

Economic Development Framework

For a Northern Province Master Plan

A Report commissioned by the Central Bank of Sri Lanka

The views expressed in this report are those of the independent committee members and do not necessarily reflect the position of the Central Bank of Sri Lanka

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CONTENTS

1. Introduction

2. Chapter 1

3. Chapter 2

4. Chapter 3

5. Chapter 4

6. Chapter 5

7. Chapter 6

8. Chapter 7

9. Chapter 8

10. Chapter 9

11. Chapter 10

12. Chapter 11

13. Chapter 12

14. Chapter 13

15. Chapter 14

16. Chapter 15

17. Chapter 16

18. Chapter 17

19. Chapter 18

20. Chapter 19

21. Chapter 20

22. Chapter 21

23. Chapter 22

24. Chapter 23

25. Chapter 24

26. Chapter 25

27. Chapter 26

28. Chapter 27

29. Chapter 28

30. Chapter 29

31. Chapter 30

32. Chapter 31

33. Chapter 32

34. Chapter 33

35. Chapter 34

36. Chapter 35

37. Chapter 36

38. Chapter 37

39. Chapter 38

40. Chapter 39

41. Chapter 40

42. Chapter 41

43. Chapter 42

44. Chapter 43

45. Chapter 44

46. Chapter 45

47. Chapter 46

48. Chapter 47

49. Chapter 48

50. Chapter 49

51. Chapter 50

52. Chapter 51

53. Chapter 52

54. Chapter 53

55. Chapter 54

56. Chapter 55

57. Chapter 56

58. Chapter 57

59. Chapter 58

60. Chapter 59

61. Chapter 60

62. Chapter 61

63. Chapter 62

64. Chapter 63

65. Chapter 64

66. Chapter 65

67. Chapter 66

68. Chapter 67

69. Chapter 68

70. Chapter 69

71. Chapter 70

72. Chapter 71

73. Chapter 72

74. Chapter 73

75. Chapter 74

76. Chapter 75

77. Chapter 76

78. Chapter 77

79. Chapter 78

80. Chapter 79

81. Chapter 80

82. Chapter 81

83. Chapter 82

84. Chapter 83

85. Chapter 84

86. Chapter 85

87. Chapter 86

88. Chapter 87

89. Chapter 88

90. Chapter 89

91. Chapter 90

92. Chapter 91

93. Chapter 92

94. Chapter 93

95. Chapter 94

96. Chapter 95

97. Chapter 96

98. Chapter 97

99. Chapter 98

100. Chapter 99

101. Chapter 100

Preface

We wish to thank Dr. Indrajit Coomaraswamy, Governor of the Central Bank of Sri Lanka, for commissioning this Framework for an Economic Development Master Plan for the Northern Province. We also thank the management of the Central Bank for extending their support.

We are grateful for the insight and experience shared by all those who engaged in our consultations and field visits. This report could not have been accomplished without the logistical support provided by the staff team at the Central Bank of Sri Lanka Regional Office – Kilinochchi, and in particular we thank Mr. R. Lanson and Mrs. T. Jayaruby for their role as secretaries of this Committee. We also thank Ms. J. Kuhanendran for her research support.

We remember the contribution of two of our committee members. Mrs Somesasunthary Krishnakumar was keen to engage with this effort but was unable to continue her participation due to her deteriorating health and passed away before the completion of the report. Similarly, we are deeply saddened by the sudden death of Professor Shahul Hasbullah, only days before the report was finalised. We express our appreciation and gratitude for the lifetime of dedicated work and invaluable research by both of these esteemed academics, and their tireless efforts to give voice to the excluded and marginalised communities across the nation.

We hope this Framework will be of use of to those concerned about the sustainable development of the Northern Province.

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Contents

1. Executive summary	3
2. Introduction	6
3. Northern economy in context	8
4. Post-war reconstruction policies and their challenges.....	10
5. Framework for an Economic Development Master Plan	13
6. Overarching challenges of the North.....	21
7. Sector priorities.....	23
8. Macroeconomic priorities.....	27
9. Conclusion.....	28

Economic Development Framework for a Northern Province Master Plan

1. Executive summary

This 'Framework for an Economic Development Master Plan' aims to be a realistic and dynamic tool to create a 'blueprint' for the future long-term growth and development of Northern Sri Lanka to 2030. A committee to take forward its conceptualisation was established on the request of the Governor of the Central Bank of Sri Lanka. It was observed during meetings held in the North with the participation of the Governor, that the outcomes of post-war development programmes have been inadequate, particularly the crisis of indebtedness that has arisen from the lack of viable employment and incomes for the local population.

Drawing on perspectives and experience coming out of the region, this Framework is offered as a resource for policymakers, donors and civil society to chart a new way forward to bring prosperity and equity to the Northern Province. In doing so, it is hoped that wider objectives of peace and reconciliation, and reintegration to the growth of the national economy can also be sustainably achieved.

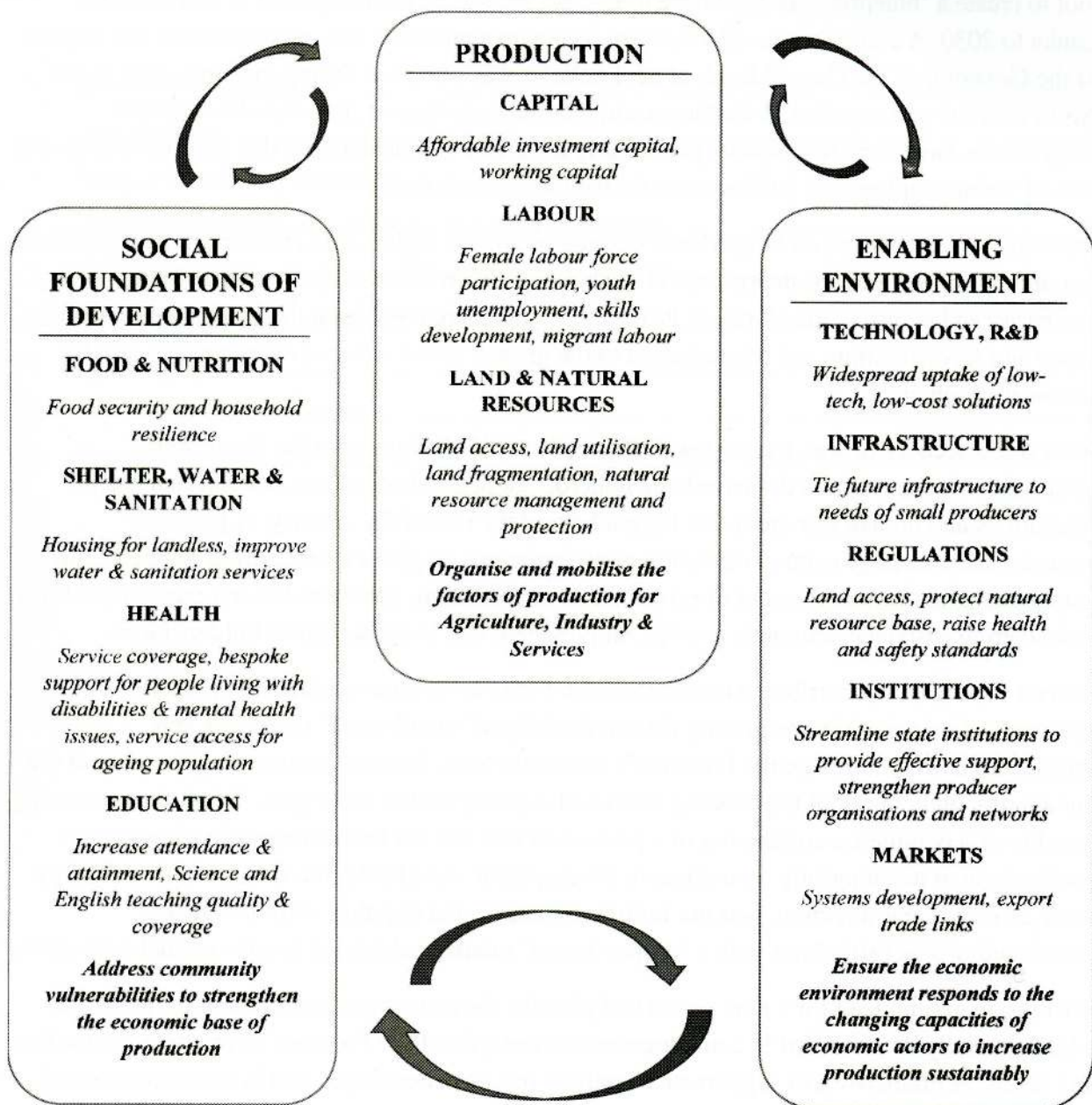
After three decades of war, the post-war socio-economic challenges in the North were tremendous in terms of the destroyed and underdeveloped infrastructure, deteriorated social institutions and human resources that lagged behind the rest of the country. A post-war reconstruction strategy centred on building infrastructure, expansion of credit to promote self-employment and encouragement of private-sector investment, however, has not met expectations in delivering sustained economic growth, employment and increased household incomes.

