SRI LANKA AS A WELFARE STATE: AN OVERVIEW*

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For a less developed country, Sri Lanka – which is listed among the thirty six (36) low income developing countries in terms of the World Bank classification[1] – has achieved a commendable and unique record of social progress. This has largely been the result of nearly four decades of state sponsored and state financed social welfare services, mainly free education, free medical and health care and subsidised food distribution. The overall impact of social welfare and redistributive policies had enabled the country to achieve a remarkable degree of success in terms of the now widely discussed Physical Quality of Life Index (PQLI – 83/100) and 'Basic Needs' fulfilment, unmatched by many of the other less developed countries with comparable or even higher per capita income levels.

This paper seeks to highlight (i) the circumstances that led to the emergence and continuance of 'social welfarism' as a major component of government socio-economic policy commitments, (ii) the magnitude of social welfare spending, (iii) the overall impact of social welfare services and (iv) the important issues pertaining to social welfare-growth interrelationships. The paper also highlights the serious economic and financial problems that confronted the country in the 1960s and 1970s, in the context of which the social welfare policy commitments themselves proved to be a heavy burden on the government finances.

Socio-Political Foundations

The foundations of social welfare policy in Sri Lanka came to be laid in the decade that prededed the grant of political independence (1948), when the country had already enjoyed a substantial measure of self-government[2]. In the years that followed a more pronounced trend towards 'social welfarism' in state policies became clearly marked.

Since independence successive governments were strongly committed to the policy of providing extensive social welfare services – mostly free or subsidised – to nearly all sections of the country's population. Free education from primary to tertiary levels, free medical and health services and food subsidies formed the major components of the social welfare programmes channelled through the government budget. In addition, public assistance and relief measures to specific groups were also provided through the budget. Moreover, subsidised fares and rents in public transport and housing, respectively, as well as controlled or subsidised prices of essential consumer items also conferred benefits directly and indirectly on the consumers.

The general social welfare services encompassing almost the entire population and channelled through the budget were supplemented by an enlightened system of social security and wage labour regulation through labour welfare legislation. The latter covered largely the organised and formal urban segment of the economy – involving both the private and public sectors – in which there had developed a strong trade union movement since the 1930s dominated by the left-wing and marxist-parties in the fifties and sixties.

Government commitment towards social welfare programmes operated in the context of an expanding role of the state in the post-independence period in directing and guiding the country's socio-economic development within the framework of what may be termed a 'mixed economy'. The increasingly important role that the government assumed was a consequence and a necessary concomitant of the emergence of a 'welfare state' in Sri Lanka. Social welfare and redistributive policies were a significant facet of the enhanced role assumed by the state as a principal agent of socio-economic transformation in the country.

It is important to note that the continued commitment to 'welfarism' in state policy since the mid-1940s arose out of, and was partly determined by, the socio-political system that evolved in the country. Since the granting of adult franchise in 1931, there had developed gradually a liberal and open political system based on parties and parliament in which electoral politics with a high degree of voter participation was a dominant feature.[3] The electoral system also gave a considerable weightage to the rural areas where the majority of the population lived. The political system with a democratic base, despite deficiencies and the challenges it faced, had survived. In this system governments were periodically changed through popular elections. Such a system made the ruling parties and governments very much responsive to popular needs and pressures. This inevitably gave a definite orientation towards social welfare policies – the benefits of which were intended to reach the low

1. See, *World Development Report,* World Bank, 1981 (Table 1 – Basic Indicators) The group of 36 low income developing countries consists of those countries with a per capita income of $ 370 or less in 1979 (Sri Lanka had a per capita income of $ 230). Sixty (60) middle income countries listed are those with a per capita income of or more than $ 370.

2. L. A. Wickremaratne, "The Emergence of a Welfare Policy 1931 - 1948", *University of Ceylon History of Ceylon,* Vol. III, Colombo, 1973.

3. For a comprehensive account about the evolution of the political system, see James Jupp: *Sri Lanka – Third World Democracy,* London, Frank Cass 1978: A. J. Wilson: *Politics in Sri Lanka* 1947 - 1973, Macmillan, London 1974 and Robert N. Kerney: *The Politics of Ceylon (Sri Lanka)* Tithaca, New York, 1974.

income majority in the rural and urban sectors. It is in this context that commitments to social welfare once initiated had to continue even if they proved burdensome – for their large scale withdrawal would have meant political unpopularity and even political unrest for the government in power. This has generally been the experience of governments in power in Sri Lanka particularly in regard to the question of 'consumer subsidies' which had always remained a politically sensitive issue.

