

# Sri Lankan Economy: A Critical Analysis of the Past and Present

## Introduction

Sri Lanka, has had an excellent prospect for development since independence in 1948. Unlike the other former British colonies, Sri Lanka was well-equipped with superior economic and social infrastructure, advanced political, legal and governing systems, a population with adaptive mentality and a pool of financial resources to finance development expenditures. (World Bank, 1953; Snodgrass, 1998; Lakshman and Tisdell, 2000).

The country, however, soon plunged into serious economic and political problems, losing its initial advantage for development, mainly due to the short-sighted or wrong political and economic priorities, ambitious welfare-enhancing programs without an economic backing for its sustainability, and

later a prolonged civil war that lasted for nearly three decades (Alailima, 1997). The country has become a test case among development economists as an economy characterised by slow economic growth with high social welfare and basic human need satisfaction (Osmani, 1994).

## Economic Performance

Economic growth of Sri Lanka during the last six decades was insufficient to make a big push for an economic takeoff, but it was not too small compared to the countries that followed similar populist and nationalist policies or faced with violent civil conflicts or war at times. On average, Sri Lanka has been able to maintain a growth rate of 3-4 percent between 1950 and 1977 and 5 – 6 percent thereafter. Sri Lankan economy has shown remarkable resilience to both internal and external shocks such as oil crisis, droughts, riots and civil war. The country was able to maintain positive growth rates around 2-3 percent in the early 1970s during severe droughts and the youth uprising. During the civil war era since 1983 to 2009, the country's growth rate was more

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than 4 percent except in 2001 (Ganeshamoorthy, 2002). The main conclusion one might draw from Table 1 is that the country's growth performance was closely associated with political and economic ideologies of the ruling parties.

The two main parties that ruled the country almost alternatively since independence till 1994, namely, the United National Party (UNP) and the Sri Lanka Freedom Party (SLFP), have followed diametrically opposed political and economic ideologies. Being a pro-western capitalist party, the UNP subscribed to liberal

**Table 1. Political regimes, economic policy and economic performance of Sri Lanka from 1950 to 2010**

Time Period	Political Regime	Economic Policy	Economic Growth %
1950-1955	UNP – rightwing populist	liberal market economy	4.26
1956-1964	MEP- leftwing socialist	closed economy	2.50
1965-1969	UNP - rightwing populist	partial open market economy	4.64
1970-1976	SLFP – leftwing socialist	closed economy	2.52
1977-1993	UNP – rightwing capitalist	open market economy	4.92
1994-2000	PA - leftwing capitalist with human face	open market economy with intervention	5.17
2001-2002	UNP- rightwing capitalist	open market economy	1.25
2003-2004	PA – leftwing capitalist with human face	open market economy with intervention	5.65
2005-2010	UPFA – leftwing nationalism	open market economy with nationalistic sentiments	6.36

\* Average Annual Economic Growth

UNP – United National Party

SLFP – Sri Lanka Freedom Party

Source: Author's compilation.

MEP – Mahajana Eksath Peramuna

UPFA – United People's Freedom Alliance

market economy ideals and the country's economic policies were directed towards this end at the times of the UNP rule, whereas the SLFP was an anti-western nationalistic party believing in socialist ideals, so that periods of the SLFP was witnessed in closed economy with widespread nationalistic sentiments.

The discontinuity in economic policies was a major impediment for launching a development drive that could have taken the country towards a high growth path as was happened in Singapore and Malaysia. This impediment has, however, been removed in 1994 following a left-wing PA (People's Alliance) government decided to follow the economic policies adopted by the previous government without major changes. Yet, another tumbling bloc, the civil war, played a major role in reducing the growth potential of the country thereafter (Arunatilake *et al.*, 2000).

Growth performance of Sri Lanka varies significantly under different political regimes. Economic growth of Sri Lanka was relatively high during the periods of right-wing governments compared to that of the leftwing. Table 1 shows that this trend continued till 1993, and then, there was a remarkable departure from the hitherto existed practice of changing economic policies with the change in the government of a different party. The newly-elected PA government in 1994 decided to continue the policies of the previous regime with some basic changes that deemed necessary. The new policy was termed as 'market economy with human face' and this was considered as a

positive step in the right direction. The current UPFA regime itself did not deviate much from its predecessor in terms of macroeconomic policy.

