SRI LANKA STATE OF THE ECONOMY 2023

Economic Policy Choices: From Stabilisation to Growth



INSTITUTE OF POLICY STUDIES OF SRI LANKA

SRI LANKA
STATE OF THE
ECONOMY
2023

INSTITUTE OF POLICY STUDIES OF SRI LANKA
100/20, Independence Avenue, Colombo 7, Sri Lanka

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Institute of Policy Studies of Sri Lanka

ISBN 978-955-7397-30-6

National Library of Sri Lanka-Cataloguing-In-Publication Data

Sri Lanka State of the Economy 2023. - Colombo: Institute of
Policy Studies of Sri Lanka, 2023.
382 p.; 25 cm.

ISBN 978-955-7397-30-6

i. 330.95493 DDC 23

1. Sri Lanka-Economic conditions
2. Sri Lanka-Economic conditions-21st century
3. Sri Lanka-Economic development

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The contributions of Gayendri Karunaratne in providing editorial support and Nayomi Jayakody in providing administrative support under the overall guidance of Dinali Perera are acknowledged.

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ACRONYMS

AAS	Adopt-a-school Programme
ADB	Asian Development Bank
A-Level	Advanced Level
ASC	Agrarian Services Committee
BOI	Board of Investment
BOP	Balance of Payments
Bt	Bacillus Thuringiensis
CARE	Cooperation for Advancement, Rehabilitation, and Education
CBI	Climate Bonds Initiative
CBSL	Central Bank of Sri Lanka
CC	Climate Change
CEB	Ceylon Electricity Board
CHE	Current Health Expenditure
CIF	Climate Investment Fund
CIT	Corporate Income Tax
CKDu	Chronic Kidney Disease of Unknown Etiology
CMSA	Compulsory Medical Saving Accounts
CO2	Carbon Dioxide
COD	Country of Destination
COO	Country of Origin
COVID-19	Coronavirus
CPP	Climate Prosperity Plan
DCS	Department of Census and Statistics
DDR	Domestic Debt Restructure
DSF	Debt Sustainability Framework
EDO	Economic Development Officer
EDR	External Debt Restructuring
EFF	Extended Fund Facility
EMDE	Emerging Markets and Developing Economy
EPF	Employees' Provident Fund
ERP	Effective Rate of Protection
ESC	Education Service Contracting
ESG	Environmental, Social and Governance
ETCA	Economic and Technical Cooperation Agreement
ETF	Employees' Trust Fund
EU	European Union
EV	Electric Vehicle
FAO	Food and Agriculture Organization
FBR	Family Background Report
FD	Forest Department

FDI	Foreign Direct Investment
FIT	Feed-in Tariff
FLC	First Land Commission
FLFP	Female Labour Force Participation
FTA	Free Trade Agreement
G2G	Government-to-government
GCF	Green Climate Fund
GDP	Gross Domestic Product
GHG	Greenhouse Gas
GM	Genetically Modified
GMO	Genetically Modified Organism
GN	Grama Niladari
GIS	Geographic Information System
GOSL	Government of Sri Lanka
GSP+	Generalised System of Preferences
GVC	Global Value Chain
HEI	Higher Education Institution
HIC	High-income Country
IBSC	Institutional Biosafety Committee
ICT	Information and Communications Technology
IEA	International Energy Agency
IFC	International Finance Corporation
ILO	International Labour Organization
IOM	International Organization of Migration
IPR	Intellectual Property Right
IPS	Institute of Policy Studies of Sri Lanka
IRENA	International Renewable Energy Agency
ISB	International Sovereign Bond
ISICr4	International Standard Industry Classification Revision 4
ISSC	Industry Sector Skills Council
IWMS	Integrated Welfare Management System
LCGD	Land Commissioner's General Department
LDO	Land Development Ordinance 1935
LFS	Labour Force Survey
LIC	Low-income Country
LKR	Sri Lankan Rupee
LMIC	Low-and-middle-income Country
LMO	Living Modified Organism
LTGEP	Long-Term Generation Expansion Plan
LUPPD	Land Use Policy and Planning Division
MAA	Mahaweli Authority Act, No. 23 of 1979
MIC	Middle-income Country

MNC	Multinational Company
MOE	Ministry of Education
MOPE	Ministry of Power and Energy
MSDVT	Ministry of Skills Development and Vocational Training
MW	Megawatt
NAITA	National Apprentice and Industrial Training Authority
NBC	National Biosafety Committee
NCD	Non-communicable Disease
NCRE	Non-conventional Renewable Energy
NCS	National Competency Standard
NDC	Nationally Determined Contribution
NE	Nuclear Energy
NGO	Non-governmental organisation
NSDC	National Skill Development Corporation
NTM	Non-tariff Measure
NVQ	National Vocational Qualification
NZE	Net Zero Emission
O-Level	Ordinary Level
OOPE	Out-of-pocket Expenditure
OPL	Official Poverty Line
ORE	Other Renewable Energy
PAYE	Pay-as-you-earn
PC	Provincial Council
PHC	Primary Healthcare
PIT	Personal Income Tax
PLA	Paddy Lands Act of 1958
PMC	Primary Medical Care
PPP	Public-private Partnership
PRI	Principles for Responsible Investment
PSSP	Primary Health Care System Strengthening Project
PTA	Preferential Trade Agreement
PV	Solar Photovoltaic
RCEP	Regional Comprehensive Economic Partnership
RE	Renewable Energy
SCL	Special Commodity Levy
SDG	Sustainable Development Goal
SDO	Samurdhi Development Officer
SEA	Sustainable Energy Authority
SFDR	Sustainable Finance Disclosure Regulation
SHI	Social Health Insurance
SLC	Second Land Commission
SLTDA	Sri Lanka Tourism Development Authority

SLTFTA	Sri Lanka-Thailand Free Trade Agreement
SME	Small and Medium-sized Enterprise
SOE	State-owned Enterprise
SPTAC	Sector Policy and Training Advisory Council
SSDP	Sector Skills Development Programme
SSLFTA	Sri Lanka–Singapore Free Trade Agreement
STEM	Science, Technology, Engineering, and Mathematics
T&G	Textiles and Garment
TAA	Trade Adjustment Assistance
TVEC	Tertiary and Vocational Education Commission
TVET	Technical and Vocational Education and Training
UCS	Universal Coverage Scheme
UGC	University Grants Commission
UHC	Universal Health Coverage
USD	United States Dollar
VRE	Variable Renewable Energy
WB	World Bank
WNA	World Nuclear Association
YoY	Year-on-Year

TOWARDS ECONOMIC STABILITY

1. Policy Perspectives

The Sri Lankan economy was slowly but steadily pulled back from the abyss over the course of 2023. The implementation of economic stabilisation measures has advanced as has the groundwork on institutional and regulatory reforms to support growth. These measures have its critics, concerned about the intense economic pain that will fall on those least able to cope with the fallout. As a country that faces years of weak growth, difficult policy choices will have to be made.

The economy will continue to contract in 2023, albeit by a much smaller percentage relative to the economic collapse the year before. The International Monetary Fund (IMF) puts this at -3%, while the Central Bank of Sri Lanka (CBSL) forecasts a more optimistic -2%. What is more notable, though, is the widening range of expectations for GDP growth in the medium-term; both the IMF and CBSL project a return to positive growth in 2024, reaching a modest 3% by 2026, according to the former and a brisker recovery to 4.5% by the latter.

The more forward-looking the analysis is, the divergences in forecasts are to be expected. Accurately predicting the future of an economy that has suffered a sudden and sharp crisis, including defaulting on its debts, using the standard tools of macroeconomic policy prescriptions can be problematic. For Sri Lanka, uncertainties arise from social and political opposition to growth-inhibiting austerity policies, a complex debt negotiation process, and highly volatile global economic conditions riven by rising geopolitical tensions.

Amidst these, the tools in hand to deal with the economic meltdown are severely limited. The time to act and phase-in a more gradual and perhaps a less painful austerity drive was frittered away. The result – a huge hole in fiscal balances, near-zero foreign reserves, and the door to capital market access shut firmly – bore all the signs of an economic experiment gone wrong. As the currency tumbled and inflation got severely out of control, Sri Lanka was spurred finally to meet 'prior actions' for an International Monetary Fund (IMF) bailout. The actions are firmly rooted in setting the stage for more disciplined macroeconomic policy under an Extended Fund Facility (EFF) arrangement that was finally signed in March 2023 – Sri Lanka's 17th IMF programme since independence, and little more than three years after walking away from the previous one. Compelling Sri Lanka to 'front load' the adjustment pains as prior actions is also not unexpected given this sketchy record. The onus was thus very firmly on the Sri Lankan authorities to prove that they can be relied on to deliver on promises made.

Accurately predicting the future of an economy that has suffered a sudden and sharp crisis, including defaulting on its debts, using the standard tools of macroeconomic policy prescriptions can be problematic.

The front loading, even before the EFF was formally entered into, included steep increases in value-added taxes (VAT) and personal income taxes, hikes on energy and fuel prices, and a freeze on public sector wages. The tough austerity measures were then built into the medium-term fiscal deliverables – to bring about

a primary surplus of 2.3% of GDP by 2025, reduce the debt-to-GDP to 95% by 2032, and ensure average gross financing needs remain below 13% of GDP between 2027-2032.

A steep monetary tightening cycle and a hands-off policy on the exchange rate – after the Sri Lankan Rupee (LKR) tumbled in value by 80% between February and April 2022 – were the other two prongs of the standard policy prescriptions to stabilise an economy under severe distress. Higher taxes and spending restraints, high interest rates and a devalued currency in combination are intended to bring about income cuts and higher prices to squeeze aggregate demand in the economy.

These growth-inhibiting prescriptive policies attract criticism from those who argue that they are often counterproductive, by curtailing GDP growth (at least in the short-term) and thereby worsening a country's debt ratios. The social cost, too, can be very painful owing to rising unemployment, declining living standards, widening inequality, and greater poverty. These costs are even more intense when a country plunges from a crisis and into a deep slump, as Sri Lanka has done, recording the largest-ever GDP contraction of 8.7% in 2022. This output contraction is consistent with the demands of rapid fiscal consolidation and monetary tightening.

Evidence of the socio-economic downside impacts is readily available. A large vulnerable population has already tipped into poverty, with poverty rates estimated to have doubled from 13.1% in 2021 to 25% in 2022 alone.[1] Inequality, as measured by the Gini coefficient, has widened from 37.7 in 2019 to 39.8 in 2022. Rocketing inflation has eaten into household savings even as income tax increases further eroded their spending power. A proxy of real wage growth – the informal private sector employees' Wage Rate Index – suggests real wages have shrunk by nearly 20% between January 2022-June 2023. Sri Lankans, by and large, face huge challenges in making ends meet and those who are able to, seem to be leaving the country in large numbers in search of better living standards overseas.

Blaming the IMF for prescribing austerity to backstop Sri Lanka's economic crisis is unimaginative. On its own, the 48-month USD 3 billion (Bn) EFF – amounting to less than 8% of the country's central government external debt stock – provides scant liquidity provisions. The funds are also drip-fed, with countries qualifying for the next tranche on meeting quantitative performance criteria. What matters more is its catalytic effects to coax other official lenders, private investors and creditors. This show of confidence is the belief that an IMF programme exerts 'discipline' when economic mismanagement stands in the way. The downside of implementing necessary stabilisation measures under an IMF programme is that the adjustment gets squeezed into a narrow timeframe, intensifying the economic pain in the short run. Additionally, the time-bound, target-driven IMF templates often appear to sidestep attention on short to medium-term output growth. Indeed, its stated preference for further monetary policy tightening by the CBSL in March 2023, when inflationary pressures had already begun to subside was overkill,[2] especially given the mostly supply-side-driven nature of Sri Lanka's inflationary spiral.

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1 World Bank. (2023, April). *Sri Lanka Development Update*. Washington, D.C.: World Bank.

2 Central Bank of Sri Lanka. (2023, March). *Monetary Policy Review No. 2*. Colombo: Central Bank of Sri Lanka.

For now, though, there are notable successes on the stabilisation front. The LKR has steadied, and in fact, has regained some of its value, appreciating by 12% in the eight months to August 2023. The surge in consumer prices continues to fall steadily, with inflation coming in at 4.6% in July 2023 from an all-time high of 73.7% in September 2022. Import restrictions are being lifted and capital flow controls are being eased. The monetary policy tightening cycle was reversed in June 2023 with a steady 450 basis point reduction up to August 2023. Reflecting these positives, the contraction in GDP growth of 7.9% in the first half of 2023 is expected to gradually decelerate over the rest of the year.

The downside of implementing necessary stabilisation measures under an IMF programme is that the adjustment gets squeezed into a narrow timeframe, intensifying the economic pain in the short run.

Despite the economic hardships, the public mood has remained surprisingly pliable, albeit with charges of a heavy-handed approach being taken to quell any large-scale protests. The mood softened as queues dispersed, power outages were done away with, and basic essentials became available once again. The public's appetite for a re-enactment of the violence that spilled out on to the streets in 2022 also diminished, possibly in view of Sri Lanka's past experiences of violent upheavals and the desire to avoid further political and economic dysfunction.

However, this is not to say that such threats to socio-political stability have passed. Even assuming all goes according to plan, it will be another 2-3 years before the general public comes to feel any real improvement in their economic conditions. The government's hope would be that people will have sufficient patience to wait while austerity-inducing painful reforms work. This may well have been the case if not for a glaring threat on the horizon – the all-important presidential elections due in 2024.

The frightening speed of Sri Lanka's economic collapse appeared to bring a rare moment of political consensus on the need to take timely action to halt the damaging impacts on the country's national aspirations. This allowed a peaceful transfer of power to a new president, elected by a majority of votes in Parliament but unelected as the people's choice, to push ahead with milestones to resolve the country's immediate economic problems. Whilst active support from opposing parties has been withheld, there has also not been a full-frontal confrontation, partly because of widespread understanding of the vastly depleted policy choices on hand.

The coming together of a more stable economic environment and sights on a presidential election will change these dynamics. Traditional politics will dictate opposition to austerity and any other reforms for votes. Any eventual winner, though, will soon realise that the economy is not strong enough to test a return to one mired in populism. As such, Sri Lanka's key commitments on the fiscal, monetary and exchange rate policies on the current EFF are likely to be persisted with. What may suffer is the complementary 'reform' push to raise economic efficiency and productivity, such as those tabled on state-owned enterprises (SOEs), land, labour and education sectors, trade and competition, amongst others.

The more contentious of these are likely to slow down or stall altogether between now and elections in 2024, to be picked or discarded thereafter, depending on the electoral outcomes. The possibilities add a great deal of uncertainty when economic confidence has already been sapped as never before. In particular, two risks prevail. First, any government will have far fewer resources in hand to compensate those who are bound to lose out from reforms; this can mean a watered-down effort. Second, public mistrust and loss of faith in the country's institutional and governance systems is deep-rooted; this may mean that no single party wins a strong mandate and thus weakens political resolve.

The solution and best hopes are to build cross-party consensus on areas that do need fixing. Sri Lanka's disproportionate attention to investing in infrastructure with borrowed funds now has to shift to making the country's exports more competitive globally. Externally, building partnerships to achieve these ends is fast becoming a diplomatic and geopolitical game. The global economic order is being reshaped as US-China tensions mount – trade and investment have become battlegrounds as countries opt for 'near-shoring' or 'friend-shoring' with factories and critical supplies relocated closer to home or in trusted friendly countries. Large subsidies and tax incentives to build up domestic production capabilities in strategic industries like semiconductors and clean energy are being rolled out, while export bans are imposed on crucial raw materials and other products.

These developments resonate with policy debates in Sri Lanka on ways to align industrial and trade policies with the common objective of boosting exports. The prevailing incentive structures have a built-in bias against exports. In fact, despite having liberalised its economy very much earlier, Sri Lanka's global value chain (GVC) activity is even lower than that of Bangladesh.[3] The result has been 'premature deindustrialisation' with a heavy dependence on services activities for growth. That will not matter if the economy can create highly productive and well-paid services sector jobs. If not, there are worrying implications for a country's labour market conditions and the quality of jobs available. These concerns are magnified in the context of a notable movement of workers back to the agriculture sector owing to the economic crisis, as job growth in the other two sectors slows down.

More than a quarter (27.3%) of the Sri Lankan workforce was to be found in agriculture as of 2021, with over 80% of them low-skilled.[4] In the industry sector, manufacturing (16.8% of employment) and construction (8.5%) subsectors generate the most jobs, but 61% of workers in manufacturing and 73% of workers in construction were low-skilled. In the services sector, too, (46.7% of employment), 55% were low-skilled. Low-skilled jobs are not the only issue. There is also a high degree of informality involved in these jobs. In agriculture, the vast bulk (92%) are informal workers. This is also true in industry, with 85.1% of those in construction and 57.2% in manufacturing being informal workers. In the services sector, 74.8% of workers are informal workers.

Low quality, informal jobs also mean low average wages and limited social security. It is not surprising, therefore, that Sri Lanka's economic crisis saw a jump in large numbers (2.5 million [Mn]) estimated to have fallen into poverty in 2022 alone, leading to a doubling of national poverty levels to 25% and

3 See Chapter 4 of this report on 'Finding the Narrow Corridor: Reforms for Export-led Growth.'

4 See Chapter 6 of this report on 'Decent Jobs and Sri Lanka's Labour Market Conditions.'

a tripling of urban poverty to 15%.[5] These trends are consistent with evidence of household food insecurity. Whilst recording a substantial decrease from the height of the food crisis in 2022, 3.9 Mn people (17% of the population) were still in moderate acute food insecurity by the first quarter of 2023.[6]

The immediate instinctive response of many Sri Lankans was an attempt to seek better jobs and living standards overseas.[7] The scale, as captured by registered departures maintained by the Sri Lanka Bureau of Foreign Employment (SLBFE) as a proxy, suggests the numbers exceeded pre-pandemic annual averages – 311,269 departures in 2022 from a yearly average of 200,000. There was also a 60% growth in new passports issued in 2022. Snap surveys support this ground reality. More than 50% of a sample of 200 potential migrants cite the economic crisis as the primary driver of their desire to seek better jobs, more opportunities and a higher standard of living abroad. Disturbingly, the bulk of aspiring migrants in this sample were undergraduates (29%) and those holding Advanced Level (A-Level) qualifications (23%), bringing home the real threat of losing a generation of young skilled workers.

The fact that many of those leaving the country are professional, skilled or semi-skilled workers is of grave concern. It will add to existing disparities between the demand and supply of workers, particularly in higher education and highly skilled workers. Only 39% of Sri Lankans aged 20 and above have completed secondary-level education.[8] Here, inequities in access to good quality education significantly constrain youth from tapping good jobs. Enrolment rates at A-Level vary from 30% in the poorest household decile to 73% in the wealthiest decile. Even of those enrolled and who go on to sit exams, 61% of the wealthiest decile pass their A-Levels, but only a meagre 17% of the poorest decile manage to do so.

Beyond that, of those who qualify to enter Sri Lankan universities, only around 23% are able to do so owing to limited placements. Not surprisingly, it means that a low 4.5% of the population aged 25 years and above holds a degree-level qualification. There are also labour market imbalances as many opt out of Science, Technology, Engineering and Mathematics (STEM) subjects, but a large 44% of unemployed graduates hold degrees in Arts subjects. These skills gaps magnify as new technologies such as artificial intelligence (AI) advance rapidly across the globe, disrupting industries and business models.

These figures point to the scale and complexities of dealing not only with the fallout of Sri Lanka's economic crisis but also of addressing deep-rooted structural problems ingrained in the economy. In many instances – such as in education and health – improvements to outcomes can be met only partially through a revamp and reallocation of existing resources. In the health sector, for instance,

5 World Bank. (2023, April). *Sri Lanka Development Update*. Washington, D.C.: World Bank.

6 Food and Agricultural Organization and World Food Programme. (2023, May). *FAO/WFP Crop and Food Security Assessment Mission (CFSAM) to Sri Lanka*. Rome: Food and Agricultural Organization and World Food Programme.

7 See Chapter 9 of this report on 'Balancing Brain Drain and Immigrant Workers for Resilient Growth and Recovery.'

8 See Chapter 7 of this report on 'Improving Equity and Quality in Education.'

resource allocation imbalances mean a low spending level on primary health care (9.6%).[9] At the same time, Sri Lanka's out-of-pocket expenditure (OOPE) on health care at 47% of total expenditure is much higher (38%) than its Southeast Asian neighbours. Thus, new investments too are required, and as the country battles its way out of financial insolvency, Sri Lanka will have to make difficult fiscal choices and explore new financing models.

Sri Lanka's attempts to improve allocative efficiency and achieve better outcomes in its social protection programmes offer a microcosm example of the key challenges. Even adequate social safety nets would not have sufficiently compensated for real income lost during a high inflationary context of the kind that Sri Lanka suffered from. But to begin with, social protection cover is highly inadequate. More than 50% of the 60+ population is not covered by social protection, while over 60% of the workforce (primarily those in informal employment) do not have access to employment-related social security benefits.[10] Politicisation of beneficiary selection and significant targeting errors have dogged the Samurdhi poverty alleviation programme. A new cash transfer programme, 'Aswesuma', was meant to address the worst of these excesses by limiting the total beneficiaries to 2 Mn families through a carefully screened and objective selection criteria. Whilst an improvement on the Samurdhi, this programme too has been dogged by controversy regarding the selection process, etc., undermining its credibility to provide assistance to the neediest at least cost.

Delivery on this front is crucial and the best safeguard against creeping populism. Most of the government's other efforts so far have focused on institutional reforms and overhauling legal enactments such as the new Central Bank Act and those in the pipeline dealing with fiscal rules, etc. These are positive steps – and as good as the broader environment for sound governance and accountability – but will not deliver immediate tangible benefits to the masses at large. By contrast, a fairer social safety net system, improved delivery of public services, or accountability for wrong doing and corruption will ease frustration and be a force to unify public support.

Having entered its 17th IMF programme in the worst shape imaginable, Sri Lanka will no doubt leave the programme in somewhat better shape on the macroeconomic stabilisation front. But, macroeconomic stabilisation alone does not mean that an equally pertinent economic problem has been resolved – quality GDP growth that produces good quality jobs to make Sri Lankans hopeful of their future. It would require making some difficult choices to tackle growth-constraining policy obstacles while guarding against widening income gaps, popular anger and social unrest.

These issues are examined in some detail in the rest of this report under the theme of 'Economic Policy Choices: From Stabilisation to Growth'. A reform drive is almost never popular, but the idea of a fresh start is always appealing. Indeed, an economic crisis is often touted as a catalyst for just such an eventuality where a country may benefit then from a 'reform dividend'. In Sri Lanka's case, better macroeconomic conditions and a painfully slow return to modest levels of positive growth can get a boost from such reforms. Advances on the former are less likely to reverse if only because the menu

9 See Chapter 8 of this report on 'Building a Resilient Health System.'

10 See Chapter 10 of this report on 'Towards an Efficient and Integrated Social Protection System.'

of options has been exhausted for now. And, Sri Lankans have largely accepted the sacrifices they have been called on to make, albeit with the expectation that relief will be provided in the not-too-distant future.

Having entered its 17th IMF programme in the worst shape imaginable, Sri Lanka will no doubt leave the programme in somewhat better shape on the macroeconomic stabilisation front.

Topping these up with deregulatory reforms that tackle contested issues such as the appropriate trade incentive regime, functioning of land and labour markets, immigration policies that are at odds with the need for high-skilled professionals or public-private financing models for education and health services, amongst others, are far harder. The reality is that depleted resources in hand to compensate those who lose out and ease public opposition makes a reform process a much tougher prospect. And, for Sri Lanka, while each previous crisis dimmed its progress to economic development, the setback from the current crisis is unparalleled. If the people are to overcome its grave challenges, making the right policy choices alone will not be enough. More accountable institutions and ways of conduct that cement political legitimacy will be crucial too if the economic setback is to be transformed into a success over time.

2. Economic Performance

Sri Lanka's overall output is expected to slowly recover from the sharpest contraction ever of 7.8% in 2022. The pace of recovery though is subject to a host of uncertainties that in turn yield divergent forecasts. The International Monetary Fund (IMF) in its latest outlook expects a further contraction of 3% in 2023 while the Central Bank of Sri Lanka (CBSL) expects a more benign 2% contraction. What is more noteworthy is the even more pronounced divergence of Sri Lanka's medium-term growth outlook thereafter. The CBSL anticipates a steady recovery to 4.5% growth by 2026; the IMF expects it to be 3% by the same year.

The underlying analysis to arrive at these estimates vary. First, the global economic outlook is weakening, with unusually large revision to forecasts – the latest in April 2023 suggesting a slowdown to 2.8% for the year relative to the original 3.6% estimate arrived at 12 months earlier.[1] Second, the magnitude of debt restructuring and the pace at which negotiations will proceed cannot be predicted with any degree of assurance. Third, and importantly, the intersection between Sri Lanka's economic turbulence and its political landscape is set to be tested in the near-term, adding to uncertainty on the speed and scope of growth enhancing reforms.

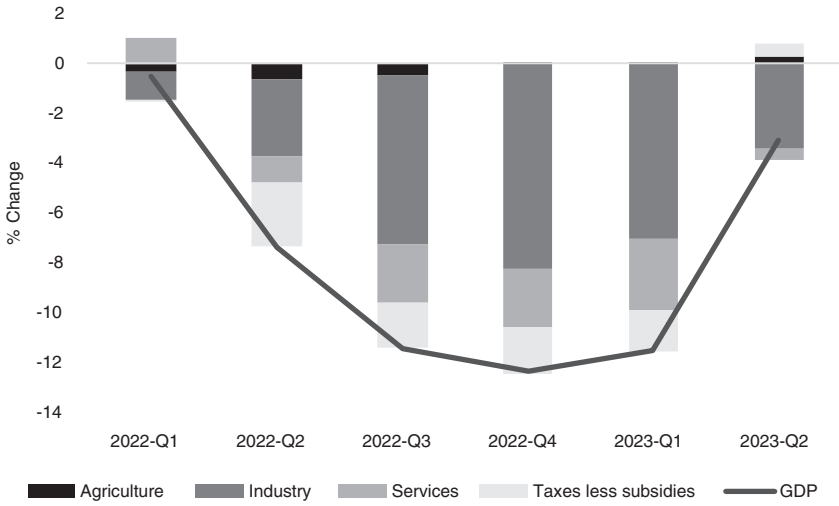
Sri Lanka's United States Dollars (USD) 3 billion (Bn) Extended Fund Facility (EFF) arrangement with the IMF announced in March 2023 will be its 17th since independence and comes a little more than three years after the country abandoned its previous one by pushing forward large tax cuts. Even without an IMF agreement, the economic prescriptions contained in the EFF, including the 'prior actions', would have been required to restore investor confidence in the economy. What the IMF agreement has imposed over and above that, is a much stricter and gruelling timeline in which to get them done. This chapter examines the policy path to stabilisation and strengthened macroeconomic fundamentals, alongside their associated impacts on output recovery and its sustainability.

2.1 Savings, Investment and Output Growth

As shown in Figure 2.1, gross domestic product (GDP) estimates suggest that the notable output contraction in 2022 was driven by a downturn in industry production activities, both its components of tradable manufacturing and the non-tradables (electricity, water, sewerage, construction). Manufacturing exports, however, have remained robust and has been the mainstay of industrial performance in 2022. While total manufacturing output contracted by 12.6% in 2022, the production of textiles, wearing apparel and leather showed positive growth of 8.1%. Thus, despite the many challenges arising from power cuts, fuel shortages and a foreign currency liquidity crunch, export-oriented sectors were able to withstand the domestic shocks.

1 International Monetary Fund. (2023, April). *World Economic Outlook*. Washington, D.C.: International Monetary Fund.

Figure 2.1
Quarterly Real GDP Growth Sector-wise, 2022-2023



Source: Based on data available from the Department of Census and Statistics (DCS).

As the economic recovery progresses, the contraction in output is expected to moderate in 2023. In the first half of 2023, the output contraction was at a still high of 7.9%, but the squeeze will lessen as the economy bounces back from plummeting depths reached from the second quarter of 2022. For 2023 as a whole, the CBSL projects a contraction of 2% while the IMF puts it at a higher 3% (Table 2.1). These differences in projections widen over the medium term and are an indication of the many uncertainties ahead. While the CBSL is more upbeat, expecting GDP growth to speed up to 4.5% by 2026, the IMF projects a more prolonged and painful recovery phase for Sri Lanka, with GDP growth expected to reach a mere 3% by 2026.

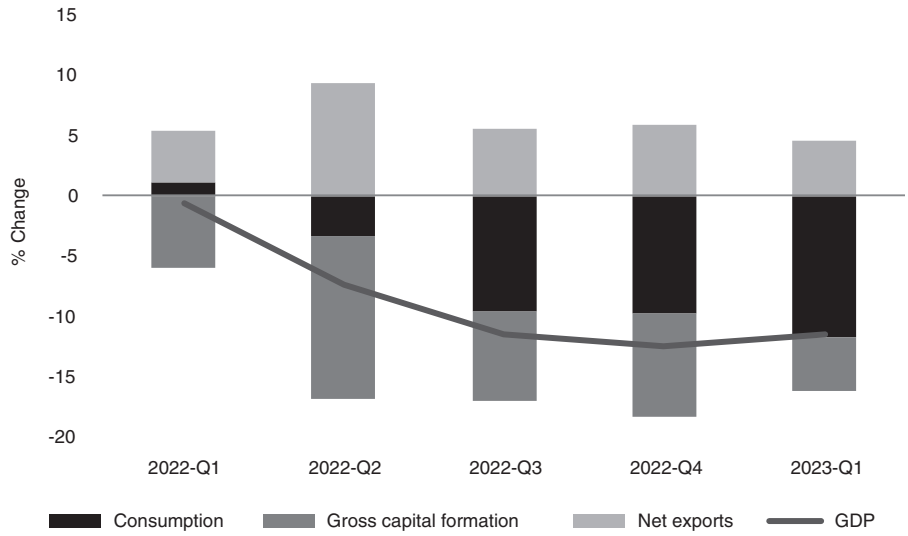
Table 2.1
Medium-term Macroeconomic Outlook

		2022	2023	2024	2025	2026
Real GDP growth (%)	CBSL	-7.8	-2.0	3.3	4.0	4.5
	IMF	-8.7	-3.0	1.5	2.6	3.0
Per capita GDP (USD)	CBSL	3,474	3,489	3,621	3,811	4,030
Investment (% of GDP)	CBSL	34.4	34.9	35.4	35.9	36.4
	IMF	26.8	28.0	29.4	30.3	30.7
National savings (% of GDP)	CBSL	33.1	33.8	34.1	34.6	35.3
	IMF	24.8	26.4	28.0	28.9	29.3

Source: Based on data available from the CBSL, Annual Report 2022 and IMF, 2023. Sri Lanka: Request for an Extended Fund Facility. IMF Country Report No. 23/116.

Two factors are critical in explaining why the forecasts cannot be firmed up with any degree of certainty. First, the outlook on the global economic front remains volatile at a time when Sri Lanka has been highly dependent on foreign demand for its goods and services for growth. As illustrated in Figure 2.2, the contribution to GDP growth by expenditure shows net exports to be the only positive driver.

Figure 2.2
Quarterly Real GDP Growth by Expenditure, 2022-2023



Source: Based on data available from the DCS.

Faced with galloping inflation, soaring public debt levels and a currency under pressure, the typical macroeconomic adjustment process is targeted to reduce aggregate demand in the economy.

Faced with galloping inflation, soaring public debt levels and a currency under pressure, the typical macroeconomic adjustment process is targeted to reduce aggregate demand in the economy. As such, income cuts are brought about via fiscal consolidation (tax increases and expenditure cuts and/or freezes). A squeeze on demand is imposed via a tight monetary policy stance (high interest rates). A sizeable depreciation of the exchange rate adds to price increases. While domestic demand is curbed, a resource reallocation via a depreciation of the real exchange rate towards tradable production is expected to boost exports. As previously noted, Sri Lanka's key manufacturing export sector – textiles and garments (T&G) – significantly outperformed the rather dismal overall performance of manufacturing activities early on. However, from the fourth quarter of 2022, this sector recording a contraction in output growth (Figure 2.3a).

Figure 2.3a
Manufacturing Growth

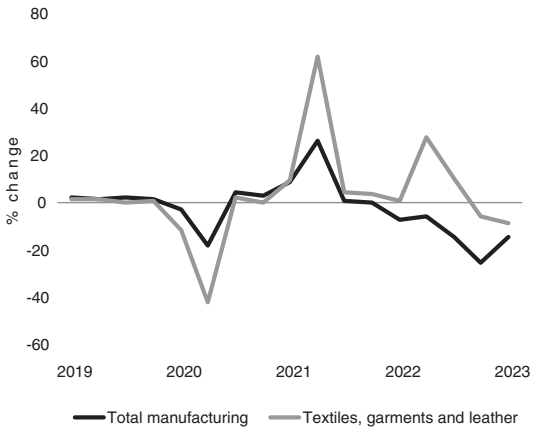
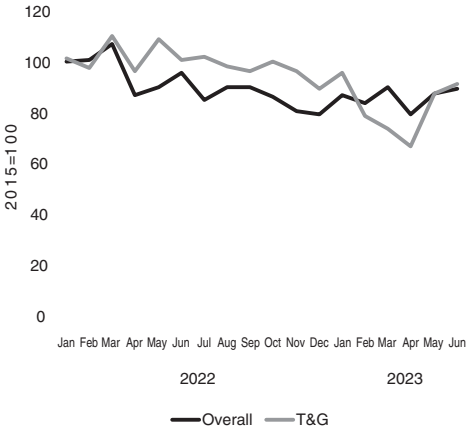


Figure 2.3b
Index of Industrial Production



Source: Based on data available from the DCS.

In this context, the more recent persistent downward revisions to the global growth outlook, especially impacting Sri Lanka's key export markets, is even more unwelcome than at other times. In particular, external sector conditions have deteriorated for Sri Lanka's most crucial export item of ready-made garments. Slowing global demand in key export markets such as the United States (US) and European Union (EU) is expected to slash earnings in 2023.[2] In the first half of 2023, export earnings from garments had already dipped by 18% relative to the corresponding period in 2022.

These figures are consistent with evidence from the Index of Industrial Production (IIP) compiled by the Department of Census and Statistics (DCS). While overall industrial production is limping along – with the volume in the first half of 2023 lower by 6.7% than the same period in 2022 – the T&G sector has been more volatile seeing a sharp downturn in the first quarter of 2023, although there are signs of a pick-up in the second quarter (Figure 2.3b).

The second reason why the medium-term growth outlook cannot be predicted with any degree of accuracy is the uncertainty associated with a debt restructuring process. The progress on negotiations has a bearing not only on investor confidence, but also on the pace at which the immediate crisis measures – aimed to curb domestic demand and rein-in inflationary pressures – are eased.

As adjustment and stabilisation measures took effect, domestic consumption has faltered as has the demand for investments, especially from mid-2022 (see Figure 2.2). These trends have continued into the first quarter of 2023, with the squeeze on consumption seeing no lessening. The potential for domestic demand to pick-up, and incidentally to bridge the downside risks from lower foreign demand for Sri Lanka's goods and services, will depend on how much fiscal tightening can be offset by monetary easing, and what the impacts will be on savings, consumption and investment.

2 Reuters. (2023, May 3). *Sri Lanka Apparel Exports to Drop by USD 1 Billion in 2023*. Retrieved July 20, 2023, from Reuters: https://www.reuters.com/markets/asia/sri-lanka-apparel-exports-drop-by-1-bln-2023-trade-body-2023-05-03/

The IMF medium-term macroeconomic framework as well as that of the CBSL, appear to suggest a steady increase in national savings and investment to support growth. Indeed, it is rather puzzling to note a 40% nominal growth in private savings reported in 2022,[3] suggesting real savings contracted by around only 7.5%. The only assets to provide significantly high financial returns were investments in government securities and conversions of foreign currency, both favouring the more better-off.

For many, household disposable incomes would have shrunk, and the real value of their savings too would have plummeted. Over the medium-term, any increase in national savings will only be consistent if there is rising inflows of transfers to households from abroad. Similarly, firms' willingness to borrow will hinge on how quickly interest rates adjust to policy signalling by the CBSL and investor sentiments on the medium-term outlook for the country – the latter being of particular importance for hopes of bridging the national savings-investment gap with higher inflows of foreign direct investment (FDI). These issues will be dealt with later in the chapter.

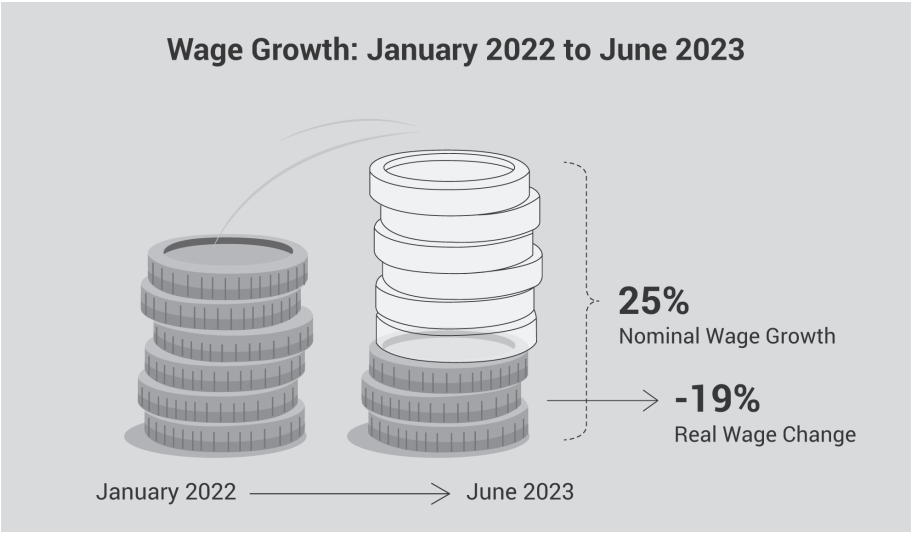
Overall, what is evident is that the output contraction will drag down Sri Lanka's per capita income while the low growth environment in the next few years will slow the rebound to pre-crisis levels. Indeed, even with the CBSLs more optimistic outlook, Sri Lanka is expected to match its pre-crisis 2019 per capita income of USD 4,082 only in 2026 (see Table 2.1). Thus, the country's economic progress has been set back by years while its peers will be advancing and overtaking Sri Lanka's development. As income growth and household consumption slows, there are real concerns about the socio-economic fallout and the associated risks that they pose to political and policy stability, especially in the medium-term.

2.2 Employment, Poverty and Inequality

With the onset of the economic disruption brought on by the coronavirus (COVID-19) pandemic, Sri Lanka's unemployment rate fluctuated mildly from 4.8% in 2019 to a high of 5.5% in 2020 before falling back to 4.7% in 2022. But, these overall trends camouflage a more troubling increase in youth unemployment. For instance, taken as a measure of those aged 15-24 years out of jobs, the ratio jumped from 21.5% in 2019 to 26.5% in 2021 before falling back to 22.8% in 2022.

These trends also mask a declining labour force participation rate, falling from 52.3% in 2019 to 49.8% in 2022, suggesting that fewer people of working age are actually looking for jobs. Sri Lanka's employment landscape has deteriorated with more jobs being created in the agriculture sector during 2020-2022 relative to total job contraction in industry and services (Figure 2.4a). On a net basis during this period, agriculture has generated approximately 87,000 jobs, corresponding to losses in industry (of 100,000) and services (of 87,000). Agriculture is the least productive sector and is the likely fallback option in the absence of employment generation in the other more desired sectors of economic activity.

3 Central Bank of Sri Lanka. (2022.). *Annual Report 2022.* Colombo: Central Bank of Sri Lanka.



Source: Based on data available from the CBSL.

Sri Lanka's bout of high inflation which peaked at 73.3% on a year-on-year (YoY) basis in September 2022 has sharply eroded real wages. As per the informal sector private Wage Rate Index collected through a country-wide system by the CBSL, nominal wage growth peaked at 32% in August 2022 before tapering off (Figure 2.4b). Wage growth from January 2022 to June 2023 in nominal terms stood at 25%, but in real terms, wages had shrunk by 19% in the same period.

Figure 2.4a
Sectoral Employment

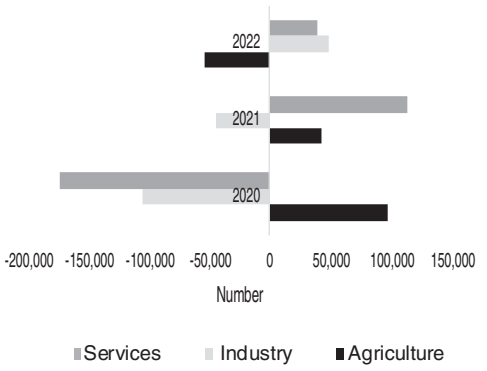
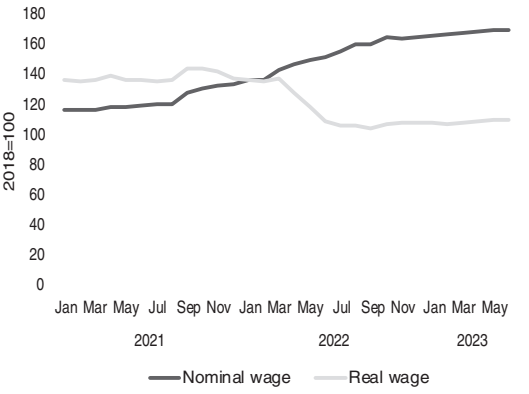


Figure 2.4b
Informal Sector Nominal and Real Wages



Source: Based on data available from the CBSL.

Aside from the erosion of real wages, households' disposal incomes too have shrunk with the introduction of a revised pay-as-you-earn (PAYE) schedule. The tax threshold was reduced from Sri Lankan Rupees (LKR) 3 Mn to LKR 1.2 Mn. Higher tax rates will apply on a progressive basis for slabs of LKR 500,000, whereby for each slab, the personal income tax (PIT) rate of 6%, 12%, 18%, 24%, 30% and 36% applies. The number of active taxpayers in Sri Lanka has been low historically,

but even of the registered 1.5 Bn income taxpayers in 2019, the numbers are estimated to have fallen drastically in the ensuring years with the ill-conceived abolition of the PAYE in 2020.[4] The progressive nature of the tax system also means that it is the richer who will pay more. Nevertheless, Sri Lanka's middle-class earners are also hit particularly hard.

Despite the obvious distress on households, private consumption grew in nominal terms owing to high price inflation, rising marginally to 62% of GDP 2022 from 61.2% in the previous year. This nominal growth, however, masks a serious downturn in real consumption at the household level. Adjusted for sector-wise inflation, private consumption spending on food has declined notably in 2022, by nearly 22% (Figure 2.5a). Real private consumption spending on health still remains above pre-pandemic levels given that it is a basic essential for most households (Figure 2.5b). Real spending on education too has kept pace, with a marginal increase.

Figure 2.5a
Food and Total Consumption

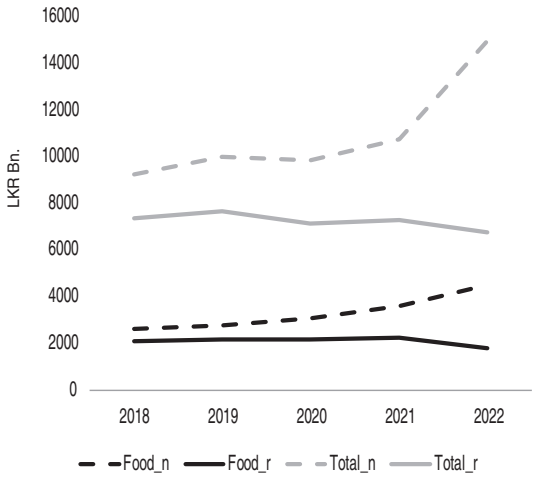
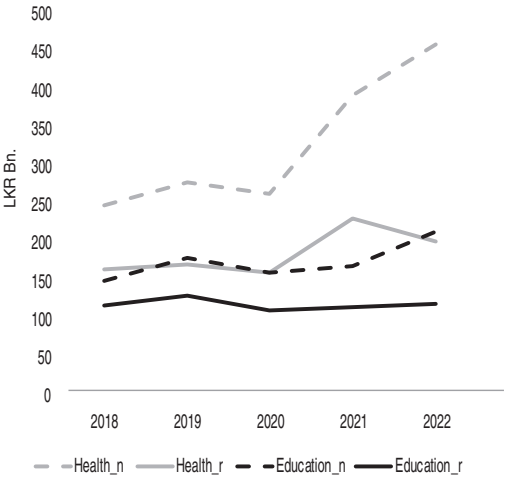


Figure 2.5b
Health and Education

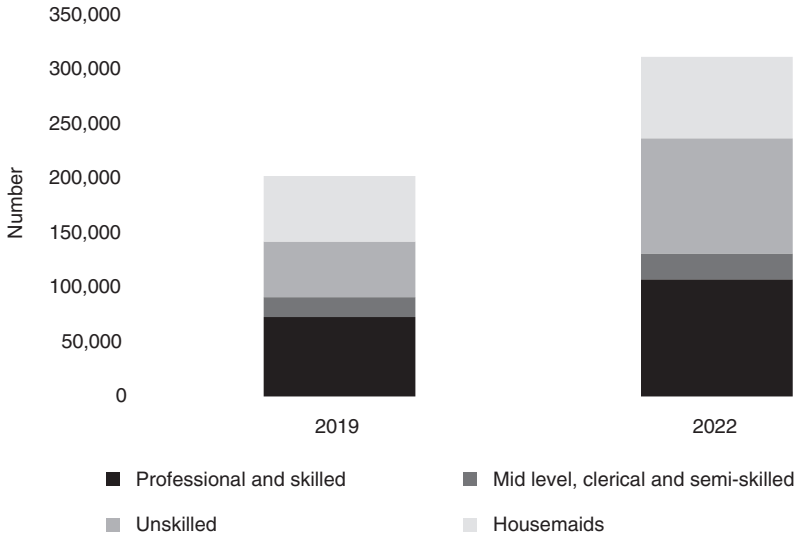


Note: Figures refer to Private Real Consumption, where real values have been derived using NCPI-2013 Index.
Source: Based on data available from the CBSL.

The economic distress has prompted a surge in out-migration, with those leaving and registered with the Sri Lanka Bureau of Foreign Employment (SLBFE) surging by 53% in 2022 relative to pre-crisis departures in 2019. These numbers are merely capturing only those registered with the SLBFE, whereby the actuals are likely to be much larger, including those seeking permanent migration channels abroad. In particular, the exodus of professional and skilled workers will deplete the available pool of human capital to drive productivity growth in the coming years (Figure 2.6).

4 Bloomberg. (2022, May 05). *Sri Lanka Lost over a Million Taxpayers in Last Two Years: Sabry.* Retrieved from July 20, 2023, from Bloomberg: https://news.bloombergtax.com/daily-tax-report/sri-lanka-lost-over-a-Mn-taxpayers-in-last-two-years-sabry

Figure 2.6
Departures for Foreign Employment



Source: Based on data available from the CBSL.

The more educated and better-off are able to withstand economic crisis more so than the poor who have limited assets to deploy as coping mechanisms. A larger income gap between the rich and poor is also evident in the case of Sri Lanka. The World Bank estimates overall inequality measured by the Gini co-efficient to have increased from 37.7 in 2019 to 39.8 in 2022.[5] It finds poverty rates to have almost doubled from 13.1% in 2021 to 25% in 2022, dragging an additional 2.5 Mn people into poverty. Households considered to be vulnerable to income shocks – i.e. those living close to the poverty line – are also expanding in numbers owing to the economic insecurity arising from job losses, lower incomes, etc.

These socio-economic conditions are being addressed through targeted schemes to deliver time-bound cash transfers under a newly devised scheme administered by the Welfare Benefits Board. The reforms to the current beneficiary selection process are welcome given the high degree of mis-targeting involved. Additionally, the positive signals of the IMFs more flexible approach to ring-fenced social protection spending despite ambitious primary-surplus targets is also a welcome departure from its past practices. Against this, Sri Lanka's own 'social-spending floor' aims to capture approximately the poorest 2 Mn Sri Lankans as beneficiaries of state support.

Whilst targeted social protection is a part of the necessary crisis management, the broader fiscal rigour and other conditions accepted as part of the IMF programme paint a rather gloomy growth outlook as noted previously. This is a dilemma that has dogged the time-bound, target-driven IMF programmes. Notably, as pointed out by its critics, the IMF-EFF neglects discussions on growth and employment creation. If the macroeconomic adjustments threaten to drag growth below desired levels, it should ideally prompt discussions to help build political consensus around the related reforms.

5 World Bank. (2023, April). *Sri Lanka Development Update*. Washington, D.C.: World Bank.

2.3 Recalibrating Fiscal Policy

At the heart of the EFF adjustment programme is the restoration of firms' and households' confidence. The supposition is that fiscal consolidation will lower future uncertainty about government tax policy and debt, and will raise private spending and investments over time. This view is predicated on the idea of 'crowding-in' the private sector to use up scarce capital and labour.

The fact of Sri Lanka's public finances being unstable and requiring drastic reforms is not in dispute. With a fiscal deficit averaging 10.2% of GDP during 2020-2022 and public debt soaring to 113.8% of GDP by 2022, and no actions being taken to course-correct, the loss of investor confidence was a foregone conclusion. The reforms spelt out in the EFF programme are also those that the government should have considered in the first place. Reversing Sri Lanka's progressive decline in revenue collection – down to an abysmally low 8.2% of GDP in 2022 – and trimming expenditures from haemorrhaging state-owned enterprises (SOEs), a bloated public sector cadre and unsustainable and inequitable subsidised goods and services have been key points of policy recommendations.

The problem when implementing reforms to tackle these under an IMF programme is that the time frame is apt to get squeezed very tightly, with milestones and each tranche of money drip-fed on meeting the performance criteria. For Sri Lanka, under its latest programme, this means ensuring that average gross financing needs remain below 13% of GDP between 2027-2032 and annual foreign exchange debt service of the central government should remain below 4.5% of GDP during the same period. Facilitated by a debt restructuring, this is to allow Sri Lanka to reach a crucial 2.3% of GDP primary surplus by 2025, the key fiscal target set by the IMF.

Table 2.2
Medium-term Fiscal Targets

	2022[a]		2023	2024	2025
Revenue and grants	8.5	8.3	11.0	13.3	14.9
Expenditure	18.9	18.5	19.0	19.7	19.9
Primary balance	-3.8	-3.7	-0.7	0.8	2.3
Overall balance	-10.4	-10.2	-8.0	-6.4	-5.0
Central govt. debt	117.7	113.8	100.0	101.6	103.3

Notes: a. IMF and CBSL estimates for 2022 differ. The first column gives IMF estimates and the second column gives CBSL estimates.

Source: Based on data available from the CBSL, Annual Report 2022 and IMF, 2023. Sri Lanka: Request for an Extended Fund Facility. IMF Country Report No. 23/116.

To advance on these, the key revenue adjustments included: (i) Value-added tax (VAT) increase from 8% to 12% (May 2022) and further to 15% (September 2022) and lowering of threshold to LKR 120 Mn (Mn) from LKR 300 Mn (October 2022); (ii) reduction of PIT threshold to LKR 1.2 Mn and increasing marginal PIT rates 6% for every LKR 500,000 up to a top rate of 36% (January 2023); and (iii) increasing corporate income tax (CIT) from 24% to 30% (January 2023).

On the expenditure front, public sector recruitment and a wage freeze, identification of key loss making SOEs for divestiture, introduction of a fuel price formula, and other measures to curb expenditures of ministries and public entities have been rolled out. The room for major expenditure cuts is limited. Interest payments alone amounted to 6.5% of GDP in 2022, absorbing 80% of total revenue. Indeed, Sri Lanka's public debt problem largely stems from collapsing revenues rather than from high expenditures. By middle-income standards, the peer average for government expenditures is far higher as is the revenue to GDP ratio. In 2022, the average expenditure to GDP ratio for emerging market and middle-income (EMMI) economies was at 31.2% while the revenue to GDP ratio was 23.8%.[6] Against a peer group comparison, Sri Lanka is a clear outlier in weak revenue collection and high public debt (Table 2.3).

Table 2.3
Comparative Fiscal Positions

	Fiscal Balance	Primary Balance	Revenue	Expenditure	Debt
India	-9.6	-4.4	19.2	28.8	83.1
Indonesia	-2.3	-0.4	15.2	17.5	39.4
Malaysia	-5.3	-3.2	19.0	24.3	66.3
Pakistan	-7.8	-3	12.1	19.9	75.8
Philippines	-5.2	-3.4	21.6	26.8	57.5
Sri Lanka	-10.4	-3.8	8.5	18.9	117.7
Thailand	-5.5	-4.4	20.1	25.6	60.5

Source: International Monetary Fund. (2023, April). *Fiscal Monitor.* Washington, D.C.: International Monetary Fund.

The key item of discretionary spending is salaries and wages on Sri Lanka's large public sector. It shows a decline to 4% of GDP in 2022 from 4.5% in the previous year owing to expenditure controls and higher nominal GDP growth. The same also holds true for the public sector pension payments; it typically averages around 1.5% of GDP but dipped to 1.2% of GDP in 2022. But, caps on wage and pension payments are unsustainable beyond the short-term, especially in the face of substantive price inflation that has already eroded their real value.

For sustained gains, public sector reforms are necessary. Sri Lanka's total public sector cadre of 1,394 Mn in 2022 (17% of the total employed) was down a mere 0.5% from the previous year. The maintenance of a large defence cadre in peace time is a much disputed and identified area for spending reduction. Expenditures on wages and salaries of defence personnel in 2022 came to 23% of the total wages and salaries bill, rising to 33% if salaries and wages of police and public security personnel are added in.[7] The large public sector also has a bearing on pension payments which also shrank as a share of GDP in 2022 to 1.3% from 1.5% in pre-crisis year of 2019.

6 International Monetary Fund. (2023, April). *Fiscal Monitor.* Washington, D.C.: International Monetary Fund.

7 Ministry of Finance. (2022). *Annual Report 2022.* Colombo: Ministry of Finance.

The sweeping expenditure rationalisation measures have also taken a toll on social sector spending on education, health and welfare. As a share of GDP, spending on all three sectors has dropped in 2022 compared to 2019 (Figure 2.7a). These trends are not ideal beyond the immediate stabilisation period, especially where significant and often unproductive spending is directed elsewhere. Total losses of 52 key SOEs in 2022 amounted to over 3% of GDP with energy and aviation being the main culprits (Figure 2.7b). Aside from a salary and recruitment freeze on public sector jobs, higher taxes, etc., the rapid fiscal consolidation process also required cost reflective pricing on energy. The result was a 60% increase in the national average price of electricity as per revised tariffs imposed in February 2023.[8] Additionally, the outstanding foreign currency guaranteed debt of the Ceylon Petroleum Corporation (CPC) was absorbed into central government debt at end 2022, in line with agreed actions under the IMF-EFF arrangement to restructure the balance sheets of selected SOEs.

Figure 2.7a
Social Sector Spending

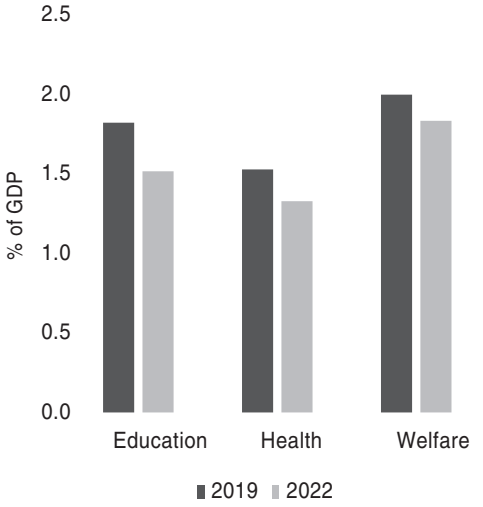
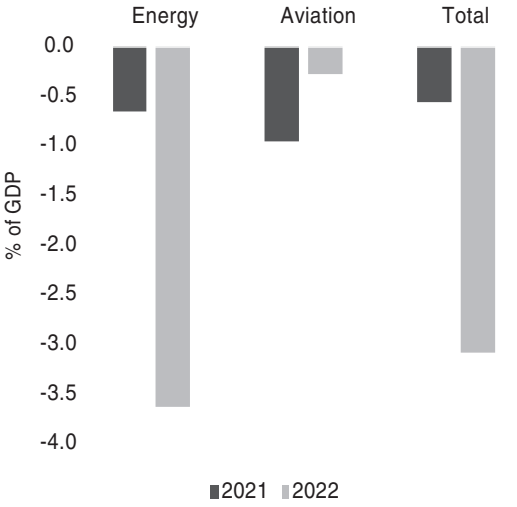


Figure 2.7b
SOE Losses



Source: Based on data available from the CBSL.

While the skyrocketing energy costs will hurt consumers, turning around large loss making SOEs has to be addressed. With the establishment of an SOE Restructuring Unit, select entities have been identified to advance this process. The entities include:

8 DailyFT. (2023, June 23). *Your Electricity Bill is 50% More than What It Should Be*. Retrieved July 20, 2023, from DailyFT: https://www.ft.lk/columns/Your-electricity-bill-is-50-more-than-what-it-should-be/4-749955

- Sri Lankan Airlines Ltd including Sri Lankan Catering Ltd
- Sri Lanka Telecom PLC
- Sri Lanka Insurance Corporation Ltd
- Canwill Holdings Pvt. Ltd., (Grand Hyatt Hotel)
- Hotel Developers Lanka Ltd., (Hilton Hotel Colombo),
- Litro Gas Lanka Ltd., including Litro Gas Terminals (Pvt) Ltd., (LPG retailing)
- Lanka Hospital Corporation PLC

The International Finance Corporation (IFC) will oversee the divestiture of Sri Lankan Airlines Ltd., Lanka Hospitals Corporation PLC and Sri Lanka Telecom PLC while the other four entities will be under different transaction advisors. The inclusion of profit making entities such as Sri Lanka Telecom predictably raised opposition. Asset sales can help to raise financial resources whilst improving service delivery to consumers. But, for a divestiture programme to gain acceptability, aside from transparency and accountability in the process, ensuring that uncompetitive monopoly conditions are addressed through appropriate regulatory provision is important. Only if divestitures are seen to provide high-quality, affordable infrastructure will the public be convinced of its merits in the long-term.

Progress on such expenditure rationalisation is critical owing to gaps in estimated revenue collections. Indeed, success in meeting revenue targets will contribute towards the most crucial fiscal performance indicator that the IMF will look for – i.e. the primary surplus. In 2022, revenue collection met 94% of the forecast in the Interim Budget presented in August 2022) and 89% of the original forecast set out in November 2021 for the full year. The relative success owes to one-off taxes implemented such as the 25% surcharge tax on individuals and companies whose taxable income exceeded LKR 2,000 Mn for the year of assessment of 2020/2021. By contrast, revenue generation in 2023 will be solely dependent on a recovery in economic activities more generally and better tax administration and collection. The latter will likely be strengthened with the return of more easily administered taxes such as PAYE and Withholding Tax (WHT).

In the first quarter of 2023, tax collection had improved to 7.8% of GDP from 6.7% of GDP recorded in the first quarter of 2022. The budgeted tax revenue for the year is set at 10.3% of GDP and there is still some considerable way to go. While revenue collection under the purview of the Department of Inland Revenue (IRD) is improving, it appears to be mainly owing to higher tax rates, new taxes, etc., rather than a broadening of the tax base.

Table 2.4
Revenue Collection by the IRD (LKR Mn), First Six Months

	2022	2023
Corporate and non-corporate income tax	213,421	243,842
Advanced personal income tax	12,021	70,001
Value-added tax (VAT)	121,483	230,638
Social security levy (SSL)		79,980
Other	14,907	72,485
Total	361,832	696,946

Source: Daily Mirror. (2023, July 18). *First Half Tax Revenue Almost Doubles to Rs.697 Bn From Last Year.* Retrieved July 20, 2023, from Daily Mirror: https://www.dailymirror.lk/print/business/First-half-tax-revenue-almost-doubles-to-Rs-697bn-from-last-year/215-263329

Aside from the IRD, other revenue collecting agencies such as the Department of Customs and Excise Department may struggle from continued restrictions on imports of vehicles, and price inelasticities on non-essentials such as alcohol and cigarettes. As of end June 2023, revenue collection had grown by 42% to LKR 1.4 Bn, meeting 37% of the annual target. Expenditure on the other hand had grown by 41% to LKR 2.6 Bn, taking up 44% of the annual allocation. Given a substantive increase in domestic interest expenses (by 52% to LKR 1.3 Bn.), Sri Lanka was able to report a primary surplus of 0.1% of GDP. Crucially though, a financing gap larger than estimated in Budget 2023 is likely to emerge. The revenue targets for 2023 – a 2.5 percentage point increase in GDP share – is a tough task in a climate of subdued consumer spending and output contraction. Not surprisingly, revenue is the one IMF quantitative target that Sri Lanka missed as of June 2023.

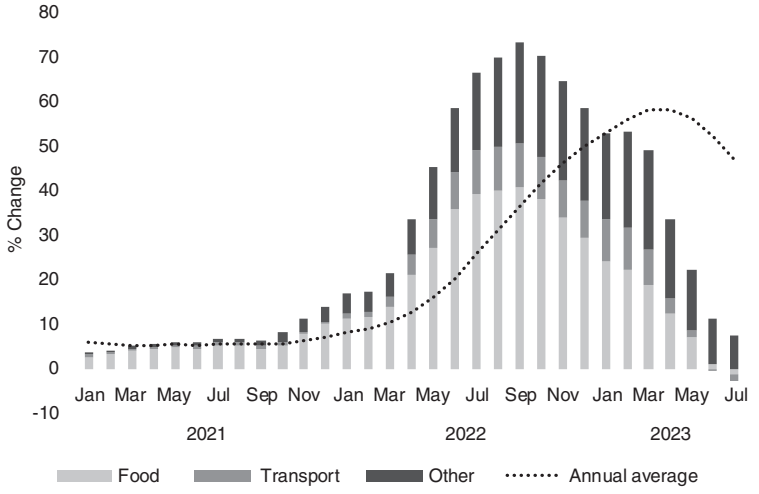
The fiscal squeeze, including its impacts on the delivery of public services and potential labour market disruptions, is consistent with the current output contraction to persist as a low growth environment for the next 3-4 years. Monetary policy easing will be the key macroeconomic instrument to offset the stranglehold on output growth.

2.4 Monetary Policy as a Counterweight to Fiscal Austerity

Sri Lanka's YoY inflation peaked at 74% in September 2022. Annual average inflation peaked at approximately 54% in February 2023 before starting to decelerate in line with YoY trends.[9] The primary drivers of this spiralling inflation spell were rising food and transport costs as evident from Figure 2.8. The former fuelled by import restrictions and low domestic agricultural yields owing to the short-lived ban on chemical fertilisers usage, etc. Such supply-side shocks are not responsive to monetary policy tightening, and the return to more typical agricultural yields assisted in the overall rapid decline in inflation.

9 From January 2023, the DCS uses 2015 as its base year to estimate National Consumer Price Inflation (NCPI) without continuing the previous 2013 base year series in tandem.

Figure 2.8
Sector-wise Price Inflation Trends



Source: Based on data available from the DCS.

But, expectations of how a central bank will react to changing economic circumstances matter. This was the key motive behind the sharp policy rate adjustment of 700 basis points in April 2022 to convey the CBSLs renewed intentions to do whatever necessary to curtail inflationary expectations. The stance of monetary policy thereafter is also determined by output gaps in the economy. Despite YoY inflation pressures easing from February 2023, monetary policy was tightened further as Sri Lanka completed its IMF preconditions (Figure 2.9a). The tightening cycle was reversed only from June 2023 as interest rates peaked, with the 3-month Treasury bill rate climbing to nearly 26% (Figure 2.9b). It not only added to Sri Lanka's fiscal financing costs but also continued to further drag down output contraction, with first quarter 2023 GDP growth coming in at -11.5%.

Figure 2.9a
Policy Rates and Market Liquidity

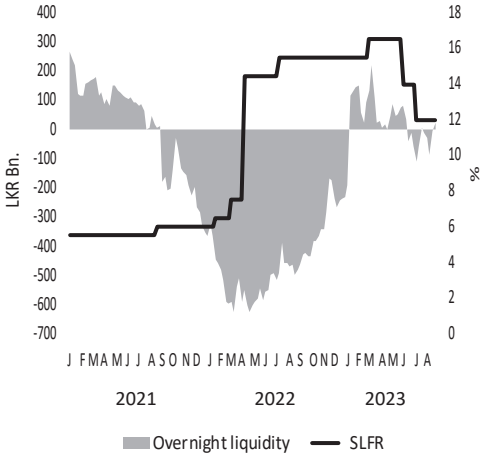
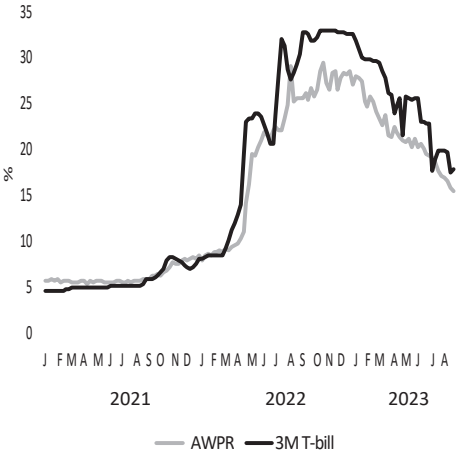


Figure 2.9b
Interest Rates



Source: Based on data available from the CBSL.

In fact, the IMF appears to have sought a 250 basis point hike in March 2023 as opposed to the announced 100 basis point increase as a compromise.[10] The IMF's rigid prescriptive policy adherence to meet its quantitative performance criteria is often blamed for overkill in helping countries fight economic crises. A priority on the macroeconomic front is also to assess trade-offs between the fight against inflation, especially when it is mostly supply-driven, and using available tools to address output gaps in the economy to drive growth.

The IMF's rigid prescriptive policy adherence to meet its quantitative performance criteria is often blamed for overkill in helping countries fight economic crises.

As employment and consumption falls, and the economy continues to be in recession, the associated socio-political risks mount and place the entire stabilisation and reform process at risk. Annualised inflation of over 50% means that even with the rapid decline in price increases underway, the impact on household incomes and savings in real terms has been huge. In an environment of contracting and/or very subdued consumption demand following a major economic shock, demand-driven inflationary pressures are also largely absent. There are also fewer risks of an across-the-board wage-price spiral taking off. While some degree of nominal wage adjustment has occurred as noted in Figure 2.4b previously, real wage growth has been negative. Wage freezes across the large public sector workforce have no doubt helped to keep a lid on demands, more generally for wage increases too. While this is unlikely to be a sustainable policy option beyond the immediate near-term, even when the freeze is lifted, the slowdown in price inflation will mean that the subsequent wage adjustments will be modest. For those households on fixed incomes, the erosion in real terms will persist in the medium-term.

10 Cassim, Nisthar. (2023, March 07). *CBSL Says Ready for IMF Programme*. Retrieved July 20, 2023, from Daily FT: https://www.ft.lk/top-story/CBSL-says-ready-for-IMF-program/26-745989

While reforms to address the root causes of Sri Lanka's labour market rigidities is a medium and long-term process, the impacts of macroeconomic policies on short-term growth drivers should not be ignored. Wage distortionary shocks as experienced in recent times can lead to labour market disruptions. First, the high number of professional and skilled worker outmigration is causing tight labour market conditions in certain sectors including essential services. Second, as noted earlier, there has been positive growth in net exports. But, even if faster productivity growth in the tradable goods sector pushes up wages, labour market rigidities may not allow a movement of workers into these sectors. Indeed, Sri Lanka has been witnessing a movement of labour into the least productive agriculture sector in the wake of the crisis. If labour market rigidities in turn lead to higher wages in the non-tradable sector too, where productivity growth is slower, the impact on overall productivity is adverse. This may mean that the country runs the risk of being unable to turn the output deceleration into a swift and sustained positive growth process.

Monetary easing has been used aggressively from June 2023 with successive policy rate reductions as the counterweight to offset fiscal tightening. The CBSL is also actively providing overnight liquidity to allow market interest rates to follow (see Figure 2.9a). However, monetary policy easing to incentivise private investment has generated only limited signs of successes for now. The steady deceleration in credit growth to the private sector – a key objective of the CBSL's decision to bring about a cut in consumption and production by hiking interest rates – is yet to reverse (Figure 2.9b). Indeed, monetary policy works with a significant lag, and as such, the contraction in credit growth to the private sector (at 8% as of June 2023) will take time to unwind. A major economic downturn as witnessed in Sri Lanka can slow this process – high indebtedness may prevent firms and households from borrowing, regardless of the interest rate.

Figure 2.10a
Credit Growth

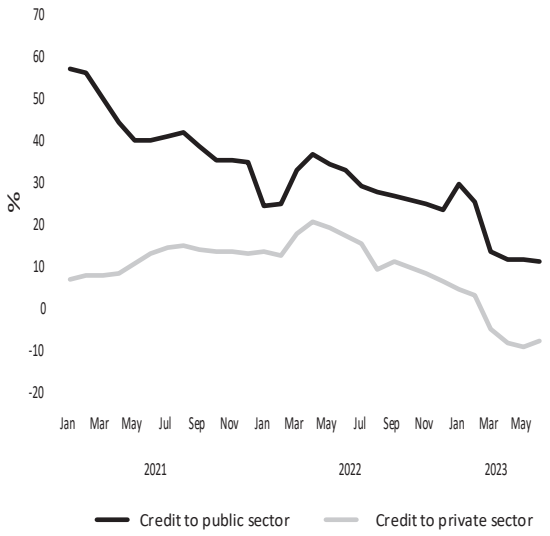
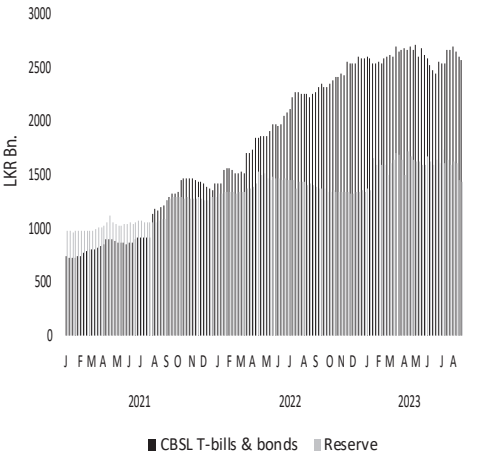


Figure 2.10b
Reserve Money



Source: Based on data available from the CBSL.

Economies cool in very different ways and predicting the future path of price inflation of an economy that has suffered a sudden and sharp crisis is never easy. Indeed, as inflation falls, getting monetary policy right will be harder than during a bout of runaway inflation. Sri Lanka's reserve money base – the base from which banks expand their balance sheets to push up total money supply in the economy – has expanded (Figure 2.10b). As the country's net foreign assets position is rebuilt with the purchase of USD, the CBSL's choices are whether or not to sterilise the intervention. These policy choices will have a bearing on market liquidity and interest rate structures, and critically on anchoring inflation expectations.

The formalisation of a monetary regime is intended to help narrow the causes that the CBSL will pursue, whilst leaving scope to balance the core goal of stable inflation with an eye on nominal GDP growth.

The CBSL is expected to be better positioned to manage these challenges under the newly enacted Central Bank Act 2023 paving the way to anchor price expectations by setting an explicit inflation target and preventing direct lending to the government. Under the proposed framework, the CBSL will announce a target (or range) for inflation in the medium-term and will be called on to achieve it, inclusive of making publicly available information on the strategies and decisions leading up to the outcomes.

