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POST - 1977 PERIOD

Economic Reforms in Sri Lanka

EDITED BY: MUTTUKRISHNA SARVANANTHAN

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Preface

Amidst deepening economic and balance-of-payments crises as a result of rise in global oil prices, severe drought resulting in power shedding and drop in agricultural output, and galloping military expenditures Sri Lanka resorted to borrowing from the International Monetary Fund (IMF) in April 2001. This USD 250 million standby credit facility by the IMF was offered on the conditions of number of structural reforms to be undertaken. This standby credit agreement between the IMF and the Government of Sri Lanka (GoSL) rekindled the issue of economic reforms in Sri Lanka. In this background, the International Centre for Ethnic Studies (ICES) Colombo organised a civil society public dialogue with the IMF in August 2001, where I presented a critique of the standby credit agreement and the then Senior Resident Representative of the IMF in Sri Lanka, Dr. Nadeem Ul Haque, responded, which was followed by public discussion.

At the end of this public dialogue the Director of the ICES Colombo, Dr. Radhika Coomaraswamy, encouraged me to undertake a study on the merits and demerits of the economic liberalisation regime in Sri Lanka since 1977. This edited volume is the end product of her encouragement. It was decided to choose contributors locally. The ICES called for papers from academics at the Sri Lankan universities, researchers at public institutions, independent private research institutions, and the civil society. All the contributions to this volume (barring just one) are published here for the first time. The contributors come from varied academic disciplines and different walks of life such as academics, independent researchers, and development practitioners. The unique features of this volume are that all, but two, contributors are young researchers (i.e. 7 out of 9), there is gender parity of contributors (i.e. 5 females and 4 males), and the contributors are ethnically mixed (i.e. 7 Sinhalese, 1 Tamil & 1 Muslim).

This study was commissioned in early-2002 and was originally planned to be completed by early-2003, i.e. in one year. However, it was completed only by early-2004, thus taking two years. The first drafts of individual papers were presented at a workshop in July 2002 at the ICES. Dr. Colin Simmons, Professor of International Economic Development, University of Salford, England, was the external reviewer of the draft papers. He provided extensive and valuable comments/suggestions for revision of the draft papers, which is gratefully acknowledged. I am also indebted to Dr. Wilbert Gooneratne (former Director, Development Studies Institute, University of Colombo) for going through the first complete draft of this book patiently and providing incisive suggestions for improvement. In spite of the delay, all the contributors have put in lot of effort and thought in the preparation of their respective chapters to whom I owe my sincere gratitude. I would also like to acknowledge with gratefulness the financial sponsorship for this study by the Norwegian Agency for Development Cooperation (NORAD) in Colombo. Finally, I would like to thank all the staff at ICES Colombo for their assistance during the course of this study.

As the team leader I humbly take full responsibility for all the errors, omissions, and shortcomings in this volume. At the same time all commendations for this volume are, first

and foremost, due to my collaborators who had given their best to make it a quality product. I earnestly hope that this volume will be of use to students, teachers, policy makers, and development practitioners in Sri Lanka and abroad. Further, this volume will be translated into both the national languages, i.e. Sinhala and Tamil.

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Chapter 1

Introduction

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1. Economic Reforms: Global Perspective

In the aftermath of the Second World War most of the present day developed countries pursued economic strategies that were state-driven and commonly known as welfare states. This was primarily to counter the socialist economic systems of the socialist countries spearheaded by the now defunct Soviet Union. The present day developing countries, which gained independence after the Second World War due to de-colonisation, also followed similar state-driven development strategies. However, as a result of the oil crisis of the early-1970s these state-driven development strategies and welfare states became unsustainable even in a developed country like the United Kingdom, which had to resort to borrowing from the IMF in 1976 due to balance-of-payments crisis. The developing countries were also severely affected by the oil crisis because of deteriorating terms of trade for their primary commodity exports.

Worldwide economic crisis of the 1970s called for rethink of the state-driven development strategies and the welfare states. Margaret Thatcher in the United Kingdom and Ronald Reagan in the United States spearheaded this rethink in economic strategy. The former became the Prime Minister of the United Kingdom in 1979 and the latter became President of the United States in 1980. These two political leaders embarked on far reaching economic reforms in their respective countries, which saw the ascendance of 'neo-liberalism' in the world.

A similar rethink of the development strategy took place in developing countries as well. Perhaps Chile was the first country in the developing world to embark on economic liberalisation in the mid-1970s[1]. Intellectual demonstration of this rethink was the scathing critique of the "poverty of development economics" by Deepak Lal in 1983. Moreover, the theoretical advancement and outcome of a series of comparative studies in the area of trade strategy such as those of the OECD, World Bank, and the National Bureau of Economic Research (NBER) since the early-1970s confirmed the growth-conducive traits of trade liberalization pushing the developing countries to undertake reforms.

The overall argument of the neo-liberal paradigm was that state interventions in the economy and inward looking policies have been detrimental to economic growth. The neo-liberal paradigm gained added strength due to the fall of the Soviet Union and other East European socialist economies in the late-1980s and early-1990s. The fall of the state-controlled economies in Eastern Europe propelled a global consensus on neo-liberal paradigm. However, there were dissident voices against the neo-liberal paradigm as well, particularly after the Asian financial crisis of the late-1990s.

Foregoing were the sources and phases of economic and political reforms in the first, second, and third worlds in the past quarter century. Such economic and political

reforms centered on the role of state in economic management. The common trait was to reduce the role of state and increase the role of markets and the private sector in economic management.

2. Economic Reforms: The Case of Sri Lanka

Interestingly the economic reforms in Sri Lanka, which began in 1977, preceded the first wave of economic reforms at the global level spearheaded by Margaret Thatcher and Ronald Reagan. Besides, Sri Lanka became the first South Asian country to embrace the neo-liberal economic paradigm. The main reason for this lead position was the disgruntlement with the type of economic regime between 1970-77 in Sri Lanka. Nationalisation of the plantation agriculture sector, import substitution industrialisation, price controls, exchange controls, interest rate ceilings were some of the salient features of the socialist economic policies pursued in Sri Lanka during 1970-77. The welfare state in Sri Lanka reached unprecedented heights during this seven-year period of coalition government led by the Sri Lanka Freedom Party (SLFP). Shortages for essential commodities including rice (the staple food of the population) resulted in long queues to purchase essential commodities and the growth of informal markets. Severe restrictions on the foreign exchange market resulted in a thriving informal market. In short, consumption was artificially restricted by state policies, which resulted in huge pent-up demand for consumer goods including essential food items such as rice, lentils, sugar, and milk.

The United National Party (UNP) government that swept to power in 1977 obtained four-fifth majority in parliament due to the huge discontent created by the socialist policies of the 1970-77 period. For the new UNP government the role model was Singapore. The new government aspired to make Sri Lanka the Singapore of South Asia. Hence, export-led growth model of Singapore became the role model for Sri Lanka. Liberalisation of the foreign trade regime, exchange controls, administered pricing system, and interest rate ceilings were undertaken. Parallel to this new economic regime, political power was also gradually concentrated in the hands of the ruling party. The aim was to create a one-party democratic state as in Singapore. The justification for the concentration of political power was that Singapore prospered because of political stability ensured by one-party rule.

The attempt to establish a one-party rule as in Singapore negatively impacted on the process of economic reforms in Sri Lanka. The discontent spurred by the political reforms (such as the political victimization of the then opposition leader and former Prime Minister, introduction of executive presidential system, and the proportional representation system of elections) hindered the process of economic reforms. Hence, the economic reform process in Sri Lanka ended up being predominantly a trade liberalisation process due to political constraints. There was very little attempt to address the fundamental institutional and structural problems in the economy, such as the state domination of the plantation agriculture, loss making public industries/ enterprises, bloated bureaucracy, state domination of the financial sector, and labour market rigidities. Antagonism towards political reforms and the eruption of the ethnic conflict in 1983 were the two major factors that hampered a systemic economic reform programme in Sri Lanka despite being an early reformer.

Only in the 1990s did denationalisation of the plantation agriculture and divestiture of state industries/ enterprises take place in earnest. However, the long overdue reform of the public sector, financial sector and the labour market were yet to take place. In short, the economic reform process in Sri Lanka has been piecemeal and did not have a

strategic focus. The economic and political reform process can be sub-divided into four phases. The first being 1977-1988, second 1989-1994, third 1995-2001, and fourth being 2002 to date.

The export-led growth model dominated the first phase (1977-1988). Therefore, partial floating of the national currency, relaxation of exchange controls, incentives for foreign investment (such as tax holidays), reduction in import and export duty rates, partial withdrawal of the non-tariff barriers to trade, withdrawal of price controls (except on a handful of essential items), promotion of labour exports particularly to the Middle East, promotion of tourism were the major policy reforms of that phase.

The second phase (1989-1994) continued the reforms of the first phase in addition to promoting a private sector led growth model. The denationalisation of the management of plantation agriculture and divestiture of loss making public enterprises began in earnest during this period. Further reforms of the external trade, foreign investment and exchange controls were undertaken. An aggressive industrial export promotion dominated by the readymade garments took place during this time. A lukewarm restructuring of the public sector, and ending of the state monopoly on rice imports were significant developments during this phase.

The third phase (1995-2001) included a significant privatisation programme incorporating complete denationalisation of the plantation sector, partial privatisation of the national airline (Air Lanka, now known as Sri Lankan Airlines) and the national telecommunications service (Sri Lanka Telecom). Complete free float of the local currency was instituted in January 2001. However, intensification of the civil war during this period derailed the economic reform agenda.

For the first time in the post-independence period Sri Lanka experienced negative economic growth rate in 2001 as

GDP contracted by 1.4%. Hence, the new government, which came to power in December 2001, has begun to address the fundamental, institutional, and structural weaknesses in the economy. Huge public debt (103% of the GDP in 2002) and double-digit budget deficits were the order of the day during the 1980s and 1990s. The present government seems to be committed to arrest these trends by undertaking public and financial sector reforms, labour market reforms, and reform of the provision of welfare benefits to the poor. At last the fundamental macroeconomic imbalances have begun to be addressed. This reform process is coupled with the cessation of hostilities between the government forces and the LTTE (Liberation Tigers of Tamil Eelam) rebel group since February 2002 brokered by the Royal Norwegian government. Hence, the economic and political milieu seem to be in favour of undertaking far reaching economic and political reform programme.

Sri Lanka opened up its economy in 1977; the first one to do so in South Asia. It is now 25 years since the liberalisation of the Sri Lankan economy began. It is time to take stock of the pros and cons of the economic liberalisation and reform process in Sri Lanka. This is undertaken in order to learn from the strengths and weaknesses of the past liberalisation, and chart the future economic reform agenda of Sri Lanka.

2.1. Political Consensus

Two major political parties have ruled Sri Lanka since gaining independence from the British empire in 1948, viz. the United National Party (UNP) and the Sri Lanka Freedom Party (SLFP). The UNP ruled the country from 1948-1956, 1965-1970, 1977-1994 & 2001 to date, and the SLFP from 1956-1965, 1970-77, and 1994-2001. Thus, the former has ruled for 32years and the latter for 23years of the 55-year post-independence history of the country. However, it is important to remember that the governments of 1956-1965, 1970-77, and the last one from 1994 to 2001 were coalition governments led by the SLFP. Two other main constituent parties of the latter two coalition governments (1970-77 and 1994-2001) were the Lanka Sama Samaja Party (LSSP - a Trotskyite party) and the Communist Party of Sri Lanka (CPSL).

As regards economic policy and development strategy the two major political parties have pursued different strategies. The UNP has always pursued (and still adheres to) liberal open market economic policies, and the SLFP-led coalition governments have pursued policies such as nationalisation, state-control of the economy, import substitution and price controls. However, the last SLFP-led coalition (Peoples' Alliance) government which came to power in 1994, for the first time, embraced open market economic policies with emphasis on private-sector and export led economic growth strategy (in spite of leftwing coalition partners such as the LSSP and CPSL). Hence, since 1994 there is a broad consensus between the two major political parties about pursuing free market economic policies. Nonetheless, they still differ on the degree or extent of openness of the economy. More importantly, though in principle the PA government was committed to liberal economic policies, in practice there was a lot of bickering within its coalition partners about various economic reforms to be undertaken.

2.2. The Unfinished Agenda

Despite three tranches of economic reforms in the preceding quarter-century (1977-2001) several structural and institutional impediments to economic growth still persist. These can be observed from several macroeconomic indicators that are outlined in Chapter 2. This is because economic reforms in Sri Lanka have been piecemeal and with very little long-term perspective. Economic policy making was mostly ad hoc which lacked coherence and consistency. Hence, the private sector, which was promoted to be the engine of growth, lacked a clear signal from the governments in power. The protracted ethnic conflict in the North-East Province and the Southern insurrection of the late-1980s also distracted the economic reform agenda in Sri Lanka. Reforms of the overburdened public sector, state-dominated financial sector, archaic labour laws, and by and large off-targeted poverty alleviation programme are some of the prerequisites for a sustainable higher economic growth path for Sri Lanka.

The role of the state in the economy has been changing in the last quarter-century, albeit slowly. Land reforms undertaken during the 1970s made the state owner of over 80% of the total land area of Sri Lanka[2]. Instead of redistributing land to the land-less poor the state has become the biggest landholder in Sri Lanka.

Sri Lanka is burdened with one of the biggest bureaucracies in Asia (including public corporations and semi-government institutions). There were 57 persons in the public service for every 1,000 citizens in Sri Lanka in 2000. The corresponding figures for Malaysia is 45, Singapore is 37, Thailand is 31, Indonesia is 21, India and Pakistan is 19, and Bangladesh is 10[3]. In other words, for every 16 citizens there was 1 public service employee in Sri Lanka in 2000, which was 1 for every 24 citizens in 1978. The public sector is not only too big for the country it is also inefficient with low productivity. This bloated bureaucracy thwarted attempts by successive governments since 1977 to establish an effective enabling environment for private sector led economy. The failure to reduce the size of the bureaucracy and make it more efficient could be one of the principal reasons for the slow pace of economic reforms and the consequent moderate growth rate since 1977.

The state in Sri Lanka owns/employs large proportions of the two main factors of production viz. land and labour. As noted above, over 80% of the total land area of the country is still owned by the state. Further, the state employed nearly 1.2million personnel (i.e. 20% of the total labour force) out of the total labour force of 6million in 2000. In fact, the public sector employees (including regular, contractual and casual employees in the public service, public corporations and semi-government institutions) increased from 597,000[4] in 1980 to almost 1.2million in 2000[5]. Hence, the state, instead of shrinking, has expanded in terms of the number of personnel. Therefore, state control of the economy and society in Sri Lanka is still dominant despite quarter-century of economic liberalisation and reforms.

One of the salient features of the economic liberalisation and reforms in Sri Lanka in the past quarter-century has been the predominant role of women in the commanding heights of the economy. Presently, tea, garments and labour exports are three cornerstones of the Sri Lankan economy. These three goods and services are the largest foreign exchange earners contributing to over 90% of the total foreign exchange earnings of the country. More importantly all these are dominated by female labour. The tea sector always relied on female workforce, but the garments and labour exports are new post-liberalisation sectors that are dominated by female workforce. Therefore, the contribution of women to the Sri Lankan economy is immense, though it is not adequately recognised by the state and society. It would not be an exaggeration to claim that women are the unsung heroines of the transformation of the Sri Lankan economy from an agrarian to an industrial cum service-oriented economy in the past 25 years.

3. Economic Reforms and Economic Freedom[6]

Economic freedom is an essential ingredient of democracy like political freedom. Yet economic freedom is less understood compared to political freedom. Though the concept of economic freedom gained momentum with the ascendancy of neo-liberal economic paradigm since the early-1980s in the United States and United Kingdom (which later spread to the rest of the world) there was hardly any yardstick developed for the measurement of economic freedom. Only in the mid-1990s a composite index to measure economic freedom was established after several years of groundwork.

The objectives of this section are quite modest and attempt to answer the following questions:

* What is economic freedom and how can it be measured?
* What is the state of economic freedom in Sri Lanka?
* What are the deficiencies in the measurement of economic freedom in Sri Lanka?

3.1 Economic Freedom: An Introduction

According to Gwartney and Lawson (2003: 5) "the key ingredients of economic freedom are personal choice, voluntary exchange, freedom to compete, and protection of person and property". A country's adherence to such economic freedom is measured by the Economic Freedom of the World (EFW) index developed by the Fraser Institute based in Vancouver, Canada. The EFW index is based on 38 variables (including 18 survey-based variables derived from the International Country Risk Guide and the Global Competitiveness Report) and was available for 123 countries in 2001, the latest available year. The EFW index has a scale

of 0 to 10 - zero depicting no economic freedom at all and 10 depicting highest economic freedom.

The EFW index is subdivided into 5 major components: (i) Size of Government: public expenditures, taxes and public enterprises; (ii) Legal Structure and Security of Property Rights; (iii) Access to Sound Money; (iv) Freedom to Exchange with Foreigners; and (v) Regulation of Credit, Labour and Business. Further, the 'Size of Government' is subdivided into 5 components[7]; 'Legal Structure and Security of Property Rights' is subdivided into 5 components[8]; 'Access to Sound Money' is subdivided into 4 components[9]; 'Freedom to Exchange with Foreigners' is subdivided into 9 components[10]; and 'Regulation of Credit, Labour and Business' is subdivided into 15 components[11] (Gwartney and Lawson, 2003: 6-10). Hence, altogether 38 variables compose the EFW index.
In 2001 the top ten countries in terms of economic freedom were Hong Kong (8.6), Singapore (8.5), United States (8.3), New Zealand (8.2), United Kingdom (8.2), Canada (8.1), Australia (8.0), Ireland (8.0), Switzerland (8.0) and Netherlands (7.8). The bottom ten countries were Myanmar (3.8), Democratic Republic of Congo (3.9), Zimbabwe (4.0), Algeria (4.2), Guinea-Bissau (4.4), Republic of Congo (4.5), Ukraine (4.6), Romania (4.7), Malawi (4.8) and Central African Republic (4.9) (Gwartney and Lawson, 2003: 11). The world average economic freedom rating was 6.4 in 2001 (Table 1).

There also seems to be a positive correlation between economic freedom and economic growth, per capita income, life expectancy, income inequality, literacy rate, access to safe sanitation facilities and safe water (see Gwartney and Lawson, 2003: 20-21, 35).

3.2 Economic Freedom: The Case of Sri Lanka

In South Asia economic freedom indices are available for the largest five countries, viz. India, Pakistan, Bangladesh, Nepal and Sri Lanka. Sri Lanka had the highest economic freedom rating in South Asia (6.3) during 2001, the latest year for which data is available. This may not be surprising because of the fact that Sri Lanka was the first country in South Asia to open up its economy in 1977. But, in 1980 Nepal (5.7) and India (5.2) had higher ratings than Sri Lanka (4.9). In 1985 and 1990 Nepal (5.3) had higher ratings than Sri Lanka (5.1 & 5.0 respectively). Nevertheless, since 1995 Sri Lanka (6.1, 6.1 & 6.3) has had the highest ratings though in 2000 India (6.1) and Sri Lanka (6.1) had equal rating. Yet economic freedom in Sri Lanka during 2000 and 2001 (6.1 & 6.3 respectively) were slightly less than the world average of 6.3 and 6.4 respectively (Table 1).

Sri Lanka had a very restrictive and inward looking economy between 1970 and 1977. Unfortunately the economic freedom index of Sri Lanka for 1970 and 1975 are unavailable. It would have been certainly far below the 1980 rating because of nationalisation of the plantation sector, price and exchange controls resulting in parallel markets for commodities and foreign currencies, high import tariff rates and high income, property & wealth taxes inter alia. Although economic freedom rating for 1970 and 1975 are unavailable data for certain components of the economic freedom index are available. For example, for 1970 some sub-components of the 'Size of Government', 'Access to Sound Money' and 'Freedom to Exchange with Foreigners' are available while for 1975 in addition to the foregoing some sub-components of the 'Regulation of Credit, Labour and Business' are available (see Gwartney and Lawson, 2003: 142).

Though Sri Lanka tops in economic freedom within South Asia it lags behind Southeast Asian countries barring Indonesia (Gwartney and Lawson, 2003: 11). Sri Lanka's top

position in South Asia in terms of economic freedom is buttressed by the facts that it has the highest economic growth rate, per capita income[12], life expectancy, literacy rate, access to safe sanitation facilities and safe water in South Asia (Mahbub ul Haq Human Development Centre, 2003: 228-231).

Table 1: Economic Freedom Rating in South Asia

Country	1970	1975	1980	1985	1990	1995	2000	2001
Bangladesh	N.A	3.8	3.7	4.1	4.6	5.4	5.5	5.6
India	5.0	4.4	5.2	5.0	4.9	5.6	6.1	6.1
Nepal	N.A	N.A	5.7	5.3	5.3	5.2	5.6	5.7
Pakistan	4.7	3.8	4.6	5.1	5.0	5.6	5.5	5.4
Sri Lanka	N.A	N.A	4.9	5.1	5.0	6.1	6.1	6.3
World Average	6.3	6.4						

Source : Gwartney and Lawson, 2003: 3, 46, 91, 115, 123 & 142.

Note : N.A = Not Available.

In terms of the ranking of economic freedom indices Sri Lanka was in the 70th position in 1980 that improved to 64th position in 2001 (out of 123 countries). Sri Lanka's position fluctuated between the lowest 74th (in 1990) to highest 57th (in 1995) during the period 1980 and 2001 (Table 2). Economic freedom index of Sri Lanka is unavailable for 1970 and 1975. However, as argued above it would have been lower than that in 1980.

As a corollary to the top position in terms of economic freedom rating Sri Lanka was at the top in terms of ranking of countries according to the degree of economic freedom within South Asia in 2001. However, in 1980 Nepal and India were well ahead of Sri Lanka and in 1985 and 1990 only Nepal was ahead of Sri Lanka. Since 1995 Sri Lanka had the best ranking (jointly with India in 2000) (Table 2).

Again, Southeast Asian countries (barring Indonesia) were ahead of Sri Lanka during 2001 (Gwartney and Lawson, 2003: 11). The comparison of economic freedom rankings overtime may be misleading because the number of countries incorporated in the exercise has been growing. For 1970 only 53 countries were rated, which increased to 70 countries for 1975, 102 countries for 1980, 109 countries for 1985, 113 countries for 1990 and 123 countries for 1995, 2000 & 2001. Whilst the number of countries incorporated in the exercise increased Sri Lanka's position improved, which means Sri Lanka had fared much better than the rankings in Table 2 would show. For example, in 1980 Sri Lanka was in the 70th position out of 102 countries but in 2001 it was in the 64th position out of 123 countries. That means, in 2001, Sri Lanka's position improved by more than 6 places (than reflected in Table 2).

Table 2: Economic Freedom Ranking in South Asia

Country	1970	1975	1980	1985	1990	1995	2000	2001
Bangladesh	NA	69	98	93	93	79	92	91
India	41	58	59	73	80	74	70	73
Nepal	NA	NA	39	60	64	86	89	89
Pakistan	48	69	76	68	74	74	92	101
Sri Lanka	NA	NA	70	68	74	57	70	64

Source : Gwartney and Lawson, 2003: 46, 91, 115, 123 & 142.

Note : N.A = Not Available.

It is important to note that the ratings and rankings of each component and sub-components differ from the aggregate ratings/rankings given in Tables 1 & 2. That is, though overall Sri Lanka seems to top in economic freedom

within South Asia since 1995 in certain components and sub-components of the index it lags behind some other South Asian countries (see Gwartney and Lawson, 2003: 46, 91, 115, 123&142).

3.3. Economic Freedom Index of Sri Lanka: A Critical Evaluation

Though the overall economic freedom index of Sri Lanka is fairly positive its performances in some of the sub-components of 'Legal Structure & Security of Property Rights' (military interference, integrity of legal system and protection of intellectual property), 'Freedom to Exchange with Foreigners' (restrictions on foreign capital transactions, hidden import barriers and costs of importing) and 'Regulation of Credit, Labour & Business' (time spent with government bureaucracy, price controls, impact of minimum wage, flexibility of hiring and firing and private ownership of banks) are lagging behind (Gwartney and Lawson, 2003: 142).

Further, the changes in the ratings of some of the components of the economic freedom index from one year to another are suspect. For example, Sri Lanka received 7.2 rating for 'time spent with government bureaucracy' in 2000 which declined to 4.0 in 2001. Likewise, for 'flexibility in hiring and firing' Sri Lanka received a rating of 2.9 in 2000 which jumped to 4.6 in 2001. Further, the rating for 'impartial courts' rose from 5.0 in 2000 to 6.1 in 2001. Moreover, the rating for 'protection of intellectual property' jumped from 3.5 in 2000 to 5.0 in 2001. The foregoing changes in ratings between 2000 and 2001 appear to be doubtful because there do not seem to be any considerable improvement in any of these factors in just one year. Besides, the quality of the underlying statistical data on which the economic freedom index is based is wanting.

Moreover, though as per the economic freedom index Sri Lanka enjoys considerable economic freedom (as is evident in Table 1) in reality a large chunk of the population has been deprived of economic freedom due to the civil war in the past twenty years. The secessionist struggle in the North&East Province of the country has resulted in severe erosion of economic freedom, inter alia. A devastating economic embargo imposed on the North&East Province since 1990 has seriously hampered productive activities (see Sarvananthan, 2003a). This economic embargo included essential food commodities, medicines and agricultural inputs such as fertilisers, pesticides and fuel as well. Besides, arbitrary and extra legal taxes imposed by various rebel groups also impinged on the economic freedom of the masses in the North&East Province.

The GoSL unilaterally lifted the economic embargo in January 2002 prior to the signing of an indefinite ceasefire agreement with the LTTE in February 2002. However, arbitrary and extra legal taxes imposed by the LTTE rebels have become further entrenched and widespread during the past 18 months. Though with the lifting of the economic embargo economic freedom of the people of the North&East Province has been restored to a considerable extent various rebel taxes impinge on economic freedom (see Sarvananthan, 2003b).

In addition to extra legal taxes the farmers and fisherpersons in the North&East Province are faced with a monopsony (single buyer), which is the LTTE. After the ceasefire agreement agricultural and fishing activities have received a tremendous boost in rebel held territories. However, the rebels purchase farm and fish produce at a fixed (below market) price and transport to Colombo to sell at a higher price. Thus the rebels have taken away the freedom of the producers to market their own produce. This restriction imposed by the rebels even during peacetime

impinges on the economic freedom of the people in the North & East Province.

In these circumstances, fairly high economic freedom ratings received by Sri Lanka throughout the 1990s seem doubtful. Thus, non-incorporation of the taking away of economic freedom by state and non-state actors in the theatres of civil war appears to be a major deficiency in the economic freedom index of Sri Lanka. Similarly the economic freedom index may overlook intra-country disparities in economic freedom in other civil war-torn countries and even federal states (where different tax regimes, size of government, regulations, etc, may prevail). Some mechanism has to be found to take on board the intra-country disparities in economic freedom, as in the case of Sri Lanka, in the compilation of such index. For example, an index for the war-torn regions and another for the rest of the country can be compiled and then the average of the two could become the country index.

Access to correct and truthful information is sine qua non for the effective functioning of an open market economy and to this end a vibrant free media is a must. There appears to be a positive correlation between freedom of the media (both print and electronic) and economic development. A recent World Bank study has highlighted the positive correlation between free media and economic development in several countries both developed and developing (World Bank, 2002). In the case of Sri Lanka considerable state-ownership of both print and electronic media has a debilitating effect on economic development and empowerment by way of spreading false and misleading information to the masses. Further, the Tamil language newspapers (both national and North&East-based) are coerced and/or bribed to toe the line of the LTTE seriously jeopardising the political and economic freedom of the masses in the North&East region. In short the Tamil language newspapers (national & regional) have become mouthpieces of the LTTE shunning any alternative views or opinions.

Hence, a rating for freedom of the media should be incorporated in the economic freedom index. An organisation such as the Article 19, which monitors media freedom globally, may have a dataset that can be used in the EFW index. Here again intra-country differences should be captured.

The economic freedom index is little known in Sri Lanka and hence rarely used in policy dialogue. There is a dearth of awareness about the economic freedom index among bureaucrats and the academia. However, there is some knowledge about the index among the business community, especially within the chambers of commerce and industry. In this background a campaign to create awareness about the economic freedom index among the bureaucracy, academia, business community and the general public is a long felt need.

In sum, though the economic freedom index is a valuable measure it needs to be modified to incorporate intra-country differences and include additional criteria as it become relevant and necessary. Thus the economic freedom index should keep on evolving diachronically.

4. Organisation of the Book

Chapter 2 provides an overview of macroeconomic development in Sri Lanka in the liberalisation period particularly in the past twelve years, i.e. 1991-2002. It traces the movements/trends of several macroeconomic indicators in the past twelve years such as the GDP growth, agriculture, industry, savings & investment, interest rate, inflation, unemployment, public finance, public debt, international trade, balance-of-payments, foreign remittances, tourism, inequality & poverty, and regional development. In a nutshell

this chapter highlights the strengths and weaknesses of the economic liberalisation process in Sri Lanka.

Chapter 3 traces the evolution of the public service system from the colonial to present times. Then it identifies past attempts at public service reforms and the reasons for their failure during the liberalisation period. In order to identify the requisite reforms in the public service the chapter draws lessons from several other countries that have undertook public sector reforms, both in the developed and developing world. Finally, this chapter proposes a number of steps to reform the public sector in order to meet the contemporary development challenges in Sri Lanka.

Chapter 4 provides a comprehensive survey of liberalisation measures undertaken in the financial sector in Sri Lanka since 1977. The implications of such liberalisation measures are analysed during two time periods, i.e. 1977-1987 and post-1987. Further, it discusses the effects of financial sector reforms on the macroeconomic indicators, and the effects of macroeconomic policies on financial sector reforms. It highlights the piecemeal nature of financial reforms hitherto undertaken, and identifies the remaining reforms to be carried out in the financial sector.

Chapter 5 begins by tracing the origins of the politicisation of labour movements in Sri Lanka from colonial times. This chapter discusses the demand for and supply of labour in Sri Lanka, while special emphasis is made of enormous legislation governing labour relations. A number of recommendations are made in order to remove the structural rigidities in labour market and make it globally competitive. A case for an efficient, flexible, and adaptable labour force in Sri Lanka along with the safeguarding of labour rights and decent work is made.

Chapter 6 provides a detailed account of poverty in all its manifestations in Sri Lanka along with comparisons with other developing countries. Further, it gives a historical account of various anti-poverty strategies in Sri Lanka beginning in the colonial era. It also discusses the pros and cons of theses anti-poverty strategies in combating poverty by highlighting the different approaches to poverty alleviation in the pre-liberalisation period (1948-1977) and during the liberalisation period (1977-todate). Flowing from this analysis a set of proposals is outlined in order to make anti-poverty programmes robust that would alleviate poverty in Sri Lanka.

Chapter 7 weighs the ideological debate whether poverty is caused by lack of economic liberalisation or an effect of economic liberalisation in Sri Lanka. Such debate draws lessons from the experiences of South East Asian countries as well. This chapter provides a critical evaluation of different poverty alleviation programmes since independence, particularly since 1977. It provides an in-depth critical analysis of the current and immediately preceding poverty alleviation programmes in Sri Lanka with special emphasis on implications these have on broader economic reforms. Arising out of this discourse the need to revamp the present poverty alleviation programme is emphasised. Besides, the critical need to balance economic reforms required to boost growth and effective social protection to vulnerable groups in society is stressed.

Chapter 8 discusses gender implications of economic reforms by way of looking at the economic reform agenda espoused in key recent government policy documents. As a prelude to this it provides an overview of women's role in the economy, particularly highlighting the liberalisation-induced segments such as the migrant workers, and export garments factory workers. Besides, it gives a detailed account of the various government initiatives/ institutions to address the issue of gender inequality in society and points out the weaknesses. A case for mainstreaming gender in all policy discourses is advanced.

Chapter 9 is a short empirical study of micro impact of macro policy environment. Labour exports, particularly to the Middle East of which 70% are female, is a post-1977 liberalisation-induced sector of the Sri Lankan economy. The critical domestic factor that spurred labour exports was the macro policy environment characterised by the open economic model. This chapter illustrates the dichotomy of limited economic independence enjoyed by female migrant workers as a result of macro policy environment amidst increased social marginalisation at the community level. Hence, a case is advanced for the integration of female migrants in the international labour market with 'decent work', dignity, and equality with their male counterparts.

Chapter 10 outlines the major reforms undertaken in the past two years (2002 & 2003) by the new government and the proposed reforms for 2004. Of course this volume does not cover the entire gamut of economic reforms undertaken in Sri Lanka in the past quarter-century. Specific sector-wise assessment of economic reforms such as in the agriculture, industry, education, health, etc is not covered. Instead the chapters deal with economic reforms at a very macro level. One of the major drawbacks of the volume is that there is no specific chapter on trade liberalisations; the international trade sector underwent the most far-reaching liberalisations.

Generally, in the literature, the terms 'economic liberalisation' and 'economic reform' are used inter changeably. However, the author would like to make a distinction between 'economic liberalisation' and 'economic reform', whilst acknowledging that there is an overlap between the two. According to the author, 'economic liberalisation' means removing restrictions, relaxing controls, etc, i.e. undoing or diluting past policy measures. On the other hand, 'economic reform' means undertaking proactive measures to address the root causes of economic stagnation.

Thus, economic reform is much more than economic liberalisation, though the former would incorporate the latter as well. For example, reduction of tariff rates and removal of non-tariff barriers to trade are measures of liberalisation. On the other hand, simplification of Customs procedures, automation of Customs procedures in order to expedite clearance of goods, reducing the transaction costs of international traders through institutional changes (for example, plugging the loopholes for rent seeking) are measures of reform. The former can be undertaken quite easily because there would be no opposition to such liberalisation measures. However, the latter could be a much more difficult task to undertake because of opposition from vested interests. Hence, economic reforms are of strategic nature.

Footnotes

[1] After the illegal overthrow of the democratically-elected socialist government of Salvador Allende by the military in 1973.

[2] Government of Sri Lanka, Draft Poverty Reduction Strategy ,November 2001: 24&25.

[3] Cited in World Bank, Sri Lanka: Recapturing Missed Opportunities, Country Report, 2000: 22.

[4] This figure includes only the regular staff of public and semi-government institutions.

[5] Department of Census and Statistics, Statistical Pocket Book 2000, Table 3.5: 21 and Central Bank of Sri Lanka, Annual Report 2000, statistical appendix table 48 & special statistical appendix table 3.

[6] This section was first published in *Contemporary South Asia*, Vol.13 No.1, 2004, Oxford.

[7] Government consumption, transfers & subsidies, government enterprises & investment, top marginal income tax rate and top marginal income & payroll tax rate.

[8] Judicial independence, impartial courts, protection of intellectual property, military interference and integrity of legal system.

Growth of money supply, inflation variability, recent annual inflation and freedom to own foreign currency.

[10] Taxes as percentage of exports & imports, mean tariff rate, variability of tariff rates, hidden import barriers, costs of importing, size of trade sector, official versus black market exchange rate, access to foreign capital and restrictions on foreign capital transactions.

[11] Private ownership of banks, competition from foreign banks, extension of credit to private sector, avoidance of negative real interest rates, controls on interest rates, impact of minimum wage, flexibility in hiring & firing, collective bargaining, incentives from unemployment benefits, military conscription, price controls, administrative obstacles for new businesses, time spent with government bureaucracy, ease of starting a new business and irregular payments to government officials.

[12] Although the Maldive islands has a higher per capita income than Sri Lanka, as the economic freedom index is not compiled for that country, it is left out of comparison.

Chapter 2

Macroeconomic Overview

- Muttukrishna Sarvananthan -

1. Introduction

Sri Lanka opened up its economy in 1977; the first one to do so in South Asia. It is now 25 years since the liberalisation of the Sri Lankan economy began. It is time to take stock of the pros and cons of the economic liberalisation process in Sri Lanka. This is undertaken in order to learn from the strengths and weaknesses of the past liberalisation, and chart the future economic reform agenda of Sri Lanka.

The objective of this chapter is to provide a critical evaluation of the post-liberalisation economic development in Sri Lanka. This is done by analysing the key macroeconomic indicators of Sri Lanka in the past 25 years. The overall argument of the chapter is that economic liberalisation in Sri Lanka has not resulted in the desired level of economic growth due to structural and institutional impediments to growth and the civil war.

The data presented in this chapter is for the last twelve-year period, 1991-2002, due to brevity of space. However,

we may refer to earlier period as well provided it is useful. Most of the data presented below are aggregate macro-level national data and therefore should be considered cautiously due to wide discrepancies at sub-national and micro-level. Where available and relevant we have incorporated dis-aggregated/sub-national data. More importantly and restrictively, all post-1990 data cited in this chapter exclude the North-East Province due to non-availability of data as a result of the protracted civil war.

The year 2000 has seen dawn of an economic crisis in Sri Lanka due to petroleum price hikes in the global market, rise in military expenditures after the fall of the strategic Elephant Pass in the Northern Province to the LTTE rebels, and a severe and prolonged drought. The current account deficit in the balance-of-payments peaked to nearly 7% of the GDP, and the foreign exchange reserves of the country dipped to little over USD 1billion; adequate to meet the import bills of just four months (excluding import of aircraft). In order to bolster the external reserves the Sri Lankan Rupee (LKR) was freely floated in January 2001[1]. Due to the deteriorating balance-of payments position the government was forced to resort to borrowing from the International Monetary Fund (IMF). This was the fourth time the Government of Sri Lanka (GOSL) has resorted to borrowing from the IMF in the last quarter-century, previously in 1983, 1988, and 1991.

2. Economic Growth

The annual Gross Domestic Product (GDP) of Sri Lanka grew on an average of 4.9% in real terms during the 25-year period 1976-2000. In the preceding 25 years (1951-1975) the annual real GDP grew on an average of 3.7%[2]. Therefore, the foregoing growth rates reveal that the post-liberalisation economic growth in Sri Lanka is not substantially different from the pre-liberalisation period, contrary to expectation. Though the post-liberalisation growth rates of Sri Lanka have been lower than anticipated they were reasonably steady. The real GDP growth rate in the last twelve-year period (1991-2002) averaged 4.5% annually (Table 1).

In fact, we would argue that the economic growth rate in the last quarter-century would have been lower compared to the previous quarter-century because of non-inclusion of almost one-third of the country (North-East Province) in the national income accounting since about 1990. The government administration does not extend to bulk of the North-East Province since about 1990. Even the national census undertaken recently in July 2001 (after twenty years) could not be carried out in most districts/areas of the North-East Province.

As a result of the protracted civil war it is plausible that the North-East Province would have incurred negative economic growth in the past twelve years due to widespread disruption to agricultural production, and destruction of economic, social, and physical infrastructure. This province was (and is) predominantly an agricultural region comprising food crops, livestock, and fisheries. Rice, onions, chillies, tobacco leaves, and fish were (and are) some of the largest produce of this province. Limited supply and consequent high price of fuel and fertiliser hampered food crop production in the region. Fishing in the region was curtailed due to restrictions on distance and time imposed by the security forces. Further, the primary sector production was negatively affected by lack of transport of produce to markets in other parts of the country, especially from the Northern Province. Most primary sector produces are perishables that require speedy transport to markets. However, since the indefinite ceasefire agreement signed in February 2002 almost all the above restrictions have been lifted.

The official statistical data of Sri Lanka (economic, social, and other) do not incorporate the North-East Province since about 1990. Hence, if we take into account the supposedly negative GDP growth of the North-East Province, the average GDP growth rate of the country would have been much less than the present official statistics would want us to believe. Thus, it may be the case that if the North-East Province were taken into account the GDP growth rate in the quarter-century 1976-2000 would have been lower than the preceding quarter-century 1951-1975.

This could be an indication that the economic liberalisation in Sri Lanka may not have resulted in a higher economic growth plane. It is popularly extolled that the Sri Lankan economy is resilient despite a vicious civil war for the past 20 years. We would argue that the "great resilience" of the Sri Lankan economy is nothing but a great myth. The negative growth areas are left out of the national income accounting system and a partial and distorted picture of the economy is portrayed for public consumption both domestically and internationally.

In the fifty years from 1951 to 2000, only during two years did the real GDP growth of Sri Lanka fall below one percent. In 1956 the real GDP growth rate plummeted to 0.7% and in 1971 to 0.2%[3]. The former year was marked by the ascendancy of a nationalist (inward looking) economic regime after eight years of liberal economic regime since independence. The latter year was marked by the first youth armed revolt of the country spearheaded by the JVP (*Janata Vimukthi Peramuna* - Peoples Liberation Front), and the dawn of one of the worst *dirigiste*[4] economic regimes in South Asia.

The year 2001 was the first year, since independence, the economy recorded negative growth. That is, the economy contracted by 1.4% during 2001. This was due to the impacts of prolonged draught and the consequent power crisis, rebel military strike at the Katunayake airport, abyss of political crisis faced by the country, and the US war on Afghanistan leading to deterioration in the international economic environment. Nevertheless, the economy bounced back in 2002 to post a real GDP growth of 4%.

The *per capita* income of Sri Lanka averaged USD 549 between 1990 and 1995, and was USD 856 in 2000[5]. Sri Lanka's *per capita* income in 2000 was the second highest in South Asia after the Maldives islands. However, the *per capita* income declined to USD 810 in 2001 due to the negative growth of GDP, and then increased to about USD 840 in 2002.

Table 1 Growth Rate 1991-2002

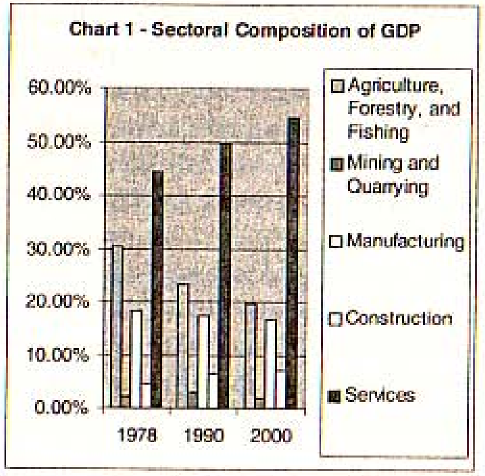
	GDP Growth Rate (%)
1990	4.6
1992	4.3
1993	6.9
1994	5.6
1995	5.5
1996	3.8
1997	6.3
1998	4.7
1999	4.3
2000	6.0
2001	(-) 1.4
2002	4.0

Source: Central Bank of Sri Lanka, *Annual Report 2002*, special statistical appendix table 7.

Further, if we look at the changes in sectoral composition of the GDP in the last quarter-century it is evident that Sri Lanka has a long way to go to become an export-led newly industrialising economy. The contribution of the primary sector (agriculture, forestry, and fishing) to

GDP has contracted from 30.3% in 1978 to 23.3% in 1990 and to 19.7% in 2000, which may be considered a positive development. The mining and quarrying sector contributed 2.2% to GDP in 1978, 3.0% in 1990 and 1.9% in 2000. According to growth theories, as an economy progresses the contribution of manufacturing sector is expected to increase. However, most disturbingly the contribution of the manufacturing sector to GDP in Sri Lanka has declined from 18.4% in 1978 to 17.5% in 1990, and further to 16.5% in 2000. The construction sector contributed 4.7% in 1978, 6.7% in 1990 and 7.2% in 2000 to the GDP. Moreover, the services sector contributed 44.4%, 49.5% and 54.6% to the GDP in 1978, 1990, and 2000 respectively (Chart 1). Hence, the decomposition of the GDP by sector between 1990 and 2000 also does not bode well for transforming the Sri Lankan economy into a high growth manufacturing economy in the near future.

It is argued by some that the drop in proportionate contribution of the manufacturing sector in the post-liberalisation period was due to closure of several small and medium manufacturing plants as a result of their inability to compete with cheaper imported goods. This argument is only partially correct. A much more compelling reason for the closure of small and medium manufacturing plants in the post-liberalisation period is the restrictive and archaic labour laws in the country. In a modern economy when local firms are exposed to vagaries of international trade they have to restructure their operations in order to keep afloat. This is very difficult in Sri Lanka due to restrictive labour laws. For example, it is not easy to retrench workers in firms that employ more than 50 persons. These firms have to undergo a lengthy bureaucratic process at labour tribunals to do so, which takes years to complete the cases. Hence, the easiest option for manufacturers is to wind up their operations altogether resulting in the loss of employment of the entire workforce. This is the principal reason for the closure of several small and medium manufacturing enterprises in the country during the last quarter century.



Source : Central Bank of Sri Lanka, *Annual Report 2000*: 4&5.

3. Agriculture

Sri Lanka has transformed from primarily an agriculture economy to a service-centered economy in the last quarter-century. Four principal crops are paddy, tea, rubber, and coconut. The former is a food crop and the latter three cash crops. Tea and rubber are primarily export commodities. A considerable proportion of the coconut production is also exported in processed forms, such as desiccated coconut, coconut oil, copra, coconut cream, and coconut milk powder.

The production of paddy increased from 2.4million metric tons in 1991 to 2.9million metric tons in 2000 indicating a 21% rise. Tea production increased from 241million kgs to 306million kgs (27% rise), rubber production decreased from 104million kgs to 87million kgs (16% drop), and coconut production increased from 2.2billion nuts to 3.1billion nuts

(41% rise) between 1991 and 2000. The yield per hectare in paddy cultivation increased from 3.4tons to 3.9tons, but decreased in rubber cultivation from 706kgs to 694kgs between 1991 and 2000. However, rubber production between 1992 and 1999 showed a healthy upward trend[6]. Thus, year 2000 was an unusually bad year for rubber production.

The food crop and fishery sub-sectors have been hampered by the ongoing civil strife. The North-East Province has been (and is) predominantly an agriculture region. Even after independence only a handful of industries were setup in the province; notable ones being the cement factory in Kankesanthurai, chemical factory in Paranthan (both in the North), and the paper factory in Batticaloa (in the East).

4. Industry

A structural transformation has taken place in the industrial sector in the last quarter-century. In 1991 textiles, wearing apparel & leather products accounted for 33%, food, beverages & tobacco products accounted for 29%, and chemical, petroleum, rubber & plastic products accounted for 19% of the total value of industrial production in the country. However, in 2000 the former sub-sector has increased its share to 47% whilst the latter two sub-sectors have contracted their shares to 23% and 16% respectively[7].

The role of the state in industrial sector has also diminished over the years. Industries in the first two sub-sectors are entirely in the private sector. Two-thirds of the industries in the chemical, petroleum, rubber & plastic products sub-sector were in the private sector and one-third in the public sector in 2000[8]. Altogether only about 10 industries were state-owned in 2000 comprising sugar, salt, coconut oil, soap, timber, paper, ayurvedic drugs, petroleum, rubber, Ilmenite, rutile, crude zircon, and phosphate production, and employed 33,247 persons[9].

One of the striking structural transformations in Sri Lanka's exports is the acceleration of industrial exports and the deceleration of agricultural exports. Industrial exports comprised 62% of the total exports (in LKR terms) in 1991, which has leapt to 78% in 2000[10]. The industries that have singularly contributed to this structural transformation of exports are the textiles, wearing apparel & leather. The textiles, wearing apparel & leather industrial exports accounted for 40% of the total exports in 1991 and have steadily increased to 54% in 2000[11].

However, the textiles, wearing apparel & leather exports of Sri Lanka are subject to vagaries of two principal markets, viz. USA and UK. In 2000, 62% of the garment exports were destined to the USA, and 22% to the UK (in terms of LKR value). Thus, these two markets accommodated 84% of the total garment exports by Sri Lanka in 2000[12].

With the phasing out of the Multi Fibre Agreement (MFA) in January 2005 Sri Lanka will be forced to compete in the global garments market, which is at the moment thriving due to quotas to the USA and European markets. China is expected to dominate the quota-free world market for garments. India is another major competitor to Sri Lanka in the region. Hitherto Sri Lanka has steadily expanded its garment exports. However, from 2005 onwards garment exports may also experience instability as in the case of tea exports. Therefore, Sri Lanka should aim to diversify the composition of its manufacturing exports, because at present it is lopsided as 70% of the manufacturing exports are textile and garments.

5. Savings and Investment

The domestic savings rate increased from 12.8% in 1991 to 19.5% in 1999 and then declined to 14.6% in 2002, while the national savings rate increased from 15.2% to 23.5% and then declined to 19.7% in the corresponding years (Table 2). Both the domestic savings rate and the national savings rate as a percentage of GDP have increased by 52% and 55% respectively between 1991 and 1999, which was remarkable. However, disappointingly both the savings rates have been declining in 2001 and 2002. The savings rate in Sri Lanka has been historically low compared to many other developing countries, notably India.

These low savings rate may be explained by the existence of considerable under-reported and unreported income in Sri Lanka. Private income and expenditure data of many developing countries are not very reliable due to under-reporting and non-reporting. Likewise, there is a tendency to overestimate private consumption whilst underestimating private savings and investment. In this circumstance, the savings data presented in the following table should be considered cautiously.

As a corollary to low savings rate the investment rate is also low in Sri Lanka. Both private and public investment together accounted for 23% of the GDP in 1991, which had increased to 28% in 2000 and then declined to 21% in 2002 (Table 2). Though considerable increase in the investment rate during the period 1991-2000 was a positive development, part of the increase in public investment was due to investments in the defence sector, which could not be for the purpose of development. More importantly, the investment rate should be above 35% of the GDP in order to attain a sustainable growth rate of 8% or above. The growth of investments in 1999 and 2000 could be attributed to the expansion of telecommunications and purchase of aircraft by the partially privatised national airline. Disappointingly the investment rate has dropped dramatically by a quarter to 21% in 2002 from the peak 28% in 2000. This may be partly explained by the drop in investment in the defence sector in 2001 and 2002.

Table 2 - Savings and Investment Rate 1991-2002

	Domestic Savings Ratio as a % of GDP	National Savings Ratio as a % of GDP	Total Investment as a % of GDP
1991	12.8	15.2	22.9
1992	15.0	17.9	24.3
1993	16.0	20.2	25.6
1994	15.2	19.1	27.0
1995	15.3	19.5	25.7
1996	15.3	19.0	24.2
1997	17.3	21.5	24.4
1998	19.1	23.4	25.2
1999	19.5	23.5	27.1
2000	17.4	21.5	28.0
2001	15.8	20.3	22.0
2002	14.6	19.7	21.3

Source : Central Bank of Sri Lanka, *Annual Report 2002*, special statistical appendix table 9.

6. Interest Rate

The bank rate has remained constant at 17% since 1991 until 1998. Then it declined to 16% in 1999 and later shot up to 25% in 2000 denoting a deepening economic crisis in the country (Table 3). This is one of the highest rises in a particular year. However, since then it has declined to 18%

in 2001 and 2002. With such high rates of interest the domestic manufacturing sector is unable to compete with cheaper imported manufacturing products. The high rate of interest is an impediment to investment, and hence to economic growth as well. High interest rate has forced the closure of several small and medium enterprises throughout the country that have become financially unviable.

Table 3 - Interest Rate 1991-2002

	Bank Rate
1991	17.0
1992	17.0
1993	17.0
1994	17.0
1995	17.0
1996	17.0
1997	17.0
1998	17.0
1999	16.0
2000	25.0
2001	18.0
2002	18.0

Source: Central Bank of Sri Lanka, *Annual Report 2002*, special statistical appendix table 24.

7. Inflation

The Colombo Consumers' Price Index (CCPI) is the measure of inflation used for policy purpose in Sri Lanka despite several other measures made available by the Department of Census and Statistics. There is Colombo district price index, Greater Colombo price index, and district-wise price indices. Since mid-2002 the Census Department has begun computing a new Sri Lanka Consumers' Price Index (SLCPI) taking 1995-1997 = 100. However, since the SLCPI is available only from January 2002 we use the CCPI as the measure of inflation in this chapter.

There are several deficiencies in the CCPI; the most critical one is the base year. The CCPI is calculated on a basket of consumption goods based in 1952, which is outdated. One of the glaring deficiencies is the almost constant value imputed for 'rent' since 1952, which is a gross underesti mation. The index for rent was only 109.8 in 2000 that has remained so since 1970, which is absurd. Despite these deficiencies the CCPI is the standard measure of inflation used in Sri Lanka.

Inflation in the past twelve years has had its ups and downs. The annual average rate of inflation was 12.2% in 1991, which almost consistently declined to 7.7% in 1995. It shot-up to 15.9% in 1996 and then consistently declined until 1999. It began climbing up again and peaked to 14.2% in 2001. However, it declined to 9.6% in 2002 (Table 4). Very high inflation in 2001 was due to the rise in cost of living as a result of fuel price hikes, depreciation of the rupee, and higher import and domestic taxes. Inflation measured by CCPI is the highest, whereas rest of the country may experience lower inflation. All other measures of inflation are usually lower than the CCPI.

Table 4 - Inflation Rate 1991-2002

	Inflation Rate measured by Colombo Consumers' Price Index (1952=100)
1991	11.4
1992	12.2
1993	11.7
1994	8.4
1995	7.7
1996	15.9
1997	9.6
1998	9.4
1999	4.7
2000	6.2
2001	14.2
2002	9.6

Source : Department of Census and Statistics.

8. Unemployment

The measure of unemployment rate is arbitrary in developing countries where disguised unemployment and under employment are widespread. This is specially so in agrarian and service sectors dominated economies such as Sri Lanka. Above 40% of Sri Lanka's service sector comprises wholesale & retail trade. Both the agrarian and wholesale & retail trade sectors are rampant with disguised unemployment and underemployment.

Nonetheless, given the limitation of data, the unemployment rate has steadily declined from 14.7% in 1991 to 7.6% in 2000, which seems a remarkable achievement (Table 5). Both the male and female unemployment rates have declined consistently and considerably during the decade till 2000. However, it is disappointing to note that the female unemployment rate is nearly double that of males though the gap has been narrowing (Table 5). In 2001 and 2002 the overall unemployment rate has started shooting up again to 7.9% and 9.2% respectively. Correspondingly the male and female unemployment rates have also climbed up (Table 5).

Table 5 - Unemployment Rate 1991-2002

	Unemployment Rate (%)	Male (%)	Female (%)
1991	14.7	9.9	23.4
1992	14.6	9.4	23.1
1993	13.8	9.7	21.7
1994	13.1	9.7	20.1
1995	12.3	9.0	18.7
1996	11.3	8.2	17.7
1997	10.5	7.7	16.1
1998	9.2	6.5	14.0
1999	8.9	6.7	13.0
2000	7.6	5.8	11.1
2001	7.9	6.2	11.4
2002	9.2	7.0	13.6

Source: Central Bank of Sri Lanka, *Annual Report 2002*, special statistical appendix table 4.

The forgoing data pertains to national level, which hide provincial variations. For example, Southern and Central Provinces recorded higher unemployment rates than the national rates in 1997, 1998, and 1999. In all the provinces female unemployment rates were much higher than that of the males[13].

9. Public Finance

One of the undesirable developments of the post-liberalisation period was the acceleration of government budget deficit. The budget deficit, which remained at single-digit levels since independence until 1977, began to accelerate since 1978. Every year since 1978 until 1991 the budget deficit has remained at double-digit levels (barring just 1984)[14]. This was partly due to a massive irrigation development project, the accelerated Mahaweli development project, undertaken during that period. However, 1990s were once again a decade of fiscal prudence. During most years since 1992 fiscal deficit has declined to single-digit levels (only in 1994 and 1995 it was marginally above 10%) (Table 6).

The budget deficit as a percentage of GDP of Sri Lanka has declined from almost 12% in 1991 to almost 9% in 2002, though shooting to almost 11% in 2001 (Table 6). It is commendable that the government has been successful in containing the budget deficit to single-digit levels in the last five years.

Budget deficits need not be necessarily bad for the economy. If deficits are incurred mainly for productive public investments then it could have positive impacts on the economy, on the proviso that such public investments are in the non-military sector. On the other hand if deficits are incurred mainly for public consumption, as is the case in Sri Lanka, then it could have negative impacts on the economy such as high interest rates and inflation. Further, budget deficits also crowd out private investment, because of excessive government borrowing through the issue of treasury bills.

Table 6 - Public Finance 1991-2002

	Govt Revenue as a % of GDP	Govt Expen diture as a % of GDP	Budget Deficit as a % of GDP
1991	20.5	32.3	-11.9
1992	20.2	28.2	-8.0
1993	19.7	28.4	-8.7
1994	19.0	29.5	-10.5
1995	20.4	20.5	-10.1
1996	19.0	28.5	-9.4
1997	18.5	26.4	-7.9
1998	17.2	26.3	-9.2
1999	17.7	25.2	-7.5
2000	16.8	26.7	-9.9
2001	16.7	27.5	-10.9
2002	16.5	25.4	-8.9

Source: Central Bank of Sri Lanka, *Annual Report 2002*, special statistical appendix table 20.

As we can note from the above table government revenue as a percentage of the GDP has continuously declined, barring 1995, during the twelve years under consideration. This is a serious problem for the management of public finances. Next to liberalisation of the international trade regime domestic tax regime has undergone the most profound changes during the 1980s and the 1990s. There was a conscious shift away from direct taxes to indirect taxes. That is, the government increasingly relied on indirect taxes for its revenue. Besides, corporate taxes were continually slashed in order to stimulate private investment and hence growth.

Further, providing tax holidays as incentives for foreign investors facilitated the export-led industrialisation strategy. Tax holidays were a severe drain on the public exchequer whilst increasing foreign investment. Progressive reduction in business taxes, import tariffs and tax holidays to foreign investors have resulted in one of the lowest tax ratios in the region. Declining tax collection has contributed to growing public debt that exceeds the GDP of the country in recent years. Since the direct tax regime in Sri Lanka depends largely on self-assessment tax collection is far less than optimal. Although a value added tax was introduced in 2003 in order to streamline the indirect tax regime it is undergoing teething problems. Moreover, the government's attempt to streamline and enhance tax collection by amalgamating the Inland Revenue Department, the Customs Department, and the Excise Department into a single Revenue Authority has not borne fruit because of legal and labour wrangling. Hence, there appears no quick way out of this quagmire.

The defence expenditure of Sri Lanka has become a bone of contention, especially since 2000. After the fall of strategic Elephant Pass to the LTTE rebels in April 2000 Sri Lanka went on a shopping spree for modern weaponry. This shopping spree in the global armaments market severely strained the already precarious balance-of-payments position of Sri Lanka due to continued rise in global fuel prices since 1999. In Table 7 we compare and contrast defence expenditures with social expenditures[15] as proportions of total public expenditures in the past ten years. A very disturbing trend is clear in the table. In the early-1990s defence expenditures as a proportion of total public expenditures were more or less equal to the total social expenditures as a proportion of total public expenditures. In contrast, since 1995 defence expenditures as a proportion of total public expenditures has begun to accelerate while social expenditures as a proportion of total public expenditures remained more or less at the same level. However, in 2000 social expenditures declined sharply whilst defence expenditures registered a hike. The gap between defence expenditures and total social expenditures widened in favour of the former during the six-year period 1995-2000. In year 2000 the defence expenditure was almost 80% greater than that of the social expenditures as a proportion of total public expenditures (Table 7). Nonetheless the gap between the defence expenditures and the social expenditures has begun to narrow since 2001 as a result of the peace process with Norwegian facilitation.

Table 7 - Defence/Social Expenditure as a Proportion of Total Public Expenditure 1991-2002 (%)

	Defence Expen ditures	Social Expen ditures	Edu catio	Health	Poverty	R&R
1991	11.2	11.2	3.5	2.4	5.3	
1992	12.0	13.0	5.4	3.1	4.5	
1993	10.9	9.9	4.3	1.9	3.7	
1994	12.9	12.8	4.5	2.6	5.7	
1995	14.3	12.7	3.5	5.2	2.0	2.0
1996	17.7	13.5	4.2	5.0	3.2	1.1
1997	16.8	12.6	4.2	4.7	3.0	0.7
1998	16.9	12.0	4.7	4.0	2.5	0.8
1999	16.4	12.7	5.0	4.8	2.6	0.3
2000	17.7	9.8	3.8	3.9	2.0	0.1
2001	14.2	11.7	4.2	3.2	3.0	1.3
2002	10.8	9.6	3.3	3.6	2.2	0.5

Source: Central Bank of Sri Lanka, *Annual Report*, various years.