Nevertheless, main focus has been on the rural economy with a nationalistic sentiment (Election Manifesto of People's Alliance government in 1994 and Mahinda Chintana 2005). The remarkable growth performance of the current UPFA regime since 2005, despite an ever increasing war budget, has shown that high economic growth is feasible even under a left-wing government if economic policies are directed on right path (Central Bank of Sri Lanka, 1995-2010).

The Sri Lankan economy underwent significant structural changes during the last sixty years (Table 2). The economy was dominated by the agriculture sector (46.3% of GDP (Gross Domestic Product)) in 1950. The relative importance of the agriculture sector to GDP has come down to a mere 12.8 percent in 2010, while the contribution of the services

**Table 2 Structural change of GDP of Sri Lanka from 1950 to 2010**

Year	Agriculture	Industry	Services
1950	46.3	19.6	36.9
1960	37.8	16.8	45.4
1970	28.3	23.8	47.9
1980	27.6	29.6	42.8
1990	26.3	26.0	47.7
2000	19.9	27.3	52.8
2010	12.8	29.4	57.8

Source: Annual Reports, Central Bank of Sri Lanka.

sector to GDP has increased from 36.9 percent to 57.8 percent in 2010, making Sri Lanka a services sector-driven economy. The contribution of the industrial sector to GDP has also risen from 19.6 percent in 1950 to 29.4 percent in 2010. This change is considered, however, as inadequate to sustain the economy on its industrialisation growth path. The typical transition of an under-developed economy to a developed country status usually involves a transformation from agriculture to industry, and then from industry to services sector dominant economy as it was happened in the United Kingdom (UK), Germany and in many western countries. However, countries such as Singapore, Hong Kong and the Maldives have made the transformation from agriculture to services sector-driven economies,

**Table 3 Social indicators of Sri Lanka from 1946 to 2010**

	1946	1953	1963	1973	1980	1990	2000	2010
Adult Literacy	58	65	72	78	86	88	90.7	91.3
School enrolment (aged 5-14)	41	58	65	86	100	100	100	100
Life expectancy	43	56	63	66	68	72	74	75
Infant mortality (1,000 live births)	141	71	56	46	34	18	9.8	10
Death rate (1,000)	20	11	9	8	6	6	6.1	6.2
Birth rate (1,000)	37	39	34	28	28	21	18.4	17.6
Natural increase(%)	1.7	2.8	2.5	2.0	2.2	1.5	1.7	1.5
Population growth	2.3	3.3	2.5	1.6	1.8	1.1	1.3	1.0

Source: Compiled by the author using data at Snodgrass (1998). Central Bank of Sri Lanka 2010.

directly bypassing the industrial sector. The major advantage of services sector growth is that, it requires a short time to develop with relatively small amount of resources using simple technology compared to industries. However, services sector-led economic growth is highly fragile since the services sector is more vulnerable to both internal and external shocks. The major contributors to the services sector of Sri Lanka include retail and wholesale trade, transport and communication, banking, insurance and real estate and government services (Central Bank of Sri Lanka, 2010).

### Social Welfare Conditions

Sri Lanka has been considered as an outlier among developing countries on the social welfare indicators and the fulfilment of basic human needs. The first government of the independent Sri Lanka announced proudly that the primary objective of the new regime was to create a welfare state in the country. The three ambitious pillars of Sri Lanka's welfare policy, viz. free health, free education and free or subsidised food on a universal basis have led to such a remarkable achievement in social indicators (Table 3). These indicators are comparable with developed high-income and middle-income countries. Nevertheless, sustainability of these programs was the major problem without

sufficient economic growth as it drained resources meant for the country's economic growth (Snodgrass, 1998).

