

NATIONAL ECONOMIC DEVELOPMENT OF SRI LANKA: AN UPDATE

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When Sri Lanka gained independence in 1948 the country had achieved a reasonable level of socio-economic development and was commended as a country that had the best chance, compared to its neighbours, for a prosperous economic future (Kelegama, 2006; Lal and Rajapathirana 1989). On the political front, it evolved as a parliamentary democracy based on the Westminster model although the record of democratic governance of the country has been strained to some extent during the last two decades.

Socio-economic indicators of post-independent Sri Lanka have been more in line with those of a developed country despite its per capita income representing the characteristics of a developing country. With 19 million people, Sri Lanka has maintained a literacy rate above 80% and an average life expectancy above 70 years which is a remarkable achievement in a developing country. In 2006, Sri Lanka was categorized as a “lower middle income country” by the World Bank with a per capita income of US\$ 1335 (Central Bank of Sri Lanka 2006). Despite this record, the country has not been able to maintain reasonable economic growth compared to its potential.

This problem has become more obvious as the country’s economic growth experienced a considerable fluctuation over time. Further, current socio-economic indicators show that while inequality between rich-poor and urban-rural areas is widening, nearly 23 percent of people still live under the national poverty line. This indicates that the most vulnerable sectors of the economy have been left out from the main stream of economic development (Ishil 2007; Samaratunge 2000; World Bank 2005 & 2002). Political and economic consequences of these developments have been so overwhelming that Sri Lanka has witnessed two youth uprisings, first in the early 1970s and then the late 1980, followed by the ethnic problem that has led to ongoing civil war and political turmoil since the 1980s (Jayasuriya 2000).

It is argued that Sri Lanka should be able to perform better not only because of the better opportunities it already possesses, but also due to the new avenues opened by

globalization. Small economies such as Sri Lanka often succeed at globalization when they are able to combine economic competitiveness, continual innovation and increasing higher value-added production with strengthening of human development (Brautigam, and Woolcook 2001). In practice, Sri Lanka represents a story of missed opportunities (Kelegama 2000; Lakshman 1997; Wijewardena, 2006). Therefore, the attempts on national development in Sri Lanka should be looked at in the perspectives of the country's record of socio-economic development together with its development prospects and challenges. This article analyses important aspects of economic development so that socio-economic outcomes of the country could be better understood. As the country radically turned to a new development strategy direction with an extensive liberalisation program in 1977, this article mainly focuses on the period since this time. The key challenges the country faces in relation to its economic development are briefly presented.

Economic Development: the Experience of Sri Lanka 1977-2006

The economic performance of Sri Lanka has been reviewed from different perspectives (Athukorala and Jayasuriya 1994; Danham and Jayasuriya 2001; Institute of Policy Studies 1993; Kelegama 2006 & 2000; Sandaratne 2005 & 2000; World Bank 2002 & 1994). The period after 1977 has been a testing time for the country because Sri Lanka became the first South Asian country to embrace liberalisation-led growth abandoning the regime of state-controlled, closed economic model it pursued previously (Athukorala and Jayasuriya 1994). The policies under liberalisation encouraged private sector participation in economic activity, pioneered a number of large-scale public investment projects with foreign assistance and created a favourable policy regime for foreign investment.

Though elected on a promise to continue the extensive system of food subsidies implemented by colonial rulers, the government in 1977 chose to abandon welfarism that had long been demanded by the business community, foreign investors and leading international financial institutions. This dramatic change was made possible by the magnitude of the government's parliamentary supremacy and its willingness to placate the demands of the global investment community and the international financial agencies. The World Bank was particularly forthcoming in its willingness to provide the government with inducements to encourage it to embrace a pro-export oriented development strategy facilitating a significant increase in foreign loans and aid from 1977 which continued through to the mid 1990s reaching 56.6% of GDP by 1995 with the Bank being the primary contributor (ADB 1997).