Notes:

(a) Education includes higher education as well.

(b) Health includes indigenous medicine and social services as well.

(c) Poverty alleviation programmes are *Janasaviya* (1991-1994) and *Samurdhi* (1995-2002).

(d) R&R means Rehabilitation and Reconstruction.

(e) From 1991 to 1994 R&R and Poverty are clubbed together.

The prioritisation of military development as against social development in the six-year period 1995-2000 was a consequence of the then government policy of 'war for peace' (or 'peace through war'). This policy of 'war for peace' has not only resulted in deterioration of the educational, health, social, and rehabilitation & reconstruction services in the country, but has also immensely contributed to corruption in the defence sector and rapid rise in crime rates throughout the island. It is the deserters from the armed forces who commit most of the crimes (murder, robbery, rape, and extortion) in southern and western parts of the country[16].

10. Public Debt

Total public debt (domestic plus external) of Sri Lanka was almost equal to its GDP throughout the 1990s, and surpassed the GDP in 2001 and 2002. There has been a structural change in public debt during 1991-2002. Domestic debt as a percentage of GDP increased from 41% in 1991 to 60% in 2002 while the external debt decreased from 58% to 46% in the corresponding period (Table 8). These figures indicate declining foreign aid to Sri Lanka and corresponding increase in dependence on domestic borrowing during the past 12 years. The debt service ratio[17] has decreased from 19% in 1991 to 13% in 2002, which is a positive development (Table 8). The debt service ratio of Sri Lanka is one of the lowest in South Asia. India and Pakistan, for example, have much higher debt service ratios.

One of the striking features of the composition of public debt in the past 12 years is the decline of external debt and increase of domestic debt as a proportion of the GDP. The changing composition of public debt has advantages and disadvantages to Sri Lanka. The lesser dependence on external debt is politically advantageous, because external debt mostly comes with strings attached. The conditionalities of external debt could be economic and/or political. However, lesser dependence on external debt and consequent greater dependence on domestic debt are economically disadvantages, because domestic borrowing is costly to the government. Loans by bilateral and multilateral donors are offered at very concessionary rates of interest and the repayment periods are very long with a long grace period. Almost all the bilateral and multilateral loans are long-term and lent at less than 5% interest per annum, whereas domestic borrowings by the government are at double-digit interest rates and are short-term. The Treasury bill rates have been in double-digits in the past 12 years. As noted above the interest rates have been and are quite high in Sri Lanka. In contrast, even the interest rates on commercial loans in international markets are less than 10%. Hence, external borrowing would be cheaper for Sri Lanka even taking into account the depreciation of the rupee over time.

Not only the interest rates on domestic borrowing by the government is much higher than external borrowing it is also the case that domestic borrowing by the government is a major impediment to the development of the capital market in Sri Lanka. The Treasury bonds and bills issued by the government are the most secured investment available as it is guaranteed by the state. Therefore, domestic investors opt to invest in the guaranteed Treasury bonds and bills rather than in the stock market that is risky. Hence, greater dependence on domestic borrowings is costly in terms of higher interest payable, and also crowd out investment in the capital market. Thus, on balance, we would argue that external borrowing is cheaper than domestic borrowing. That is, the declining trend of external debt as a proportion of GDP is not a welcome development.

Table 8 - Public Debt (Domestic and External) 1991-2002

	Domestic Debt as a % of GDP	External Debt as a % of GDP (LKR)	External Debt as a % of GDP (US$)	Total Public Debt as a % of GDP	External Debt Service Ratio
1991	40.9	57.6	72.1	98.5	18.5
1992	40.0	55.4	70.4	95.4	17.1
1993	42.8	54.1	73.4	96.9	13.8
1994	43.0	52.1	70.8	95.1	13.7
1995	43.3	51.9	66.7	95.2	16.5
1996	46.4	46.8	61.1	93.3	15.3
1997	43.5	42.3	54.3	85.8	13.3
1998	45.5	45.3	55.5	90.8	13.3
1999	49.1	45.9	57.8	95.1	15.2
2000	53.8	43.1	54.5	96.9	14.7
2001	58.0	45.3	54.3	103.3	13.2
2002	59.8	45.5	56.1	105.3	13.2

Source: Central Bank of Sri Lanka, *Annual Report 2002*, special statistical appendix, tables 19 & 22.

There may be a likelihood of an indirect political hand in the decreasing dependence on external borrowings and the consequent increasing dependence on domestic borrowings between 1995-2001, because historically the SLFP-led coalition governments have been less inclined to borrow externally (from bilateral and multilateral donors). This is because they are relatively more averse to conditionalities (both economic and political) of foreign loans.

11. International Trade

Considerable trade liberalisation has taken place since 1977. Perhaps the liberalisation of international trade sector has been the most successful of all. Export taxes have been completely withdrawn and the import tariff bands have been restricted to just three, viz. 10%, 20%, and 25% (which is expected to be reduced to two bands in the near future). Besides, non-tariff barriers to trade have been lifted altogether. Further, foreign exchange controls have been relaxed to a considerable extent. Nonetheless, temporary restrictions on imports (especially on food imports such as rice, lentils, potatoes, onions, vegetable oil, etc) are imposed from time to time in order to protect domestic production. Further, a 40% import surcharge was imposed since the beginning of 2001 to be effective for one year in order to restrict imports as a result of the deteriorating balance-of-payments position. This was reduced to 20% in the budget for 2003.

Sri Lanka is also in the forefront of forging bilateral trade arrangements in the region. The Indo-Sri Lanka Free Trade Agreement (ISLFTA) came into operation in March 2000, and a similar free trade agreement with Pakistan is in the offing. These bilateral free trade agreements are expected to be precursors to an eventual multilateral free trade agreement in South Asia, namely the South Asia Free Trade Agreement (SAFTA).

Sri Lanka's international trade has undergone a significant positive change in the twelve years. Agricultural exports have declined from 32% of the total in 1991 to 20% in 2002 whilst industrial exports have increased from 62% in 1991 to 77% in 2002. Consequently the share of the US market for Sri Lanka's exports has increased from 28% in 1991 to 38% in 2002. The share of the European markets increased from 31% in 1991 to 34% in 2002. In contrast, the share of the Asian markets declined from 16% in 1991 to 13% in 2002 (Table 9).

On the import side the share of the US, European and Asian markets have declined in 2002 compared to 1991. But, the share of "other" markets has increased from 15% in 1991 to 22% in 2002 denoting import diversification (Table 9). These "other" markets are mostly Eastern European countries.

Table 9 - Exports and Imports 1991-2002 (percentage)

	Exports					Imports		
	Agri culture	Indus -try	USA	Europe	Asia	USA	Europe	Asia
1991	32.3	61.7	28.1	30.9	15.9	5.7	19.9	59.6
1992	24.6	71.7	34.0	36.0	12.3	4.5	19.4	60.7
1993	22.9	73.4	35.2	35.6	13.0	3.3	20.5	60.0
1994	21.9	74.8	34.8	34.9	14.5	6.0	20.6	56.5
1995	21.8	75.4	35.6	36.4	14.4	3.3	20.1	54.2
1996	23.5	73.4	34.0	37.2	14.7	3.6	19.4	55.1
1997	22.9	74.1	35.9	36.0	13.4	3.2	17.3	56.6
1998	22.6	75.2	39.3	32.6	11.2	3.9	17.9	60.0
1999	20.5	77.0	38.8	33.0	11.7	3.6	15.1	58.2
2000	18.2	77.6	39.5	31.0	12.7	3.5	13.5	54.4
2001	19.3	77.1	40.0	30.9	11.7	4.4	14.7	56.2
2002	19.9	77.3	37.5	33.8	13.4	3.6	15.4	58.6

Source: Central Bank of Sri Lanka, *Annual Report 2002*, special statistical appendix table 16.

The trade pattern of Sri Lanka is such that bulk of its exports are destined to USA and Europe while bulk of its imports are from India, Japan and other Southeast Asian countries such as Hong Kong, Indonesia, Korea, Malaysia, Singapore, Taiwan and Thailand. India and Japan account for roughly 10% of the total imports each. Hence, Sri Lanka has trade surpluses with USA, Britain and most European countries whilst having trade deficits with India, Japan and most Asian countries.

12. Balance of Payments

The trade deficit of Sri Lanka increased from almost USD (-) 1billion in 1991 to almost USD (-) 1.4billion in 2002, peaking to USD (-) 1.8 billion in 2000. However, the current account of the balance-of-payments, which posted a deficit of USD 600million in 1991, expanded to USD 1billion in 2000 but dropped to nearly USD 300million in 2002. Likewise, the current account deficit as a proportion of GDP declined from (-) 6.9% in 1991 to (-) 6.4% in 2000, and to (-) 1.6% in 2002 (Table 10). Thus, year 2000 experienced a balance-of-payments crisis. It has to be remembered that 1991 was also a bad year for the balance-of-payments of Sri Lanka prompting the GOSL to resort to a structural adjustment facility from the IMF. But the difference between the balance-of-payments crisis in the early-1990s and the 2000 one is that last time the overall balance (of the current and capital accounts) was positive whereas in 2000 even the overall balance was in the red (see the last column in Table 10).

The balance-of-payments crisis in 2000 was due to rapid rises in petroleum prices and military expenditures. Not only did the trade deficit and current account deficit increase substantially, but even the balance in the overall balance-of-payments posted a deficit of half a billion US dollars, which was very unusual. The deficit in the overall balance-of-payments reached 3% of the GDP in 2000, which was precarious (Table 10). However, in 2001 the overall balance-of-payments improved to a surplus of over USD 200million, partly due to borrowings from the IMF. It further improved in 2002 as the economy began to revive with a new government in power (Table 10).

Table 10 - Balance of Payments 1991-2002

	Trade BalanceUS$ million	Current Account Balance US$ million	As a % of GDP	Capital Account BalanceUS$ million	Overall BalanceUS$ million	As a % of GDP
1991	-997	-619	-6.9	858	290	3.2
1992	-1,045	-555	-5.7	664	190	2.0
1993	-1,148	-496	-4.8	1,108	661	6.4
1994	-1,559	-860	-7.3	943	240	2.0
1995	-1,505	-787	-6.0	699	52	0.4
1996	-1,344	-677	-4.9	459	-68	-0.5
1997	-1,225	-393	-2.6	602	163	1.1
1998	-1,092	-226	-1.4	413	37	0.2
1999	-1,369	-563	-3.6	373	-263	-1.7
2000	-1,798	-1,066	-6.4	443	-522	-3.1
2001	-1,158	-244	-1.5	562	220	1.3
2002	-1,407	-264	-1.6	506	338	2.0

Source: Central Bank of Sri Lanka, Annual Report 2002, special statistical appendix table 18.

13. Remittances

Remittances from expatriate workers are the largest net foreign exchange earnings to Sri Lanka after garments exports in recent years, which have surpassed a billion US dollars in 2002. The net private remittances (inward private remittances *minus* outward private remittances) have been steadily increasing in the past two decades; Sri Lankan labour in West Asia contributing almost two-thirds of it in the past few years (Table 11). Major sources of remittances by region and their respective shares in the total are given in Table 11.

The bulk of labour exports of Sri Lanka are unskilled and women who work as domestic aides in West Asian countries. The skilled male expatriate workers seem to be less inclined to repatriate their earnings to Sri Lanka as is evident from the contributions to net private remittances from non-West Asian regions (Table 11). However, the contributions to remittances by regions other than West Asia in the official statistics are under-estimations because of substantial use of unofficial channels for remitting money from western countries to Sri Lanka.

It is important to note that labour export is a post-liberalisation trade and therefore suitable for further study into the pros and cons of economic liberalisation. At the macro-level (by enormous contribution to the foreign exchange reserves) and at micro-level (by contribution to the households of such labour who are largely from rural areas) remittances have played a vital role in the economy of Sri Lanka. However, unfortunately, this economic success has created enormous social problems in the rural hinterland due to broken families and children going astray as a result of the missing women.

Table 11 - Private Remittances 1995-2002

	1995	1996	1997	1998	1999	2000	2001	2002
Net Private Remittances (US$ million)	675	710	788 (724)	848 (770)	887 (802)	974 (929)	984	1,097
West Asia (%)	58.2	58.1	61.0	61.2	61.7	62.9	60.8	59.8
European Union (%)	14.8	14.7	13.8	13.5	13.6	13.5	15.5	17.1
North America (%)	8.0	8.4	7.8	7.6	7.3	6.7	7.0	6.7
Far East Asia (%)	7.6	7.3	6.6	6.2	6.1	5.9	5.3	4.9
Europe Other (%)	5.1	5.2	4.9	5.3	5.2	5.1	5.2	5.2

Source: Central Bank of Sri Lanka, *Annual Report*, various years, statistical appendix tables 97, 98 & 99.

Note: Net Private Remittances = inward private remittances – outward private remittances. The figures for 1997-2000 include compensation received for loss of employment due to the Gulf war. The figures in parentheses are net of such compensation payment received.

14. Tourism

Tourism is extolled as one of the largest foreign exchange earners of the country. However, the author feels that it is a lot of hype than real, because what is more relevant are the net earnings and not gross earnings. If we subtract the expenditures of Sri Lankan tourists travelling abroad from the income from tourists visiting Sri Lanka then the net tourism earnings is a meagre amount (Table 12). In fact, the net earnings from tourism in 1996 & 2001 were negative. The net foreign exchange earning from tourism on average was only USD 27million per annum between 1995 and 2002.

Hence, tourism is not a significant foreign exchange earner, contrary to popular perception. Yet, it is an important sector in so far as it compensates the expenditures of Sri Lankans travelling abroad. Besides, since most of the tourist attractions are in the interior of the country it creates lot of local employment, because the hospitality industry is labour-intensive.

Tourism was badly hit in 2001 in the aftermath of the rebel military strike on the Katunayake airport and the US war on Afghanistan. However, it bounced back in 2002 due to an indefinite ceasefire between the GoSL and the LTTE.

Table 12 - Net Tourism Revenue 1995-2002

	1995	1996	1997	1998	1999	2000	2001	2002
Travel (US$ million)	40	(-) 10	29	28	55	8	(-) 37	100
Credit	226	166	209	230	274	252	213	363
Debit	186	176	180	202	219	244	250	263

Source : Central Bank of Sri Lanka, *Annual Report*, various years, statistical appendix table 97&98.

Note : Credit = Income from tourism to Sri Lanka. Debit = Expenditures of Sri Lankan travellers abroad.

15. Income Inequality and Poverty

Income inequality in Sri Lanka during the last half-century has remained more or less at the same level. The data is available for 1953, 1963, 1973, 1979, 1982, 1987, and 1997 only. The lowest 40% households received roughly around 15% and the highest 20% received roughly around 50% of the national income during the years for which data are available. The Gini coefficient remained almost static hovering around 0.45 during the years for which data are available (Table 13).

However, it is significant to note that during 1973 (a *dirigiste* economic year) the income share of the lowest 40% households increased considerably to 19.3% and the income share of the highest 20% households decreased significantly to 43%. As a corollary, the Gini coefficient decreased remarkably to 0.35. After all, the *dirigiste* economic regime did have a positive outcome on the well being of the lowest income earners.

International experiences (both in developed and developing countries) show that at the early stages of economic liberalisation income inequality tend to increase[18]. However, the case of Sri Lanka did not corroborate to these international experiences. This is a positive aspect of economic liberalisation in Sri Lanka. At the same time it can be argued that this positive result was due to lack of strategic economic reforms.

Table 13 - Income Inequality

	Income Received by Lowest 40% of Households	Income Received by Highest 20% of Households	Gini Coefficient
1953	14.5 %	53.8 %	0.46
1963	14.7 %	52.3 %	0.45
1973	19.3 %	43.0 %	0.35
1979	16.1 %	49.9 %	0.43
1982	15.3 %	52.0 %	0.45
1987	14.1 %	52.4 %	0.46
1997	15.7 %	49.4 %	0.43

Source : Central Bank of Sri Lanka, *Consumer Finances and Socio-Economic Survey*, various years.

The foregoing data are at national level, and therefore may hide variance in income inequality within rural, urban, and estate sectors. The urban sector had the worst income inequality with a Gini coefficient of 0.47 followed by the rural sector with a Gini coefficient of 0.46 in 1995/96. The plantation estate sector with a Gini Coefficient of 0.34 had the least income inequality in 1995/96. However, income inequality in the urban sector has decreased remarkably between 1990/1991 and 1995/1996[19]. It is very important to note that the classification of rural and urban areas in Sri Lanka is rather dated because it does not take into account the graduation of rural areas into urban areas over time. Unfortunately, income inequality by province or district is unavailable to date.

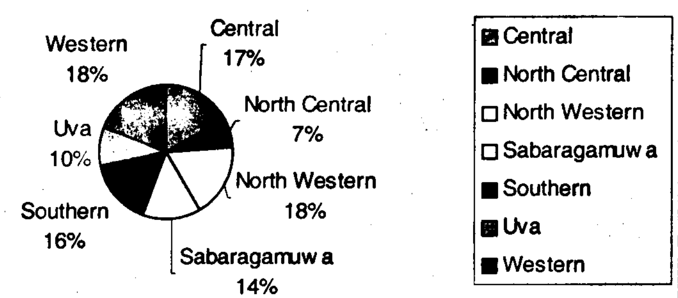
The Department of Census and Statistics used a lower consumption poverty line (LKR.792 per person per month) and a higher consumption poverty line (LKR.950 per person per month) to measure poverty during 1995/96. Accordingly, little more than 30% of the population of Sri Lanka lives under the higher poverty line. Poverty in rural areas seems to be the worst followed by plantation estate areas. During 1990/1991 the North Central, Uva, and Sabaragamuwa, provinces experienced highest incidences of consumption poverty while the Western province experienced the lowest. During 1995/1996 Sabaragamuwa, Central, Uva, and Southern provinces experienced highest incidences of consumption poverty while the Western province once again experienced the lowest[20].

Human poverty levels in all the provinces are lower than their respective consumption poverty levels[21]. This is an indication that Sri Lanka faces consumption poverty more than human poverty. This result tally with the impressive human development index of Sri Lanka; accordingly, despite low-income levels, social/human development in Sri Lanka is quite high[22].

Distribution of the total population that is poor among sectors, districts, and provinces is diverse. Out of the total number of poor, 87% resides in rural areas, 9% in urban areas, and 4% in plantation estates[23]. However, distribution of the total poor among the three sectors is not very wide off the distribution of total population among the three sectors. Here again the distinction between rural and urban areas is dated.

In the district-wise dispersion of the total poor Kurunegala is home to the largest single share of total poor, i.e. 12%, which is greater than its share in the total population of Sri Lanka (9%)[24]. Dispersion of the total poor by province is depicted in Chart 2. The North Western and Western provinces accommodate 18% of the total poor each. However, in proportion to their respective populations a higher burden of poverty is placed on the former. Though the North Central province accommodates only 7% of the total poor almost 47% of its households are poor, because it is a sparsely populated province.

Chart 2 - Distribution of Total Poor by Province 1995/1996



Source: Department of Census and Statistics, *Household Income and Expenditure Survey 1995/1996.*

Note: North-East Province is excluded due to non-availability of data.

Apart from incidence of consumption poverty (headcount) there are other measures of consumption poverty such as poverty gap and severity index that we have not dwelt upon due to brevity of space.

16. Regional Development

One of the less acknowledged features of the post-1977 liberalisation period is the regional imbalance in development. Although regional imbalance has been a perennial issue in Sri Lanka (like in many other developing countries) it appears to have accentuated during the liberalisation period, particularly during the late-1990s. Regional imbalances can be measured by various criteria. However, here we use the contributions made by each province to the national GDP to highlight the acute regional imbalance in the country.

Accordingly, the Western Province contributed almost 50% of the national GDP in 2000, rising from 40% in 1990. Besides, just four provinces (out of nine) contributed almost 80% of the national GDP in 2000. That is, Western Province contributed almost 50% and North Western, Central and Southern provinces around 10% each. While the contribution of the Western Province to the national GDP increased by roughly 25%, contributions of the Central, Sabaragamuwa, Uva, North Central, and Northern provinces decreased between 1990 and 2000. The contributions of Uva and Northern provinces halved during the reference period (Table 14).

This regional concentration of economic power stems from the export-led growth strategy of the liberalisation period. As we have discussed above export industries were the prime contributors to economic growth during the past quarter century. These export industries required faster access to global markets. Western Province has the only

international airport and seaport of Sri Lanka and naturally most of the export industries are situated there. This in turn raised the economic power of the Western Province and the adjacent North Western, Central and Southern provinces.

Table 14: Share of GDP by Province in Sri Lanka 1990-2000

Prov	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
WP	40.2	40.4	41.4	41.5	41.9	42.3	43.5	43.9	45.0	48.6	49.4
NWP	11.1	9.9	9.9	9.6	9.8	9.6	11.3	12.0	12.0	10.3	10.4
CP	12.1	12.3	11.8	11.8	11.7	11.7	10.6	11.1	10.3	9.7	9.9
SP	9.5	9.8	9.6	9.7	9.6	9.5	8.9	8.7	9.2	9.4	9.3
SgP	8.1	7.8	7.6	7.7	7.8	7.7	9.1	7.7	6.7	6.5	6.7
EP	4.2	4.5	4.7	4.7	4.5	4.6	4.8	4.9	5.5	5.0	4.5
UP	8.1	7.8	7.6	7.7	7.8	7.7	5.0	5.0	4.9	4.0	4.0
NCP	4.8	6.1	6.0	6.2	6.3	6.3	4.5	3.9	3.6	4.1	3.8
NP	4.4	3.8	3.6	3.2	3.2	3.1	2.4	2.7	2.8	2.5	2.1
SL	100	100	100	100	100	100	100	100	100	100	100

Source : 1990 - 1995 - Department of National Planning, Colombo, cited in North East Province (2002: 284).
1996 - 2000 - Mutaliph, Wasantha, and Bandaranaike (2002: 4).

Note : WP – Western Province, NWP – North Western Province, CP – Central Province, SP – Southern Province, SgP – Sabaraga muwa, EP – Eastern Province, UP – Uva Province, NCP – North Central Province, NP – Northern Province, SL – Sri Lanka.

Regional disparity in economic growth has much more than economic implications. Regional polarisation in economic growth is a major contributory factor to youth revolts in the South and North&East alike. The youth revolts in the southern parts of the country in 1971 and the late-1980s and the secessionist struggle in the North&East Province of the country since the early 1980s are partly due to regional inequities and deprivation. Therefore, it is a serious issue that needs to be addressed.

Some have argued that the present administrative division of the country in terms of districts and provinces was done for a different purpose by the British colonial government, which is ill suited for the modern economic development strategies. That is, the present administrative division does not tap the full potential and comparative and competitive advantages of the regions (see for example Gooneratne, 2002). Further, some contend that river basins or watershed areas should be the criteria used for territorial division of the country towards regional economic advancement[25].

The present administrative division of the country has also attracted criticism because of the 13th amendment to the Constitution that established provincial governments, which has become very costly to the exchequer with overlapping administrative functions between the Centre and the Provinces. The Poverty Reduction Strategy Paper (PRSP) of the GoSL attempts to address the regional inequities in development by proposing major economic infrastructure projects to link the centre and the peripheries. The Central Government in 2002 created regional development ministries for the first time in order to effectively address the lopsided economic growth of the country. As a corollary the BOI was also decentralised in 2003 into five regional Boards of Investment in order to attract foreign investments to the regions away from the Western Province.

While it is too early to evaluate the outcome of the above steps taken to correct regional imbalances there is a growing body of policy papers addressing the issue of regional disparities in Sri Lanka (See for example Gooneratne, 2001 and references therein).

17. Ethnic Conflict and Economic Reforms

Coincidentally, the economic liberalisation period (post-1977) was marred by a vicious ethnic conflict in the country. Although the origins of the armed secessionist struggle by the Tamil minority community can be traced back to 1972 when a republican Constitution was enacted, it gathered momentum since the 1977 general election when the main Tamil nationalist political party (namely the Tamil United Liberation Front) swept the elections in the North&East campaigning on a separatist platform. The armed secessionist struggle developed into a full blown civil war after the 1983 ethnic riots.

Economic liberalisation measures undertaken in the country had very little impact on the N&E Province as it was engulfed in civil strife. It would be interesting to find out whether the civil war, largely confined to the N&E, had any considerable impact on the economic liberalisation and reform process or vice versa. Some social scientists argue that the economic inequality and social stratification propelled by the economic liberalisation process had fuelled the ethnic conflict (see for example, Dunham and Jayasuriya, 2000). However, the proponents of this view have failed to establish the correlation between ethnic conflict and economic liberalisation convincingly. In the absence of a convincing causality it is hard to conclude one way or the other.

Though rising military expenditures resulted in rising budget deficits the liberalisation process was not severely affected. There were a number of reasons for this. One is that the civil conflict was largely confined to the N&E and did not engulf the entire country like for example in Mozambique. The second is that the international donor community tied their aid to economic liberalisation and reform and hence the government had no choice other than to continue the reform process. Thirdly, the liberalising economy yielded relatively higher economic growth, which in turn was necessary to sustain the rising military budget. Further, the growing dependence on the private sector for economic growth mitigated the economic impact of the anti-state revolt in the Southern parts of the country during the late-1980s.

It is beyond the scope of this volume to study the full impact of the ethnic conflict on economic reforms and vice versa. However, we would like to suggest the following. The notion that liberalisation of the economy and the supposed rising income inequality had fuelled the ethnic conflict is based on gut feelings rather than convincingly establishing causality. Moreover, we would suggest that the civil war and consequent galloping military expenditures might have hastened the economic liberalisation and reform process due to the unsustainability of the remnants of the welfare state. Two significant phases of the liberalisation process, in the early-1990s and mid-1990s, coincided with very critical security situation in the country. As a result of an anti-state revolt in the Southern parts of the country in the late-1980s the public coffers were depleted so much so that pruning public expenditures (by, for example, privatisation of loss making public enterprises and shedding public sector workforce) became inevitable. In a similar way, the resumption of the Eelam War 3 in late-1995 necessitated further trimming of the public sector to finance the 'war for peace' effort. As a consequence, latter half of the 1990s saw major privatisations such as the Sri Lanka Telecom, Air Lanka, tea plantations, etc.

Hence, it is very difficult to determine the cause and the effect of conflict and liberalisation dilemma. I suppose we are in the classic 'chicken or the egg' dilemma on this matter.

18. Conclusion

There is considerable convergence in economic policy between the two major political parties that have been ruling the country since independence. Some of those are; (i) role of the state in the economy will continue to diminish with greater reliance on the private sector for managing the economy, including the commanding heights of the economy such as utilities and infrastructure (electricity, highways, ports, telecommunications, transport, water, etc), (ii) export-oriented industrialisation as opposed to import-substitute industrialisation, (iii) determination of prices of goods and services by market forces as opposed to price controls by the state, (iv) continued liberalisation of the external trade sector by further reducing and streamlining the tariff structure. This is a positive enabling environment for economic restructuring and reform and the private sector to steer the economy forward to a higher growth plane. Yet, frequent ad hoc changes in the economic policy environment are a destabilising factor.

In spite of considerable liberalisation of the economy since 1977 several structural and institutional impediments to economic growth persist. Reform of the public service, banking and insurance, labour laws, divestiture of remaining state holding in the Sri Lankan Airlines, Sri Lanka Telecom, and Shell Gas Lanka Ltd, and divestiture of remaining state enterprises such as the State Banks, Railways, Co-operative Wholesale Establishment (CWE), Ceylon Electricity Board (CEB) are long overdue. It is these unfinished economic reforms that hold the key to long-term prosperity of the country.

Both the UNP government (1977-1994 & 2001-to date) and the SLFP-led coalition government (1994-2001) recognised the private sector as the 'engine of growth'. If this professed policy was implemented then it logically follows that the public service should have shrunk over the quarter-century 1976-2000. Although several public sector enterprises were privatised the public service did not contract accordingly. On the contrary, the public sector, in terms of number of employees, expanded by 100% between 1978 and 2000. In 1978 the public sector employed almost 600,000 persons, which has doubled to 1.2 million in 2000. Herein lies the paradox of economic liberalisation and reforms in Sri Lanka. On the one hand the private sector was professed to be the harbinger of the economy, and on the other public sector was burdened with excessive labour. Successive ruling political parties have been indiscriminately hiring their supporters to public service. This has led to increase in public expenditure, wastage, and inefficiency in the public sector. Sri Lanka's public sector, per capita, is one of the largest in Asia. That is, for every 16 citizen of this country there is one public sector employee. However, the kind of services received by the general public from the public sector does not reflect or justify such a low proportion of citizens to each and every public employee.

In fact, the thorniest impediment to economic liberalisation and reforms in Sri Lanka is not the politicians, private sector employees, or the ordinary masses, but the bloated public sector employees. It is the underemployed public sector employees who are the biggest stumbling block to economic liberalisation and reforms in Sri Lanka. It is these public sector employees who resist economic reforms and hinder the implementation of progressive government policies (whichever political party is in power). Therefore, reducing the size of the public sector and improving its efficiency are *sine qua non* for Sri Lanka to attain a sustainable high rate of economic growth. One of the most critical factors that have cost Sri Lanka the competitive edge over many other Asian developing countries is the failure to trim down the public sector in the past 25 years.

In order to effect reforms in the real sectors of the economy the reform of the financial sector is very essential. Reform of the real sectors and the financial sector should go hand in hand for a successful economic reform programme. Unfortunately this has not happened in Sri Lanka in the past quarter-century. The financial sector is still dominated by the state banks, which account for over 60% of the total deposits in the banking system. More importantly, as long as the state control in the financial sector is overwhelming Sri Lanka cannot have an independent monetary policy determined by the market forces. An indication of a progressive economy is the detachment of monetary policy from the clutches of the government.

The labour laws of Sri Lanka are antiquated and do not conform to the economic liberalisation and reform programmes of the successive governments since 1977. It is high time the labour laws are made flexible to meet the vagaries of an open market economy. Industrial restructuring according to market situation is not an option for many small and medium enterprises because of the rigid labour laws. This leads to closure of industrial units as the most viable option thereby leading to bankruptcies and loss of employment. The former destabilises the banking sector. Thus, labour market reforms are a prerequisite for economic takeoff.

Although about 30% of the total population are poor in Sri Lanka almost 50% receive relief under the *Samurdhi* poverty alleviation programme. Furthermore, 40% of the poorest income quintile does not receive any benefit at all under the *Samurdhi* programme, and there seems to be an ethnic bias in disbursement of poor relief[26]. Reform of the poverty alleviation programme is critically important in order to combat poverty. The politicisation of poverty alleviation programmes in the past 25 years has made the poor remain so for long. De-politicisation and decentralisation of the poverty alleviation programme is crucial to reduce poverty in Sri Lanka.

Economic reforms should ensure gender equality and correct past inequities. The role of women in the Sri Lankan economy of the 21st century is predominant. However, they do not seem to receive their due share in the national wealth. Wide regional disparities in economic growth need to be rectified in order to maintain socio-political harmony in the country. After recording the worst economic performance in 2001 the Sri Lankan economy revived with 4% growth in 2002, and achieved 5.9% rate of growth in 2003. This quick economic revival was possible because of the indefinite ceasefire between the GoSL and the LTTE. The new government, which came to power in December 2001, is also undertaking further economic reforms to remove the remaining barriers to sustained economic growth. The new government inherited twin ills of the civil war and an economy in the red, and the challenge was to restore peace and undertake economic reforms. So far the government has been quite successful in doing both. However, a lot more remains to be done towards achieving durable peace and sustainable economic growth and prosperity. Hopefully Sri Lanka can rise to these twin challenges.

Footnotes

1 The LKR was partially floated in November 1977 itself and the Central Bank determined the buying and selling rates of foreign currencies by commercial banks. However, since January 2001, due to free float of the LKR, commercial banks (including state-owned) are now free to determine the buying and selling rates of foreign currencies.

2 Central Bank of Sri Lanka, Annual Report 2002, special statistical appendix table 7.

3 ibid.

4 This term was coined to characterise the socialist-oriented socalled mixed economies of the late-1960s and 1970s (for example, in India) by Deepak Lal (1983).

5 Central Bank of Sri Lanka, Annual Report 2000: 1.

6 Central Bank of Sri Lanka, Annual Report 2000, statistical appendix table 12.

7 Central Bank of Sri Lanka, op cited, statistical appendix table 17.

8 Central Bank of Sri Lanka, op cited, statistical appendix table 20.

9 Central Bank of Sri Lanka, op cited, statistical appendix table 23&24.

10 Central Bank of Sri Lanka, op cited, statistical appendix table 79.

11 ibid.

12 Central Bank of Sri Lanka, op cited, statistical appendix table 85.

13 Department of Census and Statistics, Statistical Pocket Book 2000, Table 3.9: 25.

14 Central Bank of Sri Lanka, Annual Report 2002, special statistical appendix table 20.

15 Public expenditures on Health, indigenous medicine and social services, Education and higher education, Poverty alleviation programmes (Janasaviya & Samurdhi), and Rehabilitation and Reconstruction comprise social expenditures in this chapter.

16 Chris Smith, (2003), In the Shadow of a Ceasefire: The Impacts of Small Arms Availability and Misuse in Sri Lanka, Small Arms Survey, Geneva.

17 Value of external debt repayment as a proportion of value of exports (of goods and services).

18 Simon Kuznets, (1963), "Quantitative Aspects of the Economic Growth of Nations: Distribution of Income by Size", Economic Development and Cultural Change, part II, January, pp1-80.

19 Department of Census and Statistics, Household Income and Expenditure Survey, 1990/91&1995/96.

20 *ibid.*

21 Department of Census and Statistics, *Household Income and Expenditure Survey*, 1995/1996. UNDP, *National Human Development Report* 1998.

22 Here we have to be cautious about this data as it excludes the North-East province.

23 Department of Census and Statistics, *op cited*, 1995/96.

24 Department of Census and Statistics, *op cited*, 1995/1996.

25 L.M. Samarasinghe, "River basins as administrative divisions", *Ceylon daily News*, 21-03-2003: 8; Denis N.Fernando, "Development oriented administrative boundaries for Sri Lanka", *Ceylon Daily News*, 09-05-2003:9.

26 GOSL, *Draft Poverty Reduction Strategy*, November 2001: 79 & Annex 2, Table 1.

Chapter 3

The Essence and Direction of Public Administration Reforms

- Lloyd Fernando -

Introduction

Sri Lanka is currently facing the challenge of dealing with a three-pronged problem affecting development. Firstly, it is facing the challenge of eliminating the fundamental causes of a long drawn ethnic conflict, which has resulted in heavy loss of life and damage to economic and social development[1]. Secondly, it is facing the challenge of arresting a gradual erosion of the value of democratic institutions and people's perception of their effectiveness.[2] Thirdly, it is facing the problem of accelerating economic growth as a platform for poverty alleviation and improvement of the living conditions of the people in general.[3] These three aspects are inter-related and have a symbiotic influence on each other. The role of government in Sri Lanka, therefore, is to effectively address these issues in a systematic and cohesive manner.[4]

Government comprises the political executive- the Cabinet of Ministers and the administrative mechanism- the public administration system (PAS), through which policies are implemented. The PAS, however, does not confine itself to implementation. It is often called upon to assist the political executive in determining and defining policy through the analysis of facts and suggestions of alternative solutions. The PAS therefore has a vital role to play in promoting development.[5]

The PAS in Sri Lanka owes its origins to the days when it was a British colony. Political Independence, in 1948 did not make much of a difference to the style and content of its role. It was driven by an elitist civil service, which was proud of its 'independence' from political interference, providing in the process a lot of space for misunderstanding of its role in a post independence era. The power of the civil service extended throughout the country. The central government administration was assisted by a network of district administration, which extended control down to the village level. This network exists even today, except that it has got more complex, both in terms of functions and lines of authority and control. The introduction of Provincial Councils under the 13th Amendment to the Constitution is one of the main reasons for such complexity.

The definition of PAS in the chapter includes the peripheral administration covering Provincial Councils and District and Divisional Administration. It excludes personnel in the school and health systems run by the government, except those who are strictly dealing with administrative functions. The total size of the PAS, in terms of the number of personnel employed is around 257,000, approximately 44 percent of which is in the periphery (sub-national institutions).[6] The total number of employees constitutes 1.36 percent of the population or 3.7 percent of the labour force. The wage bill to sustain this workforce amounts to 6 percent of total government expenditure or 1.1 percent of GDP.[7]

The main aim of this chapter is to examine what reforms are necessary in Sri Lanka's public service to make it an effective and efficient instrument of meeting the present challenges of development facing the country. To get to that point, we examine past experience with regard to administrative reforms. We analyse, first of all the various proposals for reform that have been made by advisory committees appointed by successive governments as well as by international lending agencies. We also try to explain the reasons for their non-implementation. Thereafter, an attempt is made to develop a conceptual framework for administrative reforms in Sri Lanka, drawing also from the lessons of experience of other countries, which have implemented administrative reforms. Finally, we analyse approaches needed to implement a viable programme of administrative reforms to meet recent development challenges facing the country.

1.0 Sri Lanka's Past Experience

Sri Lanka, at independence inherited a colonial administrative structure built on the elite Civil Service. Gradually, the realization grew that the civil service leadership lacked the perspective needed to implement policies and programs of populist governments.[8] The public service cadre increased rapidly in the 1950s with the expansion of government intervention in agriculture, industry, infrastructure, health and education. The new recruits drawn mostly from rural backgrounds felt alienated from and dominated by the civil service, which controlled the administrative system. Indicative of the pressures that were building up, particularly within the public service itself, was Mr. J.R. Jayawardene's proposal in 1951 as Finance Minister, for gradual abolition of the civil service and the creation of a unified administrative service. The Ceylon Administrative Service

Association was formed in 1952 comprising senior officers who did not belong to the Civil Service to agitate for a unified administrative service.

Not even the radical changes in the economy in the aftermath of the 1956 change of government, led by nationalist forces proved sufficient to sweep away the influence of the Civil Service. It was only in 1963, after the publication of the Wilmot Perera Commission Report (1961) that the Government decided to absorb the Civil Service in a unified Ceylon Administrative Service (CAS).[9] By that time, Sri Lankan polity was deeply embedded in running a state controlled economy with expanding trade and aid relations with the Socialist countries. The Ceylon Civil Service nurtured under a colonial regime was almost universally considered an anachronism completely out of tune with the needs of the day. In hindsight, however, it appears that with the abolition of the Civil Service, Sri Lanka "threw the baby with the bath water". The Administrative Reform Committee (ARC) (1986) recognized the role of an elitist Senior Management Service in giving leadership to radical economic and social development. It suggested that, what was required was a change of perspective within the Civil Service rather than its total abolition.[10]

1.1 The PSC

The public service in Sri Lanka, however, continued to enjoy considerable insulation from political interference. An independent Public Service Commission (PSC) handled the appointment, transfer, promotion and dismissal of officers. Perhaps the "socialist" coalition of 1970, which was swept into office with a radical election manifesto, felt that public service autonomy would stand in the way of its implementation. Indeed, there were those within the government who thought that public service perspectives had

been "corrupted" by the attempts to liberalise the economy and turn towards the west for aid and investment during the previous regime, 1965-70. The result was the abolition of the Public Service Commission in the 1972 Constitution and its replacement by the State Services Advisory Board and the State Services Disciplinary Board, whose decisions were not binding on the Cabinet or individual ministers. All the powers held by the PSC were conferred on the Cabinet, which delegated some of them to Heads of Departments, effectively strengthening the position of individual ministers over the destiny of public servants. This move provided legal backing to a process of politicisation of the public service, which had already begun.

The economic liberalization process ushered in by the new regime in 1977 demanding greater flexibility and responsiveness of the public service did not, however bring with it the necessary relaxation of political control that was stifling its initiative. The 1978 Constitution restored the PSC, but made it subordinate to the Cabinet. Under the new Constitution all powers of appointment and disciplinary control of public officers were vested in the Cabinet, except in the case of secretaries. The President of the Republic was vested with the power of appointment of secretaries. The PSC was required to delegate all its powers in respect of the lower grade officers to the Heads of Departments and Secretaries, ultimately retaining no original powers, except appellate ones, which were vitiated depending on political circumstance.

With the establishment of the Provincial Councils under the 13th Amendment to the Constitution, an arrangement was made to appoint provincial public service commissions, which were subordinated to the Governor of the Province, who was given the power to "alter, vary or rescind any appointment, order of transfer or dismissal or any other order relating to a disciplinary matter" made by the Provincial

Public Service Commission.[11] The 13th Amendment also affected the distribution of functions between the centre and the periphery (Provincial Councils) which were defined in three annexed lists – provincial, concurrent and reserved – which added further confusion to public administration in the absence of a political will to make them meaningful in practice.

1.2 Economic Reforms

The post–1977 economic reforms introduced a new dimension to development management in Sri Lanka, posing new challenges to the public administration system. The reliance on the private sector as the "engine of growth," which was the main focus of the reforms, required that the government played a fundamentally supportive role, providing the necessary macro-economic environment, a conducive regulatory framework, infrastructure facilities, the financial architecture, and above all, conditions for harmonious labour relations. To supplement inadequate domestic savings, foreign aid had to be mobilised and foreign private investment attracted through a variety of measures. This called for a new form of public management.

Inadequacies of the existing administrative system gradually started making themselves felt, slowing down economic growth, increasing inflation, widening infrastructure gaps, deepening fiscal, and balance of payment deficits, causing aid fatigue and discouraging investment. In the circumstance, multilateral donor agencies such as the World Bank, IMF and the ADB called for more professional approaches to decision making as well as policy and project implementation. Not surprisingly, therefore the strongest voice for comprehensive administrative reforms was heard from the Ministry of Finance and Planning.

1.3 World Bank Pressure

What propelled the government into action was the World Bank alert on the prospect of Sri Lanka losing its growth momentum and investor (and donor) confidence, unless the administrative system attuned itself to the new development requirements.[12]

The World Bank while acknowledging it to be politically sensitive drew attention to the proliferation of ministries and "ministerial intervention in civil service appointments and individual items of public expenditure," as critical issues, which needed urgent attention of the government. At that time there were 36 ministries, as well as 25 district ministries, with some ministries also having representation in the districts. It was the World Bank's view that "if the number of ministries could be reduced to 10 or 15, business could be cleared more efficiently and rapidly and the pressure on senior officials much reduced". It was also stated that if a similar rationalisation of other government agencies could be made, it would "also increase the efficiency of the administrative system, allow clearer definition of accountability and enhance government's ability to evolve policies and to plan and implement development programs".[13]

In a special Annex, the World Bank report referred to quality and motivation of public servants, particularly those at professional and managerial levels as being the most immediate problems affecting Sri Lanka's public sector performance. It mentioned in this regard, the differentials in remuneration between comparative levels of the public and private sectors, which affected mostly the executive grades of professional staff. However, it warned that salaries and emoluments already amounted to as much as 25% of recurrent expenditure and that any improvement in remuneration had to be accompanied by reduction and rationalisation of public service cadre.

The other recommendations included the creation of a senior management and professional cadre from top ranks of the existing service on the basis of merit, academic qualifications, some provision for external recruitment on fixed-term contracts, and premium incentives.

The Bank laid emphasis on the need for on the job and full time training of cadre and the provision of incentives, as well as penalties to promote better performance by public servants. To lay the foundation for a more efficient and effective public service, the Bank recommended as a priority consideration, a government-wide job analysis, which would help define duties, responsibilities and functions of each job, as well as specify the qualifications, training and experience needed for each.

1.4 Wanasinghe Committee

Most of the above World Bank concerns and recommendations were echoed in the report of the Administrative Reforms Committee, chaired by Shelton Wanasinghe.[14] This report, published in October 1987 in 10 volumes contains recommendations on the functioning of the administrative system examined under three broad categories of deficiencies – structure, personnel and work procedures.

The structural deficiencies were observed mainly in the absence of a system-wide focal point, with adequate authority and proper location to provide substance and meaning to the public service personnel function.

It was also observed that there had been a proliferation over time of departments, ministries, authorities and enterprises leading to serious problems of coordination, planning, programming and implementation. While provision for decentralisation of functions was found to be ineffective, a major problem within the entire administrative structure, which put undue pressure on senior management causing inefficiency, was the lack of delegation of authority and responsibility.

Personnel system deficiencies were traced in the report to poor cadre management systems. Public service compensation, particularly in the case of senior management was found to be unattractive. Further, it was the view of the Committee that there was no national training policy for public servants and that the institutional arrangements for training were poor, with inadequate allocation of resources. The committee also found the absence of a scientifically selected multi disciplinary group of senior managers, as a constraint to effective managerial leadership in the public service.

With regard to work procedures, the committee observed that they were "lengthy, dilatory and client unfriendly". The use of modern technology, in particular the use of computers, was rather weak. Financial management systems and procedures too were found to be obsolete, while the financial management cadres suffered from poor training facilities.

The Wanasinghe Committee suggested that in order to implement its recommendations, a focal point – a Ministry of Public Service, appropriately staffed with senior and experienced personnel should be established. Since the establishment of such a Ministry may take time, it recommended that an effective secretariat under its purview be set up immediately in order to prevent a hiatus in implementation. The Committee saw the need for such an arrangement in the imperative of adopting a holistic approach to implementation. It stated that it "does not consider that it is possible to implement bits and pieces of the proposed agenda and to expect to improve effectiveness. Actually, the implementation of bits and pieces of the suggested agenda could be dangerous in that it would lead to incoherent and chaotic results which would put the administrative system back rather than propel it forward".[15] Further, the Committee felt that the location of the Ministry should be directly under the President of the Republic, in view of the wide-ranging ramifications of the recommendations, which affect the status quo of all ministries and departments. In support of this recommendation the Committee referred to the practice in other countries where administrative reforms have been a success. It was mentioned that in Malaysia, Kenya, UK, France and India, this function is carried out under the direct purview of the head of government.

In order to remove the political element in cadre management, the Committee recommended the establishment of an independent Public Service Commission that will be in charge of recruitment, promotion, transfers and discipline of public servants, subject to policy being determined by cabinet. This institutional arrangement was to be reinforced by an "objective performance appraisal system" and the formulation of a national public service training policy supported by financial provision and responsibility cast on secretaries and heads of departments for implementation of specific programmes. Training was recommended to be linked to career progression. It was also recommended that a "senior management group" be established to provide the public service "with qualitative leadership; which would serve as the inter-face between the public service as a whole and the legislative and the political executive; which sets the tone for the whole public service; and which acts as the guardian of the value system of the public service".[16]

1.5 Post - 1989

Implementation of the Wanasinghe recommendations could not have been attempted at a more inopportune time. The years 1988 and 1989 were politically tumultuous ones, with the JVP uprising, confusion with regard to the future of the Provincial Councils, and high inflation. In the circumstance, the government rushed to give salary increases to public servants taking a cue from the Wanasinghe Report that they are poorly paid but ignoring the pre-conditions. The Wanasinghe Committee had recommended that before giving salary increases, two inter-related exercises relating to a comprehensive cadre review in all public service organisations and a detailed analysis of jobs in the public service should be carried out. In particular, relating to the Combined Services in the middle and upper management groups, it was recommended that Minutes of all these Services should be revised both to embody post-graduate management or professional training as preconditions for movement from the lowest through to the highest class and to bring the cadre strength of the different classes and grades in line with the actual availability of posts with commensurate responsibility following from the job classification exercise.[17]

The aim of the Wanasinghe recommendations was to link salary increases to higher productivity promoting measures, while maintaining the total salary bill more or less at the same level. Closure of redundant institutions and reduction of excess staff were measures that were proposed to reinforce this position. The sudden rise in the salary bill forced the government to attempt drastic measures in that direction. Two departments were closed down–the Government Supplies Department and the Department of Commodity Purchase. To reduce staff, a scheme of "golden handshakes" was introduced in October 1990. According to this scheme, a public officer was permitted to retire prematurely in order to qualify for an enhanced commuted pension, which was not recoverable from subsequent monthly payments of pension. The scheme, however, did not produce the results expected for no more than 15,000 opted to benefit from it. A large number of them were teachers, while the others were those who had good prospects of alternative employment and could have contributed to public service productivity if they stayed behind. Worst of all, casual and temporary hands were appointed to fill the vacancies that were created. They were subsequently made permanent. Thus the salary bill, as well as the pension bill increased significantly.

An important decision taken by the Cabinet in October 1989, following the Wanasinghe recommendations, was to set up Management Development and Training Units (MDTUs) in important sectoral ministries and other organisations at central and provincial levels with a view to assist identification of training needs, organisation of training activities and development of management capabilities. Lack of trained staff, procedures for identification of training needs and commitment of secretaries and heads of departments seriously affected the effectiveness of the MDTUs. While the Ministry of Public Administration set up an MDTU quite diligently, they were non-existent or inefficiently run in most of the ministries. The only active ones were found in the Provincial Councils.

The government, however, remained committed to improving public sector management through rationalisation of its functions and capacity building. It is for this reason that UNDP assistance was sought. As a result, a technical assistance grant was made available to the government in November 1991, which resulted in the setting up of the Restructuring Management Unit (RMU) at the Ministry of Policy Planning and Implementation that functioned under the President. It had an agenda, less ambitious in scope, but similar to what was envisaged in the Wanasinghe recommendations. Through the various studies that were conducted under its auspices, the RMU was able to throw further light on a number of issues relating to public service management. The major studies that made significant

contribution to knowledge on the issues concerned were as follows:

* Rationalisation of structures and cadres of ministries and departments
* Rationalisation of structures and cadres of Provincial Councils.
* Improvement of work procedures and systems.
* Enhancement of efficiency and effectiveness of Divisional Secretariats.
* Development of an integrated management information system (MIS)
* Strengthening of the planning, budgetary and accounting systems.
* Enhancement of the capability of apex ministries.

The RMU, after three years of existence, however, found that, its results perhaps fell short of its expectations.[18] One of the fundamental reasons was that some of the recommendations were politically sensitive. For example, reducing the size and scope of departments, and reducing the organisational structures of Provincial Councils were resisted at the political level. Political priorities sometimes were completely out of line with what appeared to be rational in an objective analysis of issues. This appeared to be particularly the case with the establishment of Divisional Secretariats, which the government was keen on rushing through under its "Grama Rajya concept", seen by many as an attempt to undermine the authority of the Provincial Councils.[19]

1.6 Post - 1994

In 1995, under the new government, a fresh initiative was launched to continue the administrative reform process. The impetus came from UNDP funds left over from the RMU operations, which wound up in December 1994. An administrative reforms unit was established at the Presidential Secretariat, which serviced a Committee of Secretaries, chaired by the Secretary to the President. The objective was to plan and implement administrative reforms based on the Wanasinghe Report. The ADB had, by this time, set up its Governance Unit, which was willing to provide technical assistance to a select group of regional countries for governance related initiatives, with administrative reforms being a key area. It was felt that the ADB involvement, (the largest donor to Sri Lanka), in administrative reforms with its programme conditionalities, would spur a wavering government into action. The government accepted the ADB offer of assistance and a team of consultants, financed under a technical assistance grant, submitted a report in February 1997, after a brief study. The report, which was quite precise, and action oriented, set out the following objectives, in line with Wanasinghe recommendations:

* Formulation and adoption of a vision of the government's future direction.
* Structural re-organisation of government to promote efficiency based on;
  - Clear goals & performance information,
  - Competition
  - Rationalisation.
* Framework for management to promote "service delivery" focused on detailed performance objectives.

* Capacity to develop methods of budgetary expenditure savings.
* An enabling environment to promote private sector led economic growth.

For follow up, the government set up a new institution – the Advisory Board on Administrative Reforms, (ABAR) first chaired by the Secretary to the President and later by the Minister of Public Administration. The administrative reforms unit in the Presidential Secretariat serviced it. Some of the members of the earlier Secretaries' Committee were absorbed into the new advisory board. The Board cleared a number of useful studies that shed more light on the issues and the remedial actions required. In fact, the government, based on the studies, took a number of initiatives. Among these was the initiative to require every ministry and department to prepare a Mission Statement, through a participatory process, assisted by MDTUs set up in 1990, which were revived for the purpose. The objective of the exercise was to weed out those that did not serve the "mission" and to identify new activities that needed to be undertaken to meet current needs. The government also decided to hold a competition to encourage ministries and departments to review work methods and procedures with a view to improve them. The most important of all the initiatives taken, was the attempt to introduce an effective Performance Appraisal System, linked to annual increments and career prospects. It was initially confined to executive grade officers, but later extended to cover all the other grades on the advice of the Attorney General. None of these initiatives however were followed up to their desired end for a variety of reasons, not least of all for lack of commitment– both political and administrative, as well as lack of technical and managerial competence of the participatory entities and staff.

1.7 Politicisation

Sri Lanka's experience with PAR or attempts to align the administrative system to development needs, according to government perspectives dates back to the 1950s. Throughout these years, all governments have attempted to weaken the "autonomy" of the public service in the name of giving political leadership to the development process. The abolition of the Civil Service, removal of the PSC (1972), its restoration *sans* real powers (1978), interference with public service appointments and meddling in the implementation of projects, programmes and policy measures, have all led to a phenomenon commonly referred to as "politicisation". While there is general acceptance that Max Weber style bureaucracies are no longer viable in meeting modern development challenges, it is equally accepted that indiscriminate political interference could rob the public service of its initiative and dynamism.

The public service essentially has a political role to play, in the sense of implementing the political will of the government. Public Servants must, however feel free to follow rules, regulations, procedures and offer professional advice without fear that non-discrimination could become a cause for penalties. In short, it means freedom to practice good governance, irrespective of the narrow partisan ends of the government in power. In the extreme case, it means working against the parochial interests of the "rogue minister", which are in conflict with the collective interests of the government. Larson and Coe, who advise permanent secretaries how to handle them, define a rogue minister as "one whose personal agenda is in conflict in some substantial way with that of the government of which he (sic) is a part"[20]

Politicisation of the public service gathered momentum in the aftermath of the 1977 elections with the introduction of the job bank scheme and the "chit system"[21]. Under this system party loyalty rather than merit, became the criterion for recruitment. This criterion further extended to promotions and transfers. The system reinforced the politicisation process, demoralised capable public servants and robbed them of initiative. Playing safe and following the political edict became the order of the day. The government realized the corrosive effect of political appointments and abolished the "chit system" in 1990.

The politicisation process, however, continued unabated. A commonly held view is that the root cause of politicisation was the Constitutional provision granting too much power to ministers with regard to personnel matters. This was the main reason for civil society to mount pressure on both the government and the opposition to change the Constitution, *inter alia*, providing for an independent Public Service Commission.

1.8 The 17th Amendment

The 17th Amendment to the Constitution passed by Parliament in October 2001, is a result basically of civil society pressure. Under paragraph 55 (1) of this Amendment a new Public Service Commission, will be appointed by the President on the recommendation of the Constitutional Council, to be vested with the powers of "appointment, promotion, transfer, disciplinary control and dismissal of public officers".[22] The question that arises is whether this constitutional amendment will be sufficient to ensure 'independence' of public servants and make them practise good governance without discrimination.

The problem is that paragraph 55 (3) of the amendment seems to take away what is given by paragraph 55 (1). It says "Notwithstanding the provisions of paragraph (1) of this Article, the appointment, promotion, transfer, disciplinary control and dismissal of all Heads of

Departments shall vest in the Cabinet of Ministers, who shall exercise such powers after ascertaining the views of the Commission".[23] The mitigating factor here is the caveat "after ascertaining the views of the Commission".

The provision of the 17th Amendment, it appears will benefit mostly the middle and lower grade officers. Even in their case they will continue to be subject to local political pressure. Most of them will agree to 'play ball' simply for the sake of peaceful existence; more so in the case of the easily dispensable, whose professional capacity is low. Only the exceptional officer who decides to put up a fight will seek refuge in the PSC. The point therefore is that unless there is a parallel change in the political culture, the new institutional changes will not achieve very much as far as official conduct is concerned. Only the formal personnel management activity such as recruitment, promotions, transfers and disciplinary action, will receive the benefit of the new arrangements. Senior officials such as Secretaries and Heads of Departments will continue to operate "at the pleasure" of ministers. Even in the 'rogue minister' situation their ability to withstand parochial pressure will depend on their ability to render professional advice that would be appreciated by the rest of the government. This brings into focus the question of technical and professional capacity of officials.

To sum up, there has been a paradigm shift in the Sri Lankan administrative system. Governments after Independence in 1948 gradually came to the view that new administrative approaches would be required to meet the new challenges of development. It is perhaps due to this view that politicians felt justified in interfering with normal routine administrative functions. While it is not contested that ministers as representatives of the people have the right to determine policy and guidelines for administrative action, it is a firm principle of democracy that in the application of

such policy and guidelines there should be no interference based on partisan interests. Violations of this principle are more apparent in the case where there have been "rogue ministers'. What gave an impetus to this development in Sri Lanka was the abolition of the Public Service Commission. Even though it was restored later, powers relating to recruitment, transfer, promotions and disciplining of staff were retained with the ministers. This politicisation process vitiated the administrative powers and the advisory role of public servants, allowing free reign to ministers in regard to the size and numbers of ministries, departments and institutions, as well as cadre. The 17th Amendment to the Constitution has provision for greater independence of public servants, even though heads of departments will be still appointed by the cabinet of ministers. Associated with the politicisation process in Sri Lanka was the decline in standards of recruitment, lack of motivation for initiative, efficiency and effectiveness of staff, the adoption of cumbersome and dilatory procedures and the downgrading of training as a requirement for career advancement. Several efforts made to address these issues starting with the Wanasinghe Committee failed, mostly due to lack of political will. While past experience provides much food for thought on what needs to be corrected, a comprehensive administrative reforms process requires a conceptual framework to provide the guidelines for setting priorities and methods to be followed. In this regard, Sri Lanka could benefit also from the lessons of international experience.

2.0 A Conceptual Framework for PAR

Sri Lanka is not unique in the pursuit of public administration reforms (PAR). Many developing, transitional and developed countries have pursued PAR and are continuing to do so with a view to addressing the challenges of development facing them. Any new attempts in Sri Lanka therefore could benefit from their experiences as well.

Vigorous and concerted efforts at bringing about radical change in public administration, in whatever name they have been described – new public management, managerialism, entrepreneurial government, re-inventing government, have been made in the US, UK, New Zealand and Australia among the developed countries.[24] Their experience offers useful lessons to both developing and transitional economies. The most successful of the developing countries – the East Asian bloc – South Korea, Taiwan, Malaysia and Singapore, have aligned PAR to economic reforms. In the US, five Presidential Study Commissions have been created since 1937 to review the structure of the federal executive branch, giving indications of a continuous process. Former Vice President Al Gore's Task Force on Re-inventing Government, which was established in 1995, provided the latest inspiration for PAR.[25] In the UK, the impetus was provided by Margaret Thatcher's attempts to improve public service performance through privatisation, downsizing and reorganising civil service structures to make them more accountable. New Zealand brought a new dimension, which was later followed by Australia and to some extent by the UK, by introducing a system of management contracts with departmental heads who were responsible for recruitment, termination and advancement of subordinate staff, the main focus being on the achievement of specified results.[26]

Among the developing countries, the experience that is of closest relevance to Sri Lanka is that of Malaysia. Public sector reforms in Malaysia, including important changes in the civil service, have featured in the government agenda since 1957. There have been continuous efforts thereafter, to improve public sector performance through various PAR initiatives, the main focus of which has been facilitation of increasing private sector involvement in economic

development. These initiatives also covered a wide range of areas affecting public sector performance, encompassing changes in structure, management technology, knowledge and skills, attitudes, systems and procedures. As against the Malaysian experience, most of the developing country efforts have been of short-term and *ad-hoc* nature.

