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Issues in Transition Economy towards Inclusive Growth

An Assessment of Growth policies Sri Lanka

Prof. G. M. Henegedara

Abstract - **The paper describes issues in adopting inclusive growth policies in transition of economy in Sri Lanka. It assess the impact of various inclusive growth policies on sustainable development. Inclusion of all the segments of the society has accepted as a required factor of sustainable development and thus all the nations follow inclusive growth strategies as broad based growth, shared growth and pro-poor growth policies. As an emerging market economy, the successive governments of Sri Lanka followed this ideology and implemented various policies and programs in view of assuring growth with equity and equality of opportunities in production process. Broadly it includes various programs such as social and physical infrastructure development, agricultural development, industrial and institutional changes made under protective, liberal and neoliberal policy frameworks since independence in 1948. However, the impact of policy interventions on economic growth were not fascinating in terms of stability and sustainability due to various setbacks. The paper expects to review the outcome of policy interventions in terms of receiving stable GDP growth rate, equity, equality of opportunity and protection in market and employment transitions along with identifying policy implications on sustainable development. The analysis was based on counterfactual evaluation method of comparing key economic indicators at different policy regimes during 1960-2016 period. It includes key indicators i.e. GDP growth rate, per capita income, savings, poverty, employment and equity. The analysis based on ttime series data revealed that growth policies had an impact on increasing. GDP growth rate and per capita income with sufficient improvement in human development indices. Nonetheless the pace of GDP growth rate insufficient to boost the economy as in other developed economies. Continues budget deficit and imbalances in BOP, Low savings and reliance on foreign capital, deteriorating terms of trade and political instability led to peg the country with debt trap, that cussed as the main hinder for inclusive growth..**

Key Words — bindings, equity, GDP growth rate, per-capita income, policy interventions

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I. Introduction

Sri Lanka is an emerging market economy located in the Indian sub-continent. The total land area of the island is 65,610 sq. km. and nearly 2.16 billion people lived there in 2018 (https://www.cbsl.gov.lk). Inclusive growth with shared growth and pro poor growth become the essence of economic development policies of the country since its independence gained from the British Empire in 1948. Along with the inclusive growth policies, the overall economic growth performance of the country for the past 70 years is not satisfactory compared to other developing nations. The pace and pattern of growth was not adequate and stable. The core issues prevailed in the eve of independence were interconnected with critical problems such as low income, low production, continues deficit in balance of payment, insufficient domestic food production, unemployment and population pressure in the western region (Fernando, L, 1997). Thus, all the successive governments in Sri Lanka paid its utmost attention on avoiding these issues and implemented broad based and pro poor growth strategies such as production and employment generation, poverty eradication, income redistribution, area development and community welfare programs. Despite slow growth rate in GDP, the impact of policy interventions was somewhat effective in reaching quality of living standards in literacy rate, life expectancy and mortality rates (Kelegama, S, 2012). Nevertheless, pace of GDP growth rate during 1948 - 2000 period was around 4.2 percent per year and slightly increased to above 5 percent per annum during 2001-2016. However, the purchasing power parity income and human development indices were improved substantially while decreasing the poverty ratio from 43 percent in 1983 to 6.7 percent in 2013 (https://www.cbsl.gov.lk/). Thus the actual growth performances in the past 70 years in Sri Lanka showed a mixed picture indicating positive and negative trends in terms of inclusive growth performance.

Having a stable growth rate accompanied by structural transition in the economy is a required factor for the sustainable development of a country in the long run. Nonetheless it was not happened in Sri Lanka and inconsistencies in pace and pattern of economic growth become a visible issue in assuring total inclusiveness in economic development. It raises basic questions about rationale of ends and means of policies adopted i. e. what policies work, what doesn't work, what are the barriers? Why doesn't response? and what are the alternatives? Hence, it is worthwhile in investigating causal relationship of inconsistency in pace and pattern of growth in Sri Lanka. The issue reflects typical causes inherited to a developing nations i.e. resource scarcity, technological gap, low savings and low investment, institutional barriers, manmade hazards or natural hazards and subsequent effects of slow growth, under employment and under development. Thus the main objective of the paper is to assess the impact of inconsistencies in broad based and pro poor growth policies in Sri Lanka on achieving sustainable inclusive growth in the long run.