Several factors have contributed to these results. First, development initiatives failed to systematically invest in transforming the productivity of 'small-sized' producers and organisations who dominate the Province's economic base. Second, forthcoming investment did not appropriately build on the existing skills and capacity within the region. Third, the continuing fragility of a population coming out of a protracted war has not been adequately addressed to enable them to meaningfully participate in development. And lastly, the reconstruction strategy itself lacked a clear direction, was not holistic in nature, and together with insufficient coordination, was carried out with a 'project-based' mindset which led to sub-optimal outcomes.

There is an urgent need for a new vision and path for the economic development of the North which crucially, is grounded in a macroeconomic analysis of the Province's resources, capacities and needs. A Framework to support such analysis has been developed and is structured around three inter-dependent pillars: the factors of production, the enabling environment, and the social foundations of development.

The factors of production examine the Province's endowments of capital, labour, and land and natural resources as the key inputs to increase production and economic growth. Recognising

that the environment in which production occurs has a significant impact on its potential growth, the framework identifies the facilitative roles played by technology, infrastructure, regulations, institutions and markets as components that require attention. Finally, emphasis is given to investing in people to ensure their ability to participate in development by strengthening the social foundations, particularly with respect to food and nutrition, living conditions, health and education.



Analysis using the Framework suggests that an economic growth path that is slower but more stable, and which invests in communities to strengthen their social resilience could be an appropriate strategy for the North. The focus of a new development model should:

- invest capital appropriately into existing and new small-scale producers and industries to begin the process of productivity improvement
- be labour-intensive to get as many people into safe, secure and regular work as possible
- make extensive use of the large endowments of land and natural resources and essentially be agriculturally-led
- support medium-term efforts for those able to take greater risks and move into higher value markets including exports
- be dispersed fairly across the Province and among the different population groups to ensure regional and gender disparities are reduced.

This two-pronged strategy of focussing on strengthening the economic base while supporting initiatives for export development will create a stronger, more resilient economic foundation in the North, from which growth can be accelerated in the long-term.

Furthermore, in future planning and implementation, challenges specific to the North's post-war legacy must be considered from the outset. These include the need for leadership to take forward a new economic development agenda, re-orientation towards development programming by implementing actors, greater community participation, workforce development, and planning for uncertainties such as climate change.

Delivering a new strategy for economic development must be undertaken at a provincial level to ensure the best use of resources. The following sector-wise priorities and thrust areas are identified as possible ways forward:

- **Agriculture:** Invest in agriculture to achieve household resilience and food security; increase profitable sustainable agricultural production through widespread productivity improvements and; reduce risks affecting sustainable agriculture e.g. water scarcity.
- **Industries:** Focus on the development of small industries using local resources that build appropriately on existing skills and capacity. Suggested industries to focus attention include: agro-based processing for value addition, craft-based industries, light manufacturing and renewable energy.
- **Services:** Re-think and expand services to meet local needs in areas such as financial services, public transport, care services and water and sanitation. The long-term viability of IT and tourism should be explored further, with the caveat that support from experienced firms from the South may be required to sustain growth.
- The formation of a **Northern Planning Bureau** is also recommended to undertake long-term planning and coordination informed by the unmet specific needs of a war-torn society. Such needs include securing long-term development financing, labour market expansion, natural resource management and monitoring of development outcomes.

2. Introduction

Purpose and scope

This 'Framework for an Economic Development Master Plan' aims to be a realistic and dynamic tool that provides a 'blueprint' for future long-term growth and development of the Northern Province of Sri Lanka. A committee to develop such a Framework was established on the request of the Governor of the Central Bank of Sri Lanka in acknowledgement of the inadequate development outcomes to reconstruct the Northern economy, including the crisis of indebtedness and the lack of viable employment and incomes for the local population.

There is a dearth of macroeconomic analyses of the Northern economy to inform the design of development policies and strategies, particularly in terms of the dynamic relationships between production, growth and distribution. Through analysis of development outcomes, challenges and opportunities, this Framework aims to set out a new 2030 vision and direction for economic development, providing thrust areas to be incorporated into a future master plan.

The report aims to make three important contributions:

1. It seeks to highlight specific development issues and challenges in the North due to the legacy of war which require a unique policy approach
2. The report provides a perspective from the North, with committee members drawing insight from local knowledge, networks and research
3. The Framework is forward looking; it takes a holistic macro view of the economy and provides direction for development over the medium to long-term (2030).

The Framework is intended as a resource for policymakers, implementing agencies, donors and other actors to support future economic development design and planning processes concerning the North. It is also hoped that the report will be used to generate dialogue within the Province to encourage future participation and ownership of development initiatives.

The work of the Committee is not intended to be a comprehensive analysis of the Northern economy, which other state and research institutions are better positioned to undertake. The Committee's intervention aims to provide a broader analysis of the challenges of reconstructing a war-torn economy, highlighting the major gaps in the substance and process of development.

Chaired by the Manager of the Regional Office of the Central Bank of Sri Lanka (Kilinochchi), an independent committee of invited experts, academics and professionals with knowledge, skills and experience relevant to the economic development of the Northern Province was formed. The Committee worked on a voluntary basis from February to August 2018.

Approach and methodology

A thematic approach to analyse the various sectors of the Northern economy was utilised. First, an overview of the major themes deemed important in analysing post-war economic outcomes and the process of development were examined. These covered agriculture, industries, services, and social and physical infrastructure. Second, specific challenges to be addressed over the next decade identified as major gaps in current development initiatives were explored. These included human resource development, youth issues, spatial planning, banking and finance, coordination among development actors and the use of technology.

The above, though not an exhaustive list, has formed the content of local discussions and debates over the recent years in framing development initiatives for the long-term. The report was further enhanced by the experience, research and knowledge of the committee members, and supported by field visits to the five northern districts where stakeholders with economic development responsibilities and interests were consulted.

