Sri Lanka
State of the Economy Report 2012

Chapter 4
Reducing Inequality Amidst Fast Growth

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4. Reducing Inequality Amidst Fast Growth

4.1 Introduction

Policies directed towards accelerated growth have become the centre of policy efforts in the world. Yet, inequality trends in the world are on the rise. Even traditionally more egalitarian countries such as, Germany, Denmark and Sweden, have experienced widening inequalities between the rich and the poor. This implies that, though strong economic growth has been able to reduce absolute poverty, it has not been able to distribute its benefits evenly.[1] Consequently, there has been a shift in the emphasis of policy frameworks of many countries from poverty reduction to the reduction of inequality.

Sri Lanka is not an exception in setting its policies towards accelerating economic growth but ensuring, at the same time, that issues of equity are not neglected. This, the country has achieved in its post-conflict phase of development, sustaining growth in excess of 8 per cent during 2010-11. Even more critically, the country has witnessed a sharp reduction in poverty over the recent past. These achievements are in line with one of the major objectives of the 'Mahinda Chinthana: Vision for the Future' development strategy – i.e., to achieve equitable development through pro-poor, pro-growth and pro-regional public spending. The most recent available data suggest that while reduction in poverty has been accompanied by improvements in bridging inequities, socio-economic disparities still persists among provinces and population groups in the country. In this backdrop, it is important to examine where Sri Lanka stands in terms of income inequality and the possible causalities behind the current status. This will enable a better understanding of whether the benefits of accelerated economic growth have permeated to all segments of the population in the country. To this end,

> ***'The benefits of growth take considerable time to reduce inequities substantially. Policy efforts on growth have to be aligned with appropriate welfare policies to meet the challenges of inequality'***

[1] Gurría, A., (2011), Remarks made at the press conference organised at the launch of the report on "Divided we Stand: Why Inequality Keeps Rising", OECD, Paris. Available at http://www.oecd.org/document/22/0,3746, en, 21571361_ 44315115_49185046_1_1_1_1,00.html. (Accessed on 23/04/2012).

Section 1.2 discusses the relationship between economic growth and income inequality. Section 1.3 identifies income inequality trends in Sri Lanka. Section 1.4 discusses how far the country is from achieving equity. Section 1.5 identifies possible reasons that determine inequality in Sri Lanka. Section 1.6 concludes with policy implications.

4.2 Income Inequality: A Matter for Growth?

The relationship between income inequality and growth is complex and could work both ways. On the one hand, inequality could become an incentive for effective functioning of a market economy - i.e., if all individuals in a society are not getting an equal share of income, it would be an incentive for a person to get ahead of the other. On the other hand, inequality might also be destructive for growth - i.e., if only a few have all they want while others struggle to survive, it will hold back growth. Neither of these scenarios will allow an economy to grow at its fastest possible rate,[2] and striking a balance between these two extreme scenarios, therefore, is of some importance.

If income inequality is an incentive for people to work, earn and invest more, why is it a matter of policy concern? Income inequality has inefficient social and economic outcomes, and addressing it is of importance for a number of reasons: (i) Income inequality is directly linked to poverty reduction. Poverty reduction in a given country and at a given point of time is fully determined by the rate of growth of the mean income of the population and change in the distribution of income;[3] (ii) Extreme inequality leads to economic inefficiency and curtails growth; (iii) Higher inequality is associated with higher levels of crime in a country. A positive relationship between income inequality and crime is to be found;[4] (iv) Income inequality leads to unequal access to health care services and education. Indeed, high income inequality is reflected in a lower life expectancy rate; (v) The labour market is also affected by income inequality in a country. Equal income distribution can minimize the gender wage gap and discrimination against women; (vi) Similar to the link between income inequality and crime, there is also a positive relationship between income inequality and corruption; and (vii) Extreme inequality can undermine social stability and solidarity.

Theories on economic growth and inequality have a long history dating back to the era of classical economists like Adam Smith and David Ricardo, and to Marxian theory. According to Adam Smith, economic inequality is unavoidable in an attempt to achieve higher economic growth. Higher social division as a result of income inequality is also argued to lead to higher productivity. In contrast, Marxian theory suggests that economic growth will be sustained with equal income distribution. Kuznets theory, which argues that income inequality would change as economic growth changes -- or more precisely, income inequality would rise first and then decline with economic growth – can be considered as a plausible theory of inequality.

There is mixed evidence on growth and inequity around the world. For instance, there are studies that point to a significant negative relationship between inequality and growth in democratic countries.[5] By con-

[2] See Berg, A. G. and J.D. Ostry (2011), "Inequality and Unsustainable Growth: Two Sides of the Same Coin?", Staff Discussion Note, IMF, April 2011.

[3] Bourguignon, F., (2004), "The Poverty-Growth-Inequality Triangle", proceedings of the Indian Council for Research on International Economic Relations. New Delhi.

[4] ILO (2008), "World of Work Report 2008: Income Inequalities in the Age of Financial Globalization", ILO, Geneva.

