

Abstract

The *State of the Economy* report is an annual publication of the Institute of Policy Studies of Sri Lanka (IPS). The report provides an assessment of Sri Lanka's economic performance in 2007/08 and comments on the outlook in the context of developments in the global economy. The report also highlights topical issues of medium-term policy relevance for the Sri Lankan economy.

The 2008 report notes that while the Sri Lankan economy has been performing creditably to post an annual average growth rate of 6.9 per cent during 2005-07, higher growth has also been accompanied by a weakening of macroeconomic stability. Despite a much tighter monetary policy stance adopted in 2007, the lagged effects of past excesses in monetary aggregates – and cost push effects from price increases in fuel and food – have ensured a continuation of inflationary pressures into 2008. Whilst a sharp drop in credit growth is expected to moderate inflationary pressures to an extent in the immediate short-term, the medium-term outlook for price stability will hinge critically on Sri Lanka's fiscal policy stance. In this regard, the report highlights the need to watch the future path of debt management in Sri Lanka. Increased recourse to foreign currency denominated debt borrowed on commercial terms not only exposes the economy to higher risks, but also complicates monetary policy and exchange rate management. The report notes that external sector developments need to be given careful consideration in view of an anticipated deterioration in the global economic environment during 2008/09.

The report also highlights emerging socio-economic issues in key areas of medium-term policy relevance for Sri Lanka. Taking the political economy dilemma of institutional change and reforms as a theme, detailed analyses of related topical debates currently facing the Sri Lankan economy are taken up. These include:

- the political economy dilemma of reforming state-owned enterprises in Sri Lanka,
- addressing the delivery of basic services to bridge emerging inequities as evidenced from an analysis of the Household and Income Expenditure Survey of 2006/07,
- the pros and cons of adopting different public-private partnerships in the provision of education services in Sri Lanka,
- the rationale for reforms in the energy sector in view of escalating international oil prices and concerns regarding climatic change,
- the impact of 'foodflation' and attendant reforms to the agriculture sector in Sri Lanka,
- sustaining economic growth through services sector reforms, and
- the challenges of implementing effective fiscal decentralization under the 13th Amendment

The report is available for sale from the IPS premises, 131, St. Michael's Road, Colombo 3 and bookshops in Sri Lanka.