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Poverty Situation and Policy in Sri Lanka

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I. Introduction

Since its independence, Sri Lanka has shown impressive progress in reducing the incidence of poverty, reflected in terms of improvements in human development indicators as well as in consumption terms. Two general factors contributed to this progress: (i) a satisfactory long-term growth performance, with real per capita GDP growth of about 2.5 percent per year on average during the last five decades; and (ii) satisfactory provision of basic health and education together with either food subsidies or income transfers that enabled higher consumption by the poor.

Sri Lanka is well known as an exception among developing countries for its achievements in human development indicators (see, for instance, Table 1). However, the country still remains a low-income country. Although Sri Lanka's long-term growth compares favorably with developing countries, it falls short of the growth achieved during the last 50 years by the high-performing East Asian economies such as Republic of Korea, Malaysia, and Thailand. This was partly due to policy mismanagement and the on-going war that has now continued for 17 years. It was also a case of missed opportunities (Kelegama 2000).

Table 1. **Social Indicators: Sri Lanka and Selected Asian Countries**

| Indicators | Sri Lanka | Bangladesh | India | Pakistan | Malaysia | Thailand |
|---|-----------|------------|-------|----------|----------|----------|
| Populations, mid-year (millions) 1998 | 18.8 | 125.6 | 979.7 | 131.6 | 22.2 | 61.1 |
| Population – average annual growth 1992-1998 (%) | 1.3 | 1.6 | 1.7 | 2.5 | 2.5 | 1.1 |
| GNP per capita (US\$) 1998 | 810 | 350 | 440 | 480 | 3,600 | 2,200 |
| GNP growth rate (1988-98) | 5 | 4.8 | 5.6 | 4.5 | 7.8 | 6.9 |
| Life expectancy at birth (years) | 73 | 61 | 63 | 62 | 72 | 69 |
| Infant mortality (per 1000 live births) | 14 | 57 | 70 | 95 | 11 | 33 |
| Child malnutrition (% of children under 5) | 38 | 68 | 53 | 38 | 20 | Na |
| Access to safe water (% of population) | 70 | 84 | 81 | 62 | 89 | 89 |
| Access to sanitation (% of population) | 63 | 48 | 29 | 47 | 94 | 96 |
| Illiteracy (% of population age 15+) | 9 | 47 | 44 | 59 | 14 | 5 |
| Gross primary enrolment (% of school age population) | 109 | 96 | 100 | 74 | 102 | 87 |
| Male | 110 | 93 | 109 | 101 | 101 | – |
| Female | 108 | 100 | 90 | 45 | 103 | – |
| Urban population (% of total population) | 23 | 20 | 28 | 36 | – | 21 |
| Expenditure on health and education | 48 | 3.8 | 3.8 | 3.6 | – | – |
| Per capita expenditure on defense (US\$, 1997 prices) | 31.0 | 5.0 | 14.0 | 28.0 | – | – |

Notes: Most recent estimate (latest year available, 1992-98) for indicators 5-12.

Sources: Gunatilaka (2000) and World Bank (2000).

In Sri Lankan policy, it has always been a tradition to put efforts to reduce poverty on top of the government agenda. It was one of the first developing countries, by accident or by choice, to understand the multidimensional nature of poverty, and strongly emphasized policies of free health and education as early as the 1930s. In addition to its achievements in social indicators, Sri Lanka managed to completely eradicate starvation and destitution. Despite these achievements, between one fifth and one third of the population remains poor depending on the poverty line used (Table 2). A much deeper reduction in poverty would have been possible with stronger economic performance.

Table 2. Consumption Poverty in Sri Lanka by Sector (1985/86, 1990/91 and 1995/96)

| | Incidence of Poverty (percent) | | | | | |
|---------------|--------------------------------|---------|---------|---------------------|---------|---------|
| | Lower Poverty Line | | | Higher Poverty Line | | |
| | 1985/86 | 1990/91 | 1995/96 | 1985/86 | 1990/91 | 1995/96 |
| Sri Lanka | 27 | 22 | 21 | 41 | 35 | 33 |
| Rural Sector | 32 | 24 | 23 | 45 | 38 | 35 |
| Urban Sector | 16 | 18 | 12 | 27 | 28 | 21 |
| Estate Sector | 14 | 13 | 12 | 31 | 28 | 27 |
| | Depth of Poverty (percent) | | | | | |
| | Lower Poverty Line | | | Higher Poverty Line | | |
| | 1985/86 | 1990/91 | 1995/96 | 1985/86 | 1990/91 | 1995/96 |
| Sri Lanka | 7 | 5 | 4 | 11 | 9 | 8 |
| Rural Sector | 8 | 5 | 5 | 13 | 10 | 9 |
| Urban Sector | 3 | 4 | 2 | 7 | 7 | 5 |
| Estate Sector | 4 | 2 | 2 | 8 | 5 | 5 |

Notes: Estimates based on consumption needs. Lower poverty line denotes minimum expenditure necessary to reach minimum nutrition requirements and minimum level of clothing, footwear and nutrition. This was calculated as Rs.471.20 per person per month in 1985/86 and 1990/91 at 1990-91 Sri Lanka prices, and Rs.717.09 per person per month in 1995/96. Higher poverty line denotes minimum consumption necessary to achieve a decent standard of living and includes a small amount of discretionary expenditure over essentials such as food, clothing, housing, transport, communications, and health expenses. The higher poverty line was Rs.565.44 per person per month in 1985/86 and 1990/91 and Rs.860.51 per person per month in 1995/96.