[5] Persson, T. and G. Tabellini (1994), "Is Inequality Harmful for Growth? Theory and Evidence," *American Economic Review*, Vol. 84, pp. 600-621.

trast, other studies suggest that there is a negative relationship for poor countries, but a positive relationship for rich countries.[6] According to Berg and Ostry (2011), the more relevant issue for the developing countries is the relationship between income distribution and sharp growth spells,[7] rather than the long-run average growth. Longer growth spells are associated with more equality in income distribution. They note that "half the inequality gap between Latin America and emerging Asia would, according to our central estimates, more than double the expected duration of a growth spell. Inequality typically changes only slowly, but a number of countries in our sample have experienced improvements in income distribution of this magnitude in the course of a growth spell. Inequality still matters, moreover, even when other determinants of growth duration – external shocks, initial income, institutional quality, openness to trade, and macroeconomic stability – are taken into account."

Among the several social and economic impacts of income inequality, its impact on economic growth and poverty reduction is important. Thus, policy frameworks of many countries have been changed over time in response to this. The first generation of Poverty Reduction Strategy Papers (PRSPs) focused mainly on 'poverty reduction,' and consequently, each country PRSP began by providing a contextual definition of poverty and designing projects and programmes aimed at reducing poverty in their respective countries. The second generation of PRSPs which focuses on growth, poverty and inequality is a response to the involvement in the first generation PRSPs. This paradigm shift shows that policy concerns of these countries shifted from poverty reduction to achieving equity. Income inequality is twofold: vertical income inequality and horizontal income inequality. Vertical inequality consists of inequality among individuals or households, while horizontal inequality is defined as economic, social, and political inequality among groups with common identities, typically culturally defined – e.g., by ethnicity, religion or race.[8] In other words, vertical inequality is a summary measure of the general level of inequality between rich and poor people in a country, irrespective of the group characteristics such as ethnicity, caste, gender and location.

Given that achieving a targeted rate of growth depends on the level of inequality at the aggregate and spatial levels, where inequality can either promote or hold back accelerated growth, understanding country contexts is critical for future policy decisions. In this context, the next section provides a detailed analysis of the current situation of income inequality in Sri Lanka. Different inequality measurement indicators such as distribution of income across different income groups (quintiles), income distribution ratios (quintile ratio) and Gini coefficient are used to assess the prevailing situation.

4.3 Income Distribution across Different Income Groups

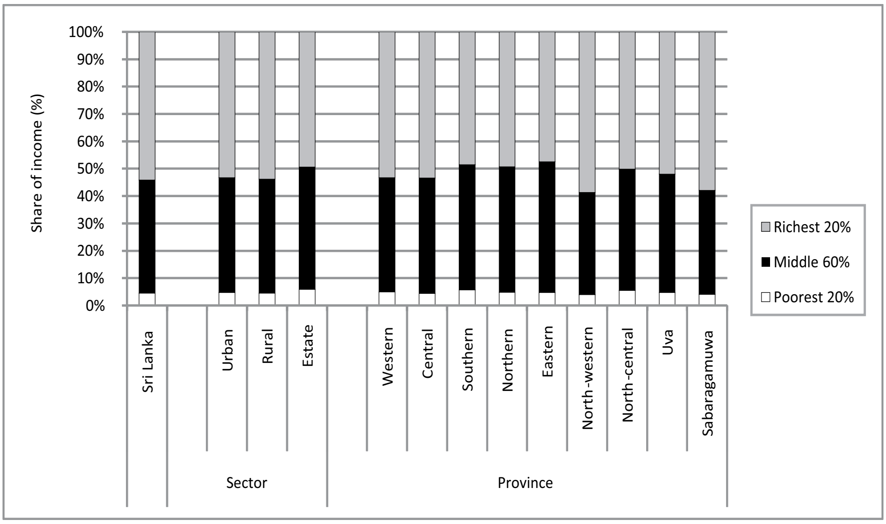
The income distribution pattern across different income groups (quintiles) shows the inequality of wealth concentration. In Sri Lanka, at the aggregate level, more than half of the income is earned by the richest 20 per cent of households. In contrast, the poorest 20 per cent of households receive less than 5 per cent of the income (4.5 per cent). The remaining 60 per cent of households, who are in the middle income categories, receive

[6] Barro, R. J., (2000), "Inequality and Growth in a Panel of Countries", *Journal of Economic Growth*, Vol. 5, pp. 87-120.

[7] Defined as the interval starting with a growth up-break and ending with a down-break.

[8] Stewart, F., G. Brown, and A. Cobham (2009), "The Implications of Horizontal and Vertical Inequalities for Tax and Expenditure Policies", CRISE Working Paper No. 65.

Figure 4.1
Share of Income of Households across Income Quintiles by Sector and Province- 2009/10



Source: Based on Department of Census and Statistics of Sri Lanka, 2011, *Household Income and Expenditure Survey 2009/10 Final Report*.

41.4 per cent of income. The distribution of income across the income groups at the aggregate level itself shows the income inequality that persists in the country (Figure 4.1).

