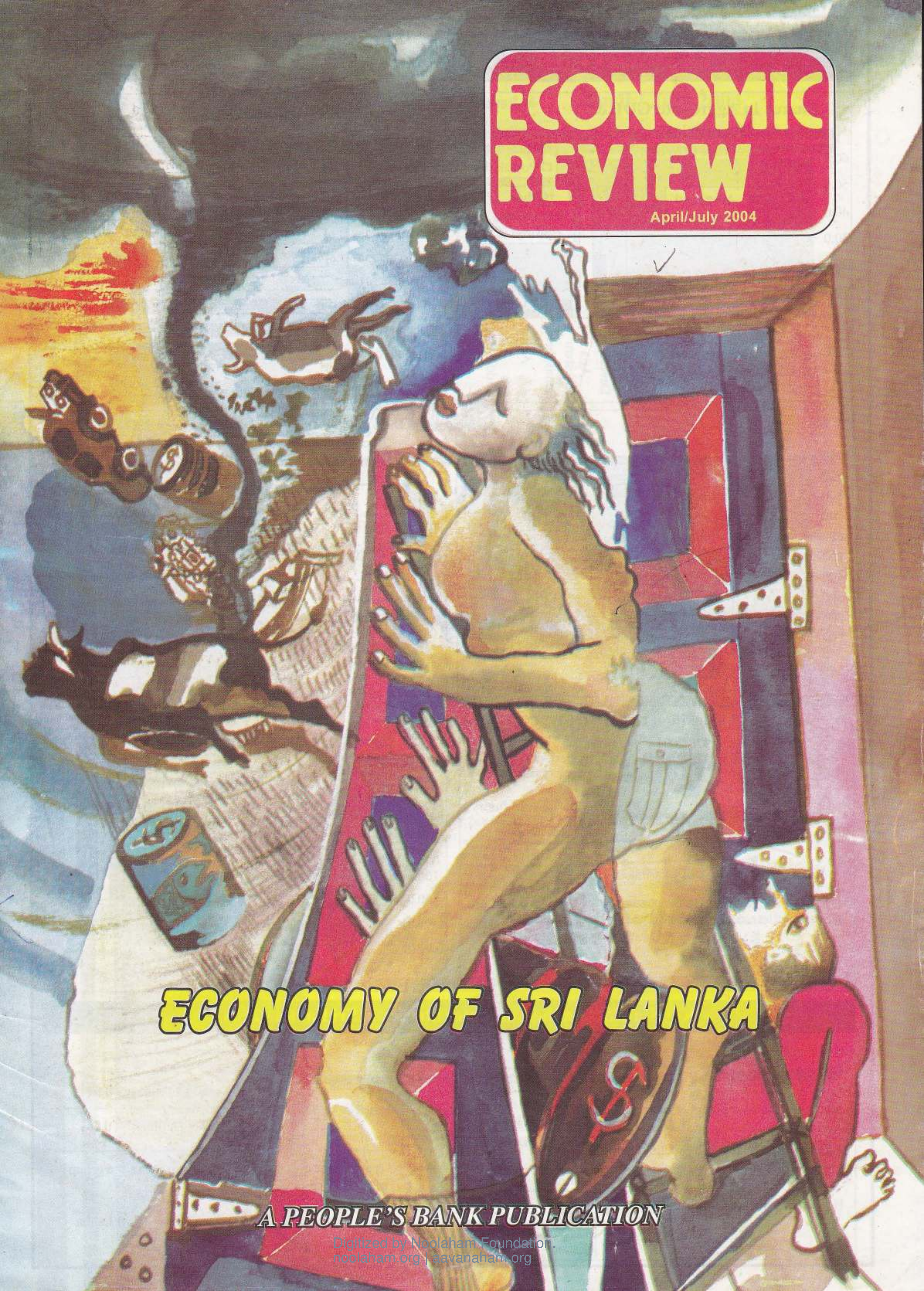
ECONOMIC REVIEW

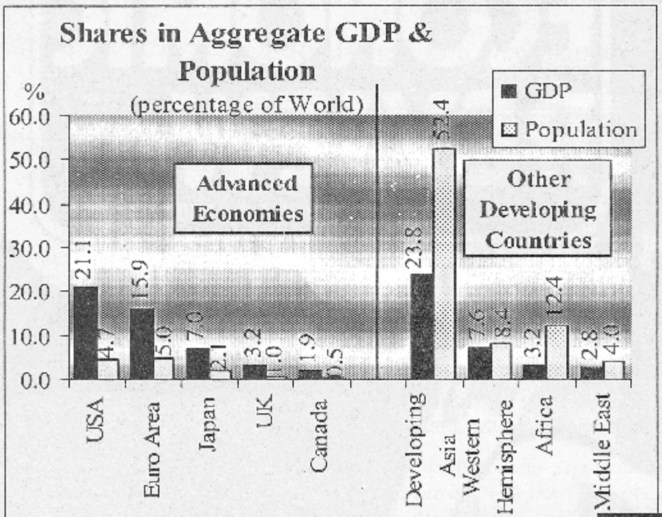
April/July 2004

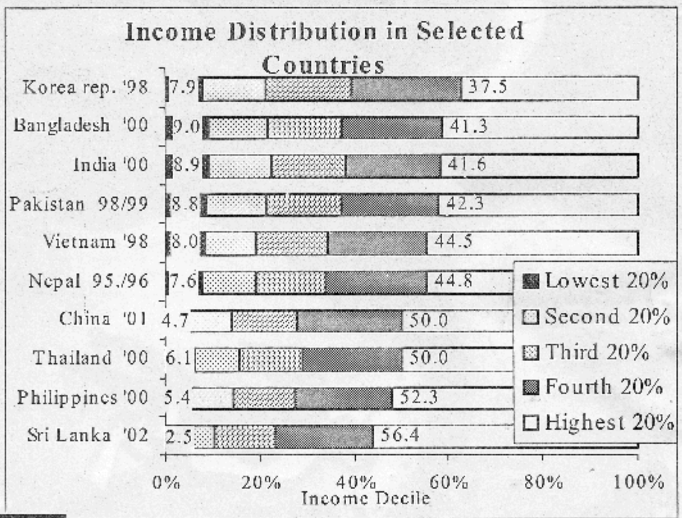


ECONOMY OF SRI LANKA

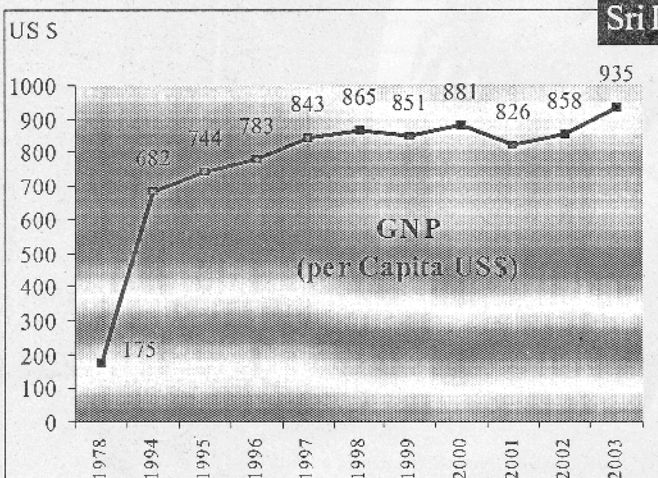
A PEOPLE'S BANK PUBLICATION

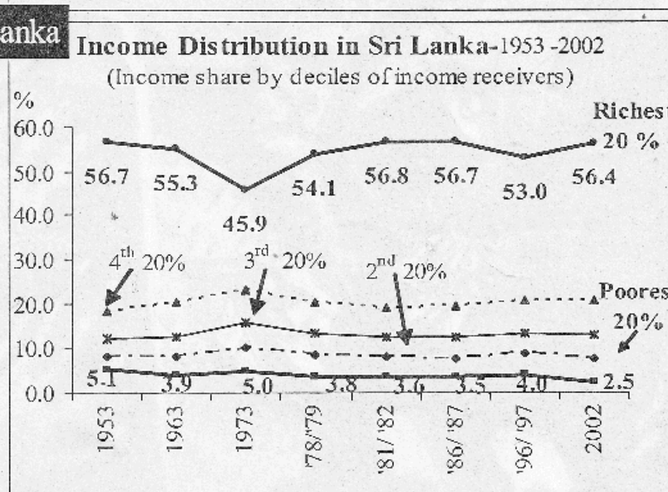
ECONOMY OF SRI LANKA - AT A GLANCE





Sri Lanka





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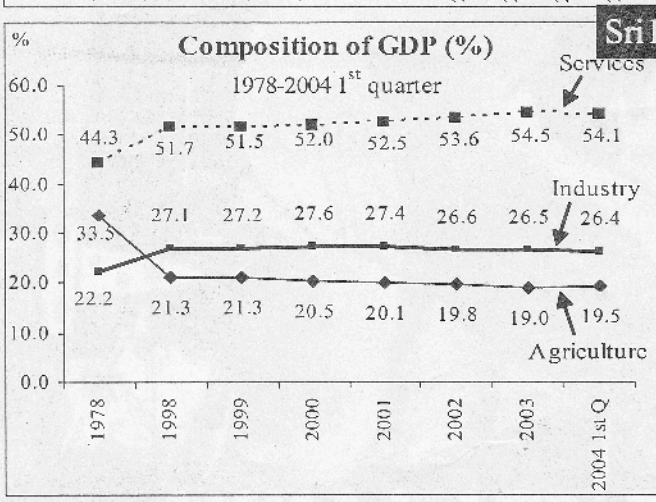

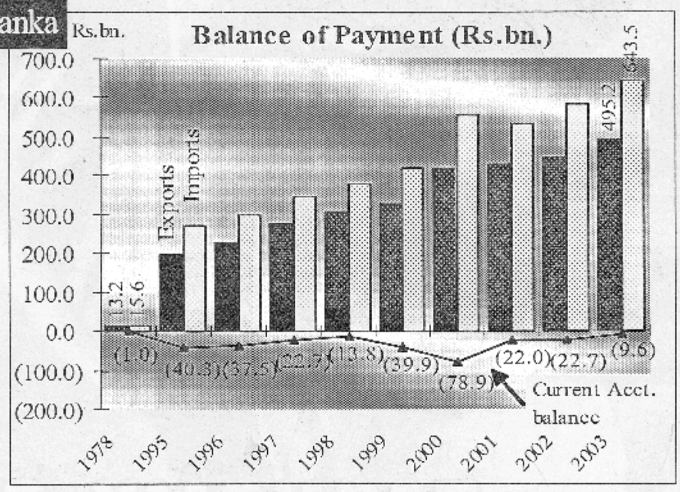

Key Statistics on the Computer literacy in Sri Lanka - 2004

Computer Literacy *1		9.7%
Awareness on Computers & their applications*1		18.2%
No computers but strongly feeling the need		36.1%
Households having Computers	National	3.8
	Urban	10.5
	Rural	3.1
	Estate	0.3

Households having	e-mail facilities	0.9%
	internet facilities	0.7%

*1 (percentage of household population in the age group of years 5 - 69)

Source: Department of Census & Statistics - Sri Lanka

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CONTENTS

COLUMN / FEATURE

	02	Diary of Events
Dr. G.Mahinda Henegedara	28	Rapid Economic Growth and Develaopment in China: An overview of Chinese Economy

SPECIAL REPORT

ECONOMY OF SRI LANKA

Ananda Silva	04	An Analysis of Trends in Key Macroeconomic Aggregates: In Post Independent Sri Lanka
Rev. (Dr). Wijitapure Wimalaratana	09	Benefits of R egional Economic Intergration in the Global Age
Dr. Sirimal Abeyratne	15	Development Models of Sri Lanka: An Overview
Rukmal Abeywicrama	19	Sri Lankan HDI – Comparison with other Developing Countries
J.H.J. Jayamaha	20	Foreign Aid and North East Rehabilitation
Sunil Thenabadu	25	Harnessing Human Resources in the Development Process: A Sustainable Solution to Unemployment and Poverty

Next Issue
Coconut Industry

THE ECONOMIC REVIEW is intended to promote knowledge and interest in the economy and economic development process by a many sided presentation of views and reportage, facts and debates. THE ECONOMIC REVIEW is a community service project of the People's Bank. Its contents however are the result of the editorial considerations only and do not necessarily reflect Bank policies or the official viewpoint. Signed feature articles also are the personal views of the authors and do not represent the institutions to which they are attached. Similar contributions as well as comments and view points are welcome. THE ECONOMIC REVIEW is published bi-monthly and is available both on subscription and on direct sale.

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Diary of Events

July 2001

The Department of Census and Statistics conducted a Census of Population and Housing on 17th July after a lapse of 20 years. The 2001 Census covered only 18 out of 25 districts due to the security situation in the North and East.

August

Following an attack on the Katunaike Airforce base and the International Airport on 24th July, landing charges were waived for all foreign aircrafts that bring more than 200 passengers to the country. This was to remain in force until 31st December 2001.The estimated revenue loss was around Rs. 20 million a month. In the immediate aftermath of the attack a number of airlines either suspended or curtailed operations to Colombo.

October

The Central Bank of Sri Lanka reduced the overnight Reverse Repurchase Rate from 15.00 percent to 14.00 percent and Repurchase Rate from 13.00 percent to 12.00 percent effective from 17th October.

G.T.L.Global Park, the first and largest logistics centre in South Asia, was opened in Seeduwa on 18th October. The B.O.I approved U.S. $.9 million joint venture will house 365,000 square feet of warehousing space in a 13 acre site.

November

Asian Development bank (ADB) approved a loan of SDR 19.3 million (US $ 25 million) for the Southern Province Rural Economic Advancement project. (REAP)

The Ministry of Education and Higher Education launched a national Policy to introduce Information Technology to the school curriculum.

December

The port tariff rates for all imports and exports, including essential goods, were reduced with effect from 1st December. Under the revised rates, tariff on flour and fertilizer were reduced from U.S. $ 51.75 per ton to U.S. $.38 per ton and for textiles from U.S. $ 145.50 per ton to U.S. $ 80 per ton.

The Government of Sri Lanka and Japan signed an agreement to provide for a grant of 481 million Yen (approximately Rs.356 million) for the improvement of the Nuwara Eliya Water Supply System.

The Government of India agreed to provide Sri Lanka with 300,000 metric tons of wheat over a twelve month period in terms of an agreement reached between the two countries at the conclusion of the Sri Lankan Prime Minister's three day official visit to India.

January 2002

As a part of the new Government's 100 day programme the state sector banks agreed to Suspend Parate Executions for a period of six months in respect of loans taken by micro industries and individuals.

February

The Government's remaining 19 percent stake in Talawakelle and Malwatte Plantation Companies was sold at the trading floor of the C.S.E fetching Rs.111.7 million.
The Government stipulated a guaranteed price of Rs.13.50 per kilo of paddy.

Sri Lankan Airlines agreed to grant a concession of 20 to 30 percent on airfares to Middle East job seekers, effective from 1st February.

The government withdrew the National Security Levy on wheat, wheat flour and bread effective from 22nd February.

The Jaffna-Kandy Road (A9 Road) was reopened up to Killinochchi.

March

The Central Bank increased the limit on the daily net open position (n.o.p) of commercial banks from 10 percent of Capital Reserves to 15 percent. The limit on the duration of foreign exchange forward contracts was extended to one year to improve the flexibility and stability in the foreign exchange market.
MTN network, the second largest telecom operator in the country whose holding company is Telekom, Malayasia, received an eight year syndicated loan of US$ 21 million, and the underwriters were Citibank N.A. Commercial Bank of Ceylon, N.D,B , N.S.B, and the D.F.C.C.
The UNF Government's maiden budget was presented by the Finance Minister on 23rd March in Parliament. The budget also proposed to replace the Goods and Services Tax (G.S.T.) and National Security Levy (N.S.L.) with a value Added Tax (V.A.T.).

An agreement was signed between the Governments of Japan and Sri Lanka, providing Japanese Yen 506,000,000 (approximately Rs.359 million) to purchase laboratory and engineering equipment for the University of Moratuwa, and a further Yen 3.5 million under the Japanese Government Debt Relief Grant Fund.

The Cabinet endorsed the continuation of the Upper Kotmale Hydro power project supported by the Japan Bank of International Cooperation. The project, which is expected to be completed in 2008, will generate 120 M.W.

April

The Ceylon Electricity Board (C.E.B.) announced an increase of 35% in electricity tariffs, effective 1st April.

The stamp Duty was removed on 30th April.

The first ever Sri Lankan manufactured car named "Micro" was launched. The car is aerodynamically designed with seating capacity for five, and dual facility for gasoline and L.P.Gas.

The Central Bank of Sri Lanka delegated the function of clearing of cheques to Lanka Clear Ltd, Which is a limited liability company.

May

The power cut was totally removed effective 15th May, following heavy rainfalls in catchment areas, which increased generation capability.

At the C.S.E, the all Share Price Index (A.S.P.I) recorded its highest level in four years-685.1 points on 29th May, while the Milanka Price Index (M.P.I) rose to 1196.3 points-the highest point since its inception.

June

The Public Enterprise Reform Commission (P.E.R.C) commenced privatizing the Sri Lanka Insurance Corporation (S.L.I.C) by appointing a team led by Pricewaterhouse Coopers to advice on the sales process.

The Indian Oil Corporation (I.O.C.) and Ceylon Petroleum Corporation (C.P.C.) signed a Memorandum of Understanding (M.o.U.) on 12 June to the effect that the C.P.C withdrew 100 C.P.C owned retail outlets in favour of the I.O.C and will assist the I.O.C in reassigning the franchise outlets.

The privatization of Sevanagala Sugar Industries Ltd. was concluded on 28 June. Daya Apparel Export (pvt) Ltd. bought 90 percent of the shares for Rs.600 million.

The Government announced suspension of recruitment to the public service, Provincial Public Service, local authorities, public corporations, statutory boards, and all government owned companies.

July

Value Added Tax (VAT) Bill was passed without a debate in Parliament. Accordingly, it would come into force in August 2002.

John Keells Holdings Ltd. emerged as the clear shareholder in the bid to get 90 percent stake in the State owned Lanka Marine Services Ltd.

The Chinese government extended an outright grant of Rs.250 million and another interest free loan for Rs.375 million to Sri Lanka, to be repaid in 30 years.

August

Janashakthi Insurance Company Limited bought the remaining 39 percent stake of National Insurance Corporation Ltd. for Rs.287.5 million and acquired the full control of NICL. In June 2001, JICL acquired a 51 per cent stake of NICL for Rs.450 million and the government retained 49 per cent inclusive of 10 per cent share holding of the NICL employees.

October

Nation Trust Bank (NTB) took over the commercial banking and foreign exchange operations of American Express Bank (AEB) in Sri Lanka.

November

The second budget of the UNF government was presented in Parliament on 6 November. The overall estimated budget deficit was Rs. 134 billion.

The ADB approved a loan of US$ 95 million to the Road Development Authority (RDA) for the construction of the Colombo - Matara expressway which is to be completed in 2007.

December

Tokyo Cement Group, through its subsidiary Sanuoki Cement Company Lanka (pvt) Ltd, opened a modern bagging plant with an initial capacity of 600,000 tons per annum at the Colombo Port.

2003

January

The first Homoeopathic Hospital in Sri Lanka was commissioned in Welisara. The hospital with 20 beds was built at a cost of Rs.15 million.

February

The government decided to provide training to 8000 unemployed graduates under a programme jointly implemented by the Ministries of Labour and Employment and Tertiary Education and Training, with the assistance of joint business councils.

March

The Central bank implemented an Open Market Operating (OMO) system, as an instrument of monetary policy to regulate the volume of money in the economy. Accordingly, Repurchase and Reverse Repurchase Transactions will be conducted at rates of interest determined in the market.

April

The Agriculture and Livestock Ministry introduced a National Policy on Agriculture and Livestock, for duration of seven years with effect from 2003.

The agreement to hand over the management and shares of the six cluster bus companies which were divested to the private sector (IBIS of UK) was signed on 31 March. 39 per cent shares of six of the 13 CTB cluster bus companies were purchased by IBIS of UK in October 2002.

June

Cargills Ceylon Limited and Asia Capital Consortium were short listed by the Cabinet Appointed Tender Board as the successful two bidders in the CWE privatization deal. Bids to sell 40 percent of the share capital of the CWE Sathosa Retail Ltd were called for in November 2002 and was valued at Rs.400 million.

2004

July

Customs data for the period January - May 2004 confirms that a total of 118 million kilograms of tea was exported. This is an increase of 6% on the quantity of 112 Kg. shipped during the same period last year. Value of exports has grown 12.5% to Rs.27.9 bn. Over the 2003 figure of 24.9 Bn.

The 45th meeting of the World Tourism Organisation (WTO) for South Asia was held in Colombo on 6th July. The two day event was hosted by the Sri Lanka Tourist Board together with the Ministry of Industries, Tourism and Investment Promotion.

Sri Lanka and Vietnam recently agreed to encourage and facilitate individual or group travel by their citizens and those from third countries to Vietnam and Sri Lanka signing the Tourism Co-operation Agreement.

Former Hayleys chairman Sunil Mendis assumed duties as the Governor Central Bank of Sri Lanka on July 3rd for a term of six years. As Governor, he would function as the Chairman of the Monetary Board of the Central Bank.

Russia's leading Oil Company YUKOS, was brought to the verge of ruin to leaving a bailout by president Vladimir Putin's tax authorities. Yukos, which pumps more than two percent of the total world oil output.

Vega Nutritional, leading UK company in innovative complementary health products, launched the Vega brand in Sri Lanka in partnership with the Maharaja Organization at a ceremony held at Taj Samudra hotel. Vega Nutritional has appointed the Maharaja Group Company Harrisons Pharma as its sole distributor in Sri Lanka.

Researches from the National University Hospital in Singapore have revealed that tears could be a means of spreading SARS. Dr. Seng Chee Loon and his colleagues have found the virus in samples taken from tear ducts they analyzed from 36 patients suspected of being infected last year.

India has for the first time exceeded its revenue targets from the privatization of State run firms, according to the government's Annual Economic Survey tabled in parliament. The sale of stakes in six blue-chip state firms, including India's largest car maker Maruti and Oil and National Gas Co-operation, in the last quarter of the financial year had earned 141.35 billion rupees.

Courtesy : State of the Economy.

(Published by the Institute of Policy Studies)

An Analysis of Trends in Key Macroeconomic Aggregates In Post Independent Sri Lanka*

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Deputy Director,
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Central Bank of Sri Lanka.

