

# **Economic growth, employment, and decentralised development in Sri Lanka**

Arve Ofstad

WP 2000: 11



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Chr. Michelsen Institute *Development Studies and Human Rights*

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## **Indexing terms**

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## 1. Economic growth during the 1990s<sup>1</sup>

The economic growth rate in Sri Lanka has been relatively impressive with an average annual rate of 5.2 per cent during 1990-98,<sup>2</sup> in spite of the ongoing internal military conflict.<sup>3</sup> From an official Sri Lankan point of view, however, this is considered disappointingly slow. Their aspirations are to achieve at least an 8 per cent annual growth rate, in order to “catch up” with the fast growing economies in East and Southeast Asia.<sup>4</sup> The actual growth rate has nevertheless resulted in a real GDP in 1998 50 per cent higher than in 1990. The estimated GNP per capita in 1998 of USD 810 places Sri Lanka in the category of lower middle-income countries, up from the 1997 position as a low income country. With an estimated average population growth at 1.3 per cent during the same period, the per capita GDP has increased in real terms by 35 per cent over the 8-year period. In other words, and with similar growth also in 1999 and 2000, per capita income will increase by almost 50 per cent during the decade of the 1990s.

However, the war has its costs, both human and economic, and both direct and indirect. The Central Bank acknowledges that without the conflict, “the economic performance of the country would have been far more impressive”. (Central Bank, 1998: p.177.) The war in the north and east has deprived Sri Lanka of between 2 and 3 percentage points of economic growth each year in this decade. (See i.a. Kelegama, 1999 and Ofstad, 2000.) Not taking the previous years into account, this implies that only since 1990 Sri Lanka’s GDP today might have been some 20 to 25 per cent higher on account of the war alone.

The main contribution to the economic growth is the fast growth in manufacturing industries with an annual growth of 10 per cent. This is followed by a higher than average growth in services, especially in trade activities, transport and communication, and banking. These four sectors alone (manufacturing; trade; transport and communication; and banking) accounted for almost 75 per cent of the GDP growth during 1990-97, according to Central Bank figures (cited in World Bank, 1998). Agriculture, however, experienced a rather slow average growth of only 1.4 per cent, and its share of total GDP fell from 23 to 18 per cent.

More specifically, some pertinent features of the economy have had a particular impact on developments during the 1990s:

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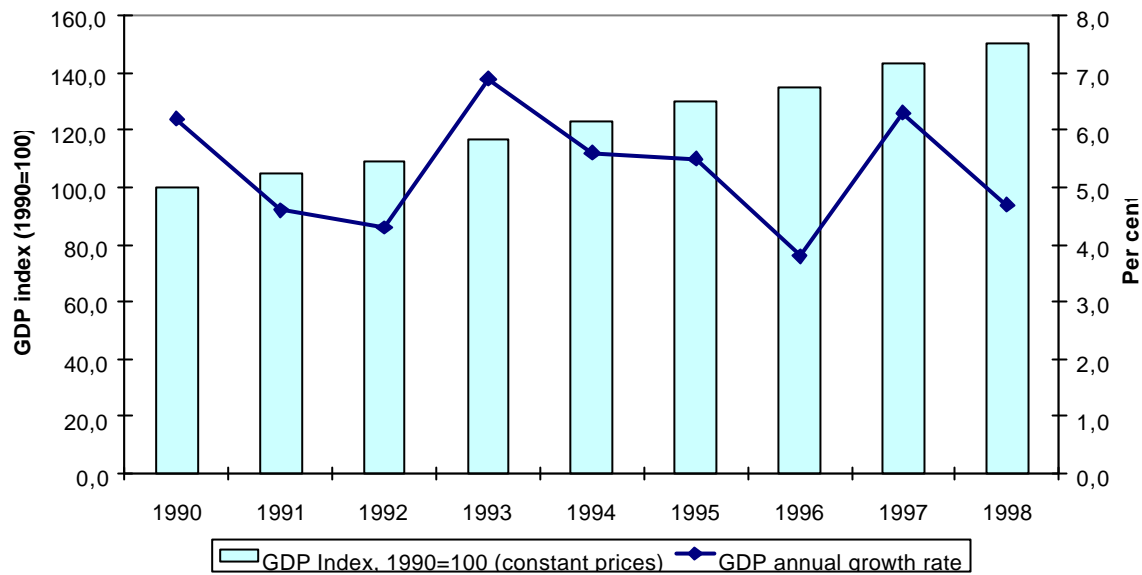
<sup>1</sup> This Working Paper was originally commissioned as a desk study by the Norwegian Agency for Development Cooperation (NORAD), and has only been slightly revised for editorial purposes. However, the author is fully responsible for the contents, and NORAD does not necessarily agree with the analysis, conclusions and recommendations.

<sup>2</sup> Calculated from figures published by *Central Bank of Sri Lanka*. Unless otherwise mentioned, all figures are from either the Central Bank or the *Department of Census and Statistics*. The World Bank, EIU and most other secondary sources are based on the same. There is generally no discrepancy in available figures.

<sup>3</sup> The economy experienced a slow-down during 1987-89 due to the JVP conflict in the South, and poor climatic conditions. However it picked up again with a 6.3 per cent growth in 1990. Using 1990 as a starting point for our analysis should thus avoid the distortions of the late 1980s. The second phase of the “Eelam wars” started with the breakdown of a cease-fire in mid-1990.

<sup>4</sup> See i.a. the World Bank/ Government of Sri Lanka joint document, *Sri Lanka in the year 2000 – An agenda for action*. World Bank 1996, p.37 which speaks of a potential for 8-9% p.a. growth.