The methodology of the paper was based on counterfactual evaluation method by comparing pre and post situations of policy impacts by key growth indicators of Sri Lankan economy. Thus the paper consists of five sections. The section one briefly describes the background, the problem and the objective of the paper. The section two reserve for the literature review in view of conceptual base, growth measures and the growth experiences of Sri Lanka. The section three describes methodology of the paper while presenting the test results in the fourth section. The section five presents discussion by reviewing results of growth indicators in accordance with policy objectives. It also presents the implications of inclusive growth approaches on sustainable growth in Sri Lanka. The last section presents concluding remarks and policy recommendations.

II. Literature Review

As a new development concept, inclusive growth provides diverse definitions as it described in many policy analysis. Though it defined as broad based growth, shared growth and pro-poor growth)Rauniyar, G. and Kanbur, R. 2009, https://www.weforum.org/reports/the-inclusive-development-index-2018(, broadly it views as combined effort of achieving these three ideas together. Thus the concept focuses on both pace and pattern of growth, emphasizing long term sustainable rapid growth, broad based across sectors and inclusive of the large part of the country's labor force. This definition shows a direct link between micro and macro determinates of growth and captures structural transformation for economic diversification and competition (Ianchovichina, E. and Lundstrom, S. 2009). Both pace and pattern of growth are crucial for achieving sustainable growth rate and poverty reduction. This idea was historically proved by the developed European countries (Goldstone, J. 2002). It also empirically proved with findings in the growth report of strategies for sustained growth and inclusive development that published by the Commission on Growth and Development of the World Bank (2008). The report states that inclusiveness is a concept which consisted of equity, equality of opportunity and protection in market and employment transitions that required for any successful growth strategy. It also referred as longer term perspective of productive employment rather than on direct income redistribution. Thus the difference between inclusive growth and pro poor growth is clear. Pro poor approaches intended in improving welfare of the disadvantage groups while inclusive growth approaches intends to enhance opportunities for the majority of labor force including poor and middle class equally. Financial inclusion or access to financial services were also recognized as the important aspects of inclusive growth approaches. According to evaluation report published by IGP group of World Bank in 2005, though 700 million people have gained access to formal financial services in the past few years, still 2 billion remain excluded. Thus financial inclusion that allow to access by poor families and microenterprises to financial services is also been an objective of the World Bank Group for a long time (ibid).

Though literature on growth reveals some discrepancy between neo classical growth models and new growth models, having high sustainable growth rate over long period is a required factor for reducing poverty(Todaro, M. P and Smith, S. C 2009). Nonetheless, high growth rates and poverty reduction can be realized only when source of growth are expanding and increasing the share of labor force more efficient manner. Some other important facts derived from literature are; IG focuses not only on productive employment growth but also on the productivity growth; IG is fueled by market driven sources of growth and the role of the

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government limits to facilitating and regulating functions (Deininger and Squire 1998, Dollar and Kraay 2002, Bourguignon 2003 and Kraay 2004). The literature on inclusive growth pattern in Sri Lanka is not in consistency and it available in different forms i.e. pro poor growth, income redistribution, rural development and poverty alleviation studies (Perera, I. R.1988, Gunawardena, D. 1998, Dias, etal 1990, and Lakshman, W. D.2000).

