XII. RURAL POVERTY IN SRI LANKA*

Definition and extent of rural poverty

A. Measurement of poverty

To determine the idea of poverty, a poverty line derived by using a nutritional norm has been adopted. The major shortcoming of this technique is ignorance of the variances in calorie intake at given consumption expenditure levels. For the purpose of determining the incidence of rural poverty in this paper, a poverty line has been defined by using a nutritional norm based on the Workforce Survey and Household Income and Expenditure Survey of 1990/91 as well as information given in the World Bank report on Sri Lanka Poverty Assessment 1995. In defining the poor, two levels of caloric and income criteria were considered in the Household Income and Expenditure Survey.

Poor level 1: Those households spending more than 50 per cent of their total household expenditure on food, but whose adult equivalent monthly food expenditure level is less than the average per adult equivalent monthly food expenditure level observed for those households in the bottom two expenditure quintiles and which have a per adult equivalent calorie consumption level between 2,475 and 2,750. (The average adult equivalent monthly food expenditure of those households in the lowest two per capital expenditure quintiles, and having per adult equivalent calorie consumption between 2,475 and 2,750 is known as the minimum required Adult Equivalent monthly Food Expenditure).

Poor level 2: The same as in poor level 1, except the minimum required adult equivalent monthly food expenditure which, in this case, will be the average adult equivalent food expenditure of those households in the lowest two quintiles whose adult equivalent calorie consumption is between 2,200 and 2,750.

The poverty incidence of all island, rural and estate sectors was estimated using the criteria described above, as indicated in table XII.1.

Table XII.1. Incidence of poverty by sector and all-island, 1990/91

Sector	Poor level 1	Poor level 2
All island	30.4	27.4
Urban	18.2	16.3
Rural	34.7	31.3
Estate	20.5	18.0

Source: Household Income and Expenditure Survey 1990/91, Department of Census and Statistics.

B. Rural poverty

The data presented in table XII.1 clearly show that the incidence of poverty is high in the rural sector compared with the urban and estate sectors. That high incidence of rural poverty is also evidenced by the poverty incidence developed by the World Bank.

The estimates show that poverty in Sri Lanka is predominantly a rural phenomenon; the rural sector accounts for about four-fifths of aggregate poverty. The share of the rural, urban and estate sectors in the total number of the poor (by the reference poverty line SL Rs 471.20/person/per month) is 79, 17, and 4 per cent respectively. The relative contribution of those sectors to national poverty are largely invariant over different poverty measures and poverty lines.

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The geographical distribution of incidence of rural poverty varies from one province to another. The incidence of poverty is also high in the rural North-East, North-Central, Central, Uwa and Sabaragamuwa provinces. Except for the Western Province, where the capital city is situated, the incidence of poverty in the other provinces is above the national average. The high incidence of poverty in the rural provinces is also coirmed by the World Bank poverty assessment of Sri Lanka conducted in 1995.

The high incidence of poverty in the rural provinces as well as in the rural sector of the Western province, where the capital city is located, suggests a failure to produce an effective flow of the benefits of the government development programmes down to the rural provinces.

C. Income distribution and rural poverty

The unequal distribution of the benefits of the development programmes has resulted in a very low per capita monthly income in the rural areas. Per capita income per month was reported to be SL Rs 708 in 1990/91. It was SL Rs 1,096 in the urban sector, SL Rs 614 in the rural sector and SL Rs 514 in the estate sector. The highest per capita income was reported from the Western province and the lowest per capita income was reported from the North-Central province.

The 1990/91 Household Income and Expenditure Survey estimated the average monthly household income of the country to be SL Rs 3,549. Sector-wise distribution of household income SL Rs 5,741 in the urban sector and SL Rs 3,057 in the rural sector compared with SL Rs 2,429 in the estate sector. The poorest 10 per cent of the households recorded an average of SL Rs 661 per month while the richest 10 per cent of the households recorded an average of SL Rs 12,963 per month.

The lowest 50 per cent of the households received 21 per cent of the total household income and the highest 50 per cent of the households received 78.8 per cent of the total household income. The low income of the rural households was further confirmed by the sectorial distribution of monthly income per income receiver income.

Income inequality measured by the Gini coefficient was 0.52 in 1990/91 (table XII.2) indicates a more equal distribution in favour of the monthly income in more recent years.

As shown in table XII.3, there has been a favourable shift in the distribution of income in favour of the urban sector, where nearly 22 per cent of the population lives. The rural sector, which comprises 72 per cent of the population, has suffered a loss of 12 per cent in its share. The figures are indicative of the pattern of economic growth in the 1980s which had a low concentration towards rural development based on agriculture, mining, fisheries and other rural industries.

As indicated in table XII.3, sectorial income for the rural area decreased from 67.2 per cent in 1981/82 to 59.4 per cent in 1985/86 by approximately by 12 per cent. However, the sectorial income of the urban sector increased by approximately 8 per cent, from 28.5 per cent in 1981/82 to 35.5 per cent in 1985/86. The decrease in sectorial income and the increase in rural population can be identified as one of the major factors influencing rural poverty to a great extent.

D. Family size and rural poverty

The overall average household size for Sri Lanka is just under five persons. Therefore, it is not surprising that household size declines when moving up from the

Table XII.2. Poverty in Sri Lanka by sector

Sector	1985/86			1990/91		
	Head count	Poverty gap	P_2	Head count	Poverty gap	P_2
Sri Lanka	27.33	6.94	2.31	22.36	4.82	1.62
Urban	16.43	3.48	1.11	18.31	4.14	1.37
Rural	31.67	7.67	2.75	24.41	5.27	1.78
Estate	14.31	3.81	1.37	12.62	2.11	0.68

Source: Sri Lanka Poverty Assessment 1995, World Bank.

Table XII.3. Poverty by province

Province	Poor level 1	Poor level 2
Western	20.1	17.6
Central	33.5	30.7
Southern	32.6	29.6
North-East	33.6	30.2
North-Central	39.1	34.9
Uwa	38.8	34.4
Sabaragamuwa	36.4	33.3

Source: Household Income and Expenditure Survey 1990/91, Department of Census and Statistics.

poorest to the richest strata of the population. The average size of a household in the poorest group (below 50 per cent of the poverty line) is about seven. It is around 4.5 for the non-poor, and 3.6 for the richest group (above four times the reference poverty line).

The poor households in the rural sector tend to have large families; that in itself is another a reason for the perpetuation of rural poverty in Sri Lanka. The positive relationship between household size and poverty is confirmed by the information given in table XII.4.

Although the national population growth rate of Sri Lanka has been reduced to 1.2 per cent per annum, the rural sector still experiences a higher birth rate because of the decrease in human development poverty in the rural areas brought about by the government welfare programmes. That, in turn, has extended the household size of the rural sector to between 4.5 and 5 persons per household. A higher incidence of poverty, ranging from 15.6 to 22.9 per cent is experienced by the rural households because of their extended family size and low household income.

Table XII.4. Poverty by region and sector

Region	Population share (percentage)	Mean consumption (SL Rs/person/ month)	Head count index	Poverty gap index	Squared poverty gap index	Gini coefficient
Western	30.29	943.84	19.30 (1.12)	3.96 (0.30)	1.28 (0.14)	34.8
Urban	14.20	1,050.81	17.45 (1.35)	4.10 (0.39)	1.37 (0.17)	37.5
Rural	16.09	849.40	20.93 (1.95)	3.85 (0.49)	1.20 (0.22)	31.1
Central	15.90	713.52	23.73 (1.50)	5.53 (0.45)	1.94 (0.20)	25.4
Urban	1.59	886.52	21.00 (2.96)	4.23 (0.78)	1.33 (0.32)	29.6
Rural	14.32	694.34	24.03 (1.72)	5.67 (0.52)	2.00 (0.24)	24.2
Southern	14.48	733.03	24.23 (1.54)	4.93 (0.42)	1.61 (0.18)	26.6
Urban	2.47	846.28	19.86 (2.48)	4.25 (0.69)	1.42 (0.30)	30.0
Rural	12.01	709.80	25.12 (1.90)	5.07 (0.52)	1.64 (0.22)	25.4
North-Western and North-Central	20.19	743.66	22.34 (1.37)	4.91 (0.39)	1.62 (0.17)	26.4
Urban	1.20	875.38	18.10 (2.98)	3.87 (0.89)	1.48 (0.48)	27.5
Rural	18.99	735.32	22.61 (1.52)	4.98 (0.43)	1.63 (0.19)	26.2
South-Central	19.14	730.68	24.65 (1.43)	5.41 (0.42)	1.88 (0.20)	26.0
Urban	1.41	844.06	21.36 (3.23)	4.49 (0.83)	1.31 (0.31)	27.8
Rural	17.73	721.68	24.92 (1.58)	5.49 (0.47)	1.92 (0.22)	25.7
Total	100	795.48	22.36 (0.61)	4.82 (0.17)	1.62 (0.08)	29.7

Source: Household Income and Expenditure Survey 1990/91, Department of Census and Statistics.