**GDP growth 1990-1998**



- **Manufacturing**, and especially **the garment industry**, has had a rapid growth. This is partly the result of investments made in the 1980s and the early 1990s in new factories and expanded capacities. These are export-oriented industries with a relatively high level of imported inputs, and provided in 1995 direct employment for some 230,000 persons in 750 factories. Expansion took place partly as a result of “quota hopping” by the East Asian suppliers, but has also been actively stimulated by the Sri Lankan government. Measures include tax incentives through the Board of Investments (BOI), facilities in Export Processing Zones, and the “Two Hundred Garment Factories Programme”. Total exports of garments (gross) amounted in 1997 to USD 2.1 billion, or 45 per cent of total export earnings.
- While overall agriculture has been sluggish, the **tea** sector has done very well during the 1990s mostly due to boom prices (until a crisis in August 1998). Volume growth has been moderate, but export earnings increased to almost USD 780 million in 1998. Tea is the country’s second most important export commodity, and Sri Lanka maintains its position as the world’s largest tea exporter.
- The **tourism** industry has picked up since the late 1980s and has reached the previous level of 400,000 visitors of the early 1980s, despite a downturn again in 1996. Most tourists are relatively low spenders, however, and the industry has expanded its capacity for a considerable future increase.
- Within the transport and communication sector, the **Colombo port** has continually increased its throughput for the domestic market as well as for trans-shipments. The container terminal is now utilised for its full capacity, and further extensions have recently been approved.
- The number of **migrant workers** from Sri Lanka employed abroad, primarily in West Asia, has continued to increase. It is estimated that remittances from approximately 500,000 Sri Lankans abroad are providing for net private transfers at around USD 850 million in 1998. (Central Bank cited in EIU, 1999: p.42.) This figure is higher than the value of tea exports, and also higher than the receipt of foreign assistance.



## 2. Distribution of growth, employment and regional inequalities

An increase in the per capita income at around 35 per cent should allow for a substantial reduction in the incidence of **poverty** during the 1990s, even without strong efforts to ensure a more equal distribution. However, according to the preliminary findings of the *Framework for Poverty Reduction in Sri Lanka* (FPR)<sup>5</sup> there is an alarming halt in the decline of absolute poverty during the 1990s, which has remained at around 20 per cent of the total population<sup>6</sup>. The FPR points very preliminary at the effects of the ongoing armed conflict in the North and East, sluggish growth in agriculture (except for tea), moderate performance in industry (except for garments), low productivity in the informal sector, a regionally unbalanced growth, and structural economic rigidities hampering the trickle-down process.

It is obvious that the growth process has not been sufficiently broad-based to incorporate the poorest 20 per cent of the population, but this does not give any clear indication of how the benefits have been distributed among the 80 per cent less poor and the non-poor. While mostly the “modern sectors” – and the tea industry – have experienced high growth, most of the more “traditional” sectors including the basic paddy production have suffered from stagnation. Remittances from migrant labour and from soldiers in the military have nevertheless provided an important additional source of income for many poor families. The government’s welfare transfers to internally displaced (food supplies) and to other poor through the Samurdhi programme have also been substantial, amounting to the equivalent of USD 50 million and USD 150 million respectively on an annual basis.

The **unemployment** rate has nevertheless gone down, from around 14.4 per cent (1990-94 average) to 9.1 per cent in 1998. (Central Bank, 1998 p.1) According to the Central Bank, key areas of employment generation were manufacturing, construction, trade, hotels, insurance, real estate and personal services. (*ibid*, p.9) The share of public sector employment has actually been declining from 25 per cent in 1993 to about 18 per cent in 1998. The (registered) unemployment rate has always been highest among the young, with more than 70 per cent of total unemployed in the 15-29 year group. A substantial number of the unemployed are educated, and more than 40 per cent of them have obtained the GCE “O level” exams or higher.<sup>7</sup> Many of the registered unemployed are therefore not among the very poorest, but can afford to wait for some time for entry into further education, or for a more suitable job opportunity. The falling rate of unemployment therefore is an indicator of slightly better job opportunities for educated youth. But substantial increase in employment has also been generated through migrant labour and to some extent by the expansion of the military forces.

Despite some reduction in the figures on unemployment, there is no doubt that inadequate and insufficient job opportunities remain a very serious problem. The net growth of the

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<sup>5</sup> This is an initiative by the Ministry of Finance and Planning and the Ministry of Samurdhi, Sports and Youth Affairs and co-funded by UNDP and the World Bank. The studies are undertaken and lead by a team of independent Sri Lankan experts. A series of sub-studies have been undertaken (but not yet published) and the final policy document is expected to be finalised during the 1<sup>st</sup> half of 2000.

<sup>6</sup> This is an headcount index indicating the number of poor people living on less than the “1\$-a-day” poverty line.

<sup>7</sup> The Ordinary (“O”) level General Certificate of Education (GCE) is normally achieved after 10 years of schooling, and comparable with Norwegian *ungdomsskoleeksamen*.

labour force is around 150,000 annually who need job opportunities, in addition to those unemployed at present and the need for creating better job opportunities for the many working poor.

Dissatisfied – and partially educated – youth was an important background to the violent JVP uprisings in the early 1970s and the late 1980s. Even though JVP as a party has now joined the democratic mainstream, frustrated youth could again create problems. Similarly, the frustrated opportunities for education and employment were an element behind the militant Tamil uprising. Today's economic stagnation and lack of opportunities in the North and East continue to feed into more recruitment for the LTTE. This is further enhanced because the Tamil population of the East find it equally difficult to seek employment in the Colombo region, because they feel discriminated and harassed there.

Another group that have limited job opportunities are the next generation of Tamil youth in the plantation areas. For several generations they have been restricted to employment in the plantations which have been isolated from the rest of the economy and society. They are generally poorly educated, and there is still a large number with unsettled citizenship. In earlier years some have migrated to work as agricultural labour in the North, especially in Vavuniya, but these opportunities are now reduced because of the armed conflict. Because of their social background, language, and their skills handicaps, they are experiencing additional barriers on the job market. With falling employment in the plantations this is becoming a growing problem, which is only partially being tackled.

Today migrant employment is available primarily in west Asia, but new opportunities are becoming available also in places like South Korea (primarily for male industrial and skilled workers) and Southeast Asia (primarily for female housemaids). In the medium future, such solutions may not feel satisfactory for split families, and alternative opportunities have to be created closer to home. Efforts to assist the migrants in making better use of remittances for investments in the future are not sufficient today.