The new Act proposes a 'flexible' inflation targeting framework, meaning that in a crisis, flexibility is provided for the monetary authorities to prioritise fighting a troubling output gap (or unemployment). The formalisation of a monetary regime is intended to help narrow the causes that the CBSL will pursue, whilst leaving scope to balance the core goal of stable inflation with an eye on nominal GDP growth. The hoped-for outcomes of tying the CBSL's hands by setting thresholds for inflation, etc., is also to insulate the monetary authority from political meddling.

While the provisions of the Act fall short of providing policy independence to the CBSL, stronger accountability for policy errors and failings than previously provided may hopefully strengthen monetary policy formulation over time. This is vital in view of the complexities of setting monetary policy viz. exchange rate management, as Sri Lanka attempts to emerge from its unenviable 'default' status. Here too, the new CBSL Act attempts to avoid past costly mistakes that sought to fix the value of the LKR and set interest rates, while a de facto open capital flow regime prevailed. Exchange-rate flexibility is a prerequisite for an inflation targeting framework.

2.5 Exchange Rate Risks

Following a near 80% official devaluation of the currency, jumping from LKR 200 to the USD to LKR 365 between February-April 2022, and 'settled' at LKR 365 until February 2023 (Figure 2.11a). At its lowest, Sri Lanka's gross official reserves plummeted to USD 1,812 Mn in April 2022 – barely sufficient to cover even that month's imports of USD 1,700 Mn. In fact, figures on official reserves were also an overestimate in view of USD 1.5 Bn of the total being a swap facility from the People's Bank of China with conditions on usability.

Figure 2.11a
Reserves and Exchange Rate

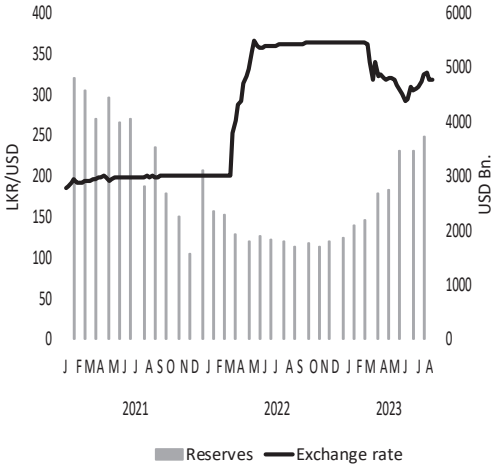
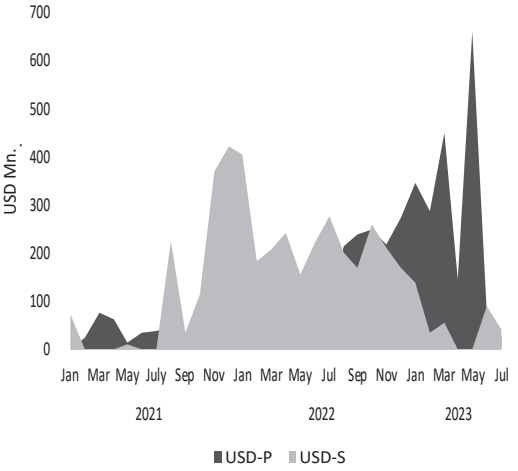


Figure 2.11b
Forex Sales and Purchases



Source: Based on data available from the CBSL.

From August 2021, when the CBSL took a policy decision to arbitrarily fix the currency to LKR 200 per USD, available reserves were depleted to the value of USD 2.2 Bn in USD sales up to April 2022 (Figure 2.11b). The shift to towards the purchase of USD and build up reserves gathered pace with the signing of the IMF-EFF in March 2023. But, notwithstanding the moratorium on debt repayments until external debt negotiations are finalised, such payments accumulate for future settlement. The pace at which the CBSL is able to shore up reserves in the interim will depend critically on recovery in key export earning sectors like tourism and worker remittances. There is a sense of optimism that 2023-2024 will be better years for these sectors. A slow-paced recovery in tourist arrival numbers is apparent, as also reflected in earnings from tourism as well as worker remittances (Figures 2.12a and 2.12b). However, the performance is still well below pre-pandemic/crisis levels (2018) in both instances.

Figure 2.12a
Tourist Arrivals and Worker Migration January-June

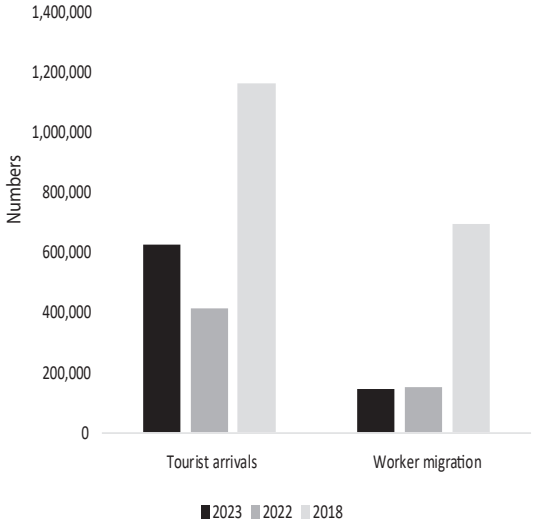
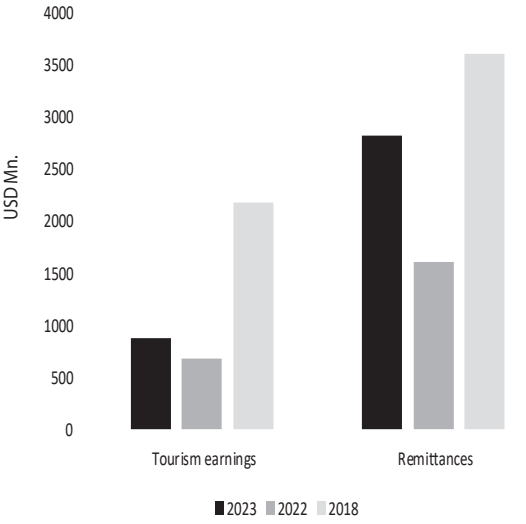


Figure 2.12b
Tourism Earnings and Worker Remittances, January-June



Source: Based on data available from the CBSL.

For a sustained productivity-driven long-term growth model, reliance on tourism and remittances will not work. This requires a structural transformation of the economy that produces high-skilled jobs in manufacturing and services. Sri Lanka has performed poorly in its industrial transformation, leaping ahead instead to services sectors that generate unskilled jobs. Indeed, it is argued in some quarters that the current crisis is a manifestation of an economy that has become overdependent on imports. Clearly, a more diversified export base has long been seen as a necessity. The problem is to ensure that in supporting industrial sector growth, governments devise policies that avoid past mistakes.

Today, political and economic uncertainties globally are leading to a reassessment of industrial policy, a form of 'industrial policy nationalism', with ramifications for forces of freer trade and competition. A range of interventions – from subsidies to tax credits or outright bans on exports of raw materials – are being rolled out to secure supply-chains and build domestic capacity in strategic sectors. For countries like Sri Lanka where inadequate industrialisation has been a big part of its limited export base, ensuring that any policy intervention in this direction is qualitatively different from the way that industrial policy tended to develop in the past will be the key challenge. Industrial policy was mainly deployed in the cause of import substitution, and all too often, it favoured low-productivity firms from the foreign competition that would have made them more efficient. Such past mistakes have to be avoided while incubating new higher-value industries if Sri Lanka is to successfully help industrialisation along towards rapid manufactured export growth.

Balancing the needs of industries and firms for exports and imports to support output growth and productive job creation is not easy with very few macroeconomic policy levers in hand, especially on the fiscal front. For the CBSL, it will mean walking a fine line in containing any excessive speculative impacts on the exchange rate as foreign exchange controls are eased whilst continuing to build up reserves. Often, the temptation is to intervene in the currency markets, especially when a country is vulnerable to foreign-currency shortages. The adoption of a flexible exchange rate regime under the new Central Bank Act will curb the worse excesses of such interventions that has seen regular cycles of LKR devaluations after futile attempts to peg the currency artificially to the USD. Coupled with the flexible inflation target framework, the appropriate tool is to 'sterilise' – i.e. mop up any excess LKR liquidity arising from the purchase of USD by selling bonds if the inflation target is not to be compromised.

All things considered, until Sri Lanka's external debt repayment schedule is finalised with a successful conclusion of negotiations, a cloud of uncertainty on exchange rate pressures will persist subjecting the LKR to considerable volatility.

2.5.1 External Debt Restructuring

Sovereign debt restructuring can be pre-emptive or post-default. Whilst both are inherently costly, the latter – as followed by Sri Lanka in announcing a default in April 2022 when it was deemed unable to service outstanding debt – is the more damaging. Output losses for the defaulting country are higher in a post-default restructuring.[11]

For the debtor country, in allocating the associated economic costs of a restructuring, it must secure secure participation from its creditors, applying comparable treatment to all, with negotiations framed within certain desired outcomes to minimise the costs to the economy. In this exercise, Sri Lanka has gone beyond its early inclinations to exclude domestic debt from a restructure. The substantial real erosion in value to domestic debt holders as inflation spiralled was one of the main reasons. But, Sri Lanka's bondholder group's request to the IMF in February 2023 that "domestic debt is reorganised in a manner that both ensures debt sustainability and safeguards financial stability" appears to have led to a change of stance to ensure a quicker overall resolution. Indeed, there is evidence that even in a post-default setting, output costs can be reduced the quicker the debtor country is able to reach an agreement with its creditors.[12]

As a middle-income country (MIC), Sri Lanka also has limited room to circumvent a domestic debt restructure (DDR) altogether. The inclusion of domestic debt optimisation is implicitly encouraged in the IMF's debt sustainability framework (DSF) for market access countries (middle-income). It focuses on the total stock of public debt but is avoided by low-income countries (LICs) where the applicable DSF focuses only on external public debt.

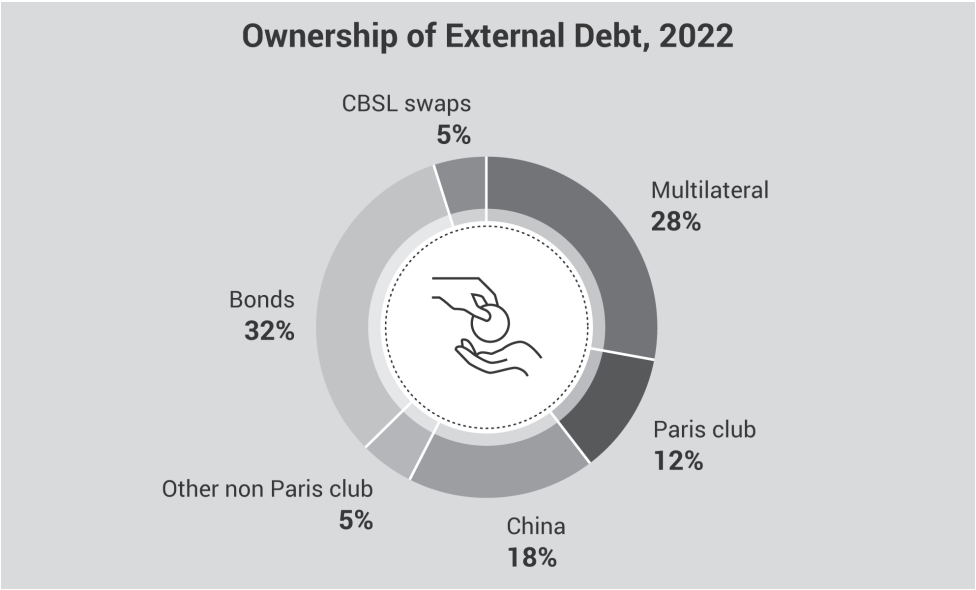
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11 Asonuma, T., & Trebesch, Christopher. (2016). Sovereign Debt Restructurings: Preemptive or Post-Default. *Journal of the European Economic Association*, 14(1): 175-214.

12 Asonuma, T., Chamon, Marcod D., Erce, Aitor., & Sasahara, Akira. (2019). *Costs of Sovereign Defaults: Restructuring Strategies, Bank Distress and the Capital Inflow-credit Channel.* IMF Working Paper. Washington, D.C: International Monetary Fund.

The DDR exercise was contained to Treasury bonds and directed primarily at superannuation funds (holding 43% of total outstanding bonds as at end 2022) while excluding banks (holding 44%), private bond holders and primary dealers. Banks were excluded for fears that their inclusion would add to pressures on the overall financial system stability – built up since the pandemic-related debt moratoriums and as holders of nearly 30% of Sri Lanka's outstanding international sovereign bonds (ISBs), etc. The concerns that a banking crisis would significantly exacerbate Sri Lanka's already crisis-hit economy is valid in view of available evidence to suggest that when sovereign defaults are accompanied by a banking crisis, the fall in output is particularly large.[13] Additionally, pressure on the banking sector may require that negative externalities (recapitalising costs) are internalised by a fiscal authority, particularly when a strong link exists between the state and its financial system.[14] In setting aside such resources to ensure financial system stability, the anticipated fiscal benefits are potentially much less.

The disproportionate reliance on superannuation funds, especially the captive CBSL managed Employees' Provident Fund (EPF) being assured only of a 9% return, and requirement that other pension funds take a 30% haircut or be liable for higher taxation at 30% instead of the prevailing 14%, has generated criticism on the principles of 'comparable treatment' and 'securing participation'. But, Sri Lanka's DDR is an example of the considerable degree of influence that a state can exert over domestic legal and regulatory frameworks unlike that of an external debt restructuring (EDR).



Source: Based on data available from the CBSL.

13 Asonuma, T., Chamon, Marcod D., Erce, Aitor., & Sasahara, Akira. (2019). *Costs of Sovereign Defaults: Restructuring Strategies, Bank Distress and the Capital Inflow-credit Channel.* IMF Working Paper. Washington, D.C: International Monetary Fund.

14 Grigorian, D.A. (2023). *Restructuring Domestic Sovereign Debt: An Analytical Illustration*. IMF Working Papers Issue 024. Washington, D.C.: International Monetary Fund.

With the DDR in place, attention is once more on the EDR. As end 2022, bonds accounted for 28% of total external debt with China (18%), Paris club (12%) and other non-Paris club (5%) being the major creditors owed repayments.[15] Aside from those, CBSL swap lines consisted of another 5%, with the largest chunk (32%) of multilateral lending including those of the IMF, not subject to restructuring under current practices.

Comparable treatment by way of a 30% haircut on EDR, too, is being offered by Sri Lanka, mindful that a deeper haircut will make debt more sustainable but may also prolong negotiations. Indeed, the size of creditor losses (haircuts) is found to be among the best predictors of participation rates on bond restructuring.[16] Sri Lanka's complex creditor group and their associated geo-political wrangling add to the risks of long-drawn negotiations. China's preference globally is for a deferral rather than a reduction on two key arguments: first, that its loans are development-oriented, tied to projects that generate revenues for the recipients; and second, that multilateral banks should also participate, instead of the current stance of having their loans repaid in full.

In many ways, Sri Lanka will be a test case on these issues as a MIC that has a sizeable share of debt owed to non-Paris club members. So far, China has persisted with maturity extensions and coupon adjustments. In its dealings with Ecuador, a MIC, a deal was reached in 2022 that included maturity extensions and interest rate adjustments on debts worth USD 4.4 Bn. Similarly with Zambia in 2023, China agreed to push back repayments and accommodate interest rate cuts to restructure USD 4.2 Bn of loans under an initiative driven by the G20 Framework for LICs.

2.6 Conclusion

From the vantage of Sri Lanka's accelerated descent into economic and political chaos in March 2022, the upturn since has brought a measure of relief to most citizens. Chief amongst these are the absence of violent protests and political turmoil, access to basic essentials, and a downturn of rapid cost-of-living pressures. The return to some form of normalcy, however, does not mask the stark reality of Sri Lanka's current predicaments: a large vulnerable population tipped into poverty, with poverty rates estimated to have doubled from 13.1% in 2021 to 25% in 2022 alone. The numbers can swell further owing to job and income losses if the current recessionary conditions merely transform into a period of painfully low economic growth over the foreseeable medium-term. Sri Lanka will then not recover the substantial output losses incurred post-crisis.

The risk of this occurring is tied to a crucial element – the 2024 inflection point, when the current economic stabilisation and reform agenda will run up against Sri Lanka's traditional politics mired in populism. The slowdown in the rate at which the economy is contracting – expected to come in at around 2-3% by year end in 2023 against -8.7% in 2022 – does not mean that the stabilisation

15 International Monetary Fund. (2023). *Sri Lanka: Request for an Extended Fund Facility*. IMF Country Report No. 23/116. Washington, D.C.: International Monetary Fund.

16 Schumacher, J., Trebesch, C., & Fang, C. (2020). *Restructuring Sovereign Bonds: Holdouts, Haircuts and the Effectiveness of CACs.* Working Paper Series No. 2366. Frankfurt: European Central Bank.

process is at near completion. In the first instance, any change to assumed timelines on finalising EDR negotiations has ramifications on the macro setting. Second, as the electoral cycle edges closer, any policy procrastination will dull investor confidence. Third, Sri Lanka will find it harder to grow its economy and create jobs in an increasingly volatile and divided global environment.

Having more or less exhausted the menu of policy options for economic stabilisation, there will be little room for any party to divert from the IMF-EFF commitments in the short- to medium-term.

Having more or less exhausted the menu of policy options for economic stabilisation, there will be little room for any party to divert from the IMF-EFF commitments in the short- to medium-term. Any moves in that direction will plunge Sri Lanka back into an economic abyss. The divergence from current policy – framed within the broad concept of a 'social market economy' to drive export expansion through competitiveness and productivity growth – will likely materialise in related areas. Ongoing proposals on regulatory reforms (land and labour markets, education sector, SOEs, competition policy, investment laws, bilateral and regional trade agreements, etc.) can either be halted, slowed down or altered substantially. Without improvements to productivity and competitiveness, the economy will grow as it bounces back from a sharp recession, but the growth momentum is likely to settle at a very low equilibrium.

This is worrying because the IMF-style macroeconomic 'straight jacket' ignores growth for the most part. Indeed, its medium-term framework suggests that private sector savings and investment will keep rising 2023/2024 onwards. But, declining living standards and a floundering economy with job and income losses are unlikely to generate a domestic savings base. It also remains to be seen whether the private sector retains sufficient confidence to expand their operations in Sri Lanka or opts to spread their risks elsewhere. Thus, Sri Lanka will presumably depend heavily on net capital inflows in the form of inward FDI to achieve a shrinking savings-investment balance as modelled by the IMF.

The best bet to mitigate the downside risks and ensure that progress on economic stabilisation transforms to productivity driven higher growth is for Sri Lanka's political class to arrive at a consensus for a minimum common programme of reforms that can be advanced, irrespective of party fortunes at the polls.

3. Global Economic Developments and Impacts on Sri Lanka

3.1 Introduction

The global economy encountered a series of severe and interrelated shocks in the recent past. As the coronavirus (COVID-19) pandemic began to subside worldwide, the Russia-Ukraine conflict unleashed the biggest war in Europe after seven decades, disrupting food and energy markets and supply-chains. Soaring inflation eroded real incomes, triggering a global cost-of-living crisis that pushed millions into poverty and economic hardship. Those in the developing world were particularly hard hit and much felt the blow with rising food insecurity and malnutrition. Exacerbating these tumultuous events are the ever-present shocks from climate change, as extreme weather events such as heat waves, wildfires, floods, and hurricanes caused grave humanitarian and economic damage in many parts of the world.

As a result, the global economy has struggled to gain a firm footing so far in 2023. Indeed, it is beset by rising uncertainties that have seen unusually large revisions to global economic growth forecasts. Projected gross domestic product (GDP) growth of 3.6% in 2023, made in April 2022 by the International Monetary Fund (IMF) was revised to 2.8% a year later in April 2023.[1] This represents one of the lowest growth rates in recent history, as many developed and developing countries adopt persistent monetary tightening measures to battle rising inflation.

Although global growth is predicted to pick up moderately to 3% in 2024, the toxic mix of continued economic uncertainties, political dysfunction in key economies, and geopolitical rivalries – that have seen the United States (US) banning the export of certain semiconductors and machines to Chinese firms – hangs over the world. These developments will have serious repercussions for countries struggling with growing sovereign debt overhangs, with an estimated 56% of low-income developing countries already in debt distress or at high debt risk, while 25% of emerging market economies are also estimated to be at high risk.[2] Sri Lanka has been one of the worst hit, defaulting in early 2022, while others, such as Egypt, Tunisia and Ghana, sought help from the IMF. Fiscal and monetary policy rebalancing measures as preconditions for Sri Lanka's United States Dollars (USD) 3 billion (Bn) Extended Fund Facility (EFF) Arrangement announced in March 2023, has restored a measure of macroeconomic stability. However, implementing the EFF programme targets, debt restructuring negotiations, and broader institutional and structural reforms will take place against a less than favourable external environment.

Sri Lanka's key export markets – the US and Europe – are experiencing low growth and weakened demand. Internally, rising financing costs, higher import costs from the local currency depreciation

1 International Monetary Fund. (2023, April). *World Economic Outlook: A Rocky Recovery.* Washington, D.C.: International Monetary Fund.

2 *Ibid*.

(and restrictions on imports of non-essential goods), high energy costs, worker retention, etc., further add to the domestic cost of production. Investor sentiment on the country's economic outlook has been severely impacted with limited avenues to attract much needed foreign direct investment (FDI). Amidst these challenges, the near-term policy priority is to expedite some of Sri Lanka's stalled bilateral free trade agreement (FTA) negotiations with India and China, initiate fresh FTAs with Thailand and Bangladesh, and consider more medium-term options such as the Regional Comprehensive Economic Partnership (RCEP). Against this backdrop, this chapter discusses the global economic outlook, the downside risks to a resilient recovery and the likely impacts of these developments on Sri Lanka's external sector in supporting the country's post-default economic prospects.

3.2 Global Economic Prospects

A high degree of uncertainty reshapes the current state of the global economy. The disruptions of the COVID-19 pandemic confounded forecasting problems, notwithstanding subsequent shocks brought on by the prolonged Russia-Ukraine war. Inflation has risen to unprecedented levels in many economies due to a combination of pent-up demand, persistent supply disruptions, and spikes in commodity prices. Rapid interest rate hikes and diminishing purchasing power have undermined consumer confidence and investor sentiment. Indeed, tighter financing conditions threaten to raise private and public debt further, drive up debt servicing costs and increase sovereign credit risks in many parts of the world. Combined, these developments obscure the near-term growth prospects for the global economy.

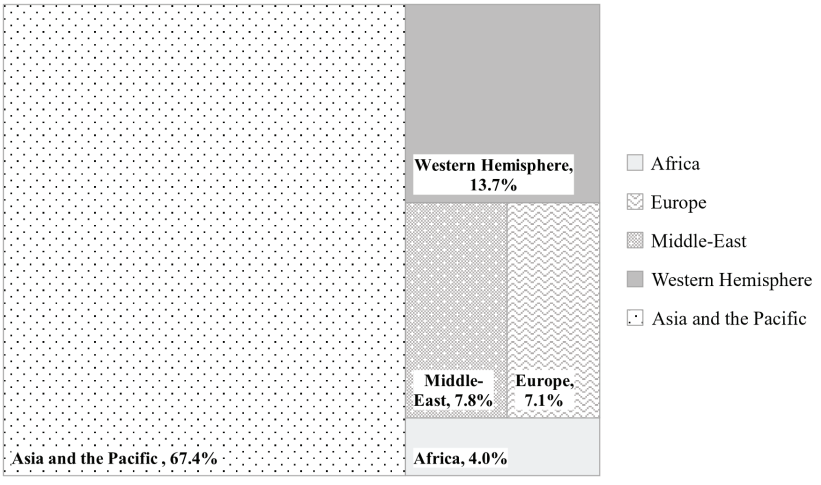
The uncertainty has meant serious downgrades in growth forecasts for most countries in 2023, with the global output growth expected to be the third weakest in nearly three decades. The baseline forecast for global output growth is to decline from 3.5% in 2022 to 3.0% in 2023 and remain at a similar level in 2024 (Table 3.1). Approximately, 70% of this global growth in 2023 comes from Asia and the Pacific region, boosted by China's reopening following its zero-COVID policy and India's continued growth momentum (Figure 3.1).

Table 3.1
World Economic Outlook Projections (Real GDP, Annual % Change)

	Estimates	Projections	
	2022	2023	2024
World Output	3.5	3.0	3.0
Advanced Economies	2.7	1.5	1.4
US	2.1	1.8	1.0
Euro Area	3.5	0.9	1.5
Japan	1.0	1.4	1.0
UK	4.1	0.4	1.0
Canada	3.4	1.7	1.4
Emerging Market and Developing Economies	4.0	4.0	4.1
Russia	-2.1	1.5	1.3
China	3.0	5.2	4.5
India	7.2	6.1	6.3
Saudi Arabia	8.7	1.9	2.8
Brazil	2.9	2.1	1.2
Nigeria	3.3	3.2	3.0
Emerging Market middle-income Economies	3.9	3.9	3.9
Low-income Developing Countries	5.0	4.5	5.2

Source: International Monetary Fund. (2023, July). *World Economic Outlook*. Washington, D.C.: International Monetary Fund.

Figure 3.1
Regional Share of Global Growth in 2023



Source: International Monetary Fund. (2023, April). *World Economic Outlook*. Washington, D.C.: International Monetary Fund.

By contrast, 90% of advanced economies are projected to undergo a decline in growth in 2023 and are considered at a higher risk of a 'hard landing'.[3] Aggressive monetary policy tightening in the US is expected to significantly decelerate its output growth, while the Euro area is struggling with severe energy supply disruptions and price hikes. Combinations of adversities such as slow growth, tightening financial conditions, and heavy indebtedness will likely weaken investment and trigger corporate defaults. Rising real interest rates and historically elevated corporate and household debt also pose a serious downside risk.

3.2.1 Advanced Economies

The growth rate in advanced economies almost halved from 5.2% in 2021 to 2.7% in 2022.[4] This deceleration represents the fourth most rapid downturn observed in the past five decades. During the latter half of 2022, economic conditions seriously deteriorated as high inflation eroded household purchasing power and damaged consumer confidence. Additionally, the sharp tightening of monetary policies by most central banks exerted downward pressure on demand. In 2023, expectedly, the continuing cycle of monetary tightening measures and persistent energy supply challenges will further hinder economic growth, particularly in the Euro area. Projections indicate that growth in advanced economies will decline by nearly half, reaching 1.5% in 2023, and remain at similar levels in 2024. On the positive side, signs of resilience are visible in economic activity, as labour markets remain robust in most advanced economies.

90% of advanced economies are projected to undergo a decline in growth in 2023 and are considered at a higher risk of a 'hard landing'.

In the US, the growth rate declined from 5.7% in 2021 to 2.1% in 2022, representing the weakest performance outside official recessions since 1970.[5] This decline is attributed to the combined effects of rising food and energy prices, as well as a tight labour market, which contributed to heightened inflation levels in 2022. Growth is projected to further decline during 2023-2024.

3 International Monetary Fund. (2023, April). *World Economic Outlook: A Rocky Recovery.* Washington, D.C.: International Monetary Fund.

4 *Ibid.*

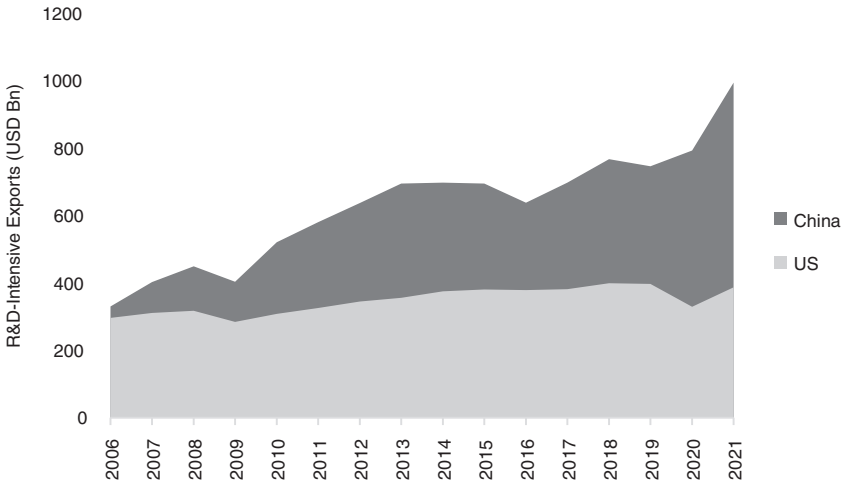
5 World Bank Group. (2023, January). *Global Economic Prospects*. Washington, D.C.: World Bank Publications, The World Bank Group.

Box 3.1
Global Industrial Policy Shifts

In recent years, the US has encountered a multitude of challenges, including the COVID-19 pandemic, global supply chain disruptions, climate change, and China's growing influence. These challenges have sparked renewed discussions about industrial policy involving government support for strategically important industries. Thus, this new era of industrial policy is marked by government efforts to promote specific sectors deemed crucial to safeguard national security and geopolitical ambitions, with much focus on heavy manufacturing or military applications, such as aerospace, semiconductors, and shipbuilding. Various policy measures, like protective tariffs, subsidies, public spending on research and development (R&D), and government procurement, are deployed to bolster these industries.

As illustrated, a notable concern arises from China's ascendancy in R&D-intensive exports. For instance, the US depends heavily on the Taiwan Province of China for over 90% of its advanced chips vital for defense and artificial intelligence (AI). In response to this vulnerability, the US government has devised plans to allocate USD 39 Bn from the USD 280 Bn CHIPS and Science Act to bolster advanced semiconductor manufacturing capabilities, with the overarching objective of establishing two semiconductor manufacturing clusters by the year 2030.[a] Recent legislative endeavours underscore a proactive approach to industrial development in the US, as described below.

Exports of Highly R&D-intensive Goods



Note: Values are at current USD.

Source: Author's illustration using OECD data based on Siripurapu & Berman (2022).; Siripurapu, A., & Berman, N. (2022). *Is Industrial Policy Making a Comeback?*. Retrieved July 18, 2023, from CFR: https://www.cfr.org/backgrounder/industrial-policy-making-comeback?gclid=Cj0KCQjwib2mBhDWARIsAPZUn_nRBOR2w1Xii845cYu-9k63pTDnqkSNRzmTd2c4pAJNCuiGa3zMbioaAj5_EALw_wcB.

Recent Legislative Efforts to Support the US Industries

- **Creating Helpful Incentives to Produce Semiconductors (CHIPS) for America Act** (Title XCIX, P.L. 116-283).

  It establishes investment and incentive schemes to support US semiconductor manufacturing, R&D, and supply chain security.

- **Infrastructure Investment and Jobs Act (P.L. 117-58).**

  Among other matters, it establishes requirements and incentives to support R&D and energy infrastructure and cybersecurity and ensure a supply chain for critical minerals and battery materials.

- **CHIPS and Science Act of 2022** (P.L. 117-167).

  As part of a wider set of China-focused measures, it provides funding to support US semiconductor manufacturing, R&D, and supply chain security.

- **Inflation Reduction Act (IRA) of 2022** (P.L. 117-169).

  Among other matters, it aims to support investments in domestic energy production, incentivise the procurement of domestically produced or assembled inputs and products, and boost R&D of clean-energy technologies.

Source: Schwarzenberg, A (2023). *Industrial Policy and International Trade*. Retrieved July 20, 2023, from Congressional Research Service: https://crsreports.congress.gov/product/pdf/IF/IF12119

Numerous countries, including Germany, Japan, South Korea, and various Latin American nations, have embraced industrial policies with differing degrees of success. Noteworthy examples include China's 'Made in China 2025' initiative, aimed at boosting domestic high-tech manufacturing, and the EU's commitment to invest Euro (EUR) 43 Bn in the semiconductor industry, to elevate Europe's share of global chips production from below 10% to 20%.[b] In contrast, Japan is actively providing substantial subsidies exceeding USD 500 Mn to 57 companies, seeking to encourage domestic investments and reduce dependence on China.[c]

Advocates of the novel US industrial policy contend that it is imperative to counteract China's state-led development, safeguard access to critical materials and products, and advance environmentally sustainable technologies. However, critics caution that such policies may distort free market dynamics, stifle innovation, and impede overall economic growth. Instead, they propose the negotiation of new trade rules as a more effective alternative to address concerns pertaining to trade and market distortions.

The growing inclination towards trade interventions through industrial policies, subsidies, and import restrictions, driven by national security and environmental considerations, coupled with export controls to exert geopolitical pressure and ensure domestic supply, has the potential to impact the trajectory of globalisation in the future. While these measures aim to safeguard

domestic industries, they also carry the risk of obstructing the economic progress achieved by many developing economies through active participation in the global market.

Source:

a. Agrawal, R. (2023, March 21). *Is It Time to Strike a New Balance Between State Intervention and Market Forces?*. Retrieved July 20, 2023, from International Monetary Fund: https://www.imf.org/en/Publications/fandd/issues/Series/Analytical-Series/industrial-policy-and-the-growth-strategy-trilemma-ruchir-agarwal

b. Schwarzenberg, *A. (2023). Industrial Policy and International Trade*. Retrieved July 20, 2023, from Congressional Research Service: https://crsreports.congress.gov/product/pdf/IF/IF12119

c. *Ibid*.

In the Euro area, the growth forecast for 2023 is even lower at 0.9%, a downward revision from 3.5% in 2022. This is primarily attributed to ongoing disruptions in energy supply and a more substantial tightening of monetary policies than initially anticipated. Inflation reached record highs due to the natural gas supply cuts caused by Russia's invasion of Ukraine, leading to a surge in energy prices. The United Kingdom (UK) has been one of the most severely affected, struggling with a slow recovery in its labour market and persistently low levels of investment and productivity. The UK may experience a 0.4% growth in 2023, a significant reduction against 2022, accompanied by high inflation and rising unemployment. In contrast to advanced economies in the West, the Japanese economy is expected to accelerate growth to 1.4% in 2023, driven by supply chain logistics improvements and strong services sector growth, especially in tourism.

3.2.2 Emerging Market and Developing Economies

The adverse shocks of the past three years have led to long-term scarring effects for emerging markets and developing economies (EMDEs) too. Global financial conditions – rapid interest rate hikes that caused capital outflows and currency depreciations, leading to balance of payments (BOP) pressures and intensifying debt sustainability risks for some – inflation, weak demand, and the spillover effects of the Russian invasion of Ukraine have resulted in large cumulative losses, especially in output and investment. However, EMDEs have relatively stronger economic prospects than advanced economies, with growth expected to remain stable at 4% in 2023 and rise to 4.1% in 2024, with a moderate increase with China's impact on offsetting the decline in other EMDEs.

The decelerating global demand has substantially impacted EMDE export growth, especially in economies with strong trade linkages with dominant economies like the US, Euro area and China.

Nonetheless, higher borrowing costs and lower growth can cause systemic debt distress in some EMDEs. Private investment has been weak owing to higher borrowing costs, weakened confidence, and elevated uncertainty. EMDEs' investment growth is expected to remain below its 2000-2021 average pace. The decelerating global demand has substantially impacted EMDE export growth, especially in economies with strong trade linkages with dominant economies like the US, Euro area

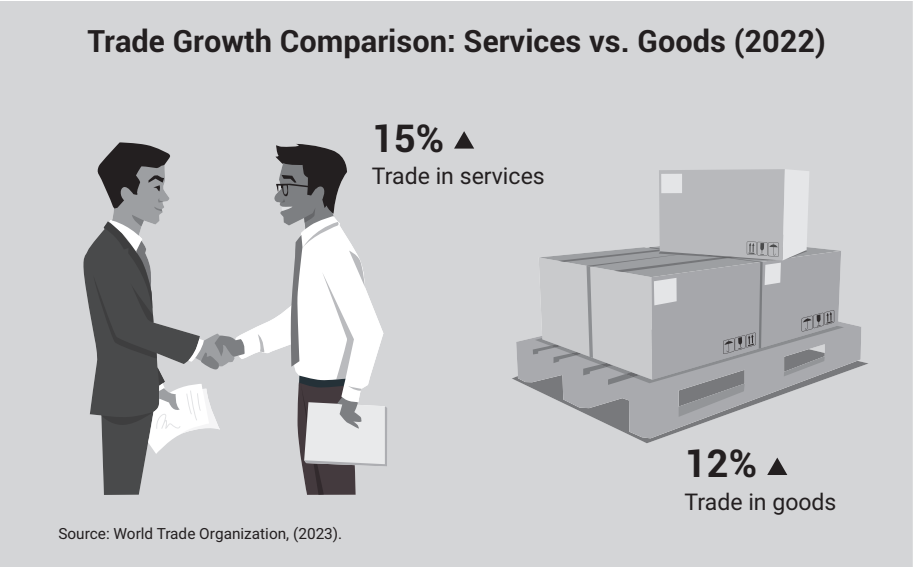
and China. As China's economic outlook improves with a projected growth rate of 5.2%, driven by increased consumer spending as pandemic restrictions are lifted, positive spillover impacts on Asian EMDEs are likely. Such spillovers will be bolstered by robust growth in India – expected to reach 6.1% in 2023 – a notable exception amidst the sluggish global growth. Along with China, it is anticipated to contribute to around 50% of the global economic expansion in 2023.[6]

Some EMDEs face significant risks due to high corporate and sovereign debt and currency depreciations against the USD. Countries with large fiscal and current account deficits are especially vulnerable to challenges in accessing external credit. Although these risks are high in large regional economies, still, many countries in all regions are exposed to elevated risks.

3.3 Global Trade and Commodity Prices

Geopolitical tensions, inflation, energy and other commodity price movements, and the lingering effects of COVID-19 heavily influenced the fluctuations in global trade and commodity prices during past years. After two years of rapid catch-up growth following the pandemic-related contraction, global trade growth decelerated in the second half of 2022. It mirrored declining economic activity in major economies and the shift in spending from traded goods back to domestic services. While weak global demand and renewed supply chain issues persist, intensified trade protectionism, fragmentation of trade networks, and security concerns regarding supply chains pose further risks. These can exert pressure to further increase trade costs and result in slow trade growth.

Despite these constraints, goods trade surpassed pre-pandemic levels in 2022. Services trade continued to recover due to a gradual shift in demand towards services, with the rebound of tourism flows as travel restrictions were lifted in many countries after COVID-19 disruptions. By the end 2022, trade in services reached around 15% growth which is higher than the 12% growth of trade in goods.

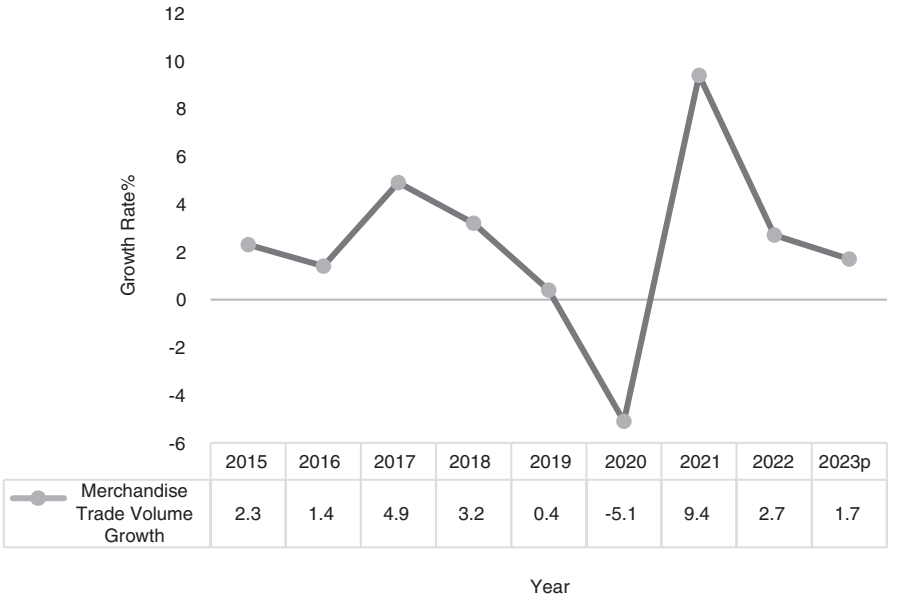


6 International Monetary Fund. (2023, April). *World Economic Outlook: A Rocky Recovery.* Washington, D.C.: International Monetary Fund.

3.3.1 Merchandise Trade

In 2022, the world merchandise trade grew by 12% to reach USD 25.26 trillion (Tn) as measured by value (the average of the USD value of exports and imports). It was up 32% compared to its pre-pandemic level in 2019. In volume terms, global merchandise trade is expected to grow by 1.7% in 2023 after a 2.7% growth rate in 2022 (Figure 3.2). This deceleration in trade expansion in 2023 can be ascribed to various factors, notably the ramifications of the Russia-Ukraine conflict, saw elevated inflation rates, tighter monetary measures, and prevailing uncertainties in financial markets. The growth is also expected to be impacted by rising trade barriers and the effects of USD appreciation in 2022, which made traded products more expensive for numerous economies.

Figure 3.2
Global Merchandise Trade Volume Growth



	2015	2016	2017	2018	2019	2020	2021	2022	2023p
Merchandise Trade Volume Growth	2.3	1.4	4.9	3.2	0.4	-5.1	9.4	2.7	1.7

Note: p refers to Projections.
Source: World Trade Organization. (April, 2023). *Global Trade Outlook and Statistics.* Geneva: World Trade Organization.

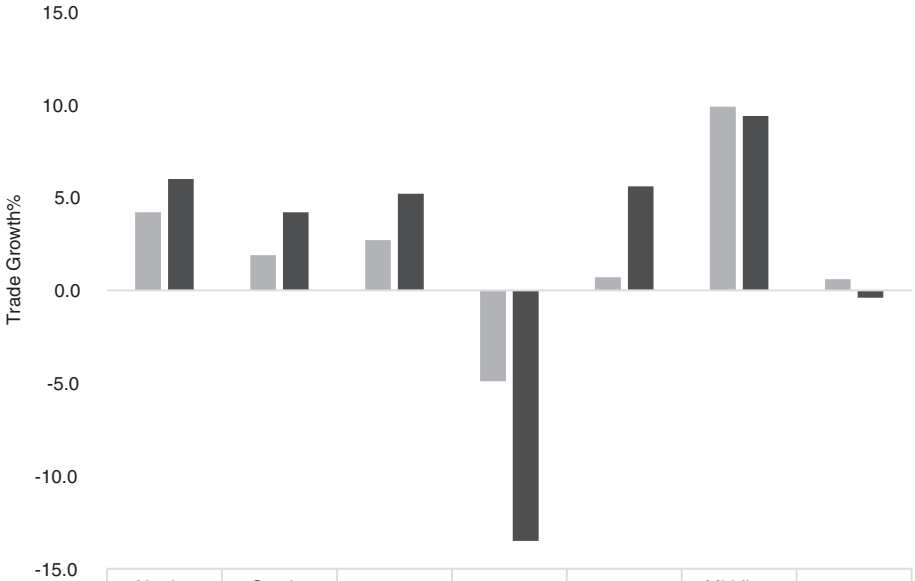
In 2022, the leading exporters and importers were the US, China, Germany, Netherlands, and Japan, with China being the leading exporter and the US being the leading importer (Table 3.2). China's economic slowdown resulting from its surge in COVID-19 infections impacted trade patterns in Asia (Figure 3.3). Nonetheless, this negative influence is expected to reverse in 2023 as pandemic restrictions have been eased, potentially offering a substantial lift to global trade. Europe also faced repercussions from the Russia-Ukraine war, whereby exports and imports plunged by 33% and 23%, respectively, and the recovery from these setbacks is yet to accomplish.

Table 3.2
Leading Exporters and Importers in Global Trade, 2022

Rank	Exporter	Value USD Bn	Rank	Importer	Value USD Bn
1	China	3,594	1	USA	3,376
2	USA	2,065	2	China	2,716
3	Germany	1,655	3	Germany	1,571
4	Netherlands	966	4	Netherlands	899
5	Japan	747	5	Japan	897

Source: World Trade Organization. (April 2023). *Global Trade Outlook and Statistics.* Geneva: World Trade Organization.

Figure 3.3
Regional Merchandise Trade Growth, 2022



	North America	South America	Europe	CIS	Africa	Middle East	Asia
2022 Exports	4.2	1.9	2.7	-4.9	0.7	9.9	0.6
2022 Imports	6.0	4.2	5.2	-13.5	5.6	9.4	-0.4

Note: CIS refers to the Commonwealth of Independent States.
Source: World Trade Organization. (April 2023). *Global Trade Outlook and Statistics.* Geneva: World Trade Organization.

Although the outlook for global merchandise trade is uncertain, positive factors are expected to counteract some negative trends. The reopening and growth of China's economy are predicted to generate positive spillovers, particularly for countries with strong trade connections with China. Additionally, falling shipping costs and improved logistics are expected to facilitate trade. The weakening of the USD after appreciating in 2022 is also a promising sign. Nonetheless, geopolitical tensions, such as the ongoing Russia-Ukraine conflict, continue to pose the biggest risk to international trade in 2023. Notably, fuel trade growth in 2022 was particularly high, reaching 61%, mainly reflecting rising energy prices related to the conflict. The energy crisis has also propelled changing dynamics in global merchandise trade, with a boost in trade in environmentally friendly goods, particularly in the energy sector. Inflation, commodity prices, interest rates, concerns about debt sustainability, and the reshaping of global supply chains are expected to adversely affect the macroeconomic conditions of many countries. Furthermore, trade policies for the green transition are emerging as significant concerns in global merchandise trade.

Geopolitical tensions, such as the ongoing Russia-Ukraine conflict, continue to pose the biggest risk to international trade in 2023.

3.3.2 Services Trade

Much of the global trade involves physical goods, with services accounting for a smaller portion. However, the demand for services has gradually increased, and the value of world commercial services trade rose by 15% to reach USD 6.8 Tn in 2022.[7] While developed countries still dominate service exports, developing countries are becoming increasingly important suppliers of services, particularly in the construction and insurance sectors.

This growth has been particularly strong in sectors such as telecommunication and information technology (IT) services, R&D, and professional consulting. In 2022, business, professional, and technical services accounted for around 40% of digitally delivered services exports, followed by computer services (20%), financial services (16%), intellectual property-related services (12%), insurance services (5%), telecommunications services (3%), and audio-visual and other personal, cultural, and recreational services (3%), with information services accounting for 1%.[8] Due to the pandemic's impact on mobility, digitally delivered services exports continued to grow, with computer services being the most dynamic service sector over the past decade. The growth of these exports has been driven by the increased demand for remote working, online learning, and entertainment, with software, cloud services, machine learning, and enhanced cybersecurity being particularly popular. Ireland is the leading global exporter of computer services, with a share of 27% in 2021.[9]

After three years of COVID-19 restrictions, international tourism is recovering, with travel restrictions being lifted globally. While tourism is rebounding, it remains uneven across regions, with European

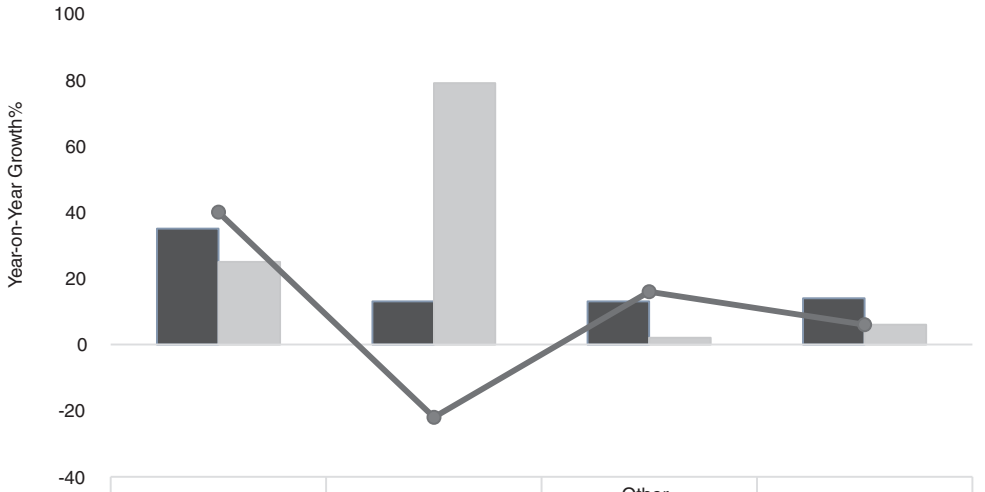
7 World Trade Organization. (April 2023). *Global Trade Outlook and Statistics*. Geneva: World Trade Organization.

8 *Ibid.*

9 *Ibid*.

countries and the US experiencing the most growth due to the strong USD. Although tourism expenditure grew by 79% in 2022, it remained 22% below pre-pandemic levels, with Asia remaining largely closed (Figure 3.4). Nevertheless, the demand for travel appears to be resilient. The reopening of China's borders in early 2023 is expected to boost regional and global travel as, in recent years, China has been the largest tourism outbound market and spender. Transport also experienced considerable growth, with trade up by 25% in 2022 and 40% above 2019 levels. However, growth has slowed as shipping rates have declined, reflecting the shift back to consumer spending on services as the health situation normalises (Figure 3.4).

Figure 3.4
Global Service Trade Growth



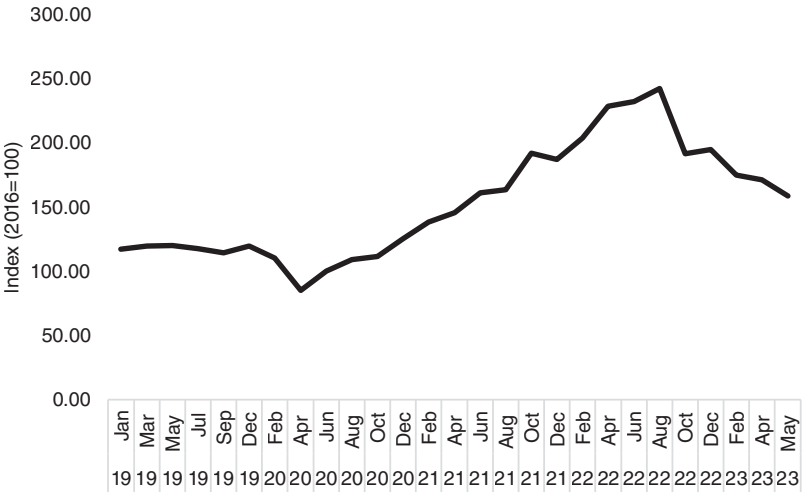
	Transport	Travel	Other Commercial Services	Goods-related services
2021	35	13	13	14
2022	25	79	2	6
2022 vs 2019	40	-22	16	6

Source: World Trade Organization. (April 2023). *Global Trade Outlook and Statistics*. Geneva: World Trade Organization.

3.3.3 Global Commodity Market Overview

Commodity prices plummeted after reaching record-high levels in 2022. In the first quarter of 2023, global commodity prices fell by 14% with a 30% decline by the end of March from their peak in June 2022, mainly due to the depreciation of the local currency in many countries compared to the USD (Figure 3.5). This price decline is expected to be the steepest since the pandemic, led by falling energy commodity prices, down 46.4% between August 2022 and February 2023.

Figure 3.5
Global Commodity Price Index



Source: Author's illustration based on International Monetary Fund, Commodity Prices Index-Monthly.

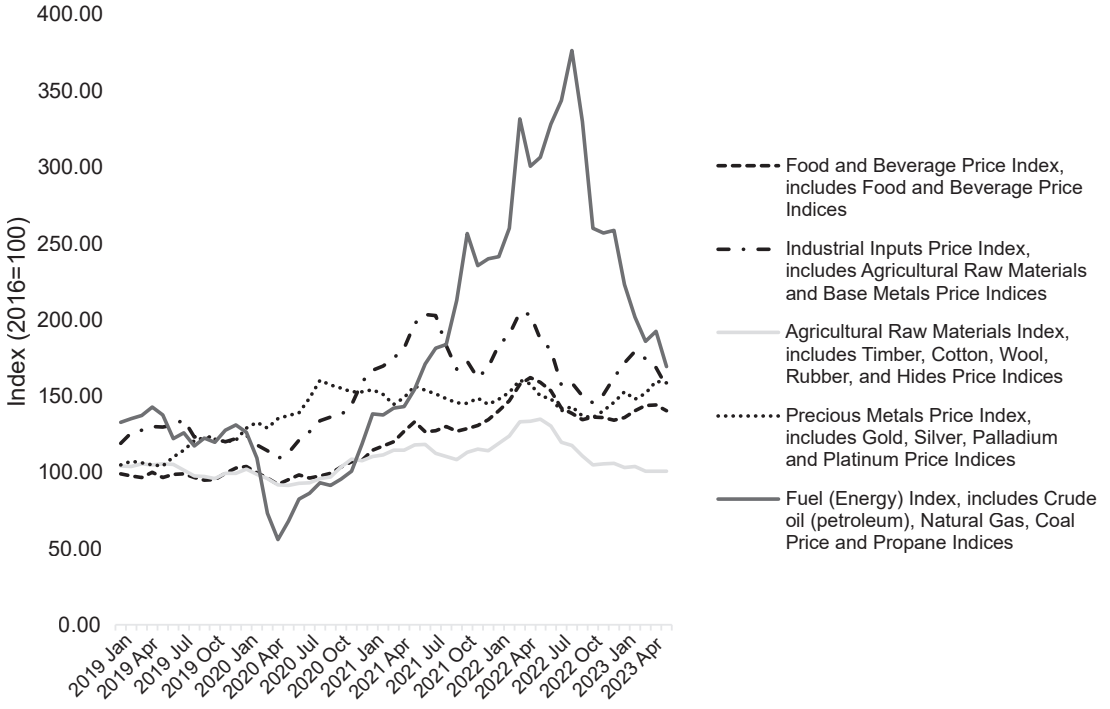
The price surge that followed Russia's invasion of Ukraine has been attributed to a combination of factors, such as a slowdown in economic activity, favourable winter weather, and a global reallocation of commodity trade flows. It is forecasted that commodity prices will remain relatively stable for the rest of 2023. However, these are expected to remain high above pre-pandemic levels, which could challenge affordability and food security. Potential risks that could drive prices up include supply disruptions in energy and metals due to trade restrictions, geopolitical tensions, a stronger-than-expected recovery in China's industrial sector, and adverse weather events. Moreover, disappointing global growth remains the major downside risk.

In 2023, over 349 Mn people worldwide are predicted to be food insecure due to conflicts, economic shocks, climate extremes, and soaring fertiliser prices.

The expected decline in energy prices in the first quarter of 2023 is predicted to plateau and then see a slight uptick in 2024 due to supply pressures. While most commodity prices have eased to some degree since June 2022, these are still expected to remain well above the average of the past five years. The Agricultural Raw Materials Index grew in the first quarter of 2023, driven by a rise in timber prices (Figure 3.6). However, agricultural raw materials, including cotton, timber, and rubber, are expected to decrease by around 7% in 2023 due to sluggish global industrial demand growth and then rebound by 2% in 2024 as China's demand picks up. Apart from these, the Precious Metals Index increased by 9% in the first quarter of 2023 due to a weakening USD, safe haven buying following banking stress in the US and Europe, and strong industrial demand for platinum and silver.[10]

10 The World Bank. (2023, April). *Commodity Market Outlook*. Washington, D.C.: World Bank Group.

Figure 3.6
Global Price Indices



Source: Compiled with data from International Monetary Fund, Commodity Prices Indices-Monthly.

In 2023, over 349 Mn people worldwide are predicted to be food insecure due to conflicts, economic shocks, climate extremes, and soaring fertiliser prices.[11] The war in Ukraine remains perilous that could unsettle markets for wheat, maize, oilseeds, and fertilisers, potentially raising prices. In the short-term, removing trade restrictions and slowing global growth may lead to lower food prices, geopolitical risks and severe weather events that could increase food prices. Long-term risks such as climate change are projected to continue to impact food production and prices, leading to food shortages, hunger, desertification, land degradation, crop failures, and damage to food supply infrastructure.

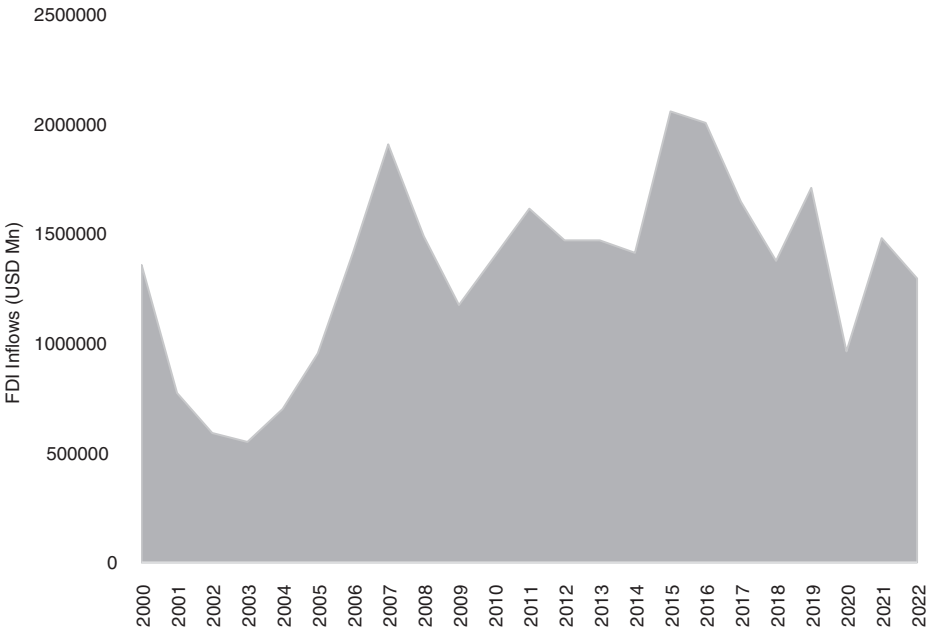
3.3.4 Foreign Direct Investment

The outlook for international investment has been somewhat bleak owing to a convergence of health, climate change, and economic crises, intensifying global investor uncertainty. Inflation, recession fears, and financial market turbulence further contributed to a slowdown in investment plans. Notably, global FDI declined by 12% in 2022, reaching around USD 1.3 Tn (Figure 3.7). However, investment flows to developing countries showed a slight growth, and investors announced new projects

11 World Bank. (2023, April). *Commodity Market Outlook.* Washington D.C.: World Bank Group.

in industry and infrastructure, providing some resilience. Nonetheless, the global FDI outlook for 2023 remains uncertain, with negative economic growth, deteriorating financing conditions, investor uncertainty, and mounting debt-related risks, particularly affecting developing nations, according to the World Investment Report in 2023.

Figure 3.7
Global FDI Inflows



Source: Compiled based on data from United Nations Conference on Trade and Development.

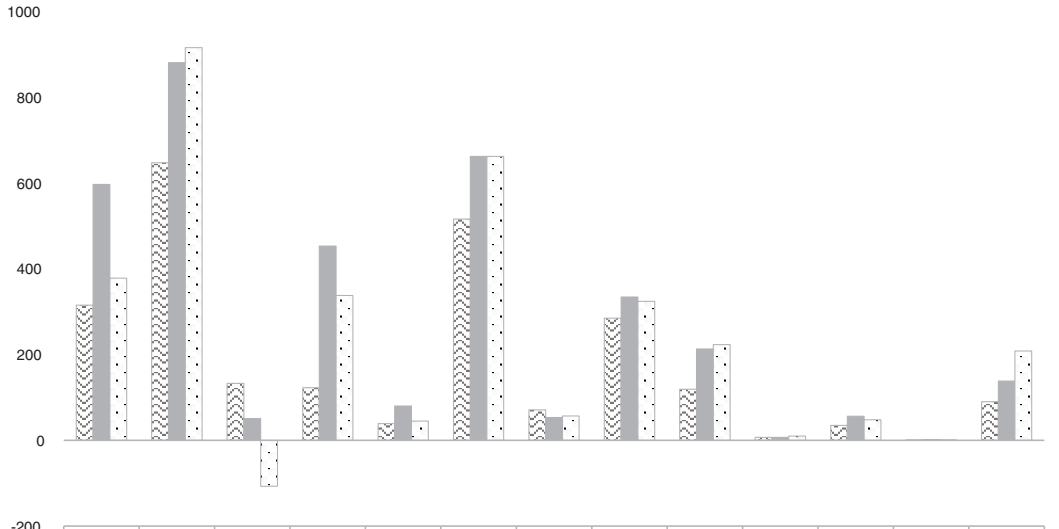
In 2022, the number of investment projects, including greenfield projects and international project finance deals, rose by 14%. Developing economies' share reached nearly 40%, up from an average of 33% in the past two years. The US remained the largest host for announced greenfield projects and international project finance deals, followed by the UK, India, the United Arab Emirates (UAE), and Germany for greenfield projects, and India, the UK, Spain, and Brazil for project finance deals.

Geopolitical tensions are prominent in FDI fragmentation, with flows becoming more concentrated among geopolitically aligned countries.

Developing countries typically account for over two-thirds of global FDI, but such flows tend to be concentrated among a select group of large emerging economies such as China, Singapore, Hong Kong (China), India, and the UAE, capturing almost 80% of FDI inflows to the region. India has seen a growth of 10% in FDI flows to USD 49 Bn, making it the third largest host for announced greenfield projects and the second largest for international project finance deals. Key greenfield projects included Foxconn (Taiwan

Province of China) and Vedanta Resources (India) jointly establishing one of India's first chip factories for USD 19 Bn and a USD 5 Bn joint venture between TotalEnergies (France) and Adani Group (India) to produce urea from green hydrogen.[12]

Figure 3.8
FDI Inflows by Region



	Developed Economies	Developing Economies	Europe	North America	Africa	Asia	South Asia	East Asia	South-East Asia	Central Asia	West Asia	Oceania	Latin America and the Caribbean
2020	315	647	133	123	39	516	71	285	119	7	35	1	90
2021	597	881	51	453	80	662	53	334	213	7	56	1.3	138
2022	378	916	-107	338	45	662	57	324	223	10	48	1.2	208

Source: United Nations Conference on Trade and Development. (2023). *World Investment Report*. Geneva: United Nations Conference on Trade and Development.

Geopolitical tensions are prominent in FDI fragmentation, with flows becoming more concentrated among geopolitically aligned countries.[13] Rising tensions prompted companies and policymakers to enhance supply chain resilience through relocation strategies. The share of FDI flows among geopolitically aligned economies has been rising, potentially impacting EMDEs reliant on FDI from distant nations. Amidst global economic uncertainties, various developing economies are implementing policy measures to attract FDI. Bangladesh extended patent protection, the Philippines allowed full ownership of small and medium-sized businesses for international investors, and Ethiopia provided tax exemptions and eased import duties. Additionally, sustainability measures, including carbon emissions reporting, were introduced in several economies.

12 United Nations Conference on Trade and Development. (2023). *World Investment Report*. Geneva: United Nations Conference on Trade and Development.

13 Ahn, J., Habib, A., Malacrino, D., & Presbitero, A. (2023, April 5). *Fragmenting Foreign Direct Investment Hits Emerging Economies Hardest*. Retrieved July 20, 2023, from IMF Blog: https://www.imf.org/en/Blogs/Articles/2023/04/05/fragmenting-foreign-direct-investment-hits-emerging-economies-hardest

3.4 Implications of External Environment Developments on Sri Lanka

As the COVID-19 pandemic receded, Sri Lanka's economic conditions went into a tailspin. The crisis manifested through severe BOP pressures, dwindling gross official reserves, and a dearth of foreign exchange liquidity in the domestic market followed by a sudden and sharp exchange rate depreciation. The liquidity shortage in the domestic foreign exchange market led to constraining imports of essential goods, such as petroleum oil, cooking gas, medicines, and fertilisers, resulting in social unrest and political instability.

Of several policy interventions imposed to contain the foreign exchange crisis, a temporary suspension of certain imports was one of the first. In the medium to long-term, such measures can prove to be counterproductive. Substituting imports domestically can lead to efficiency loss from resource misallocation, being cut off from global value chains (GVCs) and generating adverse distributional effects on household welfare, affecting food security and nutritional levels. An IPS study finds that 90% of food imports were under non-price import controls by September 2022 and food products had a 11.8% higher probability of being subject to non-price import controls compared to non-food products.[14] These products are within the set of products that are easily substitutable for a country like Sri Lanka, which has a comparative advantage in low-tech manufacturing and a significant labour force in agriculture. Therefore, even without a protectionist motive, the structure of import controls can inadvertently incentivise import substitution. While the intermediate and capital goods have been prioritised in phasing-out such controls, a considerable number of food products are still under restrictions as of August 2023.

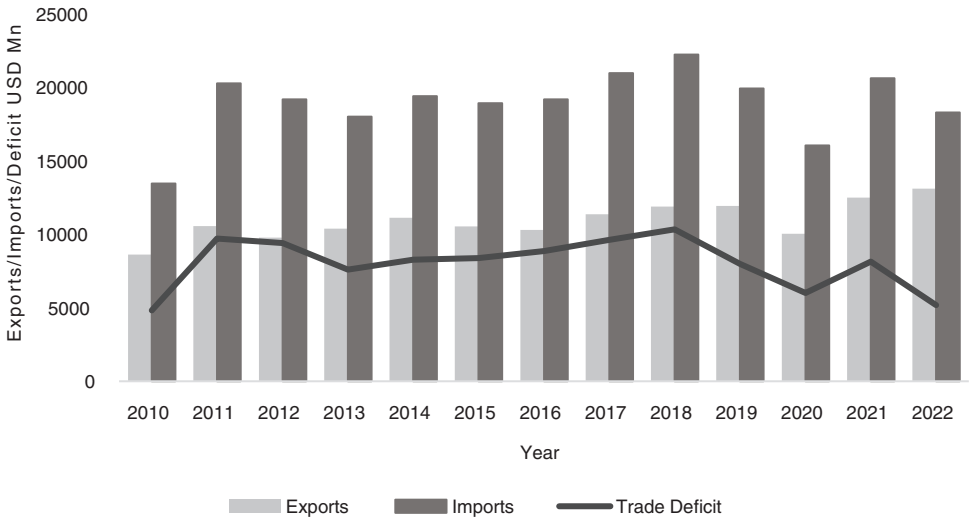
In recent months, Sri Lanka's key foreign exchange earnings have continued to grow, including merchandise exports, remittances, and tourism, allowing the government to incrementally lower the number of commodities subject to import restrictions. Nonetheless, Sri Lanka remains highly vulnerable to reversing these positive developments as it engages in a series of policy interventions, some of which are required under the IMF-EFF arrangement.

3.4.1 Merchandise Trade Overview

Sri Lanka has reported its lowest merchandise trade deficit in 2022 since 2011, mainly due to a significant decline in merchandise imports and the notable increase in merchandise exports (Figure 3.9). The main reason for the decline in import expenditure is the combined impact of import curbs and the foreign exchange liquidity constraint that applied for much of the year. The increase in exports is mainly due to favourable exchange rates, high commodity prices in the global market and the recovery in global supply chains.

14 Wijesinghe, A., Yogarajah, C., & Rathnayake, N. (2023). *Import Controls in Sri Lanka: Political Preference and Incentive Distortions*. Colombo: Institute of Policy Studies of Sri Lanka.

Figure 3.9
Exports Values, Imports Values and Trade Deficit in Sri Lanka



Source: Compiled based on External Sector Performance data, Central Bank of Sri Lanka.

In 2022, merchandise exports have grown by 4.9% compared to the previous year. The share of export earnings as a percentage of GDP in 2022 rose to 17%, the highest since 2008. While agricultural exports, which accounted for nearly 20% of total earnings declined (by -5.9%), industrial exports that accounted for 80% of total earnings expanded (by 7.9%), as did mineral exports (by 12.3%). This growth was driven by higher volumes and prices, leading to an overall increase in export earnings.



Of industrial exports, the textiles and garment (T&G) industry remained the main export earner, accounting for over 45% of total exports. In 2022, the apparel sector rebounded due to global supply chain improvements. In 2022, volume and value indices of T&G exports grew by 2.8% and 9.5%, respectively, compared to 2021. The beneficial devaluation of the Sri Lankan Rupee (LKR) too favoured exporters. Despite challenges like power outages, material shortages, and subdued demand, major manufacturers persisted with production. For instance, to tackle delayed raw material imports caused by shipping issues, top apparel makers redirected supplies to South India, minimising delays. However, earnings started tapering in late 2022 due to the global demand slowdown triggered by high production costs and rising inflation. The Joint Apparel Association Forum (JAAF), the industry's apex body, expects around USD 1 Bn earnings drop in 2023 due to dwindling orders.

The major export destinations for Sri Lanka's T&G sector remain the US and Europe, with the former taking accounting for 42% and the European Union (EU) absorbing another 30%. The UK (12.6% share) is the other single largest buyer. Given the overwhelming dominance of the T&G exports in Sri Lanka's total merchandise goods basket, this market concentration is also replicated at the aggregate level. The US and EU, with a combined value, account for nearly half of Sri Lanka's export earnings, with the US as the largest single market (25.3% of total exports), with the EU (23.2%), the UK (7.3%) and India (6.6%) being the others.

Both the product and market concentration of Sri Lanka's export basket has been a cause of concern for decades. It makes the country far more vulnerable to sector-specific shocks. The policy response has been to prioritise Sri Lanka's bilateral negotiations on FTAs (Box 3.2). Indeed, there is growing concern that the combined impacts of the economic slowdown in Sri Lanka's major markets and domestic challenges will hinder a progressive improvement in export growth. There are indications that the global market demand for T&G already decreased from the third quarter of 2022, impacting earnings.[15] On the domestic front, cost escalations and labour shortages might induce large T&G firms in Sri Lanka to expand their operations abroad rather than reinvest in the country.

Box 3.2
Sri Lanka's Current Bilateral and Regional Trade Negotiations

In the year 2022, Sri Lanka has taken proactive steps to restart negotiations on FTAs to optimise trade growth. Several noteworthy negotiations are currently underway:

Sri Lanka-Thailand Free Trade Agreement (SLTFTA): The fourth round of negotiations for the proposed SLTFTA concluded in March 2023. This agreement could yield a substantial 38% increase in Sri Lankan exports to Thailand if tariffs are fully eliminated.[a] However, it also presents challenges due to Thailand's competitive prowess, which might lead to a widening trade deficit. Despite these challenges, the SLTFTA opens avenues for Sri Lanka to participate in electric

15 International Textile Manufacturers Federation. (2023). *21st ITMF Global Textile Industry Survey*. Retrieved July 20, 2023, from International Textile Manufacturers Federation: https://www.itmf.org/images/dl/publications/GTIS-Vol21-07-2023-short-report.pdf

equipment manufacturing value chains and provides access to the Association of Southeast Asian Nations (ASEAN) economies. Therefore, it is imperative for Sri Lanka to engage in negotiations for a deep trade agreement with Thailand that incorporates investment promotion, trade facilitation, and competition laws.

Bangladesh-Sri Lanka Free Trade Agreement: In 2023, Sri Lanka is expediting the finalisation of a proposed Preferential Trade Agreement (PTA) with Bangladesh. Preliminary estimates suggest modest gains for both countries, even after fully eliminating sensitive lists. Nevertheless, complete removal of the sensitive list poses political complexities, particularly for least developed countries (LDCs) like Bangladesh.[b] Hence, a limited PTA could emerge, considering existing trade agreement weaknesses in the South Asian region.

Sri Lanka-Singapore Free Trade Agreement (SLSFTA): Originally signed in January 2018, this agreement encountered a suspension due to opposition from Sri Lankan political parties and professional entities. However, negotiations have recommenced in 2022. The SLSFTA intends to gradually eliminate tariffs for around 80% of tariff lines over 15 years span. This recalibration aims to enhance a more structured environment for service providers by allowing third-party invoicing arrangements and safeguarding market access.