Sustainable development perspective

While tailoring a new approach to the needs of a society emerging out of war, a new path towards transformative sustainable development can draw on national policies and progressive international norms. As a signatory to the UN's 2030 Agenda for Sustainable Development, Sri Lanka has committed towards achieving its 17 global sustainable development goals (SDGs). National policy places special focus on five of the SDGs: no poverty, quality education, renewable energy, reduced inequalities and sustainable cities and communities. The economic strategy of the Government's Public Investment Programme (PIP) 2017-2020 also reflects these in four of its seven components: to upgrade the quality of human resources, promote equity in economic and social spheres, minimise regional disparities, and protect the environment and conserve the natural resources. These areas align well with the broad social planks on which development has to be strengthened in the Northern Province.

Guided by the above, the Committee took forward the formulation of this Framework with the vision of creating a "*prosperous and equitable Northern Province*". In approaching development, the Committee was conscious of the need to achieve high levels of productivity and economic growth, delivered using local resources in an ecologically sustainable manner. Economic development over the next decade should be transformative with regards to the prevailing socio-economic structure, and inclusive by catalysing structural changes to address inequalities, social exclusion and marginalisation of various population groups, the urban-rural divide and the uneven development of the regions. And as a war-torn society, development efforts should universally raise incomes and human development indicators of the population, while re-building social resilience after decades of vulnerability and precarious life.

3. Northern economy in context

Post-independence to pre-war

Historically, Jaffna was dominated by a smallholding agricultural caste where educational institutions and a remittance economy thrived with its middle classes working in the colonial public service. The political economy of the Northern Province went through considerable changes during the post-independence decades from 1948 until the war started in the mid-1980s.

The population of the Vanni increased with settlements arising from policies to develop dry zone agriculture, as population pressure increased in Jaffna during the 1960s. This led to the further development of irrigation schemes and increased production of paddy. Periodic communal violence in the South led to relocation of displaced Up-Country Tamils to the Vanni. For the most part, this displaced population remained landless and found employment as farm workers. With minimal educational and job opportunities, the *Vanni districts remained underdeveloped*.

In Jaffna, where much of the population of the Northern Province continued to reside, smallholder farmers' intensive cultivation of cash crops such as red onions and green chillies for Southern markets during the import substitution regime and intensive fishing for domestic consumption and exports, led to an agricultural boom. This accumulation during the 1960s and 1970s was reflected in increased social mobility such as cement houses for the lower-middle classes in rural Jaffna, strengthening of consumer and producer co-operatives and urban development of Jaffna and many small towns in the peninsula. State corporations producing cement, salt and chemicals; small industries nurtured by the state including in the Atchchuvely Industrial Zone; and a textile industry built by the co-operatives, led to the *emergence of a small industrial sector mainly located in Jaffna with a limited worker base*. The transport of seafood, cash crops and textiles were facilitated by road and train service linking Jaffna to Colombo and other national trading centres.

The war decades

Immediately prior to the war, the North was characterised by outstanding educational institutions, a prosperous class of professionals, a booming agricultural economy and a nascent industrial sector. The escalation of the war disrupted this socio-economic trajectory with outmigration of youth and the professional classes to Western countries. Eventually, *mass migration and internal displacement led to considerable depopulation of the North*.

Agriculture, fisheries and small industries were all disrupted due to displacement and war-time restrictions. *With reduced production and minimal accumulation, there was little investment* to upgrade or build new production facilities. Market connectivity to domestic and international markets were cut off with the closure of the A9, and essential items were produced locally for

subsistence and local sales. The *education and working life of several generations of children, youth and workers were repeatedly disrupted*. Furthermore, an intergenerational gap was created with fewer educationists, managers and other professionals capable of mentoring the next generation.

Post-war to present

After three decades of war, the post-war social and economic challenges were tremendous in terms of the destroyed and underdeveloped infrastructure, deteriorated social institutions and human resources that lagged behind the rest of the country. Soon after the war, *local production was subjected to a market shock as road connectivity resumed to the wider market with far more advanced production*. In this context, with a post-war reconstruction strategy of building infrastructure, expansion of credit and the rebuilding of livelihoods and self-employment schemes financed by loans, the population recovering from the war had to rely on their meagre assets, ultimately resulting in widespread indebtedness and a rural economic crisis.

Northern province statistics at a glance¹

	Indicators	Northern Province	National
1	Population	1,090,000	20,660,000
2	Households	268,000	5,437,000
3	Median income (Rs.)	34,500	43,511
4	Poverty headcount index ²	7.7	4.1
5	2016 GDP contribution (Rs. millions)	497,950	11,906,752

¹ Items 1 – 4 [Household and Income Expenditure Survey (2016)]; item 5 [Annual Report 2017: Central Bank of Sri Lanka].

² The Poverty Headcount Index is defined as the percentage of the population living below the poverty line.

4. Post-war reconstruction policies and their challenges

The use of outdated technology, lagging productivity and a low economic base left the prevailing economy in the North ailing and weak at the end of the war. An immediate focus on recovery, reconstruction and rehabilitation boosted the Province's economic growth rate between 2010 and 2012³. This was mainly due to resumption of economic activity in the agriculture sector involving 60% of the population following de-mining, land release and removal of coastline fishing restrictions.

Medium-term post-war development strategies focused state policies and investment towards:

- **Infrastructure-driven development:** Initially, prime importance was given to the reconstruction of infrastructure as a strategy and foundation for economic development⁴.
- **Credit expansion for rural development:** Self-employment and livelihoods strengthening schemes subsidised by government grants and low-interest rate loans were promoted as a broad-based development policy to generate income streams for rural communities.
- **Tax incentives for private-sector led development:** To encourage domestic, diaspora and foreign private-sector investment, tax breaks and subsidies were offered with the expectation that new industries and services would create jobs in the North once essential infrastructure and a business-friendly climate was in place.

At a provincial level, outcomes of these strategies have fallen short of their expectations. Overall, the rate of provincial growth slowed down after 2012⁵. As of 2017, the Northern Province was host to the lowest number of industrial enterprises in the country⁶ and of the 23 enterprises registered under the Board of Investment, only one has been diaspora funded; the northern industrial sector continues to expand at far lower levels than the national average⁷; and

³ The Northern Province recorded a Provincial GDP (PGDP) growth rate of 25.9% in 2012 contributing 4.0% to the national economy up from 3.4% in 2010. The average PGDP growth at 25.2% in the Northern Province was much higher than the national average of 16.2% from 2010 to 2012 period. [Finance Ministry Annual Report 2013].

⁴ A comprehensive infrastructure development programme costing Rs. 221 billion covering the Northern Province during 2009-2013 was implemented to restore highways, railways, water supply, irrigation, housing, hospitals, school facilities and administrative buildings. This was at a time when the 2011 Northern Provincial GDP was reported as Rs. 243 billion [Ministry of Finance Annual Report 2013; Economic and Social Statistics of Sri Lanka 2017: Central Bank of Sri Lanka].

⁵ Northern Province GDP contribution to National GDP was 4.2% in 2016. Increases after 2012 were mainly from the construction industry and services such as trade and transport. [Economic and Social Statistics of Sri Lanka 2018: Central Bank of Sri Lanka].

⁶ Furthermore, of 5,332 industrial enterprises across the country, only 34 (0.6%) are situated in the North [Annual Report 2017: Central Bank of Sri Lanka].

⁷ Between 2011 and 2015, the percentage increase in the contribution of the industrial sector to provincial GDP was 42% in the North, well below the national figure of 63% [Economic and Social Statistics of Sri Lanka 2017: Central Bank of Sri Lanka].

employment creation has not satisfied demand⁸. Of greater concern is the impact that this has had on the wellbeing of the war-affected population. Mullaitivu and Kilinochchi districts report the lowest monthly incomes in the country⁹; there has been exponential growth of indebtedness including an increasing number of suicides and attempted suicides; nutritional status of children in the Vanni districts has deteriorated to alarming rates¹⁰; and the participation of women in the labour force continues to be far below the national average¹¹.