Figures on registered unemployment therefore do not provide a complete picture of the actual levels of un- and underemployment, partly because those with education and others seeking non-agricultural employment are more likely to register than those seeking agricultural and low skilled work in the informal sectors. Official figures<sup>8</sup> nevertheless show that (registered) unemployment is highest in the Southern province, but this is followed by the most developed Western province and in Kegalle district nearby. Unemployment figures are lowest in the more remote Uva, North Central and North Western provinces where also job opportunities are fewer, while there are no official figures for the North and East.

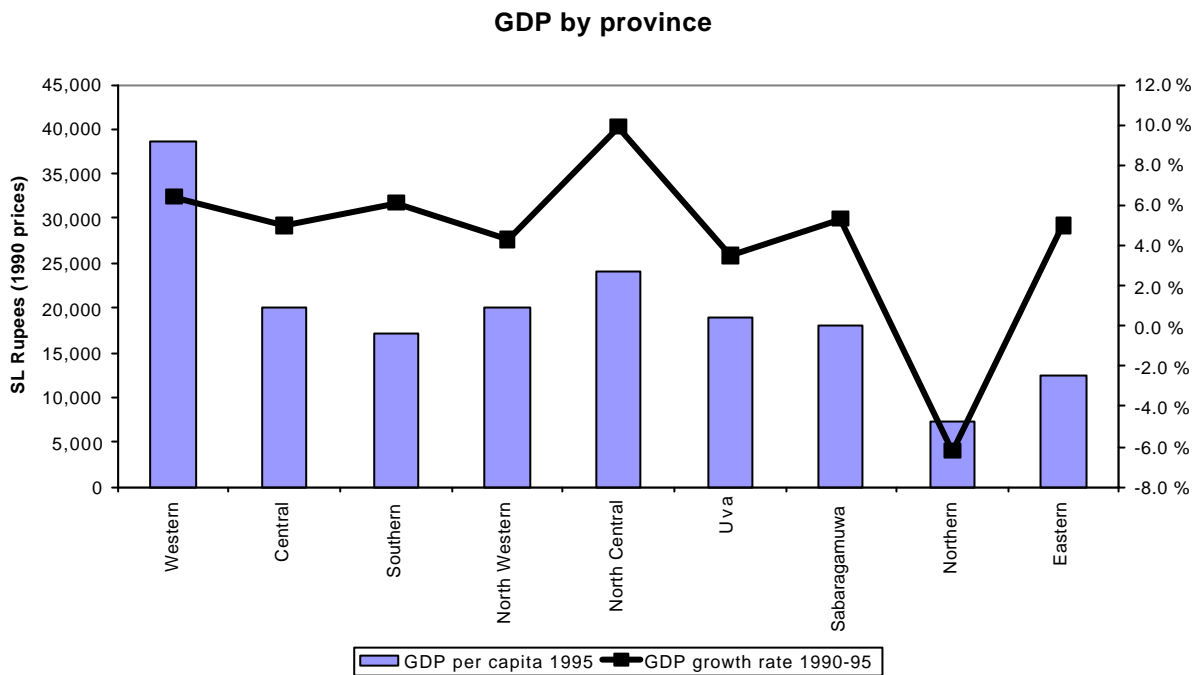
It is remarkable, however, that the unemployment rate among females is more than double the rate for males. Since the labour participation rate among males (66 per cent) is about twice the rate for women (32 per cent), this nevertheless implies that the actual number of jobless women is more-or-less the same as for men. This is important to keep in mind for policy-makers because the job market is still strongly segmented along gender lines.

There is a strong interrelationship between the distribution of growth and poverty among economic sectors and the **regional and district distribution**. The graphs (based on

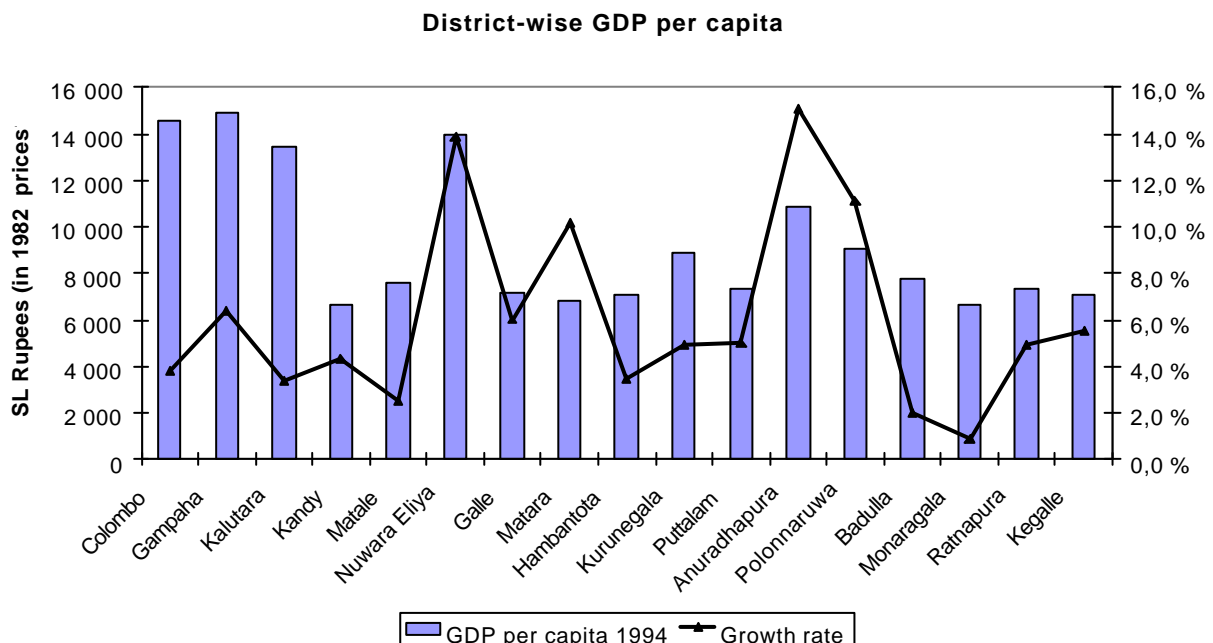
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<sup>8</sup> Figures are produced by Department of Census and Statistics, and reproduced i.a. in Aturupane et al (1998: p.51).