With the relaxation of economic, administrative and foreign trade restrictions, the economy responded positively and GDP growth increased significantly from 3% in 1976 to 8.2% in 1978. However, a rather unsatisfactory feature of this period is that the economy was unsuccessful in realising early beginners' advantage and failed to maintain the annual growth rate it attained after the reforms. The average annual GDP growth rate during the thirty year period between 1975 and 2005 has never reached beyond 5.5%. In contrast, the annual GDP growth rate of a number of other countries in the Southeast Asian region increased significantly achieving 7 to 8% growth rates since the 1980s (ADB 2007; Porter 2006). It shows that Sri Lanka has missed the opportunity in realizing the much anticipated benefits of the liberalisation program. It is noteworthy that in 2001 for the first time in its history, Sri Lanka experienced a negative growth rate at -1.5% (Central Bank of Sri Lanka 2003). Subsequently, Sri Lanka has achieved only a modest average annual growth rate which is slightly above that of pre-liberalisation period.

Sri Lanka, which was predominantly an agricultural economy, has witnessed structural and qualitative transformation since 1977. The diversification which was very gradual until the late 1970s gathered momentum with the introduction of liberalisation policies in 1977. In 1995 the industrial sector overtook the agricultural sector in terms of contribution to GDP. Much of the investment that increased in the post-reforms period went to the manufacturing sector. The service sector which accounted for 55.8 percent of GDP in 2005 has shown a marked expansion over the last two decades. The telecommunication sector has been at the forefront of this growth performance, reflecting increasing private sector participation. The expansion of banking activity, the tourist industry, trade, real estate and regional container traffic are the other key sectors that have contributed to steady growth of the service sector (Central Bank of Sri Lanka 2005).

As Table 1 reveals, the share of total employment in the agriculture sector has declined gradually during this period. The share of total employment in the agriculture sector has reduced from 38% in 1996/97 to 33% in 2003/04 while total employment in the services sector has increased from 37 percent in 1996/97 to 41% in 2003/04 (Central Bank of Sri Lanka 2005)

Table 1: Employment by Production Sector: 1963-2004 (Percentage of employed)

Production sector	1973	78/79	81/82	86/87	96/97	03/04
Agriculture	54.5	48.3	51.2	47.7	37.7	32.8
Industry	11.7	20.9	19.5	21.6	25.6	26.0

Services	33.8	30.8	29.3	30.7	36.7	41.2
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Sources: Central Bank of Sri Lanka, Consumer Finance & Socio Economic Survey Report 2003/04 –Part 1 & Annual Report 2005

One of the most important objectives sought through market oriented economic reforms in Sri Lanka was a rapid creation of employment opportunities. In the 1970s the country experienced an unemployment rate of nearly 20%. With the beginning of export-oriented industrialisation and the launch of a number of large construction projects such as accelerated Mahaweli program through foreign assistance, the rate of unemployment declined to 12% in 1981/82 (Lakshman & Tisdell 2000). The private sector has been the key sector generating many of the employment opportunities. With the increased number of export-oriented industries, particularly in the garment sector there has been a rapid expansion of female labour force participation rate. The share of females in the labour force increased from 26% in 1981 to 35% in 2002 (Central Bank of Sri Lanka 2003). With the increasing demand for skilled and semi skilled labour in the global labour market, Sri Lanka has experienced a significant outflow of labour since 1980. Its impact on the country's economy has been dramatic.

Both internal and external factors were responsible for the failure of the economy to sustain the growth momentum beyond a short period. Important external factors include the world recession and the second oil price hike. The Central Bank of Sri Lanka observed that the increasing oil price since 2000 has become a key factor affecting the current account balance problems in the country (Central Bank of Sri Lanka 2005). While the reduction of commodity prices in the world market seriously affected the revenue of key agricultural exports of the country, prices of the major imports such as food commodities and intermediate products increased significantly creating a considerable burden for the balance of payments and domestic prices in Sri Lanka. The country's narrow export-base with garments and tea accounting for two-thirds of merchandise exports further exacerbates the problem.

Internal disturbances due to aggravating ethnic crisis that has been going on since the early 1980s and civil unrest in Southern Sri Lanka in the 1980s have impacted the economy through the disruption of economic activities, fall in tourism and reduced foreign investment. Ethnic and political conflicts that surfaced in the early 1980s reached crisis proportions in the following years leading to a sharp increase in defence expenditure from 1.2% in 1978-82 to 5.5 percent in 2003-2006 (Central Bank of Sri Lanka 1980 & 2006). This has been at the cost

of a decrease in economic growth declining from 6.2 to 5.1% due to the ethnic violence in the North and subsequent serious socio-economic upheaval in the South in the 1980s. This also created negative implications for the economic growth prospects in the long run.