In the perceptions of government socio-economic policies, there has always been an underlying egalitarian element which reflected a concern and commitment to improve the lot of the poor, particularly the rural masses, through direct social welfare measures. This became a guiding principle since the late 1940s, especially when very little basic structural changes were envisaged in the country's economic system. In the context of social and economic backwardness and widespread poverty, particularly in the rural sector, it was understandable that government policies reflected a bias towards direct welfare oriented programmes. Thus partly in response to popular needs and pressures transmitted through the political system – and as a safeguard against political instability and social unrest – and partly out of concern to improve the welfare of the low income majority, social welfare and redistributive measures came to be accorded a significant place in goverment policies and programmes during the post-independence period. It is also important to note that all political parties supported such commitments, though with less enthusiasm while in power.

In the formulation and implementation of social welfare programmes – involving mainly education, health and food subsidies – by the government, a factor that added a significant dimension to policy commitments has undoubtedly been the rapid population growth experienced by Sri Lanka in the 1940s and 1950s. Since the mid-1940s, there was a very marked acceleration in the growth of the country's population and the rate of increase continued to be high till the mid-1960s. During the two intercensal periods 1946 - 53 and 1953 - 63, Sri Lanka's population increased at an average annual rate of 2.6 percent. There was a dramatic fall in the country's crude death rate – largely on account of malaria eradication and the general improvement in medical and health facilities – from 20 per thousand in 1943 – 45 to 14 per thousand by 1947; thereafter it continued to decline steadily, but gradually, reaching 8.4 per thousand in 1960. On the other hand the birth rate has remianed at traditionally high levels for a long period. This upsurge in the growth of population resulted in a near doubling of the country's population within twenty five years – from 6.6 million in 1946 to 12.6 million in 1971. The 'demographic revolution' experienced in the 1940s and 1950s resulted in an age-structure with a high proportion of dependent young age groups. The rapid growth of population, with

TABLE 1 – Social Welfare Expenditure – Sri Lanka (Value in Rs. Million)

	1955/56	1960/61	1965/66	1970/71	1975	1980
Total Government Expenditure	1,322.7	1,976.4	2,609.0	3,973.8	7,186.7	28,532.3
1. Education	182.1	297.6	346.5	527.0	707.6	1,845.7
% of total expenditure	13.7	15.0	13.2	13.2	9.8	6.4
% of GNP	–	4.7	4.5	3.9	2.7	2.4
2. Health	119.4	154.0	173.0	275.8	410.8	1,341.8
% of total expenditure	8.9	7.6	10.4	6.9	5.7	4.7
% of GNP	–	2.4	2.2	2.0	1.9	2.1
3. Food Subsidies (gross)	79.9	248.0	487.4	614.0	1,230.4	1,807.0*
% of total expenditure	5.9	12.4	18.6	15.4	17.1	6.3
% of GNP	–	3.9	6.3	4.5	4.8	2.3
4. Social welfare expenditure (including special welfare and community services)	436.9	737.5	1,045.1	1,463.7	2,450.2	5,193.2
% of total expenditure	33.0	37.3	40.0	36.8	34.0	18.2
% of GNP	6.2	11.0	13.5	10.8	9.6	7.3
5. Current outlays on social welfare as % of total current expenditure	38.9	44.8	48.3	43.8	42.7	30.7
6. Current outlays on social welfare as % of government revenue	26.7	43.5	52.7	48.3	(45.0)	28.5

Source: *Central Bank of Ceylon – Annual Reports*

a high proportion of dependent groups, had far-reaching implications *vis-a-vis* the social welfare commitments in the 1950s. This inevitably pushed up the financial outlays on the largely population-linked welfare services provided by the government. This trend was clearly reflected in the central government expenditures during the 1950s and 1960s.

Social Welfare Expenditure

The government budget in Sri Lanka operated as a major instrument of welfare and redistributive policies. This marked emphasis was reflected in the central government expenditure throughout the post-independence period. The government commitment to maintain certain per capita levels of social welfare services combined with a rapidly expanding population (until the mid-1960s) led to a substantial increase in outlays on social welfare spending.

Total expenditure — including both current and capital outlays — on education, health, other special welfare and community services and food subsidies (gross), which together constituted the bulk of government social welfare spending, increased nearly six-fold from Rs. 437 million in 1955/56 to Rs. 2,450 million in 1975 (See Table 1). Part of this increase of course reflected the rise in prices. However, the annual rate of inflation had been below 5 percent in the 1950s and early 1960s; only in the subsequent period did the country experience higher rates of inflation exceeding 10 percent.

It would be more meaningful to relate welfare expenditure to total government expenditure and to the country's gross national product (GNP). As a proportion of total government expenditure social welfare spending — as already specified — increased from 33 percent in 1955/56 to 40 percent in 1965/66; thereafter the proportion had tended to decline. Expressed as a proportion of the GNP (at current factor cost) social welfare expenditure ranged from 10 to 13 percent between 1960/61 to 1970/71; this ratio too showed a decline during the 1970s. However, for several years the total social welfare expenditure in relation to the GNP varied between 10 to 12 percent which is indeed a high proportion for a less developed country.

