

Sri Lanka

Status Index (Democracy: 6,00 / Market economy: 7.25) 6.63		Management Index 5.32	
HDI	0.751	Population	20.4 Mio.
GDP p. c. (\$, PPP)	3,778	Population growth¹	1.3%
Unemployment rate	9.2	Women in Parliament	4.9%
UN-Education Index	0.83	Poverty²	7.6%
		Gini-Index	33.2
Source: UNDP: Human Development Report 2005. Figures for 2003 – if not indicated otherwise. ¹ Annual growth between 1975 and 2003. ² Population living below \$ 1 (1990-2003).			

A. Executive summary

Sri Lanka is a country whose democratic heritage has been wasted by chauvinist majoritarian policies, leading to the progressive discrimination of the Tamil minority, the dismantling of the secular state character, a full-fledged civil war from 1983 to 2002 and the widespread violation of human rights. The government is only slowly re-building the democratic fabric, by conceiving a federal solution to the ethnic conflict, calling for international mediation and safeguarding the cease-fire. To find a sustainable solution is difficult, due to coalition partners and powerful interest groups opposing a truly federal political set-up on the one side and the poor conciliatory and democratic credentials of its radical Tamil opponents on the other.

Thus, problems of stateness persist, the military has become independent to a certain degree, the monopoly of the state on the use of physical force is not assured in the Tamil areas, where rebels have installed a parallel administration. Political participation has always been remarkable in the country, and freedom of association is secured, although freedom of opinion is restrained by heavy political influence on the media. The separation of powers leaves much to be desired, as parliament has been partly deprived of its authority, the independence of the judiciary has been eroded and the introduction of a semi-presidential system has created two centres of political authority and legitimacy. Democratic institutions have nevertheless remained stable, supported by an equally stable, but fragmented and slightly polarized party system.

The economic record of the country is excellent, despite the recently concluded civil war. Rising exports, remittances and foreign direct investment allowed a narrowing of the balance of payments deficit and a moderate build-up of foreign exchange reserves. This is mainly a result of market-friendly policies, deregulation and a comparatively well-skilled workforce. There are some reform deficits with regard to the land and labor market and the privatization of remaining state enterprises. Foreign trade is nearly deregulated, the tax regime is

liberal, the authorities are pursuing sound macroeconomic policies and inflation rates have fallen markedly. The budget deficit remains however excessive and is due to untargeted subsidies, overstaffing in the public sector and high defense expenditures. Private property is well protected, except the agricultural sector. Social exclusion of women is non-existent, whereas poverty is still relatively widespread despite a whole gamut of (poorly targeted) anti-poverty programs.

The level of difficulty for political transformation is considerable, because quite a few veto players can and do obstruct the peace process and ethnic harmony. The steering capability of the government in economic matters has been remarkable, although recently there was a slight relapse into populist policies. The steering capacity in democratic and peace consolidation suffered from the veto power of important actors. This also made consensus-building rather difficult.

B. History and characteristics of transformation

Economic and political transformation in Sri Lanka happened at different times. General, free and fair elections were already introduced under colonial administration (from 1931 onwards), leaving Ceylon at independence (1948) as a democratic regime copying the British model and politicians socialized in this tradition. These politicians took care in the first years after independence to safeguard this heritage. They drafted a pluralist constitution protecting the minorities, educationally put into an advantage by the British. The Sinhalese majority was however soon mobilized by the opposition with the aim to revise the plural character of the state by introducing Sinhala as the only official language (1956), abolishing Christian (but not Buddhist) schools, elevating Buddhism to the rank of state religion (with the new constitution in 1971) and by impeding university access for Tamil students. This laid the basis for the radicalization of the Tamil youth and the civil war later.