2.1 The Old Model

The new PAR efforts make departure from the traditional Weberian model of public administration[27]. Max Weber's first of six principles, which however is still relevant, is that bureaucratic authority is derived from law. The second is that authority has a hierarchical structure, which means that any official could act with the authority of the whole organisation based on delegation of functions. Deriving from this second principle the organisation has an existence separate and distinct from the private lives of the employees. Decisions are based on precedents, which mean that records have to be kept, and files maintained so that the organisation is consistent with regard to the application of rules. Fourthly, administration was considered a specialist occupation, which could be handled by those trained for the purpose. Fifthly, working for the bureaucracy is a full time occupation and could no longer be treated as a secondary activity by administrators. Finally, office management was an activity following general rules, which could be learned, as it was presumed that whoever occupied a particular office could carry out the rules in the same manner.

This model that persisted, perhaps with a few amendments, in almost all countries, not always through explicit adherence, was not able to meet the challenges of the new development paradigm confronting public administration. In fact, it has been found "to breed time savers, not innovators, (encouraging) administrators to be risk averse rather than risk taking and to waste scarce resources instead of using them efficiently"[28]. Weber's ideal type has been criticised also for producing "inertia, lack of enterprise, red tape, mediocrity and inefficiency".[29]

2.2 New Challenges

A system of public administration confined to collecting revenue and regulating economic activity cannot meet the new challenges of development. In fact, the role of government has changed. As a result, the implementation arm of government, constituting public administration, had to be calibrated to perform new functions. In the aftermath of World War II, Europe and Japan in particular, as well as Australia and New Zealand among the developed countries, not to mention the Soviet bloc, ventured deeply into state directed economic activity and the provision of social welfare services. Developing countries, which emerged as independent states, emulated the "state interventionist" approaches of the developed countries.

The world economy underwent many changes in the years that followed. Economies expanded, economic relations became more complex, the private sector emerged as an increasingly dynamic force, liberalisation of international trade and investment became pervasive with globalisation and governments could no longer meet the challenges of the new development paradigm without change. The new globalisation wave, which swept the international economy with the collapse of the Soviet economic system and the information revolution, intensified the challenge of competition among economies. In the process, the role of government changed from that of entrepreneur and regulator to a facilitator of economic and social progress through the private sector, and increasingly the third sector, comprising largely NGOs.

2.3 Emulating Private Sector

At the heart of the new public administration system pursued by many countries through PAR, is management for results as against total adherence to procedures, rules and regulations. It is an attempt to emulate private sector management styles in dealing with public service concerns. Osborne and Gaebler set out the new perspective for the United States in this regard in a ten point programme to "re-invent government", which has inspired many other countries as well, including developing countries attempting PAR.

> *Most entrepreneurial governments promote competition between service providers. They empower citizens by pushing control out of the bureaucracy, into the community. They measure the performance of their agencies, focusing not on inputs but on outcomes. They are driven by their goals – their missions – not by their rules and regulations. They redefine their clients as customers and offer them choices...They prevent problems before they emerge, rather than simply offering services afterward. They put their energies into earning money, not simply spending it. They decentralize authority, embracing participatory management. They prefer market mechanisms to bureaucratic mechanisms. And they focus not simply on providing public services, but on catalyzing all sectors – public, private and voluntary – into action to solve their community's problems.* [30]

The attempt to emulate private sector methods of management and establish the "post-bureaucratic" model, however, is constrained. First, government institutions enjoy coercive powers, which are not enjoyed by the private sector. People can be forced to comply with decisions, pay taxes, have their property acquired and be subjected to sanctions. Many of the services provided by government are monopolies and there is less choice for the people with regard to supplies. In these circumstances, there is less incentive for government institutions to treat citizens as clients or customers the way the private sector is called upon to do, particularly under conditions of a competitive market. When government institutions are in competition, like in the case of the public utilities market being open to the private sector, government institutions have to be customer oriented to stay in business.

A further issue with regard to adopting private sector management styles is the contrast in the methods of accountability. Private sector managers are no doubt accountable, at least theoretically, to their stakeholders. But they are largely judged by their performance in regard to the "bottom-line" – profits. Of course dynamic advantage considerations such as increasing market share or opening of new markets may mitigate the requirement for profit maximisation. Questions of equity in the recruitment, promotion, transfer or dismissal of staff, choice of suppliers or customers to be served, rarely come into the picture unless they threaten profits. Public servants, on the other hand are accountable to the political leadership, parliament and the general public not only for results but also for processes. The emphasis unfortunately is more on the processes rather than results, since expected outputs cannot be easily specified. As Hughes observes, "it is difficult to determine objectives or to measure results in the public sector".[31]

Even though Weberian principles advocate separation of politics from administration, the reality is that the public service is essentially an instrument of implementing the political will of the government in office, whether democratically elected or not, and the political objectives of the government may not always conform to notions of effectiveness and efficiency that is associated with the private sector. While it is a legitimate function of politicians to set the policy agenda, they may not hesitate to interfere also

with implementation, unless it is explicitly decided by government to allow public servants the necessary autonomy to make administrative decisions. However, the prevailing political culture militates against such freedom. Further, where such autonomy is allowed, the extent of administrative control by public servants would be strongly correlated to the number of "rogue ministers" in the government.

2.4 Steering against Rowing

In view of the constraints to incorporating private sector styles of management, many countries are either privatising some of the traditional government service delivery functions or entering into contracts with private sector organisations. This does not necessarily mean that governments are relinquishing their responsibilities for these services. "It is rather a change from delivery by the public service to delivery by the private sector of a government service."[32] This approach frees a government from engaging in cumbersome details of service delivery functions, to concentrate on what is really its primary duty, (apart from maintaining law and order) to decide on policies, monitor their implementation and evaluate impacts, to provide the feedback for better decisions in the future.

Osborne and Gaebler forcefully advocate this new approach to government functions in their 1992 publication, *Reinventing Government*. They saw the government function more in the light of playing the catalytic role rather than doing everything by itself. The new function was called "steering as against rowing". However, they emphasized the importance of the quality of the people who run the administration if steering is to be successful. "Steering requires people who see the entire universe of issues and possibilities and can balance competing demands for resources. Rowing requires people who focus intently on one mission and perform it well. Steering organisations need to find the best methods to achieve their goals. Rowing organisations tend to define 'their' method at all costs".[33]

An extreme example of the 'steering' principle being employed is the contractual system adopted in New Zealand for delivery of functions that are essentially the responsibility of government. Under this system, ministers can purchase services from government departments or from any alternative public or private supplier. Allen Schick, in a World Bank sponsored study, observes that these contractual arrangements "have been extended to policy advice as well, so that ministers can opt to obtain information and ideas from consultancies and other external sources".[34] Schick however does not encourage the many developing countries that have shown interest in the New Zealand model to follow suit since they do not possess the robust markets and established mechanisms for enforcing contract.[35]

2.5 Pressure for PAR

Learning from each other's experience and from developed countries, many developing countries have launched reform initiatives to improve public service management. It is either the challenge of change arising from an economic problem or political pressure from civil society that has prompted governments to move in this direction. Theoretical perspectives of economic efficiency or good governance have hardly pushed governments to make hard choices in regard to PAR. Mascarenhas, for instance has found that "although CSR (PAR) may be on everyone's checklist, it does not have priority on anyone's agenda............it can always be deferred".[36] He also observed that powerful politicians and sections of the public service have vested interests in

maintaining the status quo. "Its dysfunctions are far more comfortable than the uncertainties that real reform will bring. Moreover, many influential civil servants have strong interests in protecting their own special authority, and connections, and change may threaten their position and control"[37]. What has spurred PAR in most of the developing countries is the immediate compulsion of dealing with an unmanageable budgetary burden imposed by a bloated public service which is inefficient, ineffective and an impediment to dynamic private enterprise. Multilateral donor agencies too have had a significant hand in bringing home this realisation. However, without exception, successful reforms were introduced only when the necessary leadership emanated from the top of the political hierarchy.

2.6 PAR in a nutshell

The various reform measures introduced by both developed and developing countries are too numerous to be dealt with, within the scope of this chapter. The following summary by Kernaghan provided in Figure I is useful in focusing on the main issues.

The essence of international reform effort has been to promote pro-active results oriented approaches by their public administrative systems, which effectively responded to citizens' needs and promoted private enterprise. Governments have also started to re-define their functions and seek methods of providing a better service by engaging the private sector. The essence of the new approach is participative leadership, the government's role being that of a catalyst in development.

Figure 1: From the bureaucratic to the post-bureaucratic organization

Characteristics of the post-bureaucratic organization	Characteristics of the bureaucratic organization
Policy and management culture	
Organization-centred Emphasis on needs of the organization itself	Citizen-centred Quality service to citizens (and clients/stakeholders)
Position power Control, command and compliance	Participative leadership Shared values and participative decision making
Rule - centred Rules, procedures and constraints	People-centred An empowering and caring milieu or employees
Independent action Little consultation, cooperation or coordination	Collective action Consultation, cooperation and coordination
Status quo-oriented Accountability for process	Results oriented Accountability for results
Structure	
Centralized Hierachy and central controls	Decentralized Decentralization of authority and control
Departmental form Most programmes delivered by operating departments	Non-departmental form Programmes delivered by wide variety of mechanisms
Market orientation	
Budget driven Programmes financed largely from appropriations	Revenue driven Programmes financed as far as possible on cost recovery basis
Monopolistic Government has monopoly on programme delivery	Competitive Competition with private sector for programme delivery

Source : Kenneth Kernaghan, The post-bureaucratic organization and public service value, in Overview of Public Sector Reform, Commonwealth Secretariat, August 2000.

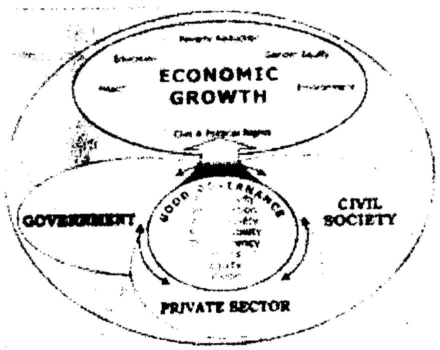
2.7 Role of the Public Service

The analysis of various country experiences indicates that a primary concern of governments is the promotion of development. Marsh, Blondel and Inoguchi point out "there is evidence of the adoption of broad socio-economic goals by all states, though with varying degrees of explicit articulation."[38] What is different among countries, however, is the approach to development; the question that is resolved being whether governments should perform their role through "rowing" or by "steering". There is also variance in the emphasis given to different aspects of development; the determining factors being both temporal and spatial. The concept of development too is no longer confined to economic growth. There is a growing awareness internationally, that development is multifaceted.

Development, however is propelled by economic growth, which economists would consider as "a necessary, though not a sufficient condition". The other aspects - poverty alleviation, environmental management, gender equality, education, health as well as civil and political rights - could subsume all the indices which now comprise the composite Human Development Index estimated by UNDP.[39]

Figure II below attempts to illustrate the relationship between good governance and development in the context of a world that is well integrated through globalisation.

Figure II
The Development Paradigm



The global context of development is an important consideration, since no country today could remain an economic, social or political island, even though many are, in a geographical sense. But geographical barriers are breaking down with globalisation, an essential feature of which is the rapid development of information technology and the integration of markets and indeed economic structures.

Good governance, following the general consensus promoted by the UNDP, arises out of a partnership involving government, the private sector and civil society, in which the Government plays the catalytic role, in an effort to meet society's needs. The elements of good governance are given different emphasis in the literature but all that is discussed in context could be subsumed within the following – efficiency, participation, predictability, accountability, transparency, ethics, equity and vision.[40] In fact, these

elements could be regarded as conduits through which the public service, as the principal instrument of implementation of government policy, could contribute to development. Recent research at the World Bank by Daniel Kaufmann, Aart Kray and Pablo Zoido–Lobaton provides new empirical evidence on the "development – dividend" of good governance.[41]

2.8 The Development Challenge

Prime Minister, Ranil Wickremasinghe in his policy statement to Parliament on the 21st January 2002, summed up the current development challenge facing Sri Lanka. He identified three fundamental issues that need to be addressed through systemic effort. They are as follows:

* Resolution of the ethnic conflict and achievement of peace.
* Acceleration of economic growth and reduction of poverty.
* Strengthening of democracy.

It should not be difficult to discern the contribution that could be made by good governance to the resolution of these issues. The resolution of the ethnic conflict itself depends on the efficiency of implementation of the negotiated settlement when it arrives. Devolution of power, it appears will be a cornerstone in this package. Whatever form it takes, a concerted effort will be required from all parties to the devolution process to make it work efficiently and effectively. This certainly poses new challenges to the public service. New procedures and methods, as well as pervasive skills would be required within the public service to meet this challenge. Similarly, as will be observed later in more concrete form, the public service will have to play the key role in stimulating economic growth and reducing the incidence of poverty.

The relationship between democracy and development has not been firmly established either way, according to the empirical evidence that is available.[42] However, the controversy could be settled, if democracy could be included as a development objective, rather than as a developmental factor.[43] On the other hand, democracy and good governance, as societal needs, reinforce each other.

2.9 Economic growth

The government has announced an economic growth target of 10 percent per annum to increase incomes, reduce unemployment and lower the incidence of poverty.[44] An examination of this target would indicate the challenges faced by society as a whole, and the crucial role that must be played by the public service in forging the dynamic partnership that is required, in order to face them. The rationale of PAR more concretely, is to strengthen the capacity of the public service to play that role.

The average rate of growth of the economy during the last ten years has been approximately 5 percent per annum. To achieve this, the country invested capital amounting to 25 percent of its GDP. This amount was built up from the following sources:

Domestic savings :	18 percent
Foreign aid :	6 percent
Foreign private investment :	1 percent

The incremental capital output ratio (ICOR) was approximately 5. Thus with no change in ICOR, which largely reflects efficiency of capital, to achieve 10 percent growth, total investment will have to double to 50 percent per annum. This is not possible, indeed, not achieved anywhere. Even more modest increases are constrained by the structure of capital. Domestic savings can be increased only through cuts

in mass consumption in the short run. With economic growth, it would be possible to increase this amount gradually, but that too would require greater efficiency.

Foreign aid is drying up globally. It would be an achievement, if Sri Lanka could at least attract the present levels, which presupposes efficiency in aid identification, negotiation and more significantly, absorption. The peace process, if successful, could have an aid dividend but given the global trends it is not possible to envisage an increase of aid that could make a significant dent in the 50 percent of GDP requirement. Foreign private investment (FPI) is still at a very low level. Ironically, FPI flows are mostly to economies that are dynamic and has a future growth potential. Furthermore, foreign investors rarely ignore bureaucratic red tape and inefficiency. The basic message therefore is that the country needs to reduce the requirement of capital by increasing its productivity, that is effectiveness multiplied by efficiency.

A fundamental question of productivity is the division of functions among the three segments of society – the government, private sector and the third sector (NGOs). Government must handle those activities for which it is best equipped; otherwise it would be pre-empting resources that could be put to more effective and efficient use. It is extremely important that for instance, each rupee it acquires through revenue sources, borrowings or monopoly profits produces a comparatively higher return to social welfare than it is if left for use by the private sector or the third sector. In general, governments are better equipped to handle law and order, protect property rights, provide a conducive economic policy environment, regulate (umpire) to ensure economic competition, maintain health and safety standards, protect vulnerable groups in society – poor women, children and minorities, protect the environment and promote good labour relations. This leaves out economic activity. Usually the argument for government investment is extended on the basis of the existence of natural monopolies, externalities, as well as difficulties of raising large-scale capital for high risk and long gestation projects.

Larger the share of total income (GDP) acquired by government, the lower the share that would be available to the private sector. Total government revenue in 2001 amounted to 16.5 percent of GDP, which was short of meeting its total expenditure requirements by approximately 11 percent of GDP. Foreign financing and privatisation proceeds (0.6 percent) together amounted to only 2 percent of GDP. Therefore, around 9 percent of GDP came from domestic financing sources, pre-empting their use by the private sector. This is why it is extremely important that government should select only those activities that it is better equipped to handle. This is a fundamental issue regarding public service activity that should be addressed through PAR.

Equally important is the question of allocation of government resources between current and capital expenditure. In recent years, current expenditure requirements have exceeded total revenue forcing government to borrow, in order to finance the deficit thus created, as well as to maintain public investment, which has dropped gradually from an average of about 13 percent of GDP in the 1980s to approximately 6 percent in 2001. The drop in public investment is alright, if it is the result of a deliberate policy of disengagement by the government from investment activity to promote private investment. However, in Sri Lanka's case it is more a reflection of the government's inability to mobilise sufficient domestic resources to provide counterpart funds to absorb foreign aid in the pipeline.

The structure of the current account is also a matter of serious concern. Over 40 percent of total revenue was spent to pay interest on government borrowings, reflecting the large budget deficits Sri Lanka has been encountering

continuously over the years. Total public service wage bill, excluding payment to defence staff is around 21 percent of total revenue. Non-contributory pension payments amounted to a further 12 percent.

Viability of the size of the PAS, however is a contentious issue. The World Bank, ADB and even the Wanasinghe Committee have made references to a large PAS, which needs drastic reduction. According to the Wanasinghe Committee, the PAS was at least 25 per cent overstaffed in the mid-1980s. With the subsequent increases over the years, going by this argument, the surplus should be now even higher. However, this argument should be first of all reconciled with international comparison given in Table 1.

There is often a tendency to include administrative staff with other government employees such as teachers and medical personnel. When allowance is made for such categories, the total administrative staff, including those serving in the provinces and the districts, amounting to no more than 1.36 percent of the population, compares well with other countries, except India and Singapore. The low-income group average is dominated by the Indian statistic. India naturally has a smaller percentage in view of its large population. In absolute numbers, the PAS in India absorbs about 10 million people. Singapore on the other hand, is a small country with no peripheral administration. An interesting observation is that the two developed countries, UK and France, have comparatively large percentages of their population in the PAS.

Similar comparisons are not possible with regard to the wage data due to differences in the definition of government employees. However, Sri Lanka's PAS wage bill (excluding education and health) is only 1.1 percent of GDP.[45] The question whether the PAS is overstaffed or the wage bill is excessive can be determined only through a PAS cadre needs analysis.

Table 1: State Sector Employment (Percentage of Total Population)

	Sri Lanka	Middle Income Grp Avg	Low Income Grp Avg	High Income Grp Avg	India	Malaysia	Singapore	UK	France
Civilian Central Govt (1)	0.76%	0.6%	0.5%	2.8%	0.3%	1.7%	0.9%	3.1%	3.6%
Sub National Govt (2)	0.60%	0.6%	0.5%	2.8%	0.6%	-	0.0%	3.4%	2.4%
Education	1.04%	1.2%	0.9%	1.3%	0.3%	0.9%	0.5%	1.4%	1.6%
Health	0.44%	0.7%	0.6%	1.1%	0.1%		0.2%	1.6%	1.6%
Police	0.45%	0.3%	0.3%	-	0.1%	1.0%	2.7%	-	-
SOE	1.43%	3.6%	13.1%	-	0.7%	-	-	-	-

Note :
1. Civilian Central Government includes central executive and legislative administrative in ministries & depts., excluding education, health & police employees.
2. Sub national government encompasses all government administrative employees who are not directly funded by the Central Government such as those in municipalities, regional provincial and other institutions: excluding education, health and Police personnel.

Source : World Bank - www.worldbank.org/publicsector/civilservice/cross.htm
For Sri Lanka - www.statistics.gov.lk/empcensus/emp.pdf

Sectoral allocation of resources has an effect on both the structure and dynamism of the economy. Optimality is reached, where resources flow to the most dynamic sectors both in terms of production potential and markets. Even though, allocation of resources by sectors is essentially a private sector function, conducive government policies and facilities could channel private investment in the right direction. Government still plays a major role in health, education and infrastructure services, which are also important from a private sector point of view. The government must therefore possess the capacity to provide the macroeconomic environment and services conducive to private sector investment. These are essentially functions of the public service.

The government's decision making capacity depends to a great extent on the size and structure of cabinet and the professional capacity of the public service; that is, its ability to present the facts, analyse them and put forward viable options. There is no optimum size of the Cabinet but UNDP studies suggest that it should be "kept low, if at all possible, below 20; it should never exceed 25.[46] Realisation of the importance of a manageable size cabinet has prompted some countries to restrict the proliferation of ministries either by law or consensus. Equally important is the need to avoid duplication and overlap of functions among ministries. Plowden and Matheson, for instance, list thirteen common failings of Cabinets. One that has great significance in Sri Lanka's context is the "unmanageable agenda cluttered with issues that could be dealt with at a lower level." [47]

2.10 Vision

Countries are often faced with conflicting objectives and competing demands for resources. Thus, a government must have a clear vision of the objectives it must achieve, within a particular time horizon. This vision is articulated by the government in power and implemented principally by its bureaucracy and other institutions of the state. In good governance, the Government shares it with the business community (private sector) and civil society. In sharing, progressive governments involve the other two partners at the very outset, that is, when the vision is being formulated.

Singapore articulated such a vision. So did Malaysia, Thailand, Taiwan, South Korea and China. Key facets of Singapore's Vision are economic dynamism, a high quality of life, a strong national identity and the configuration of a global city. Malaysia not only articulated a long-term strategy of development for the country through its vision 2020 statement and the National Development Policy, it also set out a vision for its public service.[48] Vision 2020 identifies the development of a mission-oriented public service capable of effectively delivering a quality service in an environment of creativity and innovation in order to transform Malaysia into a modern industrialised nation. It emphasized therefore the need to develop a new mindset internalising seven fundamental values: quality, productivity, innovativeness, discipline, integration, accountability and professionalism.[49]

To provide the necessary leadership and guidance, and to monitor progress of implementation of the vision, a separate Development Administration Unit was set up within the Department of the Prime Minister.

2.11 Equity

Equity is not equality in distribution. It is equal access to opportunities. It is the opposite of discrimination and deprivation perpetrated by one set of people against another because they are different due to race, religion, caste, gender or social class. It is a moral question, as well as an issue concerning development. Discrimination prevents people not only from enjoying the fruits of development but also from contributing to development.

Amartya Sen (2000) has identified the problem of poverty not as one confined to low incomes, but more often it is a question of social exclusion.[50]

> *Social exclusion comprises all the deprivations that diminish a person's life and freedom and suggests how this level of capability deprivation has come about. It also reinforces the understanding of poverty as going beyond low income to include form and causation in being deprived of the opportunity to pursue valued goals. Even if one prefers to view poverty in terms of low income, adding a social exclusion dimension broadens the horizon of concern for marginalized people.*

Part of the problem is created by ignorance of opportunities. There is also the problem of deliberate discrimination because the poor are incapable of returning a favour. The poor appearing in the portals of bureaucratic power are kept waiting for hours or even days; sometimes asked to return several times to receive a simple dispensation which is theirs as a legal and constitutional right.

The problem of access to opportunities and facilities provided by government is exacerbated further by the cumbersome procedures adopted by government agencies and the amount of complicated paperwork involved. This is one of the causes of small time corruption, which affects the poor most. The affluent could always afford to pay a few rupees to bribe a petty officer to get a job done expeditiously. Worse still, the poor have no redress. Legally, they could complain to highest authorities but lack of access prevents such a remedy. Similarly, they cannot approach the ombudsman. The public service must come to grips with these issues if it is to render an efficient, equitable service to the people and reduce the scourge of poverty.

2.12 Ethics

Credibility of the public service in the eyes of the business community and the citizenry is an important element of the development process. Lack of credibility erodes the power of the public service to obtain compliance with rules, regulations, procedures and policies. Public servants must not only be fair and above corrupt practices but also seen to be so. Hughes sees a breakdown of the traditional position.

> *Public administration in its Golden Age was a valuable and valued profession. This is no longer the case and individual bureaucrats have to cope with antipathy from the citizenry. Weber wanted bureaucrats to be respected as an elite group, but increasingly, they have been vilified as wasting scarce taxpayer money. Not only are there attacks on what government does but also on its structures and management style, even against the idea of public interest. The bureaucracy is now something to be minimised and treated with suspicion.*[51]

A question that may arise is whether a code of ethics for public servants will help meet the challenges posed by these pressures. Such a code may not be sufficient, but could provide the necessary platform for moral behaviour and dedication to duty by public servants. Studies done by organisations such as Transparency International indicate that the problem of deteriorating ethical standards and increasing corruption is pervasive, affects not only developing countries, but the developed countries as well. This explains the reason why the Council of OECD adopted on 23rd April 1998 a set of principles and recommended that its member countries take action to establish "well-functioning institutions and systems to promote ethical conduct in the public service." These principles are listed below.

1. Ethical standards for public service should be clear.
2. Ethical standards should be reflected in the legal framework.
3. Ethical guidance should be available to public servants.
4. Public servants should know their rights and obligations when exposing wrongdoing.
5. Political commitment to ethics should reinforce the ethical conduct of public servants.
6. The decision-making process should be transparent and open to scrutiny.
7. There should be clear guidelines for interaction between the public and private sectors.
8. Managers should demonstrate and promote ethical conduct.
9. Management policies, procedures and practices should promote ethical conduct.
10. Public service conditions and management of human resources should promote ethical conduct.
11. Adequate accountability mechanisms should be in place within the public service.
12. Appropriate procedures and sanctions should exist to deal with misconduct.[52]

The OECD code has been prepared with the developed countries in mind. However, it provides a basis for the preparation of similar codes for developing countries, suitably modified to take account of their respective cultural nuances. To make this exercise a fruitful one, it is important to find out why commonly known principles are often violated. Perhaps "appropriate procedures and sanctions reinforced by legal provision could function as a deterrent to misconduct."[53]

2.13 Accountability

The OECD Code of Ethics refers to accountability mechanisms, thus establishing a connection between the two concepts. There is also a link running through accountability, transparency and predictability. This explains the reason why they should be examined together. There is also a close link between these elements of governance and participation.

The OECD Code also gives an indication of accountability, which means it indicates that public servants should be accountable for their actions, to their superiors and to the public, for compliance with rules and ethical principles, as well as for results that should be achieved. The latter emphasizes the importance of the outcome of actions taken by public servants.

Traditionally, the principal aim of accountability is to prevent corruption: the abuse of public office for personal gain. Thus rules and regulations are formulated in order to make public officials follow ethical standards and account for their actions. This applies particularly to the handling of financial transactions such as procurement and sale of government assets. Another area is the use of official position to gain financial favours or other advantages, which behoves reciprocation.

There is enough evidence quantified through surveys carried out by Transparency International as well as the World Bank, that corruption has a corrosive effect on socio-economic development.[54] There is, on the other hand, a commonly heard view that corruption merely "greases the wheels of commerce" and that without it there would be no transactions and no growth. This view is based on the observation of economic growth in some of the East Asian Countries (excluding Singapore) where the two - corruption and growth - appeared to be on parallel course. The point, however, is debatable since there is no measurement to indicate how much better off the people of these countries would have been in terms of economic, social and indeed political indices, if there was less corruption.

Corruption has many corrosive effects on development. Firstly, it discourages investment, for in the presence of corruption businessmen are often made aware that an up-front bribe is required before an enterprise can be started. This is an additional financial burden to be borne by them. Corruption also misallocates talent, for rent-seeking activity becomes more lucrative than productive activity. This is often the outcome of trade restrictions (import controls), poorly targeted subsidies, price controls and foreign exchange allocation schemes. Corruption also leads to misallocation of resources, particularly foreign aid and foreign private investment. Large-scale infrastructure projects provide better opportunities for corruption than educational or health projects. Even where educational and health projects are concerned an increase of construction activity enhances the prospect of kickbacks.

For accountability to have an impact on corruption, the following elements must be effectively in place:

* Well-defined rules, norms and procedures to be followed by public servants.
* Institutional arrangements for timely reporting, scrutiny and apportioning of responsibility.
* Deterrent penalties for violations

Accountability has been invoked in the traditional model, basically to ensure that there is no corruption. But in the new management paradigm, it is important that government systems - the bureaucracy - are not only corruption free but also efficient and effective. The traditional system appears to be biased towards "playing safe", as observed by Osborne & Gaebler. They quote a Ford

Foundation executive who puts it more dramatically as follows:

> *In government all of the incentive is in the direction of not making mistakes. You can have 99 successes and nobody notices, and one mistake and you are dead.*[55]

The traditional system of accountability lays emphasis on rules relating to behaviour, processes, and inputs as against the outcome of actions of public servants. One may follow procedures and rules diligently but may fail to bring about the desired impact.

The encouragement is to play safe, no matter what the outcome is. The new public management paradigm, however, lays emphasis on the outcomes rather than on the processes. It means that the traditional "fairness and finances" approach should be complemented by performance accountability.

2.14 Transparency

The most effective means of accountability of public servants is through mechanisms of transparency. Transparency mechanisms should make government rules, regulations, policies and decision-making processes accessible and visible to the people. However, transparency mechanisms may not achieve this objective, if the rules and procedures themselves are complex and difficult to understand by stakeholders. They have to be simple, straightforward and easy to apply, to avoid conferring discretionary powers to government officials or susceptibility to different interpretations. This is often the case with multiple tariff rates as against uniform tariffs. Even though the former may be justified on economic and social grounds, they may offer opportunities to customs officials to exercise discretionary power over the classification of goods. Under uniform tariffs traders would know exactly what payment is required.

Ensuring transparency entails recognizing and respecting the right of citizens to information. To the extent that decision-making processes become visible, access to information becomes a powerful mechanism of accountability. Citizens, however, could exercise their right to accountability only when elections are held. Meanwhile, pressures could be exerted through civil society organisations, which "connect individuals with the public realm and the state". Civil Society has been described by the UNDP as the "political face of society". Civil society organizations are generally taken to include chambers of commerce and industry, trade unions, employers' groups, academic and research institutions, the media and religious groups. Some definitions also include political parties in this category.

There are, however limits to transparency. In this regard it is important to make a distinction between information as a commodity, and information as a process. For instance, it may not be politically feasible, even within a liberal democratic system to divulge what goes on in Cabinet discussion, but the decisions once taken must be announced unambiguously to the people. It is also possible to anticipate a number of situations in which parties may choose not to enter a negotiation for fear of exposing their position to public hostility, or for fear that rivals may take advantage of the information. Hilton Root indicates three instances when transparency can be counter-productive.

> *In diplomacy, it is generally accepted that transparency is temporarily suspended when negotiating concessions from parties to an agreement may require delaying public exposure of the terms under discussion until the reactions of parties directly privy to the agreement are registered. Another trade-off is between transparency and innovation. Transparency between bidders for existing public utilities to supply new capacity requires specifying the type of plant. However a bidder may resist precise specification when innovative*

solutions are being considered. Changes in exchange rates represent another area in which premature exposure could invite behaviour that undermines the policy.[56]

2.15 Predictability

Predictability assumes that laws, rules, procedures and policy decisions, once adopted are followed diligently. To change these in midstream is like shifting the goal post in a football match to influence the outcome. Predictability is based on the cardinal principle of "rule of law" which means that decisions made by government are not arbitrary but instead are founded on well-defined rights and duties. It also means that rules are applied without exceptions. Where rules appear to be inappropriate to changing situations, their annulment or amendment must be decided *ex-ante*, providing sufficient time to private decision-makers and stakeholders to adjust their plans. Failure to follow adopted rules and procedures has often ended in costly litigation, involving investors. Consider the case of an award of a government tender, which is later quashed by the courts because the proper procedures have not been followed. Far worse are the examples where tenders have been received, processed and decisions taken, only to find the terms of reference not consonant with the objectives of a project, requiring a new process to be started. It is important to appreciate, in this regard, that a predictable regulatory framework enables firms to calculate the return on their investment. On the other hand, uncertainty regarding the application of regulations raises the cost of capital by increasing the risk of investment. Investors need to be assured that bidding processes are fair and free from undue political influence or bureaucratic discretion. It means that results of public bidding should be honoured and implemented.

2.16 Participation

Participation is considered to be the very essence of good governance. According to the UNDP, governance is the result of interaction among government, private sector and civil society. Osborne & Gaebler, defines governance as "the process by which we collectively solve our problems and meet our society's needs. Government is the instrument we use".[57]

Participation is also closely linked to other elements of governance in a mutually reinforcing relationship. For instance accountability is enhanced in a participatory process. Participation helps not only to realise a vision, but also to shape it in a way so that it becomes a feasible proposition. On the other hand, equity promotes participation. There is greater transparency when partnerships are forged through information sharing.

Participation could also take many shapes and forms. It could range from arrangements for mere information sharing to strategic partnerships involving long-term high impact collaboration. The advantages of participation, therefore ranges from information sharing to stakeholder ownership of decisions and joint activity.

Strategic partnerships that involve government, private sector and civil society representatives have all the above advantages of participation, and their main strength lies in the opportunity for a shared vision. A shared vision is crucial for stakeholder ownership of policies. Such ownership not only absolves a government from undue blame when things go wrong, but also makes implementation of policies, and where necessary, corrective action, easier.

For a strategic partnership to work there must be three conditions:

* A will to share a vision,
* Capacity to interact effectively,
* An institutional framework

A number of observers have noted that the political and the bureaucratic elite in the East Asian countries have been constantly engaged in a dialogue with the private sector, albeit through different mechanisms depending on the country. This continuous dialogue, it was argued, ensured a constant feedback on government policies from those who were affected by them.

It is not always easy to forge a shared vision. The first necessary condition is that the government must have its own perspectives clear. That is, there must be a good understanding and a broad consensus within the government itself, about the goals and what is possible to be achieved over a certain time horizon; provided the necessary measures are taken. The public service comes into play in defining these measures and examining their feasibility *vis-a-vis* socio-political-economic and institutional constraints. It is only then that the public service could give the necessary leadership to a strategic partnership. Leadership is required not to force its will, but to arrive at a shared vision and determine feasible methods of realising it, through cooperative effort.

The second condition for an effective shared vision with the private sector and civil society is that there must be a consensus within them. It is not the individual views of businessmen that matter but the collective position, as far as possible, of these segments of society. This implies that there are institutional arrangements within the private sector and within civil society for internal consultation and striking common positions.

Related to the issue of internal consensus or striking common positions, is the question of technical and professional capacity. This is important not only in the public service but also in the private sector and civil society. Representative bodies of these groups must have the technical capacity to negotiate with public officials on an equal footing, on matters of concern to them. A good example is macro-economic policy, particularly fiscal and monetary policy that has a decisive impact on private sector performance. Usually, private sector firms are able to discuss taxes, tariffs and exchange rates in relation to their own business, but they find it difficult when they are asked to examine issues in the broader national context. Part of the problem is the availability of information and data, over which public servants have greater control. This is why transparency mechanisms are an essential ingredient of effective participation, as observed below by the World Bank.

> *In East Asia, by institutionalising public – private deliberation Councils, comprising representatives of labour unions, industry and government, policy makers were able to get broad agreement on economic policy issues and the necessary commitment to intervene quickly and flexibly.*

The need for strong internal partnerships within the public service is not given adequate treatment in the literature, perhaps due to the assumption that this must invariably happen. By "internal partnerships" within the public service, we refer to inter-ministerial, inter-departmental and inter-institutional participation. The traditional method used is the "Committee System" to share information, take decisions, avoid duplication of effort and engage in coordinated activity through a sharing of responsibility. Meetings are useful and often imperative for these purposes. However, if not properly conducted they can result in a waste of time and effort, and even confusion.

It is extremely important that meetings are well planned, the objectives are well defined, the agenda is results-oriented and each participant's role is clearly identified. Good leadership is required to steer a meeting to achieve the desired results. One way of saving time spent on meetings is e-government systems for both information sharing and decision-making.

To sum up, the role of the public service has changed in all countries, in response to the new challenges of development. This role has changed from that of entrepreneur and regulator, to a facilitator of economic and social progress, essentially through the private sector. At the heart of the new public administration is management for results, as against total adherence to procedures, rules and regulations. A critical element of the new approach is the formulation of a vision of development, around which the entire society could be mobilized as partners and stakeholders. The various elements of good governance, in their symbiosis, act as conduits through which development goals are reached. Therefore, a new public administration that could promote the achievement of development goals in the new paradigm has to be based on good governance.

3.0 An Agenda for PAR

If Sri Lanka is to reach its development goals, it has to gear its public administration system to this end. An attempt has been made recently to formulate a development vision for the country through a participatory process, in which public servants interacted quite intensely with private sector representatives and academics. The vision, entitled *Regaining Sri Lanka* envisages reduction of the size of government and shifting its functions away from the direct involvement in the production of goods and services to a facilitating role, through deregulation and conducive economic policies to spur private enterprise. To implement the vision a critical role has been assigned to the reform of the public sector, which includes state-owned enterprises. For this purpose the Government has appointed a high level committee comprising senior public servants, academics, ex-public servants and private sector representatives, under the chairmanship of the Secretary to the Prime Minister. Perhaps, with this appointment the Government has indicated its political will to carry through a programme of administrative reforms, which quite significantly will be linked to the implementation of its economic and social programme.

As indicated by the UNDP, "with a prime minister or, as in the case of the USA, the vice-president initiating and supporting the process, CSR (civil service reform) commands sufficient respect and clout in the system to ensure effective monitoring and coordination". However, the speed and consistency with which reforms will be implemented by government will depend also, and quite significantly on the keenness and enthusiasm of the private sector and civil society. The reason is that, firstly, "not reforming the civil service never seems momentous enough to force it into the political mainstream; it can always be deferred." Secondly, there could be political powerbrokers and career public servants who may have a strong stake in maintaining the status quo. On the other hand, governments, which are driven by an urgent political need to reform the public service as a strategic element of economic and social reform, have taken the initiative in mobilising outside support by pushing the relevant issues to public debate, through effective communication. This is what was done in countries like Malaysia and New Zealand.[58]

3.1 Sequencing PAR

The Wanasinghe recommendations and subsequent attempts to implement some of them give a good indication as to what public service reforms should be undertaken and how. In the present context in Sri Lanka, what may be needed as a first step, based on past experience, is to identify strategic issues and actions required to give substance and direction to a meaningful reforms effort. For actions to become strategic moves, it is necessary to plan their sequencing and timing. Schiavo-Campo, de Tomasso and Mukherjee, in a World Bank sponsored study on reform efforts in several countries, stress the importance of sequencing," so that each decision is facilitated by the previous ones".[59]

While identifying strategic moves, it is equally important to set in motion institutional mechanisms that could continuously and consistently follow them up throughout all the relevant entities of the administrative system. One of the first strategic moves is to select for implementation, measures that are relatively easy to adopt, whose outcomes are predictable and could win support within the public service for further action. For instance, measures to shed excess staff may be a poor first step, for it could build up resistance to measures that may under normal circumstances be quite acceptable. Measures opening up career advancement prospects are generally popular. Incentive schemes linked to objective performance appraisal schemes, also fall into this category. Senior public servants would always support measures that enhance freedom from political interference, particularly in regard to personnel matters such as appointments, promotions, transfers and disciplinary action. Reform measures should be designed taking into account the views of public servants, whenever possible, in a way that they do not become alienated from the decision making process. Once started, the reform process must continue

according to plan. Piecemeal, *ad hoc* interventions, as noted by Wanasinghe, could be counterproductive since they may even disrupt existing systems.

3.2 De-politicisation

Arrangements for de-politicisation could give confidence and a sense of achievement to public servants who have lost initiative, due to interference by political authorities in matters, which are essentially administrative in nature. Ministers no doubt, have a political stake in administrative outcomes. While policy decisions are ultimately their prerogative, they also have a right to ensure that those decisions are effectively implemented. However, for that purpose, what is required is to decide on the procedures and rules of application, which public servants must follow, without violating the principles of equity. Political interference is usually invoked to make exceptions, for the benefit of persons whom the ministers and other political authorities would like to favour. Public servants would find it difficult to resist such pressures, even though they would be violating principles of equity, when their career prospects are at stake. Implementation of the new Public Service Commission, in accordance with the 17th Amendment to the Constitution, could to a great extent remove the political "Sword of Damocles" that hangs over their heads, by the curtailment of the powers of individual ministers, with regard to their promotions, transfers and termination of service. However, it would be necessary to remove the uncertainty caused by paragraph 55-3 which retains the power of appointment of heads of departments with the Cabinet. This uncertainty could be mitigated by a decision of the Cabinet itself that, unless justifiable cause for exemption exists, it would exercise this power only in consultation with the PSC.

Equally important in the de-politicisation process, is the demarcation of functions and powers of the minister's personal staff, so that they do not have leeway for interference with the administration. This was one of the major issues that were discussed at the Conference of Secretaries and Chief Secretaries held in April 2002. There is no doubt that the restoration of the PSC would, to a great extent, remove the threat of political interference from this quarter, but a firm government decision separating the personal political agenda of ministers from the Government's collective decisions and policies, could greatly enhance the opportunity for public servants to be more self-assured and innovative.

3.3 Driving Force

The ARC is basically a policy formulating body that makes recommendations to Cabinet for decisions. Reforms have to be carried through at ministries, departments and other entities, both at the centre and the periphery of the administrative system. For this process to be successful, there is a need for a driving force. It is necessary to have a task force charged with the responsibility of providing the necessary leadership and drive, in each of those entities, particularly at the ministry level. The head of this task force has to be the secretary of the ministry, and in the case of the Provincial Councils, the chief secretary, since administrative authority flows from them down the line of the administration. The secretary, however, has to be assisted by a group of specialists covering various aspects of the reform process, who will constitute the membership of the task force.

Administrative reforms cannot be divorced from economic and social development policy; they have to be harmonized for effectiveness. In view of the need to keep the task force small (dearth of qualified personnel also does

not allow larger numbers) its functions could be organized under four categories, each covered by a member. The four categories are: planning, implementation, organization and human resource development. Task force members would be required to not only offer advice to the secretary but also carry decisions down the line to the implementing entities. To be effective the task force members will have to work as a team, in constant consultation, sharing knowledge and tasks.

Most ministries and departments have planning units. If competent, the heads of these units are the most appropriate persons to handle the planning task, which involves basically sequencing, and timing of reform measures, as well as their harmonization with the strategic planning objectives. Monitoring of reform implementation is a crucial task but to make it effective, the planning unit must translate decisions regarding reforms into operational plans. It is also the task of the "implementation" unit to carry out ex-post evaluation of reform measures with a view to providing a feedback to the decision makers. Reform measures invariably have implications for organizational change, particularly in regard to work procedures, rules, regulations and assignment of duties and functions. This is not an area that can be covered by circulars and written instructions alone. Organizational change also requires an appreciation of tradition, attitudes, habits and vested interests of officers in maintaining the status quo. One cannot expect these matters to be resolved on their own, through the issue of instructions. They have to be implemented through effective participatory processes.

The human resource development aspect covers not only training of personnel to undertake new tasks and responsibilities, but also their motivation through objective performance appraisal systems and related incentive schemes. The task force members too may need training, at least orientation, which has to be organized system-wide, through an ARC approved scheme.

3.4 Role of the Secretary

The Secretary of a Ministry or Chief Secretary of a Provincial Council is not only the head of a task force but also de-facto member of the public service top management team. In some countries such as New Zealand and the Netherlands and UK, senior management groups have been formally established with specific agendas of activity. The performance of the secretary, determined by his/her abilities, commitment and freedom of action is crucial not only for the success of the reform process but also for the functioning of the ministry (or Provincial Council) s/he covers. It is, therefore necessary to examine the role of the secretary and make provision in an administrative reforms package for his/her effectiveness.

Larson & Coe identify three basic roles of the 'permanent' secretary as follows: a) policy advisor to the minister; b) head of department; and c) member of the public service top management team.[60]

As policy advisor to the Minister, the secretary, is expected to examine issues based on objective information and data and provide options for resolution, laying forth the implications of each option. The secretary is expected to bring to bear in these cases, his knowledge not only of the technical, managerial, legal and financial issues but also of the political implications of the options before the Government. The Minister may not depend entirely on the secretary's advice. He may have other advisors within and outside the Government. The secretary therefore has to constantly improve his competence, if s/he is to provide the required leadership as administrative head of the ministry.

The head of department role of the secretary relates to direction and management of the tasks of the Ministry, which s/he is expected to perform, principally on behalf of the Minister. Larson & Coe are of the view that it is the duty of the secretary to respond to the minister's priorities and carry out the administration in accordance with the minister's

direction and interests. "From time to time this may require implementing policies which the permanent secretary has reservations about, or may even have advised against". This is the "rogue minister" case but they feel that "nevertheless, as a loyal public servant, the permanent secretary has the duty to respect the authority of the democratically elected political level, and to carry out its policies to the fullest extent possible. They say, however, that in dealing with the 'rogue minister", the secretary's first course of action is to explain the inconsistencies of his/her actions with government policies and priorities; failing which, to "seek the advice of the head of civil service or the cabinet secretary". The problem is when the Minister does not listen to advice or penalizes the secretary for tendering such advice. The course of action available to the secretary in those cases will depend largely on his "independence". In most countries, the head of government or the head of state, with which the secretary may consult, appoints secretaries. This is the ultimate course of action when the rogue minister syndrome leads to violation of anti corruption laws and procedures. Where deviations from government priorities and requirements of coordination are involved, the secretary's position is determined by the effectiveness of the "senior management club" to which he belongs.

3.5 Senior Management Team

As a member of the senior management team of the Government, the secretaries are expected to work with each other, sharing a collective responsibility for the management of the public service as a whole. This collective responsibility is spelt out in the advice issued by New Zealand's State Services Commissioner to all chief executives (permanent secretaries): "you have a key role in ensuring that the collective interest of government is not lost sight of, and indeed is enhanced by your department's actions. While departments properly and necessarily specialize in certain areas, it is important that they always consider the relationship of their own policy advice and programme to the wider context of the government's strategy".[61] Mascarenhas is of the same view but he emphasizes the quality and efficiency aspect of the service.

The Wanasinghe Committee emphasized in a dedicated volume, the importance of formally establishing a senior management group. It said that, what the public service urgently requires is a "leader group" which would provide the service with qualitative leadership; which would serve as the inter-face between the public service as a whole and the legislative and the political executive; set the tone for the whole public service; and act as the guardian of the value system of the public service. The Wanasinghe Committee considered the establishment of such a service urgent in 1988. Since then, the general perception, in the public service and elsewhere is that the quality of the public service and its ability to work without political interference has deteriorated further.

The Wanasinghe Committee did not envisage automatic membership of such a group by virtue of a position in the administrative hierarchy. It envisaged a process of talent hunting. The members were expected to display capacity for policy management, crisis anticipation and control, as well as leadership capability. These are indeed the qualities expected of the members of the ministerial task forces that have to catalyze administrative reforms. If the administrative reforms process is to succeed, there is a need to establish a senior management group and provide the members with appropriate training facilities. This should include apart from economic analysis and best management practices, a thorough understanding of the globalization process. This is neassary due to the increasing need for senior public servants, to

interact with international rule making organizations such as the WTO, the IMF, and the World Bank and regional trading blocs such as APEC, NAFTA or SAARC in Sri Lanka's case.

3.6 Cabinet Structures

PAR efforts, however, will yield low returns if nothing is done to rationalise the proliferation and fragmentation of ministries, which not only prevent meaningful discussions at Cabinet meetings but also effective inter-sectoral coordination. The number of Cabinet appointments and the choice of members reflect the political balance of forces within the Government party, indeed a coalition of parties in the present context in Sri Lanka. The political leadership will require enormous courage to reduce the number of ministries from its present size of 51 portfolios. One feasible option in the circumstance would be to set up several Cabinet sub-committees, based on the principle of most effective sectoral coordination.

The following appears to be a feasible classification of ministerial clusters:

1. Agriculture, lands, irrigation, rural industries, forestry and environment.
2. Industry, fisheries, finance, trade and services, including tourism.
3. Infrastructure- roads, highways, transport, power and energy and telecommunications.
4. Education, science and technology, cultural affairs and sports,.
5. Health, social welfare, children and women's affairs.
6. Foreign affairs, defence, internal security, public administration, provincial councils and home affairs.

The above classification would indicate the technical possibility of keeping cabinet size to around 25 to 26 ministers. However, the actual number would depend on political considerations. Further, even the division of functions are often determined on the basis of political assessment of individual members of the cabinet and their capabilities. However, from a policy coordination point of view it would be feasible to keep as close as possible to the above division of portfolios. An option available, that would not cause too many problems from the point of view of sectoral coordination, in case it is politically imperative to give a few more jobs, is to create a number of junior ministries that could function in coordination with the cabinet rank ministries. The number of clusters could be either reduced or increased depending on political feasibility. However, the sectoral classification principle is very important for effective policy coordination.

3.7 Performance Appraisal

A priority item for administrative reform, which could provide motivation to public servants for effective participation in the process, is a viable performance appraisal system linked to career prospects and other incentives. To be effective, the appraisal system must have an inbuilt mechanism for definition of functions not only of institutions but also of individual officers. The previous attempt in this regard failed to bear fruit due to several reasons, notably a) the inability to define the aims and objectives of work in respect of individual officers; b) the reluctance of supervisors to provide objective assessment of work done by subordinates and c) absence of clear guidelines regarding the appraisal process.

An objective appraisal system linked to career prospects and other incentives could make training programmes

popular. For this purpose it would be necessary to make the acquiring of appropriate training an important performance indicator. However, to give meaning to this, the Government will have to adopt a national public service training policy and make provision for its implementation at various levels and institutions of the public administration system. The national training policy once adopted by the Government should be used as the basis on which all government training programmes are planned and executed. To reinforce training initiatives, all administrative entities should be encouraged to adopt the 'learning organisation' concept, where the head of each entity not only takes on the responsibility for training by bringing it directly under his/her purview but also providing the required leadership through involvement. Accordingly, heads of departments and secretaries would be required simultaneously to become mentors and learners themselves. The concept of training should not be confined to the mere acquisition of skills, but more importantly must extend to attitudinal change, for the transformation of public servants from process managers to results achievers.

To sum up, there is an urgent need to launch a comprehensive, consistent, well-planned administrative reforms process to meet the challenges of development facing Sri Lanka today. Sequencing and timing is of the essence, in this process. It must also have a driving force. A fundamental prerequisite, however, is the political will and commitment to carry through a continuous and consistent programme of action. As observed in the earlier sections, such will and consistency were not always discernible even internationally. In the past, Sri Lanka had many good intentions of introducing administrative reforms, since there was no lack of appreciation of the need. However, consistency was lacking. As observed in the case of other countries, such consistency could be expected only when there is sufficient pressure, particularly from civil society.

Conclusion

Many countries- developed and developing, have over the years, attempted to introduce administrative reforms. This is mainly in response to the paradigm shift in the role of government The Weberian model of bureaucracy, which laid greater emphasis on rules, regulations and procedures was no longer appropriate in an era when a government's role was perceived to be that of a facilitator of private enterprise. The government in the new circumstance is expected to concentrate on what it can handle best; also, to use the maxim introduced by Osborne and Gaebler in *Reinventing Government*, 'the government must steer, not row'. Public administration therefore must be pro-active, results-oriented, efficient and competitive. In short, it must reflect the best attributes of good governance.

Sri Lanka, many times since Independence in 1948, has introduced administrative reform measures but always in *ad hoc*, manner. In 1977, there was a major shift in development policy. The governments since then have followed market oriented economic policies in which the private sector was expected to play the key role. The Government's role was perceived to be one of facilitating private economic activity, while it still maintained control over key infrastructure and there were moments of inconsistency of policy. A new approach to public administration therefore became imperative. The Wanasinghe Committee was a reflection of that perception. Its recommendations were comprehensive, far reaching and addressed the needs of the new development policy. It warned against piecemeal attempts. However, that is exactly what happened. The many attempts made to implement the Wanasinghe recommendations were not only ineffective but also at times, proved to be counter productive. One of the major shortcomings was the absence of a central authority capable of planning reforms and getting them implemented.

Sri Lanka is today facing new challenges of develop ment. The Government has articulated them as follows:

* Resolution of the ethnic conflict and achievement of peace;
* Acceleration of economic growth and reduction of poverty;
* Strengthening of democracy.

All these challenges need effective policy responses from the Government for their resolution. The public administration system has a big role to play in translating those policies into results. However, the present system is perceived to be ineffective in dealing with the complex administrative demands associated with that role. There is an urgent need therefore, to address issues relating to the effectiveness of the country's public administration system. In this regard, the Wanasinghe recommendations and the several attempts made to implement them have many lessons to offer.

The present Government and the ones before have not displayed any lack of appreciation of the need to revamp the public administration system. A high level committee on administrative reforms operating under the purview of the prime minister has been charged with the responsibility of pushing through measures that could make the system responsive to the development needs of the country. This is not the first time, however that such a high level committee has been appointed. It is therefore necessary to learn from the shortcomings of the earlier arrangements if the present initiative is to succeed.

A committee on administrative reforms, even if it is under the purview of the highest level of authority could play, in the best instance, only an advisory role. Therefore, there must be a central driving force to ensure its advice is implemented. The Wanasinghe Committee saw this need and recommended for its purpose, the establishment of a Ministry of Public Service. There is today a Ministry of Public Administration, Management and Reform. It is not clear whether it is 'appropriately staffed with senior and experienced personnel' as envisaged by Wanasinghe. It was also recommended by the Wanasinghe Committee that, since the establishment of an appropriate ministry will take time, a secretariat should be set up under its purview. The present administrative reforms committee has established a secretariat. There is a need, however to define its authority *vis-à-vis* the Ministry of Public Administration in pushing through reforms. In any case, the final outcome will depend largely on the capacity of the individual ministries and other administrative entities to carry through the reform measures. The nature of these reforms is such that they cannot be implemented by mere administrative circular; they need the active participation of public servants.

In order to promote such participation and give substance and direction to reforms, it is necessary, at least at each ministry and provincial council to establish a task force led by no other person than the secretary or chief secretary. A competent team of officials, who will share responsibility for planning, implementation, organizational change and human resource development, should assist him/her. The modus operandi of the team should be based on the *learning organization* concept, covering all the target groups of reform.

Success of reforms also depends on sequencing and timing, so that each reform measure is facilitated by what was achieved earlier. Dealing firstly, with measures, which are relatively easy to implement in regard to acceptance and support, builds up confidence and anticipation of subsequent measures. It is also important to bring forward measures, which would be seen as beneficial to the majority of public servants in terms of career prospects as well as opportunities.

Motivation of public servants this way, helps reinforce partnerships, which are crucial for the success of reforms.

Democratic governments with short-term electoral horizons often find themselves caught up between long term perspectives and short-term political needs for survival. In the process, long gestation programs such as administrative reform packages often get pushed back. They are sustained usually through external pressure. It is worth repeating, therefore that commitment to consistency of administrative reforms by governments, needs constant pressure from the private sector and civil society.

Footnotes

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4 The Statement to Parliament by the Prime Minister of Sri Lanka, Hon. Ranil Wickremasinghe on 21.01.02, Hansard.

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Chapter 4

Financial Sector Reforms[1]

- Shanaka Jayanath Peiris -

1. Introduction

The Sri Lankan economy prior to 1977 was mostly characterised by stringent administrative controls on the exchange and trade system, financial sector, resource allocation and price determination resulting in a poor growth performance. The change of government in 1977 marked a turning point of economic policies in Sri Lanka. The new government's intention was to embark on a market and export oriented growth strategy. The main emphasis of the economic liberalisation program introduced in late-1977 (first wave of liberalization) was on the removal of foreign trade and exchange controls, removal of price controls, fiscal reforms and liberalisation of the financial sector. It was thought that the structural adjustment efforts would achieve a sustainable rate of economic growth, reduce inflation and attain a viable balance of payments situation. In general, the objectives of financial liberalisation undertaken were to enhance efficiency through a greater reliance on market forces as well as to improve the effectiveness of monetary policy.

The key reforms were aimed at liberalising interest rates, reducing controls on credit, enhancing competition and efficiency in the financial system, strengthening the supervisory framework, and promoting the growth and deepening of financial markets. The liberalisation of the domestic financial system was accompanied by the relaxation of restrictions on exchange controls and a shift toward more flexible exchange rate arrangements. Overall, financial liberalisation has been a gradual, phased, and continuing process rather than being concentrated in discrete episodes of comprehensive liberalisation.

The economy responded impressively in the initial years following economic liberalisation with a jump in real GDP growth, investment and financial savings. However, domestic savings did not keep pace with the moderately high levels of investment while rising real consumption also contributed to the deterioration of the balance of payments. The adjustment effort was further sent back with the extra-ordinary rise in the budget deficit. The budget deficit was heavily financed by external sources together with domestic borrowing from the financial system. Stabilisation efforts failed and the economy was beginning to experience considerable macroeconomic instability (1980-85). However, the rate of inflation was relatively low during 1985-87 in spite of a large budget deficit around 15% of GDP.

Stabilisation and adjustment efforts were re-started in 1988 but were disrupted by civil disturbances, exacerbated demand pressures and elections. The fiscal situation worsened together with a rise in monetary expansion and thus inflation. The economy began to recover in 1990 with a real GDP growth rate of 5.5% during 1990-93. This trend was associated with the implementation of substantial structural reform in the early-1990's (second wave of liberalization) under an Enhanced Structural Adjustment Facility of the International Monetary Fund (IMF). The major

objectives were to restructure the government budget, accelerate the pace of privatisation, minimise government regulation of industry, promote foreign investment, financial sector reform and further liberalisation of the trade payments system. Full convertibility of the Current Account was achieved in 1994 and certain restrictions were lifted with respect to Capital Account transactions. However, macroeconomic imbalances mainly resulting from the elections and widening fiscal deficits emerged in 1994. A change of government also took place in 1994. The new government continued to focus on adjustment efforts and promote the private sector as the engine of growth. Attempts were also made to bring peace to the drawn out ethnic conflict in the North-East. Unfortunately, hopes of peace faded in 1995, which saw an escalation of hostilities with a jump in military expenditure and the fiscal deficit. The continuing conflict and stalled fiscal consolidation and reform agenda lead to an ever-growing budget deficit and stock of government debt. The deteriorating macroeconomic conditions precipitated a balance of payments crisis in early-2001, which resulted in the free float of the exchange rate and a stand-by agreement with the IMF. The main elements of the IMF program were to arrest the severe deterioration in the fiscal accounts and press ahead with the structural reform agenda, including financial sector reform. However, after success in the first-half of 2001, the macroeconomic situation drastically deteriorated as a result of political instability and other domestic and external shocks. The government was unable to take corrective measures and the IMF program went off track while the government lost its parliamentary majority in July leading to elections in December 2001. A new government brought the IMF program back on track and to a successful completion and also signed a ceasefire agreement with the Liberation of Tigers of Tamil Eelam (LTTE), which lays the foundations for peace.

Therefore, this is a perfect opportunity to take stock of the reform process in Sri Lanka and its consequences; and identify the remaining obstacles to development and set out a clear path for reform so that the country can finally realize its full potential. This chapter contributes by addressing these issues in the case of the financial sector while keeping in mind the micro and macro linkages in the economy, although the impact of civil disturbances and the North-East conflict on the liberalisation process and its consequences cannot be overemphasised in the Sri Lankan context, a detailed analysis of which is beyond the scope of this chapter.

The first major component of this chapter would be to consider each broad area of financial liberalisation and its consequences during 1977-87 at a disaggregate and macroeconomic level. Special attention would be paid to the outcome of financial reforms in context of the macroeconomic policies and background. The effects on financial savings, private investment, allocative efficiency[2] and financial soundness will be investigated empirically while the role of state-owned financial institutions and government intervention in the entire process would be examined in detail. The second component of analysis would be to examine the post-1987 financial sector reform efforts on a case-by-case basis while focusing on its implications. That would also involve identifying the remaining distortions in the financial system today and indicating a future policy direction for financial sector reform.

2. Macro economic backgrounds and the financial sector on the eve of financial liberalisation

Sri Lanka experienced a prolonged period of stagnation before 1977. The inflation rate as measured by the consumer price index (CPI) averaged 6.4% during 1970-76, and was only 1.3% and 1.1% in 1976&77 respectively. The relatively low inflation

before 1977 is partly explained by the existence of domestic price controls, relatively stable exchange rates and widespread subsidies (the GDP deflator averaged 14% during 1974-77, and was 8.8% and 16% of nominal GDP). The Balance of Payments (BOP) remained precarious, even with stringent exchange and trade controls (Table 1).

