Economic Reforms in Sri Lanka: Progress & Constraints

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Economic Reforms: 1977/78

- 1977/78 reforms: major shift in economic policy
- Underlying conditions
  - New govt. with overwhelming majority (140/180 seats)
  - Stagnant growth (2.9% p.a. during 1970-77)
  - High unemployment (24% in 1973)
  - BOP pressures from dependence on commodity exports
- IMF assistance as part of reform package
  - Consensus is that it was not externally driven, but had substantive domestic ideological commitment

Economic Reforms: 1977/78

- Reforms contained most elements of a structural adjustment
  - Rationalization of fiscal policy, trade and payments reforms, financial sector reforms, institutional changes, etc.
- Anticipated ‘winners’ and ‘losers’
  - Employment dislocation in industry/agriculture
  - Removal of universal subsidies, etc.
- Attempts made to minimize adverse impacts
  - Massive public investment program launched, counter to general wisdom on fiscal consolidation
    - Hydro energy projects as source of immediate employment and medium-term employment for agriculture
    - One million public housing program for the poor

Select Economic Indicators: Pre & Post Reform

		1970-77	1978-83	1984-89
GDP	%	2.9	6.0	3.5
Budget deficit	%	-9.5	-16.2	-11.8
Inflation	%	5.8	15.3	9.9
Exports	% of GDP	15.9	25.6	21.7
Imports	% of GDP	17.2	41.9	31.5
C/A deficit	% of GDP	-1.2	-9.6	-5.0

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

Setbacks: 1983-89

- Reform process began to falter from mid-1980s
  - Outbreak of separatist armed conflict from 1983 (LTTE)
  - Growing opposition to reforms from Marxist-oriented political forces (JVP)

- Growing perception of inequitable distribution of benefits of reforms
  - Urban/rural divide

- Economic & political disaffection coalesced into violent JVP uprising during 1987-89.

Second 'Wave' of Reforms: 1990/91

- Aimed at building on previous reforms
  - Aggressive pursuit of privatization of SOEs
- Checks & balances
  - Introduction of national poverty alleviation program (janasaviya), countering IMF pressure for fiscal consolidation
  - Privatization sold as "peopalization"
  - Incentives for industry to locate in rural areas as way of offering employment to rural youth (e.g., 200 garment factory programme)
- Start of major privatization initiative from 1992
  - Easier 'commercial' establishments

Economic Reforms: 1994-2001

- Change of government in 1994 saw no major policy shift
  - Major privatizations during 1994-98 (public utilities, services sector)
- Since late 1990s, reform process has been piecemeal
  - Institutional changes to governance structures a key constraint
- Electoral changes
  - Introduction of Executive Presidential system in 1978
  - Replacing first-past-post with combination of first-past-post and proportional representation
- Rise of ‘coalition politics’
  - Far more difficult for one single party to gain substantial majority in Parliament
  - Increase in size of Cabinet, patronage

“Political” Obstacles to Reforms

- Since late 1990s, reforms have been piecemeal and half-hearted
  – Smaller parties advance the interests of narrower constituencies
- For those opposing reforms, Sri Lanka has provided many examples
  – Privatization has been ad hoc, often tainted by corruption
  – In the last 12 months, Supreme Court has rescinded 3 such deals
- Perceptions of inequality of benefits has persisted
  – One of 9 provinces in Sri Lanka accounts for 50% of GDP
  – Evidence of widening income inequality in the country

Trends in Poverty Reduction

Sector	1990/91	1995/96	2002	2006/07
National	26.1	28.8	22.7	15.2
Urban	16.3	14.0	7.9	6.7
Rural	29.4	30.9	24.7	15.7
Estate	20.5	38.4	30.0	32.0

Source: Department of Census and Statistics

Case Study of Failure to "Sell" Reforms: 2002-04

- Twin pronged approach of new government in Dec. 2001
  - Pursuit of a negotiated peace settlement with LTTE
  - Pursuit of a substantive economic deregulation program, beginning with macroeconomic stabilization

- Stabilization measures paid off
  - Fiscal consolidation by freezing public sector wages/recruitment, elimination of fertilizer subsidy, etc.
  - GDP growth picked up, inflation dropped, stock market picked up, etc.

- Government failed to be re-elected after snap elections were called in 2004
  - Disaffection with handling of peace process
  - Perception that economic benefits confined to the better-off

Case Study of Failure to "Sell" Reforms: 2002-04

- Failure to "buy-in" support
  - Benefits seen in stock market, services, trade, FDI, etc.
  - Fiscal consolidation alienated important constituencies (e.g., public sector, rural farming community, etc.)
- Perception of "external" interference
  - International donors (including WB/IMF) tied proposed $4.5 bn aid package to 'progress on peace talks'
  - Overt dependence on foreign consultants at Ministry level
- Most critically, failure to effectively convey message of medium-term benefits of a reform program

Nuanced Shift in Policy: 2004-2009

- Current economic policy to "strengthen national economy"
  - Emphasis on reviving rural/agriculture sectors
  - Privatization ruled out
  - Influence of smaller constituent parties has been more visible

- Focus during 2006-09 on military efforts to defeat LTTE
  - Policy attention could well return to economic reforms

- Future shape/debate on economic reforms will depend on political will/mandate following fresh elections
  - President/government remains popular, can expect political consolidation
  - May allow difficult institutional reforms (labour, education, public services, etc.)
  - If reconstruction efforts in North & East of country is combined with reforms, will give a boost to long-term development prospects

Thank You

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