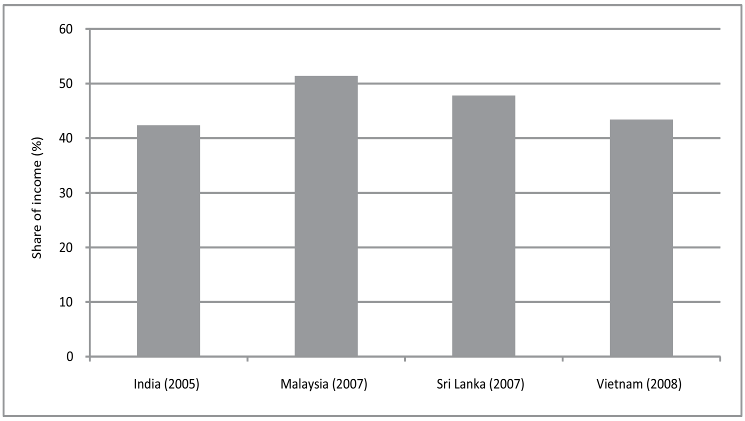
Spatial inequality can be observed by examining income distribution across sectors and provinces of the country. The estate sector shows a relatively low level of inequality compared to the rural and urban sectors. Yet, close to half of the income (49.4 per cent) of the estate sector is concentrated with the richest 20 per cent of households. Comparatively higher levels of income inequality can be observed in urban and rural sectors. In both these sectors, over half (53 per cent) of the income is with the richest 20 per cent of households (Figure 4.1).

Similar inequality patterns among income groups can be observed across provinces, with slight variations. In the North-Western and Sabaragamuwa Provinces, the richest 20 per cent of households receive close to 60 per cent of income, while the poorest 20 per cent receives less than 5 per cent. This signals the prevalence of higher levels of inequality in these provinces. The Southern, Northern and Eastern Provinces show relatively lower levels of inequality, with the richest 20 per cent of households receiving less than half of total income of each province (Figure 4.1).

District-wise observations show that in all the districts, the richest 20 per cent of the households receive more than 40 per cent of income. However, inequality levels are much higher in Ratnapura, Kurunegala, Gampaha, and Matale districts.

A comparison of income distribution among a few selected countries in Asia shows that such high levels of unequal distribution of wealth is a common phenomenon, irrespective of the level of economic growth (Figure 4.2). More than 40 per cent of income is found to be concentrated with the richest 20 per cent of households in these Asian countries.

Figure 4.2
Comparison of Income Shares of the Richest 20 per cent of Households across Countries

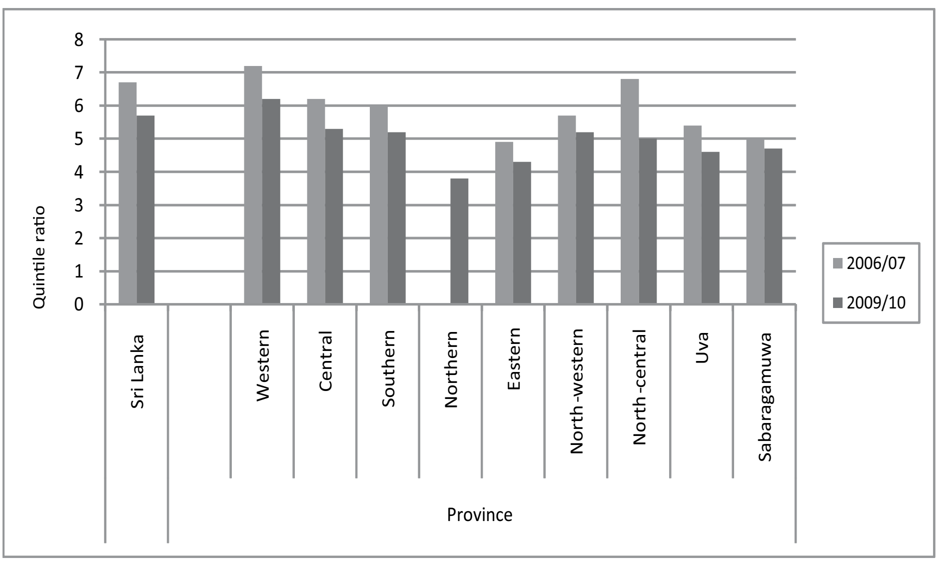


Notes: Income shares are graphed for the latest year for which the data are available or taken for earlier years for comparison purposes.

Source: Based on World Bank, World Development Indicators (WDI) database.

The quintile ratio is also widely used as a measurement of inequality. It measures inequality as a ratio of income received by the richest and the poorest. Whilst the ratio can

Figure 4.3
Quintile Ratios by Provinces in 2006/07 and 2009/10



Note: Quintile Ratio is the ratio of income received by the richest 20 per cent of households to the income received by the poorest 20 per cent of households (expenditure quintiles have been taken as a proxy for income as used by the Department of Census and Statistics of Sri Lanka).