Introduction

During the past few decades, there has been a significant change in the structure of the economy, particularly after the adoption of the more market oriented and outward looking development strategy in 1977. The country's dependence on the agricultural sector has gradually declined and the manufacturing and services sectors have emerged as the key driving sectors of the economy, which have provided increasingly more growth and employment opportunities over the years. Both foreign trade policy as well as external trade have undergone significant changes. The financial sector, which has expanded significantly, has facilitated the changing structures in many sectors. New areas such as tourism and worker remittances have emerged as important foreign exchange earners to the economy. Private sector participation in economic activity has expanded into many areas of the economy including areas like infrastructure, education, and health which were earlier dominated by the government, enhancing the growth prospects.

Responding to these changes, real GDP was growing by about 4-5 per cent during the last two decades despite the civil conflict. As successive governments have continued their efforts in providing free education and health services, and food subsidies, Sri Lanka is now on par or ahead of many middle-income countries in terms of many human development indicators. With the increase in domestic manufacturing and imports, the range of goods available to consumers significantly expanded. In addition, the expansion of the services sector, supported mainly by the reforms in the banking, telecommunication and electricity sub-sectors contributed to expand the quality of life.

Economic policy since 1977 has been broadly focused on maintaining an open economy and allowing greater private sector participation in economic activity. The major policy targets of successive governments were to achieve a higher rate of suitainable growth with greater provincial participation, low and stable inflation, low unemployment and more equitable distribution of income. However, largely as a result of the long-drawn civil conflict, and some policy slippages, developments as reflected in a number of mcaroeconomic aggregates indicate the necessity of re-ordering some of our priorities to achieve these objectives. Although the overall output has grown by about 4-5 per cent during the last few decades, this growth has been skewed with the benefits of economic growth accruing mainly to a few districts showing that there is sepos for higher growth if other districts also make equal conribution.The unemployment rate continues to remain high but there is a skill gap in the labour market. The incidence of poverty is another problem with at least one quarter of the country's population living below the poverty line. Budget deficits have been persistently high in most years, increasing the future debt burden, reducing resources available for economic activity undertaken by the private sector and increasing the pressure on interest rates. Reflecting the impact of supply bottlenecks, supply shocks and aggregate demand pressures, inflation continues to be high and volatile. The continuous deficit in the trade account which was not fully offset by the earnings in the services account, together with lower inflows to the government resulted in a deficit in the overall balance of payments during some years. The overall deficit in the BOP and higher domestic inflation as compared to trading partners resulted in the exchange rate continuing to depreciate vis-à-vis major international currencies. In addition to these macroeconomic imbalances, developments in the international economy necessitate the re-orienting and accelerating of the pace of internal transformation in the domestic economy. In the context of globalised market structure and the rapid advancement of information and communication technology, more efficient producers of high quality products would have greater ability to compete in international markets and derive higher benefits. At the same time, globalised markets offer new opportunities to attract foreign capital and technology, which could be used to supplement the rising needs of investments, particularly in the face of the decline in aid flows to the developing world. Therefore, in addition to domestic factors, fundamental changes in the international markets along with globalisation too require a re-examination of some of the policy priorities and implementation strategies pursued.

This paper presents the trends in key economic aggregates first followed by a discussion of some key areas that need to be focused in promoting growth prospects and challenges lies ahead.

2. Trends in Key Economic Aggregates

Economic Structure and Overall Growth

At the time of independence the economy was predominantly dependent on agriculture in terms of output and employment. The agriculture sector mainly constituted three agricultural export commodities, viz., tea, rubber and coconut and the production of paddy. Within the agriculture sector, paddy production has assumed much importance given that it provides the livelihood for a significant proportion of the population in the country, the majority of whom live in rural areas. The adoption of far reaching reforms in 1977 and subsequent reforms in many areas had a significant influence in transforming the country's trade and industrial and services sectors and reducing the share of agriculture sector.

The per capita GDP which was US$ 120 in 1950 reached US$ 899 by the year 2000, and increased further to US$ 947 by 2003. In 1997, Sri Lanka joined the Lower-Middle income-earning category of countries from the Low-Income category. As shown in **Table 1,** the overall economic growth has increased during periods that followed more liberal policies with greater private sector participation as compared to period that followed more inward looking policies.

Responding to the numerous attempts to industrialize the country by different regimes and following economic liberalisation, the share of industry has increased to 26 per cent of total output by 2003. Similarly, services which now accounts for 54 per cent of overall output, and provides employment to 43 per cent of the labour force. The expansion in trade, financial services including banking and insurance and telecommunication have been the main factors driving the growth in the service sector. The promotion of an efficient services sector is not only important in expanding employment and output but helps reduce transaction costs and increase convenience.

*The views expressed in the paper are those of the author and do not necessary report those of the Central Bank of Sri Lanka.

Table 1 : Changes in the Structure of the Economy

Period	Agriculture (%)	Industry (%)	Services (%)	GDP Growth %
1951-1960	40	[illegible]	40	[illegible]
1961-1970	[illegible]	18	44	4.4
1971-1980	28	27	46	[illegible]
1981-1990	27	[illegible]	50	4.3
1991-2000	[illegible]	27	50	5.2
2001-2003	20	26	54	3.0*

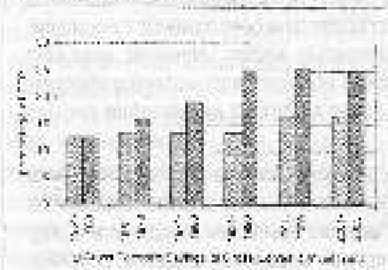
Source: Annual Report 2003, Central Bank of Sri Lanka
*Average growth of 2002-2003 only

However, the regional dimension of the overall economic progress has gained increasing attention as there is evidence that the benefits of economic growth are not distributed evenly across country. Also agriculture is still the largest employment sector of the country and its decreased contribution to the GDP and lower labour productivity are evidence of widespread underemployment in the sector.

Domestic Savings and Investment

Domestic savings of the country continue to remain low, and are not sufficient to raise investment to a level required to promote high sustainable growth. Domestic savings as a ratio of GDP has remained at around 15 per cent of GDP in the post independence period. After 1978, however, national savings have been higher than domestic savings, partly due to remittances of migrant workers.

Figure 1: Savings and Investment



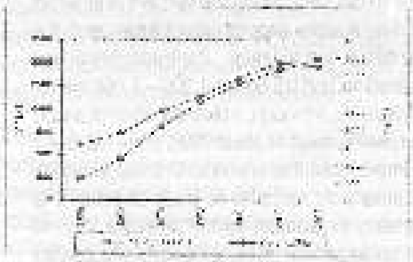
Total investment has increased gradually from an average of 15.8 per cent prior to 1977 to about 28 per cent during 1978-1984 as a result of the increase in investment by the private sector supported by foreign investment. Early 1980s marked the highest investment levels with both private as well as government investment increasing. This is mainly due to the government's large-scale infrastructure development projects. Since then, investment by the private sector tends to be closely related to the Civil war situation, and is seen by decreasing investments in the mid and late 1990s.

The investment as a ratio of GDP at present is around 21-22 per cent of GDP, which is very much lower than the more desirable level of about 30 per cent of GDP on a sustainable basis to achieve a higher growth of about 8 per cent. In addition to increasing the level investment, increasing investment efficiency is another factor that needs to be examined.

Agriculture

The agriculture sector plays a dominant role in the early stages of the development process in a country. As countries develop, the relative importance of the sector diminishes with rapid development of other sectors of the economy. This form of transformation occurs when the industry and services sectors grow at a faster pace than the agriculture sector. In Sri Lanka, the share of agriculture in GDP was 43 per cent in 1950. This gradually declined over the years and at present accounts for 19 per cent (2003). Simultaneously with this trend of transformation the share of labour force employed in agriculture too generally diminishes resulting in improving the productivity of labour. However, in Sri Lanka the migration of labour from Agriculture to Industry and services sectors have not kept pace with the development of those sectors. As a result a very high percentage of the total labour force continues to be employed in Agriculture.

Figure 2: Increase in Paddy Production and Yield



One of the main objectives of every government that came to power since the country attained independence was to achieve self sufficiency in rice. Food security concerns as well as the heavy import bill on account of rice imports induced successive governments to increase domestic rice production. State investments were directed towards both extensive and intensive cultivation practices. While increasing the irrigable extents, the governments were also conscious of increasing paddy production through intensive cultivation practices and by improving the productivity. In this respect, the Rice Research and Development Institute at Batalagoda was established in 1950 with a mandate to develop new high yielding rice varieties to replace the low yielding local varieties. Unlike the local varieties, the newly bred high yielding varieties were responsive to inorganic fertilizers. At present nearly 95 per cent of the extent is planted with New Improved Varieties bred at Batalagoda and the other rice breeding stations of the Department of Agriculture. As a result, Sri Lanka's average paddy yields improved dramatically and are presently higher than most of the countries in the region.

Even though Sri Lanka's paddy production per unit of land is higher than that of most of the rice exporting countries in the region such as Myanmar, Thailand, Pakistan and India the cost of production is much higher than in those countries. The main reason for the high cost of production is the small scale of production in Sri Lanka due to the fragmented nature of paddy lands.

At present, there is a severe shortage of labour for paddy cultivation especially during the peak labour demand periods like transplanting of paddy seedlings and the harvesting period. As a result most of the farmers have given up transplanting of seedlings. One alternative in addressing the issue of labour shortage would be to mechanise the cultivation process. However, mechanisation is not practical in most instances due to the fragmented blocks of land, which do not permit the benefits of economies of scale.

One way to overcome the problem of fragmented lands is to allow consolidation. For consolidation to occur, the farming communities should have alternative employment opportunities so that the people who do not wish to remain in agriculture could leave and dispose their lands. Then those who remain in agriculture could acquire those lands and have bigger plots which could reap the benefits of economies of scale.

Industry

With the change in policy emphasis, from import substitution to export oriented industrial development, particularly after 1977, the industrial sector has undergone significant structural changes. The average annual growth of the industrial sector which was 3.4 per cent during 1950-1977 rose to about 6.8 per cent in the period 1977-2003. As opposed to government intervention and state capital participation in industry, the expansion of private sector industries continued with the setting up of free trade zones, with the expansion of the apparel industry with the benefits of quota system. By 1990, the share of private sector industrial output was 60 per cent, and by 1995 it has increased to 91 per cent, 2003.

One of the major factors that contributed to the faster growth of the industrial exports after

Although the agriculture sector contributes 19% to GDP, agriculture, forestry and other agriculture [illegible] in the region [illegible] production [illegible] people depend on paddy production.

1977 was the growth of the industries coming within the purview of the Board of Investment of Sri Lanka. The growth of these industries also made a significant contribution of changes in the industrial sector. The share of the exports by companies coming under the BOI in the total industrial exports of the country increased from 8.7 per cent in 1980 to 83 per cent in 2003. This was mainly a result of the implementation of Two Hundred Garment Factory Programme, the expansion of BOI status to the whole island, establishment of mini export processing zones and implementation of Garment Factory Programme.

A major issue that would be faced by industrial sector, especially the export manufacturing sector in the nest millennium is the improvement of external competitiveness. This would first be seen in the apparel industry where quota system is to be phased out by 2005. The external competitiveness of a firm is the result of an excellent firm level strategies and industry leadership as well as a sound macro and micro economic environment. At firm level, competitiveness can be improved by improving technology, waste reduction, and efficient resource management and skill developments. The provision of adequate infrastructure is considered one of the major pre-requisites for industrial expansion. Industrial peace and the proper functioning of labour market without artificial barriers have been cited as one of the important factors in improving investor confidence.

The commercialization of research findings and innovations are also essential to the continuous expansion of productivity and competitiveness of the industrial sector. The availability of skill labour and trained managerial personnel is another major requirement for growth in the industrial sector.

External Trade - Exports and Imports

The structure of Sri Lanka's foreign trade probably marks the most significant structural change facilitated by more liberal external sector policies followed since the latter part of the 1970s. Restrictions on external trade were relaxed. The export licensing requirements were removed. Import controls and export duties were gradually removed. The tariff structure was rationalised to a significant

As a result of these changes, the export structure changed rapidly from an agricultural to an industrial exports base. In 1986, the share of industrial exports surpassed that of agricultural exports and reached about 75 per cent by 1995 but remained around the same level thereafter. Agricultural exports consist of around 19 precent of exports by 2003. While tea was the most important export from Sri Lanka until 1970s, garments took the place of tea as the largest export in the 1980s. The USA has emerged as the largest buyer of our garment exports, accounting for 61 per cent of total garment exports.

Table 3: Trade Dependency Ratios

Item	1970	1980	1990	2000	2003
Exports as a % of GDP	14.8	26.4	24.7	33.1	28.1
Imports as a % of GDP	17.1	20.5	33.5	44.1	36.6
Exports as % of world exports	0.12	0.06	0.06	0.10	0.07
Imports as % of world imports	0.13	0.10	0.08	0.13	0.09

Sources : CBSL Annual Reports International Financial Statistics - IMf

The structure of Sri Lanka's imports also shows a radical change. From the time of independence until the mid 1970s, most of the imports were forconsumption goods. However, with the development of the industrial sector, Sri Lanka began to import more of intermediate goods. Lack of domestic resources as well as imports of raw material for the garment sector have contributed to this.

Another development seen in international trade is that Sri Lanka's has entered into bi-lateral and multilateral trade agreements with several regional economies. The most important among these is the Free Trade Agrrement with India, which contributed to enhanceboth import and export trade with India. Since imports grew at a higher rate (of about 10 per cent during the last two and a half decades) thanthe exports (about 8 per cent) the trade deficit has widened. The trade deficit has remained around US dollars 1,200 – 1,400 million last fiveyears. Although, a diversification of export structure was seen till about 1990, there has been little improvement afterwards. In order toreduce Sri Lanka's vulnerability to trade shocks, it is necessary to promote further diversification of exports. In addition,exports markets should also be further diversified. These measures are particularly important now as the Multi Fiber Agreement expires by the end of 2004.

extent, thereby moving to a two-band tariff structureby 2000. However,some items were brought under different traiff rates thereafter.

Infrastructure – Economic and Social Infrastructure

Both economic infrastructure as well as social infrastructure are crucial for economic development. However, infrastructure bottlenecks have been a major constraint to economic development in Sri Lanka.

Until recently, the government has been the sole investor in the infrastructure sector. Public investment in economic services during the past five years averaged 4.5 per cent of GDP. Economic services absorbed over 66 per cent of the total capital expenditure of the government during the same period. The share of infrastructure services (electricity, gas, water, sanitary services and transport, storage and communications) in GDP has been about 12 per cent, which is comparable with other countries in the region. Over 300,000 direct employment (4.5 per cent of total employment) opportunities have been created in the economic infrastructure sector. However, even with decades of investments and policy changes, Sri Lanka's physical infrastructure remains

The public sector was the main provider of infrastructure facilities until the 1980s. As the demand for infrastructure services grew rapidly, along with expanding economic activities, particularly in the areas of passenger transport, power and telecommunications, it was recognized that the private sector too could participate in providing some these services competitively and efficiently. Accordingly, passenger transport, power generation and telecommunication sectors were opened up to private sector participation. However, various shortcomings still present in most infrastructure sectors such as supply shortages, managerial and financial inefficiencies, inadequate maintenance, and irrational pricing policy. Private sector participation in a competitive environment within an effective regulatory framework has now been recognised as one way for efficient provision of infrastructure services. Greater involvement of the government could then be restricted to core areas and to the areas where private sector participation is limited.

Table 2 : External Trade – Exports, Imports and Trade balance (In US$ million)

Item	1970	1980	1990	2000	2003
Exports	338.7	1,064.7	1,978.0	5,522.0	5,133.0
Imports	391.8	2,051.2	2,681.0	7,320.0	6,672.0
Trade Balance	-53.1	- 986.6	-703.0	-1,798.0	-1,539.0

Source: CBSL Annual Reports

Education and Health

Health

In terms of key health indicators, Sri Lanka stands well above comparable developing countries and is on par with many developed countries, mainly due to free health care services and other welfare programmes implemented by successive governments since independence. Expectation of life at birth has increased to around 73 years while infant mortality and maternal mortality rates have dropped to 13.2 and 0.2 per 1000 live births. Sri Lanka's Human Development Index (HDI) of 0.741 ranks Sri Lanka at 89 among 173 countries.

Insufficient quantitatively and qualitatively to cater to the expanding economic needs

Despite these achievements Sri Lanka faces a number of health sector issues. Among them, a high level of malnutrition among children and pregnant women, the resurgence of communicable diseases such as malaria and dengue, the increase in non-communicable diseases such as heart diseases, diabetes, hypertension, and mental illness, changing life style leading to substance abuse, depression, suicides and accidents, an aging population and the increasing health needs of the elderly and the disabled are threatening the future health status of the country. Also, problems in the health services obstruct the smooth functioning of the health sector. Prominent among these are problems in the curative health services such as lack of trained health personnel, weak management, lack of essential health infrastructure and equipment, deficiencies in health promotion, weak preventive health care services, unequal distribution of available resources, congestion in some hospitals and underutilization of some other hospitals. Insufficient financial resources are central to many of these problems. Another issue is the reduction of the expenditure in this sector although the quality and increased technology demand higher investment. The total expenditure on health by both the government and the private sector amounts to 3.5 per cent of GDP presently compared to over 8 per cent in developed countries. Government expenditure on health services stands at around 1.5 per cent of GDP.

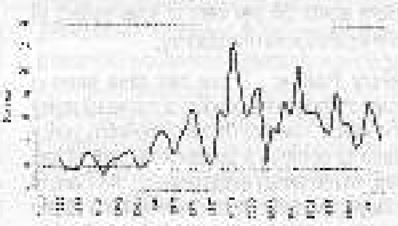
Education

Sri Lanka, being a developing country, has achieved a relatively high rate of literacy of around 90 per cent and stands on par with many developed countries on this aspect of human development. Government sponsored free education from grade 1 to university level, sufficiently high school density (a school per 6.7 sq. km), and other welfare programmes implemented for decades are mainly responsible for this achievement. However, this high level of literacy has not been translated into satisfactory learning achievements geared towards sustainable economic development. The qualities and attributes that are most sought after in the present day labour market are productivity, versatility and adaptability, leadership and team work, confidence to face challenges, positive work ethics and communication skills. These qualities are reported to be lacking in many students who complete secondary and tertiary education programmes. This indicates the need for extensive reforms in this sector to meet the skill imbalance in the economy.

Inflation

During the last few decades, inflation in Sri Lanka has been relatively high and volatile (Figure 2). The low inflation that prevailed in the early times began accelerating and peaked at 26 per cent in 1980. Since 1980, inflation has been declining, albeit with high volatility.

Figure 2
Annual Average Inflation in Sri Lanka
(Changes in CCPI)
1953-2003



The period after economic liberalisation witnessed relatively high inflation, not only due to the immediate direct effect of the relaxation of price controls, but also due to the depreciation of the Sri Lanka rupee and the removal of subsidies. Further, the continuously high budget deficit, which was financed through expansionary sources, also contributed.

The inflation rate, however, decelerated subsequently and moved in a range of 4-14 per cent during the 1989-2003. Inflation remained volatile due to both domestic and international factors. As the food comprises a large share of the consumer basket, the improvement of the domestic supply situation has a significant impact on inflation. In addition, the demand pressure as a result of continued budget deficits and monetary expansion too contributes to maintain inflation at a higher rate.

Government Finance

Since regaining independence, successive governments have played a key role in formulating and implementing social and economic policies in the economy and have also introduced a number of social welfare schemes. Meanwhile, the slow progress of the private sector participation in the economy compelled the governments to undertake some of activities in economic services, largely by establishing public enterprises. The share of the government in economic services was further expanded with the nationalisation of some privately owned businesses. However, most of these public enterprises were managed on a non-commercial basis resulting in their depending partly on the government budget. Consequently, governments adopted a deficit budget policy under which government expenditure has been higher than government revenue.

Revenue mobilisation of the government was maintained at around 20 per cent of GDP until the early 1990's. Since then, the total revenue to GDP ratio has gradually declined, reaching 16.5 per cent of GDP in 2002. The reduction in the revenue to GDP ratio was entirely due to the decline in tax revenue collection from around 19 per cent of GDP to about 14.5 per cent of GDP, while non-tax revenue has been maintained at around 2 per cent of GDP.

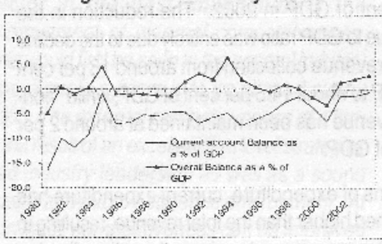
In terms of expenditure, current expenditure has remained higher than the total revenue, resulting in negative government savings. The rationalisation of government welfare programmes began from the end of the 1970's. This process was further strengthened by the consolidation of various household oriented welfare programmes from the mid 1990's. However, the benefits of the rationalisation and consolidation of welfare expenses on the government budget was off-set by the acceleration of expenditure on national security due to the conflict in the North and the East from 1983.

The continued high budget deficits compelled the government to raise funds domestically and internationally to finance the resource gap of the government. The government's borrowing needs were aggravated by high welfare expenditure from the 1950's to the late 1970's, a sharp increase in expenditure on public investment during the late 1970's to the early 1990's and acceleration of defence expenditure since 1983. As a result, the outstanding government debt, in absolute terms has been rising continuously and reached to a unsustainable level by end of 1990's. The debt service payments (repayment of principal and interest) exceeded the total revenue of the government and interest costs of the existing debt stock became the largest single expenditure item in the government's recurrent budget. Recognising the destabilising threat emerging from the fiscal sector to overall macroeconomic management, the government has taken a series of measures since 2002 to ensure the sustainability of the fiscal sector and minimise its destabilising impacts on the other sectors of the economy. The most important step taken was the enactment of Fiscal Management (Responsibility) Act in 2003. Under this Act, the government is committed to reducing

Balance of Payments and the Exchange Rate Movements

Within the balance of payments, the current account has in general been negative primarily due to deficit in the trade account. However, with the expansion in exports, inflows from worker remittances, the current account deficit which was around 10-11 per cent of GDP during early 1980s declined to around 5-6 in 1990s. The inflows from worker remittances have now become the primary source in offsetting a large part of the trade deficit. In the service account, tourist earnings have begun to improve, after the slowdown experienced during the second quarter. Income from port services is another area that is becoming important.