E. Poverty by sector of employment

Sri Lanka, which is predominantly an agricultural country, still has a high employment rate in the rural agricultural sector.

Since agriculture remains the major employment sector and income earner in the rural sector it has a considerable influence on rural poverty as well as the national poverty incidence of more than 72 per cent of the total population. Data on the incidence of poverty by sector and the occupational groups of the main income earner show a high incidence of poverty in the agricultural sector.

F. Other indicators of rural poverty

Some indirect indicators, apart from the poverty indicators mentioned above, reflect that the incidence of poverty in the rural areas has also been used as "proxy" measurements to map out the distribution of poverty.

G. Resource endowment and poverty

Land is the most important asset for farming households since they derive their main income from crop cultivation. Land scarcity and the ownership of fragmental parcels of unproductive land are two of the major reasons for the high incidence of poverty in the rural areas. The extent of rural poverty in the country largely depends on the level of economic activities of the rural sector. Economic activities of most of the rural areas are mainly related to agriculture which, in turn, depends largely on the availability of arable land. Hence, it is reasonable to assume that rural poverty is related to the availability of land which is the primary source of income in most of the rural households in Sri Lanka. Landlessness and the availability of smallholdings are the common characteristics of rural poverty.

Some 70 per cent of rural householders live in the wet zone which has only 30 per cent of the total available land. Ninety-one per cent of wet zone tenants cultivate holdings of less than two acres. In that area, soil erosion and fragmentation resulting from partition have created severe problems. Because of joint inheritance of minimal plots, land owners often have the right to cultivate the land only once in two or three years. Nearly 11 per cent of households are absolutely landless and 42 per cent own less than four hectares, amounting to about only 7.1 per cent of the total land. They are, therefore, functionally landless.

In the dry zone, the normal picture of tenancy is reversed. Those leasing out land to tenants are often from poor households who lack the means to cultivate the land themselves. Farmers with high land and paddy land holdings of less than one acre invariably exhibit a high percentage of poverty in rural areas.

H. Unemployment and poverty

Even though Sri Lanka is experiencing a high unemployment rate of 14.4 per cent, according to the World Bank assessment, it is interesting to note that there is lower unemployment rate in the rural sector compared with the urban unemployment rate that has prevailed throughout the past two decades.

The survey conducted in the first quarter of 1996 by the Department of Census and Statistics estimated the unemployed population in Sri Lanka (excluding the Northern and Eastern provinces) at 0.71 million, of whom 0.33 million were males and 0.31 million were females. Of the unemployed, 0.11 million resided in the urban sector and 0.6 million resided in the rural sector. The estimated unemployment rates in Sri Lanka by age group also confirm the low incidence of unemployment in the rural sector of Sri Lanka.

The unemployment rate was higher among females than males in the urban and rural sectors, as indicated by the Labour Force Survey for the first quarter of 1996.

The high unemployment rate among females is one major reason for the prevailing high incidence of poverty in female-headed families in Sri Lanka.

Trends in rural poverty

An attempt is made in this section to analyse the trends in rural consumption and human development poverty by using various available data bases. First, the trends in 1983-1985 are examined, using data on private consumption obtained from the National Accounts and data on household income distribution from several household surveys. Then a more in-depth analysis of the 1985-1990 period is made, using data from household surveys conducted in 1985/86 and 1990/91.

Attention is also given to the trends in the distribution of household income as well as to the trends in consumption per capita. Distribution of the total one-month income of spending units (household) is taken into account in the analysis of income distribution. Data from 1953 to 1986/87 indicate that, with the exception of 1973, the share in question as estimated from various surveys, has moved within a narrow range of about 20-23 per cent. Household income distribution in Sri Lanka, especially in the rural sector, apparently became less skewed between 1963-1973, but later returned to a pattern similar to that observed in the 1950s and 1960s.

Consumption per capita can also be taken into account for the purpose of consumption poverty analysis. Data on private consumption per capita for selected years from 1953 to 1993 indicate that over the entire period there was a large increase in private consumption per capita in constant prices. It appears to have more than tripled from 1953-1985, when consumption per capita was deflated, using a CPI from an index of 30.6 in 1953 to 100 in 1985.

A. Trends in consumption poverty, 1953-1985

A significant decline in consumption poverty can be observed both at the national and rural levels from 1953 to 1985, since the overall consumption per capita in real terms increased by two to three times from 1953 to 1985. The magnitude of the decline in incidence would vary depending on the precise definition of the poverty line.

B. Trends in consumption poverty, 1985-1990

The latest available statistics, generated by the Labour Force and Socio- Economic Survey of 1985/86 and the Household Income and Expenditure Survey of 1990/1991, show a significant decline in absolute poverty in the period covered, both at the national and rural levels. According to the Head Count Index, using the reference poverty line, there was a decline of about 18 per cent from 27.3 per cent of the population in 1985/86 to 22.4 per cent in 1990/91. There was a decline in rural poverty from 31.7 per cent in 1985/86 to 24.41 per cent in 1990/91. The decline in the poverty gap and squared poverty gap indicates a significant decline in both the depth and severity of poverty from 1985/86 to 1990/91. The modest increase in consumption per capita and the improvement in distribution, explained by the Gini coefficient, combined to produce a significant decline in poverty, both at the rural and national levels over that particular period.

An uneven change in poverty occurred in the three sectors between the two survey periods. The incidence of poverty declined substantially in the rural sector by 23 per cent, and more moderately in the estate sector by 12 per cent, while in the urban sector there was a poverty increase of 11 per cent. The uneven change in poverty can be explained by the differences in evolution of per capita consumption and Gini coefficient for the three categories. In the case of rural residents, there was an increase in per capita consumption of about 5 per cent and also an improvement of more than two points in the Gini coefficient of consumption. For urban residents, by contrast, there was a decline of nearly 5 per cent in per capita consumption and hardly any change in the Gini coefficient.

General review of macroeconomic policies of Sri Lanka

A. Macroeconomic policies and their impact

The evidence and analysis in the previous section clearly indicate that post-independent Sri Lanka has made impressive progress in reducing the incidence of poverty, both in consumption and human development. That progress has been achieved as a result of the combination of two major factors:

(a) The strong social welfare programmes which basically concentrated on health, education and income transfers;

(b) The relatively good long-term growth performance of about 2.5 per cent per year.

Since political independence in 1948, all successive Sri Lankan governments have taken various progressive steps to develop the country as a "social welfare State" by investing a considerable amount in social and human development. A relatively high percentage of expenditure on social welfare has been maintained to safeguard the basic needs of the low-income groups, thereby enabling them to meet their essential food, education, health and other infrastructural requirements. During the early years of independence, when resource availability was sound, the governments provided social welfare benefits universally. However, as the population increased and resources were depleted, successive governments were compelled to curtail some of the universally targeted welfare programmes such as the provision of free and rationed food to selected groups, while maintaining free education and free medical facilities in universal welfare programmes.

