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# MAKING GROWTH MORE INCLUSIVE IN SRI LANKA

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## INTRODUCTION

Since the ending of Sri Lanka's long-drawn separatist conflict in May 2009, medium-term growth prospects for the country have looked promising. However, sustaining growth and ensuring peace depends on reducing disparities and improving opportunities for participation in development. It has been established that growth is a necessary condition for poverty reduction: most countries that have experienced high levels of growth have also experienced reductions in the number of poor (Rodrik, 2000). However, it is increasingly acknowledged that poverty alleviation depends not only on growth, but also on income distribution. For example, at Brazil's level of inequality, one per cent growth is estimated to reduce poverty by less than one per cent, while in India and China – countries with greater equality – one per cent growth is estimated to reduce poverty by more than three per cent (Thomas, 2007, cited in IPS, 2011).

Recent debates on development have focused on the need for 'inclusive growth' to achieve sustained growth outcomes. The inclusiveness approach focuses on addressing disparities in population groups across a variety of dimensions, including sector, industry, geographic location, gender, and ethnicity. Inclusive growth strategies have become increasingly popular among developing Asian economies which have faced both rapid growth and rising inequalities in the recent past.

Sri Lanka is no exception. While being well-known for exceptional human development comparable to developed economies, Sri Lanka faces significant challenges, post-conflict, and in order to sustain growth momentum in the long run, it is imperative to address sources of exclusion.

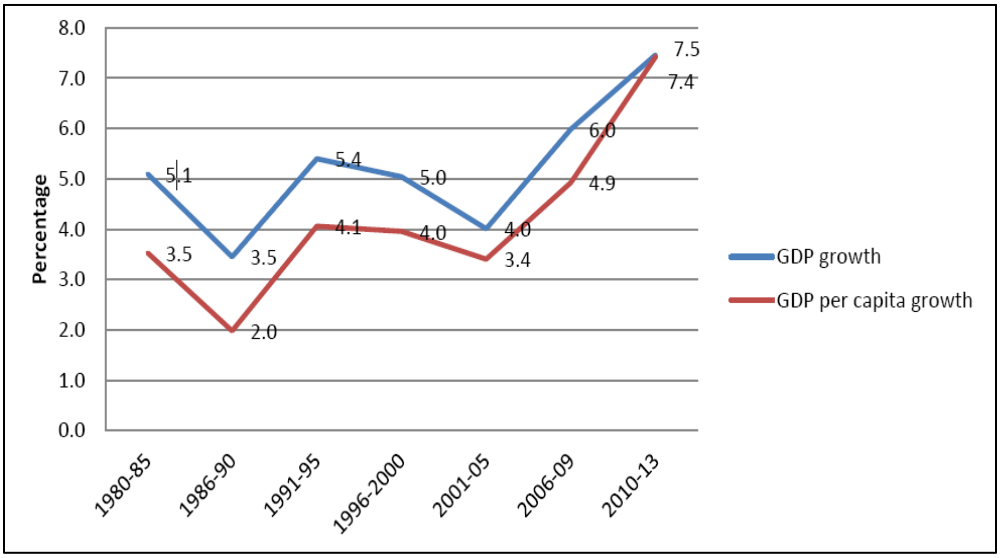
This paper is organised as follows. The next section examines trends and patterns of growth and inclusiveness in Sri Lanka, both at national and at disaggregated levels. Section 3 attempts to link empirical findings with economic and social policies adopted over time that have impacted growth and made it more inclusive. The final section concludes and offers some policy recommendations on making growth more inclusive.

## TRENDS AND PATTERNS OF GROWTH AND INCLUSIVENESS

### Economic Growth

In line with the majority of Asia-Pacific economies, Sri Lanka has experienced an overall increasing trend in economic growth, both in terms of real GDP growth and growth in GDP per capita. As depicted in Figure 1, the early 1980s recorded a GDP growth rate above 5 per cent, triggered by the open economic policies introduced in the late 1970s. The fall of growth rates in the late 1980s reflects the effects of the ethnic conflict which began in 1983. The early 1990s saw a revival in growth rates following further liberalisation. Sri Lanka's growth performance has been impressive in the post-conflict period, recording average GDP growth rates of 7.5 per cent in the 2010-13 period, and similar growth in GDP per capita to reach US$ 3,280 in 2013, indicating a general improvement in living standards. Indeed, consequent to the rapid increase in per capita income, Sri Lanka was categorised as a middle income country by the IMF in January 2010.

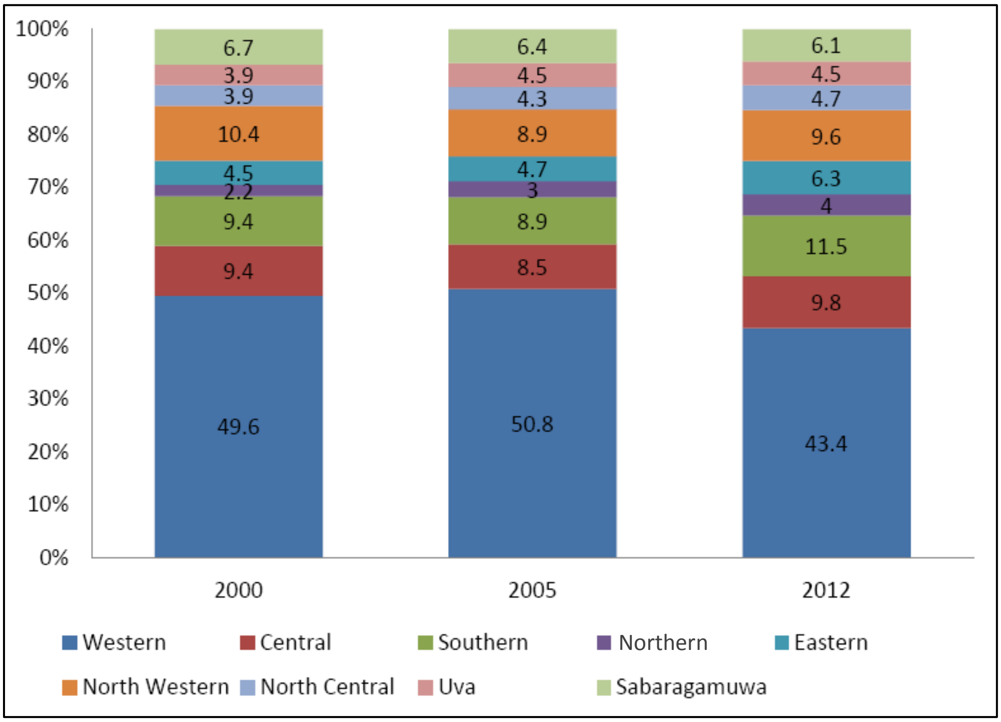
**Figure 1: GDP and GDP Per Capita Growth Rate Averages in Sri Lanka: 1980-2013**




Source: World Bank, *World Development Indicators 2014.*

The contribution to overall growth is, however, mixed across provinces and industries. Economic activity remains highly concentrated in the Western Province, which contributed to 43 per cent of GDP in 2012; somewhat lower than the 50 per cent figure recorded in 2000 and 2005 (Figure 2). This decline has been accompanied by marginal increases in the contribution of other provinces, most notably of the Southern Province[1]. It is also encouraging to note a rise in the contribution of the Northern and Eastern Provinces following the end of the war. Sabaragamuwa is the only province to record a declining share over the years.