Deeper examination of the causes for the shortfall in development outcomes suggests that important macroeconomic features and specific socio-economic challenges of the war-torn North were inadequately considered in policy formulation.

Firstly, the existing economic structure was and continues to be dominated by '*small-sized economic actors*' - smallholder farmers, small-scale fishers and small industries, businesses and co-operatives. The majority of these uncompetitive Northern producers suffered significant economic losses as a result of the sudden reintegration with the market in the rest of the country. A compelling case for a time-bound state sponsored protection of the region accompanied by a systematic investment programme to raise productivity and efficiency of small producers was evident. But development efforts have either omitted these groups or insufficiently catered to their transformation needs¹². Whereas public sector development funding in construction created short-term increases in employment and incomes, the much-needed change in the long-run structure and productivity of the economy to sustain growth has not been achieved.

Secondly, aid actors have tried to jump start production by introducing sophisticated technology in selected industries or promoting the establishment of new businesses. These attempts have largely been unsuccessful because of a lack of understanding of the *existing institutional capacity and skills* within the region. The war caused capital flight in the form of money, technology and an exodus of highly educated and skilled workforce. Alongside insufficient working capital for small businesses to utilise capital-intensive equipment, an intergenerational vacuum of skills, experience and mentorship to be able to run such operations exists. A stark example of this is seen in the resurrection of Atchchuvely Industrial Estate, costing Rs.210

⁸ Over 2011 – 2016, the change in number of people in employment in the North was 54,096, an increase of 15% over the period; 24,000 people are estimated to be seeking employment in 2016 [Labour Force Survey, Annual Report 2011 and 2016].

⁹ Rs.25,526 and Rs.27,050 median monthly incomes respectively [Household Income and Expenditure Survey 2016].

¹⁰ In terms of child malnutrition, Kilinochchi district reported the highest wasting rates (34.9%) and iron deficiency (12.9%) [National Strategic Review of Food Security and Nutrition, World Food Programme (2017)].

¹¹ Female labour force participation in 2016 was reported as 25% as opposed to the national average of 36% [Labour Force Survey Annual Report 2016].

¹² For example, while 50% of households in the Jaffna District are engaged in agricultural livelihoods, Jaffna District Secretariat estimates that only 2.4% of its public investment over 2010 – 2016 was spent on the agricultural sector [Jaffna District Five Year Development Plan (2018)].

million in 2013, with the hope of attracting 16 medium-scale industries. As of July 2018, only a few industries are present, of which most are only partially operational.

Thirdly, these development initiatives have been implemented for a war-affected population whose *social vulnerabilities have yet to be adequately addressed*. For the 80% of the population who live in the rural areas, income streams are low and insecure, education has been disrupted, war-related physical and mental health issues lack appropriate attention, thousands of households continue to be landless, and weak social networks and institutions are yet to be restored. In a context where consumption needs are unmet and social safety nets are inadequate, the inappropriate distribution of grants and loans to support livelihoods and self-employment led to fragile household finances. The expansion of microfinance and leasing activities further siphoned out rural incomes instead of encouraging local re-investment.

Finally, for the most part, *post-war development initiatives in the North have been reactive and piecemeal*. A focus on 'project-based' development designed in the absence of a macroeconomic vision, flawed development policies and a lack of overall coordination are at the core of the economic crisis affecting the Northern Province.

Overall, development actors seem to have identified the lack of finance and infrastructure as the main barriers holding back economic growth in the North. Such analysis neglected an understanding of the region's post-war legacy. There is an urgent need for a new sustainable development model for the Northern Province that can deliver *balanced and inclusive growth* while addressing post-war challenges. Such a model will need to learn lessons from what has worked and what has not over the past decade.

5. Framework for an Economic Development Master Plan

Guided by the critique of the post-war development trajectory over the last decade and drawing on the above sustainable development vision, the remainder of this document focusses on constructing a new macroeconomic approach for development of the Northern Province.

Pillars of the framework for economic development

Figure 1 below presents a Framework centred around three inter-dependent pillars that influence sustainable economic development: *the factors of production, the enabling environment and the social foundations of development*. The factors of production examine the Province's endowments of capital, labour, and land and natural resources as the key inputs to increase production and economic growth. Recognising that the environment in which production occurs has a significant impact on its potential growth, the framework identifies the facilitative roles played by technology, infrastructure, regulations, institutions and markets as components that require attention. Finally, emphasis is given to investing in people to ensure their ability to participate in development by strengthening the social foundations, particularly with respect to food and nutrition, health, living conditions, and education. Engaging the northern economy through this 'big picture' frame of inter-dependent dynamic relationships aims to provide insight to pave a new development path.