Sources: Gunatilaka (2000). All estimates based on data for the first quarter from the Household Income and Expenditure Surveys of 1985/86 and 1995/96.

One reason for the lack of good economic performance was the social welfare programs themselves creating problems for economic management. Sri Lanka went through all three stages of demographic transition in a relatively short period of 50-70 years, thanks to the social welfare programs. The second stage of demographic transition led to a population explosion that the economic growth process simply could not accommodate and cater to (Sanderatne 2000). For

example, the population below 20 years comprised 50 percent of the population in the early 1970s, and the prevailing economic growth could not offer employment opportunities to these youth, resulting in sociopolitical disruptions. Some Asian countries too faced such demographic transitions but of a different nature (ADB 1997).

After experimenting with an inward-looking strategy for nearly two decades, Sri Lanka embarked on an economic liberalization exercise in 1977. The historical bias in policy that favored social infrastructure at the expense of physical infrastructure underwent a change. There was also a shift in emphasis from universal food subsidies to targeted income transfer programs and interventions aimed at assisting the poor to participate in the growth process. Since the mid-1980s, the relationships between the overall economic performance and reduction of poverty have preoccupied policymakers. And since the late-1990s rural poverty alleviation has become a major plank in Sri Lanka's development policy framework.

II. Poverty Profile of Sri Lanka

People fall below the poverty line because stocks of productive assets owned by them, given the prevailing returns to the assets and the availability and cost of publicly provided goods and services, are insufficient to enable them to attain a minimum acceptable standard of living. Thus it is essential to have a broad look at several areas that influence poverty directly as well as indirectly. As stated, Sri Lanka has been experiencing a tragic war in the North-East provinces for the past 17 years, so much so that its defense per capita expenditure is now higher than its neighboring countries (Table 1). Due to the disruption created by the war, the data from these two provinces are highly questionable. Thus, the rest of the paper excludes these two provinces in the analysis.

Although poverty in Sri Lanka has been subject to debate for many years, there is no clearly defined poverty line. There is no officially designated poverty line, which is applicable across all sectors (see, for instance, Tudawe 2000). This is a major problem in obtaining information on changes in poverty status in the country (Dutt and Gunawardena 1995).

Poverty is observed to be greatest in the rural sector and the least in the estate sector, with the urban sector in the intermediate position in the early 1990s but equalling the position of the estate sector in the mid-1990s (according to the lower poverty line; Table 2). The shares of the rural, urban,

and estate sectors in total number of poor are 79, 17, and 4 percent respectively, compared with their respective population shares of 72, 21, and 7 percent (Dutt & Gunawardena 1997). The rural sector accounts for approximately four fifths of aggregate poverty. Rural poverty appears to have declined much more slowly than urban poverty during the early 1990s to mid-1990s (Table 2). According to Dutt & Gunawardena (1997) this proportion is largely invariant over different poverty measures and poverty lines. A little less than half the poor depend on agriculture for their livelihood, while another 30 percent depend on other rural nonagriculture activity.

Within a region, rural poverty is generally higher than urban poverty. Over the late 1980s, there has been a considerable narrowing of rural–urban poverty differentials within regions. Sri Lankan poverty varies on the basis of regions: Western vs. other provinces (Table 3); sectors: urban vs. rural (Table 2); agriculture vs. nonagriculture, etc. Regional disparity, particularly between the economically dynamic Western province and the rest (Table 4), and between urban sectors and rural sectors continue to concern policy makers (Gunatilaka 2000).

Table 3. GDP Growth and Poverty Incidence by Region

| Province | Annual Average Growth, 1990-95 (%) | Growth Ranking | Poverty Incidence (%) | | Poverty Ranking | |
|---------------|------------------------------------|----------------|-----------------------|---------|-----------------|---------|
| | | | 1990/91 | 1995/96 | 1990/91 | 1995/96 |
| North Central | 9.9 | 1 | 18.2 | 31.2 | 3 | 4 |
| Western | 6.4 | 2 | 15.2 | 13.6 | 1 | 1 |
| Southern | 6.1 | 3 | 23.7 | 26.5 | 6 | 2 |
| Sabaragamuwa | 5.3 | 4 | 23.1 | 31.6 | 4 | 5 |
| Central | 5.0 | 5 | 23.5 | 27.9 | 5 | 3 |
| Eastern | 5.0 | 5 | N/A | N/A | N/A | N/A |
| North Western | 4.3 | 6 | 18.0 | 33.9 | 2 | 6 |
| Uva | 3.5 | 7 | 23.7 | 37.0 | 7 | 7 |
| Northern | -6.2 | 8 | N/A | N/A | N/A | N/A |

Source: World Bank (2000).

Despite reducing poverty from 27 percent in the mid-1980s to 21 percent of population by the mid-1990s, the experience during 1990-1995 has not been very impressive. As Table 2 shows, poverty declined very little between 1990/91 and 1995/96 from 22 to 21 percent of the population. Some have argued that the year 1995/1996 should be excluded from poverty trend analysis in Sri Lanka because it happens to be a drought year. However, the slow progress in consumption-poverty

reduction was striking in the backdrop of relatively faster GDP growth (average 5 percent) during the first half of the 1990s.

