

# Impact of the End of the Conflict and Development of the North and East on the Macro-Economy of Sri Lanka<sup>1</sup>

## Introduction

The end of the prolonged conflict, ushering in a more peaceful era, has brought about new expectations and confidence to Sri Lanka. The people in the country are now engaged in their day-to-day activities virtually with a feeling of existence of security. That itself demonstrates the positive sentiment that has been created by the end of the conflict. The peaceful environment will provide strong catalyst for future performance with far reaching positive implications.

It is widely known that, despite the conflict for nearly three decades, the country was able to record an average economic growth of around 4.8 per cent during the period from 1983 to 2008. This has been mainly due to the performance in some sectors, including tea, garments and several service sector activities, which did not get adversely affected by the destruction created by the conflict. However, many believe that Sri Lanka could have grown at a higher rate, if there were no conflict situation in the country. The post-conflict environment and the gradual recovery of the global economy will provide enhanced prospects to the entire country, with the North and East having the best ever opportunities to grow faster in the catching up process.

## The Impact of the Conflict

There is no disagreement that the conflict has adversely impacted, in many ways, on the entire country in general and the people in the

North and East in particular. A prolonged conflict in any country, more often, makes a significant direct impact: it creates human costs in terms of fatalities, disablement, displacement and homelessness; destroys physical infrastructure; reduces service delivery capacities; interrupts the smooth operation of services, including education and health, particularly in the affected areas; inhibits the effective functioning of governance structures and leads to migration and associated loss of human capital, adversely affects business confidence, and both domestic and foreign investment, and production. Indirectly, it adversely affects economic activities, such as, trade and tourism, and weakens the country's fiscal position, thereby, creating difficulties in the financial management while hurting economic growth. Some indicate that the conflict in Sri Lanka has particularly affected adversely on the country's fiscal accounts as it had to incur relatively high amount of military expenditure which has apparently lowered the availability of resources for other social spending, such as, education, health, and other activities. However, there is a counter argument on this view which indicates that defence expenditure can be considered as an investment as it improves the security situation of the country, thereby enhancing private savings and investment and attracting foreign investment to create growth.

The implications of a conflict extend well beyond those people and

**K.M.Mahinda  
Siriwardana**  
*Additional Director,  
Economic Research Department,  
Central Bank of Sri Lanka.*

institutions directly touched due to the conflict. This is common to Sri Lanka as well, since the impact of the prolonged conflict was felt in almost all the sectors in the entire country while disrupting both social and economic life of the people for nearly three decades. The devastation due to the conflict, particularly in the North and East, is great and requires enormous effort for rebuilding. As the rebuilding process in the East is being progressed since 2007-08, the next challenge would be the rebuilding of the North.

## Post-Conflict Development Process

The post-conflict development process requires a multidisciplinary, comprehensive and integrated approach to bring economic, social, political and cultural development in affected areas in line with other provinces. These needs spread from emergency relief to a long-term development framework. In order to provide these needs, the government implements two province-specific accelerated development programmes, *Nagenahira-Navodaya* (NN) in the East and the *Uthuru Wasanthaya* (UW) in the North (See Box 1). The focus in these programmes is mainly on the resettlement of displaced families,