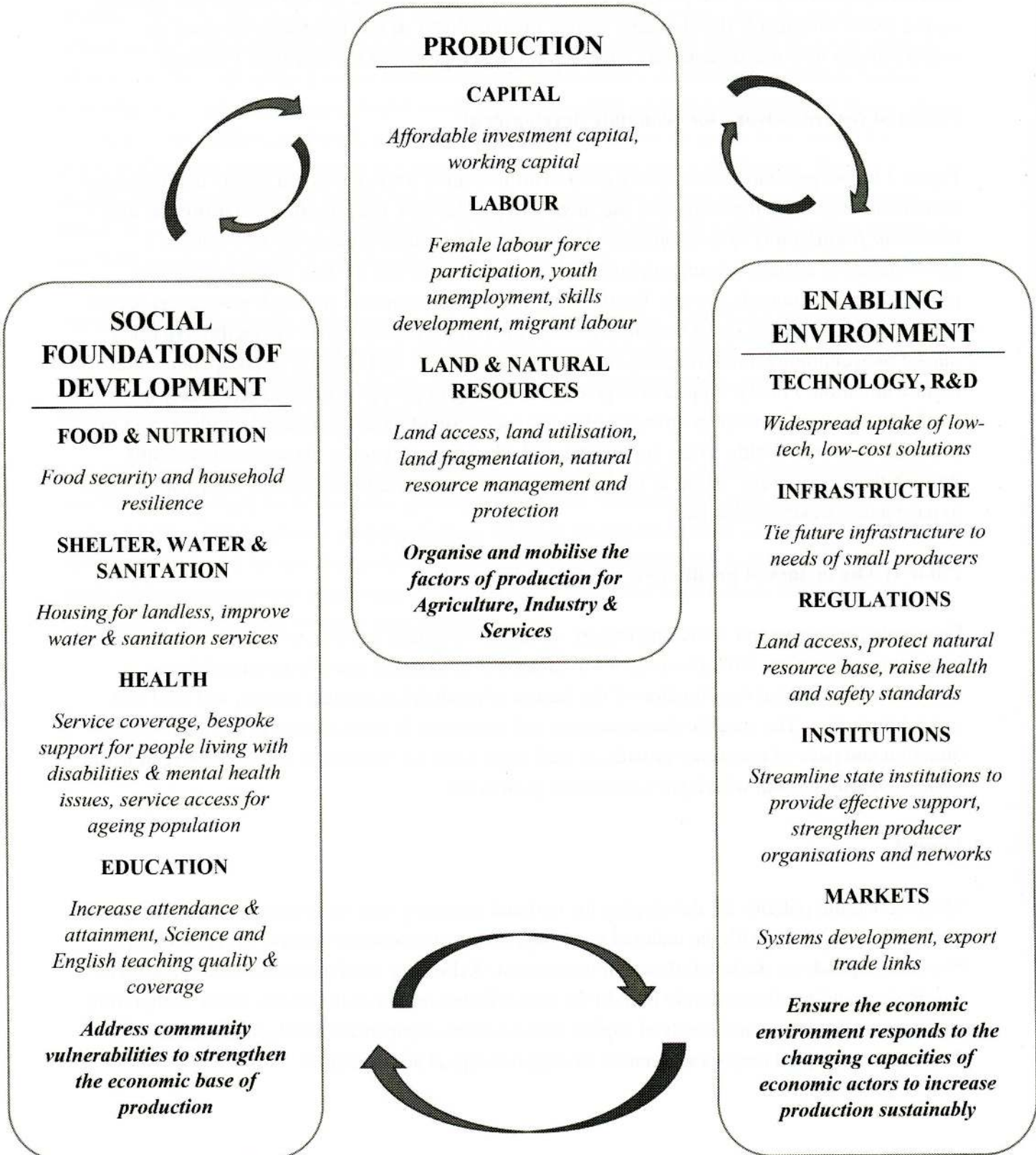
Pillar 1: The factors of production

Economic prosperity and wellbeing require sustained economic growth, which in turn relies on increasing production. Effective policies to maximise production must be grounded in an analysis of the optimal combination of the factors of production: capital, labour, and land and natural resources. The specific characteristics and quantities of these factors determine the direction and pace of economic growth, as well as its form i.e. whether it will be job-creating or jobless growth, growth with equity, sustained growth etc.

Capital

Macroeconomic policies for developing the national economy aim for investment in the order of 30 - 35% of GDP. As with the national economy, the macroeconomic growth of the Northern Province depends on the level of capital investment. Achieving similar rates of national growth requires expanding the economic base in the war-affected region of the North. There is therefore an argument for far greater levels of capital investment to compensate for the tremendous destruction of capital assets and decades of crippled capital accumulation.

Figure 1: A Framework for an Economic Development Master Plan



While there have been high post-war levels of investment in the northern economy, the character of capital invested (mainly in infrastructure and loans for individual livelihoods and self-employment schemes) has not delivered in terms of sustained income streams and employment. It has neither generated a virtuous cycle of production, accumulation and investment.

First, the lack of retained earnings by firms and producers characterises a shortfall in the availability of *long-term capital investment* to expand and diversify production capacity and the product base. Secondly, *access to working capital* necessary to increase capacity utilisation of existing assets and for continued operation of new plants has been lacking. Long-term investment and working capital have not been forthcoming from commercial banks in the practice of recovering short and medium-term loans with high interest overdraft facilities backed by collateral. Facilitation and support to access affordable finance from formal banking institutions must be a critical component of future development planning.

Labour

Increased participation of labour in production can immediately increase economic growth and employment. Given the low female participation rate in the North, *bringing more women into the labour force* will significantly increase production. These new employment opportunities must be designed to accommodate women's domestic responsibilities, providing decent working conditions, proximate location and time flexibility. Livelihoods programmes targeted at women must go beyond default responses such as handicrafts production that tend to omit the costs of labour. Finding avenues for *integrating youth* into production and regular employment is equally important.

Continual investment in *upgrading the quality of human resources*, particularly of youth, is required to enable higher long-term levels of productivity and better returns to labour from small agricultural producers, to skilled labour and professional business and financial management required for industries and service sector firms. In parallel, initiating workforce development programmes that are in line with how the structure of the economy is predicted to change over the next decade will also be important. Outmigration patterns¹³ will continue on the current upward trend without a concerted effort to increase both the quality and quantity of work opportunities in the Northern Province.

¹³A 50% increase of departures for foreign employment from the Northern Province was reported over the period 2011 - 2016, with a peak annual figure of 12,642 in 2014 [Economic and Social Statistics of Sri Lanka 2017: Central Bank of Sri Lanka].

Land and natural resources

Land and local natural resources can be better utilised in production. The Northern Province is host to plentiful resources of farming land, forests, in-land water reserves and tanks, an extensive coastline for fisheries, pastureland for livestock and a vast supply of naturally growing Palmyrah. Increasing both the *quantity of land and natural resources* used in production, as well as improving *unit productivity and efficiency* will contribute to increasing economic output and growth¹⁴.

In the Vanni region, there are considerable state lands available for further land alienation, and an untapped reserve of Palmyrah resources that can be used as *raw material for small scale commercial production of value added goods*. In areas where natural resources and land are less available such as in Jaffna peninsula, increases in water-use efficiency through the introduction of new technology such as drip irrigation can increase productivity. Improving practices to reduce post-harvest losses can also produce economic gains across all agricultural sub-sectors.

Optimal combination of factors of production

The priority is to mobilise and organise the factors of production in the North in such a way that structural changes of these factor markets will ensure sustained increases to growth over the medium to long term. Optimising investment will create a virtuous cycle of increased primary production and value addition; the latter in turn stimulates the demand for primary production and will result in raising income streams. Higher incomes and employment simultaneously increase demand for goods and services, and if these can be supplied locally, will generate further demand for labour and employment.

Pillar 2: Enabling environment

Production does not happen in a vacuum. To ensure gains are maximised, it is imperative that the state and other development actors create an enabling environment that promotes provincial growth and distribution. Critical constraints identified in the North include: appropriate technological upgrading, post-war infrastructure gaps, regulatory shortcomings, institutional weaknesses, and market access including viable market connectivity.

Technology, and research and development has lagged behind the rest of the country due to the lack of investment in the North. To achieve the sought after increases in productivity required for sustained economic growth, a systematic policy approach to encourage the uptake of new

¹⁴ The agricultural sector contribution to provincial GDP has hovered between the range of Rs.47,577 – 59,911 million over the period 2011 – 2015 demonstrating the sustained absence of productivity increases [Economic and Social Statistics of Sri Lanka 2017: Central Bank of Sri Lanka].

technology is required. Such a policy must ensure that the form of technologies introduced are appropriate to the current capacity, skills and resources of the existing economic base and actors. A stable approach would see immediate gains from the widespread adoption of currently available low-tech, low-cost solutions.

Infrastructure required for 'productive' economic activities continues to be a gap. Looking forward, infrastructural investments should be aligned to removing barriers to production and tied to the province's underlying economic strategy, which will initially be dominated by small scale production. Examples include coastal infrastructure for small scale fishers and rehabilitation of minor water tanks for in-land aquaculture, livestock rearing and farming.

Regulation should be employed as a policy tool to support sustainable development by removing constraints to production but simultaneously safeguarding the factors of production (e.g. the natural resource base and labour) from exploitation. Concerns in the North regarding access to sufficient pastureland for livestock farming, continued fragmentation of arable land, and the destruction of the seabed caused by bottom trawling need to be addressed immediately to ensure sustained production. Lastly, as part of the effort to integrate this once isolated region into the national economy, increased awareness and application of national legislation and regulation is required. With the future establishment of new industries in the North, updating regulation and enforcing policies to promote health and safety is particularly important to enable the sustained participation of an expanding workforce.

Institutions, specifically state-run institutions aiming to support increased economic production, lack coordination and are unable to provide effective support for Northern producers and organisations. Limited funding is spread too thinly across too many actors, which inhibits the cultivation of specialisation and expertise to deliver results. State institutions are powerful vehicles to drive development and therefore there should be fundamental re-thinking to develop effective policy, direction and allocation of multi-year budgets to support long-term planning and development.