The next constitution in 1977 (after the victory of the conservative UNP) brought the introduction of a semi-presidential system and limited decentralization. This could not stop the escalation of the “ethnic” conflict, which was first dealt with by special anti-terrorist laws and a massive military build-up against several militant Tamil organizations, later on by calling an Indian intervention force (1987) and the offer of a quasi-federal solution by way of the introduction of provincial councils. The democratic heritage was damaged during this period by the extra-constitutional extension of the sitting parliament, the more or less permanent invocation of the state of emergency, the arming of paramilitary forces to fight against the Tamil rebel forces and militant Sinhalese youth in the southern part of the country and the massive violations of civil rights.

Increasing war fatigue on both sides brought a first formal cease-fire under the new left government of the People’s Alliance in 1994. During the following years the government adopted a two-pronged strategy against the Tamil rebels by

offering a federal solution and simultaneously intensifying military pressure. The federal solution was frustrated by the Sinhalese opposition, the military solution by the fighting strength of the main rebel group Liberation Tigers of Tamil Eelam (LTTE). In 2001 a new cease-fire agreement was achieved by Norwegian intermediation, followed by several rounds of peace negotiations between government and LTTE. Slow implementation of the negotiation results by the government and different conceptions of an interim administration in the Tamil provinces led to the suspension of peace negotiations, rendered more difficult by the electoral advances of chauvinist parties in 2004.

Economically, the British left Sri Lanka with an efficient plantation economy, financing a system of free education and health care, but also with a stagnant agricultural and weakly diversified industrial sector. The government adopted a strategy of import substitution (financed by consumers and the plantation sector) and public sector companies. The results were mounting payment deficits, weak export and employment growth, fuelling the first youth rebellion of 1971. The election victory of the UNP in 1977 brought a first modest modification of that model: the rupee was devalued, exports were subsidized, free export zones created, price controls abolished and a massive debt creating public investment program was launched. Later on, in spite of the civil war and handover of government to the left parties, market-oriented reforms became more broad-based, by massive privatization, reform of the public sector and liberalization of trade and capital movements. Of late, a moderate return to a more people-oriented economic policy was announced.

Contrary to popular perceptions, Sri Lanka never followed a basic needs policy. Social programs were introduced early and did improve social indicators substantially to the level of some developed countries, but were never targeted at the poorest sections or concentrated on basic services.

C. Assessment

1. Democracy

1.1. Stateness

There are several problems of stateness in Sri Lanka: First regarding the question of national identification, a majority of Ceylon-Tamils would opt for independence, as long as substantial autonomy is not constitutionally provided. Practically, not all citizens enjoy equal civil rights, which are suspended against suspected terrorists and in military zones. There is secondly no clear separation of religion and politics as long as Buddhism remains state religion, monk orders and Buddhist universities are supported by the government (and allowed to obstruct the peace process). Although the constitution unequivocally establishes civil

control over the military, during the civil war and because of numerous exceptional laws, not to mention through the establishment of a special task force and militias, the military has gained extensive independence and has long promoted the militarization of the ethnic conflict. In addition, the establishment of private armies of politicians, acting as subsidiary agencies of crime prevention must be mentioned. Administrative efficiency is slowly improving; the public sector is however still massively overstaffed, thus acting as a labor market-buffer, recruitment follows a political and clientelistic logic, corruption is still widespread.

1.2. Political participation

Sri Lanka has always shown very high participation rates in elections (often above 80%) in spite of sometimes militant boycott initiatives by rebel organizations and decreasing violence during elections. There was a frequent change of government and elections were frequent; manipulation of election schedules and massive indoctrination through the state media are still common phenomena. Candidates of minority parties in the Tamil areas (sometimes also in the Sinhalese South) still run a considerable personal risk. Part of the press and the media is under state control. Critical journalism on government initiatives, human rights violations etc. are therefore rare. Quite often, journalism is subject to censorship, especially during periods of intensified fighting. In addition, attacks on foreign or critical journalists occur occasionally.

1.3. Rule of law

In relation to the separation of powers, Sri Lanka deteriorated in maintaining the rule of law in the late 1970s. The introduction of a semi-presidential system in 1977 led to the centralization of power in the executive, while parliament was degraded to a rubber-stamp institution and members of parliament were forced to underwrite undated letters of resignation. This tendency was reinforced by the fact that the president also acted as leader of the ruling party, which weakened during periods of cohabitation of dual offices (2001-2004). The division of powers is also restricted by the high number of ministers, making nearly every second member of parliament wearing two hats.