Table 1: Macroeconomic Indicators 1973-77

	Aver 74-77	1973	1974	1975	1976	1977
Real GDP growth rate	4.20%	.....	4%	470%	4.40%	3.80%
GDI to GNP	17.70%	15.10%	17.40%	17.50%	19%	16.80%
ADS to GNP	13.90%	13.70%	9.10%	9.10%	16.30%	21.10%
Fiscal Deficit to GNP	-7.98%	-5.83%	-4.83%	-8.92%	-11.35%	-6.81%
Exchange Rate (1 US$)	7.74	6.4	6.65	8	8.5	9.7
Balance of Payments						
Current account/ GDP	-0.87%	-0.88%	-3.80%	-2.88%	-0.17%	3.36%
Capital account/ GDP	1.55%	1.83%	2.84%	2.26%	1.25%	-0.14%
Inflation (CPI)	5.30%	.....	12.30%	6.70%	1.30%	1.10%
Inflation (GDP deflator)	14%	.....	24.20%	7%	8.80%	16%

Source : Central Bank of Sri Lanka

ADS = Aggregate Domestic Savings

GDP = Gross Domestic product

GNP = Gross National Product

GDI = Gross Domestic Investment

CPI = Colombo Consumers' Price Index

In 1977, Sri Lanka had a fairly modern financial sector with a variegated institutional pattern; the commercial bank's (CB) share of total financial assets was 35%. There were three major state-owned banks, two state-owned commercial banks (SOCBs)-Bank of Ceylon (BC) & Peoples Bank (PB), and a savings bank-National Savings Bank (NSB), which were the main mobilizers of domestic savings. Non-state commercial banks together with development banks and insurance companies were operating, but their assets as a proportion of total financial assets were small.

Monetary policy instruments adopted prior to the reforms were interest rate regulations and directed credit controls. These policies led to a segmentation of financial markets; an official segment consisting of formal financial institutions (mainly banks) and an unregulated market segment consisting of informal credit institutions and private moneylenders.

The financial system was 'financially repressed', with negative real interest rates and relatively limited financial assets, as reflected in their low ratio to GDP (Table 2). Most credit to the priority sectors was subsidised through selective credit policies. The subsidy was financed by the Central Bank of Sri Lanka (CBSL) through the liberal and unrestricted accommodation the banks enjoyed, with the latter at a subsidised refinance rate. It was observed that financial dis-intermediation was taking place in Sri Lanka (Khatkhate 1983).

The Monetary Law Act (MLA) in 1949 made provision for the CBSL to examine the books, accounts and records of banking institutions periodically as well as to monitor the performance of banks through a continuous supervisory process. However, Sri Lanka did not have in its statute book a general banking law and inadequate resources further hampered supervision. Observers claim that supervision was ineffective.

Table 2: Financial System 1970-76

Year	CB Deposit Rate	Inflation Rate	Real Interest Rate	TFS (ratio to GDP)
1970	4.75	5.9	-1.15	34.6
1971	4.75	2.7	2.05	37.2
1972	4.75	6.3	-1.55	42.7
1973	4.75	9.7	-4.95	38.6
1974	4.75	12.3	-7.55	34.1
1975	7.5	6.7	0.8	32.6
1976	7.5	1.2	6.3	36.2

Source: CBSL CB Deposit Rate = Commercial bank one-year deposit rate (maximum) TFS= Total financial savings

3. Financial liberalization

3.1 Interest rate reform process

The main thrust of Sri Lanka's initial financial reform process was on the removal of restrictions on interest rates. First, the interest rates on deposits of the NSB were raised sharply, which was used as the apex institution to raise the deposit rates structure aimed at stimulating savings, especially with financial intermediaries. The savings and one-year fixed deposits of the NSB were raised from 7.2% and 7.5% respectively to 8.4% and 15% respectively in September 1977. Faced with stiff competition the commercial banks were compelled to follow suit raising the deposit rate from 5.5% to 7.2% and one-year fixed deposit rates from a range of 7-7.5% to a range of 14-15% in late-1977. The administered interest rates were revised upwards in 1980 as illustrated in Table 3 and continued until 1981 when the rates reached a maximum. Furthermore, the NSB as well as commercial banks introduced two-year fixed deposits with higher rates of interest.

Table 3: Nominal and Real interest rates

Year	Savings		One year fixed		Real one year fixed		Real savings	
	CB	NSB	CB	NSB	CB	NSB	CB	NSB
1976	5.5	7.2	7-7.5	7.5	6.1	6.8	4.3	6
1977	7.2	8.4	14-15	15	13.3	13.8	6	7.2
1978	7.2	8.4	14-15	15	2.4	2.9	-4.9	3.7
1979	5-9	8.4	14-15	15	3.8	4.3	-3.7	-2.3
1980	10-14	12	20	20	-6.1	-6.1	-14.1	-14.1
1981	10-14	12	20-22	20	3	2	-6	-6
1982	10-14	12	15-22	20	7.7	9.2	1.45	1.2
1983	10-15	12	15-25	18	6	4	-1.5	-2
1984	10-15	12	14-25	20	2.9	3.4	-4.1	-4.6
1985	10-15	12	12-22	15-16	15.6	13.6	11.1	10.6
1986	6-13	12	8.5-17	13	4.7	5	1.5	4
1987	6-12	12	8.5-14	13	3.5	5.3	1.3	4.3

Source: CBSL
Real = Average of minimum and maximum rates adjusted for annual monthly average change in CPI., CB= commercial banks

3.2 Reductions in credit controls

The selective control policy continued but was made, even more selective, and the concessional element in interest rates was eventually scaled down. In 1978, selective credit ceilings on commercial bank credit to finance companies engaged in lending and hire purchase activities were relaxed, while those on commercial bank credit to government corporations and statutory boards were withdrawn. Selective credit ceilings on bank credit to residents or companies registered in Sri Lanka for purchase of plantations or immovables were withdrawn in 1982. In 1983, overall credit ceilings on commercial banks were removed. Banks were also given, more freedom to determine lending rates to the final borrowers. However, sectoral credit allocation requirements and selective credit ceilings remained.

3.3 Financial system reforms

Efforts were made, to enhance the financial systems efficiency by increasing competition and by broadening the financial structure in terms of institutions, markets and instruments. The CBSL expanded its structure further influencing the allocation of credit. Regional offices were established, together with regional rural development banks (RRDB). Sri Lanka undertook measures to reduce obstacles to competition and market segmentation by allowing greater freedom of entry, expanding the scope of permissible activities for different types of institutions, and relaxing restrictions on the activities of foreign banks. As a result, foreign commercial banks gradually began to open branches together with new domestic commercial banks. Corporate banking, trade and treasury services recorded tremendous growth along with branch numbers. Overall, there was a broad-based expansion with respect to commercial banking together with a sophistication of activities. Many new non-bank financial institutions (NBFI) were also established. They consisted of two development banks (SMIB and NDB[3]), another state-owned insurance company (NIC[4]), a trust fund (ETF[5]), merchant banks, and several new finance companies (FCs).

Deregulation of the financial system was, however, accompanied by limited measures to strengthen the supervisory framework. The CBSL initiated its activities on the supervision and regulation of finance companies under Act. No.27 of 1979. Although, discussions on a general Banking Act was actively pursued it was not until 1988 that the Banking Act No. 30 came into operation. Prior to this Act, the supervision of banks was carried out, under the MLA, but the Bank Supervision Department of the CBSL was handicapped by a lack of well-trained staff. In practice, regulation was inadequate and supervision was infrequent and ineffective.

The government undertook measures to develop the dormant securities markets. The main developments were with respect to sub-markets, institutions and the legal framework. In order to popularise transactions of Treasury Bills (T-Bills) among non-Central Bank institutions and individuals, the CBSL in 1981 established a secondary Treasury bill market. Such a market was also thought to be a flexible method of managing liquidity by enhancing open market operations. Initially, interest rates of secondary treasury bills were based on the inter-bank call money market, but since 1982 the Central Bank tended to fix the rates at relatively low levels as compared to 1981. However, from 1987, the market was used to reduce the excessive holdings of primary bills by the CBSL. As a result, the rates in the secondary Treasury bill market together with transactions have shown a rise, especially since 1988. The inter-bank call money market was activated in 1977 with rates mainly determined by market forces. In order to develop foreign exchange facilities and an offshore foreign exchange market for the newly established free trade zone ventures, the CBSL authorised commercial banks to establish separate foreign currency banking units (FCBUs) since 1979. These units were allowed to accept time and demand deposits from non-residents in specific foreign currencies, and grant loans to institutions approved by the authorities. The CBSL also encouraged the issue of certificate of deposits (CD's) as a new money market instrument so that it would act as an effective method of absorbing liquidity in the unorganised and black money markets in the economy. Equity market activity recorded a reasonable growth at least up to 1983, which was comparable to the relatively high economic growth

rates experienced during 1977-83. The Colombo Securities Exchange (CSE) was established in 1985 while the Securities Council was set up in 1987 to regulate the securities market.

3.4 Reductions in exchange controls and more flexible exchange arrangements

Together with the liberalisation of domestic financial markets, Sri Lanka relaxed exchange controls. A process of delegating authority to commercial banks with regard to selected current account transactions and exchange control functions began in 1977. Exchange controls on remittances were relaxed while exchange entitlements were enhanced for travel, business, education etc. Commercial banks were permitted to open Non-Resident Foreign Currency (NRFC) accounts (1978) and Resident Non-National Foreign Currency (RNNFC) accounts in 1980. In 1978, the Greater Colombo Economic Commission was set up to facilitate foreign and domestic investment in the export processing zones.

In 1977, the dual exchange rate system was abolished and a unified rate adopted with 44 percent devaluation against the US dollar. The fixed exchange rate system was replaced with a managed float system adopting US dollar as the intervention currency.

4. The Consequences of Financial Liberalisation

The consequences of financial reforms on the financial system depends not only on the principal elements constituting the reforms and their mode of implementation but also on how these reforms interact with the macroeconomic policies and background. Therefore, it is crucial to examine the impact of financial reforms in the context of these factors. The real GDP growth rate immediately after financial liberalisation was the highest at 7% and averaged approximately 5.5% until 1985. Gross Domestic Investment (GDI) increased rapidly from 14% of GDP in 1977 to a peak level of 34% of GDP in 1980 and averaged around 24% of GDP during 1977-87. In contrast, domestic savings as a ratio of GDP fell from 18% in 1977 to 11% in 1980 and averaged 13.9% during 1977-87 compared to 12.1% experienced during 1970-6. Thus, high domestic investment was sustained mainly through foreign savings (borrowing) resulting in a widening current account deficit. The rate of inflation as measured by the CPI averaged 11.9% during 1977-86. The fiscal deficit expanded rapidly, ranging between 7-21% of GNP, with massive infrastructure projects and increased recurrent expenditure (Table 4).

4.1 Level and structure of interest rates

Real interest rates on one-year fixed-deposits of commercial banks and the NSB remained positive after liberalisation, with the exception of 1980. However, real rates on savings deposits have been negative in many years as illustrated in Table 3. Although, market considerations were given some weight, the level and structure of interest rates cannot be said to be market determined. The guiding hand of the monetary authorities often signalled changes in the interest rates charged by commercial banks and finance companies. For example, the authorities did not allow the interest rate structure to adjust in response to the sudden dip in inflation in 1985 because it was perceived that a sudden drop in nominal rates would discourage financial savings. The instrument of administrative control was the T-bill rate and the yield on the Central Bank's own securities. Furthermore, the NSB and the state-owned banks fixed its deposit rates under the guidance of the monetary authority. In practice, the T-bill rate represented the lower end of the range of what the authorities preferred, while the rate paid by the NSB on its deposits represented the upper end. The weighted

Table 4: Macroeconomic Indicators 1978-87

	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
Real Sector										
Real GDP Growth Rate	7%	6.4%	5.8%	5.8%	5.1%	5%	4.10%	4.5%	5.1%	1.5%
Gross Domestic Investment/ GNP	21.9%	25.8%	33.4%	28%	30.4%	28.9%	26.6%	23.9%	23.8%	23%
Gross Domestic Savings/ GNP	16.7%	13.8%	11.1%	11.8%	11.8%	13.9%	19.8%	11.2%	12.1%	12.83%
Balance of Payments Current Account/GDP	-2.38%	-6.74%	-16.28%	-10%	-11.54%	-9.03	0.06%	-6.93%	-6.53%	-5.12%
Capital Account/GDP	5.20%	6.42%	9.39%	8.42%	12.26%	8.64%	4.6%	5.97%	5.31%	4.8%
External Debt/GDP	47.8%	55.5%	60.3%	58.8%	50.9%	59.9%	64.3%	65%		
Fiscal Deficit/GNP	-15.37%	-14.55%	-21.97%	-15.68%	-17.43%	-13.7%	-9.13	-11.61%	-12.2%	-10.6%
Inflation GDP Deflator	9.6%	15.4%	20%	20.8%	11.1%	16.7%	21.5%	5.5%	12.5%	7%
CPI	12.2%	10.8%	26.1%	17.9%	10.9%	14%	16.6%	1.4%	8%	7.7%
Exchange Rate 1 US$:	15.61	15.57	16.57	19.25	20.81	23.52	25.43	27.16	28.01	29.5

Source: CBSL

average lending rate of commercial banks (WLR) was positive, except in 1980 (Table 5). The lending rate structure was distorted to a certain extent by government influenced lending by the state banks and development finance institutions (DFI). The abolition of ceilings on interest rates slightly narrowed the differential in interest rates charged by different financial institutions (Table 3&5).

Table 5: Deposit and Lending Rates at Different Institutions

Year	T-bill rate	WLR	CCPI	Real WLR	NSBL	SMBL
1977	9	11.3	1.2	10.1	9-12	5-12
1978	9	12.8	12.2	0.6	9-13	5-12
1979	9	13.9	10.7	3.2	9-13	5-18
1980	13	17.2	21.6	-4.4	9-17	5-20
1981	13	18.4	18	0.4	12-17	12-24
1982	13.5	20.2	10.8	9.4	12-17	12-24
1983	12	20.6	14	6.6	12-17	12-24
1984	14	20.5	16.6	3.9	12-17	12-24
1985	11.52	20.1	1.4	18.7	12-22	10-24
1986	11.2	19	8	11	12-21	8-20

Source: CBSL

WLR = Commercial bank weighted average lending rate

NSBL = NSB lending rate

SMIBL = SMIB lending rate

4.2 Competition and profitability of the financial institutions

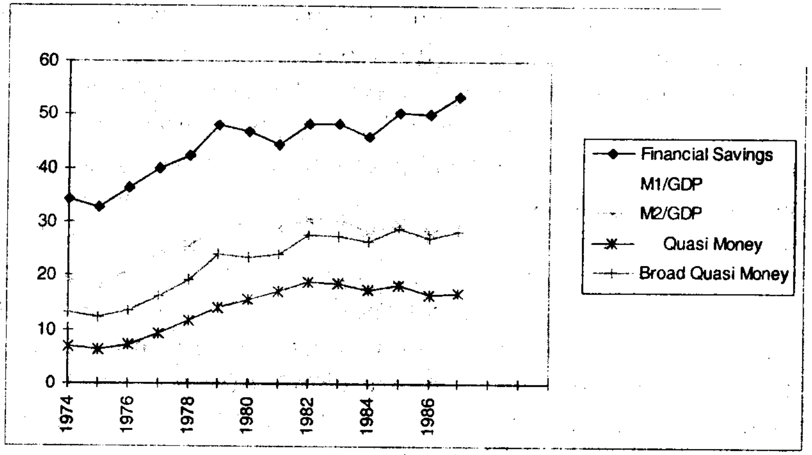
After financial liberalisation there was freer entry of new foreign banks, domestic and foreign currency banking units, and a number of NBFI. However, financial markets remained highly concentrated and the state dominated with almost 80% of total financial assets in state hands. There were still restrictions on branch opening by private banks, especially foreign banks. The stifling influence of the inefficient state-owned commercial banks was exacerbated by operations of the NSB, whose fiscally privileged position (lower tax on interest income) tended to distort financial markets. It could attract deposits at very high interest rates with a government guarantee of repayment (only institution to have free explicit deposit insurance) despite the fact that its operating cost often exceeded the yield on its assets, since the negative differential was covered by a government subsidy. This meant that commercial banks and finance companies were not in a position to effectively compete with the NSB. Furthermore, there was no competition among government owned long-term financial institutions, as they were used as captive sources of government borrowing.

4.3 Growth of the financial sector

The deepening of the financial sector through reforms is expected not only to raise the availability of funds for investment but also to reduce the wedge between cost of funds and borrowing rates, thereby facilitating more investment while transferring funds for more productive purposes. Selected indicators of financial deepening that measure the behaviour of financial savings are presented in Table 6 and Figure 1.

Total financial savings rose sharply from 36.2% of GDP in 1976 to 53.3% by 1987. As expected, the ratio of cash and demand deposits (narrow money) to GDP has declined, time plus savings deposits held by the private sector with commercial banks and the NSB (quasi-money), and quasi-money plus private deposits with finance companies (broad quasi money) has increased significantly as a proportion of GDP. Therefore, we see that there has been a significant

Figure 1: Indicators of Financial Deepening



Source: Derived from CBSL data

Table 6: Selected indicators of Financial Deepening

Year	Financial Savings	M1/GDP	M2/GDP	Quasi Money	Broad Quasi Money
1974	34.1	12.39	19.22	6.82	13.2
1975	32.6	11.62	17.9	6.28	12.2
1976	36.2	13.79	20.93	7.13	13.5
1977	39.9	14.74	23.93	9.2	16.3
1978	42.4	13.91	25.53	11.62	19.1
1979	48.1	14.64	28.74	14.1	24
1980	46.7	14.17	29.85	15.68	23.5
1981	44.3	11.79	28.76	16.97	24
1982	48.3	11.85	30.74	18.89	27.6
1983	48.3	12.13	30.64	18.51	27.4
1984	46	10.94	28.25	17.3	26.5
1985	50.4	11.55	29.81	18.26	28.8
1986	50.1	11.79	28.32	16.53	27.1
1987	53.3	12.75	29.65	16.9	28.1

Source : CBSL
All figures given as a percentage of GDP
Financial savings = currency, demand deposits, time and savings deposits with CB and NSB, finance company deposits, deposits with RRDB, member balances with EPF and life insurance policies.

growth[6] in financial savings during 1977-87. However, aggregate domestic savings (ADS) and aggregate domestic private savings (ADPS) failed to grow significantly indicating that financial deepening was a reflection of the transfer of physical savings and informal sector savings towards institutional financial savings (Table 7 & 8).

Table 7: Aggregate Domestic and Private Domestic Savings

% of GDP	1976	1977	1978	1979	1980	1981	1982	1983
ADS	13.8	18.1	15.3	13.8	11.2	11.7	11.86	13.79
ADPS	14.3	17.8	16.6	13.4	14.8	13.5	13.3	13.7

Source: CBSL

Table 8: Indicators of Financial Savings

	1976	1977	1978	1979	1980	1981
Individual owner - ship of time deposits (% of private deposits)	34.4	38.8	42.6	38.1	42.4	46.8
Financial Investment as % of Physical Investment						
- Urban			29.94			250.43
- Rural			9.24			116
- All Island			15.93			141.69

Source: CBSL

4.4 Structural changes in interest rates and credit allocation

The interest rate spread between the deposit and lending rate expressed as a wedge actually widened since 1981 (Table 9). The limited competition among financial institutions (especially in outstations), state-ownership and associated inefficiency, high reserve requirements, explicit taxes on financial intermediation and the high incidence of non-performing loans explain the large spread in Sri Lanka[7].

Table 9: Wedge between Deposit and Lending Rates of Commercial Banks (in percent)

Year	Interest Paid on deposits as % of total deposits	Weighted Average Lending rate	Wedge
1977	2.58	11.3	8.72
1978	4.47	12.8	8.33
1979	5.39	13.9	8.51
1980	7.15	17.2	10.05
1981	10.63	18.4	7.77
1982	11.73	20.2	8.47
1983	10.98	20.6	9.62
1984	10.51	20.5	9.99
1985	9.69	20.1	10.41
1986	8.17	19	10.83
1987	7.05	18.2	11.15

Source: Derived from CBSL and Commercial bank data

Similar to that observed by Diaz-Alejandro (1985) in Latin America, interest rate reforms in Sri Lanka made short-term deposit rates exceed long-term savings instruments such as government bonds and SMIB debentures. This in turn caused a substantial shortening of the maturity period associated with medium and long-term savings instruments. Consequently, there remained a very high concentration of short-term loans in commercial bank loan portfolios and a high reliance on short-term funds for the limited long-term lending. Furthermore, lending was geared towards low-risk commercial and housing purposes failing to yield a structural change in bank credit towards medium and long-term productive investment (Table 10). Even long-term credit

institutions' contribution to term credit has been limited with a significant proportion for unproductive purposes (Table 11). However, it should be noted that term credit has been constrained from the demand side, since bankable projects have not been forthcoming due to political uncertainty. The development of an active equity market was also stifled by high interest rates (especially the NSB), a lack of attractive stock offerings, political uncertainties, and most importantly the absence of a well-designed legal framework further limiting term finance.

Table 10: Commercial Bank Credit to the Private Sector by Purpose and Maturity (as a % of total Purpose wise Credit)

Year	Commercial	Commercial ST	Housing	Total ST
1977	47.7	88.8	3.6	77.5
1978	45.5	80.9	3.3	74
1979	48.9	82.6	3.7	75
1980	51.2	79.2	4.5	70.2
1981	48.5	81.2	5.6	68.9
1982	48	80.8	6.1	68.9
1983	48.6	82.7	6.3	71
1984	49.7	83.5	7.2	72.2
1985	49.6	81.8	7.5	70.7
1986	49.8	81.9	8.4	69.6

Source : CBSL

ST= Short term (six months) Commercial = Credit for commercial purposes as a percentage of total commercial bank credit Commercial ST= Short term credit as a percentage of credit for commercial purposes Housing = Credit for housing purposes as a percentage of total commercial bank credit.

Total ST= Short term credit as a percentage of total commercial bank credit.

Table 11: Housing loans as % of loans by long-term credit institutions and total credit by these institutions as % of GDP

	1979	1980	1981	1982	1983	1984	1985	1986
Housing % of total	58.4	13	12.9	20.3	25.4	34.6	31.6	35.2
Total as % of GDP	1.7	1.6	1.7	1.9	1.5	1.6	2.8	3.4

Source : CBSL

Includes DFI, SMIB, Housing finance corporations and the Insurance Corporation of Sri Lanka.

5. Effect of macroeconomic policies on the outcome of financial reform

5.1 Fiscal aspects

An increase in financial savings brought about by the reform process may not necessarily lead to an enhanced availability of credit for private sector investment and a reduction in lending rates, if more savings are pre-empted by the public sector. In view of rising government expenditure (especially capital expenditure) and persistent budget deficits since 1977, the government largely took recourse to domestic borrowing thus crowding out private sector borrowing (Table 12). Domestic financing by the government as a percentage of domestic savings rose from 42% during 1970-77 to 55.9% during 1978-87.

Table 12: Financing the Budget deficit (Rs. Mn.)

Year	BD deficit	Foreign	Domestic	Domestic as % of Domestic Savings
1977	3074	1779	1295	19.6
1978	7165	1454	2711	41.6
1979	8791	4237	4554	63.1
1980	15967	6735	9232	124
1981	14866	8208	6658	66.9
1982	20091	8794	11297	96
1983	21329	10950	10379	61.2
1984	15861	11251	4610	15.1
1985	25676	12205	13471	70
1986	28071	15874	12237	56.6
1987	27342	15083	12259	48.6
1970-1977				42.2
1978-1987				55.9

Source: CBSL

The Central Bank financed 75% of treasury bills and provided a significant part of government revenue, as provisional advances at zero interest cost in addition to the transfer of profits since 1983. Almost a fifth of commercial bank credit was diverted to the government (Table 13). Moreover, about 85% of total lending or investments of NBFI's (Table 13), especially through the NSB and EPF, were captured by the government at significantly lower rates (5-16%) against the high borrowing rates faced by the private sector (15-35%). This is of particular relevance, because, as in the case of savings mobilisation, NBFI's played a major role in distributing credit, which actually exceeded total lending by all commercial banks in many years.

Table 13: Distribution of Credit to the Government (Rs. Mn.)

Year	Commercial bank to Government	NBFI's to Government
1977	1711 (29.4)	4945 (94)
1978	2184 (25.3)	6111 (93)
1979	3153 (26.6)	7908 (93)
1980	3475 (21.5)	10437 (91)
1981	4643 (21.8)	11952 (87)
1982	4852 (19.1)	15448 (85)
1983	4283 (13.5)	19091 (85)
1984	4794 (13.3)	23081 (82)
1985	4145 (10.6)	27527 (80)
1986	4150 (10)	32461 (78)
1987	9810 (19.3)	39384 (78)

Source : CBSL and relevant institutions

The figures in the brackets give credit to the government as a percentage share of total lending by these institutions.

NBFI's include EPF, NSB, DFI's, SMIB, ETF, and FC's.

So the increased financial savings was mobilised mostly through state-owned financial institutions (captive sources), which were mainly directed to invest in non-market determined government paper (in the case of NBFI's) or lend to government corporations (in case of SOCB's). This not only reduced the availability of private sector finance and put upward pressure on real interest rates, but also distorted the interest rate mechanism and stifled the development of a capital market. As we shall soon see, the heavy reliance on the Central Bank to finance the budget deficit also meant excessive monetary expansion and thus inflation. This together with the maintenance of high deposit rates in order to mobilise financial savings to bridge budget deficits also

prevented the decline in lending rates. So, in reality, the marked increase of deposit rates mainly facilitated the borrowing needs of the government at the expense of the private sector. All this emphasise the need to scale down state intervention and ownership in the financial system while maintaining fiscal discipline in order to reap the benefits of financial reform.

5.2 Monetary policy

Both narrow money (M1) and broad money (M2) recorded double digit growth rates during 1977-87. The excess growth of money represented as the growth of M1 minus the rate of economic growth was 12.8%, while the inflation rate (CCPI) was 11.6%. This reflected a close relationship between excessive monetary expansion and prices (also confirmed in econometric studies-Saini 1982), and at the same time indicated the negative impact of monetary expansion on savings in the period.

In light of the excessive growth in money and prices, the Central bank was compelled to carry out a restrictive monetary policy. However, even though, credit to the government and private sector had been equally responsible for excessive money growth (Table 14), almost all monetary policy instruments were directed towards containing credit growth to the private sector while the government's financial needs were accommodated.

Table 14: Change in Money Supply and Causal Factors

	M2	Credit to Government		Credit to Private Sector	
1978	2175	-1126	-51.80%	1890	86.90%
1979	4166	1057	25.40%	2003	48.10%
1980	4802	6052	126%	4544	94.60%
1981	4587	3817	83.20%	4055	88.40%
1982	6063	4361	71.90%	3986	65.70%
1983	6747	383	5.70%	6170	91.50%
1984	5990	-2979	-49.70%	4104	68.50%
1985	4982	5794	116.30%	3480	69.90%
1986	2451	2198	89.70%	2260	92.20%
1987	7454	4502	60.20%	4628	61.90%

Source : Derived from CBSL data

The percentage responsibility of each of these two major causal factors is calculated by expressing the value of each factor as a percentage of total change in M2 in that year.

Borrowing under the Bank rate was restricted and ultimately withdrawn in 1984 making commercial banks maintain more liquidity for precautionary purposes and thus reducing credit to the private sector. This also induced commercial banks to hold more T-bills raising the availability of credit to the government. Moreover, the availability of credit to the private sector from commercial banks was substantially contained through the imposition of selective credit ceilings. The growth of private sector credit was reduced from 26% in 1981 to 7% in 1986. It is important to note that credit restraints were not imposed on the government, thus defeating the effectiveness of monetary policy in maintaining price stability.

The use of reserve requirements as a tool of monetary policy was extensive in the post-77 period. The reserve ratio was raised to 14% of demand deposits and 6% of time and

savings deposits in 1981. Very high reserve ratios were maintained until 1987 when reserve ratios on all types of deposits were unified at 10%(however, this ratio was raised to 15% in 1988). The extensive use of reserve requirements, which weren't paid any interest, widened the wedge between deposit and lending rates by increasing operating costs, thus discouraging financial intermediation and private sector investment.

The Central Bank continued to intervene in the allocation of credit during 1977-87[8]. An annual exercise known as national credit planning attempted to plan credit to the private sector in advance since 1981, thus influencing the direction and allocation of credit, especially of commercial banks. Many refinance schemes were enhanced or introduced since 1977 (medium and long-term credit fund, comprehensive rural credit scheme, the pre-shipment export credit refinance facility and the supplementary refinance facility). Refinanced credit, which stood at Rs.389m in 1976 rose sharply to Rs.3,496m in 1987 with a significant portion on export refinance. Apart from its availability, refinance credit affected the market allocation of credit through subsidised interest rates. Subsidised interest rates reduced the need for intermediaries to mobilise their own resources, leading to a lower level of financial intermediation. Credit guarantee schemes were another non-market credit allocation device employed by the CBSL (e.g. Small and Medium Enterprise, SME, schemes).

Overall, the inability to maintain monetary stability due to excessive budget deficits imposed a dual and conflicting function on the monetary authority. The CBSL had to extensively use reserve requirements as a tool of monetary management while knowing that such a tax on financial intermediation would widen the wedge between the deposit and lending rate. Similarly, credit ceilings were necessitated to maintain price stability while subsidised refinance credit aimed to reduce the adverse impacts of tight monetary policy. Continued intervention in credit allocation distorted the interest rate mechanism. The ability to borrow at cheap rates through refinance schemes encouraged less productive investment while borrowers wilfully defaulted knowing no action would be taken resulting in large non-performing loans. Selective credit ceilings constrained private sector investments.

The role of exchange rate policy on financial reforms is not considered here because the capital account of the balance of payment was not liberalised in the period under consideration.

5.3 Effectiveness of monetary policy

Not only does monetary policy influence the outcome of financial reforms, financial liberalisation itself affects the effectiveness of monetary policy. The Central Bank continued to target credit aggregates while also introducing and using M2 as a new target for monetary policy. Financial liberalisation facilitates a greater reliance on market-based instruments of monetary policy and away from direct controls. One advantage of using indirect instruments is that economic decisions are left to markets, resulting in a more efficient allocation of resources. In addition, reserve requirements and other taxes on financial intermediation can be scaled down. The shift towards indirect monetary control entailed a greater reliance on open market operations in Sri Lanka. However, open market operations were initially handicapped by huge holdings of treasury bills by the Central Bank, thinness of private money markets, a limited secondary market for treasury bills and the administrative control of interest rates. The introduction of weekly T-bill auctions (1986) and reduced intervention in determining rates in the T-bill market (1988) facilitated the more effective use of open market operations since 1988.

5.4 Financial distress

The solvency of commercial banks in Sri Lanka was adversely affected by the incidence of non-performing loans and inadequacy of capital, although none of the banks experienced a suspension of transactions. The amount of non-performing loans is significant and increasing after 1983. Capital adequacy ratios show a declining trend since 1981 and fall short of the Basle 8% risk adjusted assets international standard (Table 15).

In the absence of published data on non-performing loans, the percentage of actual interest income received on lending is compared with the weighted average lending rates charged in order to obtain a partial indicator of such loans. As illustrated in Table 15 the difference expressed, as a percentage of their lending to the private sector is significant and increasing since 1983. The difference in 1987 expressed as a per cent of the WLR indicates a non-performing assets ratio of 39.5%[9]. As expected the increase in non-performing loans coincided with the rise in the interest rate spread. An attempt has also been made to assess the capital adequacy of commercial banks as observed in Table 15. The figures should be interpreted with caution due to the non-inclusion of off-balance sheet items in total assets or liabilities and the disregard for asset risks due to lack of data.

The causes of financial distress among banks in Sri Lanka seem quite clear. Apart from macroeconomic causes such as inflation, price distortions and the slowdown in the services sector to which banks had a high exposure; the distress was mainly due to inadequate prudential regulation and supervision. As mentioned earlier, inadequate regulation permitted risky lending while ineffective supervision permitted banks to ignore their losses. Attention has been also drawn to the paucity of debt recovery legislation and sharing of credit information among banks. Government influenced lending to favoured borrowers, high concentration

Table 15: Non-Performing Loans Indicator and Capital Adequacy (values in Rs. Mn.)

Year	1 Ratio of interest income to lending	2 WLR	Non performing loan indicator 2-1	3 Capital a)	4 Total Assets	3 as % of 4
1977	7.35	11.3	3.95	374	10252	3.648069
1978	9.13	12.8	3.67	520	13837	3.75804
1979	10.47	13.9	3.43	906	18653	4.857128
1980	13.18	17.2	4.02	1272	26601	4.781775
1981	16.19	18.4	2.21	2268	32755	6.924134
1982	17.83	20.2	2.37	2603	40194	6.476091
1983	16.49	20.6	4.11	2705	50382	5.368981
1984	15.59	20.5	4.91	2932	56553	5.184517
1985	13.91	20.1	6.19	3164	62383	5.071895
1986	12.61	19	6.39	3410	66320	5.141737
1987	11.01	18.2	7.19	3954	76824	5.146829

Source : Derived from CBSL data
a) paid up capital, reserve funds and undistributed profits.

of risks, poor quality of information flows, defaults of subsidiary companies of state banks and government corporations were also contributory factors to a high incidence of non-performing loans in banks, especially in SOCBs.

Finance companies recorded tremendous growth in terms of numbers, deposits and liabilities since 1977. However, 13 finance companies, which accounted for 1/5 of deposits of the 53 finance companies in operation in 1987, faced financial difficulties and their activities were suspended by the Central Bank during 1987-88. The reasons for failure were inadequate regulation and thus unchecked growth by offering unrealistic interest rates, and also the slowdown in the mid-80s. The regulatory framework did not specify prudent ratios and the legal cover was inadequate to deal with the collapses.

The economic consequences of financial distress have also been clear. The volume of credit that can be extended to new clients have been limited while credit allocation has become perverse with banks extending more loans to their least solvent clients further deteriorating their own solvency. The increase in demand for credit has put upward pressure on real interest rates. High real interest rates and the extensive use of credit to fund interest payments have stifled productive investment. The financial systems diminished capacity to improve the allocation of resources has prevented any gains in the productivity of investment.

5.5 Assessment

From a theoretical perspective, macroeconomic stability and a prudential regulatory framework are preconditions for successful financial liberalisation[10]. In the case of Sri Lanka, considerable macroeconomic instability did not cause extremely high real interest rates, widespread insolvency, and a re-imposition of direct controls like the Southern cone countries (see Diaz-Alejandro 1985). This was because liberalisation was gradual; the government retained certain controls on interest rates and restricted capital flows while encouraging greater competition and adjusting interest rates to reflect market conditions. However, the inadequate regulatory framework left the financial system in distress. Moreover, the gradual and limited liberalisation (e.g. state ownership and continued intervention - implicit economic regulation) may have avoided highly destabilising effects but the persistent distortions constrained the rapid expansion of the financial system (Figure 1)[11] and aggregate domestic savings (Table 7). Private fixed investment also did not respond strongly from its nascent base as expected, except for a jump in 1979 (Table 16), and the deterioration of the Incremental Capital Output Ratio (ICOR) figures suggest that greater financial depth and the subdued boost to private investment did not increase the average productivity of investment due to persistent interest rate distortions, constraints placed on financial intermediaries and their inefficiency, partial elimination of directed credit programs, lower productivity of public investment, and/or excessive budget deficits crowding out private investment[12, 13].

Table 16: Gross Domestic Private Fixed Capital Formation (% of GDP) and Productivity of Investment

	1974	1975	1976	1977	1978	1979	1980	1981	1982
ICOR	---	---	---	3.78	2.87	4.03	5.82	4.79	6.02
Gross Fixed Private Investment	7.7	8.2	7.9	7.2	7.9	13.0	12.9	12.7	14.6

Sources: CBSL and Cho & Khatkhate (1989)

6. Post-87 Financial Sector Reforms

6.1 Monetary and debt management

Interest rates in the primary T-bill market were to be determined by market conditions as against the previous practice of administratively determining rates as of 1988. As mentioned earlier, this was to facilitate more effective use of open market operations and reduce distortions in the interest rate structure. The result was a significant rise in the T-bill rate due to increased demand for funds by the government in the latter part of 1988. In response, discount and rediscount rates in the secondary T-bill market rose together with the inter-bank call money market rate and other rates in commercial banks. Interest rates continued to be fairly responsive to market forces and rose due to inflationary pressures until mid-1991. The CBSL holding of T-bills declined and open market operations were enhanced with greater transactions of treasury bills. However, T-bill rates, which have a pervasive influence on the interest rate structure because of the large amounts outstanding, are still managed by the CBSL. It determined the cut-off rates in the auctions, managed the pricing decisions for the EPF (the largest purchaser), and published the weighted average results reflecting all of the above as the T-bill rate.

Monetary policy and government debt management has been further strengthened in the 1990's. Credit ceilings on commercial bank lending to selected non-priority sectors were removed in 1992. In general, selective credit controls have been scaled down after their tightening in 1989. CBSL's subsidised refinance schemes have been scaled down and virtually stopped by 1997. This is because refinance facilities discourage equity financing and undermine monetary control since refinance is automatic against eligible bank loans. In 1995, commercial banks were permitted to obtain foreign loans up to 5% of their capital and reserves, which are limited to 15 percent at present. The functioning of the treasury bill market was improved by introducing a system of primary dealers who have specific responsibilities and privileges (1992&1994), although infrastructure for the market including modern systems for clearance, settlement and secondary market trading are not yet developed. Repurchase agreements (1993) and reverse repurchase agreements (1995) were introduced for T-bill transactions in order to provide short-term liquidity. Overall, the tools for monetary and debt management have been improved.

However, domestic financing of the budget deficit continues to be highly distortionary and crowd out the private sector, especially at the long-term end of the market. The principal financial market instrument remains to be the T-bill, which is auctioned weekly to securities dealers including captive sources such as the NSB and EPF/ETF. Liquid asset requirements for financial institutions provide a captive market for treasury bills. In addition, nearly two-thirds (although the proportion changes significantly at times) of government debt securities is sold directly to captive investors, mainly the NSB, retirement funds, and state-owned banks. These are predominantly under-priced, fixed rate, non-marketable, intermediate instruments called 'rupee loans'. This practice keeps borrowing cost low but distorts the interest rate mechanism and crowds out private investment, especially long term financing. Therefore, the domestic debt market being dominated by government securities stifles the establishment of market determined interest rates and the pervasive distortions created by inefficient state-owned financial institutions. Moreover, state-owned financial institutions create anomalies by setting interest rates based on non-commercial criteria while their investment policies are influenced by the government.

The inter-bank money market has been very active in the 1990s with a relatively high volume of overnight credit

and foreign exchange transactions, although SOCBs have accounted for more than half of the value of the transactions. The BOP crisis caused a severe liquidity crunch in the later part of 2000 and during 2001, and was associated with a significant jump in interest rates, which has gradually eased since then. The temporary restrictions on banks' net open positions in foreign exchange during the lifting of the exchange rate band system also substantially reduced foreign exchange rate transactions, which have been slow to recover.

6.2 Regulation and supervision of financial institutions

The Banking Act No.30 of 1988 introduced prudent regulations with respect to a minimum capital ratio of 4% of bank liabilities, a minimum liquid asset requirement of 20% of liabilities, and a limit on lending to a single borrower of 30% of capital. It also required more extensive bank disclosure and reporting. The Basle Accord capital guideline of 8% of risk-adjusted assets as the minimum level of capital requirement was adopted in 1993 to replace the inferior ratio adopted in 1988. From a risk management point of view, capital requirements are not effective unless loan classification and provisioning standards are satisfactorily enforced. So, in the same period, additional regulatory requirements were introduced including suspension of interest on non-performing loans and more stringent provisioning requirements. However, a substantial volume of overdrafts complicated the treatment of delinquent loans and continued accrual of interest income on non-performing government guaranteed loans (especially relevant to state banks), which has been rectified since then. But, both classification and provisioning rules still fall short of international standards. The Banking Act of 1995 further strengthened the supervisory and regulatory framework, especially with regard to FCBU's, enacted minimal capital standards for specialised banks (NSB, RRDB, SMIB, NDB, DFCC) and extended CBSL supervision to these institutions. However, bank supervision remains weak, mainly due to inadequate operating procedures and lack of human resources. Off-site monitoring is particularly weak. Moreover, prudential standards are not applied to commercial bank FCBU's and gaps remain in the regulatory framework for insurance companies, and provident and pension funds.

CBSL was given wider powers in terms of Control of Finance Companies Act No. 78 of 1988 to regulate finance companies and set up a new department for supervision of non-bank financial institutions. In response to the serious difficulties faced by FC's, the Act and amended version of 1991 substantially increased regulatory and capital requirements to prudent levels (similar to those faced by banks). Only 20 FC's met these requirements. Despite these difficulties, finance companies have managed to keep pace with the growth in the banking sector, although competition has become severe.

6.3 Debt recovery

In the 1980's banks and NBFI's experienced serious difficulties in debt collection. Therefore, the government established special courts to deal with debt recovery and enacted many Acts to improve debt recovery (1990). The loan recovery by banks has been enhanced through parate execution powers which allows banks to take over mortgaged assets in the event of borrower default without going to courts. However, debt recovery legislation has not always included FC's and commercial court operations remain limited and time consuming. The establishment of a credit information bureau (1990) for banks and access to NBFI's in 1995 improved credit appraisal while a credit rating agency was also established. These were expected to help market participants make better-informed decisions, thereby improving financial stability.

6.4 Commercial banks

The government recapitalized the two SOCB's in 1993 and 1996 respectively (costing a cumulative 5% of GDP), which enabled the banks to temporarily meet capital adequacy standards. Bank of Ceylon's performance improved (qualification soon) since recapitalization but Peoples Bank's performance deteriorated (Table 17&18). It should be noted, however, that interest income on large non-performing loans has been accrued in the figures because the government guaranteed interest payment. At present, the two SOCBs account for about 55 percent of commercial banking assets and 30 percent of total financial assets, while both have high costs and insufficient capital, while the People's Bank has a large negative net worth. The main problems of the SOCB's relate, to excess staff, skill shortages, obsolete technologies, lack of independence from government, large NPL's, and lending to debt-ridden SOEs, including foreign currency loans. The situation is not much better in non-SOCBs, with only a few foreign and domestic private banks having NPL ratios below 12 percent. Moreover, the reported level of NPLs may be underestimated because classification falls short of international norms while the level of provisioning for NPLs is insufficient due to over-optimistic allowances for collateral.

Table 17: Comparative Financial Performance of Banks

	1989	1993	1995
Return to assets			
BC	0.30%	2.10%	2.40%
PB	0.60%	0.80%	1.10%
Private Banks	2.10%	1.50%	1.50%

Source : World Bank (1998)

Table 18: Efficiency of Banks

	State Banks			Private Banks		
	1993	1994	1995	1993	1994	1995
Interest spread	8.0	7.7	9.1	9.6	12.0	10.0
Employee expense/ ToT income	41%	40.20%	35.80%	26.50%	26.10%	27.30%

Source : World Bank (1998)

The banking systems capitalization is relatively low given the high level of NPLs and likely under provisioning (Table 19). The state banks and a number of private banks are unlikely to meet the higher 10 percent risk-adjusted capital requirement to be introduced in January 2003 if remedial measures are not taken. In addition, if provisioning were to increase to more reasonable levels, the average level of capital to risk weighted assets in the banking system would deteriorate significantly. For example, the recently conducted FSAP (Financial Sector Assessment Program) for Sri Lanka indicated that an increase in the provisioning ratio to that of prudent foreign banks might lead to average capital adequacy declining by nearly 4 percent. The efficiency and profitability of the banking system as a whole has not significantly improved in the last few years while there is an excess liquidity problem due to subdued demand for private credit and the large stock of government debt (Table 19). The health and efficiency of the SOCB's haven't significantly improved with recapitalization, setting targets and close monitoring by the government. Therefore, privatisation seems the only solution. However, owing to the political difficulty of such a move at the present time, restructure and pre-privatisation preparation is the best course of action. In the case of the insolvent People's Bank, the government intention to separate it into a commercial bank, a savings bank, and a debt recovery unit; and privatise the commercial bank is a step in the right direction.

Table 19: Banking System Efficiency and Soundness Indicators in % (1997-2001)

	1997	1998	1999	2000	2001
Capital adequacy					
Regulator capital to risk weighted assets	11	10.7	10.6	8.3	7.8
Net worth to total assets	6.5	5.9	4.3	3.7	3.8
Asset composition and quality					
NPLs to gross loans 1	16.4	16.6	16.6	15	16.9
NPLs net of provisions to capital 1)	65.6	73	90.9	96.1	135.8
Efficiency and profitability					
ROA (before tax)1.6	1.3	-0.2	0.8	0.8	
ROE (after tax)	17.3	13.9	-10.1	13.1	15.5
Net interest income to total assets	3.9	3.9	3.2	3.3	3.2
Personnel cost to total income	13	14.7	16.1	15.5	13.8
Interest spread 2)	5.2	5.7	6.8	11.56	..
Liquidity					
Liquid assets to total assets	12.5	13.1	11.3	11.4	9

Source : CBSL and IMF (2002)
ROA – Return on Assets, ROE – Return on Equity
NPL – Non-Performing Loans
1) Applies only for domestic banking units
2) Difference between the commercial banks' weighted average deposit and prime lending rate

6.5 Non-Bank Financial Institutions

The NDB expanded its capital base in 1993 with a public share issue while the government sold most of its remaining shareholding to foreign investors in 1997. The government's share ownership in DFCC was also sold to the public. Some attempts are being made to restructure the NSB- lifting of favourable tax treatment of NSB deposits (1991) and authority to lend up to 40% of assets in non-government instruments- but the outcome of its restructure remains to be seen. Other state-owned financial institutions have not been restructured in any noteworthy manner[14]. Finance companies typically collect short-term deposits and engage in leasing contracts exposing them to significant interest rate and liquidity risks due to asset-liability mismatches. Housing finance institutions also face substantial asset-liability mismatches and should engage in mortgage securitization while the regulatory framework should ensure an even playing field for housing finance. There are a large number of financial institutions catering the SME and household sector including rural banks and micro finance institutions, which should be encouraged but given a proper legal framework while ensuring that they do not become tools of government sponsored/directed, credit programs.

6.6 Capital markets

Many obstacles to capital markets development have been addressed in the 1990's. Efforts have focused on the development of the local stock market infrastructure resulting in the establishment of a modern stock exchange in Colombo. Several tax reforms were instituted while the Securities Act was amended to form the Securities and Exchange Council (SEC) with effective and wider powers, including regulation of unit trusts (1991). Measures were also taken to promote foreign participation in the capital markets through a reduction in exchange controls and liberalisation of restrictions on foreign investment in equities (1990 onwards). Permission was granted to foreign funds, non-resident individuals and corporate bodies outside Sri Lanka to invest in shares up to 100% of issued share capital, subject to exclusions, limitations and conditions set out by controller of exchange (1992). A scheme of Share Investment External Rupee Accounts (SIERA) was introduced through authorised dealers to facilitate and monitor such investments (1991). The

securities and investment fund management industries substantially progressed through joint ventures with foreign investors. Moreover, foreign portfolio investors have become a major source of trading activity in the CSE, accounting for about half of the trading activity in the 1990s. In the last few years, however, there has been a sharp reduction in the volume of new issues and trading owing to an unstable political and economic climate. Overall, CSE capitalization as a percentage of GDP is only 8.5% (2000) illustrating its small contribution as an instrument of private savings mobilisation. In general, high interest rates, insufficient linkages between the privatisation programme and capital markets development, inadequate institutional investor participation owing to investment restrictions to capture funds for government debt financing, and country risks have stifled equity market development.

Some progress has been made in the development of bond markets. The primary market for corporate debt received some impetus as of late although secondary market trading on the CSE is insignificant. This has been due to underdeveloped infrastructure and regulation for debt trading, lack of government long-term debt instruments and the fact that foreign investors are not permitted to invest in debt securities. In the case of government debt instruments, the primary market is large but the secondary market is not well developed largely due to the captive nature of major investors, which has led to immobilisation of government debt securities in state-owned institutions. Recently, the government started issuing long-term treasury bonds (1997) to deepen the government securities market and provide a benchmark for pricing private bond issues, which should be extended. However, it is unlikely that a private bond market would develop further without complementary policies and macroeconomic stability.

6.7 Exchange controls and foreign investment

Exchange controls in Sri Lanka were relaxed to a considerable extent in the 1990's. In 1991, exporters were permitted to borrow from FCBU's for financing imports of inputs to execute export orders while money changers were authorised to purchase and exchange foreign currency. Sri Lankan residents and non-residents were also allowed to open resident foreign currency accounts (RFC's). Export proceed could be retained in foreign currency either in Sri Lanka or abroad (1993), and Sri Lanka abolished all remaining restrictions on current account transactions and accepted Article VIII of IMF charter (1994).

In 1992, the status of the GCEC was elevated to level of a Board of Investment (BOI) to facilitate foreign investment in the entire country. The role and scope of the BOI has expanded over the years to become a one-stop shop for foreign and export-oriented investment. However, the mirage of incentives offered by the BOI is distortionary and should be eliminated while strengthening the domestic tax structure.

7. Assessment and future policy direction

The piecemeal financial sector reforms traced out from 1987 reflected fairly favourably on the financial sector, the financial sectors' contribution to GDP increased from 4.6% to 7.6% from 1990 to 2000. National savings increased from 14.6% in 1989 to 21.5% of GDP in 2000 with broad money reaching 32% of GDP from 28% in the same period. Thus, the financial sector deepened somewhat, but the financial system still remains shallow dominated by the state-owned financial institutions and large pockets of inefficiency reflected by high intermediation costs and thus large interest spreads (Table 19). The high interest rate spreads have reduced the size of the financial system and affected monetary

policy instruments; particularly interest rate policy becomes less effective when interest rates exhibit downward rigidity due to such structural weaknesses. The level of non-performing loans in the commercial banking systems is still high (about 10-20% of gross loans) and is probably underestimated warranting further provisioning and capital infusions to the banking sector to meet prudential standards. The SOCBs, which account for 55 percent of commercial banking assets and 30 percent of total financial assets, have large NPLs and high credit risk concentrations to specific sectors and SOEs in foreign and domestic currency. In this regard, the SOCBs should implement comprehensive debt recovery plans, recognise the 'true' value of its collateral, particularly real estate, and resolve its outstanding debt to SOEs, especially the Ceylon Petroleum Corporation and Ceylon Electricity Board as they undergo restructuring. The setting-up of an Asset Management Corporation to facilitate the disposition of NPLs is also a step in the right direction. Overall, restructure and some consolidation in the financial sector including bank closures, mergers and/or privatisation of SOCBs is imperative.

Dominance of the state sector has also stifled effective competition and distorted the interest rate structure while large budget deficits continue to crowd out the private sector and stifle the development of private debt markets by pre-empting financial savings, especially at the long end of the market. Fiscal adjustment should be at the forefront of financial sector reforms and structural adjustment. The dominance of state-owned financial institutions, including the NSB, SMIB, Sri Lanka Insurance Corporation, and EPF/ETF should be reduced while further liberalising the government debt market. Financial intermediaries ought to be strengthened by reforming governance, promoting market competition and maintaining an effective regulatory framework. The insurance and provident fund sectors should be restructured and eventually privatised to reap the benefits of the large pool of resources and modern management and technologies available. In the area of financial regulation and supervision, there is a need to consolidate prudential standards to domestic and foreign currency banking units and strictly enforce capital adequacy and other prudential standards while strengthening supervision using modern risk assessment models, frequent and detailed off-site assessments, and well-trained staff. Moreover, the CBSL should devise a credible and efficient framework for dealing with weak banks, and rationalize the regulatory framework to facilitate consolidation in the financial sector. Liquidity problems in the foreign exchange market and inter-bank rupee market should be addressed and a transparent effective framework for CBSL intervention should be instilled. More generally, financial saving must be encouraged through a wide range of instruments and institutions that can meet savers' varying risk-reward objectives. Credit discipline among borrowers and lenders must be encouraged through incentives and effective legal and judicial practices. Finally, plans for the introduction of modern payments systems and scripless debt trading systems should be expedited.

8. Conclusion

Sri Lanka's liberalisation regime was comprehensive and embraced all sectors of the economy. The main thrust of the financial liberalisation process was on the relaxation of interest rate regulations, promoting competition and a watering down of the selective credit programs. Financial savings increased significantly with the establishment of positive real interest rates. However, domestic savings failed to grow substantially indicating that financial deepening took place partly as a transfer of physical savings and informal sector savings towards institutional financial savings.

Moreover, the full effects of the liberalisation were not as beneficial as expected because they were offset by dissonant economic policies. A high investment rate was maintained by foreign borrowing resulting in an appreciation of the real exchange rate. An excessive budget deficit was heavily financed by expansionary sources together with domestic borrowing from the financial system. Macroeconomic instability and inefficient state-owned financial institutions discouraged savings and investments while domestic government borrowing crowded out private sector investment. The inability to maintain monetary stability imposed a dual and conflicting function on the monetary authority, as it had to tighten private sector credit, intervene in credit allocation and extensively use reserve requirements, which widened the interest spread. Sri Lanka was able to avoid the highly destabilising effects observed in the Southern Cone counties because liberalisation was gradual and limited. However, government intervention and control over most financial institutions resulted in interest rate distortions and minimal or no gains in allocative efficiency. Furthermore, inadequate prudential regulation and supervision resulted in financial distress.

The post-87 financial sector reforms tried to address some of the deficiencies remaining in the financial system. Noteworthy progress was made with respect to equity markets development, debt recovery, disclosure and provisioning standards, prudential regulation and supervision of financial institutions, and sophistication of monetary and debt management tools. However, the financial sector is still relatively shallow and many of the problems previously identified still remain. There are large pockets of inefficiency in the banking system as evident by high intermediation costs. The high level of non-performing loans in the SOCBs and inadequate provisioning is a large contingent fiscal drain on the government and continues to stifle private sector credit. Domestic financing of the budget deficit continues to be highly distortionary and crowd out the private sector, especially at the long-term end of the market. The non-market oriented state institutions mobilise large sums of long-term savings and invest primarily in short-term government securities (treasury bills and 'rupee loans'). The dominance of the state sector has stifled effective competition and narrowed the range of available financial instruments. All this suggests the need for fiscal stabilisation and reduced state presence in the domestic financial system in order to mobilise more resources and channel investments into more productive purposes. The CBSL should also strengthen the regulatory and supervisory regime as well as its policy framework and promote restructure and consolidation in the financial sector. This chapter has traced the financial sector reform process in Sri Lanka and mapped a path for future reform, but the details of which need to be worked out with the help of our development partners and vigorously implemented so that we can realize our full potential for reducing poverty and increasing social welfare.

Footnotes

1 This chapter is an updated version of 'A Survey of Financial Sector Reforms in Sri Lanka' published in Upanathi (now defunct), Volume 10, 1999. The view expressed in this chapter are those of the author and do not necessarily represent those of any institution.

2 The analysis of the allocative efficiency of the liberalised regime is highly complex and is hampered by a lack of disaggregated data.

3 SMIB- State Mortgage and Investment Bank, NDB- National Development Bank

4 NIC- National Insurance Corporation

5 Employers Trust Fund

6 The growth in financial savings has been significant but not as rapid and large as expected.

7 Further explanation is given later.

8 However, a major policy initiative was the termination of the Comprehensive Rural Credit Scheme, under which the Central Bank subsidized and guaranteed loans provided to the agriculture sector.

9 A non-performing assets ratio of 35% was recorded for the SOCB's in Sri Lanka in World Bank (1989).

10 See Villanueva and Mirakhor (1990).

11 Say to the magnitude of Korea, Thailand, and Malaysia; see Cho & Khatkhate (1989).

12 The Central Bank stopped publishing a separate private investment series since 1983. However, there is reason to believe that private investment did not shoot up during 1983-87 due to the beginning of the ethnic conflict and civil unrest and tapering off, of gross domestic investment (Appendix Table 4).

13 There have been a few econometric evaluations of the impact of financial liberalization on domestic savings and investment to test for the Mckinnon (1973) and Shaw (1973) hypothesis (e.g. Athukortala and Rajapathirana, 1993, and Fernando, 1991), but it is impossible to come to a firm conclusion given the short time series and non-stationarity of the data questioning the credibility of the findings.

14 The SMIB was considered for privatisation, but was unfortunately withdrawn due to trade union action.

Chapter 5

Labour Market Reforms

- *Shyamali Ranaraja* -

1. Introduction

The labour market in Sri Lanka operates within an extensive legal framework formulated over half a century ago. Subsequent legislation has been enacted to achieve specific policy objectives of various administrations or have arisen as a result of lobbying by groups with specific interests. Amendments and changes to legislation required to facilitate economic and industrial objectives have not been carried out, and the result is an undeniably rigid and complex legal framework with the security of the employed as its focus. However, the effectiveness of the administration and enforcement of the labour law system has deteriorated over time, leaving large sections of the workforce outside that system, denying those workers even basic rights and minimum conditions of employment.

These shortcomings have reduced labour market efficiency and given rise to distortions, impeding investment growth, employment creation and business expansion. Thus, while reforms to labour legislation and practice have been

acknowledged as being necessary by the Government, employers and employees, the nature and extent of such reform has been contentiously debated. Given the entrenched nature of the legal framework and the historical significance of many of its legislative provisions, labour market reform needs to balance the need for increased flexibility in the market with the obligation to provide a minimum level of protection for the workforce. Reforms are also likely to have considerable adverse impact on poverty, as any reduction in the security of employment would be detrimental to the sources of income of those sections of the workforce most affected by poverty.

In identifying and prioritising reforms required to the legal framework which underpins labour market mechanisms, it is important to consider briefly the evolution of that framework in order to identify the constraints that make such reforms a potentially hazardous exercise.

2. Political and Labour Movements in Sri Lanka: Historical Linkages

Sri Lanka waged a relatively painless struggle for political independence from colonial rule in comparison with its colonial cousins in Asia, and the contribution made by the working masses and their leaders to achieving comfortable independence is well recognised. However, the linkages between political causes and the labour movement, born of necessity a century ago, have continued to shape and colour the post-independence events of the country.

In the latter-half of the 19th Century, the coffee plantations of the British were being decimated by disease; in its stead, the potential for tea as a commodity was becoming more and more evident. The importation of South Indian labour to work in tea plantations, and the abysmal working conditions and terms they were subjected to, served as a catalyst to the formal organisation of workers, by focusing attention on the repressive legislative provisions dealing with plantation workers. Ironically, however, the labour movement in Ceylon has its roots not in the plantations, but in the urban economy nurtured by the prosperity of the plantations. At the turn of the 20th century, commercial ventures necessary to facilitate the export-import trade of plantation produce were thriving in Colombo, and were creating a new social structure built on divisions of labour, while undermining the old. Services, especially road, rail and sea transport intended to link the plantations with these facilities were established and served to bring labour together in larger numbers than ever before.

The early strikes, by printers in Colombo in 1893, the carters in 1906, and the railway workers in 1915, while not entirely successful in improving conditions of labour served to highlight the need for labour to unite to obtain better working conditions. In the absence of any response from the colonial Government to correct the social injustices perceived as causing these strikes, the working population flocked to radical national leaders. Their advocacy of civil disobedience, boycotts, and militant trade union activity to attain complete self-government, trade union rights, and universal franchise, appealed to labour exasperated by the insensitivity of colonial rulers to contentious issues of working conditions and wages.

The Ceylon Labour Party was formed in 1928 by A.E.Goonesinghe, a veteran labour leader, with the objective of changing legislative provisions affecting workers, to support the cause of universal franchise, and to ensure that labour had a share in the profits arising from their efforts (*Jayawardena, 1972*). This is the first instance in Ceylon of a trade union being affiliated to, or closely linked with a political party, in order to promote the cause of labour in the legislature. Although the linkage arose of necessity in a country under colonial rule, most major political parties since then, whatever their ideological orientation, have continued to nurture connections with labour, and this has necessarily influenced the brand of labour relations prevailing in the country today.