Systems of organisation and cooperation between economic actors have been decimated by the protracted war. Small farmers and fishers who were traditionally part of collectives that sought efficiencies through bulk input purchasing, savings and loans, marketing etc., now largely operate as individuals, leaving room for exploitation. Reinvigorating and strengthening organisations and networks for producers, workers and firms is important to organise production and increase bargaining power. Additionally, strong organisational systems will also enable a two-way dialogue with the state and private sector to make markets and development initiatives work in a mutually beneficial way.

Market systems and access on fair terms provides the vital link to facilitate trade. The Northern economy has only recently opened up to the rest of the country and lacks the infrastructure,

transport facilities, information, networks and relationships to ensure Northern producers are able to plan production to respond to market demand and sell surplus production at fair prices. The issue of 'fairness' is critical for the North, where small producers dominate and where margins are low because of lower productivity and the use of outdated technology.

Access to market research and trend analysis, and development of market linkages and trade relationships within domestic, diaspora and export markets are critical to absorbing substantial future increases in production from the North. Finding effective ways of facilitating market connectivity within the North and with value chains in the South are urgently required.

Pillar 3: Social foundations of development

The success of any economic growth strategy for the Northern Province should be judged by the changes in the quality of people's lives. Social vulnerabilities created by the war and unaddressed through previous development efforts must be tackled to remove barriers for community participation in development.

To sustainably strengthen the community foundations on which economic growth in the North is to be built, action should be taken to improve the 'circumstances in which people are born, grow, live, work and age: the social determinants of health'. This approach recognises that the quality of food, education and skills, housing, the living environment and social networks are as important as creating jobs and increasing incomes. For the North, focussed attention on four aspects of food and nutrition; shelter, water and sanitation; health services; and education are recommended.

Food and nutrition: The resilience of households must be achieved with importance placed on achieving food security. Investment must generate access to diversified income streams for the poorest households to meet their nutritional needs in cash or kind. State schemes to implement this must be holistic in nature and based on equity (i.e. on the needs and capacity of each individual household). This goes against the common practice of beneficiary selection for distribution programmes based on giving handouts to households considered as deprived. Those in poverty, will need more assistance both in terms of resources to meet needs and accompaniment to ensure it is used for its intended purpose.

Shelter, water and sanitation: Approximately 10% of the Northern Province population are completely landless¹⁵ and are considered highly vulnerable because of their dependency on wage labour. While current state resettlement programmes inadequately cater to need, by design, they have excluded the landless by imposing the need for owning a minimum area of land to qualify for housing schemes. A highly disproportionate incidence of common notifiable diseases in

¹⁵ Data has been compiled from District Secretariats and the Provincial Council as of August 2018.

Jaffna¹⁶ highlights the critical need to invest in improved water and sanitation services within the Northern Province to keep people healthy. Solutions will need to be carefully designed, taking account of the dry zone climate, impacts of climate change and affordability for the largely rural population.

Health and social care services: Health and social care services for community groups severely affected by the war are currently inadequate. Services in the North are running significantly below capacity with high vacancies in both nursing and medical officer posts. People living with disabilities and those with mental health concerns need enhanced and bespoke services such as counselling and social support to lead active and healthy lives. The national trend towards an ageing population is more pronounced in the North due to the loss of life and continued outmigration. Re-thinking service delivery models in light of access and affordability issues is required.

Education: The current poor educational attendance and attainment of students in the Northern Province¹⁷ can be explained by the decades of disruption to education services as a result of the war, but also as a symptom of the poverty and low incomes faced by families in the North. The high levels of school dropouts in the North can be reduced by expanding mid-day school meals and other nutrition programs. An increase in Science and English teachers in the Vanni Districts in particular can contribute towards employability in the future.

A fairer distribution of money, power and resources can ameliorate the existing differences in social vulnerabilities within the region. Communities living under or just above the poverty line cannot participate in development while facing daily challenges of food security nor secure employment without education. It is this context that the state should commit to the social development of the North alongside economic growth initiatives, by strengthening household resilience and delivering universal, well-funded services for health, education and social welfare.

Proposed strategy for stable growth with distribution and resilience

The above macroeconomic analysis suggests that the priority to increase production and create jobs using the Northern Province's endowments of capital, labour, and land and natural resources is indisputable. But, equally important is the means of achieving these ends. A sustainable strategy must **invest in increasing production and productivity of the existing economic base of small producers and industries; and create new and secure employment** for those excluded from the workforce. High growth strategies that do not meet the above criteria will again fail to deliver outcomes to address the vulnerability of the war-affected community.

¹⁶ In 2017, the incidence of dysentery and typhus fever in Jaffna District alone accounted for 20% and 34% of national levels [Weekly Epidemiology Report Vol. 44 No. 52, Epidemiology Unit, Ministry of Health].

¹⁷ Mullaitivu and Kilinochchi districts report the lowest literacy rates in the country of 84% and 85% respectively [Labour Force Survey Annual Report 2016].

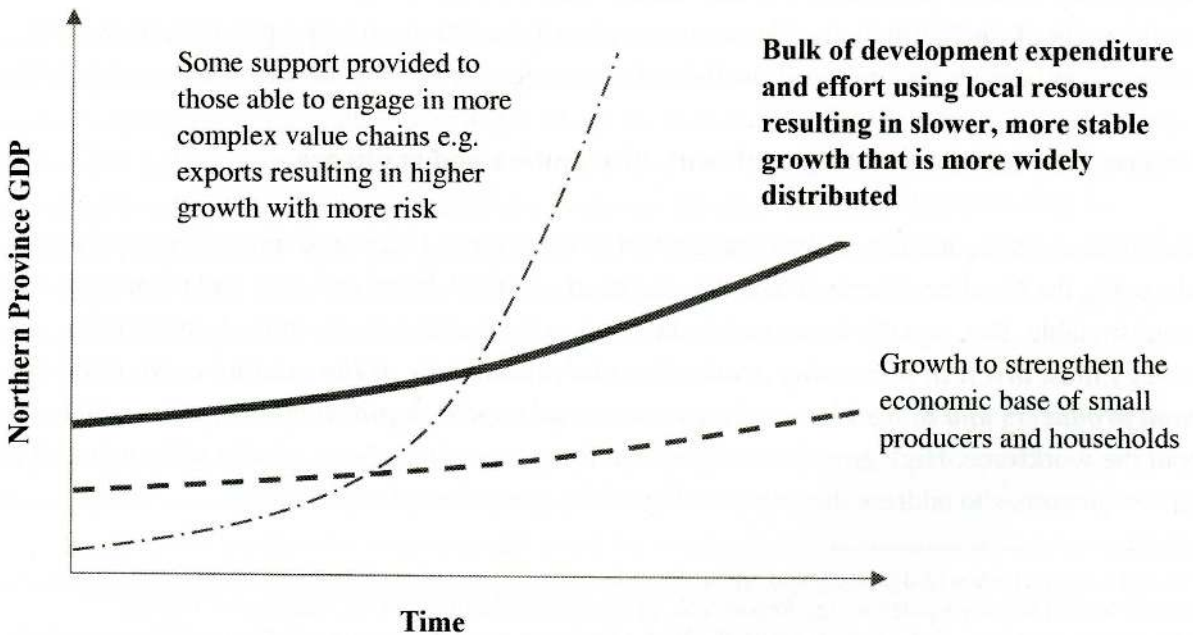
The chosen growth strategy must also distribute the gains from growth widely to provide socio-economic stability and resilience for the population as a whole. *The development path may therefore be slower and fundamentally low-risk* in order to achieve dual objectives of transforming the existing economic base while simultaneously addressing social vulnerabilities and inequalities that lag from the war.