Fig3 : Balance of Payments



As the current account remained negative, the capital and financial account developments dominated the changes in the overall BOP position. When there is a reduction in foreign inflows to government or a reduction in foreign direct investments to the country, the overall balance of payments (BOP) tuned into a negative position, resulting a reduction in external reserve position and exerting pressure on the exchange rate. At present, the gross official reserves is about US dollars 2.1 billion (3.5 months of imports) while the total reserves of the country is around US dollars 3.1 billion (5.2 months of imports).

One of the significant changes in the exchange rate regimes is that Sri Lanka moving to independently floating exchange regime in January 2001 from the fixed exchange regimes that existed till 2001. Over the years, rupee has depreciated against the US dollar and against other major international currencies, mainly reflecting the widening of the current account deficit and high domestic inflation. The depreciation of the rupee, however, has helped to maintain Sri Lanka's external competitiveness despite the rise in domestic inflation. International competitiveness, as measured by the depreciation of in the real effective exchange rate.

Financial Sector Developments

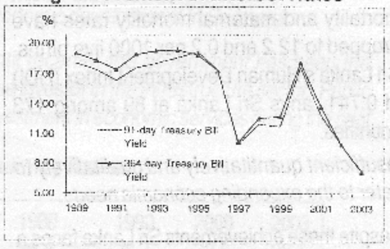
Given the importance of access to financing to ensure a sustainable and higher economic growth, a series of financial sector reform measures have been taken to enhance the efficiency and stability of the financial sector. These reforms and initiatives included the liberalisation of financial market allowing foreign participation, expansion of the institutional structure, developments in money and capital markets. As a result of these measures, increased competition, and increased use of information technology, the financial sector recorded a healthy expansion as seen by increased ratio of financial assets to GDP. Within the financial system however, banks are the systemically most important financial institutions. At present, the total assets of licensed commercial bank and licensed Given the importance of access to financing to ensure a sustainable and higher economic growth, a series of financial sector reform measures have been taken to enhance the efficiency and stability of the financial sector. These reforms and initiatives included the liberalisation of financial market allowing foreign participation, expansion of the institutional structure, developments in money and capital markets. As a result of these measures, increased competition, and increased use of information technology, the financial sector recorded a healthy expansion as seen by increased ratio of financial assets to GDP. Within the financial system however, banks are the systemically most important financial institutions. At present, the total assets of commercial bank specialised banks represent about 56 per cent of total assets of financial institutions in the country.

Monetary Policy: There has also been a significant change in the conduct of monetary policy over the years. The main focus of monetary policy has been to achieve a sustainable path of low inflation. In monetary management, the Central Bank has gradually moved away from direct controls to now more on market oriented policy tools. Moving further in this direction, in March 2003, Central Bank moved to more active Open Market Operations in March 2003 enabling it to manage market liquidity more effectively, while encouraging improvement in liquidity managementof financial institutions

Financial Stability: The soundness of the financial sector, especially the banking sector is important to safeguard the interest of the depositors and ensure that the financial system is well equipped to support growth process. In addition, developments in the financial sector led by increasingly complex and dynamic financial activities requires greater attention of the stability of the financial stability. Accordingly, financial stability was incorporated as one of the two objectives of the CBSL with the amendments to the MLA in 2002.

The CBSL has taken several measures to promote the soundness of the banking system by strengthening the regulatory and supervisory framework. Since the efficient and secure payment and settlement system is the key for the development of the financial system, measures have also been taken to upgrade and modernise the payment and settlement systems. CBSL implemented Real Time Gross Settlement System (RTGS) in 2003 to settle large value/ or time critical inter bank transactions on a real time basis reducing the settlement risks and improving efficiency. A Scripless Securities Settlement (SSS) System along with the Central Depository System (CDS) was implemented in 2004 to enhance the integrity and tradability of government securities, i.e.,

Fig 4:Movement of Interest Rates



Treasury bill and bonds, improving efficiency and liquidity in the bond market **Interest rates** in many market segments rose to a higher plateau in the 1980with the rise in inflation. Along with the easing of inflationary pressure, there has been a decline in interest rates. For instance, the yield rate of one year Treasury bills declined from 18 per cent in 1990 to 7 per cent by end 2003. The prime lending rate declined from 18.6 per cent in 1990 to 8.95 per cent in 2003. However, the issues such as high intermediation margin, high non-performing loans in the banking sector are some of the concerns.

3. Some of Key Areas that Need to be Focused

As discussed above, Sri Lankan economy has shown an improvement in a number of areas during the last few decades. However, the achievements in relation to major objectives such as balanced economic growth, reduction of poverty and unemployment, and low and stable inflation have been less than expected, indicating the need for significant catching up. Although not an exhaustive list, following are some of the key areas that need to be focused.

Regional Disparities in Output Growth: The regional dimension of the overall economic progress shows that the economic growth is highly skewed towards few provinces that are richly endowed with basic infrastructure facilities. Therefore, adequate provision and improvement to existing infrastructure is an extremely urgent need to expand the economic activity in these areas. The expansion of infrastructure would also help in promoting service oriented activity such as tourism, where Sri Lanka has a comparative advantage. In addition, availability of infrastructure would help in relocating and diversifying export oriented industries.

Reduction in High Budget Deficit

Persistently high budget deficits due to a

Contd. on page 18....

BENEFITS OF REGIONAL ECONOMIC INTEGRATION IN THE GLOBAL AGE

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The world is now fast becoming closer where the hyper-dependency of individual economies is the reality of the day. Trade and commerce, as integrated in its process, is the driving force of the market economy, which involves the infinite number of buying and selling of goods and services. Now economic growth and development of a country, its economic transactions are innately related to the rest of world. International economic relations are becoming stronger than ever before. As a result of this trend, the socio-economic well being of a country is extensively dependent on the world economy where commercial intercourse is on an ever expanding path, and its horizon is endlessly widening up. The economic benefits that a country could derive from this process are not necessarily guaranteed and they are conditioned by such factors as resource endowment, economic policies, and the institutional framework of the country is concerned.

In the context of current world trends, borders are no more than arbitrary lines on the map where trade and commerce has a key role to play. Similarly, the market mechanism is considered as the engine of economic growth in the current mainstream policymaking exercises, where the trade and commerce has a prominent role to play. The free flow of goods, services, and factors of production facilitate the international division of labor and specialization in the production process and to realize the advantages of the scale of economies. As a result, no nation carries out the task of producing all productions what she needs; instead each specializes in which the country has a competitive edge over other countries. This will ultimately uplift the involved countries through a higher ground of socioeconomic welfare by way of the mutual benefits originating from the process itself. It is widely accepted that regional economic integration such as SAARC, EU, ASEAN, and NAFTA will generate higher welfare effect under the current world economic order.

When the South Asian Association for Regional Cooperation (SAARC) is taken as a regional group, there is a wide geographical imbalance among the member countries. India stands first in the rank on the basis of geographical area with 3,166,829 square kilometres, followed by Pakistan with 804,000 square kilometres, and all the other nations have less than 150,000 square kilometres. Though there exists certain differences among the SAARC member states such as geographical and population imbalances, they have many factors in common - rural economies, low income, population pressure, unemployment, geographically neighbour states and dependence on external assistance, to name a few.

The region altogether represents nearly one fifth of the world population where India alone exceeds the one billion population figure. Yet, the region is one of the poorest areas in the world though it is generously endowed with untold fortune of tremendous economic potentials even to surpass the highest developed areas of the world economy. The irony is that intra and international trade and commerce have not reached to the maximum potential levels warranted by the economies of the region and to benefit the mutual benefits that otherwise would have been achieved by the countries of the region.

Interestingly, SAARC region endows a long range of products and services for intra-regional and international trade and commerce with emerging business activities and entrepreneurship. This will certainly include, among a whole host of others, industrial, agricultural, animal husbandry, marine resources, minerals, forestry, handicrafts, items, IT products, and numerous services along with the machineries, vehicles, and equipments. This is not all; the region possesses unparalleled natural beauties, rich cultural heritage and historical sites, and every aspect of nature's bountiful gifts to be explored and exploited to the fullest possible extent of mutual benefits.

Modern economic development in general has meant an unprecedented advance for most of the population in food, clothing, shelter, household furnishings, health, education, and recreational facilities to the extent that dire conditions such as malnutrition have virtually been eliminated. However, the overwhelming majority of population in the SAARC region are still denied such basic requirements of their lives, even though the quality of such provisions to be contended with.

The promotion of intra and international trade and commerce in the region will make a real change to the economic backwardness. That is, mostly individuals in a developed society naturally expect non-economic aspects of their lives such as freedom, equal rights and opportunities, and participation to the decision making process. The democracy, political expression of the market economy, is supposed to guarantee the smooth functioning of the trade and commerce activities as well as the provisions of non-economic aspects of the life. The SAARC is not simply possible keep the blind eye at the changing needs of the modern world as well as the vicious trends created by the changing world. For instance, leaders of the group agreed to combat the trafficking of women and children, to draft a constitution for the promotion of child welfare and to develop a social charter that will focus on poverty eradication, population stabilization, and human resource development. The leaders called for eradicating illiteracy in the region through cooperative endeavours within the SAARC framework and condemned the exploitation of children by terrorist groups.[2]

Exchange and Consumption: The high degree of interdependency among contemporary individual economies reflects no more than the historical evolution of the world economic and the political order over hundreds and thousands years. This progression has shifted the consumption process, the closest companion of the well being of a society, from locally produced articles to regional, national and global articles. The service sector is now becoming the forerunner in this exercise. The quantity, quality, variety and security of the supply of consumer articles and services have also much changed and improved compared with the old subsistence economies. Introduction of new goods and services or the changing of the character of old goods and services is a never ending enterprise. The life span and model of consumer articles are becoming shorter and shorter. Many new goods are produced each year and many more old products are changed in a significant manner.[3] Not only are the new consumer articles, but also the new consumers moving around the world. They migrate with new consumer cultures demanding more and more international trade for goods and services. In the globalized world, vigorous trade and commerce have made inroads to the consumer's menu providing more choice in the market, tendency for greater spending, rising living standards and a growth in international travel and tourism. With all that, there is a popular belief among developing countries that the new world economic trends usher the poor countries through an unfamiliar territory where developed countries and multinational companies soaked up the essence. Therefore, developing countries are not gaining creditable benefits from the international commercial transactions.

The conventional wisdom suggests that the international trade and commerce improve the welfare of people who are actively involved with it. As we have pointed out already, the world is now passing through an advanced stage of its civilization, which is heavily dependant on each other's countries, different territories, human settlements, and individuals for the smooth function. One would prefer to say that the world is passing through a "globalisation" era, a concept which was first coined in the 1980s, but it stretches ostensibly back decades, even centuries, if we count the old trading empires. Alternative policies such as autarky or highly restricted international trade are now becoming no more than outmoded dogmas beyond the grasp of the modern ages. It is obvious that since the end of World War II, trade flows have increased much faster than the world population, and even faster than the overall world economic growth. Initially trade expansion fuelled the post-war economic miracles in countries like Germany and Japan. More recently, it has become the engine of development across many Asian developing countries, transforming the economy of such countries as South Korea and Singapore into near Western standards of living.[5]

The nations, which pursue prudent open economic policies and manage to keep a delicate balance between openness and economic control, at least at the early stages of economic growth and development, have become the winners in the modern world. These countries have developed advanced production, distribution, and consumption levels, which are unparalleled to the countries such as in the SAARC region that were not able to exploit the opportunities offered by the international trade and commerce prudently in the modern periods.

The selective structural economic reforms will be extremely helpful to exploit the benefits offered by trade and commerce. This will include, among others, such areas as reforming laws and regulations to cope with the modern requirements of the changing world, efficient administration, transparency of all political and economic activities and good governance, and institutional reforms. These reforms are not essential for the sake of trade and commerce itself, but also to such burning problems as poverty reduction, and also to lay a strong foundation for the sustainable economic growth and development. Yet reforms and changes are extremely vital not only to promote the free trade and commerce but also to grab the benefits offered by the process itself. More business means more people will be involved in business; more opportunities will be open for them to consume and to have higher living standards.

It is maintained that the international trade and commerce creates a partner friendly environment, which provides large potential for welfare effects, even in a static constant returns to scale environment if world economy is competitive. Whether the developing countries are able to exploit the benefits offered by the international trade and commerce are doubtful since the world economy is dominated by highly sophisticated monopolistic elements. This is further aggravated by the advents of globalisation, coupled with the growing competition between regional economies. It seems that all those new developments have underlined the importance of a closer economic partnership between regions in close proximity. This has been more obvious in the WTO era as an instrument to enhance the regional bargaining power. Regional cooperation will ensure other benefits too, such as facing the new world trade order together, and taking joint positions on the global economic system. Shaukat Aziz, Pakistan's Finance Minister says that representing SAARC's 1.3 billion people with one voice will give these countries a tremendous firepower to talk to the rest of the world.[6]

To exploit benefits offered by international trade and commerce and to become economically strong, countries have to make use of their limited resources in the most efficient manner. It is true that there are differences among countries in the quantity, quality, and the opportunity cost of these resources. Its social institutions condition the advantages that a country inherits on the basis of a natural resource endowment, and their value system and the nature of physical and human capital such as a trained and educated labour force, good roads, telecommunication systems, harbours, airports etc. Inadequacy of some resources could be offset by prudently exploiting the abundant resources similar to the way that Japan used its institutional factors to offset its scarce natural resources.

SAARC countries still account for roughly half of the world's illiterates and 40% of the world's poor. Trade and commerce will increase the production, income, and employment generation in the region and it will reduce poverty and illiteracy. When trade policies are discussed nationally or internationally, people, as consumers, are largely forgotten. Despite their numbers, they do not carry the weight that producers and other lobbies command.[7] "Larger intra-regional capital flows, full operation of the South Asia Preferential Trade Agreement (SAPTA), faster movement towards South Asia Free Trade Area (SAFTA) for eventually forming a customs union to be followed by an Economic Union," say SAARC Finance Ministers. Such steps will help alleviate poverty among the region's 1.3 billion population of whom 550 million live below the poverty line. Forty per cent of these people live in "absolute poverty."[8]

The global trade provides opportunities for consumers with a greater selection and a variety of goods and services to choose from. Often these goods are available at lower prices, and the quality is also higher compared to the local products. Free trades provide consumers with the most of goods and services at the lowest possible prices by increasing the consumer surplus. The consumer will have the freedom to buy from whomever produces the goods and services most efficiently. Trade liberalization can improve consumer and environmental protection, a steady liberalization of the global economy and a steady strengthening of regulatory standards.[9]

Consumers have enjoyed an enormous growth in the range and quality of products in their shops as a result of the multi-lateral trading system. Many fruit and vegetables are available even out of season throughout the year. Exotic foods, never seen just ten or twenty years ago, are now commonly found on supermarket shelves. Cut flowers are being transported fresh by cargo planes daily from one country to the other. Many industries are also consumers of imported goods. Manufacturers can depend on cheaper and better products from overseas in order to maintain their own competitiveness in their domestic market and, especially, in their export markets.[10] Greater economic co-operation could provide for mutual economic benefits, such as lower prices for consumers, much-needed revenue for the Governments and cost effective gas import to India via Pakistan.[11]

An analysis based on the benefits of international trade and commerce is directly involved with the expansion of consumption levels and living standards of general mass. The expansion of consumption standards, both vertically and horizontally, is the striking feature of economic development. The vertical expansion of consumption standards is involved with what economists widely term economic growth and the horizontal expansion is related to the distribution of prosperity among the general mass of the people. Popularly known growth plus development indicators are no more than the shadows of the average consumption levels and standards (if we turn a blind eye to the psychological, social, and environmental problems). In economically backward countries, average consumption levels and standards are generally lower than those of developed countries and so are the shadows behind them.[13] The demand is kept at a low level in these countries due to the low income and poverty of the people. Therefore, the demand driven growth of the production sectors is mainly confined to the mere increase in the number of consumers as a result of higher population growth.

However, consumer centred policies produce undesirable results sometimes. For instance, the competition from imported items will dislodge inefficient domestic products, which may lead to unemployment and slower economic growth. If agricultural products can be produced more efficiently in another country and consumers are free to purchase them, then counterpart domestic products will lose business leading to ask for government protection by limiting imports or imposing high tariffs on imports.

The consumption pattern of developing countries is a mirror image of their production, income, exchange, and behavioural patterns. A higher percentage of the income of ordinary masses, the majority of them are poor people like in the SAARC region, is spent for the food and beverages, the very basic requirements for their lives. The small economies in the region are unable to export products competitively to India to cater to the lower end of the market due to her huge resource base, resource diversity, and low production cost. Still, these small economies can target the niche market of the huge middle class, which is estimated to be around 300 million, to offset the small-big country disadvantage rather than compete with the lower end of the market. The Sri Lankan Export Development Board (EDB) was planning to set up a pavilion to showcase some of the country's products to create a greater visibility of these products in India. The plan was to bring in at least niche products, which have international acceptability such as ceramic ware, gems and tea.[14]

Consumers, especially the poor, suffer when prices go up while companies under invest because of the unpredictable legal environment and political uncertainty in some countries. Even if congenial environment is created, consumers all over the world, both in rich and poor countries, are robbed of billions of dollars each year by cartels and over-charging by dominant firms. Competition authorities of developing countries are making efforts to protect their consumers from these abuses. But they will need cooperation from agencies in rich countries where the cartels are usually located and/or cooked up.[15]

Diversification: It is reasonable to argue that even though it makes sense to allocate limited resources to the most productive goods and services and to be specialized in those areas, no country wants to rely on only a few areas of products. It is obvious that this makes the country vulnerable to changes in the world economy, international politics, and natural calamities. For instance, wars, political rows, crop failures, floods, earthquakes, recession, new trade laws, technological shifts and international treaties are common occurrences which change the trade pattern temporarily or permanently.

A country that relies too heavily on one, two, or three products is especially susceptible to a greater risk. If demand suddenly drops for one or more of those products or if cheaper alternatives become available for the buyer, the economy of the country could be damaged due to rapidly diminishing foreign demand. This argument is particularly relevant to small economies in the SAARC, which depend on a few primary commodities. A major share of their international trade is also based on the export of these primary products and the import of raw materials and other capital goods required for the export sector, as well as for other sectors of the economy.[16] By developing a diversified economy, a country can make sure that even if some products are suffering, other favourable products will keep the economy relatively healthy. India, which has a diversified export base, is exceptional in the SAARC region. It is competitive in IT, automobiles and other heavy industries, and pharmaceuticals and communications, among others. Even if prices of some products suddenly go down, others will help to keep the economy going. The narrow primary production export sector devastates the prospect for long-term stable economic growth and development. Referring to the Vietnam paddy farmers, it is said that they should be supported in practicing agricultural diversification for sustainable development and higher income.[17] SAARC partners have adopted various strategies for the diversification of their economies, from production of primary products to that of manufactured goods. As far as Bangladesh, Bhutan and India are concerned, the industrial sector and the services sector have gained at the loss of agriculture. However, in the case of Nepal and Pakistan, the role of industry has improved at the cost of the agriculture and services sectors. The prominent trading and commerce activities in Sri Lanka have made the service sector more vital than the agricultural and industrial sectors of its economy.[18]

Specialization: The neoclassical trade theories suggest that the free market provides opportunities to the world to get higher benefits through specialization than otherwise. Instead of taking pains to produce each and everything by itself, countries can concentrate on producing things that they can produce most efficiently at low prices and high quality as proposed by the literature. The world depends on each other's mutual cooperation and one of the ways in which this cooperation manifests is through the voluntary actions and exchanges of people who specialize in doing one or a few other particular tasks. This will enable them to produce and trade those for other goods and services they need. The specialization facilitates for trade and commerce increasing the volume of supply, which will bring the prices down, making them more affordable to a large segment of the society. This will also create more employment, higher income, and research and development, especially in the production area.

Specialization provides, under the open economic policies, a wider variety of goods and services to consumers, for example autos and machinery from India, tea and textiles from Sri Lanka, cotton yarn and cotton fabrics from Pakistan, cotton and textiles from Bangladesh, carpets from Nepal, timber and fruits from Bhutan, and fish products from Maldives are just a few items to mention. Services such as tourism, shipping, aviation, banking and insurance are some of the potential areas that could be specialized in SAARC countries. However, unless countries involved can trade with large numbers of individuals, the specialization will not be fully beneficial. In doing so, the countries involved and the world as a whole becomes wealthier and the people of those countries will have higher living standards.

It is not fair to say that specialization generates only benefits. There are ample historical and contemporary evidences to suggest that international specialization generates negative effects as well. It is pointed out that specialization appears to be the predominant cause for the economic backwardness in developing countries, which continue to be dependent on primary commodities and commodity processing for the world market. Thus the specialization predicted by the theories appears to be in terms of developed countries producing a wide range of manufactured goods, which they trade among themselves, and developing countries that produce primary products, which they trade for the manufactured goods of the developed countries. A well-known fact is that the terms of trade between the primary and manufactured commodities behaves in favour to the latter by giving undue advantage to developed countries, which produce manufactured goods to the world market.

The majority of the poor in developing countries such as in the SAARC region live in rural areas where agriculture and handicrafts play an important role. Except for Pakistan and Sri Lanka, where the service sector plays a major role than agriculture, in all the other countries, the contribution of agriculture to GDP is the highest.[18] The opening up of markets for their products, mostly agricultural products, would have enormous impact on poverty reduction, as proposed by the conventional trade theories. The major challenge in this endeavour is that many developed countries still provide heavy subsidies to their agriculture producers, including the European Union, Japan, and the US.[19] Therefore the opening up of the local market will not essentially support the improvement of the living conditions of developing countries. In addition to this, there are some other problems as well. The overwhelming majority of the rural producers in developing countries are small-scale farmers or craftsmen, so that they are unable to exploit the benefits of large-scale economies involved with specialization. Research and development in agricultural and industry, and their application, is based on the large-scale production rather than small scale in developing countries. The agriculture in developing countries is still years, if not decades, behind the developed countries.