The magnitude of such outlays may be seen in another form. The total current payments incurred on education, health, specific welfare and community services and food subsidies formed 40 - 45 percent of the total current expenditure in the central government budget; they also absorbed 45 - 50 percent of the total Central government revenue in the 1950s and 1960s. The government outlays on social welfare expenditure undoubtedly became a heavy burden on the budget by the end of the 'sixties and contributed to the mounting budget deficits, which contined to be a marked feature. The relative decline in the ratio of social welfare expenditure in relation to total government expenditure (as well as GNP) in the 1970s partly reflected the governmental attempts to limit the increase in social welfare spending on account of budgetary constraints.

Of the three major components of social welfare expenditure, education and health formed more or less stable items of governmental spending not very much influenced by short run policy considerations of the government. Together they constituted 18 to 22 percent of the total central government expenditure and 5 to 7 percent of the GNP. Education absorbed a somewhat greater share of the expenditure than what went to health

Educational development has been a major concern of all governments during the post-independence period in Sri Lanka. Government commitments to education and educational expansion came to be viewed also as a social need providing access to all sections of the population. Such commitments began in a big way with the introduction of universal free education (1949) which continued to be the basis of educational policy in Sri Lanka. The government policy — commitment to educational expansion over the years — had enabled the country to develop a comprehensive system of formal education with an extensive network of schools that covered almost the entire country. The impact of rapid population growth since the mid-1940s came to be felt in the educational sphere as well. The school-going population nearly doubled in the 1950s increasing from 1.2 million in the 1950s to 2.2 million in 1960 and further increased to 2.7 million in 1970.

School enrolment in the 5 - 19 years age group recorded a substantial increase from 40 percent in 1946 to 61 percent in 1971. with a marked narrowing down of the differences between males and females. The policy of 'swabhasha' education formed another important facet of the process of educational expansion with a wider social impact. The 'take-over' of private schools in 1961 was a further landmark in the development of a comprehensive educational system financed and maintained by the state. While it would be inappropriate to speak of an educational system that gave equal access to all citizens, it can not be denied that Sri Lanka has made rapid progress in the direction of equalising educational opportunities for her citizens.

Despite deficiencies that still existed in the country's educational system, many of the social benefits from several years of educational progress bacame visible in the 1950s and the 1960s. The most significant social impact has been the marked improvement in literacy and the average level of educational attainment of the country's population. The percentage of literacy in the population over 10 years in both sexes increased from 40 percent in 1921 to 78 percent in 1971 and 86 percent in 1978/79.[4] For males, literacy rates increased

4. Department of Census and Statistics, *Population of Sri Lanka*, Colombo, 1974, p. 51 and Central Bank of Ceylon, *Report on Consumer Finances and Socio Economic Survey*, 1978/79 Colombo, 1983, 1983 p. 25.

from 56 percent to 85 percent and for females from 21 percent to 71 percent between 1921 and 1971. The substantial increase in the percentage of literates among the females is a good index of the increasing number of females having gained access to the expanding educational opportunities in the country. Sri Lanka's overall literacy rate is much higher than that of may other developing countries with similar or even higher per capita income levels. It has been reported that Sri Lanka's adult literacy rate of 85 percent (1976) was very much higher than the 'low-income' countries (weighted) average of 51 percent.[5] It is further revealed that Sri Lanka's adult literacy rate was the highest among the 36 low income countries excluding Vietnam (86%). The adult literacy rate in Sri Lanka was also found to be above the average (71%) for the 'middle-income' countries and was higher than that of many other individual middle income countries themselves.

The expansion of educational facilities during the past three to four decades in Sri Lanka had raised the educational levels, by and large, of all sections of the population with the notable exception of people in the estate sector who had a strikingly low level of educational attainment. While the rural sector in Sri Lanka also showed a relatively high illiteracy compared to the urban sector the rate of illiteracy was found to be the highest in the estate sector. In the country's population, classified according to educational status by sectors, it is noticed that the 'no-schooling' (illiterate) category constituted 23 percent for the whole island, 18.5 percent for the urban sector, 22.5 percent for the rural sector and 43.6 percent for the estate sector in 1978/79.[6] For the people in the estate sector, schooling proceeds very little beyond the primary level. Persons with secondary education and beyond showed a strikingly low percentage of 8 percent – of the population – in the estate sector, while the corresponding percentages for the rural and urban sectors were found to be 37.0 percent and 46.5 percent repectively. The estate Tamil population of Indian origin had remained largely outside the mainsteam of the national education system and were not beneficiaries of the educational progress that the country in general achieved in the post-independence period.

The state-sponsored and state-financed medical and health care which had developed over the past four decades or so included both curative and preventive services and programmes related to health, sanitation, water supply and health education. People had a fairly broad-based acccess to such facilities despite the many shortcomings – including regional and/or sectoral imbalances – that still persisted in the country's medical and health services.