Even though Sri Lanka has achieved a considerable reduction in consumption poverty and a remarkable improvement in human development indicators that is far superior to most other developing countries, it is still defined as a low-income economy. Although its long-term growth rate in per capita terms compares favourably with most of the developing world, in the past three decades it has fallen well short of the growth rate achieved by the high-performing East Asian economies. The low economic growth rate of Sri Lanka can be explained mainly by factors such as low productivity, the high cost of domestic savings, poor macroeconomic management, low private sector participation in economic development activities, labour market interventions, high inflation, a weak exchange rate, an unfavourable balance of payments etc.

The economic development activities of Sri Lanka, until the import substitute industrial policies were introduced in the 1960s, were basically concentrated on agriculture. The low income generated by the agricultural sector in turn reduced the economic performance in the early years of independence. Several industries and service sectors initially brought about a rapid growth rate of the economy from 0.4 per cent in 1953 to 5.3 per cent between 1965 and 1970.

Following a period of rapid growth in the second half of the 1960s, the Sri Lankan economy, as measured by GDP per capita, slowed down between 1970 and 1977 to 2.6 per cent. The slowdown was the result, in part, of exogenous supply side shocks, particularly the 1973 oil price increase, and a series of droughts in 1971, 1973, 1975 and 1976 which severely affected agricultural production, especially paddy. That, in turn, led to the import of large quantities of rice at a time when the world price of rice was increasing. The performance of commercial crops such as tea, rubber and coconuts was also weak, and output in 1977 was far below 1970 levels. Production of tree crops may also have been affected by the nationalization of estates by the government during 1970-1977. More than 60 per cent of the tea estates were transferred from the private sector to the government sector between 1972 and 1975. Apart from the estate nationalization policy, the Land Reform Law of 1972 capped the size of private paddy holdings at 25 acres and mixed holdings at 50 acres. During the first stage of the land reform, implemented in 1973 and 1974, about 560,000 acres were acquired by the Land Reform Commission; in the second stage, another 418,000 acres were acquired in 1975. All estates held by large companies were nationalized in 1975. About 115,000 acres, approximately 12 per cent of acquired land under the Land Reform Law, was distributed among the landless poor families, mainly to be used as homesteads. The production of tree crops also dropped as a result of the division of large estates into smallholding estates, mainly as homesteads between 1970 and 1977.

Industrial policies, which emphasized import substitution between 1970 and 1977, were similar to those of the 1960s and were not able to compensate for the difficulties experienced in the agricultural sector, even though there was a rapid increase in manufactured exports in that period. The government resorted to tightening up import restrictions as a macroeconomic policy measure to overcome the balance of payments problem caused by low availability of foreign resources; increased reliance was placed on quantitative controls rather than on devaluating the domestic currency in real terms. The ratio of investment to GDP, which was reduced to a peak of 19 per cent in 1969, declined through 1973 and then remained at around 15 per cent until 1978; private consumption as a percentage of the GDP, on the other hand, increased from 0.72 in 1970 to 0.76 in 1973, and remained at that level throughout 1976.

However, during the same period, the government was able to improve equity in society, as an explicit goal, through a variety of policies. Those policies included generous public spending on social welfare programmes, price control policies to protect consumers from price increases which resulted from the tough restrictions placed on imports and the transfer of land ownership to the poor, which specially benefitted the rural poor directly. However, there was little structural transformation between 1970 and 1977 in support of industrial and rural development. By 1977, in the midst of the worsening balance of payments, high unemployment and slow economic growth, it had become apparent that a change in economic strategy was needed to revitalize growth and speed up the structural transformation of the economy. The government introduced a set of adjustment policies to move the economy onto a recovery path. While introducing those new economic policies, the government attempted to create an economic environment conducive to private sector participation in broader economic activities and increase the role of markets by reducing restrictions on pricing, investments and external trade and payments.

During that process the government intervened whenever appropriate in the management of the demand and/or supply side of the economy. In an attempt to reduce the size of public expenditure, measures were taken to eliminate a number of subsidies, notably those on wheat flour, rice and fertilizer; that move resulted in a budgetary saving of about 1 per cent of GDP. Growth of GDP accelerated to 6-7 per cent between 1978 and 1980, and remained at an average of nearly 5 per cent through 1985, despite the difficulties that developed as the reform effort slowed down in early 1980, particularly the reform programme which did not address the restructuring of the over-extended public sector including public enterprises. Meanwhile, with a view to improving the business environment and building private sector confidence, the government lifted restrictions on foreign participation, except in certain specific areas, and eliminated the 100 per cent transfer tax on share transactions by foreigners. As a further step towards trade liberalization, the national tariff system was simplified and the maximum nominal tariff was lowered.

The full benefits of economic development brought about by the new economic reforms could not be enjoyed by Sri Lankans because of the serious ethnic and political conflict that began in 1983, peaking between 1987 and 1989. The conflict led to a sharp increase in military expenses on a percentage of GDP from 0.7 per cent in 1973-1977 to 1.2 per cent in 1978-1982 and 3.7 per cent in 1988-1993. The increasing military expenses adversely affected the economic performance of Sri Lanka to a great extent.

The economy has experienced a rebound in growth since 1989, with enhanced private sector confidence and open market activities. The new economic reform programme launched in 1989 focused on reducing the macroeconomic imbalances and improving the incentives for the private sector, resulting in strong growth in the industrial and services sectors. That, in turn, increased GDP by an average of 5 per cent between 1989 and 1992 and 7 per cent in 1993, according to preliminary estimates. The current account deficit declined to about 5 per cent of GDP, while official reserves increased to five months of imports. The fiscal adjustments introduced by the government in curtailing public sector expenditure and public investments reduced the budget deficit sharply from almost 16 per cent of GDP in 1988 to 8.1 per cent in 1993.

Substantial progress was made on the structural side between 1989 and 1993 with the new economic reform policies adopted by the government.

B. Welfare policies and programmes

Since the political independence in 1948, the types of welfare programmes implemented for the poor have varied, depending on prevailing economic conditions. Land reform, price control, a minimum wage, free education and free medical care are some of the major welfare policies and programmes adopted by successive governments for upgrading the standards of living of the poor from 1948 into the 1990s. In this subsection, emphasis is given to the major welfare programmes implemented after 1989 to cushion the poor against some of the hardships arising from the implementation of reforms and adjustment policies.

The government responded to the challenge of price increases and economic hardships experienced by the poor by committing about 3.5 per cent of its to programmes aimed at reducing those hardships and alleviating poverty. Included among the welfare programmes supported by the government through the provision of budgeting resources are:

(a) The food programme;

(b) The Janasaviya programme:

(c) The school midday meal programme:

(d) The Samurdhi programme.

1. *Food stamp programmes*

The food stamp programme, which was introduced to minimize the hardships faced by the community due to the severe food scarcity in the war- time, has been in operation since the Second World War. However, successive governments have extended the programme because a sizeable number of people in the country continue to live below the poverty line.

For a long period, the programme covered the entire population without any classification. In the early days of the programme, given the relatively low international prices of food grains, particularly rice, operating a universal food subsidy was not an unbearable fiscal burden on the government.

Because of the budgetary problems faced by the government in the early 1970s, the policy of providing subsidized food commodities to the whole population was reviewed; significant changes were made in 1975 by introducing an income criterion to determine the eligibility of people to participate in the programme. Consequently, the free rice ration issued to income tax payers and their dependents was withdrawn. In 1978, a further significant reduction in the number of beneficiaries was effected by limiting the free-food ration to families whose incomes fell below a particular cut-off point. That move reduced the food subsidy programme to only 50 per cent of the population who had declared themselves as poor. Another substantial modification to the nature of the food subsidy programme was introduced by the food stamp scheme in late 1979. The major fiscal advantage of the food stamp scheme is that the size of the entitlement is set in nominal terms, i.e., Sri Lankan rupees, so that it is easier to maintain a “stable” budget. However, the food stamp scheme is disadvantageous to the beneficiaries as the real value of that income supplement is eroded by rising food prices, unless deliberate decisions are taken periodically to devise a mechanism to index or update the food stamp values and thus offset the effect of inflation.

