceed 100% due to fluctuations in enrolment. Where such results are published, they should be interpreted as the country having a survival rate approaching 100%.
- j.Data show the ratio of the income or expenditure share of the richest group to that of the poorest. Because of rounding, results may differ from ratios calculated using the income or expenditure shares in columns 2-5.
- k.A value of 0 represents perfect equality, and a value of 100 perfect inequality.
- l.Estimates maintained by the Internal Displacement Monitoring Centre (IDMC) based on various sources. Estimates are associated with high levels of uncertainty.
- m.Data refer to the end of 2005 unless otherwise specified.
- n.Data refer to national literacy estimates from censuses or surveys conducted between 2000 and 2005, unless otherwise specified. Due to differences in methodology and timeliness of underlying data, comparisons across countries and over time should be made with caution. For more details, see <http://www.uis.unesco.org/>.
- o.Data refer to a year or period other than that specified.
- p.Preliminary UNESCO Institute for Statistics estimate, subject to further revision.
- q.Data refer to the 2003 school year.
- r.National estimates.
- s.Data refer to the 2002 school year.
- t.Data refer to the 2004 school year.
- u.Estimates are based on regression.
- v.Estimate excludes certain parts of the country or some groups of internally displaced people.
- w.In the absence of recent data, estimates from UNESCO (United Nations Educational, Scientific and Cultural Organization) Institute for Statistics. 2005. Correspondence on adult and youth literacy rates. March. Montreal. , based on outdated census or survey information, were used and should be interpreted with caution: Bangladesh 33.1, Cape Verde 70.8, Comoros 49.7, Congo 80.8, El Salvador 78.8, Mozambique 35.6, Nigeria 64.2, Samoa (Western) 98.4, Trinidad and Tobago 98.3, United Arab Emirates 82.7, Uruguay 98.4, Uzbekistan 99.1, Yemen 33.4 and Zimbabwe 86.3.
- x.In the absence of recent data, estimates from UNESCO (United Nations Educational, Scientific and Cultural Organization) Institute for Statistics. 2005. Correspondence on adult and youth literacy rates. March. Montreal. , based on outdated census or survey information were used, and should be interpreted with caution: Bangladesh 51.7, Cape Verde 86.6, Comoros 63.9, Congo 91.2, El Salvador 83.6, Mozambique 65.7, Nigeria 96.9, Samoa (Western) 98.9, Trinidad and Tobago 99.2, United Arab Emirates 76.8, Uruguay 97.5, Uzbekistan 99.6, Yemen 72.5, Zimbabwe 93.8.

Source:

UNDP (2007), Human Development Report 2006 at http://hdr.undp.org/hdr2006/statistics/build_your_table/default.cfm
For details of sources for each indicator, see UNDP (2007)

Table 6: Selected human development indicators by sector and province (%)

	Child Malnutrition		Primary Education Completion Rate		Under five mortality rate		Infant mortality rate		Maternal mortality rate	Proportion of households with access to safe drinking water	Proportion of households with access to improved sanitation	Proportion of households with access to electricity
	2000		2002		2002		2002		2002	2001	2001	2003/04
	Males	Females	Males	Females	Males	Females	Males	Females				
Sri Lanka	29	30	94.7	96.5	14.9	12.0	12.9	10.2	14.4	82.0	67.5	74.9
Sector												
Urban					18.7	14.9	16.9	13.1	13.3	95.9	77.8	
Rural					7.6	6.4	5.2	4.6	13.8	81.2	67.5	
Estate					22.1	20.6	16.4	15.7	88.1	61.0	43.2	
Province												
Western	19	23	98.7	99.5	15.6	12.2	14.0	10.5	9.0	91.5	77.6	92.4
Central	37	38	95.2	96.7	18.2	14.5	16.1	12.4	18.1	78.3	56.6	72.7
Southern	24	33	94.4	96.9	10.3	7.4	9.3	6.7	14.8	80.5	72.3	78.4
Northern			88.6	90.7	10.5	8.7	7.6	6.1	13.3			63.6
Eastern			90.3	92.9	15.0	11.4	10.6	8.1	19.1			65.6
Northwest	31	33	95.1	97.6	12.5	11.1	10.8	9.6	10.3	87.9	69.6	68.5
North Central	28	33	96.2	98.1	20.3	17.5	18.6	15.8	13.1	80.5	49.7	62.0
Uva	40	38	92.8	94.7	16.0	12.2	14.4	10.8	28.7	67.9	50.9	56.7
Sabaragamuwa	39	22	95.3	96.1	15.0	13.6	12.7	11.4	17.0	63.8	66.1	64.7

Source: Child malnutrition rates from World Bank (2005). Access to electricity from Central Bank of Sri Lanka (2007); other statistics from Department of Census and Statistics (2005)

Notes: Child malnutrition defined as percent of children who are moderately or severely underweight.

Table 7: Poverty Rates by Industry, Education and Occupation of Household Head, 2002

	Poverty Incidence
	(%)
<i>Industry of employment of household head</i>	
Agriculture, forestry and fisheries	40
Manufacturing	21
Construction	27
Wholesale and retail trade	16
Hotels and restaurants	20
Transport and communications	16
Financial intermediation and real estate	10
Public administration and defence	5
Education	2
Health and social work	7
Miscellaneous labour work	45
Not adequately defined	27
<i>Education level of household head</i>	
No schooling	45
Primary (grades 1-5)	34
Junior secondary (grades 6-9)	21
GCE O' Levels	7
GCE A' Levels	2
Graduate	1
<i>Occupation category of household head</i>	
Senior officials and managers	1
Professionals	3
Associate professionals	5
Clerks	5
Sales and service workers	11
Agricultural, forestry and fisheries workers	34
Craft and related workers	25
Plant and machine operators	16
Elementary occupations	38

Source: World Bank (2005)

Figure 1: Map Showing Sri Lanka's Provinces



¹ Excluding the Northern and Eastern Provinces since the data used for the estimations excluded the conflict zone.

² The method used by Gunatilaka and Chotikapanich (2006) to calculate the Gini coefficient is different from that used in the World Bank study. Hence they found that inequality rose faster in the 1990-95 period than in the period 1995-2002. Nevertheless, their findings on the contributory causes throw further light on the reasons why inequality in Sri Lanka rose during this period.

³ Central Bank of Sri Lanka, Press Release, 13 July 2007.