A. *Sri Lankan Economy and Need for Inclusive Growth*

Sri Lanka is known as middle income country as per the World Bank's classifications on development (2008) and its GNP per capita income was US $ 4102 in 2018. Population of the country is nearly 2.16 billion and approximately 60 per cent people live in rural areas. The country maintains 6.1 per cent average growth rate during the past 2010-2016 period even under the pressure of global economic shocks. The share of the GDP from agriculture has declined from 46.3 per cent in 1960 to 7.9 per cent in 2018 while the share of GDP from industrial and service sectors have increased respectively from 19.6 and 36.9 per cent to 27 and 57 per cent during the respective period. Though the relative share of the agricultural sector has declined over the years, the sector is still important as the main source of employments by contributing 27 per cent of labour force utilization (https://www.cbsl.gov.lk).The main feature of the agriculture sector is its dualistic nature that inherited from the British colonization as commercialized plantation economy and subsistence economy based on food crops (Snodgrass, 1966). Thus tea, rubber and coconut were cultivated as plantation crops for the export market and paddy, vegetables and other field crops were cultivated in the domestic food crops sector. The industrial and service sectors also become dynamic sectors after 1980 as the economy opened for the global trade opportunities.

Being a small British colony, the economy of Sri Lanka had faced many challenges for the development since its independence in 1948. These challenges were closely related with inherited causes such as scared resources, low productivity, population pressure and unemployment etc. (Snodgrass, D. R. 1996). Consequently, low production, unemployment, low income, poverty, malnutrition, social unrest and political instability arisen as the core factors of long term inclusive growth (Laksman, 1997). Therefore, all the successive governments followed various policy adjustments through protective and liberal policy measures (Alailima, 1997, Fernando, 2010). It includes welfare and income distributary programs such as free education, free health services, rice and input subsidies, poverty eradication, rural infrastructure development and micro finance programs (Somaratne, 2002). Though these programs had a significant impact on improving quality of life standards together with reducing poverty level and inequalities, long term sustainable development that required employing majority of labor force effectively is yet to be achieved. Similarly, outcome of rural and agricultural development policies envisaged on improving irrigation and rural transport were not so effective in overcoming uncertainties faced by small producers though it has some effect on improving livelihood, food security and income distribution of rural communities.

Considering overall development performance over the past 70 years since independence in 1948 four policy regimes were identified in accordance with its vision, objectives, strategy and programs implemented by policy makers (Athukorala, P. and Kelegama, S. 1996, Somaratne, W. G. 2002). It includes

- Closed economic policy regime (1948-77): Policies followed during this period were inward looking and aimed at self-sufficiency. Thus import restrictions, market regulation policies and promotion of domestic industries were followed as key strategies
- The first pace of Open economic policy Regime (1978-1987): liberal economic policies were introduced and abolish economic restrictions on trade and finance. Thus a broad policy reform made on liberalizing trade, finance, market and fiscal activities (ibid) while implementing welfare policies to protect disadvantage groups.
- The second pace of open economic policy Regime (1988-2004): Continuation of open economic policies by implementing structural adjustment policies introduced by the International Monitory Fund (IMF) and World Bank (Kelegama, S. 1991). Nonetheless, various social protection policies were continued to protect low income categories.
- Neo Liberal policy regime (2005- to date) Policies implemented during this regime could be regarded as the continuation of liberal policies followed since 1977 focusing on globalization and social democratic policy options. Since 2015, policies focused more on

privatization, free trade and austerity along with good governance and social justice.

In spite of different policy regimes all the successive of governments of Sri Lanka has implemented several inclusive growth programs in view of attaining growth and equity (Alailima, 1997). It includes;

- Infrastructure Development Programs launched for building economic, social and financial infrastructure i.e., electricity, telecommunication, irrigation, rural roads, financial institutions and rural marketing centers
- New Irrigation development and settlement programs i.e. irrigation settlements under major irrigation schemes , Mahaweli Ganga development
- Rural and Regional Development Programs i.e. Integrated Rural Development Projects (IRDP) and Regional Economic Advancement projects (REAP)
- Agricultural and Agrarian Development Programs i.e. agricultural settlement programs and improving farm services such as credit, extension and marketing services
- Establishing free trade zones, harbor development and airport development for employment generation
- Price support polices for safeguarding local producers i.e. guaranteed Price (GPS) and input subsidies.
- Poverty alleviation programs such as rice subsidy, Janasaviya and Samurdhi,
- industrial development programs i.e. establishing Industrial Development Board (JDB) and regional industrial estates
- Community strengthening and empowering programs i.e. Divineguma
- Micro finance programs

The expected outcomes from these programs were broad-based development in view of improved quality of life through mode of production, infrastructure development, institutional development and capacity building along with increased GDP growth rate and per capita income, improved health education and public welfare of the nation, increase savings and investment ratios, poverty eradication and employment generation etc.