It must be noted that, with the introduction of the food stamp scheme, prevailing prices of imported rice, sugar and flour were permitted to reflect actual import costs and world market trends. That step, i.e., the removal of the decades-old subsidized pricing system could, however, also be interpreted as an essential ingredient of a production-oriented strategy which could shift the internal terms of trade in favour of agricultural production.

The government had to strictly curtail the food stamp scheme to the needy since several studies conducted on the food stamp scheme and socio-economic conditions in the country indicated that the level of poverty was much lower than the numbers suggested by the food stamp programme. Accordingly, the number of beneficiaries was reduced by 40 per cent of the population, i.e., 7.4 million individuals in 1.5 million households. The criterion adopted for selecting beneficiaries was that their monthly income did not exceed Sl Rs 700. A beneficiary family received a maximum monthly subsidy of SL Rs 250 in food stamps. In addition, food stamp recipient households that did not have access to electricity qualified for the monthly kerosene stamp worth SL Rs 28. The actual cost of the programme was SL Rs 3.8 billion. At the end of 1995, the food stamp programme was replaced by the Samurdhi programme, as described below.

2. Janasaviya (Strength of the People) programme

Designed in 1989 as a crash programme for poverty alleviation, the Janasaviya programme was initiated as a result of an emerging awareness of the aspirations of the poor as well as the social tension which was attributed to those aspirations. From a wider perspective, Janasaviya is a people-based programme. Therefore, it differs from the other development programmes in many ways. In essence, the Janasaviya programme:

(a) Intended to give first priority to;

(b) Considered human beings as the primary resource;

(c) Depended mainly on self-reliance and a bottom-up approach;

(d) Enjoyed cultural harmonization;

(e) Achieved true island-wide implementation.

The objective of the Janasaviya programme was to cover all those households enrolled in the food stamp programme that had seen their benefits fall in real terms over the years because of inflation. Under the programme, each poor household received a monthly grant of SL Rs 2,500 for 24 months. The grant was in two parts: SL Rs 1,458 for the purchase of a specific basket of mainly foodstuffs, of which SL Rs 458 would be spent or saved in a government bank according to the individual household wish. The balance of SL Rs 1,042 per month was to be deposited with a government bank until it had accumulated after two years to the sum of SL Rs 25,000, at which point it should be made available as capital or as collateral for a loan to be invested in an income-generating activity.

Janasaviya was directly linked to a training-cum-production programme where beneficiaries were required to work 20 days in a month in a productive activity or be in a place of training to qualify to receive the benefits. The activities would be assets creation and improving the human capital through training activities that would help the beneficiary family to improve their quality of life. Those who did not participate in such activities on a regular basis were removed from the programme.

The first round of the programme started in September 1989 in 28 of the 278 Assistant Government Agent (AGA) divisions of Sri Lanka. A total of 164,000 families were selected from the 224,000 families entitled to the food stamp scheme as Janasaviya beneficiaries after two rounds of screening. The second round was started in December 1990 in another 30 AGA divisions and absorbed nearly 120,000 families drawn from those families entitled to food stamps and with an income of less than SL Rs 700 per month.

The programme provided a strong disincentive to work since it provided a monthly consumption grant of SL Rs 1,458 in a rural economy which paid an unskilled wage of some SL Rs 1,000 per month. It also created inequality between the Janasaviya programme recipients and those originally above the income cut-off line and between the early Janasaviya programme recipients and those who joined it much later.

The implementation of the Janasaviya programme was aimed at achieving self-sustaining development among the poor that was initiated and supported through their own efforts. However, a number of evaluations of the first and second rounds revealed that despite huge expenditure and the involvement of the entire machinery of the government, the implementation of the Janasaviya strategy still kept 90 per cent of the beneficiaries in poverty with very little chance of their getting out of it, and in addition left them more exploited than before. Based on that experience, the Janasaviya programme was replaced by the Samurdhi programme in 1995.

3. School midday meal programme

The school midday meal programme (MMP) was launched at the beginning of 1989 with a budgetary allocation of SL Rs 2 billion in order to provide one meal a day to all children enrolled in primary and secondary schools nationwide. Under the programme, funds were provided to provinces on the basis of the school population in the provinces with the objectives of:

(a) Providing a wholesome midday meal of 600-800 calories to every student;

(b) Generating self-employment in the immediate neighbourhood by motivating people to produce food items that would be used for the midday meal, thereby contributing to the development process of the country.

Initially, the midday meal programme was implemented in about 10,000 schools where four million school children were entitled to receive a stamp of SL Rs 3. To be entitled to receive benefits under the programme, a child was expected to bring a home-prepared lunch to school.

However, the programme was restructured in 1993, with a view to providing assistance to the most needy children of the food stamp families. However, it was subsequently decided to include those children who applied for such assistance, bringing the total of recipients to about 3.2 million from a school population of about 4.1 million children. At the latter stages of the programme, a child was entitled to SL Rs 500 per month under MMP. The programme was absorbed into the Samurdhi programme in 1995.

4. Samurdhi programme

The Samurdhi (prosperity) programme was initiated by the government in 1995 for the reduction of poverty on a sustainable basis through the broadening of horizons and the creation of opportunities for income enhancement and employment.

The main thrust of the poverty reduction strategy, as embodied in the Samurdhi programme, is to ensure the participation of the poor in the production process. That is achieved through increased access by the poor to resources for self-employment, enhancing their health and nutritional status, and improved rural infrastructure.

The main objectives of the Samurdhi programme are to:

(a) Expand opportunities for income enhancement and self-employment;

(b) Organize youth, women and other disadvantaged persons into small groups, and encourage them to participate in decision-making activities and the development process at the grass-roots level;

(c) Assist persons to develop their talents and strengthen their asset bases through productive employment;

(d) Establish and maintain productive assets to create additional wage employment opportunities at the rural level;

(e) Support the really needy by providing social welfare assistance.

The Samurdhi programme attempts to enhance the capacity of the poor to effectively take initiatives to improve the quality of life of the family by implementing economic development projects identified on the basis of family needs, skills and assets, together with the financial, technical and management support provided by the government. The programme has a separate initiative for enhancing human capital development among the poor through investments in health, nutrition, education, extension services and vocational training. Thus the programme strives to alleviate poverty on a sustainable basis.

The Samurdhi programme is implemented by the *Samurdhi Balakaya*, which comprises *Samurdhi Niyamakas* and other members elected at the village level. The members of the executive committee of the Samurdhi programme are youths aged between 18-35 years and permanent residents of the village. The *Samurdhi Balakaya* is the development task force at the village level.

The welfare component of the Samurdhi programme covers one-third of the entire population of the country, consisting of about 1.2 million families estimated to be at the bottom of the income scale. The beneficiaries of the Samurdhi programme receive a monthly welfare payment of between SL Rs 100-1,000, depending on household income, which is intended to raise the income of a household to about SL Rs 1,500 per month. The beneficiaries are also expected to use the payment to increase the household income from SL Rs 1,500 to SL Rs 2,000 per month through the self-employment activities. The beneficiaries of the Samurdhi welfare programme will exit from it when their income exceeds Rs 2,000 per month for a continuous period of six months, or when at least one member of the family finds employment.

All Samurdhi beneficiaries are encouraged to save a part of the income supplement in order to develop a culture of thrift and savings among them. The accumulated savings can be used to finance new income-generating projects among the beneficiaries, either on an individual or group basis.

The ultimate objective of the Samurdhi programme is not to perpetuate poverty and dependency, but to promote self-reliance on the basis of nurturing the saving habit and the development of income-generating self-employment. To achieve that ultimate objective, the government is planning to adopt the following holistic approach rather than continue the distribution of a welfare payment among the poor.

Agricultural growth and rural poverty

A. Agricultural policies

Sri Lanka is predominantly rural; of its total population of 18 million, an estimated 72 per cent live in rural areas. Since agriculture remains the mainstay of economic activity in rural Sri Lanka, it has a considerable influence on the lifestyle of the rural households. Agriculture contributes 11 per cent to GDP, 22 per cent to export earnings and 42 per cent to total employment. In 1995, of the 1.5 million hectares of cropped area, 58 per cent is under the major export crops of tea, rubber and coconuts, and 42 per cent under paddy and other minor crops.

