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Development Strategies, Welfare Regime and Poverty Reduction in Sri Lanka

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Sri Lanka has been always praised for its achievements in human development despite being a developing country. The achievements in human development are indicators of the success of different policies on social welfare followed by the country's governments. Sri Lanka's achievements in social development which were arrived at in a short period of time after political independence despite a low per capita income and low levels of economic development is a widely discussed issue. What is more impressive is that the country had been able to continue this level of social development despite various downfalls in the economy and in different economic and political regimes. This can be seen from Sri Lanka's Human Development Index (HDI) which was 0.743 for the year 2005, ranking 99th in the country list of 117. According to UNDP, 2006, to mention some indicators of human development, the life expectancy at birth is 71.6 years (2005), adult literacy 90.7 (% ages 15 and older – 1995 - 2005), infant mortality rate is 12 (per 1,000 live births - 2005) and maternal mortality ratio reported 1990-2005 is 43 (per 100,000 live births). However, it is argued that the Sri Lanka's high achievements in human development indicators despite downturns in the economy have concealed many issues in social development. Hence it is worthwhile to examine its development strategy with a historical perspective and with a special emphasis on social development and its evolution over the years and how it had kept off the ground over the years even with the economic rigidities. This will also help to understand certain drawbacks too.

Development Strategies, Structural Transformation, Inequality and Poverty

Development strategy in a historical perspective

At the time when Sri Lanka gained political independence from the British in February 1948, the country had a successful primary exports based economy. However, the predominantly agriculture based economy hitherto gradually transformed into a more diversified one with increasing dependence on the manufacturing sector. For the easy analysis of the development strategies over time, the report will discuss the development strategies of the entire period from 1948 todate, divided into two periods (i) 1948 – 1977 and (ii) 1978 to present, for each topic under discussion.

A historical perspective of development strategies

1948 – 1977 period

The first period represents the first three decades after independence, where the country had a favourable terms of trade. The country predominantly had an agriculture based economy based on plantation crops, mainly Tea, Rubber and Coconut. During the period between 1948 to 1955, though the county's economy was heavily dependent on a few primary commodities, the increasing commodity prices which were on an upward trend allowed the country to retain a favourable terms of trade. The prices of tea and rubber continued to rise. However, during this period, with the weak budgetary policy of the Government and the weak monetary policy of the Central Bank, there was no adequate control to the increasing incomes of the people or to reduce the high liquidity of the economy. Personal incomes were on the rise and private consumption was increasing-especially due to the consumer subsidies available at that time. Consumer imports also increased tremendously during this period. The major problem with these strategies is that, investment was not considered as seriously as it should have been to ensure sustenance. Government efforts to lay a good infrastructure foundation were far from adequate. As a result, the productive capacity of the economy remained static.

Further, the government policies did not lay any foundation to diversify agriculture, which led the economy to depend on the three main primary exports of tea, rubber and coconut until very recently. Nor did the government identify the importance of reducing Sri Lanka's dependence on agriculture by diverting investment or developing the industrial sector. Government expenditure was utilised mainly for maintaining the redistributive expenditure rather than on capital formation (Indraratna, 1998).

The period from 1956 to 1977 is significant due to the restrictive policies adopted by the regimes at the time. During this period, the country had experienced a considerable deterioration in the economic situation. By the middle of 1955, the export boom collapsed when the commodity terms of trade began to deteriorate, and the economy kept deteriorating during subsequent periods too. Despite the obvious shrinking of the economy the government continued to adhere to the same policies, until the 1960s. Food subsidies absorbed a major portion of the government budget while imports kept increasing at a relatively higher rate than exports.

By about 1958/59, with the long term objective of increasing private sector savings and investment, the government introduced a new direct taxation scheme. However, this had to be abandoned later due to problems that arose in implementation. In 1957, the State Industrial Corporation Act was passed and several State Corporations were established to produce import substitutes. Some State-Owned Enterprises (SOEs) which came into operation before the Act too were nationalised.

Another turning point came about in 1960 with the Sri Lanka Freedom Party (SLFP) coming to power, while the economy still was in a downturn. The government pursued a policy to protect the domestic market, by restricting imports through elevating the tariff levels, imposing licensing quotas and banning selected imports which would harm the domestic producers. As such, the Government followed a policy of Import Substitution in Industry (ISI). The ISI policy promoted the expansion of industries (which were earlier mainly confined to government corporations) by encouraging the entrance of the private sector with a wide range of small and medium enterprises (SMEs) in manufacturing. However, the whole ISI policy became a failure, mainly owing to the reason that domestic substitution was not adequate to offset the shortfall in curtailed imports, except in a few product lines. The government was unable to maintain good macroeconomic conditions and many SOEs were running at a loss with high government subsidies. As Indraratna, 1998 points out, 'the entire approach of the development policy during this whole time period had been marked by a spirit of experimentation'.