Some of the important health indices showed, among other things, that Sri Lanka succeeded to a remarkable degree in reducing the death rate and infant mortality, and in raising life expectancy within a relatively short period of time. The country's death rate witnessed a phenomenal decline in the 1940s and early 1950s and reached 8 per thousand around 1960 which was one of the lowest among the developing countries. Infant and maternal mortality rates too recorded a substantial decline in the post-1946 period. The infant mortality rate which was 141 (infant deaths per 1000 live births) in 1946 dropped sharply to 82 in 1950 and more gradually, to 43 in 1971.[7] The maternal mortality rate was less than 2 per 1000 live births in 1971 compared to 15 in 1946. The general improvement in health conditions came to be reflected in a notable change in life expectancy for both males and females. Life expectancy that stood at 44 years for males in 1946 increased to 66 years in 1979; and for females, it increased from 42 years to 70 years during the same period. Among the group of (36) 'low income' Third World countries – according to the World Bank classification – Sri Lanka's life expectancy (66 years) in 1979 was the highest.[8] Sri Lanka's life expectancy is even higher than that of many 'middle income' less developed countries. The state medical and health services in Sri Lanka enabled the benefits to reach all sections of the population, although the health status of the estate Tamils, in many respects, still compares very poorly with the rest of the population.

Food subsidies occupied an important place in government policy aimed at consumer subsidisation, 'income transfer' and stable cost of living. Food subsidies, the bulk of which constituted the subsidy on rationed distribution of rice – the staple diet of the people – had also for a long time remained a highly sensitive issue in Sri Lankan politics. The rice subsidy scheme was initially introduced during the second World War as part of government policy aimed at ensuring the availability of essential food stuffs at controlled prices and/or through rationing.

Since the mid-1950s the food subsidies in general and the rice subsidy in particular had continued more or less uninterruptedly with minor modifications. Under the rice subsidy scheme all persons (income tax payers were excluded after 1972) were entitled to a weekly ration issued through the co-operative stores and other retail outlets. Rice issued under the subsidised rationing scheme comprised both locally produced rice and imported rice – though a major proportion in the 'fifties and sixties' was imported rice. Apart from the domestic budgetary outlays, food subsidies in general and the rice subsidy in particular, also had important foreign exchange implications as the

5. *World Development Report*, 1981, op. cit., (Table I p. 134).

6. *Report on Consumer Finances and Socio Economic Survey* 1978/79, op. cit., p. 28.

7. *Population of Sri Lanka*, op. cit., p. 27.

8. *World Development Report*, 1981, op. cit., (Table I p. 134).

government had to depend on imports to operate its food subsidy schemes. Furthermore, import of rice and its subsidised distribution influenced the open market price with possible disincentive effects on local rice production, which has been the mainstay of the rural economy. The government price-support policy through the Guaranteed Price Scheme has been among the important measures adopted to provide incentives to local farmers. However, this did not always function effectively especially in relation to the cost of production and open market prices.

The cost of food subsidies (on a gross basis) increased rapidly partly reflecting the increase in population. In the later years, especially since 1970, the increase in world prices also played an important part. Total outlays on food subsidies increased from 6 percent (Rs. 79.5 million) of total government expenditure in 1955/56 to 18 percent (Rs. 487 million) in 1965/66. By 1975 the total cost of the food subsidy amounted to Rs. 1230 million – 17 percent of total government expenditure and nearly 50% of the total social welfare expenditure. Food subsidies on the whole claimed 20 to 25 percent of the total current expenditure in the 1960s. The outlays on food subsidies continued to be a heavy burden and contributed to the sharp increase in the current expenditure of the central government budget.

Social Welfare-Growth Relationships

The fiscal system in Sri Lanka – through its expenditure and taxation policies has throughout acted as a principal mechanism effecting a net transfer of 'benefits' from the higher to the lower income groups. One estimate of 'fiscal incidence' showed that for all income groups below Rs. 800 per months the 'expenditure incidence' has out-weighed the 'tax incidence'. The excess of the former over the latter has been particularly marked in the income groups with a monthly income of below Rs. 400.[9]

Sri Lanka's experience in regard to income distribution is particularly noteworthy in that it showed a significant improvement until in the mid-1970s. The data from the Consumer Finance Surveys conducted by the Central Bank provide adequate evidence in this respect. The concentration ratio (Gini coefficient) for income receivers declined from 0.50 in 1953 to 0.41 in 1973 and for spending units the decline was even more marked from 0.46 to 0.35 during the same period. It is significant to note that the share of the bottom 40% (spending units) increased, particularly between 1963 and 1973, from 14.6 percent to 19.3 percent. Also noteworthy is that the share of the top 20 percent declined from 52.3 percent to 42.9 percent in the same period. The middle income groups too have made significant gains during this period.