Recent evidences suggest that the small producers in developing countries are struggling to cope with the accelerated advance of international trade alongside the economic liberalization. India's southern state of Andhra Pradesh, for example, at the forefront of the country's drive toward globalisation, is grappling with the toll that economic liberalisation has taken on its traditional weavers, who are being driven to suicide in droves. The government, having committed itself to opening up the state to textile imports, has little inclination to support traditional weaving, once a major export earner, and has been silently watching it die a natural death.[20] This is more common in small economies as the efficiency of the producer has been severely restricted by the limitation of the market imposed under the protective regimes that hindered the growth of an efficient size firm and an efficient industrial structure. The hand and power loom production in Sri Lanka has totally been wiped out after the import liberalization in the post 1977 period. Under such circumstances, regional integration is seen as an excellent opportunity to expand the market size of small economies depending on the preferential trade arrangements provided by the large economies to the small economies in the group.

Efficient production heavily relies upon the peripheral facilities required for the production. Many developing countries do not have such facilities as infrastructure, and also commercial, financial, and political power to edge out the powerful rival producers of developed countries in the home market as well as abroad. This once again thwarts the ability of developing countries to exploit the benefits offered by the international trade and commerce. The snail's pace progress in the field of technology and organisation of production structures, and also institutional difficulties in these countries further aggravate the problem.

The services sector could also be introduced to the international market for the mutual benefit of the parties involved. It is argued that considerable gains could be made by opening up the tourist sector and by liberalising the movement of people, the immigration, and emigration. In particular, an increase in temporary unskilled migrants from poor to rich countries could boost the income of developing countries. However, international migration, especially from developing to developed countries, is severely restricted by the latter though the globalisation is being promoted in every field.

Comparative Advantages and IIT: Even though some countries, especially large countries with a diversified huge resource base such as India, can produce almost everything more efficiently than many small countries, still there is scope for international trade and commerce with other countries by specialising in certain areas. In this manner, a country can maximize its benefits by putting its resources into the most competitive goods and services, regardless of whether other countries are more competitive in those products. The principle of allocation of limited scarce resources in this way is called the law of comparative advantage in the conventional wisdom. The allocation of resources into the most productive enterprises in each country will result in more products to exchange with other countries at low prices.

The consumer is considered as the best judge of his or her own welfare in modern democratic societies. The privilege of freedom as a consumer is called consumer sovereignty that enables him to choose what gives him the highest satisfaction from an array of varieties. International trade and commerce under such circumstances encourages the import of commodities, which are produced and exported by the country itself. This practice, which is contrary to the comparative advantage principle, is called intra industry trade (IIT). It refers to simultaneous exports and imports of commodities in the same industry or production group in a given period of time. The classical reasons for intra industry trade are; differentiation of consumption and production, economies of scale at the firm level and industry level lead to country-specific goods, categorisation of products, geographical and seasonal problems, and the degree of processing in terms of value added. Under such circumstances there are plenty of opportunities to trade among countries with similar factor endowments and similar products.

It is argued that the exports of SAARC region are of broadly the same kind of products such as agricultural commodities and basic manufactures. This means that there is little incentive for these countries to trade with each other. It is pointed out that the intra-SAARC trade is merely 5.0 percent of their entire exports, and 1.3 per cent of their imports. It is trivial in the context of $ 6.0 trillion global export market.[21] The long negative lists themselves speak of the region's inability to engage in intra industry trade, when SAARC members sign bilateral free trade agreements. For instance, silk saris from Benares in India could not be exported to Bangladesh and muslin saris from Dhaka were contraband goods in India. Therefore, suggestions are made that export alliances can be constructed and intra-industry linkages nurtured to promote regionalism.[22] This has been one of the missing vital elements in the region since long. It is pointed out that since the inception, SAARC had not witnessed any dramatic changes in trade and other economic linkages within the region. The total intra-trade of SAARC countries was minimal (around 3 per cent) when SAARC was first established and it still remains small.[23] This backdrop is now being emphasised at top-level regional meetings. For instance, the Indian Prime Minister stressed the need for increase intra-regional trade, which is limited by a variety of national barriers.[24]

The benefits of specialization as pointed out earlier is said to be greater for the countries that engage in intra-industry trade in manufactured goods than they do for countries that specialize in primary commodities. However, like in agriculture, there are some other shortcomings in this strategy. When these countries produce industrial goods they often use technologies that are less efficient than those used in developed countries. This is further complicated since the trans-national corporations provide the vehicle for much of the intra industry trade, which is not organized by country boundaries, but by the technological considerations. Similarly only few developing countries produce trans national corporations, and they do not enter these intra-industry trading networks.[25]

Competitiveness: In the long run, the competitiveness of a country depends on its natural resources, stock of capital, technology, institutions, and the skills of its workers in creating goods and services that people want to buy. Natural resources are predetermined and must be used efficiently, but others are human behaviour and action related ones. The mainstream economics suggests that the relative productivity and the liberal economic environment ensure a sustainable competitiveness rather than ad hoc policies such as subsidies, protective tariffs, and competitive currency devaluation. If one country can produce a better product at a lower cost than another, it is said to be more competitive. This is a matter of concern for some countries as uncompetitive production, though important to the economy, will not survive in a competitive environment. The ability or inability of a country to do this effectively determines whether it can remain competitive in the world economy.

The price and quality of a product are good indicators of the competitiveness, especially in the long run. However, such phenomena as regional integration and most favoured nation status and other preferential treatments distort the cost structure created by the competitiveness in the world market. For instance, the competitiveness of the Sri Lanka tea in the Egypt market has gone down as a result of the 'Common Market for Eastern and Southern Africa' where Kenyan tea is given preferential tariff treatment by Egypt as a member of the group. Here the member country has gained benefits as a result of market creation while the non-member country faces the costs of trade diversion. Sri Lanka could have cushioned the adverse effect if such treatment was given sufficiently in the SAARC region.

As history witnesses, economic integration has taken place among countries in close proximity. Therefore, the member countries have added advantage of less transportation costs due to geographical closeness, which is an important competitive element, that promote the regional trade. In the case of economic integration among developing countries, for many instances, the cost of production of primary and labour intensive goods is lower than the cost of similar products coming from developed countries. It is a plus point to promote trade between developing countries in the areas of unsophisticated products as long as products are non competitive within the group. If the countries are following the long-term mutual benefits principle, intra industry trade could be promoted even in competitive areas.

In the area of consumer durables, machines and equipment, SAARC countries get benefits from cheap Indian products such as autos, transport equipment, and other capital goods. No country in the region can easily compete with such Indian products. These products, in particular, are attractive for the growing middle class segment of small countries such as Sri Lanka. Similarly, the poor who cannot afford expensive branded pharmaceutical items from developed countries often benefit from cheap generic production from India and Pakistan. In the field of research and development, academic and publication, India has a competitive edge over many members in the group and its benefits may trickle down to other member countries either in the form of low cost products or through concessional programs on science, technology, and education. It was widely agreed that each country should shape its competition law to meet national economic and social conditions. Small economies can take advantage of the strong competition regimes of their large neighbours or regional arrangement to overcome their own capacity constraints as Nepal can benefit from the Indian regime.[25]

Economies of scale: The law of comparative advantage, the theoretical backbone of the international trade literature, maintains that a country can become more competitive by diverting its resources to the most efficient production sectors from inefficient sectors. This enables a country to increase its output in efficient production sectors at a decreasing per unit cost and sells them at lower prices, if the increasing returns to scale prevail. This particular long-term relation between the inputs and outputs is called the economies of scale in the literature. Such lower-priced and high quality goods are more in demand in the global market and this enhances the benefits to increase for consumers as well as producers.[26]

The Indian consumer goods industry has the advantage of producing for the large Indian market and reaping economies of scale. This is not only providing benefits to India itself, but also to other SAARC members. For them, imports from India will be cheap and it will be even cheaper due to the reduction or elimination of tariffs under the regional integration. As a result, there will be trade diversion and trade creation in the region increasing production in many sectors. The classical source of gains from trade is that global free trade allows consumers and firms to purchase from the cheapest source of supply, hence ensuring that production is located in accordance with a comparative advantage. A noteworthy factor for low intra-regional trade is the competitive nature of the SAARC members in the global market. For example, India, Bangladesh, and Sri Lanka compete with respect to tea; India and Bangladesh compete with respect to jute; India, Pakistan, and Sri Lanka compete with respect to ready wear products etc. Thus, there is a need for a united marketing strategy by SAARC members in order to compete in the global market for mutual benefit.[27]

Peace is a must: A number of countries in the region have internal and external conflicts or near conflict situations, which have thwarted the benefits that otherwise could have been achieved by the poor masses of those countries. Internal and intra regional confidence building and prudent and dedicated policies towards the regional stability will guarantee the mutual benefits of trade and commerce. Ever since its inception in 1985, SAARC has been restricted by the ongoing hostility between India and Pakistan. The organisation is supposed to meet once every year, but tension between the two countries has taken toll on this requirement in a number of occasions. The failure of SAARC to turn its dreams into realities could, however, be attributed to many reasons and issues, the major being the Indo-Pakistan effect.[28] "When elephants clash, the grass is crushed" is a popular Pakistani saying. When India and Pakistan clash - no offence intended - the small SAARC nations (Bangladesh, Sri Lanka, Nepal, Bhutan and Maldives) get at least small end.[29] The constitution of the SAARC does not provide opportunities to discuss contentious bilateral issues in its gatherings. Therefore, the organisation has little or no power to address regional bilateral political issues, which are more important in achieving economic goals in the region. For instance, the inherent suspiciousness in the relationship between India and Pakistan has made it difficult to explore rather than exploit the opportunities offered by trade and commerce. The important point of view with respect to economic co-operation is that unless the political matters are settled first, there is little scope for fostering regional economic co-operation. The cold war like situation between India and Pakistan definitely has a high level of correlation on other matters too. Further, the ethnic issues in Sri Lanka have worsened Indo-Sri Lanka relations.[30] Bhutan is under increasing Indian pressure to push the Assam rebels out of the kingdom where rebels have their hideouts though they have been given a last chance to leave the country.[31] There are some more sensitive issues in the region such as the Bhutanese refugees of Nepalese origin living in refugee camps in Nepal. Once the Bhutanese King announced that he would not attend the heads of states summit as a result of poor relationships between the two kingdoms rather than the official claim of 'domestic engagement'.

It is obvious that these thorny issues have prevented the potential rapid growth and development in the region as a whole. The total trade of Pakistan with India is much less despite the fact that the Pakistani economy is much larger than other SAARC neighbours. With a better trade climate, the trade with Pakistan can increase between $2 billion and $4 billion. This includes the legalisation of $2 billion of unofficial trade.[32] The intra-state conflicts within the member states contributed negatively to developing a strong, sustainable, and high quality industrial base in the member states that could facilitate the export of such items in the international markets and earn FE for a sustained development and prosperity of the member states. The weak social indicators and poor socio-political-economic conditions of the member states also contributed towards poorer cooperation and development amongst the member states.[34]

In addition to that, the smaller countries in the group such as Nepal and Sri Lanka seem to have perceived that India, the largest and strongest country in the region, throws its weight around them putting undue pressure at times.[35] This situation was described in 1985 by Sri Lanka's late president, J.R. Jayewardene, when he said in Dhaka that India being "the largest in every way, larger than all the rest combined" could "by deed and words create the confidence so necessary to make a beginning."[36] Foreign Minister Yashwant Sinha, during his whirlwind tour of all the neighbouring countries of South Asia, except Pakistan, since taking up his new assignment last, said that India was indeed a big country in all aspects in South Asia but she would maintain bilateral ties on the basis of equality and as sovereign countries.[37] This fear goes well beyond the political fear into the economic issues as well. Some of the smaller countries in the region, for instance, have long been reluctant to dismantle trade barriers for fear of being swamped by cheaper Indian products. Amongst the member states, India, being the biggest market in the world after China, enjoys a unique status because of its bigger population.[38] The Gujral Doctrine often accords higher priority to South Asia and treats neighbours with indulgence. The rationale of the doctrine was that the region's biggest power could not demand reciprocity from smaller and more vulnerable countries is an admirable thesis that could, if honestly implemented, lead to regional equilibrium. In practice, while India's neighbours grabbed what they could, India's irrational swings from generosity to rigidity wiped out goodwill.[39] SAARC countries were part of a single economic entity under the British. Trade was free and there were no restrictions on movement. Therefore, India, as the strongest, can take the initiative to nurture trade among members of the region. She is strong enough to vacate certain businesses, if needed, in the interest of the smaller members.[40] SAARC's performance so far, in comparison with other regional organisations, had been dismal.[41] Bangladeshi Prime Minister Khaleda Zia said the decision-making in SAARC is slow. [42] This is mainly due to lack of confidence and prudent leaderships among members.

Conclusions: As theories indicate, the international trade and commerce can offer tremendous benefits to the participants, if only the conditions are right and participants follow the rules of the game. The role of trade and commerce in economic growth may now be increasing for developing countries. Manual workers in developed countries are particularly under threat as companies shift their production lines overseas to low-wage economies. When SAARC was set up 13 years ago, it was nicknamed the poor man's club of aspiring rich men. SARRC aims to alleviate poverty and promote trade in the region. The group has not been able to replicate the successes of the regional groupings from which it drew inspiration such as the European Union and Asian. Members of the group are not ready, or not able to settle regional disagreements and to strengthen economic ties between member states. Members have made a commitment to take measures towards making South Asia a free trade area, steps to combat drug smuggling, and initiatives to increase co-operation in the fields of science and technology. However the prorogues made in these areas and others are not satisfactory, and cooperation has been hindered by a lack of political will and the Association is still very far from its goal of maturing into a regional economic grouping.

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Notes

[1] The original version of this paper was presented at the SAARC Social Scientists Seminar 'Partners in Peace and Progress' held in New Delhi, India, on 27-28 August 2003.

[2] This comprising the seven South Asian countries of Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka, formally came into existence in 1985 with the adoption of its Charter at the first Summit in Dhaka *(7- 8 December 1985)*. The idea of regional cooperation was first proposed through 'a regional forum' by Bangladesh in 1980.

[3] http://www.yeahindia.com/saarc3.htm

[4] The Colombo Declaration, 10th SAARC Summit, July 1998, *Frontline*, Vol. 15, No. 17, August 15 - 28, 1998

[5] James, JeffreyJames, Jeffrey. *Consumption and Development*, p. 15.

[6] http://news.bbc.co.uk/2/hi/special_report/1999

[7] Aftab,M., 'South Asia Awaits Trade Winds to Blow'. *The Dawn* (internet edition), 19 May 2003

[8] Narasaiah, Lakshmi, 'International Trade with the Consumer's Money'. *Coop Dialogue*, Vol., No. 1, Jan-April, 1997, pp.21-22

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[13] Wimalaratana, W. *Changes in Consumption Pattern and Economic… in British Ceylon*, p.97.

[14] *Business Line*, Financial Daily from The Hindu group of publications, Thursday, Sep 05, 2002

[15] http://cuts.org/comp-event-geneva.htm

[16] http://www.yeahindia.com/saarc3.htm

[17] Luat, Nguyen Van et al 'Rice Production and Export in Viet Nam'. A Paper Presented to the Regional Workshop on Commodity Export Diversification and Poverty Reduction in South and South-East Asia (Bangkok, 3-5 April, 2001), Organized by UNCTAD in cooperation with ESCAP.

[18] http://www.yeahindia.com/saarc3.htm

[19] http://www.yeahindia.com/saarc3.htm

[20] President George W. Bush signed a farm bill in May 2002 to provide new subsidies for US farmers over the next decade. It officially closed the book on the nation's experiment with free market policies in its troubled farming sector. The bill is generous and will provide a safety net for farmers, and it will do so without encouraging overproduction and depressing prices. Under the WTO limits, certain US farm subsidies cannot exceed $19.1bn annually. However, the bill authorizes the agriculture department to adjust subsidies to stay under the cap. See *The Financial Times*, May 13 2002. Similarly in March 2002 the Bush administration to impose tariffs of up to 30 per cent on imported steel to protect the local producers. See *The Financial Times*, May 22 2002

[21] Padma, T.V., *World News*, Inter Press Service, http://www.oneworld.org, July 19, 2003.

[22] Aftab, M.,'South Asia Awaits Trade Winds to Blow', The Dawn (Internet edition), 19 May 2003.

[23] Kemat, A.R. et al, 'A Plan to Strengthen...' in T. N. Srinivasan (ed.) *Trade, Finance*, ... 2002.

[24] http://www.yeahindia.com/saarc3.htm

[25] Vajpayee, Atal Bihari, 11th SAARC Summit, Kathmandu, *The Rising Nepal*, January 6, 2002.

[26] Kregel, Jan, 'Technology, Trade and Development', Third World Network,
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Contd. on page 18.....

Development Models of Sri Lanka An Overview

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The development models adopted by Sri Lanka and their changes during the past five decades generally reflect the development thinking and policy tendencies in the contemporary developing world. In a broad sense, a well-known distinction is drawn between two development models adopted in developing countries: the restrictive trade regimes established by most of the developing countries during the post-war period until the 1970s and the liberalized trade regimes promoted by them during the period after the 1970s.

Sri Lanka also shares this experience with the rest of the developing world. However, the country's development models were characterized by some unique features which were not shared by many other countries. These features are centered on the initial conditions conducive to rapid growth and development, long-standing extensive welfarism, and frequent policy swings accompanied by political swings. With the co-existence of both common and unique features within which the development models adopted by the country, it is not surprising that its growth and development experience over past few decades has become a source of controversy. The achievements seem to be classified as 'good' or 'bad' depending on the comparisons undertaken, the aspects included in, or excluded from the analyses, and the perceptions of the analysts themselves. The controversy has been further heightened by the fact that the country was able to maintain high social development since the time of independence against its low per capita income.

The objective of this paper is to outline the development models adopted by Sri Lanka during the past five decades with an emphasis on the unique features of these models. Moreover, a brief assessment of economic outcome of the alternative models guides us to answer the question whether Sri Lanka has performed better or not, and whether such performance is satisfactory given the initial development prospects of the country.

Commencing Development Process

It is widely acknowledged that the economy of Sri Lanka, at the time of independence from Britain (1948), was much more prosperous than most of its Asian Neighbours. The colonial inheritance included a high human development standard, well-developed infrastructure, a well-functioning judiciary and a democratic political system of the Westminster type. Along with its high income, the country's achievements in health and education were exceptional among the developing countries and were comparable with those of developed countries. The main development challenge at the time was not that of raising the people's living standard, but of maintaining it in the face of a rapidly growing population. Sir John Hicks who visited Colombo as an economic advisor to the Sri Lankan government in the late 1950's wrote: "If it were not for the population pressure, the urge for development [in Sri Lanka] might not be so very great; for there is not at the moment a crushing problem of poverty and malnutrition such as there is in neighbouring countries" (Hicks, 1959:3). In referring to the favourable initial conditions as well as the peaceful transfer of power from colonial rule to independence, Snodgrass (1999: 89) questioned: "What more could a newly independent nation want?"

The Sri Lankan economy, thanks to the favourable initial conditions conducive to the achievement of growth momentum, promised to be a 'best bet' in Asia. However, the subsequent period of decades to come were marked by unsatisfactory economic performance among the developing countries in Asia and backward performance among the high-performing economies in Asia. This is confirmed by a comparison of the growth performance of Sri Lanka with not only that of the 'high-performing economies' in East and Southeast Asia, but also with that of the South Asian neighbouring countries (Abeyratne 2000; Athukorala and Rajapatirana 2000). The development history of Sri Lanka is, therefore, as Snodgrass (1999) called it, a tale of missed opportunities. Generally it is true that Sri Lanka was able to maintain the record of social development standards laudably in the midst of sluggish growth performance. But many other Asian countries which started all their development process at lower levels than that of Sri Lanka surpassed the country over the past few decades in terms of growth and development performance.

Development Models

On the basis of economic and political ideology governing the choice of development models, typically the post-independence development history of Sri Lanka is divided into three major phases: 1948-1956 as a period of continuing with the colonial free-market economy; 1956-1977 as a period of adopting a closed economy model; and post-1977 as a period of adopting open economy model. However, there were interruptions and variations in policy within these phases which were governed by a number of factors. The most important among these were the differences in economic ideology of the ruling parties, initial conditions set by the political regimes changed frequently, the contemporary changes in development thinking and practice in the world economy, the internal and external shocks in the respective periods and the role set by the country's political economy.

1948-1956: Continuation of the Colonial Free-Market Economy

The colonial policy regime was based on the principles of free-market economy with special provisions made in respect of the country's relationships with Britain. Within this policy framework, the first national government formed by the United National Party (UNP) showed its willingness to continue with the existing primary export economy and the expansion of the social welfare structure built during the colonial times, and ignored the need for structural changes in the economy.

The development ideology of the UNP government after independence was also not in favour of an industrialization process in any direction. As Oliver (1957) noted, there was much concern about the need for industrialization at policy levels, but in reality the government placed little emphasis on industrialization. It also faced the problem of continuing with existing state-owned inefficient manufacturing enterprises that had emerged during the period of the Second World War. In fact, there was a gradual disengagement of the government from commercial and industrial ventures, while a number of these inefficient industrial ventures were closed down. Even though the government was in favour of allowing the private sector to play a major role in industrial development, an industrial capitalist class had not yet emerged in order to undertake this task. The private sector, which made a marginal contribution to the growth of savings and investments in general and to the accumulation of industrial capital in particular, concentrated more on plantation and related trading and commercial activities than on manufacturing, as a heritage of the colonial legacy.

In contrast to the government's attitude towards industrialization, its development strategy was strongly directed at agricultural development with a view of reviving the country's ancient self-sufficient agricultural economy. The agricultural development strategy consisted of rehabilitation of the irrigation systems, colonization of abandoned agricultural land and, a programme for resettlement of farmers by reducing the population pressure in the South.

The regime was marked by rising public and private consumption fed by the contemporary export price booms and irreversible expansion in welfare expenditure. However, this was unsustainable due to poor growth performance against rapidly growing population. The regime set the parameters of Sri Lanka's distinctive features of the post-independence development process as well as for economic, social and political issues leading to radical changes in the policy regime that were due to come. The UNP regime opened up avenues for major criticisms that were centered on the fact that it did not bring about any significant changes in the colonial economy. These criticisms were seen as applied not only to economic issues but also to social and political issues, which altogether set the conditions for giving birth to a new development model in 1956.