Characteristics of such a broad-based development model will:

- invest capital appropriately into existing and new small-scale producers and industries to begin the process of productivity improvement
- be labour-intensive to get as many people into safe, secure and regular work as possible
- make extensive use of the large endowments of land and natural resources, and essentially be agriculturally-led
- support medium-term efforts for those able to take greater risks and move into higher value markets including exports
- be dispersed fairly across the Province and among the different population groups to ensure regional and gender disparities are reduced.

Systematically implementing such a two-pronged strategy that focusses on slower broad-based growth along with some investment to develop exports, will create a stronger, more resilient economic foundation in the North, from which growth can be accelerated in the long-term.

Figure 2: Proposed economic growth trajectory for the Northern Province



6. Overarching challenges of the North

The critical current and future challenges for sustainable development of the North are centred on mobilising resources and strengthening development processes.

Leadership

A clear vision for the North's economic development and strong local leadership to drive it forward is of urgency. State machinery, civil society and communities need to be actively mobilised to reverse the post-war legacies of aid-dependency, the culture of handouts and general stagnation in the North towards a new vision and direction where people can see and believe the potential for change. Little appreciation of, and advocacy regarding the gravity that economic issues have had on the lives of war-torn communities by local leaders has in part, contributed to the poor outcomes and inadequate responses observed today. The perspective of those in powerful representative roles must now prioritise the objective of broad-based, equitable economic development and take up the challenge to deliver results.

Development processes and participation

While political leadership is paramount, the role of administrative and community leadership and their structures is vital to ensure that the Northern economy moves on a progressive path. Having spent the majority of their careers responding to humanitarian crises, Northern administrators may need ***re-orientation towards a long-term development focus*** for planning, coordination, and implementation. To complement this, central government and donors should ***provide space to actively consult with their Northern counterparts*** to understand if special considerations and needs of various war-affected population groups should be incorporated in policy formation and programmes to be implemented in the North.

People's participation in development must be invigorated through revitalisation of rural development societies, co-operatives, farmers' organisations and community centres. Stronger voice and collective action through the strengthening of women's organisations can raise the need for specific services and appropriate design of livelihoods opportunities.

The weak state of social institutions and networks has meant that communities have not effectively participated in local governance processes. This is seen in the continuing inequalities, uneven development between and within regions, disparities and exclusion along the lines of gender, ethnicity, caste and returnee status that continue to be neglected or inadequately addressed in local development agendas. Participatory control of development projects and funding will serve to re-balance power between social institutions and local government officials, moving from top-down to community-centred development.

Workforce opportunities and standards

A *major shift in the opportunities provided to the younger generation*, many of whom were born into the war, is fundamental to achieving economic growth in the long-run. These generations, and groups disproportionately affected by the war such as ex-combatants, disabled people, women-headed households and families with missing persons require special attention towards reintegration into an economy that has remained stagnant for decades, and which is set to change. Investment in the labour market, particularly for rural youth and women, in the form of internships, work-study programs, flexible or part-time adult education and training is needed. Such opportunities must also be remunerative to ensure that rural job-seekers do not face additional barriers to participation. All programmes must be well-defined and tied to the underlying economic strategy for the Province.

Similarly, upgrading institutional capacity for development given the special needs of a war-torn society is required. Workers' rights and safety standards have been neglected over the decades, and there is a need to *rebuild trade unions and other workers institutions to raise labour standards*. Human resource development is required to improve capacity, and effective employment services to match job vacancies with available labour are needed. State institutions for agriculture and industries have to be given more resources to nurture and generate innovation in new ventures for small producers and industries. Technical collaboration with national and international institutions could usefully support such an objective.

Climate change and other uncertainties

Building resilience and adaptation to climate change and natural disasters must be mainstreamed into economic growth strategies, particularly given the Northern Province's dependence on agriculture and its location in the dry zone. While the impacts of climate change can be unpredictable, there is wide scope for policymakers and economic actors to plan action to anticipate, organise and adapt to mitigate climate change risks. There are vast international resources to learn from; best practice examples include improved systems to disseminate weather information, development of climate resilient seeds, provision of low-cost insurance etc.

While some attention has been given to the urban development of Jaffna, the planning of smaller towns in the North has largely been neglected leading to uneven development and geographical disparities. Rural economies are inextricably tied to small towns; they become the focal point for multiple sources of income generation opportunities upon which rural households depend. Their importance as an economic and market hub has also risen as a result of depopulation. Zoning for housing and production facilities, transport access, and services such as health and education should be part of the development agenda for small towns in the Northern Province.

7. Sector priorities

Agriculture

The smallholder agricultural sector is a key driver for the Province's future economic growth. It contributes directly to food security and supports mass poverty reduction through engaging approximately 60% of the region's households. With the North's abundance of land, there is vast potential to increase production and incomes, and in the process supply raw materials to develop local agro-industries, stimulate feeder industries and create real demand for rural non-farm goods and services. Success in stimulating growth must be based on a mixture of strategies that take account of the *heterogeneous nature of the sector's economic actors*.

- **Agriculture for household resilience and food security:** Importance must be given to ensure that households can meet their basic food and nutritional needs within the homestead, particularly those dependent on subsistence agriculture. Development strategies must aim to diversify income sources using a holistic approach centred on both households and communities. This may include promoting home gardening, livestock rearing, freshwater fish production as a package, supported by interventions to encourage seed production and water management locally. Surplus production at the household level can be sold locally and used to supplement wage income.
- **Increasing profitable sustainable agricultural production:** The quality and quantity of agricultural output across farming, fishing and livestock rearing can be increased. Thrust areas can include: widespread promotion and uptake of low-cost technology such as drip irrigation; provincial-wide efforts to raise production processes from average to best practice; and a focus to increase vertical efficiency i.e. increased output of land cultivated and per unit of input used. Lastly, investment in research and development, disseminated through effective extension support will ensure that future increases in economic returns are shared widely. The above should be underpinned by a push to promote profitable environmentally friendly practices from organic farming to biodegradable packaging.
- **Tackle macro issues and risks for sustainable agriculture:** To ensure the long-term viability of agriculture, action to tackle known future risks must be taken now. Water scarcity will be the most limiting factor, therefore water-use efficiency in agricultural production should be increased together with expanded capacity of water storage. Ecosystem management and protection of the natural resource base will be essential to sustain future production. Development of collective systems to stay informed of market demand and to organise collection, sorting, grading, storing and marketing of produce would be beneficial to address consistent market price fluctuations which currently devastate agricultural incomes.

Industries

As with any developing economy, industrialisation is crucial to achieving higher levels of economic growth. Industries can create employment providing regular monthly incomes, which are in high demand in the war-torn Northern Province. In this context, an industrial policy suitable for a region emerging out of a protracted war is required to address the disruption to production and a weakened labour force¹⁸.

The North is not conducive for large industries. The lack of a large and skilled labour force and other issues such as distance from metropolitan centres and the port limit the ability to be competitive. Decades of lag in local industries also means that production in the North cannot compete on the basis of labour efficiency alone. Therefore, it is *micro, small and medium (MSM) industries that utilise local resources to produce goods for the local market and for export* that are likely to succeed. National policies promoting MSM enterprises should be leveraged by directing their investment and activity towards specific industries and sectors where the North has a comparative advantage with respect to existing resources or skills.

Given the depopulation and distribution of the labour force, industries should be spread across the region, leading to balanced development with opportunities for the wider rural population. In the urban centres, geographical planning of industries should support the galvanisation of clusters of existing small industrial producers to create synergies and ensure better use of infrastructure, rather than create industrial zones and assume new industries will arrive.