III. Methodology

As an evaluation study, the methodology was designed to assess that how growth policies implemented by the government have impacted on changing pace and pattern of economic growth in Sri Lanka. The Impact was measured by key economic indicators such as GDP growth rate, per capita income, savings, investment ratios, poverty, life expectancy, literacy ratios, income distribution and employment status. The assessment was done by reviewing variation and trend of economic indicators for1960-2016 period in accordance with four main policy regimes i.e. closed policy regime (1960-77), the first pace of open economic policy regime (1978-1987), the second pace of liberal policy regime (1988-2004) and third liberal policy regime (2005-2016).

The relationship between key economic indicators and different policy regimes were analyzed using graphical methods in statistics. Policy regimes were demarcated according to macroeconomic viewpoints such as production, consumption, investment, employment and price stability. Economic data published by the Central Bank of Sri Lanka and the Department of Census and Statistics of Sri Lanka were used for the analysis. Economic performance that highlight pace and pattern of growth for the consecutive period has presented in table 1. It reflects key indicators such as GNP growth rate, GDP Per capita, share of GDP for agriculture, industrial and service sectors, population growth rate, labour force participation, unemployment, investment, national savings rate, poverty rate, human development index and life expectancy. It also includes government debt, BOP deficit, birth rate, death rate, exchange rate and consumer price index.

IV. Results

As shown in table 1, GNP growth rates has changed in accordance with policy regimes. It reflects that growth rates during liberal and neo liberal policy regimes were higher than the growth rates at closed policy regime. The average growth rate for entire period (1960-2016) is 4.8 and It increases from 3.8 in closed policy regime to 8.1 during second pace of open economic policy regime (1988-2004). Hitherto average growth rate is inadequate the economy as the emerging market countries in Asia i.e. Singapore, Malaysia and China. It is not attractive to maintain a sustainable growth path required for inclusive growth. According to Bradly's law of 72, 14.5 years require to double the GDP under overall growth rate of 4.8. However, it requires nearly 12 years under 6.1% of the average growth rate in third regime (1988-2004).

Per capita income has increased steadily during four policy regimes of 1960-2016 period indicating Sri Lanka was able to double her per capita income within 15 years during 1960-1975 period and again within 16 years in 1975-1991period. Nevertheless, it took 13 years to double during 1991-2004 period and only 4 years to increase, from $ 1062 in 2004 to $ 2014 in 2008. Though it was predicted to double from $2014 in 2008 to $4000 by 2016, it couldn't achieved until 2018 (Central Bank of Sri Lanka, 2018).

As shown in table 1 and fig. 2, the structure of the GDP has changed reducing the share of agriculture from 33 percent in1960-77 period to 9 percent in 2005-16 period while the share of industrial sector has increased from 21 to 28 percent and service sector from 46 to 57 percent in the same periods. Though the relative share of agriculture has declined, still 30 percent of labor force of the country is employed in the agricultural sector.

The most important requirement for maintaining sustainable GDP growth rate is savings ratio because it determines the investment ratio of the economy. Table 1 and fig 3 show that the annual savings ratio (24%) of the country is not adequate to meet the required investment ratio (30%) of the economy. Thus savings-investment gap of the economy is 6% and subsequently government had to rely on the external funding source such as foreign direct investment, loans and grants. Though the national saving rate has increased over the years, reliance on foreign loans become the main source of the fulfilling savings and investment gap. It created a greater threat to the economy to peg with debt trap and to realize the dream of inclusive growth.