Economic and Technology Cooperation Agreement (ETCA): This proposed agreement aims to enhance the existing India-Sri Lanka Free Trade Agreement by extending its coverage to services and the service sector. While it aims to promote low-cost goods for Sri Lankan consumers and foster high-end goods sales to India, concerns have arisen regarding the potential influx of cheaper Indian labour and its implications for employment in specific sectors in Sri Lanka.

Developing Countries Trading Scheme (DCTS): The UK introduced the DCTS in August 2022, which became effective in January 2023. This scheme furnishes Sri Lanka with a three-year duration of duty-free and quota-free access to the UK market for goods originating from developing countries. The scheme's key outcome is enabling Sri Lanka to engage in tariff-free trade on approximately 92% of goods, substantially heightening the competitive stance of Sri Lankan products within the UK market. Notably, this is attributed to the burgeoning demand for sustainable and fair-trade products, aligning well with Sri Lanka's offerings.

Regional Comprehensive Economic Partnership (RCEP): Sri Lanka is proactively pursuing participation in the RCEP, which stands as one of the largest trade blocs globally, encompassing nearly 30% of global GDP. China plays a pivotal role in RCEP, contributing to approximately 55% of its combined GDP. While accession to RCEP holds the potential for enhancing exports, attracting investments, integrating with value chains, and the implications of tariff reductions on the already extensive trade deficits Sri Lanka has with the other RCEP member countries require careful consideration.

Indonesia-Sri Lanka Free Trade Agreement: The most recent addition to the bilateral trade negotiations is the Indonesia-Sri Lanka Free Trade Agreement. These negotiations are expected to facilitate increased trade volumes and bolster bilateral cooperation between the two countries.

Sri Lanka's diplomatic strategies for these negotiations entail meticulous consideration of trade imbalances and regulatory intricacies to extract the maximum benefits from each bilateral and regional trade negotiation.

Sources:

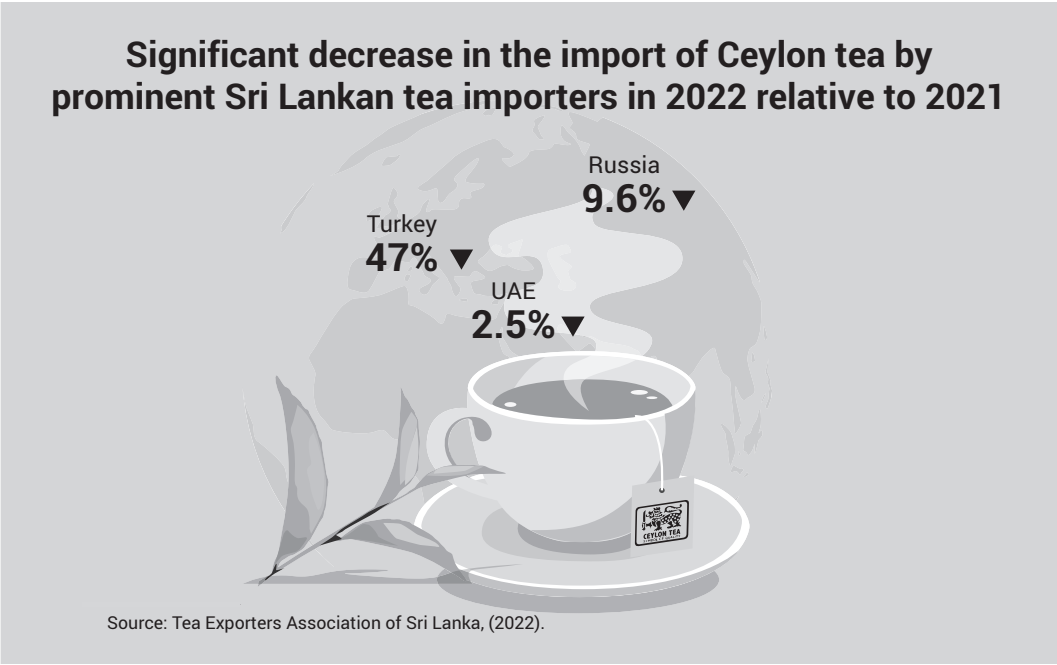
a. Wijesinghe, Asanka., & Rathnayake, Nilupulee. (2023, May 11). *Overcoming Obstacles: The Economic Case for a Sri Lanka-Thailand* FTA. Retrieved July 20, 2023, from IPS: https://www.ips.lk/talkingeconomics/2023/05/11/overcoming-obstacles-the-economic-case-for-a-sri-lanka-thailand-fta/

b. Wijesinghe, Asanka., & Yogarajah, Chathurrdhika. (2022, January 20). *Bangladesh-Sri Lanka Preferential Trade Agreement: Gains and Policy Challenges.* Retrieved June 10, 2023, from IPS: https://www.ips.lk/talkingeconomics/2022/01/20/bangladesh-sri-lanka-preferential-trade-agreement-gains-and-policy-challenges/

Of related concern was the future of Sri Lanka's access to preferential tariff treatment under the EU Generalised System of Preferences (GSP+), up for renewal from January 2024 to December 2033. The new EU GSP+ has six new international conventions in addition to the existing 27 conventions. Sri Lanka was optimistic about securing it as it has already ratified the six new conventions despite concerns that the proposed Anti-Terrorism Act can threaten the renewal of the EU GSP+ facility. A withdrawal of preference can cause an estimated USD 627 Mn loss to Sri Lanka's exports to the EU as it increases the zero tariffs for Sri Lankan products up to the Most Favoured Nation (MFN) tariffs.[16] In July 2023, the EU suggested extending the current scheme for a further four years.

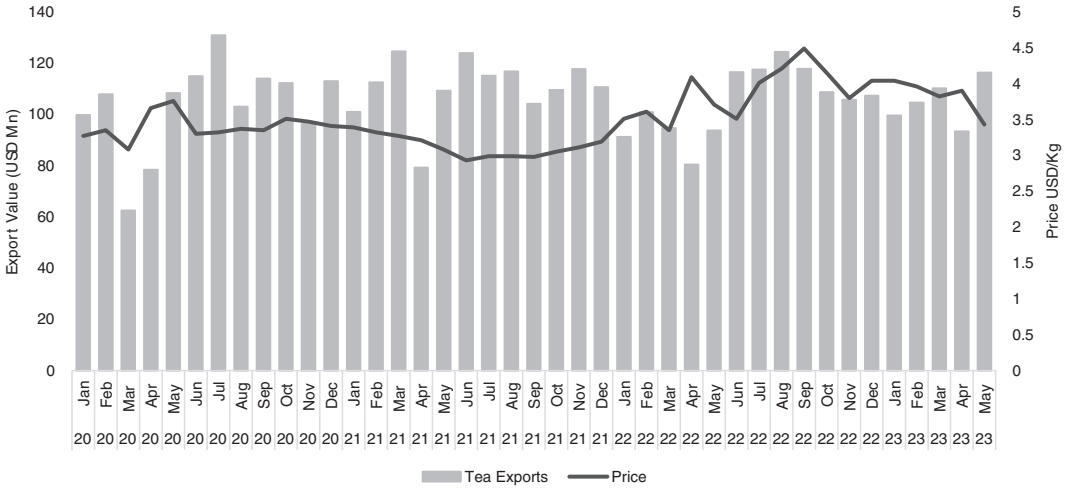
In contrast to industrial exports, inadequate fertiliser availability stemming from the hasty ban and subsequent reversal of chemical fertiliser usage had wide-ranging impacts on agricultural output. Despite an average price increase, tea exports in value dropped by 5.9% in contrast to 2021. Notably, both the value and volume indices for tea exports exhibited negative trends, decreasing by 5% and 12.1%, respectively, from 2021 to 2022. The reduction in tea volume can be attributed to a fertiliser scarcity arising from the agrochemical ban, which also explains the drop in tea exports in value for the year 2022. Additionally, the significant decrease in the import of Ceylon tea by prominent Sri Lankan tea importers in 2022 relative to 2021, including Russia (by 9.6%), the UAE (by 2.5%), and Turkey (by 47%), also underscores this trend. Tea prices per unit have not displayed significant fluctuations in 2023 (Figure 3.10). The trajectory of forthcoming tea prices will predominantly hinge on the unfolding supply dynamics in the upcoming months of the year. Amidst a hopeful perspective on prices, the industry grapples with persistent wage hikes, limited mechanisation, and notably, a sharp surge in financial costs. These factors collectively impede competitiveness due to elevated average production expenses compared to other major producer and exporter nations.

16 Wijesinghe, Asanka., & Munasinghe, Eleesha. (2021, September 28). *GSP+ Withdrawal: How Would It Impact Sri Lanka's Economy?*. Retrieved June 10, 2023, from IPS: https://www.ips.lk/talkingeconomics/2021/09/28/gsp-withdrawal-how-would-it-impact-sri-lankas-economy/



On the other hand, minor agricultural exports such as areca nuts and sesame seeds showed a significant increase in 2022. The Department of Export Agriculture carried out campaigns in places like Anuradhapura, Polonnaruwa, Ampara, Vavuniya, and Jaffna to boost export agriculture in minor export crops, including areca nut in 2022. The FTA between India and Sri Lanka was also a key influencer in boosting the export of areca nuts. India, the main destination for these exports from Sri Lanka, accounted for the bulk 98% of the total.

Figure 3.10
Tea Exports Values and Monthly Auction Prices



Source: Compiled with data from Central Bank of Sri Lanka and Tea Exporters Association of Sri Lanka.

As the lagged effects of fertiliser shortages ease, agricultural exports, including tea, experienced an improvement in the first quarter of 2023. However, as of June 2023, earnings declined again compared to June 2022, driven by a decline in earnings from tea, spices (primarily cinnamon and cloves), and seafood (primarily processed fish) due to the lower volumes despite higher export prices. More worryingly, earnings from industrial exports have also decreased compared to the same period in 2022. As previously mentioned, the decline has been partly caused by reduced orders in the T&G sector.

India regained its position as the largest source of imports in 2022 after attaining the same in 2018, accounting for 25.9% of total imports. This is partly due to utilising credit lines provided by India to support essential imports.

The expenditure on imports decreased by 11.4% in 2022 compared to 2021. However, import expenditure remained more or less stable at 23.7% in 2022 as a percentage of GDP. Import compression via restrictions, higher taxes and foreign exchange controls account for the decline. Notwithstanding these curbs, rising global prices of major commodities, particularly petroleum oil, led to higher spending on intermediate goods, which accounted for 68% of total imports in 2022. Expenditure on fuel imports grew by 30% and non-fuel intermediate goods declined by 12% in 2022.

Import expenditure on consumer goods, which represented 15.4% of total imports, started to rise in the latter part of 2022 due to the relaxation of certain import restrictions. Of particular note is that despite a 3.5% decrease in import expenditure on food and beverages in 2022, expenditure on rice imports grew by about 300%, mainly due to domestic market shortages brought about by fertiliser scarcity. Imports of non-food consumer goods declined by 44.8% in 2022 due to the import restrictions. Import expenditure on investment goods saw a 32.1% drop, reaching its lowest level since 2010, mirroring foreign exchange shortages and the contraction in economic activities.

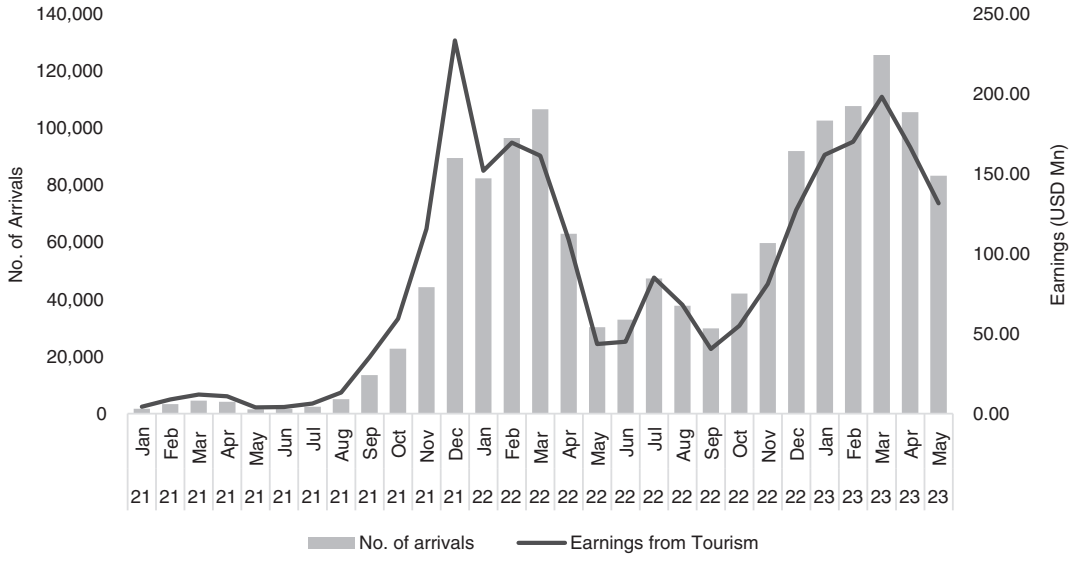
India regained its position as the largest source of imports in 2022 after attaining the same in 2018, accounting for 25.9% of total imports. This is partly due to utilising credit lines provided by India to support essential imports. The other major source of imports continued to be China, accounting for 18% of total imports in 2022.

Available data indicate that the decline in import expenditures is continuing into 2023. As of the first quarter, expenditure on fuel imports shrank by 28.5%. The forecast that international oil price rises are likely to remain muted in 2023 will also assist Sri Lanka in managing its BOP pressures. As the country begins to ease import curbs and foreign exchange restrictions, pent-up demand for imports will become more evident amidst signs of a slowdown in export earnings. As such, moderation in oil prices will help contain Sri Lanka's overall trade deficit without necessarily resorting to import restrictions that have unintended consequences on the efficiency and productivity of the economy at large. More importantly, though, Sri Lanka has to revive its foreign exchange earnings from other crucial sources, tourism and worker remittances being the ones to show immediate gains.

3.4.2 Tourism

Despite various challenges, the tourism industry in Sri Lanka experienced a steady recovery in 2022, with increased tourist arrivals and earnings from tourism. This was despite a faltering start as the breakout of the Russian invasion of Ukraine in February 2022, which dealt a severe blow to Sri Lanka's tourism recovery post-pandemic. The bulk of its early visitors were drawn from Russia and the number of arrivals from the Russian Federation saw a steep decline from 13,478 in January to 1,426 by August 2022, adversely impacting earnings. Further, the shortages of essentials resulting from the economic crisis, outbreaks of violence due to political instability, and associated social unrest, led to heightened travel advisories across various countries worldwide, rendering Sri Lanka a challenging destination. Consequently, the decline in tourist arrivals persisted from February 2022 onwards until the fourth quarter of the same year (Figure 3.11). By year end, the tourism sector performed better than expected, totalling 719,978 arrivals, albeit much lower than the pre-pandemic peak of 2.3 Mn tourist arrivals in 2018. In a positive trajectory, the year 2023 witnessed a noteworthy surge in monthly tourist arrivals compared to the previous year, thus signalling a recovery trend. However, from March to May 2023, the decrease in arrivals can be attributed to the off-peak season in Sri Lanka (Figure 3.11). As the mid-peak season starts in the third quarter of 2023, tourist numbers are anticipated to increase steadily.

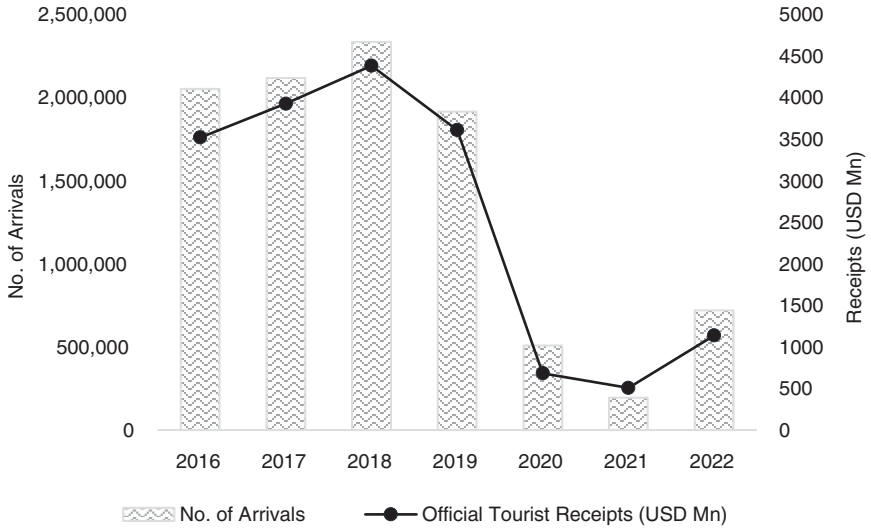
Figure 3.11
Monthly Tourists Arrivals and Earnings



Source: Compiled with data from Sri Lanka Tourism Development Authority, Annual Statistical Report (Various) and Central Bank of Sri Lanka, External Sector Performance data.

Europe accounted for 60% of the total tourist arrivals in 2022 (Figure 3.13). India, however, was the leading single country source, accounting for about 17% of total arrivals, followed by Russia, the UK, Germany, and France. Earnings from tourism in 2022 amounted to USD 1,136 Mn, recording an impressive annual growth of 124.2%, yet far below the USD 4.4 Bn level achieved in 2018 (Figure 3.12).

Figure 3.12
Tourists Arrivals and Official Tourist Receipts

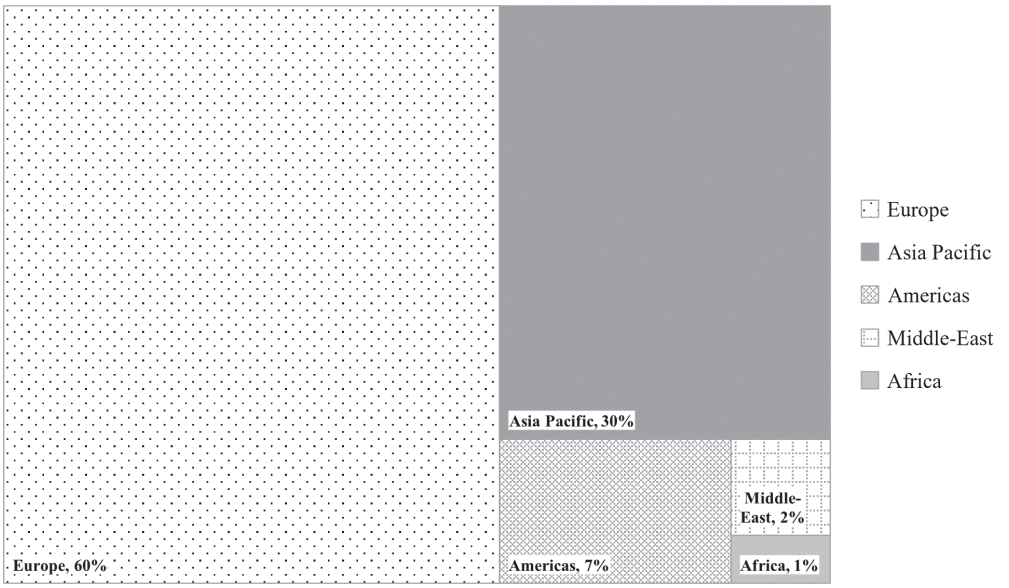


Source: Compiled with data from Sri Lanka Tourism Development Authority, Annual Statistical Report (Various) and Central Bank of Sri Lanka, External Sector Performance data.

The United Nations World Tourism Organization (UNWTO) anticipates that the number of international tourists in 2023 may range from 80% to 95% of pre-pandemic levels.[17] According to the same source, the latest UNWTO Confidence Index reveals increased cautious optimism among travellers worldwide as of March 2023. One of the key reasons for the optimism is the delayed removal of COVID-19 travel restrictions in China – the country with the highest outbound tourism expenditure. However, tourists may adopt a more prudent approach, influenced by the economic slowdown, opting for reduced spending, shorter vacations, and a preference for destinations closer to their homes.

17 The United Nations World Tourism Organization. (2023, January). *News Release Jan 2023*. Madrid: The United Nations World Tourism Organization.

Figure 3.13
Regional Composition of Tourist Arrivals in 2022



Source: Compiled from Annual Statistical Report 2022, Sri Lanka Tourism Development Authority.

In the case of Sri Lanka, as of March 2023, a notable improvement was evident in arrivals numbers hitting 125,495 – a 17.8% rise from March 2022 and a 54% reach from the pre-pandemic level in 2018. However, still, many challenges remain. On the supply side, investment in the tourism sector has seen delays and down-scaling of projects amidst challenging economic conditions, resulting in a 48.8% decline in the investment value of projects received in 2022, compared to 2021.[18] Additionally, hikes in electricity tariffs, taxes and levies for businesses in the tourism sector, a lack of skilled staff in hotels due to high labour migration, reduced arrivals from the Commonwealth of Independent States (CIS) region due to the Russia-Ukraine war, and continued adverse travel advisories, amongst others, pose challenges. Overcoming these challenges entails a combined effort of multiple stakeholders – from the government and private sector tourism and other industries – as Sri Lanka rebuilds its brand identity as a safe and preferred destination.

3.4.3 Remittances

Workers' remittances are critical in Sri Lanka's foreign currency earnings and help to bridge and protect against a persistently large trade deficit. Workers' remittances have shielded approximately 80% of this annual trade deficit for the past two decades.

In 2022, workers' remittances amounted to USD 3,790 Mn, a decline of 31% against the previous year. Unrealistic conversion rates for foreign currency imposed by the Central Bank of Sri Lanka

18 Sri Lanka Tourism Development Authority. (2022). *Year in Review.* Colombo: Sri Lanka Tourism Development Authority.

(CBSL) and various mandatory conversion schemes on foreign exchange earnings that spurred confusion amongst Sri Lanka's migrant worker community were the key reasons for this contraction in official figures. To bypass officially mandated conversion rates, many migrants reportedly adopted unofficial channels to transfer necessary funds to their families at home.

Large-scale migration of workers, including white-collar employees permanently with long-term economic repercussions due to brain drain, needs urgent policy attention.

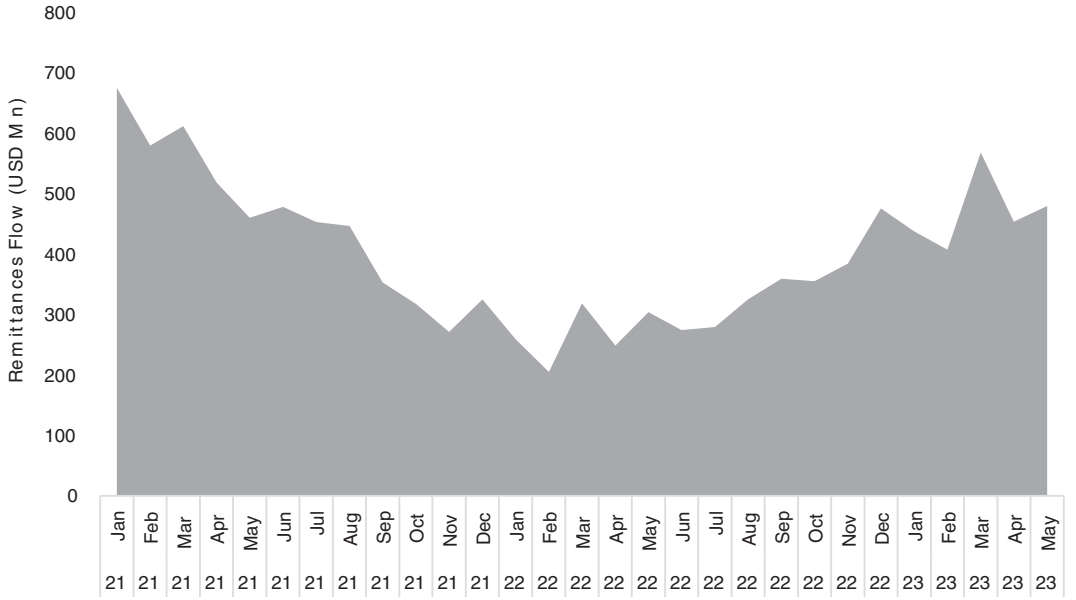
With many of these policies being gradually phased out or abandoned (as in the case of a fixed exchange rate), inward remittances began to pick up slowly in the second half of 2022 (Figure 3.14). Efforts by the CBSL to encourage migrant workers to use official channels and promotion of digitalisation have been an important part of this exercise. At the same time, though, Sri Lanka began to see departures in large numbers, most in search of better paid jobs overseas as a direct outcome of economic distress. The Sri Lanka Bureau of Foreign Employment (SLBFE) captures only those migrant workers who register with the SLBFE and thus misses records on many others who find jobs independently. The number of departures increased significantly in 2022 –311,056 workers against a pre-pandemic average of approximately 200,000 departures annually. The combined impacts of these developments saw remittances increase noticeably in the fourth quarter of 2022 (Figures 3.14 and 3.15).

Sri Lanka has historically relied on the Middle Eastern region as host destinations. While the importance of this region remains intact (accounting for 51.1% of total remittances in 2022), alternative destinations offering employment for a wide range of job categories with high wage potential in countries such as South Korea, Singapore, Japan, and many European countries have also emerged. In the first half of 2023, workers' remittances had grown to USD 2.8 Bn, albeit below the USD 3.6 Bn reached pre-pandemic in the first half of 2018.[19] But, Sri Lanka's quest for higher worker remittances must be finely balanced given growing concerns about the large exodus of its workers. By June 2023, 146,437 workers had departed for foreign employment.[20] This large-scale migration of workers, including white-collar employees permanently with long-term economic repercussions due to brain drain, needs urgent policy attention.

19 Central Bank of Sri Lanka. (2023, March). *External Sector Performance: Press Release.* Colombo: Central Bank of Sri Lanka, various issues.

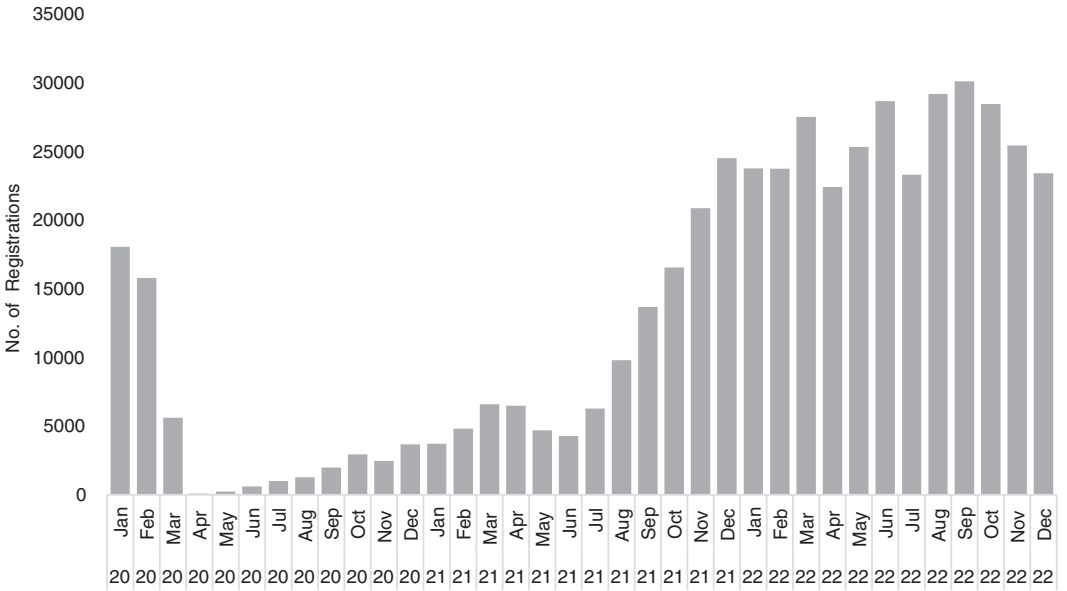
20 *Ibid*

Figure 3.14
Monthly Remittances Flow



Source: Compiled based on External Sector Performance data, Central Bank of Sri Lanka.

Figure 3.15
Monthly Number of Migrant Registrations in Sri Lanka Bureau of Foreign Employment



Source: Compiled based on External Sector Performance data, Central Bank of Sri Lanka.

3.4.4 Foreign Direct Investment

Sri Lanka's economic crisis – and the country's sovereign default status – can reshape the perception of it as a not particularly attractive destination for foreign investors. Aside from the economic meltdown, public protests, strikes and violence would also have kept investors away from Sri Lanka. In a highly competitive global environment for FDI, political and policy stability accompanied by a sound macroeconomic setting is the key priority for investors with a wide array of countries to choose from. A country's business and regulatory environment to facilitate private investments is integral to this landscape.

Post-war Sri Lanka saw its FDI inflows peak in 2018, attracting a total volume of USD 1.6 Bn. In 2022, this had dropped to USD 898 Mn, albeit from even lower volumes (USD 434 Mn in 2020) recorded at the height of the pandemic (Figure 3.16). Of total FDI inflows to Board of Investment (BOI) registered companies, 53.5% were invested in infrastructure projects in 2022, while manufacturing and services sectors accounted for 33.8% and 12.5%, respectively.[21] India was the largest source of FDI in 2022 which amounted to USD 238 Mn (Figure 3.17). The main investments from India were in petroleum retail, tourism and hotels, manufacturing, real estate, telecommunications, and banking and financial services.

Faced as it is with years of modest growth ahead, Sri Lanka will have to go the extra mile to not only retain existing investors but harder still, to attract fresh investments in the current inhospitable investment climate.

The BOI aims to attract USD 2 Bn in FDI in 2023.[22] The tourism sector remains a key target. Other targeted sectors are IT and investments in large projects such as the West Container Terminal in the Colombo Port, the Colombo Port City and the Hambantota Port project. Some of these investments have been controversial. It is argued that in some quarters, FDI fragmentation occurs owing to rising geopolitical tensions as bilateral FDI becomes increasingly concentrated among countries with similar geopolitical views.[23]

Faced as it is with years of modest growth ahead, Sri Lanka will have to go the extra mile to not only retain existing investors but harder still, to attract fresh investments in the current inhospitable investment climate. In this backdrop, an incentive package is being considered as a possible policy intervention. The BOI finds tax incentives to be an essential component of this, as in most peer countries to attract FDI and develop key industries. However, getting the right mix of policies is crucial for its effectiveness. Given the continuing economic crisis, competing with peer countries with an attractive incentive package remains a real challenge in 2023.

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21 Central Bank of Sri Lanka. (2022). *Annual Report 2022.* Colombo: Central Bank of Sri Lanka.

22 Board of Investment. (2022). *FDI into Sri Lanka Stay Robust amid Challenges.* Retrieved June 10, 2023, from BOI Sri Lanka: https://investsrilanka.com/2022/12/02/fdis-into-sri-lanka-stay-robust-amid-challenges/

23 Ahn, J., Habib, A., Malacrino, D., & Presbitero, A. (2023, April 5). *Fragmenting Foreign Direct Investment Hits Emerging Economies Hardest.* Retrieved July 20, 2023, from IMF Blog: https://www.imf.org/en/Blogs/Articles/2023/04/05/fragmenting-foreign-direct-investment-hits-emerging-economies-hardest

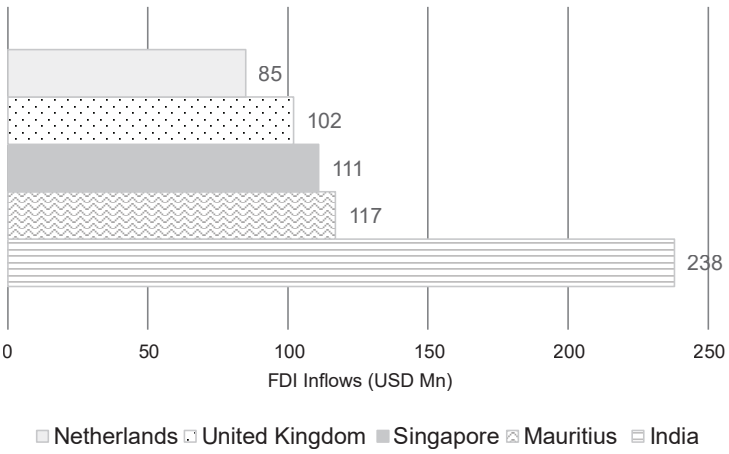
Figure 3.16
Yearly FDI Inflows



	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
FDI Inflows	477	955	941	932	893	679	898	1373	1614	743	434	592	898

Source: Author's compilation based on External Sector Performance data, Central Bank of Sri Lanka.

Figure 3.17
Top Five Country Sources for FDI in 2022



Source: Central Bank of Sri Lanka. (2022). *Annual Report 2022.* Colombo: Central Bank of Sri Lanka.

3.5 Conclusion

The global economy is currently grappling with a high degree of uncertainty brought on by aftershocks of the COVID-19 pandemic and geopolitical tensions, such as Russia's invasion of Ukraine. As a result, hikes in inflation rates across many economies and tight monetary policy responses have led to a marked reduction in growth projections. Making trade-offs in controlling inflation while preserving financial stability and maintaining economic growth has been arduous for governments. The adverse impacts on global economic conditions are further compounded by climate-related disasters, food insecurity, and rising levels of poverty and inequality, particularly in low-income countries.

Sri Lanka's economy has been susceptible to policy missteps that exposed it heavily to external global economic shocks. Building the economy's resilience against external pressures must necessarily be a crucial part of the adjustment and recovery process. While export earnings, remittances, and tourist earnings are recovering gradually, Sri Lanka needs to implement concrete policy measures to diversify its export basket and connect to GVCs. Attracting the right kind of FDI to make this a reality is a key part of the solution.

Several initiatives have been undertaken to resume bilateral trade negotiations and pursue fresh regional trade agreements too. One of the main objectives of these initiatives is to diversify the export portfolio and strengthen connections to GVCs by establishing stronger trade relationships with neighbouring giants and peers. To achieve this goal, negotiations are ongoing on various stalled trade agreements with India, China and Thailand, amongst others, while expressing interest in joining the RCEP trade bloc. However, notably, Sri Lanka can no longer approach efforts to expand and diversify exports in a piecemeal fashion. High energy costs, labour shortages, and scaling back on infrastructure spending, amongst others, impact the operating environment for businesses. Sri Lanka’s longstanding structural bottlenecks must be overcome by implementing the necessary reforms to raise productivity for sustained growth if the country is to regain lost confidence in its economic prospects.

ECONOMIC POLICY CHOICES: FROM STABILISATION TO GROWTH

4. Finding the Narrow Corridor: Reforms for Export-led Growth

4.1 Introduction

Amidst a deep economic crisis, there is a widespread demand for economic reforms in Sri Lanka to advance fiscal consolidation, enhance productivity, and promote export-led economic growth. Following the country's second round of liberalisation efforts in the 1990s, there has been a persistent call for another round of reforms in the policy sphere. Indeed, in the aftermath of the post-2019 economic crisis, the calls for a comprehensive overhaul of economic policies have been given a fresh momentum.

Sri Lanka's past two episodes of economic reforms, occurring in 1978 and 1990, were preceded by economic and political crises. The reforms in 1978 were prompted by an inward-focused policy framework, which resulted in pervasive scarcities, the proliferation of state-led economic activities, a grave balance of payments (BOP) predicament, an extensively regulated trade system, and the deprivation of the industrial sector from essential raw materials. Similarly, the reforms in the 1990s were implemented against a backdrop of challenging macroeconomic and political circumstances.

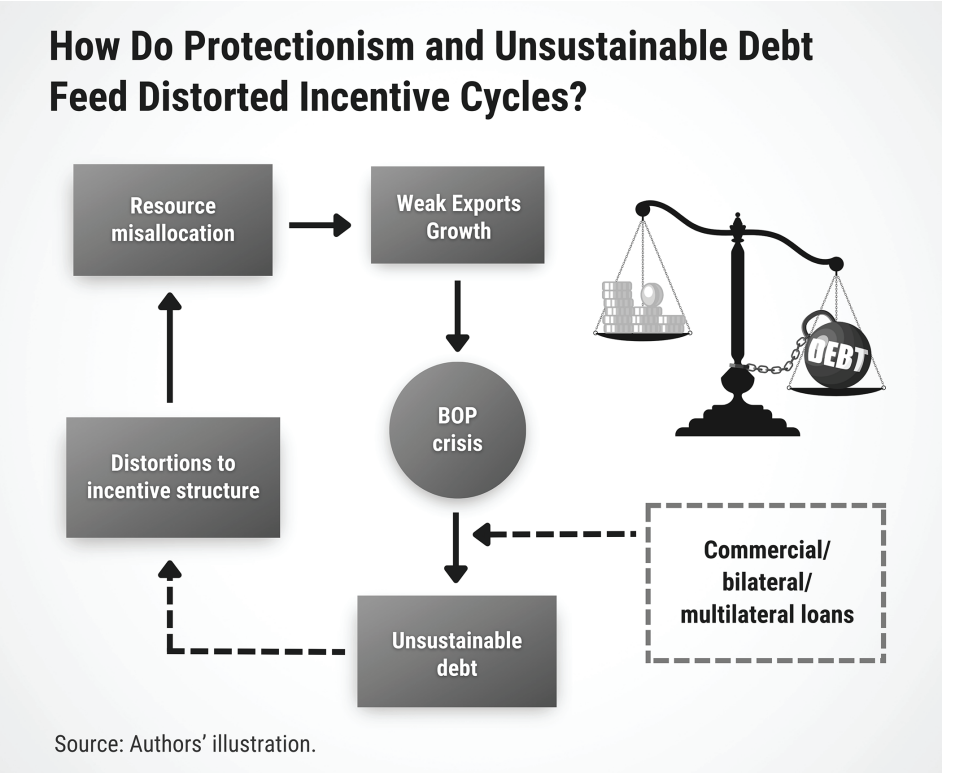
Among the various reforms on the agenda, trade policy reforms present one of the most formidable challenges owing to their high distributional and adjustment costs.

The current push for reforms amidst another ongoing crisis is complicated by various factors, including a default on external debt obligations, a unique political circumstance, and targets to be met under an Extended Fund Facility (EFF) programme with the International Monetary Fund (IMF). With the debt default, Sri Lanka's access to domestic and foreign finances will be significantly constrained for several years. Together with the EFF conditionality, which requires Sri Lanka to achieve a primary surplus, it further limits the government's fiscal space. This challenging macroeconomic landscape has critical implications for implementing reforms, as the government's ability to finance complementary spending programmes alongside the reforms is now limited. Sri Lanka utilised such complementary spending programmes to mitigate the adjustment and distributional costs associated with market economic reforms during the 1980s and 1990s. Among the various reforms on the agenda, trade policy reforms present one of the most formidable challenges owing to their high distributional and adjustment costs.

4.2 Rationale for Trade Policy Reforms

Consumer gains from free trade are often subtle, but the adverse impact on producers and domestic workers is prominent. Usually, consumer gains are dispersed, but the losses to producers are concentrated, making the latter more visible and politically costly. Direct adverse effects like individual wage and employment losses, community-level effects of mass layoffs and deindustrialisation generate political backlashes and undermine the sustainability of trade reforms.

Despite the challenges in pushing through trade reforms, Sri Lanka's growth potential relies on the ability to produce goods or services competitively for the export market. The country's post-war construction-led economic boom disproportionately expanded the non-tradable sector of the economy, contributing to an unsustainable external debt crisis. Reviving the export content of the economy again to a satisfactory level requires trade reforms that remove existing distortions affecting the incentive structure. As such, Sri Lanka needs to implement timely and sound reforms for sustainable export growth and break the vicious cycle of BOP crises and unsustainable expansion of external debt (see infographic).



Source: Authors' illustration.

The political economy implications of trade policy incur distortions to the incentive structure, causing resource misallocations and hampering export growth, ultimately aggravating the external debt crisis. Industries protected from global competition would only produce for domestic consumers and enjoy the rent at the expense of consumer welfare without pursuing innovations for product enhancement

and cost-cutting. These protected industries would not achieve scale economies. Moreover, the political economy of the distributional costs of exposing domestic industries and producers to global competition is an unescapable political challenge.

Advocates across the political spectrum recognise the importance of boosting exports as a common objective but differ in their approaches in achieving it. Whether Sri Lanka should adopt an industrial policy or rely on a trade policy that allows market forces to determine production based on comparative advantage is highly significant, particularly given that Sri Lanka is at crossroads. Moreover, each approach has its pros and cons. Therefore, it is crucial to thoroughly evaluate the costs and benefits, drawing on empirical evidence, to select an effective policy package that sets Sri Lanka on a sustainable export-led growth path.

A pitfall that needs to be avoided in finding the optimum level of trade policy for Sri Lanka is falling into ideological entrenchments. Rejecting the market economic framework adopted in the late 1970s trade liberalisation process as having attributed to Sri Lanka's current crisis and embracing unbridled economic liberalism, ignoring its adjustment and distributional costs, are avoidable extremes. Both approaches ignore existing evidence, political constraints, and socio-economic ramifications undermining the political feasibility and sustainability of reforms.

Against this backdrop, this chapter raises three vital questions intending to find the narrow corridor of the optimum set of trade policies for Sri Lanka. The first question is 'what went wrong with Sri Lanka's trade policy?'. Answering this question, the chapter intends to diagnose the existing weaknesses of trade policy that caused slow export growth (in both goods and services), an unsatisfactory rate of product innovations, and weak integration into manufacturing value chains. The second question is 'what needs to be done to increase exports, innovation into more products, and integration into manufacturing value chains?'. The third question is about how reforms should be implemented.

4.3 Sri Lanka Slow Export Growth and Weak GVC Integration: A Diagnosis

Sri Lanka's export sector has been experiencing slow growth, reduced openness, limited integration into global value chains (GVCs), insufficient innovation in new products, and a stagnant export basket complexity. After the 1990s, Sri Lanka lost its momentum in export growth. The structural transformation is biased towards the service sector, while the industrial sector growth remains inhibited.

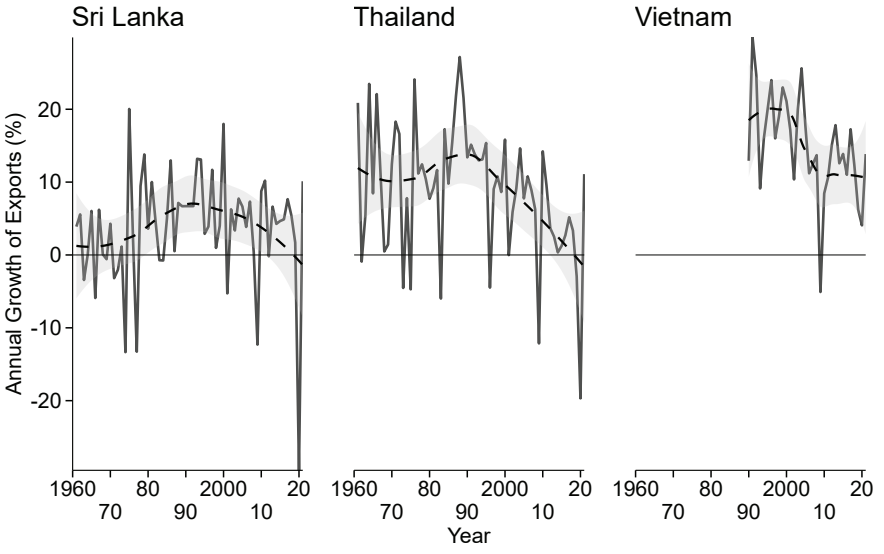
The annual export growth rates for Sri Lanka, Thailand, and Vietnam showcase a general trend of declining growth for all three countries (Figure 4.1). However, being a more complex economy, Thailand achieved high export growth of over 10% until the year 2000 before gradually slowing down. Thailand expanded its export base to include electronic equipment production and ventured into new product lines. Over time, the rate of innovation in new products may have declined, making expansion at the intensive margin the only possibility, potentially limiting Thailand's export growth in the post-2000 period. Similarly, Vietnam has maintained a robust export growth rate since the

1990s (Figure 4.2). It is worth noting that the data presented in Figure 4.1 encompass both goods and services exports, and the decline in growth after 2019 can be attributed to the impact of the coronavirus (COVID-19) pandemic.

The above broad trends also apply to Sri Lanka's export growth, albeit with some distinctions. With only a few exceptional years, Sri Lanka generally exhibited a slower export growth rate than Thailand and Vietnam. Additionally, the level of innovation in new products was unsatisfactory. Consequently, the export sector remained weak and experienced a continuous decline in its contribution to gross domestic product (GDP). The growth of imports also declined, as illustrated in Figure 4.3.

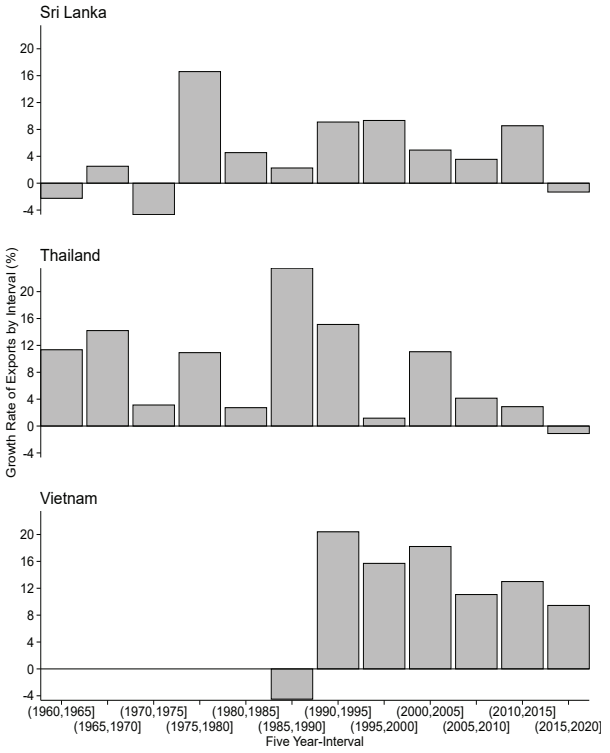
The sizeable decline in the share of exports of goods and services to GDP from 39% in 2000 to 21.8% in 2019 attests to the diminishing contribution of the export sector. Arguably, the export share plunged as GDP grew faster in the immediate aftermath of the end of the war in 2009. However, this period coincided with a simultaneous increase in external debt, resulting in a detrimental combination of high external debt and a weakened export sector. Foreign exchange earnings experienced a temporary period of growth between 2010 and 2015, primarily driven by a flourishing tourism industry in the aftermath of the war. Yet, the period from 2015 to 2020 saw a collapse in growth.

Figure 4.1
Average Annual Growth of Exports of Sri Lanka, Thailand, and Vietnam, 1960-2021



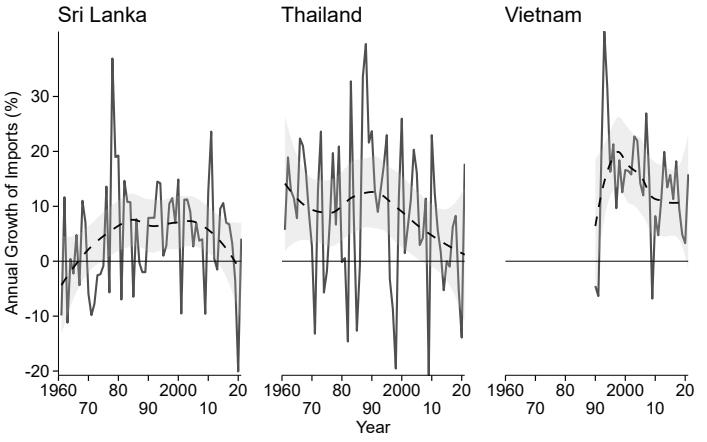
Source: Authors' illustrations using WDI data.

Figure 4.2
Growth in Exports of Goods and Services in Five-Year Intervals



Source: Authors' illustrations using WDI data.

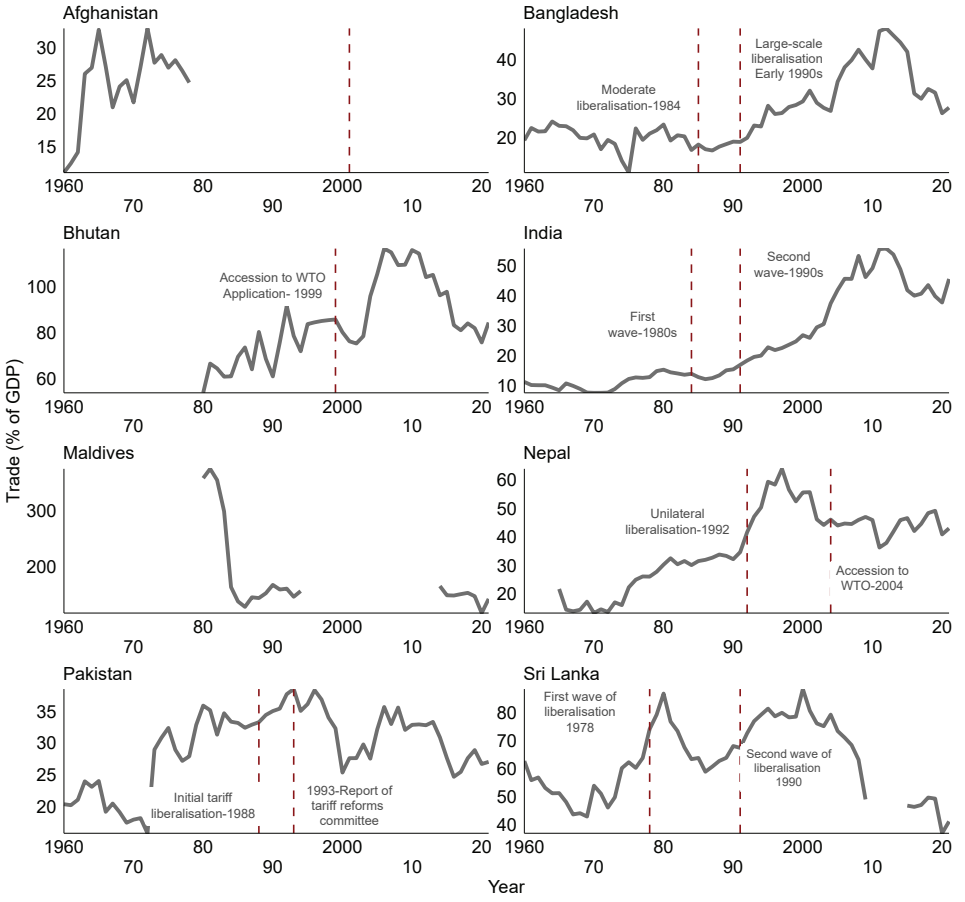
Figure 4.3
Average Annual Growth of Imports of Sri Lanka, Thailand, and Vietnam, 1960-2021



Source: Authors' illustrations using WDI data.

The percentage of trade in Sri Lanka's GDP plummeted, almost halving from 89% in 2000 to 49% in 2019,[1] indicating a decline in the openness of the economy. This decline can be attributed to the expansion of the non-tradable sector and the sluggish growth of exports and imports. Compared with other countries, it becomes evident that many of Sri Lanka's peer nations have surpassed its openness over time. Despite this, Sri Lanka maintains a higher level of openness among South Asian countries. Nevertheless, as mentioned above, the significant decline over the past 15 years has brought Sri Lanka's trade openness closer to that of India, which opened up its economy much later than Sri Lanka (Figure 4.4).

Figure 4.4
Trade Openness of South Asian Countries



Source: Authors' illustrations using WDI data.

1 Trade includes both exports and imports which is taken as a share of GDP to represent a country's openness.

A widely accepted option for a country like Sri Lanka with a low resource-endowment is to connect with a global manufacturing production sharing network. Overall, the share of domestic value-added generated from GVC activities through downstream firms in South Asian countries is low. However, the involvement in GVCs through backward linkages, which refers to the share of value-added from GVC activities through upstream firms, is comparable to those in other Asian and Oceania countries.

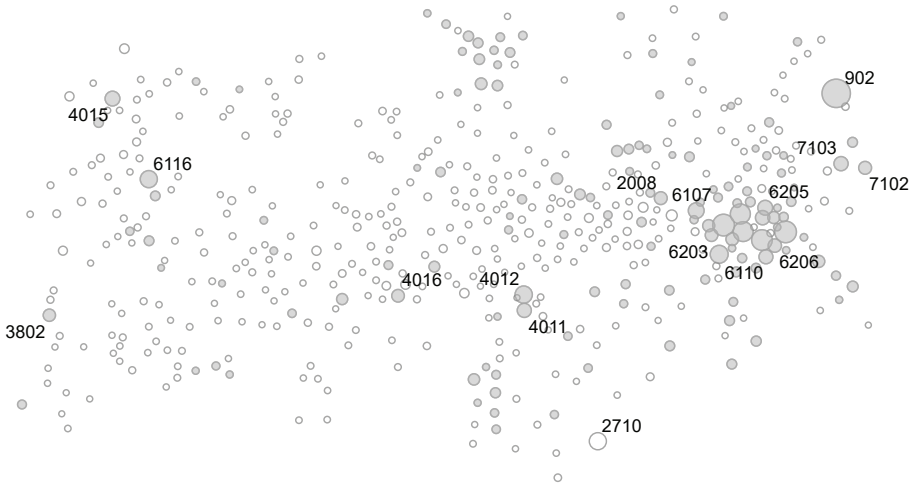
Even within the region, Sri Lanka faces a distinct problem as the contribution of value chain activities to the total value added has declined over time, while Bangladesh and India have improved their GVC-related activities.[2] This decline in GVC activities suggests that Sri Lanka relies more on domestic intermediates to produce finished goods. The challenge posed by the increase in domestic value addition is the resulting decline in economic efficiency and the impediment to leveraging comparative advantage through specialisation. The allocation of resources to sectors where Sri Lanka lacks a comparative advantage is inefficient and entails substantial economic costs. The necessity for expanded participation in GVCs is crucial for fostering product innovations, an aspect in which Sri Lanka significantly needs to catch up. A close look reveals the concentration of trade protection over domestic consumption-oriented consumer goods and agricultural production manufacturing. This explains the increased domestic content of the economy over time.

The visualisation of Sri Lanka's exports with a comparative advantage in the product space reveals a concentrated clustering of products. The primary cluster in the periphery of the product space consists of ready-made garments and agricultural products, notably tea, signifying Sri Lanka's competitive edge in low-tech manufacturing and tea production (Figure 4.5). In contrast, successful country examples of export-led growth, such as Vietnam, exhibit multiple clusters dispersed across the product space. One noteworthy cluster is the electronics and electronic equipment group (encompassing HS-84 and HS-85-chapter products)[3], as shown in Figure 4.6. The unevenness of the product space indicates that diversification tends to occur much more easily for densely populated countries situated in the centre, as these have numerous nearby opportunities for diversification. In contrast, countries located at the periphery face challenges in diversification, as the knowledge and expertise required for products at the periphery are less easily transferable to a wide range of new industries.

2 Wijesinghe, A., & Yogarajah, C. (2022). Trade Policy Impact on Global Value Chain Participation of the South Asian Countries. *Journal of Asian Economic Integration*, *4*(1), 24-48.

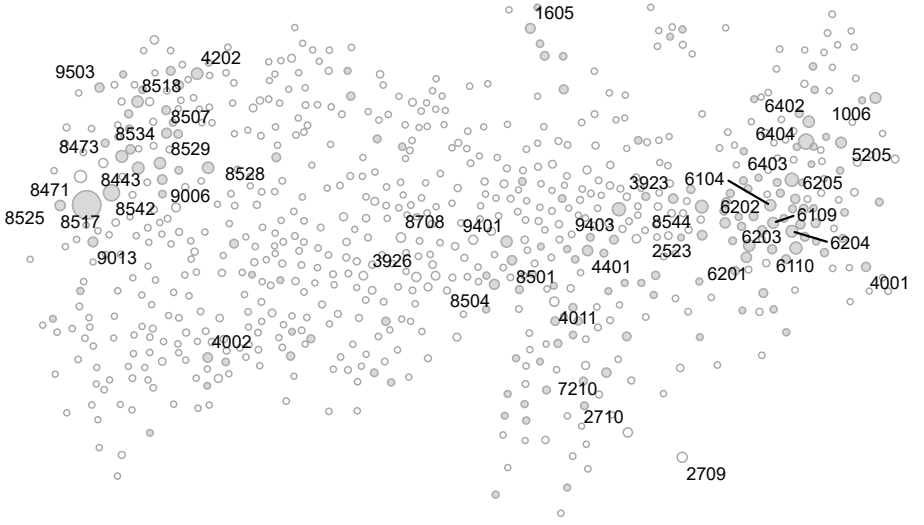
3 HS denotes Harmonised System, which is a standardised numerical method of classifying traded products.

Figure 4.5
Sri Lanka's Exports at HS-Four Digit Level on Product Space



Source: Authors' illustration using Harvard Atlas of Economic Complexity - The Growth Lab at Harvard University. (2019). *Product Space Networks - Harvard Dataverse*. Retrieved July 20, 2023, from Harvard Dataverse: https://doi.org/10.7910/DVN/FCDZBN, V1, UNF:6:TVterrG9HFnvjAYNEU8ppw== [fileUNF] and World Integrated Trade Solutions (WITS) data.

Figure 4.6
Vietnam's Exports at HS-Four Digit Level on Product Space



Source: Authors' illustration using Harvard Atlas of Economic Complexity and WITS data.

The lack of innovation in venturing into more complex new products has led to a stagnant export basket complexity for Sri Lanka. The importance of discovering new comparative advantages in relatively more complex products cannot be overstated for several reasons.[4] First, the currently exported products with a comparative advantage lie within the domain of low-tech manufacturing and face intense wage competition from developing countries. Second, diversifying into more complex product exports accelerates the country's export revenue growth, thereby alleviating pressure on its BOP position. Third, manufacturing complex products generates employment opportunities with higher wages, enabling competition with non-tradable sector salaries in Sri Lanka. One significant source of non-tradable sector employment is the public sector.

The data reveal that the transformation was from agriculture to services – i.e., a rapid decline of the agriculture sector in the economy was accompanied by a significant expansion of the services sector. In contrast, the industrial sector growth was substantially low. The quality, productivity, and wages of the services sector activities in Sri Lanka are also questionable.

While the liberalisation efforts have led to a strong export sector in specific domains, such as ready-made garments that capitalise on Sri Lanka's comparative advantage in assembly activities, the expansion of the industrial sector has been inadequate. A comparative analysis of data reveals that Sri Lanka experienced a transition from the agricultural sector to the services sector, indicating signs of 'premature deindustrialisation' (Figure 4.7). The data reveal that the transformation was from agriculture to services – i.e., a rapid decline of the agriculture sector in the economy was accompanied by a significant expansion of the services sector. In contrast, the industrial sector growth was substantially low. The quality, productivity, and wages of the services sector activities in Sri Lanka are also questionable.

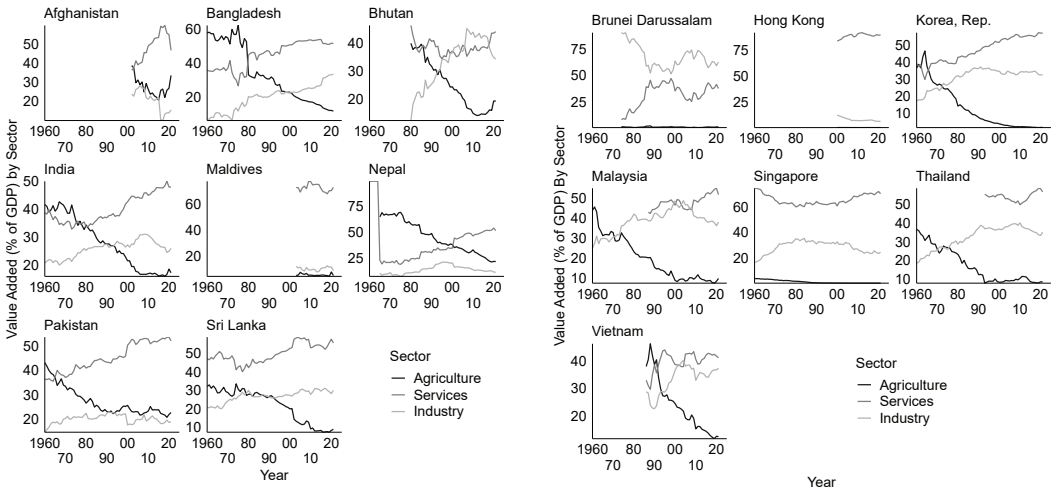
In 2020, 13.7% of employed persons were engaged in activities related to wholesale and retail trade and repair of vehicles.[5] Usually, these services activities depend on domestic demand, primarily within the non-tradable sector, and inherently offer limited potential for boosting productivity. Instead, manufacturing activities in the tradeable sector have a greater scope for increased productivity which drives the income growth of a country.

In this context, it is crucial to introduce policy changes that target a gradual transformation from agriculture to manufacturing and then to services. As the agricultural labour force is disproportionately high compared to the sector's contribution to value-added production of the country, the migration of such labour to industries – accompanied by productivity growth – will bring a quality structural transformation to the country.

4 Hidalgo, C. A., Klinger, B., Barabási, A. L., & Hausmann, R. (2007). The Product Space Conditions the Development of Nations. *Science*, *317*(5837), 482-487.

5 Department of Labour. (2022). *2020- Labour Statistics Sri Lanka*. Retrieved July 20, 2023, from Department of Labour: https://labourdept.gov.lk/images/PDF_upload/statistics/ls2020.pdf

Figure 4.7
Structural Transformation of South Asian Countries and East Asia



Source: Authors' illustration using WDI data.

It should be noted, however, that an industrial growth phase is not a necessity for structural transformation. The literature argues that structural transformation and growth are possible in developing countries even without industrialisation.[6] Nonetheless, for a few reasons, Sri Lanka might need to focus on expanding the manufacturing sector, particularly in tradeable sectors. First, the East Asian experience shows that an extended period of manufacturing growth facilitated structural transformation and economic growth. The counterarguments are mainly based on the highly productive and well-paid services sector jobs available in developed countries. Second, Sri Lanka's macroeconomic conditions necessitate a robust export sector. Certain services can indeed be exported. Services in finance, insurance, tourism, and a modern knowledge economy might even fetch higher prices than exporting manufactured products. However, the required investments in education and digital infrastructure might be challenging at Sri Lanka's current stage of development. In this setting, advancements in these areas will be gradual and slow.

Although outward migration for jobs can be a key source of remittance, such flows can be highly volatile. Economic shocks and foreign exchange shortages that prompt governments to peg their currencies in desperate attempts to limit depreciating pressure can deter inflows, as was the case in Sri Lanka. To spur growth in finance, insurance, tourism, and a modern knowledge economy also needs services sector liberalisation, but such attempts can face formidable challenges from vested groups. Additionally, Sri Lanka already has a large services sector – with a 58.1% share of GDP in 2019, even prior to the economic crisis and even ahead of South Korea at 57.2% of GDP. Thus, manufacturing growth is indispensable in structural transformation in the short and medium run.

6 Gollin, D. (2018). *Structural Transformation and Growth without Industrialisation*. Background Paper. Oxford: Pathways for Prosperity Commission.

The precise factors influencing Sri Lanka's sluggish export growth, stagnant product basket complexity, limited innovation in new product lines, inhibited industrial sector growth and inadequate integration into GVCs cannot be determined through empirical analysis alone. However, these underperformances can be attributed to a combination of structural impediments, policy barriers, and deficiencies in knowledge and capacity within the export sector. Research findings suggest the presence of distortions in the incentive structure, favouring domestic consumption-oriented production over exports. Empirical studies have also highlighted the negative impact of trade policy on participation in GVCs. Additionally, regional integration efforts have not yielded the desired outcomes, as regional trade agreements impose strict regulatory barriers that impede value chain activities.[7]

Although outward migration for jobs can be a key source of remittance, such flows can be highly volatile. Economic shocks and foreign exchange shortages that prompt governments to peg their currencies in desperate attempts to limit depreciating pressure can deter inflows, as was the case in Sri Lanka.

Foreign direct investment (FDI) inflows into non-traditional exports such as electronics and electrical equipment manufacturing remain sluggish in Sri Lanka. On the one hand, the main constraints for FDI inflows include coordination failures, limited access to land, uncertainty in trade and tax policies, and transportation challenges in certain regions of the country. On the other hand, constraints related to access to finance, education, healthcare, electricity, and labour regulations – particularly related to employment termination – macro-fiscal stability and institutional weaknesses in addressing corruption and crime are non-binding constraints for FDI inflows.[8] Among many trade and other auxiliary reforms required, removing biases in the incentive structure for resource-based and consumption-oriented production, which acts as a barrier to exports, is one of the more crucial.

4.3.1 Incentive Structure Biases: Effective Rates of Protection

An appropriate trade protection measure is the effective rate of protection (ERP). The ERP measures the level of protection provided to a sector's final output compared to the protection given to its inputs. A positive ERP indicates that the overall tariff structure protects the sector, while a negative ERP suggests that the tariff structure imposes net taxation on the sector. When the final product is protected but inputs are exempted from tariffs, the ERP exceeds the nominal protection (Box 4.1). The ERP estimates for 2015 by the Department of Census and Statistics (DCS) shed light on trade protection patterns that are currently in place.

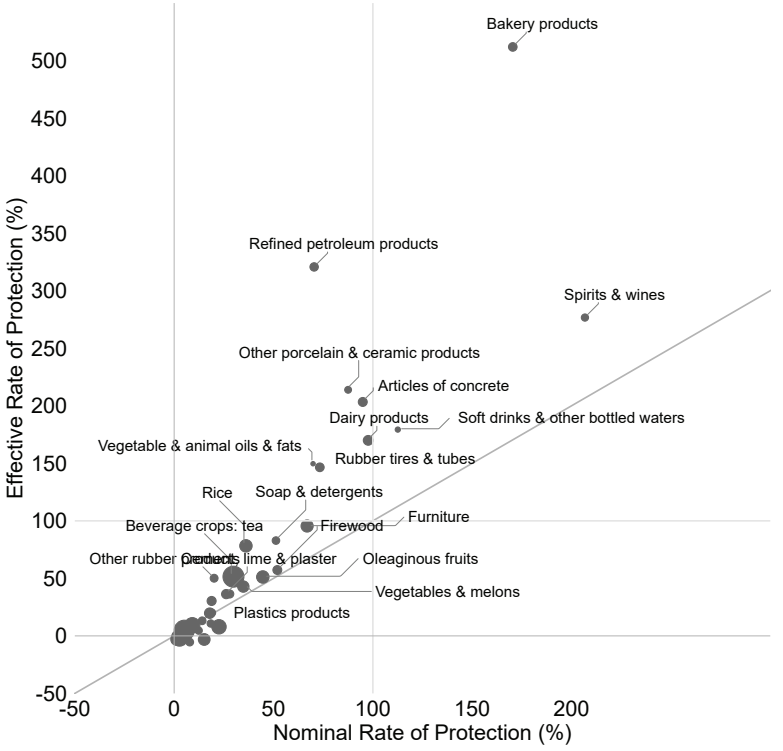
Sri Lanka's past waves of liberalisation in 1978 and 1990 led to a significant reduction in the ERP for import-competing manufacturing industries. The ERP for these industries decreased from 137%

7 Wijesinghe, A., & Yogarajah, C. (2022). Trade Policy Impact on Global Value Chain Participation of the South Asian Countries. *Journal of Asian Economic Integration*, *4*(1), 24-48.

8 Center for International Development. (2018). *Sri Lanka Growth Diagnostic Analysis*. Cambridge, MA: Harvard University.

in late 1978 to 56% by the early 2000s.[9] However, there has been a reversal in this trend, with Sri Lanka experiencing an increase in ERP, thereby negating the efforts to reduce the bias against exports (Figure 4.8).

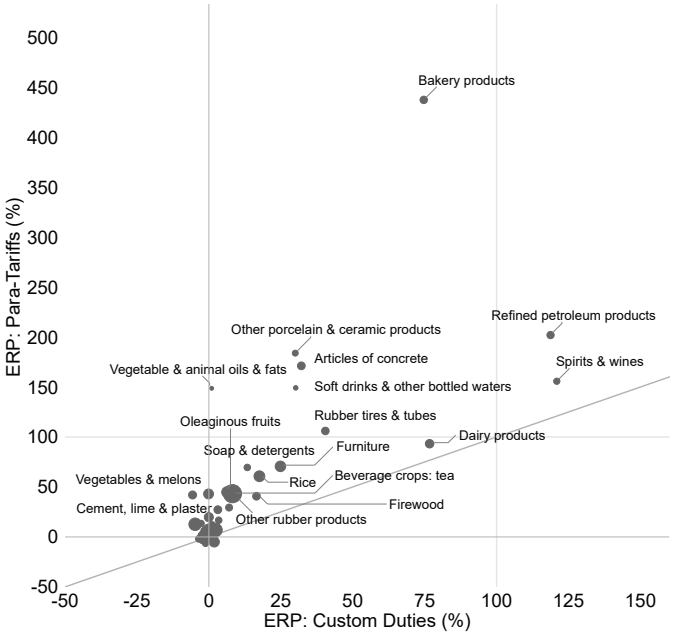
Figure 4.8
Effective Rate of Protection (ERP) and Nominal Rate of Protection for Sectors / Products



Source: Authors' illustration using DCS data.

9 Athukorala, P. C. (2017). *Manufacturing Exports from Sri Lanka: Opportunities, Achievements and Policy Options*. Colombo: Institute of Policy Studies of Sri Lanka.

Figure 4.9
Effective Rate of Protection from Custom Duties Vs. Para-Tariffs



Source: Authors' illustration using DCS data.

According to DCS data, the average ERP in 2015 was 63.2%. Apart from customs duties, various para-tariffs contribute significantly to the overall increase in ERP (Figure 4.9). Noticeably, domestic consumption-oriented products – bakery products, soap and detergents, confectioneries, dairy products, manufacturing of ceramics, and soft drinks – receive substantial protection, while certain agricultural products, pharmaceuticals, and raw materials used in export industries have a negative ERP. This negative ERP arises from the imposition of high tariffs or para-tariffs on intermediates, which offsets the protection provided by tariffs on the final product (Table 4.1).

Table 4.1
Selected Sectors/Products Receiving Negative Rate of Protection (ERP)

Sector/Product	ERP (All Tariffs)	ERP (Para-Tariffs)	ERP (Custom Duties)
Mining and quarrying	-1.73	-0.30	-1.43
Grain mill products	-3.11	-4.97	1.87
Rubber	-3.28	-2.58	-0.70
Tropical and subtropical fruits	-1.83	-1.73	-0.10
Livestock	-3.75	-3.64	-0.11
Spinning and weaving of textiles	-1.32	0.48	-1.80
Finishing of textiles	-7.74	-6.58	-1.16
Egg production	-2.70	-1.16	-1.54
Ships and floating structures	-21.81	-19.72	-2.09
Milk production	-8.31	-7.67	-0.65
Machinery for textile production	-4.03	-0.53	-3.50
Engines and turbines	-0.95	0.11	-1.06

Source: Compiled based on data from National Accounts, DCS. Retrieved July 20, 2023, from DCS: http://www.statistics.gov.lk/NationalAccounts/StaticalInformation/SNA_Accounts

Although rubber, milled grain products, livestock, and egg production face negative protection, rice cultivation enjoys an ERP of 78.27%. The main driver of this ERP is the presence of para-tariffs. Furthermore, various quantitative and import price controls implemented after the onset of the currency pressures have further distorted the incentive structure (Box 4.1). Non-tariff measures such as import control licenses, bans, credit-based requirements, and temporary suspensions have raised the ERP. By mid-2023, a policy preference was formed to exempt intermediates and restrict final consumption products, particularly in the food sector.