Per capita GDP growth was in the order of 3.0 percent per annum during this period between 1990 and 1995/96. According to various surveys many of the poor experienced an increase in poverty. The slow decline in poverty during 1990/91-1995/96 is puzzling in the light of the above facts: (a) economic growth recorded an average 5 percent; (b) unemployment declined from 17 percent in 1990 to 11 percent in 1996; (c) private remittances doubled; and (d) expenditure on education and health was maintained despite escalation of defence expenditure.

What explains the modest decline in poverty? Poverty is highest (32 percent) in households that derive their income from agriculture. 38 percent of the Sri Lankan labor force is still engaged in the agriculture sector. Slow growth in agriculture was perhaps the main factor of slow poverty reduction during 1990-1996. Agriculture grew only by 1 percent during 1990-1996. The restructuring of estates in the early stages of privatization, low paddy production, etc., contributed to the poverty in estates and rural areas. Availability of two data points call for caution in interpreting the trends. Even so, the slow decline in poverty during the first five years of the 1990s shows that the poor remain highly vulnerable to income shocks and are unable to take advantage of the opportunities generated by high growth in the early 1990s.

Favourable impact of economic growth on consumption-poverty may be reduced if there is contemporaneous increase in income inequality. Some rise in inequality in the process of rapid economic growth is, however, unavoidable, as the classic Kuznets income-inequality relationship would imply (inverted-U hypothesis). A sharp rise in inequality in the early eighties is thus understandable in the context of rapid economic growth and structural change (Kelegama, 1993 and Table 5). However, the Sri Lankan experience in the backdrop of 5 percent average growth during the 1990s shows little decline in inequality. Note that the Gini index of income (expenditure) distribution as a measure of relative income (expenditure) inequality did not vary much (Table 6). Sri Lanka has not achieved high growth rates like China to compensate for the increase in income inequality. Also as Ravallion (1997) has argued initial inequality matters and this could dampen the impact of economic growth on poverty alleviation.

Table 4. Income and Human Poverty by Province (percentage of population)

| | Population 1994 (millions) | Population Density per sq. km (1991) ^b | Income poverty incidence | Deaths before age 40 | Adult Illiteracy | No access to safe water | Children not fully immunized | Births not in Institutions | No access to electricity | No access to safe sanitation | No Access to Hygienic Toilet Facilities (1994) | Road Density (km/1000 population) Rural Roads (1995) ^g |
|---------------|----------------------------------|--|--------------------------------|----------------------------|---------------------|----------------------------------|------------------------------------|----------------------------------|-----------------------------|------------------------------------|---|---|
| Western | 4.7 | 1174 | 13.6 | 0.09 | 6.2 | 18.2 | 14.4 | 3.0 | 35.3 | 11.2 | 19 | 1.89 |
| Central | 3.9 | 385 | 27.9 | 0.10 | 15.3 | 26.1 | 13.8 | 21.5 | 65.0 | 24.4 | 40 | 3.60 |
| Southern | 2.6 | 389 | 26.5 | 0.07 | 11.2 | 35.0 | 10.4 | 8.6 | 59.2 | 20.3 | 37 | 2.50 |
| N. Western | 2.0 | 51 | 33.9 | 0.09 | 8.1 | 34.6 | 3.8 | 12.8 | 68.7 | 30.3 | 42 | 5.80 |
| N. Central | 1.3 | 94 | 31.2 | 0.15 | 9.6 | 48.0 | 2.1 | 20.0 | 72.2 | 31.7 | 56 | 8.84 |
| Uva | 1.0 | 122 | 37.0 | 0.10 | 17.1 | 44.6 | 12.3 | 36.1 | 73.5 | 34.1 | 57 | 4.58 |
| Sabara-gamuwa | 1.1 | 332 | 31.6 | 0.07 | 11.2 | 32.1 | 12.0 | 16.9 | 74.4 | 22.7 | 57 | 3.58 |

Sources: World Bank (2000) and Gunatilaka (2000).

Table 5. **Income Shares Spending Units**

| Category | 1978-79 | 1981-82 | 1986-87 | 1996-97 |
|-----------|---------|---------|---------|---------|
| Bottom 40 | 16.6 | 15.2 | 14.1 | 14.6 |
| Top 20 | 48.9 | 52.0 | 52.3 | 51.6 |

Source: Based on Dunham and Jayasuriya (1998).

Table 6. **Gini Coefficient**

| | 1953 | 1963 | 1973 | 1978/79 | 1981/86 | 1986/87 | 1996/97* |
|------------------|------|------|------|---------|---------|---------|----------|
| Income Receivers | 0.50 | 0.49 | 0.41 | 0.50 | 0.52 | 0.52 | 0.50 |
| Spending Units | 0.46 | 0.45 | 0.35 | 0.44 | 0.45 | 0.46 | 0.45 |

Preliminary Estimates (Round 1)

Source: Central Bank of Sri Lanka, Consumer Finances and Socio-Economic Surveys.

To summarize, first, consumption poverty remains high in Sri Lanka and it is primarily a rural phenomenon. Second, there has been slow progress in poverty reduction in the first half of the 1990s and also greater volatility in poverty levels. Third, there are acute regional disparities in poverty.

III. Poverty Strategy in Sri Lanka

A. Poverty Alleviation Program – SAMURDHI

The food subsidy program centered on free or concessional rice and applied universally across the population was the main poverty support system in Sri Lanka until 1977. This program was dismantled and a targeted food stamp program was introduced in the late 1970s. However, this program suffered from various shortcomings (Herse et al. 1989) and there were indications of poverty increasing and income inequality worsening by the mid-1980s (UNICEF 1985). A High Level Poverty Committee that was appointed in 1988 made several recommendations to arrest the situation. Consequent to this report a targeted safety net program called Janasaviya came into operation. It was an income-transfer program that was designed to supplement the growth process (Lakshman 1997). The program also had a credit-based entrepreneurial development dimension (see World Bank 1995). There were various add-ons such as the free mid-day meal program, free school textbooks, etc., that complemented the Janasaviya program (see Table 7).