The more recent statistics on income distribution show a relative deterioration compared to the early 1970s. The Gini Coefficient has increased from 0.41 in 1973 to 0.49 in 1978/79 and to 0.52 in 1981/82 for income receivers (see Table 2). In terms of spending units too, the coefficient increased from 0.35 in 1973 to 0.45 in 1981/82. It is significant to note that while the share of income received by the top 20 percent increased from 45.84 percent in 1973 to 54.30 percent in 1978/79 and to 56.52 percent in 1981/82, the share of the bottom 20 percent of the income receivers declined from 4.97 percent in 1973 to 3.76 percent in 1978/79 and to 3.70 percent in 1981/82; almost similar trends are observed in the share of income received by the spending units. During this period the shares of income deciles in the middle range also declined relatively.

There is little doubt that the period after 1973, particularly since 1978/79, as revealed by the available statistics, shows a greater unevenness in income distribution in contrast to the trends observed in the earlier period. This is probably a reflection of the

TABLE 2
Percentage of Total (one month) Income Received by Each Ten Percent of Ranked Income Receivers and Spending Units

	Income Receivers					Spending Units				
Decile	1953	1963	1973	1978/79	1981/82	1953	1963	1973	1978/79	1981/82
Lowest	1.51	1.17	1.80	1.20	1.21	1.90	1.50	2.79	2.12	2.18
Second	3.56	2.70	3.17	2.56	2.49	3.30	3.95	4.38	3.61	3.55
Third	3.56	3.56	4.38	3.60	3.47	4.10	4.00	5.60	4.65	4.35
Fourth	4.37	4.57	5.70	4.76	4.61	5.20	5.21	6.52	5.68	5.24
Fifth	5.71	5.55	7.10	5.93	5.57	6.40	6.27	7.45	6.59	6.35
Sixth	6.31	6.82	8.75	7.29	6.93	6.90	7.54	8.75	7.69	7.02
Seventh	7.94	8.98	10.56	9.12	8.56	8.30	9.00	9.91	8.57	8.69
Eighth	10.39	11.46	12.65	11.23	10.64	10.10	11.22	11.65	11.22	10.71
Ninth	14.16	16.01	15.91	15.26	14.82	13.20	15.54	14.92	14.03	14.52
Highest	42.49	39.24	29.98	39.04	41.70	40.60	36.77	28.03	35.84	37.29
Gini Coefficient	0.50	0.49	0.41	0.49	0.52	0.46	0.45	0.35	0.44	0.45

Source: *Central Bank of Ceylon Report on Consumer Finances & Socio-Economic Survey, 1981/82, Sri Lanka, October 1984*

9. P. J. Alailima, *Fiscal Incidence in Sri Lanka*, ILO 1977, quoted in Peter de Valk: *The State & Income Distribution – with a Case Study of Sri Lanka*, Institute of Social Studies, The Hague, 1981.

outcome of the 'open economy' policies of the post-1977 period. The greater stress on growth and investment under the influence and direction of market forces (and increasing privatisation) possibly led to greater ineaquality in earned incomes in some of the important sectors of the economy.

On the whole, many of the socio-economic indicators in Sri Lanka showed positive achievements judged by such criteria as educational progress, improvement in health and nutrition levels and reduction in income and wealth disparities.[10] However, it must be noted that such significant improvements have taken place against a background of relatively poor performance of the economy with regard to growth, investment and domestic savings and, furthermore, the deteriorating economic situation in the 'sixties and seventies' as reflected in the high rate of unemployment, the persistent budgetary imbalance and balance of payments disequilibrium. In this background, questions relating to welfare-growth inter-relationships in the Sri Lankan context become relevant.

In terms of the 'growth-oriented' approach – which has, of course, come in for a great deal of criticism in recent years – emphasising mainly the rate of investment, savings and economic growth, Sri Lanka's experience since the late 1950s has been unsatisfactory. In the 'fifties' and 'sixties' the economy experienced no marked upward trend in the rate of overall investment. The investment ratio (investment as a proportion of GNP at current prices) averaged 15 percent during 1959 - 64 increased to an average of 17 percent in the second half of the 1960s and then remained around 16 percent during the first half of the 1970s.[11] Gross domestic savings appeared to have stagnated around 13 percent in the 1960s with only a marginal change in the first half of the 1970s. Since the mid 1960s domestic savings were increasingly supplemented by 'foreign' savings. The overall growth in the economy in the 'sixties averaged 4.4 percent per annum in real terms. This, when adjsuted for the annual rate of increase in population gave an average annual increase of 2 percent in GNP per capita. There was a marked lowering of the overall growth rate in the economy during the first half of the 1970s, averaging only 3 percent per annum.

It is necessary to draw attention to one key factor, namely, the steady deterioration in the country's terms of trade which dominated the Sri Lankan economic scene in the 1960s and 1970s. The persistent and marked decline in the terms of trade – which was of crucial importance to an economy in which exports and imports played an important role – meant a reduction in the country's import capacity with an adverse effect on the potential availability of imported supplies of raw materials, investment goods and consumer goods. Since the early 1960s Sri Lanka faced a worsening balance of payment problem in the context of which – with import controls and exchange restrictions – foreign exchange scarcity became a major constraint on the economy.