1956-1977: Closing up of the Economy

The development model adopted during 1956-1977 is generally viewed as a regulated economy in which the state was assigned to play the major role in economic development and in which import substitution industrialization was received priority. Nevertheless, in line with frequent changes on the political front brought about by general elections and the contemporary economic and political issues confronted by the respective governments, the development model was characterized by policy swings as well as intensifications. The economy was seen as moving from a 'soft' phase of import substitution and economic regulation during 1956-1970 to one of its 'hard' phases during 1970-1977. There was, however, a period of policy reversal with an attempt for gradual liberalization during 1965-1970. Except during this period in which a party coalition headed by the UNP was in power, the regulated economy was mostly under the governments led by the Sri Lanka Freedom Party (SLFP) or its coalitions that favoured state intervention and import substitution. Although the SLFP was not committed to socialism *per se*, it did not oppose to add elements of socialist economic philosophy such as central development planning, nationalization of private business ventures, state enterprising in basic industries and in key areas of the service sector. In fact, the government received the support of the Soviet bloc, which was seen at the time as a successful case of import substitution industrialization and, for that matter inspired by the development policy of neighbouring India.

The import substitution industrialization after 1960 started with increased tariffs and quantitative restrictions on imports and controls over foreign exchange payments, initially designed to meet the growing balance of payments problems. A distinction was made between 'essential' and 'non-essential' imports in order to discourage the latter with a view of saving scarce foreign exchange. Import controls, though initiated primarily in response to the foreign exchange problem, had the twin objectives of exerting control over trade balance and providing protection to domestic producers. As the foreign exchange problem worsened over the years, the government was inclined to tighten these controls assuming that the resultant increase in import substitution production would ease the external and internal imbalances. Apart from the inducement for the production of import substitutes given by import controls, the government emphasized the need for import substitution production with the provision of a wide range of incentives.

The government's direct involvement in industry was expanded with an increase in public resources allocated to state-owned industries and setting up of public sector industrial corporations with the assistance of the Soviet bloc. Although the government announced a policy package for attracting foreign direct investment (FDI), there was a virtual boycott of the country by foreign capital. The restrictive trade regime resulting from controls over imports and foreign exchange was not conducive to FDI flows. Besides, it was futile to anticipate FDI flows in a policy regime characterized by nationalization of the private and foreign business ventures, which was initiated in the late 1950s.

The period of 1965-1970 was marked by a partial deviation from the previous regulated economy model, although the UNP-led coalition government was reluctant to make a radical change in the existing import substitution policy framework. It was characterized by a moderate liberalization of import trade and foreign exchange payments, initiation of some export promotion policy measures, an attempt to restrict state intervention in economic activities, and a resurgence of policy emphasis on import substitution in agriculture. Allowing the private sector to take its due place in industrial development, de-prioritization of the previous state-led industrialization was apparent in the new policy. The UNP-led government of 1965-1970, which opt for a cautious, selective and gradual liberalization, appears to have suffered from a policy dilemma in translating its economic ideology into practice for two reasons. If the government had initiated a full-scale liberalization programme in 1965, it would have been a radical and risky exercise at a time when world development thinking and practice were against such a policy stance. Secondly, the potential political resistance that it would have produced otherwise weakened the popular political will and the capacity of the government for liberalization. The government would have expected that the positive outcome of export promotion and agricultural development would pave the way for a gradual move towards a liberalized trade regime by averting its short-term cost of adjustment. However, this expectation was not realized, as the overall outcome of policy within a given short period of time was not satisfactory.

A coalition of SLFP and left-wing parties, known as United Front (UF), formed new government followed by general elections in 1970. The new government reversed the liberalization attempt of the previous regime with tightened import substitution policies and increased control over the economy by moving the economy towards a 'hard' phase of a regulated economy. Although tariffs were raised and differentiated, the quantitative restrictions over imports and foreign exchange payments, including individual licensing system and government monopoly over the importation of 'essential' commodities, were more effective than high tariffs as import controls. The government, as an entrepreneur intervened in almost all areas of production, distribution, trade and commerce. This resulted in an unprecedented expansion of the government over the private sector. These were combined with stringent measures adopted to achieve redistributive justice, which in most of the cases were in conflict with the growth objective. With the influence of the left-wing parties associated with the new government, it also had a declared goal of laying the foundation to establish a 'socialist economy' in Sri Lanka.

Even though the policies were consistent with the ideological base of the UF coalition, the youth insurrection in 1971 and the oil price hike in 1973 strengthened the policy-making to establish a highly regulated economy in Sri Lanka. In the context of weakened economic performance, the government was left with no option other than tightening its stringent controls to save internal and external balances and to strengthen the 'socialist' outlook of the economy. By mid 1970s, Sri Lanka was one of the highly regulated economies in the world outside the socialist countries. The severe economic hardship that the public had to undergo due to dismal economic performance and import controls in the restrictive trade regime paved the way for trade liberalization.

Post-1977: Opening up of the Economy

The development model in the post-1977 period is basically a liberalized trade regime in which export promotion received priority and in which private sector was assigned to play a major role in economic development. Policy reforms were aimed at integrating the domestic economy with the international markets, creating an environment conducive for market forces to function, and allowing the private domestic and foreign capital to replace state capital in economic activity. The government was confined to play a facilitating role and to limit its public investment mainly to large-scale infrastructure.

A drastic shift in development model from a regulated towards a liberalized economy was initiated by the UNP government elected in 1977, which had to its advantage the economic crisis of the previous regime. Even though the basic political thrust on a liberalized trade regime continued to remain to date, the reform process and outcomes were not free from reversals and disturbances. Moreover, in line with the current policy debate over the issue whether export promotion should be market-led or government-led, there were policy swings within the liberalized economy model. An outstanding issue that continued to remain has also been the lack of institutional reforms in line with trade liberalization. The major areas that have come under the issue of inadequate institutional reforms are the efficiency of the public sector, the size of the government, deregulation, labour market reforms, property rights, and rule of law.

The overall post-1977 liberalized trade regime was also characterized by different phases led by a number of complex economic and political issues. In general, the initial policy reforms were accompanied by attempts to terminate the country's historical policy and political swings. These measures were aimed at ensuring the long-term decision-making power of an executive presidency, by changing the constitution and election systems and by repressing dissenting political and semi-political institutions. The UNP government, which continued to sustain its power for 17 years through these measures, was able to establish the liberalized policy regime. Although country was seen at the time as an attractive investment centre in Asia, by the early 1980s the continuity in the reform process and resultant economic performance, however, came under threats. The first is a macroeconomic instability caused by the short-term adjustment costs of liberalization and the massive increase in public investment in infrastructure and non-tradable sector. The second was the eruption of a 'twin' political conflict led by the Tamil separatist movement in the North and the Sinhala youth insurgency in the South.

The second wave of policy reforms commenced after 1989 with the military success in the South and the temporary truce in the North. The policy reforms were aimed at stabilizing the economy with fiscal and monetary prudence, reducing pressure on the balance of payments, deregulating the market mechanism, liberalizing current account transactions, and enhancing export promotion. The government showed its active involvement in export promotion, and initiated the privatization programme, which has derived since the inception of policy reforms. There was also a resurgence of redistributive measures, which had faded away after 1977. Although the economy showed the signs of recovery with an enhanced growth momentum, this was short-lived as the 17 year rule of the UNP came into an end in 1994. With this, the economy entered into a state of political instability affecting economic performance. Although the liberalized trade regime continued to be in effect, the period 1994-2004 witnessed emerging political issues taking precedence over economic issues. The formation of weak and unstable governments threatened their own survival and constrained decision-making ability reflecting the need for achieving broader political consensus to ensure long-term economic development.

Development Performance and Challenges

Sri Lanka has never been able to sustain a higher growth momentum, but maintained its real GDP growth at average 4.5% per annum during the past four decades after 1960. However, there is little dispute over the fact that growth performance in the post-1977 liberalized trade regime was greater than that in the pre-1977 restrictive trade regime. There are some important features associated with the long-term growth performance and its short-term fluctuations within each of the policy regimes. Having failed to exploiting the initial advantageous position, the economy entered into a stage of deep and prolonged stagnancy during the period until 1977, covering the first and the second policy regimes. However, together with an expansion in manufacturing production, the growth of GDP shows a moderately upward trend in the initial phase of import substitution in the 1960s. This reflected the result of the exploitation of initial 'easy' import substitution opportunities, which dried up quickly through market constraints in a small economy and the policies of a highly-controlled regime prevalent during 1970-77.

The initial phase of trade liberalization had resulted in a substantially higher growth performance, led more by an unprecedented expansion in construction and service sectors, than by manufacturing growth. The mid 1980s were marked by an important turning point as the trend of GDP growth started to reflect the growth of the manufacturing sector together with a rapid expansion in the export of labour-intensive manufactures. However, the growth performance and export promotion in the liberalized trade regime did not reflect a consistency, since they were closely linked to the divergences in economic policies and macroeconomic stability, the outbreak of civil wars and, the changes on the political front. Even with relatively higher average growth performance, the evidence suggests that the country had not yet set the conditions for sustainable growth and stability by the turn of the century.

By rejecting the fact that Sri Lanka is a 'small' economy greatly tied up with the international economy, the fundamental issue of growth was not addressed at source for three decades after independence. When the fact was realized at policy level, the country had missed the trade opportunities that the international market would have otherwise allowed for gaining growth momentum. In most of the cases, policy formulation has taken the form of short-term 'crisis management' rather than that of a long-term growth objective.

The analysis on the growth performance suggests that the continuation of 'growth-constraining' policies were more important than a direct tradeoff between growth and welfare, in explaining the poor growth performance of the restrictive trade regimes. This does not, however, rule out the implications of the attempt to achieve redistributive justice in a stagnant economy through an extensive welfare system. To a great extent, it set the rules of the game, which made the policy makers 'interlocked' in undermining the policy priority for long-term growth and stability. Moreover, the attempts for achieving redistributive justice in a stagnant economy make no sense as there was so little to distribute.

It is often argued that, being a highly 'trade-dependent' economy, Sri Lanka's growth performance continued to be hindered by the short-term swings and long-term deterioration of the terms of trade. An analysis of growth experience supports a 'reverse' causation running from export promotion to the behaviour of terms of trade. It was since the mid-1980s that the terms of trade have been relatively stable due to the change in export composition. The internal and external imbalances, however, deteriorated substantially during the initial phase of policy reforms in 1977, constraining the expansion in the tradable sector. The question *of how the economy recovered from these initial macroeconomic instabilities remains unanswered since the economy never recovered, due to the eruption of the civil wars. Evidence suggests that not only the macroeconomic stability is important for achieving a sustainable growth momentum, but also growth itself is necessary to maintain the stability.*

Concluding remarks

In a broader sense, the choice of development models in the development history of Sri Lanka coincides with changes in development thinking and practice in the contemporary developing world. Sri Lanka adopted a regulated economy in the pre-1977 period and a liberalized economy in the post-1977 period. However, there were crucial unique features of the Sri Lankan development models, which were not shared by many other countries and, which were in effect undermining the potential growth and development of the economy.

While coping with both economic and political turbulences, Sri Lanka has recorded higher growth performance in its liberalized trade regime than in the restrictive trade regime, though it has so far failed to sustain a steady growth path. There were many gray areas of policy reforms, particularly due to their incompleteness and inconsistency. Besides reforms in policies for trade liberalization, they were not accompanied by purposive and fundamental changes in institutions relating to market regulations, the public sector, the role of the state, and the political structure in consistent with policy reforms. What Sri Lanka needs at its current juncture of the growth process is a challenge, as it requires political stability and consensus to ensure a smooth reform process aimed at achieving long-term development objectives, supported by purposive institutional reforms.

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combined outcome of declining revenue as well as increasing government expenditure are the major problem in the country's public finances at present. Consequent to the higher deficits and resultant borrowings from both domestic and foreign sources, the outstanding stock of government debt has also risen to an unsustainable level. Past experience reveals that the level of public investment has gradually declined mainly to compensate the high budget deficits that are causing from higher recurrent expenditures. As such, increasing public investment has become important to facilitate the private sector participation in economic activities. Accordingly, measures are being introduced particularly to enhance the tax revenue collection and reduce the expenditure almost entirely through further rationalisation of current expenditure are urgent needs.

Skill Development: *Those with appropriate skills at all levels in institutions would help in increasing investment efficiency and hence the overall growth prospects in an economy. As the business environment and consumer demands are changing, continuous upgrading of skills and facilitating the acquisition of new skills is crucial.*

Health and Education: In view of the Sri Lanka's remarkable achievements in the areas of health and education, and constraints in government financing, policies relating to public sector health and education need to be revisited. The policy on health to provide more emphasis on controlling emerging and remerging communicable diseases and high incidence of non-communicable diseases, while focusing more on curative heath care services of vulnerable groups and preventive health care services. Private sector health services needs to be promoted particularly in the area of curative health care services. Health insurance schemes also need to be promoted.

Education: Sri Lanka's remarkable achievements in the spare of education in terms of literacy, has not been able to translate in to educational achievements mainly due to qualitative mismatch between the demand and the supply. This situation demands broad reforms in the secondary and tertiary level education. Given the limited financial resources available in the public sector, private sector investments needs to be encourage within an effective regulatory framework, while public sector education policy giving high priority to provide quality educational facilities at all levels for the underprivileged groups.

Maintaining Greater Stability in Prices: As discussed above, a major share of the consumer basket is essential consumer items, in particular, food items. Therefore, measures are necessary to increase supply condition along with the improvements to productivity, removing bottlenecks in infrastructure and inputs markets. A prudent and independent monetary policy and appropriate fiscal policy too are important in achieving long term goal of price stability.

Financial Sector Reforms: Although the financial sector expanded during recent past, the depth of the financial sector is low as shown by some indicators. For instance, the share of broad money is around 38 per cent in Sri Lanka as compared over 50-60 per cent in neighbouring countries. The intermediation cost in the banking sector which occupy a dominant position in the financial system is high, adversely affecting both savers and borrowers. The high non-performing loans in this sector is another concern. Accordingly, further reforms and improvements in the financial sector, specially in the areas of legal frameworks, debt markets, provident and pension funds is necessary to expand and develop and further improve the efficiency of the financial sector.

In conclusion, however, it needs to be reiterated that the success of many of the above critically dependent on achieving a durable peace. The continuous civil unrest had a huge cost on economic activity with a direct and indirect impacts. In addition, macroeconomic policies, fiscal and monetary policies in particular need to be harmonaised to achieve a stable macroeconomic environment.

Sri Lankan HDI – Comparison with other Developing Countries

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Sri Lanka has gained impressive social indicators during the past decade achieving rates well above world averages. There have been significant gains in the basic health and education indicators such as infant and maternal mortality, life expectancy and literacy through delivery of adequate health care and social services.

There are a number of organizations that have been engaged in major exercises to obtain and analyze data to assess how far countries have been moved towards achieving their goals. The Physical Quality of life Index (PQLI) is one of the early attempts to measure the quality of life or well-being of a country. This index was developed in 1979 by Morris D. Morris of the Overseas Development Council, by averaging rankings on three indicators - literacy rate, infant mortality, and life expectancy at age one – to form the PQLI, which ranges from 1 (for the poorest performance) to 100 (for the best performance). However, the PQLI was abandoned since it captured only the health and education dimensions, leaving out the economic dimensions. Also there is considerable overlap between infant mortality and life expectancy. In 1987, the International Human Suffering Index was introduced comprising ten indicators, but it proved controversial and was not continued.

A more recent measurement of the quality of development is the United Nations Development Programme's (UNDP) Human Development Index (HDI). HDI combines indicators of social development, namely, life expectancy, mean years of schooling, and adult literacy, with an indicator of economic development – real per capita Gross Domestic Product (GDP). According to their performance in the HDI, countries are ranked in three categories-low, medium and high human development countries.

International comparisons of human development show that Sri Lanka has achieved a level of human development well above its level of per capita income. According to HDI ranking, Sri Lanka comes under medium human development category i.e. ranked in 89th position among 173 countries (Human Development Report, 2002). The overall HDI of South Asia has improved substantially over the nineties. Sri Lanka has achieved significant increases in life expectancy, infant mortality and literacy, almost equal with developed countries.

Table 1: Achievement in Social Indicators: International Comparisons

Indicator / Measure	Norway	Malaysia	Thailand	Maldives	Sri Lanka	India	Pakistan	Bangladesh
Life expectancy at birth (years) 1995-2000	78.5	72.5	70.2	65.4	71.6	62.9	60.0	59.1
Adult literacy rate (% age 15 and above) 2000	99.0	87.5	95.5	96.7	91.6	57.2	43.2	41.3
Infant mortality rate (per 1000 live births) 2000	4	8	25	59	17	69	85	100
Human Development Index Rank	1	59	70	84	89	124	138	145
Human Development Index (HDI) value 2000	0.942	0.782	0.762	0.743	0.741	0.577	0.499	0.478

Source: Human Development Report 2002

For the construction of HDI, life expectancy at birth is used as a proxy for the first dimension of human development. Life expectancy at birth in Sri Lanka increased from 43 years in 1946 to 70 in 1981, 72 in 1991 and 73 from 1996-2001 (Department of Census and Statistics), almost equaling almost developed countries. There is a wide gap between the males' and females' longevity 70.7 years and 75.4 years (2000) respectively. This reflects a dramatic improvement in the survival of those groups that were most vulnerable and exposed to high risk of mortality, namely, infants and children in the age group 1-4, and women of child bearing age. In comparison with developing countries, Sri Lanka is well above Pakistan, India, Thailand and Maldives. A considerable variation can be seen within individual countries with people in Sri Lanka living up to 72 years and while those in Nepal live up to 59 years (Human Development Report 2002). The major reason for the improvement of life expectancy in Sri Lanka is the marked increase in the performance and coverage of the health system over the previous decades.

The Infant Mortality rate (IMR) in Sri Lanka has fallen very fast from a very high rate (263 per 1000 live births) in 1935. A decline in the IMR was observed after 1946, and this decline continued during the past few decades. In 2001, it remained at 12.2 per 1000 live births (Registrar General's Department). The highest rate is recorded in the estate sector. A close relationship is seen between the mother's educational attainment, age of the mother, birth order and birth interval in the significant decline in IMR in Sri Lanka. Health care programmes such as immunization, carried out throughout the country at grass-roots level, have also contributed positively towards this progress. The present IMR in Sri Lanka is compatible with most developed countries exceeding the average rate of developing countries which is 60 per 1000 live births (Human Development Report, 2002). Developing countries in South Asia such as India, Pakistan, Bhutan, Nepal, Maldives have very high rates of infant mortality, the highest being in Pakistan of 85 per 1000 live births (Table 1).

The literacy rate is defined as the percentage of the population aged 10 years and over, who are able to read and write at least one language. The Sri Lanka literacy rate has increased from 57.8 percent in 1946 to 91.8 in 2000 with a higher literacy rate among males than females at all ages (Annual Health Bulletin, 2001). Out of the developing countries in South Asia, Pakistan, Nepal and Bangladesh have the lowest rates in literacy. However the literacy rate in the Maldives is well above the rate in Sri Lanka, where it is 96.7 in 2000 (Table 1). While the developing countries in East Asia and the Pacific i.e. Thailand and Philippines, indicate a higher rate of literacy than Sri Lanka, Malaysia, a country with higher per capita income and higher HDI ranking indicates a low literacy rate (87.5 in 2000) than Sri Lanka (Table 1). It is apparent that education leads to many social benefits such as reduction in infant mortality, improvement of standards of hygiene etc.

In the recent past, the World Bank and World Health Organization (WHO) have identified several novel measures to assess overall population health, using information about mortality and disability. They are the burden of

Contd. on page 24...

Foreign Aid and North East Rehabilitation

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Foreign aid plays an important role indevelopment financing in Sri Lanka. On average foreign aid accounts for 4% of the GDP and about half of the government capital expenditure.

Foreign aid consists of concessional loans, outright grants and officially supported export credit financing. The providers of foreign aid are multilateral agencies (Asian Development Bank, World Bank, United Nations etc.) and bilateral donor countries. Concessional loans are provided with low interest, usually around one percent per annum and long maturities of 30 to 40 years with 5 to 10 years grace periods. Officially supported export credit facilities are extended with guarantees provided by the lender country under the OECD Arrangement, with maturities up to 10 to 15 years and in some cases with interest subsidies. Both concessional loans and export credit facilities are for financing of specific projects and they accumulate to external debt stock of Sri Lanka. Grants are also for specific projects or technical assistance programs in the form of providing equipment, consultancy and training which have no repayment obligations.

1. Aid Commitment, Disbursement and Debt

Receipt of foreign aid for a particular year can be accounted on the basis of commitment (amount agreed for the entire life span of the project) or on the basis of disbursement (expenditure incurred in that year). Commitments and disbursements of loans and grants during the past 5 years are given in the Table 1.1 & 1.2 below.

Table 1.1 Foreign Aid Commitments 1999 -2003 (in US$ mn.)

Year	1999	2000	2001	2002	2003	Average 1999 - 2003
Concessional loans	587.0	235.5	610.0	728.2	739.4	580.0
Export Credit	53.1	18.3	76.5	50.8	69.4	53.6
Grants	71.0	96.2	67.3	111.4	144.0	97.9
Total	711.1	350.0	753.8	890.4	952.8	731.7

Table 1.2 Foreign Aid Disbursements 1999 – 2003 (in US$ mn.)

Year	1999	2000	2001	2002	2003	Average 1999 - 2003
Concessional loans	331.4	333.7	404.6	441.7	734.7	449.2
Export Credit	16.4	10.8	21.3	52.8	68.1	33.8
Grants	109.0	71.0	69.0	77.2	83.0	81.8
Total	456.8	415.5	494.9	571.7	885.8	564.9

The External debt on account of concessional loans and export credit during the 1999 – 2003 period with the proportion of non concessional elements and non concessional commercial bank debt is given in the Table 1.3 below. As shown in the table about 96% of our external debt is on account of concessional loans.

Table 1.3 **External Debt stock 1999 - 2003** (in US$ mn.)

External Debt	1999	2000	2001	2002	2003	Average 1999-2003	%
Concessional	**6925**	**6683**	**6550**	**7367**	**8710**	**7247**	95.7%
Loans	6876	6629	6484	7260	8539	7158	
Export credit	49	54	66	107	171	89	
Non concessional	**313**	**235**	**160**	**155**	**357**	**244**	4.3%
Loans	190	148	87	85	184	139	
Export credit	43	31	23	24	25	29	
Commercial Bank	80	56	50	46	148	76	
Total	7238	6710	6710	7522	9067	7491	100%
% of GDP	47%	44%	44%	46%	50%	46%	

Aid Commitment and Disbursement for North and East

The foreign aid committed and disbursed for the North East Rehabilitation during the 1999 – 2003 period are given in table 1.4 below:

Table 1,4 **Foreign Aid for North East Rehabilitation** (in USS mn.)