Table 7. **Welfare and Social Infrastructure Expenditures (SL Rs. Million)**

| Type of Program | 1996 (Actual) | 1997 (Provisional) |
|--|------------------|-----------------------|
| Poverty-focused Programs | | |
| 1. Samurdhi | 7,340 | 9,040 |
| 2. NDTF | 510 | 250 |
| 3. IRDP | 1,092 | 1,375 |
| 4. Public Assistance (widows, orphans, etc.) | 240 | 240 |
| 5. Food Stamps | 831 | 0 |
| 6. Kerosene Stamps | 228 | 0 |
| 7. Infant Milk Subsidy | 70 | 132 |
| 8. Triposha | 250 | 264 |
| 9. Mid-day Meals (school children) | 0 | 0 |
| 10. School Textbooks & Season Tickets | 816 | 950 |
| 11. School Uniforms | 1,157 | 1,100 |
| 12. Emergency Food (refugees) | 3,185 | 3,077 |
| Other Programs | | |
| 13. Wheat Flour Subsidy | 7,500 | 0 |
| 14. Fertilizer Subsidy | 1,500 | 1,500 |
| 15. Public Health Service | 12,028 | 16,338 |
| 16. Public Education Services | 15,911 | 17,959 |
| Poverty-focused Programs and Transfers as % of GDP (items 1-12) | 2.0 | 1.9 |
| Poverty-focused Plus other Social Welfare Expenditures as % of GDP (items 1-16) | 6.9 | 5.9 |

Source: Central Bank of Sri Lanka.

In 1995 a more ambitious program called Samurdhi replaced the Janasaviya program. There were a number of differences between the two programs as to coverage (see Dissanayake 1995). The program is basically an income transfer to the poor to get out of the poverty trap. It covers 55 percent of the population by targeting 2 million households. The allocation for the program (1998) amounted to 1.3 percent of GDP and 3.6 percent of government expenditure. As can be seen in Table 7 the poverty-focused programs accounted for nearly 2 percent of GDP in 1997.

The Samurdhi program has three components. The first is a welfare grant to purchase essential commodities of poor households that acts both as a consumption subsidy and a nutrition

supplement. In 1998, 80 percent of the Samurdhi expenditure was allocated for this grant. The grant amounts to Rs. 100-1000 (US\$1.20-11.80) per household per month depending on its level of poverty and demographic composition.

The second component is the savings, credit, insurance, and social security schemes that improve access to finance for households. The credit is used for microenterprise launch and income-generating activities. It is basically intended to expand the productive assets available to the poor. The credit is obtained from Samurdhi Banks and Samurdhi Bank Societies holding deposits of Rs. 400 million (US\$4.7M) and Rs. 230 million (US\$2.7M) respectively.

The third component is a community infrastructure development program where irrigation, roads, and water supply projects, among others, are undertaken by the community. Some 11,000 such projects have been implemented at the cost of Rs. 560 million (US\$6.6M) and generated nearly 37,000 jobs for youth. This increases incomes among households and reduces political unrest.

The Samurdhi program is overlooked at the grassroots level by 36,000 Samurdhi animators working under 1,500 Samurdhi managers. The administration cost was 10 percent of the Samurdhi budget in 1998.

B. Employment Creation and the Labor Market

In general, the strategy for poverty reduction is equated by such institutions as the World Bank with employment generation and the economic growth process. The general consensus is that to absorb the annual addition of about 160,000 to the labor force, the economy should grow by at least 8 percent. The economy has grown at an average rate of 5 percent during the 1990s and is therefore not in a position to absorb all the labor that enters the market. Overseas migration and self-employment have been two major sources of employment generation and this has helped to decrease unemployment from about 16 percent in 1990 to 11 percent in 1999.

The usual link between poverty and unemployment exists in Sri Lanka (Dutt and Gunawardena 1995). The unemployment rate declined from about 25 percent for the poorest group (below 80 percent of poverty line) to 5.5 percent for the richest (above 400 percent of the poverty line) (World Bank 1995, 27). But the link is not obvious and there are unemployed who are not necessarily poor, while there are employed who are poor (ADB 1998, 23). Unemployment is to be found sometimes with the better educated and the less poor, mainly in the rural areas. Female

unemployment continues to be twice the male rate and there has been an increase in the number of women involved in unpaid work.

The 5 percent growth rate could have absorbed more labor if not for structural problems in the economic system. Based on structural factors, there are three explanations that have been provided to explain the unemployment problem in Sri Lanka, namely, “skills mismatch” hypothesis, queuing hypothesis, and labor market rigidities hypothesis. The “skills mismatch” hypothesis argues that Sri Lanka’s education system produces skills that are not valued by employers, while raising the expectations of those who acquire them. As a result, the unemployed are not interested in existing job vacancies, and employers are not willing to fill them with available candidates. Thus it is suggested that there should be educational reform with emphasis on vocational training geared to the needs of the labor market.