Natural causes further exacerbated the fluctuation of economic growth as it was reduced to as low as 3.8% in 1996 due to prolonged drought, which not only affected domestic agriculture, but also created an energy crisis that disrupted industrial production (Central Bank of Sri Lanka 1998). The Tsunami in 2004 also proved to be a devastating blow to the economy of the country.

Economic Development: Lessons from Experience

The case of Sri Lanka shows that the high expectations of the economic reforms in 1977 have not been realised even though the country has benefited from the new economic strategy. As Table 2 reveals, Sri Lanka stands well above comparable developing countries and is on par with many developed countries and has already achieved several of the Millennium Development Goals (Central Bank of Sri Lanka 2006). However, these overall outcomes did not seem to have made a significant impact on social well-being of a large proportion of the population. As World Bank (2005) observes:

The economy grew at a healthy rate over the past decade but failed to benefit the poor. 23% of people still live under the national poverty line. Between 1990/91 and 2002 per capita consumption increased by 29% in real terms. The average consumption for the richest 20% of the population increased by 50%, while that for the poorest 20% barely increased by 2%. Inequality between urban and rural areas has been also widening with residents in rural/remote areas being left out of benefits from economic development.

Table 2: Social Indicators for South Asian Countries

	Sri Lanka	India	Pakistan	Bangladesh	Nepal	Bhutan	Maldives
Human Development Index (HDI)	0.755	0.611	0.539	0.530	0.527	0.538	0.739
Rank on HDI (of 177 countries)	93	126	134	137	138	135	98
Life expectancy, years	74	64	63	63	62	63	67
Literacy rate %	91	61	50	41	49	47	96
Infant mortality, per 1000 live births	12	62	80	56	59	67	35
Telephones per 1000 persons	51	41	30	6	15	33	98

Source: UNDP, Human Development Report 2001

In 2002, the poorest 10% of households received 1.7% of total household income while the richest 10% received about 38.6%. It is noted that the income share received by the poorest 10% has become smaller, while that of the top 10% increased during the period of 1990-2002 (ADB 2007; Central Bank of Sri Lanka 2004). The grim reality of this development is that in terms of income inequality, the relative position of the poor has fallen over the past few decades and hence the economic reforms pursued during this period have been more beneficial to the well-off classes despite a number of programs which have been implemented focusing on reducing poverty.

Rising regional income disparities have been another negative aspect of increasing income inequality. Table 3 shows that the national income is concentrated mainly in the Western Province. The province generated 50.9% of GDP in 2005 increasing from 43.7% in 1996. All other provinces in comparison have earned relatively poor shares of GDP and these shares have not significantly increased over this period. It could be argued, therefore, that while GDP may be rising in Sri Lanka, this growth is not being transformed into poverty

reduction as the share of the growth that should go to the poor is not significant enough, and in addition, is also falling.

Table 3: Regional Income in Sri Lanka 1996-2005 (Per capita GDP in Rs)

(Percentages of GDP)

Province	1996	2003	2004	2005
Western	43.7	49.7	51.4	50.9
Southern	9.0	9.9	8.9	8.9
Sabaragamuwa	9.0	6.0	6.4	6.3
Central	10.0	8.6	9.2	8.4
Uva	5.1	4.1	4.3	4.4
Eastern	4.8	6.1	4.9	4.8
North Western	11.3	9.2	8.5	8.9
North Central	4.6	3.7	3.6	4.3
Northern	2.4	2.8	2.9	3.0

Source: Central Bank of Sri Lanka, Annual Reports

The problem of governance in Sri Lanka has been a key issue causing much concern since the 1980s. With a clear majority in the parliament, the new government elected in 1977 introduced a number of reforms related to governance. The main purpose of these changes was to promote the active participation of civil society in decision making at all levels of the government. However, it appears that the absolute majority (a two-thirds majority) in the parliament severely challenged the country's longstanding democratic practices and serious problems relating to public accountability started to emerge in Sri Lanka. Elections were delayed and widespread allegations of vote rigging at elections have become the common practice in the country's political culture. In 1982, the ruling party extended the life of the parliament through a referendum which was 'the most dramatic change in political practice in Sri Lanka since independence' (Manor 1984: 1).