A development of particular significance in this era was the signing of the first collective agreement between labour and employers. In 1929, the tramcar workers' strike for better terms and conditions was accompanied by unprecedented violence by the general public in Colombo (who were supportive of the strikers) against the police. The Employers' Federation of Ceylon, which was a grouping of the main British business firms in Ceylon, excluding plantations, had been formed in 1928 under the Chairmanship of S.P.Hayley. Concerned with the disruption of industry by the escalation of strikes under A.E.Goonesinghe's leadership the Employers' Federation of Ceylon entered into the agreement whereby, in return for the recognition of the trade unions under the umbrella of the All-Ceylon Trade Union Congress by the member firms of the Employers' Federation of Ceylon, the unions agreed not to call a strike without first attempting to arrive at a settlement with the employer, or in the event of negotiations failing, not to strike without giving the Employers' Federation seven clear days' written notice of the intention to strike (*Amerasinghe, 1994*). This agreement marks a watershed in the process of industrial relations in Sri Lanka, for it is the first express recognition by employers of the right to organise and to bargain collectively for better terms in return for industrial peace. The agreement was also far ahead of collective agreements in operation in other parts of the world.

In 1931, Ceylon was granted universal suffrage - the first colony to be granted the franchise - which was explicitly intended to enhance the responsiveness of the government of the day to the needs of labour. The Commission's recommendation was made specifically to remedy what it considered the backward character of social and industrial legislation in Ceylon.[1] The franchise elevated the status of workers as a group with the potential to obtain considerable political power, and served as an incentive for aspiring politicians to enter the trade union field (*Kearney, 1971*).

It is noteworthy that the Ceylonese worker gained the political right to vote before his/her trade union and industrial rights were legislatively recognised, and it became inevitable that the right to vote should be used to obtain the right to organise. Similarly, since the workers themselves had demonstrated their willingness by then to band together to achieve their demands, socialist political leaders turned to trade unionism as the main machinery to develop mass support for their political parties. Thus, unionisation led by the employees themselves did also come about, but the major trade unions were organised by leaders of political parties.

The significance of this nexus between politician and trade unionist in the evolution of the labour laws that shaped the labour market became evident during the coalition Government formed in 1956. The Minister of Labour in that Government was T.B. Ilangaratne, the former leader of the Government Clerical Service's Union, and he was instru mental in granting Corporation status to the nationalised omnibus transport services and the port services, making the State a key player in employment creation for the first time.

The political significance of organised labour and the support of worker based political parties was clearly felt at the election in 1970 when the Sri Lanka Freedom Party (SLFP), the Lanka Sama Samaja Party (LSSP - a Trotskyite party espousing Marxist ideology), and the Communist Party of Sri Lanka formed the United Front Government, with Mrs. Sirimavo Bandaranaike as its Prime Minister. With Colvin R. de Silva, the leader of the LSSP as Minister of Plantations, the Government proceeded to nationalise the (mainly British) company-owned plantations. Other changes were the

establishment of Employee Councils in State Corporations to encourage worker participation in management, and the amendment of the Trade Union Ordinance to permit trade unions of public servants to join unions common to all public servants. A distinguishing feature of Government policy on labour in this era was the use of legislative provision to implement fundamental changes affecting labour, thus entrenching the policy of state intervention in the determination of terms and conditions of labour.

The United National Party (UNP), which had formed governments alternatively with the SLFP since independence, won 142 seats out of 168 in the legislature at the general elections in 1977 on a pledge of economic reform and market liberalization, which proved attractive to a country that had been experiencing shortages that resulted from the import-substitution policies of the 1970-1977 period. Sweeping legislative changes were initiated, the foremost being the second republican constitution. Key fundamental rights and freedoms important to labour, such as the fundamental right to form associations (Article 14(1)(c)), the freedom to form and join a trade union (Article 14(1)(d)) were recognised. These rights were also extended to hitherto 'stateless' persons (mainly immigrant Indian workers in the plantations) on the basis of residence for ten years in the country.

2.1 Establishment of Free Trade Zones

The Greater Colombo Economic Commission Law in 1978 provided for the first-time the establishment of 'Free Trade Zones' or 'Export Processing Zones', which had a major impact on the economy as well as labour and industrial relations in the latter period of the last century. The UNP Government also sought to prune certain legislative provisions, which had been enacted in an era of predominantly socialist policies focused on the working masses, and therefore perceived as discouraging to free enterprise (and entrepreneurs) and foreign investment.

The first of these changes was the permission granted to employers to employ women workers for the night shift, pending the withdrawal of Sri Lanka from adherence to ILO Convention No. 4 of 1948, the Night Work (Women) Convention. This Convention was one of the first to be enacted by the International Labour Organisation, and prevented the employment of women during the night in any public or private manufacturing establishments. It is considered as one of the fundamental principles of employment to be accepted by that organisation, and its renunciation by Sri Lanka has had a considerable impact on changing the social structure of the country in the latter part of the 80's and 90's.

2.2 The Labour Reform Agenda in Economic deregulation

Even as far back as 1965, the UNP-led Government attempted to amend and reform existing labour legislation in a more "investment-friendly" or "open-market" manner. However, during the periods when the UNP was in the opposition SLFP-led Governments, which have been considered to be "pro-labour" or more socialist in its policy orientation, has enacted legislation that has progressively added to the rigidity of the labour and industrial relations system.

In 1987, the then President J.R. Jayawardena outlined new measures intended to address certain difficulties arising from labour practices and legislation, including the amendment to the Termination of Workmen (Special Provisions) Act No.45 of 1971 to allow employers to lay off employees or terminate employment in accordance with an agreed formula for compensation, the introduction of unemployment benefits, and the rationalisation and

codification of existing labour legislation, and a transition to productivity based approach to wage determination.[2]

Despite this public commitment to a more productivity and efficiency based approach to labour relations, by the late-eighties the leadership in the Government had changed, and with it, the political will to pursue that approach. On the contrary, in direct contradiction to the intentions expressed previously, an amendment to the Termination Act was enacted to extend its coverage to even temporary or casual labour. At the General election in 1989 the majority commanded by the UNP was reduced, and with the escalation in the ethnic conflict in the North and East of the country, the period of UNP administration ended in 1994 without any of the objectives stated in 1987 being realised.

The UNP was defeated at the election in August 1994 by the People's Alliance (PA) consisting of the SLFP, the LSSP, and 9 other parties. The Election Manifesto of the PA had referred to 'the repressive policies' adopted by the UNP in relation to labour since 1977 and pledged to introduce reform. Accordingly, in September 1995 the Government announced the introduction of the Workers' Charter, setting out the obligations of the State, the employers and the workers in the area of labour relations. Although the charter was to be enacted as a statute, pressure from business groups prevented its presentation in Parliament. Nevertheless, during this period there were significant legislative amendments, such as the amendments to the Workmen's Compensation Act No.19 of 1934 that expanded the occupational health protection of workers, and the 1999 amendment to the Industrial Disputes Act that enlarged trade union rights of workers.

With the election of a UNP led Government in December 2001, the pro-investment and pro-liberalisation approach to labour law reform has witnessed a resurgence. Several legislative amendments intended to reduce restrictions on the right of employers to terminate employees were brought before Parliament, and were challenged before the judiciary by trade unions and workers' organisations as being unlawful.

Thus, the post-independent history of the country indicates clearly the political interests that have made labour market reform a tool of expediency. The absence of a pragmatic approach to such reform has prevented the introduction of mechanisms and processes to enable the labour market to function efficiently, and to reduce the role of legislation in balancing the rights of workers and the flexibility neassary for entrepreneurs. The resultant distortions and anomalies are evident in existing labour market conditions.

3. Labour Market: Characteristics and Constraints

Despite frequent and drastic changes in political leadership and policies since independence as outlined above, by the early-1990's Sri Lanka had made impressive social gains in basic health, education, and other quality of life indicators. Country's literacy and life expectancy rates, for example, were among the highest in the developing world. But these achievements have come at a considerable cost to the economy. The social security and welfare expenditure necessary to achieve the improvement in the physical quality of life were financed mainly by taxes on the export sector, and this had turned Sri Lanka into one of the most inward-looking welfare states in the world. By the early-1970s the government had taken over many sectors of production (e.g. tea, rubber, many industrial enterprises) and the economy was characterized by low growth and high unemployment, within a mainly import-substitution economic policy regime. A change of Government in 1977 saw the initiation of reforms to shift the economy from a partially closed to an open, market-friendly one. Trade liberalization and partial

liberalization of financial markets spurred economic growth and higher incomes. In turn, higher incomes allowed cuts in welfare expenditures. During the two decades thereafter, economic growth has averaged around 5.0 per cent per year, but significant fluctuations were visible due to both external and internal factors. Of the latter, ethnic disharmony, which erupted into armed conflict in 1983, and the southern civil insurrection during the period 1987-89, were most signifi cantly disruptive of the economy. It is estimated that the cost of the war in terms of annual economic growth foregone would be at least two percentage points (Central Bank, 1998).

Notwithstanding the difficult environment of war and conflict, Sri Lanka made substantial progress in its adjustment program during 1989-95. The program sought to continue the reorientation of the economy begun in 1977, a process disrupted by the ethnic and civil conflicts that had dominated most of the policy decisions of the late-1980s. Sri Lanka's second period of adjustment opened the economy to competition and the private sector, enabling growth to resume in very difficult circumstances. By 1993-95, the economy was experiencing robust growth, a lower budget deficit, and a smaller external current account balance. Privatization of manufacturing enterprises also largely succeeded. But attempts to stabilize the economy failed again, as they had during 1977-87, mostly because hostilities made the implementation of many of the stabilization measures difficult. Moreover, civil service reform, a cornerstone of fiscal reform, failed. By 1995, the principal measures taken to scale down the civil service had been reversed, making it even larger than it was at the start of the reforms.

Another development that had a critical impact on the labour market was the nature of investments in the Export Processing Zones (EPZ), which saw the proliferation of production units based on low-skilled labour, mainly in the garment and apparel sectors.

These rapid socio-political and economic policy changes had a lasting impact on the labour market. In the open economy, several factors such as the increase in the numbers of women entering the labour market, the migration of people away from agriculture into manufacture and services, and the outward-bound migration of a large section of the labour force, impacted significantly on the supply of labour. Increased foreign direct investment within the country, and the entrance of multinational players seeking to capitalize on lower production costs, as well as the changing nature of industrial and entrepreneurial activity also transformed the traditional demand for labour.

The macroeconomic indicators relating to the labour market appear to be favourable over time, as indicated in Table 3.1. The growth in population in Sri Lanka is now amongst the lowest globally, whilst growth in the labour force and in employment appear to be gaining parity. Productivity has improved, and overall growth remains reasonable with the exceptions noted in relation to the period 2000-2001.

Table 3.1: Annual Growth Rates of GDP, Population, Labour Force, Employment and Productivity (1959-1999)

	1959-63	1963-71	1971-80/81	1980/ 81-90	1990-99
GDP	4.0	4.4	4.5	3.6	5.1
Population	2.7	2.2	1.7	1.4	1.2
Labour Force	1.8	3.4	2.5	2.2	1.2
Employment	0.6	1.7	2.9	2.3	2.1
Productivity	3.4	2.7	1.5	1.5	3.0

Source : Alailima, Patricia J, *Sri Lanka: Growth, Distribution and Redistribution*, (2001), Ministry of Finance and Planning, Colombo.

Note : Labour Force/employment data for 1990-99 is for seven provinces only, hence productivity estimates are inflated.

However, a more detailed scrutiny reveals distortions and imbalances within these indicators that affect the functioning of the labour market.

3.1 Labour Market Supply in the 1990s

Demographic changes

After a lapse of two decades the Census of Housing and Population was conducted in 2001, and provided data both to evaluate the changes that have take place in the country since the previous census in 1981, and to formulate the policies and strategies in every aspect of Government. Of significance were the increase in the proportion of the female population and the change in the ageing patterns of the population, which would necessarily have an impact on the labour force.

Table 3.2: Demographic Changes (1971-2001)

	1971	1981	2001
Population ('000)	12,690	14,847	18,732
Growth rate	2.3	1.6	1.2
Density (population per Km²)	196	230	299
Gender ratio (males per 100 females)	106	103.9	97.8
Age below 18 years (percentage)	49.6	41.6	32.9
Age above 65 years (percentage)	4.2	5.4	7

Source : Department of Census and Statistics, Colombo (2001), *Census of Population and Housing*.

Table 3.3: Composition of the Labour Force (1992-2001)

	1993	1994	1995	1996	1997	1998	1999	2000	2001
Labour Force '000	6,032	6,079	6,106	6,242	6,266	6,660	6,673	6,627	6,730
Employed	5,201	5,281	5,357	5,537	5,608	6,049	6,082	6,310	6,207
Unemployed	831	798	749	705	658	611	591	517	523
Labour Force Participation Rate (%)	49.1	48.7	47.9	48.7	48.7	51.7	50.7	50.3	45.7
Male	65.3	65.4	64.4	65.9	65.7	67.3	67.7	67.2	66.4
Female	32.0	31.7	31.7	31.6	32.0	36.4	34.1	33.9	31.7
Employment Status (% of Labour Force)									
Public Sector	17.4	16.4	15.6	15.0	15.1	14.5	14.4	13.4	13.9
Private Sector	42.8	44.3	44.2	45.9	44.4	41.1	43.1	42.9	45.4
Employers	2.0	2.3	2.5	2.3	2.3	1.9	2.0	2.6	2.4
Self-Employed	27.4	28.3	28.3	26.8	28.8	28.9	28.3	28.4	28.3
Unpaid family workers	10.4	9.4	9.4	10.0	9.4	13.6	12.2	13.0	10.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.3	100.1

Source: Quarterly Labour Force Survey, Department of Census and Statistics, Colombo (2001)

Labour Force Participation

A steady decrease in the labour force participation rate[3] since 1998 is a cause for concern, as is the sharper decline in the participation of females. Although it is tempting to attribute the decline in the rate of female participation to outward bound migration for employment abroad, the proportion of females leaving the country for employment during the same period (Table 3.11) has also reduced, thus raising the possibility that these women were migrating towards economic activity in the informal economy.

The labour force participation of both males and females in the age group of 15-19 years in the 1990s reduced slightly, possibly due to improved access to both tertiary and vocational education, which would delay entry into the labour force. The proportion of those in employment having post-secondary qualifications doubled, whilst the proportion of those without any schooling at all declined significantly, highlighting the importance of education as a pre-condition for employment.

Table 3.4: Age distribution of the labour force (as a percentage of the labour force)

year	Age groups (years)							
	10-14	15-19	20-24	25-29	30-39	40-49	50-59	60 & over
1981	1.3	9.6	17.6	16.1	24.9	15.8	9.7	5.0
1991	0.7	7.5	17.0	14.1	25.1	19.3	10.2	6.1
1995	0.3	6.8	14.8	14.8	25.1	21.6	10.8	5.7
1999	0.8	7.4	14.3	12.6	24.9	21.5	12.5	5.9

Source: Census of Population 1981; Quarterly Labour force Surveys, 1991,1995 & 1999 (North and East excluded).

The share of those with educational qualifications of up to 10 years of schooling did not change significantly. However, the proportion of children abandoning schooling before completing the 10th year to engage in economic activities is rising rapidly and at present is as high as 20 per cent (Sri Lanka Child Activity Survey, 1999). That unwillingness or inability to obtain an educational qualification will affect the employability of these youth in the long term, making them more vulnerable to market conditions.

Table 3.5: Educational attainment of the labour force

Level of attainment	Percentage of Employed		
	1985/86	1990	1999
No Schooling	10.9	7.0	4.1
Primary (Years 1-5)	28.5	24.9	21.2
Secondary (Years 6–10)	41.0	45.1	45.8
GCE Ordinary Level	14.6	16.0	18.0
GCE Advanced Level & above	5.0	7.0	11.0
ALL	100	100	100

Source: Labour Force and Socio Economic Survey, 1985/86; Quarterly Labour Force Survey, 1990 & 1999.

3.2 Labour Market Demand in the 1990s

The economic policies adopted after 1978 had an impact on the composition of the labour market, especially in relation to the movement of economic activity away from the public sector, which had become the dominant sector in the economy in the early-1970's. From a high percentage of over 20% of total employment in the period 1978/79 (*Consumer Finance and Socio Economic Survey, 1978-79*), public sector employment has decreased steadily to about 15% in the period 1996-97. However, this share expanded gradually to exceed 18% in

2001, including those employed on contractual and casual basis in the Government sector (*Central Bank, 2001*), due not to an increase in the commercial activities of the state but to the increase in the number of Ministries in Government since 1994, and the increase in defence personnel.

Growth of the Informal Economy

The informal economy in Sri Lanka can be considered as including a wide range of individuals and small production units producing goods and providing services mainly by the use of their own or family-based labour, and often employing very little capital. They are characterized by having fewer formal procedures such as statements of accounts, and even where they employ others doing so under non-contractual informal agreements terminable at will. Most informal enterprises are household-based activities. While the legality or formal registration of the enterprise is not used in defining this sector, many activities in the informal economy tend to be unregistered and therefore less likely to be regulated (Sanderatne, 2000).

Significantly, following the adoption of liberalized economic policies in Sri Lanka, there has been a movement of economic activity from the organised to the unorganised sector, which now accounts for nearly 70% of the employment in Sri Lanka. (CFSE, 1996/97). This trend is reversed in rural areas where the unorganised sector has seen a slight decrease, due largely to the expansion of the organized sector and to a lesser degree, to the expansion of provincial governments.

The public sector as defined in respective enumerations comprise the institutions under the Central and Provincial Government (i.e. State sector) and the semi-government segment consisting of public corporations, statutory boards and private-public companies. However, the data in the above surveys have excluded from consideration personnel in the armed forces.

Table 3.6: Employed Persons by Sector (1986-87 and 1996-97)

Sectors	Urban		Rural		Estate		Total	
	86/87	96/97	86/87	96/97	86/87	96/97	86/87	96/97
Public Sector	25.2	19.4	15.4	13.5	82.1	8.9	24.5	13.9
Central Government	15.2	11.7	8.4	9.2	6.2	1.4	9.3	9.0
Local Government	2.3	2.4	0.3	1.4	0.8	0.2	0.7	1.4
Corporations & Boards	6.7	4.7	5.7	2.2	75.1	7.2	13.6	2.8
Co-operatives	1.0	0.6	1.0	0.7	0.0	0.1	0.9	0.7
Private Sector (Organized)	19.3	22.1	6.5	10.8	7.0	72.5	8.8	16.2
Private Sector (Un-organized)	55.5	58.5	78.1	75.7	10.9	18.6	66.5	69.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Consumer Finance and Socio Economic Survey, 1986-87 and 1996-97.

Apart from military recruitment, there was also irregular recruitment into the state cadre from time to time, particularly after the change of government in 1994. Thirty-five thousand teachers were recruited in 1995 and a further 12,000 in 1998. Another deviation was the recruitment of 24,000 animators to run the new income-transfer programme – *Samurdhi* - launched in June 1995. In May 1999, eight thousand university graduates were recruited outside the established cadre on a directive from the President. Although these initiatives reflect government awareness of the problems of educated youth, they injected a degree of unpredictability to the labour market (Rodrigo, 2001).

It has been found that the public sector is still the preferred avenue of employment, particularly for those in the lower and middle strata of the occupational hierarchy. The public sector is still the major source of employment for professionals (teachers, medical and engineering personnel, etc.) as well as for white-collar job seekers with secondary school qualifications. The preference is conspicuous among college-graduates educated in the vernacular languages. The perceived 'social status' attached to public sector employment, employment security and social security benefits upon retirement are among the attractions stated (Aturupana, 1996). However, at the upper end of the occupational ladder the attraction is increasingly towards the private sector, due to higher wages and benefits, and the ability to achieve a higher standard of living.

The dramatic reduction in employment of the estate population in Corporations and Boards in the period 1996/7 was due to the privatisation of plantations companies in that period. The share of the public sector reduced in the urban and rural areas as well, due mainly to the privatisation of other state owned enterprises, such as telecommunications and the national airline.

The impact of the expansion in the informal economy is clear in the increase in non-formal employment in the same period (Table 3.5). Casual workers now exceed a third of the labour force, and this can be attributed to the increase in the sub-contracting and out-sourcing practices resorted to increasingly by the formal sector in manufacturing, construction, and trade & services. In the rural sector, the number of those who are self-employed and who are in casual employment is higher than in other sectors, and is a factor of the greater impact of the informal economy.

This development is of significance because the very nature of "casual" employment adds a dimension of uncertainty to the labour market. Casual workers are those employed without formal contracts of employment or other benefits such as paid leave, statutory payments and contributions, and in types of work which do not provide security of employment. These characteristics affect the earning capacity and income security of such employees, and also make the regulation of such employment more difficult, thus adversely affecting the enforcement of laws relating to labour, taxation, and industrial safety.

Table 3.7: Status of those in Employment

Status	1986 – 87 (%)	1996 – 97 (%)
Regular Employees	29	23
Casual Employees	29	35
Employers	2	1
Self-employed	30	30
Unpaid Family Workers	10	11
Total Labour Force	100	100

Source: Consumer Finances and Socio Economic Survey, Central Bank of Sri Lanka (1986–87 & 1996– 97)

The Nature of Economic Activity

The types of economic activity engaged in by the labour force have changed rapidly since the economic liberalisation in 1977. While at that time the agricultural sector accounted for more than half of all economic activity and services less than 30 per cent, thereafter the share of agriculture has decreased by one-third and services have increased by a corresponding amount. However, employment in other areas has fluctuated periodically, in response to changes in economic policies.

Unemployment

Unemployment continued to decline from about 18 per cent of the labour force in 1981 (Census, 1981) to 14.7 per cent in 1991 (*QLFS, 1991*), and to 7.7 per cent in 2001 (Census, 2001). The rate of unemployment of women has continuously been about twice that of males, and in 2001 was 11.6 percent and 5.9 per cent respectively.

Of greater concern is the unemployment level in relation to education. In 2000, 11.3 per cent of those who were unemployed (as a percentage of the labour force) had completed the G.C.E. (Ordinary Level) examination (ten years of schooling), whilst nearly 15 per cent had completed the G.C.E. (Advanced Level) examination or a higher qualification. Those entering the labour force after graduation from universities, especially those qualifying in the fields of arts and social sciences have been found to be unable to obtain employment in the private sector, and the state has been "creating" employment opportunities in the public sector for these graduates (*Central Bank of Sri Lanka, Annual Report, 2001*). Nevertheless, the highest enrolment in universities in Sri Lanka continue to be for courses in these fields, due to low qualifying criteria perpetuating this imbalance.

Table 3.8: Unemployment: By gender, level of education and age (1992-2001)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Total Unemployment (% of Labour Force)	14.6	13.8	13.1	12.3	11.3	10.5	9.2	8.9	7.6	7.8
By Sex										
Male	10.7	9.7	9.7	9.0	8.5	7.7	6.5	6.7	5.8	5.9
Female	22.9	21.7	20.1	18.8	18.0	16.1	14.0	13.0	11.1	11.6
By Level of Education										
No Schooling	3.0	3.1	2.6	1.8	2.8	2.0	1.0	0.4	1.2	1.2
Grade 0-4/ Year 1-5	4.7	4.9	5.0	3.4	3.4	2.4	2.4	1.9	1.0	1.0
Grade 5-9/ Year 6-10	15.9	13.7	13.0	12.8	12.2	10.6	9.0	8.2	7.5	7.5
GCE (O/L)/ NCGE	22.2	21.3	19.6	18.4	16.4	15.9	13.7	13.6	11.3	11.3
GCE (A/L)/ HNCE and above	22.4	23.3	23.7	20.0	19.0	19.3	17.5	17.9	14.9	15.6
By Age Group										
15-19 Years	39.1	38.4	40.7	60.5	36.5	34.0	27.3	28.4	23.3	30.6
20-29 Years	27.5	25.2	24.5	31.7	22.0	21.9	19.3	18.9	17.4	18.1
30-39 Years	7.8	8.4	7.6	8.0	6.0	5.2	4.9	4.4	3.6	3.0
40-49 Years	3.5	3.3	2.5	2.9	1.9	1.7	2.0	1.6	1.4	)
50 Years and above	1.4	1.5	1.2	0.4	0.5	0.6	0.7	0.8	0.8	)0.9

Source: Quarterly Labour Force Survey, Department of Census and Statistics, various years, Colombo.

Table 3.9: Graduate Unemployment (1990-2000)

Subject Stream/ Discipline of Study	Unemployment (as a percentage of total unemployment)	
	Male	Female
Professional Science-based studies (medical, engineering)	10.2	13.9
Other Science studies	18.4	13.9
Law and Management	8.2	11.1
Commerce, Arts, Social Sciences and Humanities	63.2	61.1
Total	100.0	100.0

Source: Jayaweera and Sanmugam (2002), *Graduate Employment in Sri Lanka in the 1990s*, Centre for Women's Research, Colombo.

In 1999, nearly a quarter of those unemployed were found to have had some level of vocational training (*QLFS, 1999*). The effectiveness of identitying vocational training to be provided to entrants to the labour force is also questionable, as the determination of course content does not appear to be market driven.

It would appear that unemployment is highest among those who have followed training in computer operations and clerical work, two sectors in which greater employment opportunities can be expected. Most computer training programmes provide basic training and therefore are not effective in helping trainees to obtain employment (Leelaratne, 2001).

Thus, the employment-oriented skills obtained at secondary, tertiary, and vocational levels are clearly not in line with those demanded by the labour market, resulting in almost 50 per cent of those in the age group of 15-29 remaining unemployed (Central Bank of Sri Lanka, *Annual Report 2001*).

Table 3.10: Employment/unemployment rates of persons receiving vocational training (1999)

Vocation / Trade	No. of per sons trained under vocational training programs	Percen tage Emplo yed	Percen -tage Un employed
Fitting and Welding	24,253	81.3	18.7
Refrigeration and Air Conditioning	6,491	83.6	16.4
Electrical, Electronic & Telecommunication	45,096	83.9	16.1
Motor & Related Mechanics	70,610	88.7	11.3
Television and Radio Repairing	6,876	90.0	10.0
Carpentry	58,359	94.1	5.9
Masonry	61,000	96.1	3.9
Plumbing	2,556	99.2	0.8
Painting and Finishing	8,645	91.5	8.5
Computer & Data Entry Operation	58,962	62.7	37.3
Gem Cutting and Jewellery Manufacturing	8,747	98.7	1.3
Heavy Vehicle Driving	116,555	92.8	7.2
Plant & Machinery Operation	3,329	90.8	9.2
Printing	6,802	94.8	5.2
Manufacturing of Shoes & Leather Products	2,192	96.1	3.9
Hotel & Restaurant Related	13,091	80.2	19.8
Textile and Apparel Manufacturing	114,761	82.4	17.6
Agriculture Related	7,312	88.1	11.9
Clerical & Related	50,227	69.9	30.1
Total	665,864	81.7	18.3

Source: Labour Market Information Bulletin, Technical and Vocational Education Commission (December 2000).

Factors Affecting Labour Absorption

Labour absorption into formal employment during the 1990s relied on three main sources:

1. Employment creation through the EPZ and foreign/ local investment under the Board of Investment.
2. Recruitment to the armed forces during the heightened ethnic conflict in the north and east of the country.
3. Employment outside the country.

The impact of these factors on the labour market differed in that the affected groups were different: the EPZ provided employment mainly to young females entering the labour market, defence forces recruitment attracted to a large extent rural, male youth, with at least ten years schooling, and overseas employment was resorted to by females from a slightly higher age group, generally married and with dependant family members.

Employment generation through EPZ

The Export Processing Zones were established through the establishment of the Greater Colombo Economic Commission (GCEC) in 1978 to promote foreign investment. Generous tax concessions were offered to attract foreign investors. In November 1992 the status of GCEC was elevated to a Board of Investment (BOI) with responsibility for extending activities in respect of both foreign and domestic investment in the whole country. Also initiated in 1992 was an independent programme for establishing 200 export-oriented garment factories in peripheral administrative divisions. The concessions that were initially operative in the designated Export Processing Zone enclaves were subsequently extended to all foreign-collaboration enterprises irrespective of location and the entire segment became known as the BOI sector (Rodrigo, 2001).

The PA Government that assumed office in 1994 emphasised employment and income generation in rural areas and regional industrialisation as priorities in the "New Industrialisation Strategy for Sri Lanka" announced in 1995. Under this strategy, in addition to the three EPZs then in existence in the country, five more EPZs and one Industrial Park were established during the period 1998-2000. However, as three of the EPZs were located in the Gampaha District, within a short distance of the capital Colombo, and two in the Kurunegala District within a short distance of each other, the objective of regional industrialisation does not appear to have been actively pursued. The establishment of three zones within the Gampaha District also lends a political flavour to the decision to locate zones, as the Gampaha District is the primary voter base of the main political party within the PA, and the home electorate of the President (Peiris, 2001).

Between 70-80 per cent of the labour force in the BOI sector consists of women, concentrated mainly in the garment and apparel sector, which is both the largest contributor to the export income and the largest employer. The majority of these women are unmarried and have secondary school leaving qualifications. The jobs typically do not correspond to their training educational attainments or to their aspirations. The majority are concentrated in low-skilled pursuits with poor career prospects and many leave after they marry as difficulties begin to surface in combining career with family responsibilities. Even after two decades after the creation of EPZs married women make up scarcely 10 percent of the total workforce. (AFFLI - ACCTUF, 1995).

Table 3.11: Employment and Export Earnings of BOI Enterprises

Categories	Employment				Gross Export Earnings(Rs. Mn) (F.O.B)			
	1998	1999	2000	2001(a)	1998	1999	2000	2001(a)
Food, beverage and tobacco products	11,699	11,571	15,207	15,112	9,329	8,256	12,413	12,861
Textiles, wearing apparel and leather products	189,395	216,700	242,435	257,515	114,794	127,008	162,583	174,527
Wood and wood products	2,723	2,148	1,822	1,857	380	344	409	420
Paper and paper products	871	969	1,618	1,605	1,137	941	1,250	842
Chemical, petroleum, rubber and plastic products	25,699	24,234	29,675	31,880	20,270	21,956	28,583	30,288
Non metallic mineral products	10,920	12,559	13,061	12,598	5,742	7,901	8,605	9,605
Fabricated metal products, machinery, transport equipment	2,503	3,998	4,182	4,466	3,425	1,832	1,949	2,375
Other Manufactured products	31,538	32,958	33,394	32,449	16,718	18,966	24,056	20,384
Services (b)	19,033	21,922	26,455	28,552	9,963	13020	18,772	23,912
Total	294,381	327,059	367,649	386,034	181,758	200,205	258,620	275,214

Source: Central Bank of Sri Lanka, *Annual Report 2001*. (a) Provisional. (b) Excluding Air Lanka Ltd.

Enterprises enjoy tax concessions as well as relief from some labour regulations. Unionisation is discouraged indirectly by restricting the entry of all unauthorized persons, including trade union activists, into the Zones. The employers in the Zones contend that the absence of trade unions is not detrimental to workers as their interests are adequately represented by a system of Workers Councils (Gunatilleke, 2001). Operative wages in the BOI sector are guided by statutory minimum wage rates laid down by the relevant Wages Boards, particularly the garments trade. The base wage is supplemented with overtime and bonus benefits. Compared with the statutory unskilled minimum wage of Rs.2, 525 (1999), the unskilled earnings level is reported to be about Rs.3, 500 - 4,000 on average (equivalent to about US$1.50 a day). Difficulties with Transport and sub-standard accommodation, long working hours and strenuous workloads are among problems reported most frequently (ACFFTC - AAFLI, 1995).

Employment in the Armed Forces

Recruitment into the armed forces became a regular feature due to prolonged hostilities during the period 1983-2001. The number in service has increased progressively, and although recruitment figures are not available, Kelegama (1998) estimates strength of 240,000. Recruitment is dominated by rural youth with secondary school leaving qualifications. The government meets the defence force payroll, and although the level of pay is standard, the base rate is supplemented with a package of fringe benefits especially in areas of hostilities.

Civil insecurity has also made it necessary to guard entry points to establishments in the city and outstations. In recent years such security work has become an important outlet for informal sector workers, including women. A

number of private security agencies have come up catering to this demand. A Wages Board lays down the minimum wage rates for this type of work. Enforcement is weak and there is substantial abuse in respect of overtime payments, leave and security of employment (Rodrigo, 2001).

Outward-bound Migration for employment

Migration for employment on a regular and systematic basis began in the 1980s with the opening of the economy, and the liberalization of currency and exchange control laws and travel restrictions imposed during the period 1970-77. The Foreign Employment Agency Act, No.32 of 1980, and the Sri Lanka Bureau of Foreign Employment Act, No. 21 of 1985, have established institutions to facilitate such migration. Favoured destinations are the Middle Eastern countries (over 90%), Maldives, Republic of Korea, Hong Kong, Cyprus, Italy and Malaysia. Annual remittances have reached Rs.1,000 million in 2001 (Central Bank of Sri Lanka, *Annual Report 2001*), and are now a major source of foreign exchange earnings to the country.

Out of the migrant employees from Sri Lanka over 65% are females employed as low-skilled domestic aides in the Middle East, Singapore, etc. However, as part of a strategy to broad-base foreign employment and remittances, the government is encouraging the migration of higher skilled workers (*National Employment Policy, 2002*).

Table 3.12: Foreign Employment (1997-2001)

	1997	1998	1999	2000	2001(a)
Employment Placements (Nos.)	150,283	159,816	179,114	181,370	183,856
By Gender (Percentages)					
- Male	25	34	35	33	32
- Female	76	66	65	67	68
By Category (percentage of placements)					
- Housemaid	66	53	49	54	56
- Skilled Labour	16	20	21	20	20
- Unskilled Labour	14	21	24	20	18
- Other	4	5	6	6	6

Source : Central Bank of Lanka, *Annual Report 2001*.
(a) Provisional

Most migrants are from low-income households and the monetary gain provides useful income source to this strata. However, migrants and their families have little or no capacity to invest these earnings, in avenues, which would yield sustained annual returns, and most earnings are utilized for high-value personal consumption without income-generating ability. As over two-thirds of migrants are married women with families to support, their absence from their traditional role within the family has also brought adverse social repercussions associated with long separation from the family, neglected or abused children, abuse/exploitation in the workplace and reintegration of returning migrants, etc.

3.3 Labour Productivity and Wages

Rodrigo (2001) argues that, an employment expansion of 2.6 per cent a year between 1991 and 1999, and a GDP (real) growth performance of a little over 5 per cent per annum over the same period, implies a productivity growth amounting to around 2.5 per cent per annum on average. However, labour productivity in the non-BOI private sector is estimated to have decreased by 2.5 percent over the levels in 2000 (Central Bank of Sri Lanka, *Annual Report 2001*).

There is little or no linkage between wages and wage increases to productivity. Wages in the public sector are determined principally according to cost of living and length of service, and not in relation to productivity. Political expediency has also become a factor in determining wages. The Cabinet of Ministers decide the criteria for annual bonus payments in the public sector and the bonus is given across the board regardless of job or performance (Dissanayake, 1998).

In the private sector, trade unions and workers' organisations have strenuously and vociferously resisted a linking of monthly wages to productivity (Dissanayake, 1998). Practical difficulties in measuring productivity and performance, the reluctance of trade unions and employees to accept the assessment made by the management of both those factors, and the fear that employees will be unable to challenge those measurements, are some of the reasons for this reluctance. Productivity linked pay schemes are also viewed as being more vulnerable to external influences, which would affect primarily the lower wages of most manufacturing sector employees. This has resulted in employers having to introduce the concept of productivity related remuneration, by having performance or production-based incentive schemes, gain-sharing schemes (where a percentage of any profit achieved over and above a pre-determined target is shared with employees), piece-rated schemes, and the like. These schemes are outside the scales of basic monthly remuneration, which is determined as in the public sector by reference to cost of living factors and length of service.

However, in both the private and public sectors, individual performance-related wage increases are prevalent at executive levels, with the practice being less marked in the latter sector, due to institutional constraints. Similarly, the earnings of commission agents and sales personnel depend on the business canvassed by them, and prove to be extremely effective depending on the particular scheme of incentives and commissions practices in different companies.

Two issues that remain significant barriers towards linking productivity to wages are:

(a) The lack of real wage increase in the private sector due to below-inflation rate wage adjustment; and

(b) The generous leave and holiday entitlements in the public and private sectors.

Inadequate inflation adjustment

Although wages in the private sector increased sharply immediately following the liberalization of economic policy in 1977, the increase tapered off towards the latter part of the 1980's. In the period 1999 to 2001 employees in the formal private sector experienced a loss of remuneration for their services in relation to inflation, except for the services sector, which saw a marginal increase in 2001. The wages in the public sector increased less rapidly in the post-1978 period, and due to periodic agitation by various factors, continued to increase gradually thereafter (Central Bank of Sri Lanka, *Annual Report 2001*: 137). In the period 1999 to 2001 the public sector experienced a real increase in wages of around 5 per cent, due mainly to politically motivated "interim adjustments" in 2000 and 2001, as discussed above.

Leave and Holiday Provisions in Sri Lanka

Sri Lanka has without doubt one of the most generous public holiday structure in the world, in addition to statutorily imposed paid leave for various categories of employees.

Table 3.13: Holiday and Leave provisions in Sri Lanka

Types of holiday & leave	Employees covered by SOE Act	Trades covered by the wages boards			Public sector
		Planta - tions (83%)	Other Trades (13%)	Workers affectedBy 1972 exten sion (4%)	
Holidays					
Weekly	78	52	52	52	104
Statutory	8	3	8	8	13
Poya	12	12	12	12	12
	98	67	72	72	129
Leave					
Annual	14	14	14	14	24
Sick/casual	7	0	0	28	21
	21	14	14	42	45
TOTAL Non-wor king days p.a.	119	81	86	114	174
working days per annum	246	284	279	251	191

Source : Ekanayake, U.B, (2001), Impact of Labour Legislation on Labour Demand in Sri Lanka, International Labour Organisation, Colombo.

It is clear that a system where the public sector employees can remain away from work with full pay for almost half the year needs revision without delay. Some private sector employers, especially those established during colonial times offer annual, casual and medical leave entitlements comparable to the public sector, and are prevented from unilaterally reducing the number of days of paid leave by applicable legal provisions. In addition, the statutory holidays (public, bank and mercantile) differ in relation to the private and public sector, and in relation to the industry in which an enterprise is deemed to operate. For instance, the public sector, and banking institutions both public and private are entitled to holidays, which differ from the private commercial sector, thus disrupting the commercial activities of those enterprises that do not follow that holiday. This double-tier system of holidays creates economic disadvantages for those enterprises, as well as confusion for consumers. Uniformity in the system of leave and holidays is therefore a practical, common sense requirement.

This system of leave and holidays also imposes a hidden liability, especially in relation to public holidays, as employers who require employees to work on these days are generally permitted to do so, but on the payment of overtime calculated at up to double the wages due for work during a normal working day. A further provision, applicable to the private sector under the Shop and Office Employee's Act and the Wages Boards Ordinance, also increases the number of holidays by at least three or four additional days a year. This is due to the legislative requirement that, where a public holiday falls on a day that is a non-working day for any employee (such as the weekly holiday on Saturday and Sunday), *the employer must grant an additional holiday during the week immediately following that public holiday*. The rationale for this nonsensical requirement, if there was one, is lost in the mists of time, but due to this rule, employers in the private

sector in the year 2001 (for example) were required to grant three additional days as holidays.[4]

Table 3:14: Provisions governing work performed on holidays

Type of holiday	Rate of Overtime	Holiday in Lieu
Weekly holiday or Weekly half- holiday	1 ½ x normal hourly wage for eight hours or normal working day 2 x hourly wage for any additional work -	Paid holiday within next six days
Statutory (public) holiday	An additional days' pay irrespective of time worked OR	Day off before the end of the year
Full Moon Poya	Additional ½ days' pay irrespective of time worked	NO DAY OFF

Source: Compiled from Shop and Office Employees' Act.

Thus, especially in the private sector where employers must operate in the global market place without limits of time or location, competitiveness and productivity suffer a double blow either in the form of loss of working time, or by the payment of highly increased wages. The trade unions, both in the private sector and the public sector, vehemently resist any attempts to reduce the non-working days in a calendar year, considering these as fundamental terms of their employment.

4. Labour Market Interventions

In addition to supply - demand mismatches, there are other forms of interventions which have a considerable impact on the operation of the labour market.

4.1 Labour legislation

Issues of employment, employee rights, working conditions, resolution of employment-related disputes and industrial relations in Sri Lanka are governed by a body of law comprising about 45 statutes. Much of this legislation was enacted during the period immediately preceding and after independence, and since that time various administrations have "tinkered" with legislation based more on ideology than on pragmatism. The law governing employment that exists today is thus not the outcome of a broad-based strategy to achieve economic objectives, but rather a result of political expediency and ad hoc problem-solving strategies.

The cumulative effect of these laws has been erod to the absolute right of an employer to determine the terms of a contract of employment offered to an employee, and have in some instances, superseded contractual terms voluntarily agreed to between employer and employee. However the effectiveness of these laws have largely depended on the commitment and capacity with which the provisions are enforced.

Some of the main legislative provisions are summarised below. This legislation applies to the private sector, state-owned commercial enterprises and public companies, public corporations and statutory boards or authorities. However, they do not apply to employees of central and local governments (ministries and government departments), which are governed by the Establishments Code and Cabinet and Ministerial decisions issued from time to time.

The Trade Unions Ordinance No. 14 of 1935 made the registration of trade unions a pre-requisite to exercise rights granted under the Ordinance. Due to this requirement, the Ordinance was viewed as an instrument to control the growth of trade unions. However, the Ordinance for the first time gave legal sanction to the right of association of workers,

and recognised the right of trade unions to bargain collectively with employers.

The Industrial Disputes Act No. 43 of 1950 provided for the settlement of industrial disputes through conciliation and voluntary or compulsory arbitration, collective agreements, and adjudication of disputes in a system of labour courts (by subsequent amendments).

The Shop and Office Employees' Act, No. 19 of 1954 provided for the payment of wages, paid leave, calculation of overtime, etc, of private sector commercial establishments, and is applicable to all persons employed in shops and offices.

The Termination of Employment (Special Provisions) Act No. 45 of 1971 is without doubt the most significant of the statutes enacted during the hey-day of labour in the early-1970s. Initially intended to prevent the lay-off of workers *en masse* due to shortages in raw material, the Act has survived and evolved into a statute applicable even to individual terminations (Amerasinghe, 1994), distorting the right to "hire and fire" of an employer which is a key factor affecting any labour market. The Act effectively prevents any employer who employs more than 15 persons from terminating the services of an employee, without:

(a) The express consent of the employee; or

(b) Where that consent is not forthcoming, the permission of the Commissioner of Labour (subject to the payment of such compensation as may be ordered by the Commissioner of Labour in his/her absolute discretion.)

The Commissioner of Labour is not compelled required to grant permission when an employer makes an application to terminate an employee, and may refuse permission, compelling an employer to continue to employ that worker against the will of the employer.

A direct impact of the Termination Act on the labour market was evident during the economic turbulence of 2001. Although many enterprises were compelled to downsize their activities due to economic uncertainty and loss of markets, employees were advised to stay at home on payment of their minimum monthly salary, excluding allowances, in order to minimise costs and avoid closure of business, as the process for termination or laying-off in terms of this Act was time consuming and impractical.[5] In the hotel sector, although it was expected that laying-off workers would be inevitable after the terrorist attacks on the country's international airport in July 2001, the Termination Act prevented such terminations. Accordingly, the forced maintenance of employment levels prevented a clear reflection of the economic slowdown on employment reduction in the affected sectors (Central Bank of Sri Lanka, *Annual Report 2001*).

The Termination of Employment Act (TEA) was amended in 2003. Accordingly all inquiries under this Act should be completed within two months, and it also empowered the Minister of Employment and Labour to gazette a formula setting out the compensation that could be awarded by the Commissioner of Labour when an employer seeks permission to terminate the services of an employee or when a termination in violation of the TEA had taken place. This formula was gazetted in 31st December 2003 limiting the compensation that could be awarded based on past service (up to a maximum of 15 years) and prospective service until retirement. Although this formula has been welcomed by some employers (for instance, large-scale apparel manufacturers who could be faced with the need to retrench workers at the end of the Multi Fibre Agreement and the quota system) it has come under severe criticism by small and medium scale entrepreneurs as being too costly, and by workers' organisations on the basis that it ignores the ability of the employers to pay.

The Government also announced plans to combine the compensation scheme with an unemployment benefit scheme for workers who have been retrenched under this provision, but this has been criticised by workers as being more advantageous to employers. Faced with mounting criticism by a number of organisations the Government attempted to adjust the formula after the gazette publication, but indications are that it will be abandoned and the absolute discretion of the Commissioner of Labour to determine compensation in relation to each case will be restored.

The Payment of Gratuity Act No. 12 of 1983 was enacted to provide a minimum level of income security to workers terminated from employment. The statute provided for 2 weeks pay per year of service, subject to a minimum qualifying period of five years continuous service with an employer. The trade unions saw this as being designed to help enterprises in the EPZ, as the newly established enterprises were considered to have a high turnover, with very few employees completing the qualifying period of five years' service (*Weerakoon, 1986*). However, the Act is applicable not only in the EPZ, but to all employers in the private sector, and has come to be recognised as an important interim measure in the effort to formulate a system of social security.

The Wages Board Ordinance No. 27 1941 provides for the establishment of tripartite Wages Boards for the regulation of wages and working conditions in any trade or industry as deemed appropriate. The Wages Board constituted for a particular trade is empowered to determine minimum wage rates, maximum working hours, leave, holidays (including weekly, and public holidays) and overtime, and such determinations are legally binding irrespective of the worker's employment status (whether casual or regular). At present there are 43 tripartite Wages Boards in operation covering trades in the agriculture, manufacturing, and service sectors. This multitude of authorities empowered to set wages and terms of employment has become cumbersome and complex, with the multi-dimensional workplaces, which may be covered by the provisions of several Wages Boards.

The Factories Ordinance No. 45 of 1942 regulates the occupational health and safety of workers in factories and industrial establishments covered by the Act. Coverage extends to all factory workers irrespective of status, but its implementation has been ineffective due to the absence of a requirement for compulsory registration of such workplaces.

The Workmen's Compensation Ordinance, No. 19 of 1934 applies across a broad spectrum of establishments, and provides for compensation in the event of accident/injury sustained in the course of work, or for industrial and occupational diseases contracted whilst working.

The Employment of Women, Young Persons and Children Act, No. 47 of 1956 is applicable to the employment of women and younger workers. It regulates the working hours, conditions of work, and prevents the employment of vulnerable persons in hazardous activities.

The Maternity Benefits Ordinance, No.32 of 1939 and the relevant provisions in the Shop and Office Act provides for paid maternity leave and other maternity benefits, and prevents the employment of female workers in hazardous activities in the period before and after confinement.

The Employees' Provident Fund Act, No. 15 of 1958 provides for a contributory scheme of superannuation for all employees other than those directly employed by the State, through a minimum contribution by employer and employee. However, the entirety of the amount lying to the credit of an employee in the fund (EPF) can be withdrawn at the time of qualifying for payment, and as such there is no provision for the fund to supply a continuing source of income upon retirement as would be desirable. **The Employees' Trust Fund (ETF) Act, No. 46 of 1980** requires employers to contribute a sum of 3% of the salary of all employees (who are also entitled to EPF benefits) to the fund, which is intended to tide employees over in difficult times, as the moneys in the fund can be withdrawn once every five years.

4.2 Trade unionism and workers' organisations

Because of the close-relationship between political parties and trade unions outlined above, Sri Lanka has a strong and politically influential trade union culture. However, the rate of unionisation has varied in the recent past, with a gradual decrease being the feature in the latter half of the 1990s. This decrease can be attributed to the employment growth in recent years taking place mainly in the EPZ/BOI sector, where trade unions are virtually non-existent (especially within the zones), the shift in employment from the formal to the informal economy, where it is difficult for unions to establish themselves, and the outward-bound migration of workers for employment. The increase in the armed forces, which has absorbed young, male entrants to the labour force who are potential trade union members, has also had an impact on the rate of unionisation as the members of the armed forces cannot form or join trade unions. In addition, the privatisation of large state-owned enterprises resulting in the disintegration of the organised workforce has also affected trade unions.

While union statistics highlight the problem of a multiplicity of unions, membership is concentrated in a few big unions and federations. As a sector of the workforce unionisation is highest among plantation workers and the biggest unions in terms of membership are in the estates sector. At the end of 1991, twenty-three unions with membership of over 5,000 each accounted for 92.5 per cent of reported membership[6]. Membership is predominantly male, and union participation and representation of women within the trade union hierarchy is weak except in the estates sector.

4.3 Dispute Resolution

The Industrial Disputes Act ("IDA") provides for several mechanisms for dispute resolution:

1. Arbitration (both voluntary and compulsory where parties are required to restore the *status quo* pending a decision);
2. Conciliation (by the Commissioner of Labour between parties to industrial dispute);
3. Adjudication by Labour Tribunals (in matters relating to termination of employment). The IDA empowers the Labour Tribunal to make an order in an application challenging termination notwithstanding any provision in the contract of employment between the
4. By entering into collective agreements without the intervention of the Commissioner of Labour (especially in relation to wages and terms of employment). The collective agreements are however registered by the Commissioner of Labour to give legal effect to the terms of such agreement.

These mechanisms are intended to operate efficiently and expeditiously, in order to minimise the dysfunction caused to the labour market, but that is no longer a reality due to the deficiencies built-up within these systems. For instance, although the IDA contains a provision which indicates that an application made by a workman/woman against the termination of his/her services to the Labour Tribunal should be decided within four months, the average duration of such an inquiry at present is about three years.

Similar delays and inefficiencies plague the systems of arbitration, conciliation, and inquiries conducted by the Commissioner of Labour preventing the early resolution of disputes, and continuing the imbalance created by such disputes in the Labour markets.

The right to strike as a means of dispute resolution

The right of workers to resort to strike as a legitimate trade union action is well recognised both in legislation and by judicial decisions in instances where strike action has been challenged or disputed. However, although the number of strikes has declined across all industries, possibly due to the decline in the rate of unionisation, the number of human days lost has not decreased substantially. One reason is the inability of the system of dispute resolution to bring such strikes to an end swiftly, as the Department of Labour has rarely used its powers under the IDA to compel the adjudication of the dispute and the restoration of industrial peace. Striking workers have also demonstrated a disturbing tendency to resort to militant and violent conduct amongst strikers, such as hostage-taking, destruction of property, forcible occupation of company premises, etc, which does not promote early success in negotiations between the adversaries.

Since the commencement of the ethnic conflict in the North and East, the Emergency Regulations have been used to declare various industries as constituting "essential services", thus making strikes in such sectors illegal and punishable by termination of employment. An example of this was the strike by public servants in July 1981, which deprived many public employees of both their employment and the right to take strike action. However, the use of this provision has drawn widespread criticism, and with the possibility of peace, the legislative source from which the Executive derived these draconian powers is likely to be repealed.

4.4 Determination of Wages

Wages are determined in Sri Lanka under an assortment of mechanisms. In the government sector remuneration levels are determined/reviewed periodically on the recommen dations of Pay Commissions appointed by the government from time to time for the purpose. Since independence there has been eight such Commissions effecting overall reviews, the latest being in 1997. Apart from such overall reviews, periodic adjustments in the living allowance component of the public servants' pay packet are made from time to time by Cabinet decision to compensate the workforce for the rise in the cost of living. The 1980s featured six such adjustments followed by a further three in the 1990s (Rodrigo, 2001), and two "interim adjustments" effected before successive general elections in 2000 and 2001 which sought to quell public sector dissatisfaction over wage levels.

For the private sector employees the wage setting machinery consists of several mechanisms:

1. **Tripartite determination under provisions of the minimum wage legislation and the Shop and Office Employees Act, i.e. Wages Boards and Remuneration Tribunals**

   Minimum Wages are determined as stated before by Wages Boards set up under the Wages Boards Ordinance for specific industries. However, workers covered by the decision of a Wages Board are free to resort to other mechanisms (e.g. collective bargaining) to obtain wages above the stated minimum.

2. **Collective bargaining**

   This is a process favoured by several urban commercial/mercantile sector categories such as bank employees, member firms of the Employers' Federation of Ceylon (EFC), and among white-collar grades in the estates sector. For blue-collar categories in estate employment collective wage bargaining was a subsequent development; the first wage-related settlement was effected in 1967. With the subsequent divestiture of estates from state management to private companies from 1995, the estate unions negotiated a major collective agreement with management companies, largely those in the membership of the Employers' Federation of Ceylon, in February 1998.

   Although the legal recognition of the right of association and the immunities and privileges statutorily afforded to unions were intended to redress the unequal bargaining power between the employers and trade unions and thus create an environment conducive to collective bargaining, collective agreements are more the exception than the rule in the labour market in Sri Lanka. Due to the reluctance of the Commissioner of Labour to enforce terms of a collective agreement against trade unions in the event of a breach of such terms, employers have generally remained vary of undertaking the commitments of a collective agreement. Similarly, trade unions have largely been unwilling to undertake any obligations in return for the concessions granted by the employer.

   For parastatals wage determination/review has ypically been within the guidelines laid down by the Treasury and the parent ministry. The state banks with their collective agreements constitute a major exception. At times task specific commissions are also appointed to make recommendations on issues in dispute. Under the liberalized economic strategy the number of parastatals is being reduced through privatization. Divestiture of public enterprises entails a status transformation of the workforce from public to private sector employees.

3. **Awards under the Industrial Disputes legislation**

   These awards are made in wage related industrial disputes, which have been referred to voluntary or compulsory arbitration under the IDA. The awards are binding on the parties for a period of time, but can be rejected thereafter subject to the process set out in the Act.

4. **Individual bargaining, and managerial decisions**

   These mechanisms constitute the primary wage determining mechanism in the informal sector. Individual bargaining prevails strongly in the higher professional and administrative categories as well. Little information is available on the agreements reached.

The EPZ/BOI sector with its employed workforce of 327,000 deserves special mention in view of its distinct characteristics. Employers in this enclave enjoy certain concessions, which give them some relief from stringent labour regulations. While the contention of the Department of Labour is that the normal laws of the country apply, there are ways of bypassing labour laws and practices and union pressure. Union organization within the Zones is restrained by entry restrictions to the enclave. The firms also subcontract work outside in order to cut cost further. The

workers are predominantly unmarried women. Wages in these establishments are anchored to the statutory minimum wage rates in the respective industries at $2-3 a day. Together with overtime and bonus payments operative wages are reported in the range of Rs.3, 500 - 4,000 on average monthly.

There have also been instances of the Government effecting adjustment for private sector workers by direct government decree. For instance, on the eve of the announcement of the general election in October 2000, the President by Gazette notification issued on 31st July 2000 directed that all employers in the private sector, regardless of capacity to pay or financial status, should increase the salaries of all employees by Rs.400/- with effect from the 1st of that month. This order, which ignored the application of the entire wage setting mechanisms, noted above, caused grave concern regarding such unjustified interventions motivated solely by political gain, and which undermined all efforts undertaken regarding labour market reform.

5. Labour Market Reform

Although the analysis of labour market conditions in Sri Lanka includes the public sector the discussion on labour market reform is confined to the private sector (both formal and informal) as the considerations for reform are different in the public sector. The scope and capacity for reform is dependent on the political will of the Government in power, and the degree and nature of control it exercises, rather than emerging from within the market. In addition, market forces do not operate within the public sector, due to the high degree of regulation and control vested on the Government by Constitutional provisions, which have proved to be difficult to change or vary.

5.1 Labour market imbalances in the private sector

The formal and informal private sector, demonstrates several imbalances, as indicated by the foregoing analysis on labour market conditions:

* Supply imbalances: There is a marked mismatch between the skills possessed by entrants to the labour market through the secondary, tertiary and vocational education system and the demand for such skills as indicated by available employment opportunities. This imbalance is particularly marked in relation to university education, with as much as two-thirds of those qualifying being unable to find employment. In addition, inherent inefficiencies of the system, such as the quality of education and location of schools, have resulted in lower skill levels in the labour force seeking employment.
* Disparities in employment (demand) generation: A disparity exists between the type of employment sought by entrants to the labour force, as indicated by their skills mix, and the available avenues for labour absorption. In the decade 1990-2000 employment generation has been mainly in the BOI sector, the armed forces and foreign employment (Rodrigo, 2001). The BOI sector jobs are predominantly of the unskilled/semi-skilled type, and the extent to which they meet the aspirations of the holders is clearly unsatisfactory. Career prospects are poor and labour turnover is high, with young women in the EPZ considering their employment as a means of making the transition between school and marriage (ACFFTC-AAFLI, 1995). The absorption by the military of young, rural, male labour force entrants cannot be considered desirable or a "long-term" source of employment for obvious reasons. In relation to foreign employment, in 2001 nearly

75 percent of those who were outward bound for employment were in domestic or other unskilled employment. Further, such employment is of relatively short duration and has no avenues for career progression within that employment.
* Limitation on the right to fire: The ability of employers to determine the human resource requirement of their enterprise is limited by legislation, and there is little flexibility to reduce employee numbers in times of economic downturn due to high compensation payments. In addition, a decision to terminate the services of an employee can be set aside by a Labour Tribunal or the Commissioner of Labour, with an order for compulsory reinstatement, thus compelling an employer to continue to employ a person in whom the employer has no confidence, and (in some instances) who the employer believes to be guilty of misconduct. A Labour Tribunal can also ignore the contract of employment between parties in arriving at a decision.
* Absence of a social "safety net": The mobility of labour is hampered and restricted by the absence of any form of social security or unemployment benefits, making employees reluctant to change jobs or accept voluntary separation schemes. In the instances of reduction of staff, an unfair burden is placed on employers by making them solely responsible for compensation for loss of employment. There is no scheme to provide income-support for the employee until s/he finds alternate employment, nor any systematic provision for retraining, those who have been made redundant

* Distortions in wage setting mechanisms: The ability of parties to a contract of employment to determine the wages payable to the employee are limited by the various provisions outlined above. Especially in the industrial and manufacturing sectors, undue confusion is created by the multitude of Wage Boards established for different "trades", creating instances where an employer may need to refer to decisions of several Wages Boards in order to determine the minimum wages payable to the employees. The rigidity within the various wage-setting mechanisms also prevent any linkage of productivity and wages, rewarding employees for mere attendance at work, regardless of the quality of the work performed by them.
* Protected "status" for employees : Although in theory employers and employees are free to determine the terms of a contract of employment by mutual agreement, many of the terms and conditions are stipulated by law, such as working hours, permissible overtime, type and amount of paid leave, the manner in which wages are to be paid, working conditions, and other benefits. For instance, where there is an operative collective agreement between a trade union and an employer, the employer would be required to extend its terms and conditions to all employees including non-union members, and even to those who are recruited subsequent to the signing of the collective agreement.

  Even though an employment contract may stipulate that the employer may terminate the services of an employer with three months' notice, or the payment of three months' wages in lieu of notice, that term can be overlooked by a Labour Tribunal if the employee challenges such a termination. Similarly, the

  Labour Tribunal can look beyond a contract of employment for a fixed period, or specific purpose, and determine that the employee was in fact employed on a permanent contract of employment. This provision therefore confers an unfair advantage on the employee, who may agree to stringent terms merely to enter employment, and thereafter be exempted from being bound by those terms.
* Productivity constraints: A laissez-faire holiday and leave system add to labour costs directly, while also oreating the need to carry excess staff to cover high absenteeism by. There is also a requirement for enhanced rates of pay and holidays in lieu where an employee is required to work on a holiday, which affects the ability of Sri Lankan employers to compete effectively in the market for which it produces.
* The expansion of the informal sector: It is a feature of the informal sector that it keeps costs down through substandard wages and non-compliance with legislation (Sanderatne, 2000). Evasion of social security payments, and non-observance of overtime regulations providing for higher rates of pay for additional work, is common. A survey of three industries (in the garments, construction and container transport sectors) found that only half of the sample enjoyed EPF and ETF benefits (Rodrigo, 2000). Kelegama (1995) contends that only 35 per cent of registered employers comply with the EPF Act.

