

# BTI 2010 | Sri Lanka Country Report

<b>Status Index</b>	1-10	<b>6.17</b>	# 48 of 128	
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scale: 1 (lowest) to 10 (highest)    score    rank    trend

This report is part of the Transformation Index (BTI) 2010. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 128 transformation and developing countries are evaluated.

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## Key Indicators

Population	mn.	20.0	HDI	0.76	GDP p.c.	\$	4244
Pop. growth	% p.a.	0.6	HDI rank of 182	102	Gini Index		41.1
Life expectancy	years	72	UN Education Index	0.83	Poverty <sup>2</sup>	%	39.7
Urban population	%	15.1	Gender equality <sup>1</sup>	0.37	Aid per capita	\$	29.4

Sources: UNDP, Human Development Report 2009 | The World Bank, World Development Indicators 2009.

Footnotes: (1) Gender Empowerment Measure (GEM). (2) Percentage of population living on less than \$2 a day.

## Executive Summary

Sri Lanka's trajectory during the past two years has been marked by continuing economic development amidst some deterioration in political institutions. Increased foreign remittances, continuing direct foreign investment and rising exports have, so far, countered deteriorating terms of trade, rising imports and the global recession. Foreign trade is mostly deregulated, policies are market-friendly and the tax regime is liberal. The education level of the workforce is high. Educational opportunities for women are excellent though there are considerable gender barriers to engagement in society and the economy. Private property is relatively well-protected. On the other hand, there has been no major reform of the overstuffed and relatively inefficient public sector and illegal siphoning of funds from state ventures has continued. The budget deficit is being reduced gradually but inflation is in double digits. The privatization of state enterprises has halted.

The political picture is less hopeful. The military defeat of the separatist Liberation Tigers of Tamil Eelam (LTTE), whose forces are now surrounded in a small forested area, has removed a major danger to the state. On the other hand, considerable challenges remain. The factors that pushed many Tamils to support the separatists have not yet been addressed. The recent conflict has had adverse implications on people in the north and east in terms of loss of human life and of property. The conflict has also had an impact on areas outside the areas of conflict where the freedom to criticize the government has been equated with disloyalty. Opposition news outlets are under siege, vulnerable to attacks by armed gangs. Electoral processes have continued with extensive political participation but the contests have been lopsided partly due to open state support of some groups. The Supreme Court's refusal to consider that the president can be legally held accountable for acts of omission and commission while he is president has undermined Article 17 of the constitution that sought to restrain presidential authority. Fundamentally, there is strong public support for the democratic process, and democratic institutions seem stable.

There are considerable impediments to political transformation because the civil war has strengthened ethnic sentiments and because political rewards do not seem to flow to moderates. The government has shown some steering capacity in economic matters and has made a concerted attempt to assist the poor during the period under review.

## History and Characteristics of Transformation

By the end of British colonial rule in 1948, the country's elite had been socialized into accepting a British-style parliamentary system, which survived several power transfers in the wake of successive defeats of the ruling party in the 1950s and 1960s. A party system developed with the United National Party (UNP) and the Sri Lanka Freedom Party (SLFP) as the two major parties. During the second half of the twentieth century, the two parties combined won a steady 80% of votes and seats.

However, the political transformation to a third world democracy met several obstacles. Political parties remained elite-dominated with minimal internal democratization. Ethnic tensions escalated, principally between the majority Sinhalese and minority Sri Lankan Tamils of the north and east. Sinhalese politicians implemented a number of policies that alienated many Sri Lankan Tamils, including the exclusion of most Tamil plantation workers in the central part of the country ("Up-Country Tamils") from citizenship in 1948, making Sinhala the only official language in 1956, and giving special constitutional recognition to Buddhism – the religion of most Sinhalese – in 1972. The largely Hindu Sri Lankan Tamils were further aggrieved by diminishing opportunities for state employment in the 1960s, and schemes intended to limit their access to some areas of university education in the 1970s. During the 1950s, Sri Lankan Tamil politicians demanded a federal system, and in the 1970s began a campaign for a separate state.

In the late 1970s, the more radicalized Tamil youth moved towards armed struggle. Faced with these challenges, as well as a short-lived insurgency among the Sinhalese youth in 1971, the state began to continually invoke a state of emergency, exerting greater control over the media and expanding the military forces. A new constitution in 1978 established a French-style presidential system and new anti-terrorist laws were enacted. Increasing attacks on state institutions and on the armed forces by Tamil militant groups in the 1980s and a pogrom against Tamil civilians in 1983 made matters worse. An offer of a quasi-federal system following Indian armed intervention in 1987 failed to resolve the issue. By the late 1980s, the state faced twin armed insurrections, one by Tamil separatist groups and another by Sinhalese Marxists. It was able to crush the latter, but the Liberation Tigers of Tamil Eelam (LTTE), which emerged as the dominant Tamil rebel group, defeated its rivals and established control over some territory in the northeast.