**Figure 2: Contribution to GDP by Province, Percentage Share, 2000, 2005 and 2012**



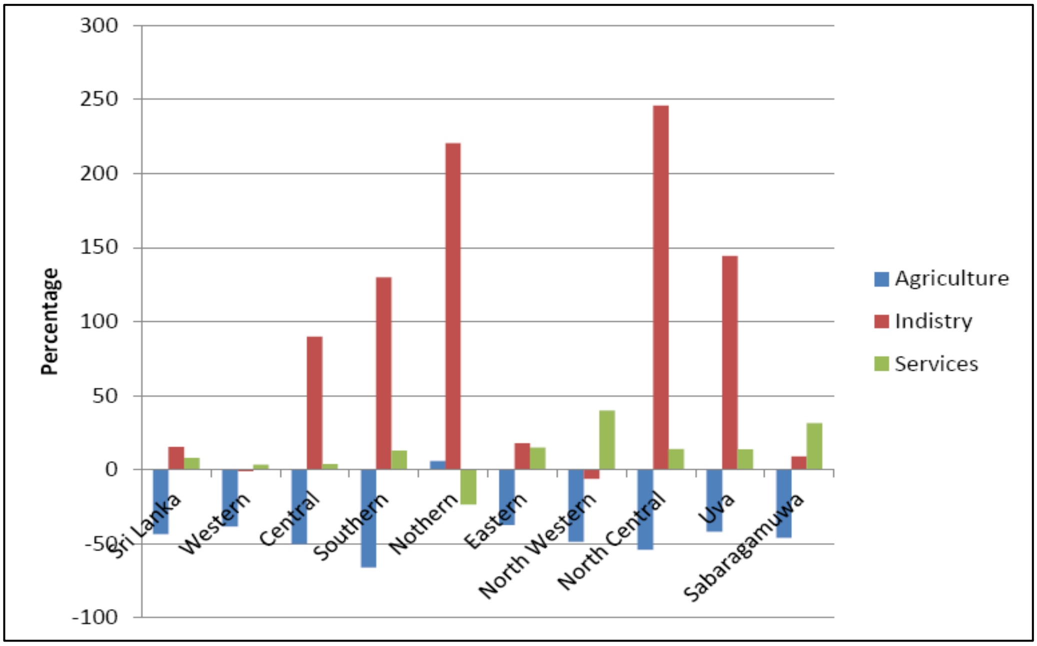

Source: CBSL, *Annual Report*, Various Issues.

In the overall economy, growth has been driven mainly by industry- and service sectors. The contribution of the agricultural sector to the overall economy has declined from 19.4 per cent in 2000 to 11 per cent in 2012, while the contributions of industry- and service sectors increased over the same period by 16 and 8 percentage points to reach 31.5 per cent and 57.5 per cent respectively. In all provinces except the Northern Province, the share of the agricultural sector declined, while that of the industrial and services sectors gained (Figure 3). In the Western Province, shares of both the agricultural and industrial sectors have declined, albeit marginally.

[1] The growing contribution to GDP by the Southern Province can be attributed to the numerous infrastructural projects taking place in this region.

However, patterns of change in sectoral shares are not uniform across provinces. The share of the industrial sector has increased sharply (over 200 per cent) in the North Central and Northern Provinces, while that of the services sector increased markedly in the North Western and Sabaragamuwa Provinces (by 40 and 32 per cent, respectively). On the other hand, the services sector in the Northern Province has recorded a notable decline in contribution to GDP.

**Figure 3: Changes in Sectoral Shares of GDP across Provinces, 2000 and 2012**




Source: Calculated using data from CBSL, *Annual Report*, Various Issues.

**Poverty**

Sri Lanka has made considerable progress in reducing poverty during the past two to three decades. The proportion of population living below the official poverty line – referred to as the poverty headcount ratio (PHCR) – has dropped from 26.1 per cent to 6.7 per cent between 1991 and 2013: a reduction of 74 per cent. Indeed, Sri Lanka achieved the MDG target of halving the incidence of income poverty at the national level seven years ahead of the target-year 2015. Achievements in poverty reduction extend beyond national level to the sectoral.

The PHCR computed by the Department of Census and Statistics of Sri Lanka (DCS) lies in-between two poverty lines used for international comparisons: US$ 1.25 and US$ 2 (in terms of purchasing power parity) per person per day. As indicated in Table 1, national estimates are higher than the US$ 1.25 poverty line figures, but significantly lower than the corresponding figures for the poverty line based on US$ 2. This is of concern, as it indicates that there are a large number of people just above the poverty line who are vulnerable to external shocks, ill health or any other domestic shock, and at risk of slipping back into poverty. In fact, estimates from the Household Income and Expenditure Survey (HIES) conducted by the DCS reveal that there are approximately 620,000 persons within a band of 10 per cent above the poverty line and 1.3 million persons within a band of 20 per cent above the poverty line (UN and IPS, 2014), which together account for 9.5 per cent of the total population.

**Table 1: Comparison of Incidence of Poverty based on International Poverty Lines and the National Poverty Line, 1990 to 2010**

| Survey Year | PHCR based on International Poverty Lines | | PHCR based on National Poverty Line |
|---|---|---|---|
| | US$ 1.25 | US$ 2 | |
| 1990/91 | 15.01 | 49.5 | 26.1 |
| 1995/96 | 16.32 | 46.68 | 28.8 |
| 2002 | 13.95 | 39.74 | 22.7 |
| 2006/07 | 7.04 | 29.13 | 15.2 |
| 2009/10 | 4.11 | 23.85 | 8.9 |

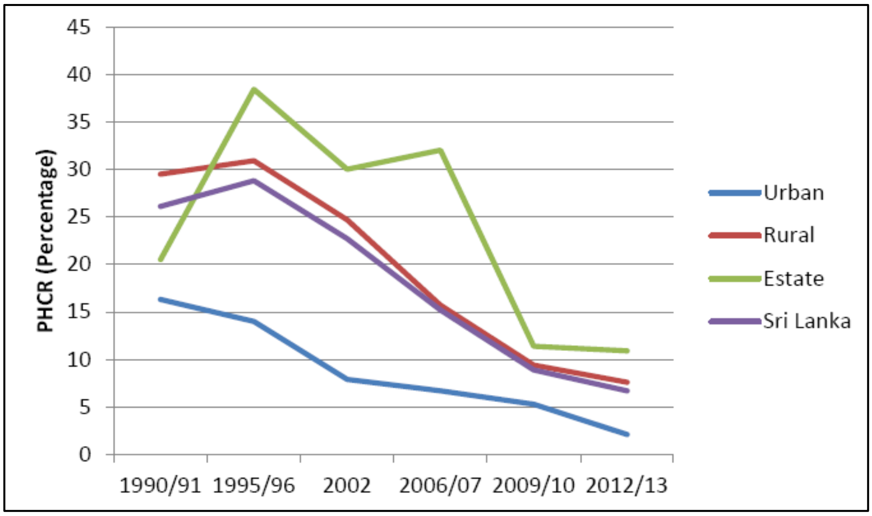
Source: World Bank, *World Development Indicators 2014*.

The figures above also show that the PHCR increased between 1990 and 1995 before starting on a declining trend thereafter. This is at a time when the economy was growing at a rate of over 5 per cent and hence indicates that the poor were unable to take advantage of opportunities generated by high growth at the time. That there is an issue with regard to poverty reduction also becomes clear when growth rates and poverty reduction are evaluated between 1990 and 2002, where the per annum poverty headcount reduction was 1.1 per cent, compared to a GDP per capita increase of close to four per cent per annum. One possible explanation is the slow growth of the agricultural sector[2] during this period, where the incidence of poverty is highest (Kelegama, 2014). The restructuring of estates in the early stages of privatisation and low paddy production also contributed to poverty in estates and rural areas. In fact, Dunham and Edwards (1997) argue that poverty levels in the mid-1990s would have been higher if not for workers in ready-made garment factories, those in the armed forces and remittances from overseas workers.

[2] Agriculture grew by only 1 per cent during 1991-1996.

Similar to national-level trends, the PHCR has also shown declines at sectoral level. The urban sector, where poverty incidence is substantially lower than the other two sectors, has experienced steady declines in poverty over the years (Figure 4). The rural sector, which accounted for 86.8 per cent of the poor Sri Lanka in 2012/13, shows a poverty trend similar to the national trend, where the percentage of population below the poverty line has declined continuously since 1995/96. The estate sector in Sri Lanka accounts for the largest percentage of poor, and it has also experienced upsurges in poverty in some years – peaking at 38.4 per cent in 1995/96 – in contrast with the other sectors. However, the PHCR for the estate sector has recorded impressive declines in more recent years – from 32 per cent in 2006/07 to 10.9 per cent in 2012/13.