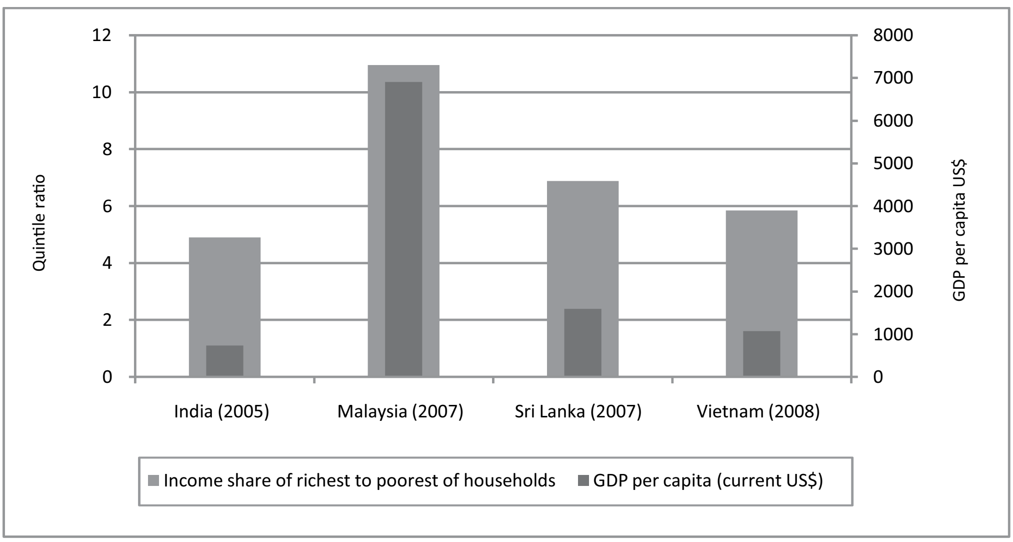
Source: Based on Department of Census and Statistics of Sri Lanka, 2011, *Household Income and Expenditure Survey 2009/10 Final Report*.

be measured in alternate ways,[9] for the purposes of this analysis, the quintile ratio is taken as the income received by the richest 20 per cent of households in comparison to the income received by the poorest 20 per cent of households. At the aggregate level, the quintile ratio has fallen from 6.7 in 2006/07 to 5.7 in 2009/10. This shows that the richest 20 per cent of households received a 6.7 times higher income than that of the poorest 20 per cent of households in 2006/07 (Figure 4.3). Given that the ratio has dropped to 5.7 by 2009/10, these figures indicate a reduction of inequality at the aggregate level over recent years in Sri Lanka.

The quintile ratios across the provinces also show a declining pattern, indicating a fall in inequality in all the provinces between the two periods. However, the Western Province shows the highest level of inequality (with a quintile ratio of 6.2 in 2009/10), followed by the Central, Southern and North-Central Provinces (Figure 4.3).

The comparison among the same set of Asian countries as before, shows higher quintile ratios for all the countries, indicating higher levels of inequality in these countries. Further, as shown in Figure 4.4, the level of inequality in these countries is also associated with their per capita GDP -- i.e., higher the per capita GDP, higher the inequality and vice versa.

Figure 4.4
Country Comparisons of GDP Per Capita and Inequality



Notes: Quintile Ratio is the ratio of income received by the richest 20 per cent of households to the income received by the poorest 20 per cent of households. Quintile ratios are graphed for the latest year for which the data are available for comparison purposes.
The GDP per capita values are taken for the respective years the quintile ratios are calculated for each country.

Source: Based on World Bank, World Development Indicators (WDI) database.

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9 Different ways of measuring the quintile ratio: [Q5/Q1], [Q5/(Q1 + Q2)], [Q1/Q5]. The 'Q' refers to the Quintile. The number shows the quintile. i.e.: Q1 is the poorest, while Q5 is the richest.

The above section looked at the income inequality in Sri Lanka using both the distribution of income across different income groups and the quintile ratio. The next section looks at inequality using the Gini coefficient – a widely used measurement of inequality.

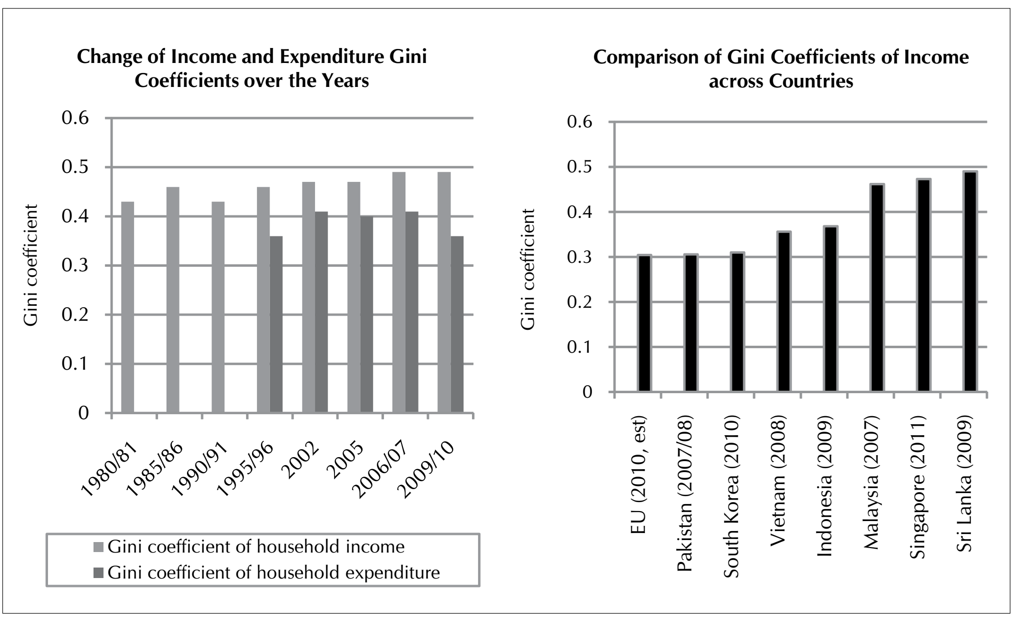
4.4 How far is Sri Lanka from Achieving Income Equality?