A federal solution was and continues to be opposed by significant numbers of Sinhalese. In February 2002, Sri Lanka and the LTTE agreed to yet another cease-fire, this time with Norwegian mediation and with a task-force on the ground to monitor the cease-fire. However, peace talks stalled after April 2004, and there has been extensive fighting since mid-2006. By early 2009 (at the time of this writing), the state was poised to take over control of the land hitherto controlled by the LTTE, though a political settlement remained elusive.

Meanwhile, reforms permitted most Up-Country Tamils to gain citizenship rights in the 1980s and Up-Country Tamil political parties currently participate in mainstream politics. Muslim political parties that had emerged in the last twenty years, and had advocated a separate Muslim province have begun to ally themselves with one or the other of the main parties. Despite these advances, the tendency towards accumulating power by the ruling political group has resulted in some backsliding along the path of political transformation.

The economic transformation has been more promising. The British left Sri Lanka with a colonial economy in which the state depended on the plantation sector for much of its revenue. Sri Lankan politicians maintained the well-developed health care system that they inherited, and they vastly expanded secondary education. On the other hand, they also inherited a weak industrial sector and had to make heavy investments in agriculture to reduce the country's dependence on food imports. A development model of import substitution and of economic development through public sector companies was attempted until 1977. From then on, market-oriented reforms were gradually adopted. Successive governments of different political hues have pursued privatization, public sector reforms and the liberalization of trade and capital movements, although populist opposition to these changes continue.

## Transformation Status

### I. Democracy

#### 1 | Stateness

A determined military campaign against the LTTE in 2007 and 2008 has enabled the state to restore its control over most of the country. As of January 2009, the area under LTTE control was reduced to a small enclave near the northeast coast. While state forces appear to be on the verge of a major military victory, their dominance over parts of the north and east depends partly on armed Tamil militias who have broken with the LTTE. In other parts of the country there is an increase of extra-judicial killings and of gang violence.

Monopoly on the use of force

All groups in Sri Lanka have legal access to political rights. However, considerable numbers of ethnic Tamils do not accept the current Sri Lankan state as legitimate and the current military conflict has widened the ethnic divide.

State identity

The state supports all major religions in Sri Lanka, with a minister for religious affairs, and state departments supporting Buddhism, Hinduism, Islam and Christianity. In effect, however, the Buddhist lobbies have extensive influence and the constitution specifies that “The Republic of Sri Lanka shall give to Buddhism the foremost place,” although it also safeguards freedom to have or adopt a religion of one’s choice and the freedom to teach and practice one’s religion in public or private. The last two years have seen attacks on some evangelical Christian churches by Buddhists, due to suspicions of evangelization with the help of foreign funds. However, Buddhist efforts to legally prohibit the use of inducements for conversion have failed.

No interference of religious dogmas

Sri Lanka has an effective administrative structure that provides basic health and educational facilities to all areas. Central and provincial agencies provide power, water, housing and other basic facilities, and implement state policies such as those relating to fertilizer subsidies. In the north and the east, the end of violence in some regions has led to the resumption of state services but, by late 2008, about several hundred thousand civilians caught in the conflict was without basic services. The level of corruption in state administration has worsened. Political interference in the

Basic administration

operation of the administration is routine and recruitment to state agencies (except in the case of professionals such as doctors) is carried out almost entirely through political recommendations.

## 2 | Political Participation

The provincial and local elections in the Eastern Province were not free and fair because of the use of state resources in favor of ruling coalition candidates and because the ruling party's Tamil political ally, the Tamizh Democratic National Alliance, was supported by an armed militia that openly displayed its weapons. The ruling party won these elections with a 53% vote. The intimidation of opposition media outlets and the government's use of state resources during political campaigns underline the continuing challenges to the democratic process.

Free and fair elections

Democratically elected officials have been able to implement their policies. The president is the commander-in-chief of the armed forces and has been able to appoint his choices of chiefs for the army, navy, air force and police without precipitating a crisis. Administrative officers are transferable and subject to political will. Legislators wield extensive influence with administrators in their constituency. However, local and provincially elected officials in the opposition are not assured of cooperation from state agencies in enforcing their policies and regulations unless they are political supporters of the government.

Effective power to govern

Under the laws relating to public security, the state can restrict public meetings of groups, although this is rarely done. However, gangs attached to individual politicians intimidate voters and opposition politicians participate in politics at some personal risk. In areas under LTTE control, there has been no room for dissent.