The queuing hypothesis is linked to public sector employment and pay policies. At the lower level of the public sector in Sri Lanka, payments and fringe benefits are higher than in the private sector. Hence, new entrants to the labor market have an incentive to wait for such attractive job openings in the public sector, with the majority choosing to remain inactive instead of taking available jobs outside the public sector. Since the government recruits people to the public sector to reduce unemployment, job seekers wait for their opportunity. The waiting period is facilitated by remittances and income transfers to rural households. It is suggested that the public sector recruitment and pay policies should be reformed to discourage “queuing”.

Rigidities in the labor market have prevented the poor from reaping the benefits of the economic growth process. In other words, the rigid laws governing the labor market have been identified as an impediment to employment creation. It is argued that due to these laws, low-quality jobs are created because there is evidence that casual labor, subcontracting, fixed period consultancies, etc., are on the increase (CBSL 1999). Furthermore, it is argued that these laws discourage firms from restructuring and future expansion. Many youth employed in the informal sector look for jobs in the formal sector. It is suggested that less rigid labor legislation will facilitate labor mobility and reduce the wedge between protected and unprotected jobs.

The government acknowledges that to reduce the unemployment rate significantly there is a need to create good jobs (such as those in the regulated sector) faster than the labor force grows, by

improving the flexibility of the labor market. However political economy considerations go hand-in-hand with such good intentions, thus diluting any reform efforts (Section 5).

C. Irrigation and Land Settlement Policies

Since Independence in 1948, these two areas were used for poverty alleviation purposes. Due to historical reasons land settlement schemes centered on irrigation schemes were regarded as the best way to restore the country's past prosperity.

The poor living in rural agricultural areas face scarcity of land, small size of land holdings, and lack of adequate water. Since Independence, various governments have designed policies to make available fresh land for cultivation and to assist farmers to settle in new, cultivable areas. Irrigation and land settlement policies may have contributed to poverty alleviation among the rural agrarian poor (Sanderatne 2000). The land:man ratio worsened despite forest cover in the country declining significantly since Independence. The agricultural land per family fell to 1.9 acres in 1982. The Accelerated Mahaweli Development Program enabled this ratio to be slightly increased to assist the poor.

The shortage of new land has had an adverse impact on poverty in the rural sector, with the average land holding falling below commercially viable levels. Roughly 67 percent of land holdings in Sri Lanka are less than 2 hectares. As the size of agriculture plots decrease rural farmers become more risk-averse, relying more on low-risk, low-yield crops such as paddy. Lately, many rural households have increasingly become more dependent on transfers and remittances from family members working in urban areas or abroad.

Land distributed by the government under various protected tenure arrangements such as land settlement schemes, colonization schemes, and village expansion schemes do not contain free-hold rights. Free-hold rights were not granted on the thinking that if granted free-hold, indebted farmers may sell the land and such sales of land could increase landlessness and poverty. This policy encourages rural small-holder agriculture and restricts transfer of cultivable land. The World Bank (1995) argues that lack of free-hold decreases investment efforts by farmers as they do not fully own the properties, and it intensifies uneconomical land fragmentation by preventing farmers from selling their land and moving to other activities. The pros and cons of these arguments are currently being analyzed by the government.

D. Social Welfare Expenditure

After liberalization in 1977, expenditure on all social services as a percentage of GDP fell from 9 percent during 1970-1977 to 5.5 percent during 1981-1985 and remained at 6 percent of GDP during 1986-1990 (Table 8). This reduction in overall expenditure in social welfare was reflected in the performance quality of both the health and education sectors. In the 1990s there was once again an increase in social welfare expenditure to 9.3 percent of GDP (1991-1995 average). World Bank (1995, 27) estimates that health and personal care account for 3 percent of total expenditure of the poor while education accounts for a little over 1 percent.

(i) Public Expenditure on Health

As Table 8 indicates, total expenditure on health declined from 1.5 percent of GDP during 1971-1975 to around 1 percent of GDP during 1981-1985 but remained around 1.5 percent of GDP from 1986-1995. In the late 1990s public expenditure on health remained at 1.5 percent of GDP and 5.7 percent of total government expenditure.

Table 8. Social Development Expenditure in Five-Year Periods as Percent of GDP

| | 1951 to 1955 | 1956 to 1960 | 1961 to 1965 | 1966 to 1970 | 1971 to 1975 | 1976 to 1980 | 1981 to 1985 | 1986 to 1990 | 1991 to 1995 |
|--------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Social Development Expenditure | 7.1 | 8.1 | 10.5 | 9.0 | 9.9 | 9.1 | 5.5 | 6.0 | 9.3 |
| Food Security | 2.4 | 2.1 | 3.7 | 2.7 | 4.3 | 3.4 | 0.2 | 1.1 | 0.9 |
| Education | NS | 3.3 | 4.0 | 3.6 | 2.9 | 2.3 | 1.9 | 2.6 | 2.8 |
| Health | NA | 2.0 | 2.0 | 1.8 | 1.5 | 1.2 | 1.0 | 1.6 | 1.5 |
| Other Social Services | 0 | 0 | 0.1 | 0.2 | 0.2 | 0.2 | 0.1 | 1.9 | 4.1 |

Source: Central Bank Annual Reports, 1950-1995.

Approximately 3 million in-patient days and 35 million out-patient visits a year are served by 550 government hospitals with 55,000 beds and 380 central dispensaries in the country. As is well-known, the Sri Lankan government offers universal free health care, which has made a significant contribution to improving health among the poor. However, the overall health environment in the country is relatively weak. The prevalence of malnutrition, lack of access to safe water, poor sanitary conditions, and disease outbreak are common (see Table 4). Although the number of nurses

increased from 9,000 in 1991 to 16,699 in 1997 and doctors from 2,900 to 5,300 during the same period, there are problems of quality—there is a shortage of qualified medical specialists and trained nurses. In rural areas where a high proportion of the poor live, the scarcity is felt more. Moreover, there is congestion in government hospitals and standards of hygiene are low and maintenance of facilities is poor.