The independence of the judiciary eroded after the constitutional reform of 1977. For instance, a Supreme Court sentence declaring a law unconstitutional, can be overruled by a two-thirds majority in parliament. During this period, the Supreme Court was filled with adherents of the ruling party, with judges who pledged allegiance to the preceding constitution being forced to retire. Of late the court has once again become more proactive. The president is authorized to install special investigation commissions, whose recommendations cannot be questioned by the courts. Intimidation and transfers of judges have become routine procedures. The

level of corruption in Sri Lanka is moderate, but higher in government procurement and public transfer payments. Political interference in the working of the administration and in recruiting personnel is common. Respect for human rights did suffer a lot during the civil war. After 1983 the security forces were granted special powers and immunities, the Northern and Eastern part of the country were under near permanent emergency. In addition a Special Task Force (consisting to a great extent of unemployed and lowly disciplined youth) and home guards for the defense of Sinhalese settler colonies were established. In combination with the inevitable brutalization ensuing from civil wars, this explains the massive scale of human rights violations, torture and “disappearance” of suspected people. The activity of international human rights organizations was forestalled, and violations brought to the knowledge of national human rights commissions did not entail judicial sanctions for quite some time.

1.4. Stability of democratic institutions

Democratic institutions were more or less stable, leaving aside defects in the rule of law, the observance of human rights and election-related violence. As governments often only commanded a thin and unstable majority, they were not able to push through wide-ranging plans for bringing about peace and reducing interethnic tensions. Different views of the president and the prime minister regarding concessions toward Tamil militants during the period of cohabitation played an important role, becoming an additional obstruction to the resolution of the conflict. Nevertheless, democratic procedures are widely regarded as the only ones conferring legitimacy. They are not questioned by any major party or group, although sometimes subverted in practice. Voter participation is very high and voters do even accept risks to cast their votes.

1.5. Political and social integration

Sri Lanka possesses a relatively stable, but fragmented party system, where two major Sinhalese parties and their allies are the main blocks, completed by minor Tamil and Muslim parties. Party polarization is less than their oft revolutionary mottos would suggest, but is significant in the question of a federal solution to the civil war. Party membership is wide, exact data are however not available. Party discipline is lower, cross-over of individual members of parliament between parties after elections is not uncommon. Union coverage is also broad (approximately 45%), but unions are organized at the company level, affiliated to political parties (except unions in the plantation sector which became parties in their own right) and their space of action is limited in the public sector. Nevertheless, the incidence of labor disputes is high but declining. The power of employers' federations is considerable; they forcefully support economic reforms and the peace process. There is also a wide range of NGOs actively engaged in the upliftment of poorer sections and in the creation of ethnic harmony.

2. Market economy

Sri Lanka is a full-fledged market economy. The remaining transformation deficits relate mainly to the finance sector, reform of the public service, cutting of subsidies and the necessary reduction of the still massive public deficit.

2.1. Level of socioeconomic development

The central development indicators classify Sri Lanka as a middle-income country. In regard to the Human Development Index, the country surpasses comparable economies, albeit at a diminishing rate. Basic social exclusion in regard to education or gender aspects hardly exists, apart from the war-inflicted regions. Absolute poverty is slowly declining to about 25% of population and is concentrated regionally on provinces in Central and Eastern Sri Lanka, which are also poorly provided with public services. Income distribution became slightly less egalitarian since the civil war, but is still moderate. The civil war is partly to be blamed for less satisfactory outcomes in terms of poverty reduction and social indicators in recent years. Poverty is most widespread in the countryside and among less educated people, ethnically among Muslims. There is no correlation between unemployment and poverty, as only better educated and more affluent people can wait for better job opportunities.