Association / assembly rights

The state controls significant portions of the news media, including major newspapers and state TV. There are a few independent media outlets critical of the government. Freedom of expression has been severely restricted in the northern and eastern areas due to the civil war. In early 2009, the murder of Lasantha Wickrematunga, the editor of an opposition newspaper, an attack by gunmen on the studios of the Maharaja Television/Broadcasting Network and the attempted murder of another opposition newspaper's editor and his wife created a chilling atmosphere because this violence was perceived to have state sanction.

Freedom of expression

## 3 | Rule of Law

The ruling party needs to control both the presidency and the legislature to abridge the separation of powers. In the period from 2001 to 2006, the president had to deal with a legislature where the president's party was either in a minority or had to depend on a coalition partner for a majority in the legislature. Since early 2007, the

Separation of powers

president has used his powers of patronage to win over opposition members. The president's refusal to fill vacancies in Constitutional Council, set up by the 17th Amendment to the Constitution in 2001, (thereby undermining its functioning) has expanded the power of the presidency because that council was intended to give others a voice in the appointment of key state officials.

There is a well-organized legal system with a system of appellate courts and an influential lawyers' association. However, political appointments to the bench (in all courts) and the intimidation and transfer of judges (mostly in the lower courts) have diminished the judiciary's independence. Corruption and political influence have undermined confidence in the judiciary. The judiciary is not empowered to rule on the constitutionality of legislation after it is enacted, though bills can be challenged before they become law.

Independent  
judiciary

Judges of the Supreme Court and of the Court of Appeal are appointed by the president and cannot be removed from office except with majority support in the legislature for proven misbehavior or incapacity. No judge has ever been removed under this provision. However, the Supreme Court has failed to protect the independence of the judiciary. The president has appointed two judges to the Court of Appeal, the President of the Court of Appeal and a Supreme Court judge without going to the Constitutional Council, as he is required to do by law. The judiciary has ruled that the president cannot be sued because Article 35(1) of the constitution confers immunity (with certain exceptions) to the president from prosecution for all acts of omission or commission while in office. Two Supreme Court judges resigned with effect from 2 February 2006 from the Judicial Services Commission on grounds of "matters of conscience." Confidence in the judiciary is at a low point.

Inefficiency, anomie and corruption are widespread at all levels of government as is the impunity with which such practices and human rights violations are perpetrated. The latter especially has ascended to new heights under the Mahinda Rajapaksa government. No high-ranking politician or public servant has been prosecuted for abuse of power while in office despite evidence that seemed to warrant prima facie cases. Successful prosecutions after political defeat are extremely rare. There is no practice relating to disclosure of financial interests while in office.

Prosecution of  
office abuse

The civil war has led to militarization, human rights violations, torture and disappearances, particularly, but not exclusively, in the northeast. There are instances of torture, rape and abuse at the hands of the state security forces. In areas under LTTE control, abductions and the recruitment of child soldiers is extensive, as is a system of summary justice. With declining confidence in the judiciary, the number of fundamental rights applications filed has declined from 2005 onwards.

Civil rights

#### 4 | Stability of Democratic Institutions

The president has been able to negotiate for support within the legislature and is in control of the administration and armed forces. In areas under LTTE control however, policy was dictated by unelected leaders.

Performance of democratic institutions

Democratic procedures, though sometimes subverted in practice, are widely regarded as the only means conferring legitimacy. 67% of voters participated in the Eastern Provincial Council Elections. Voters sometimes accept personal risks in order to cast votes.

Commitment to democratic institutions

#### 5 | Political and Social Integration

The party system is moderately fragmented in terms of the effective number of parties, and voter party loyalties appear to be fairly stable. The two largest parties, the UNP and the ruling SLFP, dominated by Sinhalese Buddhists and middle-upper class interests, have been able to absorb adherents of smaller parties, including those who had supported Marxist groups. The two major parties agree on broad economic and social policies. Individual politicians seem comfortable in changing allegiance from one major party to the other. Nevertheless, there is considerable polarization between the two major parties on the one hand and the minority ethnic parties on the other although they form alliances of convenience. Party organization is undemocratic. Parties center on personalities and patronage. Party branches become active only at election time and act mostly to mobilize voters.

Party system

Religious interests such as groups of Buddhist monks and the Catholic Church are vocal, with Islamic and Hindu groups being less active. Trade union membership has continued to drop and currently includes only about 20% of all workers. Many unions are affiliated with political parties. Public sector trade unions have recently resisted government moves to restructure the state-owned electrical utility board and the petroleum company. Employers' federations are influential in pushing economic reforms. There are many NGOs actively engaged in supporting poorer sections of society and in the creation of ethnic harmony, but the leadership is thin and NGOs dependent on foreign grants have come under attack as "foreign agents."