**Box 1**

**Some selected information on the Northern and Eastern provinces**

Item	Northern province	Eastern province
Land Area	-8,884 square kilometres covering 13.6 per cent of the country's total land area.	-9,361 square kilometres accounting for about 15 per cent of the country's total land area.
Population	-Estimated 1.3 million accounting to about 6.5 per cent of the country's total population	About 1.6 million, which is about 7.9 per cent of the country's total population
Districts	-Jaffna peninsula -Vanni (Kilinochchi, Mannar, Mullaitivu and Vavuniya)	-Trincomalee, Batticaloa and Ampara
Natural Resources	-Fertile agricultural lands -Minerals -Forests -Wet lands -Beautiful beaches -Coastal shallow sea enriched with a very high fish density in seas around the country and coral deposits	-Trincomalee Port that has the potential of becoming a major commercial and industrial hub for the South Asian region -An ideal place for high intensity agricultural practices with rich soil conditions, the high level of precipitation brought about by the Northeast monsoons and the large extents of sparsely populated areas -The coastline that stretches 436 km, harbouring large stretches of beautiful beaches and ecological conservation areas that could be tapped to support a vibrant tourism industry -Access to vast stretches of sea that offers opportunities to develop the fisheries resources
Key Economic Activities	-Crop agriculture (paddy, red onions, green gram, maize, chillies, black gram, sesame, ground nuts, fruits and Palmyrah plantations) -Fishing (coastal and off shore fisheries and inland fisheries) -Livestock (cattle and buffalo, goat and poultry) -Agro processing and rice mills -Fish processing -Wholesale and retail trade -Tourism	-Crop agriculture (paddy, maize, vegetables, green gram, red onion/big onion, coconut, fruits) -Livestock (cattle and buffalo, goat and poultry) -Fishing (coastal and off shore fisheries and inland fisheries) -Fish processing -Agro processing and rice mills -Wholesale and retail trade -Handloom industry and other small industries -Tourism
Contribution to GDP	-3 per cent (2008)	-5 per cent (2008)
<b>Post-Conflict Development Plans</b>		
Name of the Plan	<b>Three-Year Investment Programme for the Northern Province: 2010-2012 (Uthuru Wasanthaya)</b>	<b>Three-Year Eastern Province Development Plan: 2007- 2010 (Neganahira Navodaya or Eastern Revival)</b>
Major Objectives of the Plan	-Resettlement of people and rehabilitation and reconstruction of economic infrastructure to restore livelihoods and basic needs, such as, roads, transport, water supply, sanitation, electricity, health and education facilities, etc. -Creation of income generating activities -Rehabilitation of the children, women and youth living in the area, and the rehabilitation of the former LTTE members. -Reconstruction of the rail track and highways connecting the North and the South and schools, hospitals, government offices and houses.	-Improve and upgrade the infrastructure and supportive services in the province, enabling a sustainable economic revival. -Immediate restoration of fundamental rights and ensuring the safety of the people and communities of the region before delving into reinstating their livelihoods. -Develop the agriculture, fisheries, industries, tourism sectors through the development of economic infrastructure, human and natural resources over the 2007-2010 period.
Total Estimated Cost of the Programme	-Rs. 294.9 billion during the period from 2010-2012	-Rs. 198.5 billion during the period from 2007-2010
Amount of Funds to Key Sectors during the Project Period (Estimates)	-Human settlements development (Rs. 45.7 billion) -Improving economic infrastructure (Rs. 176.2 billion) -Strengthening social infrastructure and fostering social services (Rs. 29.3 billion) -Social protection and livelihood development (Rs. 15 billion) -Revitalisation of productive sectors (Rs. 28.4 billion)	-Resettlement of IDPs (Rs. 21.5 billion) -Economic infrastructure (Rs. 84 billion) -Social infrastructure (Rs. 19 billion) -Productive sectors (Rs. 34 billion) -Human settlements (Rs. 38 billion) -Capacity building of the public institutions (Rs. 2.2 billion)

<b>Potential Investment Areas</b>	
<b>Sector/Area</b>	<p><b>Agriculture Sector</b></p> <ul style="list-style-type: none"> <li>-Farming associated with infusion of advanced technology, seeds production and development of high yielding varieties, organic farming-Collection, distribution and marketing of agriculture produce, storage and cold rooms facilities</li> <li>-Fishing (both deep sea and coastal and inland fishery), dairy farming, poultry and animal husbandry, ice plants</li> <li>-Out grower schemes, plant and nursery, advanced technology for pre/post harvest management, cultivation of plants of any description</li> <li>-Agriculture service centres</li> <li>-Research and development</li> <li>-Developing cluster of hatcheries along with a aqua culture breeding centre in each district, particularly in the North</li> </ul>
	<p><b>Industry/ Manufacturing Sector</b></p> <ul style="list-style-type: none"> <li>-Small and medium enterprises, enhancing value addition methods, including packaging, industrial parks, construction industry</li> <li>-Agro processing, fish processing, textile, garment and accessories, leather products, wood and wood products, rubber based industry, electronic, electrical and assembling industry, paper, paper products, chemicals, rubber and plastic, non-metallic mineral products, fabricated metal, machinery and transport equipment</li> <li>-Manufacture of boats and fishing gear, ship and boat building</li> <li>-Cement and mining industry</li> <li>-Modernisation and/or resumption of operations related to Kankesanthurai Cement Factory, Paranthan Chemical Factory, Kantale Sugar Factory and Valachchenai Paper Mill</li> </ul>
	<p><b>Services Sector</b></p> <ul style="list-style-type: none"> <li>-Tourism, recreation and establishment of tourist attractions while promoting eco tourism</li> <li>-Information Technology(IT)/Business Process Outsource(BPO)/Knowledge Process Outsource(KPO) related activities, including training</li> <li>-Ship/boat repairing and maintaining services, and port related services</li> <li>-Transportation to link farmers, factories and markets, building freight stations</li> <li>-Educational and skill development, vocational training management</li> <li>-Enhancing financial inclusiveness by providing banking and financial services, including development institutions, to provide credit facilities for capital investment for the resumption of economic activities</li> </ul>