Box 4.1
Economic Crisis, Import Controls and Distortions to the Incentive Structure

The concept of ERP expresses protection on a sector's final output relative to the protection given to inputs. If the final product is protected and inputs are exempted from tariffs, the ERP exceeds nominal protection. A positive ERP suggests that the overall tariff structure provides protection to a sector, while a negative rate indicates that the tariff structure imposes net taxation on the sector.

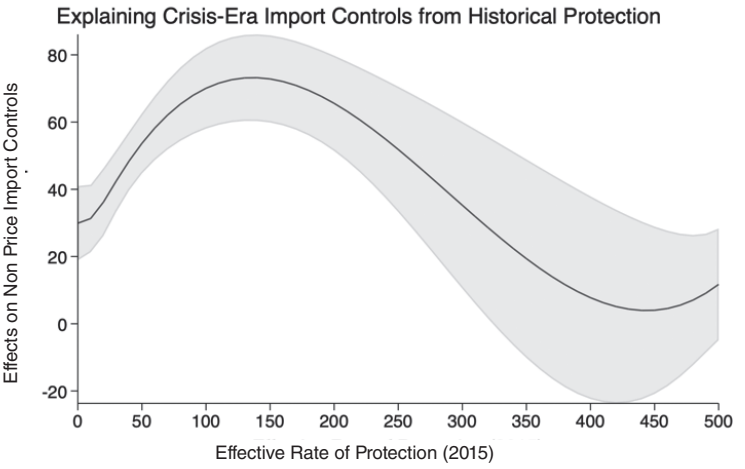
Amidst the economic crisis, Sri Lanka tightened import controls to manage its scarce foreign reserves. However, even before the economic crisis, the incentive structure was biased towards the domestic production of processed food, dairy products, bakery products, light manufacturing like porcelain, ceramic products and beverages. Import controls imposed with the onset of the economic crisis further increased the protection given to these industries as well as to agricultural production (Figure B.4.1).

ERP on Input-output Sectors in 2015

Product/Sector	ERP All Tariffs	Product/Sector	ERP All Tariffs
Processing and preserving of fruit and vegetables	523.79	Spirits & wines	276.67
Bakery products	511.87	Other porcelain and ceramic products	213.87
Macaroni, noodles, and similar farinaceous products	398.68	Articles of concrete, cement and plaster	203.32
Refined petroleum products	320.67	Soft drinks and other bottled waters	179.29
Refractory products	297.03	Dairy products	169.94

Source: Compiled with data from DCS, 2015.

Figure B.4.1 Relationship between Imports Controls in the Economic Crisis and Historical Protection



Source: Authors' estimates.

Implementing import controls during the post-COVID-19 economic crisis in Sri Lanka further distorted the incentive structure. Sectors such as cultivating oleaginous fruits, food manufacturing, communication equipment, electric wires and cables, steam and air conditioning supply, and dairy products were subjected to non-tariff import controls. Non-tariff import controls covered a significant proportion, ranging from 90-100% of the value of imports in each sector. It is crucial to note that conventional ERP calculations do not account for non-tariff barriers.[a] If the ad-valorem equivalent of non-tariff barriers was adequately incorporated, the ERP could be much higher, particularly in sectors where imports of final goods are heavily controlled. Additionally, it is noteworthy that raw material imports were less likely to be subjected to import controls compared to final goods for consumption.[b] Such a tariff structure amplifies the ERP for the production of final goods.

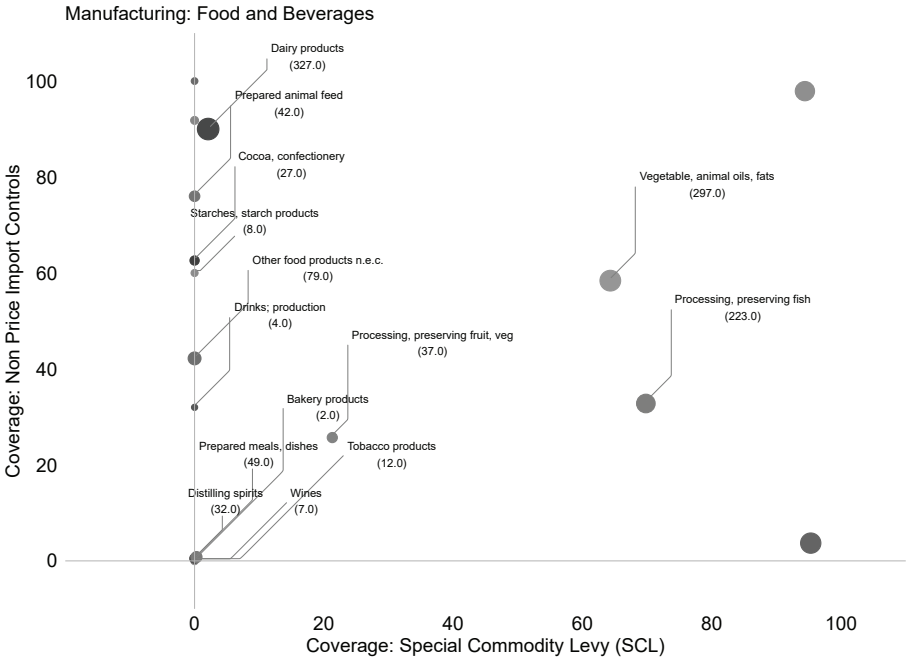
Source: Compiled by the authors from various sources.

a. Shepherd, B. (2020). *Effective Rates of Protection in a World with Non-Tariff Measures and Supply Chains: Evidence from ASEAN*. Jakarta: Economic Research Institute for ASEAN and East Asia.

b. Wijesinghe, A., Yogarajah, C., & Rathnayake, N. (2023). *Import Controls Sri Lanka: Political Preference and Incentive Distortions*. International Economic Series Working Paper No.15. Colombo: Institute of Policy Studies of Sri Lanka.

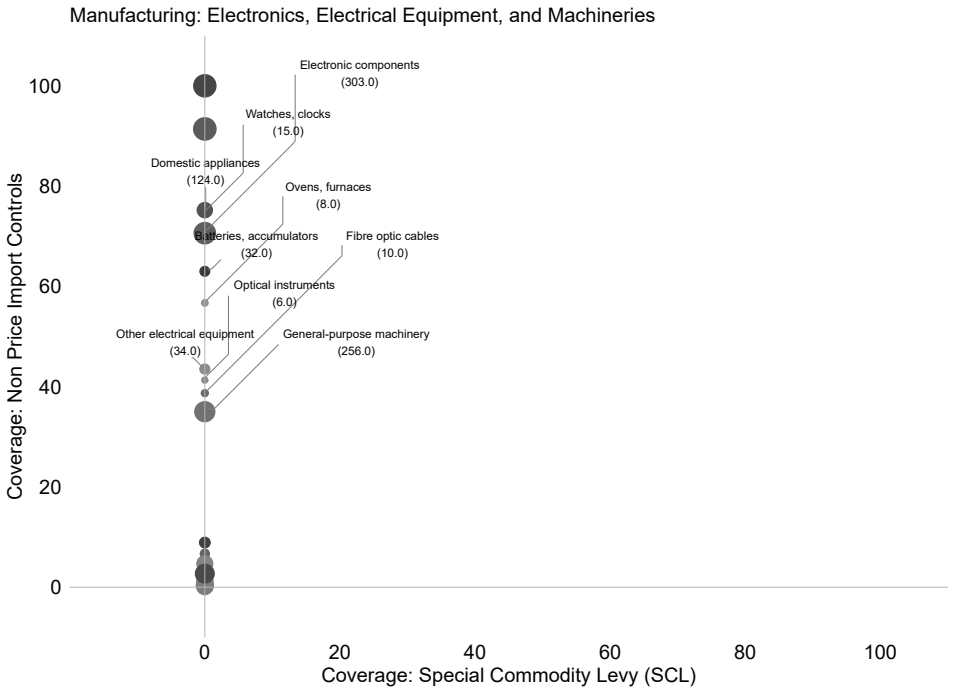
The drift towards higher protection incentivises import-competing industries. In Sri Lanka's case, it favoured certain products, including household electronics, wires, domestic appliances, consumer electronics, and dairy products (Figures 4.10 and 4.11). It is important to consider the increased impact of non-tariff measures when analysing the incentive structure during this period.

Figure 4.10
Coverage of Economic Crisis Era Import Controls on Food and Beverage Manufacturing Sector by Mid-2023



Source: Wijesinghe, A., Yogarajah, C., & Rathnayake, N. (2023). *Import Controls Sri Lanka: Political Preference and Incentive Distortions*. International Economic Series Working Paper No.15. Colombo: Institute of Policy Studies of Sri Lanka.

Figure 4.11
Coverage of Economic Crisis Era Import Controls on Electronics, Electrical Equipment, and Machineries Sector by Mid-2023



Source: Wijesinghe, A., Yogarajah, C., & Rathnayake, N. (2023). *Import Controls Sri Lanka: Political Preference and Incentive Distortions*. International Economic Series Working Paper No.15. Colombo: Institute of Policy Studies of Sri Lanka.

Altering the existing distorted incentive structure to create a 'neutral incentive structure' for exports and import substitution industries has been a widely identified policy reform for a long time in Sri Lanka.[10] However, implementing such a reform strategy can involve significant distributional and adjustment costs, thereby raising concerns about the political feasibility of such reforms. These issues will be discussed in detail in the rest of this chapter.

4.4 A Framework for Politically Feasible and Effective Trade Policy Reforms

The analysis as presented previously in this chapter suggests that Sri Lanka needs crucial reforms to adjust prevailing incentive structures to eliminate the bias against exports. Currently, industries involved in import substitution, such as consumer products, food processing, and rice cultivation, benefit from higher levels of ERP. Notably, policymakers utilise para-tariffs to elevate the ERP for these sectors. Higher customs duties are concentrated on sectors producing for domestic consumption – such as manufacturing of bakery products (including biscuits, cookies, and snacks); manufacturing of

10 Athukorala, P. C. (2017). *Manufacturing Exports from Sri Lanka: Opportunities, Achievements and Policy Options*. Colombo: Institute of Policy Studies of Sri Lanka.

soft drinks, macaroni, noodles, cocoa, chocolate, and confectioneries; manufacturing of plastic products and furniture; processing and preserving vegetables; and manufacturing of soap and detergents. According to the distribution of existing protection, probably producers of domestic consumer goods also resist trade reforms significantly in addition to agricultural producers.

Given the additional distortions introduced by the recent economic crisis, the process of ERP removal should be approached gradually. The initial step involves reverting to the pre-2019 incentive structure by eliminating existing non-tariff measures and special commodity levies (SCLs) imposed during the post-2019 crisis. Subsequently, efforts should be made to dismantle the post-2000 period incentives for import-competing industries, aiming to restore the incentive structure to the levels observed at the end of the 1990s. In this regard, Sri Lanka has proposed a phased reduction of para-tariffs in the 2023 Budget, demonstrating the government's intentions to advance the reform agenda. Once these measures are implemented, Sri Lanka can start removing deeply entrenched incentives, such as the incentives for crop production, including rice and other field crops and domestic non-agricultural consumer products.

As of August 2023, several waves to phase out import controls had been implemented. However, phasing-out prioritised intermediate products can increase the ERP for final consumer goods. Some consumer goods also saw import controls being lifted, but SCLs on food continued to be in place.

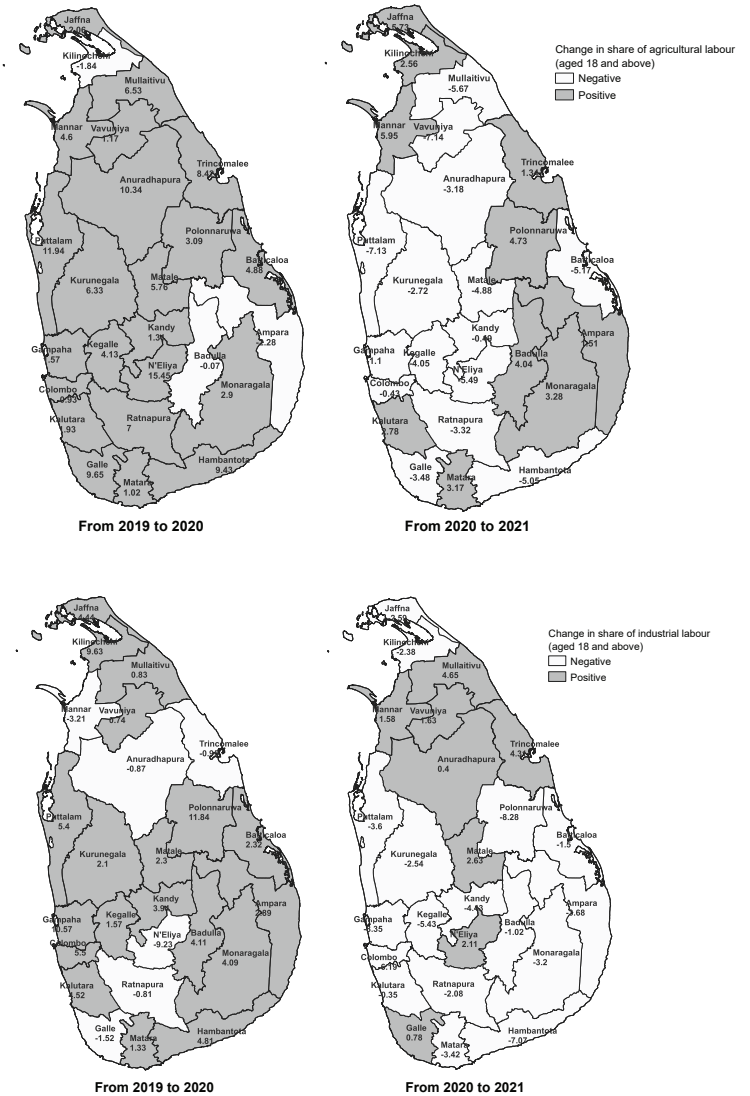
Still, the main obstacle to removing the protectionist measures implemented during the economic crisis is the inadequate levels of foreign reserves in hand. Although the import controls introduced during the crisis may not have been explicitly protectionist, these inadvertently created a favourable environment for import-competing manufacturing due to the altered incentive structure. While a policy intends to remove these import controls, several factors can impede the process. The low level of reserves poses a significant challenge, and potential is likely for opposition from industrialists who have benefited from the heightened trade protection in the interim. As of August 2023, several waves to phase out import controls had been implemented. However, phasing-out prioritised intermediate products can increase the ERP for final consumer goods. Some consumer goods also saw import controls being lifted, but SCLs on food continued to be in place.

The constraint imposed by foreign reserve limitations cannot be immediately overcome, despite some improvement after implementing an IMF arrangement and approving other multilateral loans. The increased influx of remittances and earnings from tourism provides a certain degree of flexibility for the government to reconsider import controls. However, achieving the fiscal targets outlined in the IMF programme is imperative to alleviate pressure on the trade balance and the exchange rate unless a surge in import demand leads to another round of import controls.

An arduous task ahead involves dismantling the protection afforded to the agriculture sector, specifically rice cultivation, dairy production, and other field crops. Although the ERP calculations indicate a bias against certain agricultural activities, various non-tariff measures effectively shield

them from foreign competition. Moreover, government subsidies and auxiliary policies, such as land regulations, contribute to the substantial presence of labour in the agriculture sector. The economic crisis and the impact of the COVID-19 pandemic have led to a reversal in the structural transformation, with a notable return of the labour force to the agriculture sector. The overall rise in job losses and reverse migration has led to a rise in agricultural sector employment, and its growing significance is evident in most districts between 2019 and 2021 (Figure 4.12).

Figure 4.12
Change of the Significance of Agricultural and Industrial Labour Force from 2019-2021



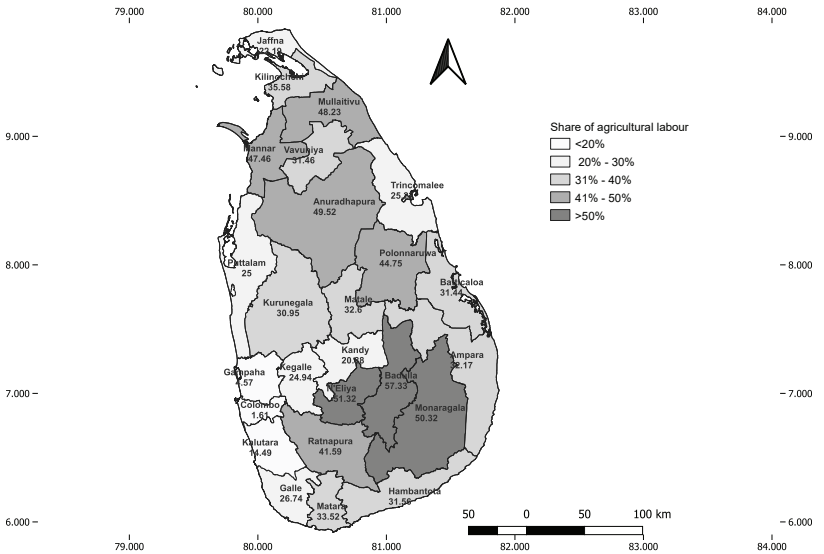
Source: Authors' illustration using Labour Force Survey data from 2019-2021.

Even prior to these events, many districts in Sri Lanka already had a substantial agricultural labour force. In districts such as Mullaitivu, Mannar, Anuradhapura, Nuwara Eliya, Badulla, and Monaragala, the agricultural labour force accounts for nearly half the working population eligible to vote. Except for the densely populated Western Province, a large proportion of districts have an agricultural labour force share exceeding 25% (4.13). As such, the electoral significance of this voting bloc is substantial.

In a closely contested election, the winner's margin is close to 5% in historically closely contested districts. Considering the substantial presence of the agricultural labour force in these districts, it is evident that politicians encounter a formidable challenge in formulating economic policies that resonate with agricultural sector voters.

Figure 4. shows the winning political party's margin in the 2015 general election in Sri Lanka. The 2015 election was the most closely contested parliamentary election recently in the country. In a closely contested election, the winner's margin is close to 5% in historically closely contested districts.[11] Considering the substantial presence of the agricultural labour force in these districts, it is evident that politicians encounter a formidable challenge in formulating economic policies that resonate with agricultural sector voters. All in all, the trade policy formulation process is inevitably influenced by the demands of influential agricultural labour constituencies, as well as the lobbying power of domestic manufacturers in specific sectors.

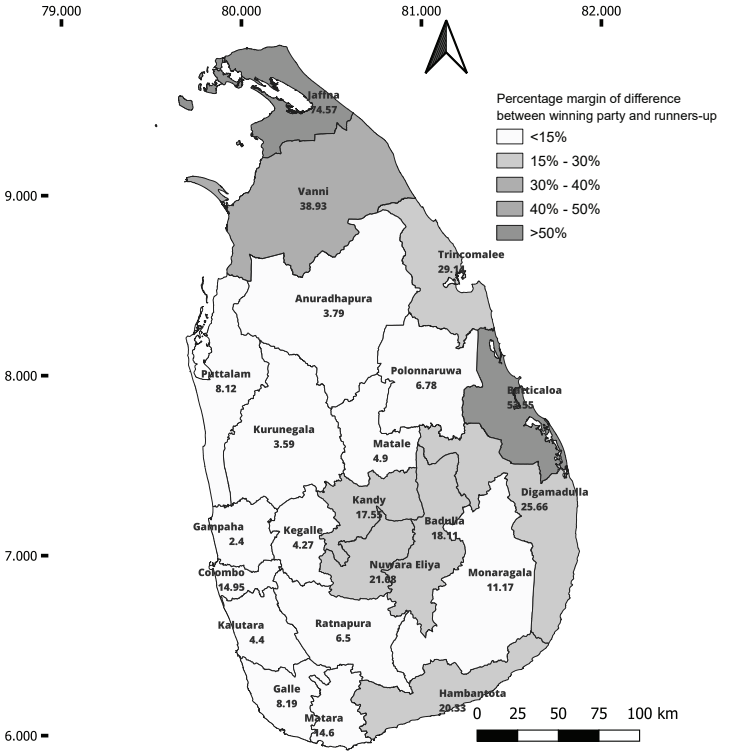
Figure 4.13
Distribution of Agricultural Labour Force Across Districts: Share of Agricultural Workers in the Labour Force Eligible to Vote in an Election, 2019



Source: Authors' illustration based on calculations using Labour Force Survey data-2019.

11 In Sri Lanka, historically, there are green-districts voting for the United National Party or its alliances- and historically blue-districts voting for Sri Lanka Freedom Party or its alliances-districts. However, there are some districts, which the winner carries. Puttalam, Anuradhapura, Polonnaruwa, Kurunegala, and Matale are such districts.

Figure 4.14
Winner's Margin in 2015 Parliamentary Election: The Margin as a Share of Two-party Vote Share



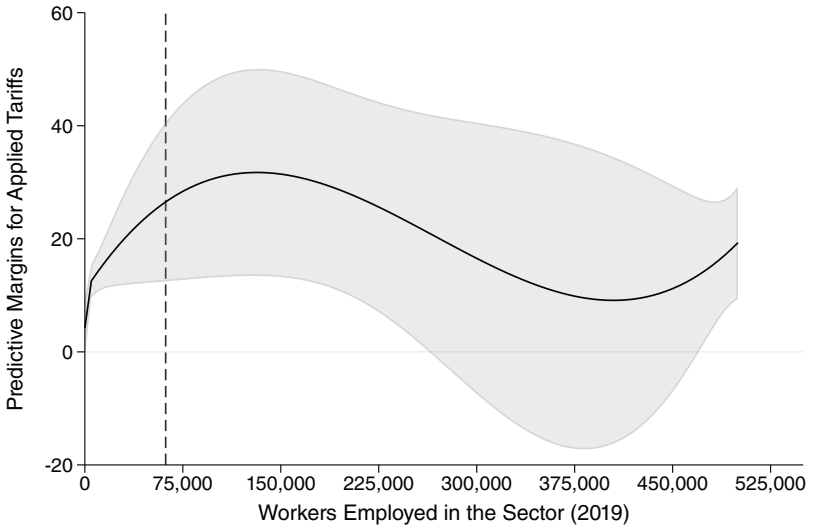
Source: Authors' illustration based on calculations using election data from the Election Commission of Sri Lanka.

Examining the relationship between prevailing customs duties within four-digit sectors of the International Standard Industry Classification Revision 4 (ISICr4) classification and the respective sectoral employment provides compelling evidence of the impact of electoral considerations on Sri Lanka's trade policy formulation. Figure 4.15 depicts predictive margins, and the number of employed workers within these sectors distinctly influences effective tariffs in Sri Lanka. A politically nuanced interpretation of this connection suggests that sectors wield considerable electoral sway tend to benefit from heightened protection via customs duties. The underlying dynamics of this political-economic interplay will significantly affect trade policy reforms, as resistance from safeguarded sectors with substantial employment could hinder reform endeavours.

Table 4.2 summarises the top 10 sectors with the highest rate of customs duties and volume of imports. Important sectors with a history of resistance to trade liberalisation are the manufacture of bakery products including biscuits, dry bakery products, and cookies, and other food items like macaroni and noodles. Noteworthy sectors with high protection through applied tariffs outside the top 10 list are manufacturing of dairy products (22.6%; United States Dollars [USD] 318.8 Mn), manufacturing of vegetables and animal oils and fats (23.5%; USD 295.7 Mn), manufacturing of parts and accessories

for motor vehicles (23.8%, USD 104.4 Mn), manufacturing of other food products (20.9%, USD 122.3 Mn),[12] manufacturing of soap and detergents (19.5%, USD 94.8 Mn), and growing of cereals and other crops (18.6%, USD 460.8 Mn).[13]

Figure 4.15
Predictive Margins for Applied Tariffs of Sri Lanka to the World



Notes: The dashed line shows the 95th percentile of the workers employed at 61,876. It implies that 95% of the sectors had workers employed within 61,876. If only those sectors are taken into account, it is evident that workers employed consistently and positively impact the tariffs. The non-linear impact results from lower tariffs on export-oriented sectors like ready-made garments, which employs about 460,000 workers.

Source: Authors' estimates.

12 This class includes coffee products, packing and blending of tea, vinegar, baby food, baby formulae, artificial honey and caramel, and sauces and condiments (excludes growing spices).

13 Applied tariff rate and imported value in 2017 are given in parentheses.

Table 4.2
Custom Duties for Each ISICr3 Sectors and Sectoral Imports

ISICr3 Code	Sector	Simple Average (%)	Weighted Average (%)	Import Value (USD Mn in 2017)
1600	Manufacture of tobacco products	156.2	132.7	6.8
1422	Extraction of salt	30.0	30.0	1.5
1541	Manufacture of bakery products	30.0	30.0	1.5
1554	Manufacture of soft drinks	30.0	30.0	1.1
3610	Manufacture of furniture	29.3	29.8	39.8
1513	Processing and preserving of fruit and vegetables	29.1	29.3	26.2
1544	Manufacture of macaroni, noodles and couscous	29.0	29.9	1.6
113	Growing of fruit, nuts, beverage and spice crops	28.1	28.0	110.3
1531	Manufacture of grain mill products	28.0	30.0	308.8
2023	Manufacture of wooden containers	27.9	29.1	3.0

Note: Tariff year is 2019 and Trade year is 2017.
Source: Authors' compilation using data from WITS.

While employed sectors can act as a guideline for potential resistance from the workforce, workers' skill level or education can also predict the possible resistance to trade liberalisation. Factor-based models predict that lower-skilled workers should be more opposed to trade openness than skilled workers in advanced skill-abundant economies. Distinctly, in developing economies where labour is the abundant factor of production, less opposition should be expected from less-educated/less-skilled workers. However, empirical evidence shows that less-educated workers consistently oppose trade liberalisation across countries. In recent years, Sri Lanka's trade liberalisation attempts, mainly in the form of free trade agreements, saw opposition mainly from the educated workforce. For example, opposition to the Economic and Technology Cooperation Agreement (ETCA) came from medical and information technology (IT) professionals, amongst others. However, Sri Lanka has the potential to benefit from services sector liberalisation, especially with emerging evidence pointing to a shortage of IT professionals, technicians, business professionals, and science and engineering professionals.[14]

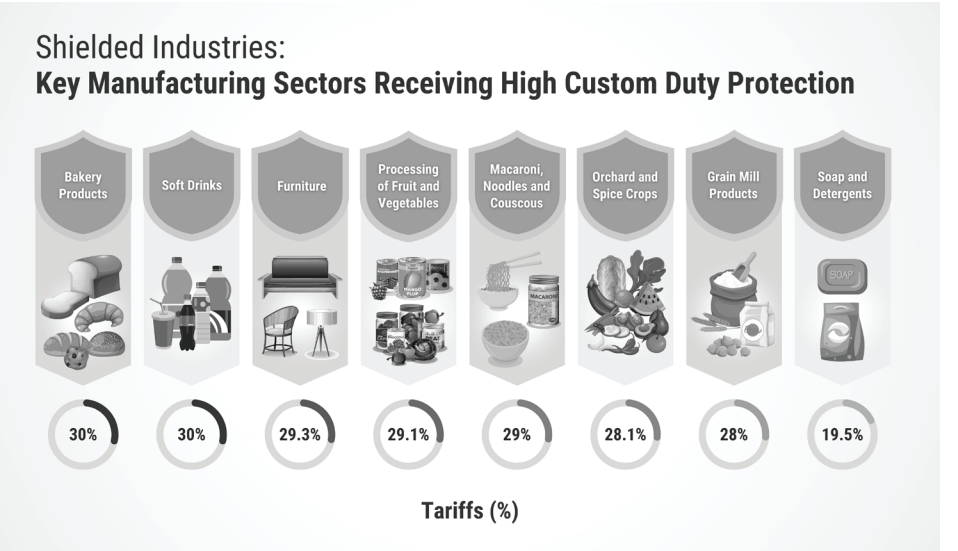
By examining the actions of policymakers in Sri Lanka, it becomes evident that they are responsive to the prevailing constraints, with political considerations playing a crucial role in shaping and timing policy reforms. During both waves of economic liberalisation, heavy public spending initiatives were implemented alongside the push for liberal economic policies. Assessments of the reform

14 Nedelkoska, L., O'brien, T., & Stock, D. (2018). *Does the Sri Lankan Economy Need More University Graduates.* Cambridge, MA: Center for International Development, Harvard University.

episodes have seen a departure from the expected macroeconomic reforms accompanying the trade liberalisation process. The 1978 episode, for instance, involved implementing projects such as the 'Accelerated Mahaweli Development Project' and extensive public housing and urban development initiatives that resulted in macroeconomic imbalances and placed significant pressure on the exchange rate.

Hence, the 1978 reform package was somewhat deficient in incorporating a stabilisation component, despite being branded as 'neo-liberal' by left-leaning advocates. This deficiency in stabilisation and the subsequent slow down in the trade reforms resulted in a 'half-hearted' or 'unfinished' process. However, factoring in the political constraints and the history of Sri Lanka's reforms, the 1978 reforms were substantial.[15]

In the second wave of economic reforms in the 1990s, despite measures taken to achieve macro stabilisation, a substantive public spending component was evident. Further, this period witnessed the implementation of noteworthy public initiatives such as large-scale welfare programme and the '200 Garment Factories Programme'. The former involved additional public spending despite efforts to achieve the stabilisation objectives of macroeconomic adjustment. Thus, in these liberalisation waves, the inclusion of such programmes was considered crucial to ensure the political sustainability of the reform process, as these addressed important distributive concerns.[16]



Source: Authors' calculations using WITS database, World Bank. (2023). World Integrated Trade Solution (WITS) database for Tariff and Trade Simulations [SMART]. Retrieved from http://wits.worldbank.org/WITS/WITS/TariffAndTradeSimulations/SMART/SmartQuery.aspx?Page=SMART

15 Weerakoon, D. (2011). Role of Market Regime in Transformation from Developing to Middle Income Country: What Next?. In *Economic and Social Development Under a Market Economy Regime in Sri Lanka*, Kelegama, S., & Gunerwardena, D. (Eds). Colombo: Vijitha Yapa Publications.

16 Kelegama, S. (2006). *Development Under Stress: Sri Lankan Economy in Transition*. New Delhi: Sage.

Despite the political imperative to implement complementary public spending programmes for redistribution purposes, such programmes pose economic challenges in light of Sri Lanka's macroeconomic conditions. Sri Lanka is committed to lowering its fiscal deficit and achieving a primary surplus under its IMF programme, leaving little or no space for incurring increases in expenditures apart from those related to the social protection of the poor. However, the need for programmes that mitigate the adverse effects of liberalisation and reforms on vulnerable sectors remains pertinent.

Considering the existing conditions of the variables that influence the reform process, a methodical sequencing of reforms becomes imperative. Implementing a comprehensive and abrupt trade reform cycle, often called a 'big-bang' approach, will likely incur heavy political and social costs. Adopting a sequential reform process also carries the inherent risk of periodic regression, whereby political considerations take precedence over economic realities. Consequently, a political consensus and strong political will are requisites to achieve meaningful trade policy reforms.

To assist in formulating a well-structured reform agenda, Table 4.3 offers a framework for prioritising the elimination of trade policy distortions, considering the political challenges associated with reforms and the expressed commitment to gradually remove import controls and para-tariffs implemented during the economic crisis. Undoubtedly, phase III of the sequencing process will pose the greatest difficulties, as it involves reforming deeply entrenched trade distortions.

Table 4.3
A Framework for Trade-Policy Reforms

Phase	Reforms	Sectors and Specific Measures
Phase-1	Phase-out NTMs and SCLs imposed in the economic crisis	Existing high Non-tariff Measures (NTMs) and SCLs on food need to be phased out. Bans, and high SCLs on food imports like pulses, fruits, and dairy products incentivise domestic resource allocation to these sectors.[a] In addition, light electronics, and household equipment like ceramic tiles received high protection in the crisis. Phasing-out of crisis era import controls on low tech manufacturing is necessary as domestic consumption-oriented substitution is more possible in this sector.
Phase-II	Phase-out para-tariffs and start neutralising incentive structure for export and import-competing sectors	Existing para-tariffs provide unequal incentives to sectors like porcelain and ceramic products, vegetable oils and fats, rubber tires and tubes, dairy, rice, fruits, and vegetables and melons. Phasing-out para-tariffs reduce the distortions in one layer, keeping the distortions at the customs duties and NTMs. Thus, removing para-tariffs is the initial step in reducing the incentives to highly protected sectors mainly domestic consumption-oriented. A neutral trade policy has an incentive structure which does not discriminate between exportables and importables.
Phase-III	Broad-based tariff reforms and reforms in producer subsidies to remove distortions in the incentive structure	In a broad-based tariff reform, the primary goal should be reducing the existing high tariffs for the sectors currently enjoying high protection (see Table 4.2). Lowering high tariff bands to a lower band, increasing the binding coverage of tariffs for commitments on bound rates under the World Trade Organization (WTO) framework, and removing existing discriminatory high tariffs for selected products are crucial steps in this stage.

Note: a. Higher level of NTMs and SCLs on food were reported in the economic crisis. Though selective interventions were made to import food like rice and eggs when the shortages were rampant, bans on pulses continued. High SCLs on food imports like fruits and dairy products continued to the second half of 2023, as the import control phasing-out up to August 2023 did not relax the food import controls.

Source: Authors' compilation.

Once the incentives are uniform, resource allocation occurs on principles of comparative advantage. Domestic factors of production will shift towards appropriate GVCs to capitalise on their comparative advantage.

During phases II and III, substantial opposition can be anticipated from the domestic consumption-focused manufacturing sectors, which rely on trade protection, as well as from agricultural producers. Once import controls and para-tariffs associated with the COVID-19 era are lifted by phase II, the primary distortions will stem mainly from customs duties. Theoretically, eliminating incentive distortions in phase III involves reforming the differentiated tariffs that currently apply to specific industries. Achieving such parity would necessitate the introduction of a uniform tariff structure, thereby ensuring a uniform level of protection across all industries. Once the incentives are uniform, resource allocation occurs on principles of comparative advantage. Domestic factors of production will shift towards appropriate GVCs to capitalise on their comparative advantage.

The transition towards uniformity in phase III is expected to trigger prominent opposition from sectors that previously benefited from unique protective measures. Given the presence of elevated tariffs and a track record of resistance towards trade policy changes, industries involved in producing bakery goods, soaps, detergents, confectioneries, leather goods, plastics, and ceramics will likely respond strongly to the reforms introduced in phase III. Consequently, the potential surge in imports could lead to the displacement of workers within these sectors due to their limited global competitiveness. This situation underscores the need for the government to implement a well-structured trade adjustment programme (Box 4.2).

Box 4.2
Trade Adjustment Programmes

Globally, trade adjustment assistance (TAA) packages are used to address the dislocations of workers caused by trade. The adjustment measures can be active labour policies, including retraining, skill development, and matching job seekers with existing vacancies. In addition, passive labour market adjustment measures like unemployment benefits, credit financing, relocation allowance, and housing policies help the workers cope with the adjustment.

The TAA programmes of the US, European Globalisation Adjustment Fund, Austrian Steel Foundation, and trade adjustment programme for Australia's textile, clothing, and footwear (TCF) provide useful case studies for the effective implementation of TAA programmes.

Mimicking international best practices after customising to the country's context is essential, as inadequate compensation results in populist backlashes against trade reforms. Extensive scholarly literature delves into the limited efficacy of the US TAA programme in catering to the requirements of individuals adversely affected by globalisation, leading to a polarisation of American politics.

The polarised political environment set the stage for the electoral success of Donald Trump, the candidate who espoused populist and anti-globalisation sentiments during the 2016 elections.

International experiences reveal that TAA programmes carry a significant fiscal burden and pose a challenge in identifying the affected workers due to import competition. The US TAA programme paid 70% of unemployed workers' previous wages. The fiscal burden motivates policymakers to follow stringent eligibility requirements, which in turn reduces the effectiveness of the programmes. In the US, evidence exists on discontent related to the TAA because of a high rate of denials of applications. A generous eligibility criterion with retraining tailored to specific needs increases the effectiveness of TAA programmes. For example, the Austrian Steel Foundations trade adjustment tailored to individual worker's needs, proved to be effective. Vocational training, small-business start-up assistance, extensive training, formal education and job search assistance resulted in higher employment prospects for the participants. In the US, in addition to the displaced workers, a small portion of the funds is allocated for affected farmers, firms and communities, making the TAA programme comprehensive. Loan guarantees, technical assistance for market research, IT consulting, and product development services were provided to the firms.

In the Sri Lankan context, displaced workers, farmers, and firms should be the focus of a trade adjustment programme. An adjustment period can be allowed for firms and producers producing for domestic consumption under trade protection to shift production to new areas once trade reforms occur. Trade adjustment programmes must provide technical assistance, product development, coordination with potential buyers, retraining of the required workforce and skill development to the affected firms to alter the production to globally competitive sectors. Loan facilities will assist the firms in upgrading technology for export-oriented production. The US' trade adjustment assistance for firms (TAAF) programme provides useful guidance in designing producer-oriented trade adjustment measures.

Research evidence from the US and Europe shows that educated and high-skilled workers face import-competition-induced dislocations better. The educated workforce in skill-abundant countries is less affected by import competition. Even if displacement happens, they could switch to different jobs. Thus, structural changes in the labour force are also an important aspect of TAA programmes. It includes improving the workforce's general education level and STEM skills through school and college education.

Note: STEM denotes Science, Technology, Engineering, and Mathematics.
Source: Compiled by the authors from various sources.

Inevitably, broad-based tariff reforms will need to extend to eliminating agricultural subsidies and incentives provided through tariffs, para-tariffs, and non-tariff measures on imports. The expected outcome of such reforms is to facilitate the labour force transition from agriculture to manufacturing, where considerable potential lies in productivity growth. As discussed in the earlier sections of this chapter, service sector activities have driven the structural transformation of Sri Lanka in the post-liberalisation period.

Arguably, exposing the agriculture sector to competition should be contingent upon the presence of a robust industry capable of absorbing the influx of labour. Besides, a counterargument posits that industrial growth cannot be achieved in an environment characterised by high wages and food prices resulting from trade protectionism and low agricultural productivity. This dilemma, often called the 'chicken or egg' problem, presents a challenge for Sri Lanka. Eliminating trade protection afforded to agricultural production could lead to the displacement of a substantial number of agricultural producers and workers, subsequently causing an influx of labour that exerts downward pressure on wages. Additionally, importing food staples – in a scenario of liberalised food trade – such as wheat, rice, vegetable oils, and pulses at global market prices has the potential to lower domestic food costs, thereby fostering a favourable environment for industrial sector growth. However, achieving such a transformation is politically viable and sustainable only if the increased labour supply finds well-paid jobs within the industrial sector, complemented by robust safety nets and well-structured trade adjustment initiatives established by the government to facilitate a smooth transition. Formulating an effective industrial policy is essential in creating high quality and well-paid employment opportunities within the industrial sector (Box 4.3).

Box 4.3
Industrial Policy Vs. Neutral Trade Policy: Are These Mutually Exclusive?

"Whatever the future direction, we can probably safely say that the renewed interest in industrial policy is not a short-term phenomenon. Industrial policy will be with us in the years ahead."

(This section draws from Aiginger, K., & Rodrik, D. (2020). Rebirth of Industrial Policy and an Agenda for the Twenty-First Century. *Journal of Industry, Competition and Trade*, *20*, 189-207).

The resurgence of industrial policy has emerged due to a combination of factors in the global context. Premature deindustrialisation and the limited expansion of high-quality employment opportunities in developing countries, along with the labour market consequences stemming from the rise of globalisation and the China-US economic and ideological conflict,[a] have heightened the need for proactive government interventions. Additionally, the neglect of regions such as the Rust Belt in the US and the persistent decline in manufacturing employment shares across the US and Western European countries have further amplified the call for diversified and upgraded economies. These circumstances have propelled the demand for government policies that go beyond mere market liberalisation, aiming to foster economic transformation and development.

Neutral trade policy ≠ *Laissez-faire*

Contrarily, the prevailing paradigm in economics has largely revolved around a 'neutral trade policy'. A trade policy is considered neutral when the incentives provided for exports and imports are approximately balanced. The potential for achieving accelerated growth rates through pursuing a neutral trade policy has been widely acknowledged. Nevertheless, the ascendancy of neutral trade policy in policy circles can be attributed to the underwhelming performance of the import substitution industrialisation (ISI) strategy. The ISI approach entrusted the state with significant roles, including pre-determining economic activities, implementing a standardised list of subsidies and incentives, which materialised as import controls to safeguard 'infant' industries, and employing a top-down policy formulation process.

It is important to distinguish between a neutral trade policy and *laissez-faire* liberalism and recognise that an industrial policy and a neutral trade policy can coexist without being mutually exclusive. It is worth noting that the effective rates of protection for sectors catering to the domestic market and export market were similar in East Asian nations.[b] Sri Lanka should avoid the regressive aspects associated with interventionist trade policies, commonly called industrial policies. An effective industrial policy should refrain from pre-selecting specific activities to be promoted or policy instruments, endorsing protectionism that encourages rent-seeking behaviour, conflicting with competition policies, and engaging in manufacturing activities through state-owned enterprises.

As highlighted by prominent scholars in industrial policy, contemporary industrial policy diverges from the aforementioned undesirable characteristics. Its primary focus lies in fostering sustained collaboration between the public and private sectors to enhance productivity and address coordination challenges. Furthermore, it prioritises the attainment of social objectives such as the creation of well-compensated employment opportunities and the promotion of environmental sustainability. The way forward involves a combination of neutral trade and industrial policies, coupled with optimal macroeconomic fundamentals, a stable trade policy framework, the state's commitment to education and training, public-private partnerships in innovation and production, and integration into global markets.

Source: Compiled by the authors from various sources.

a.Goldberg, P. K., & Reed, T. (2023). *Is the Global Economy Deglobalising? And If So, Why? And What is Next?* (No. w31115). Cambridge, Massachusetts: National Bureau of Economic Research.

b. Lal, D., & Rajapathirana S. (1989). *Impediments to Trade Liberalisation in Sri Lanka*, No.5. Gower, Aldershot: Thames Essay Series.

The role of industrial policy is subject to debate. Given the failures of previous attempts at import substitution through interventionist industrial policies, the term 'industrial policy' often evokes notions of selecting specific industries and implementing policies to support them, along with import controls to protect chosen 'infant industries'. While *laissez-faire* policies are destined to fail due to associated costs related to distribution, adjustment, and politics, interventionist industrial policies can lead to resource waste, inefficiencies, and slow economic growth, as Sri Lanka experienced during 1970-77. Therefore, the role of industrial policy should focus on fostering sustained collaboration between the

public and private sectors to enhance productivity and address coordination challenges. The debate should be over *how* rather than *why* on industrial policy.[17]

Implementing industrial policy is a crucial consideration. Top-down approaches with rigid action plans, specific time frames, and grand targets may prove to be ineffective.

An effective industrial policy requires incentives different from tariff protection and subsidies. It should encompass a range of business services such as marketing, management, technical assistance, infrastructure support, and seed money or loan assistance for acquiring productivity-improving technologies. Furthermore, the industrial policy should prioritise workforce training and skill development to meet the demands of a modern economy and create well-paying industrial and knowledge-based jobs. It is worth noting that the public sector in Sri Lanka plays a significant role in the education and vocational training sector.

Generally, in traditional industrial policies, the focus is to establish large and globally competitive manufacturing firms. However, focusing on small and medium-sized start-up firms in the services sector is vital. Financing new industries poses a challenge as private lenders perceive firms without a proven track record as highly risky. Additionally, the lack of complementary services and inputs further complicates the situation. Moreover, investing in new industries involves training workers and managers, who may leave for competing firms or imitate successful practices. Within these complications and uncertainties, inevitably, the state has a role. To foster the expansion of existing firms into new product lines, Sri Lanka requires an effective industrial policy. Such a policy should focus on providing market information, financial support for technology acquisition, developing a skilled labour force specialising in new production areas, and assisting with certification requirements.

The focus of the industrial policy should go beyond manufacturing as the service sector provides a large share of jobs with the progress of structural transformation. Sri Lanka's industrial policy must focus on tourism, financial services, developing a knowledge economy, and education. As noted in this chapter, the quality of the existing service sector jobs in Sri Lanka should transform.

Implementing industrial policy is a crucial consideration. Top-down approaches with rigid action plans, specific time frames, and grand targets may prove to be ineffective. While setting objectives such as creating high-quality jobs and diversifying the export basket is important, action plans should be adaptable to the private sector needs. Therefore, an effective industrial policy should be characterised by provisional goals, iterative benchmarks, collaborative decision-making, continuous monitoring, and the ability to revise goals and instruments based on new information. In summary, the involvement and collaboration of the public sector in industrial policy should be guided by the specific requirements of private firms.

4.5 Conclusion

The major economic reforms in Sri Lanka have historically been preceded by significant economic and political turmoil. The current push for reforms also shares this common characteristic but differs in several ways. One notable difference is the high level of political uncertainty, contrasting with the strong mandate of 1977 and the parliamentary power held by the Executive President's political party in 1990. Additionally, the macroeconomic landscape necessitates strict stabilisation policies constrained by the IMF programme, leaving little room for deviation. As a result, implementing large-scale public spending programmes to mitigate the impact of the reforms becomes challenging. In light of these circumstances, it is crucial to consider the adjustment and distributional costs associated with reforms and adopt a balanced approach free from ideological biases. The key to attaining strong export-led growth and building a modern economy with a diversified product portfolio lies in the effective and sustainable implementation of trade reforms.

The overarching objective of the reforms is to stimulate economic activities that foster the creation of higher-paying employment opportunities and facilitate structural transformation. This entails transitioning a large and unproductive agricultural labour force towards the manufacturing and services sectors. It is crucial to prioritise the expansion of the manufacturing sector, considering that Sri Lanka's manufacturing value addition has reached a plateau while the services sector has experienced growth. The political ramifications arising from the adjustments and distributional costs of the reforms, particularly concerning the politically influential agricultural labour force, should not be disregarded during the planning and implementation of the reform process.

Sequential implementation of trade reforms to remove the distortions to incentives – entrenched distortions due to political economy reasons, post-2000 distortions due to revenue concerns, and distortions in the economic crisis – will enhance the political viability of the reforms. This sequential approach, coupled with an appropriate adjustment package, will likely garner greater support and acceptance for the reforms. Finally, a neutral incentive structure should be established to remove the anti-export bias in the economy.

The expansion of the industrial sector plays a vital role in absorbing the labour force from agriculture. To achieve this, Sri Lanka requires a modern industrial policy that diverges from the traditional top-down and interventionist approaches aimed at import substitution. A common criticism of industrial policy is that it can conflict with competition policy, which is designed to protect consumer welfare. This criticism arises from the potential creation of monopolies and the resulting increase in domestic prices under the old-style interventionist industrial policy. An effective industrial policy action plan should prioritise collaboration between the private and public sectors, considering the need of firms for production expansion, the provision of diverse business services, and the facilitation of market connections instead of import substitution. Such an industrial policy does not compete with other policies, including competition policy. Therefore, it is essential for Sri Lanka to concurrently introduce a competition policy alongside market reforms and industrial policy to ensure the protection of consumer welfare.

Trade adjustment assistance is necessary to reduce the adjustment costs of trade liberalisation. Adjustment measures targeting individual workers, firms, producers, including farmers, and communities need to accompany broad-based tariff reforms that remove deeply entrenched incentive distortions. Active and passive labour market measures and structural improvements can ease hiccups and assist in making the transition smoother. One important structural improvement is enhancing the skill level of the labour force through investments in education. Skilled workers face adjustment costs well by re-employing themselves in a short period as their skills are compatible with many of the modern manufacturing and services sector jobs.

5. Reforming Land Policies for Economic Development in Sri Lanka

5.1 Introduction

Land is a valuable economic resource crucial in various sectors, including agriculture, housing, infrastructure development, and industrialisation. However, in many countries, land markets are often subject to numerous regulations, bureaucratic processes, and restrictions that hinder efficient land transactions and impede economic development. Therefore, reforming existing land policies towards land market liberalisation has captured policymakers' renewed attention in most countries, including Sri Lanka. While it remained a major focus of successive governments in Sri Lanka until the late 1990s, the three decades of conflict that ended in 2009 brought different priorities to the forefront during the first decade of the 21st century. With a primary focus on infrastructure-led growth in the post-war era, attention returned to land policy matters, albeit with a few hiccups. These emanated from political and policy uncertainties associated with frequent regime changes and deteriorating socio-economic conditions with the onset of the coronavirus (COVID-19) pandemic, etc. However, with a renewed focus on promoting investments to boost export-led growth, land reforms have returned to the forefront of policy discussions.

Most segments of the Sri Lankan population depend on land for their livelihoods. This is noteworthy because land and agriculture have been crucial in the country's social, economic, and political life for centuries. Agriculture is the main source of livelihood for a large chunk of the population. Although the contribution of agriculture to economic output is low, the importance of agriculture as a livelihood is significant. A quarter of Sri Lanka's labour force is engaged in agriculture, although the sector's contribution to the gross domestic product (GDP) is less than 8%. As the population increases, despite the increasing demand for land in the country, the scope is limited to increasing land availability. Increased competition for land usage between agricultural and non-agricultural uses has also become an issue, especially due to urbanisation, industrialisation and development activities. In rural and suburban areas, agricultural lands under crops such as rubber and coconut are fast being converted for residential, commercial, or industrial purposes.[1] Also, large-scale land acquisitions for infrastructure projects, industrial agriculture, and other commercial purposes often result in the displacement of local communities and loss of livelihoods, undermining food security and rural income generation.

Apart from these, the growing scarcity of land due to population growth and lack of clear titles has led to a division of agricultural land into smaller and economically unviable plots over generations (i.e., fragmentation of land). Land tenure is also threatened by perverse incentives that lead to land fragmentation and encroachments, negatively affecting initiatives supporting its sustainable

1 Samaratunga, Parakrama., & Marawila, Dilhani. (2006). *Major Characteristics and their Determinants of the Rural Land Sector in Sri Lanka and Implications for Policy.* Research Studies: Agricultural Policy Series No.7. Colombo: Institute of Policy Studies of Sri Lanka.

The issue of land scarcity is growing rapidly. On top of this, Sri Lanka cannot allocate land for other economic uses sustainably unless a rational policy is devised to improve the efficiency of existing land uses and to balance the growing demand between agriculture and land for industry, infrastructure, residential sectors, etc.

management. Land productivity is a serious issue in agriculture and efforts to intensify productivity through conventional methods have also resulted in unsustainable outcomes such as land degradation, soil erosion, water depletion and pollution, and destruction of biodiversity.

Indeed, there is overwhelming evidence that the expansion of human economic activities such as deforestation creates growing pressure on ecosystems, leading to the degradation of air, water, and land resources in rural and urban areas with many negative spillover effects. According to the Global Forest Watch, the total area of humid primary forest in Sri Lanka has decreased by 1.7% from 2002 to 2020.[2] Although seemingly a marginal decline, the magnitude of the issue raises a red flag on impending environmental concerns. The decline of forest cover has led to a loss of ecosystem services, sometimes irreversibly, resulting in depletion of groundwater levels and increased scarcity of water, loss of fertile soil, siltation of reservoirs and degradation of productive land assets, which directly or indirectly affect agriculture. These further imply that the issue of land scarcity is growing rapidly. On top of this, Sri Lanka cannot allocate land for other economic uses sustainably unless a rational policy is devised to improve the efficiency of existing land uses and to balance the growing demand between agriculture and land for industry, infrastructure, residential sectors, etc.[3] As an important means of generating livelihoods, accumulating wealth and transferring it from generation to generation, especially for the poor,[4] inefficient land use also contributes to inequity and poverty. These deficiencies arise primarily from the lack of a coherent land policy and failure to adopt sustainable land management practices, which impact land use practices and property rights related to land and proper allocation of land.[5]

In the above-explained setting, this chapter aims to discuss how Sri Lanka's land policies and institutional setup have led to inefficient land use and compromised the well-being of the land users; it also makes policy recommendations to maintain the balance between competing demands within changing priorities for export-driven industrial growth and sustainable development. The chapter starts with a conceptual framework to identify the driving factors of land use in terms of economic growth, human welfare, and sustainability of natural resources. Building on this conceptual framework, the successes and failures of global reforms of land use are discussed, followed by a brief review of the

2 Global Forest Watch. (n.d.). *Forest Loss*. Retrieved July 10, 2023, from Global Forest Watch: https://www.globalforestwatch.org/dashboards/country/LKA

3 Senaratne, A. (2017). *Revisiting Land Policy: Reforms to Match Evolving Economic Needs*. In *Sri Lanka: State of the Economy of Sri Lanka 2017*. Colombo: Institute of Policy Studies of Sri Lanka.

4 Deninger, K. (2003). *Land Policies for Growth and Poverty Reduction*. Washington, D.C.: World Bank.

5 Doughan, Y.A.R. (2020). Factors of Production, Economic Growth, and Sustainable Development. In: Leal Filho, W., Azul, A., Brandli, L., Lange Salvia, A., & Wall, T. (Eds.). *Decent Work and Economic Growth. Encyclopaedia of the UN Sustainable Development Goals*. Springer, Cham. https://doi.org/10.1007/978-3-319-71058-7_121-1.

evolution of land policies and institutional framework in Sri Lanka. The current situation, the trends of land resources in the country, and contemporary challenges are examined next with appropriate policy suggestions to mitigate them.

5.2 A Conceptual Framework for Land Use Dynamics

Factors of production are the inputs or resources that individuals use to produce goods and services. Land is one of the four factors that include labour, capital and entrepreneurship. It comprises several resources on the surface or inside the land, such as water and forests (renewable resources) or oil, gas, and minerals (non-renewable resources).[6] The gradual changes in land use and land cover necessitate land reforms. Land use changes are driven by the decision making of people and are influenced by several factors. Since the factors causing land use change are complex, it is important to frame a concept that helps to understand the land-use change process that calls for changes in land reforms. According to the conceptual framework (see infographic), land-use change is always caused by multiple interacting factors that vary in time and space, according to specific human-environment conditions. These affect economic growth, natural resources, and human welfare and can be categorised under (i) natural and environmental factors, (ii) economic and technological factors, (iii) demographic and cultural factors, and (iv) governance and institutional factors.[7]

5.2.1 Demographic Factors

Demographic factors play a significant role in influencing land use and land cover change.[8] Changes in population size, distribution, and composition, including urbanisation and migration, can drive shifts in land use patterns to accommodate various human needs. Rapid population growth increases the demand for housing, infrastructure, and agricultural land, converting natural areas into urban and agricultural landscapes. Migration patterns (such as outmigration, including for seasonal occupations) influence land use. Consequently, land cover change as people settles in new areas, resulting in the development of infrastructure and changes in land use to accommodate the needs of the new population. As people move from rural areas to urban centres for better opportunities, cities and towns expand, converting agricultural and natural lands into built-up areas.

At the same time, the outward expansion of urban areas into adjacent rural and suburban regions, driven by factors such as improved transportation and the desire for larger residential spaces, led to sizeable changes in land use and loss of natural habitats. Changes in population demographics, such as the age distribution, family size and cultural and social preferences of the population, can influence housing demand, infrastructure requirements, employment dynamics and the need for recreational

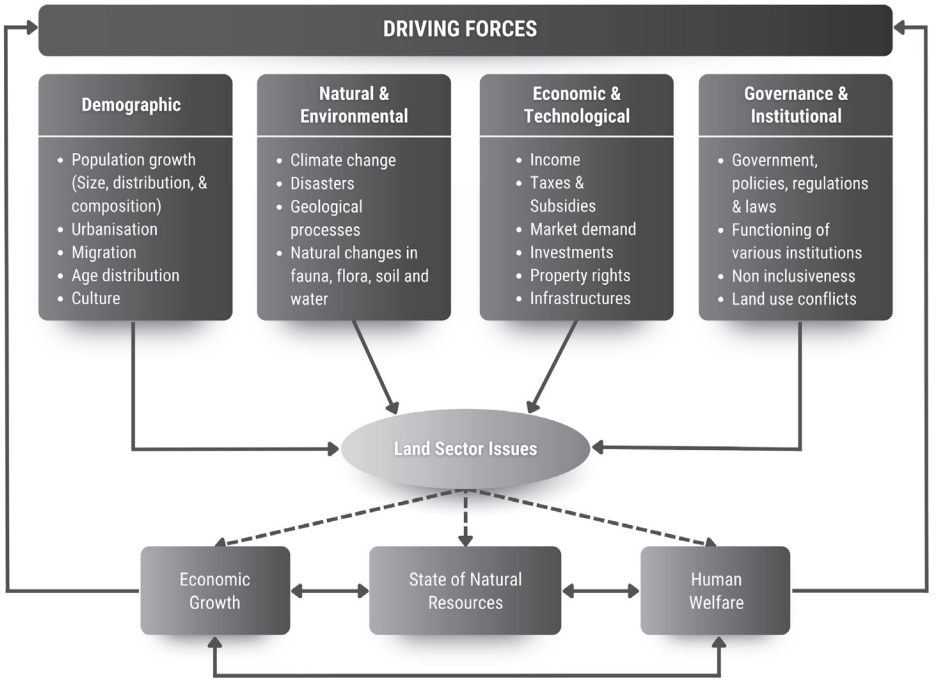
6 Doughan, Y.A.R. (2020). Factors of Production, Economic Growth, and Sustainable Development. In: Leal Filho, W., Azul, A., Brandli, L., Lange Salvia, A., Wall, T. (Eds.). *Decent Work and Economic Growth. Encyclopaedia of the UN Sustainable Development Goals.* Springer, Cham. https://doi.org/10.1007/978-3-319-71058-7_121-1.

7 Lambin, E., F., Geist, H., J., & Lepers, E. (2003). Dynamics of Land-use and Land-Cover Change in Tropical Regions. *Annual Review of Environment and Resources* 28:205-241.

8 Hoffmann, J. (2021). Demographic Change and Land Use. In: Weith, Thomas & Barkmann, Tim & Gaasch, Nadin & Rogga, Sebastian & Strauss, Christian & Zscheischler, Jana. (Eds*.). Sustainable Land Management in a European Context: A Co-Design Approach*. Springer.

areas, impacting land use decisions. For instance, an ageing population (as more people shift from the workforce as dependents) might lead to shifts away from labour-intensive agriculture, affecting land use patterns.

Conceptual Framework on Land Use Dynamics



Source: Authors' illustration based on various sources.

5.2.2 Natural and Environmental Factors

Natural and environmental causes are driven by various natural processes and interactions within the environment and can significantly influence land use and land cover change.[9] Natural geological processes like erosion and sedimentation can alter land surfaces, leading to changes in topography, soil characteristics, and land suitability for different uses. The presence and movement of water bodies can influence land use patterns, affecting agriculture, settlements, and biodiversity distribution. Natural changes occurring in the soil, including nutrient cycling, affect agricultural productivity and land suitability for various crops and types of land uses. Changes in natural habitats, such as wetlands, grasslands, and forests, can influence land use patterns and the distribution of human settlements. Natural changes in vegetation, such as succession and forest regrowth, could also influence land cover patterns over time.

9 Shaghla, P., Bashir, J., & Bushra, P. (2018). A Literature Review on Land Use Land Cover Changes. *International Journal of Advanced Research*. 6(7): 1-6.

Land reforms are necessitated by the land use changes and the land use changes are influenced by several factors; namely (i) natural and environmental factors, (ii) economic and technological factors, (iii) demographic and cultural factors, and (iv) governance and institutional factors.

While natural environmental change and variable geographical processes, vegetation dynamics, etc., interact with human causes of land use change, highly variable ecosystem conditions driven by climatic variations amplify the pressures arising from high demands on land resources. Shifts in climate can lead to alterations in suitable agricultural areas, changes in vegetation distribution, sea level rise, and the frequency of extreme weather events like droughts and floods. Rising sea levels due to climate change can lead to coastal erosion, saltwater intrusion into coastal inland areas, and changes in land use patterns in low-lying coastal regions. Long-term climate cycles, such as El Niño and La Niña events, can trigger variations in weather patterns, affecting agricultural productivity and land use decisions. Natural disaster events such as earthquakes, tsunamis, landslides, and wildfires can give rise to rapid and drastic changes in land cover, leading to forest destruction, erosion, and the conversion of natural landscapes.

5.2.3 Economic and Technological Factors

Economic and technological factors are significant drivers of land use and land cover change as the recent land-use changes have been driven mainly by individual and social responses to changing economic conditions.[10] Economic factors can be defined as a range of variables like income, input and output prices, taxes, subsidies, production and transportation costs, investments, credit access, trade, and technology that directly impact decision-making by people.

These factors influence how land is utilised for various purposes, including agriculture, urbanisation, industrialisation, and infrastructure development. Economic development often leads to urbanisation, real estate development, industrial growth, energy demand and infrastructure expansion, converting rural and natural lands into urban areas and industrial zones. Market demand for goods and services can also influence land use decisions. For example, rising demand for biofuels may lead to converting agricultural land to grow energy crops. Advancements in agricultural technology, such as improved irrigation methods, genetically modified crops, and mechanisation, can lead to changes in land use patterns. Intensification of agriculture may result in increased land clearing and changes in crop choices. Similarly, technological advancements in construction, mining, and other industries can enable the extraction of resources from previously untouched areas, affecting land cover.

10 Lambin, Eric F., & Meyfroidt, Patrick. (2011). Global Land Use Change, Economic Globalisation, and the Looming Land Scarcity. *Proceedings of the National Academy of Sciences*. 108(9): 3465-3472.

5.2.4 Governance and Institutional Factors

Policy and institutional factors such as government regulations, laws, and the functioning of various institutions responsible for land management and planning play a significant role in shaping land use and land cover change.[11] Land use planning policies, zoning regulations, and development plans set by governments at different levels (national, regional, and local) dictate how land use can be for various purposes, such as agriculture, residential, industrial, and conservation. Agricultural policies, such as subsidies, incentives, and price support mechanisms, can influence land use decisions and agricultural practices, affecting the amount and type of land dedicated to farming. Environmental, forest and wildlife regulations and conservation policies usually aim to protect sensitive ecosystems, wildlife habitats, and natural resources from unsustainable land use practices and development. Therefore, these have significant adverse impacts on land use decisions and land cover change. Land tenure systems and property rights influence land use decisions and investment in land management since secure land tenure can incentivise sustainable land use practices.

The effectiveness of land use policies depends on the capacity and coordination among various institutions responsible for land management, planning, enforcement, monitoring and reporting. Involving the public and stakeholders in land use decision-making processes helps ensure that policies align with local needs, interests, and conservation objectives. Efficient mechanisms for resolving land use conflicts can prevent illegal land conversion and unsustainable practices that contribute to land cover change. The interaction of these policy and institutional factors can significantly influence the direction and intensity of land use and land cover change. Well-designed and effectively implemented policies, coupled with strong institutional governance, can help promote sustainable land use practices and ensure the conservation of valuable natural resources.

Advances in remote sensing and geographic information systems (GIS) have enabled more accurate land cover mapping and monitoring, facilitating better land use planning and management. It is essential to consider these economic and technological factors when formulating land use policies and strategies to ensure sustainable development and conservation of natural resources.

5.3 Global Experiences of Land Reforms: Successes and Failures

Land reform has been implemented in various regions/countries worldwide, each with its own unique experiences and outcomes. Land reforms globally have had a mixed record of success and failures, depending on a range of factors. In general, East Asian countries like South Korea, Japan and Taiwan provide classic examples of successful land reforms, while the experiences in most South American, South Asian, and African countries have shown some mixed results.[12]

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11 Corsi, A., & Selod, H. (2023). Legal, Institutional, and Governance Challenges Facing Land Use in MENA Countries. In: *Land Matters: Can Better Governance and Management of Scarcity Prevent a Looming Crisis in the Middle East and North Africa?*. Washington, D.C.: World Bank Group.

12 Yapa, L.F. (2022). Policy Intervention and Land Reforms for Consolidating Small Holdings for Improved Productivity. In Ranjith Senaratne (Ed), *The Future of the Agriculture and the Agriculture of the Future: From Beaten Track to Untrodden Path. Matara:* Matara: University of Ruhuna.

Land reform in South Korea was a significant part of the country's development strategy after the Korean War (1950-1953). The government implemented a land-to-the-tiller programme, which redistributed land from large landowners to tenant farmers equitably. This helped reduce rural inequality, laid the foundation for agricultural growth and rural development and resulted in the emergence of a strong middle class in rural areas. Taiwan followed suit and implemented land reforms in the 1950s and 1960s. The land was redistributed to small farmers, and agricultural cooperatives were established. The reforms played a crucial role in transforming Taiwan's agricultural sector and contributed to its economic development. By these reforms, Taiwan was able to achieve self-sufficiency in food production and increased rural incomes while laying the foundation for its industrialisation and economic growth. After World War II, land reforms were implemented in Japan, targeting the historical concentration of land ownership among a few wealthy people. Like in South Korea and Taiwan, the reforms in Japan contributed to a more equitable land distribution, increased farm sizes, and improved agricultural productivity. Japan's agricultural sector became highly efficient and productive, playing a significant role in the country's economic development.

In the case of China, following the Chinese Revolution in 1949, large estates were confiscated from landlords and redistributed to peasants, often organised into collective farms.[13] While these reforms initially led to increased agricultural production and social equality, these also resulted in widespread famine, loss of individual land rights, and widespread inefficiencies in agricultural management, which later resulted in declining agricultural productivity. In subsequent years, China introduced market-oriented reforms and allowed the transfer of land-use rights, leading to increased productivity and rural development. In India too, land reforms have been a significant aspect of the country's socio-economic development since its independence in 1947. Its land reform policies addressed historical injustices, reduced rural poverty, promoted social equity, and enhanced agricultural productivity. Despite significant progress, failures were primarily due to implementation issues like resistance from vested interests, complexities associated with tribal land rights, lack of post-reform support and rehabilitation, etc.[14]

In Southeast Asia, land reforms in the Philippines faced significant implementation challenges such as insufficient funding, land distribution delays, landowners' resistance, and lack of support services for agrarian reform beneficiaries. In Russia, too, land reforms to transition from collective farming to private ownership after the collapse of the Union of Soviet Socialist Republics (USSR) faced charges of corruption, land grabbing, and the lack of infrastructure and support services for individual farmers. These challenges hindered agricultural development and led to a decline in overall productivity.

Similarly, experiences across Latin America have been mixed. In Mexico, large landholdings were expropriated and redistributed to peasants as communal land (known as ejidos) in the early 20th

13 Griffin, K., Rahman Khan, A., & Ickowitz, A. (2002). Poverty and Distribution of Land. *Journal of Agrarian Change,* 2 (3): 279–330.

14 Yapa, L.F. (2022). Policy Intervention and Land Reforms for Consolidating Small Holdings for Improved Productivity. In Ranjith Senaratne (Ed), *The Future of the Agriculture and the Agriculture of the Future: From Beaten Track to Untrodden Path. Matara:* University of Ruhuna.

century.[15] Initial successes were followed by challenges pertaining to productivity and individual land rights. In recent years, Mexico has implemented reforms to allow ejidos to be converted into private property, aiming to improve agricultural efficiency and investment. Similar land reform efforts in Venezuela to expropriate large estates and redistribute land to peasant farmers and cooperatives have often been marked by a lack of planning, inadequate support, and political motivations. These factors have resulted in a decline in agricultural productivity and food shortages. In Brazil, too, successive governments implemented various programmes to promote land redistribution. These initiatives aimed to settle landless farmers on unused or underutilised land, promote sustainable agriculture, and improve rural livelihoods. However, the process has encountered challenges, including conflicts with large landowners, insufficient funding for infrastructure and support services, and difficulties in ensuring the long-term viability of settled farmers.

In Africa, Zimbabwe implemented a controversial land reform programme in the early 2000s, characterised by fast-track land invasions and expropriations from white farmers, for redistribution to landless black farmers to address historical imbalances in land ownership. The process faced criticism for its lack of transparency, political motivations, and disruptions to agricultural productivity. The reform resulted in significant economic challenges, including a decline in agricultural production, food insecurity, and negative impacts on the country's economy. Issues of corruption, lack of planning, inadequate support, and access to resources for resettled farmers and uncertainty around property rights were crucial weaknesses. A similar exercise after the end of apartheid in South Africa, which saw land reform policies to address historical injustices and inequalities in land ownership faced numerous challenges. Land restitution, redistribution, and tenure reforms to provide equitable access to land for previously disadvantaged groups saw inadequate funding, bureaucratic delays, lack of technical support, and disputes over land rights, which slowed progress and sparked debates on the effectiveness of reforms. As a result, the government faced issues that called for better implementation.[16]

As highlighted above, the outcomes and effectiveness of land reform initiatives vary significantly depending on the country's specific context and political dynamics, implementation strategies, stakeholder inclusiveness and the support provided to beneficiaries. They offer valuable lessons for designing and implementing future land reform programmes. While some land reforms have successfully addressed historical injustices and promoted rural development, others have faced challenges related to implementation, governance, support services, and tenure security.

Successful land reforms provided access to land, secure tenure, and support services such as credit, extension, etc. and helped reduce inequality in land ownership, alleviate poverty and improve the livelihoods of small-scale farmers and marginalised communities, boosting investments in agriculture and food production. However, land reforms globally failed primarily due to poor implementation, political interference and corruption, resistance, and conflicts. Without proper support, beneficiaries

15 Barraclough, S. (2007). The Legacy of Latin American Land Reform. In *NACLA Report on the Americas*. Retrieved July 20, 2023, from North American Congress on Latin America: https://nacla.org/article/legacy-latin-american-land-reform

16 Obeng-Odoom, Franklin. (2012). Land Reforms in Africa: Theory, Practice, and Outcome. *Habitat International,* Volume 36, Issue 1, 2012, pp. 161-170.

may struggle to make productive use of the land they receive. Political interference and corruption lead to inefficiencies, inequities, and disputes over land rights, while political instability and regime changes also disrupt land reform programmes. Land reforms always face resistance from powerful vested interests, such as large landowners or entrenched elites, which lead to conflicts, legal disputes, and social unrest, hindering the implementation and success of land reform initiatives.

Careful planning, effective implementation strategies, strengthening governance mechanisms, providing adequate support mechanisms, and considering local contexts and dynamics remain important considerations for successful land reforms. Moreover, political willingness and inclusiveness in ensuring broad-based participation and consultation are crucial for resolving conflicts and ensuring the success of land reforms.

Further, insufficient and limited access to credit and inputs, inadequate infrastructure, and weak extension services and poor market linkages have hampered the success of land reform initiatives in most countries. Therefore, merely redistributing land is often not sufficient for long-term success. Adequate post-distribution support is crucial for beneficiaries to utilise the land and sustain their livelihoods effectively. Without such support, land reform beneficiaries may struggle to overcome challenges and fully benefit from redistributing land. In some cases, land reforms have inadvertently contributed to environmental degradation. For example, converting forested or ecologically sensitive lands into agricultural areas without proper environmental safeguards has led to deforestation, soil erosion, and loss of biodiversity. These highlight the importance of careful planning, effective implementation strategies, strengthening governance mechanisms, providing adequate support mechanisms, and considering local contexts and dynamics remain important considerations for successful land reforms. Moreover, political willingness and inclusiveness in ensuring broad-based participation and consultation are crucial for resolving conflicts and ensuring the success of land reforms.