Interest groups

The 2005 survey on the State of Democracy in South Asia (the latest we have) concluded that support for democracy in Sri Lanka was higher than in any other country in the region with democracy supported by 86%. The support was stronger among the more educated and the urban dwellers and strong among minorities. Participation in elections has been high with over 73% in the presidential election of 2005 and 67% in the 2008 provincial elections in the Eastern Province.

Consent to democratic norms

There is no reliable survey data on interpersonal trust but extensive social networks exist in Sri Lanka. Many of them are based on religious affiliations. Social organizations in rural areas tend to concentrate on helping neighbors facing a crisis. In urban areas, the upper-middle class participates in organizations such as the Lions Club, Jaycees and the Rotary Club. Trade unions have 1.5 million members but are concentrated in plantations and among urban wage earners.

Associational  
activities

## II. Market Economy

### 6 | Level of Socioeconomic Development

Sri Lanka is a middle-income country that performs much better than comparable economies in terms of the Human Development Index. Poverty as measured by the Household Income and Expenditure Survey of 2006/07 declined to 15% from 23% in 2002. Some of this change was due to extensive investment in the Southern Province, the political base of President Rajapaksha. These figures do not represent conditions in the Northern and Eastern Provinces because they have been excluded from the survey. Indeed, conditions in the war-torn areas have deteriorated. People in these regions are largely Tamil though they include some Sinhalese and Muslims. Education is disrupted; children are abducted to serve in militias. Shortages of food and other necessities have accompanied the armed clashes between the state and the LTTE. Also, in the plantation areas the percentage of those in poverty rose from 30% to 32% during the same period. Safe drinking water and modern sanitation are not available to most of the workers living on plantations. Interpersonal income inequalities remain high with the Gini Coefficient of consumption in 2006/07 unchanged from 2002 at .40 and higher than its 1990/91 level of .32. Civil conflict, inflation, and poor infrastructure progress in rural areas despite overall growth rates of over 6% in the economy in the last few years. Low child mortality and high female higher education levels have not translated into greater equity in economic participation and more decision-making power for women. Men hold over 60% of employment in the organized sector.

Socioeconomic  
barriers

Economic indicators		2004	2005	2006	2007
GDP	\$ mn.	20662.5	24405.8	28281	<b>32357</b>
Growth of GDP	%	5.4	6.2	7.7	<b>6.8</b>
Inflation (CPI)	%	7.6	11.6	10.0	<b>15.8</b>
Unemployment	%	8.5	7.7	6.5	<b>6.0</b>
Foreign direct investment	% of GDP	1.1	1.1	1.7	<b>1.9</b>
Export growth	%	-	-	-	-
Import growth	%	-	-	-	-
Current account balance	\$ mn.	-647.6	-650.1	-1498.0	<b>-1400.9</b>
Public debt	\$ mn.	9847.4	9651.8	10317.4	<b>11878.6</b>
External debt	\$ mn.	11085.1	11268.1	11642.5	<b>14020.4</b>
Total debt service	% of GNI	3.8	1.9	3.4	<b>2.6</b>
Cash surplus or deficit	% of GDP	-7.3	-7.0	-6.9	<b>-6.5</b>
Tax Revenue	% of GDP	13.5	13.7	14.6	<b>14.2</b>
Government consumption	% of GDP	12.6	13.1	15.4	<b>15.3</b>
Public expnd. on edu.	% of GDP	-	-	-	-
Public expnd. on health	% of GDP	1.9	1.8	2.0	-
R&D expenditure	% of GDP	0.2	-	0.2	-
Military expenditure	% of GDP	2.7	2.5	2.8	<b>2.9</b>

Sources: The World Bank, World Development Indicators 2009 | UNESCO Institute for Statistics | International Labour Organization, Key Indicators of the Labour Market Database | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security.

## 7 | Organization of the Market and Competition

Market competition in Sri Lanka is stable. Discrimination against foreign investors is very low with investment up to 100% allowed in many sectors. However, (with some exceptions) foreign investment under \$1 million is prohibited in areas of retail trading and non-bank lending, and in some sectors, foreign investment exceeding 40% is subject to screening and approval. Outward investment needs state approval. The movement towards privatization has halted in the past two years. The top income tax rate is low at 30% and the top corporate tax rate 32.5% (including a 2.5% surcharge).