Aturupane et al, 1998) illustrate the geographic distribution of GDP and GDP growth during the first half of the 1990s, for the period that figures are available.



These figures show that the three districts (Colombo, Gampaha and Kalutara) in Western province are clearly those with the highest per capita GDP. These represent the economic centre of the country, with Colombo as the major port and international airport and the commercial and financial centre. Gampaha and Colombo have more than 70 per cent of all industrial production, and Kalutara has the most developed tourist industry.



Perhaps more surprisingly, Nuwara Eliya has a high GDP per capita equivalent to these three districts. Nuwara Eliya has widespread poverty and poor living conditions especially among the plantation workers, as shown below by the Human Poverty Index. However, in economic terms the district is a rich agricultural district containing the best tea plantations and prosperous vegetable farms.<sup>9</sup> The district has a low incidence of income poverty, but scores among the lowest in social conditions.<sup>10</sup>

Thirdly, the two districts (Anuradhapura and Polonnaruwa) in North Central province have registered a high growth during the 1990s, giving them a higher-than-average GDP level. This may also seem surprising, as these have limited industrial development and rely to a large extent on paddy production which in general has not done well. It seems that the expansion of irrigation under the Mahaweli programme has caused these positive results, but Anuradhapura may also have benefited indirectly from military investments and activities.

For the other districts, variations in GDP per capita are relatively moderate, with the exception of the very low figure for the Northern province. The figures for the North and the East are not very reliable, but there is no doubt that both have suffered seriously under the armed conflict. In the North in particular, heavy damages and losses, together with sanctions on economic activities and large-scale displacements have caused a strong economic setback.

The poorest districts after the North and East are the three districts (Galle, Matara and Hambantota) in Southern province, Monaragala (in Uva) and Kandy (in Central). Matara, Hambantota and Monaragala are more remote districts without any strong resource base, and this is also the case for Puttalam. For Kandy and Galle, however, their low GDP per capita may be more surprising, since both have district capitals with tourism and other activities, and a reasonable distance to Colombo. Kandy district has, however, a large share of poor peasants with too little land, and the products of “home garden” agriculture and traditional handicrafts have suffered from low prices for many years. Galle has also stagnated from limited port traffic and low tourist volumes.

The figures in the two graphs (for districts and provinces, respectively) are not fully compatible, but both indicate that the economic growth rate in the most prosperous Western province has not been (substantially) higher than the overall growth in the economy.<sup>11</sup> It was Nuwara Eliya and Anuradhapura/ Polonnaruwa that experienced the highest growth rate during the first part of the 1990s, enabling these to get “closer” to the districts in Western province. These were followed by Matara district which thus caught up with the neighbouring poor districts in Southern province. The lowest growth rate after Northern province, was suffered in Badulla and Monaragala districts. Both are located in Uva province and were already among the poorest.

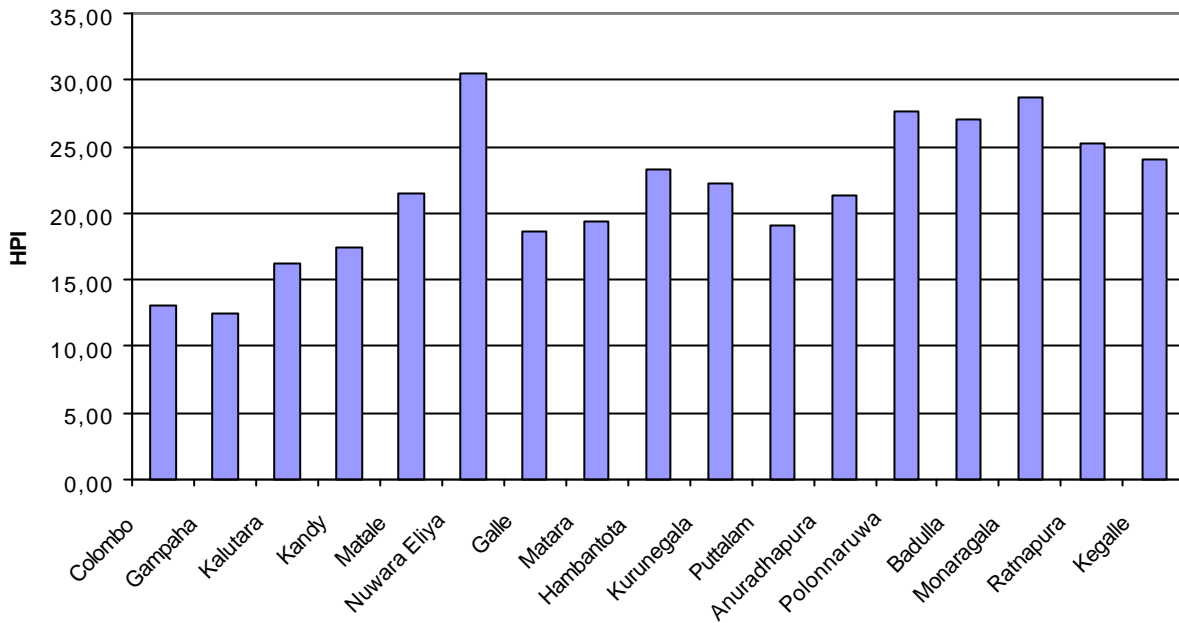
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<sup>9</sup> This statement and many of the other comments in this section are taken from Aturupane et al., 1998: pp.14-17.

<sup>10</sup> Nuwara Eliya has a large number of plantation workers who earn a regular monthly wage above the poverty line. However, they have little or no agricultural land on which to supplement their incomes. The health and education conditions are also very low for these workers. Apparently, social problems and alcohol abuse is widespread. These workers are not so poor in income terms, but have most other characteristics of poverty.

<sup>11</sup> These districts were already better off than the rest, and may have experienced an element of “saturation”. This is nevertheless a paradox.