Types of Aid	1999	2000	2001	2002	2003	Average 1999-2003
Loans: Commitment	48.7	0.0	24.8	50.3	37.3	32.2
Disbursement	12.6	6.8	5.9	27.4	42.9	19.1
Grants: Commitment	1.2	2.4	1.2	31.3	29.8	13.2
Disbursement	7.6	6.2	1.9	5.0	17.7	7.7
Total: Commitment	49.9	2.4	26.0	81.6	67.1	45.4
Disbursement	20.2	13.0	7.8	32.4	60.6	26.8
% of Total Commitment	7.6%	1.0%	3.8%	9.7%	7.6%	
Disbursement	4.6%	3.2%	1.6%	6.2%	7.5%	

Note: Loans include the concessional and export credit.
All island projects which have North East components are not included.

2. North East Rehabilitation

Unlike conflict situations in other countries, the Government of Sri Lanka has from the start recognized its obligations to the conflict affected population and committed to provide humanitarian relief, essential services, rehabilitation and development support even while the conflict endured. Through the government civil administration, which continued to function in the all affected areas, food and medicine being provided by government agencies to all recognized displaced persons

Besides, public services in education and health were provided to the population by the civilian administration under difficult and restrictive conditions. The donor community has amply acknowledged the government efforts and generously provided assistance to lessen the hardships of people exposed to the conflict to support rehabilitation of persons and to create an environment that is conducive to reconciliation.

The affected area covers eight administrative districts in Northern and Eastern Provinces and parts of four adjoining districts namely Puttalam, Anuradhapura, Polonnaruwa and Monaragala.

The first attempt for the mobilization of donor funds exclusively for rehabilitation of North East made in the late 1980s consequent to the signing of the Indo Lanka Peace Accord in 1987. This was spearheaded by the World Bank and all the major multilateral and bilateral donors contributed to this effort. With the resumption of the war in the early 1990s the major rehabilitation efforts were retarded. However donor funds were continued to flow into the North East in reduced amounts mainly for relief and humanitarian assistance. For the convenience of recording we have identified two distinguished periods to present foreign aid flows to North East. These are:

Phase I: Since mid 1980s to early 2000 with the objectives of providing relief, humanitarian assistance and some effort in reconstruction.
Phase II: Consequent to the peace process with more emphasis on urgent rehabilitation and resettlement with donor pledges at Oslo and Tokyo Conferences.

Foreign Aid for Rehabilitation-mid 1980s to the early 2000s

Outright grants and concessional loans disbursed or expenditure incurred from various donor agencies from 1985 to 2001 are given in Table 2.1. During this period around US$ 252 million of grant and loan funds were disbursed for infrastructure rehabilitation in power, agriculture and housing in addition to humanitarian and emergency relief assistance for resettlement of internally displaced persons (IDP). Of this amount concessional loan funds disbursed by 3 donors account for US$ 133 million and grant funds account for US$ 119 million. The figures however, do not include foreign aid disbursed to the North and East from the all island donor funded projects. In particular, funds under all island donor funded projects in the sectors such as Health and education had components in North and East.

Foreign Aid for Rehabilitation 2001 onwards

As shown in the Table 2.2, on the basis of commitment i.e. loan/grant agreements signed, the flow of foreign aid is in increasing trend compared with the previous period of 1985 – 2001. However there are grant assistance continuing from the previous period. In addition to the support extended for infrastructure development, humanitarian, food and relief assistance, technical assistance was also provided for the peace process. Total commitments from 2001 up to now is around US$ 925 million excluding North East components of all island projects. This represents 10% of the total aid commitment to Sri Lanka in this period. Of the total commitment, funds disbursed or expenditure incurred is around 10% during the 2001 – 2004 (up to June) period.

Table 2.1 Disbursement of Foreign Loan & Grants for Rehabilitation 1985 – 2001
(Amounts are in US$ mn. Converted at Current Exchange Rate)

Donor	Type of Assistance and Purpose	Duration	US$ million
	Grants		
Australia	Rehabilitation & Reconstruction	1989 – 1995	2.5
	Community Resettlement	1998 – 2001	2.3
India	Emergency Reconstruction During Occupation of IPKF	1987 – 1990	6.25
Italy	Health Assistance to Displaced People	1990 – 1992	2.0
Netherlands	Rehabilitation Reconstruction	1988 – 1994	10.6
	Reconstruction Damage Houses Amparai	1996 – 2000	2.7
	Rehabilitation – Agriculture in Jaffna	1996 – 1997	1.3
Norway	Rehabilitation Activities Program	1994 – 1998	9.5
	Batticaloa Integrated Rehabilitation	1989 – 1998	9.5
	Humanitarian Assistance to Displaced Persons	1991 – 1993	1.9
	Welfare Centres in Vavuniya	1997 – 1998	0.8
Sweden	Emergency Refugees Assistance	1989 – 1990	0.3
	Humanitarian Assistance	1996 – 1998	0.5
Switzerland	Rehabilitate Thambalgama Rural Hospital	1992 – 1993	0.05
	Reconstruct Kuchchaveli Rural Hospital	1993 – 1996	0.6
UK	Jaffna Power Rehabilitation	1998 – 2000	3.2
Germany	Refugee Rehabilitation – Jaffna	1992 – 1999	15.0
USA	Emergency Relief & Rehabilitation	1983 – 1999	21.6
FAO	Emergency Assistance in Agriculture	1997 – 1999	0.7
UNDP *	Emergency Reconstruction & Rehabilitation	1988 – 1996	3.0
	Health care Facilities	1994 – 1996	0.1
	Rehabilitation & Resettlement in Jaffna	1997 – 2001	2.9
WFP	Emergency Food Assistance to Displaced Persons	1991 – 1999	21.2
			118.3
	Concessional loans		
Italy	Rehabilitate Housing & Health Sectors	1992 – 1996	11.5
ADB	Emergency Road Restoration	1990 – 1994	10.9
	Emergency School Restoration	1988 – 1996	16.3
	Agriculture Rehabilitation	1989 – 1996	22.3
World Bank	Emergency Reconstruction & Rehabilitation	1988 – 1994	46.1
	North East Irrigated Agriculture – Phase I	1999 - 2004	26.2
			133.3
	Grand Total		251.6

3. Institutional Arrangements

In order to address challenges faced by the government in the implementation of an effective relief and rehabilitation programs, in July 1999, the Government initiated a process to develop a framework for relief, rehabilitation and reconciliation. Its objectives were to help strengthen Sri Lanka's Capacity (1) to ensure that the basic needs of people affected by conflict are met; (2) to rebuild productive livelihoods; and (3) to facilitate reconciliation across ethnic lines.

Table 2.2 : Foreign Loan/Grant Commitments for Rehabilitation 2001 onwards
(Amounts are in US$ mn. Converted at Current Exchange Rate)

Donor	Type of Assistance and Purpose	Duration	US$ million
	Grants		
Netherlands	Establishment of the Peace Process	2002 – 2003	0.4
	Community Restoration & Development (NECORD)	2002 – 2004	6.8
Norway	Development & Rehabilitate Batticaloa (DERBA)	2001 – 2005	8.4
	Jaffna Water Conservation & Environment Management	2002 – 2005	1.8
	Rehabilitate Schools Vacated by Forces	2002 – 2004	0.8
Sweden	Secretariat for Coordinate Peace Process	2002 – 2004	0.2
Germany	North East Rehabilitation Fund	2003 – 2006	1.4
(GTZ)	Northern Rehabilitation Project	1996 – 2007	11.0
	Rehabilitation Measures North & East	2001 – 2006	6.3
	Resource Network for Conflict Studies	2003 – 2005	3.0
	Food Security of Conflict Transformation	1999 – 2006	8.4
	Local Initiatives on Conflict Transformation	2003 – 2005	3.2
USA	Humanitarian Assistance Program	2001 – 2004	2.0
	Support to Peace Process	2003 – 2007	1.9
FAO	Resettling Farmer Families	2003 – 2004	0.4
	Emergency Provision of Agriculture	2003 – 2004	0.9
UNDP	Umbrella Project Conflict Affected Area	2001 – 2004	1.2
	Support to National Mine Action	2002 – 2004	0.8
	Creating Dividends of Peace	2002 – 2004	0.2
	Invest in Peace – Main Phase	2003 – 2004	0.6
	Strengthen Information for Peace Process	2003 – 2005	0.6
WFP	Relief Recovery Assistance Conflict Areas	2000 – 2004	31.0
European Commission	Rehabilitation of Valachchanei – Batticaloa Railway line	2003 – 2005	2.2
World Bank	North East Housing Reconstruction	2004 –2005	0.4
			93.6
	Concessional loans		
ADB	N/E Community Restoration & Development (NECORD)	2001 – 2007	28.5
	Conflict Affected Areas Rehabilitation (CAARP)	2004 – 2008	51.5
	North East Coastal Community Development	2004 – 2009	20.3
World Bank	North East Irrigated Agriculture – Phase II	2004 – 2009	65.0
OPEC	N/E Community Restoration & Development	2002 – 2007	4.0
Saudi Fund	Kinniya Ferry Bridge	2004 – 2008	10.6
Japan	Pro-poor Economic Advancement and Community Development (North East Component)	2003 – 2009	10.0
	Export Credit		
UK Export Credit	Rehabilitation of North East Bridges	2003 - 2006	39.6
	Grand Total		323.0

The process was to generate outputs in the form of revised policies, guidelines, strategies and mechanisms providing a common basis and direction for effective support to people in the affected areas.

Thus preparation of the National Framework for Relief, Rehabilitation and Reconciliation took a lengthy consultative process involving all stakeholders and it provides institutional, coordination and logistical requirement for conduct of effective relief, rehabilitation and reconciliation program in the conflict affected areas. This was one of the documents presented to the Donor Forum held in Colombo in June 2002.

The document provided the basis for the establishment of institutional and delivery mechanism for the relief, rehabilitation and reconstruction in the conflict affected areas. However, multiplicity of the agencies involved in such activities did exist till the implementation responsibility was entrusted to the Ministry of Relief, Rehabilitation and Reconciliation in April 2004. With implementation of projects and programs funded by both donors and the government was ensured. The coordination mechanism was further strengthen by the establishment of the Donor Coordination and North East Funding Programme Cluster (NEDCO) under the National Council for Economic Development (NCED). The primary function of the NEDCO will be to facilitate donor coordination in the relief, rehabilitation and reconciliation by acting as a trouble shooter which will assist the line ministries to clear implementation problems.

4. Needs Assessment on North East Rehabilitation

Subsequent to the signing of the Cease Fire Agreement in February 2002, on the request of the Government ADB, World Bank and the UN conducted a Needs Assessment for 8 districts in the North and East and 4 adjoining districts. The Needs Assessment represented an identification of the most evident rehabilitation and development needs of the people in these districts in mid 2003. This was presented to the Tokyo Donor Conference in Reconstruction and Development along with the Poverty Reduction Strategy which form the basis for the US$ 4.5 billion pledged for the period 2003 – 2006.

Salient Features of the Needs Assessment are;

(a) Needs have been sequenced "immediate" (within next 24 months) and medium term (to be undertaken within a six year time frame)

(b) Around 800,000 internally displaced persons (IDP) along with their infrastructure (economic & social) as well as environment facilities are targeted.

(c) The funding requirements are US$ 493 million for immediate needs and US$ 942 mn. for medium term needs.

(d) In addition to all socio-economic sectors and sub sectors, human protection and resettlement and capacity development were considered.

(e) Geographically not only the conflict affected eight districts in North East, but also the parts of other adjoining 4 districts which have been affected were taken into account.

(f) Implementation arrangements are done through Ministry of Relief, Rehabilitation & Reconciliation and relevant Provincial Councils with the support of other Government agencies and NGOs.

In 1st June 2004, the Multilateral Group (MG) representing the agencies of the United Nations together with the World Bank, ADB, IMF and International Organizations for Migration presented a draft on 'Preparing for Transition in Sri Lanka'. This new document has given greater focus in some of the longer term capacity building needs and support for livelihood generation than in the Needs Assessment. The proposed contribution is organized under five thematic areas, namely, (a) Human Security (b) Rehabilitation of Social and Economic infrastructure (c) Revitalization of Economic Infrastructure (d) Restoration of Economic Livelihood and Opportunities and (e) Governance and Capacity Development.

Based on the finding of the Needs Assessment the document on 'Preparing for Transition in Sri Lanka' has identified the following sectoral issues in the conflict affected areas.

a) Health

As a result of two decade long conflicthealth infrastructure has been severely damaged and there is a serious lack of all levels health staff. Out of 400 health institutions 55 are totally destroyed and 49 are not functioning. Of the 11,000 posts in the health care 4500 posts (41%) are vacant mainly in the skilled and professional cadre. Infectious diseases, HIV/AIDS risk and also disability due to landmine accidents are also concerns in the area.

b) Education

In addition to damaged infrastructure in education sector major problems are non-enrolment, drop-outs, absenteeism and learning quality as a result of displacement, psychosocial problems, lack of teachers and nutritional deficiencies.

c) Shelter

Fifty eight percent of housing stock (about 325,000 houses) in North and East have been damaged or destroyed. Estimated cost exceeds US$ 1.0 billion and nearly 50% damaged houses are in Jaffna and Batticaloa districts.

d) Roads/Railways

Damaged roads which require rehabilitation are 700km in class A and B, 600 km class C and D. There are bridges and ferries needs to be rehabilitated & replaced. Damage of the Northern Railway line from Vavuniya onwards.

e) Power

Total damage for power in North and East is about 110mw. Households currently electrified in the North is 22% and in the East 40% as against national coverage of 58%. Transmission line length of 150 km between Vavuniya and the North has been destroyed.

f) Irrigation

Due to the conflict most of the irrigation systems which cover total 323,000 of hectares of agriculture have been neglected or damaged.

g) Water & Sanitation

As a result of prolonged war the proportion of households that have access to safe water in North East is limited to 20% compared with 45% nationally. In many urban water schemes tanks and distribution networks have been damaged or destroyed.

h) Human protection

Legal protection, social protection and physical protection of the people have been lost due to war in last two decades. Almost all people were suffered livelihoods and fear of imminent threats to life.

i) Internally Displaced Persons

Around 356,000 internally displaced persons may return to their permanent places of living from refugee camps and other places.

Donor involvement in various sectors of North East Rehabilitation is given in Table 4.1 below:

5. Pipeline Projects for Foreign Aid - Rehabilitation of Conflict Affected Area

There are substantial number of foreign aid funded projects for the rehabilitation of conflict affected areas which are in pipeline. They are listed below:

Table: 4.1 Donor Involvement in Sector/Activities for Rehabilitation

Sector/Activities	Donors
Health	
- Nutrition Services for Children & Women	World Bank (WB), WHO, UNICEF, UNFPA
- Raise Awareness & Prevent HIV/AIDS	WHO, World Bank, UNHCR, UNFPA, UNICEF
- Prevent and Control of Diseases	WHO, World Bank
Food Hygiene and Safety Standards	WHO, FAO, WFP
- Health Information System	WB, WHO, UNICEF, UNFPA
- Strategies to Policy Issues	WB, ADB, WHO, UNFPA
Early Childhood & School Nutrition	WFP, WHO, FAO, UNICEF
Education	
- Increase Quality of Education	ADB, WB, UNICEF, WHO
Catch up Education	ADB, WB, WHO, WFP, FAO
Shelter	
- Temporary & Semi-temporary Shelter	UNHCR, IMO
- Unified Assistance Scheme	UNDP, WB, ILO, WFP, USA
Roads	
- Rehabilitate Class A & B Roads & Bridges	ADB, WB, Bilateral
- Rehabilitate Class C & D Roads	ADB, WB, ILO, WFP, EC
Power	
- Rehabilitate Main Transmission Line, Vavuniya-Kilinochchi	ADB, JBIC & Germany
- Provide Rural Electrification	ADB & Bilateral
- Provide Alternate Energy Systems	WB, ADB, Bilateral
Irrigation	
- Rehabilitate Major & Medium Systems	WB, ADB, IOM, Bilateral
- Rehabilitate Minor Irrigation Schemes	WB, ADB, WFP, Bilateral
Water & Sanitation	
- Urban & Rural Water/Sanitation Schemes	ADB, WB, Bilateral
- Rehabilitate Jaffna Water Supply & Sewerage	ADB, WB, Bilateral
Institutions, Water & Sanitation	ADB, WB, UNICEF, Bilateral
Human Protection	
- Legal Protection	HRC, UNHCR, UNDP, UNFPA, ILO, UNICEF
- Social Protection	UNHCR, UNICEF
- Physical Protection Through Integrated Demine Action	UNDP, UNICEF, WB, ADB, UNHCR, NGOs

Asian Development Bank (ADB)

Total outlay of ADB projects to support conflict affected areas is estimated at US$ 190 million for the period 2004 – 2006. Two pipeline projects for which agreements to be signed are; Power and Electrification ($ 33 mn) and Secondary Towns Community Based Water and Sanitation ($ 30 mn).

Food and Agricultural Organization (FAO)

Two projects are in firm pipeline with estimated cost of US$ 2.9 mn up to 2006 on agriculture, fisheries to facilitate returning IDPs.

International Fund for Agriculture Development (IFAD)

The Livelihood Support in Dry Zone Project will be concentrate in areas adjoining the North East conflict zones. Another project which is in pipeline focuses on fisheries and marine resources development in the North East coast.

International Labour Organization (ILO)

Technical assistances, specific for North & East are in pipeline will concentrate skills training, entrepreneurship, labour based technology, workers rights and social protection.

International Organization for Migration (IOM)

IOM's pipeline programs for the period 2004 – 2006 are estimated approximately US$ 5 mn. This consists of Reintegration of refugees returning from India ($ 2.0 mn), capacity building in migration management ($ 2.0 mn) and assistance for sustainable reintegration of IDPs ($ 0.7 mn).

United Nations Children's Fund (UNICEF)

The total budget of UNICEF's programs for 2004 – 2006 period targeted at conflict affected areas is $ 37 mn on health, nutrition, education, social protection and to ensure rights of children.

United Nations Development Program (UNDP)

UNDP assistance to conflict affected areas is estimated at US$ 15 mn for next 3 years (2004 – 2006) transition programs. Another major intervention in the pipeline is the Mine Action Program ($ 3.5 mn).

United Nations High Commission for Refugees (UNHCR)

UNHCR's operation for 2005 and 2006 for North and East is estimated US$ 4 mn each year on protection, community services and domestic needs/household support. In addition UNHCR joint projects with other UN agencies will be implemented.

World Bank

In addition to existing commitment for North East rehabilitation, major project in pipeline is Housing Reconstruction Program for North East with US$ 75 million.

European Commission (EC)

EC has earmarked a grant of Euro 13 mn for the rehabilitation of C & D class roads in the North and East.

Japan

Japan is financing the erection of 132kv power transmission line from Vavuniya to Kilinochchi and the substation in Kilinochchi. In addition, provision of 35 Mw Power Plant to strengthen the power supply in Jaffna is under consideration. Rehabilitation of Jaffna Teaching Hospital will also be financed by Japan.

Germany

Germany is financing the erection of 132kv power transmission line from Kilinochchi to Jaffna.

France

French government is providing funding to conduct a feasibility study to augment the Trincomallee Water Supply Scheme.

Conclusion

Amidst the conflict situation the Government of Sri Lanka continued to provide humanitarian relief, essential services, rehabilitation and development support to the affected people. This was amply supported by the donor community. In the 1985 to 2001 period a total of US$ 251.6 mn was disbursed in the North and East for such programs. This has strengthen the hands of the Government in maintaining essential services and provision of humanitarian assistance in difficult and restrictive conditions. With the signing of the Cease Fire Agreement and the initiation of the peace process the donor community has pledged enhanced assistance for the rehabilitation of the conflict affected areas. During the period from 2001 up to now a total of US$ 323 mn has been committed by the donors for the rehabilitation of conflict affected areas of which 40% has been disbursed. Of this about US$ 93 mn is in the form of grants and the balance US$ 230 mn in concessional loans and export credit. However, the implementation of donor funded projects in the conflict affected area is slower due to depleted human resources, lack of basic raw material, logistical problems, security consideration and enhanced contract costs due to extra payments etc. While some of these problems can be addressed with the new coordination mechanisms brought under the leadership of the Ministry of Relief, Rehabilitation and Reconciliation and the Donor Coordination and North East Funding program cluster of NCED, implementation of a more speedy reconstruction programme needs to await normalcy through a political resolution to the problem.

Contd. from page 19...

disease' i.e. disability adjusted life years (DALY), and some measure of life expectancy i.e. Disability adjusted life expectancy (DALE) (Arneson and Nord, 1999). According to WHO Reports (1999/2000) DALE ranking shows Sri Lanka in the 76th position, which further shows the better achievement in population health.

Table 2 : GDP per capita (PPP$) in South Asia

Year	India	Pakistan	Bangiadesh	Nepal	Sri Lanka	Bhutan	Maldives
1990	1072	1862	872	920	2405	800	1200
1992	1230	2890	1230	1170	2850	750	1200
1994	1348	2154	1331	1132	3277	1289	2200
1996	1580	1600	1010	1090	2290	-	3140
1998	2077	1615	1361	1157	2979	1536	4083
2000	2358	1928	1602	1327	3530	1412	4485

Source: Human Development in South Asia, 2002

Despite the relatively high achievements in social development, Sri Lanka has performed unsatisfactorily in the area of economic well-being, measured in terms of real GDP per capita. In terms of purchasing adjusted GDP per capita, Sri Lanka is above the average for developing countries and the mean for least developed countries (Table 2). However it is considerably below the world average (National Human Development Report, 1998). Norway, Sweden and Canada can be identified as the countries which are at the top of the HDI ranking and Sierra Leone, Niger and Burundi at the bottom. There are wide disparities in global human development where Norway's HDI value of 0.942 is more than three times Sierra Leone's 0.275 (Table 1). The HDI value for Sri Lanka is well above the average for all developing countries and substantially above the average for least developed countries. However, in comparison with 173 countries , Sri Lanka is well below the mid position in GNP per capita ranking.

However, the link between economic prosperity and achievement of better indicators is neither automatic nor obvious. Two countries with similar per capita income can have very different HDI values and also countries with similar HDI values can have very different income levels. It is evident that there are outside factors contributing to the significant increase in social indicators. In the case of Sri Lanka, free health care, the priority given by the successive governments to heavy investments in several welfare measures such as free education, subsidized or free supply of essential food items etc. have contributed to its success.