The increase of population and the universal nature of the welfare provisions made its maintenance difficult, and the successive governments tried to scale down the welfare provisions particularly the subsidised food. These moves met with stiff resistance – sometimes turned to be violent – from organised groups as the welfare issue was highly politicised. Therefore, any move on reducing welfare expenditure was considered as politically too costly and governments maintained this welfare state intact till the major change in 1977. The universal nature of the food subsidy was abolished replacing it with a food stamp scheme on a selective target basis in the budget of 1978. Yet, the other two pillars, free health and free education, continued, but the expenditure on these has frequently been clipped significantly. Spending on education and health is considered as an investment on soft infrastructure. The faster growing nations, such as, India and China, invest heavily on education and research and development. The government spending on education and health in Sri Lanka is a mere 2 percent of the GDP at present. The

participation of the private sector in health and education sectors has helped reducing expenditure on them. These two sectors are growing faster with the participation of local as well as foreign private investors (Central Bank of Sri Lanka, 2010).

The welfare measures adopted by successive governments in Sri Lanka can be considered as a strategy to achieve redistributive justice. Sri Lanka's income distribution did not change significantly even after six decades after independence. More than half of the country's income is enjoyed by the top richest twenty percent while the bottom poorest twenty percent receive only 4.7 percent (Table 4). This does not show the existence of a fair distribution of income in the country. Therefore, the larger portion of any economic growth achieved by the country goes to the richest segments of the society. Intervention of the government is, therefore, essential to help poorer segments of the society and to reduce poverty. The UPFA government's efforts in poverty reduction have been commendable. The increased focus on the rural economy, where a majority of poor people live, by capacity building as well as creating opportunities under various programs initiated by the government recently has produced favourable results. The

**Table 4** Income distribution of Sri Lanka from 1953 to 2009/10

	1953	1963	1973	1978/ 1979	1981/ 1982	1986/ 1987	1996/ 1997	2003/ 2004	2006/ 2007	2009/ 2010
Richest 20% share	56.7	55.2	45.9	54.1	56.8	56.8	53.0	55.1	54.7	52.1
Poorest 20% share	5.1	3.9	5.0	3.8	3.7	3.6	4.1	3.6	4.6	4.7
Middle 60% share	38.2	40.9	49.1	42.1	39.5	39.6	42.9	41.3	40.7	43.2
Gini Coefficient	0.46	0.45	0.35	0.43	0.45	0.46	0.43	0.46	0.49	0.47

Source: Central Bank of Sri Lanka, (various years).

incidence of poverty expressed in terms of poverty head count index has come down from 22.7 in 2002 to 7.6 in 2010 indicating a significant progress in poverty reduction in the estate, rural and urban sectors. Yet, the poverty level is higher in the estate sector (11.4) well above the national average (7.6), making Sri Lankan poverty as an 'estate phenomenon' (Central Bank of Sri Lanka, 2010).

### The Role of Government Sector

Sri Lanka maintains a large government sector in terms of number of employees, government institutions and ministries and the size of public expenditure. The resources required to run the government machinery are mainly derived from taxation and borrowing. Generating adequate income through taxation has its limitations given the country's narrow tax base and an inefficient tax administration. Since the half of the country's national income is enjoyed by the top richest 20 percent of the society, revenue generation from income taxation was limited. Augmenting more revenue from corporate income taxes is constrained by various tax concessions offered by successive governments to investors as an incentive to encourage private investment and the existing higher tax rates. Taxes in international trade have been the major source of revenue for the Sri Lankan governments till 1977. The importance of trade taxes diminished since 1977 as a result of trade liberalisation initiatives of the government and domestic indirect taxes as a main source of tax revenue. The recent recommendations by the Tariff Commission can be considered as an attempt to widen the tax base

**Table 5 Government fiscal operations (as a percentage of GDP) from the year 2000 to 2010**

Year	Government Revenue and grants	Government Expenditure	Overall budget deficit (after grants)
2000	17.2	26.7	-9.5
2001	17.0	27.5	-10.4
2002	17.0	25.4	-8.5
2003	15.6	22.9	-7.3
2004	15.3	22.8	-7.5
2005	16.8	23.8	-7.0
2006	17.3	24.3	-7.0
2007	16.6	23.5	-6.9
2008	15.6	22.6	-7.0
2009	15.0	24.9	-9.9
2010	14.9	22.0	-7.9

Source: Central Bank of Sri Lanka, 2010.

while simplifying the tax structure and making tax administration efficient. The present government has been able to increase tax revenue collection significantly with new measures and efficient implementation (Central Bank of Sri Lanka, 2010).