2.2. Organization of the market and competition

The basis of market competition in Sri Lanka is assured and stable. The formerly high regulation density of the economy was reduced, the discrimination of foreign investors completely eliminated. There are still some liberalization deficits in regard to the labor and land market, the pricing of public services and privatization/commercialization of public enterprises. Foreign trade is nearly deregulated, tariffs have been reduced to two standard rates (10 and 25%). There is a free trade agreement with India, allowing tariff-free imports of several hundred items. Sri Lanka can boast of the most free trade regime in South Asia. This also applies to the investment regime of the country, serving foreign investors with a uniform administrative set-up and dispensing of too liberal incentives. The formerly rigid labor laws of the country were streamlined in 2003 with the aim of making the labor market more flexible, new labor courts were installed and mandatory severance payments for dismissed employees were introduced. The local tax regime is quite liberal, maximum rates for income taxes have progressively been reduced to 30%, while the resulting revenue shortfall was compensated by higher indirect taxes (especially for luxury goods).

2.3. Currency and price stability

Since some years, Sri Lankan authorities have pursued sound money and exchange rate policies, trying to contain inflation without unduly obstructing economic growth. This development commenced after 2002, supported by some improvement in the fiscal position along with structural adjustment and a concomitant Fiscal Management Responsibility Act. Inflation rates fell continuously till 2004 (to 3.9% in the first half of the year), which helped to sustain international competitiveness of Sri Lankan exports and led to a remarkable easing of balance of payments problems. This also went along with bringing in line banking practices (liquidity requirements, calculation of assets) to international standards and with the transition to open market transactions by the Central Bank. Traditionally high credit rates came down, although the gap between savings and credit rates is still considerable. Part of these achievements are in danger with the more profligate policies of the new government, especially the massive wage hike and recruitment spree in the public sector. International debts of the country are not excessive (58% of GDP), capital service even less so (11.6% of exports) as most of debt is of official, long-term character. The level of international reserves has become comfortable during the period of this review.

2.4. Private property

Property rights and acquisition are adequately secured in the industrial and service sector. The situation is different in agriculture where 80% of arable land is state-owned, but usually leased to private farmers. Their rights to the land are however ill-defined, part of it cannot be sold and is in addition badly demarcated, although there is some progress in upgrading land registration, reform of land rights and abolition of restrictions for selling and leasing land. Mobility of farmers is therefore still limited.

Privatization of public enterprises made some headway, albeit at certain stages. During a first wave, plantations, parts of the national airline, hotels etc. were privatized, earning the government considerable income. During the period of cohabitation there was first a slowing down of the process, reversed with the signing of adjustment programs with the IMF and the World Bank. After the victory of the new alliance in 2004, a return to the (unsuccessful) policies of the early 1990s was proposed, trying to make public enterprises self-sufficient without privatizing them. Labor laws are traditionally very complex, rigid and worker-friendly; dismissals in the formal sector nearly impossible. Wages in the public sector (in less qualified positions) ranged above those in private companies. In the last few years a reform effort was made to streamline laws and to reduce overstaffing in the public sector.

2.5. Welfare regime

Sri Lanka has a long-standing, progressive, comprehensive system of social services and poverty programs. That is why social indicators range still above the level of comparable countries. Food subsidies were introduced early and replaced in the late 1970s by targeted but still widely distributed food stamps. In addition, several poverty programs of self-help character exist. This social heritage has seen some erosion in the last decade because available resources for these programs stagnated, while the disease and education pattern (in accordance with the ageing of the population and the saturation at the primary educational level) shifted to more expensive services. There is factually no gender gap in educational enrolment or achievement, outlays are however too low to allow the expansion of the tertiary sector or quality improvement. Poverty programs are still poorly targeted, since half of the population benefits from them, allocation is politically influenced and the poor do not participate in the implementation of programs. As their costs are considerable, very less is left for the really vulnerable (widows, orphans of the civil war etc.).