Sources: *Central Bank of Sri Lanka, Annual Reports: 2007 and 2008* -Three-year Eastern Province Development Plan: 2007-2010 and Three-year Investment Programme for the Northern Province: 2010-2012, Department of National Planning, Ministry of Finance and Planning.

infrastructure development and facilitating the affected people to restart their normal lives and livelihood activities. Under these programmes, a general strategy of taking immediate steps to provide basic infrastructure facilities, public utilities and welfare facilities required for resettlement is followed by the implementation of integrated development programmes, which include sector/area-based short-, medium- and long-term development projects.

The NN focuses mainly on the improvement of economic infrastructure, including roads and bridges, electricity, water supply, transport and ports, as the resettlement of internally displaced persons has progressed in the East. The UW is in progress to expedite the resettlement and rehabilitation process, and rebuild

the damaged infrastructure, including roads and transport, power, water supply, manufacturing, housing, agriculture and irrigation with measures aimed at reducing the poverty and providing social safety nets. In addition, the government has taken initiatives to increase the private sector involvement in this process as well. These include the provision of various incentives, including tax relief, to encourage private sector investment in these areas.

Micro-finance activities are also being introduced to further facilitate grass roots economic activity and diversification. The introduction of refinance facilities to the people in the region and setting up and strengthening of necessary infrastructure for undertaking financial activities are also being undertaken. Transport

infrastructure is coming up. As trainable and hard-working people are available, and local entrepreneurs have the business know-how, there is a huge potential for all the sectors to grow.

#### **Potential Impact on the Macro-Economy**

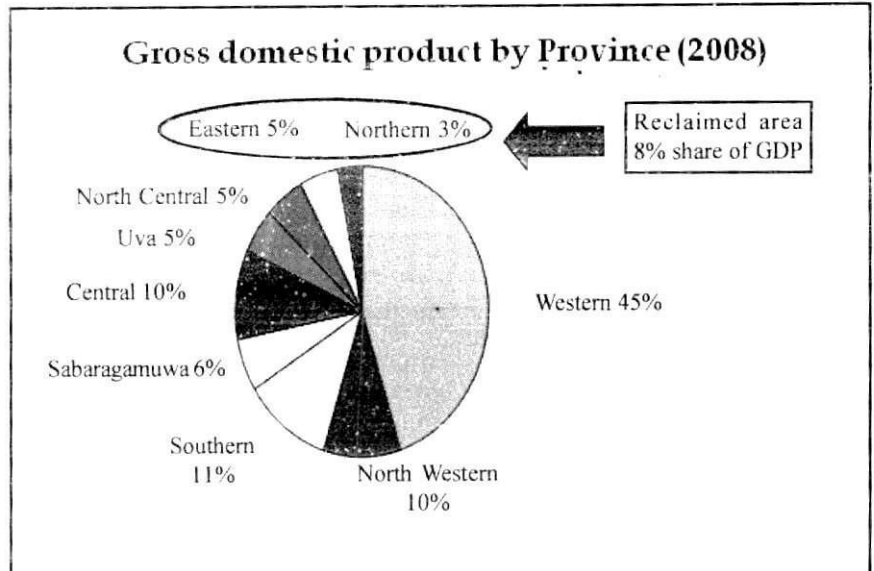
The revival of the North and East would not only improve the livelihoods of the people in those areas. It would also contribute towards the development of the adjacent provinces through the trickle-down effect, thereby, contributing to the development of the entire country. In this background, the impact of the end of the conflict and the reconstruction and development in the North and East could be identified by looking at the potential impact on the key sectors in the macro-economy.