Market-based  
competition

The only monopolies that exist are state-owned (e.g., electricity). The state controls some wages and prices, including the prices of petroleum, water, power, bus and rail fares, and bread. There are no specific anti-cartel laws but market competition has prevented the growth of monopolies or cartels.

Anti-monopoly  
policy

Foreign trade is deregulated and the weighted tariff rate was 7% in 2006. The South Asian Free Trade Agreement began to be implemented in 2006. However, there was no further movement towards liberalization in the past two years. In fact, tariffs were increased on imports of some agricultural and food products already produced in Sri Lanka and on some select imports such as refrigerators and ready-made garments. Import licensing, restrictive standards, non-transparent government procurement, export subsidies, and corruption add to the cost of trade. On the other hand, the exports in 2007 were 29% of GDP as compared with about 5% in the 1970s.

Liberalization of  
foreign trade

Regulations permit foreign control of banks, insurance companies, and stockbrokerages but foreign banks need the central bank's approval before opening branches. The two major state-owned commercial banks hold almost 50% of banking sector assets. Banking practices including liquidity requirements and calculation of assets conform to international standards. There are reporting requirements and limits on payments and transfers. By early 2009 the Colombo Stock Exchange had 237 listed companies, and in response to the global economic crisis, the All Share Price Index dropped from 2384 in 2006 to around 1700 in January 2009.

Banking system

## 8 | Currency and Price Stability

Inflation as measured by the Colombo Consumer Price Index, caused by rising prices for petroleum and the cost of war, peaked at 28% in June 2008 but fell to about 19% by December 2008 due to the global economic downturn and the fall in oil prices. In 2007, the central bank of Sri Lanka adopted a policy designed to control the supply of money but this had only a moderate impact. The average weighted prime lending rate charged by commercial banks has risen from 15% in January 2007 to 19% in January 2009. Although the projected budget deficit for 2009 is projected to be 6.5% of GDP, as against 7% in the previous year and 7.7% in 2007, the increase in military expenditure continued. The Sri Lankan rupee held steady around 108 per U.S. dollar during the past two years but fell 15% against the euro.

Anti-inflation /  
forex policy

International reserves continued to be fragile in 2007 and 2008, with increasing deficits in the trade balance. Increased foreign remittances from Sri Lankans overseas limited the current accounts deficit to about \$1400 million despite changes in terms of trade. The gap was filled by increased foreign private investment and

Macrostability

international aid. In October 2007, the government floated its first sovereign bond issue and up to 10% of treasury bills and bonds are now open to foreign investment. The external debt has risen and the debt service ratio as a percentage of earnings from merchandise exports and services rose to over 13% in 2008, but this is seen as manageable.

## 9 | Private Property

Property rights and acquisition are adequately secured in the industrial and service sectors. Land ownership and sale are safeguarded, although land registration procedures are cumbersome. Private land ownership is limited to 50 acres per person. Foreign investors can purchase land, but there is a 100 percent tax on such transfers. In practice, the cumbersome legal and administrative procedures pose some challenges to the enforcement of rights. In parts of the country where state land is granted free to agricultural settlers, it is held in leasehold and is not legally disposable.

Property rights

The legal framework for the functioning of private enterprise is present. However, the Rajapaksa government rejects the further privatization of state enterprises, including state-owned banks, and electrical utilities. Instead, it plans to retain ownership and management of these enterprises and make them profitable. There are no plans to take over private privately owned enterprises.

Private enterprise

## 10 | Welfare Regime

Sri Lanka's HDI continues to be above that of many countries with higher per capita GDP because of long-standing and comprehensive welfare programs. Free health care implemented for over half a century continues, but is challenged by financial constraints, the high incidence of malnutrition among children, the re-emergence of communicable diseases such as malaria and dengue fever, and a demographic transition that has led to greater demand for care of the elderly. One in five Sri Lankans does not have access to a safe water supply. Basic provision of education is comprehensive, with state or state-assisted schools providing education free, but there is a shortage of teachers in foreign languages and in technical subjects. Tertiary education is not well-funded. The rural population and most in the urban sector have no insurance coverage for natural disasters, disability and old age.

Social safety nets

Access to public services is open by law. There are however, inequalities in practice. There is no gender gap in educational enrolment or achievement, but men dominate the more lucrative levels of employment in both the public and private sectors. There are regional and urban-rural disparities in the quality of the education system. Access to financial resources is limited for the poorer sectors of society,

Equal opportunity

despite the state's encouragement of micro-lending. In 2006, banks were instructed to devote 10% of their lending portfolio to agriculture. Access to opportunity has been severely limited in areas of conflict of the north and east, which has affected large numbers of minority Tamils and Muslims and some Sinhalese.