**Figure 4: Poverty Headcount Ratio by Sector, 1990-2013**



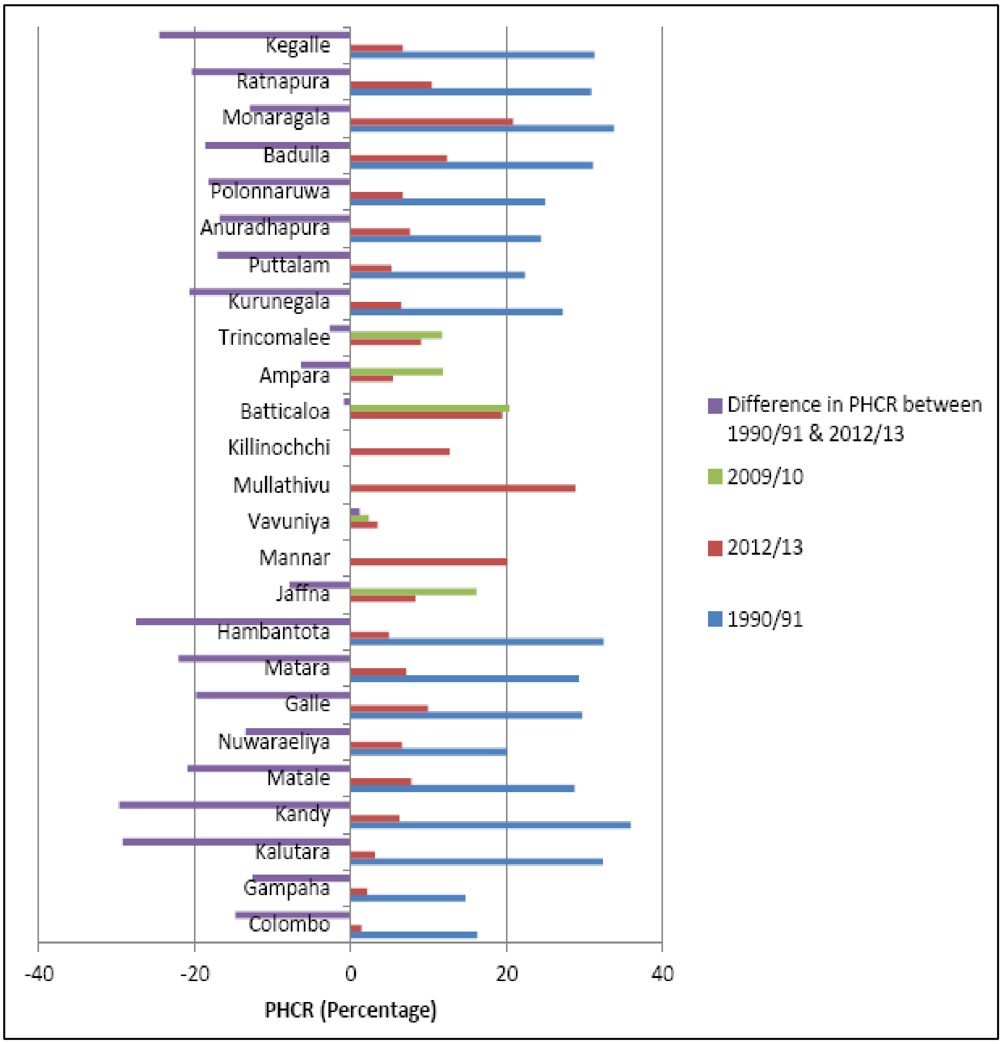

Source: DCS, *HIES*, Various Years.

Regional disparities in poverty persist, with some regions of the country lagging behind (Figure 5). Nevertheless, the data indicate that economic growth has been beneficial across provinces, with more deprived provinces (i.e., those outside the Western Province) showing greater reductions in poverty; with the exception of some districts in the Northern and Eastern Provinces which are still home to a notable percentage of poor[3]. Nonetheless, remarkable progress has been made in Jaffna and Ampara where poverty was halved over the two time periods, driven by the development activities and improvements in service-delivery mechanisms in the post-war period. The Mullathivu district, for which poverty estimates were available for the first time in 2012/13,

[3] Poverty estimates for these two provinces are available only from 2009/10 onwards, as indicated in the Figure.

recorded the highest incidence of poverty (28.8 per cent), underscoring the need for continued development efforts in war-torn areas. The Monaragala district records the second highest occurrence of poverty (20.8 per cent). Poverty has risen in the district from 14.5 per cent in 2009/10, which is of concern and requires urgent attention of policy makers.

**Figure 5: PCHR in 1990/91, 2009/10 and 2012/13 by District**




Source: DCS, *HIES*, 1990/91, 2009/10 and 2012/13, cited in UN and IPS, 2014.

The Poverty Gap Ratio (PGR) is another measure of poverty that measures the "poverty deficit" of the entire population: the per capita amount of resources that would be needed to bring all poor people above the poverty line through perfectly targeted cash transfers. Hence the indicator is often described as a tool for measuring the per capita amount of resources needed to eliminate poverty, which makes it a useful indicator for policy makers. The larger the poverty gap, the poorer, on average, the people below the poverty line, and the more the resources needed to lift them out of poverty.

In Sri Lanka, the PGR has declined sharply since 1995/96, both at the national and sectoral levels. The PGR in fact demonstrates a very similar trend to the PGCR. The national ratio has declined from 6.6 per cent in 1995/96 to 1.2 in 2012/13, with corresponding declines recorded in the urban and rural sectors. As with the PHCR, the PGR has fluctuated in the estate sector, but has recorded significant declines in recent years. At the district level, the PGR is lowest in Colombo (0.3 per cent), Gampaha (0.4 per cent), Kalutara (0.5 per cent), Vavuniya (0.5 per cent) and Ampara (0.6 per cent) districts, whereas it is high in Mullathivu (6.2 per cent), Mannar (4.6 per cent), Batticaloa (4.5 per cent) and Monaragala (4.2 per cent) (UN and IPS, 2014).

International estimates of the PGR based on the US$ 1.25 and US$ 2 poverty lines lie above and below the national estimate for Sri Lanka respectively, similar to the PHCR. These measure the percentage of the population living on less than $1.25 and $2 a day at 2005 international prices. As a result of revisions in purchasing power parity exchange rates, poverty rates for individual countries can be compared with these international estimates only after 2005 (Table 2).

**Table 2: Comparison of Sri Lanka's PGR based on International Poverty Lines and National Poverty Line – 2006/07 and 2009/10**

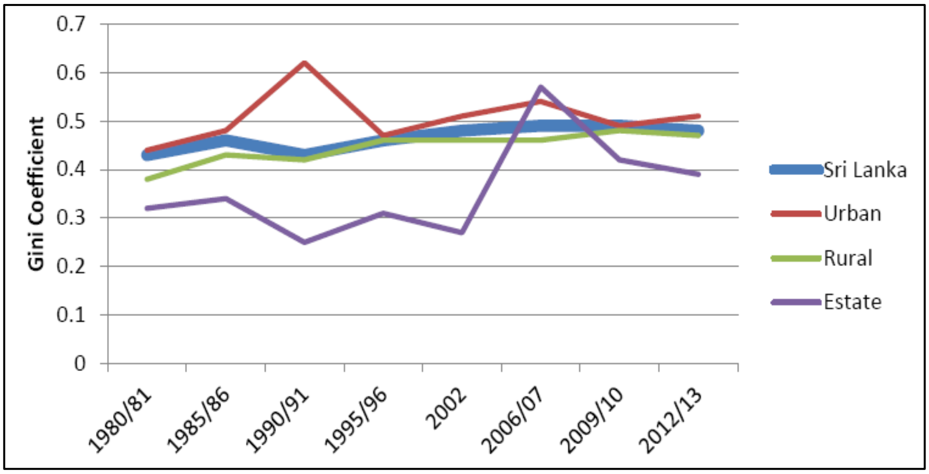
| Survey Year | PGR based on International Poverty Lines | | PGR based on National Poverty Line |
|---|---|---|---|
| | US$ 1.25 | US$ 2 | |
| 2006/07 | 0.98 | 7.38 | 3.1 |
| 2009/10 | 0.65 | 5.37 | 1.7 |

Source: World Bank, *World Development Indicators 2014*.