Before independence, the agricultural policy in Sri Lanka was heavily focused on the plantation sector. As food scarcity and other problems such as unemployment and landlessness were encountered, successive governments attempted to develop the peasant agricultural sector by concentrating on two broad issues:

(a) The improvement of productivity of land;

(b) The utilization of more land to expand the extent under cultivation.

In order to achieve the above objectives, the following components were included in the government agricultural development strategy:

(a) Investment in land, irrigation and infrastructure;

(b) Rehabilitation of the tree-crop export sector including the development of subsidies and fertilizers;

(c) Changes in land policy to enable the inflow of private capital and the participation of enterprises in agriculture and agro-based industries;

(d) The liberalization of the internal trade of farm products and changes in the pricing policy of such products;

(e) Special incentives such as tax holidays for agricultural and agro-based products.

With the intention of solving the landless problem and upgrading the standard of living of the rural poor, the government implemented the Land Reform Law in 1972. A large amount of privately-owned land was acquired, and individual ownership of land was limited to 25 acres of paddy land or 50 acres of mixed crop land under the Land Reform Law. More than 50 per cent of the acquired land was distributed among the poor as smallholdings. This in turn affected the productivity of the land as a result of the division into smallholdings, the low utilization of fertilizer, uprooting of trees etc. The deterioration of productivity of tree-crop land was further affected by the transfer of the ownership and the management of large private estates to the Janatha Estate Development Board in 1975. The recipients of smallholdings did not benefit from the land reform other than receiving a block of land, as they were unable to generate sufficient income from the lands as a result of constraints such as high production costs, low productivity etc.

In improving the agricultural sector, the government, among other actions, used the pricing policy as a means of guiding producers and consumers in the allocation of scarce development resources. A number of guaranteed price schemes were introduced by the government for the benefit of producers of agricultural and non-traditional agricultural products. The Paddy Marketing Board (PMB) was established as a government organization to purchase paddy at a guaranteed price in order to protect the farmers.

As a consequence of the government's agricultural policy, a large smallholding sector has been created, with self-employment expanding within that sector. The existing farm sector that comprises mainly the poor is engaged in subsistence rice cultivation, home gardening with mixed crops and *chena* cultivation in highland plots. In that sector, women were employed in greater number as unpaid family workers, while the men were largely engaged as own-account workers.

The post-1977 agricultural pricing policy has pivoted on an overall scheme of economic liberalization. In real terms, subsidies on fertilizer and consumption have been reduced. In 1984, a revenue collection system was established for irrigation water. Since 1977 direct government participation in rice distribution, mainly through PMB, has been virtually eliminated.

B. Rural credit

Rural credit plays a vital role in development because of the non-availability of a sufficient capital in this sector mainly because of poor incomes and low savings among rural households. Given the low and unsteady income levels of the farming sector, there is a very high demand for credit facilities in the rural areas. This, in turn, motivates the farmers to borrow from the informal credit market at very high interest rates in addition to the financial facilities provided through government banking and other financial programmes under various credit schemes, such as the "Nawam Sapiri Rural Credit Programme" and "Sapiri Rural Credit Programme" for agricultural activities.

Although commercial banks have a network of over 800 branches in Sri Lanka, they have been constrained in their outreach to smallholding farmers and producers by low profitability, crippling defaults and a corporate culture which is geared to large-scale commerce and industry sectors and, in agriculture, to public estates and large plantation cultivation. The banking system has suffered from high administrative costs, inflexible standards of credit analysis and insistence on security. Much of their rural credit has been developed in tandem with the Central Bank of Sri Lanka rediscount and credit guarantee schemes, which have been used to subsidize interest rates to borrowers and depress lending margins.

Regional Rural Development Banks (RRDBs) were established in 1985 by the Central Bank to bridge the gap between rural branch bank services and informal credit sources. There are 12 RRDBs with 90 branches. Loan recovery is less than 70 per cent and defaults appear to reflect a widespread attitude RRDBs have towards lending government funds and the fact that these funds are only disguised grants. RRDBs have granted loans totalling more than US$ 6 million with assistance from the International Fund for Agricultural Development (IFAD). RRDBs have commenced lending to producer groups relying on peer pressure as collateral. In addition to taking banking to the village level, RRDBs have also simplified lending procedures and made them more flexible.

It has been estimated that the formal credit institutions supply less than 19 per cent of the credit requirements of smallholders. Informal credit sources vary from professional money lenders through landlords, shopkeepers and traders, to friends and relatives. The informal credit system is complex with a variety of interest rates and repayment terms. Interest rates charged by money lenders range from 60 to 150 per cent. Such high rates absorb all or most of any production surplus. However, because of the easy access and simple procedures which do not require documentation and securities, more smallholders are attracted towards the informal credit market. It is impracticable to analyse the informal credit market because of the lack of data related to this segment of rural credit supply.

Apart from the formal and informal credit market, NGOs, thrift and credit cooperative societies, cooperative rural banks, women's organizations and *cheetus* are among the other credit sources available to the smallholders in rural areas.

C. Composition and growth of agriculture

Because Sri Lanka is predominantly an agricultural country, preference and greater emphasis has been placed on the agricultural sector in economic development policies.

However, negative growth has been observed in the agricultural sector as a result of its continuous declining performance, mainly in tree crops and paddy production. That, in turn, reduced the share of agriculture in GDP from 40 per cent in the early 1960s to 20 per cent in 1995 except in the area of domestic market-oriented agriculture and agro-based products.

The Sri Lankan plantation industry, once pre-eminent in the economy, has been experiencing intermittent crises over a very long period. Problems related to high wage costs, low yield and low productivity became accentuated after the State assumed ownership following land reforms. The result was a drop in the share of total tree-crop production in the overall agricultural output from 31 per cent in 1982 to 25 per cent in 1995. As a remedial measure, in 1992 the government decided on a restructuring programme under which the majority of State plantations were handed over to private management companies on a five-year contract basis. However, because of the short-term nature of those contractual arrangements, there was little incentive for the private sector to undertake new investments and improvements which would yield results over the long term. The government, in 1995, decided to privatize the management of State plantations for a 50-year period with high expectations placed on the private sector.

Owing to bad weather, the division of large land areas into smallholdings, and decreasing productivity as a result of the low utilization rates of expensive fertilizer, total paddy production also exhibited a decreasing trend, and the share of paddy in total agricultural production decreased from 26.4 per cent in 1982 to 24.8 per cent in 1995.

The prices of domestic-oriented agricultural products started rising in the local market as a result of restrictions imposed on their imports. That situations, in turn, motivated the farmers to deviate from unprofitable paddy production to commodities such as potatoes, red onions, chillies and big onions, increasing the share of such products in total agricultural production from 42.5 per cent in 1982 to 49 per cent in 1995.

Allocation of public funds to the agricultural sector shrank gradually from about 18.3 per cent in 1991 to 13.6 per cent in 1995, worsening the declining trend of the sector. That motivated the government to adopt several new agricultural development strategies.

Rapid growth is expected in the agricultural sector with the adoption of the above measures through improved income generation, employment opportunities and, consequently, a decrease in rural poverty.

Rural industrialization and rural infrastructure

At the present stage of economic development the industrial sector of Sri Lanka, which comprises around 400 large-scale and 25,000 small- and medium-scale enterprises plus over 100,000 micro enterprises scattered all over the country, has emerged as the most dynamic sector and offers the greatest potential for creating employment opportunities. During the past decade, the share of industrial products in GDP increased from 14.36 per cent in 1982 to 20.41 per cent in 1995. In the past five years, the industrial sector grew at an average rate of 9.4 per cent, which compares well with the average annual GDP growth rate of 5.5 per cent. The value of industrial output grew by 10.2 per cent in 1995, thus surpassing the agricultural sector. The major contribution to this expansion came from the private sector, which grew at an average rate of 13 per cent during the past five years; in contrast, the public sector industrial output recorded a decline by 13 per cent, excluding petroleum.