The country experienced a very serious unemployment problem since the end of the 1960s. The overall rate of unemployment which stood at 14 percent of the labour force in 1969/70 increased to 18 percent of the labour force by 1973. The problem of unemployment became severe among youths with educational attainments. There has developed a serious imbalance between the pace and pattern of educational expansion and the capacity of the economy for employment generation – resulting also in a serious 'mis-matching' of job aspirations of educated youths and the pattern of employment opportunities.[12]

It has been observed[13] that Sri Lanka's commitment to welfare services, on a significant scale for a long time, has progressively limited the amount of resources that could otherwise have been diverted to investment, contributing directly to increased physical productive capacity (and thereby greater employment potential) in the economy. This is not to be denied, although it has been observed that the "trade-off" between expenditure on human development and growth has thus not been so sharp as it is sometimes suggested".[14] This is based on the reasoning that Sri Lanka's growth rate in the 1960s (4½ percent on average) has not been that low; and that the deterioration in the first half of the 1970s may be attributed to reasons not necessarily related to welfare policies.

It is true that Sri Lanka's unsatisfactory growth and investment and savings performance had also been associated with factors unconnected to social welfare policies – such as, the effect of adverse weather on agricultural production, the effect of government policies on incentives to

10. See Lal Jayawardene, "Sri Lanka" in Hollis, Chenery and Associates, *Redistribution with Growth*, London, Oxford University Press, 1974; and W. D. Lakshman: *Income and wealth Distribution in Sri Lanka – An Examination of Evidence Pertaining to Post 1960 Experience*, International Development Centre of Japan, Working Paper Series No. 16, 1980, Tokyo.

11. N. Balakrishnan, "A Review of the Economy" in Tissa Fernando & Robert N Kerney (Eds) *Modern Sri Lanka; A Society in Transition* Syracuse University, 1979.

12. International Labour Office, *Matching Employment Opportunities and Expections – A programme of Action for Ceylon*, Geneva, 1971.

13. H. N. S. karunathileke, "Impact of Welfare Services on the Economy", *Central Bank Staff Studies*, Colombo April 1973.

14. World Bank: *World Development Report*, 1980 p. 90.

private investment and savings; inefficiency in and mismanagement of public corporations; and foreing exchange constraints largely determined by external factors. Nevertheless, one cannot ignore the fact that a good part of the government resources devoted to social welfare spending did compete with resources that would have been made available for directly growth-inducing and capacity-creating investments. While stating this, one should not also overlook the possible indirect and long term 'productivity' effects of human resource development that has been associated with social welfare policies and programmes in Sri Lanka. Social welfare expenditure would have certainly contributed to the improvement in the "quality" of the people. Improvement in the quality of the people – or human resource development – could give rise to indirect economic or productivity gains though they cannot easily be quantified or assessed. Besides, the Sri Lankan economy was faced with the situation in which the country's human resources were not fruitfully utilised and this was reflected in the large scale unemployment that emerged in the 1970s. This itself was caused by the lack of adequate physical investment in the economy. Thus there emerged a basic imbalance when the human resource development was not matched by the expansion of the physical investment capacity and therefore the potential economic gains from human resource improvement could not be fully realised.

There is substance in the view[15] that some aspects of the welfare and redistributive policies in Sri Lanka conflicted with the incentives for higher growth and productivity in the economy. Government food import policy coupled with consumer subsidisation tended to have a depressing effect on producer prices in the domestic food producing sector – particularly the paddy sector. Food subsidisation with a view to stabilising the cost of living was very much consumer – oriented and was not without conflicts with producer interests. This inconsistency was especially marked in the domestic agricultural sector which is dominated by paddy production. Such disincentive effect of food imports linked to consumer subsidisation on the agricultural producer came to be recognised by the government and important policy changes were effected in the late 1960s – while still retaining the food subsidy scheme – so as to provide stronger price – incentives to the paddy producers.

Government taxation policies aimed at redistribution also could not avoid problems that emerged with some adverse effects on private incentives to save and invest. Redistribution policies directed towards lower income groups with a high propensity to consume may have partly undermined the overall savings capacity in the economy. Moreover, many public enterprises incurred heavy losses in the initial period partly due to inappropriate pricing policies and partly due to inefficient management, and consequently, they were a burden on the government finances.