2.6. Economic performance

In spite of the ongoing civil war, growth rates of the economy were very satisfactory from the late 1990s onward, apart from the crisis year 2001. This is due to the dynamics of slowly diversifying exports, buoyant remittances and increasing transfers of foreign private capital as well as relatively generous development assistance. This satisfactory performance was possible because of sound macroeconomic policies, moderate inflation and – as a result – a remarkable record of private investments. After signing and implementing market-friendly adjustment programs with the IMF and the World Bank, thus giving a boost to privatization, deregulation of the labor market etc., the record improved even further, supported by the positive effects of the lasting cease-fire in terms of mounting international assistance, the revitalization of the transport sector and of tourism and the increase of arable acreage in agriculture. This demonstrates the even greater potential effects of a lasting peace solution.

2.7. Sustainability

Environmental degradation in Sri Lanka has reached a serious level due to deforestation and soil erosion, use of wood for cooking and encroachment on natural reserves. This is connected with adverse effects for biodiversity, cleanliness of ground water and the maintenance of coral reefs. Water consumption in agriculture is enormous, due to subsidies for canal irrigation. Consequently, fields often become salinated and marshy. Natural tropical forest cover has shrunk to small sizes. Damage from ecological degradation was calculated at 2.5% of GDP per annum. In reaction to this, the government has

adopted a comprehensive action plan and earmarked large areas as natural reserves.

3. Management

3.1. Level of difficulty

The level of difficulty faced by the government in creating lasting peace was considerable. In relation to the majority, the last government was confronted with a powerful presidency of the opposing party blocking peace efforts regarded as too conciliatory toward the Tamil rebels and using its constitutional powers to undermine the government. In theory the level of difficulty should have diminished with the victory of the presidential party and its partners in 2004; the new government was however dependent on the support of the traditionally chauvinist JVP and the even less conciliatory party of the monks (JHU). The tension eased with the party of plantation workers (CWC) joining the government and the renewed pressure exerted by the international community on the new government for finding a lasting peaceful solution. On the side of Tamil rebels the peace process was obstructed by proposing a federal solution falling only very short of full secession (interim administration under full and sole authority of the LTTE, including taxation, allocation of development assistance, foreign trade, law and order etc.) and declaring these proposals as non-negotiable. Accepting this would have meant a revision of the constitution and political suicide for the government.

The difficulties for continuing market-oriented reforms were less, as the government can rely on a well-educated workforce, sufficient international transfers of capital and a solid coalition of groups benefiting from market-friendly policies. It has to be acknowledged however, that quite a few sections of the population felt overlooked by these policies and therefore voted the last government out of office. Most vocal among these groups are thousands of educated unemployed, traditionally backing the radical JVP. Therefore the new government could not help but to present a budget with a human face, doling out benefits for the poorer and rural sections, public employees and the unemployed, thereby also trying to suppress popular frustration about mounting prices of essential food items.

Profile of the Political System

Regime type:	<i>Democracy</i>	Constraints to executive authority:	3
System of government:	<i>Semi-presidential</i>	Electoral system disproportionality:	3.6
		Latest parliamentary election:	02.04.2004
		Effective number of parties:	2.8
1. Head of State:	<i>Chandrika Bandaranaike Kumaratunga</i>	Cabinet duration:	12/01- 04/04
Head of Government:	<i>Ranil Wickremasinghe</i>		
Type of government:	<i>divided government</i>	Parties in government:	1
2. Head of State:	<i>Chandrika Bandaranaike Kumaratunga</i>	Cabinet duration:	04/04- present
Head of Government:	<i>Mahinda Rajapakse</i>		
Type of government:	<i>divided government</i>	Parties in government:	1
		Number of ministries:	42
		Number of ministers:	42
<p>Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional constraints posed by a federal or decentralized state, a second parliamentary chamber, referenda, constitutional and judicial review and the rigidity of the constitution. Electoral disproportionality (Gallagher index) reflects the extent to which electoral rules are majoritarian (high values) or proportional: $\sqrt{\frac{1}{2} \sum (v_i - p_i)^2}$; v_i is the share of votes gained by party i; p_i is the share of parliamentary mandates controlled by party i. For presidential/ semi-presidential systems, the geometric mean of presidential election and parliamentary election disproportionality is calculated. Number of ministries/ ministers denotes the situation on 1 January 2005.</p>			