- **Agro-Industries for value addition:** Given that agriculture forms the base of the Northern economy, the natural starting point for expanding industries should be founded on small agro-industries for value addition. An extensive increase in industries processing farm produce, seafood, dairy and other livestock will create regular employment and increase both demand and hence incomes for primary producers¹⁹. Agro-industrial products unique to the region such as palmyrah-based products and various seafood also have potential for exports.
- **Expansion of craft-based industries:** The North has a history of skilled craft-based production including in carpentry and metal work. Building on these existing skills, small industries can be developed and upgraded with mechanisation to achieve higher levels of production. Gradual modernisation and scaling up the production of these industries will

¹⁸ As of 2013, the Northern Province hosted a minute share of 1.4% of the total formal industrial establishments in the country, employing a 0.2% of the total number of persons engaged in formal industries [Economic Census 2013/14].

¹⁹ In 2015, agro-industries contributed only 18% to the overall contribution of the industrial sector to Northern Provincial GDP, as compared to the national average of 35% [Economic and Social Statistics of Sri Lanka 2017: Central Bank of Sri Lanka].

enable them to benefit by supplying inputs for the construction industry and related reconstruction programmes.

- **Developing a new manufacturing sector:** Incubation of assembly-based production such as electronic goods, light engineering of products etc. could be piloted as a first step towards creating a new manufacturing base for the Province. Partnerships with enterprises from the South and Tamil Nadu where language will not be a barrier may be a useful avenue for technology transfer, mentorship and business development support. Industries should be chosen carefully on the basis of local demand, which is a critical factor for future expansion. The lack of working capital will also need to be addressed to ensure higher capacity utilisation through increased production.
- **Renewable energy generation:** With abundant access to both solar and wind energy, and a relatively low population density, the Northern Province has considerable scope to establish a new industry in renewable energy generation. Along with long-run cost savings, such an initiative aligns to national strategy towards building a green economy.

Services

The service sector in the North has been expanding after the war and contributes 60% to the Provincial economy²⁰. Currently, the sector consists largely of transport, communication and, retail and trade services. There is scope to widen its base locally and generate value creating forms of service production, as well as reform existing services in the financial sector and public transport to appropriately meet local needs.

- **Re-thinking financial services:** Financial services, particularly in the rural sector, need to be re-designed in light of the major indebtedness crisis that has affected the North. The pressing requirement is long-term, low-interest investment to increase production and affordable rural credit for small-scale production. Working capital to activate production is also a necessary.
- **Public transport services:** Expanding public transport is a real need for both increased labour participation and social life. Transport services to and within the rural regions are required to increase the participation of women in the labour force, improve the mobility of people living with disabilities and the elderly, and ease the burden of sending children to school.
- **Care services:** Demographic changes brought about by migration, the emergence of an aging population and a shift towards women working in white-collar jobs has created

²⁰ Economic and Social Statistics of Sri Lanka 2017 [Source: Central Bank of Sri Lanka].

growing and unmet demand for care services in the North. Increased supply of services and higher standards in elderly and child care has the potential to be sustainably supported by the diaspora for elderly relatives and local professionals for their children. Increasing women's participation in the work force will also require affordable care services for their dependents.

- **Water and sanitation services:** The urban centres in the North in particular have a high incidence of communicable diseases due to the lack of water and sanitation infrastructure. The Government should prioritise investment along with community medical services to redress these problems.
- **IT and tourism:** These sectors may attract greater youth participation in the labour force. However, their viability and success in creating secure and well-paid employment may depend on investment and nurturing by companies in Colombo over a considerably longer period to ensure sustained development and growth and to avoid premature stagnation.

8. Macroeconomic priorities

This Framework for economic development has identified several issues requiring action at a provincial level to deliver a new 2030 vision for the North. In this context, the formation of a **Northern Planning Bureau** is recommended to undertake the long-term strategic planning, coordination and oversight of development efforts, informed by the specific needs of a war-torn society. The Bureau should encourage collaboration between civil society and the state through membership of leading intellectuals, the private sector, provincial and central government officials. Independence of the Bureau will be important for its effectiveness, but ownership of its outputs must be gained from meaningful involvement of actors with implementation responsibilities. Initially, the Bureau could lead in seeking solutions to the following challenges:

- **Development financing:** The formation of a *development finance entity* for the North should be considered to mobilise long-term investment that nurtures small industries, and provides investment advice, expertise and monitoring to ensure their success. It can also provide affordable working capital to raise capacity utilisation of assets for increased production and employment, as well as greater demand for primary production.
- **Labour market expansion:** Analysis, planning and monitoring, particularly in terms of forecasting labour demand and supply to inform workforce development programmes is essential to address the long-term changes needed in the labour participation of women and youth. Labour market policy development must also be undertaken to incentivise diverse working opportunities, improve working conditions and human resource capacity building. An *employment centre for the North* could be explored to overcome the lack of information on labour availability, to connect people to jobs, and provide career advice.
- **Natural resource management:** Given the importance of the agricultural sector for the region's development, the formation of a *Northern natural resource management committee* could be considered. Its primary functions would be to oversee the sustainable use of land and natural resources, take responsibility for ecosystem management including planning use and environmental protection, and plan strategies to address risks such as water scarcity. Immediate action is required to resolve access issues and conflicts.
- **Research and policy for sustainable development:** There is a need for a Northern-based institution to undertake research, policy engagement and monitoring of development initiatives for war-affected communities. A *research and policy institute for sustainable development* could track development and market trends, monitor large-scale development projects, raise timely concerns and generate ideas to support evidence-based policy development to address existing and emerging issues such as widespread indebtedness, youth unemployment, challenges of women with dependants.

9. Conclusion

The economic crisis in the North, characterised by high unemployment, poverty and increasing indebtedness, calls for a new long-term vision and direction for economic development that is informed by a nuanced understanding of its post-war legacy. This report offers a macroeconomic analysis through the development of a Framework that draws on three lenses: it identifies the appropriate means of production based on the Province's relative distribution of capital, labour, and land and natural resources; it emphasises the importance of an enabling environment that facilitates such production and which acts on current and future obstacles; and it roots such production in the capacities and alleviation of vulnerabilities of the communities it aims to serve.

An economic growth path that is slower but more stable, and which invests in communities to strengthen the social foundations for development, is proposed as an appropriate strategy for the North. The strategy should build on the existing economic base dominated by small-scale producers, make use of local resources and look to incrementally improve current levels of skills and capacities. Investment in community resilience building such as in health and food security, together with appropriate technology, regulation and market systems development for example, will reinforce the overall push for sustained growth, creating much-needed jobs and raising incomes.

The report highlights challenges that are specific to the North's post-war legacy. There is a need for leadership to take forward a new economic development agenda, re-orientation towards development programming by implementing actors, increased community participation and workforce development. Effective action to address these while delivering a new growth strategy can only be undertaken at a provincial level to ensure the best use of resources and efficient decision-making. Sector-wise provincial priorities in agriculture, industries and services have been identified. The establishment of a special vehicle to lead the planning and coordination of the strategy as well as to tackle unique post-war challenges such as securing long-term development financing and broadening the labour market is also recommended.

Drawing on perspectives and experience coming out of the region, this Framework is offered as a resource to support the creation of a master plan for economic development of the North. It is hoped the contents will stimulate further discussion, debate and research by decision-makers in government, the donor community and wider civil society, and encourage collaboration and cooperation towards a shared goal of bringing prosperity and equity to the Northern Province.