The Gini coefficient measures the extent to which the distribution of income (or consumption expenditure) among individuals or households within an economy deviates from a perfectly equal distribution. The closer the coefficient is to zero, the more equal the distribution of income is. Overall, Sri Lanka has experienced a reduction of inequality in recent years. The Gini coefficient of expenditure has come down from 0.4 in 2002 to 0.36 in 2009/10. However, the Gini coefficient of income does not show a reduction of inequality (Figure 4.5). Nonetheless, it should be noted that expenditure is the more reliable indicator, since households are prone to smooth expenditure when income changes. As such, the Gini coefficient of expenditure would be the more reliable indicator of income distribution.

A comparison across countries show that Sri Lanka has a long way to go in achieving equality compared to other countries such as Indonesia, South Korea and the EU region. However, it should be noted that the cross country comparison uses the Gini coefficient of income due to data limitations (Figure 4.5).

There are also considerable levels of inequality across geographical regions in Sri Lanka. The level of inequality is higher in both the

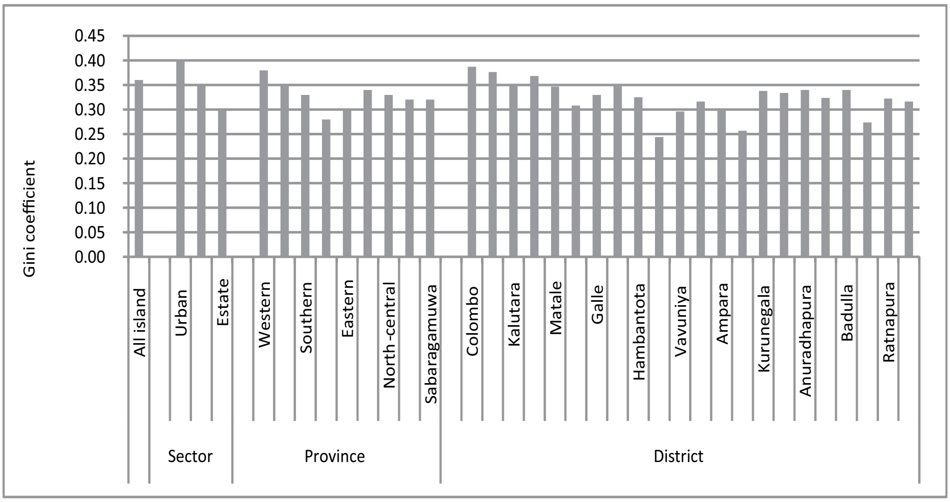
Figure 4.5
Change in Gini Coefficient over the Years in Sri Lanka and Comparison across Countries



Source: Based on Department of Census and Statistics of Sri Lanka, 2011, *Household Income and Expenditure Survery 2009/10 Final Report*.

Source: Based on Central Intelligence Agency (CIA), *The World Fact Book*.

Figure 4.6
Gini Coefficient by Sectors, Provinces and Districts in 2009/10



Notes: Gini coefficient here refers to Gini coefficient based on expenditure (Gini coefficient of expenditure is a better measurement than Gini coefficient of income).

Source: Based on Department of Census and Statistics of Sri Lanka, 2011, *Household Income and Expenditure Survey 2009/10 Final Report*.

urban and rural sectors, as compared to the estate sector. This implies that despite a higher level of poverty in the estate sector, income is much more equitably distributed in this sector compared to the other two sectors of the economy (Figure 4.6).

Across provinces, the Western Province has the highest level of inequality measured by the Gini coefficient. The Central, Southern and the North-Western Provinces record the next highest levels of inequality (Figure 4.6). Similarly, higher levels of inequality are to be found in the districts of Colombo, Gampaha, and Kandy. The districts of Jaffna, Trincomalee, Moneragala and Vavuniya have experienced the lowest levels of inequality in the country.

While it is important to analyze the current status of inequality, it is also necessary to understand changes in inequality over time. This is examined both at the aggregate level and in terms of spatial differences as depicted in Figures 4.7 and 4.8, respectively.

At the aggregate level, the level of inequality measured by the Gini coefficient has reduced by 0.04 points between 2006/07 and 2009/10. The changes across sectors and the districts provide an understanding of the changes in spatial inequality during this period. Although the current status of inequality is lower in the estate sector compared to the other two sectors, inequality has increased only in this sector. It has increased from 0.26 to 0.30 between 2006/07 and 2009/10. This indicates that the reduction of poverty in the estate sector has not necessarily brought equal benefits to all households in the sector. This is re-inforced by the rise in district Gini coefficients of Nuwara-Eliya and Kegalle districts, where there is a substantial share of the estate sector population. In contrast, the level of inequality measured in terms of Gini coefficient in all other districts have reduced in 2009/10 as compared to 2006/07.