**Human Poverty Index - By District**



The above comments are reflected in the graph showing the Human Poverty Index by district, as calculated by Aturupane et al (1998). This is based on the UNDP poverty index, slightly adjusted to conditions in Sri Lanka, and reflects several aspects of deprivation in knowledge, access to safe drinking water, safe sanitation, basic health care, electric power and energy, and social deprivation. Human poverty is lowest in Western province, and highest in Nuwara Eliya and in the more remote districts Polonnaruwa, Badulla and Monaragala, but also high in Ratnapura, Kegalle and Hambantota. Unfortunately, sufficient data were not available for the North and East.

### **3. Barriers to regional economic development, and present policy measures**

Regional growth have been almost totally been based on the natural resources in specific regions, be they agricultural (plantations, paddy) or other (gemstones, tourist attractions). Sectoral policies thus have strong regional implications, such as the Mahaweli programme for expanding irrigated paddy land, or (lack of) efforts to promote tea, rubber, coconut or silk, etc. Since the liberalisation from 1977, government direct interventions in the economy have gradually been reduced, but with many important exceptions. The most visible expression of the result of previous governments' localisation policy, is the industrial sector, where more than 70 per cent of industrial establishments – and employment – has been located in Western province, primarily in Colombo and Gampaha districts.

Colombo, and even more the two first Export Processing Zones (EPZ) in Colombo, were natural choices of localisation, especially for the “foot-loose” export-oriented and import-dependent industry. The industry is dependent on good infrastructure and good communication to harbours and airports. In the EPZ all facilities were created, including special labour regulations that made it practically impossible (and initially prohibited) to organise in labour unions. Alternative locations were considered inferior on most accounts, with poorer facilities, less reliable infrastructure (power, water and telecommunications),

longer distance and poorer communication with international harbour/ airport, and generally less conducive industrial environments. With the exception of Kandy, the lack of high quality (and high prestige) schools also made it less attractive for industrial entrepreneurs.

Central government policies to diversify industrial location, have nevertheless included several measures, including<sup>12</sup>:

- The Urban Development Authority (UDA) which was established in 1978 as a central planning authority for all urban centres around the country, made attempts to identify industry that could be located outside of Colombo, but these policies were very weak.
- The Two Hundred Garment Factory Programme (THGFP) under the late President Premadasa regime (1989-93), aimed at establishing a garment factory in every Pradeshiya Sabha Division throughout the country, and by 1996 154 such factories were in operation. This may be practically the only effective measure undertaken to diversify industry, but many entrepreneurs felt coerced into participating, and very few of these locations have brought any secondary industry along or created any industrial “environment”.
- Kogala EPZ was established near Galle in 1992, and has at least attracted some factories to locate there, to around 50 per cent of its capacity.
- The Board of Investments (BoI) now offers the same tax and customs concessions for export oriented industries regardless of whether they are located in an EPZ or not. This reduces the significant discrimination in favour of the Colombo EPZ, and allows factories located elsewhere more equal terms.
- The Ministry of Industrial Development has launched a programme for Regional Industrial Parks, but few results have been seen so far. One such Industrial Park in Southern province is still absolutely empty, and there is nothing but a signboard.
- New Industrial Parks around 50 km out of Colombo are being established at present. While these may reduce the congestion closer to Colombo, this is hardly an effective regionalisation policy.
- Industrial estates are classified as “difficult” or “most difficult” which is the basis for special tax concessions. As a result, the Industrial Estates in Colombo, Gampaha, Kalutara and Kurunegala are considered “difficult”, and all the rest are termed “most difficult”.<sup>13</sup> There are few indications that these concessions have been sufficient to make any impact on actual location.
- Central funding institutions such as NDB (National Development Bank) and DFCC (Development Finance Corporation of Ceylon) have recently established branch offices in districts outside of Colombo.
- Major government investment plans have generally remained as plans during the 1990s. This applies in particular to the big plans for development of Trincomalee, which were launched at the CG meeting in Paris in April 1995, and the Southern Development Authority plans for new “Ruhunapura” in Hambantota. The former plans were shelved as the war resurfaced, and the latter seem to be postponed or shelved due to the crisis in Southeast Asia from where a major portion of the investments was to come.

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<sup>12</sup> Most of this information is taken from Central Bank (1998: p.127).

<sup>13</sup> Information available on the Board of Investment Internet web-site: [www.boisrilanka.org](http://www.boisrilanka.org).

- New power plants are being constructed, partly with private co-funding, to increase total power generation. The existence of a national grid makes localisation less of an important issue, except as part of an “industrial environment”.

It is nevertheless evident that central government “push” to locate industry and other economic activities in the regions, has not been sufficient. Major impediments such as road/rail communication, basic infrastructure – and good quality schools – are still lacking. These require major investment programmes, which at present may be difficult to fund from the government budget where investments in infrastructure is a major “casualty” because of the defence requirements. Of the major donors, only the Asian Development Bank and Japan may still be willing to provide funding for basic physical infrastructure, as the World Bank is totally focussed on education and health (and considering a new poverty reduction programme) and the bilateral donors do not consider this a priority. The government may still hope to attract private funding for the railways as well as for some road construction, but this is not very likely to succeed in the near future.

**Port development:** This has been a highly debated issue in Sri Lanka during the 1990s. Big plans have been launched for the development of Trincomalee, Galle, and most recently for Ruhunapura in Hambantota. So far, only the port in Colombo has been funded for further extension, while the other plans for various reasons have been shelved or postponed. From the point of view of stimulating a more balanced regional development with emphasis on employment and income generation in less developed regions, the expansion or construction of major ports both in *Ruhunapura* and *Trincomalee* would be very beneficial. *Galle* would also benefit from a smaller development, potentially connecting to the airfield at Kogale nearby, but conditions there are not ideal for a major port development. *Trincomalee* would seem very well suited with a natural harbour and sufficient space for developing a major industrial site even allowing for recreation and environmentally protected areas. This would be extremely important for balancing economic development in a post-conflict situation, and should perhaps be pushed more strongly even today as an indication of interest in economic development and regional integration.<sup>14</sup> The proposed *Ruhunapura* development might likewise stimulate to an accelerated development in the south-eastern regions including in particular Hambantota and Moneragala but also the southern parts of Ratnapura. All of these districts are suffering today from lack of employment opportunities for educated (and uneducated) youth, and were the breeding ground for the violent JVP uprisings in the early 1970s and late 1980s.