5.4 Sri Lanka's Land Policy, Regulatory and Institutional Frameworks

5.4.1 Colonial Era

Sri Lanka's current context of land resources and land use is directly related to the past policies on the land sector, starting from the colonial rules. A self-sufficient economy comprising a peasant agricultural sector and little international trade was to be transformed into an export agricultural sector consisting of large plantations, with the British colonial era starting in 1815. For this purpose, colonial interests lay in an overt land grab sanctioned by the Crown Land Ordinance No. 12 of 1840. More land accumulation resulted from two further ordinances, namely, the Registration of Temple Lands

Ordinance, No. 10 of 1856 and the Waste Lands Ordinance, No. 1 of 1897. Under the former, all land claimed by temples was surveyed and registered to acquire large extents of land owned by temples. At the same time, the latter gave the facility to the Crown to declare vast tracts of forest, chena or unoccupied wasteland in the country as Crown land.[17]

All these restricted traditional land use and ownership patterns, ensuring that a large proportion of used and unused land was made available for European investors. This land use system implemented by the British mainly focused on individual land ownership based on private property, replacing the traditional communal land tenure systems prevalent in Sri Lanka.[18] Foreign capital was invested on establishing large plantations in such acquired lands, resulting in a steep rise in the acreage under the 'export agricultural sector'. In contrast, the neglected 'peasant agricultural sector' stagnated. The latter was produced mainly for household consumption with a little surplus of food crops aimed at the local market. In fact, the role of domestic food production was further marginalised by depressed prices in these markets following the widespread promotion of cheap imported foods. With these developments, Sri Lanka's economic output grew fast owing to plantation export earnings while the contribution of peasant food crops gradually shrank.

The first change in this pattern appeared from a 'nationalistic' awakening within local political movements and the subsequent appointment of the First Land Commission (FLC) in 1927 to look into matters on land policy and make recommendations to overcome the emerging problems within the land sector. Following the recommendation of the FLC, the Land Development Ordinance of 1935 (LDO) was brought into effect to promote domestic food production and to distribute land among the landless in the country's wet zone. Large irrigation projects were undertaken in the Dry zone and the developed lands were distributed among the landless from other areas, mainly for the production of rice as the main staple food. All these marked the beginning of an era of rapid land settlement that shaped the present system of land use in Sri Lanka.

A slight upward trend in the domestic food production sector, which began with this second wave of land policies, was further reinforced by the scarcity and high prices of imported food, mainly rice, during World War II (from the early 1930s to mid-1940s). In order to facilitate the irrigation requirements of the Dry zone alienated lands under the LDO, the Irrigation Land Ordinance (ILO) was enacted in 1946. Among the other legislations enacted before independence were the Temple Land (Compensation) Ordinance of 1944, which made provision for compensation under the Land Acquisition Act in respect of land belonging to temples and the Crown Land Ordinance of 1947, which made provision for the grant and disposition of Crown lands in Ceylon and management and control of such lands.

It is essential to examine the colonial land policies from different perspectives to gain a comprehensive understanding since land grabbing and the establishment of plantations in Sri Lanka had both costs

17 Samaratunga, Parakrama. (2004). Land Policy in Sri Lanka. *Sri Lanka State of the Economy 2004*. Colombo: Institute of Policy Studies of Sri Lanka.

18 Samaratunga, Parakrama. (2012). Achieving Economic Efficiency and Equitable Distribution of Land Use through Reforms and/or Market Discipline. In Saman Kelegama & Dileni Gunewardena (Eds.), *Economic and Social Development under a Market Economy Regime in Sri Lanka – Buddhadasa Hevavitharana Felicitation,* Volume 2. Colombo: Vijitha Yapa Publications.

and benefits. The plantation sector played a significant role in transforming the Sri Lankan economy, with cash crops like tea, rubber and coconut becoming major exports, generating revenue, creating employment opportunities, and stimulating economic growth for over a century. Technological advancements in terms of modern agricultural practices, machinery, and processing techniques improved agricultural productivity, increased crop yields, and enhanced the overall efficiency of the agriculture sector. Further, the plantation sector led infrastructure development, including roads, railways, ports, etc., that had long-term benefits for overall connectivity and accessibility across the country. Despite all these, however, these policies have been criticised for their significant environmental impacts, such as deforestation, soil degradation and erosion, disruption of ecosystems and loss of biodiversity, etc., many of which are still evident and prevalent today.

Further, under their rule, the British introduced land registration and surveying systems in Sri Lanka to establish clear property rights, resolve land disputes, and streamline land administration. However, implementing these systems was often biased towards the interests of the colonial administration and the plantation owners, further marginalising local communities. The consolidation of land ownership especially disrupted the customary land rights of local communities, generating a huge blow to the subsistence and well-being of the peasants who were largely dependent on chena cultivation for their livelihood. The British also introduced land taxation policies, such as the Grain Tax Ordinance of 1878, which burdened small-scale paddy landowners, causing them to dispose of large tracts of their paddy lands to outsiders to pay the tax.

5.5.3 Post-Independence to Pre-Liberalisation Period

When Sri Lanka gained independence in 1948, the country faced serious implications on food production and consumption. From this point onwards, the drive for domestic food production was given prominence with self-sufficiency in rice as the prime objective. Therefore, the alienation of state land under various land tenure schemes, settlement programmes and irrigated colonisation schemes which started with the LDO can be considered as the main component of Sri Lanka's post-independence land policy too.

With continued land development and support prices for rice, growth momentum in the domestic food production sector showed signs of pickup. Living conditions improved even amidst difficulties of poor irrigation at the early stages, which was resolved to a greater extent with the implementation of the ILO (and amended in 1951 and 1968). Shortly after independence, a Land Reform Act (1950) was introduced to address land inequality and redistribution of land to landless farmers. The primary goal was to break up large estates and distribute the land among small-scale farmers. The Soil Conservation Act, No. 25 of 1951, was another important legislation relating to land policies that provided for regulations on soil conservation.

The Second Land Commission (SLC) was appointed in 1955 to examine government policy on the alienation of crown land, assistance to peasant colonists, efficient use of Crown land and to propose necessary amendments to the LDO of 1935. Based on the SLC recommendations, minor amendments were made to the LDO in 1960 and 1969 and new Acts were enacted occasionally.

The Paddy Lands Act (PLA) of 1958 is a piece of legislation that governs the country's management and administration of paddy lands (rice fields). It was to support the marginalised poor of the rural sector by increasing the security of tenure of tenant cultivators of paddy lands and regulating the rents paid to landlords. Under the said Act, paddy land was preserved for agricultural purposes, food security, and farmers' livelihoods and ensured paddy lands were protected from unauthorised conversions, encroachments, and other forms of illegal activities. The Act also includes provisions to promote the conservation and sustainable use of paddy lands and their associated ecosystems.

A Land Reform 1972 Law (LRL) No. 1 enacted in 1972 is one of the most significant in Sri Lanka's land policies. Under this law, the government acquired ownership of plantations which were previously owned by foreign companies and individuals, and facilitated the redistribution of the nationalised plantations to the landless rural poor and smallholders. The objective was to address the historical inequities in land ownership and provide opportunities for landless individuals to engage in agricultural activities. Smallholder farmers were encouraged to form cooperative societies and engage in collective agricultural activities on the redistributed land. The government took direct control of the production, marketing, and overall management of the plantations and the government leased back a portion of the land to the former owners for continued cultivation, subject to certain conditions. The Agricultural Productivity Law (APL), No. 2 of 1972 was enacted to ensure the proper utilisation and development of all acquired lands by replacing the PLA. The specific impacts, successes, and challenges of the LRL of 1972 have been a subject of debate and varied perspectives and it was later repealed and replaced by subsequent legislations.

Following the LRL, the APL of 1972 was to provide for maximum productivity of agricultural land through their proper use and management. Additionally, the Agricultural Lands Law of 1973 was passed to provide security of tenure to tenant cultivators of paddy lands, to specify the rent payable by tenant cultivators to landlords, to make provision for the establishment of cultivation committees, to provide for the determination of tenurial and other disputes in respect of agricultural lands, etc.

5.4.3 Post Liberalisation Period

Despite the opening up of the Sri Lankan economy in 1977, the historical bias towards agriculture remained with the main objective of achieving food self-sufficiency, particularly with respect to rice.[19] First, the Agrarian Services Act of 1979 (ASA) replaced both the APL and ALL to include their provisions and set up Agrarian Services Committees (ASCs) to oversee the efficient management of all agricultural lands. A key milestone came with the enactment of the Mahaweli Authority Act (MAA), No. 23 of 1979, to establish the Mahaweli Authority of Sri Lanka (MASL) as a statutory body responsible for the planning, coordination, and implementation of the Mahaweli Development Programme and overseeing the overall management and development of land, water, and other resources in the Mahaweli river basin. The Act provides a legal framework for land acquisition,

19 Weerahewa, Jeevika., Hemachandra, Dilini., & Pushpakuamra, Gamini. (2021). Land Regulations, Tenure, and Land Use of Sri Lanka: A Historical Analysis on Agricultural Lands. In *Examining International Land Use Policies, Changes, and Conflicts,* G. N. Tanjina Hasnat & Mohammed Kamal Hossain (Eds.). *IGI Global,* 2021, pp. 139-161.

resettlement of affected communities, and land allocation to beneficiaries under various schemes implemented by the authority. The MAA has contributed to establishing irrigation systems, settlement schemes, hydropower generation, and regional rural development initiatives.

The Land Development (Amendment) Act, No. 27 of 1981 permitted land grant under 'Swarnabhumi' and later 'Jayabhumi' schemes, replacing permanent lease. It provided legal provisions to mortgage such lands only to prescribed banks and institutions, while the subsequent amendments empowered mortgaging lands in state banks (1993) and enabled mortgaging in private banks (1996). The Title Registration Act, No. 21 of 1998 was enacted to transform deeds and other documents (such as permits) into clear freehold titles and eliminate certain restrictions imposed on lands under leases, grants and permits. The Agrarian Development Act (ADA), No. 46 of 2000, which replaced the ASA, further empowered the tenant cultivators and Agricultural Development Councils (ADCs), which replaced the ASCs were vested with powers to take over and cultivate unproductively used land. The ADA and the Amendment Act No. 46 of 2011 continued with the restriction of converting paddy land to other uses.

To strengthen ownership of land by providing secure titles to those possessing or utilising a parcel of land, the Registration of Title Act, No. 21 (1998) launched the Bim Saviya Land Title Registration Programme in 2007 to survey lands to define boundaries to ensure ownership under a clear and secure title certificate. Registration of titles was expected to provide benefits like security of ownership and tenure, reduction of land disputes, stimulation of the land market and investment, security for credit, proper management of state land, etc. Another progressive step in improving land security and marketability is initiating a Digital Land Information System for better land administration. In 2014, the Land (Restrictions on Alienation) Act, No. 38 of 2014, was enacted to regulate and restrict the transfer of land to foreign entities in order to safeguard national interests and prevent large-scale land acquisition by foreign investors. In 2016, efforts were made to establish a Land Bank to efficiently manage state-owned land and promote investments in agriculture, industries, and other sectors.

5.4.4 Institutional Framework Governing Land

At present, several institutions perform key functions in land-related matters under the Ministry of Tourism and Land. Additionally, several other institutions perform land-related auxiliary functions under different Ministries such as the Ministry of Public Administration, Home Affairs and Provincial Councils and Local Government; Ministry of Irrigation; Ministry of Wildlife and Forest Conservation; Ministry of Finance, Economic Stabilisation and National Policies; Ministry of Urban Development and Housing, etc. The Ministry of Lands was established in 1932 with the objectives of formulating and implementing state land policies, conserving state lands, and implementing activities related to land settlement and land acquisition for public purposes. Several institutions, namely, the Land Commissioner's General Department (LCGD), Land Reform Commission (LRC), the Land Use Policy Planning Department (LUPPD), the Sri Lanka Survey Department (SLSD), the Land Title Settlement Department (LTSD), Land Survey Council (LSC), and Institute of Surveying and Mapping (ISM) fall under the purview of the Ministry.

The complex policy and regulatory framework governing land use has been further complicated by institutionally and functionally fragmented and complex land administration processes. The challenges arising from these include land scarcity, tenure insecurity, land fragmentation and degradation, land encroachment and deforestation, and lack of institutional coordination in policy implementation.

The LCGD is the main government agency responsible for land administration and management in Sri Lanka. Its functions are to manage state lands and ensure their optimum utilisation to create a freehold land-owning society for sustainable development. The LRC bears responsibility for utilising lands and physical resources vested under the Lands Reform Act (LRA) by implementing land reform processes, improving the productivity of lands, managing the ownership of physical resources, ensuring their protection, giving effect to the maximum limit of ceiling on timely requirement, paying compensations, investing in productive economic fields, and maintaining a reserve of lands. The LUPPD assists with formulating and implementing land use policies and developing land information system. The SLSD is responsible for the standardisation and production of all surveying and mapping activities as well as the establishment of a national cadastre under the land titling programme. Aside from these, the Urban Development Authority (UDA) and the National Physical Planning Department (NPPD) have responsibilities for integrated planning and development.

Further, several environmental regulatory bodies, including the Forest Department (FD) and the Department of Wildlife and Conservation (DWC), oversee land use in environmentally sensitive areas and enforce environmental protection laws. The Forest Ordinance No.10 of 1885, which made provisions for the declaration of reserved forests and the National Heritage and Wilderness Areas Act, No. 3 of 1988 which, provides special protection to the forest areas that have unique ecosystems, genetic resources, or outstanding natural features are administered by the FD. The DWC is governed by the Fauna and Flora Protection Ordinance, No. 2 of 1937, which provides legal provisions to identify and declare suitable areas as wildlife reserves. Both FD and DWC function under the Ministry of Wildlife and Forest Resources Conservation. Other than those institutions, some institutions under the Ministry of Agriculture and Ministry of Environment shoulder some responsibility related to land use.

At the sub-national level, each province is responsible for properly managing state lands. However, there are uncertainties in the devolution of responsibilities to the Provincial Councils as per the 13th Amendment to the Constitution. The Constitution specifies that state land required for the purposes of the government in a province may be utilised in accordance with the laws governing the matter, which means the central government holds the executive power related to the use of state lands. Divisional Secretariats (DS) function as the local custodians of state lands by evaluating, processing, and recommending applications and requests from the public to the LCGD.

5.5 Current Challenges of Land Use in Sri lanka

The above discussion on the evolution of land policy, regulations and institutional framework highlights the major directions of land policy in Sri Lanka over three distinct periods. The complex policy and regulatory framework governing land use has been further complicated by institutionally and functionally fragmented and complex land administration processes. The challenges arising from these include land scarcity, tenure insecurity, land fragmentation and degradation, land encroachment and deforestation, and lack of institutional coordination in policy implementation.

5.5.1 Land Scarcity

Sri Lanka's total land area is 65,610 sq. Km (6.56 million [Mn] Ha), out of which 3,750 sq Km (6%) is inland water. Land scarcity is a significant issue in Sri Lanka, particularly due to its relatively small land area and growing population. Due to population growth and urbanisation, increased demand for housing, infrastructure, agricultural land, and urban development exerts enormous pressure on the available land resources. This has led to the expansion of populated areas as well as cities and towns, converting agricultural and natural lands into built-up areas and converting natural forest and conservation areas for agricultural purposes in villages. According to the FAOSTAT data, in 2020, out of the total land mass, only 22% is arable due to permanent crops, forest conservation, unsuitable terrain, rocks, etc.[20]

The available data on major land uses in Sri Lanka provides insight into how land policies prioritised land allocation. Accordingly, agriculture has been the major land use historically, followed by forestry (Table 5.1). While this has changed over the years, nearly half of the total land area remains under agricultural uses (with 33% in direct agriculture and 18% as home gardens).

20 Arable land (Ha per person) includes land defined by the FAO as land under temporary crops (double-cropped areas are counted once), temporary meadows for mowing or for pasture, land under market or kitchen gardens, and land temporarily fallow. Land abandoned as a result of shifting cultivation is excluded.

Table 5.1
Major Land Use Patterns in Sri Lanka, 2007 and 2018

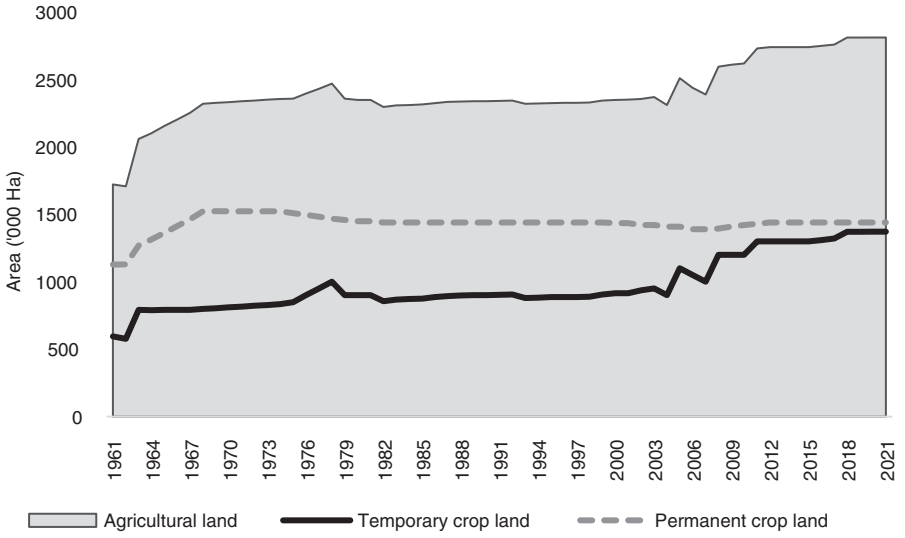
Land Use Type	2007		2018	
	Extent (Ha)	Percentage (%)	Extent (Ha)	Percentage (%)
Urban Land	**36,620**	**0.6**	**85,094**	**1.3**
Homesteads/ Home Garden	**10,28,600**	**15.7**	**11,92,925**	**18.2**
Agricultural Land	**32,25,157**	**49.2**	**21,47,149**	**32.7**
Tea	1,89,800	2.9	2,28,118	3.5
Rubber	1,83,200	2.8	1,86,334	2.8
Coconut	3,13,700	4.8	2,08,368	3.2
Paddy	8,44,000	12.9	9,83,550	15.0
Mixed tree & Other Perennials	1,64,325	2.5	82,227	1.3
Sugarcane	13,800	0.2	29,808	0.5
Other Agriculture/ Sparsely used Land	15,16,332	23.1		
Palmyrah			15,833	0.2
Oil palm			8,781	0.1
Cinnamon			21,015	0.3
Banana			14,203	0.2
Field Crops			3,07,311	4.7
Other Cultivations			12,941	0.2
Abandoned Agricultural Land			48,660	0.7
Water Bodies	**3,03,068**	**4.6**	**3,74,553**	**5.7**
Forest Land	**18,43,775**	**28.1**	**25,16,437**	**38.4**
Dense Forest	11,23,700	17.1	13,53,351	20.6
Open Forest	4,03,975	6.2	4,95,197	7.5
Scrub	1,38,600	2.1	5,30,006	8.1
Grassland	90,600	1.4	69,780	1.1
Forest Plantation	86,900	1.3	68,103	1.0
Wetland	**43480**	**0.7**	**85,443**	**1.3**
Rocks			**87,089**	**1.3**
Sandy Areas			**19,623**	**0.3**
Barren land	**80,300**	**1.2**	**52,687**	**0.8**
Total	**65,61,000**	**100**	**65,61,000**	**100**

Source: Land Use Policy and Planning Division (LUPPD) Data

Rice accounts for 15% and major plantation crops (tea, rubber and coconut) occupy 10% of the agricultural land (see infographic). The conversion of agricultural land for non-agricultural purposes – such as housing, industries, and infrastructure – has shrunk the availability of arable land for farming. Land under agricultural uses, particularly rice lands in the wet zone and marginal tea, rubber and

coconut lands are being continuously converted to non-agricultural uses. This could be attributed to the increased demand for land by both local and foreign investors, the low productivity of privately owned small agricultural holdings and high replanting cost of plantations. Even though the area under agricultural use has grown over the years until it has become a plateau in recent years, most of the potential agricultural land is sparsely used. This is shown by the rise in temporary crop land and lower permanent crop land over the years (Figure 5.1).

Figure 5.1
Agricultural Land Use Changes in Sri Lanka, 1961-2021



Source: Food and Agriculture Organization. (n.d.). *FAOSTAT Food and Agriculture Data*. Retrieved July 20, 2023, from Food and Agriculture Organization: https://www.fao.org/faostat/en/#data/RL

Addressing land scarcity in Sri Lanka requires a comprehensive and integrated approach that includes effective land use planning, sustainable land management practices, and the implementation of appropriate land use policies. Encouraging land consolidation, promoting efficient land use, and investing in urban planning are some strategies that can help mitigate the impacts of land scarcity and ensure the optimal use of limited land resources in the country.

5.5.2 Land Fragmentation

Land fragmentation is a significant issue in Sri Lanka, where land holdings are often divided into small and scattered parcels. Several factors contribute to land fragmentation such as population pressure, inheritance and the land tenure system, and lack of land markets. Due to population growth, the total land area per capita has gradually reduced. The per capita land extent was 0.94 Hectares (Ha) in 1946 and more than halved to 0.41 Ha in 1982 (Table 5.2). In 2014, it reduced further to 0.30 Ha. Even though land area under agriculture has increased, the size of a holding has decreased over time, as shown in Table 5.1. By 1946, the total extent of agricultural lands in Sri Lanka was 1.73 Mn Ha and the

size of a holding was 2 Ha. It halved to 1.10 Ha per holding in 1982 (in 36 years) and halved again to 0.52 Ha per holding in 2014 (in 32 years).

Table 5.2
Extent and Holding Size of Agriculture Land Holdings (1946-2014)

	Agriculture Land (Ha)	Number of Holdings	Population	Agriculture Land Extent/ Holding (Ha)	Total Land Extent Per Capita (Ha)
1946	1,726,955	854,575	6,657,339	2.02	0.94
1962	1,888,487	1,174,102	10,267,067	1.61	0.61
1982	1,973,652	1,800,000	15,438,753	1.10	0.41
2002	1,942,662	3,253,000	19,110,707	0.60	0.33
2014	2,283,641	4,353,000	21,239,457	0.52	0.30

Source: Department of Census and Statistics (DCS), Agriculture Census -1946, 1962, 1982 and 2002; Economic Census -2013/2014.

With a growing population, the division of land among family members becomes increasingly common, leading to further land fragmentation. Sri Lanka's traditional land tenure and inheritance practices often lead to the division of land among heirs, resulting in smaller and fragmented land parcels over generations. The absence of a functioning land market in rural areas hinders the consolidation of land parcels and prevents landowners from selling or merging their plots while the absence of proper land consolidation programmes and mechanisms means that fragmented land holdings remain as small, separate plots. Inefficient land administration and cadastral systems, too, can contribute to land fragmentation, as boundaries may be inaccurately defined or recorded. Land fragmentation can have various adverse impacts on rural livelihoods, including reduced land use efficiency and productivity, increased risk vulnerability, land use conflicts, limited investment, etc.

Addressing land fragmentation requires a comprehensive approach that involves land consolidation programmes, land use planning, improved land administration systems, and awareness campaigns on the benefits of consolidating lands. By promoting larger, more viable land holdings, Sri Lanka can enhance agricultural productivity, improve land use efficiency, and support the livelihoods of rural communities.

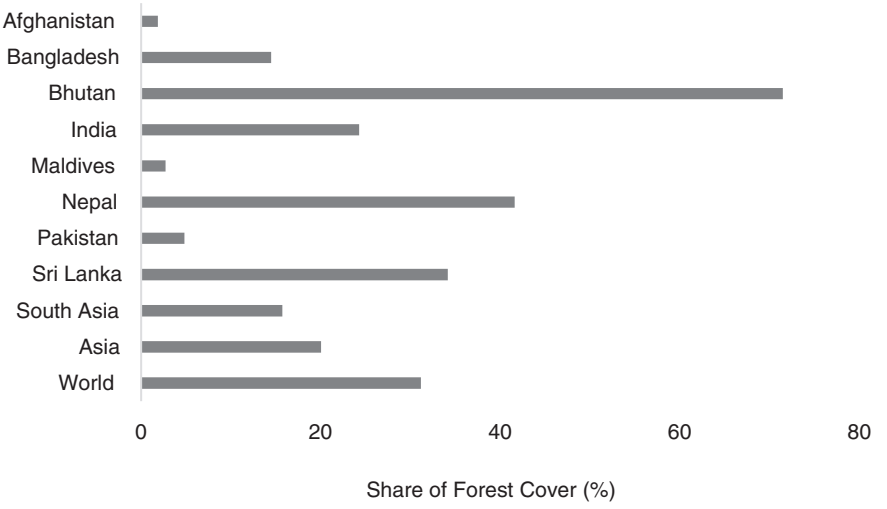
5.5.3 Deforestation

Sri Lanka's forest cover at 34% of the total area is much higher than the average for South Asia (16%) and Asia (20%) and even slightly above the world average (31%) as shown in Figure 5.2.[21] In South Asia, Bhutan has the highest forest cover (71%) followed by Nepal (42%) while all other South Asian countries have a lower share than Sri Lanka. The country's total area of forest lands has been

21 According to LUPPD, it was 38.4% in 2018.

estimated to be 2.5 Mn Ha in 2018. As seen in infographic, dense forests (54%) occupy the highest land area in the forest sector, followed by open forests (19%). The balance of the forest lands consists of forest plantations (3%), scrubs (21%) and grasslands (3%). The natural forest area largely covers districts in the dry zone and much of these lands are scrub jungles or sparsely spread forest lands, while the wet zone with relatively stable forest cover mainly comprises small and fragmented forests which cover only a minor extent of the natural forests. These different forest types make for specific ecosystems with very high biodiversity. The state owns almost all the country's forest lands.

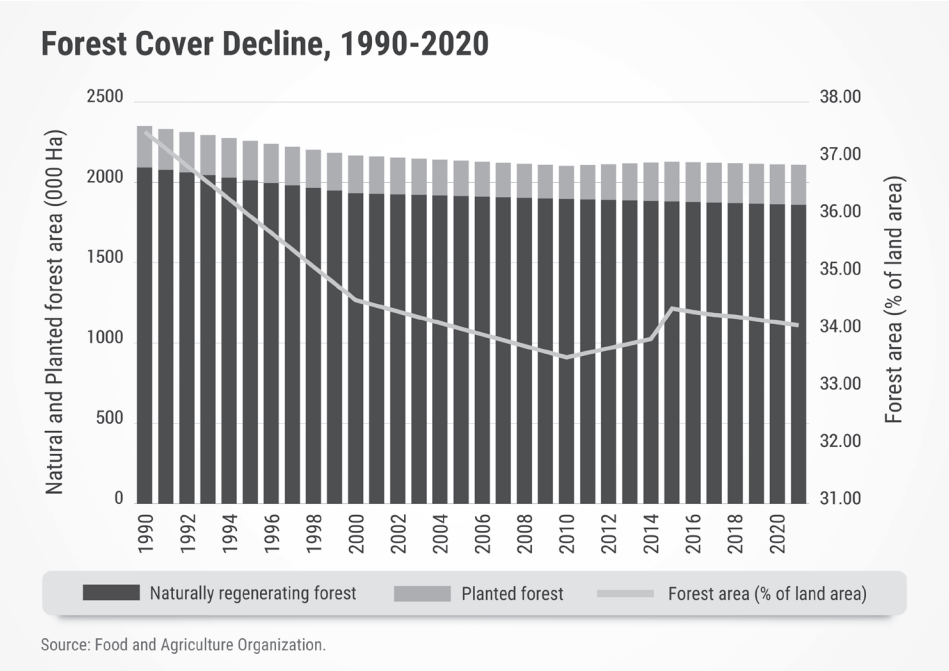
Figure 5.2
Share of Land Covered by Forest in South Asian Countries



Source: Richie, H. (2021). *Forest Area.* Retrieved July 20, 2023, from Our World in Data: https://ourworldindata.org/forest-area

However, deforestation in Sri Lanka has been a pressing environmental issue for several decades. The country has experienced a significant loss of its natural forests due to man-made causes like various human activities such as agricultural expansion, illegal logging, and timber extraction and natural causes such as climate change. The total area of forest lands was estimated to be 2.35 Mn Ha in 1990 (37% of the total land area), but this had diminished by 10% to 2.10 Mn Ha by 2021 (34% of the land area), which is a significant decline.

Not only has the forest area as a percentage of the total land area but the share of the natural forest areas has been declining over the years, with only the share of planted forests showing a slight increase (see infographic). Deforestation in Sri Lanka has had several adverse consequences, including loss of biodiversity, degradation of watersheds, soil erosion, and negative impacts on local communities that depend on forests for their livelihoods and sustenance. While some measures have been taken to address deforestation, such as establishing protected areas, promoting afforestation and reforestation projects, and implementing forest conservation programmes, weak enforcement of forest protection laws and inadequate governance have contributed to illegal activities that lead to continued deforestation. Continued efforts and stronger enforcement of conservation measures are necessary to protect the remaining forests and promote sustainable land use practices in the country.



Source: Food and Agriculture Organization.

5.5.4 Land Degradation

Land degradation is a significant environmental issue in Sri Lanka, affecting rural and urban areas. It is driven by a combination of natural and human-induced factors leading to the deterioration of land quality and loss of productivity. Inappropriate land management practices, including inadequate soil conservation efforts, misuse of agro-chemicals, poor soil fertility management, deforestation, waste disposal, over-extraction of groundwater, indiscriminate sand mining in rivers and streams are the main reasons for land degradation. Uncontrolled water runoff during heavy rains also leads to the removal of topsoil, further exacerbating soil erosion and land degradation. In Sri Lanka, improper land use on steep slopes that include chena cultivation, tobacco, clean weeded clonal and seedling tea are erosive land uses with high soil losses, which could result in landslides and soil instability, causing land degradation and threatening communities (Table 5.3).

Table 5.3
Soil Losses in Different Land Uses in Different Agro-Ecological Regions

AER	Land Use	Erosion (Tons /Ha/Year)
MCWZ	Seedling tea without conservation	40
	Well-managed tea in contour	0.24
	Mixed home gardens	0.05
UCWZ	Clean weeded Vegetatively Propagated tea	52.6
	Vegetatively Propagated tea with mulch	0.07
MCIZ	Tobacco no conservation	70
	Capsicum no conservation	38
	Carrot no conservation	18
LCDZ	Sorghum, Pigeon pea	21.3
	Sorghum, Pigeon pea with mulch	3.9

Notes: AER= Agro-Ecological Region; MCWZ= Mid Country Wet Zone; UCWZ= Up Country Wet Zone; MCIZ= Mid Country Intermediate Zone; LCDZ= Low Country Dry Zone.

Source: Ministry of Environment and Renewable Energy (2014). *National Action Programme (NAP) for Combating Land Degradation in Sri Lanka 2015-2024*. Battaramulla: Ministry of Environment and Renewable Energy.

Poverty, unfavourable land tenancy, pressure for land, weak institutional frameworks, ignorance of land users, inappropriate development activities, failure in law enforcement and political interference are the key drivers of land degradation, which results in adverse impacts such as depletion of water resources, loss of biodiversity, downstream sedimentation, loss of land productivity, increased cost of production, water pollution, loss of productive lands and increased poverty. For example, 54% of agricultural households do not do any form of soil conservation measures as per the Agriculture Household Survey 2016/2017 of the DCS.

Thus, addressing land degradation in Sri Lanka requires a multi-pronged approach, including sustainable land management practices, reforestation and afforestation programmes, improved irrigation techniques, and better enforcement of environmental regulations. Collaborative efforts from government agencies, local communities, and other stakeholders are essential to promote land conservation and sustainable land use practices in the country.

5.5.5 Land Tenure Insecurity

The insecurity of land tenure rights is a significant issue in Sri Lanka, particularly in rural areas and among marginalised communities (Table 5.4). Land tenure insecurity refers to the lack of legal recognition and protection of land rights, which can lead to the displacement and vulnerability of landowners and users. Several factors contribute to the insecurity of land tenure rights in Sri Lanka.

The country has a complex history of land ownership and disputes, including issues related to land taken over during colonisation, political conflicts, and post-independence land reforms. Many of these disputes remain unresolved, leading to uncertainty and insecurity of land tenure. A significant portion of landholdings in Sri Lanka operates under informal tenure systems, where land rights are not formally recognised or documented, leading to insecurity and vulnerability to land grabbing. Land distribution has been historically unequal, with large landholdings concentrated in the hands of a few, while many small farmers and marginalised communities face challenges in securing land rights. In many rural areas, land deeds and documentation are not properly maintained or updated, leading to disputes and uncertainty over land ownership. Also, women in Sri Lanka often face challenges in accessing and holding secure land tenure rights due to cultural norms and discriminatory practices.[22] Land administration systems also suffer from inefficiencies, corruption, and lack of transparency, leading to delays and challenges in obtaining secure land tenure. Adding to all these, past conflicts have resulted in forced displacements and loss of land rights for many communities, particularly in conflict-affected regions.

Table 5.4
Different Types and Categories of Tenure of Agriculture Lands

Type	Category	Percentage
Inherited		52.0
Granted	Government	16.8
	Others	1.6
Purchased	With title	9.9
	Without title	1.8
Rent/ leased	Government-owned	0.4
	Private owned	6.0
Borrowed for free		2.2
Encroached		5.9
Fallowed paddy land		0.1
Other		2.8

Source: Agriculture Household Survey 2016/2017, of the DCS.

Encroachment onto public or privately owned lands by individuals or groups can result in conflicts and undermine land tenure security. Insecure land tenure can lead to forced evictions and displacement, making communities vulnerable to poverty and landlessness. Insecure land tenure discourages investment in land improvement and development, as landowners fear losing their investments in case of disputes. Conflicts and legal disputes, in turn, lead to lengthy litigation processes.

22 Gunasekera, Viyanga. (2021). *Women and Land in Sri Lanka: A Literature Review*. Colombo: International Centre for Ethnic Studies.

Insecurity of land tenure can deter farmers from making long-term investments in agricultural practices, leading to reduced productivity. There is also no motivation for the farmers to adopt soil conservation practices because the benefits of investments in land conservation are realised only in the long-term. For example, linkages between soil erosion and insecurity of tenure are reported with heavy soil degradation with the thinnest topsoil found in encroached government lands and leased lands from the government and the private sector.[23] Sri Lanka has made some changes to the process of registering property in recent years, such as attempts to implement a fully digital land registry, roll out a geographic information system and create a single window counter for the issuance of certificates, etc.

Land tenure insecurity impedes large-scale development projects that require land acquisition and clear land rights. Addressing land tenure insecurity in Sri Lanka requires comprehensive land reforms, effective land administration systems, and measures to protect the rights of vulnerable communities, including women and marginalised groups. Ensuring clear land documentation, providing legal assistance to landowners facing disputes, and promoting equitable land distribution can help enhance land tenure security and contribute to sustainable land management in the country.

5.5.6 Encroachment of State Lands

Over 80% of Sri Lanka's land is under state control in different forms – as alienations under land distribution programmes, lands vested with state institutions and plantation companies and protected land (Table 5.5). Unutilised land constitutes a considerable extent of state land, with much of it found in the North and East and to a lesser extent in other dry zone districts.

Land encroachment refers to the unauthorised occupation or use of land, often involving the illegal construction of buildings or structures on land that does not belong to the encroachers. This problem has multiple underlying causes, including population growth, urbanisation, inadequate land management, weak law enforcement, and corruption. Rapid urbanisation and population growth have led to increased demand for land, creating pressure on available land resources and contributing to public and private land encroachment. Inadequate land management and administration have made it easier for encroachers to occupy land illegally, while corruption within the land administration system can allow encroachers to bypass legal procedures. The lack of a proper land registry and land-use planning has exacerbated the problem. In some cases, powerful individuals or groups may use their influence to facilitate land encroachments for personal gain. In certain regions like North and East Provinces, land disputes have been linked to ethnic or religious differences, adding complexity to the problem.

23 Agriculture Sector Modernisation Project. (2022). *Policy Research in the Area of Agricultural Land. Analytical and Policy Advisory Support.* Research Report – No 08. Battaramulla: Agriculture Sector Modernisation Project.

Table 5.5
Land Statistics in Sri Lanka, 2019

Criteria	Extent
Total land (Ha)	6,561,000
State land (Ha)	5,403,809
Percentage of state-owned land	83%
No. of issued land permits	2,952,542
No. of Issued land grants	1,361,391
No. of surveyed lands	701,398
No. of plots yet to be surveyed	436,993
No. of issued long-term leased land permits	261,572
No. of land plots yet to be regularised	600,000

Source: Agriculture Sector Modernisation Project. (2022). *Policy Research in the Area of Agricultural Land. Analytical and Policy Advisory Support.* Research Report – No 08. Battaramulla: Agriculture Sector Modernisation Project.

Land encroachment has led to several environmental and economic problems, such as deforestation, habitat destruction, loss of biodiversity, increased land degradation, slow groundwater recharge, sedimentation of reservoirs, deforestation, threats to archaeological reserves and places of scenic beauty and damage to infrastructure. While certain measures have been taken to address the issue of land encroachment, their effectiveness if often hampered by various challenges, including limited resources and systemic inefficiencies. A significant extent of state land has been encroached by different user groups and the ownership of much of these land parcels has been regularised occasionally, possibly stimulating further encroachment.

5.6 Conclusion and Way Forward

Land scarcity and land fragmentation that occur (i) due to expanding population and demand for non-agricultural uses, (ii) land degradation due to inappropriate land management and erosive land uses, (iii) deforestation due to various human activities and natural causes, (iv) unavailability of a well-functioning land market with secure property rights, and (v) encroachments have been cited as the major issues related to land use in Sri Lanka. These have been direct outcomes of past land policies and regulatory frameworks. Several reasons have further exacerbated such problems. These include a lack of transparency in land administration due to complex administrative structures, regulatory barriers, and poor implementation and enforcement of available legislation protecting land health, including soil conservation, management, land degradation, land fragmentation and deforestation. The result is uneconomic land holdings, poor soil health conditions and lack of soil conservation measures, low productivity in agricultural lands, low investments and poverty, etc.

Land reforms to address a similar set of challenges globally have had a mixed record of successes and failures, depending on a range of factors. However, these offer valuable lessons for designing and implementing land reform programmes that include careful planning to match priorities scientifically,

strengthen policy and governance mechanisms, improve implementation of renewed regulations, provide adequate support mechanisms and infrastructure, show political willingness and inclusiveness, and ensure broad-based stakeholder participation and consultation. The most important lesson from this analysis is the critical need for land reform focusing on five major areas: policy and governance; institutional and coordination; regulatory; and information and technology.

Policy and Governance Reforms: The national land use policy should be formulated in line with the government's current national development strategies and overall economic policies. Historically, land use policies in Sri Lanka focused more on providing a policy framework to ensure land administration but not land use planning for improving productivity and proper land management for land use optimisation. Land use policies in Sri Lanka have historically been confined to broader policy statements without focusing on specific action plans, making the implementation difficult. This needs to be addressed in future policymaking processes. Also, the primary focus was on land use in small-scale agriculture and protecting and conserving natural resources. However, the present government strategy encourages export-driven growth based on a diversified economic base. Therefore, land use policies and priorities should be aligned with sustainable development principles, environmental conservation, and social and economic considerations to suit modern-day needs and challenges. For example, given the growing population and rapid urbanisation, sustainable urban planning with efficient public transportation and green infrastructure is essential to create liveable and resilient cities.

Institutional Reforms: Land administration in Sri Lanka is institutionally and functionally fragmented, with many national and sub-national government organisations involved in diverse functions with some overlapping and duplications. For example, at the national level, Land Commissioner General's Department and Land Reform Commission have some similar mandates for land acquired in different periods. Even though there are Provincial Land Commissioners, they have to depend on the Land Commissioner General and the Divisional Secretaries of the National government, and the land administration under inter-provincial projects like Mahaweli continues to be under the Mahaweli Authority. Therefore, reforming institutional structures is mandatory, with a clear demarcation of responsibilities and activities to be carried out by the different institutions with a stipulated timeline. This can come within the proposed new policy and should be legally binding for proper implementation and monitoring. While the proposed process integration can be short to medium run, long run land administration could consider creating a new land agency from the merger of key land sector agencies to facilitate speedy and lawful land transactions.

Regulatory Reforms: Imperfections, overlaps and complexities associated with the existing legal framework connected to land have often been a barrier to well-functioning land markets and investments. Therefore, the current regulatory framework for land policy, which involves a complex array of legal provisions, should be reviewed and necessary revisions must be made. For example, appropriate revisions can be introduced to allow the transfer of cultivation or user rights from the permit and grant holders to prospective users to promote investment and cultivation. This also applies to diversifying paddy lands with alternative crops, where paddy cultivation is not deemed profitable. Further, to minimise land fragmentation and non-viable holdings, regulatory frameworks

could be introduced restricting sub-divisions below certain extents, except in situations where novel technologies are being used to improve productivity. Transfer of permits to freehold titles should be done with regulations to maintain the minimum possible land extent to prevent uneconomical land fragmentation and encourage land markets. Considering the possible negative consequences of giving freehold titles, such farmers should be given initial support and incentives to utilise the land efficiently and market the products. However, in the long run, incentive schemes should be targeted only to the efficient producers who deploy the lands economically.

Information & Technological reforms: The absence of a formal land market information system and poor land administration causes malfunctioning land markets in Sri Lanka. Therefore, the quality of land administration should be improved with modern land management practices to address inefficiencies and efficiently transfer land to investors. For this purpose, measures like land suitability assessments, identifying appropriate economic uses for demarcated zones and drafting guidelines for land management practices under different zones to ensure economic efficiency, inclusivity and environmental sustainability have to be undertaken. Thereafter, a land information system must be established with digitised cadastral maps of unified state land data, deeds, titles and locations of land parcels. Finally, a market-based land management system should be promoted through the proposed new land agency/ land bank. The state intervention in regulating the land market should be minimal, and the state should act as a facilitator and a provider of support services and infrastructure. However, regular monitoring is essential to prevent any malpractices.

6. Decent Jobs and Sri Lanka's Labour Market Conditions

6.1 Introduction

The series of adverse shocks that affected Sri Lanka over the recent years has reversed growth and development in the country, and increased poverty levels. Poverty is estimated to have more than doubled from 11.3% in 2019 to 25% in 2022.[1] The main reason for this increased poverty is the deterioration of real incomes and the loss of jobs. With the economic meltdown, jobs in the service and manufacturing sectors declined, pushing more and more people into lower-paying jobs in the agriculture sector. The economic downturn has adversely affected not only poverty, but also inequality. The same source revealed that the inequality measured by the Gini Index widened from 37.7 in 2019 to 39.8 in 2022, which is worrying. Low earnings typically delays the economic recovery, due to reduced aggregate demand. As such, policies must be in place to improve access to productive jobs and social security to not only bring households out of poverty but also to ensure sustained growth and economic stability.

The International Labour Organization (ILO) promotes the decent work agenda as an economic and social strategy to reduce costs of adverse shocks to countries by improving their capacity for a swift recovery from economic downturns.[2] Although Sri Lanka launched a multipronged initiative to promote decent work in the country as far back as 2006,[3] the quality of jobs created has not developed much and the formal job creation in the private sector is relatively weak. Successive governments have indicated the need for knowledge-based private sector-led development. Moving towards a knowledge-based economy requires a large share of skilled workers and sufficient employment opportunities to keep them gainfully employed. However, the skill endowment in Sri Lanka is relatively low. In the above context, this chapter discusses different policies that can facilitate job growth, considering the country's current skill profile, the nature of existing jobs and the spatial distribution of jobs and workers.

6.2 What is the Problem?

6.2.1 Distribution of Jobs by Industry

Over a quarter (27.3%) of workers in Sri Lanka in 2021 were agricultural, and more than 80% of workers in agriculture were low-skilled workers having an education less than Ordinary Level, i.e. O-Levels. (Figure 6.2). Those having less than O-Level education will be referred to as low-skilled

1 World Bank. (2023, May 20). *Poverty and Equity Brief South Asia - Sri Lanka.* Retrieved May 10, 2023, from World Bank: www.worldbank.org/poverty.

2 International Labour Organization. (2023). *Advancing Social Justice and Promoting Decent Work*. Retrieved May 10, 2023, from International Labour Organization: https://www.ilo.org/integration/themes/dw_mainstreaming/lang--en/index.htm.

3 Ministry of Labour Relations and Manpower. (2009). *Making Decent Work a National Reality - Sri Lanka Road Map.* Colombo: Ministry of Labour Relations and Manpower.

henceforth in this chapter. Most agriculture jobs are of low quality and informal, with low average wages (Figure 6.1). Further, agriculture workers incomes are highly vulnerable to adverse weather events and harvest loss, making incomes uncertain. Being informal workers, agricultural workers have limited access to social security, increasing their risks of falling into poverty.

The second largest share of employment in Sri Lanka is in the industry sector, comprised mainly of manufacturing (16.8% of employment) and construction (8.5% of employment) sub-sectors.[4] Although not as high as in agriculture, this sector also has a high level of informality, with the informal worker component being 85.1% in construction and 57.2% in manufacturing (see Figure 6.1). Further, the average wages in these two sectors are low. The average wages in the construction sector were among the lowest, while those in manufacturing were also low. The employed in manufacturing and construction were largely low-skilled; of the total employed, 61% of workers in manufacturing and 73% of workers in construction were low-skilled.

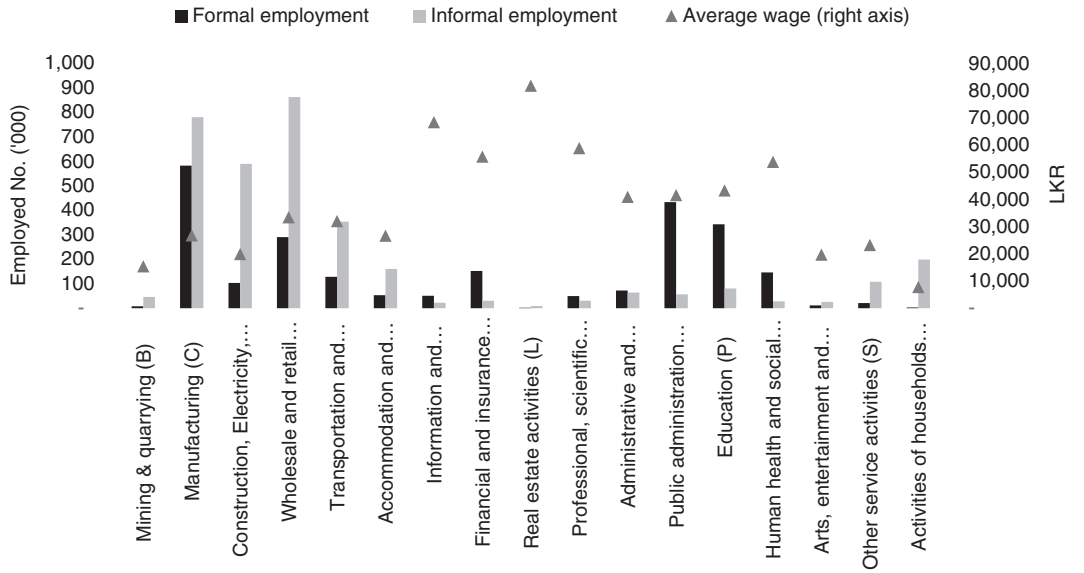
The rest of the employment (46.7%) in 2021 was in the service sector (Table 6.1), which is quite a heterogeneous sector with a variety of sub-sectors. Within the service sector, the trade sub-sector was the largest contributor (14.2% of total employment) to employment in 2021. This sector also generates largely informal jobs for low-skilled workers – 74.8% of workers were informal workers, and 55% were low-skilled. The average wages in the trade sector were slightly higher than those in the agriculture and industry sub-sectors.

Other service sector sub-sectors with large contributions to employment include public administration (6% of total employment), transport and storage (5.9% of total employment) and education (5.2% of total employment). Of these, most jobs in public administration and education sub-sectors are formal jobs in the public sector. The workers in these sectors are highly skilled, having a degree or above education. Henceforth, this chapter will refer to those with a degree or above education as highly skilled. The jobs in transport and storage are mainly informal (73.3% of employed were informal workers). The average wage in this sector is higher than that of the agriculture and industry sectors, but only marginally.

The highest average wages are seen for the service sub-sectors of 'information and communications' (ICT), 'financial and insurance activities', 'real estate activities', 'professional scientific and technical activities', 'admin and support service activities', 'public administration', education, and 'human health and social work activities' (see Figure 6.1). However, the contribution to employment in these sub-sectors is low, other than in sub-sectors with a large public sector presence. Further, informality in many of these sub-sectors is high (see Table 6.1).

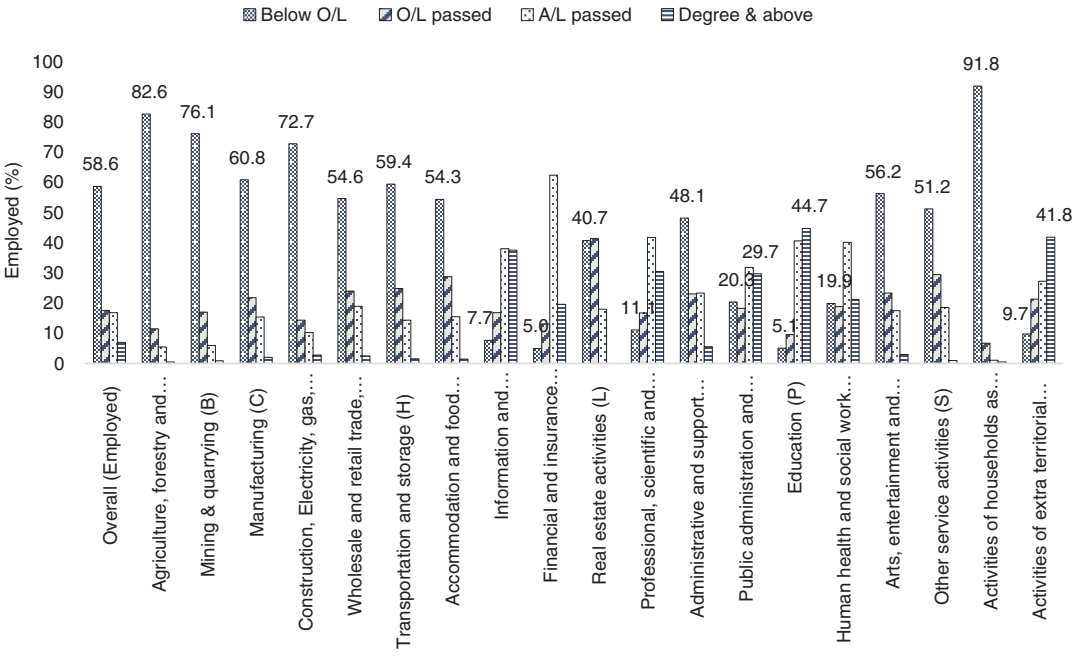
4 Construction, electricity, gas, steam, and air conditioning supply; water supply, sewerage, waste management and remediation activities will be broadly referred to as the construction sector henceforth in this chapter; wholesale and retail trade, repair of motor vehicles and motorcycles sector will be broadly referred to as the trade sector, henceforth in this chapter; the following shortened names will be used to refer to industries henceforth in this chapter: information and communication technology (ICT) activities - 'information and communication'; finance activities - 'financial and insurance activities', professional activities - 'professional scientific and technical activities', administration services - 'admin and support service activities', health and welfare services - 'human health and social work activities'; public administration includes public administration and defence compulsory social security.

Figure 6.1
Formal-informal Employment and Average Wages in Different Industries, 2021



Note: Employment in agriculture and activities of extra-territorial organisations is not shown.
Source: Authors' estimates based on Labour Force Survey (DCS, 2021).

Figure 6.2
Distribution of the Employed by Level of Education and Industry, 2021



Source: Authors' estimates based on Labour Force Survey (DCS, 2021).

6.2.2 Trends in Employment Generation

From 2016 to 2021, the country's employment grew by 2.1% (see Table 6.1). The highest contribution to this growth was from education (48%), followed by construction (46%), agriculture (36%) and trade (31%). A relatively high contribution to employment growth was reported from health and welfare activities (20%), administrative service activities (17%), professional activities (16%), and financial activities (14%).

Concurrently, the highest contraction in employment was seen in public administration (-72%), manufacturing (-35%), and transport and storage (-21%). Although most of the highest increases in employment were in industries with high levels of informality, some industries with lower levels of informality and better average wages, such as education and professional activities, also showed some growth. Most job categories contributing to growth are either created or are driven by public sector investments, with one exception of jobs in public administration.

Table 6.1
Distribution and Growth of Employment Across Industries

	Distribution (2021)	Informal Share (2021)	Change 2021-2016[a]	Contribution to Change (%)
Total	100.0	67.5	2.1	100
Agriculture, forestry and fishing	27.3	91.8	2.7	36
Mining & quarrying	0.7	84.5	-8.9	-3
Manufacturing	16.8	57.2	-4.1	-35
Construction[b]	8.5	85.1	12.3	46
Wholesale and retail trade[c]	14.2	74.8	4.6	31
Transportation and storage	5.9	73.3	-6.7	-21
Accommodation and food services activities	2.6	75.0	5.6	7
Information and communication	0.9	30.0	18.5	7
Financial and insurance activities	2.3	16.5	14.4	14
Real estate activities	0.1	81.7	37.2	2
Professional, scientific and technical activities	1.0	38.5	47.6	16
Administrative and support service activities	1.7	46.6	26.6	17
Public administration[d]	6.0	11.6	-19.5	-72
Education	5.2	19.0	23.1	48
Human health and social work activities	2.2	16.2	23.1	20
Arts, entertainment, and recreation	0.5	69.4	4.9	1
Other service activities	1.6	83.9	-6.6	-6
Activities of households[e]	2.5	98.4	-3.5	-4
Activities of extra territorial organisations & bodies	0.0	53.0	-55.6	-2

Notes: a: Contribution to change shows change in each industry group as a share of total change in employment; b: Construction, electricity, gas, steam and air conditioning supply, water supply, sewerage, waste management and remediation activities; c: Wholesale and retail trade, repair of motor vehicles and motorcycles; d: Public administration and defence, compulsory social security; e: Activities of households as employer, undifferentiated goods and services - producing activities of households for own use.

Source: Authors' estimates based on Labour Force Survey by the DCS (2016 and 2021).

6.2.3 Distribution of Employment by Employment-status and Occupation

Across employment status, the jobs were mainly created in self-employment and the public service sector. In contrast, jobs in the private sector and the share of unpaid family workers have declined. Given that 92.4% of own account workers are informal workers, most formal work was created in the public service sector.[5]

The expanding public sector in Sri Lanka is a contributory factor to the widening fiscal deficits experienced by the government, especially recently with the economic meltdown and stagflation. Shrinking the public wage bill is one main strategy the government adopts to reduce overall fiscal financing pressures. As such, reliance on the public sector to support economic job creation cannot be expected to continue. This means that the government needs to facilitate job creation in other areas of the economy. Furthermore, if job creation is not supported by economic growth but occurs in sectors/areas further inducing low productivity and waste, then Sri Lanka has to bear the burden of harsh economic consequences from doing so.

Technological changes and globalisation are considerably transforming the labour market structure towards more skilled workers. Countries worldwide are competing to attract high-skilled workers. However, less than 20% of workers in Sri Lanka are in high-skilled occupations such as managerial, professional, or technical workers.[6] Investments in expanding employment opportunities in the top three categories of major occupation groups (i.e., those needing workers with tertiary level education) are requisites to move towards a knowledge-based economy, which seeks to enhance productivity through innovations and technology adaption.

6.2.4 Access to Jobs[7]

Two key issues are the differences in access to jobs and the legal, social and infrastructural environment on access to work.

First, unequal access to employment is evident in Sri Lanka. On average, although unemployment is not a major problem for the country, some population groups face high unemployment rates. The Department of Census and Statistics (DCS) revealed that in 2021, 5.1% of those in the labour force were unemployed. However, the unemployment rates were unequal across sex and age groups, indicating inequalities in access to jobs. Youth (15-24 year-olds) had the highest unemployment rate

5 Own calculations based on Department of Census and Statistics. (2021). *Labour Force Survey 2021– Annual Report Data*. Battaramulla: Department of Census and Statistics.

6 Department of Census and Statistics. (2021). *Labour Force Survey 2021*. Colombo: Department of Census and Statistics. According to the ILO, managerial, professional, and technical workers (i.e., those in International Standard Classification of Occupations (ISCO) 1, 2, or 3) required skills usually gained at tertiary education level. In countries such as Singapore, the United States and the United Kingdom, over 50% of workers are in ISCO 1, 2, or 3.

7 This section draws from Arunatilake, N., Fernando, L., Madurawala, S., Vithanage, H., & Kiringoda, K. (2023). *Women's Access to Decent Work in Sri Lanka - Addressing Concept-Specific Barriers*. Quebec: Partnership for Economic Policy (forthcoming).

(26.5%), followed by 25-29-year-olds (11.4%). Amongst youth, young females were more likely to be unemployed (36.2%) than young males (21.3%). This is also true at the national level; more females were unemployed than males (7.9% of women and 3.7% of men in the labour force were unemployed). Unemployment rates were slightly higher in the rural sector (5.2%) compared to the urban sector (4.9%). These differences in unemployment rates have persisted over the years.

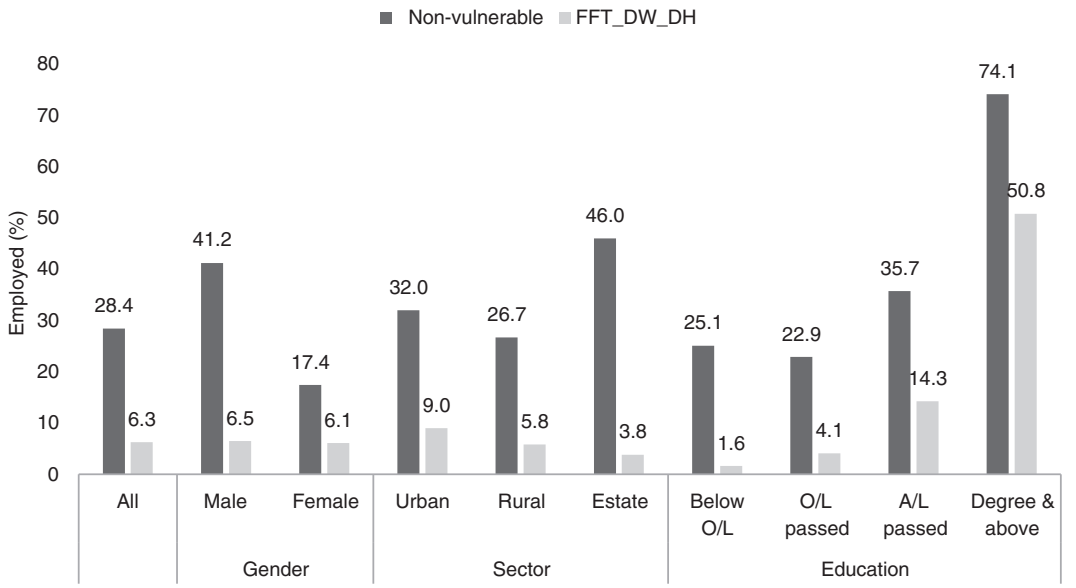
Noticeably, there is unequal access to good jobs in the country. All jobs are not the same. Self-employment and unpaid family work are considered vulnerable employment as those workers are usually not covered by social protection, and they receive variable income. As such, non-vulnerable work is considered better type of employment, however, with some exception as all non-vulnerable work are not the same. Additionally, some are precarious jobs with low wages and insecure working conditions. According to the ILO, the most desirable jobs are 'decent jobs'. Decent jobs are productive, provide social security, rights at work, and allows social dialogue.

In 2021, only 28.4% of the working-age population were in non-vulnerable jobs. Of these, males, those better educated and those in the estate sector have had better access to non-vulnerable jobs (see Figure 6.3). The surprising inclusion of the estate sector owes to the fact that most estate workers are formally contracted to work and are covered by social protection.

In 2021, only 28.4% of the working-age population were in non-vulnerable jobs.

Available information in the Labour Force Survey does not allow an assessment of the prevalence of decent jobs that satisfy all the different aspects of decent work. However, ample data are available to identify jobs that provide full-time work, jobs that are covered by social protection (i.e., formal jobs), and where working usual hours (according to the Shop and Office Employees Act, No. of 1954 and the Wages Boards Ordinance of 1988, the usual work week in Sri Lanka is 45 hours), a decent wage can be earned. On these criteria, only 6.3% of the working-age population have had access to full-time formal sector work that allows workers to earn minimum wages. According to the National Minimum Wage of Workers (Amendment) Act, No. 16 of 2021, the national minimum monthly wage payable to a worker is set as Sri Lankan Rupees (LKR) 12,500 and the daily wage is at LKR 500. Males in urban areas and high-skilled workers had slightly better access to decent work. Overall, although access to decent work varied widely across sectors and levels of education (see Figure 6.3).

Figure 6.3
Access to Different Types of Decent Jobs by Gender, Age-group, Sector, and Level of Education, 2021



Note: Calculated as a proportion of the working-age population (15 and above). FFT_DW_DH: Formal full-time employment with decent wages earned within decent working hours.

Source: Authors' estimates based on Labour Force Survey by the DCS (2021).

Second, the unequal treatment of men and women in legislation reduces the demand for females in the labour market and impacts their access to jobs. Sri Lanka's Constitution states that no person must be discriminated based on their sex. The Women's Charter which was formally adopted by Sri Lanka in 1993 recognises the rights of men and women to engage in economic activities for financial gain. However, existing legislation in the country does not align with the guidelines set out by these enactments. Some anomalies of such legislation are discussed below.

Employers have to incur higher costs when employing women due to legislative regulations. This is mainly because the costs of complying with legal requirements are the responsibility of the employer. According to the Maternity Benefits (Amendment) Act, No. 15 of 2018, employers in the formal sector must provide paid maternity leave to their female workers. The employer must bear the full cost of providing this benefit. However, according to the ILO Maternity Protection Convention (Convention No. 103), maternity benefits should be paid through statutory social insurance or through public funds. Further, to employ women in night work, the employers must obtain a written request from the Commissioner of Labour, and hire a warden, according to the Shop and Office Employees Act (1954).[8] The same Act also limits female overtime work.

8 The Cabinet approved a proposal in August 2022 to relax these conditions for a limited number of employment in the ICT sector, but not for all.

The unequal treatment of men and women in legislation reduces the demand for females in the labour market and impacts their access to jobs.

The existing legislation also implicitly put the responsibility of childcare on women. For example, according to the Employees' Provident Fund (EPF) Act, No. 15 of 1958, women can withdraw funds contributed towards EPF after marriage, if unemployed. The same provision is not applicable to men. Such regulations implicitly provide incentives for women to leave work after marriage. Further, according to the Sri Lanka Foreign Employment Bureau legislation, women with children under two years of age are required to show a family background report (FBR) that they have made provisions for the care of their children before migrating for work. The same restriction does not apply to the father. These two scenarios indicate discriminatory laws for women.

Sexual harassment in the workplace is a form of discrimination that causes women to move out of the workplace. The existing legislation does not address sexual harassment in the workplace directly, although different legislation addresses it indirectly (e.g., Section 345 of the Penal Code (Amendment) Act No. 22 of 1995, Industrial Disputes Act No. 43 of 1950). Even when it is indirectly addressed, the legislation is not supportive of the victim. According to the Penal Code, sexual harassment is a criminal offence. Unlike civil offences, criminal offences require lengthy court procedures and a higher burden of proof, which many victims cannot bear.[9] Moreover, once the incident is reported, it makes it more embarrassing for female employees as victims as they are in the public eye. Most policies are inactive and in most cases, corporate management tends to sweep this issue under the carpet.

Underdeveloped social infrastructure results in low labour force participation of females. Among the limited childcare facilities in the country, the available facilities are also not regulated. As a result, many women are compelled to use informal care options or personal maids, preferably at excessive costs taking undue risks. However, it is also the case that low-skilled women may not unable to provide such services as caregivers. As such, when women do not have family support, they either leave the labour market or resort to home-based jobs, which they can do while attending to their care responsibilities. Such work is often vulnerable work with variable incomes and no social security.

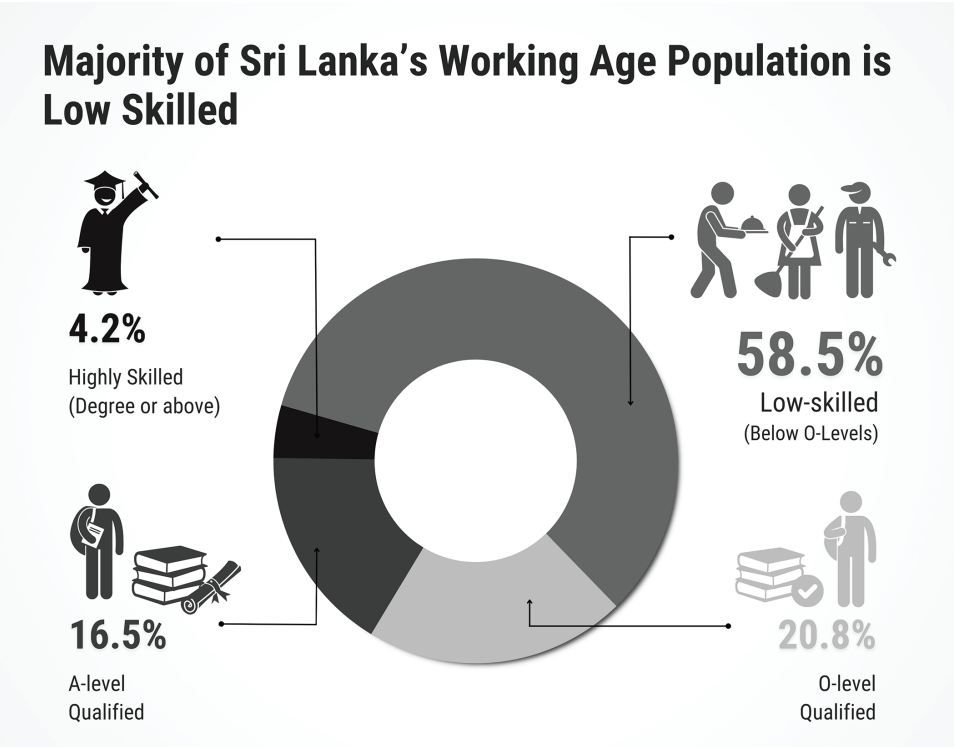
Inadequacies in infrastructure, such as in the inadequate provision of public transport, have a bearing on female labour force participation (FLFP). According to a recent study by the Institute of Policy Studies of Sri Lanka (IPS), the key problems are unreliability, inadequacy, and poor quality of public transport, which increases travel time.[10] Women, who are the main caregivers of their families find longer travel times a higher burden when accessing work. Further, according to the same study, many women experience various forms of harassment in public transport, which make travelling to work an unpleasant experience.

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9 UN Women. (2019). *Handbook Addressing Violence and Harassment against Women in the World of Work.* Retrieved May 10, 2023, from UN Women: https://www.ilo.org/wcmsp5/groups/public/---europe/---ro-geneva/---ilo-ankara/documents/publication/wcms_731370.pdf

10 This section draws from Arunatilake, N., Fernando, L., Madurawala, S., Vithanage, H., & Kiringoda, K. (Forthcoming). *Women's Access to Decent Work in Sri Lanka - Addressing Concept-Specific Barriers*. Quebec: Partnership for Economic Policy.

6.2.5 Skill Development and Job Matching[11]



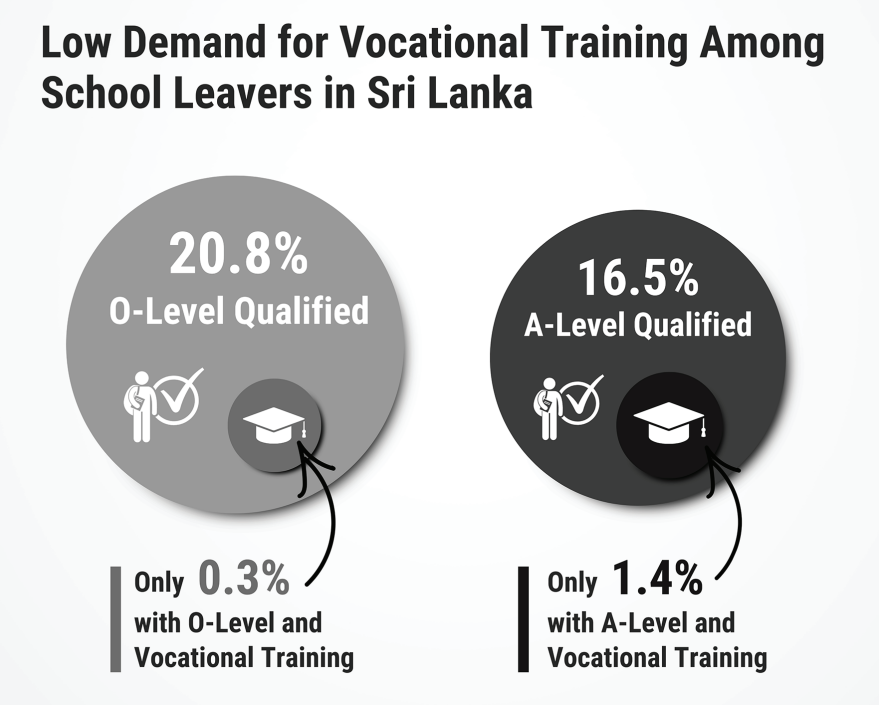
Source: Authors' illustration based on Labour Force Survey by the DCS (2021).

The skills composition of the population in the Sri Lankan economy is low, with 58.5% of those in the working age (15 and above) being low-skilled. Of the working age population, 20.8% had O-Level qualifications, 16.5% had Advance level (A-Level) and only 4.2% were highly skilled with a degree or above education qualification. Overall, statistics disclose that Sri Lanka's population is getting more educated. The data show that younger age cohorts are more educated than older cohorts (see Figure 6.6).

In addition to the academic education opportunities in Sri Lanka, there is a large network of vocational training in the country. However, the population share with high level vocational training is low. As previously observed, 20.8% and 16.5% of the Sri Lankan population had completed O-Levels and A-Levels, respectively. By contrast, only 0.3% of those with O-Levels and 1.4% of those with A-Levels have obtained a diploma. Further, a large share of individuals who start technical and vocational training do not complete their courses.[12]

11 This section uses own calculations using Department of Census and Statistics. (2021). *Labour Force Survey data*.

12 In 2019, only 69% of individuals starting a vocational training course at a public institution completed it. This section draws from Tertiary and Vocational Education Commission. (2019). *Labour Market Information Bulletin.* Colombo: Ministry of Skills Development, Vocational Education, Research & Innovation.



Source: Authors' illustration based on Labour Force Survey by the DCS (2021).

As noted previously, rapid technological changes and globalisation are increasing the demand for highly skilled workers globally.[13] Evidence from Sri Lanka shows a shortage of skilled workers for construction; and automobile repair, maintenance and service sectors.[14] As per the same source, to fulfil this worker shortage in lucrative job sectors, the education system and curricula need to change strategically and match these emerging labour demands for workers. Additionally, it revealed that the training institutions do not have the resources to constantly change training programmes to match technological changes.

The lack of data to properly analyse labour market conditions is a key gap to identify the holistic picture of the problem and address root causes. The DCS systematically collects labour market information. However, these must be enriched to capture the changing nature of the labour market. The information on labour demand is also limited, making labour market planning infeasible and lacking focus.

6.2.6 Facilitating Part-time Work

Most existing labour legislation governing the labour market in Sri Lanka was drafted in the middle of the 20th century. Since then, the labour market conditions have drastically changed. As detailed below, the current legislation is a barrier to introduce formal flexible work arrangements.