The expenditures of Sri Lankan government have always outweighed its revenue, making negative savings for the government (Table 5). Expenditure on defence, public administration and expenditure allocated to the Ministry of Finance are the major expenditure items. The large-sized government sector at the central, provincial and divisional secretariat levels siphons off considerable amount of public funds; the huge central government with more than 100 ministries

shoots up expenditures unnecessarily high. The civil war has resulted considerable drain in the public coffers, and even two years after the completion of war, the defence expenditure could not be scaled down because the government priority to maintain the fighting formations and structures developed during the war. It is mostly unlikely that defence expenditure would be reduced in the foreseeable future as the government still considers a perceived threat in the country.

**Table 6 Public debt as a percentage of GDP of Sri Lanka from the year 1950 to 2010**

Year	Domestic	Foreign	Total
1950	13.7	3.2	16.9
1960	28.9	5.1	34.0
1970	46.1	17.5	63.6
1980	43.7	33.5	77.2
1985	38.6	41.7	80.2
1990	41.6	55.0	96.6
1995	43.3	51.9	95.2
2000	53.8	43.1	96.9
2001	58.0	45.3	103.3
2002	60.0	45.6	105.6
2003	56.0	46.3	102.3
2004	54.7	47.6	102.3
2005	51.6	39.0	90.6
2006	50.3	37.5	87.9
2007	47.9	37.1	85.0
2008	48.5	32.8	81.4
2009	49.8	36.5	86.2
2010	45.8	36.1	81.9

Source: Annual Reports, Central Bank of Sri Lanka.

Public defence is utmost priority for any country in a situation of actual or perceived threat to its sovereignty and stability. When those threats wane away, government should bring down military expenditures and direct them towards civilian use (Budget Speeches, 2010 and 2011).

Widening budget deficits has been a major threat to macroeconomic stability in the country. Deficit financing from inflationary sources fuel inflation, and public borrowing from domestic sources crowds out resources meant for private sector investment. The UPFA government in recent time has resorted to market-based borrowings using treasury bills and (sovereign) bonds as the primary borrowing devices. The recent engagement with the International Monetary Fund (IMF) to obtain support in the form of a Standby Agreement required Sri Lanka to fulfil the condition of reducing budget deficit to less than 7 percent of GDP, the target which the government had missed mainly due to the war-related spending. The government should reduce its budget deficit to a manageable proportion while re-scheduling the country's spending priorities more towards economic development and to create a stable macroeconomic environment conducive for private sector investment (IMF, 2009).

Overshooting of targeted budget deficits has been a major feature of public finances of the country.

This relates to the problem of increases in public borrowings and mounting up of public debt - both domestic and foreign origin (Table 6).

Table 7 shows that public debt of Sri Lanka is mounting up and pushing the country into a

possible debt trap unless the loans taken are used effectively in productive investment. The effective use of loans in expanding the country's growth potential could improve the repayment capacity of already taken loans. In a situation where domestic resource mobilisation is difficult, resorting to foreign sources is inevitable. Since the country has been graduated to a lower middle-income group, sources of concessionary lending are no longer available for Sri Lanka, and the country has compelled to seek commercial sources for borrowing. Nevertheless, taking bigger loans to repay the loan that have already been taken and using the loan to finance recurrent expenditure of the government will set a trend of falling into a dangerous debt trap as it was happened even in such hyper economy as the United States of America (USA).

Every citizen of this country including the new born in 2010 owe a total of Rs. 222,255.60, out of which Rs. 98,028.51 is to foreigners. This is not a small amount compared to the size of the Sri Lankan economy. Moreover, around 6 percent of GDP is currently spent on interest

**Table 7 Total public debt outstanding of Sri Lanka from 1950 to 2010**

Year	Public Debt (Million Rs)
1950	654
1955	1,121
1960	2,282
1965	4,435
1970	8,689
1975	14,564
1980	51,346
1985	130,284
1990	310,779
1995	635,696
2000	1,218,700
2005	2,222,341
2006	2,582,648
2007	3,041,685
2008	3,588,762
2009	4,161,422
2010	4,590,245

Source: Annual Reports, Central Bank of Sri Lanka.