**Creating a conducive environment at the district and regional level:** However, in addition to the efforts from the centre, regional economic development is also dependent on the “pull” effects of a conducive environment and facilities being created “*from below*” at the district and provincial level. Most regional centres lack the dynamics, funding, technology and/or marketing skills to create sufficient “pull” effects.

Traditional economic activities are mostly linked to agriculture, and have created an active trading community in most local centres. There is also a long tradition for handicrafts and other small-scale informal production for a local market. Twenty or more years of “social mobilisation” with micro savings-and-credit schemes have also been tried out, but often been very politicised by the major political parties and their leaders, and seldom been able to move beyond the micro scale on to more commercially competitive production. (See i.a.

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<sup>14</sup> The political, security and economic aspects of this cannot be discussed in this short note.

Gunatilleke, 1997.) The Integrated Rural Development Programmes (IRDPs) have, since they were initiated in the early 1980s, succeeded in improving local physical and social infrastructure, including local and minor roads, rural schools and health centres, wells and water supplies, and in some districts have also successfully promoted organisation and social mobilisation. Most have been very project-oriented, and planning capacity has been developed for project planning purposes. Few IRDPs were well integrated into overall district planning, and only in recent years have some of them become more oriented towards private sector economic developments. Encouragement of private investments and marketing, establishments of chambers of commerce, etc are all phenomena of the mid-1990s.

Unclear political and administrative structures, roles, and authorities at the provincial, district, and PS division levels have not made it easier for investors and facilitators. The traditionally strongest local administrative level was the District headed by a Government Agent (GA). The GA was a local “governor” with his powers vested from the central government. However, there is no elected body at the District level, and the GA has now (since 1989) been renamed District Secretary (DS) and is reporting both to the central government and to the Provincial Secretary, depending on the issue. At the local level, there are elected Pradeshiya Sabha (with very limited power) for rural divisions, and an Urban Council for urban municipalities. A Divisional Secretary will serve the elected Pradeshiya Sabha, but also the District Secretary.

Most important since the 1989 constitutional reforms was the establishment of elected Provincial Councils and a provincial administration headed by the Provincial Secretary, and with devolved powers for certain sectors including agriculture, lower and secondary education, etc. but not for industry nor for land issues. The Provincial Councils have also limited powers and influence, and few resources, with the exception of Western province. Generally, they have been primarily concerned about utilisation of the budgets at their disposal, rather than thinking in terms of overall developments in the province. Politically, they have also been in somewhat of a squeeze especially since the change in central government in 1994, because the PA parties were originally opposed to the establishment of provincial councils and seemed intent on abandoning them. Together with the unsettled status of the North-Eastern Provincial Council (which should be confirmed by a referendum in the East), all this has made it difficult for the provinces to establish their own political agenda for the benefit of their province. However, since 1996 the same PA government has promoted a stronger devolution of powers to the provinces (to be renamed regions) as part of its solution to the armed conflict.

Developments in recent years have nevertheless contributed towards stronger emphasis on facilitation and planning for private economic development both at the district and provincial levels. The tendency in several IRDPs since the mid-1990s to focus more on economic development and integration of the whole district economy has been promoted by several donors, including Germany, Netherlands, Sweden and Norway. The government is institutionalising this in its emphasis on a Rural Economic Advancement Programme (REAP) – which seems to be implemented with less emphasis on “rural” and more on the overall integration. Secondly, a provincial perspective is being increasingly applied as a viable economic development region. This has in particular been the case in Western province, but also in the more remote Uva province (with UNDP support) and in Central province (with German support). The more extensive – and ambitious – Southern Development Authority (SDA) is another approach towards accelerated development for an economic region with widespread poverty and unemployment, which encompasses not only Southern province but



also two neighbouring districts (Monaragala and Kalutara). All these are positive tendencies that will require additional support from within, as well as from central government policies in order to have full effect.<sup>15</sup>

**Education reforms, and change of attitudes:** Finally, the availability of educated job-seeking youth does often not match the skills necessary for entrepreneurship, technical and vocational capability required for a viable industrial development. Many have said that Sri Lankan labour is well educated, but not very skilled. There is an overemphasis on formal education for university preparation, rather than practical, technical and vocational competencies. To reduce this mismatch it is not only necessary to reform thoroughly the educational system especially at the secondary and tertiary levels (which is ongoing), but also change the cultural attitudes, as well as the salary structures, to encourage and reflect such a reorientation. It seems that such reforms are of much greater importance than the liberalisation of the labour market, and reduction in labour protection, which are the main recommendations in the World Bank documents, and repeated by the Central Bank.

#### **4. Opportunities for investments in less developed areas**

A more balanced economic development therefore requires multiple efforts. Some are related to issues in the previous section, to create stronger “pull” effects and a more conducive environment at district and provincial levels, some require major investments in transport and communication infrastructure, and some will influence other “push” factors at the central level. Opportunities nevertheless exist for investments and developments in industrial sectors and regions, that may combine economic growth potentials with a policy for a stronger development of less developed regions, a more equitable and balanced regional growth strategy, employment and income generation, and poverty reduction. This is an illustrative, but not exhaustive, review of some of these:

**Paddy production:** Rice is the staple food for most Sri Lankans, and Government policy has been to make the country self-sufficient, which is now almost achieved. The main production areas are in *Anuradhapura* and *Polonaruwa* (North Central province) and *Trincomalee* on land irrigated under the giant Mahaweli irrigation scheme, but also in *Batticaloa* (Eastern province) and in *Southern province*. A total of 70 per cent of the paddy lands are irrigated. While production has increased, the average yields are lower than average in Asia, and production costs relatively high. Many small-scale farmers are poor despite support and subsidies. The World Bank lays heavy emphasis on establishment of clearer land titles and a private market for land, in order to make more efficient use of land and diversification into higher value-added crops. (See i.a. World Bank, 1996 p.19) An agricultural policy that would effectively promote higher yields and higher productivity for paddy would definitely improve the income levels for these poor farmers. So would presumably a better marketing system. Production in Batticaloa, in *Vavuniya* and other districts in the Northern province, and in the “border areas” in Polonaruwa is affected negatively by the conflict. In the medium or long term it is forecasted that rice may become more scarce in Asia and international markets, which may result in increased prices that will benefit Sri Lankan farmers. But until then, paddy remains a problematic sector.

