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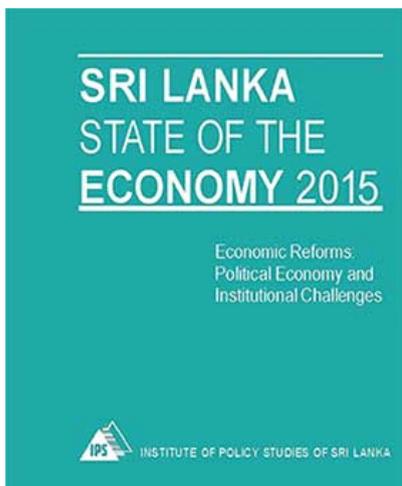
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Economic Reforms in Sri Lanka: Political Economy and Institutional Challenges

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From the IPS flagship publication 'Sri Lanka: State of the Economy 2015 Report'

The run up to Sri Lanka's January 2015 Presidential elections saw an unprecedented wave of demand for political and constitutional reforms. In the end, it was contested and won over a mandate for reforms, encompassed in a 100-day programme with the abolition or scaling-down of executive powers of the President under the country's Second Republican Constitution of 1978 as the central focus of the reform efforts. The passage of the 19th Amendment to the Constitution in April 2015 with an overwhelming majority - albeit on a less ambitious scope than originally envisaged - was the first significant milestone of thereform initiatives.

It is clear that constitutional and political reforms, such as the 19th Amendment and the proposed 20th

Amendment to the Constitution to change the country's electoral system, are the main pre-occupations of policy makers at present. However, social systems are complex and interconnected. Therefore, reforms in one sphere cannot usually generate desired outcomes without reforms in other spheres. For instance, reformed political structures require matching adjustments in economicsystemsto generateefficient outcomes. In the long run, not only political and economic reforms, but reforms in other frontiers such as social and environmental will need to go hand-in-hand to achievesocially desirable outcomes.

This Policy Insight based on the SOE 2015 makes an attempt to examine the quest for reforms that the country appears to be engaged in at presentso that a better idea ofthe desired direction of change can be gained.

Demand for Reforms: Present Context

The current reforms have been inevitablycaptured under the popular slogan of 'good governance'.The reformist agenda appears to be driven by five major demands;

- (i) Strengtheningthe democratic structures of government;
- (ii) Promotion of human rights;
- (iii) Combatingcorruption;
- (iv) Ensuring rule of law; and
- (v) (v) Enhancing transparency and accountability.

Political forces mobilized by the above demands for reform have recently passed the 19th Amendment to the Constitution, aimed to serve many of the above demands by altering the power structure of the political system byreducing the powers of the executive arm. Other legislative reforms that are considered complementary to the 19thAmendment, namely, the Right to Information Act (RTIA) and the 20th Amendment to reform the electoral system are being pursued.

The path to reforms is not smooth andis being intensely contested by parties with diverse interests. The experience of other countries suggests that desired outcomes of political reforms cannot be achieved through legislative enactments alone, but depend largely on the steadfast commitment of diverse sections of the polity to make them practical realities.

Overall, global experience suggests that democratic political reforms do not necessarily provide an automatic push for transforming countries into economic growth centres. They could act as catalysts for growth, but economies have to undergo their own paths of reform, which are not fully independent of political reforms. Interestingly, some economies that successfully transformed themselves into centres of growth did so under autocratic regimes backed by military, communist parties or even monarchical systemsat least in their early phases of transformation. Some of them have gradually

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adopted democratic systems later, but a few are still under autocratic regimes.

Today, economic reforms have to be enacted against the backdrop of rapidly advancing information technology (IT) and globalization that sets the pace of economic, social and political relations around the world. The conditions can be further complicated by a declining quality of the environment around the world and global threats, with potential for far reaching consequences. Climate change, the greatest of all externalities that humanity is experiencing is showing its capacity for unleashing damage on economies around the world. Hence, complementary reforms in social and environmental also are necessary for social progress in the current context.

The term 'reform' implies amending a system which is not performing satisfactorily. Hence, reforms are demanded due to unsatisfactory performance of a social system. The key objective of reform is changing the system from poor to better performance. Therefore, reforms are invariably associated with change. In spite of broader conceptual implications of reforms as a social process, the term has been used in recent economic literature mostly to identify a set of policy changes that have been advocated to remove certain distortions - presumably introduced by government involvement in economic activities - and open up economies to free trade and capital flows. Most economists in the neo-liberal camp and policy makers shared a common conviction that growth requires macroeconomic prudence, domestic liberalization, and outward-orientation. Thus, the core set of reforms revolved around fiscal deficit reduction, realignment of exchange rates, lifting controls on prices, deregulation of interest rates, liberalization of financial sectors, reduction of tariffs and other restrictions on imports. A reduction in the role of the state also was viewed as essential for achieving greater efficiency through reducing state discretion, downsizing governments and encouraging a greater role for the private sector. Hence, reforms aimed at privatization, deregulation, elimination of quantitative restrictions and licensing requirements, dismantling agricultural marketing boards and other forms of state monopoly became central to the reform agendas of the 1980s and 1990s. Since the early 2000s, there has been a growing emphasis on 'second generation reforms', which have been advocated strongly by the Bretton Woods Institutions. The second generation reforms aim at creating a level playing field for all sectors and implementing policies for the common good, particularly social policies that will help to alleviate poverty and provide more equal opportunities. These reforms focus on four major areas: the financial system, good governance, composition of fiscal adjustment and deeper structural reforms.

This policy insight is based on the chapter on 'Economic Reforms in Sri Lanka: Political Economy and Institutional Challenges' in the 'Sri Lanka: State of the Economy 2015 Report' (SOE 2015). The State of the Economy Report is the flagship publication of the Institute of Policy Studies of Sri Lanka. The complete report can be purchased from the publications section of the IPS, located at 100/20, Independence Avenue, Colombo 7. For more information, contact the Publications Unit on 0112143100.

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