## 11 | Economic Performance

The GDP growth rate was at 6.8% in 2007, and is estimated at about 6.5% in 2008. Unemployment (excluding the north and east) has fallen from 6.7% in 2006 to 5.3% in 2008. Agricultural and industrial production continues to grow and the rising commodity trade deficit is compensated for by a continuing inflow of private remittances. The investment-to-GDP ratio is at around 28% for 2008 partly due to a rise in public investment. However, inflation is high and the terms of trade continued to decline. Military expenses for 2009 are projected to reach a record \$2 billion. Domestic savings declined to 15.3% of GDP due to higher food and fuel prices. Reducing vulnerability of the economy to challenges arising from external shocks remains a key priority.

Output strength

## 12 | Sustainability

The encroachment of natural reserves and continued deforestation has resulted in soil erosion and other adverse effects on biodiversity. The inability of the politicized police to resist such actions by politically connected individuals worsens the situation. Air and water pollution has worsened in urban areas and development pressures have also led to the reclamation of estuarial, lagoon and marsh waters, and the unrestricted disposal of untreated sewage, leading to major pollution problems. Environmental concerns, however, tend to take a back seat to growth considerations. Ecologically sustainable growth gets only scant attention and is not reflected in the institutional framework.

Environmental policy

The existing system of education at the primary and secondary levels is comprehensive, but tertiary education continues to fall behind in quality. The law provides for a state monopoly on university education, but private tertiary educational institutions provide post-secondary diplomas and link programs with foreign universities. State universities and R&D facilities are poorly funded. Modern infrastructure does not extend nationwide, but is limited to certain segments and enclaves such as major cities and modernized economic sectors.

Education policy / R&D

## Transformation Management

### I. Level of Difficulty

In terms of structural constraints on the political process, the difficulty is medium. The distrust between ethnic groups engendered by years of conflict is a key negative. The ethnicist propaganda that strengthened support in the majority community and enabled the Rajapaksha regime to bear high costs in lives and money to ensure a military victory over the LTTE separatist forces has left a divided citizenry and a diminished readiness for reconciliation within the majority Sinhalese as well as heightened apprehensions among many Tamils. Establishing new political structures that rebuild trust will be challenging in a context where the minority Muslim community is also increasingly conscious of its identity and where Christians feel threatened by the more militant Buddhists.

Structural  
constraints

In terms of economic development, the challenges are less daunting. Sri Lanka does not have exploitable oil or coal resources. The enforcement of the rule of law is variable and the administrative structure somewhat inefficient. Continuing poverty in areas outside the Western Province, particularly in the plantations and in the north and the east leave sections of the poor feeling excluded from the benefits of economic growth. On the other hand, Sri Lanka has a good geographic location, an educated labor force and a basic (though inadequate) system of internal transport. Much of the needed economic structural reform has already been accomplished, with relatively broad consensus.

There are numerous NGOs in Sri Lanka concentrating mostly on poverty alleviation and ethnic reconciliation. While there is faith in democracy, patron-client ties are strong, and trust in state institutions is limited among the poor and ethnic minorities.

Civil society  
traditions

Civil war between the separatist LTTE and the state is the major conflict. The armed conflict intensified in 2007 and by June 2007, the state, allied with a breakaway group of the LTTE, regained control over the Batticaloa district in the east after fighting in which there were 5000 killed. During the review period, the armed forces gradually regained control over much of the land that had been held by the LTTE for some two decades. By January 2009, the remnants of the LTTE forces were bottled up in the north where over 100,000 civilians have been caught

Conflict intensity

in the crossfire. If the military success continues, the military might of the separatist group might be drastically reduced but the ethnic divide remains and among Buddhists, resentment against evangelical Christian groups is strong.

With high inflation and low wages, there is resentment over corruption and the excessive wealth enjoyed by a few. The most developed area, the Western Province, produces 50% of the GDP and has less than 15% of households below the poverty line, while about 30% of households in some the other provinces live in poverty.

## II. Management Performance

### 14 | Steering Capability

President Rajapaksha's government has clear political, economic and social priorities and the capability to attain them. However, they do not necessarily coincide with the objectives of achieving normative democracy and a socially responsible market economy. On the political front, the objective of building a consensus was achieved, at least in a limited fashion when the ruling coalition attracted 18 dissidents of the opposition United National Party to cross-over in the legislature. The government also attracted the Sri Lanka Muslim Congress and induced a breakaway group from the LTTE to turn to electoral politics. This development and the successful prosecution of the war has enabled President Rajapaksha to build a majority in the legislature and strong political support in the country. However, some of this political capital has been used to accumulate more power to the presidency by sabotaging the 17th Amendment to the constitution and by intimidating political opponents.