13 Arunatilake, Nisha., & Karunanayake, Chathurga. (2019). 4IR and the Future of Work in Sri Lanka. In *Sri Lanka: State of the Economy 2019* (pp 73-95). Colombo: Institute of Policy Studies of Sri Lanka.

14 Tertiary and Vocational Education Commission. (2019). *Labour Market Information Bulletin.* Colombo: Ministry of Skills Development, Vocational Education, Research & Innovation.

Employers are compelled to allow workers the same number of leave days and rest periods at present irrespective of the number of hours of work a day by an employee. This can deter employers from offering formal work to part-time workers. The main pieces of legislation in the country that defines work hours, holidays, and resting times of workers (e.g., Wages Board Ordinance No. 27 of 1941, the Shop and Office Employees Act, No. 19 of 1954, Employment of Women, Young Persons, and Children Act, No. 47 of 1956 and Factories Ordinance No. 45 of 1942) do not specify the minimum hours of work to qualify as a full-time employee. As such, even part-time workers will be eligible to receive the same number of holidays and rest periods as full-time workers.

As such, employers are compelled to pay the same amount of compensation irrespective of the number of work hours a day. As per leave days and rest periods, the compensation given to workers at the termination does not differentiate between part-time and full-time workers. According to the Termination of Employment of Workmen Act (TEWA), No. 45 of 1971, employees who have worked 180 days within a year are entitled to compensation if work is terminated. But the legislation does not specify the number of work hours a day to qualify for such compensation. On the one hand, this shows possibilities where the employee can lose even if a responsible employer lacks clarity regarding compensation. On the other hand, this leaves room for employers who tend to avoid their responsibility towards employees.

6.2.7 Policy Incoherence

Sri Lanka has developed numerous policies to progress job creation and productivity in the country and for skills development. Despite these efforts, the economy's structure has changed slightly in recent years and productivity levels remain low in many sectors providing employment. For example, agriculture productivity was LKR 192.87 per hour worked, compared to LKR 540.70 in the industry sector and LKR 624.58 in the service sector. [15] As shown earlier, still more than a quarter of employed in the country are in the agriculture sector.

Although many of the above-mentioned issues have been identified in policy documents with a host of different solutions recommended to address the problems, these have not been implemented comprehensively. Frequent changes to the organising of institutions responsible for implementing labour policies and a lack of capacity – human and financial – of these institutions to implement these policies are the main reasons. For example, the Ministry in charge of skills development has changed its name, its structure, and purpose several times since 2017.[16] Sometimes, skills development has come under a Cabinet Ministry and other times under a non-Cabinet Ministry. Such frequent changes to the structure of a Ministry and reporting lines disrupt the respective Ministry's activities. Thus, the Ministry responsible for some of the major skills development activities has changed along with the above-mentioned changes, hampering progress.

15 For details, please refer, Central Bank of Sri Lanka, *Annual Report* 2019, p. 162.

16 The changes are: Ministry of Skills Development and Vocational Training (2017-2018); Ministry of National Policies, Economic Affairs, Resettlement & Rehabilitation, Northern Province Development, Vocational Training & Skills Development and Youth Affairs (2019); State Ministry of Skills Development, Vocational Education, Research and Innovation (2020-2021).

6.3 Policy Choices: What Does International Experience Show?

6.3.1 Structural Transformation and Job Creation

As mentioned earlier, labour markets are changing in profound ways due to technological changes.[17] A few decades ago, manufacturing -- with its ability to generate a large number of non-agricultural jobs for low-skilled workers – was considered the main engine of growth for developing countries with large agricultural sectors, followed by movement into services. But many developing countries are bypassing the manufacturing phase to shift directly to services-led growth, sometimes termed 'premature deindustrialisation'. Although some scholars argue that premature deindustrialisation could slow overall productivity and development in the long run, others argue that the increased trade in services enabled by information and communications technology (ICT) can step in to fill the role played by the manufacturing sector previously. However, services are a heterogeneous sector that comprises many sub-sectors. Not all sectors in services contribute to productivity improvements.

Ethiopia provides an example of how agricultural-focused investments can develop productivity. In the 1990s, Ethiopia followed a development plan named Agriculture Development-led Industrialisation (ADLI). The strategy followed aimed to invest in agriculture to boost industrial demand, through increased rural incomes, lower urban food prices, increased savings in rural areas, and investments in the agro-industrial sector.

Rwanda is another country which boosted productivity by investing in improving agricultural productivity. Rwanda's success in driving productivity and reducing poverty was achieved through mixed approaches. Like Ethiopia, Rwanda also invested in improving agricultural and non-agricultural productivity, which saw increased wages for agriculture and non-agriculture sectors in rural areas. In recent times, Rwanda has also invested to develop ICT-related industries.

Both Ethiopia and Rwanda invested in modernising the agricultural sector using multiple approaches. These included strengthening workers skills and improving access to land, agricultural services as well as credit, infrastructure and enhancing farm efficiency. Concurrently, both countries invested in improving agriculture-related industries, which paved the way for non-farm employment generation as well as strengthening agricultural value chains.

Some countries – such as Costa Rica, the Philippines and Portugal – have experienced service-driven structural transformations. The main challenge for these countries is to ensure that such structural transformations are towards more productive services sub-sectors.

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17 This section mainly draws from International Labour Organization. (2019). *Structural Transformations for Inclusive Growth and Productive Employment.* Geneva: International Labour Organization.

Based on their research (in 2021), Rodrik and Stantcheva argue that multipronged policies specifically targeting job creation are crucial for effective job creation.[18] These include active labour market policies, industrial and regional policies, and innovation policies. They further argue that traditional policies centred around education, training, progressive taxation, and social insurance are no-longer adequate for addressing inequality challenges developing countries face.

6.3.2 Automation and Job Creation

Automation technological change can promote premature industrialisation of countries. An increasing number of developing countries are seen to be adopting automation technologies, which will likely have adverse effects on manufacturing sector job creation.[19] According to this argument, some countries are experiencing a dualistic manufacturing sector, where formal and informal jobs co-exist (e.g., Ethiopia and Tanzania). Some high-end firms stay competitive in these countries by adopting capital-intensive technologies from abroad. Being capital-intensive, these create fewer formal jobs in manufacturing. The jobs created are for highly skilled workers. Most jobs in the manufacturing sector are provided by small firms in the informal sector. As such, a slowdown in demand is noticeable for formal sector manufacturing jobs in these countries.

With automation, especially with the expansion of ICT-related jobs, many countries experience a rise in non-regular jobs such as part-time, on-call, and contractual jobs.[20] Part-time work has many benefits. It makes it easier for workers with other commitments – such as students and mothers – to stay connected to the labour market. Moreover, it provides space for those interested in training and means for a gradual exit from the labour market for older workers. However, in many countries, labour market regulations are not geared to accommodate part-time workers and part-time work remain informal.

Some of the ways countries are aiming to enhance the quality of part-time work include i) giving equal treatment to part-time workers in labour-laws and collective agreements according to the number of hours of work; ii) to extend equal (pro-rata) access to social protection systems, number of leave days, and rest time to part-time workers; and, iii) allowing for more flexible transitions from part-time to full-time work.

6.3.3 Social Sector Developments to Create Good Jobs

The World Bank (in 2023) reports low FLFP as a main deficit for decent work in many developing countries. But some countries have introduced policies to improve FLFP within a short period, especially Latin American countries where success stories are available. Much growth in labour force

18 This paragraph benefits from Rodrik, Dani., & Stantcheva., Stefanie. (2021). Fixing Capitalism's Good Jobs Problem, *Oxford Review of Economic Policy*, Volume 37, Number 4, 2021, pp. 824–837.

19 International Labour Organization. (2019). *Structural Transformations for Inclusive Growth and Productive Employment*. Geneva: International Labour Organization.

20 Fagan, C., H. Norman, M. Smith, & M. Menéndez. (2014). *In Search of Good Quality Part-time Employment.* Geneva: International Labour Organization.

participation rates has been for women with children. One of the drivers in this transformation is the social attitudes towards women's participation in the labour market.This was facilitated by public policies and programmes focusing on two main areas: a) those that developed the productivity of women's home production activities; and b) those that gave them access to affordable and high-quality childcare. Some examples of successful publicly provided day-care services include subsidised day-care services in Mexico and Colombia, among others. These programmes included physical infrastructure projects (such as improving access to electricity and childcare), rectifying biases in public institutions (such as in the distribution of lands), and initiatives that facilitated female access to work (such as active labour market policies).

6.4 Policy Recommendations for Action

Sri Lanka has numerous policy documents that spell out strategies for improving the quality of jobs in the country. The prevailing labour market conditions – with the main problem being that most workers are low-skilled and engaged in low-paying informal sector work, with most found in rural areas – suggests that the policy gaps continue to persist.

A 'National Policy for Decent Work Sri Lanka' along with an action plan was launched as far back as 2006. The plan was organised along the four themes of decent work: productive employment, rights at work, social dialogue, and social protection. It was comprehensive in that the focus was not only concerned with creating jobs but also about improving rights at work and social dialogue. This plan also highlighted the importance of targeting population groups with lower access to decent work – such as youth and women in lagging regions – in the planning process. Other key aspects were: a) to improve the relevance of vocational training in line with a national vocational qualification framework; b) to develop and strengthen employment services for job matching through the establishing and maintaining a labour market information system; and c) Rationalising the public sector and improving its ability to provide public services.

In 2012, a National Human Resource Development Policy (HRD policy) was launched and revised in 2017. The policy proposed several strategies to improve the productivity of different sectors. In manufacturing, the emphasis was on promoting value addition and gradually moving away from light manufacturing products to high-tech products, while it also focused on improving employment in tourism, the business process outsourcing (BPO) sector, health services, and green jobs. Several sector level policies – for instance, the Overarching Agricultural Policy, the National Policy Framework for Small and Medium Enterprise Development, etc., – also propose strategies for productivity improvements with implications for employment.

As most workers in the country are low-skilled and reside outside the Western Province, the focus should be on improving the quality of jobs for low-skilled workers in peripheral provinces.

Despite the many policy documents, it is clear that Sri Lanka's labour market conditions need urgent attention. A closer look at job generation and their spatial distribution shows that the industries that generate the bulk of the jobs in the country are informal and have low average wages. In contrast, the industries that create higher wages and formal sector jobs with high average wages create few job opportunities. Further, other than public sector jobs, the opportunities for decent jobs outside the Western Province are low. The main sectors that contributed to employment since 2016 were self-employment and public sector employment. However, given the current economic crisis and the tightened fiscal control, measures introduced to avoid a similar crisis in future increasing the number of public sector jobs, is not a suitable option.

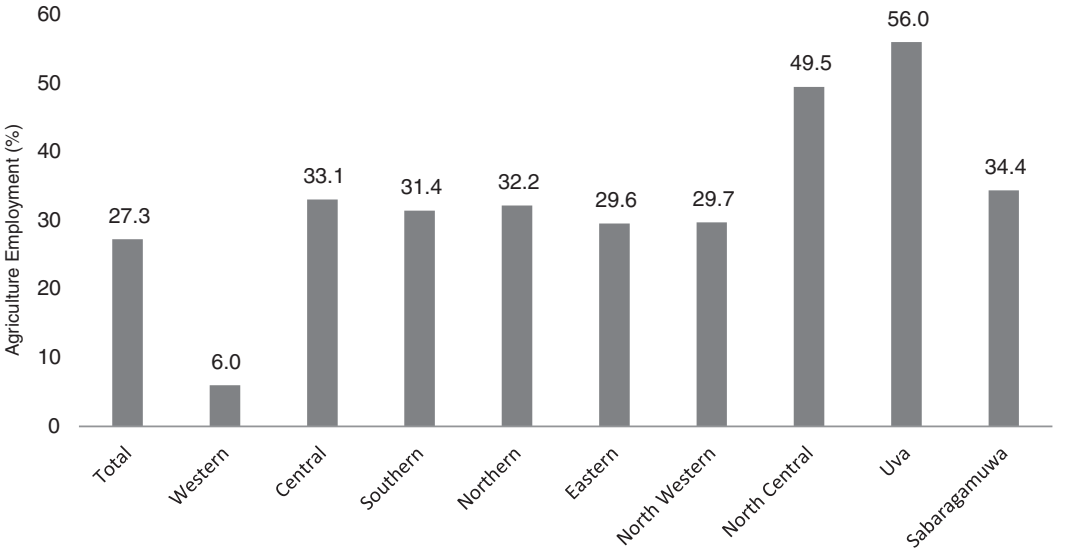
Any policy aiming to improve access to decent jobs should consider the current skill profile of the population and their distribution. As most workers in the country are low-skilled and reside outside the Western Province, the focus should be on improving the quality of jobs for low-skilled workers in peripheral provinces. Additionally, this can be a favourable move to lower the country's unemployment rate in the long run. However, moving forward, progressing on skill development and facilitating the creation of jobs for high-skilled workers require much emphasis and attention.

6.4.1 Improving the Quality of Agriculture Work

Although agriculture's contribution to gross domestic product (GDP) is low, the sector remains an important provider of employment. As seen in Figure 6.4, except for the Western Province, the province-wise contribution of agriculture to employment is higher than the total contribution of agriculture to employment in all provinces. The earnings from agriculture are low, and highly vulnerable to various types of disasters and shocks. Most workers in agriculture are low-skilled workers, and as such, in the short-term, they are unlikely to be able to access jobs requiring high-skills. To improve access to decent work for these workers, the government must focus on raising the productivity of agriculture and market linkages to enhance their earnings. Improving their access to social security is also vital as agriculture incomes are vulnerable to weather changes and climate change-related shocks.

In the short-term, low-skilled workers are unlikely to be able to access jobs requiring high-skills. To improve their access to decent work, the government must focus on raising the productivity of agriculture and market linkages to enhance their earnings.

Figure 6.4
Employed in Agriculture as a Share of Total Employed by Province, 2021



Source: Authors' estimates based on Labour Force Survey, by the DCS (2021).

Other largely agrarian countries have successfully improved agricultural workers' living standards by modernising and improving agriculture sector's productivity. As explained earlier, Ethiopia and Rwanda, were successful in doing this. Starting in the 1990s, the main features of the agriculture development programmes included agricultural extension services, land reforms and deregulation to develop the agriculture sector. Both countries coupled with agriculture productivity improvements improved access to off-farm activities.

Existing policy documents have already identified the main barriers and suggested remedies to develop Sri Lanka's agriculture sector.[21] It is important that these policy recommendations are implemented. Streamlining and improving the coordination of institutions involved in agriculture is important for effectively implementing agriculture policies. This is especially valid given that several national and provincial level Ministries and institutions are engaged in developing the agriculture sector. The organisation of institutions falling under the purview of the Ministry in charge of agriculture and the revisions made to such Ministries make strategic development of the sector challenging. The 'Overarching Agricultural Policy' was necessitated due to the need to harmonise several agricultural policies developed by various institutions and Ministries in charge of agriculture. It also makes monitoring of agriculture-related initiatives cumbersome. As mentioned earlier, although numerous policies have been developed to uplift the agriculture sector, the sector continues to face severe challenges. Establishing a more permanent governance structure and strengthening the public sector's capacity to develop the agriculture sector can progress the implementation of agriculture policies.

21 Department of National Planning. (2019). *Sri Lanka - Overarching Agriculture Policy*. Colombo: Department of National Planning.

The capacity of agricultural institutions needs to be expanded to effectively address the sector's evolving challenges. For one, climate change has shrunk the effectiveness of traditional agricultural practices to identify weather patterns and make farming decisions. Technological changes constantly introduce innovations, yielding high land and labour productivity. Further, sustainable means of improving soil fertility and controlling pests need to be introduced to the farmers to minimise losses from agriculture and increase productivity. All of this must be done with minimum environmental damage to be sustainable. Unless Sri Lanka keeps up with these changes, the sector competitiveness will likely erode with time. Conducting research and development (R&D) relating to agriculture, disseminating findings through effective extension services, and effective monitoring of regulations for protecting land and other natural resources are vital to ensure the success of agriculture over time. Further, to maintain the quality of natural resources supporting agricultural activities, the public institutional capacity for monitoring the compliance of regulations on land and other resource use is essential to boost productivity and uplift the living standards of workers in the sector.

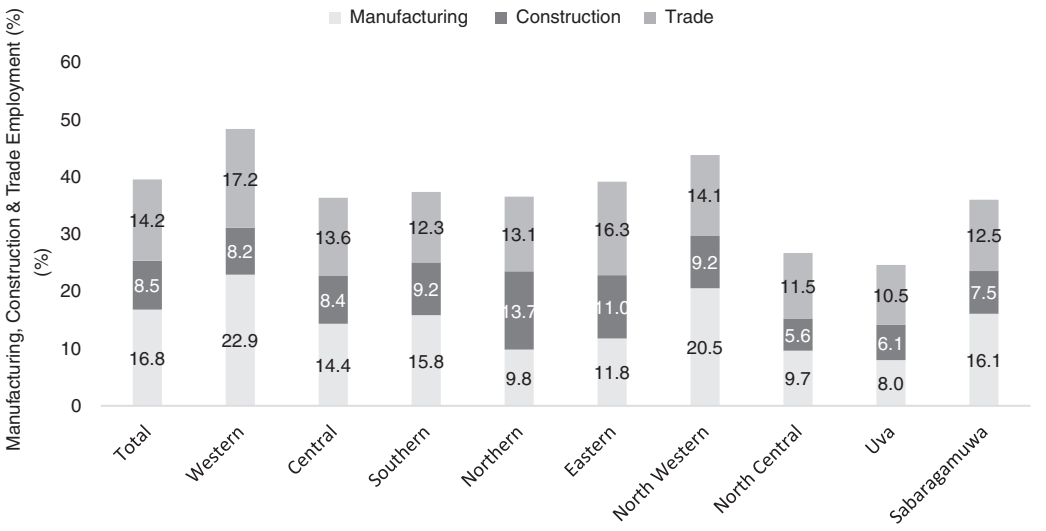
6.4.2 Off-farm Work for Low-skilled Workers

Outside agriculture, the main industries creating jobs at present in Sri Lanka are manufacturing, 'wholesale and retail trade', and construction industries (see Table 6.1). Together these three industries contribute to about a third of employment in all provinces, other than in the North Central and Uva Provinces, where the employment in agriculture is relatively high (see Figure 6.5).

Of these, the manufacturing industry has the highest potential to create formal sector jobs. Given the need for easy access to ports and infrastructure, manufacturing jobs are mainly concentrated in the Western and North Western Provinces, with a high share of jobs also in Sabaragamuwa, Southern, and Central Provinces. Historical developments in the sector show that it is highly vulnerable to changes in the global economy. For example, at present, the demand for key manufactured exports – such as garments – has waned with the ongoing global recession. Improving the business environment in the country can facilitate large-scale investments in the sector, which will drive job creation.

The manufacturing sector is unlikely to create jobs in provinces with limited links to markets and poor infrastructure. As such, currently, manufacturing job creation in the Northern, Eastern, Uva and North Central Provinces is weak. Smaller industries using local raw-material, such as agro-based industries could have increased potential for generating off-farm jobs in these provinces. In this regard, ensuring that the recommendations made in the 'National Policy Framework for Small and Medium-sized Enterprise (SME) Development' are implemented is vital.

Figure 6.5
Employment in Manufacturing, Construction and Trade as a Share of Total Employed by Province, 2021



Source: Authors' estimates based on Labour Force Survey, by the DCS (2021).

The construction sector showed the highest growth during the 2016-2021 period. This growth was mainly driven by government expenditure in the sector. According to the Public Investment Programme 2017-2020, the government spent 42.2% of total capital expenditure on commercial infrastructure.[22] Further, all these sectors generate largely informal sector employment (see Table 6.1). As the Government of Sri Lanka (GOSL) faces fiscal constraints, the sector activities are likely to decelerate. But, if aggregate demand increases, the sector is likely to pick up again. Nevertheless, a temporary pick up is not substantial to gain stability in the long run.

Construction is also a sector which can benefit from modernisation and skill improvements. Sri Lanka has a vast network of training centres dedicated to training craft level workers (such as masons, carpenters, and plumbers) who can find employment in the construction sector. But many of the current craft workers have limited technical training. In 2021, public and private sector training providers issued National Vocational Qualification (NVQ) certificates to 3,418 individuals, only for construction-related training.[23] This number is negligible relative to the 692,585 employed in the construction sector. This is partly due to the country's low demand for NVQ training. Many who work in the sector do so as informal workers. Regulations to raise the quality of workers employed by the sector, and incentives to pay higher wages can attract more people to obtain the NVQ training and get gainful employment in the sector.

22 Department of National Planning. (2017-2020). *Public Investment Programme.* Colombo: Department of National Planning.

23 Tertiary and Vocational Education Commission. (2022). *Labour Market Information Bulletin Volume 02/21,* Colombo: Tertiary and Vocational Education Commission.

Lastly, the 'wholesale and retail trade' sector is another sub-sector that comes under the services sector generating many jobs, albeit these are mostly informal sector jobs. This is another sector whose productivity can progress with skill development. Improving this sector to connect producer and consumer markets through modernisation and skills development cannot only boost earnings in the sector, but also improve earnings for agriculture. During the COVID-19 lockdown, the wholesale and retail sector was forced to adopt ICT-based solutions for sourcing and distribution of goods to consumers, including essentials like food, medicine etc. Modernising the sector and deploying the greater use of technology to connect markets to consumers can boost the productivity and wages of the sector.

'Accommodation and food service activities' is also a growing sector, albeit generating low levels of jobs at present. Like the construction and 'wholesale and retail sectors', this sector has the potential to boost productivity with training. The informal worker share is as high as 75% of the sector. The GOSL is keen to invest in the tourism sector, as it is a key avenue to earn foreign exchange. Further, as operating in diverse locations countrywide, the sector has the potential to create jobs countrywide in Sri Lanka. Similar to other sectors, better training, productivity improvements, and incentives for employers to provide higher wages can develop the quality of employment in this sector.

6.4.3 Knowledge-based Jobs

Successive governments have emphasised driving growth through improving the knowledge-based economy. Revising the classification of occupations in 2008, the ILO recognised the need to categorise occupations according to the skills required to perform the jobs effectively.[24] Accordingly, the ILO categorises skills into four levels (skill levels 1, 2, 3 and 4). Highly skilled workers are those who require skills at levels 3 and 4. Skill level 3 workers will typically have 1-3 years of post-secondary education, and/or extensive on-the-job training. Skill level 4 workers would typically have a first degree or higher-level education (i.e., 3-6 years of post-secondary education). Skill level 3 workers typically do jobs requiring the performance of complex technical and practical tasks, while workers with skill level 4 would typically do jobs requiring complex problem-solving, decision making, and creativity based on an extensive understanding of factual and theoretical knowledge.

Importantly, ICT-related and financial activities, professional activities, public administration, education, and health and social work are industries where 20% or more workers employed are highly skilled workers (see Figure 6.2). These industries are also among those that yield the highest average wages in Sri Lanka (see Figure 6.1). However, the contribution of these industries to employment is low. Over 40% of jobs in ICT-related activities, finance activities, and professional activities are in the Western Provinces. Although health and social activities, public administration, and education are industries generating jobs outside the Western Province, these are mainly created by the public sector. Given the fiscal constraints facing the government, it is unlikely that these sectors will expand to generate more jobs. The government should concentrate on facilitating the expansion of other knowledge-based industries in the country.

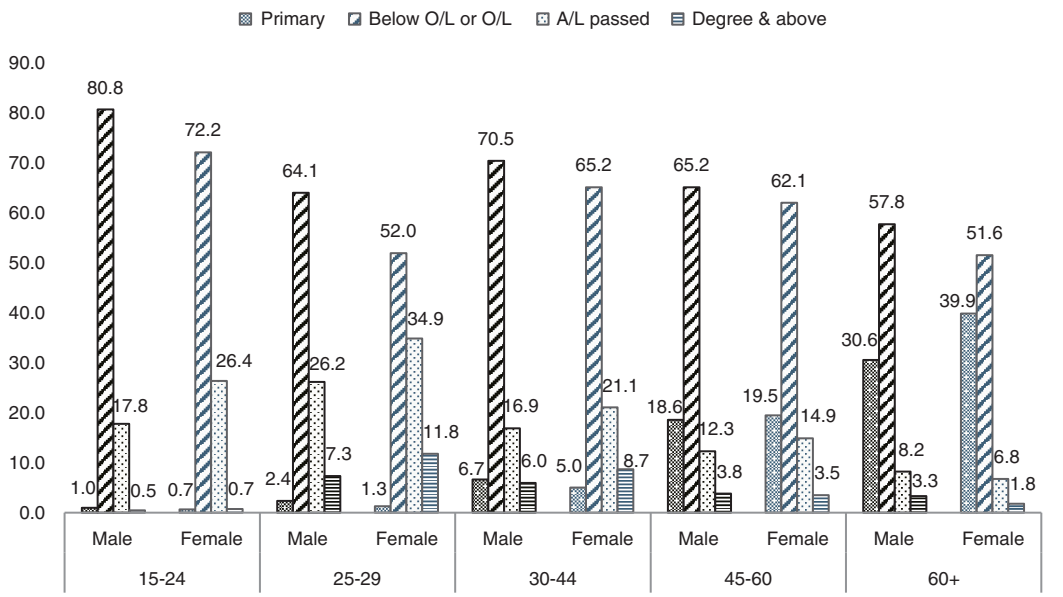
24 International Labour Organization. (2008). *International Standard Classification of Occupations*. Geneva: International Labour Organization.



Source: Authors' illustration based on Labour Force Survey by the DCS (2021).

The share of individuals with degrees is rising for younger cohorts (Figure 6.6). If these trends are likely to continue or if the lacklustre situation persists, the supply of workers for knowledge-based jobs will grow in the country. To take advantage of the increasing supply of individuals with degrees, targeted strategies should be employed to create jobs for these graduates. Currently, many jobs for those with degrees are created in the public sector. However, as mentioned previously, this is not without debates on issues regarding low productivity, potential of the employee skills base, and waste. But, going forward, the private sector too should be encouraged to generate jobs for degree holders. Such jobs will require not only a degree level qualification, but also soft skills that enable workers to do critical thinking, problem solving, decision making and creativity, as discussed earlier. Additionally, the new entrants to the job market must be equipped with skills and the positive outlook that are in demand. The degree courses in the country should ensure that graduates are well equipped for these jobs by incorporating the inculcation of such skills, internship opportunities etc., into their degree courses. Strong collaborations with the private sector and training institutions/higher education institutions (HEIs) can create synergies and mutual opportunities.

Figure 6.6
Skill Acquisition by Age Group and Gender, 2021



Note: Calculated as a proportion of the population in each age group.

Source: Authors' estimates based on Labour Force Survey, by the DCS (2021).

With COVID-19, the modes of work have changed drastically. More people are resorting to flexible work arrangements. Taking advantage of these developments, Sri Lanka can investigate facilitating private sector investments in improving access to knowledge-based employment opportunities. The initial focus should be on developing these facilities in urban centers outside the Western Province.

6.4.4 Improving Access to Jobs for Females and Youth

Access to decent work varies across different population groups in the country. The above sections discussed the varied ways of improving the availability of decent jobs across different industries, targeting populations in diverse localities with diverse skill levels. However, as shown earlier, access to decent jobs differs for different workers (see Figure 6.3). A recent study shows that women face legal, social, and infrastructural barriers to access decent work.[25]

Archaic labour laws are one reason for uneven access to employment for women. While the underlying framework for Sri Lankan legislation provided by the Constitution recognises the need for equal treatment of men and women, the legislation does not treat male and female workers equally. It is important to identify such legislation and make these gender-neutral, so employers do not incur higher costs when employing women. For example, currently the employer is responsible for providing

25 Arunatilake, N., Fernando, L., Madurawala, S., Vithanage, H., & Kiringoda, K. (Forthcoming). *Women's Access to Decent Work in Sri Lanka - Addressing Concept-Specific Barriers.* Quebec: Partnership for Economic Policy.

maternity benefits to women. But ideally, maternity benefits should be paid through a fund so that employers do not consider hiring young women a burden, thus, undermining their potential. Other related legislation which gives females special treatment should also be made gender-neutral to be congruent with overall laws impacting female employment.

The Employment Act proposed by the Ministry of Foreign Employment in July 2023 has already proposed amendments, rectifying some of these legislation anomalies. For example, the proposed legal provisions for preventing discrimination in the workplace and preventing all forms of harassment and sexual violence in the workplace will improve the workplace working conditions for all and give them equal opportunities for career progression. Relaxing legal provisions preventing night-work for women will allow employers with more flexibility to arrange staff schedules, encouraging them to give equal opportunities to workers of either sex. The proposed establishment of a social security system for paying maternity benefits, workers' health, and compensation in case of unemployment can lower the existing added costs of hiring women to employers. Such reforms can encourage more women to access decent work.

Several strategies can be used to lessen the care burden imposed on women. In the short-term, improving access to affordable and safe childcare services can ease the care responsibilities of females. These centres themselves can be a means for generating employment for some women. Further, the transport system should be made more reliable and convenient to use, to lower the time costs of accessing work. In the longer term, strategies should be implemented so that households learn to share the burden of care responsibilities regardless of gender.

Reforming labour laws to boost flexibility in the labour market can develop labour market access for youth and women. Technological change is increasing the availability of non-regular work opportunities. As mentioned earlier, improving the quality of part-time work has the potential to increase labour force participation, especially among students and women. As previously discussed, the current labour legislation does not clearly define full-time work in the country. Hence, the legislation is not clear on the level of social security benefits that are due to part-time work. Reforming labour legislation to clearly define part-time and full-time workers and ensuring that part-time workers will also benefit from the worker safeguards provided by labour legislation on a pro-rata basis can support progress the quality of part-time work. These can also draw more workers to the labour market.

The Employment Act by the Ministry of Foreign Employment in July 2023 has made proposals which have the potential to improve flexibility in the labour market, if properly designed and implemented. For example, abolishing the five-year service requirement to be eligible for service for receiving gratuity benefits will allow workers to change employment more often without the fear of losing gratuity benefits. Introducing legal provisions for recognising part-time work will allow employers to incorporate part-time work options for workers with a clear understanding of work-related benefits that are due to them. The proposal for introducing a five-day workweek and flexible working hours will help draw in women and youth to the labour market.

The success of labour reforms will largely depend on the acceptability of the proposed changes to the diverse stakeholders. Hence, it is paramount that the Ministry allows sufficient time for discussions on draft reforms before finalising legislative amendments.

6.5 Summary and Conclusion

The enormities of adverse shocks that hit the country in the past few years has amplified poverty and inequality in Sri Lanka. Good jobs – that is, jobs with adequate remuneration, social protection, rights at work, and social dialogue -- can minimise the losses and improve the resilience of households to economic fluctuations. This chapter provides insights on improving access to quality jobs in the country.

When designing initiatives aiming to improve access to quality jobs, the skill profile of the labour force and their geographical distribution are critical factors to consider. This chapter showed that nearly 60% of employed are low-skilled workers and reside in provinces outside the Western province. Of the working-age population, only a negligible 4.2% were degree holders. Most low-skilled workers were in agriculture, manufacturing, 'wholesale and retail trade', and construction sectors, where the share of informal sector workers is high, and the average wages are low. Most high-skilled workers are employed by the government or are engaged in high-end service sector jobs. They are found in sectors such as ICT, 'financial and insurance activities', 'professional scientific and technical activities', 'admin and support service activities', 'public administration', education, and 'human health and social work activities'). These jobs have higher average wages and are more likely to be formal jobs.

Improving the quality of jobs outside the Western Province in the short-term should involve two main strategies: 1) Initiatives are needed to boost the productivity of agriculture and non-agricultural jobs employing low-skilled-workers, hence the quality and wages from their work are improved; 2) the country should invest in sectors that can create quality jobs for these workers. Detailed action plans on strategies for improving the productivity of these sectors have already been identified in existing policies. However, the poor implementation of policies dilutes the effectiveness of the policies. One main reason for this adverse trend is the constant changes made to institutions and their arrangement across different Ministries. Such constant changes to the governance structures disrupt the strategic planning and operationalisation of plans, thus hindering from improving the quality of jobs in the country. The involvement of many institutions with poorly demarcated responsibilities further lowers the efficiency of policy implementation. Creating a coherent and permanent institutional setup for developing labour market policies and bringing together a clear long-term policy and proper allocation of resources for policy implementation can improve the effectiveness of existing policies.

In the long-term, the country should focus on developing the skill competencies of the population so more people are able to access quality service sector jobs and boost their creative drive. Improving skills can also enhance the productivity of jobs in the agriculture and industry sectors. Available information suggests that the skill composition of the population is already growing, with younger cohorts having higher skill-levels. But, to access quality jobs, tertiary level education alone is not

sufficient, whereas other skills such as critical thinking, problem solving, decision making, and creativity, too, are essential. These skills will allow workers not only to access good jobs, but also to be entrepreneurs who create jobs.

Lastly, the chapter highlighted the importance of reforming existing legislation to improve access to jobs for females and youth. In July 2023, the Ministry of Foreign Employment has already proposed several amendments to the existing laws of the Employment Act to improve access to quality jobs for women and youth. To be effective, these laws need to be carefully designed, implemented and most importantly, enforced. The stakeholders' concurrence should be obtained before finalising the proposed Act to avoid conflicts. In addition to these, further improving access to quality and affordable public transportation and childcare facilities can also provide an impetus for married women with children and youth to access quality jobs.

7. Improving Equity and Quality in Education

7.1 Introduction

Sri Lanka has made noteworthy progress in ensuring education accessible to all, irrespective of socio-economic differences. Free education from primary school to university has been a consistent commitment since 1945. Government allocation of funds for education covers general and higher education and most vocational education programmes. Additionally, various welfare programmes have been initiated by successive governments to improve access to general education. These include the distribution of free textbooks and uniforms, granting scholarships for underprivileged students, and providing subsidised transportation facilities. These endeavours resulted in Sri Lanka meeting the education sector-related Millennium Development Goals (MDGs) without difficulty.

Nevertheless, the Sri Lankan education system encounters fresh challenges in improving the quality and practicality of education to equip the workforce with the emerging skills demanded in the globalised world. Notable disparities exist between the demand and supply of workers, particularly in higher education concerning highly skilled workers.[1] Despite achieving near-universal basic education, a decline is seen in education participation levels more at advanced levels (A-Level). For instance, the net enrolment rate at the secondary level (grade 10-11) was 85%, while the A-Level (grade 12-13) was only 53%.[2] In this context, only 39% of the age 20 and above population has completed secondary-level education in Sri Lanka.

Only 39% of the age 20 and above population has completed secondary-level education in Sri Lanka.

A country's capacity to fulfil the growing demand for skilled workers relies on the availability of capable human capital that can meet these demands in sufficient numbers and with suitable qualifications and skills. Regrettably, Sri Lanka faces a significant challenge with a limited pool of highly educated human resources. As per the Labour Force Survey (LFS) 2019, only 4.5% of the population aged 25 years and above holds a degree-level qualification. This is primarily because the state's higher education system caters to a small fraction of the population. An alternative parallel system with private sector involvement is lacking, further exacerbating the issue. Additionally, the quality and relevance of courses offered by universities are not aligned with the labour market requirements, leading to snags in improving the education system's effectiveness.

Thus, Sri Lanka's education system must undergo significant modernisation to cater to the evolving demands of the labour market. The urgency is even more in the context of the country's current

1 Dundar, H., Millot, B., Riboud, M., Shojo, M., Aturupane, H., Goyal, S. & Raju, D. (2017). *Sri Lanka Education Sector Assessment: Achievements, Challenges, and Policy Option*s. Washington, D.C.: World Bank.

2 Author's calculations based on Housing and Income Expenditure Survey (HIES) 2019 data, by the Department of Census and Statistics (DCS).

economic downturn. It poses two immediate challenges: first, high labour outmigration, particularly of skilled workers, and second, government face fiscal constraints and competing demands on public financial resources. The outmigration of skilled workers results in a 'brain drain' where a country loses its talented workforce, including in essential services like doctors, engineers, and other skilled professionals leading to crucial bottlenecks in meeting the demand for skilled workers domestically. In such a context, fiscal constraints pose challenges in expanding investments in human capital. Moreover, hiring skilled workers and experts from abroad even in the short run, can incur excessive professional fees. Striking a balance between fiscal prudence and targeted investments in education and training programmes that develop the skills required by the domestic job market and can help bridge such gaps. Nevertheless, this is easier said than done in the context of Sri Lanka, an arduous task and hence to be backed by a good governance strategy.

However, with limited private sector participation and the government's financial constraints, addressing these education sector needs poses a significant challenge. Although efforts have been made to improve the quality and relevance of general education by introducing market-oriented subjects and practical-oriented curricula, many implementation issues at the ground level, including financial constraints and a lack of resources, hindered the expected outcomes of the attempted reforms. Additionally, in the socio-political context of Sri Lanka, avenues are limited for private sector involvement in the higher education sector. Against this backdrop, this chapter explores the prevailing key challenges within the education sector and proposes strategic policy initiatives to tackle them in light of the ongoing economic crisis and its expected spillover impacts.

7.2 Equity and Quality Issues in General Education

7.2.1 Access and Equity

Sri Lanka has achieved near-universal basic education, but a decline is seen in education participation levels at higher levels. Further, the equitability of opportunity for access to education decreases for higher school cycles. Particularly, children from lower income groups have lower access to education at the advanced level, where enrolment rates vary from 30% in the poorest decile to 73% in the wealthiest decile (Figure 7.1).

Moreover, there is a need to improve educational completion rates at all levels of education cycles. Significant disparities exist in education completion rates by income groups in Sri Lanka, particularly reflected in the ordinary level (O-Level) and A-Level success rates. For example, approximately 81% of children in the wealthiest group complete their O-Level exams, whereas only 38% of children from the most economically disadvantaged group pass the O-Level exam.[3] This trend is also evident at A-Level success rates, with respective rates of 61% for the wealthiest decile and 17% for the poorest decile. These disparities are due to several reasons, including the affordability of incurred costs for

3 Author's calculations based on HIES 2019 microdata by the DCS.

education.[4] Although state education services are free, parents have to spend on private tuition fees, which has become a crucial factor in success at the national examinations in Sri Lanka.

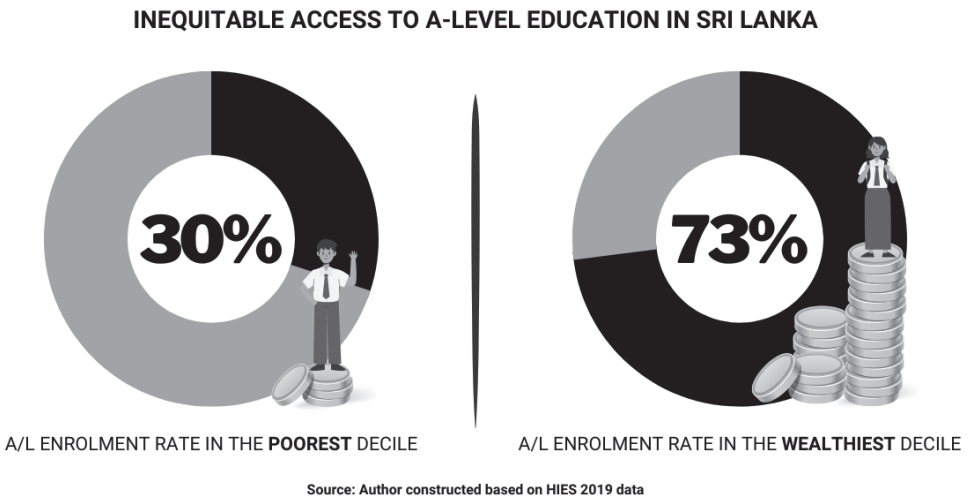
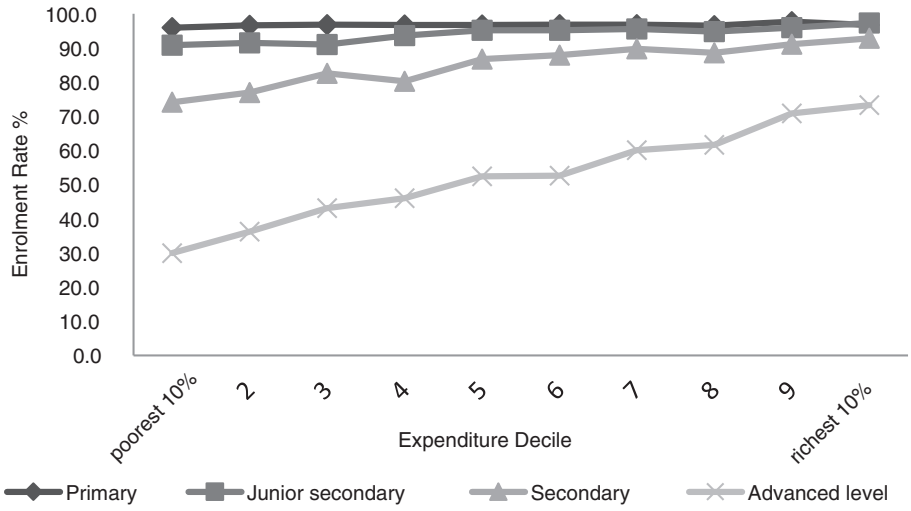


Figure 7.1
School Enrolment Rates in Major Education Cycles, 2019



Source: Author's calculations based on Household Income and Expenditure Survey (HIES) 2019 data by the Department of Census and Statistics (DCS).

4 Jayawardena, Priyanka., & Perera, Usha. (2022). Towards Universal Education and Universal Healthcare. In *Sri Lanka: State of the Economy 2022*. Colombo: Institute of Policy Studies of Sri Lanka.

7.2.2 Quality and Relevance

Sri Lanka faces significant obstacles in equipping its workforce with essential competencies in areas such as Information and Communication Technology (ICT), English proficiency, Technology, Research and Development (R&D), and more to cultivate a skilled labour force that aligns with market needs. The principal factor contributing to this skill disparity is the limited effectiveness of the general and higher education systems, primarily administered by the public sector, in imparting practical and applicable skills to students.

An IPS study finds that the provision of quality education also faces significant challenges due to shortages of qualified teachers, particularly in disadvantaged schools, for subjects such as Mathematics, Science and English.

For instance, as recognised by the National Education Commission,[5] the general education sector faces numerous underlying issues that impact its effectiveness. These issues encompass various areas such as curriculum development, content, delivery, and assessments. Problems are also prevalent in textbooks and teacher guides, as well as in the extended duration of schooling and the delays in transitioning from school to work or other life paths. Furthermore, there is a lack of adequate focus on providing career guidance and counselling to students. Due to these, discrepancies exist between market demands and graduates' skills from schools and universities.

In recent times, governments have acknowledged the necessity of departing from conventional methods and developing a skills-oriented curriculum that aligns with the demands of the workforce. Despite efforts to enhance the quality of education through curriculum reforms, deficiencies exist in the design, development, and implementation of curricula. Despite attempts to revamp the curriculum, improvements in the standard of education delivered so far have been minimal.[6] Furthermore, these assessments indicate that little progress has been made in addressing key issues such as an excessively packed curriculum, outdated teaching techniques, and a traditional examination-driven education system emphasising rote memorisation.

Providing equitable access to quality education too is a significant challenge facing the general education system. Large disparities in the quality of education arise from an unequal distribution of human and physical resources. For instance, opportunities to study A-Levels in the Science stream at the school level are limited. In 2021, 34% of schools with A-Level grades possessed the necessary facilities to provide A-Level education in all four streams – Science, Mathematics, Arts and Commerce.[7] Conversely, most schools with A-Level grades focus on offering only Arts and Commerce streams. The limited availability of A-Level science education pushes students towards opting for the

5 National Education Commission. (2022). *National Education Policy Framework (2020-2030).* Colombo: National Education Commission.

6 National Education Commission. (2016). *Raising the Quality of Education, Proposals for a National Policy on General Education in Sri Lanka.* Colombo: National Education Commission.

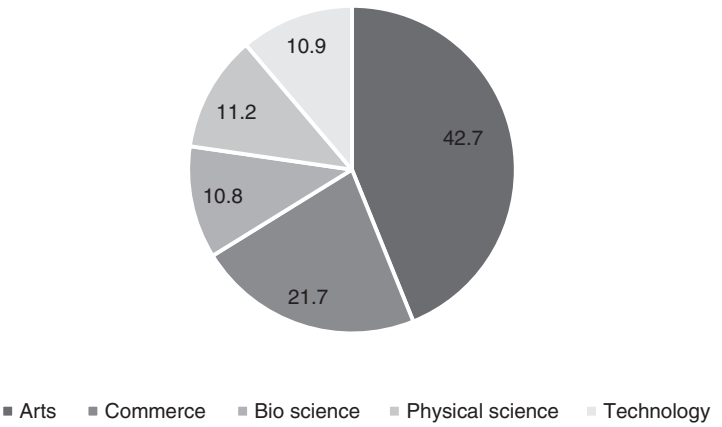
7 Ministry of Education. (2021). *Annual School Census of Sri Lanka 2021.* Colombo: Ministry of Education.

Arts stream, resulting in approximately 42% of A-Level students in 2021 being compelled to choose the Arts stream (Figure 7.2).

An IPS study finds that the provision of quality education also faces significant challenges due to shortages of qualified teachers, particularly in disadvantaged schools, for subjects such as Mathematics, Science and English.[8] Teacher shortages for more demanding subjects are partly due to the recruitment of teachers under 'unemployed graduate recruitment' schemes, whose qualifications do not align with the subjects in demand. Moreover, the teaching profession is unattractive for highly qualified individuals due to relatively low salaries. Apart from these, the quality of teachers is compromised due to deficiencies in their training both before and during their service.[9]

On top of the limited schools that have facilities for teaching A-Level Science streams, another major issue for the low student uptake in Science streams is that students are unable to meet the minimum requirement of obtaining a credit pass (C grade) in Mathematics or Science at the O-Levels.[10] This results in a significant imbalance in university-level enrolment, with a disproportionately high student uptake opting for Arts streams while the intake into Science, Technology, Engineering, and Mathematics (STEM) subjects falls short of the required numbers. Given all these factors, Sri Lanka faces considerable challenges in providing its workforce with the necessary skills in ICT, English, Technology, etc., to create a highly skilled and educated workforce with market-oriented skills.

Figure 7.2
Students by A-Level Stream (%), 2021



Source: Constructed based on Ministry of Education. (2021). *Annual School Census of Sri Lanka 2021*. Colombo: Ministry of Education.

8 Arunatilake, N., & Abayasekara, A. (2018). *Are There Good Quality Teachers for All Classrooms in Sri Lanka?* Colombo: Institute of Policy Studies of Sri Lanka.

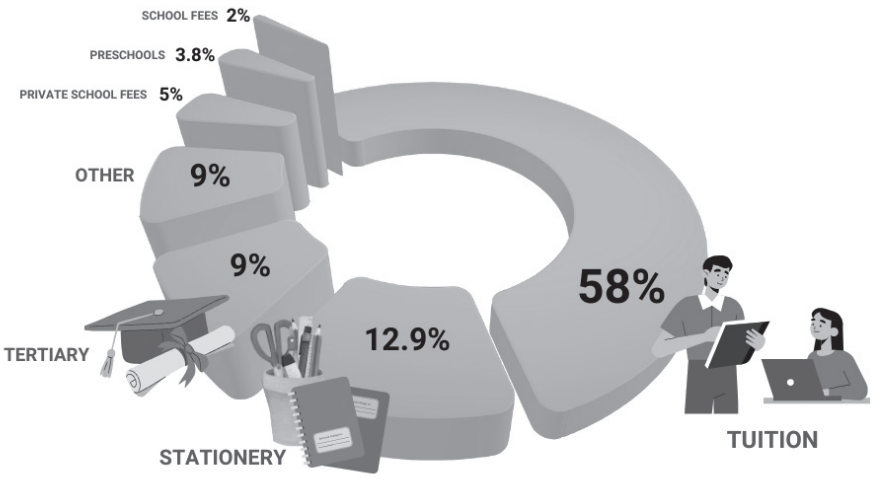
9 National Education Commission. (2022). National Education Policy Framework (2020-2030). National Education Commission

10 Institute of Policy Studies of Sri Lanka. (2018). *Towards a Knowledge Based Economy: Start with Quality STEM Teachers for Every Child*. Retrieved May 20, 2023, from Talking Economics: https://www.ips.lk/talkingeconomics/2018/02/22/towards-a-knowledge-based-economy-start-with-quality-stem-teachers-for-every-child/

7.2.3 Household Out-of-Pocket Expenditure on Education

Despite the availability of free education in public schools and several welfare benefits such as free textbooks, uniforms, and subsidised transportation, households still allocate a significant portion of their budget to education. On average, households spend around 4% of their total expenditure on education.[11] Most household expenditures on education are dedicated to private tuition (58%), followed by stationery items (13%). Further, notably, the share of household expenditure on tuition tends to be higher for even poorer households (Figure 7.3). A major portion of tuition fees suggests that many parents are compelled to invest in private tutoring for their children because of deficiencies in school education. These direct education costs are crucial in determining school completion rates and success in national examinations. For instance, children from poor households are more likely to drop out of school.[12] In particular, the unaffordability of these expenses may serve as a primary barrier to accessing higher education. Apart from the tuition fees, the expense of stationery items, including exercise books etc., has surged today with high inflation and recent hikes in imported materials.

OUT-OF-POCKET HOUSEHOLD EXPENDITURE FOR EDUCATION

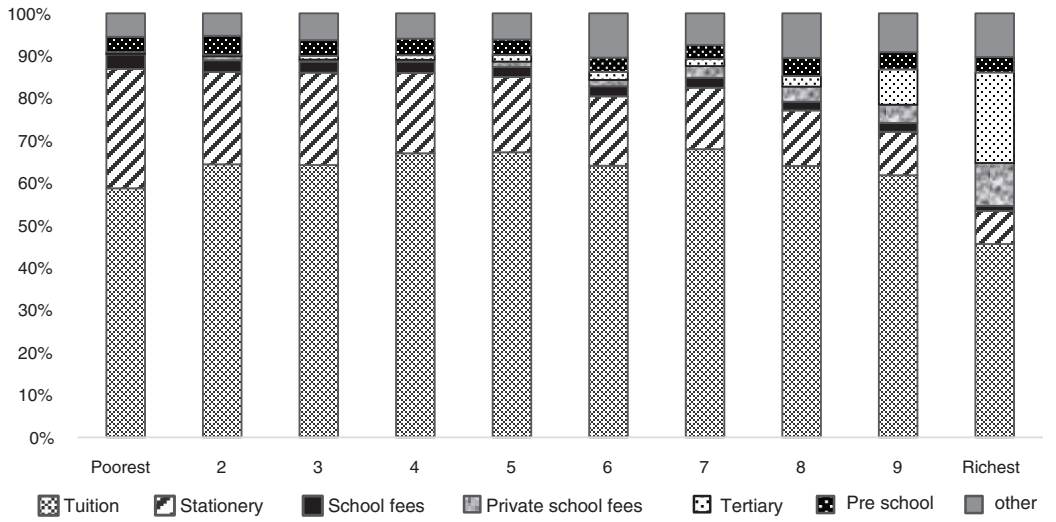


Source: Author constructed based on HIES 2019 data

11 Constructed based on HIES 2019 micro data by the DCS.

12 Jayawardena, Priyanka., & Perera, Usha. (2022). Towards Universal Education and Universal Healthcare. In *Sri Lanka: State of the Economy 2022*. Colombo: Institute of Policy Studies of Sri Lanka.

Figure 7.3
Distribution of OOPE on Education, 2019



Source: Author's calculations based on Household Income and Expenditure Survey (HIES) 2019 data by the DCS.

7.2.4 Underregulated Non-state Schools

With the nationalisation of private schools in 1961, private schools which provide general education were not allowed to be established to ensure education devoid of discrimination. Accordingly, private schools established before 1961 were taken over by the government, while some were allowed to function as private schools under the supervision of the Ministry of Education (MOE).[13] Due to restrictive legislation on private schools under-regulated international schools were established in the early 1980s. These international schools are registered under various bodies, including companies (under the Companies Act No. 17 of 1982) and business ventures under the Board of Investment (BOI). As such, international schools are not registered with the MOE and are not mandatory to follow the national curriculum or examinations.

As of 2019, 389 international schools were operating, providing education to 140,223 students. As per the MOE, only seven of these schools are registered under the BOI and the rest are registered as companies under the Companies Act.[14] While originally intended for children of expatriates, a growing number of local students are now enrolled in these schools due to high competition for admissions in government schools. However, given that these international schools are not registered under the MOE, it lacks a system to track student enrolment, curricula, quality standards, school discipline and the use of acceptable competitive exams.[15] With a growing number of students opting for international schools due to many preferences (apart from the above-mentioned high competition for admission

13 Ministry of Human Resource Development. (n.d). *Education for All National Action Plan for Sri Lanka.* Colombo: Ministry of Human Resource Development.

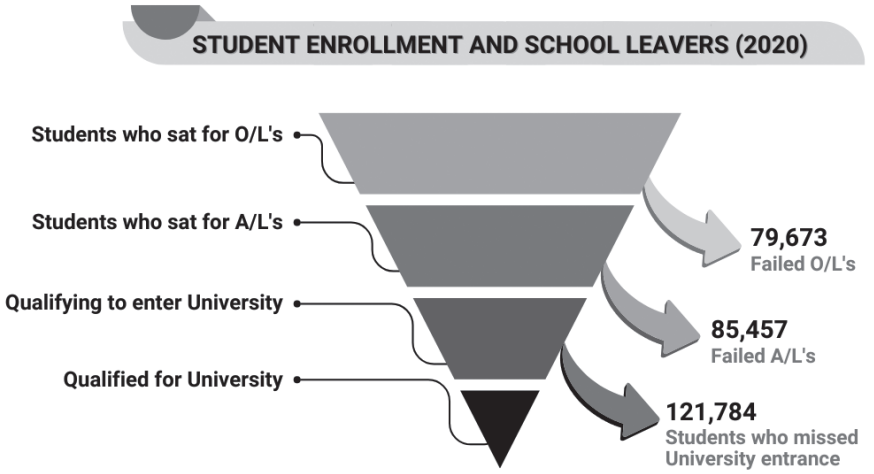
14 Central Bank of Sri Lanka. (2019). *Annual Report 2019.* Colombo: Central Bank of Sri Lanka.

15 *Ibid.*

in government schools), enhancing the legal framework and monitoring mechanisms for non-state general education institutions is imperative. This is crucial to ensure that students from these schools acquire the knowledge and skills needed for a successful future and to ensure the value of the education services provided by these institutions.

7.3 Limited Opportunities and Constraints in Higher Education

As in the case of general education, the government plays a prominent role in providing higher education services as well, but the capacity of the state university system is limited. As such, university admission has become increasingly competitive due to limited available spaces. To enable wider opportunities for higher education, university intakes substantially increased from approximately 25,000 in 2015 to about 43,927 in 2020.[16] However, among the 194,366 students eligible for university entrance based on their A-Level results in 2020, a mere 22.6% were able to secure admission to state universities due to the limited number of available placements. Similarly, each year, an estimated 130,000-150,000 qualifying students face the unfortunate reality of being unable to pursue higher education due to the scarcity of opportunities.



Source: Constructed based on Department of Census and Statistics data – 2022.

Further, the lack of avenues for higher education hampers the higher education system in Sri Lanka. Private sector involvement in higher education is limited in the prevailing socio-political context and the state sector continues to monopolise higher education. Although private universities are legally allowed to operate in the country, they cannot offer degrees unless affiliated with a foreign university. Several private-sector degree-awarding institutions have emerged nationwide in response to the increasing demand for higher education. However, policymakers have recently raised concerns about these institutions, including the high cost of degree programmes and the quality of education they offer.

16 University Grants Commission. (2021). *University Statistics 2021.* Retrieved May 10, 2023, from University Grants Commission: https://www.ugc.ac.lk/downloads/statistics/stat_2021/Chapter%202.pdf

Besides, the Technical and Vocational Education and Training (TVET) sector in Sri Lanka is in a state of underdevelopment. Hence, it is still struggling to generate an adequate number of qualified and skilled workers who can effectively meet the evolving demands of the labour market.[17] According to the Skills Toward Employment and Productivity (STEP) survey findings, over 50% of companies expressed dissatisfaction with the TVET system, stating that it fails to produce graduates who meet their desired criteria. Similarly, an equivalent percentage of firms indicated that the sector lacks practical skills and fails to provide workers with current knowledge of methods, materials, and technology. Employers also expressed discontent with the quality of university and general education.[18]

Inadequate information flows between the youth and the labour market, such as the types of job opportunities in the labour market, limit the aspirations and life goals of the youth. Due to existing information gaps, some students spend two years unnecessarily following A-Levels in fields with little demand or those with limited career prospects rather than entering vocational training after completing their O-Levels. For instance, around 25% of students who sat for O-Levels did not succeed in exams, and 35% did not qualify to sit for A-Levels.[19] These youth are the prime target for specific training and skills development programmes. However, the transition from school to vocational training is not smooth. No proper career guidance system is in place to advise these school leavers. One contributing factor to such deficiencies is the absence of a systematic connection between TVET and secondary education, which means that a significant portion of students completing their secondary education lack access to skill development programmes.

7.3.1 Quality and Economic Relevance

Adding to the supply-side challenges, Sri Lanka exhibits poor performance in the percentage of higher education students enrolled in subjects crucial for economic development, specifically in the STEM stream of study programmes.[20] It is concerning that nearly one-fourth of university undergraduates study in the less demanded Arts stream (Figure 7.4a). Compared to 97 other countries, Sri Lanka holds second regarding the percentage of students enrolled in Arts and Humanities programmes. However, in STEM, Sri Lanka ranks 59th out of the same set of countries (see Table 7.1).

To catch up with upper-middle-income countries (UMICs) and to drive future economic growth through higher value-added industries and services, Sri Lanka urgently needs to expand higher education enrolment, especially in degree programmes focused on STEM subjects (Figure 7.4b). This pattern of university enrolment is not surprising given the low enrolment of students in Science and Mathematics subjects at the school level, as discussed earlier. Moreover, graduates from the Arts stream face lower employability rates than graduates from other subject streams. This is primarily

17 Dundar, H., Millot, B., Riboud, M., Shojo, M., Aturupane, H., Goyal, S. & Raju, D. (2017). *Sri Lanka Education Sector Assessment: Achievements, Challenges, and Policy Options.* Washington, D.C.: World Bank.

18 *Ibid.*

19 Department of Census and Statistics. (2022) *Statistical Pocket Book 2022*. Retrieved May 10, 2023, from Department of Census and Statistics: http://www.statistics.gov.lk/Publication/PocketBook

20 National Education Commission. (2022). *National Education Policy Framework (2020-2030*). Colombo: National Education Commission.

due to the lower demand in the job market for subjects such as Religion and Civilisation, Aesthetic subjects, and History, which are predominantly associated with the Arts stream.

Sri Lanka's public university system is less responsive to changes in the labour market and developments in higher education worldwide. The existing curriculum in higher education lacks sufficient scope and relevance to meet market demands.[21] The identified primary areas with significant skill gaps include (i) communication, (ii) eagerness and aptitude for learning, and (iii) teamwork capabilities. This results in persistently high unemployment rates among graduates, exerting much pressure on the public sector to absorb the so-called 'unemployed graduates' regularly. The state higher education system in Sri Lanka is not adapting adequate mechanisms to address the evolving needs of the labour market in a globalised world. As mentioned before, there is a notable disparity between the courses offered by higher education institutions (HEIs) and the skills required by the private sector. These disparities are reflected in the high numbers of unemployed graduates, especially graduates in less demanded streams. For instance, the LFS 2022 reveals that of the total unemployed graduates, a considerable 43.9% were from the Arts stream.

This lack of relevant skills creates barriers for aspiring entrepreneurs and hampers the country's growth prospects. One significant factor contributing to the skills gap is the obsolete curricula, further exacerbated by the limited involvement of the private sector, which can provide insightful feedback in the design of degree programmes. A recent survey among academics and employers unveiled an overview of the collaboration between universities and industries, and the perceptions of the parties involved.[22] The survey revealed a substantial level of agreement regarding assessing the situation and a higher level of consensus regarding potential solutions. However, some notable variations are unique to the two cohorts. Academics commonly express a sense of insufficient time, whereas private employers tend to perceive academics as lacking an entrepreneurial mindset.

21 Dundar, H., Millot, B., Riboud, M., Shojo, M., Aturupane, H., Goyal, S. & Raju, D. (2017). *Sri Lanka Education Sector Assessment: Achievements, Challenges, and Policy Options.* Washington, D.C.: World Bank.

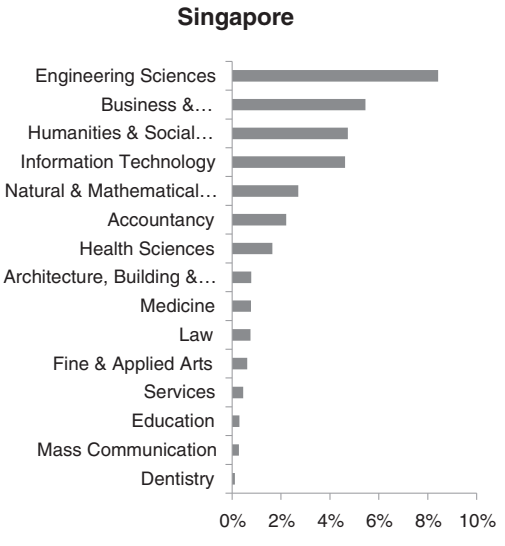
22 Ministry of Higher Education and Highways. (2016). *Promoting University-Industry Collaboration in Sri Lanka: Status, Case-Studies and Policy Options*. Colombo: Ministry of Higher Education and Highways.

Figure 7.4a
Undergraduate Admissions in Sri Lanka



Source: Constructed based on University Statistics 2021, University Grants Commission (2021).

Figure 7.4b
Undergraduate Admissions in Singapore



Source: Constructed based on Ministry of Education Singapore. (2021). Education Statistics Digest 2021. Ministry of Education Singapore.

Table 7.1
Distribution of Tertiary Graduates by Field of Study, Selected Countries, 2020

Arts and Humanities			STEM		
	%	Rank (out of 97 countries)		%	Rank (out of 97 countries)
Sri Lanka	27.3	2	Malaysia	39.2	3
South Korea	15.5	10	Singapore	36.3	9
Singapore	8.7	46	India	33.7	13
India	5.6	78	South Korea	30.2	18
Philippines	1.6	96	Philippines	22.8	49
Malaysia	7.4	60	Sri Lanka	20.7	59

Source: Author constructed based on UNESCO Institute for Statistics (UIS) database. Retrieved May 10, 2023, from UNESCO: http://data.uis.unesco.org/#

7.3.2 Non-state HEIs

Due to the restricted prospects within the state sector, a parallel non-state sector of higher education arose, creating private HEIs, of which, many have affiliations with foreign universities. In the present context, private HEIs are categorised into two: those registered under the Ministry of Higher Education as degree-awarding institutions and unregistered HEIs that are typically associated with a foreign HEI. Unregistered HEIs operate beyond the University Grants Commission's (UGC) jurisdiction. Registered private HEIs as degree-awarding institutions emerged due to the granting of 'Degree Awarding' status to institutions outside the UGC purview under the Universities Act No. 16 of 1978. It marks a crucial milestone in Sri Lanka's private higher education landscape, allowing students who cannot access traditional state sector institutions to be accommodated at these entities.

Facilitating non-state HEIs to provide higher education could save around LKR 50 billion (Bn) in foreign exchange earnings annually.

As of 2022, 24 non-state institutions offer recognised degree programmes across fields such as Information Technology, Engineering, Psychology and Management.[23] Some outstanding institutions in this sector include the Sri Lanka Institute of Information Technology (SLIIT), National School of Business Management (NSBM), Colombo International Nautical and Engineering College (CINEC), Horizon Campus, and the Institute of Chartered Accountants of Sri Lanka (CA). In 2019, non-state HEIs serving in Sri Lanka produced 6,074 undergraduates.[24]

Around 20,000 Sri Lankan students leave annually for overseas tertiary education programmes. Migrant students, on average, spend around Sri Lankan Rupees (LKR) 2.3 million (Mn) to study in Asian countries and around LKR 6 Mn to study in Europe and North America.[25] The above suggests facilitating non-state HEIs to provide higher education could save around LKR 50 billion (Bn) in foreign exchange earnings annually. Furthermore, unregistered private HEIs operate in the country. These affiliated institutions generally train and prepare students for degree programmes and offer courses from the parent university, usually a foreign university. Some are franchised institutions operating on behalf of foreign degree-awarding institutions. Several affiliated institutions – such as the Overseas Campus of Ceylon, Curtin University in Sri Lanka, Universal College Lanka, etc., operate countrywide. Courses offered at these institutions are predominantly in Commerce and Management fields. As the number of affiliated institutions grows, the absence of policies and a governing authority becomes a pressing issue. There is no legal entity or regulatory body to oversee the operations of these institutions. In addition to maintaining quality standards, regulatory and supervisory gaps in non-state sector participation in higher education delivery continue to pose problems.

23 Ministry of Education. (n.d.). *Universities under the University Grants Commission*. Retrieved May 12, 2023, from Ministry of Education: https://www.mohe.gov.lk/index.php?option=com_content&view=article&id=117&Itemid=206&lang=en

24 National Education Commission. (2022). *National Education Policy Framework (2020-2030).* Colombo: National Education Commission.

25 Weeraratne, B., Weerasekera, H., & Bandara, T. (2022). *Understanding Student Migration from Sri Lanka.* Policy Discussion Brief. Colombo: Institute of Policy Studies of Sri Lanka.

The government has attempted to enhance tertiary education and foster private investments to align with global trends. Nevertheless, it is vital to consider the country's socio-political landscape when implementing these strategies to create a conducive environment for private sector involvement. Despite the aspirations of numerous HEIs to obtain degree-granting authority, these institutions have encountered challenges stemming from political and economic factors, as well as apprehensions surrounding quality assurance.

Given the long history of free education in Sri Lanka, redirecting policies to accommodate private HEIs has faced significant pushback. Many stakeholders expressed concerns about the varying and waning quality standards among private HEIs. Mounting worries signal that private fee-based institutions contribute to income inequality, resulting in inequitable access to higher education. Opponents of private intervention also argue that fee-based education may transform education, a constitutional right, into a commodity. They emphasise the need for a robust quality assurance system in force to ensure private providers adhere to the same standards as established state-funded HEIs.

Public perceptions play a vital role in the sustainability of private HEIs. Negative publicity regarding poor quality services provided by private HEIs can tarnish the sector's reputation and hinder its ability to attract students. Although authority has been granted to certain HEIs to confer degrees, challenges persist in recognising the degree status of these institutions. For instance, the SLIIT and the National Institute of Business Management (NIBM) are non-controversial establishments operating under this system. However, others, like the South Asian Institute of Technology and Medicine (SAITM), have faced strong opposition from students and medical professionals. The SAITM has been highly controversial, attracting scrutiny and criticism in recent years. In addition, the Government Medical Officers Association (GMOA) and the Sri Lanka Medical Council (SLMC) oppose the recognition due to concerns about quality standards and maintenance, particularly regarding clinical training. The absence of a proper monitoring mechanism to ensure the quality of programmes offered by such institutions is a major contributing factor to these concerns.

Box 7.1
Example of a Prominent Non-state HEI

Sri Lanka Institute of Information Technology (SLIIT) has emerged as a prestigious institution in private tertiary education, recognised by the UGC. SLIIT was established in 1995 to educate and train professionals required by the rapidly growing IT industry. Although it initially received government funding, SLIIT has since become an independent HEI that charges tuition fees and awards degrees. A board of directors manages the institute's operations. The institute has formed partnerships with esteemed foreign universities, including renowned institutions such as Curtin, Liverpool John Moores, and the University of Queensland. SLIIT graduates are highly sought after in the job market within Sri Lanka and overseas. As such, the institute has garnered recognition as one of the most successful independent HEIs in Sri Lanka.

Source: Sri Lanka Institute of Information Technology (SLIIT). Retrieved May 10, 2023, from SLIIT: https://www.sliit.lk/

7.3.3 Governance, Management and Regulatory Gaps

The absence of an accreditation system for higher education providers is a significant regulatory gap that creates a challenging environment to ensure the quality of programmes offered by non-state HEIs. Although integrating quality assurance in higher education began in the 1980s as a response to these developments, several government attempts to tackle the issue of quality assurance in higher education have been futile. Indeed, in both 2011 and 2019, new legislation was proposed under the Bill on Quality Assurance, Equalisation, Qualification and Framework to enhance the quality of diplomas and degrees offered by both state universities/HEIs and non-state HEIs. However, the government had to withdraw the proposed Bills due to student groups and academic protests.

Thus, even though student demand has led to the emergence of non-state HEIs and intensified competition among diverse educational establishments, the necessity for a robust system of external quality assurance and subsequent accreditation to be in place is yet unresolved. It is crucial to advance on this and ensure quality and official recognition to those institutions that meet the prescribed criteria.

Sri Lanka's higher education system has grown and become highly complex regarding systems and procedures. A key aspect of good governance is striking the right balance between autonomy and accountability for public universities. It also requires strategic vision, innovation, and flexibility, allowing institutions to make decisions and manage resources without undue government bureaucracy. The higher education system in Sri Lanka has become highly complex, with various systems and procedures in operation. Arguably, the UGC's extensive control over public universities has a detrimental impact on their operational efficiency, innovation, entrepreneurial spirit, and adaptability to labour market changes.[26] The UGC's authority extends to several aspects, including approving new courses at both undergraduate and graduate levels, establishing procedures for staff recruitment and appointments, and creating new positions. However, it is important to note that UGC intervention is justifiable in certain areas, such as curriculum development, quality assurance, and the proper utilisation of public funds, which serve the public welfare.

Sri Lanka's graduates experience extended durations to complete their degrees, often surpassing the typical timeframe. This delay is primarily attributed to inefficiencies in the transition process between different educational levels and disruptions caused by university closures. The issue originates at the secondary level, where on average, half a year is wasted between completing O-Levels and commencing A-Levels due to delays in releasing O-Level results. This problem recurs between the release of A-Level scores and university admissions – a gap of up to one year. Additionally, once students enter university, they encounter several disruptions related to political issues and other factors, resulting in many graduating at 25-26 years. This delay significantly postpones their entry into the labour force while discouraging their motivation to engage in further educational endeavours and career development amid growing personal commitments.

26 Asian Development Bank. (2016). *Innovative Strategies in Higher Education for Accelerated Human Resource Development in South Asia: Sri Lanka.* Manila: Asian Development Bank.

7.4 Education Financing

Compared to regional counterparts, Sri Lanka's overall investment in public education is relatively modest (Table 7.2). Within this limited allocation for education, a significant portion (83%) is directed towards recurrent expenditure. Most (90%) of this recurrent expenditure is dedicated to cover the costs of teacher salaries and welfare programmes. Disappointingly, the minimal capital expenditure on education has hindered the enhancement of facilities. Apart from this, as discussed before, out-of-pocket expenditure (OOPE) have substantially increased for households due to quality gaps in school education.

Investments in general and higher education play a vital role in equipping future generations with the necessary skills and facilitating a smooth transition from education to the workforce. As explained at the onset, the public sector is the primary higher education provider in Sri Lanka. However, currently, the country allocates a relatively small proportion of its education expenditure to higher education, further tightened by fiscal constraints with the economic meltdown. Consequently, public universities face significant limitations in raising funds to enhance educational standards. This constraint on public resources for higher education poses a considerable challenge in expanding opportunities for university education.