From 1948, when the agricultural sector was sound, insufficient attention was given to the development of the industrial sector until the second half of the 1950s. However, the government that came into power in 1956 introduced several key policy measures required for starting industrial development. With the introduction of the Industrial Development Act, a number of large industries were established started as government corporations by utilizing public funds as well as foreign loans and assistance.

In the early years of the 1960s, restrictions were imposed on imports of several types of manufactured products in order to protect the infant industries started as import substitutions. Most of those industries were located in the Western province or around Colombo, based on political decisions as well as the availability of infrastructural facilities. However, they were unable to generate a sufficient number of new employment opportunities because they were highly capital-intensive.

The financial and commercial viability of most of those public sector industries steadily deteriorated and they ultimately became unprofitable ventures, mainly because of their high production and administration costs, low productivity, labour conflicts, management problems, and marketing and operational failures.

In the first era of the industrial development period, a large number of small and medium-scale labour-intensive industries were established, with government support and protection, in the urban and rural areas. The objective was to generate employment opportunities and additional income for the urban and rural residents.

While manufactured exports grew rapidly between 1970 and 1977 from a very small base, manufacturing value added on the whole remained at about 15 per cent of GDP throughout that period. The industrial policies of the 1970-1977 period were similar to those of the 1960s and emphasized import substitution, with its attendant anti-export bias. By 1977, the government initiated a new economic policy that sought to increase the role of markets and the private sector by reducing restrictions on pricing, investment, and external trade and payment. That new open economic policy encouraged local and foreign investors to invest more in the industrial sector.

The Greater Colombo Economic Commission was established by Act Number 4 of 1978 as an initial step in promoting Free Trade Zones in Sri Lanka, with the idea of expanding the industrial sector. Because of the incentives granted to foreign as well as local investors by the Act, rapid growth was experienced in the industrial sector. The performance of the industrial sector signified the response of the various subsectors to the desired diversification envisaged by the open economic policies. While the traditional subsectors of textiles, wearing apparel, leather products, food, beverages, tobacco, and wood and wooden products recorded healthy increases, substantial improvement also occurred with new export-oriented products of jewellery, machinery, electrical and chemical products. However, the textile and food sectors contributed 87 per cent to that growth.

The activities of the Greater Colombo Economic Commission, limited to the Katunayake Export Processing Zone, were extended to the rural areas through the establishment of the Board of Investment (BOI), initiating a rapid expansion of rural industrialization in Sri Lanka. While the bulk of BOI investment had previously gone into the manufacturing sector, in particular the textile, garment and leather industries, the more recent trends of BOI investments indicate diversification into various fields, expanding new employment opportunities nationwide. At the end of 1995, the companies registered with BOI accounted for 55 per cent of total exports, provided employment to 156,464 persons and recorded an increase in employment of 16 per cent over 1994. More than 75 per cent of the new employment opportunities were in the rural areas.

Small and medium-sized enterprises (SMEs) play a vital role in rural industrialization, which dominates the private sector. Currently, it accounts for 90 per cent of the private industrial units, 70 per cent of employment opportunities and 55 per cent of value addition in industries. The government has set up a special committee for the promotion and development of SMEs with the intention of creating 250,000 potential employment opportunities in that sector over the next five years.

The SME credit scheme, inaugurated in 1980 to fulfill the credit requirement of SMEs, was a successful attempt at expanding the sector. Nearly 14,000 loans have been granted to a total of 14,578 projects under the scheme, with a recovery rate of 80 per cent. The “Isuru” credit programme is being implemented, with IFAD assistance, by the Central Bank to facilitate rural industries, in addition to the SME scheme. “Suratura” and “Sanasa”, two recent credit schemes introduced by the government through the commercial banks and the Samurdhi Authority, provide SL Rs 50,000 and SL Rs 10,000 respectively to individual youths for starting new small-scale enterprises, especially in the rural areas.

Non-availability of sufficient infrastructural facilities is one of the major difficulties facing rural industrialization. To overcome that problem, a number of infrastructural development programmes have been implemented during the past 10-15 years by the government and NGOs with local and foreign funding.

The Integrated Rural Development Programme (IRDP) has been functioning as a lending project at the local level in order to achieve multiple objectives. The most explicit objectives are the creation of supportive infrastructure, a service delivery system, and skills development for productivity and employment of rural youth. During 1995, total expenditure doubled as a result of completion and bringing to account the infrastructure development activities funded under JICA assistance.

Allocations ares made under the Decentralized Capital Budgets (DCB) on the basis of SL Rs 2.5 million per electorate. A total sum of SL Rs 562.5 million is voted annually from the government budget for that purpose. The government issues guidelines from time to time, spelling out the broader categories of activities for which allocation should be made. It is ensured that, of the total allocation, 40 per cent goes to new infrastructural capital work, 30 per cent to rehabilitation of physical assets, 15 per cent to employment generation activities, and 12 per cent to welfare and cultural related activities.

The provincial council receives capital allocation under the Criteria Based Grants (CBG) which is determined on the basis of a set of criteria based on the population of each province and selected indicators of interprovincial, social and economic differences. The weighting given to each criterion is 10 per cent for per capita income, 10 per cent for per capita income difference, 10 per cent for poverty, 15 per cent for health and nutrition, 15 per cent for education, 15 per cent for unemployment, and 25 per cent for social and economic infrastructure.

The government has launched a regional industrialization programme in order to provide the infrastructure needed for private investment. The concept of industrial estates/parks is being used to lure investors away from the metropolitan regions. Two major industrial parks have been established with Japanese assistance at Seethawaka and Katana. The two parks will accommodate 100 industries, provide 28,000 direct and 56,000 indirect employment opportunities and develop 100 acres with infrastructure facilities.

In yet another programme, 19 sites have been selected for development. The government will provide infrastructure facilities up to the perimeter of these sites and the development will be handed over to private sector developers. Several mini-industrial parks have also been initiated with the idea of dispersing industries into rural areas by developing infrastructure facilities.

As a result of the policy with regard to rural industrialization, and the high priority assigned to supplying electricity to rural areas at present, electricity has been supplied to approximately 45 per cent of the total households in the country. So far, two phases of rural electrification have been completed; phase III is planned with Asian Development Bank assistance to commence in 1996. By the end of 1995, a total of 12,176 rural electrification schemes and extensions had been completed. Furthermore, DCB, IRDB, Provincial Councils and other specially funded schemes have also contributed to supplying electricity to the rural areas.

Sri Lanka has a road network of approximately 100,000 km penetrating into all parts of the country. This means that 1,484 km of a road network is available per 1,000 sq km of land area. The road network comes under the responsibility of several agencies, both governmental and non-governmental. The government in the past several years has progressively increased its funding for road development. The allocation for rural roads has also been increased sixfold.

Most of the roads have outlived their designed lives and consequently they have deteriorated beyond minimum serviceability levels. Maintenance, rehabilitation and new construction have not kept abreast of the growing demand for movement of passengers and goods; funding and capacity have been the major problems. Donor assistance, in spite of tendering and construction delays, has contributed to the improvement of the road sector.

The rural road network mainly benefited from new roads constructed under the Mahaweli project during the past two decades.

Marketing plays a vital role as a key success factor in the development and survival of any industry. Availability of markets and efficient channels of distribution can bring high growth opportunities to a particular industry. The non-availability of sufficient markets and efficient channels of distribution are the key limiting factors faced by most of the production-oriented rural development programmes implemented in the agriculture and industries sector of Sri Lanka. Consideration was not given to the marketing aspect of most projects at the planning and implementation levels. Most of the marketing channels, dominated by the private sector, do not offer the full benefits of the markets to the producers. A large share of the income of the farmers is deducted by the private sector vendors as transport costs, sales commission and loan installments given for cultivation and other requirements.

The Collection Centre Scheme was introduced by the government in 1991, with the idea of protecting the farmers through the direct purchase of agricultural and other rural products from the producers at a reasonable price.

A total of 300 centres have been established nationwide with government financial assistance ranging from SL Rs 100,000 to SL Rs 1 million per centre. The scheme was, in its initial stage, very successful. However, it eventually failed mainly because of the misappropriation of funds by the owners of the centres.