5.2 The Impact of Labour Market Imbalances

Reduced Competitiveness: The distortions existing in the labour market have an adverse impact on the performance, efficiency, and profitability of the enterprise, and the overall competitiveness of Sri Lanka in the global environment. For instance, in a survey of the relative competitiveness of various countries, Sri Lanka was ranked 44th, with a competitiveness of 0.29; significantly, the three countries with the best rankings - Singapore (0.94), Hong Kong and China (0.71), and Luxembourg (0.68) - scored high on labour market factors (*National Employment Policy, 2002*). There is also considerable indication that productive and high quality human resources are a better attraction for foreign investment, as opposed to cheap but low-skilled labour.

Lack of flexibility and adaptability: The high degree of security of employment in key sectors such as services, manufacturing and production, prevents companies from being able to respond to difficult market conditions as the cost of reducing or retrenching staff, especially related to the option of exiting that market, is extremely high. Even where employers offer reasonable terminal benefits or voluntary separation schemes, employees are unwilling to accept the mobility offered, as the ability to obtain alternate employment is low, especially in relation to low-skilled employment.

Employment related poverty: The reduction in the rate of unemployment to single digit levels since 1998, combined with a growth rate of 3.9 percent in per capita income in the period 1990-2000, (UNDP, 2001), it would be reasonable to assume that Sri Lanka rates well in poverty reduction. However, an analysis of poverty in Sri Lanka reveals the following profile, which has deteriorated from that which prevailed a decade ago.

* A quarter of the population is affected by chronic poverty while up to 40 per cent of the population at any given time is affected by chronic and transitory poverty combined.
* Poverty resides mostly in rural areas where about 70 per cent of the population live. It is significant that 27 per cent of the rural population is living below the poverty line, as opposed to 15 per cent of urban and 25 per cent of estate population.
* There is a co-relationship between income poverty and human deprivation.[8] However, in an apparent twist in that connection the consumption levels of the working poor in Sri Lanka are lower than that of the unemployed (PRSP, 2002).[9]

It is also significant that 95 per cent of those living in poverty are employed, with the larger proportion of the working poor located in the rural agricultural, informal, and in the plantation sector. If the labour market functioned efficiently the economic situation of the working employed should improve. However, despite a protectionist policy towards labour governing many of the conditions prevailing in the labour market, it is clear that there has been progressive erosion in the income security of those who are employed.

In this context, the PRSP also states labour market reform to be a priority, because Sri Lanka's labour market is considered to be highly distorted due to outdated laws and regulations, which impede investment growth, job creation and business expansion (p.12). However, the strategy recognises that labour market reforms are a complex exercise and that mismanaged reform could exacerbate poverty.

6. Recommendations for Labour Market Reform

Given the legislative and other constraints related to the labour market, some recommendations are made for reform to rectify some of the imbalances identified above.

* **Guidelines on complaints and applications in terms of the TEA**

The Minister could issue guidelines to be followed by the Commissioner of Labour or his/her authorised officer in inquiring into complaints made by workers of the violation of the TEA, or into applications by employers to terminate the services of worker/s. Although this would not have legal force, since at present there is an informal guideline issued by the Commissioner of Labour on compensation, the principle is not alien. The guidelines could be based on the numerous proposals by stakeholders as well as the recommendations of various research studies, and include directions on avoiding undue delays, the procedure to be adopted, and the compensation to be awarded. For instance, agreement was reached at the Workshop on the Trade Union Response to Labour Reform to initiate proceedings by filing affidavits before the Commissioner of Labour. Although this has been implemented in some instances, after the initial filing of affidavits the usual lengthy adversarial procedure appears to be followed, nullifying the benefit of procedural changes.

Identification of other causes of delay, such as shortage of personnel to record inquiries, etc, could be undertaken, and suitable action can be taken to rectify these causes.

Similar guidelines could also be formulated for the disposal of applications made in terms of other statutes to other departments, i.e., non-payment of wages under the SOE Act, etc, where applications can take a considerable amount of time to be determined.

* **Dispute Resolution**

Even where the legislative environment of the labour market is well founded and efficient, a certain level of labour and industrial disputes is unavoidable. That necessitates an equitable and expeditious form of dispute resolution in order to maintain social and industrial stability. In Sri Lanka Labour Tribunals form the foundation of the structure to resolve disputes between employer and employee, with other mechanisms such as conciliation and arbitration addressing different types of disputes. However, at all levels of this dispute resolution process, there are delays that are in-built into the system and which have now reached unacceptable levels. External factors such as the increase in applications during an economic downturn only serve to aggravate the problem.

The fundamental difficulty facing the Ministry of Employment and Labour in resolving shortcomings is the lack of authority to implement changes, due to the Labour Tribunals being under the purview of the Ministry of Justice. The authority of the latter Ministry is a necessity due to the need for Labour Tribunals to be presided over by officers with judicial training, and although not a system of courts, the impression of being a part of the judicial system is necessary to building public confidence in the system. However, the adverse impact arises from the low priority accorded to resource allocation to Labour Tribunals given its lowly place in the judicial system. This results in a chronic shortage of support staff, such as clerical staff, infrastructure, and resources to Presidents.

However, none of these drawbacks need to be rectified by legislative reform. The necessity is for a consultative and collaborative approach between the Ministry of Employment and Labour and the Ministry of Justice in order to ensure that adequate resources are allocated to ensure that Labour Tribunals can operate effectively.

* **Improving the inquiry procedure**

These two Ministries could also develop a productive collaboration to improve the process of inquiry before Labour Tribunals, as Presidents' are free to determine the procedure in each Tribunal. A shift away from lengthy adversarial proceedings, the adoption of evidence by way of affidavits, recording of factual matters agreed to by both parties (such as dates of employment, salaries, etc), framing of issues for determination, are some revisions which could be affected with little or no intervention, other than raising awareness of Presidents and practitioners of the advantages of these methods. Other revisions, such as summoning all new cases in the afternoon before the respective Tribunal in order to avoid delays to applications scheduled for inquiry, by the time consumed in dealing with the formalities attendant upon new applications, e.g. filing of documents, exploring the possibility of settlements, etc. The objective should be to ensure that every application is proceeded with on the day fixed for its inquiry except in exceptional circumstances, thus minimising delay. At present, hearing evidence in a new application is unlikely to commence until the lapse of at least 12-18 months, as precedence is given to older cases fixed for inquiry.[12]

* **Improving and revising practices adopted in Labour Tribunals, Arbitration hearings, and in inquiries before the Department of Labou**

One cause of delay in disposing of applications under the IDA and TEU is the lack of responsibility of some representatives of workers and employers in requesting unreasonable postponements, and a general lack of interest in expeditious disposal. As such representatives are not required to be Attorneys-at-law, there is no system of control or supervision of their conduct. Therefore, there is an urgent need to develop and adopt a Code of practice for practitioners in these fora, to encourage responsible and equitable representation to workers and employers. Attorneys-at-law and other practitioners cannot reject the formulation of a code of practice, as it is a means of restoring and maintaining the confidence of litigants in the quality of representation received.

Improving the capacity of Labour Tribunal Presidents, Arbitrators and Labour Officers by better access to knowledge and training

In almost every application made to these bodies, there is an element of legal interpretation, and beyond that of economics, financial principles and perhaps, of technical issues. At present, presiding officers of these bodies (especially Presidents of Labour Tribunals who are required to fulfil a quasi-judicial role) do not have adequate access to case law and legislation, authoritative textbooks, etc. Moreover, they may not have sufficient expertise in other disciplines to enable, for instance, to identify financial constraints facing an employer who makes an application for termination of employees in terms of the TEA.

These areas require a collaborative effort to obtain new resources, and to channel existing resources, efficiently to ensure continuous training and access to case law, etc.

Ensuring proper investment of superannuation, or terminal benefits

An area of concern in relation to the EPF and ETF Acts is the failure of beneficiaries to invest their payments prudently to ensure a continuous source of income. Very often it has been found that these funds have been utilised for short-term consumption, nullifying the purpose of these benefits, and creating further problems by distorting job search and re employment patterns.

In addition to the extensive range of service presently offered by the Department of Labour to workers claiming benefits under these Acts, steps could be taken to provide proper guidance and advise on the types and advantages of investments available. Institutions that could be involved in such an initiative are public and private sector banking and financial institutions, agencies dealing with opportunities for self-employment such as SMEs, and professional organisations providing skills enhancement and retraining. This is not an area in which individual employers could provide guidance to individual employees, and thus, there is a proactive role for the Ministry of Employment and Labour.

Initiate a process to provide social and income security

In relation to the agenda for labour reform, the need for a comprehensive system of unemployment benefits, and of security of income to those in need,

has become a major priority. Such a system is crucial to improving the mobility of labour, the ability of employers to adapt to market conditions by restructuring, etc. One possibility that could be considered to obtain funds to establish a social security scheme may be to utilise the surcharges made on employers defaulting on the payment of EPF and ETF contributions. This surcharge does not at present accrue to the employee in respect of whose contributions the default has occurred, and is transferred to the Central Bank. As the surcharge is considerable in relation to long term default, it may also be an incentive for the enforcement of compliance with the Act.

Establishment of a National Wage Council

The establishment of a National Wages Council/Commission is an initiative that was formally proposed in the Workers' Charter announced by the Government in the 1994/1995 periods and thereafter it has been proposed as a possible alternative by some sections of both employers and worker representatives.[13] There is an urgent need to reduce the number of Wages Boards in order to eliminate the duplication and confusion which presently exists, and to adopt either a nationally applicable minimum hourly wage for the private sector, or to establish Wages Boards in broad definition, i.e. service, manufacturing, etc. In addition, holiday and overtime provisions could be made uniform throughout this sector, except for different provisions in industries that have specific operational requirements.

Improve labour administration in Provinces

At present, much of the discussion on reform is centred on the operation and role of the Labour Secretariat in Colombo, with provincial offices carrying out basic inspection activities, and intervention in industrial disputes. The expansion of these offices into full-fledged service centres, with the capacity to address all issues relating to employment, labour, and dispute settlement, including decentralised administration of all statutory provisions, is vital to the stated government policy of expanding industrial activities to the provinces. This strategy will require the enhancement of technical capability of the provincial offices, both in terms of personnel and communication technology, and a comprehensive plan for the development of the knowledge and skills capacity of all officers is relatively low in complexity to implement, and should be proactively pursued.

Educational Reform

The nature and extent of the mismatch between the skills required by employers and those gained by entrants to the labour market produced by the education system requires urgent and radical reform. A key requirement in this area would be to disseminate labour market information to these educational institutions and to focus on reducing the clear imbalance in this area. Expansion of the composition of the National Education Commission to include representation of employers and the commercial sector would be an important step.

In this context, the recent initiative of the Ministry of Employment and Labour, to commence an internet-based employment placement system has great potential, both as a source of labour market information and as a means of correcting some of the imbalances noted in this paper.

7. Conclusion

It is vital that other policy initiatives of the Government be considered and incorporated in strategies relating to labour reform, and that the impact on the labour market by other initiatives and policies which are currently under review, be recognised. For instance, the continuation of the privatisation of state owned enterprises identified in the PRSP will increase the private sector share of industry, and alter the labour force scenario by increasing the competition for private sector employment, especially where such enterprises are intended to be restructured.

There are other issues not directly within the labour reform agenda, but which have a long-term impact on the labour force and economic growth of the country. For instance, in Sri Lanka, poverty, to which unemployment and underemployment are contributory factors, has been found to prevent access to better-quality education, healthcare, nutrition, and to facilities that improve living standards (such as access to safe water, sanitation, electricity, etc.) (PRSP, 2002). Similarly, the Sri Lankan population is ageing rapidly (Census, 2001), which impacts on policies designed to ensure income security beyond employable age. Special measures are also necessary to address the needs of the differently able, the disabled, and of women who face more difficulties in employment despite the increase in the share of their contribution to the economy.

Considering Sri Lanka's turbulent experience with youth uprising, there is also a need to address rural and youth unemployment, which has been identified as being a major contributory factor to youth unrest.[14] Other issues such as improving the rights and conditions of labour in the informal sector without hindering the assistance and development efforts in the Small and Medium Enterprise sector also need to be considered.

The challenge for Sri Lanka in carrying out reforms is to balance the needs of industry and employers with the interests of labour. Imbalances that affect both sides of the divide need to be addressed simultaneously. Although bold and visionary leadership is required to cut through the tangle of labour legislation, reforms must no longer be driven by political expediency, but rather by a consultative and participatory process involving all stakeholders.

Footnotes

1 Ceylon: Report of the Special Commission on the Constitution: His Majesty's Stationary Office, London (1928: 83).

2 Industrial Policy Statement (1987: 19).

3 The ratio of the labour force (persons aged 10 years and above who are able and willing to work in a given reference period) to the household population aged 10 and above (Central Bank of Sri Lanka, Annual Report 2001, p.144).

4 April 13th and 14th, the day prior to the Sinhala and Tamil New Years' day and Sinhala and Tamil New Years' day respectively, and declared as public holidays fell on Saturday and Sunday, and May 25th, The Holy Prophet's Birthday, also fell on a Saturday.

5 Tri Star Chairman on why he was compelled to downsize operations, Daily News, June 11, 2002.

6 Administration Report of the Department of Labour, 1994.

7 Section 31B(5) of the IDA.

8 Human deprivation is measured by the Human Poverty Index (HPI) which is a composite of other social indicators such as life expectation, literacy, access to education, access to safe drinking water, safe sanitation, adequate basic health care, and child and maternal health.

9 Tables 10 & 11 of Annex 2 of the PRSP.

10 Section 102 provides that the Minister may, by order published in the Gazette, declare that any power, duty or function conferred or imposed upon or assigned to a Factory Inspecting Engineer by an specified provisions of this Ordinance shall be exercised, performed or discharged, as respects any specified district, by such officer (other than a Factory Inspecting Engineer) ...... and, upon the publication of any such Order, any reference [in the Ordinance] shall have effect as if for any reference in that provision to a Factory Inspecting Engineer where were substituted a reference to such officer...".

11 Lankage v University of Kelaniya, (SC Application 125/94, SCM 23.2.95).

12 Due to the request of postponements etc, Labour Tribunals and other bodies are compelled to fix a large number of cases for hearing each day, in order to ensure that the Tribunal is not left without applications to inquire into. However, this results in unreasonable inconvenience to parties, as a matter may be postponed on several occasions due to the precedence given to older cases fixed for inquiry on the same day.

13 Submissions for reform made by the EFC and Mr. Leslie Devendra, General Secretary, Sri Lanka Nidahas Sevaka Sangamaya for consideration at the Labour Law Reforms Workshop (International Labour Organisation, NATURE), February 2002.

14 Presidential Commission on Youth, 1992.

Chapter 6

Evolution of Anti-Poverty Programmes

- Hasitha Wickremasinghe -

1. Introduction

Sri Lanka's current level of poverty that has persisted in spite of the shift to the market economy, decades of social welfare and over a decade of participatory development is a stark indication that Sri Lanka needs to rethink its poverty alleviation strategy and introduce reforms urgently. The fact that 1/4th of the country's population live in absolute poverty of less than Rs.791 per month and about 1/3rd below the higher poverty line of Rs.950 per month[1] implies that the country's development process has not been holistic or equitable. The poverty alleviation strategies followed so far have failed to integrate its outcomes to the main system or to eliminate the causes of poverty, which keep reinforcing the conditions that result in impoverishment.

The aim of this chapter is to identify key areas that require reform or improvement in order to effectively deal with the problem of poverty. The chapter looks briefly at

the history of poverty alleviation programmes in Sri Lanka and the successes and failures of the different strategies followed. The recommendations are based on both the issues arising from this analysis and the nature of the current poverty problem in Sri Lanka. Existing data from several sources are used in assessing the level and nature of poverty and the effectiveness of the programmes and policies followed so far.

2. Nature of the problem

Poverty is a multi-dimensional problem of deprivation of communities of essential economic and social conditions, resulting in starvation, destitution, low quality of life, and manifold social problems. The problem of poverty arises due to exclusion of communities from the growth process of a country, denying them access to resources, human development and dignity. Poverty poses a challenge as well as a threat to the development process of a state, as the essential implication of poverty is that a section of a country's human and natural resources remain neglected, hindering the realisation of the country's full potential for growth and development. Therefore, the importance and urgency of successfully overcoming poverty cannot be overemphasised. Successfully dealing with the problem lies in the precise identification of the causes of poverty and the implementation of an effective and resolute plan of action for poverty alleviation.

In examining the nature of the problem of poverty in Sri Lanka, a striking feature peculiar to Sri Lanka is the advanced position of the country's level of human development relative to its level of per capita income. Sri Lanka's Human Development Index ranks above its neighbours in the South Asian region and is on par with countries of higher economic development.

Table 1: Sri Lanka's HDI position among neighbours

Country	GNP per capita($ 1999)	HDI Value 1999
Malaysia	3,400	0.774
Philippines	1,020	0.749
Sri Lanka	820	0.735
Indonesia	580	0.677
India	450	0.571
Pakistan	470	0.498
Nepal	220	0.477
Bangladesh	370	0.470

Source: The World Bank, World Development Report 1999/2000. UNDP, Human Development Report 2001.

Sri Lanka's adult literacy rate stood at 91.4% for the year 1999 as reported by the Human Development Report 2001 of the UNDP. The level of youth literacy was at 96.7% for the same year. A comparison with the rest of the world shows that Sri Lanka is ahead in the level of literacy against both developing countries and the global average. This was the case for both males and females.

Table 2: Sri Lanka's level of literacy against world and group averages

Country/Group	Adult literacy rate (1994)	
	Female	Male
Sri Lanka	87	93
All developing countries	60	78
Least developed countries	35	57
Industrial countries	98	98
World	71	83

Source : UNDP, Sri Lanka National Human Development Report 1998, Colombo.

Sri Lanka's health indicators stand well above the regional average and compares well with its neighbours in the East Asian region. The healthcare network spread throughout the country has ensured that 95% of the country's population has access to essential drugs[2] and that over 95% of one-year olds are fully immunised against diseases such as tuberculosis and measles.[3]

Table 3: Health Indicators in selected Asian Countries

Country	Infant mortality ratePer 1000 live births1998	Maternal mortality ratioPer 1000 live births 1990-98	Total fertility rateBirths per woman1998
Malaysia	8	39	3.1
Sri Lanka	16	60	2.1
Philippines	32	170	3:6
Indonesia	43	450	2.7
India	70	410	3.2
Nepal	77	540	4.4
Pakistan	91	—	4.9

Source: The World Bank, World Development Report 1999/2000.

Sri Lanka's problem lies in income poverty[4], which afflicts 1/4th of the country's population (excluding the North and the East). Disparities in the incidence and depth of poverty are visible along the lines of regional, provincial and sector basis, with the specific problems of each group varying according to the causes of deprivation. The conflict in the North and East of the country has destroyed the social fabric of the region and the problem of poverty remains a distinct problem in this region.

Poverty in the urban sector is less acute than in the rest of the country. Urban poverty is to a large extent a spill over problem from rural poverty due to rural-urban migration of people in search of employment. Though the percentage of ultra – poor is marginally less in the estate sector compared to the rural sector, the percentage of poor according to the higher poverty line is highest in the estate sector.

Table 4: Level of poverty by sector

Sector	Lower Poverty Line (%)	Higher Poverty Line (%)
Urban	15	25
Rural	27	41
Estate	25	45

Source : Household Income and Expenditure Survey 1995/96, Depart ment of Census and Statistics, Colombo.

The level of poverty varies within provinces as well with the Western Province being the least affected and the Uva Province the most affected. These differences identifiable in the spread of poverty throughout the country are indicative that development and poverty benefits have not reached all sections of the population indiscriminately.

Table 5: Level of poverty by Province

Province	Lower Poverty Line (%)	Higher Poverty Line (%)
Western	14	23
Central	28	43
Southern	26	41
North Western	34	52
North central	31	47
Uva	37	55
Sabaragamuwa	32	47

Source : Household Income and Expenditure Survey 1995/96, Department of Census and Statistics, Colombo.

Poverty in Sri Lanka has a sector-based concentration as well. Of the total poor, 42% are employed in the agricultural sector. Mining and quarrying industry and the construction industry show a high percentage of poverty within these respective industries though the contribution to overall poverty is low. Unemployment and labour-force non-participation is not a major cause of poverty in Sri Lanka, contributing only 5% to overall poverty in the1995/96 period. Of the total unemployed only 28% were classified as poor during this period. The extended family system that is characteristic of the Sri Lankan society acts as a safeguard against poverty in such instances.

Table 6: Depth and distribution of poverty among sectors

Sector	Index*	Contribution**
Agriculture	51	42
Mining and Quarrying	59	2
Manufacturing	36	11
Construction	44	7
Wholesale and Retail Trade	30	9
Transportation	26	4
Finance	10	0.4
Communication	23	10
Unclassified	67	10
Unemployed/Non-Labour Force Participants	28	5

*Head count based on higher poverty line.

**Share of total poor, based on higher poverty line.

Source: Household Income and Expenditure Survey 1995/96, Department of Census and Statistics, Colombo.

Poverty levels also vary according to social groups along the lines of gender and ethnicity. One striking feature peculiar to Sri Lanka as compared to the rest of the developing world is that there is no significant gender inequality in the extent of income poverty even with the increased number of war-widows in the country. State assistance and family support play a role in maintaining gender parity in this situation. The UNDP Gender Development Index (GDI)[5] is almost 70% for Sri Lanka, which is higher than the global average. The problem lies in empowerment; the UNDP Gender Empowerment Index (GEM)[6] is 31% for Sri Lanka, which is lower than the average for all developing countries (37%).

Table 7: Gender equality against world and group averages

	Earned Income Share		GDI Value
	Female (%)	Male (%)	
Sri Lanka	34	65	0.69
All developing countries	32	68	0.55
Least developed countries	33	67	0.32
Industrial countries	38	62	0.86
World	33	67	0.64

Source : UNDP, Sri Lanka National Human Development Report 1998, Colombo.

Differences in poverty and access to basic utilities are visible among different ethnic groups. The Sinhalese majority is less vulnerable to income poverty and has better access to basic utilities than the other ethnic groups of the country. Poverty is a bigger problem among the Sri Lankan Tamils and Estate Tamils than other communities.

Table 8: Poverty and Ethnicity

Ethnicity	Monthly Ave. per capita consump -tion (LKR)	Access to safe drinking water (%)	Latrine (%)	Safe sanitation (%)	Safe cooking Fuel (%)	Electri city (%)
Sinhalese	4925	76	92	75	19	61
Tamil	1920	75	69	63	11	45
Estate Tamil	1396	76	81	73	4	43
Moor	2061	91	81	79	23	78

Source : The World Bank, Sri Lanka Integrated Poverty Survey 1999/2000, Colombo.

3. Sri Lanka's poverty alleviation experience

Since independence in 1948, Sri Lanka has experimented with two paradigms of poverty alleviation. Until 1978, the "top down delivery paradigm" dominated the Sri Lankan poverty alleviation agenda with the Government taking on the lead role. The poor were a passive target upon whom the state bestowed various transfers. This paradigm went hand in hand with the 'welfare state' ideology, which was strongly present in the Sri Lankan economic and political structure at that time.

As the Sri Lankan economy moved to a new phase after 1977, the welfare policies of the state were partly dismantled to make way for a more market-oriented economy. Consequently, the poverty alleviation programme took on a new dimension with the introduction of the 'participatory development paradigm' as an experiment through the Change Agent programme, in line with the new economic system. Within the new conceptual framework of poverty alleviation the 'objects' of the previous paradigm, i.e. the poor, became the 'subjects', taking on an active role in the programme. The poor became the drivers of the process with a support system consisting of the Government, NGOs, etc, providing the fuel. This was in effect a process whereby the poor, were integrated into the existing economic system by a conscious effort.

The Participatory development programmes are mainly aimed at sustaining the poor by granting a cash transfer till they are able to rise out of poverty by finding a means of income. Other measures such as social insurance and compulsory saving components of the programme provide a source of financial security for a longer period. To enable the poor to become entrepreneurs credit facilities are made available, which are generally barely accessible to the ultra poor through the market. A process of awareness creation

takes place enlightening the poor on improving their situation. Through the availability of credit facilities and the freedom to make their own decisions, the poor are empowered to shape their own destinies, using the temporary help extended by the state and various organisations of the poor. This gives the poor a voice both explicit and implicit, through the organisations of the poor and the recognition of their abilities and rights respectively

4. Welfare: The Top Down Delivery Paradigm

4.1 Pre-Independence

The roots of Sri Lanka's modern welfare policies can be traced back to the colonial period, when the Sri Lankan welfare state was modeled after the British model of social democracy. Sri Lanka's first attempt at quantifying the problem of poverty and unemployment and prescribing remedial measures took place during the Donoughmore period, with the Newham (1936) and Wedderburn (1934) reports drawing attention to the subject.[7] Poverty came into focus as a policy issue during the great depression of the 1930s, and as the nation suffered the effects of the severe drought and the malaria epidemic that followed.[8]

Several important legislations that are in force or have largely influenced the nature of today's welfare framework were introduced during this period. The labour legislation that was first introduced in the estate sector and later expanded to other sectors and the Poor Law Ordinance, which shaped the selectivist nature of Sri Lanka's modern welfare programmes were two such important examples that formed the foundation of the Sri Lankan welfare state. The universal free health and education systems emerged and expanded during the British period, as did the food subsidy scheme introduced as a wartime measure. Independent Sri Lanka retained these measures for over 50 years into independence. Colonisation schemes aimed at raising rural income and removing disparities between the urban and rural sectors were first introduced in 1939.[9]

4.2 Period 1948-1977

By 1947, welfare expenditure amounted to over 50% of total government revenue[10]. In the post-independence Sri Lanka, most of the welfare measures introduced during the twilight of the colonial era continued without much change. The agri-centric economic structure also continued unabated, under successive governments in the pre-1977 period. The food subsidy scheme remained the main tool of welfare until 1977. Health and education services expanded throughout the island resulting in high population growth and a high turnout of educated youth.

However, by the 1970s several cracks were emerging in the Sri Lankan welfare economy. The economy was not generating sufficient jobs to absorb the large number of youth that the education system was churning out. The increasing inflation eroded the real value of the food subsidy making it less effective in providing food security to the poor. Youth unrest experienced in the country that finally led to a youth insurgency in 1971 was a result of these conditions. The University admission reforms, the Sinhala-only language policy of 1956 and the nature of the political culture that developed in Sri Lanka resulted in ethnic tension in the country. The first tremors of the ethnic war that has drained the country of its resources and caused immense suffering to its people during the last two decades were already beginning to be felt. By the mid-1970s growth had slowed down considerably and the economy was facing problems in all quarters. These were the conditions under which, the people voted in a government in 1977 that promised to pursue

growth-oriented policies and to align the Sri Lankan economy with the global economic system.

4.3 Post-1977 Period

The liberalisation policies of 1977 greatly reduced the welfare measures of the preceding period. Government spending on welfare fell as the benefits of the new growth strategy were expected to trickle down to the poorer sections of society through the medium of market. Universal free health and education services were retained within the new framework. However, data reveal that public spending on these services dropped as a percentage of GDP after 1977.

Table 9: Spending on Health and Education

Period	Education Expenditure/ GDP	Health Expenditure/GDP
1960-1970	4.17	2.12
1971-1977	3.02	1.72
1978-1985	2.51	1.50
1986-1996	2.83	1.61

Source: Central Bank of Sri Lanka (1998), *Economic progress of Indepen dent Sri Lanka*, Colombo.

Other welfare measures such as the provision of uniform material and midday meals for school children and 'Mahapola' scholarships for university students were introduced in the post-liberalisation period.

The export-oriented growth policies that have been pursued since 1977 have not been able to narrow the income disparities in the country, as the benefits of the high levels of growth experienced immediately after the opening up of the economy failed to seep through to the lower income strata. Job creation was still not sufficient to absorb the increasing labour force, and the youth of the country were preparing for a second uprising. The war in the North and East of the country, which began in 1983, was taking its toll on the country's economy. It was leaving in its path widows, refugees, orphans, and handicapped persons and communities traumatised and destitute.

4.4 Achievements of the welfare state

After decades of welfare policies, Sri Lanka has much to show in the field of Human Development. The impressive figures of literacy and health indicators bear evidence to the efforts that the country has put in over a long period of time in overcoming human poverty. The World Bank Country Report on Sri Lanka, 'Recapturing missed opportunities', notes that the long term effort of poverty alleviation in Sri Lanka has resulted in the "elimination of starvation and destitution in the country" (pp. 27).

Table 10 : Health and Education indicators for the last three decades

Year	Literacy rate (%)	Life expectancy		Infant Mortality per 1,000 live births
		Male	Female	
1971	78.5	64.2	67.1	45
1981	87.2	67.8	71.7	30
1991	86.9	69.5	74.2	17
2000	91.6*	68.0**	75.0**	13.3***

Source : Central Bank of Sri Lanka (1998), Economic progress of Independent Sri Lanka, Colombo.

*Source : UNDP (2002) Human Development Report.
** Source : Asian Development Bank (2002), Key Indicators.
*** Source : Registrar General's Department.

The underlying principle of the top down welfare policies practiced in Sri Lanka is to improve the quality of life of its citizens through the delivery of basic goods and services to all persons indiscriminately. The universal free health and education services have succeeded in achieving this end in their respective areas. The welfare policies followed over a long period of time has left Sri Lanka with a solid base to build a strong framework of poverty alleviation. The level of human development achieved and the welfare infrastructure in place provide a launching pad for a broader structure of equitable development.

4.5 Failures of the Top down delivery paradigm

The failure of the post-independent Sri Lanka has been the inability of its economic system to successfully absorb the results of its welfare policies. Lack of high economic growth and the low quality of the free health and education systems have been the main causes of this situation. The economy was not able to supply jobs to the large number of educated youth that the system was turning out. It has become increasingly clear that there is a serious mismatch between the job requirement of the current economic structure and the skills and knowledge provided by the education system. The education system has not evolved with time to meet the demands of the changing economy.

The high rate of literacy that the country boasts of must go beyond an impressive human development indicator and translate itself into productivity and economic value. In order to achieve this end, the education system must be shaped with the country's economic framework in mind, and produce workers to match the demands of the system. In the case of Sri Lanka, labour force data reveal that unemployment is greater the higher the level of education. This is also an indication that higher end job creation has been low relative to the increase in the workforce.

Table 11: Unemployment by Educational Level in 2001

Level of education	Unemployment % of labour force
No schooling-Year 5	1.5
Year 6-10	6.9
GCE O/L	11.2
GCE A/L and above	15.6

Source: Central Bank of Sri Lanka, *Annual Report 2001*, Colombo.

The government spent 2.02% of GDP on education in 2001[11]. The full productivity of these resources remains unrealised due to the failure of the labour market to match demand and supply of skills.

A greater effort has to be made to keep children in schools for a longer period. They need to be given appropriate skills through training to ensure employment once they complete their education. According to the World Development Report (WDR) 2000/1 of the World Bank, net enrolment in school for Sri Lanka in 1997 stood at 100% for primary schooling. This figure dropped to 76% when it came to secondary level. These figures however, compared well with Sri Lanka's neighbours in the South Asian and East Asian regions and showed a marked increase from 1980, where the figure was 59%. However, there is a drastic drop in numbers as students reach tertiary level. According to the UNDP Human Development Report 2001, this figure stood at 6% for males and 4% for females.

The relevance of social services such as education and health in alleviating poverty lies in these services reaching the poor and improving their quality of life. Though Sri Lanka has been maintaining universal free health and education facilities for a long period, the disparities in the quality and accessibility of these services within and between regions reflect the disparities in income distribution.

Table 12: Disparities between regions in the level of illiteracy

Province	Adult illiteracy (%)
Western	6.2
Central	15.3
Southern	11.2
North Western	8.1
North central	9.6
Uva	17.1
Sabaragamuwa	11.2

Source: Saman Kelegama, (2001), Poverty situation and policy in Sri Lanka (mimeo).
ADB, (2001), Poverty reduction in Sri Lanka: Maximising the Asian Development Bank's contribution.

Both the education system and the healthcare network, with a history dating back to the colonial era, have failed to maintain uniform quality standards throughout the island. Serious gaps remain between the urban-rural and estate sectors, with these gaps widening when moving into the rural interior.

Youth revolts against the state, both from the Sinhala majority and the largest minority Tamils, bear witness to the fact that Sri Lanka has failed to effectively deal with the economic problems of a considerably large section of its population. In failing to do so, post- independent Sri Lanka has failed in the task of nation building.

Universal delivery of welfare services to the population of the country with the view to uplift the living standards of all people indiscriminately has achieved the direct implication of such policies such as literacy and human development. However, in the context of poverty alleviation with regard to income poverty, these achievements are a means to an end and not an end in itself.

Government spending on delivery of welfare services has to be a long-term investment leading to capacity building and must translate itself into economic value. That is, the returns to those spending must be visible in the country's growth process and should contribute towards its development. The proportionate benefits accrued to the country in the case of Sri Lanka in this regard has been low. Similarly, the population experiencing a high level of human development expects to derive economic returns in terms of income, housing and other utilities. The failure to satisfy these requirements leads to social unrest and invariably expression of violence. This has been true in the case of Sri Lanka.

During the early-1970s, the country was moving towards greater equity in income distribution with the left-wing government in power focusing on distribution policies and import substitution industrialisation. Growth was neglected to a large extent resulting in a drastic fall in the growth rate of the economy from 4.9% in the 1960s to 2.9% average during the 1971–77 period. It is clear that these policies were not sustainable in the long run as the economy was not generating sufficient income to support its policy of redistribution. Sources of accumulation were not adequately developed to be successful in capital formation, resulting in insufficient resources and opportunities to benefit the society at large.

The Sri Lankan polity, with a strong welfare orientation failed to identify the importance of delivery of assets and power to the people in order to lift them out of poverty and provide a means of sustenance in the long run. It also failed in creating a democratic political culture in the country, which was capable of addressing grievances of the socially excluded. These biases were reflected in the delivery of welfare resulting in the failure of the welfare state in principle to address the problems of its citizens indiscriminately.

The relatively stagnant economy of the mid-1970s resulted in the resounding victory of the UNP government in 1977, which promised a growth-oriented policy framework with liberalisation and export-oriented industrialisation as the centerpiece.

With the introduction of the new policy framework, the perception towards poverty alleviation underwent a paradigm shift from top down delivery paradigm that the country has known in the past to 'participatory development'. The poor became participants of the poverty alleviation process from a position of mere recipients of welfare services and transfers. The delivery of goods and services was replaced by an attempt at delivering power to the people to shape their own destinies. This was in effect an attempt at integrating the poor into the existing economic system by a conscious effort. The ethnic conflict however, took a turn for the worst under the new government resulting in the bloody war that has plagued the nation for two decades.

5. The Participatory Development Paradigm

With the liberalisation of the Sri Lankan economy in 1977, the focus of the state shifted towards a policy framework of growth led by the external sector. As the market became the main guide of resource allocation, the welfare framework of the pre-1977 era was largely reduced with the expectation of the trickle down effect to carry the benefits of the market economy to the lower income strata. This was the time when the ideology of participatory development was receiving much attention in international forums. The perception towards poverty alleviation was undergoing rapid change with empowerment and micro enterprises receiving attention in the developing world.

The shift from the controlled economy to a market economy saw Sri Lanka moving from delivery of goods and services to the poor to the delivery of autonomy and credit, with the state taking on a catalytic role. The decision making power was transferred to the poor themselves, to shape their own destinies within the existing economic framework. The Million Houses Programme, the Change Agent Programme and the 13^{th} amendment introduced in 1987 regarding decentralisation were all part of a process that sought to deal with the problem of poverty and inequality, which were not addressed specifically within the new economic framework. The tendency of the new economic system to actually exacerbate these problems necessitated the implementation of a parallel programme to address these issues separately.

The participatory development paradigm, which entered the Sri Lankan policy framework in 1978, through the change agent programme, was elevated to a national scale in 1989 through the 'Janasaviya' programme. This was an attempt at making the state pro-poor through nationwide mobilisation of the poor, and recognising their problems as a national problem. This was a landmark shift in Sri Lanka's poverty alleviation perception and an important step in the right direction. The current poverty alleviation programme, 'Samurdhi', came about with the change in government in 1994, as an alternative to Janasaviya, in order to overcome weaknesses in the previous programme. Samurdhi does not differ in intention and principle from the Janasaviya programme, but continues to address the issue of poverty through participatory methodology.

5.1 Janasaviya

The participatory development paradigm was elevated to a national scale with the introduction of the Janasaviya programme in 1989. The intention of the programme was to

enable the poor to establish a mode of income, either by becoming micro entrepreneurs or by acquiring relevant skills to obtain better jobs. The main tool used was a monthly cash transfer, for a period of two years, during which the households were supposed to obtain the means of exiting poverty. The cash transfer consisted of two components, (a) sum of Rs.1,000 per month granted for consumption purposes and (b) Rs.458 for voluntary saving. The cash grant was tied to a condition of 20 days of work per month by one member of each family, and 4 days of community review of actual work done. The work requirement was accommodated under the Saragam programme, which was focused on community infrastructure development. A second stream of support was provided in the form of a loan, when applied for with a feasible project.

One of the most important features of the Janasaviya programme was the intense social mobilisation process carried out at the grass root level to create awareness among the poor regarding their situation and to derive solutions from within their own communities. Communities themselves, according to local criteria, did the identification of the most needy and the lists of those selected were publicised before preparing the final identification list. This process resulted in the hardening of the identification process, making targeting more accurate. The eligibility criterion for receiving Janasaviya grants was initially set at a maximum income level of Rs.700 per household per month. However, this was later replaced by a set of region specific criteria, framed in terms of 'observable' variables such as ownership of assets and sources of income.[12]

Through the social mobilisation process and the regular community meetings, Janasaviya communities formed small groups and large organisations that actively addressed the issues of the poor communities. Another important aspect of the Janasaviya programme was the active participation of poor women in the process of poverty alleviation. The Saragam programme resulted in the formation of community assets ranging from wells to canals to pre-schools and playgrounds.

The Janasaviya programme was intended to be phased-out throughout the country in a total of 11 rounds. The first round was launched in 1989 and the 5th round which was to be the last round, in May 1994, before the change in government, which lead to the winding down of the programme.

With Janasaviya programme, numerous other initiatives aimed at poverty alleviation and human development were introduced, providing a larger pro-poor framework that went hand-in-hand with the intentions of the Janasaviya programme. These programmes sought to address the specific problems of the poor such as lack of credit, devolution of power to the community level and the problem of lack of employment opportunities.

5.2 The broader programme

The Janasaviya Trust Fund, (JTF), a US$ 1 Million fund, was inaugurated in 1991 as an initiative of the World Bank, in partnership with the Sri Lankan government. The JTF was initially to function as the apex agency that disbursed funds through partner organisations, which were NGOs, state agencies, banks, co-ops and organisations of the poor. JTF consisted of 3 main funds, which were backed by a Human Resource Development fund for the purpose of training the staff of the partner organisations and for funding the efforts of these organisations such as awareness building and entrepreneur training. The largest fund was a credit fund, which provided credit for productive investment. The other two funds, namely the rural works fund and nutritional fund were for infrastructure development and for funding the nutrition programme respectively. During the first two years however, JTF diverted from its original concept and was involved in the implementation of several small projects, neglecting its key role. Though JTF went back to its initial concept during later stages, the diversion at the earlier stages, which is attributed to differences between the World Bank and the Sri Lankan government, the performance of JTF was below expectation. With the change in government in 1994, it was finally decided to discontinue the programme.

In 1992, the Divisional Secretariat system was introduced as an administrative reform, taking the decision making level one step closer to the community level. Everything hitherto handled by the district secretariat were transferred to the divisional secretariat and to date remain the mainstream level for development in the country.

The 200 garment factories programme carried out between 1991 and 1993, was an attempt at providing employment opportunities to a segment of society that was most liable to face unemployment, namely young women from poor families. The factories were located in remote parts of the country with the vision of creating employment opportunities in the less developed areas of the country, leading to development of those areas. The employees were mainly from Janasaviya receiving families and were paid a basic monthly wage of Rs.2,500.

5.3 Achievements of the Janasaviya programme

The Janasaviya programme was a turning point in the Sri Lankan poverty alleviation perspective. The roles of the poor and the state changed drastically from the position under the welfare policy framework. The poor who were passive objects of the previous paradigm became active participants driving the process while the government, which held the decision making power and controlled the delivery function of the welfare state, took on a catalytic role under the new paradigm. A main goal of the new programme was mobilisation and empowerment of the poor, creating awareness regarding their own situation and deriving solutions that best fitted their community. The solutions took on a local outlook and drew on resources available locally. The labour of the Janasaviya recipients was mobilised to develop the infrastructure of local communities under the Saragam programme. The Janasaviya credit scheme allowed people to become entrepreneurs and develop their own businesses in their own localities. Janasaviya was a process, which targeted small communities for development nationwide and where the development process was an evolving one, which was sensitive to the needs of each community.

The cash transfer provided sought to lift the poorest of the poor out of their situation by pushing them up to a higher income decile. The value of the transfer of Rs.1,458 per month was approximately the average income level of the 3rd lowest decile of households at the time, according to the Household Income and Expenditure Survey of the Department of Census and Statistics 1990/91. Janasaviya covered around 1.1 Million households in the 5 rounds up to May 1994. However, transfers to 34,242 families in the North-East had to be suspended mid way due to deteriorating security conditions.[13]

Targeting of transfers became more accurate under the Janasaviya programme with a reduction of 31% of the families receiving transfers in the Food Stamp scheme before Janasaviya, two years into the Janasaviya programme. The social infrastructure built up through the Saragam programme was estimated to be Rs.1,139 Million in social assets and Rs.455 Million in community assets by November 1993.[14]

5.4 The Samurdhi programme

The current poverty alleviation programme of Sri Lanka, namely Samurdhi programme, replaced Janasaviya in 1995 with the change in Government the previous year. Samurdhi did not differ from Janasaviya in principle. As in the previous programme, Samurdhi consists of a cash transfer, a savings component, credit programmes and capital development programmes. The cash transfer changes in value according to the monthly income and the size of the relevant households. The cash transfer is divided among consumption, compulsory savings and a social insurance scheme. As before, Samurdhi benefits are tied up with the mandatory requirement of 'voluntary' labour for community development projects with the number of days depending on the size of the cash grant. Unlike with the Janasaviya programme, Samurdhi does not specify a time frame for receiving grants. When a household member finds employment or when a household income exceeds Rs.2,000 and remains so for six months, such households must exit from the Samurdhi programme.

A sum of Rs.25 of the cash transfer is withdrawn monthly for the social insurance scheme. The social security fund thus accumulated is used to pay social security claims in the case of births, deaths, illnesses etc.

The savings scheme under Samurdhi are twofold, with a compulsory saving component from the Samurdhi transfer being saved in either the Peoples' Bank or Bank of Ceylon through the Co-operative store and a voluntary savings scheme operating through "Samurdhi banks". Samurdhi beneficiaries are required to purchase a Rs.500 share in a Samurdhi bank to become a member of the scheme, which enables them to obtain loans from the Samurdhi banks. Loans could be obtained for both investment purposes and for consumption purposes, at concessionary interest rates.

The Samurdhi credit programme consists of several loan schemes available through the state banks. The Samurdhi Development credit scheme (SASANA) and the Samurdhi Enterprise credit scheme (SAVANA) are two such major schemes available for development purposes and as entrepreneur loans respectively. Several other smaller schemes are available for various other credit requirements.

Two types of capital development programmes are carried out under the Samurdhi programme. In the first type, labour of the Samurdhi recipients and funds from the Samurdhi Authority to rehabilitate and develop local community infrastructure as small-scale projects. The Samurdhi Commissioner's Department fully funds the second type of capital development projects, which are expected to provide off-season employment for Samurdhi recipients. These projects, which are operative on a larger scale, involve improving infrastructure such as roads, irrigation canals, bridges, safe drinking water supply facilities, dams and community centres.

Other components of the Samurdhi programme include the social development programme, which consists of an "illiteracy elimination" programme, scholarships, a narcotic prevention programme, and a programme for alcoholics and socially disadvantaged groups such as the aged, disabled persons, displaced people, victims of violence and children of single parents. These programmes consist of awareness creation, establishment of pre-schools, vocational and technical training programmes and social mobilisation programmes.

According to the Central Bank Annual Report 2001, Samurdhi absorbed 0.9% of GDP by 2001 and accounted for 4% of the total Government spending on current expenditure.

5.5 Achievements of the Samurdhi programme

The Samurdhi programme addresses poverty on many fronts. It seeks to address several dimensions of poverty through numerous fragmented programmes. However, the primary focus is on the income aspect and the main tool is the cash transfer. One of the main differences between the Janasaviya programme and the Samurdhi programme is the absence of the vigorous social mobilisation component in the latter. The lack of social action makes Samurdhi a softer programme than Janasaviya.

The number of Samurdhi recipients stood at 2 Million households by the end of 2001[15]. This figure is twice the number of poor families living below the lower poverty line of Rs.860 per capita per month according to the consumer finance survey of 1995/96. This is a clear indication that the targeting aspect of this programme is far below desirable levels of accuracy. A World Bank evaluation done on the Samurdhi programme notes that targeting levels of the programme are on par with general accuracy levels of untargeted programmes such as primary education and health services[16]. The study calculates the distribution of Samurdhi transfers from the Sri Lanka Integrated Survey 1999/2000 and shows that only around 56% of the total Samurdhi food stamp budget accrues to the lowest two quintiles, while the remaining 44% is distributed across the 3rd, 4th and 5th quintiles.[17] Targeting is more accurate between districts but less so within each district. This indicates that the problem lies at the grassroot level where most of the misallocation takes place.

The World Bank study reveals that the probability of receiving Samurdhi benefits is higher among low-income large households and also among female-headed households and families with disabled persons. However, one disturbing fact that emerges from this study is the ethnic bias in the granting of Samurdhi benefits. The study shows that Sri Lankan Tamils, Indian Tamils and Moors are less likely to receive Samurdhi grants than the Sinhalese. While the language barrier at ground level may also be a contributing factor for this situation, socio-political bias is seen as playing a major role in this regard.

Another problem that needs to be addressed is the politicised nature of the targeted poverty alleviation programmes in Sri Lanka. The selection process of the Samurdhi beneficiaries and the Samurdhi animators is arbitrary to a large extent and does not follow a system that would eliminate political bias. The Samurdhi programme received a lot of criticism during the last regime due to the politicised nature of the programme.

6. Evaluation of the poverty levels in the post-liberalisation period

In measuring the success of the poverty alleviation programmes in the post-liberalisation period, the effects on the income of the poor, the level of poverty and the behaviour of the income gap would give insights to the nature of the success achieved through these programmes. The post-liberalisation period saw the Gini coefficient on an upward trend, rising from 0.43 in 1978/79 to 0.45 in 1981/82 and reaching 0.46 the 1986/87 period. However, income distribution data show an equalising trend from 1986/87 to 1996/97 period, with the income share of the poorest 40% increasing to 15.3% from 14.14% and that of the richest 20% declining from 52.3% to 49.9%. The Gini ratio shows an improvement from 0.46 to 0.43.

Table 13 : Income distribution
(% income received by spending units)

Income group	1973	1978/79	1981/82	1986/87	1996/97
Poorest 40%	19.29	16.06	15.25	14.14	15.30
Middle 40%	37.76	34.07	32.79	33.56	34.80
Richest 20%	42.95	49.87	51.96	52.30	49.90
Gini Ratio	0.35	0.43	0.45	0.46	0.43

Source: Central Bank of Sri Lanka, (1998), Economic progress of Independent Sri Lanka.

However, figures for 1995/96 obtained from the Department of Census and Statistics (DCS) Household Income and Expenditure Survey (HIES) show that the Gini coefficient for 1995/96 was 0.46 and that the incidence of poverty increased to 25%, according to the lower poverty line, from 21% in 1990/91. The Consumer Finance Survey (CFS) of the Central Bank of Sri Lanka (CBSL) indicates that the level of poverty fell to 19% by 1996/97. Though the CFS data is not strictly comparable with HIES data, it indicates that there would have been an improvement in poverty levels during that one-year of economic recovery. Considering the difficulties undergone by the economy in 1996 in the form of a severe drought and power crisis, this is an indication that even with a poverty programme in place, people at the lower income strata remain vulnerable to shocks to the economy. Data from the DCS HIES also show that for the lowest 4 quintiles more than 10% of their income accrued from government transfers. For the poorest 10% of the households Janasaviya/Samurdhi benefits were 25% of their total monthly income. Fifty to sixty five per cent of the households in the lowest 4 quintiles received such benefits[18].

Data indicate that 34.6% of the households in the lowest income decile do not receive Janasaviya/Samurdhi/food stamps, while 38.2% of the households in the 6^{th} decile, with an average income of Rs.4,836 per month receive such benefits. The targeting of benefits is not satisfactory with targeting missing a substantial proportion of eligible households and benefits accruing to households that are not poor[19].

The rural concentration of poverty and the specific nature and sectors of employment of the poor indicate that Sri Lanka's development process has been heavily concentrated both regionally and sectorally. Observation of the infrastructure availability and accessibility regionally confirms this fact further.

Table 14: Access to basic utilities and services by sector

Sector	Access to (%)			Travel time (Minutes)		
	Safe drinking water	Safe sanitation	Electricity	Main Road	Bank	Bus Stop
Urban	97	91	84	11	12	13
Rural	74	72	57	19	28	24
Estate	72	60	43	38	50	44

Source: The World Bank, Sri Lanka Poverty Assessment based on Sri Lanka Integrated Survey 1999/2000, Colombo.

Statistics show that access to infrastructure and economic and social facilities differ according to the level of per capita consumption (Table 15). The level of development of infrastructure and facilities is a decisive factor in the level of private investment in each region.

Table 15 : Access to basic utilities and services by consumption quintile

Consumption Quintile	Access to (%)			Travel time (Minutes)		
	Safe drinking water	Safe sanitation	Electricity	Main Road	Bank	Bus Halt
Poorest	61	55	38	22	31	28
Second	74	67	49	20	31	24
Third	78	75	60	21	30	25
Fourth	82	82	67	20	27	23
Richest	89	89	82	16	22	20

Source: The World Bank, Sri Lanka Poverty Assessment, based on Sri Lanka Integrated Survey 1999/2000, Colombo.

A key ingredient in alleviating poverty is pro-poor growth. Sri Lanka has managed to maintain an average growth rate of around 4% since liberalisation and for the last decade this figure has been around 5%. While expansion of economic activity and increase in the creation of economic value would lead to higher employment and growth in resources, the benefits of growth will not accrue to the poor at large unless a conscious effort is made to direct resources towards this end. During the last two decades, Sri Lanka's national production structure has changed from an agriculture-based economy towards services and manufacture. The contribution of agriculture to GDP has dropped drastically from 31% in 1977 to 20.1% in 2001. Growth in the agricultural sector has fallen from 3% during the1951-77 period to 2.4% during the 1978-96 period. In 2000, the contribution to change in GDP by agriculture was 6.3% compared to 25.9% by manufacturing and 59.6% by the services sector. However, 46% of the country's labour force is employed in the agricultural sector, which also hosts the largest proportion of the country's poor. The diminishing importance of agriculture in the country's growth process has resulted in aggravating problems of this sector and worsening of the situation of the people involved in agriculture. Statistics indicate that the use of technology, for example in terms of the use of tractors, is at a very low level in the agricultural sector in Sri Lanka and is below the regional average.

Table 16: Use of technology in Agriculture

Country	Tractors in use in Agriculture (Total)				
	1971	1977	1990	1999	Exponential Growth
Bangladesh	2,270	3,454	5,200	5,450	3.11
Sri Lanka	**14,776**	**13,000**	**6,500**	**8,000**	**-2.65**
India	143,000	294,313	988,070	1,520,000	8.88
Indonesia	9,000	9,160	27,955	70,000	7.95
Malaysia	5,097	7,135	26,000	43,300	8.37
Nepal	800	1,740	4,400	4,600	6.46
Pakistan	24,000	61,500	265,728	320,500	9.91
Philippines	7,212	10,616	10,700	11,500	1.33

Source : FAO, www.fao.org

Limited access to technology results in low productivity and fall in competitiveness in agriculture. Effective use of technology in agriculture would lead to better-output and higher income for those involved in this sector. As shown in Table 17, statistics also reveal that in rural areas, the richer percentage of population derive most of their income from non-farm activities.

Table 17: Composition of rural income

Rural Income (Rs/Month)	Non-farm share (%)
1,000	25-30
2,000	35-40
3,000	50-55
4,000	65-70
5,000	75-80

Source : The World Bank, Sri Lanka Integrated Poverty Survey 2000/2001, Colombo.

Sri Lanka's highest export earning industries, namely the tea sector, the garments industry and migrant workers predominantly employ poor women at the production level. Though these industries enjoy an important position in the country's growth process and the balance of payments, the women employed in these sectors face numerous hardships and remain poor, especially in the Estate sector. This indicates that sectoral growth must also be made pro-poor through a conscious effort.

The experience of the anti-poverty programmes in Sri Lanka, reveal the role women play in the development of their communities. Enhancing and utilising energies of women in the development process would be mutually beneficial to poor women and the country at large. Though Sri Lanka shows an impressive rate of literacy and higher education for women, disparities remain in these areas between males and females. The education of girls is an important contributor to better health and education for the next generation and will affect fertility and infant and maternal mortality rates positively. Research has attributed 1 year of a mother's education to a 9% decline in under-5 mortality of children.[20] The empowerment of women and drawing them out to participate and take leadership in the country's poverty alleviation process would offer new insights to the development agenda of the country. While income poverty does not show a wide gap between male and female poverty levels, female empowerment remains low according to the Gender Empowerment Index. There are serious disparities in political participation of women and female presence in decision-making positions. Female perception of poverty and development and their experiences within the family and the community would give the development process a more people-based outlook. The economic value of female labour would be a major boost to low income families and would help them to rise out of poverty.

Various countries use different methods in dealing with poverty. There are strengths and weaknesses in each strategy as in the case of Sri Lanka. These strategies could be broadly categorised into two types, that is, countries having a separate poverty alleviation programme and those incorporating poverty alleviation strategies into its macro policy framework. The nature of poverty is such that it has to be dealt with at the roots and oppressive structures broken down to prevent the emergence of polarisation and marginalisation. The issues addressed by a separate anti-poverty programme must be sustainable in the long run. To substantiate achievements in the poverty alleviation effort, all essential features in addressing poverty must be brought into the broad policy framework and given a national focus. From the position of a "national plan for poverty alleviation" Sri Lanka needs to move towards a pro-poor national development plan, where the country's policy framework takes on a pro-poor outlook

The issues that emerged in the discussion regarding the measures in place in Sri Lanka to combat poverty reveals the areas neglected or not appropriately addressed in the country's struggle against poverty so far. The success of Sri Lanka's future poverty alleviation attempts will depend on addressing these issues and attacking poverty at its root.

7. Recommendations

When drawing up a plan of action to alleviate poverty both short-term and long-term aspects must be taken into consideration and these two components must converge at some point. The short-term objective should deal with temporary protection for the poor until the economy can offer them better opportunities to rise out of poverty and reduce their vulnerability. The long-term strategy must ensure that these opportunities emerge out of the country's economic and governance structures.

7.1 Improvements to the separate poverty alleviation programme

The short-term goals can be addressed within the explicit anti-poverty programme that is in place in the country at the moment. The weaknesses identified in the discussion of the Samurdhi programme need to be addressed in the short run to improve the appropriateness and the quality of the assistance provided through this programme. Targeting must be improved and ethnic and political biases eliminated in delivering poverty benefits. Since the state will play a major role in running the programme, measures have to be built into the system to safeguard the delivery of benefits from political influence. This can be achieved to a large extent by making the process of selection of both animators and beneficiaries transparent and in accordance with clearly specified criteria. Awareness creation and better monitoring will act as a hindrance to possible ethnic bias. Participation of the poor in the programme must be strengthened at the grassroots level to improve targeting within provinces. The process of mobilisation must be an ongoing one, which would lead to empowerment and recognition of economic and basic human rights. It must also create awareness of the process of poverty alleviation and training for the poor to articulate their problems and concerns effectively. The dialogue with the poor has to be strengthened and the line of communication kept open to ensure that the process is driven by the needs of the poor communities.

Another aspect of having a dedicated anti-poverty programme is the need to protect and sustain the socially marginalised and the permanently unemployable. Various social groups such as women, children and refugees require special measures to address their problems of social bias and vulnerability. A targeted programme is necessary to address these issues, which demand special attention. Households at the lower end of the income spectrum, supporting disabled family members need to be supported through state programmes. A safety net should be in place to protect such people from falling into poverty.

7.2 Asset ownership

An important aspect to poverty alleviation is the ownership of assets by the people. Issues of land distribution, house ownership and ownership of other assets must be looked at and the necessary legal framework established to enable the transfer of asset ownership to the poor. Redistribution of state-owned land and the introduction of credit schemes aimed at housing, machinery and equipment for the poor will result in building up the asset base of the poor. Economic freedom and power that comes with the ownership of assets is a cornerstone in the process of poverty alleviation.

7.3 Rural savings

Rural savings are generally low due to the low level of income earned by the rural population. An important source of savings that accrues to this sector is the remittances of the low-income migrant workers. Introduction of special schemes to encourage such transfers to be kept longer in the banking

system would greatly enhance the rural savings component. The savings of the rural poor must be directed to be invested in a manner beneficial to them and avoid rural surpluses from being transferred to urban areas through the banking system. By popularising banking practices in rural areas and offering guidance and information on saving and prudent investment, rural savings could be utilised in investment projects in those same regions.

7.4 Macro-Micro linkages

Linking of poverty alleviation measures taken outside the main system, such as delivery of goods and services to the poor in the form of cash transfers, credit schemes and health and education services with the broader macroeconomic framework is essential in sustaining the outcomes of such programmes.

Another aspect that needs to be addressed in converging with the macro framework in the long run is the job creation process for the poor using various credit schemes. While initially these enterprises will serve as a source of income and bring relief to the poor, they need to have market access and steady demand to develop in the long run. Expansion possibilities must exist for these small businesses to stabilise and grow without falling victim to market competition.

Linking micro level programmes with the macro framework requires reshaping of strategies at both levels to achieve a common goal. Development of markets and productive employment in poor communities call for development of infrastructure and other facilities in these areas. The linking of these less developed areas to developed regions and main towns require development of a sound road network and a good transportation service. Making technology accessible to all regions of the country is an important step in bridging the development gap within the country. Telecommunication and Information Technology will play an important role in connecting regions, resulting in better market access and business knowledge for the industries in poor communities.

7.5 Equitable development

This leads to the question of equitable development that must be addressed at national level, within the country's national development framework. Planned action has to be taken to address the disparities within regions in infrastructure development and delivery of facilities. Development of these facilities in less developed regions will stimulate private investment in these regions, leading to employment generation and further development. This will limit rural-urban migration contributing positively to controlling the expansion of the urban poverty problem. A bottom up approach to identifying development requirements within regions would lead to higher productivity of the resources allocated for development. The National development strategy should be formulated with sensitivity towards the people's development requirements where the need-based regional development plans are integrated and reflected at the national level.

7.6 Pro-poor growth

Pro-poor growth will take place when bottlenecks are removed, allowing the benefits of growth to reach the poor. Making technology accessible to poor producers and developing and adding value to their skills will in turn add value to their output and increase productivity. This will lead to better prices for the producers. When directing resources towards sectors with the intention of overcoming poverty through growth, it must be ensured that the low-income

workers involved in the industry receive the benefits of such interventions. Analysis shows that the trickle down effect has failed to operate within industries as well as in the overall economy. In order to reverse this trend, specific attention must be paid to ensure that the workers receive a fair share of benefits from sector growth. The establishment and protection of their rights, security and decent living conditions, fair wages and the necessary legal framework to address their grievances are essential factors in uplifting these workers and enabling them to exit poverty in all its dimensions.