## Real sector

It is expected that the end of the conflict and the rebuilding of North and East will help economic growth to pick up in the years immediately after the conflict. The impact on the real economy would come from all three sectors, i.e., Agriculture, Industry and Services. The terrorism-free environment is the most important catalyst for boosting investment in all the areas, which provides investors, both local and foreign, a good opportunity to undertake/enhance their investments in the country with certainty.

The impact on the economy that would have from the rebuilding of the conflict-affected North and the East is particularly significant. Before the conflict, the agriculture, livestock and fishing sectors in the North and East contributed to a substantial share of the country's GDP. However, after several decades, it has declined significantly, mainly due to security concerns, devastation and many other factors, including lack of infrastructure and other facilities. In 2008, the two provinces contributed to about 8 per cent of the gross domestic product (GDP) of the country. However, it is a widely known fact that the North and East have vast untapped potential to grow.

The North and East are rich with a range of natural resources. The tourism industry, both domestic and foreign, has a great potential to grow with the end of the conflict by using the large stretches of beautiful beaches and ecological conservation areas (See Box 1). This is already evidenced by the enhanced number of domestic tourists who travel around the country, particularly in the East. Foreign tourist arrivals are on the rise since the end of the conflict in May 2009 as many countries have



removed or eased travel restrictions on Sri Lanka. In fact, the New York Times paper, in January 2010, has indicated that Sri Lanka is one of the 31 places to go in 2010, which demonstrates the potential that Sri Lanka has in tourism with the end of conflict.

The positive impact on economic activities is already seen a number of other areas. In the agriculture sector, this is manifested in the increasing amount of land cultivated in the conflict-affected areas, especially in the East. Once the resettlement is completed this will be seen in the rest of the districts in the North as well. To supplement this, irrigation facilities are also being restored. The restrictions imposed on fishing have been lifted thereby promoting the once flourishing fishing industry in the North. The provision of boats, fishing nets and other equipment will improve the fish supply further. The livestock sector is another area that could be developed as it has been there for many years in the North and East. The development in this sector is in progress with the setting up of dairy villages and providing necessary training complemented by various incentives and support by the government and other agencies. The difficulties in moving

the produce to the market centre, owing to inadequate transport and infrastructure facilities, would be resolved by improving the road network and establishing collection centres. Various credit facilities that are being offered would ensure farmers having necessary credit to acquire improved varieties of calves. Meanwhile, the opening up of the roads, such as the A9, also will enhance intra-province and inter-province transportation and various economic activities. The private sector investors have already responded by commencing various other projects in the North and East. These include the hotel industry and tourism related other activities, manufacturing of readymade garments and other textile products for export, projects to manufacture concrete tiles, rice mills and furniture.

## External sector

The external sector has already shown several positive developments with the end of the conflict. The strengthened investor confidence has increased the foreign investments in government securities. The higher foreign inflows due to this as well as other factors have increased the foreign exchange reserves to a historically high level. This has even created

the pressure on the rupee to appreciate. The higher oversubscription (13 times) of the second international sovereign bond issue in October 2009 also indicated the positive investor sentiment on the country. The approval of the IMF Stand-By Arrangement in July 2009 has further boosted the enthusiasm with rating agencies revising their rating outlook upwards. The international trade activities, which decelerated in 2009 due to the global recession, will accelerate with the resumption of the normal economic activities as well as the reconstruction work in the North and East, thereby leading to a substantial increase in imports. The recovery in the global economy will provide enhanced opportunities for the export sector. The remittances will also increase as Sri Lankan diaspora would send more funds to their relatives in the affected areas who would now engage in economic activities freely. The diaspora is expected to take part in the development process as well. The building up of confidence, the new peaceful environment and the investment opportunities in the North and East will attract higher amount of foreign direct investment (FDI). With the development initiatives, inflows to the government in terms of loans and grants will also increase. The enhanced inflows will lead to record a balance of payment surplus thereby strengthening foreign exchange reserves further. The effective utilisation of foreign resources would help achieve expected higher economic growth, thereby, enhancing the debt servicing capacity of the country.

#### **Fiscal sector**

The end of the conflict has put a significant responsibility on the government's shoulders to play the keyrole in the redevelopment process of the North and East.