**Income Inequality**

A pressing issue in terms of inclusive growth in Sri Lanka is that rapid growth and poverty reduction have not trickled down to lower-income groups in the country, as evident from growing income inequality. Income inequality as measured by the Gini coefficient has increased from 0.43 in 1980 to 0.48 in 2013 (Figure 6). An increasing trend can be observed at the sectoral level as well. The urban sector shows a relatively high value of 0.51 which is above the national value, indicating that although the level of poverty is lowest in this sector, there exists considerable inequality in terms of the distribution of income among income groups. On the other hand, income inequality was lowest in the estate sector at 0.39 in 2013, despite a sharp increase in the 2006/07 period.

**Figure 6: Gini Coefficient in Sri Lanka and at the Sectoral Level, 1980-2013**




Source: DCS, *HIES*, Various Years.

The problem of income inequality is also seen in comparing the percentage shares of income that accrue to the lowest and highest quintiles of the population. As indicated in Table 3, there is a marked difference in the shares of income between the two groups, and this gap has remained at a similar level since 2002. Moreover, the ratio of the income of the 5$^{th}$ quintile to that of the 1$^{st}$ quintile, also known as the quintile dispersion ratio, has increased from 11.2 to a peak of 12 per cent in 2010 thereafter declining marginally to 11.8 in 2013, suggestive of a widening gap between the two income groups. In addition, the war in the Northern and Eastern Provinces created new forms of social inequalities, mainly in the form of entitlement failures such as loss of public entitlements, market/livelihood entitlements, and civil/social entitlements, as well as the reversal of entitlements (Kelegama 2014).

**Table 3: Share of Income by Richest and Poorest Income Quintiles (Percentage), 2002, 2010 and 2013**

| Year | Lowest 20 % (1$^{st}$ Quintile) | Highest 20 % (5$^{th}$ Quintile) | Ratio of Highest to Lowest (Quintile Dispersion Ratio) |
|---|---|---|---|
| 2002 | 4.8 | 53.7 | 11.2 |
| 2009/10 | 4.5 | 54.1 | 12.0 |
| 2012/13 | 4.5 | 52.9 | 11.8 |

Source: DCS, *HIES*, Various Years.

The favourable impact of economic growth on consumption and poverty could be dampened if there is a simultaneous increase in income inequality. Some rise in inequality in the process of rapid economic growth is unavoidable[4], and the rise in inequality in the early 1980s is thus understandable in the context of rapid economic growth and structural change (Kelegama, 1993). However, the Sri Lankan experience in the context of five per cent average growth during the 1990s shows little decline in inequality. Moreover, Sri Lanka has not achieved high growth rates like China to compensate for increases in income inequality. Also, as Ravallion (1997) has argued, initial inequality could dampen the impact of economic growth on poverty alleviation.

The World Bank undertook an exercise to decompose the change in poverty in Sri Lanka into two parts: results of growth and of inequality (World Bank, 2007). The results indicate that had inequality not increased between 1990 and 2002, the observed growth in mean consumption would have been sufficient to reduce poverty by 15 percentage points, which would have brought poverty down to single-digit level or half its actual level in 2002. In other words, the increase in inequality that took place during 1990-2002 prevented the decline in poverty headcount by over 15 percentage points.

## Social Indicators of Inclusive Growth

**Access to Social Services and Infrastructure:** A decomposition analysis on Sri Lanka's inequality undertaken by Gunatilaka in 2011 shows that income flows associated with access to infrastructure and education are the principal determinants of inequality and the main drivers of change in income distribution. In short, growing inequality is explained mainly by growing disparity in households' access to education and infrastructure. Indeed, notwithstanding Sri Lanka's remarkable progress in human development outcomes over time[5], available data show considerable gaps across sectors and provinces in accessibility of education, health and other infrastructural facilities.

The distance to schools and hospitals is an important determinant of access to educational and health facilities. Data from the HIES indicate that the mean distance for accessing facilities tends to be higher for poor households than for non-poor in Sri Lanka (DCS, 2007). Moreover, there are notable differences across sectors, provinces and districts; a relationship can be observed between poverty incidence and the mean distance of accessibility.

[4] This is implied in the classic Kuznets income-inequality relationship or the inverted-U hypothesis.

[5] The percentage of underweight children under five years declined from 37.7 to 26.9 between 1993 and 2006, and the country has almost achieved universal primary education, reaching 99.7 per cent net enrolment in 2013 (UN and IPS, 2014).

**Table 4: Mean Distance to the Nearest Place of Facility by Sector and Province, Kilometers, 2006/07**

| Sector/ Province | Pre-School | Primary School | M.V./ M.M.V./ Jathika Pasala | Hospital | Government Dispensary | Private Dispensary |
|---|---|---|---|---|---|---|
| **Sri Lanka** | **0.6** | **1.0** | **2.7** | **6.7** | **4.1** | **2.5** |
| **Sector** | | | | | | |
| Urban | 0.2 | 0.5 | 0.9 | 3.0 | 1.8 | 0.3 |
| Rural | 0.6 | 1.1 | 2.8 | 7.2 | 4.4 | 2.7 |
| Estate | 1.0 | 1.3 | 4.8 | 9.2 | 5.4 | 5.0 |
| **Province** | | | | | | |
| Western | 0.3 | 0.8 | 2.0 | 5.3 | 2.8 | 0.9 |
| Central | 0.6 | 0.9 | 2.5 | 6.0 | 3.9 | 3.0 |
| Southern | 0.7 | 1.2 | 2.2 | 6.5 | 4.0 | 2.3 |
| Eastern | 0.3 | 0.5 | 2.5 | 4.8 | 5.6 | 2.7 |
| North-Western | 0.7 | 1.0 | 3.0 | 8.3 | 4.4 | 2.7 |
| North Central | 0.8 | 1.5 | 3.6 | 9.4 | 5.3 | 4.4 |
| Uva | 0.8 | 1.4 | 4.2 | 9.1 | 6.3 | 6.0 |
| Sabaragamuwa | 0.7 | 1.2 | 3.3 | 7.4 | 4.6 | 2.6 |

Source: DCS, *HIES 2006/07.*

As shown in Table 4, the mean distances to the nearest accessibility points for schools and hospitals are highest in the estate sector (lowest in the urban sector), which also records the highest (lowest) incidence of poverty. Similarly, the Western province records the lowest mean distance to all the types of schools and hospitals considered, while the Uva Province records high mean distance more than double that of the Western Province. For instance, the mean distance from households to the nearest hospital in the Monaragala district is reported as 11.2 km, whilst the corresponding figure for the Colombo district is only 4.2 km (DCS, 2007). Moreover, data for the Northern and Eastern provinces, where mean distances are likely to be much higher, are not available for this year.

Access to infrastructure plays a key role in making growth and human development indicators more inclusive by reducing transaction costs. Available information suggests that while Sri Lanka as a whole has improved notably over the years, there are wide disparities across sectors (and provinces). Some examples of these are given in Table 5.

**Table 5: Access to Infrastructure by Sector, Percentage of Total Households, 2012**

| Sector | Access to Safe Drinking Water (2012) | Access t0 Improved Sanitation Facilities (2011) | | Access to Electricity for Lighting |
|---|---|---|---|---|
| | | Toilet Facilities | Disposal of Garbage | |
| **Sri Lanka** | **88.7** | **89.8** | **20.4** | **88.9** |
| Urban | 98.7 | 88.6 | 74.9 | 97.0 |
| Rural | 89.0 | 90.8 | 9.2 | 87.5 |
| Estate | 43.2 | 75.9 | 7.8 | 82.8 |

Notes: A safe drinking water source includes protected wells, pipe borne water and tube wells, while unprotected wells, rivers, tanks, streams etc. are listed as unsafe sources in the HIES. Toilet facilities refer to those that have their own toilet facilities as opposed to sharing with other households. Disposal of garbage refers to the percentage that is collected by a garbage truck as opposed to having to dispose of it by the household.

Source: DCS, *Census of Population and Housing 2012*.