7.7 Empowerment of women

An area that needs special focus in the struggle against poverty is the development needs of women who are poor. There is much to be gained by enhancing and extending the contribution women make within their families to the development of the community. Female education must be given special attention and opportunities created for women to participate more in the labour force with measures in place to deal with problems women would face due to their gender. Empowerment of women, however, goes beyond the legal framework and economic opportunities. Overcoming social restrictions and restrictive attitudes within institutions are essential factors in addressing the problem effectively. Awareness creation and strengthening of the gender dialogue are important aspects in the empowerment process of women.

7.8 Broad policy framework

The effectiveness of poverty alleviation measures will to a large extent depend on incorporating such measures within the macro policy framework. Various components that contribute towards poverty alleviation and social development, which fall under different ministries must be co-ordinated and recognised as parts of one integrated development plan. To effectively deal with the problem of poverty, fiscal and industrial policy must also take on a pro-poor slant. The national budget should reflect the needs of the people as identified through the process of poverty alleviation. Industrial development must be broad based and moved out of main cities to allow industrialisation to reach rural areas. Encouraging private sector initiatives in the suburbs and the rural sector will lead to rapid development of these regions. Creation of an investor friendly environment in these regions will contribute towards this end. The challenge before Sri Lanka's policy makers is to integrate the domestic development requirements with sustained growth to achieve equity and social justice. It must be recognised that this end cannot be reached only by achieving macro stability and high economic growth.

The current dominant economic ideology and the global environment define a certain pathway to development. The need for resources, high level of integration, and dependence on the global system compels developing countries to adapt their structures to be receptive to these factors. There is much to be achieved through the expansion of markets and the growth of capital. Lack of these conditions would hinder growth and hence the expansion of the already scarce resource base of developing countries. However, the net result of growth and capital accumulation should not be marginalisation and impoverishment. The possibility of widening of the income gap due to the failure of the results of growth to trickle down and the exploitation and degradation of labour due to capital expansion must be avoided through intentional measures. Enhancing labour productivity through training and making information accessible to workers will strengthen the position of manual workers. In the current development dialogue, Cowen and Shenton (1996) talk of two types of development, i.e.

"immanent development", which is driven by "an inner logic or dynamic" and "intentional development", which "consists of the means to compensate for the destructive processes of immanent change".[21] These two processes must work together to achieve meaningful development.

The macroeconomic framework of the country should be sensitive to these different needs apart from having a separate programme to deal with the problems created by or neglected by the main economic and governance structures.

7.9 Role of the Government

The state has an important role to play in the field of poverty alleviation to create a structure that ensures social justice and equity in income distribution. The responsibility of bringing these issues to the forefront of policy making and creating an environment, which is receptive of these ideas, lies with the government. While the government is being phased-out of most areas of the economy, it is necessary to clearly identify and define the responsibilities of the state. The experience of the third world is that poverty is a problem that the market cannot solve without certain interventions and clear guidance. The government must continue to play a catalytic role in mobilising the poor and providing a safety net to ensure immediate relief. It is the responsibility of the state to shape the nations thinking towards a pro-poor framework. The government needs to give direction to the private sector to take the lead in industrial development that would be beneficial to a wide spectrum of the Sri Lankan society. The elimination of ethnic and gender biases has to be dealt with consciously and the state must take the lead in this activity through awareness creation and building of the legal infrastructure to protect these groups from discrimination. Dialogue at the grassroots level must be strengthened and communication channels left open to continue the flow of information between the people and the government. The government has a role in creating markets and making markets accessible to the rural producers. Distribution channels must be established and technology and high quality inputs made accessible to increase productivity of rural farmers.

7.10 Devolving power

Another important aspect of pro-poor governance is the devolution of power, closer to the community level. Strengthening of the country's democratic political structure will enhance pro-poor development. In order to enable the people's participation in the development process political power to realise their needs must be made accessible. However, in the case of Sri Lanka, the question of devolution is dealt with on a different platform, in the context of peace making. Nevertheless, the importance of devolving decision-making power and the authority to implement development plans according to local requirements must be kept in mind when dealing with this issue.

7.11 The Peace Process

In the case of Sri Lanka, achieving peace will play a vital role in the poverty alleviation process. Peace will ensure the direction of resources towards productive economic activity and create an environment conducive for investment. During the last 7 years over 5% of GDP has been spent as defence expenditure.

Table 18: Defence cost as a percentage of GDP

	1980	1985	1990	1995	2000	2001
Gross defence expenditure	1.3	4.5	4.1	6.5	6.1	5.5

Source : Central Bank of Sri Lanka, *Annual Report 2001*, Colombo.

Destruction of property and interruption of economic activities in the war-torn areas have had grave implications for the country's economy. The human cost has created economic costs for the families affected and the military expenses have been a drain on the country's resources. Hence, the success of ongoing peace process will have important implications for poverty in Sri Lanka, both in terms of releasing resources for productive economic use and in halting the creation of conflict-related poverty.

8. Conclusion

The logic that must drive the poverty alleviation process is the realisation that poverty in effect is the failure of development. Economic and power structures that stand in the way of eradicating poverty must be broken down and pro-poor structures established. The UNDP Poverty Report 2001 on 'overcoming human poverty' notes, "the non-poor must be concerned to eliminate poverty or the poor organised to demand it". Both these components have to be present in order for the process of poverty alleviation to be of a national outlook, rallying all sections of society and all units of the country's economic and governance structures.

Footnotes

1 Department of Census and Statistics, 1995/96, Household Income and Expenditure Survey.

2 "Percentage of population for whom the a minimum of 20 essential drugs are continuously and affordably available at public or private health facilities or drug outlets within 1 hour's travel from home". - UNDP, 2001, Human Development Report: Making new technologies work for Human Development, Oxford University Press.

3 UNDP, 2001.

4 Income poverty arises due to low income, denying households access to basic economic necessities. The level of income poverty is measured using a poverty line, which is an estimated per capita cost of a bundle of basic food and non-food consumption bundle. Sri Lanka does not have a national poverty line. The Department of Census and Statistics uses Rs.791 as the lower poverty and Rs.950 as the higher poverty line. The Central Bank of Sri Lanka uses Rs.860 and Rs.1, 032 as the lower and higher poverty lines respectively.

"A composite index measuring gender inequality in three basic dimensions of empowerment

– Economic participation and decision making, political participation and decision making and power over economic resources"

- UNDP, 2001

6 "A composite index measuring average achievement in the three basic dimensions captured in the HDI

– a long and healthy life, knowledge and a decent standard of living

– adjusted to account for inequalities between men and women".

- UNDP, 2001

7 Jayasuriya, Laksiri, (2000), Welfarism and politics in Sri Lanka, University of Western Australia

8 ibid

9 Central Bank of Sri Lanka, 1998, Progress of Independent Sri Lanka

10 Jayasuriya, Laksiri, (2000), Welfarism and politics in Sri Lanka, University of Western Australia.

11 Central Bank of Sri Lanka, Annual Report, 2001, – Table 31

12 World Bank, Sri Lanka Poverty Assessment, 1995

13 The World Bank, (1995), Sri Lanka Poverty Assessment.

14 Sirivardana, Susil: A Sri Lankan study on Decentralisation, Poverty Eradication and Governance.

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18 Department of Census and Statistics, 1995/96, Household Income and Expenditure Survey

19 ibid

20 SAARC, (1992), Report of the Independent South Asian Committee on Poverty Alleviation: Meeting the Challenge.

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Chapter 7

Reform Agenda and Challenges for Poverty Alleviation Programmes

- Kalinga Tudor Silva, Myriam Fernando and A.K. Jeyanithe -

1. Introduction

Protagonists as well as critics of the economic reform agenda in Sri Lanka have employed a poverty analysis of some kind in order to support their arguments. For instance, the World Bank studies on Sri Lanka have repeatedly argued that slow economic growth caused by inadequate economic reforms and prevailing constraints to market-led rapid economic growth remain the root causes of reported high incidence of poverty (World Bank 1995, 2002; Bhalla & Glewwe 1986). On the other hand, critics of liberalisation policies tend to attribute emerging poverty trends as well as varied manifestations of conflict to social and economic polarisation and patterns of social tension produced by the liberalisation policies themselves (Clearly 1995; Moore 1995;

Lakshman 1997; Dunham 2000). In recent years as far as state policies are concerned the neo-liberal approach has gained ground with both of the two leading political parties in the country adopting market friendly policies. Sri Lanka's Poverty Reduction Strategy (PRS) as well as a subsequent policy statement titled 'Regaining Sri Lanka' are unambiguous in its emphasis on "pro-poor growth" and support for private as against state-mediated economic activity as a pre-requisite for poverty reduction (GOSL 2002).

Focusing on the Samurdhi Programme, the lead public sector programme for poverty alleviation in Sri Lanka as of 2002, the present chapter examines internal and external pressures for reforming or restructuring the programme, linkages of such pressures to the economic reform agenda driven by international lending agencies, current plans for restructuring the programme and viability of and possible challenges for the proposed reforms. Our analysis is based on examination of available literature as well as results of some recently concluded and ongoing research by the Centre for Poverty Analysis.

The chapter begins with a review of poverty analyses conducted by advocates of economic reform. Effort is then made to situate the Janasaviya – the predecessor to Samurdhi - and Samurdhi programme within the socio-political and policy context of Sri Lanka. Key parameters of the Samurdhi Programme are then discussed followed by an analysis of internal and external pressures for restructuring the programme. The chapter goes on to examine viability and possible impacts of the proposed changes. Finally certain recommendations towards evolving a realistic and socio-economically and politically sensitive poverty reform agenda are offered.

2. Poverty Analysis in the Context of Neo-Liberal Reform Agenda

A series of studies conducted by the World Bank, including Sri Lanka Poverty Assessments of 1995 & 2002, Sri Lanka Integrated Survey 1999-2000, and Sri Lanka: Recapturing Missed Opportunities (2000), have consistently marshalled evidence to show that even though Sri Lanka has made substantial progress in terms of quality of life (or human development) through a comprehensive programme of public sector investment in education, health and social welfare in general, Sri Lanka's record in reducing 'income poverty' has been rather disappointing. Further, it has been argued that policies favouring market/private sector led rapid economic growth are necessary if Sri Lanka is to make any substantial headway in poverty reduction. More recently the World Bank sponsored studies have also highlighted the need to reorient poverty alleviation policies and programmes in order to facilitate economic reforms and make the programmes more effective in reducing poverty.

In making a case for economic reforms as a prerequisite for reducing poverty in Sri Lanka, the World Bank studies have relied on three sets of comparisons. First, a comparison between poverty and income trends in Sri Lanka and selected countries in South East Asia where reform agenda has been more aggressively pursued. Second, a comparison of poverty trends in Sri Lanka over time so as to determine the impact of notable changes in the policy environment, understood as moves towards or moves away from the reform agenda. Third, a comparison of poverty profiles for various sectors and various regions in Sri Lanka with a view to assess differences in poverty incidence and trends in more advanced as against less advanced sectors within Sri Lanka. Inter-country comparison of income and poverty levels remains central to neo-liberal assessments.

Table 1 : Per Capita GNP and Incidence of Poverty in Selected Countries

Country	Income US$ Per Capita GNP 1960s	Income US$ Per Capita GNP 1999	Poverty Incidence (% of Population Below Poverty Line) International Poverty Lines $ 1 a day	Poverty Incidence (% of Population Below Poverty Line) International Poverty Lines $ 2 a day	Poverty Incidence (% of Population Below Poverty Line) National Poverty Line
Indonesia	55	580	15	66	20
Rep. Korea	94	8,490	>2	>2	-
Malaysia	338	3,400	-	-	15
Sri Lanka	151	820	7	45	25
Thailand	149	1,960	>2	28	13

Source: World Bank (2002), p2.

In the 1960s Sri Lanka's income per capita was higher than that of Korea and comparable to that of Thailand and prospects for balanced development brighter for Sri Lanka in view of the country's small size and progress in democratic political processes. By the end of the 20th century, income in Sri Lanka was less than half that of Thailand, one-fourth that of Malaysia, and just one-tenth that of Korea. Correspondingly, Sri Lanka made much less progress in reducing poverty compared to selected South East Asian countries, excluding Indonesia, irrespective of whether we use national poverty lines or International poverty lines.

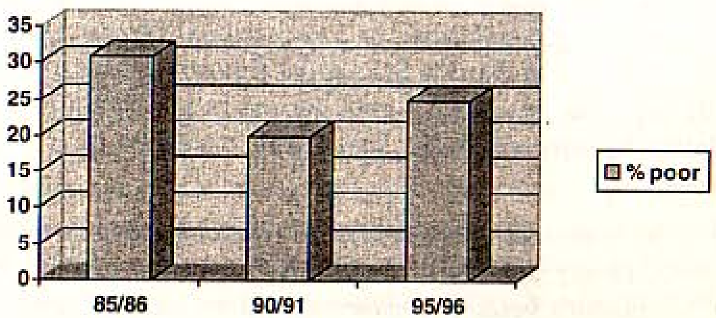
The World Bank's Sri Lanka Poverty Assessment for 2002 explains Sri Lanka's poor record in poverty alleviation relative to selected South East Asian countries in following terms:

> *An explanation for Sri Lanka's relatively slower progress in reducing poverty and increasing average incomes is the country's hesitant embrace of modern economic and social policies. Such policies would have led to: (a) withdrawal of*

the state from all areas where the private sector can be more efficient and removal of regulations hindering the effective functioning of markets, with a view to evolving a policy framework that supports creation of opportunities; (b) focusing the state on the provision of much needed infrastructure that the private sector cannot provide; (c) social policies accommodating diversity-ethnic, linguistic, political, religious- and understanding among different groups, providing fair and transparent access to resources and opportunities, and providing smaller and more transparent anti-poverty programs, focussed on the poorest. (World Bank, 2002: 2).

An assessment of poverty trends in Sri Lanka over time in relation to progress in economic reform agenda has been made difficult by inconsistent and terse implementation of the reform agenda itself and complications caused by the impact of civil war and natural hazards on consumption and poverty trends in the country. The World Bank Poverty Assessments for Sri Lanka found a reduction in poverty between 1985 and 1990 and a reversal of the trend in 1995 (see Figure 1).

Figure 1: Incidence of Poverty in Sri Lanka, 1985/86-1995/96

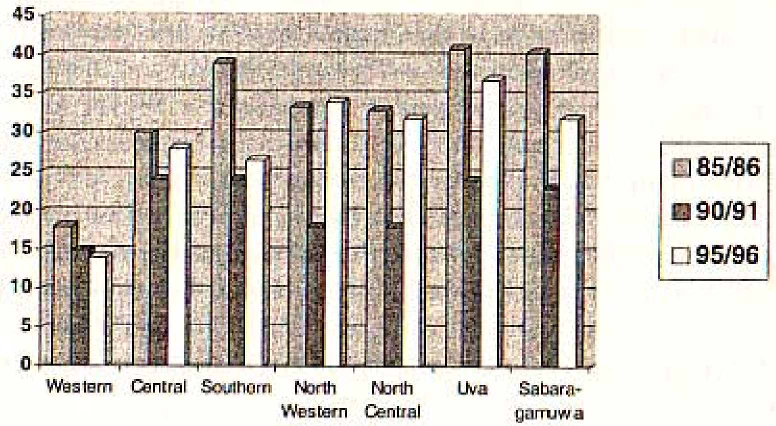


Source: World Bank (2002), p. 5.

These trends were largely attributed to changes in GDP growth rate and war and environment-related shocks and disturbances. According to the World Bank accounts, the economic reform agenda that began in 1977 faltered in the early-1980s and resumed with some vigour in 1989. In explaining the reported poverty trends the World Bank emphasised that these short-term trends are more directly attributable to the path taken by the civil war and environmental shocks rather than any shifts in the policy environment per se. The World Bank Poverty Assessment of 1995, however, was keen to point out that the downward trend in poverty between 1985 and 1990 reflected that the reform agenda resumed in 1989 did not have an adverse impact on poverty in the short-term.

Studies using a neo-liberal framework have paid greater attention to inter-sectoral and inter-regional variation in incidence of poverty. The reported incidence of poverty is highest in the rural sector, followed by the estate sector and the urban sector. The incidence of poverty in the rural sector was 27% in 1995 as compared to 25% in the estate sector and 15% in the urban sector (World Bank 2002). In terms of poverty trends, while the urban sector has shown a consistent decline since 1985, there were marked fluctuations in the other two sectors. In terms of regional differences in poverty incidence, the more urbanised Western Province has reported the lowest incidence of poverty (14% as of 1995), as against 37% in the more remote Uva Province (See Figure 2).

Figure 2: Trends in Poverty Incidence in Sri Lanka by Province 1985/86 -1995/96



Source: World Bank 2002, p. 8.

These sectoral and regional differences are attributed to divergent rates of economic growth, which in turn are explained in terms of notable differences in policy framework surrounding the respective economic activities. "Poverty is lower and has unambiguously declined in the urban sector, where the most dynamic activities - manufacturing and services - are concentrated" (World Bank 2002: 11). On the other hand, heavy state-ownership of land and water resources, unacceptable levels of government regulation in production and distribution of agricultural commodities and policies unfavourable to the development of market forces in agriculture in general have been identified as key constraints to economic growth and reduction of poverty in rural areas (World Bank 1996).

Essentially informed by neo-liberal perspectives, the World Bank studies have worked towards developing a comprehensive and an integrated framework for understanding poverty trends in Sri Lanka. In addition to utilising available data, the World Bank funded studies have

also tried to address gaps in available data, including significant data gaps relating to the conflict-affected areas. Most importantly, the World Bank initiated poverty analyses have been closely integrated with a worldwide push of an economic reform agenda. The poverty analyses conducted by the World Bank aimed at not only correcting anti-poverty policies and programmes but also asserting the need to fall back on the economic reform agenda in order to correct all evils in economic and social systems. Downsizing the state and expanding opportunities for the private sector and market forces in general are the key remedies proposed by these studies. A deeper and more nuanced understanding of the specificity of the Sri Lanka situation may be necessary in view of its widely acclaimed gains in human development, which in turn can be directly attributed to state policies and programmes encompassing universal coverage in health, education and welfare services (Dunham 2000).

The World Bank studies on poverty in Sri Lanka focus on growth issues to the neglect of distributional issues. This may be justified in view of the gains already made by Sri Lanka through public funded universally free educational and health services. No one can deny that without rapid economic growth it will not be possible to sustain the Sri Lankan welfare state in its current form. However, the war and various other manifestations of social tension in Sri Lanka clearly point to the fact that distributional issues continue to be as relevant as growth issues. For instance, the rural urban disparities in poverty levels noted in the World Bank studies not only point to the need for policy options favouring higher growth in the rural areas. They also call for a re-examination of the existing policies with a view to assessing their possible impact on intensifying rural-urban and other forms of disparities (Clearly 1995).

In the remaining sections of this chapter we review the poverty alleviation programmes of the Sri Lankan state in relation to socio-political realities in the country and imperatives of economic reform.

3. An Overview of Publicly-Funded Anti-Poverty Programmes in Sri Lanka since Independence

The early achievements of the Sri Lankan welfare state were typically associated with public funded programmes in health, education and food subsidies covering the entire population of the country. These programmes evolved since the last years of the British colonial rule in response to a variety of circumstances like the devastating malaria epidemic of 1934-35, gradual institutionalisation of electoral politics since 1931, populist political demands articulated by a variety of leftist and nationalist politicians and a favourable revenue base of the Ceylonese state at the time. In addition to the universally free services in education, health and rice subsidies there was also a programme of poor relief for the benefit of the destitute dating back to the British period.

A shift away from universal coverage to more focussed and targeted anti-poverty programmes occurred with the abolition of the rice ration scheme and establishment of a food stamp scheme in its place in 1978. The rice ration scheme had been in operation since the 1930s. Unlike the rice rations, which were available to the entire population, the food stamps were targeted to poorer section of the population. This was largely due to the fact that the rice subsidy accounted for 17% of government expenditures and 6% of GNP as of mid-1970s (Sahn and Alderman 1996; World Bank 1995). Furthermore, the subsidies on rice prices created disincentives to rice producers and caused distortions in the market. With economic stagnation and growing unemployment, the need to realign the country's welfare

programmes arose. The result was a gradual shift from programmes of universal coverage to targeted programmes where income criteria were used to identify the beneficiaries. This resulted in a significant reduction in the number of beneficiaries, limiting the food rations to such families whose income fell below a particular cut off point. The cost of the Food Stamp Scheme was 0.7% of the GDP in 1992 as compared to 7% spent on the rice subsidy in the 1970s (World Bank 1995).

Secondly, with the introduction of the Food Stamp Scheme in 1979 nature of subsidy changed from a ration of goods to an income subsidy. The major fiscal advantage of the Food Stamp Scheme was the nominal (i.e. rupee) value, thus allowing for a 'stable' budget. This on the other hand, was less advantageous to the beneficiaries, since the real value of the food stamps decreased as food prices rose. However, distribution of food stamps was often guided by political considerations rather than the stipulated income criteria, resulting in poor targeting of the programme.

There has been a proliferation of government-initiated poverty alleviation programmes in Sri Lanka since 1977 (See Table 2). The economic liberalisation policies introduced since 1977 were certainly an important factor that shaped the anti-poverty policies and programmes in the subsequent period. On the one hand, anti-poverty programmes initiated since 1977 tried to offset any adverse impact of the reform process, including removal of subsidies. On the other hand, the new programmes aimed at removing any obstacles to the reform process arising from anti-poverty activities themselves. Overall there was a change in the stated objectives from welfare to growth and a reliance on pure handouts to providing incentives towards promoting private initiatives.

Table 2: Selected Poverty Alleviation Programmes in the Public Sector Since 1977

Programme	Began	Ended	Focus
Food Stamps Scheme	1979	1994	Welfare
School Mid Day Meal	1989	1994	Welfare
IRDPs	1979	2000	Growth
200 Garment Factories Programme	1990		Growth
Change Agent Programme	1978	1998	Welfare and Growth
Janasaviya Programme	1989	1995	Welfare and Growth
Janasaviya Trust Fund	1991	1994	Welfare and Growth
Samurdhi Programme	1994		Welfare and Growth

Source: Silva, Abaysekera, de Silva & Nanayakkara (1996), p. 35.

The poverty alleviation initiatives in Sri Lanka since 1977 were shaped by influences from bilateral and multilateral donors as well as pressures from within Sri Lanka. The increased donor support consequent to the shift to the liberalised policy regime in turn called for a greater receptivity towards donor influences. On the other hand, there were diverse pressures for addressing poverty from within the local political environment. They included the need for the ruling political parties to win popularity among the poorer sections of the population in order to gain a competitive edge in their election campaigns. There were also increased challenges for the state in the form of youth uprising in Southern Sri Lanka in 1971 and 1987-89 and Tamil separatist movement gaining ground in the North since 1983. Such challenges, in turn, necessitated the state and the ruling elites to pay greater attention to social justice issues. The Janasaviya Programme started in 1989 and the Samurdhi

Programme that succeeded Janasaviya in 1994 reflected the impact of these divergent and often contradictory influences.

The Janasaviya Programme

The Janasaviya (lit 'people's power') Programme (JP) was a prominent public sector programme aimed at total eradication of poverty in Sri Lanka within the space of 11 rounds (22 years). Mr.R.Premadasa, a popular politician of the ruling United National Party, who had grassroots level connections, gave leadership to this programme. In each round lasting for two years, the poor in selected areas within each District were identified and provided with a fixed monthly cash transfer consisting of a consumption grant and a component of 'compulsory saving', expecting them to progressively work towards moving out of poverty using the cash grants, concessionary loans, social mobilisation, entrepreneurial and skills training provided by government and non-government agencies collaborating with the programme. The key elements of this programme are spelled out in Chapter 6.

From the poverty reform point of view JP had several positive features:

First, it continued the departure from universal coverage evident in welfare programmes in the previous era and tried to evolve more objective criteria for identifying the poor. The eligibility criteria was initially set at income below Rs. 700 per month per household and lists of those selected was presented at a public rally (Janahamuwa) at the village level so that those disagreed with the selection process could present their views at this rally. According to one estimate, there was a 31% reduction in number of beneficiaries in JP as compared to the previous Food Stamp Scheme (see Chapter 6).

Second, it envisaged ending of dependency of the poor on state handouts as cash transfers were given only for a period of two years and the beneficiaries were expected to gradually work towards developing their own livelihoods within the stipulated time period. While this may be seen as an unrealistic target, it underscored the necessity on the part of the poor to develop their own livelihoods within the two-year period of Janasaviya support (Mendis 1992).

Third, JP also sought to build community infrastructure through mobilisation of voluntary labour of the beneficiaries and provide incentives to the poor to pursue their comparative advantages within the liberalised economic environment. This was particularly important given the political tensions prevailing in Sri Lanka at the time and the possibility of impoverishment adding to existing tensions in the country.

However, JP also presented several problems from the angle of poverty reform.

First, in view of the heavy burden to the treasury the programme was scaled down and this meant that the time limits initially set for the programme could not be met in reality. For instance, beneficiary households were expected to get a lump sum payment of Rs.25,000 at the end of the two-year period to be used as capital for micro enterprise if necessary. However, due to fiscal constraints of the government this did not happen, but a monthly interest payment of Rs.250 was being paid indefinitely in place of the lump sum payment. This had the unfortunate consequence of extending income support under the programme beyond the two-year period stipulated at the beginning.

Second, since the programme was heavily politicised the sustainability of the programme was very much tied to the political fortunes of individual politicians who gave leadership to the programme. The programme did receive much visibility and political clout during the period when

President Premadasa was very powerful. He did utilise JP as a means of creating a political base among the under privileged groups with whom he often identified himself. However, following his assassination by suspected Tamil guerrillas, it lost much of the state patronage it had received. As a consequence of its distinctive political leanings and affiliation with the former regime, the newly elected Peoples Alliance government in 1994 prematurely terminated the programme. By this time only five of the expected 11 rounds of programme activity had been completed.

Third, as the programme was mobilised for political propaganda purpose, an objective evaluation or monitoring of the programme was neither encouraged nor feasible. While the programme was implemented through the existing state bureaucracy, its operational leadership came from hand picked bureaucrats loyal to the political leaders of the programme. Even though JP projected itself as a move away from the typical "top down" approach of government programmes (Siriwardana 1998), in reality JP was very much characterised by centralised power and authority. In spite of the ideologically driven emphasis on social mobilisation and empowerment of the poor, JP had limited achievements in articulating common interests among the poor or fostering pro-poor policies in general.

Fourth, JP was very much a state-administered programme with built in limitations for involving any non-state actors in poverty alleviation efforts. The National Development Trust Fund was established with World Bank support in 1991 with the specific objective of involving civil society and NGO actors in poverty alleviation efforts (Gunatilake 1996; Shaw 1999). However, contrary to the expectation of the donors, the NDTF, renamed Janasaviya Trust Fund (JTF) by the state showing its affinity with JP at least in the eyes of political leaders at the time, quickly became another programme directly implemented by the state with limited participation of NGOs.

Finally, independent evaluations of the programme conducted during its decline revealed that many of the expected goals were not achieved (Mendis 1992). For instance, one study found that many of the income-generating activities started by beneficiaries of JP were not successful in pushing them out of poverty or ending their dependence on the state (Gunatilake 1997). Similar criticisms were levelled against the economic and social activities sponsored bv JTF (Liyanage, et al, 1995).

The Samurdhi Programme

The change of power from UNP to PA at the national election held in 1994 led to the establishment of a new poverty alleviation programme called the Samurdhi (literally 'prosperity') Programme (SP), in place of JP. The shift indicated a politically motivated desire on the part of the newly elected rulers to set up their own anti-poverty initiative with the aim of establishing their own political base in the countryside. Led by a popular politician in the PA camp and an important power broker in subsequent political shifts in the country, SP mirrored JP in several respects. Like JP it has multiple components, including income transfer, "voluntary" savings, credit facilities, infrastructure development and support for income generation activities, including micro enterprises. Unlike JP, a time limit was not set for individual beneficiaries to exit poverty. Having set no time limit or any specific procedure for withdrawal from a given operational, area SP is implemented simultaneously throughout Sri Lanka, largely excluding conflict areas as of 2002.

As of May 2002 the Samurdhi programme covered 2.1 million families, approximately 55% of the population outside the North and East. The Samurdhi budget in 2000 was Rs.12 billion, amounting to 15 percent of the total welfare budget, two percent of total public expenditure and 1 percent of GDP (World Bank 2002; Ministry of Finance 2002).

In some respects SP represented a higher degree of politicisation compared to JP. Unlike JP implemented through the routine administrative machinery of the state, SP was implemented through a cadre of about 22,000 mobilisers specially recruited from among local level youth activists of the ruling PA. Thus at one level SP was used as an employment generation scheme for unemployed youth mobilised by the ruling party. A rigid enforcement of eligibility criteria for selection of beneficiaries was made difficult by the fact that these mobilisers responsible for selecting beneficiaries were expected to favour their own party supporters. Samurdhi mobilisers and beneficiaries were in turn mobilised by national and local politicians as a political machine sometimes engaged in election malpractices favourable to the ruling party (Gunatilake, et al, 1997). In some areas Samurdhi beneficiaries were compelled to take an open stand in favour of the ruling party by threatening to remove them from benefits if they did not obey these orders. While contravening the goals of downsizing the state and encouraging unemployed youth to look for employment options outside the public sector, the establishment of a separate administrative machinery (Samurdhi Ministry) for poverty alleviation work and recruitment of personnel through political networks were not conducive to creation of an effective and efficient public administration and proposed public sector reform in general (World Bank 2002).

As the leading public sector poverty alleviation programme in Sri Lanka since 1995, SP has several negative implications for the economic reform agenda.

First, fiscal burden of SP was heavier than that of JP. It took up 1 per cent of GDP as compared to 0.7% spent on JP at the height of its implementation. Since the programme has no definite time frame as in the case of JP and exit criteria have not been strongly enforced largely as a result of the political considerations noted above, SP has posed a serious threat to fiscal control and management. As a result, the treasury has been a major actor in recent efforts to restructure SP.

Second, poor targeting has been identified as a major drawback of SP. The evaluations of Samurdhi programme have pointed to two main targeting problems, namely leakages and exclusions. Leakages (sometimes called type 1 error) occur when some non-poor households receive Samurdhi benefits due to political or social contacts. Exclusion (also called type 2 error) takes place when deserving poor are excluded from the programme due to political victi misation or lack of necessary power and contacts. As will be explained, undue politicisation of the programme largely account for both of these biases. Apart from diluting the poverty reduction impact of the programme, such targeting errors can also add to social tensions surrounding outright discrimination in allocation of scarce resources by the state.

Third, effectiveness of the programme in providing relief to the poor and in reducing poverty has been questioned by several observers (Gunatillake, et al, 1997; Gunatillake and Salih 1999; Parker and Silva 2000). This, in turn, related to the question of poor targeting and effectiveness of the strategies used in addressing root causes of poverty.

Finally, possible impact of SP on discouraging individual drive and initiative and promoting a recipient mentality among the beneficiaries also require attention in the light of the reform agenda.

We review some of the available data in relation to the last three issues in the sections that follow.

4. Targeting Problems

Targeting errors in SP have been identified through examination of programme coverage in relation to poverty incidence as well as through sample surveys designed to

understand the coverage of the programme in different income brackets and different ethnic groups.

First, there is a clear discrepancy between reported SP coverage and reported poverty incidence in the country. In total 55% of households (excluding those in the North East) are beneficiaries, which is about twice the estimated percentage of poor in the country (Aturupane, 1999). This is clear evidence that there is leakage of benefits to the non-poor sections of the population.

Second, as evident from Table 3 there is no consistent relationship between poverty incidence and coverage of SP in various districts.

Table 3: Poverty Incidence versus Samurdhi Coverage

District	Consumption Poverty	Human Poverty	% of Households receiving Samurdhi
Colombo	19	13	23.27
Gampaha	21	12	47.17
Kalutara	38	16	37.53
Kandy	42	17	47.06
Matale	51	21	57.14
Nuwara Eliya	40	30	30.37
Galle	39	19	48.15
Matara	44	19	54.01
Hambantota	43	23	59.54
Kurunagala	53	22	61.28
Puttalam	51	19	52.29
Anuradhapura	50	21	52.57
Polonnaruwa	40	28	45.82
Badulla	48	27	40.49
Moneragala	66	29	62.33
Ratnapura	52	25	65.43
Kegalle	41	24	53.34
Ampara	NA	NA	57.69

Source: ADB (2001), p. 13.

The Samurdhi coverage does not show any consistent relationship with either reported levels of human poverty measured in terms of educational and health indicators or consumption poverty measured on the basis of reported current income and expenditure patterns. For instance, while the Gampaha District reporting low levels of both consumption and human poverty has a relatively high Samurdhi coverage, the Nuwara Eliya district, which ranks highest in terms of human poverty and moderate in terms of consumption poverty, has a low Samurdhi coverage. Similarly, Galle has a higher Samurdhi coverage than Badulla that has much higher incidences of both human and consumption poverty. This, in turn, suggests that the political leverage of the power holders in the respective areas has been equally if not more important than the real needs in allocation of income transfers under the SP. The fact that the Samurdhi mobilisers were under heavy pressure from party activists at various levels to accommodate party supporters irrespective of their income levels was confirmed in certain qualitative research conducted by independent analysts (Shanmugaratnam 1999; Parker and Silva 2000).

Table 4 : Samurdhi Coverage and Benefits by Income Quintile, Results of a Sample Survey Conducted by the World Bank under SLIS, N=6534

Benefit	Quintile					Total
	1 (Lowest)	2	3	4	5 (highest)	
% of recipients	64	53	42	30	14	40
Rs per HH(gross)	403	390	378	362	303	381
Rs per capita (gross)	88	96	93	105	107	95
Rs per HH (net)	322	315	307	301	260	310
Rs per capita (net)	71	78	77	88	94	78

Source : Sri Lanka Integrated Survey cited in World Bank (2002), p. 36.

Note : Gross receipt includes compulsory deductions while net receipt excludes them.

Third, the Sri Lanka Integrated Survey (SLIS) conducted by the World Bank found clear evidence of both leakage and exclusion in Samurdhi. SLIS found that while 14 to 42% of households in the three higher income quintiles also receive Samurdhi transfers, 36 to 47% of households in the two lowest income quintiles did not receive the transfers (See Table 4). More than 40% Samurdhi transfers in the sample were made to the wealthiest 60% of the population. Apart from the leakage issue, this situation is also bound to be a potent source of social conflict. As can be expected, households in the lower income quintiles were more likely to receive transfers compared to those in higher quintiles. Also large household size, low income, disability, landlessness and no access to electricity and latrines increased the probability of receiving transfers. However, SLIS concludes "Rather than being a safety net for a group of households in need, Samurdhi more closely resembles an income support program" (World Bank 2002: 34).

Fourth, SLIS also discovered that Samurdhi coverage is much higher among the Sinhalese as against ethnic minorities (World Bank, 2002). The programme has been weakly implemented or not implemented at all in many of the conflict areas due to logistical difficulties in extending the programme to the war-affected areas as well as due to implementation of other assistance programmes such as relief and rehabilitation programmes in such areas. The Samurdhi coverage has been low among the estate residents, partly in view of regular wage incomes received by many households in the estates. It cannot be denied, however, that the politically manipulated delivery mechanisms of the state often under serve sections of the population, including ethnic minorities.

5. Effectiveness of the Samurdhi Programme

This can be measured in two ways. One way is to measure its effectiveness as a safety net for the poor. Another is to assess its effectiveness in fostering income generation activities among the poor. On both counts the achievements of SP are less than satisfactory.

Effectiveness of SP as a Safety Net

While the coverage of programme is rather wide subject to the limitations noted in the previous section, the quantum of benefits received by each beneficiary household is quite limited as evident from Table 5.

Table 5 : No of Families Receiving Samurdhi Allowances by Size of Allowance August 2001

Allowance	No of families	%
Rs.140	9,282	0.01
Rs. 250	233,718	11.9
Rs.350	363,752	18.5
Rs.400	487,991	24.8
Rs.500	5, 182	0.01
Rs.700	858,902	43.6
Rs.1000	8,968	0.01
Total	**1,967,795**	**100.0**

Source: Samurdhi Authority, Colombo.

It is evident from Table 5 that as of August 2001, a vast majority of Samurdhi beneficiaries received a monthly allowance of Rs.700, followed by Rs.400, Rs.350 and Rs.250. Using a dollar a day criterion, the highest Samurdhi allowance of Rs.1,000 is sufficient for covering living expense of only one adult household member for a period of 10 days

per month. As illustrated most beneficiary households receive much less. Mandatory savings component tend to have the effect of further decreasing the net receipts of the poor under the income transfer programme (Table 4). As the benefits were not adjusted for inflation and/or cost of living, the real value of the Samurdhi benefits rapidly decreased over time. According to SLIS data, while the size of transfer tends to be higher for poorer households, per capita grant amount is higher for higher income households in view of their smaller household size (Table 4). SLIS found that among beneficiary households an average of 14% of total household food expenditure could be met by the Samurdhi grant. This varied from 21% for the recipients in the lowest income group to 8% for recipients in the highest income group.

While Samurdhi transfers cannot be seen as a major boost to household incomes even among the poorest groups, there is some evidence that these transfers do constitute an important component of survival strategies employed by the poor. A recent study conducted by the Centre for Poverty Analysis found that in certain poor households that depend on unstable casual incomes from wage labour, Samurdhi allowances often constitute the only predictable source of income in an otherwise highly insecure pattern of livelihoods (Silva, Weeratunge & Ibarguen 2002). Samurdhi savings and credit programmes may also be used to augment survival strategies of the poor. On the whole, Samurdhi transfers can have a considerable consumption smoothing impact on poorer households.

Effectiveness of SP in Income Generation

Several studies have assessed the impact and effectiveness of the Samurdhi Programme in developing income-generating activities among the poor (e.g. Gunatilake and Salih 1999; Gunatilake, et al, 1997).

One of the main objectives of Samurdhi is to promote self-reliance on the basis of nurturing a savings culture and development of income generating self-employment. However, in the programme implementation the consumption component of income transfers received the highest priority as reflected in the fact that 80% of the budget is allocated to the income transfer scheme. Thus, the largest component of the programme is geared towards relief of poverty rather than creating opportunities for pro-poor growth.

Gunatilake and Salih (1999), who assessed the savings and credit component of the programme, found that while providing some relief to the poor it lacks sustainability and effectiveness. The above study found that Samurdhi's intra-group credit scheme has played a key role in providing a safety net for the poor and reducing their vulnerability. However, even where participation rates are high, the credit safety net is due more to the high rate in savings participation secured by the income transfer programme, than the establishment of a dynamic savings and credit culture. The fact that the entire basis of the savings and credit scheme relies on the inflow of the income transfers weakens the sustainability of the scheme. Discontinuing the income transfer will jeopardise the survival of a majority of Samurdhi Bank Societies, as they rest on the mandatory savings scheme built into the income transfer programme. Therefore, the programme perpetuates the dependency of the beneficiaries on the state as indeed evolved throughout the post-independence era.

The scheme fails to enable the poor to move into higher income brackets. There are several reasons for this. The loans assist very small self-employed projects (each project usually benefiting one person only). The loans are too small; the scheme tends to finance the low level of investment thereby supporting existing survival strategies. Furthermore, with the high default rate experienced, the credit and savings

scheme approaches an income transfer scheme rather than a sustainable micro-finance programme.

Yet another issue is that the poor prefer their children to have government employment where they are ensured a permanent job and secure income, rather than run their own business, which is more risky and not as prestigious. Therefore, while the programme intended to provide credit for youth, few have made use of the opportunity.

This leads to the question of how suitable micro enterprise development strategies targeted at the poor are. Gunatilake and Salih (1999) conclude that 'the poorest are the least able in terms of skills, attitude towards risks, access to additional sources of financing to start viable small businesses that are anything more than survival strategies'. Furthermore, the macroeconomic conditions greatly influence the success and survival of micro enterprises in creating the necessary growth conditions. Clearly, there is a stronger demand for wage employment among the poor.

A key parameter for evaluating success of a poverty alleviation programme is the number of households that exit poverty passing through the programme. However, the Samurdhi Programme has weak exit mechanisms with no clear exit criteria. Due to the heavy politicisation of the programme, graduating rates of the Samurdhi recipients have been very low.

Impact of the Samurdhi Programme on the Drive and Initiative of the Poor

Though important from the angle of possible impact of SP on economic reform, this issue has not received systematic attention in any of the available studies. There is, however, scattered evidence that like many other government welfare programmes, SP too adds to the dependency syndrome among the poor. According to the World Bank Poverty

Assessment of 2002, large income support programmes such as Samurdhi tend to create "a culture of entitlement" that discourages individual effort and make the poor and non-poor equally dependent on a benevolent state (World Bank, 2002). In spite of the limited value of the net benefits of the programme, SP must be seen as one among many government programmes that impact on the livelihoods of the poor in such vital areas as land and employment distribution. In recent field visits authors of this chapter found examples where poor people showed reluctance to buy household durables or expand their houses in fear of loosing their Samurdhi benefits. In another instance, certain small entrepreneurs did not want to expand their enterprises again in fear of loosing Samurdhi food stamps (personal communication, a researcher in the Matale district).

The effect of transfer programmes on labour supply and productivity particularly in the rural areas is another issue that needs further research. The casual wage levels in rural agriculture are quite high and there are labour shortages in vital sectors like smallholder tea cultivations, coconut cultivations and in commercial agriculture in general, side by side with considerable youth unemployment (Silva 1999). The rural economy in Sri Lanka has been described as a 'remittance and transfer economy' not very responsive to market forces, including proposed market-oriented changes in non-plantation agriculture (Dunham & Edwards 1997). This, in turn, calls for a more systematic assessment of the impact SP on social and economic inertia and lack of dynamism in the rural sector and its possible dampening effect on the economic reform process in general.

6. Poverty Policy Reform Initiatives

Pressures for restructuring the Samurdhi Programme have come from budgetary constraints in implementing the programme, concerns about lack of effectiveness of the programme in reducing poverty, public grievances relating to targeting issues and lack of donor support for the programme in view of its structural weaknesses and institutional constraints. It must be noted here that direct budgetary pressures as well as donor pressures have been important in shaping plans for restructuring the Samurdhi programme. Following the change of government in 2001, certain supporters of the new government particularly in the rural areas also felt that the programme needs to be revamped in order to correct selection biases fostered under the previous regime.

Creating a better fit between macroeconomic policies and strategies for dealing with poverty is a main objective of the Poverty Reduction Strategy (PRS) formulated by the government of Sri Lanka in collaboration with the donor community (GOSL 2002). For the first time PRS developed a common understanding between the government of Sri Lanka and the donor community regarding the future direction of anti-poverty policies and programmes in Sri Lanka. While certain key players expressed a certain ambivalent attitude towards PRS from time to time on the government side, in many ways it was a joint initiative capturing the views of various stakeholders, including the government, donor community, NGOs and the private sector.

PRS advocates a fundamental shift in the role of government with regard to poverty reduction. "The new role of the government is to create an enabling environment for poverty reduction, not to attempt to solve poverty directly through public spending or restricting on private economic activity" (GOSL 2002: 2). While PRS reiterates the importance of strengthening the social protection system, it also points to the need to reform it. In the area of social protection, the aims of PRS are to improve access and quality of care to poorest groups, enhance the efficiency and impact of income transfer, public works and community development schemes, help poor more effectively manage risk and address the special poverty needs of socially excluded and other vulnerable groups (GOSL 2002: 90). PRS also recognises the need to address conflict-induced poverty as a critically important aspect of the new anti-poverty strategy. The PRS document has a special section on "Samurdhi reform" that primarily aims at rationalising the existing national poverty alleviation programme. The emphasis is on improved targeting of the programme so as to enhance its effectiveness for poverty reduction and reduce the budgetary constraints encountered in implementing the programme in its current form.

Plans for Samurdhi Restructuring

Side by side with the development of the Poverty Reduction strategy, the government of Sri Lanka had started several independent initiatives towards restructuring the Samurdhi Programme. According to a draft policy paper prepared by the Ministry of Finance and Planning in January 2002, Samurdhi Restructuring aims at achieving the following objectives:

* Elimination of Type 1 error in selection of beneficiaries so as to reduce the coverage of the programme from current 2.1 million families to 1.1 families to be completed by January 2003.
* Elimination of Type 2 errors and inclusion of the deserving poor so far excluded by August 2003.

* Formulation of a commonly accepted and standardised set of selection and exit criteria.
* Application of these criteria in such a way that it will rationalise the programme and enhance its effectiveness in poverty reduction.

In order to eliminate targeting errors in the programme it was expected to carry out a survey of beneficiary and non-beneficiary households with required technical support from relevant government, non-government and private sector agencies. A committee consisting of respected community leaders in each area was to decide on the beneficiaries in keeping with criteria specified by the Samurdhi Ministry. In another initiative seeking to strengthen the regulatory framework of the programme, new legal measures against misuse or abuse of the programme by non-deserving persons were being formulated as part of the proposed Social Welfare Benefit Law to be presented before the Parliament (Reference to this proposed legislation was made in the Budget Speech of 2003). Reforms to the programme, in the form of a new Social Welfare Benefit Law providing a legislative base for improved targeting of the needy and clear eligibility and exit criteria will be brought under the new law. It is envisaged that in the medium-term all welfare schemes will be brought under the Welfare Benefit Law.

7. Conclusions

A major restructuring of poverty alleviation programmes in Sri Lanka is necessary in view of a) excessive budgetary pressures exerted by the existing programmes b) their low effectiveness in relieving or reducing poverty c) widespread exclusion of certain categories of vulnerable populations, including conflict-affected populations and some of the deserving poor themselves and d) the possible adverse effects of the programmes on economic reform process as well as on social harmony in general. Essentially, informed by the neo-liberal framework, many of the recent research and policy dialogues in Sri Lanka have clearly pointed to serious weaknesses as well as possible harmful impacts of largely politically motivated nationwide public sector transfer programmes. As reflected in the PRS a consensus has gradually emerged among the various stakeholders, including the government, donor community, NGOs and other actors regarding the need to reform anti-poverty policies and programmes.

The proposed targeting exercises, however, are likely to face several challenges whatever strategies are to be employed for the purpose. This will call for politically unpopular decisions on the part of ruling elites. Given the relative weakness and instability of the current political regime and the possible adverse repercussions on the ongoing peace process of any widespread social unrest in the South likely to result from any severe cutbacks on social welfare, the chances of radical restructuring of anti-poverty policies and programmes may not be all that favourable. On the other hand, given the current financial and debt crisis faced by the government, big multi-lateral donors in particular can have considerable leeway in their ability to influence government policies and programmes, using instruments such as the PRS.

As anticipated in the PRS, poverty reform must proceed hand in hand with private sector led growth whereby the poor will have the option of and incentives for transferring from poverty alleviation programmes to productive employment. In the interim period support for self-employment and micro enterprises may be profitably used by some of the more enterprising poor, but the evidence reviewed in this essay clearly indicates that it cannot be an effective remedy for problems of poverty in general. Our analysis indicates that combing the safety nets and income

generation activities within the framework of large poverty alleviation programmes may be ineffective or even counter productive. The government and even NGO efforts at promoting income-generating activities among the poor have produced mixed but mostly negative results. In any case a clearer demarcation between safety nets and enterprise promotion may be necessary with the state primarily responsible for the former and NGOs and private sector having greater responsibility in regard to enterprise development.

In regard to safety nets the Samurdhi and other state-funded assistance programmes and social protection schemes (e.g. pension schemes for informal sector operators, public assistance for the disabled and certain relief and rehabilitation programmes) can be integrated into a comprehensive professionalised social welfare system delivered by trained social workers. This may provide considerable opportunities to rationalize and coordinate the existing government programmes. This may also be an effective way to depoliticise poverty alleviation and prevent abuses of the system by politically motivated operators. Such a service, however, must guard against excessive bureaucratisation and possible difficulties this may pose for the poor and disadvantaged groups to be served by such an agency. While providing effective protection to the needy, mechanisms for moving out of the schemes must be clearly specified and incentives provided for moving from safety nets to productive employment.

Finally, the reform process should not undermine the well-established role of the Sri Lanka state in vital social sectors such as education and health. Sri Lanka's achievements in education, health and human capital in general are well recognised even in the neo-liberal literature and proposed reforms must seek to build on these achievements rather than reversing the entire policy atmosphere. Educational reforms however will be necessary in order to prepare youth for private sector rather than public sector employment. Similarly, health sector reforms should seek to develop private sector facilities and, at the same time, enhance the sustainability of public sector facilities catering to the population at large, including the poor. This is where useful insights from the neo-liberal approach must be combined with welfare state policies in ways that equally and concurrently stimulate equity and growth.

Chapter 8

Stepping Into A New Economic Era: Gender Blind Again?

- Ramani Jayasundere -

1. Introduction

Reforming the Sri Lankan economy has never been more important than it is today in the wake of peace, and the rebuilding of the nation. Today Sri Lanka is looking at up-scaling the economy in ways and thoughts that were not evident in the midst of the northeast war and the southern insurgency. There is now sensitivity to geographic polarisation, ethnic discrimination, and class inequity that places the government's economic reforms in a different, hopefully positive light. But the gender blindness of the process continues from way back when to now, still strong and obvious, despite years of rhetoric.

This chapter focuses on several key policy frameworks of the government's economic reform process: The National Employment Policy for Sri Lanka, produced by the Ministry of Employment and Labour, in May 2002, Regaining Sri Lanka: Vision and Strategy for Accelerated Development and

Connecting to Growth: Sri Lanka's Poverty Reduction Strategy produced by the Government of Sri Lanka in December 2002, and the National Framework for Relief, Rehabilitation and Reconciliation produced by the Government of Sri Lanka in May 2002 .

All policy documents look at addressing the most pertinent issues of poverty and employment in Sri Lanka as a whole and in the conflict-affected areas particularly. These are easily identified as vital areas in the Sri Lankan economy and the most critical areas in which the Sri Lankan women's role and participation is crucial.

2. A brief background to women's economic participation

Sri Lanka's economy in the post-independence period has known many changes. From a closed inward looking economy in the early and mid seventies, Sri Lanka, in 1977, liberalised its economic policies wholly embracing an open market economy. The economy grew at an average between 4-5% and the country was impacted upon by the pros and cons of its economic policies. The impact of Sri Lanka's economic growth has been diverse on different sectors of the economy. Open market policies have seen employment opportunities soaring with the shifting of the country's production from agriculture to manufacturing as manufacturing exports accounting only 5% of total exports in 1978 rose to 72% in 1994. The rate of employment has increased and impacted on the resultant decline in the rate of unemployment (Table1).

Table 1: Unemployment Rate

Year	Male	Female	Total
1990	9.1	23.4	14.0
1994*	11.4	17.9	13.3
1996*	8.8	16.2	11.1
1997*	7.7	16.1	10.5
1998*	6.5	14.0	9.2
1999*	6.7	13.0	8.9

* North and East not included

Source : Department of Census and Statistics, *Statistical Pocket Book 2000*, Colombo.

On the positive side, the impact of the country's economic growth has been most significant on Sri Lanka's labour force of 6.7 million people of the eligible population[1]. During the period 1990 to 1998 Labour Force Participation fluctuated within a range of 48%-52% with 1999 recording 52.3% of the eligible population. Correspondingly the unemployment rate fell from 15.9% to 9.1% (Table 2).

Table 2: Labour Force Participation

Year	Labour Force Participation Rates %		
	Total	Male	Female
1981	44.4	65.4	22.5
1990	53.3	67.4	39.4
1994	48.5	68.6	28.9
1998	51.6	66.6	37.6
1999	52.3	68.2	36.6

Sources: 1981-1999 Census 1981 Labour Force and Social Economic Survey 1985/86 Department of Census and Statistics, Labour Force Surveys 1980, 1994, 1999, Colombo.

3. Women's labour force participation

Labour force participation in Sri Lanka is characterized by high participation of males where women constitute only half the number of males in the workforce. However, women's participation in the labour force has seen a gradual and continuous increase in the past two decades from a labour force participation rate of 20% in the early-1960s to 39.4% in 1990 and 36.6% in 1999, while the rate of labour force participation by men recorded 69.2% in the early-1960s, showed a slight decrease in 1990 to 67.4%, and 68.2% in 1999. The significant impact of women entering the labour market can be seen in the reduction in the female unemployment rate, which fell from 23.4% in 1990 to 13.0% in 1998.[2] Yet, the female unemployment rate remains almost double that of male unemployment. According to Swarna Jayaweera, *"women have been more vulnerable to unemployment particularly in the context of their rising educational levels from the 1960s and the economic pressures on families in the 1980s as reflected in the fact that the unemployment rates of women have been double those of men consistently over the last three decades"* [3].

But, women's increasing participation in the labour force and increasing contribution to the country's economy is not wholly satisfactory. While the number of women in the labour force continues to be noticeably lower than men, women earn only 31% of the income earned by the entire labour force.[4] Further, demand for female labour has continuously been in the form of temporary, low cost labour despite rising educational levels of women. A closer look at the status of women in the economy and related social spheres distinctly show wide gender disparities and discrimination, unequal opportunities and exploitative situations in the labour market that place women in vulnerable positions.

A perusal of available statistics shows that women's involvement in the labour force is mostly at non decision-making levels. In the major occupational categories, women's

involvement in administrative, managerial, professional and technical occupations and at the levels of foremen/women and supervisors is far less than in clerical work, sales work and semi-skilled and unskilled labour. However, the percentage of women's involvement in different categories of labour in 1993 was better than the status in 1975, in line with the rise in labour force participation rate (Table 3).

Table 3: Women's involvement in different categories of labour

Major Occupational Category	1975% of women	1993% of women
Administrative & managerial	6.6	16.4
Professional, technical & related	11.1	23.9
Clerical & related	17.1	40.5
Sales workers	13.2	35.4
Foremen/women & supervisors	12.9	24.6
Skilled and semi-skilled	34.9	56.6
Unskilled	41	51.9
Total	**34.8**	**48.3**

Source: Department of Labour, Employment Surveys 1975 & 1993, Colombo.

In 1990, only 0.42% of the total establishments in Sri Lanka had women employers. Further, in 1971, only 0.8% women were employers out of the total labour force, which increased marginally to 1.1% in 1995. In the same year it was noted that 67.6% of the female labour force worked at the level of employee. Own-account workers or independent workers remained low at 11.2 % in 1971 with a slight increase to 15.1% in 1995 (Table 4).

Table 4: Percentage Distribution by Employment Status

Employment Status	Total	Women	Men
1971 (a)			
Total	100.0	100.0	100.0
Employer	3.1	0.8	3.8
Employee	66.6	76.9	63.7
Own Account Worker	25.0	11.2	29.0
Unpaid Family Worker	5.3	11.1	3.5
1981 (b)			
Total	100.0	100.0	100.0
Employer	2.2	1.2	2.4
Employee	65.8	79.4	62.3
Own Account Worker	28.4	12.9	32.5
Unpaid Family Worker	3.6	6.5	2.8
1985/86 (b)			
Total	100.0	100.0	100.0
Employer	2.3	0.9	2.8
Employee	58.5	59.0	28.3
Own Account Worker	26.0	17.4	29.7
Unpaid Family Worker	13.2	22.7	9.2
1991 - 1st quarter* (b)			
Total	100.0	100.0	100.0
Employer	1.9	0.5	2.6
Employee	59.8	59.6	59.9
Own Account Worker	27.1	18.0	31.7
Unpaid Family Worker	11.2	21.8	5.8
1995 - 1st quarter* (b)			
Total	100.0	100.0	100.0
Employer	2.5	1.1	3.1
Employee	62.4	67.6	60.0
Own Account Worker	26.2	15.1	31.2
Unpaid Family Worker	8.9	16.2	5.7

Source: 1. Census of Population and Housing 1971 & 1981.
2. Sri Lanka Labour Force Survey 1985, 1991, 1995, Department of Census and Statistics, Colombo.

Note: *Excluding Northern and Eastern Provinces
(a) Usual Activity. (b) Current Activity.

Here one sees one of the ironic results of economic liberalisation and reforms in Sri Lanka, which is that women have been playing a predominant role in the economy. Presently tea, garments and labour exports are the three cornerstones of the economy contributing to over 90% of the total foreign exchange earnings of the country. Women are the majority in the labour forces of these three major sectors.

But, while accepting that economic growth brought on by these avenues of revenue, one traditional (tea) and the other two exclusively results of the country's open market policies, it has often been pointed out that Sri Lanka's open market policies have not generated commensurate employment opportunities as economic growth, judged not by numbers but by the quality of employment generated. All three sources of high revenue, namely tea, garments and labour exports, are dominated by female labour. All these sectors are dominated by low cost, low skilled female labour.

4. State commitment to engendering policy

As mentioned above, in looking at Sri Lanka's current economic reform agenda, three documents in particular convey the perceived crucial needs of the country; the National Employment Policy, Regaining Sri Lanka, which includes the Poverty Reduction Strategy as well, and the Relief, Rehabilitation and Reconciliation framework aimed specifically at the conflict-affected areas of the North and East of Sri Lanka.

In looking at these three policy documents, it is important to take into account the perceptions of the present government to mainstreaming gender in public policy and administration. In his policy statement to Parliament on taking office on 22 January 2002, the Prime Minister outlined the needs of the economy in a seven-page address. Although a sincere commitment to gender issues was shown in its election manifesto, the government devoted only one paragraph to the contribution of women where half of the country's population was marginalized and entrusted to one single Ministry, viz. Ministry of Women's Affairs, which received less than 1% of the national budget.

> *Women constitute a majority of our country. If we are to strengthen democracy women's rights must be protected. We introduced the "Vanitha Dirimaga" in our manifesto to ensure equality between men and women, during the last election. Our Minister for Women's Affairs will forward the proposals to Parliament to give effect to this movement.*[5]

State machinery to ensure gender equality

The vision of the Ministry of Women's Affairs is to work towards gender equality and advancement of women. Among its objectives are initiating, formulating and monitoring policies, projects and programmes to facilitate mainstreaming of gender, ensuring human and fundamental rights, gender equality and advancement of women and guaranteeing equality for women.

Sri Lanka Women's Charter

In addition to the State governing machinery Sri Lankan women are guaranteed equal status by the Constitution, and strengthened by the Sri Lanka Women's Charter and the National Committee on Women. The Sri Lanka Women's Charter was drafted and adopted by the State in March 1993 and is the main policy statement by the government, regarding the rights of women, expressing the States' commitment to remove all forms of discrimination against women and address crucial areas relevant to women. The Charter aims at eradicating gender-based discrimination and achieving gender equality and establishes standards to be

observed in seven broad areas; political and civil rights, rights within the family, right to education and training, right to economic activity and benefits, right to healthcare and nutrition, right to protection from social discrimination, and the right to protection from gender-based violence. The Women's Charter is seen as the first positive response by the Sri Lankan Government to securing the rights of women. Although the CEDAW was ratified in 1981 it took over ten years for the adoption of the Women's Charter in Sri Lanka. The Sri Lanka Women's Charter, therefore, carries a powerful State authorization to eradicate gender-based discrimination and achieve gender equality. The Charter as described above carries significant power in terms of the ability to bring about legislative reform, preventive and punitive measures, structural reform within the law enforcement authorities and support for NGO, CBO and other institutions/programmes to remedy gender-based violence.

National Committee on Women

The most significant introduction to State machinery to work towards the rights of women recognised by the Charter was the setting up of the National Committee on Women. The National Committee on Women (NCW), a Presidential Committee, has a mandate that falls into three broad categories, to entertain, scrutinize, and take action against, complaints of gender discrimination, to promote research into gender issues and to advise the Minister in charge of Women's Affairs when advice is sought or when the NCW considers it necessary.

But nearly a decade since its adoption, the Charter is yet to achieve its full potential. One of the reasons for the lack of achievement with regard to the Charter is that it is denied rightful power by the status conferred upon its monitoring arm, the NCW. The NCW although established to examine the progress made in the realization of the obligations undertaken by the Charter, lacks the statutory basis and power to effect implementation as it is yet to be enacted as law that gives teeth to its provisions and enforcement powers. To ensure effective action and fulfilment of the obligations in the Charter, the NCW must necessarily become a statutorily recognized body and become strengthened with the legal, administrative and authoritative recognition it will then receive.