The replacement of the SLFP government in 1965, with the United National Party (UNP) government brought about some major changes in the policy arena. The new government followed an import substitution in agriculture replacing the ISI policy of the previous regime. Hence, the attention was diverted into import substituting subsidiary crops for plantation and arable agriculture. However, still, the country was heavily depending on the three primary products of Tea, Rubber and Coconut. Though there was an increase in the capital formation, this was not sufficient and the efforts were not strong enough to maintain a sustainable social and economic infrastructure. Even with these efforts the economic condition kept deteriorating and the terms of trade were more unfavourable for the country.

At this stage, in 1970, again the SLFP government resumed office, with still its inward-looking policy of import substitution in hand, with further restrictions. The new government also changed the constitution converting the country to a Socialist Democratic Republic of Sri Lanka. The new government got involved in nationalisation in the form of Government-Owned Business Undertakings (GOBU) by passing the 1971 Business Acquisition Act. The plantations were nationalised and management was handed over to the Janatha Estate Development Board (JEDB) and State Plantation Corporation (SPC), under the 1972 Land Reform Law. Due to inefficiencies in management and politicisation, Sri Lanka lost its competitive edge in exports, for its primary products. Subsequently, all other sectors contracted due to the restrictive policies which inhibited the growth of these sectors. Despite the already existing high levels of import tariffs on all imports except for essential food items, all other goods came under licensing; foreign travelling, movement of capital and labour, etc. were heavily controlled. Sri Lanka became a highly restricted and regulated closed economy, in all ways, with a socialist policy. At this time, the government introduced a two-tier foreign exchange system for the fixed exchange rate system (Indraratna, 1998).

Post liberalisation period i.e. post 1977

From 1978 to present, the period represents the history of open market reforms. In 1977 with the change of the government and with the United National Party (UNP) coming to the power, the open economic policy was adopted. The reforms are a clear break away from the past economic regime and it shows a reversal of economic policies of the previous regime. The reforms are in the form of liberalisation of trade and exchange control, moving towards an economic strategy with more dependency on private investment and market forces (Sanderatne, 2005).

Within this policy frame, the government implemented a trade liberalisation package by end 1977, which brought in a sequence of drastic changes to the economy. An important move was to reduce the restrictions on imports by licensing and quotas being replaced with tariffs. In addition, the government wanted to convert expenditure on the food subsidy into expenditure on investment. This meant that the government had to come to a compromise by only targeting the subsidy to the bottom half of the population. Restrictions were relaxed for foreign travel and movement of capital and labour. Furthermore, the new government changed the two-tier fixed exchange rate system to a unified managed float (Indraratna, 1998; Jayawardena, 2004).

The new development policy of the government focused on several measures for development like, promotion of exports by setting up the Export Development Fund (EDF) and Export Development Board (EDB) coupled with other measures such as establishment of an Investment Promotion Zone (IPZ)/ Export Processing Zone (EPZs)/ Free Trade Zone (FTZ) at Katunayake which is close to the international airport of the country. The establishment of the EPZs and the privatisation programme can be mentioned as the two most important developments that occurred in the post 1977 period. This created an environment which is favourable to attract more Foreign Direct Investment (FDI). In the recent past several new EPZs were established after starting the Katunayake FTZ, especially for the expansion of garment industries. This is mainly due to the Sri Lankan garment sector benefiting from the quotas imposed by the Multi Fibre Agreement (MFA). Another eight FTZs and two Industrial Parks have added to the list afterwards. Likewise there were many other incentives for export promotion. At present, foreign investors are allowed to invest in any part of the country apart from the EPZs and they can still receive the same benefits. After realising that privatisation is a channel for entry of FDI and after realising the important role that FDI can play in the economy, the government announced the privatisation policy in 1987. As a result, in the period between 1989 and 2002, a total of 84 SOEs have been privatised (Indraratna, 1998; Thennakoon, 2007; Board of Investment, Sri Lanka[1]).