payments on public borrowing. Reducing this rate is going to be a real challenge for Sri Lanka in the years to come. A considerable amount of resources will outflow to service the debt in the future as well (Central Bank of Sri Lanka, 2010)

#### **Saving, Investment and Foreign Direct Investment**

Sri Lanka has been regarded as a consumer economy with a higher marginal propensity to consume (MPC) of around 80 percent. The private savings rate of the country

**Table 8 Savings and investment in Sri Lanka from 2006 to 2010**

	2006	2007	2008	2009	2010
Private Savings % GDP	19.3	18.7	19.8	21.6	20.8
Government Savings % GDP	-2.3	-1.1	-2.0	-3.7	-2.1
Domestic Savings % GDP	17.0	17.6	13.9	17.9	18.7
National Savings % GDP	22.3	23.3	17.8	23.7	24.7
Investment % GDP	28.0	28.0	27.6	24.4	27.8
Saving - Investment gap	5.7	4.7	9.8	0.7	3.1

Source: Central Bank of Sri Lanka, Annual Report 2010

has been low compared to that in other countries in the region. It was even much low when compared to countries such as Japan and Singapore at their initial stage of development. Japan, for example, had maintained a 30-35 percent savings rate (household and corporate saving) at the early stage of development (Herbener, 1999; <http://mises.org/daily/298>).

Table 8 shows recent data on the trends in the savings and investment of the country. Since the government savings are negative, domestic saving of the country is lower than private savings, indicating a crowding out of private savings by the government sector. The country's national saving rate in 2010 was around 25 percent of GDP while the investment as a percentage of GDP was around 28 percent. Thus, an investment savings gap of 3 percent was filled by foreign investment.

The ruling UPFA government has targeted at doubling the per capita income of the country by 2016. To achieve this ambitious task, the country needs to maintain an annual economic growth rate of more than 8 percent until 2016. Maintenance of an annual growth rate of 8-9 percent requires an investment rate of 32 -35 percent of GDP. The current investment rate of 27.8 percent of GDP is well below this requirement. The country needs to increase investment by another 5 percent of GDP to materialise the growth forecast which is not a simple task to achieve (IPS, 2007).

Raising public investments to bridge the gap is also a hectic task given the bottlenecks in the government finances. Government investment at present is 6.2 percent of GDP. Increasing government

investment is extremely difficult since the government revenue is insufficient even to finance its recurrent expenditures (Budget Speech, 2000-2010).

A possible alternative solution to increase investment is promoting the inflow of foreign direct investment. The UPFA government was highly optimistic of attracting a large volume of foreign direct investment with the end of civil war in mid 2009. But, such an influx did not happen as expected, and the actual foreign direct investment (FDI) in Sri Lanka is low as evident from Table 9. The size of inward FDI in Sri Lanka was very small when compared to countries such as India, Vietnam, and China and it is even a very small fraction of Sri Lanka's GDP. However, the Board of Investment (BOI) expects to attract FDI amounting USD 1 billion in 2010, and to increase this amount to USD 1.5 billion in 2012 and USD 2.0 billion in 2013.

**Table 9 Foreign Direct Investment in Sri Lanka from 1999 to 2010**

Year	Foreign Direct Investment USD Million
1999	210
2000	175
2001	082
2002	122
2003	229
2004	234
2005	287
2006	604
2007	734
2008	889
2009	601
2010	516

Source: Central Bank of Sri Lanka, Annual Reports (various issues)

The main FDI contributors to Sri Lanka in recent times are the arch rivals of China and India. These two countries have increased their presence in Sri Lanka by raising their investment, particularly in the government's ambitious development projects such as southern port, airport, power generation, building railways and housing projects as well as private business ventures. The engagement of these two Asian superpowers in Sri Lanka is viewed as a cold power struggle to control a strategic location in the Indian Ocean. Sri Lanka maintains a very

**Table 10 Easy of doing business in Sri Lanka**

	Singapore	Sri Lanka	Chad
<b>Easy of Doing Business (Rank)</b>	<b>1</b>	<b>102</b>	<b>138</b>
Starting a business	4	34	182
Dealing with construction permit	2	169	101
Registering property	15	155	137
Getting credit	6	72	152
Protecting investors	2	74	154
Paying taxes	4	166	179
Trading across borders	1	72	171
Enforcing contracts	13	137	164
Closing a business	2	43	183

Source: Central Bank of Sri Lanka, 2010.

cordial relationship with both countries. The obstacles and bottlenecks in the economy have to be removed to attract FDI from other sources in large volumes.