Accordingly, the efforts in many areas, including rehabilitation and reconstruction activities, are being undertaken. These are manifested in the implementation of programmes, such as, *Nagenahira Navodaya* and *Uthuru Wasanthaya*, the key development programmes of the government.

The year 2010 would be challenging to the government as it has to accelerate these development work while continuing infrastructure development projects in other areas of the country as well. The continuation of these programmes would create pressure on the government budget in the short run as it would require a higher amount of resources from both domestic as well as foreign sources.

However, in the long run, there will be a positive impact on the government budget from a number of areas. The restoration of the infrastructure and the resultant revival of the economic activities in the North and East and the enhancement of economic activities in the rest of the country would increase the revenue collection. The end of the conflict would also lower the defence-related expenditure gradually, which would be used for alternative activities, including investing in economic and social infrastructure.

#### **Monetary and financial sector**

There are a number of potential positive developments in the monetary and financial sector as well. The immediate developments in the agriculture in the North and the East will help increase the domestic production thereby reducing supply-side pressure on inflation. The new environment has been conducive on expansion of the branch network of commercial banks and other financial institutions in the North and East. It will help provide much needed

financial services to the people in those areas in terms of deposit mobilisation, lending and other financial activities. The setting up of bank branches will also help migrant diaspora to enhance their remittances through official channels. The post-conflict positive investor sentiment also resulted in improving the performance of the Colombo Stock Exchange which was manifested in the significant increases in market indices<sup>2</sup>.

#### **Way Forward**

The end of the conflict has certainly brought about new hopes to Sri Lanka to have a sustainable development. The impact of this is already visible in many fronts. The peaceful environment that has been created in the country is the most invaluable impact of the end of the conflict. The better exploitation of this new opportunity is a challenging task and is a responsibility of all the stakeholders. Although government's efforts are critical in addressing post-conflict development process, they have to be complemented with the mobilisation of all talents and resources that stakeholders have. Hence, their participation should be sought, nurtured and developed to ensure a sustained and an inclusive approach in the rebuilding process. The rehabilitation and rebuilding activities, particularly in the North, would have several positive impacts on enhancing overall economic growth. Hence, the near-term challenge under the present conditions would be the successful completion of the ongoing rehabilitation and rebuilding process. This has to be complemented with measures aimed at sustaining the positive investor sentiment.

*Contd. on page 48*

The prolonged conflict has had various implications on shaping the macro economic framework of the country to deal with the situation. In particular, the fiscal policy formulation was impacted by many developments during the conflict period and hence, the monetary and other policies were also, to a certain extent, driven with the implications that emanated from the conflict time fiscal policy. However, the new environment provides an opportunity to restructure the policies to facilitate the rehabilitation and reconstruction process in the North and East and to provide necessary support to stakeholders in the entire country to go forward. Strong macro-economic fundamentals with sound fiscal management, low inflation, and strong balance of payment position will be conducive in facilitating long-term investment. In addition, the long-term sustainability of unleashing the

full growth potential of the country will depend upon a number of other factors, including the creation of a lasting solution to the underlying causes of the internal conflict and successful implementation of the already identified and other necessary structural changes in the public sector. The success of the effective use of both the terrorism free environment and much more opportunities that have been generated by the new situation, complemented by the implementation of appropriate structural changes, will ultimately decide the macro level outcome of the ending of the conflict.

#### **References:**

Central Bank of Sri Lanka, Annual Reports, 2007 and 2008.

Three year Eastern Province Development Plan: 2007-2010, Department of National Planning, Ministry of Finance and Planning.

Three year Investment Programme for the Northern Province: 2010-2012, Department of National Planning, Ministry of Finance and Planning.

#### **Footnotes:**

<sup>1</sup> The views expressed in this article are those of the author and are not those of the Central Bank of Sri Lanka.

<sup>2</sup> The All Share Price Index (ASPI) and Milanka Price Index (MPI) closed at 3,385.6 and 3,849.4, respectively on 30 December 2009 compared to that of 2,030.9 and 2,230.3 on 18 May 2009. The market capitalization also increased to Rs. 1,092.14 billion from Rs. 661.75 billion on 18 May 2009. The Colombo Stock Exchange (CSE) was recognized as the second best performing stock exchange in the world in 2009.