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Harnessing Human Resources in the Development Process

A Sustainable Solution To Unemployment and Poverty

The concept of aiming to harness the energies, innate abilities and talents of the youth to achieve successfully more rapidly and efficiently their own progress as well as that of the nation and its people, should be concentrated upon very seriously in the development process. Harnessing human resources available in abundance is a priority sector in the development process, which will undoubtedly reap economic benefits to unprecedented levels in the vital economic development process in Sri Lanka. Ours is a country richly endowed with huge human capital. It comprises of an educated society with high professional skills. The literacy rate is one of the highest in the region-second only to Japan.

Sri Lanka is a third world developing country. However in comparison to other third world countries our progress in the economic process has not shown admirable results and a reasonable progress. Harnessing Human Resources in the development process in Sri Lanka has to be a long-term plan to sustain the economy and further development for productive expansion. In the present age of industrialization and development the country has the high potential in human resources to equal, overtake and surpass countries like Malaysia and Singapore. However with a lower potential in human resources the planning and policies of the respective administrations of these countries have made them self sufficient, rich and possessing abundance of reserve wealth.

Unfortunately the ongoing internal conflict in the north and east which has raged for over two decades devastating the north and East has made our economy to be at a low ebb forcing the administrators to be in a position of insecurity which has stood in the way of positive development. This "inverted ethnic problem" Which has prevailed for a lengthy period of time has increased the problem of unemployment and under employment in the country lack of proper vision is allowing the ethnic war to drag on, which has proved counter productive to the perpetrators now desperate for peace. Although a ceasefire agreement has been in force since February 2002 the authorities including International monitoring missions have failed to begin an exercise for LTTE cadres to change their attitudes by surrendering arms. This factor has strongly hindered and prevented harnessing the talents and innate abilities of thousands of youth to contribute to the development process to uplift the economic standards that now prevail. In this context formulating suitable schemes for academic, vocational training have been totally impossible as rehabilitation of the youth cannot by any means commence. To begin these activities initially harmony has to be totally restored.

At Independence "Indian Labour" contributed immensely towards our economy in the extensive fields of Tea and Rubber industries in particular and as tappers in the coconut cultivations for toddy and arrack traces.

Sunil Thenabadu

National Youth Services Council

Maharagama.

Unsystematic eviction from the country by questionable laws and intentions wrecked the sustenance of the economy. At the end of world war - II "Ceylon" then had the best foreign exchange resources among the countries in the East surpassing those of Burma, Malaysia and Singapore. Only Ceylon, which contributed much to the war effort with "slaughter tapping" of rubber under the colonial rule. The rubber was tapped to the maximum to build us a substantial foreign exchange reserve. During this period we were able to build Gal-oya development scheme without foreign aid. At this time future leaders like Lee Kwan Yu, eyed and envied Ceylon and wanted to make us a model for newly developing countries. Very unfortunately this was not to be. After Independence Sri Lanka without focusing on development of economic progress set it sight on reviving ancient and "national culture and heritage" at the expense of the minorities and thereby created damaging divisions within the country. This had at that time and later on made a drastic impact on the country as a whole. The Indian Tamils were deprived of their privileges in spite of carrying huge burden on their shoulders. Ceylon's export earnings. They were discriminated by law and deprived of their citizenship and a considerable number was repatriated and those who remained were made "stateless". This obviously effected their morale and their contribution to the economic progress was retarded. No indigenous working troupes were prepared to take their place in the "slavish situation" in the estate sector.

The Sri Lankan of working age were in search of "White Collar Work" for respectability especially in the public sector as the private sector was at that time was were more over non existent. They were not concerned and interested in engaging in productive work in favour of the economic progress. A minor proportion opted for "Blue collar work" with having inherent abilities in mechanical and craft work pertaining to wood, clay, coir, metal, brass, silver, straw, etc.,. The majority preferred to be administrators and clerks.

After Independence and the subsequent "Swabasification" of education the predominant products of the schools were not fit for productive employment. The majority was seeking "White Collar" jobs in the public sector. As time progressed a noticeable limitation of job opportunities was observed in the public sector. Unlike in the colonial days when a job opportunity in the public sector was much sought after today the private sector is far above as a potential sector for employment creation; thereby harnessing skilled human resources available in abundance. This is a one major area where contribution is visible towards the essential economic development process which is a vital ingredient for a 3rd world developing nation like ours, considered new born. It is also clearly visible that the trends in globalization have reduced the government's involvement in the economy relatively in relation to that of the private sector. The private sector too cannot cater at all to the demands of the potential youth qualified and trained in academic and vocational fields to a great extent as job opportunities are limited and at present reached saturation point. As the only other alternative they opted for self-employment and entrepreneurship. To fulfill this cause the government authorities should intervene by guiding them with innovative and modern methods of technology by assisting and aiding them to obtain finances without much hassle through banks and other financial institutions and finding markets for the products. The state sector should take the initiative in the formation of a strong base for the ventures of unemployed. Although the percentage is low several young entrepreneurs through self-employment have been very successfully with their projects and enterprises, which have found markets not only in Sri Lanka but in the export market as well. Some entrepreneurs have become world renowned as exporters through sheer perseverance commencing life and business on a small scale, ultimately have succeeded to be extremely famous businessmen having been able to penetrate into the export market through their innate abilities and skills by producing demanding products. They have contributed in some way in providing employment to many, contributing immensely to the unemployment problem. Simultaneously they have earned a considerable amount, in foreign exchange for the country. However solving the increasing unemployment problem, which unfortunately has major drawbacks and handicaps in our infrastructure. Some main constraints and hindrances are appended below.

a. Increase in population combined with inflation

b. Educated youth and unskilled youth

c. Devoid of a vast agriculture base

d. Limited land area and water resources

e. Fuel and energy limitations

f. Computer technology replacing man power

But if a well-planned vision is executed with great commitment a sustainable economy can be developed in the future with a higher standard of living for all. But above all peace is essential. Without peace on a permanent basis, prosperity and progress cannot be achieved. Acceptable lasting peace for all must be ensured and the minorities made to feel secure and accepted as Sri Lankans, if the country is to be stride forward in the much needed development progress. All communities should live in harmony without the country been divided. The Island's sovereignty has to be respected by all peace living people. The assistance of the International facilitators is very important. Once peace is evolved all could work with confidence, gain and regain the lost prestige with a clear vision for the future. Reconstructions and Rehabilitation must be completed at a rapid pace in the devastated areas of the North and East in particular. All citizens living in the country must be made feel secure, without security morale is affected which is turn to the cause for low productivity. Emphasis should be laid on permanent peace and security as a vital base to build up the economy through our unlimited Human Resources.

As a geographical unit Sri Lanka is endowed but not adequately in relation and comparison to those of the developed countries. The constraints concerning our administrators are:

a. Our square area of land is small

b. No fuel resources – Hydro Electric Power is insufficient

c. Rivers and reservoirs are relatively small

d. North, East and North Central areas are dry and arid

The country was even after the colonial days self sufficient in agriculture. Regretfully at present Agriculture alone cannot sustain the population to a reasonably satisfying level of living. However with the available resources it should be regarded a priority to improve this sector which is exactly the related authorities are focusing on, with a view to a prosperous future "Rata Perata"

Every endeavor should be taken to find employment for the literate in public and private sectors by creating new opportunities. But the job opportunities cannot obliviously found for the unskilled and untrained. For them future education has to made compulsorily employment oriented. That of the unemployed in the rural sector have got to be persuaded to take to self employment with projects to develop skills in numerous fields to be productive in our economic development process.

Much our consumer foods are imported from china, India, Europe, America and Malaysia. Most of these items could be produced if facilities are made available, with the assistance of technical know-how from expertise. This well ultimately save our important foreign exchange and will boost our economy through export of such items, manufactured. This in addition will help to harness our human resources and help to a great extent in the economic development process.

We have skilled workers in the textile industry. Hence we could progressively through a planned program manufacture most of our clothing, an industry, which has already got established with the assistance of foreign expertise. The final product although is for export this industry could be diversified to cater for an adequate market for the locals. This programe if properly implemented would reap benefits and solve the unemployment for some extent and reap benefits in the economic development process. The present handloom industries could be boosted for the entrepreneurs by introducing innovative technology. The final product is an ideal one which could be enlisted for export with exotic and exquisite designs and variable textures. Emphasis should be laid on quality and not quantity as such products with good finishes will no doubt catch and attract the foreign buyers with ease.

To harness human resources in our development process emphasise and focus should be made on products made as handicrafts as China does with Bamboo and Straw. They produce handicrafts on a massive scale but not with good finish. "Those engaged in handicrafts in Sri Lanka are involved in labour intensive production process using minimum technology without sophisticated machinery. The final product turned out is invariably exotic as they are hand made. Our handicraft products have good export market which has thrived in the market for a long period. There are certain manufactures who manufacture wooden and leather products who have permanent export orders for their products in countries. Like U.S.A, U.K, Germany etc.,. Similarly there are products from Brass and Silver manufactured in the hill capital which could be easily broad based to help in the unemployment and development process. The state sector should take more interest in these products and help to boost the entrepreneurs in their respective industries by providing them with more expertise advise and infrastructure facilities. If the present facilities are broad based with more research on each industry are made, these industries are sure to stride forward for the benefit of our country and the economy.

In fruit cultivation, flora and foliage industries we cannot compete with countries such as China, America, Australia, India and Thailand who have established in these fields and have strong and long standing links with their exporting countries. However as we are blessed with sun and a good climate fruits like Bananas, Mangoes, Pineapple and Pumpkin could be grown on extensive scales for export, fresh or after preservation. At present there are exporters who are engaged in this field covering our vegetables as well. The related state authorities should take steps to boost this export business which would encourage the unemployed in our development process. The final product could also be used for consumption by selling locally. To forge ahead in these areas the state and private sector should make research and tap all available resources both natural and human to contribute to our development process. Under a planned economy agriculture and industry based productivity could be expanded to absorb most of the unemployed. Foreign investors are quite aware that Sri Lankan workers especially the skilled picks up fast and gathers knowledge about the working procedures very quickly and efficiently unlike those counterparts in other countries. In this context foreign investors would prefer to invest foreign capital in our country where the human labour cost them is very negligible. Hence inviting foreign investors with huge capital for production would help to a great extent in deploying our unemployed which currently each one of our main concerns. If proper coordination with the correct foreign investors is made convincing them with regard to our infrastructure facilities these is a possibility for Sri Lanka to emerge as a country without much unemployment. Simultaneously a sustainable economy with a high standard of living for its inhabitants could be made. The main inputs for the success of economic situation is initiating a total and proper planning.

We need not rely on imports for our food. By expanding our agriculture base essential food like rice, potatoes, chilies, vegetables, gram, fruits, including grapes, apples, pears could be grown in different climates. There is a lot of scope in the fishing industry. Unfortunately the industry has not been monitored properly by the authorities to benefit the fisherman. It is the outsiders who monopolise the sales thus forcing the consumers to pay exorbitant prices for purchases. Incentives should be given to those engaged in Animal Husbandry, Poultry, Dairy, and Ornamental Fish which are popular industries in urban as well as rural areas. Many are engaged with dedication and enthusiasm in their respective self employment projects which ease the unemployment problem. Here too the state should intervene to make proper surveys and provide them with necessary infrastructure facilities and guide them to build and expand to enhance their financial status and to provide employment for the unemployed. Those interested should be provided with a platform to commence and embark on similar projects for the betterment of their economic standards. To make this exercise a reality state, corporate bodies with the assistance of rural cooperative unions must unite and work together towards prosperity which can easily eliminate to some extent unemployment and poverty. Aggressive and sustained application is bound to bring results.

Sri Lankan Law on Foreign Employment was enacted in 1985 by Act. No. 21 of 1985 in order to regulate the business of recruitment of Sri Lankans for overseas employment by private sector undertakings and public corporations. In the year 1985 the undertakings and public corporations. In the year 1985 the stock of Sri Lankans in the Gulf countries was estimated at around 150 000 workers. Today it is estimated by sources of the Sri Lanka Bureau of Foreign Employment to be nearly one million employed in the Gulf region. The majority are female migrant domestic workers. This figure contributes about one seventh of the total labour force. The amount of foreign exchange earned by the domestic and skilled and non skilled migrant workers is the highest recorded foreign currency earner of the country. The amount of foreign currency remitted to banks in Sri Lanka monthly amounts to billions of Dollars. This source of foreign currency is undoubtedly easily the highest foreign currency earner, very much more than our other export foreign currency earnings. It is reliably learnt that countries of the Middle East are keen and prefer to employ domestic workers from Sri Lanka. Unfortunately there have been several reported cases of violation of human rights, abuse, harassment and exploitation among them. Reasons for this situation may be in special socio – political structures, cultural orientations, unfamiliarity with local labour standards in the host country and unpreparedness and coping difficulties of female migrants leaving for the first time employment. However those who have migrated several times form a preponderant network of Sri Lankans with their employees and the working environment. Migrant workers are organized in cultural associations supportive to Sri Lankans in distress. However those in distress are looked into by the embassy authorities in coordination with the Sri Lanka Bureau of Foreign Employment. Migrant domestic workers contribute to the socio economic development of families, societies and economies but domestic work remains unrecognized and undervalued. Those affected such by unscrupulous job agencies are now identified, nabbed and legal action contemplated against them. The licences of many such job agencies have been cancelled. Appropriate step as migrant workers helps to a great extent in resolving of the chronic unemployment problem that prevails in our country.

The Apparel Industry, which comes under the purview of the Board of Investments in Sri Lanka, has contributed immensely towards unemployment and the development process. In addition to the factories in the free trade zones garment factories in the apparel industry have been constructed and run in rural villages and in close proximity to towns in the outstations. Thousands of females in the unemployed category have got the opportunity to be employed in these factories. The final apparel product is exclusively for export. Foreign investors have made good use of our labour in their production process. However we have gained in providing a good living in the rural areas mainly for the poor.

National Youth Services Council (NYSC) was established in the year 1969 as a pioneering step taken by the government in the field of youth development. Its scope of activities was further boosted widened with its reorganisation under Youth Services Act No.69 of 1979 enacted by the Parliament.

National Youth Services Council functions as a statutory body under the ministry of Youth Affairs and Sports headed by the Director General cum Chairman of the Council. The NYSC is the only state organization which is responsible for policy making, planning and co-ordinating youth activities at the national level and whose objective is to promote the interest of youth so as to ensure their development through participation. There are short term goals and long term goals of the National Youth Services Council to ensure holistic development and in particular:

a. To foster among youth a spirit of national consciousness

b. Sense of discipline

c. An awareness of social and economic problems

d. Sense of dignity of labour

The NYSC is presently making proposals to open 25 fully fledged Youth information centres covering all districts including the North and East. This is a new concept ideally suited in today's context where areas of academic and vocational training are to be conducted in a advanced manner to meet the required job market. The main areas will include computer technology, programs for foreign and local employment, career guidance, youth counselling which should be made possible under one roof.

Current trends in unemployment in Sri Lanka will face great difficulties for those not willing to change attitudes to match globalization. Traditional employment predominant in the colonial era such as clerical, typing cannot be validated when the economies slide towards rapidly changing globalization process in common aspects of economic, political and cultural.

In this perspective we do not have an alternative or even to think of other alternatives other than engaging with the competition created by the global markets. Therefore Sri Lanka has to adopt to work with the extremely rapidly changing market economies.

In this context and in the context of the aforegoing it is a dire necessity to harness human resources in the development process, which in turn would develop a firm base for a sustainable solution for unemployment and poverty.

Rapid Economic Growth and Development in China

An overvivew of Chinese Economy

Summary

As one of the largest economy in the world, China plays magnificent role in international trade and globalization process. The emergence of rapid development in china poses both challenges and opportunities to rest to the world indicating a sign of "awaking Gorilla". Therefore the article intends to review past economic performance of Chinese economy as the economic giant in the Asian region and the world economy. The article consists of five sections; the section one highlights background of speedy economic growth in china with respect in macro economic indicators such as GDP trade openness, per capita incom and employment etc. The section two reviews strategy and policies adopted by china in achieving rapid development. It also highlights source of economic growth. The section three present main factor contributed for the fast development in china, with special reference in features of Chinese economic growth. The section four reviews emerging issues related to rapid economic growth and its consequence effects. The section five depicts subsequence effect and impact on regional and global economy and finally, the section six presents conclusion of the review article.

Introduction

As a developing country and a transitional economy china shows very promising economic growth, maintaining around 8 percent annual growth rate in the past two decades despite slow and negative growth rates in many developed and developing countries (IMF,2000). As a result of economic reforms introduced since 1978, it was able to maintain around 8 percent consistent economic growth rate during 1978-2000 periods, with the highest 15 percent and the lowest 5 percent in some years. According to Fang and Meiyan (2002), the china was able to double it's per capita GDP within 9 years between 1978-1987, where as United Kingdom 58 years (1780-1838), and Korea 11 years (1966-1977) spent to double their per capita GDP. In 2000, China's GDP was reached RMB 8,818.9 billion (US$ 1079 billion) and able to become the sixth largest economy in the world, followed by USA ($9,883 Billion), Japan ($4'677 Billion), Germany ($1870 Billion), United Kingdom ($1413 Billion) and France ($1286 Billion). Though it indicate very impressive performance in china's economic development, still china face greater challenges in overcoming inherited rural poverty, huge urban-rural disparity and unemployment, despite some positive achievements in maintaining low inflation rate (Fang and Meiyan, 2002). Due to high growth rate and negative characteristics some economists questioned about china's economic growth (Rawski, 2001). Some of these skeptic views were mainly based on lack of consistents and reliable data base for comparable time series analysis. Though both economists and researchers were responded with the regard, it is not easy to countries, due to its specific nature of being a transitional economy as well as developing country (Gang, 2002).

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Being a communist country china's rapid growth performance present various paradoxes that have become the most interesting subject among economists and policy makers, especially in term of strategic thinking and policy formulation. As a result, lot of academicians paid special attention to study china as case study of economic development. Basically two schools of thoughts could be recognized in this regard namely experimentalist school and convergence school. The former believe that chin's fast economic development is a result of gradual process of evolutionary, experimental and incremental nature of reforms followed over the past and the second, Convergence school trust that rapid economic development is direct effect of gradual conversion and catch up of market economies (Jeffrey D. Saches and Wing Thye Woo (2000).

As a result of dynamic economic reforms followed over the since 1970s, China has enrich with ample literature and information on socio-economic pattern and distributional effects. The available literature on economic reforms and its impact on overall development could classify under two categories. Quantitative analysis, based on modeling and statistical testing [Micale Castanheira and Gerard Roland, (2000), Xiangkang Yin (2001), Guoqiang Tian (2000), Loren Brandt (2001), Wei Zhang (2001) and Albert Park and Kaja Sehrt 9200]; and descriptive analysis which mainly based on perfomance evaluations [Jeffrey D. Saches and Wing Thye Woo (2000), Cai Fang and Wang MEIYAN (2002), fang Gang (2004), Liu Shucheng, Wang Lina and Chang Xin (2002) and Wawick J. Mckibbin, Li Kui-Wai, 2001 and Wing Thye Woo (2004)]. As an academic exercise, the aim of this article is to review factor affected for rapid economic development in china by considering views of both schools of thought.

2. Strategy and Policy

Being a communist country, which followed inward looking policies nearly for forty years, China introduced outward looking development policies since 1978 as the main strategy of economic development. Outward looking policies focused mainly on liberal economic policies while ascertaining strong government sector to regularize resource distribution and to protect rural mass. As viewed by both schools of thoughts China's reform strategy followed since 1978 has been described as a "**dual track approach**": the establishment of market track in parallel to the pre existing planning track. The dual track approach pervades almost every aspects of policy making; sectoral reforms, price deregulation, enterprise restructuring, regional development, trade promotion, foreign exchange management, central-local fiscal arrangements and domestic currency issuance Zhuada fangxiao strategy, "protect the large release the small".

The dual track approach, which mainly based on agricultural sector was greatly influenced to eliminate of commune-brigade system of collective farming, replacing by leasing of commune lands to individual peasant households. Dual track strategy was adopted as the means to integrate China gradually into world trading and financial systems (Jeffery D. Saches and Wing Thye Woo (2000). In 1980, four southern coastal cities (Shantou, Shenzhen, Xiamen and Zhuhai) were designated as special Economic Zones (SEZs) with autonomic economic power deal with international economy. The resulting phenomenal growth of the SEZs spread to other regions in terms of factor mobility and demand for services.

iii. Summary. Policy reforms followed by Chinese government since 1978 could distinguish under two regimes such as 1980s regimes (Li Kui-Wai, 2001). Thus, Policies introduced during 1980s were focused on;

1. Family Responsibility System: Under the system under the system, it was intended to improve the income and output of rural households. The program was so effective that per capita consumption index of agricultural residents was increased from 100 (1978) to 199 (1986) while the index for non agricultural residents increased only to 158.1. The percentage rural households that received a net income between RMB 500-2000 was only 1.6 percent in 1980, but increased to 22.16 percent in 1985. Accumulated income in the rural areas resulted in the rise in aggregate demand for the consumer goods and light industrial goods.

2. Introduce a dual price system. It was intended to improve resource allocation through the market mechanism. A dual price system was introduced as measure to promote market economy (Wu and Zhao, 1987). The price reform concentrated mainly on the price of final products, but lacked reform in the price of factors of production such as land, labor and capital. In the state sector, wage comprises of two parts; a take home net monetary benefits and non-monetary wage comprised of various welfare related goods provide by the SOEs. Finally dual price system was ended up with severe economic distortions (Li Kui-Wai, 2001).

3. Fiscal reforms in the form of profit tax substituting for profit remittance. It was intended to change of revenue submission with a view to encourage business enterprises.

As a result of policy reforms, agricultural sector was developed more commercially leading towards provision of externalities to expand industrial and service sectors as well. Thereby some policy reforms were introduced in 1984 to reorganize state owned enterprises (SOEs) more efficient manner. Reforms introduced in 1990s were mainly concentrated on trade liberalization, structural adjustment and monetary policies. It includes;

1. Implement independent and flexible monetary policy.

2. Redirected investment priorities to ease industrial and economic bottlenecks to promote long term infrastructure development.