The doing business index places Sri Lanka in the middle range of 102<sup>nd</sup> rank among 183 countries. The data in Table 10 indicate that Sri Lanka needs to make a significant progress in the ranking, if the country is to attract FDI from internationally-reputed multinational companies operating purely on business interests. For an international investor, there are 101 countries in the list to choose from, before considering Sri Lanka. Hailing nationalism, patriotism, or emotional speeches showcasing the glory of the past do not help attracting sensible investors, but certainly creating a suitable business environment conducive for profitable ventures would do better.

Main problems in attracting FDI include;

- i. Labour market rigidities: Labour laws are very rigid and hiring a labourer is relatively easy but firing him out of the job is extremely costly.
- ii. Increasing cost of production due to high wage rates and ever increasing cost of energy.
- iii. Small size the domestic market.
- iv. Macroeconomic instability due to high budget deficit of 7 to 8 percent of GDP and increasing foreign debt.
- v. Problems related to accountability and goods governance.
- vi. Uncertainty in government policies with regard to private FDI, the recent government decisions on

**Table 11 Sri Lanka's largest export destinations (as a percentage of total exports) from 2006 to 2010**

Export Destination	2006	2007	2008	2009	2010
United States of America	29.1	25.8	23.0	22.2	21.1
United Kingdom	12.8	13.3	13.4	14.4	12.3
India	7.1	6.7	5.2	4.5	5.6
Italy	3.7	5.2	5.5	6.2	5.6
Germany	4.8	5.7	5.0	4.9	4.8
Belgium -Luxembourg	5.2	5.2	5.2	5.1	4.8
United Arab Emirates	2.5	2.7	3.1	3.0	3.0
Russia	2.7	2.7	2.7	2.7	2.9
Netherlands	1.8	2.0	1.9	2.2	2.2
Singapore	1.1	1.0	0.9	1.2	2.2

Source: Central Bank of Sri Lanka, 2010.

Apollo hospital, Shell gas company, SriLankan Airlines, and Sri Lanka Indian Oil Company can be recent example of such uncertainty.

#### **Performance of the Foreign Sector**

Sri Lanka's relations with the western nations started deterioration with the end of the three decades of civil war in mid 2009. The West alleges that Sri Lanka violated human rights during the conduct of war and thereafter, a charge that Sri Lanka vehemently denies. Sri Lanka sought help from anti-western and Islamic countries to counter the moves of the West calling for an international inquiry

on human rights issues in recent times. The country's principal allies include China, India, and Russia, Ukraine, Iran, and some countries in Africa, East Asia and in the Middle East.

This is not the first instance that Sri Lanka locks horns with the western countries. The first incidence of this nature had occurred in the late fifties following the nationalisation of foreign oil companies by the left-wing SLFP government to establish Ceylon Petroleum Corporation. The Russian government promised to supply crude oil to Sri Lanka at a cheaper price if Sri Lanka were to

**Table 12 Sri Lanka's main import origins (as a percentage of total imports) from 2006 to 2010**

Import Origin	2006	2007	2008	2009	2010
India	21.2	23.1	24.5	17.8	19.0
Singapore	9.7	9.9	8.8	10.4	11.6
China	7.6	8.2	7.9	10.1	9.2
Iran	7.4	7.5	8.5	8.8	6.7
Japan	4.4	3.7	3.0	2.2	4.3
Hong Kong	6.4	6.4	4.9	5.1	4.3
United Arab Emirates	2.1	2.9	3.0	4.0	3.5
Malaysia	4.3	2.5	2.5	2.8	2.8
Thailand	2.0	2.0	2.1	2.7	2.3
Pakistan	1.4	1.6	1.4	1.9	2.1
Canada	2.1	0.7	2.7	2.7	2.1

Source: Central Bank of Sri Lanka, 2010.

nationalise western oil companies. Keeping national interest in mind, the government went ahead with its plan of nationalisation. The US (United States) and French oil companies suffered as a result of the takeover and demanded full compensation at market value for which the government did not agree. In retaliation, the US government invoked the famous Smoot-Hawley legislation against Sri Lanka and ceased all its aid and assistance to the country until the full compensation to the oil companies was made. Sri Lanka sought assistance from Russia, China and India for its immediate needs but at the expense of a good part of foreign market, economic growth and international relations. The relationship with the West has been re-established by the UNP government in 1965, after making the full payment of compensation to the oil companies.