The market share of handicrafts and other rural products, which mainly rely on the tourist industry, started declining from 1989 with the drop in tourist arrivals as a result of the on-going conflict in the north and east of the island.

The Export Development Board was established by the government with the idea of promoting non-traditional exports by providing market information, creating awareness of the market opportunities, conducting trade exhibitions and fairs, and conducting seminars and training courses for exporters.

Rural employment conditions and opportunities

Surprisingly, even with 72 per cent of the total population living in rural areas, the rural sector of Sri Lanka has a relatively low unemployment rate of 12.3 per cent compared with 14.2 per cent in the urban sector (1995 figures). The low unemployment rate in rural areas is mainly explained by the higher workforce participation rate of 49.2 per cent in the rural sector compared with 43.3 per cent in the urban sector.

A. Employment opportunities in the agricultural sector

The share of rural employment in the agricultural sector declined by from 55.5 per cent in 1990 to 44.1 per cent in 1995, mainly because of the low performance of the tree-crop subsector. The difficulties in the tree-crop subsector were not compensated by the domestic agricultural sector because the latter failed to realize its full potential for creating more new employment opportunities in the rural sector.

A further decline in potential employment opportunities in the agricultural sector can be expected in the foreseeable future as a result of the problems related to marketing, land availability, credit and technology used in agriculture.

B. Employment opportunities in the industrial sector

The rural share of employment in the manufacturing sector grew from 12.1 per cent in 1990 to 16.0 per cent in 1995. The increase was largely the result of the employment opportunities created by the new rural industrialization policy of the government. The highest contribution came from the manufacturers in the export-oriented garment and wearing apparel sector.

A total of 156,464 employment openings were generated up to 1991 by BOI projects, in addition to approximately 130,000 employment opportunities created by approved non-BOI projects.

Enhanced private sector participation in economic development, motivated by the open economic policies, is expected to create more employment opportunities in the industrial sector, especially in rural areas.

A marginal increase of 1.5 per cent in service sector employment was recorded from 12.4 per cent in 1990 to 14.9 per cent in 1995 as a result of increased demand by expanded industrial activities in the rural areas.

The labour-intensive infrastructure development activities undertaken by IRDB and the proposed rehabilitation programmes implemented in areas affected by the on-going civil war in the north and east of Sri Lanka, together with the development programmes proposed for the Southern province under the Southern Development Authority, offer a high potential for off-farm employment, especially in the rural sector.

The large number of employment opportunities created for Sri Lankans in the Middle-Eastern countries, following the implementation of the liberalization policy, has had significant influence on the employment status and standard of living of the rural poor.

The number of persons from rural areas who have migrated for employment has increased remarkably over the past two and a half decades. The Airport Survey (1994) carried out by the Sri Lanka Bureau of Foreign Employment revealed that over 120,000 persons were securing new jobs annually; the number of departures for employment in 1995 totalled more than 150,000. Since no restrictions are imposed on women leaving the country for employment abroad, a large number of females secured overseas employment.

Impact of the reform policies on rural poverty since 1989

A detailed analysis of macroeconomic policies and their impact is given in section A above (page111).

Therefore the discussion in this section is limited to the main reforms initiated since 1989.

A. Aggregate effects of the reforms

A significantly low 1.8 per cent average annual growth rate in per capita consumption was observed in the first four years of the reforms, from 1989 to 1993, compared with 4.4 per cent average annual growth rate in GDP in the same period. The divergence between the two rates can be explained by two factors:

(a) A significant decline in the ratio of private consumption to GDP from 77.3 per cent in 1989 to 74.2 per cent in 1993;

(b) A rapid increase in CPI compared with the GDP deflator.

Thus, on aggregate, the post-1989 period saw a modest but significant increase in private consumption per capita in the first four years of the reform programme. This implies that, unless there has been an offsetting adverse change in the distribution of consumption, poverty must have continued to decline both at the national and rural levels.

B. Effects of specific reforms

1. Fiscal adjustments

A number of fiscal adjustments were implemented with the objective of reducing the overall budget deficit from 1988 to 1993. The deficit declined from 15.7 per cent of GDP in 1988 to 7.4 per cent in 1992, and a 2.5 per cent overall decline was observed in 1995; the brunt of the fiscal adjustments so far has fallen on capital expenditure. The cuts in capital expenditure especially affected capital transfers to public corporation and statutory bodies and net lending without creating any adverse impact on the poor in the short term. However, there may be a negative impact on the rural poor from the curtailed capital transfers because of the possible increases in the prices of the products and services produced and delivered by those institutions to the poor in the future.

The withdrawal of food ration schemes and food subsidies, especially the wheat flour subsidy, created a direct adverse impact on the rural poor in addition to the indirect adverse impact placed on them as a result of reduced government spending on education, health and housing, and fiscal adjustment.

The tax reforms, on the other hand, created a favourable impact on rural poverty. The tax exemptions granted on food items that were important to the poor, such as rice and wheat flour, may increase the consumption of such items and reduce the cost of living. The new tax system may help the poor indirectly by increasing efficiency in the economy while avoiding a negative direct impact on consumption levels of poor households.

C. Privatization of State-owned enterprises

Privatization has been another major thrust of the new economic reform programme. In July 1992, the government shifted the management of 449 State-owned estates in the plantation sector to 22 private companies on a profit sharing basis. By 1993, 37 State-owned enterprises had been privatized. The government planned to continue the privatization programme in the future with the following expected results:

(a) A more efficient use of the assets and primary factors of production tied up in State-owned enterprises;

(b) Elimination of the burden imposed on government finance by loss-making enterprises;

(c) Efficiency gains from enhanced competition.

The privatization programme would tend to raise the rate of growth of the economy and indirectly speed up poverty reduction in the rural areas. If retrenched employees are not provided with compensation, a direct effect of privatization may be the enlargement of the number of poor in the short term.

D. Trade reforms

The third major thrust of the recent economic reform consisted of measures to increase the openness of the economy. That part of the reform strategy began after 1977, together with the liberalization of trade. The government objectives were to: (a) replace specific duties with *ad valorem* tariffs; (b) limit discretionary authority in setting tariffs; (c) eliminate quantitative trade restrictions; and (d) reduce the level and dispersion of tariffs. The rural poor will benefit because the measures can improve the resource allocation efficiency of the economy. On the other hand, the new tariff structure allows more consumables and health items which are important to the poor to be imported at cheap prices. The tariff facilities granted to exports may create a good market for the non-traditional exports, resulting in an increase in production and thus the generation of more employment in the rural areas. However, the decrease in the flow of import substitution goods could bring some adverse impacts on rural poverty by reducing employment opportunities through the closure of import substitution industries. The severity of such hardship would depend, in part, on how quickly displaced workers are able to switch to those sectors where incentives would have improved as a result of the trade reforms.

E. Reform of strict regulation of foreign direct investment

The revision of the strict regulation of foreign direct investment, which started in 1977, resulted in a rapid inflow of foreign investment into the country, expanding the activities of the export processing zones initially in the Western province. Later, by establishing BOI, the government expanded the facilities for foreign direct investors to start industries throughout the country. The simplified regulation of foreign direct investment favourably affected the rural poor to a great extent in finding new employment opportunities in the industrial and agricultural sectors. The expanded industrial sector, through foreign direct investment, generates a large number of off-farm employment opportunities for the rural poor in infrastructure development and the service sector at the provincial and rural levels.

F. Agricultural trade reform

There may be positive as well as negative impacts on the rural poor, both as producers and consumers, from agriculture trade reforms. The most important issue in that context is the import regime for rice. Restrictions were imposed on rice imports in order to pursue the policy of self-sufficiency in rice during 1970-1977. The restrictions raised the domestic price of rice and benefited rural producers of rice, but at the same time hurt consumers.

A complex rice importation regime was introduced in 1990. Private companies were allowed to import rice, subject to several restrictions on annual import quotas, buffer stocks and minimum wholesale prices. In addition, an import duty was imposed on rice imports. The import quotas were recently relaxed, creating a more competitive market. The relaxation of rice protection favourably affected the rural poor, as their main staple is rice which accounts for about one-fourth of their total consumption. Only about 5 per cent of the rural poor households would experience negative effects from a reduction of rice protection.