Examining the changes in the level of spatial inequality with growth over the years would take the analysis a step forward. Due to the

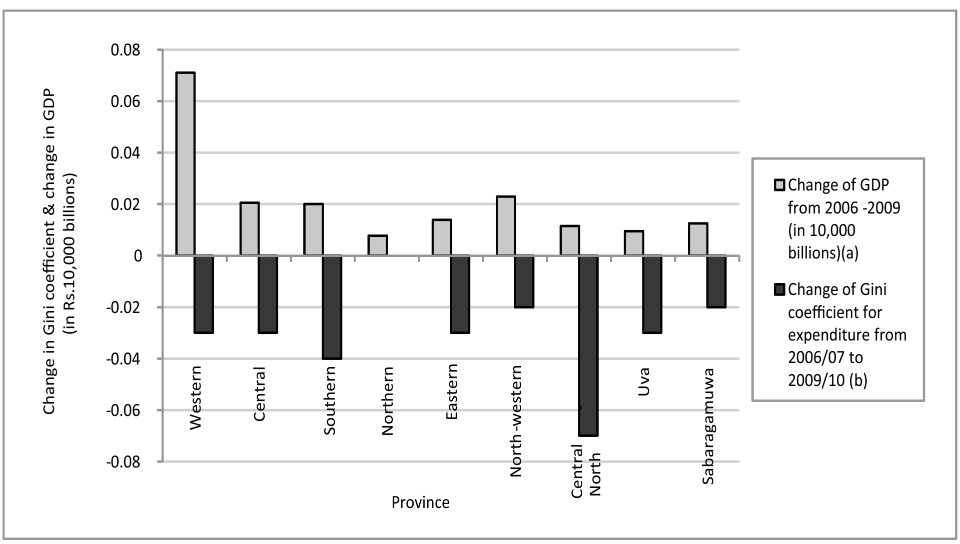
Figure 4.7
Change in Gini Coefficient by Sectors and Districts between 2006/07 and 2009/10

Notes: Gini coefficient here refers to Gini coefficient based on expenditure (Gini coefficient of expenditure is a better measurement than Gini coefficient of income).

Source: Based on Department of Census and Statistics of Sri Lanka, *Household Income and Expenditure Survey*, 2006/07 Final Report, and 2009/10 Final Report.

data limitations, the changes are graphed only at the provincial level (Figure 4.8). The data indicate the negative relationship between growth and reduction in inequality across provinces. In particular, the Western Province shows a marked growth in the output

Figure 4.8
Change of GDP and the Gini Coefficient of Expenditure from 2006 to 2009 by Provinces



Notes: The GDP change is provided in Rs. 10,000 billions

Sources: Based on CBSL, *Annual Report 2011*; Department of Census and Statistics of Sri Lanka, *Household Income and Expenditure Survey 2009/10 Final Report*.

but a lower level of reduction of inequality. This indicates that in the Western Province, benefits of growth have not trickled down adequately for a substantial reduction of inequality to have occurred. In contrast, the North-Central Province has been able to reduce inequality remarkably during the considered period, even with a lower level of growth. This suggests that growth is not the only factor which brings in income equality.

Based on the above analysis which provides an initial understanding of the current situation of inequality in Sri Lanka, measured using different indicators, the following section attempts to assess the most probable reasons for the prevalence of inequality in the country.

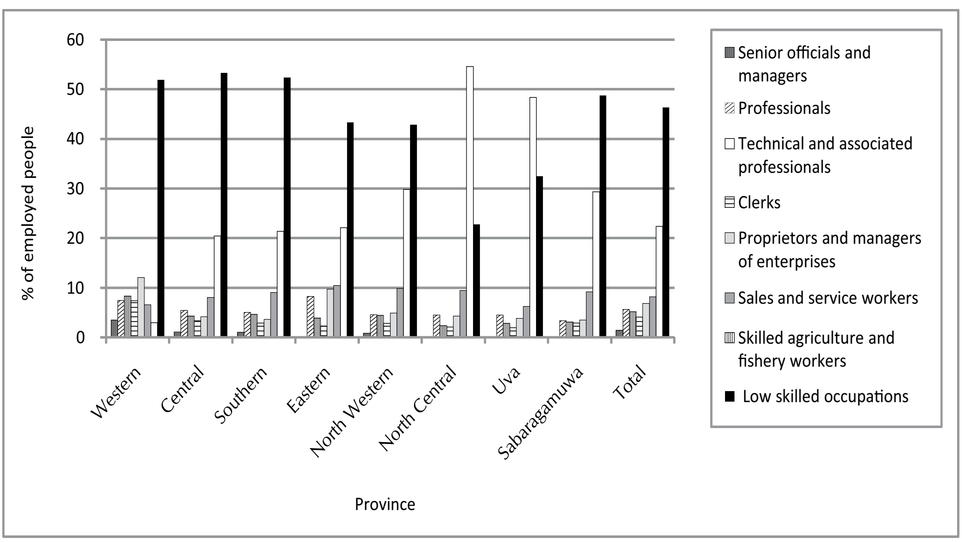
4.5 Determinants of Income Inequality in Sri Lanka

This section discusses the key factors that may be contributing to income inequality in Sri Lanka. These include wage differentials in different occupation categories, gender wage differentials, contribution of migration and remittances to inequalities, disparities in education – including both differences in access to education and educational outcomes -- concentration of economic activities, and contribution of infrastructure to inequalities. Each of these factors is discussed in detail below.

4.5.1 Wage and Skills Differentials

The determination of the wages by the market is one of the major causes of economic inequality within the modern market economies. This is caused by supply and demand interactions for different types of work. Hence, wages are determined on the market price of skills. For instance, increased competition for a given type of work can lead to a fall in wages for that type of work. Work which require higher levels of skills are often in short supply and are paid higher wages. The above interactions in labour markets lead to wage differentials, causing income inequality among workers.