In the current world geo-political power play, Sri Lanka's friends seem economically superior and more powerful than their western counterparts who are plagued by financial crises and economic turmoil in recent times. Some are highly optimistic to conceive that the twenty first century to be an Asian century, and it is predicted that all the growth of the world is going to happen in Asian countries (Scott, 2008). As such, one might argue that Sri Lanka's friendly countries will be able to support by providing market access to their countries in addition to financial and diplomatic assistance whenever required to counter the moves of the western countries.

But, even for a casual observation, it is not difficult to see the high cost of pursuing such a policy for a small country like Sri Lanka in the present context

At present, Sri Lanka depends mainly on the western markets for its exports as shown in Table 11. The USA and the UK are the two major export markets for Sri Lankan products. One third of the country's exports goes to these two countries. More than half of Sri Lanka exports destined to western countries. It is mostly unlikely that any new allies of Sri Lanka could grant such a large market access given the nature of export commodities of Sri Lanka, viz. tea, rubber, coconut, garments, petroleum products, diamonds, gems and jewellery. Indeed, both China and India depend more on the US and European Union (EU) markets for their exports as well. Therefore, finding market for Sri Lankan products in non-western countries might not be an easy endeavour. The decision of the EU to suspend the GSP+ concessions to Sri Lanka has exerted considerable pressure on its exports to the EU.

Sri Lanka's imports are originated mainly from friendly countries. India, Singapore and China are the first three largest exporters to Sri Lanka. (Table 12).

**Table 13 Balance of payments of Sri Lanka from 2006 to 2010**

Year	Trade Balance (billion USD)	Current Account Balance (billion USD)
2006	3.3	1.5
2007	3.6	1.4
2008	5.9	3.9
2009	3.1	0.2
2010	5.2	1.4

Source: Central Bank of Sri Lanka, 2010.

Sri Lanka has been experiencing deficits in both the trade and current account balance (Table 13). The higher trade deficit has offset mainly by private transfer receipts in the form of expatriate inward remittances. Hence, the current account deficit records a lower figure than trade balance. It is interesting to note that the women's contribution to the balance of payments is extremely important. The two major exports of Sri Lanka tea and garment are produced mainly by female workers. The third largest source of foreign exchange earning is migrant unskilled female workers employed mainly in the Middle East. This is not favourable for Sri Lanka to boast its image as an emerging economy.

The solution to the increasing trade deficit requires fundamental changes to the structure of exports and imports, and at large, the economic structure of the country. Efforts to diversify exports commodities have not yet made significant progress. The country has identified tourism as a leading sector that can help reducing the trade gap, particularly after the completion of the war in the North and the East. However, at present, the country does not have the

capacity to cater to large number tourist arrivals as compared to major tourist destinations such as the Maldives or Thailand. Tourism promotion activities of recent times have been successful, but the infrastructure needs to be developed to sustain the advantage as a major tourist destination. High-spending tourists destine to the Maldives than Sri Lanka, because the Maldives have reconstructed its tourism infrastructure after the devastation of the Tsunami in 2004 to attract high-spending tourists. Sri Lanka has so far failed to take this advantage and yet there is great potential to develop this sector in the future.

## Conclusion

The growth performance of Sri Lanka during the last sixty years was not satisfactory given the initial favourable conditions. The country's social development record has been impressive despite lower economic growth. Recent efforts to increase growth performance are also constrained by both domestic and international factors. Sri Lanka's economic relations with the western world have been deteriorated after the end of the civil war. Polarisation might not help Sri Lanka to materialise its ambitions development targets. A combined effort is necessary to restore the country's image as an open economy with grater human freedom.

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