New import restrictions were imposed on the importation of potatoes as a result of political pressure on the government. Imposed as a measure to protect the producers of potatoes, the restrictions negatively affected the consumers.

Conclusions and recommendations

As a result of overemphasis on welfare since 1948, Sri Lanka still remains a low-income economy. Although its long-term growth rate in per capita terms compares favourably with most of the developing countries in the region, it falls well short of the growth rate achieved in the past three decades by the high performing East Asian economies. Even though Sri Lanka has abundant natural and human resources compared to the other countries in the region, its macroeconomic policies have not been designed in such a way as to gain the maximum advantage of the resource base through economic development.

Over the years, little emphasis has been placed on growth-oriented strategies when designing poverty alleviation programmes. For a number of years the economic growth figures reflected the ill-effect of those policies. For example, GDP growth grew at 1.5 per cent in 1987, 2.7 per cent in 1988, 2.3 per cent in 1989 and 6.2 per cent in 1990. The programmes designed to alleviate poverty have failed either to appreciably reduce its incidence or make quantitative changes in the economy. The continuation of welfare policies for an indefinite period may create a condition whereby dependency on government subsidies may stifle the initiative and entrepreneurial abilities of the poor.

The withdrawal of the fertilizer subsidy, the nationalization and subdivision of land into smallholdings and the use of inappropriate technology have had a negative impact on broad agricultural productivity and the capacity of small-scale farmers to increase their income. The problem has been compounded by the current import policies, which cast an unfair burden on domestic producers who have to compete against heavily subsidized imported products.

Fifty years of free education have resulted in near total literacy but have led to a significantly high level of expectations. The backlog of educated unemployed has reached about 400,000. About 125,000 persons enter the workforce annually. Because of the mismatch between education and labour market requirements, the unemployment rate reached a level of 14.4 per cent in 1995. Such a situation is increasing youth unrest in the country.

The removal of tariff protection, import restrictions and State support for the small industry sector led to a decline in the production and displacement of employment. Small industries have failed to take advantage of the opportunities opened up by liberalization and have, in fact, been harmed in many cases. It was argued that the liberalized import of raw materials and equipment benefited the large enterprises rather than small industries. The small industries were unable to respond to the pressure of competition because of high interest rates, and limited access to technology, markets and credit facilities.

The low quality and insufficiency of infrastructure facilities in the rural sector prevented the expansion of industries into rural areas, thus blocking new development opportunities and the generation of employment to absorb employees displaced from small industries and the agriculture sector as a result of liberalization.

The social mobilization and rural poor empowerment programmes, conducted mostly by NGOs and various social institutions, have failed to achieve their objectives of empowering the rural poor because of the lack of trained personnel and financial support for their programmes.

Given the present composition of the population in poverty, the causes, the impacts of reform policies and other environmental factors, the strategy for poverty alleviation in the rural sector has to be a highly differentiated one. The following recommendations are put forward, taking all the major causes of poverty into account, for the consideration of future development and poverty alleviation programmes.

1. Labour-intensive agricultural expansion and development programmes should be introduced to the rural areas. Such programmes should be developed in such a way that they increase the demand for farm labour and for the products of rural non-farm activities. The programmes should expand the demand for transportation, trading, and storage and services which can be provided by small rural enterprises, which are usually labour intensive. A mechanism should be included in the programmes for absorbing the rising income of the farming sector through consumer goods and services, some of which can also be provided by rural enterprises.

   The new agricultural expansion programmes should educate and motivate the farmers towards using the appropriate dosages of fertilizers, diversifying production into high-priced export crops such as fruit and vegetables, for which they can find local and international markets, and employing the appropriate technology. Necessary precautions should be included for preventing the further subdivision of farming land into smallholdings.

2. A new poverty alleviation programme should be introduced with increased emphasis on growth-oriented strategies. The new programme should demotivate the beneficiaries who depend on such assistance, to make them more production-oriented rather than welfare-oriented. The assistance should be limited to the really needy. The poverty alleviation programme should not be implemented for an indefinite period, to avoid the beneficiaries developing a dependency mentality. Therefore, the new poverty alleviation programme should emphasize family-based developed projects and should provide the capital, technical and financial support to the families depending on their capabilities and requirements, rather than distributing money or food among the beneficiaries.

3. A holistic approach to micro enterprise development should be adopted. The promotion of micro/small enterprises in the rural areas requires a comprehensive assistance approach that integrates technology transfers, training of skills, provision of credit, quality control and marketing assistance. The micro/small enterprises development programmes should have intersectoral linkages encompassing small, medium and large enterprises, banks and other credit institutions, and local and export marketing organizations. The programmes should be backed by the research and development institutions in developing new products and cost-effective production methods.

4. Educational reforms are an urgent requirement to enable the problem of the mismatch between education and labour market requirements to be overcome. The reforms should be implemented taking all the existing and future trends and requirements in the labour market into consideration. Higher priority should be given to vocational education and training. The facilities available for adult education in that area should be expanded, to enable displaced workers to acquire the theoretical and practical knowledge necessary to entering new employment provided by the modern industries. The educational reforms should also give sufficient consideration to agricultural education in order to improve the knowledge of farmers concerning the use of new agricultural technology in farming, storage and transportation of their products. The value system, morals, skills and understanding required by the new economic reforms should be developed by the education system to facilitate the implementation of the reforms.

5. Integrated infrastructure development programmes should be implemented in the rural areas. It is very important to develop the existing infrastructure in the rural areas, not only to enable rural industrialization programmes to be expanded, but also to develop the standard of living of the rural poor. The programmes should be implemented with the support of the private sector, provincial administration and foreign assistance programmes.

The programmes should be labour intensive to provide off-farm employment for the rural poor. The maintenance of infrastructure facilities should be handed over to the rural residents on a contract or permanent basis.

6. Programmes for women need to be implemented. The incidence of poverty in female-headed families is relatively higher in rural areas because of insufficient employment opportunities for females. Exploitation of female labour is higher in the rural areas because of the lack of employment opportunities. Low productivity, characterized by little value addition, poor quality and weak marketing prospects of the credit-based self-employment activities undertaken by women from poor rural households do not provide sufficient income for their families. New programmes should be implemented to improve the facilities available for domestic self-employment activities of women, enabling them to generate additional income for their households.

7. A rural level participatory planning process needs to be adopted. Specific techniques such as participatory rural appraisal are important for involving the rural poor in the decision-making process in rural development. The participatory programmes should encourage the rural poor to: (a) identify and prioritize local needs; (b) formulate rural projects; (c) identify resource requirements; and (d) implement, monitor and evaluate projects. That approach will improve the self-reliance and the dedication of the rural poor. Extra care should be taken to prevent the possible influence of the non-poor, such as local politicians, bureaucrats etc., on decisions. The proposed participatory system would lead to an increase in the cost-efficiency of rural projects.

8. Appropriate and well-developed social mobilization programmes under the guidance of social mobilization experts should implemented by competent personnel for the rural poor. Such programmes can improve the awareness, self-reliance, group behaviour and support systems at the village level, thus enabling the poor to improve their living standards.

9. The implementation of a small/micro area development approach is an important component of poverty alleviation. Targeting small/micro areas identified as poverty pockets for development purposes, rather than concentrating on a very large area on the basis of specific requirements, is a cost-effective method of targeting as it avoids costly and time-consuming surveys. This approach would help to develop suitable poverty alleviation and development programmes which suit the specific requirements of the areas and, at the same time, eliminate the problems of coordinating and implementing universal programmes. On the other hand, the approach would facilitate the utilization of social mobilization and participatory approaches in rural development.

10. The integrated rural development movement should consider moving away from an exclusive focus on rural concerns to a new paradigm of regional-rural development which integrates rural concerns with a regional development process. That new approach can be used to integrate rural development activities with regional, and sometimes with provincial or national-level development programmes, to draw their benefits to the rural areas. Rural subcontracts for regional or national level industries can be developed under such an approach and it may help to develop both sectors simultaneously.