Another aspect that has been commented upon in the welfare growth relationship is concerned with the question of selectivity,[16] or rather the lack of it for a long time, in the social welfare policies and programmes that were implemented. The social welfare policies and measures were intended to, and did, by and large, cover the entire population irrespective of income levels. In the rice subsidy programme, it was only as late as 1972 that the government decided to exclude the income tax payers. The government could have

TABLE 3 Foreign Trade Indices – Sri Lanka (1978 = 100)

Year	Volume		Prices		Terms
	Exports All	Imports All	Exports All	Imports All	Trade of
1965	111	65	65	11	142
1966	101	89	15	11	137
1967	105	76	14	11	120
1968	108	77	17	14	117
1969	103	82	17	15	110
1970	107	77	17	16	106
1971	104	68	17	17	98
1972	102	67	17	18	94
1973	103	60	20	24	82
1974	89	42	31	42	72
1975	107	52	29	49	58
1976	102	57	34	44	78
1977	94	73	55	54	102
1978	100	100	100	100	100
1979	101	123	109	152	72
1980	99	140	126	217	58
1981	102	145	129	282	46
1982	102	150	119	309	38
1983	109	180	165	375	44

Source; *Central Bank of Ceylon Annual Report – 1983*

$$\textit{Terms of Trade} = \frac{\textit{Export Price Index}}{\textit{Import Price Index}} \times 100$$

15. See Marga Institute, *Welfare and Growth*, Colombo, 1974.

16. W. D. Lakshman, "Economic growth and redistributive justice as policy goals A study of Recent Experience in Sri Lanka", *Modern Ceylon Studies*, Vol. 6, 1975.

evolved at an early stage a food subsidy scheme directed towards the most needy, based on household income criterion (as was done later in 1978) or some other cirterion. Previously, the government did not contemplate such a policy partly due to the inherent administrative problems and partly for political reasons. A selective approach could have been adopted in other areas of social welfare programmes as well to save on costs. But here again the administrative difficulties would have been many and these would have created a different set of problems. There has always been a reluctance on the part of governments to adopt any selectivity criteria – especially in regard to education and health because this might not have been politically feasible as well.

While the government social welfare commitments continued – with only minor modifications – for nearly three decades, the economic situation in the country changed drastically exposing the basic weakness of the economy in many respects as well as its inability to support and sustain the various on-going social welfare programmes.

In the 1960s, the Sri Lankan economy was, by and large, in a more comfortable position. The surpluses generated from the plantation sector gave a substantial strength to the economy. There was no serious unemployment problem to contend with The policy-makers did not see any need for major structural changes in the economy. The government policy perspectives were dominated largely by the need for general infrastructure investment and development and land settlement and development to revitalise the peasant sector. In this context the commitments to direct social welfare measures – in the absence of any major restructuring of the economy – assumed importance and were also found to be less burdensome in the early years. Resource constraints in general did not weigh so heavily on the economy until the beginning of the 1960s.

With the early 1960s, the economic situation in the country changed for the worse and was further aggravated, since then, in many respects. As already observed, the decline in the commodity terms of trade continued to dominate the economic scene. (See Table 3). The substantial decline in the terms of trade inevitably reduced the country's import capacity. Sri Lanka's export sector dominated by the traditional exports, such as tea, rubber and coconut had performed badly in the 1960s and 1970s and appears to have lost the dynamism it had in the past – partly due to poor prices in the world market and partly due to the cost and productivity at home. This particularly affected the major export, tea. The land reform measures adopted by the government in the mid 1970s, nationalising all the estate lands owned by private companies and the problem that emerged had further addded to the difficulties of the traditional export sector. The percentage of the three traditional exports in relation to the value of total commodity exports had declined from 85 percent in 1971 to 58 percent in 1980. The export sector centered around the traditional exports seems to face an uncertain future – particularly in regard to tea – which can seriously undermine the country's efforts to earn the much needed foreign exchange.

In the early 1960s the country's first phase of import substituting industrialisation efforts were launched. This was followed by the imposition of an extensive system of direct controls on imports and foreign exchange. The 'inward-looking' and import-replacing industrial development that took place under a regime of stringent import and exchange controls, with a highly protected market, had reached a critical stage by the end of the 1960s when restricted import supplies led to low capacity utilisation in industy. Foreign exchange scarcity became a major bottleneck that affected productivity not only in manufacturing industry but in other vital sectors as well. Balance of payments deficits became persistent and dependence on external assiatance increased resulting in heavy external indebtedness with the external debt ratio exceeding 10 percent annually in the 1970s.

The persistent budgetary imbalance experiences since the early 1960s became a matter of serious concern. With enormous increase in fiscal commitments and operations in the1960s and 1970s – and expenditure increasing much faster than revenue – the size of the overall budget deficits progressively increased, particularly since the mid-1960s. Already by 1975, the overall budget deficit had exceeded Rs. 2000 million, constituting 35 percent of the total budgetary expenditure. The government had to depend on foreign finance and domestic borrowing to meet its budget deficits. During many years in the 1960s and 1970s the government also had to resort to "money creation" that is, borrowing from the banking system – which contributed to inflationary pressures in the economy.

Sri Lanka experienced a remarkable degree of price stability in the 1950s and a mild rate of inflation till the mid-1960s. However, in later years the economy became increasingly subject to high rates of inflation, exceeding 15 percent annually since early 1970s. The impact of oil price-hikes, world commodity inflation, exchange rate adjustments and cost escalations and internal budget deficits financed by 'money creation' – all of them – contributed to the rapid rise in the domestic price level.