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<sup>15</sup> The UNDP-supported ABGEP (Area based growth with equity programme) is an attempt to combine efforts at provincial level with central government policy support.

**Vegetable production, packaging and processing:** Vegetables are grown throughout Sri Lanka, but has had a particularly strong growth in the central highlands in and around Nuwara Eliya. This is an important supplement – and source of alternative income – to tea production in this region, which is very well suited to “temperate zone” vegetables. The tea districts in *Nuwara Eliya* and *Badulla* badly need additional sources of employment, and further development of the vegetable sector seems to be a promising option. There is a strong national market primarily in Colombo/ Western province, but also a potential export market if the industry is developed with proper packaging and processing facilities, and improved transport systems.

**Minor agricultural export crops:** Sri Lanka has the climatic and soil conditions for a number of other agricultural crops. – Spices have a long history in the country, but today this represents a relatively small level of total income and export earnings. – Sericulture (silk production) was introduced more recently some 15 years ago, primarily as an alternative to tea production, when tea prices were falling in the hill country. Initially introduced in *Kandy* district, it has not yet developed into a strong commercial product. More recently, however, more farmers in the lower hills and in the semi-dry and dry zones especially in *Monaragala* have moved into silk production. The silk industry might benefit from a revitalisation with a stronger commercial outlook. – Sugar cane plantations have also been introduced more recently, and seem to have become quite profitable in Ratnapura and Monaragala districts. One problem, however, has been a conflict with the elephant population in those areas. – Green leaves, flowers and plants: It seems surprising that Sri Lanka has not developed this sector more strongly.

**Coconut:** Coconut trees are common in many parts, but the plantation areas are concentrated in the “coconut triangle” between Colombo, Kurunegala and Puttalam, i.e. mostly in *Kurunegala* and *Puttalam* districts (North Western province), but also along the whole coastline. While the area and production have been stagnant since the 1970s, profitability has fallen, and many plantations are in poor conditions. The coconut trees are multi-purpose producers i.a. of the coconut for direct consumption, coconut oil, fibre, timber, and toddy for arrack production. However, strong renewed efforts of further intensification is needed, including more inter-cropping, for this sector to provide better incomes for its owners and employees.

**Rubber and rubber tree industry:** The present rubber tree areas are concentrated in the districts of *Kalutara* (Western province), *Kegalle* and *Ratnapura* (Sabaragamuwa province) and surrounding districts in the “wet zone”. Area planted and production has been continuously in the decline since the early 1970s. Direct employment in the rubber plantations may be further reduced, and there is a great need for creating alternative opportunities. According to a recent World Bank Study (Ridwan et al, 1997b), Sri Lanka has opportunities for further developing its rubber-based industry, but a consolidated effort is needed. This industry would have a natural location near the present plantation areas, but with good and easy communication to major markets and export outlets. In addition, efforts are made (i.a. with Swedish assistance) to make better use of the wood material from the rubber trees, for furniture, toys, etc. This would create additional employment opportunities in this sector, and possibly also stimulate the plantation sector directly.

**Diversified tourism:** The tourism sector is already relatively well developed, and several plans have been prepared, including a Tourism Master Plan. It is estimated that direct employment in tourism in 1996 stood at some 32,000, with indirect employment at another

45,000. (Central Bank, 1998: p.168) Today the tourist industry is heavily concentrated along the south-western coast from Negombo to Galle, with some additional activities around the “Cultural Triangle” *Anuradhapura-Polonnaruwa-Dambulla-Kandy*. The tourism master plan suggests way to increase incomes from the regular tourism based on higher spending per visitor, rather than increasing numbers. It also suggests to diversify tourism further, with more emphasis on cultural and religious tourism (external as well and internal) especially within the Cultural Triangle; more specialised eco-tourism based on the high bio-diversity in Sri Lanka; and health tourism including ayurvedic treatments. All of these developments would take place away from the present over-emphasis on the south-western coast, and would thus contribute to a better regional balance. Once the security situation allows, regular tourism development could be restarted in the *Eastern* province, which has an “opposite” monsoon season and therefore seasonally complements the western coast.

**Garment and textile industry:** This is now the dominant manufacturing industry, with more than 230,000 employees (more than 40 per cent of the manufacturing total) in 1995 according to Kelegama and Foley (1999). Again most of the employment is generated in the greater Colombo region, where the largest ones are located. However, because of increased pressure on the labour market in the Export Processing Zones and generally in and around Colombo, there is a tendency to locate new factories further out. The new Industrial Zones some 40-50 km out of Colombo are indicators of this trend. Previous governments have made strong efforts, such as the Two Hundred Garment Factories Programme, for locating (small) garment factories in every PS district around the country. Some of these are struggling to remain profitable, but others are doing well and appreciate their location outside of the Colombo Export Processing Zones, pointing out i.a the benefits of a more stable work force. The study by Kelegama and Foley (1999) shows that the garment industry had so far created relatively few backward linkages in Sri Lanka, but the authors expect that formation of such linkages will be a natural outcome of industrial deepening and therefore be time dependent. In the longer term Sri Lanka should probably aim beyond the simple garment production for the European and North American markets, but at present and in the medium term this sector represents the largest industrial sector with the highest number of employed. An increased effort could be made to locate more of this industry outside of greater Colombo, for instance to other regional growth centres with reasonable good communication and transport facilities, such as *Kurunegala*, *Ratnapura*, or even places like *Anuradhapura* (North Central province) and *Matara* (Southern province).