Figure 4.9
Currently Employed Persons by Occupation Categories by Provinces, 2010



Source: Based on Department of Census and Statistics of Sri Lanka, *Sri Lanka Labour Force Survey: Annual Report 2010*.

Table 4.1
Current Employed Persons, by Sector of Employment

	Public Sector		Private Sector	
	Male (%)	Female (%)	Male (%)	Female (%)
Western	61	39	69	31
Central	53	47	72	28
Southern	59	41	71	29
East	71	29	88	12
North-Western	56	44	71	29
North-Central	70	30	67	33
Uva	58	42	61	39
Sambaragamuwa	56	44	65	35
Total	60	40	70	30

Note: Percentage by gender of total employed.

Source: Based on Department of Census and Statistics of Sri Lanka, *Sri Lanka Labour Force Survey: Annual Report 2010*.

This scenario can be observed for Sri Lanka by looking at occupation categories across provinces. Western, Central and Southern Provinces, which have a higher share of people employed in low skilled occupations,[10] record higher levels of inequality (Figure 4.9). At the same time, the dominance of an economic sector in a region, in terms of providing employment, results in wage differentials. The productivity differentials of economic sectors affect wages. For example, Central, North-Central and Sabaragamuwa Provinces have the majority of their labour in the agriculture sector. The agriculture sector typically records the lowest productivity, in turn leading to greater inequality across these provinces – i.e., the low labour productivity of the agriculture sector translates into low wages for workers in agriculture, increasing inequalities in these provinces.

The higher level of employment of women in the private sector and the wage differentials for women is another possible factor leading to inequalities in certain provinces. Although women are more productive than men, they are found to be paid less in Sri Lanka.[11] In particular, women are paid less in the private sector and the agriculture sector. There is no wage difference to be found between male and female workers in public sector employment.[12] Thus, the higher rate of female participation in the private sector might be one of the reasons for high income inequality in the Sabaragamuwa, Western and North Central Provinces (Table 4.1). However, wage differentials are not the only factor, and there could be multiple reasons behind the inequality levels observed in Sri Lanka. Some of these are discussed below.

4.5.2 Contribution of Migration and Remittances to Income Inequality

Whilst migration may be identified as a response to unequal distribution of wealth, migration itself can contribute to increasing inequality. Indeed, migration is perhaps a major demographic attribute that is contributing to income inequality in Sri Lanka. As remittances increase the income of remittance receiving households, it leads to affordability for better services such as education and

[10] Craft and related workers, plant and machine operators and assemblers, and elementary occupations were considered as the occupations which require lower levels of skills.

[11] Gunawardena D., (2008), "An Analysis of Gender and Ethnic Wage Differentials in Sri Lanka: 1996-2004", available at http://www.google.lk/#hl=en&sclient=psy-ab&q=An+Analysis+of+Gender+and+Ethnic+ Wage+Differentials+in+Sri+Lanka:+1996-2004. (Accessed on 23/04/2012).

[12] *Ibid.*

health, compared to non-migrant households. Further, increased income of migrant households leads to changes in their consumption patterns. Better access to education leads to higher education outcomes among migrant households. Such developments can create income inequality between migrant and non-migrant households.

In Sri Lanka, remittances are positively related to the level of income of the income receivers.[13] Indeed, it is found that the poorest 10 per cent of income receivers gets 1.3 per cent of their income as remittances, while the richest 10 per cent of income receivers gets 4.6 per cent of their income from remittances. This clearly explains that remittances have significant impact on household income and thereby, have an impact on inequality. Further, the majority of remittances receiving households are in the top income decile which further links remittance to income inequality.[14]

In contrast to the impact of external migration, internal migration from rural to urban areas is more likely to contribute towards reduced income inequality in the long run. For example, people moving from rural to urban areas, which are considered economically advanced areas, contribute to improved production and increased incomes. As a result, income disparities among individuals between rural and urban areas can reduce in the long run.

4.5.3 Disparities in Education

Education policies are considered a tool for reducing income inequality in a country. Education has a direct link to employment and employability, which affects income and inequality. Differences in both access to education and educational outcomes contribute to income inequality. In the case of Sri Lanka, there is evidence to suggest that the contribution to total inequality from education has increased progressively over time, from 12 per cent in 1980 to 15 per cent in 2002.[15]

Despite universal free education policies, significant disparities do exist across income groups, gender, regions, in terms of access, quality of education and also in educational outcomes. For example, the estate sector and the poorest quintile register the lowest net enrolment ratio in upper secondary and collegiate education cycles. One of the factors for such disparities is the unequal distribution of resources.[16] Thus, disparities in education in countries can be a significant factor in explaining inequality.

4.5.4 Unequal Spatial Concentration of Economic Activities

The differences in intensity of economic activities across regions are a cause for spatial inequalities. The World Bank (2009) identifies three spatial dimensions of density, distance, and division to describe geographic transformation using the concept of market access.[17] The report highlights that density is the most important dimension in the 'local' geographic scale, and distance is the most important dimension in the 'national' geographic scale. The density indicates the size of economic output or total purchasing power per unit of surface area. It is found to be highly correlated with the geographic concentration of labour and capital.