Sri Lanka's socio-economic development experience showed, on the one hand positive achievements in the terms of social welfare and redistributive justice and, on the other, a totally unsatisfactory performance as indicated mainly by large scale unemployment, chronic balance of payments deficits, increased external dependence and external indebtedness and high rates of inflation. In the context of such serious economic difficulties that faced the country the question of maintaining a high level of social welfare spending

TABLE 4 Gross National Product, Real National Income, Investment and Savings (value in Rs. Million)

	(1) GNP at Current factor cost prices	Index (1970 = 100)	(2) GNP at 1970 factor cost prices	Index (1970 = 100)	Implicit GNP deflator (1)/(2)	(3*) Real National Income at 1970 factor cost prices	Index (1970 = 100)	(at current market prices) (4) Gross Investment	% of GDP	(5) Domestic Savings	% of GDP
1970	12,967	100.0	12,967	100.0	100.0	12,967	100.0	2589	18.9	2159	15.8
1971	13,486	104.0	13,034	100.5	103.4	12,975	100.1	2398	17.0	2117	15.0
1972	14,542	112.1	13.474	103.9	107.9	13,220	102.0	2638	17.3	2219	14.5
1973	17,737	136.7	13,995	107.9	126.9	13,554	104.5	2528	13.7	2305	12.5
1974	23,119	178.2	14,449	111.4	160.0	13,801	106.4	3735	15.7	1960	8.2
1975	25,478	196.4	14,837	114.4	171.7	13.812	106.5	4140	15.5	2155	8.1
1976	27,750	214.0	15,258	117.6	181.9	14,558	112.2	4896	16.2	4192	13.8
1977	34.432	265.5	15,934	122.8	216.1	15.715	121.1	5259	14.4	6591	18.1
1978	40,242	310.3	17.329	133.6	232.2	17.144	132.2	8554	20.0	6517	15.2
1979	49,542	382.0	18,430	142.1	268.8	17,595	135.6	13,527	25.8	7218	13.7
1980	61,814	476.7	19,456	150.0	317.7	18,257	140.7	22,465	33.7	7443	11.2
1981	77,469	597.4	20,216	115.9	383.2	18,728	144.4	23,610	27.7	11,851	11.6
1982	89,609	691.0	21,229	163.7	422.1	19,508	150.4	30,608	30.5	11,851	11.8
1983	108,171	834.2	22,076	170.2	490.0	20,625	159.0	35,036	28.6	16,598	13.5

Source: *Central Bank of Ceylon – Annual Reports*

Note: 3*– GNP at 1970 factor cost adjusted for terms of trade effect.
5**- Domestic Savings derived as the difference between gross investment and net import of goods and non-factor services.

assumed far greater significance in the seventies than ever before. In the 1970s, it was increasingly felt at official levels that the opportunity cost of social welfare expenditure – more specifically that which is devoted to food subsidies – in terms of 'developmental spending' was high.

When the present government came to power in 1977 and launched its new package of economic policies and measures it was officially seen as a departure from "a stagnating closed economy with a welfare bias to a dynamic open economy with an investment bias."[17] Thus when the present government withdrew the food subsidies in 1978 – from about half the population – based on the eligibility criterion of household income and later replaced the food subsidies with Food Stamps for eligible families – the decision was implemented without much difficulty at the political level. The cut back on social welfare expenditure did not extend beyond the food subsidies. Any further dismantling would not have been politically feasible and was not contemplated by the government either. However, in the post-1977 major policy orientation – some elements of which conformed to the what may be termed "the IMF-World Bank prescriptions" – 'welfarism' of the past has been over-shadowed by the primary emphasis on 'growth and inverstment' within the frame work of a liberalised 'open economy' supported by substantial foreign capital.

In terms of some key indicators[18] – especially relating to growth, investment and employment – the post-1978 period records significant achievements. An average growth rate of 6.2 percent of the GDP in real terms) – giving an annual increase of 4.4 percent in GDP per capita – achieved by the economy during 1978-82 was indeed a remarkable performance, compared to the past period. The overall rate of investment in the economy also registered a significant advance during the same period (see Table 4). However, domestic savings – performance still remains unsatisfactory. This meant that the high rate of investment, partly due to a heavy public sector investment programme, had to be sustained by substantial 'foreign savings'. During the post-1978 period, the country has been able to make a significant dent on the unemployment problem, partly eased by the migration of sizeable numbers for employment overseas. The overall rate of unemployment had dropped from 22 percent of the labour force in 1978 to 14 percent in 1982 according to official records.

Nevertheless, during this period the economy has been very much troubled by such persistent and serious problems as domestic budgetary imbalance with mounting deficits, external imbalance characterised by large balance of payments deficits and acceleration of the domestic price level and escalation of the cost of living. These continue to be major problem areas for the country's economy.

17. Central Bank of Ceylon: *Review of the Economy*, 1980, p. 70.

18. See, Ministry of Finance and Planning, *Public Investment*, 1983 – 1987, May 1983.