**Electronic software and hardware** will continue to be a highly competitive growth industry, where also Sri Lanka may participate. The most recent budget speech (November 1999) by the Deputy Minister of Finance highlighted information technology as one of the major trust areas. The sector has primarily been developed in the Colombo region, based on the skill development in the Universities of Colombo and Muratuwa, which today are the strongest in information technology. However, there should be opportunities also in other regions, perhaps primarily in *Kandy* around the University of Peradeniya, where also the climatic conditions are more favourable. With greater efforts in the more medium term potentials could be developed also in *Galle* around the University of Ruhuna, and in *Jaffna* around the University there.

**Small and medium industries:** The SMEs are crucial for developing off-farm employment and a more balanced regional development, and a potential exists in practically every district and divisional capital. While some SMEs may be established as “stand-alone” entities, many

depend on a linkage to a larger company, or need special support for access to credit, technology, or marketing skills.

**Gem mining and processing:** Gem mining for precious and semi-precious stones takes place primarily in *Ratnapura* (and *Galle*) districts. Some of this business takes place through “informal” channels, but there is also a substantial formal trade resulting in total value of gem exports in 1997 of approx. USD 100, which fell in 1998 due to the Asian crisis to USD 60 mill. The industry may well benefit from further development of processing in districts that are in the periphery of the present growth centre, and this might create income opportunities.

**Fisheries:** The fishery sector has suffered badly from the security restrictions due to the ongoing conflict, which has affected practically half the coastline in the north and east. There is, however, an active fishing industry on the west and southern coast, including *Amparai* district. A number of smaller fishing harbours have been constructed or improved, but fishing is undertaken by any combination of fishing gear and crafts from traditional canoes and stilt fishing, to a few modern trawlers. Many fishing communities are poor, but the greatest problems are found in the East and North because of the restrictions. Hopefully more restrictions could be lifted even under present conditions, but the full opportunities may only be possible after a peaceful solution has been found. Strong support may then be necessary for revitalising the sector in the East and North.

**Aquaculture/ Shrimp farming:** Shrimp farming has been developed primarily along the western coast north of Colombo/ Negombo, i.e. in *Gampaha* and *Puttalam* districts. Production became quite profitable and expanded rapidly despite protests from local farmers and fishermen, and from environmentalists because of damages to the mangroves and general contamination. The shrimp farms were badly affected by a disease a few years ago. It has been proposed to expand shrimp farming into the southern coast of *Matara* and *Hambantota*, and this could generate further employment and incomes, if managed more responsibly. – Similarly, successful pilot tests have been made for introducing combined fish/rice in paddy fields which could also increase incomes.

**Livestock and dairy industry:** Both small and large livestock are widespread. In the semi-dry zone goat rearing is promoted as a supplementary source of food protein and income. In the highlands cattle farming is promoted among poor farmers with small plots. The dairy industry in *Nuwara Eliya* (Central province) is important and growing to satisfy the growing urban markets. The development has been supported by the Indian Amul cooperative movement, and could certainly develop further to benefit poor farmers in these areas.

**Forestry and forest industry:** The tropical forests have been badly depleted during the last decades, despite strict official controls. Both legal and illegal logging is undertaken, with inadequate reforestation. The forests also provide a number of other plant and biological resources, and are important for multiple uses. Sri Lanka is known for its high biological diversity, and has a number of national parks and other protected areas. Some of these are affected by the armed conflict, however, with less control and poorer resource management. The forest industry can nevertheless be developed further, based on responsible forest management and reforestation. Swedish assistance is engaged in improving the quality and reducing losses in all aspects from logging, transport, and production of building material, furniture, etc.

## 5. Conclusions

A comprehensive economic development strategy must combine an emphasis on economic sectors with a growth potential, with an emphasis on geographic areas where there are greater needs for growth. This will make better use of the human resources in the country, and reduce the tensions that follow from unequal and unbalanced developments. This is also the essence of the government's REAP policy. As outlined above, this will require a joint effort consisting of central government creating the incentives and "push" policies for stronger economic decentralisation; consistent "pull" policies at the district and provincial levels that are conducive for private economic investments; and a major upgrading in transport and communication. One could also add the need for a successful educational reform.

Many economic sectors are important in the districts. Some may be difficult to revive from the present stagnation, and should therefore not be artificially protected or promoted. But other sectors will benefit well from systematic upgrading and further investments, to become profitable on a sustainable basis. The government, with support from donors, should therefore more actively identify the bottlenecks for growth in sectors with greater relevance in the districts, and then eliminate those bottlenecks to encourage and facilitate further growth.

A more decentralised economic growth is likely to create more job opportunities where needed, and greater forward and backward linkages locally. This is one way of improving the "trickle down" effects of growth. Whether this will be sufficient to further reduce poverty of the 20 per cent at present in deepest poverty, will depend on the type of growth. Those poorest today are among the internally displaced, among the marginal farmers with little land and no other alternative income, and among the casual workers and jobless in the slums in urban areas. They need alternative employment. The ongoing Framework for Poverty Reduction studies may reveal what additional directly targeted measures will be necessary to reduce poverty further.

The new Norwegian strategy for support to economic and business development in the South (Utenriksdepartementet, 1999) states that it will pay attention to the effects on employment creation and distribution of benefits when making decisions on funding specific measures and programmes. In Sri Lanka a combined sectoral and regional approach should make this possible.

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# Summary

This Working Paper describes the economic growth rate and patterns in Sri Lanka during the 1990s, showing the interrelationship between uneven sectorial growth and the unbalanced regional growth patterns. This is reflected in the regional distribution of unemployment and poverty. In addition, the ongoing war in the North and East has resulted in economic decline in affected areas. Secondly, the paper outlines policy measures aimed at stimulating economic activities in the regions, and underlines the need for creating a conducive environment at the regional and district level. Thirdly, the opportunities for investment in sectors with higher potential in less developed areas are reviewed. Donors may support efforts to eliminate bottlenecks and facilitate sectors that will become profitable on a sustainable basis in the regions.