3.2. Steering capability

The steering capability of the government in market transformation until recently was remarkable. Agreed structural adjustment programs were nearly fully implemented, labor laws were streamlined to make the market more flexible, privatization of public enterprises (including large and profitable companies) made headway, reduction of overstaffing in the public sector was planned and implemented, tax administration improved, the Central Bank was reduced to oversight and regulation functions and last but not least, the budget deficit was curtailed in a significant way. After the takeover of the new government in April 2004, economic steering capacity did however suffer. Privatization was stalled, prices for public goods and services were only inadequately raised, emergency measures to stop price increases of essential food items were implemented, agricultural debts restructured or cancelled, tariff rates for non-essential items were raised, a massive wage and pension hike in the public sector was granted and a likewise massive recruitment program in several agencies for unemployed graduates was started. This, together with some reasonable new programs (for poverty alleviation) led to an immediate slippage in regard to budget targets.

In regard to the peace process, the steering capacity of the previous government was obstructed by the showdown between the president and the prime minister, solved only by the dissolution of parliament and new elections. Steering capacity afterwards was limited by the veto power of the alliance partners, an internal rebellion in the ranks of the Tamil rebels and the temporary retreat of the Norwegian peace intermediaries. Later efforts of the president to bypass

parliament by establishing a National Advisory Council on Peace and Reconciliation for the elaboration of peace proposals were doomed to failure as the opposition did not participate. Government and LTTE kept to their respective extreme positions.

3.3. Resource efficiency

Resource efficiency in employing financial and manpower resources was limited. The public sector became heavily overstaffed, subsidies and poverty programs were badly targeted, defense expenses simply went out of control. Generous development assistance could not be used adequately. This brought massive public deficits and a reduction of public investments to the bare minimum. After 2002 the situation slowly improved with the promulgation of the Fiscal Management Responsibility Act and efforts to streamline the public sector, only to deteriorate again later. Contributing to moderate resource efficiency are massive irregularities in the use of public funds and the politically influenced allocation of resources. Land transactions benefited friends and relatives of politicians, resources of the poverty program were simply frittered away.

3.4. Consensus-building

Efforts for consensus-building regarding interethnic peace were made by the government in proposing its version of an interim administration in the North and East of the country, which however fell short of rebel demands. Their counter-proposals were hardly negotiable, as it meant *de facto* secession. Dim prospects for a compromise solution were never tested. The government instead relied on a certain military build-up (as did the Tamil rebels) whilst simultaneously creating a parallel discussion body for peace proposals outside the parliament.

Consensus building for economic reforms was rather effective under the last government, as no important interest group opted for a reversal of reforms. The election outcome in 2004 was interpreted by the government as a verdict against “neo-liberal economic policies” creating only growth enclaves amidst countrywide poverty. Consensus-building for a new growth cum poverty eradication program was easy, as costs of this new paradigm were imposed on the few consumers of luxury items, while subsidies were left intact, wages and recruitment in the public sector were increased in a big way.

3.5. International cooperation

The improvement of macroeconomic indicators after 2002 was due in no small part to the agreement on and enforcement of stand-by and structural adjustment programs with the IMF and the World Bank, demanding massive cuts in budget

and balance of payments deficits through a host of reform measures. Due to slippages in some areas (privatization, labor laws) and the mounting budget deficit, some programs were discontinued in Autumn 2003. As the new government is critical of neoliberal policies in general, collaboration with foreign donors might become rather difficult. This is also likely because massive commitments of donors for post-war reconstruction and rehabilitation were made contingent on progress in peace negotiations with the Tamil rebels, now stalled since early 2003. In addition, the government was traditionally not able to absorb foreign aid productively. Currently more than \$3 billion of international aid are still not used. International collaboration was more constructive in the use of and calling for international peace mediation.