National Plan of Action for Women

Sri Lanka is further strengthened by the National Plan of Action for Women adopted following the World Conference on Women (Beijing, 1995) in May 1996. The National Plan has been developed based on the Global Platform for Action on Women and is a collaborative effort between the government and the NGO sector in Sri Lanka and encompasses crucial issues; violence against women, women and human rights, women and armed conflict, education and training, economic activities and poverty, health, environment, decision making, the girl child and the media. The National Plan, in each area of concern, identifies the problem faced, takes necessary measures to address the problem, and identifies State and non-State agencies responsible for the implementation of identified measures. For the State the National Committee on Women takes responsibility to ensure the fulfilment of the National Plan of Action.

"Vanitha Dirimaga"

In addition to the above is the present government's policy for women brought out for the first time by a political party in its women's manifesto titled "Vanitha Dirimaga" (Women's path of courage). "Vanitha Dirimaga" proposed to establish a Women's Council with 50 representatives from 50 areas of

the country. The Council is mandated to be consulted regarding all decisions on laws and policy matters that impact on women and is expected to have the powers of a parliamentary committee. The main issues identified as crucial in the Vanitha Dirimaga were lobbying to increase women's political participation, setting up of 'centres' to provide solutions to various problems faced by women including labour problems and the enactment of the National Charter enabling the setting up of a National Commission on Women. It is in this background of a perplexing mix of good intentions, seeming lip service, and real burning issues that confront women in the economy the government places its policies that appear more gender confused than gender blind.

5. The *Draft* National Employment Policy

From a gender perspective, the Draft National Employment Policy is confused. The Policy attempts to take on a gender neutral tone in five of its seven sections[6], addressing the issues of employment cloaked in hue of gender neutrality which reeks of gender blindness. Two sections[7] on foreign employment and the other titled 'social obligations' speak directly and inevitably of women's contribution to the economy; yet it is patronizing and discriminating in the way it marginalizes women. It is a fine example of misplaced gender sensitivity.

The draft policy is about enhancing productivity and the competitiveness of the Sri Lankan people. It sets out in its introductory comments its main challenges as 'to facilitate employment creation through economic growth and the need to improve the position of the existing labour force'. Its objective is

> *to chart a clear plan for Sri Lanka's human capital enhancement and development in the new millennium* to fulfil the vision of *Sri Lanka to be a provider of a globally*

employable, competitive human capital, which will propel (us) to unprecedented heights in the new millennium, for Sri Lanka to be a place where any investor, foreign or local could find the required human skills and expertise for their businesses; where people would be free to use their talents to create value for all, to strive to be a leading provider of quality, skilled manpower in the global market place where (our) people would create value to any prospective employer, where (our) people will be able to enhance their quality of life through gainful employment".[8]

The comments made by the Advisory Committee which drafted the policy, made up of 15 male members and one female member representing the main stakeholders of the economy, the private sector, trade unions and the state sector, refer generally to all labour force participants irrespective of sex, signalling out only the educated and the youth as special categories. It is weighed down by the possible argument that the policy is gender neutral applying uniformly to Sri Lanka's entire workforce of 52.3% of the total population. In the total workforce male labour force participation rate is 68.2% while the female rate is 36.6%.

6. Fulfilling Social Obligations

Women's contribution to the economy is singled out specifically in the draft policy in section 5 (Initiative 5) on Fulfilling Social Obligations. Section 5 highlights several 'social problems' the country is faced with at present and seeks to remedy these problems.

One such problem is issues in relation to women in employment. While the draft policy recognizes that there are issues that need be addressed in dealing with women in employment, it makes little note of the key role played by Sri Lankan women in productive employment. The policy, once more, places women in a disadvantaged position that

justifies welfarism, condescending attitudes to women's work and the ideas that women are only supplementary income earners. The tone of Initiative 5 is somewhat that of the Constitution of Sri Lanka, it recognizes women but places women in the same socially disadvantaged categories of the disabled (and unemployed graduates and those affected by the war).

One cannot directly fault the State for ignoring the role of women in employment because the vision of Initiative 5 itself notes that the employment policy must *"fulfil social obligations whilst creating a globally competitive workforce and that opportunities must be provided to all sectors of society without any form of discrimination"* but contrary to its vision the document adopts a gender blind attitude that places women in an unequal and disadvantaged position compared to the male workforce.

The section on women in employment portrays a social blindness that is appalling in the light of extensive analysis and writing on the role of women in employment. Initiative 5.1 states that the female labour force participation has grown at a much faster rate than the male labour force in response to rising educational levels of women and to economic pressures on their families. It should be noted that women's labour force participation has grown but not due to rising education levels but due to the availability of opportunities in the labour intensive industries that demand low skilled low cost female labour. A close look at statistics on women and unemployment reveals that the highest unemployment rates among women are seen among women with 10-13 years of education and success at the Ordinary and Advanced Level examinations (Table 5).

Table 5: Unemployment by educational level and gender

	1985/86		1994		1996/97	
	Male	Female	Male	Female	Male	Female
No schooling	7.7	4.8	4.6	2.3	0.2	1.1
School year 1-5	7.0	9.4	3.8	3.7	1.8	3.6
School year 6-7	9.5	16.5	14.9	22.9	8.9	21.1
School year 9-10	15.4	3.9				
GCE O/L	14.4	35.6	16.3	28.3	8.2	24.1
GCE A/L	18.7	44.9	15.6	30.7	10.9	36.4
Degree	3.3	10.2	2.5	4.0	6.9	12.2
Post graduate degree	4.2	3.2				
Total	10.8	20.8	11.4	17.9	6.4	17.5

Source : Facets of Change: Women in Sri Lanka 1986-1995, CENWOR 1995

The policy document does not mention of the levels of unemployment of women despite 'rising levels of education' or offer remedies to improve the status of women in employment. Women's employment has remained at low levels confined mostly to clerical work, sales work and semi-skilled and unskilled labour. Further, much of the high return earning migrant labour of women has also remained at low skilled or unskilled levels for decades. In the garment factories women are also employed at semi-skilled and unskilled or trainee levels with small percentages at supervisory or technical levels.

The draft policy accepts that women's employment is perceived to be seriously constrained by existing gender biased attitudes and stereotypes in society and seeks to improve women's employability in the labour market. The objectives of the policy are positive yet the measures suggested to achieve these objectives would ensure that women would be looked at as subordinate in the labour market in the decades to come. The policy ensures that adequate attention would be paid to women's commitment to fulfil their maternal responsibilities by creating awareness amongst women that maternity would not become a hindrance to their careers. It also seeks to create changes in the mindset of employers on the same.

Looking at society almost 25 years since the enactment of laws on maternity benefits, where hundreds of women have become mothers and continued to work at levels available to them and at unchanged chauvinistic attitudes of society (including employers) of how women's place is the home, of the high social cost to families due to women working away from home, one wonders at this elementary attitude of a policy that is taking Sri Lanka to the rigours of the new millennium.

Further, the policies in support of women's employment offer childcare facilities for working women and self employment with skills training in areas such as catering, printing, photography, communication, childcare and elderly care with programmes to transfer technology for self employment. Fear of rhetoric is valid in writing on the gender implications of employment policies, yet the arguments of several decades ago on women in employment still stand valid in today's context. Women continue to be regarded as secondary and dispensable in the labour market despite statistics to show otherwise, and society continues to place disadvantageous emphasis on women's reproductive role and the ancient beliefs of being 'carers and nurturers' in a domestic sense.

7. Migrant Employment

The other section that the policy deviates from its 'gender neutral' stance is in dealing with foreign employment in Initiative 3. The policy accepts that migrant remittances amounted to around US$ 1 billion in 2000 but places the fact that about 70% of migrant workers are women as an incidental note. The redefining of foreign employment in Initiative 3 sends out mixed signals. It is outwardly gender biased and accepts the gender-biased nature of the country's present 'system' of foreign employment without question. The policy makes a gender-neutral declaration that it will adopt a proactive approach to identifying employment opportunities and will uplift the image and skills of (our) migrant human capital by providing them with appropriate training to enhance their competitiveness but its strategic approach makes strong discriminations between female workers and male workers. The policy accepts that foreign employment offers opportunities for people with varying skill levels and it is heartening to note that the policy does not discourage women seeking foreign employment and does not accept the much discussed low social status of migrant women workers.

Much of the measures identified to promote migrant employment are perceived to apply to both male and female workers especially in strengthening the Foreign Employment Bureau, ratifying treatise and conventions, providing financial support to prospective workers, training and regularizing recruitment to minimize exploitation. The measures identified specifically for female workers are pre-employment training (for domestic workers) on language, financial management, discipline and presentation, elimination of harassment and abuse at all levels of the migration process, support for families to minimize the social cost of migration and positive reintegration and investment.

All measures for female workers take on the assumption that all prospective female migrant workers fit the low skilled category of workers and are based on unexplored hypothesis.

The policy accepts the negative impact on families of migrant women workers, which has been cited as a major drawback concerning female migration. However, it fails to see the issue as a question of social responsibility and accountability and instead looks at it from a welfarist angle providing support in the form of social services and welfare. While the importance of social services to families of migrant workers in terms of educational support and health welfare to children is undisputed, such services are already in place and need only be formalised and extended. What is needed urgently in support of migrant women workers is a system that assures the social responsibility of State machinery such as systems that keep checks and balances on families and demands the responsibility of the adults benefiting from the migration, namely spouses and the extended family.

While little is documented on the families that successfully survive the mother's absence for long periods of time, extensive research has been done on the problems faced by female workers in relation to husbands, children and extended families. Statistics show that a high percentage of migrant women workers is married with children. They have not been employed prior to migration and have been full-time housewives taking on work as domestic workers in foreign countries for the first time in their lives. This fact alone indicates that adjustment by families left behind to life without the wife/mother is a difficult one. Studies have shown that serious consequences of female migration include the negative impact on children from lack of care and neglect and physical and mental abuse. It has been the trend of thought and popular acceptance in Sri Lanka that the absence of the mother results in the neglect and/or abuse of children and in the absence of female kith and kin, little responsibility and social accountability is placed on fathers and other male relatives of the migrant woman's family.

Yapa[9] analyzing the desertion of young children by mothers in a selected sample representative of all districts in the country concludes that the majority of mothers left young children only on assuring that the child would be properly cared for and in 50% of the migrant workers in the sample the immediate or extended family provided care for children and elders left behind. Hettige[10] however states, *"almost all field studies attest to the fact that the children left behind by migrant women are the worst affected by the absence of their mothers"*. He further states that children of all ages are often left in the care of grand mothers who are incapable of providing the necessary care for the children and the situation is aggravated by the fact that spouses of the migrant women are either absent or negligent. The seriousness of the lack of improper childcare is reflected in evidence from studies on the gravity of the result of neglect where children drop out of school, take to drugs and in some serious cases are physically abused by relatives including fathers.

In Sri Lanka childcare remains a task for the females in the household. On deciding to migrate for employment, a woman generally considers the arrangements for the care of her children, both infants and older age groups and she is found to rely mainly on her spouse with additional support from his extended family. However, the migrant woman appears to be well aware of the inadequacies of such arrangements and takes every effort to relieve the domestic burden cast on her spouse by assuring him of an additional family income and by material rewards to her children. The woman also consoles herself by expressing the response that she took the decision to leave her children for their betterment.

However, it would be wrong to conclude that migration for overseas employment by Sri Lankan women results in

family breakdown and child neglect as sensationalised in the local media. Research over the last decade reveals the benefits accrued to the family from the earnings of the women have contributed to a better quality of life for the family left behind, and the children have enjoyed better nutrition and more encouragement for education.

As regards elimination of harassment and abuse of migrants, the policy document looks at the very necessary aspect of bilateral agreements with labour importing countries and strengthening of Sri Lanka's overseas diplomatic missions. This rhetoric of many governments is yet to see light effectively and the policy appears to ignore the well-known abuse and exploitation within the Sri Lankan missions in labour importing countries, which continue unchecked and un-remedied.

Strengthening rational investment takes on an important part of the draft policy and the document looks at 'ensuring that migrant returnees make rational investments enabling them to reintegrate with society'. It looks at directing migrant returnees towards local community projects, micro and medium scale financing projects with management and marketing support provided with information on local employment opportunities. Skills training will also be given to ensure smooth reintegration.

It is interesting to look at writing on these issues, which have failed to impact upon the policy.

Looking at the profile of migrant women workers, the obvious categorization is that the majority belongs to low income families and have previously been unemployed, thus not contributing to the family income. With employment as domestic workers in foreign countries the increase in the levels of income, individually and in the family, is the most obvious result of migration. Increased income levels have resulted in higher living standards and investment in housing and household durables. In many instances the education of children have been important where the focus of migrant working women have been to educate their children. In expense patterns what is common is the excessive expense on consumption and meeting immediate consumer needs that help raise standards of living but not long term sustainability. What is expended on unproductive consumption results in little savings, and expense on investment resulting in families and women needing to take on a second period of foreign employment.

Studies done on migrant women workers and their families[11] show that these workers have very little savings and while most earnings are spent on improving housing, meeting consumption needs, debt redemption, purchase of consumer items, education of children/family members[12], and very little is invested in income generating activities.[13] Further analysis of the use of remittances shows that the improvement in economic situation through radically enhanced earnings does not spell financial or economic security for the women concerned.

Looking at the overall pattern of earning capacity and spending patterns as well as the social situations of migrant female domestic workers, one is faced with the question whether this particular segment of labour providers can actually look at long-term benefits of investment. Analysing the expense patterns that weigh heavily on immediate relief from the levels of poverty prior to departure, looking at the small percentage of investment in income generating activities, the emphasis on long-term earnings appears less.

Explaining this Hettige states,

> *migrant women are from poor families. This makes it difficult for many migrant women to save enough money to be able to invest in sustainable income generating projects. Family members dependent on migrant women often use remittances for unproductive consumption purposes. This somehow compels migrant women to resort to repeat migration in order to sustain their income over a longer period of time. Availability of remittances and savings allow migrant families to not only enjoy a higher standard of living but also invest on housing and household durables. Yet, in the long run, many return migrant families quickly run out of their savings and are flung into poverty again. This is due to either wasteful consumption or non investment of savings or both.*[14]

An effort to encourage investment was launched in 1992 by the People's Bank working with UNICEF where the Rehabilitation of the Gulf Returnee Project attempted to give loans for self employment and small enterprise projects to returnees from Kuwait, the majority of whom were domestic workers.[15] This scheme however was a complete failure due to a number of reasons. One reason was that it was not a state sponsored strategy for reintegration and future sustainability and thus received little overall importance and support. But the main reason was the fact that the returnees lacked motivation and skills to engage in a long-term entrepreneurial activity, which could never provide an income equal to the salaries of the unskilled domestic workers. This was further weakened by the failure of the implementers and the loanees to consider basic factors essential for a commercial venture to succeed such as markets, coping with competition, and management. Weakened by the lack of monitoring and rapport between officials and the returnees, many migrants obtained the loans and used them instead to pay agency fees for a return stint abroad or used the credit to meet consumption or emergency needs leading to the total failure of the credit programme.

The State presently offers services to encourage investment and long term financial planning among returnee migrant workers through an array of credit schemes. The viability and success of these has not yet been documented.

In the light of extensive writing and research on female migrant workers, the draft policy recommendations appear stagnant. However, in terms of the policy's perception of male workers, the situation is different.

A section on skills enhancement for male workers is based on the premise that male migrants comprise around one-third of the number of female migrant workers and Sri Lankan male workers face stiff competition from workers in the region. Proposed measures include the promotion of skilled workers shifting focus from traditional unskilled workers and to provide male workers skills and knowledge to meet the competition from other countries. Training is also outlined in partnership with both public and private sector training institutions and the policy envisages a demand in a finely detailed list of sectors including electronics, chemicals, life sciences, engineering, information technology, research & development, financial services, education, healthcare, communication & media, logistics, and arts & entertainment.

The policy polarizes male and female migrant workers by committing female workers to continued and now institutionalised work as low skilled workers and rides on the assumption that the skilled work available overseas is solely for male workers although every single available employment opportunity listed has no gender specification. Based on this the policy recommends skills training for male workers to facilitate a shift from unskilled work to skilled work. The justification of this Initiative 3 is incomprehensible and goes against the very core of the principle of equal rights.

8. Domestic garment factory workers ignored?

One glaring absence in the draft employment policy is the domestic garment factory workers. Opening up of the industrial sector brought about by the economic liberalization from 1977 onwards and the creation of new employment opportunities for young (educated and uneducated) women to provide low skilled, low cost labour to factories producing

garments for export make up a vast sector of women workers in Sri Lanka. Much debates have focused on these 'garment workers' employed in export processing zones in Katunayake (started in 1978), Biyagama (1985) and Koggala (1990) as well as in factories outside the zones, providing cheap and dispensable labour in deplorable, exploitative working conditions (Table 6).

Table 6: Employment in the GCEC/BOI Industries 1996

Occupational level	Male	Female	Total	Female %
Administrative Staff	2362	841	3203	26.3
Executive Staff				
Technical	1697	277	1974	14.0
Non-technical	1840	247	2087	11.8
Supervisory				
Technical	2139	938	3077	30.5
Non-technical	1637	2212	3849	57.5
Clerical and allied	3120	3815	6935	55.0
Skilled	9307	15105	24412	61.9
Semi-skilled	8500	52475	60975	86.1
Unskilled	8560	15580	24140	64.5
Trainees	5558	23400	28958	80.8
Other	3813	1721	5534	31.1
Total	**48533**	**116611**	**165144**	**70.8**

Source : Greater Colombo Economic Commission (GCEC) in Jayaweera, Swarna.(1999). "Socio Economic Development in Sri Lanka – Trend since the Social Summit" presented at the South Asia Regional Conference. Centre for Women's Research (CENWOR), Colombo.

Note : The GCEC includes three EPZs and factories outside the zones.

As in the case of migrant labour economic benefits of women's participation in the garment industry are undisputable, though the social cost has been serious. The situation of the workers in the Export Promotion Zones has been comprehensively documented in a number of studies and these show new employment opportunities, improved quality of life for low-income families and economic empowerment for women through independent income earnings.[16] However, quality of employment, and social consequences of migration to urban and industrial sectors appear farther away from accepted decent work standards.

Stemming from the acceptance that women provide cheap, easily acceptable and pliable labour to the manufacturing industry especially the garment industry, the exploitative terms and conditions of work, the inferior physical working conditions have been key discussion issues for a long time. At present the status quo continues.

The main piece of legislation governing the workers in the garment factories (as well as other factories in the Export Promotion Zones) is the Factories Ordinance No.45 of 1942[17], which makes provision for the safety and welfare of workers in the factories. It provides for gender-neutral health, safety and sanitary conditions and makes no special reference to female workers although the majority of workers in the EPZs are women. As a result of the absence of appropriate legislation the working environments, working conditions including hours, payment of wages, holidays, night work and overtime have reached highly discriminatory levels contradicting the provisions set out in other employment laws such as those regulating the Employment of Women and Young Persons Ordinance.

In this background the reality in the export production factories in and outside the export promotion zones is that labour laws are excessively underplayed with regard to non-conformity of paying minimum wages, working hours

exceeding statutory provisions, denial of payment for overtime, restrictions in holidays and support services like rest, medical facilities and maternity benefits leading to severe exploitations within the workplace. All these disparities are aggravated by occupational health hazards due to working conditions and rules and regulations, intimidation through punitive measures by way of wage cuts, extended hours, restricted intervals for late arrivals, failure to meet targets set for production, threat of and actual arbitrary dismissal, non existence of proper legally enforceable contracts for unfairly dismissed employees to fall back on and discouraging employees joining workers' unions.

The sociological implications of increased factory employment are felt hardest in the living conditions and the lives of workers spent away from the workplace. A number of studies in the past two decades have pointed out the appalling housing conditions of the garment workers where over ten women are confined to living in one small room, scant attention to nutritious food and healthcare, exploitation by landlords and falling prey to men who reportedly establish emotional relationships with women workers promising safety, respectability and eventually marriage only to fleece the workers of their hard earned money.[18] Years of research, survey and lobbying as well as State commitment to improving and increasing export-oriented industrialisation have yet to bring about proper living conditions for factory employees. Complacent in that the factory workers have "found" employment and achieved economic independence leading to improved living conditions for their families all incentives, support services, and benefits have been and continue to be for investors.

Moving away from the Export Promotion Zones and the export-oriented industry centered in the cities, the move to take the garment manufacturing industry to the villages in the early-1990s saw the setting up of nearly 200 garment factories in villages around the country. The consequent employing of mostly women workers from the areas of their residence in these factories saw a change in the pattern in the drift to urban and industrial sectors but not a complete stemming of the process. The opportunity for women to be employed near their homes solved housing, family care problems for some, yet the same working conditions prevail in the factories established in the villages leading to the same exploitation seen elsewhere. Setting up factories gave rise to another phenomenon of subcontracting production where mostly women based at home would undertake the production of parts of the process. This, while contributing to increased income levels and employment opportunities has placed an added burden on the women employees and their families. This is due to the push to meet targets and to produce at a rate that far exceeds their capabilities which has resulted in women working long hours for small wages, often using unpaid family labour thus affecting their health and family life.

The draft national policy further fails to note an interesting development in factory employment in the apparent decrease in demand for factory employment. Unofficial records state that in the Katunayake Export Promotion Zone over 14,000 vacancies exist continuously and cannot be filled due a dearth of applicants. This readily available labour appears to be channelled to the overseas labour markets where employment in factories abroad is more lucrative and reportedly better than employment as housemaids. But a considerable portion of the semi-skilled and unskilled labour force, which was hitherto gainfully employed, is no longer willing to accept the economic and social conditions offered by the factory industry. The search for alternatives has already commenced in the formal as well as informal economic sectors but it is essential that these alternatives ensure that the active female labour force

continues to be economically secure and the country continues to record growth through ways that are more productive, long term and which bring about dignity of labour to women.

The fact that the draft policy completely ignores this category of employment that contributes the second highest income earner to Sri Lanka is incomprehensible.

9. Regaining Sri Lanka

Regaining Sri Lanka is another apparently 'gender neutral' document. A 'vision and strategy for accelerated develop ment' formulated by the government of Sri Lanka, Regaining Sri Lanka presents, as is stated in the document itself, a framework for economic reform based on the work of a large group of people drawn from both the private and public sectors and largely focuses on the immediate actions necessary. It is set within a macro economic background looking at regaining control over Sri Lanka's economic future and aims at ensuring the provision of jobs to the unemployed and improved job opportunities to the underemployed.

The four challenges this policy document identifies are creating two million new jobs, overcoming public debt, allocating resources for reconstruction and increased income levels will, when implemented, solve a myriad problems faced by different strata of society in Sri Lanka. It reassures a worn out economy, yet reassurance does not apply to all people uniformly.

Regaining Sri Lanka does not dwell on the all-important issues of *who* contributes *what* to the economy and *who* gets affected and *how* by economic reform. It considers all issues, once again as many policy documents seem to do, from a gender neutral lens thereby losing significance of women's position in the economy as primary participants of Sri Lanka's main income generating avenues, and the effects the proposed plans would have on women. Regaining Sri Lanka echoes the gender-confused standpoint of the employment policy.

The Poverty Reduction Strategy, which is now a part of Regaining Sri Lanka, however has within it an effort to addressing gender concerns.

10. The Poverty Reduction Strategy

Despite an increase in employment and the resultant decline in the rate of unemployment, income inequalities in Sri Lanka have remained and market liberalization has had little effect on changing poverty experienced in Sri Lanka. Poverty indicators have fluctuated slightly from the post-independence period to the closed economy era to the results of the open market policies. At present a large segment of the population lives below the poverty line. Looking at the distribution of income the lowest 40% of households receive around 15% of the income and the highest 20% receive around 50% of the national income. Besides, 30.4 % of the population lives under the official poverty line (Table 7).

Table 7: Income inequality

	1953	1963	1973	1979	1982	1987	1997
Income received by lowest 40% of households	14.5%	14.7%	19.3%	16.1%	15.3%	14.1%	15.7%
Income received by highest 20% of households	53.8%	52.3%	43.0%	49.9%	52.0%	52.4%	49.4%

Source: Central Bank of Sri Lanka, Consumer Finances and Socio-Economic Survey, Colombo.

Since independence successive governments in Sri Lanka have adopted social welfare and human development policies such as free education, food subsidies, free medical services, and credit facilities that have catered to the needs of the poor and served as a 'safety net' to cope with poverty.

Poverty features as a key issue in Sri Lanka's present economic reforms. The Poverty Reduction Strategy, the government's blue print for poverty reduction was introduced in late-2002 as the culmination of consultations with different constituencies since 1998. The document later became a component of the Regaining Sri Lanka document and deals with all encompassing issues related to the state of poverty in Sri Lanka. The document makes fleeting touches on issues relating to women in its main body text. Two pages under section V in Chapter 7 towards the end of the document are devoted to 'Combating Gender Discrimination'.

It is again a gender-confused document. It is on the one hand gender blind in much of its content in the guise of being gender neutral and on the other it is wholly discriminatory against women in the guise of being gender sensitive. It is once more rhetoric over another of the State's high priority policy documents. It is the design for government's aim to 'restore economic growth and thereby effectively eliminate poverty in Sri Lanka' and it looks clearly at 'investing in people' and 'mainstreaming gender considerations in all anti-poverty efforts'. But, the document pays scant regard to the status of poor women and its misplaced efforts at gender mainstreaming and gender sensitivity ridicules the anguish of poor women as well as the State commitment to alleviating poverty of women made in its various instruments of justice and equality, the Women's Charter, the National Plan of Action for Women and even the Women's Manifesto.

Years of rhetoric on mainstreaming gender in policy, with little penetration into the mindsets, strategies and actions of key policy documents and programmes makes one actually wonder who really understands the real meaning and the need for gender mainstreaming. A senior member of the Planning Ministry on the presentation of the Poverty Reduction Strategy notes, *"one cannot be integrating 'gender sensitivity' into everything; that would make the document 500 pages"*. One would think that this factor in itself would indicate the critical nature of such integration.[19]

Poverty affects Sri Lankan women in diverse ways. Kottegoda (2000)[20] writes on women and poverty in Sri Lanka and makes an important contribution to the need for writing on poverty to consider women as an individual entity.

> *"Any study of the population in poverty must recognize the fact that the poor are not a homogenous entity: that, among other differentials, the poor comprise women and men. These women and men are part of a complex social fabric and have gender specific roles, which they perform, in their homes, their communities and in society. The socio-cultural demarcation of the genders in our society defines the roles of men and women and their place in social and political structures. Not only are women located in specific ways in relation to the economy, production and income capacities, there is a general asymmetry of power between women and men in both the social and domestic spheres which subordinates women. The demarcations of gender as well as the subordination of women have a critical bearing on their conditions of poverty and their ability to overcome these conditions."*

It is in this background of unequal power over economic status, production, resources and income which places women in poverty in a position more disadvantaged than that of poor men, that further marginalisation in social and domestic areas placed poor women in more vulnerable situations. This is the very reason that far reaching policy aimed at eradicating

poverty must concentrate on involving women at decision making levels in theory and in practice and strive to consider the gender implications of all issues and concerns related to the poverty levels of the people to the extent that gender becomes mainstreamed in all poverty alleviation strategies at every necessary level. It must necessarily be an involuntary process and not an 'issue' reluctantly included as a defensive route of escape.

The PRS is flawed in the sense that it does not respect the obligation it places upon itself – 'efforts to reduce poverty must begin with an informal understanding of the nature and magnitude of poverty in Sri Lanka'.[21] While the PRS notes geographical manifestations of poverty, conflict related poverty, the availability of social services, environmental degradation as it relates to poverty and the access of the people to resources, it fails to consider the impact of poverty on women as a category of differently affected poor. The attempt at gender neutrality appears to have confused the PRS from the beginning. The same tone of gender neutrality continues through the PRS except in Chapter 6 on 'Investing in People' where several issues very specific to women are identified, such as the health and nutrition of pregnant women, levels of anemia in women and the fact that a large number of low income households in Colombo slum communities is headed by women.

Chapter 7 of the PRS is crucial in that it is committed to 'Pro-Poor Governance and Empowerment' and makes clear the government's commitment to good governance.

> *"International experience shows clearly that those institutions that are well governed are far more likely to be effective in poverty reduction than those that are not... the poor bear a disproportionate share of the cost of sub standard governance..."*

Chapter 7 is crucial to this debate in that in subsection V it deals with combating gender discrimination. Here the argument of gender neutrality is lost in the efforts of the PRS to marginalize women, limiting focus on women in eliminating poverty to placing women's concerns in a specific (small) section. The section on Combating Gender Discrimination touches on women being the core of the country's three largest sources of income and accepts that the irony in Sri Lanka's relative progress in engendering development is the phenomenon of women being trapped in low skilled, low paid jobs clustered in domestic service, garment making and agriculture as well as traditional female occupations such as teaching, nursing and typing. It also touches on violence against women and the low representation of women in parliament and politics as forms of gender discrimination.

The PRS in subsection V of Chapter 7 makes a commitment of behalf of the government to mainstreaming gender considerations in all anti-poverty efforts and suggests as strategies the protection of women's rights as enshrined in CEDAW including the amendment of discriminatory laws; promotion of employment with equal training and opportunities and decent work which includes investigation into the working conditions and social circumstances of FTZ workers, migrant workers, sub contracted workers and plantation workers; entrepreneurship development for women aimed at small scale self employment activities, health programmes, support for victims of violence, support (unspecified) for female headed households and gender sensitisation programmes for the public and private sector.

The PRS makes little out of the vast volumes of rich research, policy discussions and working papers produced on the concerns identified in subsection V of Chapter 7. As stated in a newspaper column;

it should be noted that the PRS document shows clearly the tendency of many policymakers in Sri Lanka particularly in addressing the issue of gender, to overlook or ignore local resources and expertise, whether in the form of publications, research or in qualified and capable personnel.

The reported belated attempts to include gender aspects into the document (PRS) only serves to show that despite much lip service by global financial institutions and governments about the importance of mainstreaming gender, it remains, as always, an 'add-on' component.[22]

It is once more a cliché situation; the government is attempting to reinvent the wheel in addressing gender concerns. The difference between merely identifying women's issues and mainstreaming gender concerns is as stark in the PRS as it was in documents twenty years ago. It is this difference that would have made a change.

11. The Triple R Framework

The Relief, Rehabilitation and Reconciliation Framework is part and parcel of the government's PRS and was initiated to address immediate challenges arising out of the post-war situation in the North and East of Sri Lanka. The Triple R framework focuses on meeting the basic needs of the people affected by the conflict, improving economic conditions and facilitating reconciliation among all ethnic groups. More specifically the framework aims at three overarching goals to create opportunities for growth and better access to social services among the poor, to ensure an effective social protection system and to empower the poor by giving them a voice in matters affecting their lives.

It is unavoidable that the Triple R framework should focus heavily on ethnic reconciliation on the one hand and addressing immediate needs of those affected by the conflict.

While accepting unconditionally that those were and have to be the primary aims of the document, it can not be excused that its architects adopted, once again a gender neutral approach in setting out long and wide impacting systems of policy, guidelines, administration and monitoring on diverse issues, both economic and social, that impact very differently on men and women.

Set in the background of a large and undocumented number of female-headed households, bound in the traditions of patriarchal laws, customs and practices, faced with acute and a much feminised state of poverty and struggling with residues of war as victims and as perpetrators, women in Sri Lanka's conflict zones face as much gender discrimination as ethnic, religious or other prejudices, and cannot be reached equitably and justly through a gender neutral angle. The fact that the Ministry of Women's Affairs features nowhere in the Triple R framework and considering that the gender sub-committee on the peace process was set up long after the finalisation of the Triple R framework, merely justifies the standpoint all government policy documents have taken a blind understanding and acceptance that all economic policies can be gender neutral.

12. Conclusion

Years of rhetoric have resulted in little efforts by successive governments to integrate gender into economic policies and programmes. The lack of it has come to be cloaked in the myth of gender-neutral policies and programmes. In Sri Lanka the status of women in society, employment, production, education and whatever sphere studied shows that gender-neutral policies cannot change the disadvantages and marginalisation inherited by women. In fact, the argument that gender neutrality in policy is a myth stands well for Sri Lanka as well.

Bakker (1994) sums up this situation in a few words, effectively.

> *Systematically linking a gender relations analysis to an economic-policy framework is a difficult task, given the blindness to gender issues in economic discourse. ...economic analysis is rooted, in its basic theoretical assumptions, in a gender-neutral abstraction of markets functioning with homogeneous labour inputs. However (markets) do have a gender dimension to them. A gender-relations analysis focuses precisely on how (market) relationships that appear to be gender neutral implicitly infer the male standpoint.*[23]

This stands true in Sri Lanka as well.

The need for Sri Lanka's policymakers to accept that government policy must necessarily mainstream gender is an urgency of yesterday. Often the need to know more about what, why and how gender mainstreaming can be achieved at policy level gets veiled in the complacency that successive States in Sri Lanka express, as does the Regaining Sri Lanka document;

"Compared to the rest of South Asia, Sri Lankan women enjoy universal suffrage, high life expectancy .... unmatched in the rest of the sub continent."[24] Yet, Regaining Sri Lanka is reassuring in its platitudes. It sets out the expanse of gender concerns and issues that policy makers understand and identify as requiring reform. These include improving women's work from low skilled, low paid work, securing the rights and safety of women workers within and outside the country, creating changes within traditional 'female' occupations, increasing women in politics, government and decision making, accepting specific issues of female-headed households and conflict affected women and finally, eradicating all forms of violence against women.

The process of mainstreaming women's concerns in policy should begin with the likes of the National Employment Policy and Regaining Sri Lanka. Marginalisation of gender concerns to one or two paragraphs, sections or chapters defeats the entire purpose of mainstreaming gender. As stated earlier, gender concerns need to be contemplated from the outset and considered at every point of the whole process on the basis that policy and State decision making will not, very often, affect men and women in society equally and the acceptance of gender neutral policies often becomes the adoption of gender insensitive and discriminatory policies, which leads to inequality in resource allocation, development priorities and results in discrimination most often against women.

Footnotes

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Chapter 9

Migration of Women as Domestic Workers: Impact on Gender Relations and Ideology

- Shreen Saroor -

"Within a generally male dominated world, women's cross-border migration is often presented by images of sacrifice and suffering, and the women appear to be isolated victims. It is not obvious whether female migration itself or the gender structure within which it takes place should be seen as the problem".

Nicola Piper (2003: 28)

1. Introduction

Migrant worker remittances contributed about Rs.123 billion (or US$ 1.30 billion) to Sri Lanka in 2002[1]. It is the country's second largest net foreign exchange earner; much needed to boost the balance-of-payments of the Sri Lankan economy. Therefore, the government actively promotes it. The contribution of women to this avenue of earning foreign exchange is remarkable, because a staggering 70% of migrant

workers are women. Most of them are employed in the Gulf States, Hong Kong, and Singapore as unskilled domestic workers (Table 1). The majority of these women are between the age group of 21- 40, and married with children.

These statistics clearly point to heavily feminised labour migration from Sri Lanka, a trend similar to that in the Philippines and Indonesia. Substantial contribution of the 649,700 female migrant workers to Sri Lanka's balance-of-payments, however, needs to be evaluated against the incalculable personal and social risks to these women. As they are inexperienced in foreign employment, they frequently undergo wide range of unexpected hardships before and after their arrival in the country of employment. These hardships include: excessive recruitment charges for securing employment, employers' denial of terms of contract, unpaid wages, loss of savings, premature termination of contract, physical and emotional abuse, sexual harassment, rape, and torture that leads to disability or even death. A study by the Centre for Women Research reports that 10 percent of all Sri Lankan Female Migrant Domestic Workers (FMDWs) is subjected to some form of sexual harassment and assault by their employers or members of the households during their employment (Sthree Prabodha, 1999: 2). According to the Sri Lanka Bureau of Foreign Employment, in 2002 alone there were 114 reported deaths; 1,756 cases in which the family was unable to contact the migrant; 441 women went missing after the expiry of contracts; and 1,411 women were harassed. An extreme case recently reported the return of a body of 41-year old woman to Sri Lanka from Kuwait with some missing organs. Neither the Kuwaiti nor Sri Lankan governments investigated the case adequately[2].

Table 1: Migrant Workers from Sri Lanka by Gender and Country in 2001

	Female	Percent	Male	Percent	Total
Middle East					
Saudi Arabia	172,000	57.3	128,000	42.7	300,000
U. A. E.	94,500	72.4	36,000	27.6	130,500
Kuwait	137,700	85.2	24,000	14.8	161,700
Jordan	35,000	87.5	5,000	12.5	40,000
Lebanon	75,000	93.8	5,000	6.3	80,000
Oman	28,400	78.9	7,600	21.1	36,000
Bahrain	21,000	77.8	6,000	22.2	27,000
Qatar	7,000	17.5	33,000	82.5	40,000
Sub-Total	570,600	70.0	244,600	30.0	815,200
Percent		**87.8**		**86.5**	
Europe					
Greece	250	41.7	350	58.3	600
Italy	45,000	75.0	15,000	25.0	60,000
Cyprus	11,500	76.7	3,500	23.3	15,000
Sub-Total	56,750	75.1	18,850	24.9	75,600
Percent		**8.7**		**6.7**	
Asia					
Malaysia	150	8.1	1,700	91.9	1,850
Maldives	3,500	26.9	9,500	73.1	13,000
Singapore	12,000	85.7	2,000	14.3	14,000
South Korea	1,000	25.0	3,000	75.0	4,000
Hong Kong	2,250	90.0	250	10.0	2,500
Sub-Total	18,900	53.5	16,450	46.5	35,350
Percent		**2.9**		**5.8**	
Others-Sub total	3,450	54.3	2,900	45.7	6,350
Percent		0.5		1.0	
Total	**649,700**	**69.7**	**282,800**	**30.3**	**932,500**
Percent		100.0		100.0	

Source: Sri Lanka Bureau of Foreign Employment, 2002.

Since the mid-1980s, reports of mistreatment of FMDWs, on the one hand, and the lack of effective measures by the government, on the other, have spawned energetic campaigns and activities by non-governmental organizations in Sri Lanka at all levels: local, regional and national. These NGOs have addressed a variety of issues and organized activities essential to enhance the promotion and protection of FMDWs' rights. These include guidance and counselling, pre-departure and reintegration training programs, research and publishing, campaign and advocacy, lobbying and networking within and across national boundaries. The most recent development is a demand for absentee voting rights for migrant workers in order to enhance their power to influence policy makers and politicians.

Although female migrants face many challenges, the phenomenon is not likely to fade away for many reasons. One important reason is the high rate of unemployment among females in Sri Lanka, of whom over twenty percent are unemployed. The fact that women are migrating on their own rather than as part of family migration seems to suggest greater freedom and choice. However, their concentration in vulnerable sectors has generated much concern on how migration can have a positive impact on women's lives.

Empowerment Vs Victimization

The gender ideology that prevails so strongly in our society recognizes women's place as the home and her responsibility that of bringing up a happy family. This assumption makes the migrant woman the sole responsible person for all negative consequences of her migration. What is more disturbing is how her absence from the family brings a badge of discredit on her return. Many returnee women suffer disharmony in the family. This includes incest, neglect of children and their studies, male alcoholism and drug addiction, sexual relationship with other women, domestic violence, separation, and suicide. Above all there is the trauma of them being accused of being sexually loose and neglecting household tasks irrespective of whether their migration is a success or a failure. The purpose of this chapter is to identify the impact of female migration abroad as domestic workers on gender relations and ideology in Sri Lanka. This "gender impact," as I call it, will be discussed by identifying the positive and negative outcomes of female migration. My chapter is an attempt to answer some of the following questions that surrounds female migration for domestic work. Marxist and socialist feminists argue that women's subordination can be improved by making them economically active members of society. One could counter this argument by a series of questions. How exactly do these women's relative economic independence contribute to their path to emancipation? Do these women really break the traditional patriarchal structure by moving out of their home? How much of the economic benefits a woman gains through migration go into her own well-being? What changes do migration make in the subordinate status of our women? Do female employment overseas transform gender relations and is it successful in giving new identities to our women?

Much of the controversy over the migration of women to the oil rich Middle East hinges on the ideology that they are neglecting their "duty" by their family by leaving the home; that they should be good wives and mothers. This neglect affects not only the socialization of children but also the overall quality of life. As pointed out by Alwis (1993: 14-15), in the contemporary Sri Lankan context "motherhood" is not only the act of reproduction but also nursing, feeding and caring of babies, adolescents, the sick, the old and even grown women and men, including one's husband. Such an ideology places immense responsibility and burden on the shoulders of women. The social/ideological attitude towards

womanhood (good mother, wife and daughter) and the denial of access to the public sphere to women are reasons why female migrant returnees are stigmatised. Any woman who fails to perform the traditional roles assigned to her is considered "unfaithful, loose and shameless." A woman living abroad for years means that she has failed in her duty by her husband and children; that she has valued money over her duty. On the other hand, in our society male citizens while being socialized to be the breadwinners of the family are not socialised to do household chores. When men are compelled to do child caring and nurturing in the absence of mother, it is seen as "abnormal" by society and sometimes ends up as "mishandling", leading to child abuse and even incest.

Many news articles and research documents on female migration argue that there is chaos in the household when the woman is abroad. It is pointed out that the reason for female migration is the woman's decision to go overseas. The above assumption is not convincing in a patriarchal society like Sri Lanka, in which the male makes most of the decisions. No less than 68% of women working abroad are married women and it is very unlikely that they took the decision to migrate on their own. Almost all the married women I interviewed[3] made the decision in consultation with their husbands and some even said that the husbands were the major force in their decision. Often, a major consideration in arriving at the decision was that the husbands were unemployed or did not have a regular job. Poverty, in other words, is the major cause of their migration.

These are statements made most often by the returnees who were interviewed for this study: "I wouldn't have done this if not for the well-being of my children and my husband"; "I never saved a single cent for me. I sent all that I earned to my husband thinking that he would look after our children but he never did"; "My husband never had a permanent income. I have three kids. They need a proper home and good life, so I migrated". These women, whose migrations for employment took a great deal of courage because they went at the risk of losing their life, deserve much more. They not only contribute to the nation's revenue but also to the improved quality of their family life despite themselves having benefited very little.

Another task of this chapter is to explore the social stigma that gets attached to their sexuality when migrant women are supposedly alone in the "other" country, with no male family members chaperoning them. As a result of such ideology, i.e. these women are sexually loose, their family and the community they live in quite often systematically ostracize them when they return. Generally, women are subjected to violence at home and outside in our society, but the stereotypical thought is that women are loose when they step out of traditionally confined boundaries. Thus, migrant returnees are more prone to violence in the community.

The media is one of the major contributors to this situation as news on female migration for domestic work portray these women very negatively. Most often news on migrant women is built up as "juicy" stories to the readers. Media basically blame the women for any fault and assert that female migrants are selling their bodies rather than their labour. Once a high ranking officer of the Sri Lanka Bureau of Foreign Employment (SLBFE) told the media that 80% of Sri Lankan women working in Kuwait are kept as mistresses by their Arab employers[4]. How could he arrive at this figure, which was completely uncorroborated? Such statements contribute to the assertion that these migrant women welcome sexual advances and exploitation by their employers. This stereotype further victimises the helpless women while letting the perpetrators go free.

Increased gender-based violence in labour import countries is another reason for these women being considered loose and shameless. It is often alleged that these women ask for sexual violence by stepping out of the traditionally confined home domain. Throughout history, any violence on female body by "other men" was seen not as a crime against the woman but against her husband, father or protectors. This was mainly because her body was viewed as his property. It is part of this ideology that a woman's "honour" lies in the "purity" of her body and control of her sexuality and that the role of men in her family is to protect this honour. Women who have undergone sexual violence internalise their traumatic experiences fearing social stigma and breakage of family ties, especially with their spouse. This forces these women to keep silent about sexual abuse that they suffer at the hands of their employers.

Studies undertaken by the MARGA institute and the Centre for Women's Research reveal that the newly earned income from migration is not long lasting and not used in a productive way. They have found that major portion of women's remittances is used by their spouses on household expenses and consumer items. There is very little or no savings left for the migrant returnees to utilise on productive activities on their return. Although migrant women help to boost the country's foreign exchange earnings and maintain stability in their families, permanent change in the economic position of the returned female migrants is rare. This is mainly because her spending power has been taken over by her family members, usually men (CENWOR, 1995; Perera, 1997). From an economic perspective, it could be said that the position of the household was elevated for a limited period (generally three to four years) during the woman's stay abroad. On her return, family's economic position drops back to the pre-migration position or even lower.

From a social feminist perspective, the position of women within the household changes for the better owing to migration. Here her domestic work gets recognised as productive work. The migrant woman gets away from the physical confinement of the home to the outside world, the experience of which empowers them. Some of the women interviewed for this study expressed that they feel free from control and household burdens, got more strength to do things on their own, experienced no constraints on decision-making, and not much fear in interactions outside the home.

In these instances, the ideological gender norm of men being the main economic asset of the family undergoes a change. In the sample, some men gave up their casual jobs after their wives' migration. This shows that they become dependent upon their wives' earnings. Some of these men agreed that their women earned four to five-times their earnings. The participation of women in wage labour and their ability to earn more than their male counterparts is definitely a change in the positive direction; it breaks the traditional gender division of labour, where women are considered only to be consumers and dependents. However, what should have ideally happened here is the reversal of gender roles and the building up of a more egalitarian relationship within families. When women become the primary income earners of the family it is time for people to recognize the inequities in the gendered division of labour and the need for switching traditional gender roles. But, the reality is different. Specially, in the traditional Sri Lankan setting, the participation of males in day-to-day household chores is very marginal. Most often these returnee women are faced with the problem of their husbands spending their earnings on their own entertainment while neglecting the welfare of the family, especially the children.

Initially, even though a woman's migration abroad is not enough to give her complete economic independence, her role in alleviating the economic pressure in the household, which is traditionally a man's job, does get recognized. This leads towards upliftment of the social status of these women and is a step towards their emancipation. Engels argued that once women are brought into the work force and become independent there will be no need for male domination, but economic factors alone are not responsible for female subordination. There is a distinction between oppression and exploitation. Women are not only exploited economically; they are also oppressed ideologically.

Marital problems are another common feature of female labour migration. Women are silent about this, fearing the social stigma attached to separation. Sixty five per cent of women in the sample had problems with their spouses after migration. Reorientation with family members, especially the spouse and the children after a few years, was found to be the major problem for migrant returnee women. Further, inquiries reveal that when a woman become confident on her return with her new exposure to another country and to their culture and her new identity of being the economic provider of the family she continues to exercise her own freedom. This makes her male partner, who is still conditioned by traditional patriarchal ideology, feel he has lost his masculine "power". This in turn either brings a split in their usual family life or more control exerted over these women. This internal power struggle is further aggravated by media exposure of migrant women's behaviour in the labour receiving countries, which makes the husbands more suspicious of their behaviour there. This has been used as a weapon to reinforce their male domination that has been shaken by their female partner's new identity.

"Women who differ from a community's dominant ideological view point are often accused of moral looseness.

Here, sexuality is seen as a dangerous sign of gender that needs to be controlled," argues Maunaguru (1995: 171). Most often women become the prey of this power struggle. Either they lose their husbands to other women or to alcohol and drugs. As a result society blames the women, which makes them guilty for their husbands' behaviour. Another option that is thrust on these women is to force them to domesticate themselves further to regain harmony at home. They do comply here with the ideologies and practices of the society either because they have already internalised them through the processes of socialisation or due to no alternative.

From one perspective it is true that these female migrants are successful in getting away from the domestic sphere when they cross geographical boundaries. Whereas women employed within Sri Lanka are faced with the double burden of looking after household chores while sharing the economic responsibility with their male partners, female migrants who cross geographical border are still stuck with the same old household monotonous duties of cooking, caring and nurturing children and the old. The only difference is that they are paid abroad for the unpaid work that they perform in their own homes.

By virtue of women's place within the sexual division of labour they are disproportionately responsible for domestic work. This makes women to be more concerned and confined with housing and food provision. Female migration as domestic workers does not change their traditionally confined place. Instead it reinforces the position of women being only interested in domestic work and her secondary status in the labour market. Weerakoon (1997: 2) in her policy paper on female migration has observed the same, "Due to gender inequalities, the unpaid work done by women in the home-child care, care of the sick and elderly, housework is generally not even considered as work. A foreign female domestic worker, therefore, has low status

because of her gender, class and job, in addition to being a foreigner from a relatively poorer country and they are extremely vulnerable to exploitation at every level of the migration process". Vimaladharma (1997: 48) in his paper on female migrant labour and its impact on gender relations, argues that the production and reproduction under capitalistic development allows for the exploitation of surplus labour through women's unpaid household work and that makes labour cheap for capitalism. When women migrate they are not involved in social reproduction within their own household, but foreign capitalists exploit her surplus labour. Here, even though women manage to escape from capitalist exploitation forced on her by the patriarchal structure within their own homes, they get into another form of domestication and exploitation where their labour and status are less valued within an unfamiliar environment and are more prone to experience sexual violence.

The patriarchal tendencies in the labour receiving countries (especially in the Arab world) are witnessed by our women while in migration. Religious and cultural practices in Arab countries intensify the impact of their gender roles, especially in the case of Muslim migrant women. Most of them adhere to "purdah" (dress that covers the whole body excluding the eyes) in search of solidarity with their cultural identity. In this instance the gendered roles remain the same after their return. Indeed, sometimes it gets worse, with women not being able to get out of their home without covering themselves fully and without a male family member's company. SLBFE statistics show that 21% of female migrants are from the very conservative Muslim community. This is mainly because of poverty and the demand and preference for Muslim maids in the oil-rich Arab countries. Much of the controversy hinges with the question of how these women are able to travel abroad while their mobility within Sri Lanka is highly restricted. A research paper produced on Muslim female migration by Muthalif (1994: 81-82) studied men's responses to the migration of their spouse as domestic aide to Middle Eastern countries. Her findings explain to some extent this controversy. "Since our women work in Islamic countries where Quranic Law prevails, punishment for adultery is very severe - in case of a married women it is stoning to death. Here he is very sure that his wife would have guarded her body from others fearing the punishment."

One of the spouses of a female returnee in the sample responded to the same question this way "our women who are working in Middle Eastern countries become more religious. They cover themselves fully, they understand Arabic, which helps them to read and understand the holy Quran, and some of them have fulfilled Haj" (fifth principle of Islam - performance of rituals in Mecca). Another type of safety measure on women and control of their sexuality is the thinking that more pious and religious they are, the less sins they commit. These men believe that their wives' and other Muslim women's bodies and behaviour are well guarded within the religious framework of Islam while they are outside the domestic sphere. They seem to be proud and relieved about this cultural female body because of the punishment a woman gets if she steps out of religious codified behaviour and dress. It is also noted that in the sample all 17 Muslim women I interviewed worked in Islamic countries.

Conclusion

Gender relations and the structure within which female migration takes place in Sri Lanka not only influence the outlook but also the way in which their migration is represented, analysed and responded by researchers, activists, policymakers, the media and the migrants themselves. Treating the surrounding issues of female

migration in isolation and consistently associating their departure with sacrifice and victimisation typically leads to a strong policy orientation on various forms of protection of female migrant workers. Policymakers' ideas of 'protection' might, however, not be equivalent to migrant women's need for empowerment. Empowerment here refers to the availability of choices and actions, in contrast to 'protection' that limits already constrained choices for women. Most of the studies and policy papers produced on Sri Lankan female migration focus on the participation of women in cross-border migration as a concern thus failing to criticise the gender structure, which would force changes upon well-established gender roles. In this chapter I have attempted to highlight various forms of structural constrains that prevent female migrants from exercising their freedom and claiming their entry into international labour market with honour. Migration can be advantageous to women only if this angle of migration is looked into and addressed.

Footnotes

1 Central Bank of Sri Lanka, Annual Report 2002, Statistical Appendix Table 99.

2 Daily Mirror, August 17 & 19, 2002: 1.

3 Primary data for this chapter was collected through face-to-face interviews with female migrant returnees from different parts of the country. My sample consists of 108 female migrant returnees and 09 men who are the husbands of some of these returnees. The interviewees are from the three ethnic groups, Sinhala, Tamil, and Muslim.

4 *The* Sunday Times, August 04, 1996: 4.

Chapter 10

Conclusion

- Muttukrishna Sarvananthan -

The foregoing chapters analysed the economic liberalisation and reforms undertaken in Sri Lanka in the past quarter-century (1977-2002). While critically evaluating the past record of economic liberalisation and reforms in the public sector, financial sector, labour market, anti-poverty programmes, and gender relations the authors have also identified the future reforms to be undertaken in the respective sectors and issues.

The new government that came to power in December 2001 has unilaterally committed to pursuing a far-reaching economic reform agenda as embodied in the medium-term policy document entitled 'Regaining Sri Lanka'. For the first time the present government has committed to address fundamental, institutional, and structural impediments in the Sri Lankan economy as a matter of urgency. The rewards are already self-evident in the economic performance during the past two years (2002 & 2003).

Sri Lanka, which recorded negative growth for the first time in its post-independence history in 2001, bounced back by recording real GDP growth of 4% in 2002 and is expected

to attain 6% in 2003. The total public debt, which was 105% of the GDP in 2001, declined to 103% of the GDP in 2002 and is anticipated to decline to 100% of the GDP in 2003. The budget deficit that was almost 11% of the GDP in 2001 declined to 9% in 2002, and is expected to decline to 8% in 2003. The annual average rate of inflation, which was 14% in 2001, dropped to 10% in 2002 and is expected to drop to just 6% in 2003. The average prime-lending rate, which was 18% in 2001, dropped to 12% in 2002 and would drop to 8% in 2003.

The following two sections are based on information obtained from the Budget 2004[1] presented to the Parliament by the Finance Minister in November 2003.

Economic reforms undertaken during 2002 & 2003

A number of legislative, administrative, and institutional changes have been instituted in the last two years (2002 & 2003) to address the root causes of the macroeconomic instability in Sri Lanka. One among them is the Government's commitment to fiscal responsibility and prudence as demonstrated in the enactment of the Fiscal Management (Responsibility) Act[2] in January 2003. The unique feature of this legislation is that it was locally driven as a result of fiscal profligacy during 1999-2001.

According to the FM(R)A the budget deficit has to be brought to less than 5% of the GDP by 2006 and maintained thereafter. Besides, at the mid of each year a fiscal position report has to be presented to the parliament by the Finance Minister, which was done for the first-time in July 2003. This mid-year report is expected to reveal the fiscal position in terms of the original budget proposals for that particular year. If there are any deviations from the original estimates then the Finance Minister should spell out the reasons for such deviation/s and remedial action/s proposed to be undertaken by the government. Thus, the FM(R)A binds the government by law to restrict budget deficits to less than 5% of the GDP.

Further, at the end of 2006 the total public debt should not exceed 85% of the GDP of that year (which stands at approximately 100% in 2003), and at the end of 2013 total public debt (including external debt at current exchange rate) should not exceed 60% of the GDP of that year.

According to another clause of the FM(R)A during election times if any political party offers goodies to the electorate it has to estimate the fiscal implications of such goodies and make it public. The Election Commissioner is bound by law to enforce this clause. This is again a very timely clause, because political parties in Sri Lanka have a long tradition of promising various goodies at the time of election campaigns including "rice from the moon".

Moreover, every public institution (departments, corporations, authorities) has to submit annual performance reports and accounts to the Ministry of Finance within a stipulated time period. Apparently, according to the Director General of the Department of Fiscal Policy in the Ministry of Finance, about 90% of the public institutions has complied with this condition in 2003. The Treasury did cut off funding to public institutions that have failed to comply with the deadline.

As part of the public sector reforms downsizing of the Ports Authority, and the Cooperative wholesale Establish ment (CWE) has taken place with the introduction of voluntary retirement schemes. In fact, the CWE has been privatised in late-2003. The Ceylon Electricity Board is undergoing restructuring with greater private sector involvement in power supply. The Ceylon Petroleum Corporation has been stripped of its monopoly over refining and retailing petroleum products with the entry of the Indian Oil Company to the market. A third competitor is expected to enter the petroleum production and distribution markets

shortly. The Department of Railways has been converted into a Railway Authority in order to operate under commercial principles as a prelude to divestiture. A Public Service Commission and Police Commission have been established in order to de-politicise the public service. A Strategic Communication Unit has been set up at the Ministry of Economic Reforms in order to disseminate information regarding privatisation and other economic reforms to the general public.

As part of the financial sector reforms the Central Bank of Sri Lanka (CBSL) is undergoing a comprehensive restructuring process beginning with the downsizing of its labour force by forty percent. Two core functions of the CBSL now are (a) economic and price stability, and (b) stability of the financial system. All other functions (such as clearing agents, lender of last resort, public debt management, and custodian of the EPF) are divested now. The Monetary Law Act was amended in 2003 in order to tighten the supervisory role of the CBSL. In order to become more transparent and accountable the Central Bank releases a Monetary Policy Review every month to the public that reviews the general economic development and it's bearing on the monetary policy of the CBSL. Amendments to the Exchange Control Act were passed this year further liberalising the foreign exchange market. The number of members in the Monetary Board of the Central Bank has been increased to five (from three) with additional two members chosen from the private sector in order to have greater private sector input, and dilute the influence of the government in monetary policy making. At the CBSL a real time gross settlement system, a scrip-less securities settlement system, and automation of the general ledger have been affected in order to make its operations efficient and less time consuming.

As regards labour market reforms the Termination of Employment of Workmen's Act and the Industrial Disputes Act were amended in January 2003. However, a lot more need to be done in order to remove labour market rigidities. In the process of reforming the poverty alleviation programme a Welfare Benefit Law was enacted during 2003, which is expected to screen benefit claimants in terms of their eligibility.

A new Consumer Affairs Authority Act was enacted, replacing and merging the Consumer Protection Act of 1979 and Fair Trading Commission Act of 1987, in order to protect manufacturers/traders/service providers from unfair competition and consumers from unscrupulous manufacturers/ traders/service providers. The Public Utilities Commission Act has been enacted in order to regulate power, water, and petroleum supplies.

Economic reforms earmarked for 2004

A Voluntary Retirement Scheme (VRS) has been announced for public servants in the Budget 2004. The government anticipates that 100,000 public servants in 2004 and another 200,000 by 2006 from the lower and middle income grades would make avail of the VRS. The following legislations are in the pipeline to be enacted during 2004 as part of the continuing process of economic reforms:

* Revenue Authority Act
* Foreign Exchange Management Act
* Public Audit Act
* Amendments to the Banking Act
* Asset Management Law
* Public Finance Act

* Economic Management Law
* Freedom of Information Act

The Revenue Authority Act is proposed to be enacted in order to merge all three arms of the government revenue collection institutions, viz. Inland Revenue, Customs & Excise Department, into one institution. The proposed Foreign Exchange Management Act (FEMA) will decriminalise foreign exchange offences, inter alia. The FEMA will gradually liberalise the capital account of the balance-of-payments. The Public Audit Act is expected to strengthen the independence and autonomy of the Auditor General and the Auditor General's Department. The proposed new Banking Act would overhaul the banking sector in order for the banks to effectively compete in the market place. It will also tighten the supervisory role of the CBSL in the financial sector. The proposed Asset Management Law is expected to take care of non-performing loans in both the state-owned Banks. The management of public finances by the Ministry of Finance will be streamlined and transparent under the envisaged Public Finance Act. The Economic management Law will be enacted in order to strengthen financial discipline in the public sector. The Freedom of Information Act is expected to supersede the Official Secrets Act and is intended to make the government transactions more accountable and transparent.

Whilst the foregoing reforms undertaken during 2002 & 2003 and earmarked for 2004 are welcome it is imperative to understand that economic reform is an evolving process, and hence should continue unabated whichever government is in power.

Footnotes

1 http://www.eureka.lk/fpea

2 http://www.eureka.lk/fpea

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