When consider the equity in terms of income distribution, it shows that Gini coefficient has widen during liberal and neoliberal policy regimes due to high participation of private sector. Thus Gini coefficient has increased from 0.43 in 1982/83 to 0.48 in 2013/14. (Table 1). Household Income distribution is further described in table 2 by reflecting variation of Gini coefficient according to three sectors i.e. urban rural and estate of the economy. The variation is significant during liberal and neo liberal policy regimes.

With regard to inclusiveness in terms of labor force participation and employability, it shows that labor force participation has increased from 35.5 percent in closed economic policy regime (1960-77) to 51.2 in neo liberal policy regime of 2005-2016 period. At the same time, unemployment rate has decreased from 15, 7 percent to 5.1 during consecutive policy regimes (see table 1 and fig.4). When assess the inclusive growth in terms of poverty reduction, it shows that the poverty ratio which determine on the head count index has declined drastically from 28.8 percent (1995/96) to 6.7 percent in 2012/13. Thus poverty alleviation programs were able to decline vulnerability of poor segments during 2005-2016 period.

According to summary analysis, main economic indicators such as GNP growth rate, per capita income and the composition of GDP have increased sufficiently as require to improve pace and pattern of growth. But savings and investment ratios that crucial to maintain sustainable inclusive growth rate were not enhanced sufficiently. Nevertheless literacy rate, mortality rate and life expectancy have improved sufficiently as required for equity.

Other indicators which used as proxies to measure inclusive growth also indicate positive trend over the past 55 years. Thus labor force participation has gradually increased over the period while decreasing unemployment rate during the respective period. Nonetheless, income inequalities has widen instead of reducing it as required for assuring inclusive growth. Thus the main assumption of the analysis prove the fact that policy interventions made by the successive governments in Sri Lanka were effective in gaining inclusive growth though the pace of growth is sluggish.

V. Discussion

Despite the positive but slow impact of economic indicators on inclusive growth, performance of socio economic indicators **i.e.** life expectancy, literacy rate, birth and death rates were also improved over the period even equal to the high income countries. It was reflected by increasing Human Development Indicator (HDI) from 0.653 (1980 to 0.770 in 2018. Improvements of socio economic indicators indicate that the economy is being structurally moved towards the developed economy as occurred in newly developed countries. Many of these indicators were impressive and fulfilled the requirements of inclusive growth.

The interventions made through irrigation, agricultural policy reforms and infrastructure development programs has positively influenced to reduce vulnerability of the peasant sector by reducing uncertainty and high risk in cultivation in dry zone areas. Rehabilitation of old irrigation systems and commencing diversified new irrigations projects were greatly helped to increase the extent of paddy lands from 8844,647 hectares in 1980 to 937175 hectares in 2005 enabling to produce more than 85 percent of domestic rice requirements of the country. At the same time, 90 percent of total populations living in rural areas were able to use electricity as the beneficiaries of hydro and coal power projects implemented by the government. Nonetheless, some broad based development policies were not so effective to accelerate GDP growth rate though it helpful to reduce urban rural disparities. The factors influenced for slowing down the progress were mainly related with savings and investment gap that related with low income of the rural community. Similarly, deterioration of terms of trade of international trade, deficit in balance of payment, increasing foreign debt and slow technological progress are also greatly influenced. At the same time, nations' conventional attitudes or cultural lags for modernization were negatively affected in implementing policy reforms.

Since technology has become the most crucial factor of growth and development as disclosed by Slow's growth model (1956), the influence of technological development and innovation programs should also be considered in terms of improved factor productivity. Thus, total factor productivity in Sri Lanka has increased from 0.33 in 1960-2000 period to 0.89 during 1979-2000 period (Henegedara, 2016). Adoption of modern technology has greatly influenced in increasing productivity of agriculture and industrial sectors. However, research and development in innovative technology is yet to be improved.