Only 30 percent of government health expenditure reach the poorest 20 percent (Rannan-Eliya and De Mel 1997). Sri Lanka's health sector needs qualitative improvement. Environmental health also needs improvement. There is a chance to improve the quality of Sri Lankan health services as explained later in the text.

(ii) Public Expenditure on Education

As Table 8 indicates, expenditure on education, which declined from 2.9 percent of GDP during 1970-1975 to 1.9 percent during 1981-1985, once again increased to 2.8 percent during 1990-1995.

Primary education is offered free. Every village in the country has at least a primary school. Total enrolment in education was 4.1 million of whom 50 percent were females. It has been estimated that the poor attain approximately seven years of education (Dutt & Gunawardena 1995). The government makes special effort to attract poor children to schools by offering free school textbooks and uniforms (each child is entitled to one set of uniforms a year). The long-term impact of investment on education on poverty reduction depends on its effectiveness on enhancing human capital formation and labor productivity. Here again, the low quality of education has nullified the efficiency impact of educational investment. Rates of return at the primary-end of education is low (Athurupana 1997).

Overall government expenditure on education has made an important contribution to enhancing welfare. However, the quality of education is questionable. Athurupana (1997) shows that there is a willingness to pay for high-quality education. But for quite sometime the government has not provided a favorable environment to the establishment of new private schools and universities. However, there seems to be a revision of this attitude in 2000 when there were attempts to relax regulations in regard to private sector participation in the education sector (*Sunday Leader* 20 January 2001).

IV. Problems in the Poverty Strategy

Several studies have shown that the rate of rural poverty reduction is strongly influenced by the rate of agricultural growth. There has been a general decline in agriculture growth in Sri Lanka. The slow growth was coupled with a decline in real wages in the agriculture sector. According to Dunham & Edwards (1997) the poverty situation in rural areas would have been further aggravated if not for the following income transfers to the rural areas: (i) transfer of remittances from Middle East migrants, (ii) income transfers from armed forces engaged in the North and East of Sri Lanka, and (iii) income transfers from rural young females employed in the garment factories located mainly in the Western province. The average per capita inflows of remittances and transfers as a percentage of the World Bank Poverty Line has increased from 31 percent in 1985 to 65 percent in 1997 (Dunham and Jayasuriya 1998). All these incomes are somewhat unstable. This has become a concern for policymakers particularly when there is stagnation in the agriculture sector.

The problem of poverty in Sri Lanka is thus multidimensional. The problems in the existing strategies are identified and discussed below.

A. Politicization of Targeted Poverty Programs

All poverty alleviation programs put into operation by the state since 1989 become highly politicized at the implementation stage. This politicization has resulted in two flaws in the programs that in turn have curbed their effectiveness. These are political bias governing the program and poor allocative efficiency of the poverty program (World Bank 2000).

Genuine poverty alleviation programs have been diluted into vehicles of political patronage at the grassroots level. The current poverty alleviation program (Samurdhi) has utilized an extensive network of administrators for identifying beneficiaries and this process has had a political dimension. The Samurdhi program has a network of 20,000 Samurdhi Development Officers and 10,000 Govi Niyamakas in charge of identifying beneficiaries. Party affiliation influences the allocation of income transfers to the beneficiaries. All new evidence from international literature on poverty alleviation clearly shows that for poverty programs to be most effective in reaching the poor, the poor themselves should participate actively and freely in the political process.

Poor allocative efficiency is another problem. Several different classes of criteria are being used to target the poor. These are: (i) those based on indicators of household income; (ii) those

based on indicators derived from correlates of poverty (such as landlessness, lack of regular employment, poor nutrition, impermanent or semipermanent housing); (iii) special groups-based criteria (such as women headed or single-headed households); and (iv) criteria that are area- or region-based considering a geographic area's weak infrastructure facilities and large concentration of poor. These indications have been used either singly or in combination with each other to varying degrees of effectiveness in terms of the 'E' and 'F' errors that have occurred (Gunathilaka 1997, 15).

The Household Expenditure and Income Survey (HEIS) 1995/1996 shows that the transfer from poverty programs reached 66 percent of households in the poorest decile and 14 percent of households in the top three deciles. The Sri Lanka Integrated Survey reveals that only 60 percent of households in the lowest expenditure quintile receive Samurdhi transfers. Gunatilaka and Salih (1999) have argued that Samurdhi's group savings and intragroup credit component and the Samurdhi Bank program are functioning as vital sources of emergency credit for Samurdhi beneficiaries. However, program sustainability is heavily reliant on the income transfer component. They also find that the microenterprise credit component has failed in its objective of promoting the poor to a higher income growth path. The high rate of default makes the microenterprise development credit program completely unsustainable in the long run.

B. Problems of Rural Development Programs

The pattern of distribution of growth is crucial in fathoming whether economic growth translates into equivalent reduction in poverty (UNDP 1997). The regional imbalance in growth is also visible. Compared to the Western Province, the other provinces did not show any decline in poverty (Gunawardena 2000; see also Table 3). Current poverty analysis is looking into the role of several structural factors such as assets, human capital, credit and financial markets, existence of income earning opportunities, etc., which could explain persistent poverty in some regions (GOSL 2000). Preliminary surveys show that the regional imbalance in growth and poverty reduction are due to both the dependence on agriculture and the inadequate availability of infrastructure facilities in rural areas.