Table 7.2
Public Expenditure on Education, 2020

	As a % of GDP	As % of Total Government Expenditure
Malaysia	3.9	15.4
Singapore	2.5	11.9
Indonesia	3.5	19.2
Philippines	3.7	15.5
India	4.5	16.5
Bangladesh	2.0	10.4
Nepal	4.2	15.0
Sri Lanka	1.9	9.9

Source: World Bank Development Indicators. (2022). *Data.* Retrieved May 20, 2023, from World Bank: http://data.worldbank.org/indicator/SE.XPD.TOTL.GD.ZS

Despite the challenges posed by current fiscal constraints, it remains imperative to prioritise investments in human capital and tackle the shortage of skilled workers. These efforts are essential for fostering long-term economic growth and promoting overall development. The government must engage in careful planning and critical examination of the current and emerging needs of the education sector in the Sri Lankan context. It is essential to improve resource mobilisation and enhance the quality and relevance of education services.

The general education sector faces numerous underlying issues that impact its overall effectiveness. On the one hand, these issues encompass several areas such as physical and human resource gaps, curriculum development and learning environments, deficiencies in teacher training and a lack of adequate focus on providing career guidance and counselling to students. On the other hand, the tertiary education system caters only to a small fraction of the population, leading to limited opportunities for university education in the country. Since the public sector is the primary provider of university education, the scarcity of public resources becomes a significant constraint in expanding these opportunities. Consequently, many students who cannot enter state universities choose to pursue private diplomas, or degrees, which currently lack state regulations on quality standards.

In this context, it is imperative to explore funding options that ensure education provision of greater quality. One approach is increasing public investments in the higher education sector, while another is encouraging private participation. However, given the current fiscal constraints, relying solely on sufficient public funds for the sector may not be a feasible solution.

7.4.1 Public-private Partnership Models

Considering the substantial educational barriers developing nations face and the potential benefits of enhanced private involvement in education, policymakers have explored innovative approaches for effectively financing and delivering high-quality education. One such option is public-private partnerships (PPPs) that involve contractual arrangements, bringing together governments and non-state providers. The term ‘non-state provider’ encompasses both commercial and non-profit sectors. Several aspects of these partnerships and its potential to increase access, improve quality, enhance efficiency, and ensure accountability in education are examined below.

The choice and contracting mechanisms in the education sector can vary. Various models of private sector participation in providing educational services demonstrate a spectrum of involvement, ranging from purely private models to joint ventures between state and private organisations (Table 7.3).

Table 7.3
PPP Models in the Education Sector

PPP Type	Examples
Education service delivery initiatives	• Contracting with private schools for the delivery of education services • Contracting with private providers for delivery of specialist curricula • Provision of tutoring services
Non-state management of public schools	• Private management of public schools
Voucher initiatives	• Publicly and privately financed voucher programmes • Targeted scholarship programmes • Payment of subsidies to students at private schools • Education tax credits/tax assistance
Professional and support services	• Teacher training • Curriculum design • School review/evaluation services • Ancillary services, such as meals and transportation • Educational testing and school rating services
Infrastructure initiatives	• Private finance initiatives – finance, construction and maintenance of core and non-core educational assets • Private leasing of public school facilities • Equipping and maintenance of IT laboratories
Philanthropic initiatives	• Scholarships, private voucher programmes • School sponsorships • Adopt-a-school programmes • School construction

Source: UNICEF East Asia and Pacific Regional Office and Asian Development Bank. (2011). *Non-state Providers and Public-private Partnerships in Education for the Poor.* Bangkok: UNICEF East Asia and Pacific Regional Office and Asian Development Bank.

Educational service-delivery initiatives: These initiatives revolve around government agencies like the MOE in procuring student seats in private educational institutions. Such agreements are commonly implemented in a shortage or absence of available space in local public schools, especially in disadvantaged regions. Due to these, governments may view partnering with the private sector as a more cost-effective alternative to expanding current schools or constructing new ones.

The Education Service Contracting (ESC) scheme in the Philippines introduced in the 1980s, is one of the largest educational service-delivery programmes.[27] It primarily offers low-fee schools and

27 UNICEF East Asia and Pacific Regional Office and Asian Development Bank. (2011). *Non-state Providers and Public-private Partnerships in Education for the Poor.* Bangkok: UNICEF East Asia and Pacific Regional Office and Asian Development Bank.

prioritises those from low-income families. The government contracts with private schools to enrol students in areas with a shortage of available places in public high schools. A private non-profit organisation handles the administration of the ESC programme (the Fund for Assistance to Private Education).

The ESC programme is proven to have several benefits, including enhancing the quality of schools, alleviating overcrowding classrooms in public high schools, ensuring the financial viability of private secondary schools (with over one-third of enrolments supported by the programme), controlling the overall costs of public secondary education, and fostering household investment in education.[28] However, equity issues arise as ESC grantees must pay OOPE to cover the deficit between the ESC subsidy and their private school fees. The parents who can afford to do so imply that they do not come from impoverished households. Nevertheless, it meets one of the initial objectives, which was to provide financial assistance to 'poor but deserving' students.

Private management of public schools: Here, the government directly contracts non-state entities to oversee and operate public schools in private management programmes. While private entities manage these schools, they remain publicly owned, and the government is responsible for their performance. For-profit, non-profit, or community organisations can operate contract schools.

The schools receive a fixed payment per student or a management fee. They are also held accountable to meet predetermined performance benchmarks. Notably, unlike in education service delivery PPPs, the physical infrastructure used for teaching students is still publicly owned. Privately managed schools are typically implemented in impoverished and disadvantaged areas. Teachers in these schools may operate under centralised government contracts or have more flexible employment agreements.

This model is practised in Pakistan, where a local non-governmental organisation (NGO), Cooperation for Advancement, Rehabilitation, and Education (CARE), manages over 170 public schools on behalf of the Lahore government. Unlike most private management models, CARE receives no financial compensation from the government. Instead, it relies on raising philanthropic funds to supplement the schools' budgets for additional teachers, books, pedagogical aids, and other related necessities. The CARE schools function with a combination of regular teaching staff and contract teachers funded by the government, and additional teachers employed by CARE through its philanthropic funds.

Voucher model: School vouchers are an official document or privilege that enables parents to fund their children's education at a public or non-state school they choose rather than the nearest public school or the one assigned to them. These vouchers are directly provided by a public entity to parents or schools to empower parents to make the school selection decision instead of the government.

Voucher programmes may have unique design features and associated rules and regulations relating to eligibility, fee charges, institution registration and student admissions. For example, some programmes may allow educational institutions to charge fees on top of the voucher value, while

28 World Bank. (2011). Philippines - Private Provision, Public Purpose. Manila: World Bank.

others may not. In essence, governments use vouchers to 'contract out' the enrolment of students or buy outputs, allowing expansion of access speedily through existing institutions rather than building and equipping new ones.

Another important reason for using vouchers is that they can promote competition and choice, improving innovation and efficiency in both public and private institutions. Additionally, this can provide students with greater flexibility in choosing their educational path. Vouchers can also be much better targeted to the poor and disadvantaged students and give them various educational choices because they can attend public or private institutions. Governments can use vouchers to target low-income students; hence, publicly funded vouchers could provide a higher quality of education at a lower cost than would be possible through public provision only.

Ample global examples are available on voucher programmes. The Chilean voucher programme initiated in 1980 encompasses public and non-state schools, including secular and religious institutions. Schools receive monthly payments corresponding to the number of enrolled students. Initially, subsidised schools were prohibited from charging fees, although this policy has since been modified. Nevertheless, vouchers generally cover a significant portion of tuition expenses at eligible schools, if not the entirety. Voucher schools must adhere to specific operational guidelines concerning essential facilities, certified teacher employment, class sizes, and similar factors.[29]

Professional and support services: Governments extensively employ PPPs to facilitate professional and support services within the education sector. These services include school evaluation/review, teacher training, and textbook publication. For instance, the CfBT Education Trust regularly conducts school evaluations for public schools in Dubai, demonstrating a practical application of PPPs. Additionally, PPPs can be utilised to outsource non-instructional services such as transportation and school meals. Mongolia's primary school lunch programme serves as an example of such a partnership.[30]

PPPs for professional and support services enable governments to leverage private sector expertise and efficiency in specific areas. This approach also capitalises on economies of scale, thereby enhancing cost-effectiveness. Schools and education officials can focus on the key tasks of teaching by relying on PPPs, while private entities handle specialised services. Moreover, entering into contractual agreements facilitates the specification and monitoring of input quality, making this type of PPP partnership relatively low-risk. Virtually every public education system worldwide incorporates some form of professional and support service contracts. Furthermore, innovative utilisation of targeted support and pro-poor criteria allows governments to employ these PPPs to address disparities and reduce inequality in enrolment and completion rates, particularly among disadvantaged populations.

29 UNICEF East Asia and Pacific Regional Office and Asian Development Bank. (2011). *Non-state Providers and Public-private Partnerships in Education for the Poor.* Bangkok: UNICEF East Asia and Pacific Regional Office and Asian Development Bank.

30 *Ibid.*

Box 7.2
PPP Governance and Management Reforms in India

The National Skill Development Corporation (NSDC) is a non-profit organisation established in 2009 to support skill training initiatives by offering viability gap funding to private skill development institutions. It manages the National Skill Development Fund financed by contributions from donors, private entities, central and state governments, statutory bodies, and financial institutions. The NSDC provides soft loans with repayment moratoriums to private skill development institutions at an interest rate of 6-7%. It offers various funding options, including loans, equity, and grants, based on proposals received for establishing skill institutions. Additionally, the Asian Development Bank (ADB) provides funds and technical assistance to these skill institutions.

Source: Asian Development Bank. (2017). *Innovative Strategies for Accelerated Human Resource Development in South Asia.* Manila: Asian Development Bank.

Educational infrastructure partnerships: Infrastructure PPPs have become increasingly prevalent in the education sector to procure large infrastructure projects. The most common arrangement is the build-operate-transfer (BOT) model, where a private operator is granted a franchise or concession to finance, construct, and operate an educational facility, such as a public school, university building, or hostel. In this setup, the government effectively leases the facility from the private sector for a specific duration, after which ownership is transferred to the government.

While specific arrangements may differ, infrastructure PPPs share several key characteristics. Non-state partners invest in institutional infrastructure and provide ancillary services like building maintenance, while the government retains responsibility for core services like teaching. Contracts between the government and private sector partners are typically long-term, spanning around 25 to 30 years. These contracts outline the services the private sector is obliged to deliver and maintain the corresponding quality standards. Often, service contracts are bundled, with the private sector assuming multiple functions such as design, construction, maintenance, and employing non-core staff. Payments under these contracts are contingent upon the private operator meeting the agreed-upon service standards.

Infrastructure PPPs deviate from traditional procurement methods in several ways. Firstly, the non-state sector provides the necessary capital for project financing. Secondly, the government defines the contract as desired 'outputs' or service requirements rather than specific 'inputs'. Lastly, upon completion, the newly constructed facility remains under the operation of the non-state sector until the end of the contract period instead of being immediately handed over to the government.

Education philanthropy: Educational philanthropy is one of the most prevalent forms of partnerships between the public and private sectors in basic education. Numerous instances exist where individuals and private firms contribute goods, services, or funds to schools, either ad hoc or as part of an organisation's corporate social responsibility (CSR) endeavours. Educational philanthropy can encompass broader initiatives to enhance education, including developing innovative educational provisions, policy advocacy, scholarship/voucher financing, and other endeavours.

For instance, the Punjab Education Foundation (PEF) in India has implemented two innovative PPP programmes with funding as the basis, aiming to enhance educational opportunities for disadvantaged individuals. These programmes include the Foundation Assisted Schools (FAS) initiative, which provides a monthly subsidy per student to low-fee private schools, and the Continuous Professional Development Programme, which offers cluster-based training to teachers employed in these low-fee private schools.[31] Similarly, the Bharti Foundation in India pledged a substantial USD 50 Mn towards establishing strictly non-profit, non-state schools in impoverished rural areas of the country.[32]

In the Philippines, corporate foundations play a well-organised role in donating significant amounts to schools through initiatives like the adopt-a-school (AAS) programme and similar ventures. The assistance provided encompasses various areas such as infrastructure/facilities, teacher training, TVET, ICT integration, tertiary education, curriculum support, and health and social services. Most encouragingly, the donors are eligible for tax breaks.[33]

The AAS programmes primarily entail non-state funding for education rather than direct delivery. Instead, infrastructure initiatives are a hybrid model that combines financing for school buildings with the provision of ancillary services like building maintenance. Through AAS, the government encourages the non-state sector (individuals, corporations and NGOs) to partner with the government to redress problems in public schools, such as shortages of classrooms, desks and textbooks, to improve quality or to broaden educational access. In all instances, there is significant potential to tailor these models to address disparities in access and quality and to harness the non-state sector to mitigate existing inequities within school systems rather than perpetuate them.

7.5 Recommendations for Policy Action

7.5.1 Enhance Equitable Opportunities for Quality Education

Reforming the education system to address the discrepancy between the skills acquired through education and the demands of the labour market is a significant priority. Ensuring equitable opportunities for Science education is imperative in providing nationwide students with equal access to quality education. Furthermore, efforts should be made to eliminate involuntary discrimination in Science education. To achieve this, there is a need to expand opportunities for Science education, particularly by increasing the number of schools offering Science stream for A-Levels and ensuring their equitable distribution countrywide. However, in cases where establishing such schools may not be feasible, it becomes essential to strengthen the Technology stream as an alternative pathway for students to engage with scientific knowledge and skills. Prioritising Science and Technology education will aspire to eliminate disparities and foster equal opportunities for students in STEM education.

31 Asian Development Bank. (2017). *Innovative Strategies for Accelerated Human Resource Development in South Asia. Manila:* Asian Development Bank.

32 UNICEF East Asia and Pacific Regional Office and Asian Development Bank. (2011). *Non-state Providers and Public-private Partnerships in Education for the Poor.* Bangkok: UNICEF East Asia and Pacific Regional Office and Asian Development Bank.

33 *Ibid.*

It is crucial to revise school curricula by incorporating market-oriented subjects, particularly ICT/ Technology/Languages, as core subjects for less demanding A-Level subject streams, especially in the Arts stream.

Private investment can be encouraged by easing or lifting existing restrictions on establishing private schools.

The government should evaluate the potential of PPPs to enhance the quality of basic education. An important focus of these PPPs would be to address resource deficiencies. As practised in Pakistan and India, philanthropy funds can be used for improving the quality of basic education provision. For example, private providers can support infrastructure development activities – constructing Science labs, IT facilities, etc., – to enhance the quality of computer education and computer-aided learning. A similar approach is appropriate for improving technology development as well. This approach would not only improve the relevance of the respective subject but also contribute to bridging skill gaps and preparing students to meet the demands of the modern workforce. Simultaneously, private investment can be encouraged by easing or lifting existing restrictions on establishing private schools; as previously noted, with the nationalisation of private schools in 1961, private schools which provide general education are not allowed to be established. Enhancing private sector participation in general education allows students from families who can afford the costs to choose private schools, while those who cannot still have access to better-funded state schools. Parallelly, it is crucial to address the lack of regulatory mechanisms for international schools entering the education system in Sri Lanka. New rules and regulations concerning curriculum standards, teacher qualifications, school discipline, and other relevant aspects of these private education institutions must be incorporated to ensure proper overseeing and quality assurance. By implementing these measures, the government can boost investments in state schools while safeguarding educational standards and equity.

7.5.2 Expand Opportunities for Higher Education

The limited availability of public resources for tertiary education in Sri Lanka poses a significant obstacle to expanding university education opportunities. To address this challenge, one effective approach is to encourage private investment in higher education, operating within state regulations and standards. This would enhance the quality of education through competition, improve access to university education, and mobilise additional resources. However, implementing PPPs in higher education can be complex, requiring the government to understand constraints, duly address these and follow proper processes to mitigate potential adverse effects.

The government should also consider introducing strategic private financing mechanisms to expand higher education opportunities to accommodate students passing A-Levels. A valuable stepping stone would be to request non-state HEI authorities to provide scholarships/fee subsidies for poor students. This initiative would not only broaden opportunities but also enhance equity in education. Additionally, the government should facilitate the introduction of student loans, enabling students to pursue their chosen higher education. These measures would contribute to recognising non-state HEIs and fostering competition, improving the quality of both state and non-state HEIs.

To ensure the successful implementation of these measures and achieve expected outcomes, it is crucial to evaluate their impact and effectiveness regularly. Continuous monitoring and assessment will enable necessary adjustments and improvements, ensuring the intended purpose of recognising non-state HEIs and driving overall educational quality. Therefore, the higher education sector should prioritise a robust quality assurance and accreditation system. To stay competitive with non-state HEIs, state universities must undergo a transformative process to remain relevant in a rapidly changing educational landscape. More details of the above recommendations are discussed below.

The government should take proactive measures to improve equity and access to higher education by requesting the non-state HEI authorities to provide scholarships/ fee subsidies for students who have passed A-Levels.

Scholarships/fee subsidies by non-state HEIs: Equity concerns arise when user fees reach high levels. These create a barrier to access for the economically disadvantaged who cannot afford such services unless robust subsidy systems and state payments are implemented. However, moderate fees specifically targeted at those not economically disadvantaged can serve as valuable resources for expanding educational services. The existence of fees indicates a certain level of private demand and willingness to pay for education, which is understandable considering an individual's private benefits associated with education. Thus, the government should take proactive measures to improve equity and access to higher education by requesting the non-state HEI authorities to provide scholarships/ fee subsidies for students who have passed A-Levels. In numerous instances, non-state HEIs provide subsidies to publicly funded students, enabling them to benefit from the higher fees of privately funded students. Contractual agreements with non-state providers enhance a government's capacity to exert influence over non-governmental provisions in a manner that benefits the economically disadvantaged through the conditions attached to subsidies.[34]

The government will signal its recognition and support for non-state HEIs through these measures. This acknowledgement is crucial in promoting a diverse and inclusive higher education landscape that values the contributions of non-state HEIs. This step will bring recognition to non-state HEIs and foster healthy competition that improves the overall quality of both state and non-state players. The introduction of scholarships creates a competitive environment between state and non-state HEIs, as both sectors strive to attract the most talented students. This competition catalyses institutions to continually strive for excellence, resulting in improved quality across the board.

The government's recognition of private-sector financing will positively impact the reputation of non-state HEIs. Recognising these institutions as viable and quality options for higher education will enhance and further affirm their visibility and attract more students. This, in turn elevates the reputation

34 Lewin, K., & Sayed, Y. (2005). *Non-government Secondary Schooling in Sub-Saharan Africa: Exploring the Evidence in South Africa and Malawi*. London: Department for International Development.

and credibility of non-state HEIs within the broader educational landscape. Offering scholarships to students who have passed A-Levels opens doors of opportunity for individuals who may have financial constraints but possess the potential for academic success. By making higher education more accessible and affordable, the government enables a broader segment of students to pursue their educational aspirations and unlock their full potential.

Student loan system: A student loan system would be pivotal in widening accessibility and affordability for students pursuing their education at private institutions. By offering student loans specifically tailored for non-state HEIs, students can overcome financial barriers and pursue their desired academic programmes. Additionally, this would enable a more diverse pool of students to access quality education at private institutions, fostering inclusivity and promoting educational equity.

Implementing a student loan system for private higher education allows students to cover tuition fees and other educational costs. In addition, it empowers individuals to choose the institution that best aligns with their academic goals and aspirations rather than being solely limited by financial constraints. Furthermore, the student loan system can contribute to the growth and sustainability of non-state HEIs. By attracting more students who can afford tuition through loans, these institutions can continue to provide quality education and expand their programmes and offerings.

Student loan systems around the world have encountered various issues and challenges. Some common problems are experienced in diverse countries. For instance, many students graduate with significant debt, creating long-term financial burdens that can impact their ability to pursue other aspirations. Further, default rates in student loans are a major concern in some countries. Hence, lenders perceive it as risky and tend to assign a higher interest rate to cushion their risk in case of default. Borrowers struggle to repay their loans due to unemployment, underemployment, or insufficient income, leading to financial distress and a negative impact on credit scores. In some countries such as China, universities play a pivotal role in emphasising the necessity for repayment. For instance, under its subsidised scheme, fresh loans are unavailable to new students enrolled in institutions whose defaulted amount exceeds 20%.[35] Moreover, student loan systems may perpetuate or exacerbate social and economic inequalities. Students from lower-income backgrounds may face greater challenges accessing loans or struggle more with repayment due to limited financial resources.

Conversely, in certain countries, student loans are available to all students, regardless of their financial needs or academic ability. However, providing open access to loans can be financially burdensome for governments, especially when they bear the cost of loan capital or heavily subsidise the programme. As student enrolment continues to grow and loan recovery rates fall short, the limited funds allocated to loans face escalating and unsustainable pressures. This necessitates the implementation of loan rationing in some form.[36]

35 Ziderman, Adrian. (2004). *Policy Options for Student Loan Schemes*. Bangkok: UNESCO Bangkok/ IIEP, 2004.

36 *Ibid*.

Addressing these issues requires a comprehensive approach that includes implementing fair and flexible repayment options, and promoting policies that ensure equitable access to higher education without burdening students with excessive debt. To ensure the effectiveness and success of the student loan systems, it is crucial to establish fair and reasonable interest rates, repayment terms, and loan eligibility criteria. Transparent and comprehensive information about loan terms and conditions should be readily available to students, allowing them to make informed decisions.

Further, a collaboration between educational authorities, financial institutions, and private HEIs is essential for successfully implementing the student loan system. Clear communication channels and streamlined processes should be established to facilitate the disbursement, management, and repayment of loans. Moreover, regular monitoring and evaluation of the student loan system is vital to assess its impact, address any challenges that may arise, and make necessary improvements. Continuous refinement and adaptation of the system based on feedback and data analysis will contribute to its long-term effectiveness and sustainability.

Implementing a comprehensive quality assurance system is crucial in enhancing the quality of higher education and expanding opportunities for private sector involvement.

With effect from July 2023, Sri Lanka introduced an interest-free student loan scheme for students who have passed A-Levels. An interest-free loan of LKR 900,000 is on offer to 5,000 students who have failed to enter government universities despite passing the A-Level examination. This opportunity is given to follow selected degree programmes accredited at all the non-state HEIs approved by the MOE. Repayments start after the study period with a one-year grace period.

Quality assurance: The creation of non-state HEIs must be regulated by ensuring that the parent institutions and courses are recognised in the country of origin and Sri Lanka. To achieve this, clear guidelines must be established to recognise overseas institutions. Furthermore, the institutions should be subject to quality and accreditation requirements.

Thus, implementing a comprehensive quality assurance system is crucial in enhancing the quality of higher education and expanding opportunities for private sector involvement. The introduction of such a system guarantees that educational institutions comply with rigorous standards, resulting in improved educational outcomes and creating a conducive environment for private sector engagement in higher education. By enforcing high education standards, the quality assurance system ensures excellence in state and non-state HEIs, contributing to the advancement of the higher education sector. To establish the desired benchmarks for student recruitment criteria, fee structure, academic programmes, quality assurance, and accreditation, it is essential to compare and align the quality assurance and accreditation systems in higher education with international criteria and standards.

It is recommended that the first intake of students should only occur once the institution has obtained accreditation from the relevant professional body. This can prevent potential issues similar to the

SAITM case and ensure the quality of education. Moreover, this approach ensures that the institution meets the professional body's standards and requirements before admitting students. Implementing this measure aims to safeguard enrolled students' interests, maintain educational standards, and promote transparency and accountability within the institution.

Improving the quality and economic relevance of higher education: The traditional programmes should be transformed or phased out, and new market-oriented programmes should be developed to ensure that graduates are equipped with the knowledge, skills, and confidence to address Sri Lanka's human resource needs and to compete successfully in the job market. Since universities are responsible for addressing deficiencies in professional skills – such as proficiency in English – it is imperative to adapt curricula to prioritise these skills. Apart from these, universities must foster a learning culture and cultivate the desire and ability to learn among students, to think outside the box beyond rote learning. Students, too, must develop from starting small but growing to think big as mature professionals/employees who can conceptualise various scenarios. Additionally, promoting teamwork skills should be an essential aspect of post-secondary education, where students can deal/work closely with diverse parties and cultures to achieve a desired goal. This is so true in today's work cultures where organisations in various regions are connected through virtual platforms. The proficiency of faculty members in imparting these skills plays a vital role, emphasising the need for both pre-service and in-service training programmes for lecturers. Such training is essential in addressing employer concerns and equipping graduates with the necessary skills for the job market.

Given higher education's highly globalised and competitive nature, universities in Sri Lanka must be highly entrepreneurial and efficient in carrying out their main functions. To remain relevant in a rapidly changing market, state universities must transform into dynamic teaching and learning centres, thus, earning a reputation for doing so. State universities can enhance the quality of education by implementing a comprehensive quality assurance, assessment, and accreditation system. They can also collaborate with the industry sector to develop courses that align with market demand and promote research and creative activities within HEIs.

Many countries have demonstrated success with a combination of private and public universities that are well-managed and effective. Some of the best universities in the US are public institutions. To improve public universities, their governance structures should be reconsidered, and they should be granted more autonomy to independently manage their affairs and raise funds. The Postgraduate Institute of Management (PIM) in Sri Lanka is an excellent example. However, such changes must be made to not negatively impact students and their educational programmes. One possible solution is to allow universities to rent their facilities (when idle or extra space), such as lecture halls and playgrounds, for private sector use. Funds generated from these can be used to improve degree programmes.

7.6 Conclusion

Disparities are apparent in both general and higher education sectors, raising concerns about equipping the workforce with the emerging skills demanded in the globalised world. In general education, issues persist related to equity and quality. Similarly, the higher education sector faces challenges such as limited access to pursue higher education and inadequate quality and relevance of educational offerings.

Ensuring equal access to STEM education is crucial for equitable opportunities nationwide, necessitating the expansion of science teaching schools, and their equitable distribution is a top priority. Promoting private investments in general education is crucial, and the government should consider new approaches like venture donors and impact investors for development assistance. In addition, by lifting restrictions on establishing private schools, people who can afford private education can choose it, while those who cannot still have access to well-funded state schools. This approach maintains educational standards and equity and encourages private investment.

The government's commitment to understanding and addressing the challenges associated with PPPs will be crucial in creating a thriving and inclusive higher education landscape. The government should take measures to introduce private financing to accommodate A-Level passed students to pursue higher education. Introducing non-state HEI scholarships/fee subsidies for A-Level passed students, who are qualified to pursue higher education, is a stepping stone for this. This initiative will not only bring deserved recognition to non-state HEIs but also foster healthy competition, improve the quality of education across sectors, and enhance access and affordability for students.

Further, establishing a student loan system for private higher education is crucial to expand access and promote equal educational opportunities. Embracing this system to support students in pursuing their educational aspirations at private institutions fosters personal and societal growth. Through these, Sri Lanka can effectively expand access to higher education, improve educational quality through healthy competition, and promote equity.

Implementing a comprehensive quality assurance system is a critical step towards enhancing the quality of higher education and expanding higher education opportunities through private sector participation. Introducing such a system will ensure that educational institutions adhere to rigorous standards, leading to improved educational outcomes and a favourable environment for private sector involvement in higher education. In addition, the quality assurance system ensures that both state and non-state HEIs adhere to high education standards, fostering an environment of excellence and promoting the advancement of the higher education sector. Furthermore, the government can foster increased investment and uphold educational standards and equity through these measures.

8. Building a Resilient Health System

8.1 Introduction

The Sri Lankan healthcare system is recognised as one that has achieved good health at a low cost, albeit being a developing country, having provided free healthcare for all citizens at the point of delivery since independence. Despite a free health care system, the fundamental requirement of universal health coverage (UHC) is not met. Sri Lanka's UHC index is comparatively high,[1] even with a moderate pool of healthcare funds when compared to other countries. In addition to the existing constraints, the current economic crisis is posing fresh challenges to the country's healthcare sector, such as shortages of vital medical supplies. In particular, these include essential drugs, delays and restrictions in lab tests and surgeries, as well as limitations on public health programmes, including initiatives aimed at disease prevention and control. Thus, despite past recognition for remarkable health performance and resilience, even with limited public spending on healthcare, Sri Lanka is currently struggling to provide basic services to its citizens.

To achieve UHC while ensuring the long-term sustainability of Sri Lanka's healthcare system, some fundamental rethinking is required. Conceptually, UHC requires that all people receive health services of appropriate quality without exposing them to financial hardships, encompassing three critical coverage dimensions – population (who is covered), services (which services are covered and at what quality), and cost (how much of the cost is covered). Even before the economic crisis, Sri Lanka's healthcare system faced gaps in knowledge, capacity, and policy. The economic crisis has further exacerbated these existing gaps, highlighting inefficiencies in the existing system and its inability to withstand shocks caused by crises. This underscores the need for reforming policy and system frameworks backed by evidence and high-level political commitment.

This chapter explores these areas of concern to present policy options for a more resilient healthcare system in Sri Lanka. First, the chapter provides a background context, followed by a brief overview of Sri Lanka's health system and the effects of the economic crisis using a framework called 'Multiple Transmission Paths from Economic Crisis to Health Outcomes'. The next section identifies two critical areas within the healthcare system that require immediate attention and policy actions: health financing and efficiency improvement. Thereafter, the chapter outlines policy options available to address the identified critical areas and concludes with a set of policy measures to build a resilient health system in Sri Lanka.

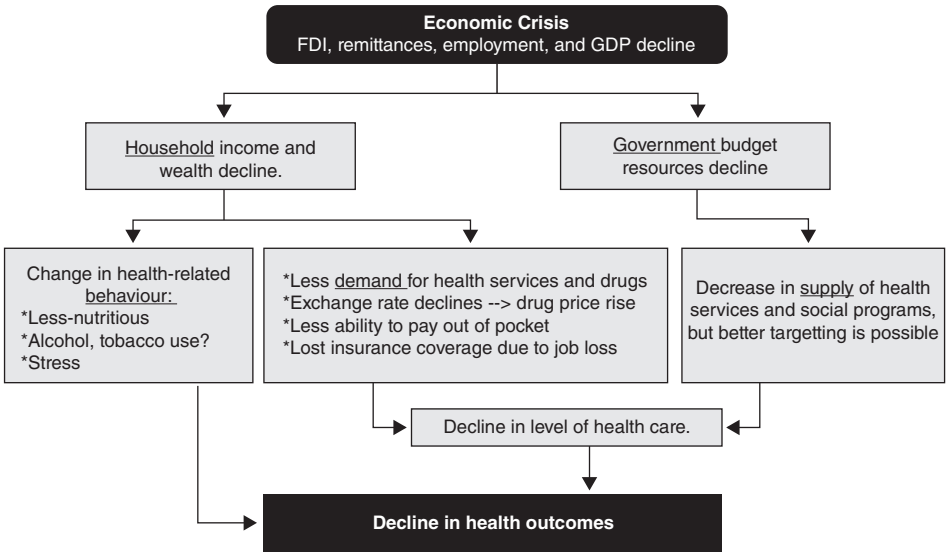
1 UHC Service Coverage Index: Coverage of essential health services is defined as the average coverage of essential services based on tracer interventions that include reproductive, maternal, newborn and child health, infectious diseases, non-communicable diseases (NCDs) and service capacity and access, among the general and the most disadvantaged population.

8.2 Economic Crises and Healthcare Provision

The relationship between health and economic growth is complex and multifaceted. A strong interdependence exists between the two, where health outcomes can impact economic growth, and economic factors can also influence health outcomes. Promoting good health and investing in healthcare systems improves economic growth by enhancing human capital, reducing poverty, increasing productivity, and fostering social stability. Likewise, sustained economic growth provides resources to improve healthcare infrastructure and services, leading to better health outcomes for individuals and communities. Indeed, empirical evidence indicates a strong positive correlation between a country's health status and its gross domestic product (GDP). Countries with better health status tend to have higher incomes than countries with worse health status, a relationship known as the 'preston curve'. A healthy and productive human capital pool can better contribute to economic growth through their skills and abilities. Additionally, a healthy population lowers healthcare costs associated with treating preventable illnesses, thereby freeing up resources for other developmental purposes without compromising people's lives. Besides, an efficient healthcare sector itself generates employment opportunities, stimulates innovation and research, and attracts investment in support of economic growth.

Adequate investments in healthcare infrastructure, services, and systems can be severely undermined during an economic crisis, among other priorities and constraints in a developing country like Sri Lanka. In such a setting, the health sector is adversely impacted through two channels: the household sector (demand side) and the government sector (supply side) as illustrated in Figure 8.1.

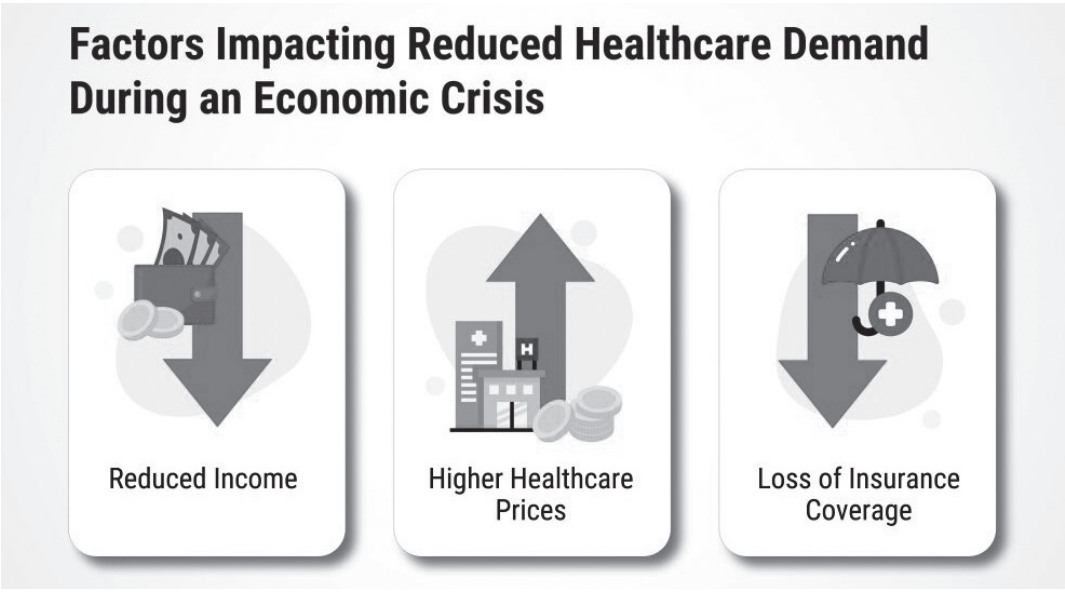
Figure 8.1
Multiple Transmission Paths from Economic Crisis to Health Outcomes



Source: Yazbeck, Abdo & Hou, Xiaohui & Velenyi, Edit & Iunes, Roberto & Smith, Owen. (2013). Learning from Economic Downturns: How to Better Assess, Track, and Mitigate the Impact on the Health Sector. Directions in Development. Washington, D.C.: World Bank.

Promoting good health and investing in healthcare systems improves economic growth by enhancing human capital, reducing poverty, increasing productivity, and fostering social stability.

The demand for healthcare services from the household sector would decrease due to reduced income, higher prices of healthcare products and services, and loss of insurance coverage resulting from job losses. Additionally, negative behavioural changes are likely to emerge within the household sector, which would have a detrimental effect on health outcomes. For example, in the face of escalating food prices, individuals may opt to cut down or compromise the quantity and quality of their food or resort to cheaper, unhealthy options. Similarly, economic recessions and related factors such as unemployment, income decline, and unmanageable debts are strongly linked to poor mental well-being, higher rates of common mental disorders, substance-related disorders, and suicidal behaviour.[2] In the case of alcohol and tobacco consumption, for example, two behavioural patterns can emerge conjointly – an increase in consumption due to psychological distress triggered by unemployment and income reduction or a decrease in consumption due to tighter budget constraints. Available literature suggests that the consumption of alcoholic beverages tends to increase during an economic crisis among certain population segments.[3] All these behavioural changes, intensified by an economic crisis, contribute to deteriorating health outcomes in the long run.



2 Frasquilho, D., Matos, M., Salonna, F., Guerriero, D., Storti, C.C., Gaspar, T., & Caldas-de-Almeida, J.M. (2015). Mental Health Outcomes in Times of Economic Recession: A Systematic Literature Review. *BMC Public Health* 16, 115.

3 de Goeij, M. C., Suhrcke, M., Toffolutti, V., van de Mheen, D., Schoenmakers, T. M., & Kunst, A. E. (2015). How Economic Crises Affect Alcohol Consumption and Alcohol-related Health Problems: A Realist Systematic Review. *Social Science & Medicine (1982),* 131, 131–146.

From the supply side, governments often limit their spending on the social sector due to limited resource availability, and a key area that could be affected is healthcare. This could lead to cuts in health budgets, which in turn would constrain the delivery of healthcare services.

8.3 Building Resilience in Sri Lanka's Healthcare System

In Sri Lanka, a diverse healthcare system is seen, with individuals often using services from a combination of different systems. The predominant system is the allopathic system, which encompasses both the public and private sectors. The public sector accounts for 95% of inpatient care and 50% of outpatient care, playing a dominant role in preventive and curative services. In contrast, the private sector primarily focuses on curative services and has a limited role in preventive services.

The government healthcare system is partially devolved, with the Ministry of Health at the central level overseeing the country's health services. The Ministry is responsible for various key aspects, including the management of national facilities, medical education, policy formulation, and procurement of drugs and medical supplies. The structure of the government healthcare system has been shaped by the Health Services Act No. 95 of 1953 and the Provincial Council Elections Act (No. of 1988). Prior to the 1980s, the central health department or the Ministry oversaw the management of the government health services. However, with the implementation of the 13th Amendment in 1987, health services were decentralised and the responsibility delegated to Provincial Councils (PCs). Each PC now has its own provincial Health Ministry. At the grassroots level, the Medical Officer of Health (MOH) areas serve as the smallest health units in the public health network. These MOH areas play a vital role in providing preventive and public health services, with a team comprising various categories of staff.

Sri Lanka's economic crisis – and the associated fiscal constraints – have had an immediate downside impact on healthcare. The most demonstrable impacts were attributable to the lack of access to medicine, mainly due to dwindling foreign currency reserves and a widening balance of payments deficit. By mid-February 2023, out of approximately 300 essential medicines, around 160 were reported to have a 'zero' stock level at the Medical Supplies Division.[4] This severe shortage of drugs forced the government to postpone or even temporarily suspend non-essential and non-urgent surgeries at government hospitals in some instances. As of January 2023, Sri Lanka was estimated to have a substantial funding gap of United States Dollars (USD) 220 million (Mn) for importing essential medicines

Contractions in health service delivery undermine the commendable progress achieved over the years and can result in increasing NCDs, malnutrition among children, communicable diseases, and mental health issues.

4 Hettiarachchi, K. (2023, February 12). *Drug Shortage – Emergency in State Health Sector that Needs to be Addressed Now: Chilling Disclosures by Powerful SLMA Panel of Health Experts.* Retrieved June 02, 2023, from The Sunday Times: https://www.sundaytimes.lk/230212/news/drug-shortage-emergency-in-state-health-sector-that-needs-to-be-addressed-now-511641.html

and supplies, compelling the government to seek international donor assistance to bridge this gap.[5] Such contractions in health service delivery undermine the commendable progress achieved over the years and can result in increasing non-communicable diseases (NCDs), malnutrition among children, communicable diseases, and mental health issues.[6]

As mentioned at the onset, even prior to the severe impact of the economic crisis, Sri Lanka's health system was already facing significant challenges and upheavals concerning capacity, knowledge, and policy gaps.[7] In terms of capacity, notable issues remain, such as inadequate planning and future-oriented strategies, as well as limitations in financial and human resources. Knowledge gaps are evident in addressing the growing burden of NCDs, data dissemination and research and development (R&D). Additionally, the health system is hindered by a lack of effective monitoring and evaluation mechanisms, policy inconsistencies, and limited avenues for influencing policy, further weakening the overall health system. Moreover, these weaknesses have prolonged, indicating that issues have not been adequately addressed or not been properly identified.

Among such gaps, the rest of the discussion will focus on the lack of financial capacity and gaps in efficiency.

8.3.1 Health Financing

Health financing is a core function of health systems that can enable progress towards UHC by improving effective service coverage and financial protection. Establishing a sustainable and resilient health financing system is vital for countries to achieve universal healthcare. Essentially, health financing revolves around three key functions: (i) revenue raising, which involves sourcing funds from various channels such as government budgets, compulsory or voluntary prepaid insurance schemes, direct out-of-pocket expenditure (OOPE) spending by users, and external aid; (ii) pooling of funds, which entails collecting and managing prepaid funds on behalf of all or a portion of the population; and (iii) purchasing of services, which involves allocating resources and making payments to healthcare providers.

Healthcare financing in Sri Lanka relies primarily on two sources, which are equally shared: (1) government transfers funded through general taxation and (2) direct payments made by households, also known as OOPE (Figure 8.2). Prior to the pandemic, in 2019, the government's share in total health expenditure was 46.3%, while households contributed 45.6%. External donor financing was relatively low, at approximately 1-2% of total current health expenditure.

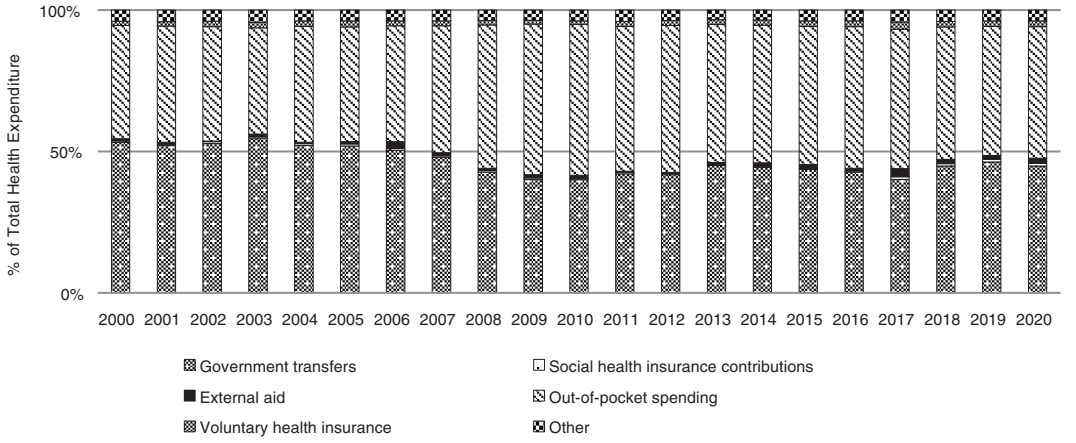
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5 World Health Organization. (2023). *WHO Delivers Essential Medicines and Supplies to Help Sustain Vital Health Services for Crisis Response and Beyond*. Retrieved June 02, 2023, from World Health Organization: https://www.who.int/srilanka/news/detail/24-01-2023-who-delivers-essential-medicines-and-supplies-to-help-sustain-vital-health-services-for-crisis-response-and-beyond

6 Matthias, A. T., & Jayasinghe, S. (2022). *Worsening Economic Crisis in Sri Lanka: Impact on Health*. The Lancet Global Health, 10(7), E959.

7 Abayasekara, A., Bharali, I., De Silva, T., Mao, W., Yamey, G., & Arunatilake, N. (2021). *Identifying the Knowledge, Capacity, and Policy Gaps in the Face of Sri Lanka's Health Transitions and Journey Towards Universal Health Coverage: A Qualitative Analysis.* SSRN – Elsevier.

Figure 8.2
Sources of Health Expenditure

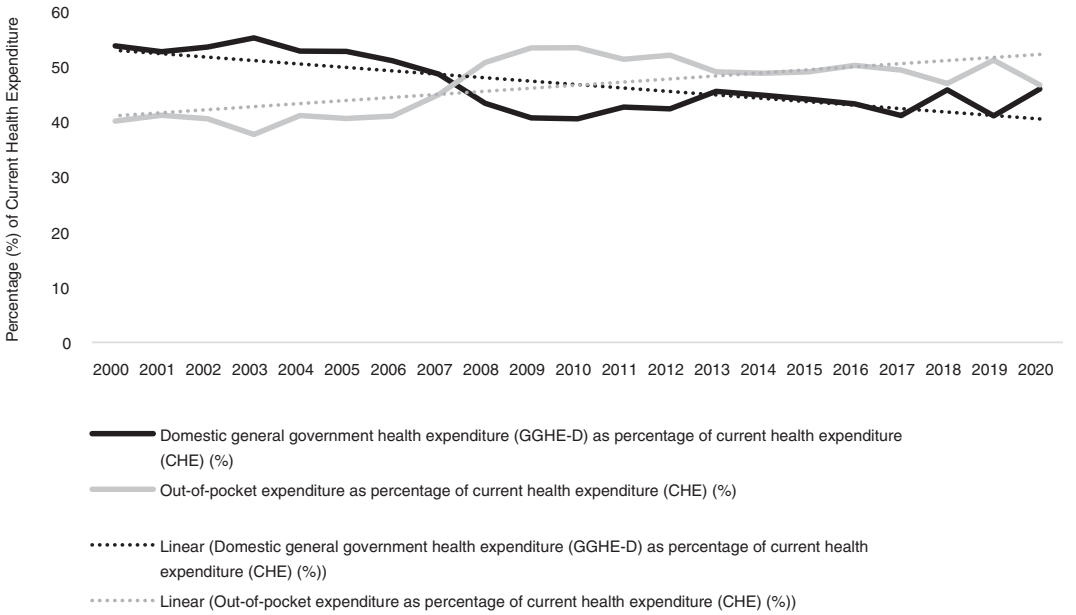


Source: World Health Organization. (2023). Global Health Expenditure Data Base. Retrieved May 10, 2023, from World Health Organization: https://apps.who.int/nha/database/country_profile/Index/en

Over time, an upward trend is visible in OOPE in Sri Lanka, accompanied by a decline in the government's contribution (Figure 8.3). Factors such as delays in accessing healthcare in public facilities, limited availability of drugs and treatment options, and convenience issues have led more individuals to seek healthcare from private facilities. Sustaining OOPE at tolerable levels by improving the healthcare system is vital for better health coverage and poverty reduction.[8] This is even more valid in times of economic crisis, where stagflation and depreciation of the local currency make private facilities and OOPE more expensive and less affordable. Although a health insurance scheme was introduced in 1997 for the public sector to alleviate the financial burden on households, its impact on easing household healthcare expenditure remains uncertain. While some private sector companies offer their employees health insurance, this seems inadequate and with low coverage. Regrettably, such schemes compel many employed in the private sector to bear the bulk of private healthcare service costs themselves.

8 Sirag, A., & Mohamed Nor, N. (2021). Out-of-Pocket Health Expenditure and Poverty: Evidence from a Dynamic Panel Threshold Analysis. *Healthcare (Basel, Switzerland),* 9(5), 536.

Figure 8.3
Trends in Government Health Expenditure and OOP Health Expenditure 2000-2020



Source: World Health Organization. (2023). The Global Health Observatory. Retrieved May 10, 2023, from World Health Organization: https://www.who.int/data/2gho/data/indicators

Studies on the subject of health financing suggest that the Sri Lanka healthcare system faces a significant challenge from insufficient government spending on health, which fails to meet the growing demand for services resulting from epidemiological and demographic transitions.[9] The current proportion of general government health expenditure in relation to general government expenditure, which stands at approximately 8-9%, is insufficient, as evident from the high levels of OOPE. Sri Lanka's commitment to health financing is comparatively lower than its Southeast Asian counterparts and even falls below global averages (Table 8.1). Apparently, Sri Lanka can no longer rely on the 'good health at low cost' approach as it is inadequate to address the current healthcare challenges and establish a sustainable healthcare financing base for the country.

Sri Lanka can no longer rely on the 'good health at low cost' approach as it is inadequate to address the current healthcare challenges and establish a sustainable healthcare financing base for the country.

9 Rajapaksa, L., De Silva, P., Abeykoon, A., Somatunga, L., Sathasivam, S., Perera, S., & et al. (2021). *Sri Lanka Health System Review*. New Delhi: World Health Organization Regional Office for South-East Asia.

Table 8.1
Comparative Health Financing Indicators

Indicator	Sri Lanka	Southeast Asia	Upper Middle-Income Countries	Global
CHE as a percentage of GDP (%) 2020	4.07	5.19	7.46	7.11
CHE per capita in USD, 2020	151.06	189.25	528.45	1,205.61
GGHE-D as a percentage of CHE (%), 2020	45.81	48.92	58.15	55.17
(GGHE-D) as a percentage of GGE (%), 2020	8.49	8.24	12.03	10.68
(GGHE-D) as a percentage of GDP (%), 2020	1.86	2.86	4.43	4.13
OOPE as a percentage of CHE (%), 2020	46.58	37.94	30.52	28.99

Notes: CHE= Current health expenditure; GGE= General government expenditure; GGHE-D= Domestic general government health expenditure.

Source: Author's compilation based on World Health Organization. (2023). Global Health Observatory Data Repository. Retrieved May 10, 2023, from World Health Organization: https://apps.who.int/gho/data/node.main.HEALTHFINANCING

8.3.2 Health Sector Efficiency

Health system efficiency seeks to capture the extent to which inputs to the health system in the form of expenditures and other resources are used to secure valued health system goals.[10] When care is delivered inefficiently, patients may experience suboptimal health outcomes or encounter difficulties within the healthcare system. Inefficiencies at any level of the system can impede patients from receiving the necessary care they require, leading to missed opportunities for improvement or even face death risks. Furthermore, inefficient usage of resources in the health sector may compromise consumption opportunities elsewhere in the economy, such as education or nutrition; it may also reduce society's willingness to contribute to the funding of health services, thereby harming social solidarity, health system performance and social welfare.

Processes in the health system may be inefficient for two distinct but related reasons.[11] The first reason is resource optimisation issues due to mismatches or non-alignment in resources and priorities. This means that resources allocated to the health system, such as expenditure and other resources, may be deployed to generate outputs that are not aligned with society's priorities. For instance, offering expensive cancer treatments for older patients can yield benefits for the patients receiving the treatments; however, society may view that the limited funds allocated to the healthcare

10 European Observatory on Health Systems and Policies. (2021). *Efficiency*. Retrieved May 10, 2023, from European Observatory on Health Systems and Policies: https://eurohealthobservatory.who.int/themes/observatory-programmes/health-systems-performance/efficiency

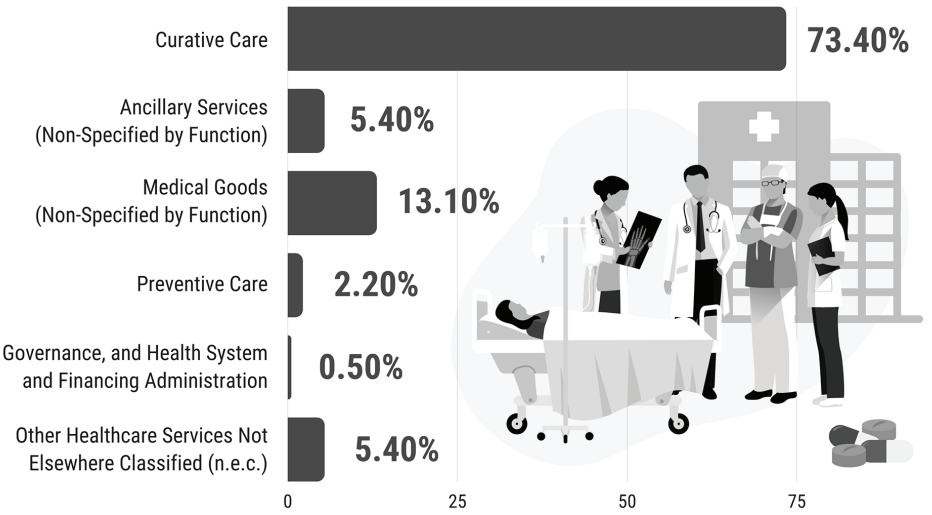
11 Cylus J., Papanicolas I., & Smith PC. (Eds.) (2016). Health System Efficiency: How to Make Measurement Matter for Policy and Management. *Health Policy Series*, No. 46. Copenhagen: European Observatory on Health Systems and Policies.

system could be more effectively utilised on alternative interventions that generate greater overall health improvements.

The second reason is the likelihood of misusing inputs in the process of producing valued health system outputs. When resources are wasted at any stage of the production process, it results in lower output than what could have been achieved with the initial level of resources. This can be seen as a form of inefficiency or wastage. Allocative efficiency and technical efficiency are the two main concepts used in measuring efficiency in a health system. Allocative efficiency simply means doing the right things (providing the highest value health services for available resources) and technical efficiency refers to doing the things right (how resources are used during service provision).

Despite the Sri Lankan health system being acclaimed as highly efficient, still, areas remain to be addressed where considerable gaps in efficiency exist. There are two major issues related to allocative efficiency. First, there is disproportionate spending on hospitals, with a higher expenditure share allocated to curative care rather than preventive care (see infographic). According to the most recent National Health Accounts for Sri Lanka, in 2018, 73.4% of the total CHE was spent on curative care, while the preventive care allocation was 5.4%. Additionally, a low level of spending is evident in primary care compared to secondary and tertiary care. For instance, in 2018, the percentage distribution of CHE utilisation by level of care accounted for 51.6%, 38.8%, and 9.6% for secondary care, tertiary care, and primary care hospitals, respectively This imbalance in resource allocation hinders the optimal distribution of healthcare services.

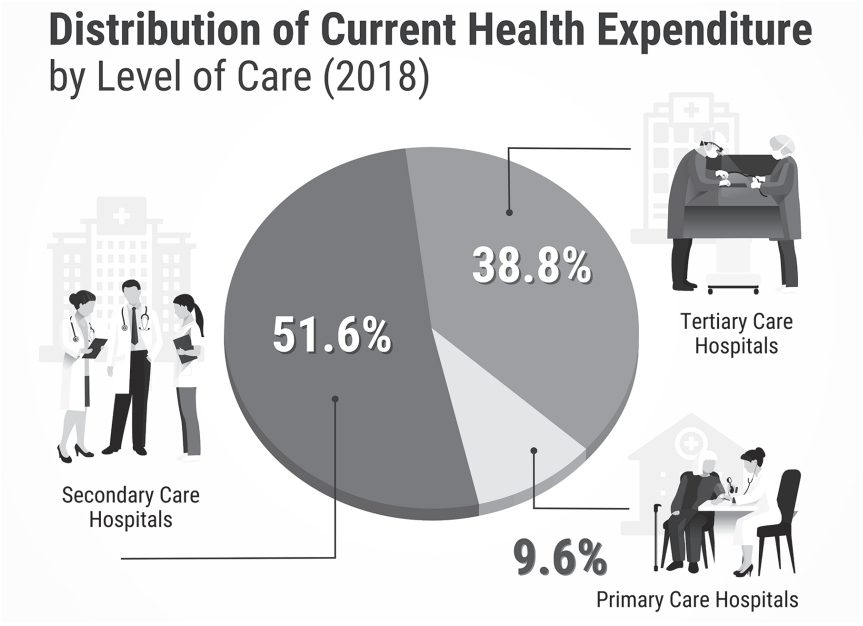
Distribution of Current Health Expenditure by Healthcare Functions (2018)



Source: Ministry of Health Sri Lanka (2022). *Sri Lanka National Health Accounts 2017 & 2018*. Colombo: Ministry of Health, Sri Lanka.

Second, a lack of systematic priority-setting is another issue in resource allocation. Instead of basing resource allocation on population needs, it is often determined by historical trends related to infrastructure and staffing. This approach fails to address the evolving healthcare needs of the population, which vary over time (such as with changing demographics etc.) and may even lead to inefficient allocation of resources. Addressing these issues and improving allocative efficiency is crucial for optimising resource utilisation and ensuring that healthcare services align with the population's needs.

In addition to the aforementioned issues, several other efficiency challenges aggravate the impediments. These mainly include fragmentation, data gaps, lack of monitoring, and human resource problems.[12] The health system in Sri Lanka is characterised by fragmentation, involving multiple actors and institutions responsible for service delivery, financing, and regulation. This fragmented structure can result in duplication of efforts, inefficiencies in resource allocation, and gaps in coordination and collaboration. Furthermore, significant data gaps exist in this regard. Accuracy, appropriateness, and timeliness are some critical data gaps prevailing in the system. For instance, the Annual Health Bulletin, one of the country's main publications on health-related data, is published with a three-year time lapse. Such gaps hinder evidence-based decision-making, monitoring of health outcomes, and the efficient allocation of resources. Besides, human resource issues pose challenges to the efficiency of the health system. Inadequate staffing levels, insufficient capacity among existing staff, and frequent staff transfers contribute to inefficiencies in service delivery. These human resource problems must be addressed to ensure a well-functioning and efficient health system.



Source: Ministry of Health Sri Lanka. (2022). *Sri Lanka National Health Accounts* 2017 & 2018. Colombo: Ministry of Health, Sri Lanka.

12 Institute of Policy Studies of Sri Lanka and the Center for Policy Impact in Global Health – Duke University. (forthcoming). *Enhancing Data and Knowledge for Strategic Planning, Improving Efficiency and Prioritisation of Health Finance in Sri Lanka.*

Overall, given the current constraints due to resource limitations, pursuing enhanced efficiency becomes an imperative policy goal to ensure that available resources are optimally utilised and patients receive the best possible care. It is a crucial long-term strategy to strengthen the resilience of Sri Lanka's healthcare system. By prioritising efficiency improvements, scarce resources can be more effectively used to enhance the overall performance and sustainability of the healthcare system.

Given the current constraints due to resource limitations, pursuing enhanced efficiency becomes an imperative policy goal to ensure that available resources are optimally utilised and patients receive the best possible care.

In any exercise to explore policy options in health financing and efficiency, policy evaluation helps to understand why and how a policy option has the potential to be successful or not, by providing an assessment of the reasons and causal mechanisms leading to policy success or failure. It also contributes to the quality of decision-making by providing insights on improving links between policy formulation, implementation, and outcomes.

By providing citizens and other stakeholders with information, the government's endeavours, including financial resource allocation, can be better assessed to understand if the anticipated outcomes will be achieved. Questions on the relevance (is the intervention doing the right things?), coherence (how well does the intervention fit?), effectiveness (is the intervention achieving its objectives?), efficiency (how well are resources being used?), impact (what difference does the intervention make?), and sustainability (will the benefits last?) are some of the commonly used criteria in evaluating a policy.[13] Moreover, feasibility (technical, financial, legal), acceptability, and risks are crucial aspects in policy evaluation.

8.4 Policy Options and Recommendations for Health Financing

Countries use various types of health financing mechanisms to fund their healthcare systems. Common types of health financing include general taxation, social health insurance (SHI), mandatory health insurance, voluntary health insurance, community-based health financing, OOPE, and external aid and donor financing (Table 8.2). Moreover, countries often employ a combination of these financing mechanisms to ensure adequate and sustainable funding for their healthcare systems. The specific mix of financing sources can vary depending on factors such as a country's economic situation, political context, and the desired goals of its healthcare system.

In the face of Sri Lanka's acute financial constraints, many health sector stakeholders have viewed external funding as a critical financial strategy that the country should prioritise as a short-term and

13 OECDiLibrary. (2023). *Applying Evaluation Criteria Thoughtfully. Understanding the Six Criteria: Definitions, Elements for Analysis and Key Challenges*. Retrieved May 25, 2023, from OECDiLibrary: https://www.oecd-dxsilibrary.org/sites/c249f611-en/index.html?itemId=/content/component/c249f611-en

immediate measure to address and mitigate the adverse effects. This includes addressing shortages in drugs and other medical supplies. However, it is important to recognise that this option should be viewed solely as a short-term measure in relation to concerns regarding the long-term sustainability of health programmes and initiatives. Overreliance on external funding can lead to dependency and undermine a country's ability to independently finance its healthcare system.

Table 8.2
Main Criteria of Healthcare Financing Schemes

	Mode of Participation	Benefit Entitlement	Basic Method for Fund-raising	Pooling
Government schemes	Automatic: for all citizens/ residents; or a specific group of the population (e.g., the poor) defined by law/ government regulation.	Non-contributory, typically universal, or available for a specific population group or disease category defined by law (e.g., TB, HIV, oncology).	Compulsory: budget revenues (primarily taxes).	National, sub-national, or programme level.
Social health insurance	Mandatory: for all citizens/ residents; or a specific group of the population defined by law/ government regulation. In some cases, however, the enrolment requires actions to be taken by the eligible persons.	Contributory: based on payment by or on behalf of the insured person.	Compulsory: non-risk- related health insurance contribution. Insurance contributions may be paid by the government (from the state budget) on behalf of some non-contributing groups of the population, and the government may also provide general subsidies to the scheme.	National, sub-national, or by scheme; with multiple funds, extent of pooling will depend on risk-equalisation mechanisms across schemes.

	Mode of Participation	Benefit Entitlement	Basic Method for Fund-raising	Pooling
Compulsory private insurance	Mandatory: for all citizens/ residents; or a specific group of the population defined by law/ government regulation.	Contributory: based upon a purchase of an insurance policy from a selected health insurance company (or other agency involved).	Compulsory health insurance premiums. Tax credits may also be involved.	National, sub-national, or by scheme; with multiple funds, the extent of pooling will depend on risk-equalisation mechanisms across schemes. Also depends on the extent of regulation of premium, and standardisation of benefits across schemes.
Compulsory Medical Saving Accounts (CMSA)	Mandatory: for all citizens/ residents; or a specific group of the population defined by law/ government regulation.	Contributory: based upon the purchase of MSAs; persons having MSAs can, however, only use the money saved, regardless of whether the saving covers the costs of the care necessary.	Compulsory, defined by law (e.g., as percent share of income).	No inter-personal (except perhaps family members).
Voluntary health insurance schemes	Voluntary.	Contributory: based upon the purchase of voluntary health insurance policy (usually on the basis of a contract).	Usually non-income- related premium (often directly or indirectly risk- related). Government may directly or indirectly (e.g., tax credits) subsidise.	Scheme level.
Non-profit institutions financing schemes	Voluntary.	Non-contributory, discretionary.	Donations from the general public, governments (budget of national government or foreign aid) or corporations.	Varies across programmes, but typically programme level.

	Mode of Participation	Benefit Entitlement	Basic Method for Fund-raising	Pooling
Enterprise financing schemes (other than employer-based insurance)	Voluntary choice of a particular corporation, with coverage based on employment at such a firm (e.g., compulsory occupational health care).	Non-contributory, discretionary with regard to the type of services, though may sometimes be specified by law.	Voluntary: choice of the firm to use its revenues for this purpose.	At an individual enterprise level.
Household OOPE	Voluntary: willingness to pay for the household.	Contributory: service provided if individual pays.	Voluntary: household disposal income and saving.	No inter-personal pooling.
Rest of the World's financing schemes	Compulsory or voluntary.	Criteria set by foreign entities.	Grants and other voluntary transfers by foreign entities.	Varies across programmes.

Source: Organisation for Economic Co-operation and Development. (2011). Classification of Healthcare Financing Schemes (ICHA-HF). *In A System of Health Accounts: 2011 Edition.* Paris: OECD Publishing.

As mentioned previously, the proportion of OOPE made by households has been rising in Sri Lanka, imposing a significant financial burden on them. Internationally, there is a strong debate to shift from excessive reliance on direct OOPE spending towards a system that incorporates a greater element of risk pooling, thus, affording greater protection for the poor.[14] A gradual reduction in OOPE is a crucial step towards achieving UHC.

8.4.1 Social Health Insurance

As explained, "SHI is a form of financing and managing healthcare based on risk pooling. SHI pools both the health risks of the people on one hand, and the contributions of individuals, households, enterprises, and the government on the other. Thus, it protects people against financial and health burdens and is a relatively fair healthcare financing method. Desirable though it is, not many least-developed and low-middle-income countries (LDCs and LMICs) have succeeded in adequately expanding coverage of SHI."[15]

Indeed, SHI is a health finance mechanism implemented in many countries to achieve UHC. To emulate the successes of SHI in many developed countries, developing and middle-income countries (MICs) have attempted to follow suit.[16] International experience with implementing SHI schemes

14 Mulenga, Arnold., & Ele-Ojo Ataguba, John. (2017). Assessing Income Redistributive Effect of Health Financing in Zambia. *Social Science & Medicine.* Volume 189. Pages 1-10.

15 World Health Organization Regional Office for South-East Asia. (2003). *Social Health Insurance*. New Delhi: World Health Organization Regional Office for South-East Asia.

16 Jamal, M. H., Abdul Aziz, A. F., Aizuddin, A. N., & Aljunid, S. M. (2022). Successes and Obstacles in Implementing Social Health Insurance in Developing and Middle-income Countries: A Scoping Review of 5-year Recent Literatures. *Frontiers in Public Health*, *10*, 918188.

provides compelling evidence of improved health outcomes. For instance, Thailand has implemented three distinct public health insurance schemes that provide coverage to the entire population since 2002. These schemes include the Civil Servants Medical Benefit Scheme (CSMBS), which caters to civil servants and their relatives; the SHI Scheme covers private and formal sector employees in companies with a workforce over 10 employees; and the universal coverage scheme (UCS), which extends coverage to the remaining population, including the poor, vulnerable individuals, informal sector employees, and those employed in small companies. Each scheme is managed by semi-autonomous or autonomous agencies affiliated with different government Ministries. Under this approach, Thailand's UHC has demonstrated exemplary outcomes in service coverage, financial risk protection, pro-poor government subsidies and reduced under-five mortality gap.[17]

In Indonesia, the significance of SHI is growing, and the country has implemented a system called the National Health Insurance Programme (*Jaminan Kesehatan Nasional - JKN*). The JKN integrates five different SHI schemes covering the public sector (since 1968), the military and police (1968), the private formal sector (1992) and the poor (2005). As at end 2019, the JKN had reached 222.1 Mn members, encompassing 83% of the population, including 96 Mn poor individuals.[18] Indonesia has made significant strides towards achieving UHC over the past few decades. The country's UHC service coverage index has risen from 45 in 2010 to 62 in 2020, indicating a considerable improvement. Moreover, Indonesia has witnessed an improvement in the level of financial risk protection, a decrease in the proportion of the population facing catastrophic health expenditures at the household level, [19] and a substantial reduction in the number of people being pushed into poverty due to OOPE.

In 2009, China initiated extensive reforms in its healthcare system, to attain UHC by establishing a SHI system. The reforms introduced a universal health insurance system that encompassed three primary social health schemes: urban employee basic medical insurance, urban resident basic medical insurance, and rural new cooperative medical scheme, supplemented by additional insurance options and private coverage. Subsequently, in 2016, the urban resident and rural schemes were consolidated into the urban-rural resident basic medical insurance to enhance administrative effectiveness. A review done in 2019 revealed the introduction of SHI enabled China to improve access to and use of healthcare, reduce the share of OOPE in total health expenditure and enhance financial protection for vulnerable people, including the poor, chronically ill or disabled, disadvantaged by geographical factors, very young, frail, and old.[20]

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17 Marshall, A. I., Kantamaturapoj, K., Kiewnin, K., Chotchoungchatchai, S., Patcharanarumol, W., & Tangcharoensathien, V. (2021). Participatory and Responsive Governance in Universal Health Coverage: An Analysis of Legislative Provisions in Thailand. *BMJ Global Health*, *6*(2), e004117. https://doi.org/10.1136/bmjgh-2020-004117

18 World Health Organization Regional Office for South-East Asia. (2021). *Crisis or Opportunity? Health Financing in Times of Uncertainty: Country Profiles from the SEA Region*. New Delhi: World Health Organization Regional Office for South-East Asia.

19 The World Health Organization defines catastrophic health expenditures as the OOPE exceeding 40% of the household income net of subsistence needs.

20 Fang, H., Eggleston, K., Hanson, K., & Wu, M. (2019). Enhancing Financial Protection under China's Social Health Insurance to Achieve Universal Health Coverage. *BMJ* 2019; 365 :l2378.

In Sri Lanka's case too, an approach based on a SHI mechanism has been identified as the best option, both for mobilising more resources and using these equitably, efficiently and ensuring greater accountability.[21]

While several countries have made remarkable improvements under the SHI system, it is crucial to acknowledge that this system also presents challenges and implementation issues. The presence of a large informal sector, high administrative costs, and the inability of small countries to generate sufficient revenue for UHC due to their small population size are some critical challenges.[22] These are relevant for Sri Lanka too. Among these challenges, the presence of a large informal sector poses a particularly significant obstacle for developing countries. When a substantial portion of the population operates in the informal economy, relying on contributions as a reliable source of revenue becomes challenging. As of 2021, the employment contribution of the informal sector in Sri Lanka accounted for 58.4%.[23] However, many countries in Latin America, including Bolivia, Chile, Colombia, Costa Rica, the Dominican Republic, Mexico, Peru, and Uruguay, have successfully overcome this obstacle by implementing government budget transfers or subsidisation arrangements. These measures are aimed at extending SHI coverage to the informal sector.

The implementation of SHI can also give rise to equity concerns, as the affordability of premiums based on income can be burdensome for low-income individuals. However, several countries have taken steps to address this barrier. One approach is the introduction and allowing of exceptions for poor and other vulnerable groups. For example, Thailand's SHI includes exception categories such as children under 12 years of age, senior citizens aged 60 years and over, the very poor, and volunteer health workers. Moreover, restructuring can be done through revisions like increasing the premium or decreasing the reimbursement tariff of the high-income group or vice versa for the low-income group to overcome this issue.

Sri Lanka already has a SHI scheme in place. '*Agrahara*' was introduced in 1997 and upgraded in 2016 as a result of increasing government interest in SHI schemes to reduce OOPE and catastrophic health expenditure. The scheme is currently managed by the National Insurance Trust Fund and provides coverage for public sector employees, complementing the existing tax-funded healthcare system. Interestingly, an evaluation of the Agrahara scheme revealed that outpatient treatment had a higher utilisation rate in the private sector. Public facility usage was higher for inpatient care, although the overall utilisation rate was only 23%.[24] The same review found that the scheme has not successfully prevented individuals from experiencing catastrophic healthcare costs, primarily due to low utilisation rates and limited coverage for family members and certain illnesses. Recommendations to enhance

21 Gopalan, S. (2023). *Health Financing Options for Sri Lanka What, Why and How?*. Unpublished paper. Colombo: World Health Organization, Sri Lanka Country Office.

22 Friebel, R., Josephson, E., Forman, R., Calza, S. (2020). *Challenges of Social Health Insurance in Low- and Lower-Middle Income Countries: Balancing Limited Budgets and Pressure to Provide Universal Health Coverage*. Washington, D.C.: Center for Global Development.

23 Department of Census and Statistics. (2021). *Sri Lanka Labour Force Survey Annual Report 2021*. Battaramulla: Department of Census and Statistics.

24 Karunaratna, S., Ranasinghe, T., Chandraratne, N., & De Silva, A. (2019). The Social Health Insurance Scheme for Public Sector Employees in Sri Lanka and its Effect on Reducing the Financial Burden of Illness. *Asia Pacific Journal of Public Health*, *31*(7), 584–593.

the policy design of the existing Agrahara scheme in Sri Lanka include raising awareness about the scheme, improving the package benefits, and expanding the coverage to include more beneficiaries.

8.4.2 User Fees

User fees refer to charges imposed on individuals when accessing healthcare services. It is a form of direct payment by users or patients to healthcare providers or facilities to receive medical treatment, medications, or other healthcare services. The rationale behind user fees includes promoting cost recovery, discouraging unnecessary or inappropriate use of healthcare services, and ensuring that individuals contribute towards their own healthcare expenses. Thus, these are often used in healthcare systems with limited financial resources, and alternative financing mechanisms may be insufficient to cover all healthcare costs. Due to insufficient public health spending, user charges are widely used in many low-income and middle-income countries (LICs and MICs).