Having a stable macro policy framework is an essential requirement for implementing development policies and programs. The study empirically proves the fact that liberal and neoliberal policy regimes were more effective in gaining macro benefits than the protective regime. It implies the fact that liberal system is more inspire in increasing growth. But the self-interest that behind the liberal and neoliberal policies are not encourage distribution or the equity. So the inclusiveness of all segments of the society should be focused on stable system associated with liberal and social policy framework that known as social democratic system.

As shown by table 1 and 2, income distribution has not occurred equally as increased GDP growth rates and per capita income. It implied that the government should mediate sharing benefits equally for assuring total inclusiveness in growth and equity, It also showed that growth and development were not occurred symbiotic manner as proceed in the developed nations in 19th centuries and as shown in Rostow's Stages of growth model and Arthur Lewi's two sector' growth model (Todaro, M.P. and Smith, S. C. 2009).

Though the poverty ratio has declined gradually in the past, causes of poverty linked with vicious circle is yet to be eradicated as required for inclusive growth. Though the table 1 and fig. 3 shows that the country was able to increase labor force participation and decrease unemployment rate, it doesn't means that the country has utilized fully its labor force along with total utilization of production possibility of the economy. Under employment and disguised unemployment should avoid by improving employability through training and micro finance projects.

In addition to the increased income inequality as shown in table 1 and 2, economic disparities have increased tremendously in the past. Development has concentrated mainly to three districts of the Western province that represent almost 50 percent of GDP share of the country in 2006. It is accepted that nearly 70 percent of urban population of the country also concentrated in the Western province. On the other hand, the poverty has concentrated to rural provinces such as Uva and Sabaragamuwa, Northern, Eastern and North Central Provinces. Thus the share of poverty in Western Province is minimal compared to other provinces. (Central Bank of Sri Lanka, 2012). Hence, a targeted poverty policy should be implement for rural areas particularly by addressing uncertainty prevailed in small farming sector.

VI. Conclusion

Considering the results and the implications of inclusive growth performance of Sri Lanka, it concludes that inclusive growth policies and programs implemented by successive governments under different policy regimes have impacted positively on increasing economic growth by changing pace and pattern of growth leading to expand the production possibility frontier. But expansion is somewhat biased more on labor intensive and agricultural products than technology oriented industrial products required for sustainable inclusive growth. Analysis showed income inequalities among urban, rural and estate sectors indicating negative signs in equity and distribution. It also revealed that the economic growth indicators were very effective under liberal and neo liberal policy regimes than the closed economic policy regime that implemented during 1960-1977 period.

So the attention of policy makers should focused on policies and programs for maintaining sustainable GDP growth rate while assuring equity in income distribution too. At the same time attention should be focused on innovations in products, technology and market by recognizing the needs of rapidly moving global economy. Though liberal and neoliberal policy regimes were more effective than protective regime for increasing GDP growth rate and percapita income, the government intervention is crucial in assuring justice, equity and equality.

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TABLE: I. AVERAGE ECONOMIC PERFORMANCE OF SRI LANKA - ACCORDING KEY INDICATORS FOR FOUR PERIODS

Indicator	1960-1977	1978-1987	1988-2004	2005-2016
National Income				
GNP Growth rate	3.8	5.2	4.4	6.1
GDP Per capita	US$ 188	US$ 321	US$ 718	US$ 2772
GDP composition.				
Agriculture Sector	33 %	27.2%	22.0 %	8.7 %
Industry Sector	21 %	27.7 %	26.8 %	28.8 %
Service Sector	46 %	44.4 %	51.2 %	56.8 %
Population Growth rate	1.8	1.1	1.0	1.1
Other Economic Indicators (As % of GDP)				
Labour Force Participation	35.5	36.2	49.4	51.2
Unemployment rate	15.7	14.6	11.0	5.1
Investment	15.6%	26.3%	24.2 %	30.2%
National savings	12.3%	15.6%	19.3 %	26 %
Government Debt	57.2	78.7	97.8	78.4
BOP deficit	-6.3	-11.5	-8.4	-6.7
Socio Economic Indicators				
Birth Rate	31.3	26.1	19.8	17.6
Death Rate	8.1	6.2	6.0	6.1
Literacy Rate	78.7	87.3	90.3	91.9
HDI	0.653 (1980)	0.706 (1990)	0.747(2000)	0.766
Life expectancy	35.5	36.2	49.8	51.2
Poverty Ratio	-	28.8(1995/96)	8.9 (2009/10)	6.7 (2012/13)
Gini coefficient	0.43	0.46(1986/87)	046 (2003/04)	0.48 (2013/14)
Exchange rate $/Rs	6.4	22.8	63.8	121.1
National Consumer price index			3.8 (2013=100)	4.0 (2013=100)