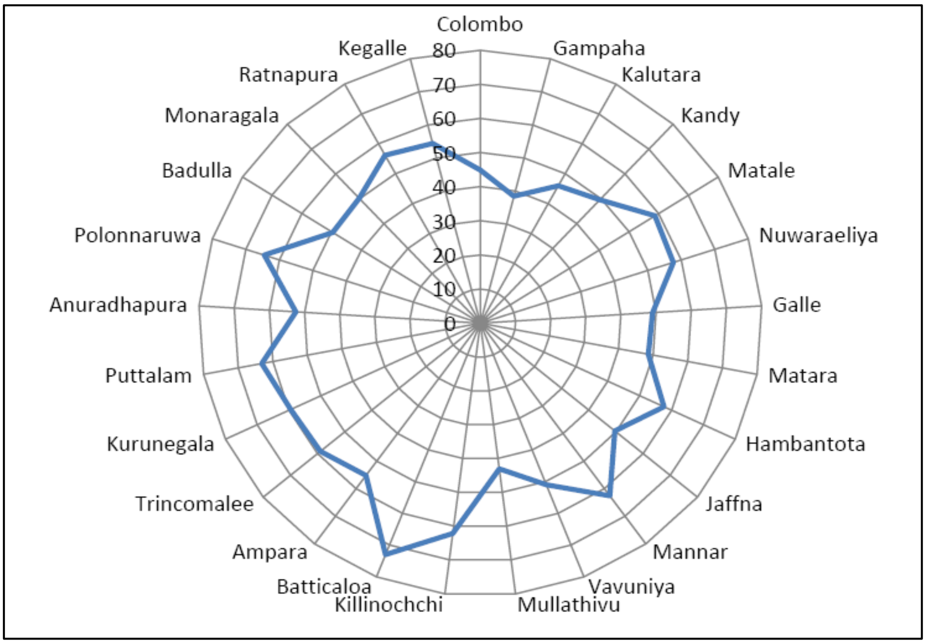
While close to 90 per cent of the households in Sri Lanka have access to safe drinking water, the estate sector still lags behind with a corresponding figure of only 43 per cent[6].

Access to own toilets is more equitable across the sectors; however, there are wide variations in disposal of garbage, which is a severe problem for most rural and estate sector households in Sri Lanka as the facility of public garbage collection is mostly limited to the urban sector. Providing electricity for all is a key economic development goal in Sri Lanka. Approximately every eight out of nine households (88.9 per cent) had the facility in 2012, which is a 3.6 per cent increase from 85.3 per cent reported in 2009/10 (DCS, 2013). While the urban sector is the most widely covered, the other sectors have shown improvements. Making further improvements in access to infrastructure – particularly in the estate and rural sectors – will be imperative in opening up opportunities for different segments of the population to participate more meaningfully in economic activities.

[6] However, this could be partly due to the HIES definition of safe drinking water, where water from springs is considered unsafe. Many people in the Estate Sector, especially in tea estates in high elevations use spring water for drinking, which they consider to be safe. Thus, it may be necessary to reconsider the definition of safe drinking water in such environments.

**Share of Employment in the Informal Sector:** Employees in the informal sector have no formal work agreements or access to fringe benefits and social protection programs; therefore being more vulnerable to economic cycles. Even though unemployment in Sri Lanka is declining, the percentage of total employed people in the informal sector remains high at 61 per cent of total employed (DCS, 2012). High informal sector employment contributes to inequality as there generally exists a large wage gap between the formal and informal sectors. Informal sector employment is as high as 85 per cent in the agricultural sector, given the nature of employment[7], whereas the corresponding figure is 50 per cent in the industry and services sectors. A majority of male and female workers are employed in the informal sector (64.4 per cent and 54.1 per cent, respectively) (DCS, 2012).

**Figure 7: Proportion of Informal Sector Workers in Total Employment, 2012**




Source: DCS, *Sri Lanka Labour Force Survey Annual Report 2012.*

There are notable variations in informal sector employment between districts, with the less-developed districts accounting for more informal workers (Figure 7). The proportion is highest in Batticaloa (73 per cent), followed by Polonnaruwa (64.5 per cent), Puttalam (63.2 per cent), Mannar (62.6 per cent) and Killinochchi (62.2 per cent).

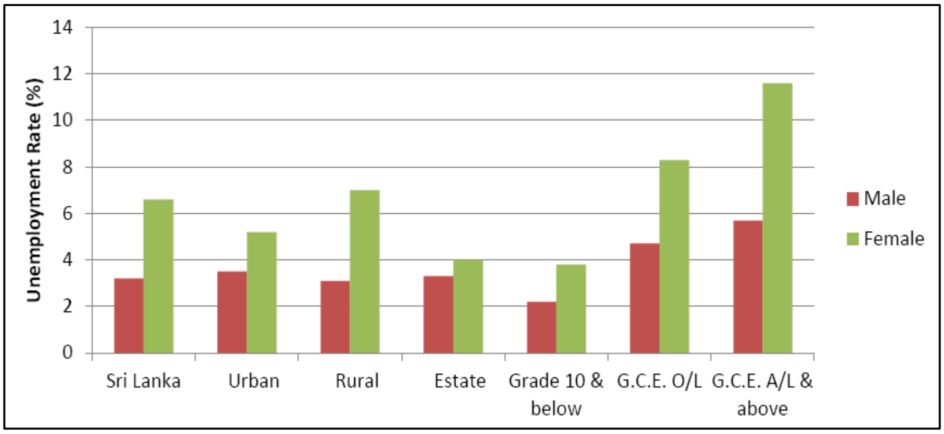
[7] Formal sector agricultural employment mainly comprises estate sector employment owned by the Government or the corporate sector.

The proportion is lowest in the three districts of the Western Province and in Mullathivu.

**Gender Equity:** Sri Lanka's progress in achieving gender equity remains mixed across various indicators. In terms of education, Sri Lanka has been successful in achieving gender equality at all educational levels. The ratio of girls-to-boys enrolled in all levels of education has increased over the years, exceeding the MDG target of 100 per cent at secondary level, indicative of a more-than-proportionate rise in female students in comparison with male. The increasing ratio of girls-to-boys in primary and secondary enrolment rates has been observed in all three sectors and across all districts (UN and IPS, 2014). In addition, available data indicates gender parity in enrolment at university level – the share of female students that entered state universities for undergraduate programs was almost 60 per cent in 2010/2011 (University Grants Commission, 2011 cited in IPS and UNDP, 2014)[8].

Notwithstanding such achievements, employment outcomes in Sri Lanka reveal a very different picture in terms of gender equity. The employment-to-population ratio for males (15 years and above) in Sri Lanka is more than 70 per cent, while the ratio for females is only around 30 per cent. Moreover, the share of women in wage employment in the non-agricultural sector has not improved significantly since 1993, with only a marginal increase from 30.8 per cent in 1993 to 32 per cent in 2011 (IPS and UNDP, 2014). Disparities in the share of women in wage employment in the non-agriculture sector are more prominent across provinces and districts.

**Figure 8: Unemployment Rates by Sector and Level of Education, 2013**




Source: DCS, *Sri Lanka Labour Force Survey Annual Bulletin 2013*.

[8] However, it should be noted that high female shares are recorded in academic streams like Arts, Law and Indigenous Medicine, while female admissions to academic streams like engineering remains much lower (around 20 per cent) compared to the admissions of male students.

The low share in wage employment stems from the low labour force participation rate for females in Sri Lanka, which has stagnated at around 30-35 per cent over the past decade and is less than half the rate for males (around 70 per cent). In addition, despite significant reductions in unemployment rates in the country – from 17.9 per cent in 1980 to 4.4 per cent by 2013 – the unemployment rate among females is twice that of males, a trend that has remained more or less the same over the past three decades. The gap between unemployment rates is particularly pronounced in the rural sector and among those with higher educational qualifications (Figure 8).

Several reasons can be put forward to explain such trends. Higher levels of education of females compared to males may be one contributory factor to low female labour force participation at young ages. Another reason could be the migration of females with less education to Middle-Eastern countries for employment. Some educated females choose not to work, given family responsibilities, while disparities in national legislation in terms of gender, such as the absence of laws entitling maternal leave for women in many industries (particularly for those in the informal sector) and a lack of equal rights for women when administering property also pose barriers to labour force participation.

The proportion of female members of Parliament – another indicator of gender equity – is also very low in Sri Lanka and has not shown notable improvement over the past two decades. In fact, contrary to Sri Lanka's superior performance in the South Asian region with respect to gender parity in school enrolment and employment, the country's performance with regard to members in the National Parliament is among the lowest in the region (Table 6).