The promotion of off-farm employment for poverty reduction is also an issue in Sri Lanka. The current state of agricultural growth and the lack of technological modernization in the sector imply that the poor have to be absorbed by off-farm activities. The major impediment to creating off-farm

employment in rural areas is the lack of proper infrastructure. Some statistics to reveal this situation may prove useful. Only 44 percent of households had access to electricity in 1994, and in some areas only 30 percent benefited from it. Less than 15 percent of rural population have access to telecommunication services or subpost offices (GOSL 2000). Capital grants provided to the provinces for the purpose of alleviating regional disparities have remained at less than 0.2 percent of GDP over the years. This partly explains why growth has not trickled down to the countryside while urban poverty levels by contrast have fallen.

The question could be posed whether rural development programs could be effective in poverty alleviation. Take, for instance, IRDPs. Gunatilaka and Williams (1999) argue that these programs typically benefited the nonpoor who had other inputs such as irrigable land necessary to benefit from such projects. The study further shows that access to infrastructural facilities are most often denied due to the quasi-public nature of many of such assets. "Given the unequal power relations that typify rural communities, the local elite is usually well-placed to capture decision making about development projects, frequently working through decentralized structures of government themselves, and the poor are often unable to challenge the established social organization and hierarchy" (Gunatilaka 2000). Poverty alleviation strategies that try to encourage the development of microenterprises in rural areas may actually spawn only survival strategies as rural producers are unable to access larger, higher-income markets due to high transport costs (Gunatilaka and Williams 2000).

Under the 13th Amendment to the Sri Lankan Constitution in 1987, decentralization of finance was supposed to come into operation and poverty programs were supposed to be decentralized. But delivery of poverty programs remained under the Central government's control. Policymakers and donors have become increasingly convinced that local governments may be better able to develop rural areas, increase interregional equity, and reduce poverty. Reducing poverty through fiscal decentralization and thereby promoting rural infrastructure development and other development has received emphasis in recent years.

Gunatilaka (2000) argues that local governments providing efficient public services depends on both their capacities and the extent to which they are accountable and transparent in their activities. Whether financial resources really reach or benefit the poor depends on factors such as the initial

endowment of complementary resources among the poor themselves, the quasipublic nature of assets, and the ability of the nonpoor to capture the decision making process.

Gunatilaka (2000) also argues that rural development policies, with or without fiscal decentralization, can reduce rural poverty and urban–rural differences only marginally, when implemented alongside macroeconomic policies that favor the dynamic forces of urban agglomeration. Contrary to conventional wisdom rural poverty reduction may actually need policies that favor planned urbanization in line with centripetal forces, and higher rates of rural–urban migration that eases the pressure on agricultural holdings, making them more viable for those who remain in rural areas. Rural development paradigm as currently conceived is fundamentally flawed.

Agglomeration forces unleashed by economic liberalization policies alongside equity-oriented rural development policies may have reinforced urban–rural differentials in Sri Lanka, perpetuated dualism, encouraged low agricultural productivity, and helped transform the rural economy into a remittance and transfer economy. This happens even when the overall policy framework does not contain an overt urban bias, and may in fact be tilted favorably toward the rural sector.

C. Social Sector and Poverty

Poverty in Sri Lanka is highly correlated with levels of human development that reflects gaps in the provision of publicly provided goods and services. HEIS 1995/1996 shows that the poverty incidence by education level of household head is highest among those with no schooling (38 percent) and only with primary schooling (34 percent). Similarly from a health perspective, in both rural and estate sectors, malnutrition reflected in low birth weights, stunting, wasting, and anemia is high. The poor suffer from low-quality social services, with disparities especially prominent in rural and estate areas where health, education, housing, safe water, and sanitation services are far below the national average.

The on-going war in Sri Lanka and the high defense expenditure has prevented the government from allocating more funds for health and education expenditure for the purpose of improving quality. However, irrespective of the war expenditures, Sri Lanka has now got an opportunity to improve the quality of both health and education due to the rapid demographic transition that has taken place. The proportion of children in the population has rapidly declined in the late-1990s due to low population growth combined with effective family planning.

Since the proportion of children in the population is declining there is less need to increase the number of schools and teachers, and less need for expanding pre-and post-natal health services in the country. This has provided an opportunity to improve both the quality of education services and health services. This opportunity has to be grabbed now because after 2006 the reduction in the child dependency ratio would be gradually offset by an increase in old age dependency. Beyond 2036 the advantage would be completely offset by the increase in old age dependants (Sanderatne 2000).

The danger however is that a government faced with fiscal difficulties may use the opportunity to reduce expenditure on education and health. This should be avoided and both education and health planning should be geared to qualitative improvement taking into account the demographic changes.

D. Unemployment and the Labor Market

The World Bank (1998) took a fresh look at the three main hypotheses in regard to explaining the unemployment situation in the country and highlighted the shortcomings of the above explanations. Basically, the study finds little evidence for the skills mismatch hypothesis and finds evidence for both the queuing and the labor market legislative framework hypotheses. Thus the suggested solution is reform in public sector recruitment strategy and labor market liberalization.