FROM 1960 TO -2016

(Annual reports, Central Bank of Sri Lanka)

TABLE II. GINI COEFFICIENTS FOR HOUSEHOLD INCOME BY SECTORS

Sector	1980/81	1985/86	1990/91	1995/96	2002	2006/07
All Island Urban	0.43	0.46	0.47	0.46	0.48	0.49
Rural	0.44	0.47	0.62	0.47	0.51	0.54
Estate	0.38	0.46	0.42	0.46	0.46	0.46
	0.27	0.34	0.25	0.34	0.32	0.57

(Household of Census & Statistics)

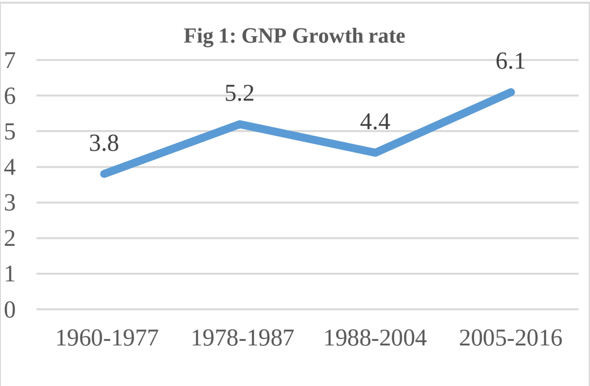

Figure 1. GNP Growth rate

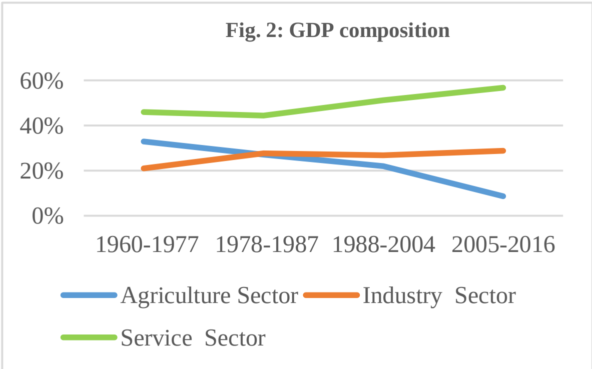

Figure 2. GDP composition

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Figure 3. Investment and Savings (As % of GDP)

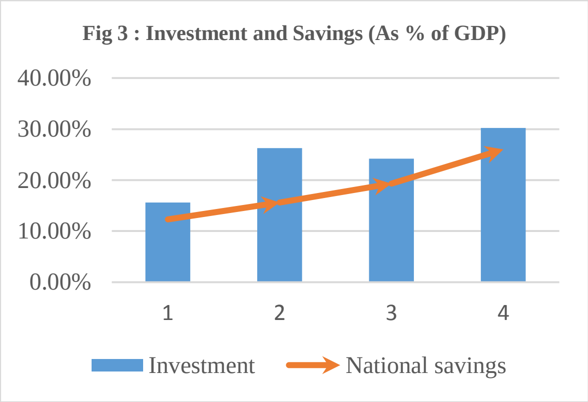

Figure 4. Labor Force Participation and Unemployment Rate