3. Introduce Zhuada fangxiao strategy, "protect the large release the small" to promote state Owned Industries (SOEs).

Reforms introduced since 1985 were emphasized the need for a strong and consistent macro economic base for sustainable growth and development. Thus it was considered four elements in achieving sustainable development; productivity of capital and labor is equally important, investment in infrastructure, backward and forward linkages in output and employment and balance growth. While macro economic reform is the main goal of the above reforms, it was expected to implement efficient management system that include corporate culture at state and enterprise levels and reduction in the agency cost and moral hazard (Li Kui-Wai, 2001). As shown by Jeffrey D. Sachs and Wing Thye Woo (2000), dismantling of communes and replace by households farm plots, liberalization of township and village enterprises (TVEs) and opening up the coastal regions could be regarded as radical measures followed by China. Compared to transitional economies in Eastern Europe and East Asian countries opening of Chinese economy was proceed more gradually and effectively to adjust with global economy by bringing huge Chinese labor force into an export oriented labor market. However, some imperfections could be seen due to partial liberalization process in some sectors.

2.1 Sources of Growth

Source of economic growth for maintaining 9.5 percent annual growth rate in 1978-1998 periods was attributed with several factors. As estimated by cai et al, (1999), it is attributed to increase in Physical capital (28 percent), labor force employed (24 percent), accumulation of human capital (24 percent), labor mobility from low productivity sector to high productivity sector to high productivity sector (21 percent) and total factor productivity (3 percent). As the most populated country of the world, China's reliance on labor force and human capital is relatively high. The contribution of total factor productivity is not attractive though the access to FDI and international market is satisfactory. Despite the fact that the total factor productivity in terms of access to technology and growth convergence is a crucial factor for fast economic development as presented in solow (1956) model, the above estimates have not given much weight in this regard as argued by convergence school. The proportion of state budgetary appropriation has increased during the period that increasing fixed assets investment from domestic loans, fund raising and others. But the share of foreign direct investment (FDI) is insignificant though it expected that China's reliance on FDI is high (Cai Fang and Wang Meiyan 2002).

According to Jeffrey D. Sachs and Wing Thye Woo (2000), two factors have effectively contributed as main sources of maintaining consistent economic growth for the reform period in China.

1. Non-state sector (including household agriculture, rural industry, private enterprises, urban collectives and joint ventures) has grown much faster than the state sector and consequently the share of SOEs in aggregate production has declined markedly. Thus, share of industrial products fell from 78% in 1978 to 63% in 1984 and 34% in 1994. The share of

Table 1: Share of Contribution to GDP growth Rate by Sectors and Ownership

Sector	Growth in 1979-1998 as a %	Growth in 1979-1984 as a %	Growth in 1985-1998 as a %
Primary sector	16.5	31.8	11.6
Industrial SOEs	19.9	20.5	11.7
Industrial COEs	25.3	12.8	28.3
Individual owned Industrial Enterprises	5.8	0.2	7.7
Other ownership	6.8	0.6	8.8
Construction Sector	5.7	5.2	0.8
Tertiary sector	26.2	28.9	25.3
Total	100	100	100

contribution to GDP growth rates by main sectors for reform period has shown in table 1.

Quoted from Article of Jeffrey D. Sachs and Wing Thye Woo (2000).

2. Agriculture provides major impetus to growth during 1978-84, but played a much lesser role after 1984 (see table 1).

3. Export become the leading factor of China's economic growth indicating a sharp increase from US$ 10 billion in 1978 to US$ 183 billion in 1997. It also reflects that non state sector

Table 2: Variation of Total Exports

Year	Total Exports	As a % of GDP
1987	347	13
1988	177	13
1989	396	12
1990	289	17
1991	383	19
1992	168	19
1993	529	17
1994	1042	22
1995	1245	21
1996	1258	19
1997	1515	20

Quoted from Article of Jeffrey D. Sachs and Wing Thye Woo (2000).

play major role for increasing trade (see table 2).

Thus it is implied that the review of fast economic growth performance of China is a direct effect of both evolutionary and convergence policy measures implemented since 1978. It is obvious that evolutionary policy measures were greatly contributed to converge advanced economies though international trade and FDI programs leading towards the rapid economic growth in China.

3. Features of China's Economic Growth

According to recent rapid economic performance of Chinese economy it indicates some inherited features specific to transitional economy like China. According to analysis of liu Shucheng, Wang lina and Chang Xin (2002), six factors recognized as main features of Chinese economic growth.

1. China's economic growth has stopped sliding and has tended to maintain sustainable stability. As indicated in fig. 1 china was able to maintain 7-8 percent annual growth rate in the recent past instead of internal and external shocks. The expansionary fiscal policy helped to hold the downslide trend in 2000.

Table 3: Demand Structure of China's Economic Growth

Fig. 1: GDP Growth In China 1990-2001

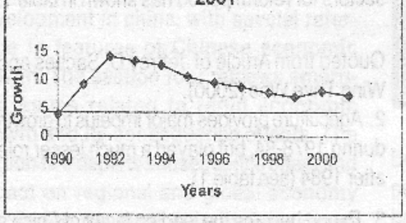


Table 3 Demand Structure of China's Economic Growth

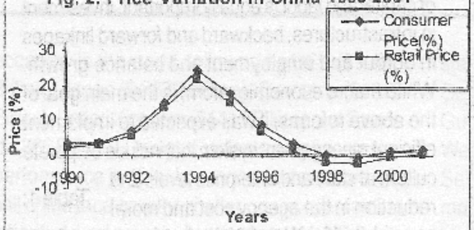
Year	GDP Growth (%)	Contribution by final Consumption (%)	Contribution by Capital formation (%)	Contribution by Domestic demand	Contribution by net Exports (%)
1995	10.9	0.4	6.9	10.9	-0.4
1996	9.6	5.1	3.3	8.4	1.2
1997	8.8	3.3	1.8	5.2	3.2
1998	7.8	3.2	2.3	5.5	2.3
1999	7.1	5.4	0.9	6.3	0.8
2000	8.0	5.1	2.9	8.0	0.015
2001	7.3	4.4	3.6	8.0	-0.7

Source: China and World Economy, vol .10, 2002

and structure for economic growth structure for economic growth shows that contribution by external demand was marginal (negative) and domestic demand alone causes the economic growth. The table 3 highlights demand structure of China's economic growth in accordance with key indicators such as GDP growth, final consumption (%), capital formation (%), contribution by domestic demand and contribution by net exports.

3. Low inflation rate: Even though both consumer price and retail price were fluctuated in 1995 years, China was able to control rise of consumer and retail prices in the recent past indicating slight deflation for some years. The fig. 2 depicts change of retail and consumer prices over the past ten years.

Fig. 2: Price Variation in China 1990-2001

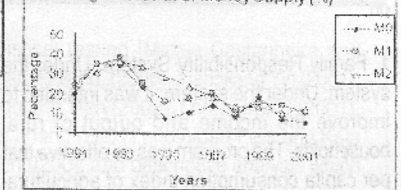


4. The employment situation shows that number of employment opportunities in non state sector has increased in contrast to dominant state sector. As indicated in fig. 4, total number of employments has increased 16616 million in 1990 to 21274 million in 2000. At the same time no of employments in state sector has decreased from 10346 million to 8102 million while employments in non state sector increased from 2721 million to 11274 million during the consecutive period (see fig.3).

5. Indicate wider regional disparities among administrative regions: Thus Eastern and middle parts of the country increased the industrial production rapidly compared with other provinces, where increased only the fixed assets investment. The main reason for concentrating development Coastal and some middle parts of the countryis well developed infrastructure and FDI project under free trade zones established (Liu Shucheng,Wang lina and Change Xin (2002).

6. China has been implementing an expansionary fiscal policy and prudent monetary policy especially during 1998-2001 periods to avoid bad effects of Asian financial crisis. The growth of narrow money, M1 has assumed a decline trend while the broad money, M2 has been lingering at below 15 percent during the same period. Growth of money supply during 1991-2001period was given fig.4.

Fig. 4: Growth of Money Supply (%)



Source: China Statistical Year Book

4. Emerging Issues

Despite magnificent economic growth in the recent past, China face some greater difficulties in achieving sustainable economic development under existing circumstances being a developing country as well as transitional economy [Fan Gang, (2002) and Liu Shucheng, et al (2002)]. Though short term and long term economic shocks which mainly created due to externalities and globalization were common to all countries of the world, China face some inherited economic problems that exceptional to the largest transitional economy of the world. Unlike Russia and Eastern Europe countries which were industrialized when transition start; China is basically agricultural economy that 80 percent of total population involved in agriculture and primary products when it starts transitional policy reforms. Therefore some argued that solutions for Chinese economic problems should also find its own way rather than imitation of other countries (Fan Gang, 2002).

Even Though, maintaining 7-8 annual growth rate under internal and external shock is very impressive achievement compared with both developing and developed countries, still China is facing greater challenge to solve unemployment problem effectively as the re-employment of laid-off workers or the transfer of large number of surplus labor from rural areas. According to Liu Shucheng, et al (2002), this is an outstanding medium and long term problem in China's economic growth. Theoretically, it involves with concept of economic growth, full employment and inflation as mentioned in Keynesian economics. Thus it relates with understanding what would be the potential growth rate and what is the gap between existing annual growth rate and potential sustainable growth rate, that country could achieve while realizing full employment without inducing accelerated inflation at any given stage of economic development. As common to many other economies, still china also face difficulties in judging figure of potential economic growth rate especially during the transitional period of economic system. Statistics related with deflation, negative price levels and unemployment shows that 7-8 percent growth rate is lower than potential economic growth (Shucheng, et al 2002).

China as a developing country with a large agricultural labor force and thereby main challenge is associated with releasing massive agricultural labor force to non agricultural sectors. Since China remains at a middle stage of industrialization, consumer demand is upgraded from "food, clothing and utilities" to "housing and travel" and material demand to service and spiritual demands. Therefore, solving the main threat of unemployment problem could be couple with potential industries in housing construction and real estate industry, transport and tourist industries which has been already establish as the main economic strategy. In addition to unemployment problem, China also face with some other difficulties to achieve sustainable development. According to Fan Gang (2002), these difficulties identified as following problems.

1. **Income Gap:** As common to many other countries income gaps are widening as increases of economic growth. Income gaps are widening mainly due to workers laid off and poverty in rural areas. As a consequence of economic reforms introduced since late 1970s social welfare system has minimized and employments in state sector were gradually reduced as mentioned fig. 4. This situation causes not only to create gaps between people in urban and rural areas but also creating problem of impoverishment of society leading to some destabilizing trend (Fan Gang, 2002). Though relative impoverishment in a society is inevitable factor, removing egalitarian policies were mainly caused to sustain the gaps. Hence, international critics of China's widening gap between rich and poor have happened mainly due to inevitable result of reform (Fan Gang, 2002). According to recent estimates, poverty rate in rural China has reduced from 17.6 percent (1988) to 14.9 percent (1995) due to effective policy measures implemented by the government. However, poverty continues to be issue China because workers in urban CHINA began to laid off and only little of the rapid economic growth in rural areas has "trickled down" (Bjorn Gustafsson and Wei Zhong, 2002).

2. **Difference between Urban and rural Areas:** The difference between urban and rural manifest themselves in the problem of agriculture and peasant economy, fundamentally caused as a result of too many people rely on limited amount of land (Fan Gang, 2002). According to statistics, only 7 percent of land in China is arable and still land is treated as a social security. Thus surplus agricultural labor becomes inevitable issue not because of modern agricultural techniques and intensive cultivation reduce the labor but because of this insufficient to absorb increasing labor force. Therefore rural urbanization becomes the essential factor in overcoming the gap. The government has taken special efforts in this regard to through developing rural infrastructure and social security programs.

3. **Regional Disparities:** As shown in section two, regional disparities become an inevitable problem in liberalization towards the international market. Since liberal economic reforms were mainly concentrated in coastal, Eastern and middle part of the country, other interior regions were rather sluggish in gaining benefits of fast economic development. Therefore, the government investment in inland regions such as Qinghai and Gansu, cannot reach the same level like in coastal areas and disparities will continue to exist (Fan Gang, 2002).

4. **Financial problem:** The issue of financial problem in China relates mainly with bad debts of banks and debt of the government (Fan Gang, 2002). The bad debts of Chinese banks are in a certain sense, debt of the states that were issued to government enterprises through government interventions. At the end of 2001, the bad debt ratio account for 26-27 percent of GDP. The government provides subsidies to SOEs in order to run those organizations. According to Gang, (2002), the total of bank's debt plus national debt in China is not very high in relative terms. China's foreign debt is still small, making up only 15 percent of GDP, in contrast to newly industrialized countries like Thailand and Korea.

5. **The Impact**

"China poses a big economic challenge. Some economists describe China as an 800-pound trading gorilla. A Hong Kong newspaper added that this gorilla was very hungry"

Hon. Prime minister of Singapore -2001

As said by Mr. Goh Chok Tong, the Hon. Prime minister of Singapore; the boom of Chinese economy would create lot of implications to world economy, especially for the Asia both in terms of factor mobility and international trade. According to the statement of Stanly Fischer, the former deputy managing director of the IMF, "... **there is a little cause for fear... a big dynamic economy in the neighborhood is a benefit, not curse, for those around it -look at Canada or Mexico... Or, one might add, look at Asia after Japan emerged as an economic power from the 1970s onward" ("Don't Fear China threat");** The statement implies two meanings: either Boom or Doom? And for whom? Thus impact of China's rapid economic development and entering to the WTO could understand by investigating how, what and which countries would affect or react on emergence of Chinese economy in world trade. The impact of Chinese economy could investigate on three strata; i.e. newly industrialized Asian tigers, developed countries and other developing and other developing countries in the Asian region, especially India.

A recent analysis on effect and impact of China's economy on the world and Asian countries highlights few main factors about the factor mobility and world trade (Warwick J. McKibbin and Wing Thye Woo, 2004).

The international impact of China's emergence as a major economic power, as marked by its accession to the WTO, is that the global division of labor at the end of the last millennium was a highly unnatural, because the self-imposed isolation of China in the 1949-78 period and its slow integration into the international economy in the 1980-1991 kept over one fifth of the human race from participation in the world trade and FDI. The analyses suggest that the full integration of China's huge labor force into the international labor could cause the Asian-4 to face the possibility of deindustrialization. However this dismal outcome is by no means inevitable. This will happen only if the Asian-4 economies allow the drop in FDI inflow to lower the technological diffusion to their economies. The finding further suggest that the Asian-4 must give the highest priority to deepening and widening of their pool of human capital by speeding up the diffusion of new knowledge to their scientist and managers, and conduction appropriate retraining programs for the displaced workers. The common challenge to governments of the developed economies from the rise of China as a major manufacturer is how to upgrade the workers who had lost jobs in their manufacturing sectors.

According to the analysis it is clear that newly developed Asian-4 tigers have to face big challenge with China for accessing FDI, technological innovations and marketing. At the same time as the labor intensive country which accounts for nearly one fourth of world population would influence to both developed and developing countries by producing labor intensive products to world markets. The impact of economic boom of China will also greatly influence to India, the second largest economy in Asia not only producing labor intensive products but also producing agricultural and primary products to international market. However impact on small countries like Sri Lanka wouldn't be harmful because China's expansion would create trade opportunities for both parties as bilateral trade agreements for primary products and industrial products.

6. **Conclusion**

Having considered the main contents of rapid economic boom of Chinese economy it is clear that both evolutionary reforms and technological convergence equally contributed to gain rapid economic development for china in the recent past. The influence of technological spill-over, convergence and catch up of advanced economies through FDI and international trade seem to be more significant though it was not supported by statistics. As proved economic analysis, effectiveness of the technical efficiency in Chinese economy rely on two drives: expansion of non state sector and effective adoption by the state sector as a subsequence China's access to WTO.

The fast economic development is mainly concentrated to coastal and middle areas of the country due to well developed infrastructure facilities and foreign direct investment. The nature of urban biased economic growth, changing egalitarian policies by liberal policy reforms, income inequalities and regional disparities were affected as a constraint of sustainable development. Nonetheless, dynamic changes lead to reduce poverty and regional disparities indicate positive trend. The impact of China's rapid economic growth and access to international market. Would be a crucial factor for developed and developing countries both in terms of factor mobility and access to international market. The future prospects of Chinese economy would depend on success of policies followed to overcome main issues. The promotion of housing construction and urbanization of rural areas through industrialization and service industries be effective strategy to overcome, income inequalities and achieve the goal of sustainable economic development.

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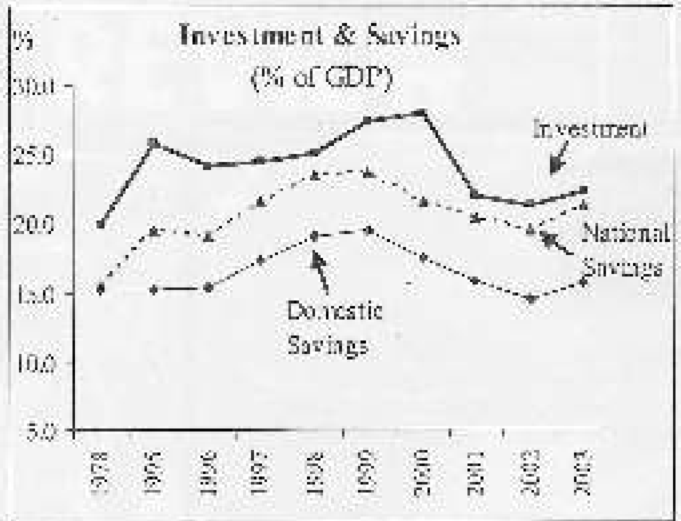
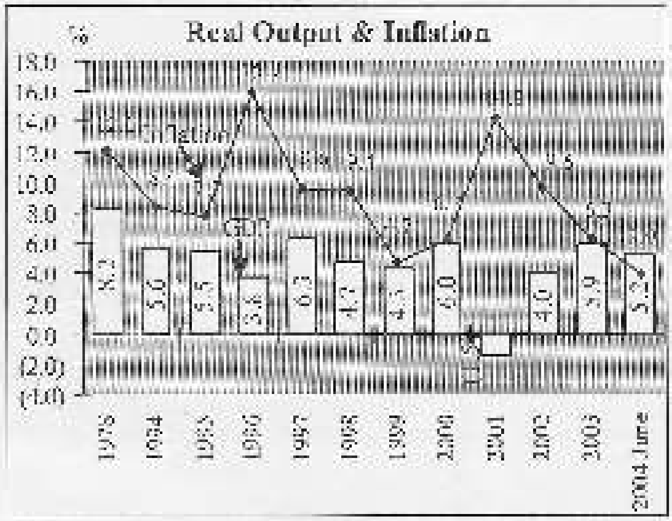
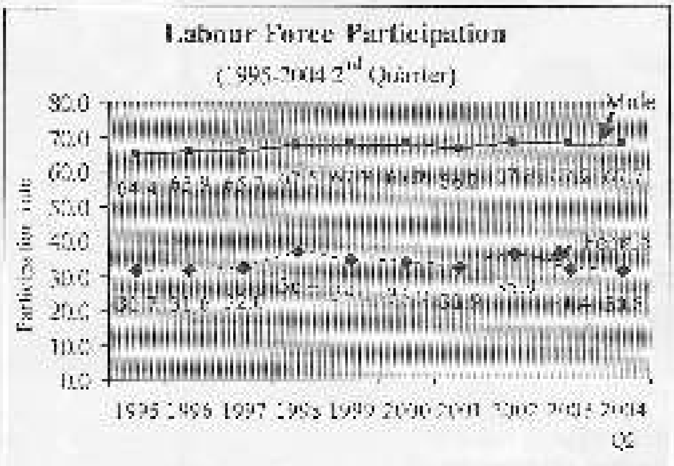
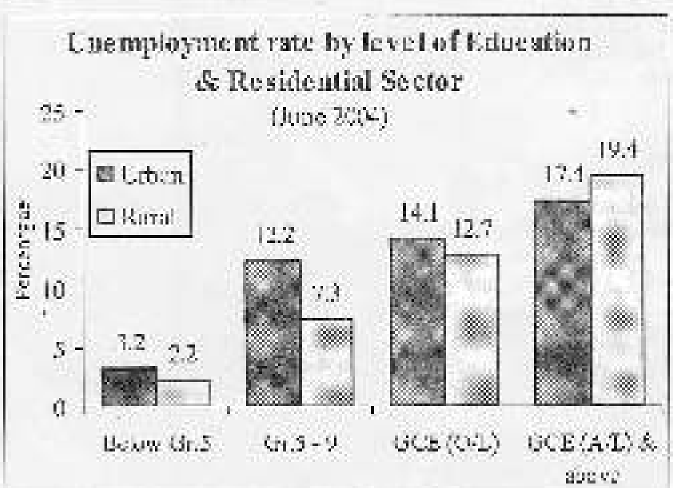
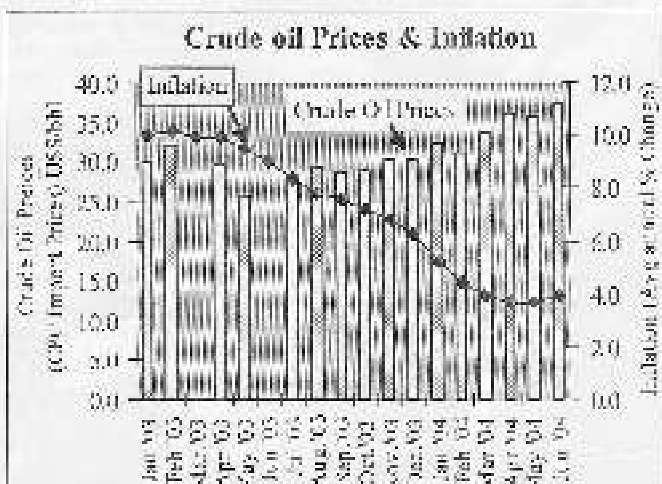
ECONOMY OF SRI LANKA - AT A GLANCE











Source: Central Bank of Sri Lanka - Annual Report 2003 & Bulletins. Household Income & Expenditure Survey 2002 - Dept. of Census & Statistics

World Economic Outlook - Sept. 2004

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Highest (more than 10 bn. US $)

Country		Country	
Japan	136,215	France	25,744
Germany	55,513	Thaiwan	25,678
Russian Federation	35,905	Singapore	18,704
China	35,422	Netherlands	16,467
Norway	28,643	Saudi Arabia	11,889
Switzerland	26,011	Sweden	10,621

Lowest (less than 10 bn. US $)

Country	
USA	(541,834)
Australia	(30,675)
UK	(26,713)
Spain	(23,676)
Italy	(21,942)
Greece	(10,405)

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