4. Trend of development

4.1 Democratic development

With regard to democratic development, the suspension of the peace process was unfortunate, caused by intransigence on the part of the rebels concerning their demand for a state-like interim administration controlled only by the LTTE, which were also divided internally for some time, due to a rebellion of the eastern wing. The government on its part was unable to secure the support of the opposition and the president for a generous federal solution and was practically made immobile after the dismissal of three ministers by the president in Autumn 2003. The Norwegian mediators retired temporarily, the government abandoned peace negotiations. The stalemate was only partially unblocked after the victory of the new left coalition which initially did not command a majority and was composed of parties averse to a genuine federal solution to the civil war. The president tried to bypass the parliamentary process by installing a new forum for the debate of peace solutions, but without success as the opposition did not participate.

4.2. Market economy development

The Srilankan economy grew in 2003-2004 at a highly satisfactory rate, supported by the cease-fire and the enforcement of structural adjustment measures, which both brought an increase of arable area, a resumption of transport and tourism, a remarkable growth of exports, remittances and international capital inflow and some easing of budget and balance of payments pressures. Inflation and unemployment came down to moderate levels, debt indicators improved. There was however some slippage in executing of structural reforms, leading to the suspension of IMF-support. The newly installed coalition government changed track, proposing a strategy based on national priorities, on the elevation of rural areas with a focus on health and education, self-sufficiency in food, a cautious policy toward privatization and trade liberalization, complemented by a generous increase in wages and pensions for the public sector. This went along with a

certain economic downturn, caused by rising international oil prices and support shortages due to the drought. Inflationary pressures were sought to be contained by ad hoc measures, which, together with the wage hike in the public sector and softening fiscal discipline, brought again some deterioration in the budget and balance of payments deficits.

	2000	2001	2002	2003	2004 (a)
Growth of GDP in %	6,0	-1,5	4,0	5,9	5,2
Export growth in %	18,3	-8,0	2,0	3,5	5,7
Import growth in %	12,9	-10,7	11,0	11,2	9,1
Inflation in % (CPI)	6,2	14,2	9,6	6,3	7,2
Investment in % of GDP	28,0	22,0	21,3	22,3	25,3
Tax Revenue in % of GDP	16,8	16,7	16,5	15,7	15,8
Unemployment in %	7,6	7,9	8,8	8,4	8,3
Budget deficit in % of GDP	-9,9	-10,8	-8,9	-8,0	8,7
Current account balance in billion \$	-1,1	-0,2	-0,2	-0,1	-0,7

(a) Provisional estimates for 2004 are based on information available up to October 2004.

Source: Central Bank of Sri Lanka: Recent Economic Developments. Colombo, Nov. 2004;

<http://www.lanka.net/centralbank/index.html>: Sri Lanka Socio Economic Data. 2003

D. Strategic perspective

The Srilankan economy has nearly all the prerequisites to play an active role in the international division of labor. It commands a highly qualified, motivated and comparatively cheap workforce (often educated in the English medium), a solid base of national and foreign export-oriented companies, operating in efficiently managed free trade zones and can boast of a rather liberal, not too cumbersome investment regime. The economy was thriving in spite of the ongoing civil war. With decreasing defense expenses, the disbursement of promised rehabilitation and reconstruction assistance by the international donor community, the revitalization of the agricultural and tourism sector in the Northern and Eastern part of the country and increasing international private investment a still higher growth rate is on the horizon.

In addition, Sri Lanka has still untapped potential in broadening its export base toward services and non-traditional agricultural products and becoming a transit base for international trade. These promising prospects are highly dependent on the pursuit of sound macroeconomic policies, market-friendly reforms and above all on efforts to find a lasting solution to the civil conflict. The international community can support this process by binding support to earnest peace efforts of both sides (the government and the LTTE) and insisting on good governance and the maintenance of human rights in using international resources. Sector-wise

international assistance should be concentrated on the reconstruction of infrastructure in the war-torn zones, on assistance to bring the public deficit under control, on encouraging labor-intensive growth (with focus on small and medium enterprises), on the control of high electricity costs (by new investment and restructuring of the sector) and on the diversification of agriculture.