The need for labor market reform is accepted, but little political consensus exists for increasing employment flexibility or eliminating expectations that the government will somehow create large numbers of positions in the civil service for educated youth. Given the sociopolitical set-up in Sri Lanka, governments regularly resorting to ad hoc creation of jobs in the public sector to satisfy the educated youth is quite understandable particularly when private sector expansion is inadequate due to the uncertainty created by the war. It is not practical in a highly politicized economy such as Sri Lanka to wait till the private sector generates employment.

The direct effect of labor legislation on poverty among employed workers can be favorable because of minimum wage stipulations by the Wages Boards, and the Employees' Provident Fund and Employees' Trust Fund guaranteeing retirement funds. The sharp decline in poverty in the estate sector during 1985/1986 and 1990/1991 can be attributed inter alia to the application of minimum wage regulations through organized union activity.

The total employed labor force was estimated at 5.3 million in 1994. The number employed by the formal sector covered by labor laws was estimated to be 2.9 million (1.6 million in the private sector and 1.3 million in government institutions). Thus, labor laws do not cover 45 percent of the employed labor force. Evasion of labor laws is also on the increase (CBSL 1999). To the extent that coverage by labor legislation is reduced by these factors the positive impact on poverty reduction is reduced.

The net impact of relaxation of labor laws on poverty depends on the extent to which flexibility in the labor market is translated into economic growth, and the strength of the trickle-down mechanism to the poor, in comparison to potential loss of worker welfare due to weakening of employee protection in the formal sector. The Sri Lankan government is of the view that labor market reform would be easy when the economy is growing fast. However, due to the war Sri Lanka has not been able to achieve high growth rates.

E. Vulnerability of the Poor

HEIS 1995/1996 data shows the significant effect of fluctuating income growth on poverty trends. A significant proportion of the population is clustered around the poverty line and is vulnerable to small changes in income. This is reflected by the fact that a 20 percent increase in the income poverty line raised the incidence of poverty in 1995/1996 from 25 percent to 39 percent. Such rise in the poverty line represents only a slight increase in consumption expenditure. The World Bank (2000) argues, "insufficient mechanism for risk management in agriculture, the large increase in casual and temporary employment in recent years, the poor targeting of beneficiaries through poverty programs contribute to the vulnerability and insecurity of Sri Lanka's poor". It could also be due to the high dependence of remittances by rural households in recent years.

Increasingly, aid donors have highlighted the politicization of the poverty strategy in the context of the broader issue of "good governance". Over the last two to three years, the government has made an effort to understand the nature of poverty in order to formulate an effective policy framework for poverty reduction. This framework was presented to the aid donors meeting in Paris in December 2000 and the government was commended for its efforts for preparing the document.

V. Conclusion

Since the mid-1980s there has been a decline in poverty in Sri Lanka. Economic growth that averaged about 5 percent during 1985-2000 has certainly contributed to reducing poverty. Simulation studies on the impact of growth on future poverty alleviation (assuming that relative inequalities remain unchanged at the observed 1990/1991 levels) have estimated that a 2 percent annual rate of growth of real consumption per capita would, by the turn of the century, reduce the proportion of ultrapoor from 22 to 12 percent, and the proportion of poor from 35 to 21 percent.

Economic growth of 5 percent annually has not been broad-based enough to realize a breakthrough in poverty reduction. In other words, economic growth has not automatically trickled down to the poor. Links between growth and poverty reduction is weak in some provinces of the country, calling for new policy measures to maintain outreach to the poor.

Liberalization of the factor markets needs serious attention. Market liberalization has not gone far enough in the labor and land market due to political economy factors. The rigidities in the land market have acted as a constraint to agricultural growth while rigidities in the labor market have reduced the labor absorption capacity of the economy. Gradual liberalization could somewhat offset high short-run adjustment costs. A start has to be made while promoting dialogue with the stakeholders.

While liberalization is essential for growth it will underuse the resources of the poor if their specific problems are not addressed directly. Sri Lanka recognized this long before many other developing countries, but the existing programs for directly addressing the problems of the poor suffer from various deficiencies. Specific poverty policies need fine-tuning to meet the current issues. The problem of targeting Samurdhi recipients has received attention in the Poverty Framework document of the government: "The use of categorical measures of impoverishment should be used to determine eligibility instead of an income-based criteria" (GOSL 2000, 53). In some regions the combination of private remittances and Samurdhi payments has raised the reservation wage and discouraged the poor from seeking employment. The report argues for exit procedures and incentives for households to graduate from Samurdhi and prevent welfare dependency.

Both the education and health sectors require urgent reform. Notwithstanding the comparative edge that Sri Lanka commands over other developing countries in these two areas, the performance record in the two areas during the last two decades has not improved in consonance with earlier achievements, especially when taking into account the quality of services provided and new indicators of sector performance. This is mainly due to the slow adjustment of policies to the emerging needs of society and an open economy. For example, the existing financial and managerial systems for the health and education sectors established over the years are no longer adequate to meet the new challenges. It is commendable that the government has recently begun to address some of these issues (GOSL 2000).

It was also shown that the poor are very vulnerable to income fluctuations. This is an area that has received increased attention in the *World Development Report 2000/2001*. One reason for this is that growth-promoting policies have been implemented unevenly with insufficient emphasis on structural reforms in the area of agriculture. All these problems have been viewed from a holistic perspective in the new Poverty Framework paper. The government is geared to address these issues. In its Vision for the 21st Century the government has spelled out its aim to raising the income levels of the poorest 8 million by increasing their share of income from the current 4 percent to 15 percent by 2010.

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