**Table 6: Proportion of Seats held by Women in National Parliament in South Asia, 1990, 2000 and 2013**

| Country | 1990 | 2000 | 2013 |
|---|---|---|---|
| Bangladesh | 10.3 | 9.1 | 19.7 |
| Bhutan | 2.0 | 2.0 | 8.5 |
| India | 5.0 | 9.0 | 11.0 |
| Maldives | 6.3 | 6.0 (2001) | 6.5 |
| Nepal | 6.1 | 5.9 | 33.2 |
| **Sri Lanka** | **4.9** | **4.9** | **6.8** |

Source: ADB, *Key Indicators for Asia and the Pacific 2013*, cited in UN and IPS, 2014.

## POLICIES TO MAKE GROWTH MORE INCLUSIVE

Since as early as the 1920s, successive governments of Sri Lanka have adopted various economic and social policies with the aim of developing the economy, while also taking care of the poor and less privileged. These played an important role in making growth more inclusive. These policies can be categorised mainly into two sub-divisions: (1) sustainable growth, and (2) social inclusion.

### Sustainable Growth

Economic growth in Sri Lanka received the biggest boost in the late 1970s following the introduction of open economic policies and in the early 1990s and 2000s following further attempts at liberalisation. Nevertheless past growth experiences were not always inclusive across population groups: underscoring the need for complementary economic and social policies. The previous development plan in Sri Lanka **-** *Mahinda Chinthana Idiri Dakma* (MCID) – a ten-year (2006-16) horizontal development plan – attempted to integrate the positive attributes of market-oriented economic policies while safeguarding domestic aspirations, by providing necessary support to domestic enterprises (IPS, 2008). Regional development was prioritized, and physical infrastructure development, promotion of a business-friendly environment for a market-oriented economy, and investing in social services were focused upon.

**Physical Infrastructure:** The previous Government had recognised that the low productivity of investment was partly due to weak infrastructure, and steps were taken under the MCID to strengthen investment in physical infrastructure. Indeed, the infrastructural drive was the key contributor to the high growth rates of over seven per cent recorded in the post-conflict period. These infrastructure projects were implemented at both the national as well as the regional level. National infrastructure development projects operated under the *Randora* Programme, while regional programmes were initiated under *Gama Neguma* (development of villages) and *Maga Neguma* (developments of roads) programmes. The *Randora* Programme covered areas of economic infrastructure, irrigation, education and health, industries, urban development, and development of townships. Huge infrastructure programmes such as the Upper Kotmale Hydro Power Project, Puttalam Coal Power Plant, Colombo Port Expansion Project, Hambantota Sea Port Development Project, Galle Port Development Project, Oluvil Port Development Project, Southern Expressway, and the Colombo-Katunayaka Expressway were covered by this Programme.

The objective of *Gama Neguma* and *Maga Neguma* was to improve small scale infrastructure facilities in all regions and improve road development, energy, water supply and sanitation, reconstruction of canals, construction of small-scale rural buildings, small-scale infrastructure development, ports and aviation, transport and rural infrastructure at regional level. These programmes followed participatory development methods for rural development. *Maga Neguma* resulted in the rehabilitation of around 1,350 km of rural roads in 2008/09, with most roads being concreted to ensure durability (IPS, 2010).

Infrastructure development is particularly important in reconnecting the Northern and Eastern Provinces with the rest of the country in post-conflict Sri Lanka. With this broader objective, the previous Government introduced two separate development programmes for the Eastern and Northern Provinces: *Negenahira Navodaya* and *Uthuru Wasanthaya*. In addition to the reduction of the gap in economic infrastructure between conflict-affected areas and the rest of the country, these two programmes aimed to compensate citizens in the conflict-affected areas for the loss of their public and livelihood entitlements (IPS, 2010; Kelegama, 2010).

**Tax Reforms:** With the aim of creating a favourable environment for the business community and thereby achieving sustainable growth, the Sri Lankan Government has proposed to restructure the current tax system as it is complex and narrowly-based. One of the main objectives of this restructuring is to promote the export-import sector, mainly by encouraging value-added exports, as it is an effective driving force for growth. A CESS (Commodity Export Subsidy Scheme) is imposed on all exports of raw and semi-processed items, while finished products are exempt from CESS. In addition, taxes on import of machinery and equipment have been reduced with the objective of improving access to world-class technology. At the same time, income tax for industries with value addition has been reduced from 15 per cent to 10 per cent, while taxes on all exports have also been reduced from 15 per cent to 12 per cent.

Promotion of services like finance, ICT and telecommunication is also important for high and sustainable growth. To improve these sectors, the Government has taken several steps to re-structure the tax system. For instance, VAT on the financial sector and income tax on profits have been reduced. The government has also made concerted efforts to promote the ICT sector by establishing IT centres such as *Nanasala* and *Vidatha*.

## Social Inclusion

Social inclusion has been a priority in post-Independence Sri Lanka, with successive Governments investing a significant percentage of GDP on social development. Lakshman (1997) argues that it has been a tradition in Sri Lankan policy to put efforts to reduce poverty at the top of the Government agenda. Sri Lanka was one of the first developing countries to understand the multi-dimensional nature of poverty and to strongly emphasise policies of free health and education, in the 1930s. Indeed, Sri Lanka stands well above its peers and very close to developed countries in terms of social indicators such as literacy and infant mortality rate. Moreover, Sri Lanka has achieved many of the MDGs. Social policy in Sri Lanka has mainly focused on the expansion of human development and safety nets.

**Expanding Human Development (Education):** According to the Education Act of 1945, education in Sri Lanka is free from Grade One to degree-level and is universal. The Government expanded the school network to fulfill demand and changed the medium of instruction from English to local languages to meet social demand. In the initial stages, there was a bias in the allocation of resources and. as a result, regional disparities in the education sector arose. With the purpose of overcoming these imbalances, increasing the educational opportunities for the poor and increasing the quality of education, successive Governments have introduced different policies over the years. The establishment of Central Colleges in 1940s, the implementation of the common curriculum in the 1970s, introduction of intervention strategies to compensate for socio-economic differences, the Grade 5 scholarship programme, district-based University enrolment since 1979, and the free school textbook programme initiated in 1980, as well as the free distribution of midday meals and free uniform material begun in 1993, and transport subsidies facilities are among the most important of such policies (Box 1).

**Box 1: Education Welfare Programmes in Sri Lanka**

Free School Textbook Programme: This programme was initiated in 1980 with the aim of improving the quality of education. School textbooks are provided freely to all students in Grades 1-11 in all State and State-aided schools**.** Currently, it benefits students in over 10,000 schools from all districts of the country. Over 30 million copies covering more than 300 different subjects in the Sinhala, Tamil and English are distributed annually under this programme, using Government and donor funding.

Free School Uniform Materials Programme: Under this programme introduced in 1993, all students in all Government schools and temple-schools are provided with free uniform material. The type of material and quantity received by students depend on their gender and grade in school. This programme is entirely funded by the national treasury.

School Midday Meal Programme: This programme was introduced in 1989 with the aim of providing one meal per day to all children enrolled in primary and secondary schools across the country. Initially, a student received a stamp of Rs.3 and was expected to

*Box 1 continued*

*Box 1 continued*

bring a home-made lunch to school. Due to budgetary constraints, this programme had to shift from universalism to a targeted programme before being finally absorbed into the *Samurdhi* poverty alleviation programme in 1995.

Target groups are school children in difficult areas, from marginalised families, and from identified schools in which at least 30 per cent of the students are malnourished.

Source: Kelegama 2014

Another more recent initiative is the *Mahindodaya* School Development Programme, under which Science and Technology Laboratories are being provided to 1000 selected secondary schools in rural areas with the aim of providing equal educational opportunities in science and technology for students of Grades 12 and 13 countrywide.

**Expanding Human Development (Health):** Similar to educational outcomes, Sri Lanka has been able to achieve remarkable health indices, such as low maternal, infant, and under-five mortality rates, and high levels of life expectancy, due to the tireless efforts of many stakeholders, and the implementation of effective policies and programmes for more than six decades.