In keeping with its more market oriented policies, the government removed the domestic control of prices and subsidies were significantly reduced or cancelled altogether. The importation and distribution of essential food which was more of a government monopoly was opened up to the private sector. Together with these initiatives the government also commenced a number of massive investment programmes specially to provide infrastructure services. One of these is the Mahaweli Development Project, which was initially proposed to take 30 years but was ultimately accelerated and completed in six years. All these led to growth in imports and exports as well as expansion of the economic activity within the country. Mainly, the increase in public investment in infrastructure and active investment of the private sector contributed to the expansion of the economy. There was a significant contribution from foreign employment after opening up of foreign employment opportunities and tourism related sectors.

Though in the first few years with the open market reforms the economy was on an upswing, due to inappropriate policies inflation started to rise; the increasing interest rates crowded out private investment and terms of trade worsened. By about 1983, the country's economic state worsened which was partly affected by the intensification of terrorism (Indraratna, 1998).

Recent development strategies

Elections in 1994 brought about a change of government; however unlike in previous years despite the change rule the continuity of the economic policies was assured. The new government adhered to open economic policies, 'with a human face'. While considering (both domestic and foreign) private sector as the engine of growth by pursuing market friendly policies, government intervention was limited to areas where the markets failed to function, so that they served the welfare of the people (Sanderatne, 2005).

The new government in 2002 presented a vision and strategy for accelerated development called 'Regaining Sri Lanka' (RSL). The framework identified accelerating the process of privatization of commercial activities, reforming the legal foundation of the economy and increasing efficiency substantially in the critical government functions as the key elements of the programme, for Sri Lanka to regain control of the economic situation. The RSL policy initiative of the United National Front (UNF) regime sought to eliminate the rigidities for investment which had made the country less competitive than other countries in East Asia. According to this report, implementing the second generation reforms of deepening economic liberalisation was the solution. Accordingly, letting the private sector play a dominant role in the economy and deregulation were a means of putting the country back on track. Furthermore the country's Poverty Reduction Strategy Paper (PRSP) was also built-in to the RSL which emphasises the trickling down of economic gains for poverty reduction. However, due to several reasons the strategy did not succeed as expected. One main reason is that the economic gains did not trickle down. The growth has been highly centred on the Western province with only little gains to other areas. However, with the change of the government after the 2004 General Election there was a halt to these reforms. This

[1]Board of Investment (BOI) Sri Lanka.
http://www.boi.lk/boi2005/content.asp?content=whyinvest7&SubMenuID=7, accessed on 18 July 2007.

shows the resilience of the people over the policy package and the peace process of the government (Government of Sri Lanka, 2003; Kelegama, 2006).

The coalition government (based on an MOU between the Sri Lanka Freedom Party and the marxist Janatha Vimujthi Peramunua) which took office in 2004 launched a five point nation building programme called 'Rata Perata' (Country Forward: Creating Our Future Building Our nation), which included a new economic order, durable peace with dignity, investing in people, clean governance and ensuring law and order. The new United People's Freedom Alliance (UPFA) adopted a different strategy to that of the UNF regime, realising that social policies are essential for growth and economic stability. The policy of the new regime emphasised an equitable distribution of income by providing enhanced relief for the poor and vulnerable while encouraging more economic activities from the rural areas, through support of small and medium enterprises. Further, the government continued with welfare measures even at a time of high fiscal constraints despite the resistance of the multilateral financial institutions. Some polices such as restoring the fertiliser subsidy, broadening the poverty alleviation programme, continuation of electricity, transport and petroleum subsidies were carried out to address the issues of poverty and unbalanced growth at the time (United People's Freedom Alliance, 2004; Kelegama, 2006).

The most recent development plan is the Mahinda Chinthana: Vision for a New Sri Lanka. It provides a development framework for the country within a ten year horizon, 2006-2016. As it mentions, its aim is to raise the GDP growth rate in excess of 8 percent. Further, it tries to integrate the positive attributes of the market oriented economic policies while safeguarding the domestic aspirations by providing necessary support to domestic enterprises and encouraging foreign investment. The planning refers to creating an economy which is largely private sector driven, more dynamic and regionally integrated. It is important to note that the current development strategy emphasises the importance of regional development, which is a timely issue. The social development plan covers many areas such as education, health, livelihood development, social protection, disaster management, water supply and development of the lagging regions. The post 2005 welfare regime strengthened targeted welfare expenditure in Samurdhi, nutritional meal programme, free school uniforms, text books and season tickets, bursaries and scholarships, fertilizer subsidy (paddy and small holding agriculture) (Ministry of Finance and Planning, 2006).

The civil conflict

At a time the economy of the country was on an upswing, in 1983, the ethnic conflict