In 1987 the Sri Lankan government introduced the provincial council system, partly in an effort to end the civil war. Financial autonomy is the key factor for effective decentralization of any kind and the provincial councils were allowed to raise limited income

through selected taxes. However, the provincial councils were poorly financed and the national government has blocked independent income sources by ‘the continued decline of capital grants to PCs [Provincial Councils] in both absolute and relative terms’ which were in place (Gunawardena et al. 1996: 29) and consequently the councils failed to achieve their main aim of creating a more responsive customer-focused government.

On the economic front, Sri Lanka has pursued an extensive privatization program since 1980s (Kelegama 2000). The process of privatization and contracting out of services came under heavy criticism because of extensive delays in granting contracts on the one hand and for a lack of transparency on the other. Hulme and Sanderatne (1997) point out that the sale process allowed the handover of these publicly owned business entities to companies which have a close relationship with the government. Both bureaucrats and politicians gained ‘unofficial commissions’ and corruption was institutionalized (Dunham & Jayasuriya 2001). Overall, privatization has had only limited success, ‘largely because of inadequate institutional arrangements to enforce smooth financial transactions and the absence of minimal safety nets for retrenched workers’ (Samaratunge & Bennington 2002: 94).

With the increasing intensity of ethnic conflict, defence expenditure increased rapidly and significantly eroded the country’s financial discipline in a number of respects. Expenditure on defence was deliberately underestimated as a government strategy to maintain the budget estimates within prescribed IMF/World Bank limits (Hulme & Sanderatne 1997) and ‘there is no proper accounting nor auditing of the monies spent in the purchase of armaments’ (Gunaratne 1990: 8) Furthermore, public accountability has been weakening over time due to a lack of institutional capacity and insufficient Parliamentary oversights (World Bank 2000). Law enforcement mechanisms are weak or heavily politicized, undermining the implementation of different accountability measures (Fernando 2002). The media has performed well below expectations with government control having increased. International development agencies have expressed their great concerns about the lack of transparency in the public sector (ADB 2004 & 2000; World Bank 2000).

The democratic process, particularly elections, was suspended and Sri Lanka’s reputation as a law-abiding country has gradually deteriorated. The media was restricted by government control in the 1970s and subject to state harassment since the late 1980s (Hulme & Sanderatne 1997). Independent pressure groups that focus on public finance are virtually non-existent. The public display little interest as long as welfare expenditure is not openly threatened, and there is little evidence that those who are negligent or corrupt have been penalised in any significant manner.

A strong relationship between the state and the civil society has been one of the main objectives in improving governance and decentralization. In Sri Lanka decentralisation policies have emphasised increasing participation of disadvantaged groups in decision making. Outside the formal political system of the country, there is an elaborate network of institutions providing for participatory democracy. Workers' councils and people's committees were constituted on a regional basis. However, the center-driven policy formulation and direct control of its implementation at the local level have provided an environment for both national politicians and bureaucrats to play a dominant role in society, undermining the role of the civil society in the development process. The partnership between the state and the civil society has become a patron-client relationship. During the last three decades the country has witnessed weakening quality of governance, increasing corruption, lack of civil society participation in development process together with deterioration of socio-economic conditions. Overall, outcome of these developments are extremely devastating.

Conclusion

Nearly 60 years after independence, Sri Lanka still struggles with issues of development and social inequalities. It is noted that even the moderate growth the country has been able to achieve has not spread amongst the masses as expected. Rather income has been concentrated amongst an elite few. Sri Lanka is still basically a rural economy with the majority of people living in rural areas engaging in rural livelihoods. The country needs to invest in building up its infrastructure, mainly the road and railways networks, modernize its education and health care systems, create new markets in a bid to boost regional development and allow the fruits of development to penetrate the regions. Sri Lanka has yet to clearly identify any areas in which it can solely specialize in and capture the international market.

Even though Sri Lanka has gone for gradual economic liberalization, the economy is still more protected than in countries which started liberalization much later. Despite continuing commitment to liberalisation and privatisation, the state plays a major role in key economic activities. In terms of social policies, it appears that the country attempts to maintain the long tradition of protecting acquired rights, and encouraging patronage, rather than stimulating market-based creation of opportunities. Instability, favoritism and violence characterize the political climate in Sri Lanka. Party politics has become the norm of all socio-economic activities. Unless Sri Lanka addresses these weighty issues promptly, its vision of realizing a newly industrialised country status will remain just another unfulfilled dream.

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