The need for developing preventive and promotive health services was recognised by the government as early as 1920. In the mid-1920s steps were taken to introduce Health Units staffed with a physician, nurses, midwives and a sanitary inspector, to provide comprehensive health care services (institutional and domiciliary) to mothers and children (Ministry of Health, 2010, cited in Kelegama 2014).The Government policy in the early 1930's enunciated the need for expanding health services throughout the country, especially in rural areas. A large number of maternity homes, rural hospitals and cottage hospitals were constructed and provided with the necessary staff. Health care services have been provided free of charge to all citizens since 1951.

An important policy which has helped Sri Lanka to retain qualified medical specialists and doctors in the country is the policy on private practice, which allows them to engage in private practice after duty-hours, and away from Government hospitals and clinics (UN and IPS, 2014). This policy has created a system where specialist doctors receive a good income comparable with what they would receive in more developed countries. This has also made specialists more accessible to the general public, and the patients have the advantage of consulting a specialist of their preference. There could, however, be a few negative effects of this policy, such as the reduction of the quality of care given to patients in Government hospitals, who tend to be poor and unable to afford private sector services) and it may also create a conflict of interest, in certain instances, depending on the practices adopted by some of the specialists/doctors (UN and IPS, 2014). However, the overall gain to the health system of the country is much higher. Compulsory posting of all newly-appointed doctors to various regions of the country and transferring them on a regular basis is another policy which has been adopted by the Ministry of Health to improve the availability of medical personnel throughout the country.

While such policies have helped in improving equitable social outcomes in Sri Lanka, persisting disparities across sectors and regions in access to health and education facilities underscore the need for continued efforts in this direction. Of particular importance is the need for concerted efforts in conflict-affected areas in the Northern and Eastern Provinces, which still lag behind other regions in the country[9] [10]. Additionally, the quality of health and educational services have been deteriorating in the recent past, which could be attributed to the declining trend in health and education expenditure in recent years. Expenditure on education as a percentage of GDP has fallen from over four per cent in 1960 to 1.75 per cent in 2013 (CBSL, 2013)[11]. Similarly, spending on health has also declined, albeit at a lower rate. These are worrying trends which need to be reversed.

**Social Safety Nets:** Social safety nets which target the poor population in Sri Lanka can be divided into three segments; (1) social assistance and welfare, (2) social insurance schemes and (3) labour market policies.

1. Social Assistance and Welfare: Sri Lanka has a long history of social welfare programmes and food subsidy schemes for its people. For over four decades, Sri Lanka had a comprehensive food subsidy scheme where relief to the poor was provided through reduction in prices of rice and sugar, increases in health benefits, village expansion and settlement schemes. This was subsequently replaced by a new food stamp scheme in 1979, under which households with an annual income less than Rs.

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[9] In terms of educational infrastructure there is a lack of essential materials such as furniture, teaching and learning aids in these areas. Similarly, in terms of health indicators, maternal mortality rate is five times higher in the conflict affected North and East than those at national level and this incidence is even worse at district levels (Kelegama, 2014).

[10] The government has taken initial steps to develop education and health facilities in the North and the East. Temporary Learning Centres (TLCs) and Catch up education systems were initially initiated to provide educational services for those living in camps, whereas The Catch up education programme reintegrates students into the regular school curriculum. The Ministry of Health has taken several steps to develop the main hospitals in the Jaffna district and has allocated US$ 4.2 million under the 'Uthuru Wasanthaya' programme to improve health facilities in Jaffna (IPS, 2010).

[11] The current 1.75 per cent of GDP average expenditure on education is below many developing countries such as India (3.7 per cent of GDP), South Korea (4.2 per cent of GDP), Thailand (4.1 per cent of GDP), Malaysia (4.1 per cent of GDP), and Vietnam (5.3 per cent of GDP).

3,600 were eligible for stamps which could be used to purchase a basket of commodities comprising of rice, wheat flour, bread, sugar, dried fish, milk food and pulses. Although such schemes have been a burden on finances, in the long run these policies and programmes have helped Sri Lanka in ensuring more inclusive growth. Two notable initiatives are the *Samurdhi* and *Divineguma* programmes.

- *Samurdhi* Programme: The *Samurdhi*, the largest poverty alleviation programme in Sri Lanka, provides social assistance, social welfare and social insurance for the poor. It was introduced in 1995 by an Act of Parliament, and according to the Central Bank of Sri Lanka (2008), 1.6 million households of the country were covered by the programme as at end-2008. The objectives of the Samurdhi Act of 1995 are: to integrate youth, women and disadvantaged groups into economic and social development activities, to promote social stability, and to alleviate poverty. It adopts both short-term and long-term strategies in reducing the vulnerability of the poor and assisting them to move out of poverty. The short-term strategies are based on poverty-cushioning methods such as income support, social insurance and social development programmes. Under long-term strategies, it aims to address core issues of poverty alleviation through empowerment, social mobilisation, and integrated rural development.

This programme is structured under two main components: the relief programme and the empowerment programme. The relief programme encompasses three sub-components namely, cash transfer, social security fund, and nutrition. The objective of the cash transfer is to provide financial assistance to low income families in order to enhance their standard of living. The social security fund provides coverage against risks and life cycle events such as death, marriage, childbirth, and illness. The nutritional programme is implemented in collaboration with the Ministry of Health and Nutrition and provides an allowance of US$ 1.9 per month and is valid for one year from childbirth. The benefits of the relief programme are based on the size of the household. There are five sub-programmes under the empowerment programme: rural infrastructure, livelihood, social development, *Samurdhi* housing, and Samurdhi Bank Societies (SBS).

Beneficiary households as a percentage of total households has declined over the years, whereas the overall budget for the *Samurdhi* programme has increased. However, this programme has been criticised due to poor targeting. According to Jayaweera (2010), it has in fact led to greater inequality, as the benefits are disproportionate to level of income.

- *Divineguma* National Programme: This is the latest poverty alleviation programme initiated by the Government. It is not only a poverty alleviation programme, but a multi-pronged and holistic programme to develop the rural economy, reduce poverty, address malnutrition and move to organic farming techniques. The mission of the *Divineguma* National Programme is to establish 2.5 million healthy and economically empowered household economic units, covering all the villages in Sri Lanka (UN and IPS, 2014). The programme includes activities such as home-gardening, cultivation of fruits and vegetables, encouraging fishery and animal husbandry, eco-friendly living patterns, cottage industries and services, as well as good community health practices.

At least 150 households are expected to be selected from each Grama Niladhari Division and advice will be given to the selected households on planning the household economic units. Technical advice, guidelines and market facilities are to be provided to the selected households. The Grama Niladhari, Samurdhi Development Officer, Agriculture Research and Production Assistant and Public Health Midwives will handle ground level implementation of the programme.

In addition to these programmes, several other welfare programmes have been introduced by successive governments with the aim of improving the living standards of citizens. The Public Assistance Programme is one such programme which targets vulnerable groups such as the poor, the elderly and disabled, families without breadwinners, destitute women, and orphans. The *Thriposha* nutrition supplement is another programme which is implemented with the purpose of enhancing the nutritional level of children less than five years old, pregnant women and lactating mothers.

2. Social Insurances Schemes: In addition to the social insurance provided by *Samurdhi*, micro-insurance programmes also play a significant role in providing social security for the poor. Micro-insurance programmes are mainly provided by microfinance institutions and are still in their initial stages. The Sarvodaya Economic Enterprises Development Sector (SEEDS), Women's Development Bank, Yasiru Mutual Provident Fund, and Sanasa Insurance Company are some of the important institutions in the microinsurance market. In addition to the microfinance institutions, commercial insurance companies such as Ceylinco Insurance Company are also involved in this field. However, there are many barriers in developing the micro-insurance sector such as lack of reinsurance facilities and human resources, among others (Tilekeratne, *et al.*, 2011).

3. Labour Market Policies: Labour market policies geared towards improving inclusiveness primarily revolve around the reform of pension schemes and retirement schemes in the context of a rapidly ageing population in Sri Lanka. At present there are

several retirement schemes under operation, both for public and private sector workers[12].