Prioritization

On the socioeconomic front too, the priorities are clear. The Southern Province that has been a Rajapaksha power-base has seen increased investment. The president's philosophy entitled "Mahinda Chinthanaya" directs policy. It includes "Gama Neguma," or a program to develop village infrastructure and rural opportunities and "Randora," a program of investment in infrastructure such as highways, power and irrigation primarily through more efficient and expanded use of state agencies. Privatization is explicitly ruled out and the importance of having a sound regulatory framework for public-private partnerships is emphasized. Political decision makers at the national level have recognized that elimination of the military conflict has precedence over economic recovery and have clearly placed their resources there

with a 20% increase in projected military expenses in the 2009 budget.

The Rajapaksha government's agenda of economic reform is generally subordinated to its concern with political survival. Decisive actions taken include moves to eliminate fuel subsidies, an overhaul of electricity pricing to get full cost-recovery, and better targeting of the Samurdhi (welfare) program. Other successes include strengthening the tax administration (including customs). The government has also introduced a number of needed laws and regulations, such as the Companies Act (2007), Payment Devices Frauds Act (2006), Finance Leasing Act (2006), Prevention of Money Laundering Act (2006), Financial Transaction Reporting Act (2006), and the Corporate Governance for Licensed Commercial Banks in Sri Lanka (2007). On the investment front, several large scale infrastructure investments, including the Colombo port have commenced. However, there is limited progress towards making the state sector less corrupt and more efficient.

Implementation

There is limited evidence of policy learning. Populist politics, centralized decision making on policy and reluctance to embrace critical views inhibit progress in this field. Thus for instance, there is a remarkable unwillingness to look at alternate frameworks of nation building.

Policy learning

## 15 | Resource Efficiency

The government does not make optimum use of available resources. The public sector is overstaffed and the appointment of new public officials is politicized except for a minority of specialized professionals such as doctors. Once appointed, public officials are protected in their positions, though they can be subject to transfers to undesirable locations. Auditing of state agencies is routine but there are instances of leakages of state resources into private hands. Elected local and provincial assemblies have legally defined spheres of activity but do not have adequate financial resources. However, more efficient collection of taxes has raised revenue as a percentage of GDP from 13.7 in 2003 to 15.3 in 2008. The criticism has been that increased military expenses, the continuation of subsidies and increased overstaffing of the public sector will likely hurt long-term economic development.

Efficient use of assets

Policy coordination through the administration is well-established; many central ministries have branches at the provincial level with coordination provided for by civil servants.

Policy coordination

There is open public criticism of corruption but the government's motivation and ability to control corruption is questionable. There is no prosecution of corrupt politicians in power. Public procurement systems are notoriously open to bribery

Anti-corruption policy

and there is virtually no accountability of officeholders in terms of asset declarations and conflict of interest rules. State spending is audited, but party financing is not regulated. The media occasionally highlights glaring instances of questionable decisions. Family members of the president hold key positions of authority. Moreover, individuals close to the president, including members of his family are seen as gaining enormous financial benefits from the state.

## 16 | Consensus-Building

The two major parties – the Sri Lanka Freedom Party (SLFP) and the United National Party (UNP) – agree on the long-term strategic goals of a market economy and democracy. The party in power, the SLFP, however, has placed greater emphasis on poverty eradication led by the public sector but within the framework of a market economy. The Marxist JVP (Peoples Liberation Party) advocates state intervention in the economy, but their popular support has clearly dwindled. The Liberation Tigers of Tamileelam (LTTE) has not voiced a coherent policy in relation to a market economy or democracy, but it clearly acts in undemocratic ways.

Consensus on goals

The major veto actor has been the LTTE, but its power is waning. It failed to prevent the 2008 local elections in the Batticaloa district in the east after it was ousted from that area in June 2007. The military has not interfered in economic and political policy-making, though it has influence over policies relating to state forces.

Anti-democratic veto actors

There is broad consensus on a market-oriented growth policy combined with poverty eradication, though the Rajapaksha government has more faith in the public sector than its predecessors, who embarked on gradual privatization. Ethnic cleavages are significant. The major issue is the reconciliation of separatist Tamils of the north and east with the state. The Up-Country Tamils in the central part of Sri Lanka also see themselves as an economically oppressed group. Muslims, who make up almost 8% of the population, are influenced by external events and have become more conscious of their identity and interests. There is significant resentment in rural areas against the more prosperous and more westernized urban dwellers. The government seems to be more effective in dealing with socio-economic cleavages than ethnic resentments.