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[13] Karunaratne, H.D., (2008), "International Labour Migration, Remittances and Income Inequality in a Developing Country: The Case of Sri Lanka", available at http://www.google.lk/#hl=en&sclient=psy-ab&q=International+Labour+Migration%2C+Remittances+and+I ncome+Inequality+in+a+Developing+Country:+The+Case+of+Sri+Lanka&oq. (Accessed on23/04/2012).

[14] *Ibid.*

[15] Gunatilaka, R., (2011), "Income Distribution after Economic Reforms in Sri Lanka, 1980-2002", in S. Kelegama and D. Gunewardena (eds.), *Economic and Social Development Under a Market Economy Regime in Sri Lanka*, Vijitha Yapa. Sri Lanka.

[16] IPS/UNDP (2012),"Second National Human Development Report: Sri Lanka", (forthcoming).

[17] The World Bank (2009), "World Development Report 2009: Reshaping Economic Geography", The World Bank, Washington DC.

With growth, economic activities are more likely to be concentrated at the local scale and then at the national scale. The local scale concentration would lead to urbanization. At the national level, production and workers will be concentrated in the leading areas. During the early stages of development, infrastructure and social services would tend to be concentrated in economic centres. Later, with progress in development, more internal integration would lead to higher distinction between the leading and lagging regions in terms of economic activity, but a lesser distinction for living standards. Further development, which would lead to structural transformation, would level off the spatial distribution of economic activities, reducing spatial disparities. However, living standards would widen for a prolonged period before slowly converging.[18]

The relationship between economic concentration and its relatedness to inequality in Sri Lanka can be observed to a certain extent when provincial level indicators are examined. For instance, the Western Province which generates close to half of the output of the country (45 per cent) records the highest level of inequality. The Central, Southern and North-Western Provinces record the next highest levels of contribution to total output of the country, together with higher levels of inequality (see Figure 4.6).

4.5.5 Differential Access to Infrastructure Facilities

Differential access to infrastructure facilities is a major determinant of spatial inequality. Studies have shown that the contribution of infrastructure to total inequality in Sri Lanka increased progressively over the years, from 13 per cent in 1980 to 26 per cent in 2002.[19] The spatial inequality could be across provinces and also within provinces, between urban and rural populations. Such studies confirm that the concentration of most of the formal employment in urban centers is due to remoteness (poor road network, communication barrier) leading to poorer access to markets for the rural population. This further prevents lagging regions from being absorbed into the growing economy.[20]

Infrastructure is one of the determinants of the spatial dimension of 'distance.' According to the World Bank (2009), the distance measures the ease of reaching markets and determines access to opportunities. Hence, when a region is far, and less accessible from an economically dense centre in a country, it is likely to lag behind. However, it should be noted that economic distance is not the same as, but is related to, physical distance. During the early stages of development, infrastructure and social services typically tend to be concentrated in economic centres, but gets leveled off during later stages.

4.6 Conclusion and Policy Implications

Inequality is desirable for economic growth. Yet, higher inequality could lead to negative effects on growth. As countries adopt accelerated growth strategies, widening of inequalities at the initial phases is an expected outcome. However, balancing growth and overall welfare of the population remains a challenge for governments in sustaining growth momentum.

There is ample evidence globally to suggest that the benefits of growth take a long time to trickle down to reduce inequalities substantially. Hence, prudent policies should be in place to address inequalities and to man-

[18] *Ibid.*

[19] Gunatilaka, R., (2011).

[20] Kumara, T. and D. Gunewardena (2011), "Spatial Inequality" in S. Kelegama and D. Gunewardena (eds.), *Economic and Social Development Under a Market Economy Regime in Sri Lanka*, Vijitha Yapa, Sri Lanka.

age rising levels of inequity. As such, improved investments in human capital and regional infrastructure -- thereby improving connectivity of lagging regions to economic centres, creating more opportunities in productive sectors and productive employment, etc., – are two key areas for policy attention.

Investment in human capital is one of the most important elements in achieving greater income equality in the country. This requires investment in early childhood development and education. Investment in education together with investment in skills development would help improve the employability of the workforce. This would be instrumental in reducing income inequality. However, this should go hand-in-hand with the creation of more productive and rewarding employment opportunities. Furthermore, it is necessary to tie up employment opportunities with training and career prospects.

Although accelerated economic growth requires that concentration be more on leading regions, lagging regions also need to grow along, without falling 'far behind.' This stresses the need to focus on regional development while achieving the objective of accelerated economic growth. In this sense, the government initiatives on regional development are noteworthy. The improvement of infrastructure, connecting the lagging regions to markets and economic centres, etc., would open up access to economic opportunities. This will help to ensure a higher possibility that the benefits of growth will be shared by all and bridge inequities across the country.

Reducing inequality also requires better jobs for the poor. Better jobs can be generated with structural transformation from agriculture to the more productive industrial and services sectors. The infrastructure improvement within the regions and connectivity is one of the ways of achieving this, as they encourage industry and services growth. However, such structural transformations may be slow to occur. In the interim, there is an onus on governments to ensure that less productive sectors of the economy and the population that derive a livelihood from such economic activities are not left behind. These and other issues of sustaining agriculture productivity and growth will be examined next in Chapter 5 of this report.