Of particular importance in the context of inclusive growth are two schemes that target informal sector workers are not covered by other schemes. These are the Farmers' Pension and Social Security Benefit Scheme and the Fishermen's Pension and Social Security Benefit Scheme, established in 1987 and 1990, respectively. These are administered by the Agricultural and Agrarian Insurance Board. The eligibility for the Farmers' Pension Scheme depends on the type of the crops cultivated, age, and non-entitlement to other retirement schemes. Eligibility criteria for the Fishermen's Pension Scheme are the same as for the Farmer's Pension Scheme except for the crop type. However, to be a member of the Fishermen's scheme, a fisherman should be own certain assets. In addition to the income component, it includes other social security benefits such as disability, disablement gratuity, and death gratuity.

In addition to these two main voluntary retirement schemes, there are other pension schemes introduced by the Social Security Board, including pension schemes for migrant workers (returnees), for small scale tea growers, craftsmen, artists and weavers of cloth. Initially known as the Self-Employment Pension Scheme, it is now open to any individual without a Government pension.

Informal sector social security schemes are however currently facing several challenges such as low coverage and inactive membership, low levels of benefits, high administration costs and lack of financial stability.

## Lessons for Other Developing Countries

Sri Lanka's social development experience has been of much interest and controversy among social scientists. Some economists cite the Sri Lankan experience as illustrative of the possibility of achieving human development even at relatively low levels of per capita income and argue that Sri Lanka has achieved a satisfactory rate of economic growth (Sen, 1981). Others challenge this view and assert that the country has had low rates of economic growth owing to its social welfare policies and point out that high achievements in human development came at a cost to economic growth, especially when comparing growth rates achieved by high-performing East Asian countries. Another perspective is that a number of factors besides welfare policies have affected

[12] Public sector workers are covered by the Public Servants Pension Scheme (PSPS) and the Public Servants Provident Fund (PSPF). The Employees' Provident Fund (EPF) and Employees' Trust Fund (ETF) cover private sector employees and is the largest retirement scheme in terms of coverage. The EPF has an active membership of over 2 million people (about 25% of the labour force).

economic growth: including export pessimism, the ethnic conflict and poor governance (Kelegama, 2006).

The main issue for many developing countries is the inevitable trade-off between growth and welfare policies, given the limited finances and resources at their disposal. What the Sri Lankan experience shows is that properly designed and implemented social development policies are of paramount importance in reducing income, social, and gender disparities as well as in ensuring equal access to opportunities. Such policies will no doubt come at a cost to economic growth; nevertheless, removing inequalities and improving human development outcomes will provide a firm foundation on which to develop further strategies to grow an economy. Good human development outcomes will also ensure that a country's citizens can contribute to their full potential towards a country's economic growth and development. The Sri Lankan experience also demonstrates that investing in social development is not a temporary endeavour; rather, it has to be an ongoing campaign towards removing all inequalities in a society. Given the budgetary constraints in developing economies, prioritizing of policies in line with a country's current conditions and achievable targets is key.

## CONCLUSIONS AND RECOMMENDATIONS

The growth dynamics of the Sri Lankan economy indicate that growth has generally been inclusive across provinces, with the exception of perhaps the Northern, Eastern, and Uva Provinces. Economic activities have moved away from the Western Province to other regions, and the shares of services and industrial sectors have increased relative to the agriculture sector. Poverty rates have also declined in almost all districts, with remarkable declines recorded in conflict-affected areas. However, growing income inequality and persisting regional disparities continue to pose problems in sustaining growth and making it more inclusive.

Increased inequality is explained mainly by growing disparity in households' access to education and infrastructure. While education and health indicators for the country have generally improved over time, the improvements have not always been inclusive. Disparities in access to schools, hospitals, clean water, sanitation and other infrastructure are still large. Additionally, the war has created new forms of social inequality between the Northern and Eastern Provinces and the rest of the country. There are also concerns with regard to gender equity, particularly in the labour market. Female labour force participation remains at relatively low levels, whereas unemployment rates are high, and these rates are higher amongst the more educated individuals.

These developments indicate that although there is progress in the right direction, much remains to be done to improve inclusion of different types of actors in the Sri Lankan economy. Below are some policy recommendations that could help in ensuring that Sri Lanka's growth is more inclusive:

**More Focus on Regional Economic Development**

Persistent income inequality is a reflection of disparities across regions and across different socio-economic groups. As such, the focus of policy may need to be on regional economic development – with special attention to helping the most deserving and vulnerable groups in each region – in order to bridge regional disparities. A key challenge for inclusive growth in the post-conflict era is to address new forms of social inequality in conflict-affected areas by expediting development efforts in the Northern and Eastern Provinces and reintegrating them with the rest of the country. This includes improving living conditions and improving access to services across the country, thereby giving them a better chance at engaging in the economic process more effectively and efficiently. The government has already embarked on several infrastructural and growth and welfare packages for North/East reconstruction and rehabilitation which need to be continued.

**Better Targeting of Welfare Programmes**

Sri Lanka is aiming at achieving zero poverty by 2016 (Ministry of Finance and Planning, 2013). This requires attention to be focused on targeted interventions, primarily through the government's most recent poverty alleviation programmes, *Samurdhi* and *Divi Neguma*. Given a history of poor targeting by *Samurdhi* and other welfare benefits, it is essential that mechanisms are put in place to properly identify those deserving the most assistance– those employed in agriculture, the elderly. And the unemployed – and to ensure that they are covered under the programmes. It is also important to improve service delivery systems, especially at the grassroot-level. Further, as discussed earlier, there are a large number of persons just above the poverty line who are vulnerable to external shocks. As such, safety net programmes need to focus on preventing vulnerable groups from slipping back into poverty.

**Improving Productivity and Sustainability in the Agricultural Sector**

Despite the growing importance of the industrial and services sectors, a large proportion of the poor are dependent on the agricultural sector for their livelihoods. Moreover, most employment opportunities in this sector are in the informal sector where salaries are relatively low. As shown in IPS (2011), although the economy is shifting towards more industrial and services-led activities, it is not possible to greatly increase employment levels in these more productive sectors in the short-term. Also, newer employment opportunities in the services sector require better skills. Given this, along with developing new growth areas, it is essential to improve productivity levels of the agriculture sector to ensure that those employed in this sector are taken care of. This would include providing opportunities to access productive assets and developing capabilities and resources.

**Creating Suitable Employment Opportunities for Women**

Low female labour force participation, especially for those with higher levels of education, is a disadvantage to the country's economy, as well as a loss of income to their own households. Therefore, special attention is necessary in developing suitable strategies to increase female labour force participation. There is an urgent need to create suitable employment opportunities for females in all the regions, to attract educated females who may wish to work closer to the areas in which they live, so that they will not have to leave their children and work in faraway places. Flexible working hours and/or working from home on a contract basis may attract more females to the labour force, especially in IT and communication related fields.

The National Employment and Human Resources Policy of Sri Lanka (NEHRP) has identified several measures to improve the country's female labour force participation and female employment. These include (i) Encouragement of more flexible work arrangements such as part-time work, (ii) provision of incentives for setting up well-monitored crèches for young children and day care centres for the elderly, (iii) investment in training females for higher skilled occupations such as in IT sector, nursing and hospitality industry, (iv) promotion of women's entrepreneurship development, enhancing access to credit, technology, business knowledge and markets for women, (v) provision of a secure environment for women to travel to and from work by maintaining law and order and (vi) promoting attitudinal changes to discourage and address gender discrimination in workplaces and to encourage equitable sharing of the burden of care and household chores between men and women (IPS/UNDP 2014).

**Improving the Institutional Environment**

The inclusiveness of future growth strategies adopted by Sri Lanka will be determined for a large part by the legal, political and institutional environment which governs economic activities in the country. In order to facilitate growth and improve inclusiveness, it is essential to critically examine the existing policy environment to identify sources of exclusion that need to be addressed. Existing constraints in the system are holding back progress on several fronts. For example, despite good access, adequate credit is still not easily available across the country which is important for developing livelihoods (IPS, 2011). As mentioned before, the legal environment with regard to gender equality is another area which needs to be examined.

These disparities and inefficiencies in institutions stem from a variety of factors, including outdated laws, lack of awareness among policy makers on the need to improve inclusiveness, and resistance to change. To improve inclusiveness, more attention needs to be paid to identify the specific causes of disparities and inefficiencies and to propose solutions.

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