Cleavage / conflict management

The political leadership does not make specific efforts to encourage the participation of civil society in the political process, but does aim to manage civilian groups who seek to intervene in politics. Several journalists have been killed during the review period. Intellectuals who criticize state policies find outlets in the media but also find themselves under attack. Professional associations and interest groups are able to influence the state only in certain narrow areas.

Civil society participation

Both the majority Sinhalese and the minority Tamils see themselves as victims of historical acts of injustice, the former during colonial times and the latter in the period since independence. The continuing ethnic divide (which extends to a lesser extent to the Muslims) hinders progress toward reform goals. There is urgent need to recognize and acknowledge more recent acts of injustice by state agencies towards the minorities and the powerless (women and the poor).

Reconciliation

## 17 | International Cooperation

The state has worked successfully with the IMF and World Bank in the past decade and continues to do so. Cooperation with India has enabled the state to use armed force against the LTTE effectively. However, the prosecution of the civil war has led international actors to warn against civilian casualties and relations with the United Kingdom suffered a setback after Sri Lanka refused to accept a special British Envoy commissioned to investigate the situation.

Effective use of support

Sri Lanka has followed through in terms of reform policies and economic commitments. It has been less successful in keeping its commitments to resolve armed conflicts and reduce human rights abuses and has faced criticism from international groups.

Credibility

Sri Lanka has excellent relations with its neighbors. Free trade agreements with India and Pakistan have significantly lowered tariff barriers and encouraged trade. Sri Lanka is a member of the regional body SAARC.

Regional cooperation

## Strategic Outlook

There are four areas in which a change in approach is recommended:

**The ethnic question:** With the impending military victory of the state forces against the separatist LTTE, the war in Sri Lanka is likely to be over. However, the “war for Sri Lanka” is just beginning. The crucial need is to bring those who were fighting for a separatist Tamil state back into the fold, and that will take time and imagination. The Sri Lankan state will need to think more creatively about delegating power to regional and local units and funding them adequately. The current government has been ready to convene an all-party discussion to discuss solutions. Connected to this is the need to tactfully tamp down jingoistic emotions aroused in the last few months among the Sinhalese, emotions that have led to public celebrations of victories against their fellow countrymen. This is a delicate issue but needs to be handled well if a compromise settlement is to receive popular support. Indirectly connected is the issue of living conditions for Tamils in the plantations in the central region of Sri Lanka. Evidence indicates that these conditions have deteriorated and this issue needs to be addressed quickly before that community becomes more alienated. With multiple parties representing the Muslims in positions of influence in the government, that community is more connected to the Sri Lankan state but overall, greater willingness to attend to minority ethnic concerns is key to building a viable democracy.

**The market economy:** The Sri Lankan economy has demonstrated the ability to deal with adverse shocks. However, inflationary pressures are increasing and the external current account is widening. The rising debt service burden makes the economy vulnerable to external shocks. Further monetary tightening may be needed to control credit growth and to keep inflation in check.

**Transparency and accountability in Sri Lankan state expenditure and procurement practices** are important in terms of checking corruption and in developing public trust. Transparency and efficiency in the legal and administrative framework will reduce the transaction costs of business enterprises and promote investment. Steps that might be taken include greater legal public access to information, timely publication of annual accounts of state enterprises and strengthening auditing and reporting procedures.

**Social justice:** Sustainable development requires that political stability and economic growth be combined with a vision for the transformation of Sri Lankan society and greater attention to social justice. The Rajapaksha government’s emphasis on reducing rural poverty is a move in the right direction. Improving law and order, and ensuring better access to the judicial system should be part of this vision, as it is needed to improve public trust. Of equal importance is the improvement of education quality and access. The state is using external assistance to improve the existing education infrastructure, but R&D expenditures remain low (less than 2% of GDP). Sustainable development also involves upgrading material infrastructure facilities such as

highways, ports, safe drinking water and power. Continued successful investment in this area is key to the future.

**The environment:** Environmental issues are linked to sustainable development. The government needs to engage the private sector, NGOs, civil society and other stakeholders in extensive talks to build a development policy consensus that pays greater attention to environmental concerns. Propaganda critical of NGOs, painting all of them as evil “agents of the West,” needs to be countered. Sixteen of Sri Lanka’s coastal lagoons that make up half of the country’s wetlands are classified as threatened. This is mostly due to development for tourism and recreational purposes, fisheries, fish farming, industrial development, unrestricted disposal of untreated sewage, large-scale sand mining and housing. Growing population pressure and some cultivation and clearing practices have led to enhanced vulnerability to natural disasters such as landslides and floods.