User fees offer some advantages, such as revenue generation and efficiency in resource allocation by discouraging overutilisation of healthcare services and ensuring that those who can afford to pay contribute towards their healthcare cost. Such fees can improve the quality of services associated with these, provided that the revenue generated from these fees remains within the local facility and is used for local purposes. There are two primary ways through which this positive impact can be achieved. The first mechanism involves using the revenue from user fees to fund quality enhancements, such as maintaining or upgrading equipment and facilities, as well as providing in-service training for healthcare workers. The second mechanism entails using the revenue from user fees as an incentive for healthcare workers. By allowing healthcare workers to directly benefit from the user fees collected, they are motivated to be more present and dedicated in their service, compared to a situation where their compensation remains unaffected. However, pay-for-service can lead to overprovision of services – i.e. moral hazard on the part of the provider.

Singapore, whose healthcare system is ranked among the best in the world, incorporates user fees, known as 'co-payments' to encourage cost-sharing and discourage excessive utilisation of healthcare services. Patients are required to contribute a portion of their healthcare expenses, with higher-income individuals paying higher amounts. The government provides subsidies and safety nets to ensure that healthcare remains accessible to low-income individuals. In African countries like Ghana, Kenya, and Uganda, user fees are used as a healthcare financing approach. In Kenya, implementing user fees and targeted exemptions in 1989 was part of an International Monetary Fund (IMF)/World Bank programme. In 2004, Kenya adopted a reduced and standardised user fee policy, granting fee exemptions to various groups. These exemptions aimed to protect the poor and specific categories of patients, such as young children and pregnant women, from healthcare costs.

Evidence also suggests that user fees can disproportionately affect low-income individuals, exacerbating existing socio-economic inequalities in health and impeding progress towards UHC.[25]

25 Qin, V. M., Hone, T., Millett, C., Rodrigo, M., McPake, B., Atun, R., & Lee, J. (2018). The Impact of User Charges on Health Outcomes in Low-income and Middle-income Countries: A Systematic Review. *BMJ Global Health*. 2018; 3(Suppl 3): e001087.

These adverse effects can be minimised by introducing exemptions and waivers, setting fee caps and limits, and strengthening primary healthcare (PHC) services. However, concerns have arisen regarding the impact of user fees on access to essential health services and the financial burden, especially for poorer households, despite the exceptions in place.[26] The shortcomings of the user fee system have led some countries that implemented this approach to abandon it, indicating the enormity of its challenges. Mexico, for instance, initially implemented user fees as part of healthcare reforms in 2003. However, due to various issues, the programme underwent several changes and was replaced in 2020 with the aim of providing free healthcare services to the uninsured population. The main criticisms of the previous programme included its lack of universal coverage for the population and services, insufficient reduction in OOPE, widespread corruption, and failure to improve people's well-being.[27]

Sri Lanka, too, has experience with user fee systems. For instance, the Sri Jayawardenepura General Hospital mobilises revenue by charging patients since its inception in 1984, as well as a 'paying wards' system at the Sri Lanka National Hospital. Indeed, proposals under the Budget 2023 recommend re-implementing the paying wards system in government hospitals, receiving Cabinet approval subsequently. Under this system, both Sri Lankans and foreigners will have access to the facilities. While the timing to introduce a more comprehensive user fee system in the current economic context may be politically unpopular due to its impact on the underprivileged, it should remain a serious consideration. A user fee approach offers an opportunity to generate much-needed funds for the government from individuals who are willing to pay, while ensuring that free health services continue to be available for others. This will also be useful in areas where private sector health services are not available, where individuals who are willing to pay a subsidised fee can access public sector services.

8.4.3 Public-private Partnerships

In the face of public sector financing constraints, public-private partnerships (PPPs) are a useful conduit to jointly provide healthcare services, infrastructure, or other health-related activities. PPPs offer several benefits, including enhanced resource mobilisation through the private sector's managerial efficiency and entrepreneurial spirit. Additionally, private sector investments bring synergies via expertise, innovation, technical knowledge, and the use of advanced technology that improves service delivery. The risk sharing between public and private sectors – where both sectors can mitigate financial burdens by increasing resources (such as direct payment for service delivery) or through cost reductions (such as contracting for food services in a hospital) can also allow for more sustainable healthcare financing.

Several country examples provide evidence of positive outcomes of implementing PPPs in delivering healthcare services. One such example is the Family Health Programme in Mexico. This assigns

26 Opwora, A., Waweru, E., Toda, M., Noor. A., Edwards, T., Fegan, G., …Goodman, C. (2015). Implementation of Patient Charges at Primary Care Facilities in Kenya: Implications of Low Adherence to User Fee Policy for Users and Facility Revenue. *Health Policy and Planning,* Volume 30, Issue 4, Pages 508–517.

27 Reich, Michael. (2020). Restructuring Health Reform, Mexican Style. *Health Systems & Reform,* 6:1.

primary responsibility for managing and delivering PHC coverage services to municipalities. With federal funding, municipalities have the flexibility to organise family health teams based on population needs and geographic characteristics, facilitating greater accountability and collaboration between the private and public sectors. This system has contributed to improved healthcare coverage and health outcomes in Mexico.[28]

PPPs have been a key component of health reforms in India too. Various types of healthcare service functions in India incorporate PPP arrangements, including the management of PHCs, mobile medical units, clinical services through contracting, and PPPs in diagnostics and dialysis. Building state capacities is essential for the effective administration and long-term sustainability of PPP initiatives. Moreover, ensuring transparency in selecting private partners, developing Memorandums of Understanding (MoUs) or contracts, building the capacity of all stakeholders, defining their roles and responsibilities, and establishing a robust monitoring system. India's experience demonstrates that these requisites are crucial for successfully implementing PPPs.[29]

Despite these positives, PPPs also raise concerns about affordability and equity. PPPs may result in increased patient costs, potentially limiting access for low-income individuals and exacerbating health inequalities. PPPs should be employed exclusively when these prove to be the most cost-effective solution in comparison to alternative procurement methods. Additionally, effective implementation of PPPs requires readily accessible capacities for planning, designing, negotiating, and monitoring long-term and complex transactions. It is crucial to establish robust institutional checks and balances to mitigate fiscal risks, maintain the integrity of procurement processes, and protect the public interest.[30]

So far, PPP arrangements have been limited in Sri Lanka, for instance, in hospital management, infrastructure development, and healthcare service delivery. Whilst there is an impetus to further expand the role of PPP arrangements,[31] concerns remain on the usage of PPPs for healthcare in Sri Lanka due to its implications on the notion of 'free health'.[32] Concerns arise due to the lack of clarity regarding how existing shortcomings in public healthcare can be addressed through PPPs.

A review done on PPP arrangements in Sri Lanka points out that private sector involvement in healthcare delivery would intensify human resource deficits in the public sector, weakening of facilities in the public sector (e.g. by contracting-in private pharmacy and laboratory services), and divert resources from an already weakened public sector.[33] The separation of healthcare purchasing from

28 Organisation for Economic Co-operation and Development. (2021). *Primary Health Care in Brazil.* OECD Reviews of Health Systems. Paris: OECD Publishing. https://doi.org/10.1787/120e170e-en.

29 Nundy, M., Sharma, S., Anjaney., Maneeta J., & Kotwal, A. (2021). *Public-private Partnerships in Health Care Under the National Health Mission in India: A Review*. New Delhi: The National Health Systems Resource Centre.

30 World Health Organization Regional Office for Europe. (2023). *Public-private Partnerships for Health Care Infrastructure and Services: Policy Considerations for Middle-Income Countries in Europe.* Copenhagen: World Health Organization Regional Office for Europe.

31 Abayasingha, D. (2019, January 31). *Sri Lanka Must Pursue Public-private Partnerships to Grow Primary Healthcare.* Retrieved May 20, 2023 from Daily FT: https://www.ft.lk/Healthcare/Sri-Lanka-must-pursue-public-private-partnerships-to-grow-primary-healthcare/45-672020

32 Kumar, R. (2019). *Public–private Partnerships for Universal Health Coverage? The Future of "Free Health" in Sri Lanka*. Global Health 15 (Suppl 1), 75 (2019).

33 *Ibid.*

provision, known as the 'purchaser-provider split', allows for diverting public funds towards private profit. For instance, in the case of '*Suraksha*,' a health insurance programme introduced for school children, the government provides funds for healthcare expenses while entrusting the purchasing function to private health insurance. It is argued that this arrangement results in significant profits for the insurance industry.[34] The contention is that PPPs have not delivered the anticipated equity or efficiency improvements in Sri Lanka. Therefore, instead of venturing into uncharted and potentially risky territory, the government would be wise to inject more funds and strengthen the existing and proven model of UHC already operating in Sri Lanka.

8.4.4 Policy Recommendations for Health Financing

Given the pressing need to secure sufficient funding for the healthcare system, implementing user fees can be considered a viable short-term and medium-term policy option for the government. Despite the inherent political risks associated with introducing user fees, particularly their impact on UHC and equity concerns, the government has decided to proceed with this policy option. The fact that there is minimal public resistance to this decision presents a favourable opportunity to test the policy, address any potential adverse effects, and eventually establish it as a long-term policy option.

SHI can be considered a feasible long-term policy option for health financing in Sri Lanka, considering the different cost elements related to its introduction and implementation. The current scarcity of resources does not allow sufficient funding to be allocated to establish the SHI system in Sri Lanka. Furthermore, considering the prevailing political concerns and potential public resistance to shifting to a new health financing system amid the turbulent socio-economic context, it is prudent to consider adopting the SHI system as a long-term policy option.

8.5 Policy Options and Recommendations for Improving Efficiency

Allocative efficiency can be improved by prioritising preventive care and strengthening Sri Lanka's PHC. As discussed earlier, a significant disparity is noticeable in how money is spent on various healthcare functions, with a clear priority given to curative services (see third infographic). The government should also allocate adequate funding to support preventive care initiatives. These include allocating a portion of the healthcare budget specifically for preventive programmes, infrastructure development, public awareness campaigns, and training healthcare professionals in preventive care practices. This can help ease the burden of expensive curative care and improve overall health outcomes.

Strengthening PHC can be done by allocating more resources to expand access to primary care facilities, enhance the capacity of healthcare workers at the primary level, and promote integrated care models. This can ensure that healthcare needs are addressed at the community level, reducing the reliance on expensive secondary and tertiary care. Sri Lanka can adopt four strategic approaches

34 Kumar, R. (2017, August 29). *"Free" Health Insurance for School-goers? Channelling Public Funds for Private Profit*. Daily Mirror. Retrieved June 02, 2023, from Daily Mirror: https://www.dailymirror.lk/article/-Free-Health-Insurance-for-school-goers-Channelling-public-funds-for-private-profit--135549.html

to strengthen PHC with comprehensive community-based and family-focused care. These strategies include: (1) adopting a life course approach and task shifting of PHC workers to combat NCDs while maintaining the three-tier health service model, (2) remodelling and reorienting Primary Medical Care (PMC) units by establishing a 'general practitioner (GP) system' to connect preventive and curative PHC services at the divisional level, (3) establishing a referral and gatekeeping system to reduce bypassing of PHC services, and (4) introducing electronic medical record systems to minimise treatment compartmentalisation and enhance the continuum of care.[35] Ample evidence from other developing countries demonstrates how strengthening PHC enables countries to achieve favourable outcomes. For example, Thailand's UCS approach, which has achieved remarkable health outcomes for the country, emphasises the importance of PHC and the rational for utilisation of integrated services that are effective and efficient. This approach provides a comprehensive benefits package at the primary care level.

The Government of Sri Lanka (GOSL) has already taken some initiatives to recognise the significance of strengthening the PHC service delivery mechanism to build an efficient health system. For instance, the 'Primary Healthcare System Strengthening Project' (PSSP) began in 2019 with funding from the World Bank, and aims to enhance the utilisation and quality of PHC services, with a particular focus on identifying and managing NCDs. This five-year project was initiated in 63 primary medical care institutions is aimed at high-risk population groups. Significant progress has been achieved to date, particularly in terms of improving population screening for NCDs at PMCIs, and enhancing the availability of trained personnel, essential drugs, laboratory services, and health management information systems, as reported in a project review.[36] However, the same review highlights several facility-specific challenges that require urgent attention to ensure the sustainability and successful scaling-up of the project.

The Health System Enhancement Project (HSEP) funded by the Asian Development Bank is a similar project aiming to develop the PHC service delivery in Sri Lanka. This too, started in 2019 as a five-year project and is implemented in nine districts of Central, North Central, Uva and Sabaragamuwa Provinces with a special focus on the geographically, socially, and economically deprived populations. It seeks to address issues such as bypassing PHC facilities, enhancing service comprehensiveness (including for NCDs), establishing a referral system, and integrating preventive and curative services more effectively.

In addition to the above, strengthening health information systems is a crucial step in improving efficiency. The Rwanda Integrated Health Management Information System (RHMIS), the District Health Information Management System (DHIMS) in Ghana, the National Health Information System (DATASUS) in Mexico, and the Integrated Health Information Platform (IHIP) in India are examples

35 Senanayake, S., Senanayake, B., Ranasinghe, T., & Hewageegana, N. (2017). *How to Strengthen Primary Health Care Services in Sri Lanka to Meet the Future Challenges?* Journal of the College of Community Physicians of Sri Lanka. *23*(1):43.

36 Thekkur, P., Fernando, M., Nair, D., Kumar, A. M. V., Satyanarayana, S., Chandraratne, N., …Harries, A. D. (2022). *Primary Health Care System Strengthening Project in Sri Lanka: Status and Challenges with Human Resources, Information Systems, Drugs and Laboratory Services*. Healthcare, *10*(11), 2251.

that demonstrate how strengthening health information systems can improve efficiency and enhance overall health system outcomes.

Both policy options discussed here (i.e., improving allocative efficiency and strengthening health information systems) aimed at enhancing efficiency in the healthcare system, can be considered as medium-term measures considering the associated costs and the necessity for capacity improvements.

8.6 Conclusion

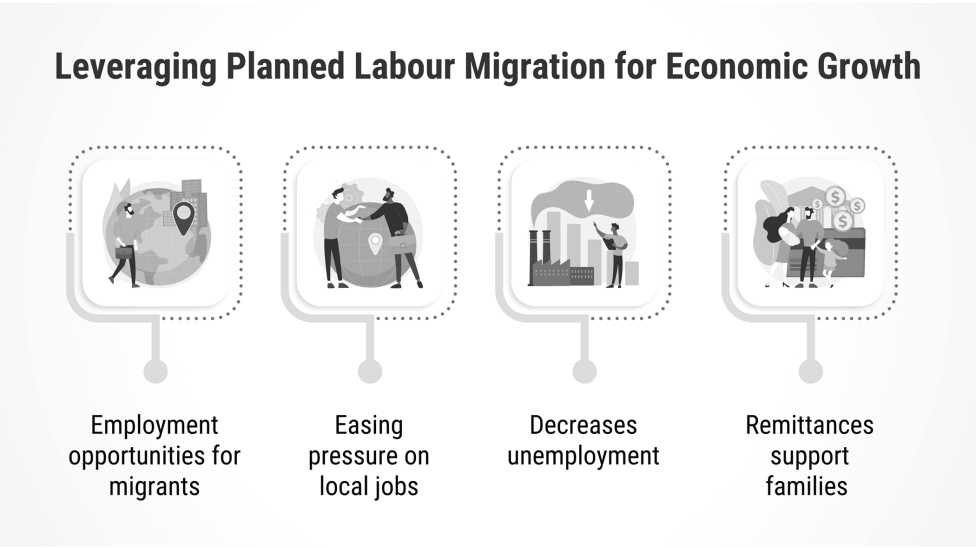
Investing in healthcare systems and promoting good health can contribute to improved economic growth by enhancing human capital, reducing poverty, increasing productivity, and fostering social stability. Similarly, sustained economic growth can provide resources to improve healthcare infrastructure and services, leading to better health outcomes. Adequate investments in healthcare infrastructure, services, and systems are crucial for both individual and societal well-being and economic progress. The Sri Lankan healthcare system is commendable for achieving good health outcomes at a relatively low cost. Despite having a moderate allocation of funds compared to other countries, Sri Lanka has achieved a high UHC index. Sri Lanka's healthcare sector is grappling with significant challenges amid the ongoing economic crisis, raising concerns about the long-term sustainability of the system. Despite its previous recognition for impressive health performance and resilience despite limited public spending, the country is currently struggling to provide basic healthcare services. Even prior to the economic crisis, Sri Lanka's healthcare system faced gaps in knowledge, capacity, and policy, which the ongoing crisis has further exacerbated. The challenges highlight the lack of sustainability and inefficiencies of the existing system and its vulnerability to shocks. Therefore, there is a pressing need for evidence-based policy reforms.

The existing literature and anecdotal evidence indicate that Sri Lanka's health system is confronted with numerous issues and significant challenges, particularly in terms of sustainability. Health financing and system inefficiencies are among the key challenges faced by the country's health system. Several policy options are available to enhance financial sustainability and efficiency. Recommended measures include implementing user fees and PPPs as medium-term solutions, as well as introducing a SHI system as a long-term measure. These recommendations are based on the current socio-economic context, the immediate need for healthcare funding, and existing resource limitations. However, conducting thorough and comprehensive evaluations of each proposed health financing policy option is crucial before implementing these measures. This is necessary to minimise any potential negative impacts on equity and unintended consequences. To improve system efficiency, medium-term policy measures such as prioritising preventive care, strengthening PHC, and enhancing health information systems are proposed. These measures aim to increase allocative efficiency and ensure the effective utilisation of resources.

9. Balancing Brain Drain and Immigrant Workers for Resilient Growth and Recovery

9.1 Introduction

With economic recovery and resilient growth at the forefront of policy imperatives, labour migration and related inward remittances as a means of generating a steady inflow of foreign exchange to rebuild Sri Lanka's depleted foreign reserves, are receiving high policy priority. Migrant workers normally remit regularly, and before the pandemic, such remittances stood above United States Dollars (USD) 7 billion (Bn). Labour migration is thus seen to yield an immediate net foreign exchange gain, with limited upfront costs in the face of established systems for recruitment and repatriation of remittances. Indeed, currently, a ready stock of potential migrant workers seeks such opportunities abroad. The backlog of migration during the pandemic due to demand shortages from overseas employers as well as large-scale returns, the reluctance of migrant workers to leave during the previous years due to the pandemic and thereafter, the latest push for migration due to the ongoing economic difficulties mean that the departure numbers have picked up sharply.



Source: Authors' illustrations.

Yet, labour migration can be a double-edged sword with the potential to boost as well as drag down growth if migration strategies are not well thought through. In boosting growth, labour migration offers employment opportunities to a population segment and eases the pressure on available local jobs and decreases unemployment; at the same time, remittances provide well-targeted support to families to overcome poverty and achieve an overall improvement in their quality of life. At the macro level, migration can lead to a large-scale exodus of human capital developed in Sri Lanka and, therefore, can deplete skilled labour, imposing significant constraints on growth. This can result

in an inability to attract investment, dragging down employment creation, negatively affecting service delivery and productivity, promoting unsustainable remittance dependence and widening income inequality. Thereby, these can cause social tensions and instability. Similarly, at the micro level, migration and remittances can promote remittance dependence and related higher value for leisure over employment/human capital development, family disruption and related social and psychosocial issues during all the stages of the migration process.

Recent trends highlight the magnitude of the exodus of workers in several key sectors, including the exodus of qualified health professionals impacting the effective functioning of health services. The contraction of economic activities in some other sectors is seen to lead to the exodus of other occupation categories. These include the construction sector, and power and internet-related services impacting the information technology (IT) sector. More generally, the increased cost-of-living at the personal level exacerbating economic difficulties also pushes many skilled workers to seek greener pastures, thus leaving for employment opportunities abroad. The resulting sectoral issues and skilled labour shortages converge, creating a challenging environment for service delivery, productivity, investment, employment creation and the hollowing out of public services. Such a scenario will eventually affect the overall quality of life of all citizens.

Therefore, much thought and effort must be placed on labour migration at this critical juncture in the economic recovery process. Over the years, while promoting labour migration has been the policy focus, very little interest has been paid to balancing policies for promoting labour migration with broader economic growth and recovery policies. Ideally, domestic labour market requirements for short, medium and long-term economic growth need to be identified and labour migration should be promoted in cognisance of these domestic labour market needs. However, this practice is nearly non-existent in Sri Lanka. This is aptly evident from the recent introduction of a policy granting government sector workers five years of no-pay leave. Initially, this was introduced as a blanket policy for all government sector workers with no restricted sectors/occupations. The restrictions for sectors, such as health and education were introduced in hindsight as amendments to the policy to address growing worker scarcity constraints in the home country.

Meanwhile, while Sri Lanka is doing very little to retain its national talent pool in these various critical sectors, other countries such as the United States of America (USA), Canada and Australia have been proactive and analysing their countries' demographic characteristics, skills/talent deficits and strategically attracting necessary skills groups based on projected labour market needs. For instance, for the fiscal year 2023, the US Congress mandated admitting 65,000 immigrant workers under its H-1B visa regular cap component and another 20,000 under the master's cap component (foreigners who have a Master's degree or higher qualification from the US are eligible).[1]

While haemorrhaging its skilled workers and doing little to plug it, Sri Lanka is also backwards in reaping the benefits of the global labour pool. As such, despite being an open economy benefiting

1 USCIS. (2022, August 23). *USCIS Reaches Fiscal Year 2023 H-1B Cap.* Retrieved March 14, 2023, from USCIS.gov: https://www.uscis.gov/newsroom/alerts/uscis-reaches-fiscal-year-2023-h-1b-cap

from trading goods and services, Sri Lanka performs rather poorly in bringing in foreign labour by considering domestic labour market needs. So far, in recent years, inward labour migration attempts have been highly criticised. For instance, previous efforts to adopt a greater degree of openness towards inward labour migration in the context of a proposed Economic and Technical Cooperation Agreement (ETCA) with India were met with considerable pushback and protests by local professional bodies, especially those representing the engineering, medical, accounting and legal fields. These criticisms were based on the scale of the Indian labour market, fears about the associated capacity of Indian professionals to 'flood' the Sri Lanka labour market, and issues related to the qualifications of inward migrants and gaps in Sri Lanka's regulatory environment. Similarly, the Singapore-Sri Lanka Free Trade Agreement (SSLFTA) was criticised on the same grounds that "without registration mechanisms," "open[ing] doors for 'non-nationals with sub-standard qualifications' to enter and practice, [would be] compromising the positions held by Sri Lankan professionals."[2] Nevertheless, some of these very sectors that opposed inward migration of foreign labour may now be somewhat less harsh in their criticism due to the skills deficit faced with outward migration.

Sri Lanka's current path to resilient growth and economic recovery requires a strategic balance between the outmigration of workers and their remittance receipts, along with meeting the domestic labour market demands.

As such, Sri Lanka's current path to resilient growth and economic recovery requires a strategic balance between the outmigration of workers and their remittance receipts, along with meeting the domestic labour market demands. At the same time, it is timely to objectively revisit the thorny issue of inward migration to address domestic labour market skills gaps. As such, this chapter initially details the current labour market issue in Sri Lanka and then explores the argument for and against outward and inward labour migration to provide objective recommendations to balance the emigration of Sri Lankan workers from the country and the immigration of foreign workers into Sri Lanka.

9.2 Dissecting Labour Market Issues

Labour shortages to support robust and sustained economic growth in Sri Lanka have been a deep-rooted problem for many decades. Despite high achievements in human capital development, the labour force is often criticised for being unemployable, leading to issues of demand and supply mismatches.

2 Sirimanna, Bandula. (2018, July 15). *Sri Lanka –Singapore FTA Comes under Barrage of Criticism*. Retrieved March 10, 2023, from Sunday Times: https://www.sundaytimes.lk/180715/business-times/sri-lanka-singapore-fta-comes-under-barrage-of-criticism-302089.html

9.2.1 Skills Mismatch

One aspect of the demand and supply mismatch in Sri Lanka is the skill mismatch – the gap between the skills possessed by potential employees and the skills sought by employers. On the labour supply side, this issue stems from all levels of the education sectors in Sri Lanka. For instance, at the school level, a wide gap is evident between what is taught in schools and what is needed in the world of work. At the higher education level, the courses offered by educational institutions and universities do not align with industry needs. The outdated curricula, lack of input from the private sector when designing degree programmes, the high number of students opting for the Arts stream (which may not offer the same employment opportunities as other streams), and lack of a well-structured career guidance system to facilitate a flow of information between the youth and the labour market are key reasons for this skills mismatch at the higher education level.[3]

Some identified weaknesses in the Technical and Vocational Education and Training (TVET) sector include poor quality and outdated TVET programmes, a shortage of trained staff, and a lack of modern technology and employer involvement.[4] The demand and supply aspects of this skills mismatch are aptly reflected in the information communications and technology (ICT) sector. In this regard, the national IT-Business Process Management (BPM) Workforce Survey 2019 showed that while the need for IT graduates sizeably grew from 6,246 in 2014 to 21,216 in 2019, the increase in supply by the training institutions grew at a much slower pace. Specifically, it increased only from 6,611 graduates in 2014 to 9,076 in 2019.[5]

Studies show that the demand for skilled workers in the food and beverage subsector is expected to rise significantly over the next seven years.[6] However, the current output of workers from both the TVET and higher education sectors falls far short of meeting this demand. The Asian Development Bank estimates this creates a skills gap of up to 19,640 workers per year under pessimistic assumptions and up to 37,588 workers per year under optimistic assumptions. The skills gap is expected to be the greatest in low-skilled and medium-skilled occupations. Under pessimistic assumptions, the electronics and electrical sub-sector is expected to have an incremental demand for skilled workers of 1,451 per year, with a skills gap of 650 workers per year, as the higher education and TVET sectors can only meet 800 of the projected vacancies. The largest skills gaps are estimated to be in low-skilled occupations, followed by high-skilled occupations. Under optimistic assumptions, the unsatisfied demand averages 1,552 per year for the next seven years. In the short run, labour shortages generated by skills mismatches create conditions to promote the inward migration of labour.

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3 Institute of Policy Studies of Sri Lanka. (2017, September). *Skill Gaps: The Achilles Heel of Sri Lanka's Education Sector: A Policy Insight*. Retrieved April 10, 2023, from IPS: from https://www.ips.lk/wp-content/uploads/2017/01/05-Bridging-the-Skills-Gaps-in-Sri-Lanka.pdf.

4 Dundar, H, Millot, B., Savchenko, Y., Aturupane, H., & Tilkaratne, A. (2014*). Building the Skills for Economic Growth and Competitiveness in Sri Lanka*. World Bank.; Dundar, H., Millot, B., Riboud, M., Shojo, M., Goyal, S., & Raju, D. (2017). *Sri Lanka Education Sector Assessment: Achievements, Challenges, and Policy Options*. World Bank Publications.

5 Information and Communication Technology Agency of Sri Lanka. (2019). *National IT - BPM Workforce Survey 2019*. Retrieved April 20, 2023, from ICTA: https://www.icta.lk/projects/national-it-bpm-workforce-survey-2019/.

6 Asian Development Bank. (2020). *Skills Gaps in Two Manufacturing Subsectors in Sri Lanka*. Retrieved April 20, 2023, from Asian Development Bank: https://www.adb.org/sites/default/files/publication/543046/skills-gaps-two-manufacturing-subsectors-sri-lanka.pdf

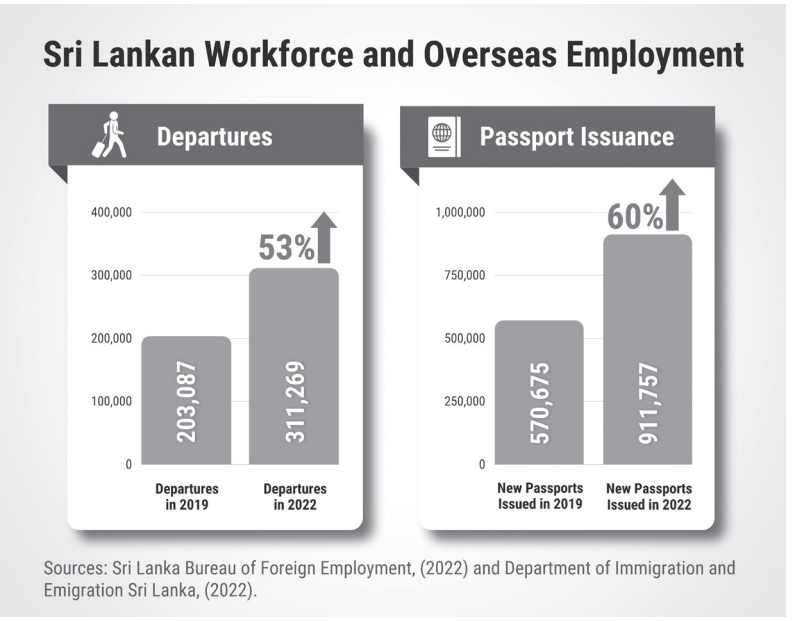
9.2.2 Sectoral and Aspirational Mismatches

Another aspect of the demand and supply mismatch in the Sri Lankan labour market is the sectoral mismatch between the jobs available and those in demand. The latest available Labour Demand Survey 2017 data compiled by the Department of Census and Statistics (DCS), indicated a shortage of workers in high demand manual jobs, while the educated job-seekers aspired for high-skill jobs, which are limited in supply. In the first half of 2017, when the private sector had 497,302 vacancies – mainly in routine and non-routine manual jobs – most job-seekers (educated youth) sought white-collar jobs. For instance, only 7.2% of private sector vacancies were in high-skill occupations.

Often the sectoral mismatch is triggered by an increase in average wages and the desire for better working conditions and career progression opportunities. These in turn, lead to higher aspirations, often not in line with their education, skills, and experience, creating an aspiration mismatch. To some extent, this aspiration mismatch is attributed to slow job creation. Aspirational mismatches can lead to frustration and discouragement, especially among youth, ultimately leading to outmigration. Here, perceived economic benefits are a significant motivator for migration.

9.2.3 Preference for Outmigration

The above-discussed labour market issues converge to propel a high preference for employment abroad amongst the Sri Lankan workforce. Before the pandemic, departures registered with the Sri Lanka Bureau of Foreign Employment (SLBFE) exceeded 200,000 in 2019. These pre-pandemic level departures were reached again (and exceeded) in 2022 with 311,269 departures. While registered departures capture only one aspect of departures, the overall high preference for migration is also reflected in the staggering 60% growth in new passports issued in 2022 – to reach 911,757, a giant leap compared to the pre-pandemic figure of 570,675.

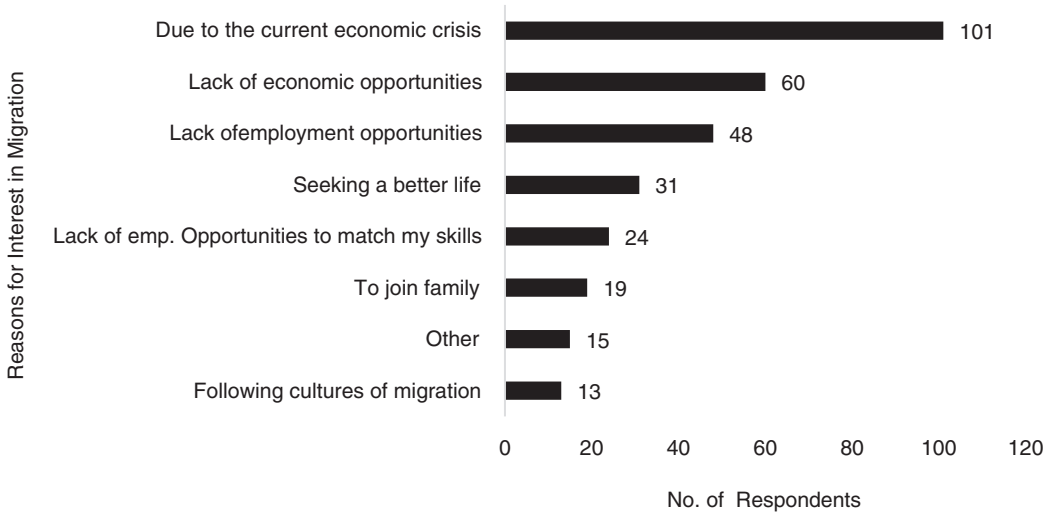


Sources: Sri Lanka Bureau of Foreign Employment, (2022) and Department of Immigration and Emigration Sri Lanka, (2022).

Outmigration since 2022 has been driven heavily by the recent economic fallout of Sri Lanka and releated difficulties. Data collected from 200 potential migrants from a few selected locations where potential migrants congregate (passport applicants at the Department of Immigration and Emigration in Battaramulla, line for foreign visa applications at the Saudi Arabia Visa Centre in Colombo 06 and Qatar Visa Centre in Kotte and the line for obtaining international driver's license at the Automobile Association, Colombo 03, in January 2023) show that over half of this sample are considering migration due to the current economic crisis. Corroborating labour market issues discussed above, the other top reason included the lack of economic or employment opportunities in Sri Lanka. Here, the lack of employment opportunities in general, as well as to match individual skills, were identified (Figure 9.1).

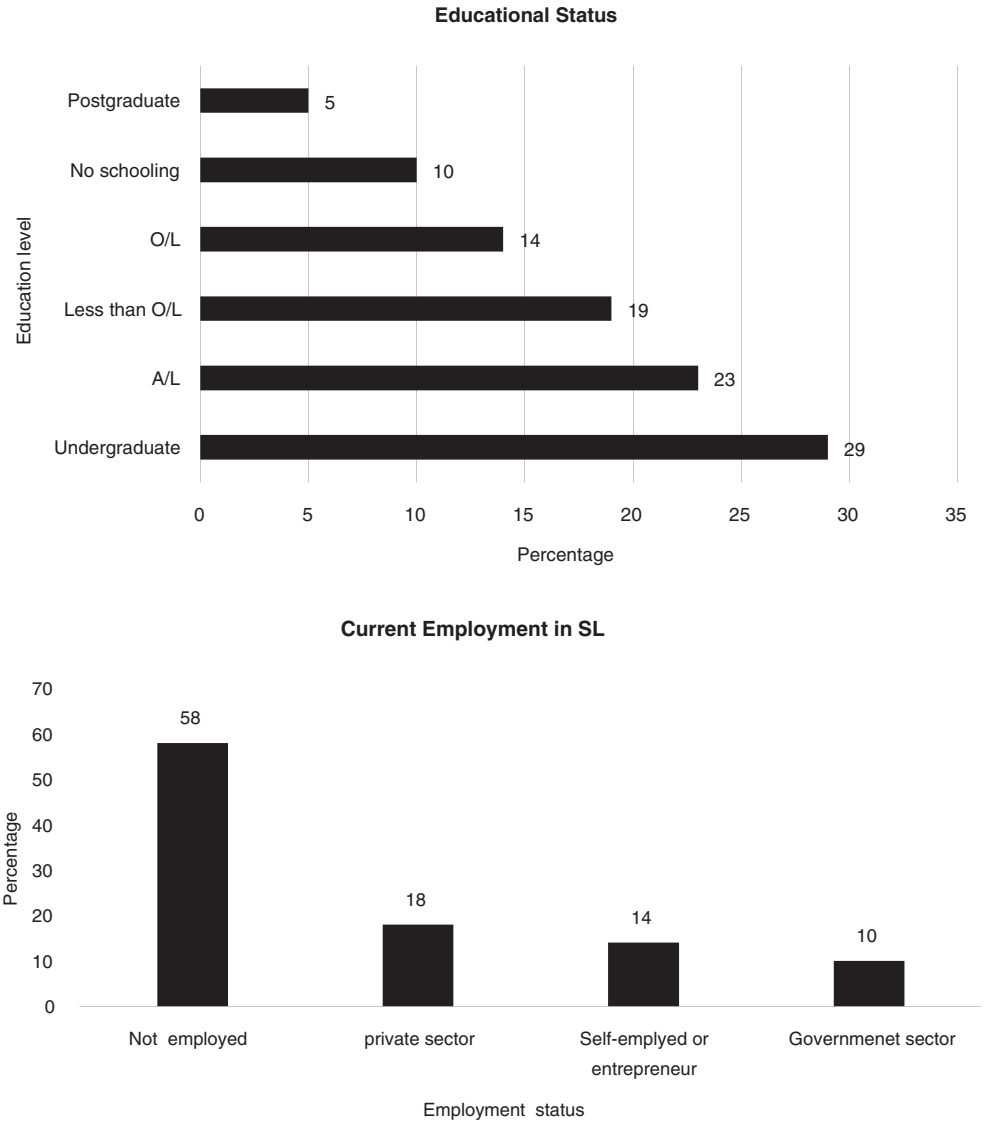
Underpinning possible skills, sectoral and aspirational mismatch dimensions, a majority of aspirant migrants in this sample were undergraduates (29%) followed by those qualified in Advanced Level (A-Level) (23%), reflecting their potential to be skilled workers (See Figure 9.2 Top panel). At the same time, 42% of the sample were currently employed or economically active and considered migration (See Bottom panel of Figure 9.2). Nearly a quarter of the sample was not intending to seek employment, while 11% did not have a job lined up though they were planning on migrating for employment (see Figures 9.3 and 9.4). While most aspirants in this sample indicated intentions of returning to Sri Lanka, most intend to migrate for up to five years. About 25% of the sample did not know their return plans, which indicates the absence of a plan to return.

Figure 9.1
Reasons for Interest in Migration



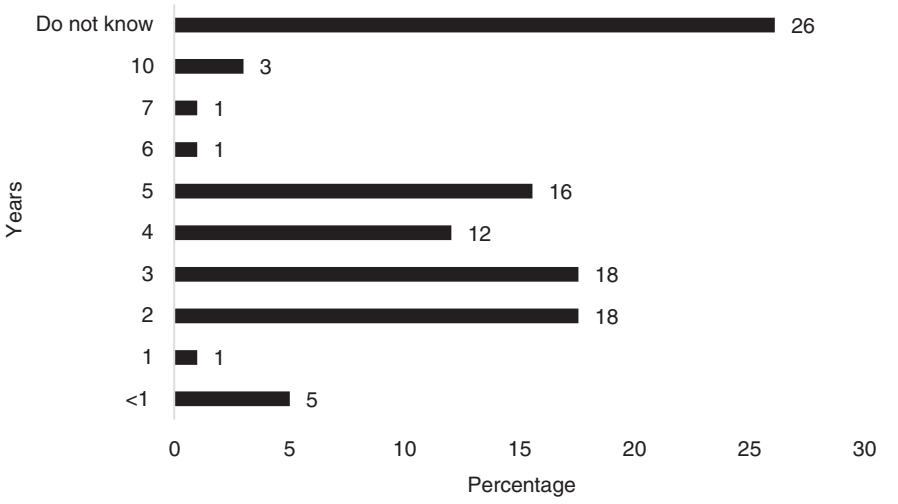
Notes: Total exceeds 200 as data reflects multiple answers for the question.
Source: Authors' illustrations.

Figure 9.2
Current Employment and Education Status of Aspirant Migrants



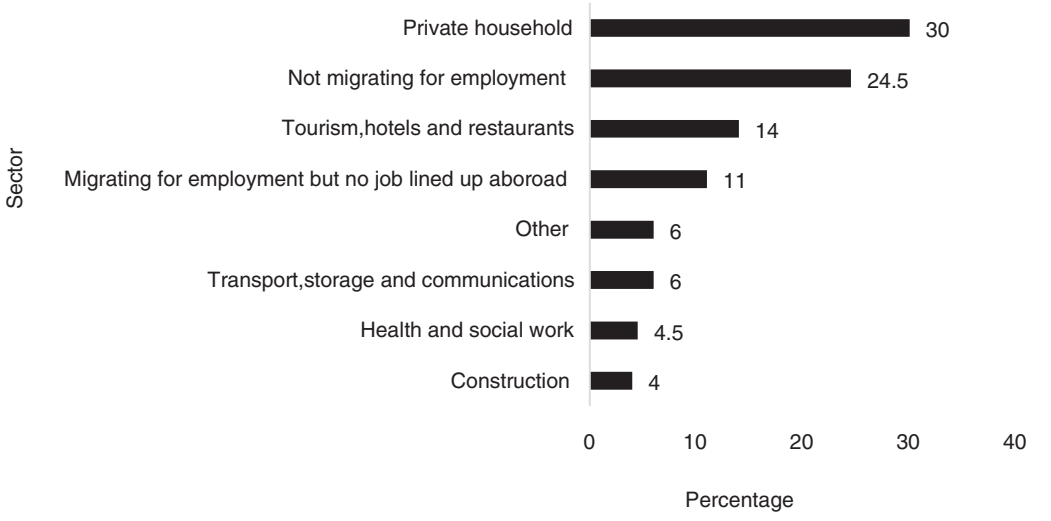
Source: Authors' illustrations.

Figure 9.3
Intended Duration of Migration



Source: Authors' illustrations.

Figure 9.4
Intended Sector of Employment Abroad



Source: Authors' illustrations.

Similarly, in another short survey among 188 respondents on brain drain and inward labour migration to Sri Lanka,[7] 69% responded that the outmigration of workers is causing a shortage of skilled workers in their respective sectors. Here, most respondents were from the education, health, financial and insurance, professional, scientific and technical, and ICT sectors. These respondents were from firms of size 1 to 31,000 workers, while the labour turnover in these firms due to migration ranged from 0 to 2,000, where the average labour turnover was 17% with a standard deviation of 24. Confirming concerns of brain drain, this sample of 188 respondents was of the view that technical and associate professionals and professionals were the main occupational groups leaving the country.

Figure 9.5
Occupational Groups Leaving Sri Lanka - Brain Drain Survey



Notes: Total exceeds 188 as data reflects multiple answers for the question.
Source: Authors' illustrations.

These snapshot findings from the survey support other recent evidence in this regard. Arguably, the current economic crisis in Sri Lanka has led to a significant shortage of ICT engineers, with a minimum of 10,000 of the country's top talents having migrated since the crisis began, according to the President of the Computer Society of Sri Lanka (CSSL). This brain drain has gravely affected the IT sector, as around 20-25% of IT-related personnel have left their respective companies due to economic needs.[8] Other professions, too, are adversely impacted. The notable trend of young engineers and quantity surveyors leaving the country, as mentioned by the International Construction Consortium, is worrisome. While established professionals stay in their home country, the younger

7 Data was collected only in English language through an online survey circulated based on snowballing techniques in April 2023.

8 Samarawickrama, Chaturanga Pradeep. (2022, November 30). *At Least 10,000 IT Engineers Migrated Since the Crisis: CSSL President.* Retrieved April 20, 2023, from Daily Mirror Online: https://www.dailymirror.lk/breaking_news/At-least-10-000-IT-engineers-migrated-since-the-crisis-CSSL-President/108-249612

generation actively migrates abroad, with an estimated 2-3 engineers leaving each month.[9] In addition to doctors, engineers, lecturers, and IT experts, more than 20,000 teachers of Science, Maths and English for A-Level classes, too, are estimated to have left the country without notifying the Ministry of Education (MOE). The MOE has found it challenging to replace teachers for these subjects, and the absence of their services is likely to have a detrimental effect on higher education in the near future.[10] This means that skilled workers from essential and lucrative sectors are already migrating from Sri Lanka.

9.3 Pros and Cons of Labour Migration

Labour migration is not without mixed outcomes. Despite evidence of large-scale outmigration for many years and the potential for inward migration, both inward and outward labour migration are highly contested narratives in Sri Lanka. Some oppose outward labour migration on arguments related to brain drain impacts and the need to protect vulnerable groups from adverse downside impacts. Others argue that migration provides positive benefits in brain gain, brain circulation, economic growth and development, etc. Meanwhile, the inward mobility of workers into the country remains a highly contentious and debated issue. Concerns centre not only on its possible ramifications on domestic worker incomes, but also on employment prospects in key sectors. For instance, there appears to be a common belief that investment projects tend to hire foreign workers instead of local labour. Additionally, concerns are raised over national security and identity issues and related problems of migrant worker groups that overstay their visa durations, etc. Such diverse arguments for and against migration in Sri Lanka are consistent with global literature on migration which is largely inconclusive on the pros and cons of migration. For instance, while some studies show that immigration poses significant costs to many members of the host-country labour market,[11] others critique this view with greater nuances of how immigrants fit into the host-country market and its positively impacts on local workers.[12]

9.3.1 Outward Mobility: Brain Drain, Brain Gain and Brain Circulation

The criticism of outmigration along brain drain arguments is macro in nature, where the exodus of a large cohort of educated nationals could negatively affect the sending country. As such, this line of argument in Sri Lanka lies in human capital development investment made by the state to educate these migrants. For instance, the expense borne to educate a medical doctor in Sri Lanka costs around Sri Lankan Rupees (LKR) 35 million (Mn) and another LKR 5 Mn for postgraduate education.[13]

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9 EconomyNext. (2022, December 15). *Sri Lanka Construction Professionals Fleeing Country After Currency Crisis.* Retrieved April 18, 2023, from EconomyNext: https://economynext.com/sri-lanka-construction-professionals-fleeing-country-after-currency-crisis-106573/https://economynext.com/sri-lanka-construction-professionals-fleeing-country-after-currency-crisis-106573/

10 Weerakoon, Jaliya. (2023, February 5). *Economy, Brain Drain and Foreign Employment*. Retrieved April 20, 2023, from Sunday Observer: https://www.sundayobserver.lk/2023/02/05/opinion/economy-brain-drain-and-foreign-employment

11 Borjas, George J. (2014). *Immigration Economics*. Harvard University Press.

12 Card, David., & Giovanni, Peri. (2016). Immigration Economics by George J. Borjas: A Review Essay. *Journal of Economic Literature,* 54 (4): 1333-49.

13 Jayammanne, Dilanthi. (2022, August 13). *Medical Professionals Jumping Ship in Droves*. Retrieved July 20, 2023, from Ceylon Today: https://ceylontoday.lk/2022/08/13/medical-professionals-jumping-ship-in-droves/

The high number of school leavers departing for higher education abroad and their continued stay in countries of destination or third countries deprives Sri Lanka of the opportunity to reap any return on the investments made from the provision of universal free education.

The same is true concerning the departure of high skilled professionals. In addition to the loss of return on investment, such departures also affect service delivery, as previously noted in the case of healthcare services. With the exodus of employees, private businesses, too, are seeing the depletion of essential teams within organisations and face considerable challenges in finding suitable replacements and training incoming recruits. For instance, as of 28th July 2023, job portals like topjobs.lk featured over 400 vacancies related to IT-Software/Database/Quality Assurance/Web/Graphics/GIS domains. These job opportunities included various positions such as 105 openings for senior developers and 140 vacancies for software engineers.

Other arguments against brain drain include the importance of retaining skilled workers for long-term development and mitigating the downside impacts on government revenue generation efforts. The migration of skilled professionals can result in a loss of tax revenues, as professionals typically have the highest earning potential in the labour market, and their migration can significantly impact tax revenues in settings where taxation is effective. Crucially though, a shortage of experienced labour in a country can impede knowledge and experience sharing, resulting in a longer learning curve for new entrants to gain the necessary high-level experience and integrate it into the country's development process.

The arguments on brain drain are often countered along the lines of brain gain and brain circulation. Brain gain is the situation where the possibility of migration stimulates higher education to elevate the overall level of human capital in sending countries. The argument is that migration opportunities encourage investments in education and increase the supply of skilled workers in the home country, as not all newly educated workers can migrate. There is evidence to support such a hypothesis; for instance, nursing enrolment in the Philippines was seen to have surged by 129% while nursing graduates significantly increased by 247%, leading to a substantial brain gain of nurses in the Philippines in response to the high demand for nurses in the US.[14]

Similarly, brain circulation is where the return of professional migrants with knowledge, skills and experience from overseas improves the level of human capital among those in the sending country. However, the validity of this argument rests on the assumption that such high skilled migrants would return to their home country. In reality, there are challenges to skills and knowledge transfer back to the country of origin (COO) when migrants are reluctant to return due to aspects such as lack of research funding, poor facilities, limited career advancement opportunities, insufficient intellectual stimulation, threats of violence, and inadequate education for their children in their home country.

14 Theoharidespaolo, C., & Abarcar, P. (2021). *Brain Gain: Providing Healthcare Workers with Opportunities to Migrate Can Increase Education and Supply of Medical Workers in Origin Countries*. Retrieved May 20, 2023, from World Bank Blogs: https://blogs.worldbank.org/peoplemove/brain-gain-providing-healthcare-workers-opportunities-migrate-can-increase-education-and

9.3.2 Migration, Remittances and Growth

As previously noted, the departure of highly skilled individuals with the potential to earn high wages depletes the economy of a segment of its tax base. Nevertheless, high skilled migrants also have the potential to attract higher wages in host countries and thereby remit larger amounts to families left behind. If this occurs, it can boost income at the micro as well the macro level.

Moreover, some migrants remit sufficient money over their lifetime to compensate for any losses to the sending countries. Other benefits of migration include boosting the sending country's image and fueling investments. Additionally, skilled migration has the capacity to facilitate trading networks. However, the potential for high remittances from high skilled migrants is challenged on the grounds of high skilled migrants often departing with families, leaving no immediate family behind in need of remittances, or remaining family members being well off to the point of not attracting remittances.

While the above arguments are based on the migration of highly skilled workers, other arguments are centred around the departure of less skilled migrant workers. Those opposed to migration point out to the fact that at the macro level, migration has aggravated labour shortages in key sectors such as construction. Apart from this, at the micro level, the pursuit of foreign remittances is criticised for promoting excessive consumption, discouraging saving, reducing labour force participation, promoting voluntary unemployment, and creating a remittance dependence culture, amongst others. Concerns are also expressed about the likelihood of growing inequality amongst remittance receiving and not receiving households. For instance, if higher-income households receive the bulk of remittances, this can lead to worsening of overall income inequality.

Nevertheless, counterarguments can also be made to the effect that migration yields benefits. These benefits include alleviating poverty, boosting consumption and mitigating income inequality when remittances are received by a majority of lower-income households that have a beneficial effect on the financial situation of left-behind families by promoting savings, reducing borrowing, and facilitating debt repayment. Similarly, migration and remittances are lauded for their positive impact on a country's balance of payments and growth through increased investment and reduced credit constraints, as remittances often support self-employment, promote small-scale business growth, and encourage entrepreneurship.

On broader social impacts, too, migration and associated social remittances can positively affect migrants' COO, when social remittances are defined as the two-way transfer of ideas, behaviours, identities, and social capital across migrants' COO and destination. Some such areas of social remittances with positive effects include the transfer of know-how, skills and innovations; views on social norms such as gender norms, healthy habits and women empowerment, as well as influence on democracy and justice mechanisms. Concurrently, some aspects of social remittances can negatively affect the social values in labour sending countries. Moreover, migration is often criticised for the social implications on the family left behind. In the case of Sri Lanka, for instance, the discourse on the negative implications on children left behind led to the introduction of the Family Background Report (FBR) policy in 2013.

9.3.3 Arguments for and Against Immigration

Similar to labour outflow, labour inflow also involves many hotly contested positions. Regarding the host economy, "economic theory implies that immigrants will generally increase the national income that accrues to the native population in the host country, and that these gains are larger the greater the differences in productive endowments between immigrants and natives."[15] Immigration can have both positive and negative consequences for local workers, depending on the skill level of the immigrants and the specific circumstances of the labour market. The same study notes that the "labo[u]r market impact of immigration hinges crucially on how the skills of immigrants compare to those of natives in the host country". Moreover, the authors argue that "natives in the host country benefit from immigration as long as immigrants and natives differ in their productive endowments; also, that when the benefits are larger, the greater the differences in endowments; and that the benefits are not evenly distributed over the native population – natives who have productive endowments that complement those of immigrants gain, while natives who have endowments that compete with those of immigrants lose."

The body of literature on the issue contends that immigration can increase the wages of local workers through cross-skill complementarity, capital inflow, and selection. Additionally, it is noted that low-skilled immigration is associated with small wage losses for similarly skilled local workers, but the most intense competition is among low-skilled immigrants themselves.[16] Nevertheless, high-skilled immigrants are found to have positive effects on high-wage domestic workers and small gains for low-wage domestic labour.

The literature also argues for immigration based on the fiscal impacts of immigration. For instance, in the US, the evidence suggests that immigrants are projected to pay much more in taxes than what they consume as benefits over the next 75 years, including low-skilled immigrants who are far less costly than similarly-educated local workers.[17] This study further suggests that immigration may even have the capacity to play a role in addressing future fiscal shortfalls in the country of destination (COD).

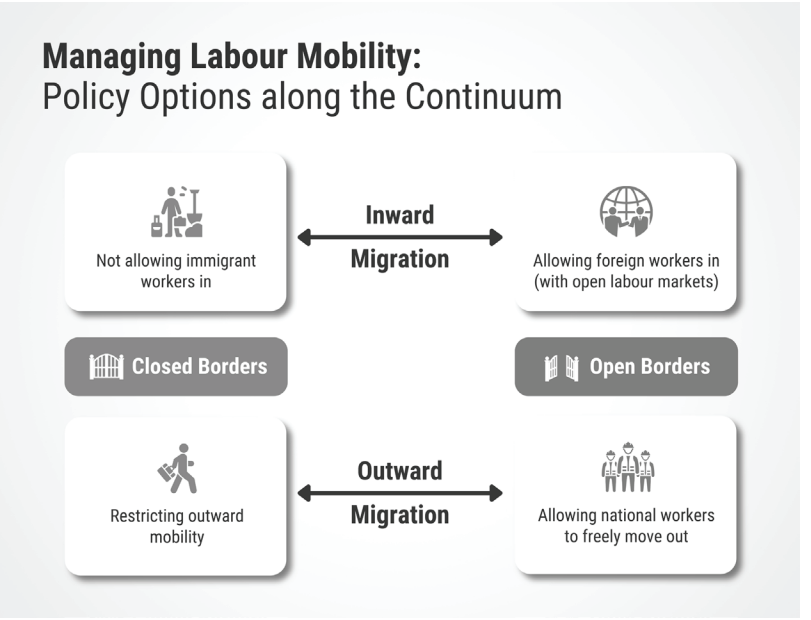
9.4 Policy Choices

When faced with concerns of labour shortage-related issues amidst a labour outflow, as in the present case of Sri Lanka, policy options are available to craft the optimal mix for a given country. These available policy options can be identified along a continuum. For outward migration, one extreme is maintaining closed borders and not allowing outward mobility from the country, while the other extreme is opening the borders and allowing national workers to move out to other countries freely. Similarly, the two extremes on the continuum for inward mobility include closed borders to not allow immigrant workers in and open borders (together with open labour markets) allowing foreign workers in.

15 Borjas, G. J. (1999). The Economic Analysis of Immigration. *Handbook of Labour Economics*, 3, 1697-1760.

16 Lin, K. H., & Weiss, I. (2019). Immigration and the Wage Distribution in the United States. *Demography,* 56(6), 2229-2252.

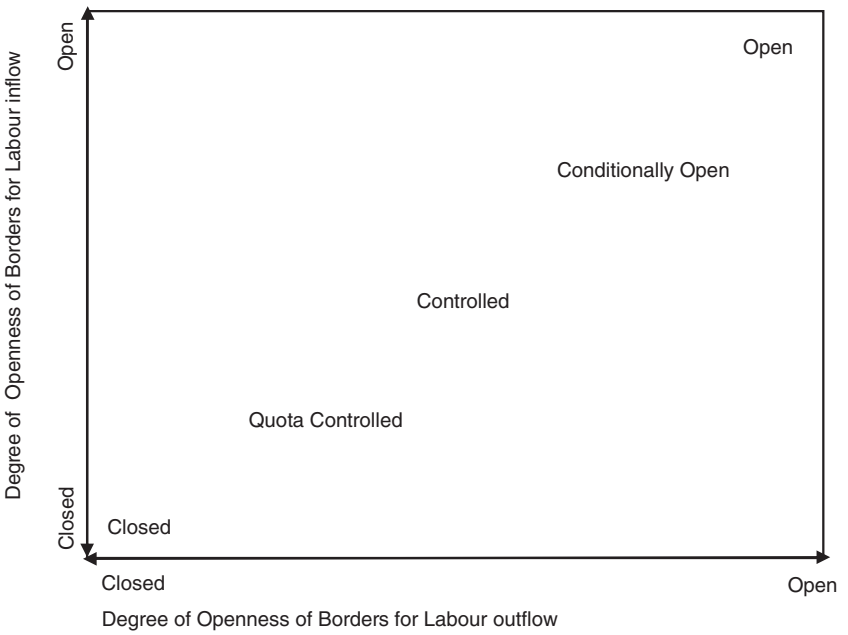
17 Orrenius, P. (2017). *New Findings on the Fiscal Impact of Immigration in the United States*. Dallas: Federal Reserve Bank of Dallas.



Source: Authors' illustrations.

However, as noted by many, borders are never entirely open or closed, it is rather a matter of degree. Borders can be more or less open in various ways depending on the recipient. In between, there are various degrees of openness towards outward migration as well as inward. These degrees of openness are identified in various ways, not limited to conditionally open, controlled, and quota-controlled borders. The migration restriction can be classified based on personal characteristics, numerical ceilings or both. In the former, personal characteristics are considered for eligibility, while in the latter, it is administered on a first come, first served basis, a random selection, or based on a points scheme. Many countries such as the US, Canada, Australia and South Korea have quota-controlled regimes for immigration of specific skills categories. An example of a random selection scheme is the US Green Card Lottery, while Canada is an example of a country with a points scheme to select permanent immigrants.

Figure 9.6
Degree of Openness for Labour Inflow and Outflow



Source: Authors' illustrations.

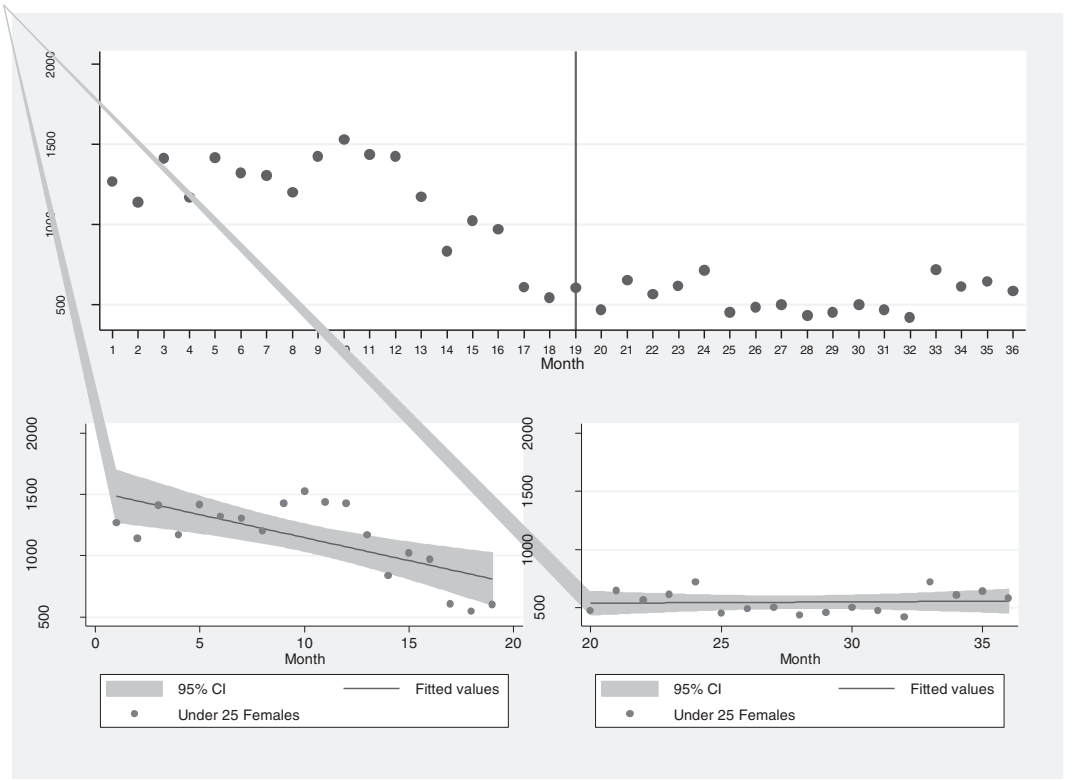
In the case of outward mobility, various exit control mechanisms have been enacted across countries to control departures. In recent times, most exit control measures in labour sending countries have been gender or skills-based protection to offset the vulnerability of women or lower skilled workers. For instance, countries such as the Philippines, Nepal and Sri Lanka have banned outward migration of domestic workers to protect them from abuse and exploitation by employers. However, for the high skilled, mobility exit controls are rarely used.

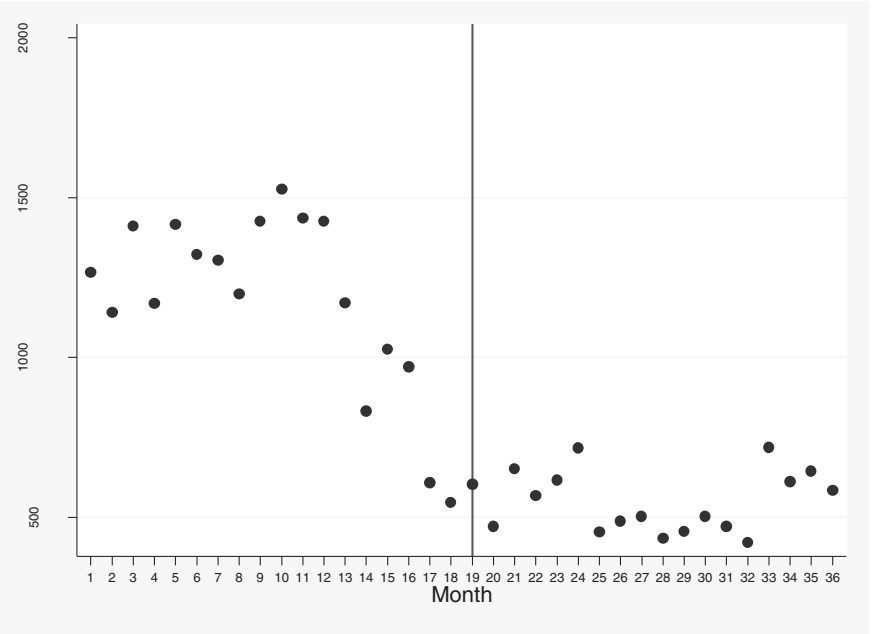
Amidst the above-discussed policy choices and its related debates, Sri Lanka must carefully craft an overall migration policy which can address the domestic labour market needs by both sending and receiving migrant workers. Traditionally, migration directives in Sri Lanka are rarely made considering the domestic labour market needs. One policy example is the introduction of the FBR policy that restricted the migration of mothers of young children, as rolled out in 2013 – an exit control based on the vulnerability of the migrant and their families but not based on market needs. Since the onset of the pandemic and the economic crisis, Sri Lanka has revisited some as well as new policies introduced to realign labour migration from Sri Lanka, with some consideration given to the overall macroeconomic conditions in the country.

One is the relaxation of the FBR policy through a series of changes. First was the introduction of two separate forms for women with and without children in November 2020. Then in June 2022, the child's age was reduced from five to two years, while also bringing down the minimum age requirement for

female migration to 21 years for all countries. All these were aimed at promoting the departure of women. Among the various components of the FBR policy, the relaxation of the age limit of migrant's child would benefit only a small group of women. Data from the most recently available Demographic and Health Survey of 2016 carried out by the DCS show that only about 11% of households consist of mothers with such young children and not every such mother/woman would consider migration. At the same time, examining the change in migration around the minimum ages of females at the time of the introduction of the FBR restriction in 2013 shows a drop in departures (Figure 9.7). Expecting the reverse with the relaxation of the minimum age restriction in 2022 would suggest an increase in the departures of females.

Figure 9.7
Monthly Departure of Females (under 25 years) Before and After the FBR, 2012-2014





Note: Month 19 = July 2013.

Source: Weeraratne, B. (Forthcoming). *Migration and Remittance Policies during Economic Crisis in Sri Lanka*. Kerala: Center for Development Studies.

Another recent policy is the Public Administration Circular 14/2022, which allows public sector workers to obtain no-pay leave for a maximum of five years. This is without any negative consequences on seniority and pensions and the absence of any obligatory period of service upon return on condition of regular remittances as outlined in the circular. While the initial introduction of the no-pay leave policy aimed to reduce the public sector's cost burden on the Treasury and reap some benefits via increased remittances, subsequent changes to it sought to impose exit controls for specific sectors such as health and education. The no-pay leave policy is also perceived as a means to dispense with the excess staff of various institutions, whilst retaining better skilled workers within the public sector. If so, in an unusual way, this policy would be consistent with the domestic labour market needs. However, when the remittance earning motive behind this policy is considered, its effectiveness is more uncertain as beneficiaries are less likely to be in well-paid jobs overseas to remit regularly or significantly.

In reality, many sectors already undergo severe labour shortages and others would reach critical levels of labour shortages if this trend in labour migration continues without strategic policy interventions to balance domestic and international labour demand. As such, if the current volumes of departures were to persist, it would severely constrain Sri Lanka's economic recovery and long-term growth prospects.

In reality, many sectors already undergo severe labour shortages and others would reach critical levels of labour shortages if this trend in labour migration continues without strategic policy interventions to balance domestic and international labour demand.

Notably, other existing policies are also in place to tangentially control brain drain. In the health sector, medical doctors are required to serve four years in Sri Lanka for every year of foreign training received. If they fail to complete the bond period, they are liable to reimburse the stipend and the salary which they received during their foreign training period. Available information suggests that medical doctors are required to sign a bond to pay approximately LKR 5,000,000 (equivalent to USD 35,000) to the government of Sri Lanka (GOSL), if they do not return to Sri Lanka and practice at a designated post for four years.[18] Yet, it is reported that from 2005 to 2016, 2,631 medical doctors left Sri Lanka for postgraduate studies overseas and that out of them, only 2,146 returned – an 18% rate of brain drain of medical officers with postgraduate training.[19] Specifically, in 2021, 299 potential specialists had gone abroad for training, while 204 of those who had trained within one or two years had returned to Sri Lanka. In 2022, the number of potential specialists who went abroad for training increased to 396, while only 106 of those who had trained within one or two years before had returned to Sri Lanka. This shows that despite the existence of policies to control brain drain, it still takes place in Sri Lanka.

While this regulation focuses on the foreign training component of human capital development of medical doctors, it fails to account for the vast investment in human capital with 13 years of free school education, five years of free medical school education, paid internship and postgraduation studies, etc. For instance, the Medical and Civil Rights Professional Association of Doctors (MCPA) revealed that nearly 100 medical practitioners had decided to leave Sri Lanka after taking no pay leave.[20] As such, when no foreign training is involved, there is no current mechanism for those who benefited from the free education system to repay for the human capital development and their inability to serve the public health sector in Sri Lanka.

Within the sphere of inward labour migration, Sri Lanka already receives foreign nationals under three operating methods of Mode 4 – Movement of Natural Persons of the World Trade Organization (WTO) General Agreement on Trade in Services (GATS). These three operating methods are i) intra-company transfers; ii) contractual suppliers; and iii) business visitors. Available data show that 57,439

18 Alwis, Sunil., Shridharan, R., Perera, Susie., De Silva, Dileep, Widanapathirana, Nimali & Wellappuli, N. (2018). *Health Labour Market Analysis: Sri Lanka.* Colombo: Ministry of Health, Nutrition and Indigenous Medicine - Sri Lanka and World Health Organization.

19 Hettiarachchi, Kumudini. (2023, January 15). *Three-prong Crisis Hitting a Body Blow to the State Health Sector.* Retrieved May 10, 2023, from Sunday Times: https://www.sundaytimes.lk/230115/news/three-prong-crisis-hitting-a-body-blow-to-the-state-health-sector-508569.html

20 Jayammanne, Dilanthi. (2023, March 31*). Medical Professionals Jumping Droves*. Retrieved April 20, 2023, from Ceylon Today: https://ceylontoday.lk/2022/08/13/medical-professionals-jumping-ship-in-droves/

were employed in Sri Lanka through these three modes in Board of Investment (BOI) projects and as private sector employees.

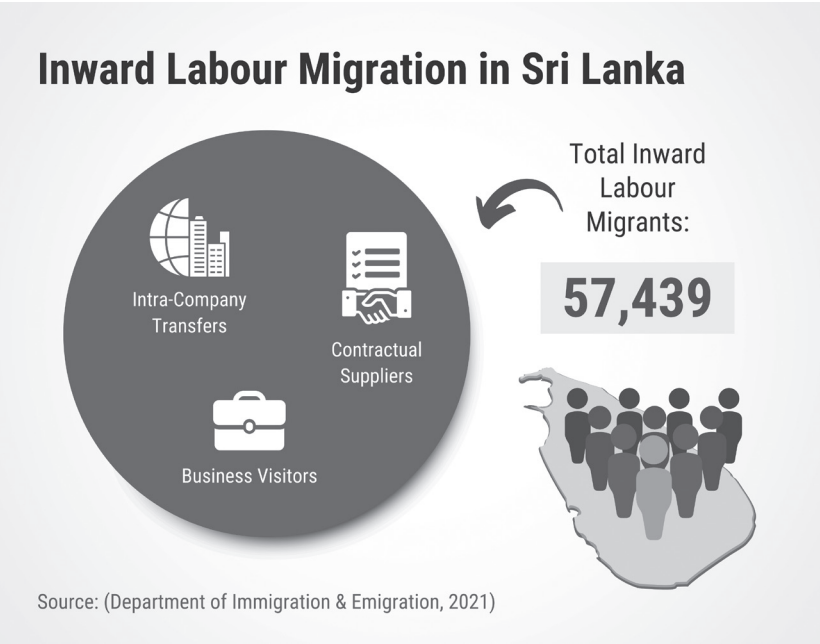


Table 9.1
Extensions and Issuances of Resident Visas for Employment in Sri Lanka, 2020-2021

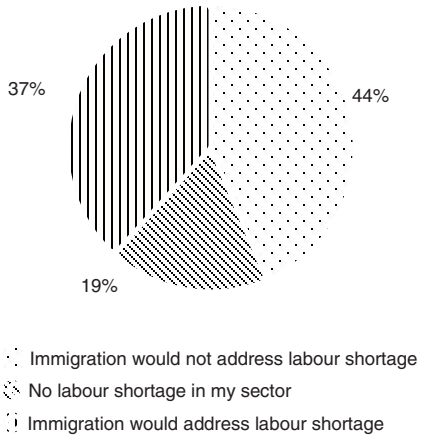
Year/Description	2020					2021				
	Extension	Issuance	Fax Messages	Messages Sent to Airports (Landing Endorsement)	Total	Extension	Issuance	Fax Messages	Messages Sent to Airports (Landing Endorsement)	Total
Employed in Board of Investment (BOI)	6,433	1,813	1,866	1,396	11,508	6,654	2,638	2,391	1,626	13,309
Arrivals for public sector employment	2,901	1,304	1,541	775	6,521	188	252	82	46	568
Employees in the private sector	7,174	1,755	738	410	10,077	4,839	4,355	2,686	1,295	13,175
Non-governmental organisations (NGO and INGO)	444	150	200	56	850	374	250	244	95	963
Total issuance	30,142	9,243	5,450	2,894	47,729	28,595	15,809	8,047	4,988	57,439

Source: Performance Report, Department of Immigration and Emigration Sri Lanka (2020, 2021).

Given that Sri Lankans are beginning to consider foreign labour as a solution for labour shortage issues, it is perhaps timely to revisit the policy landscape to attract and regulate inward labour migration.

However, despite many efforts through various bilateral FTA negotiations, such as with India and Singapore, Sri Lanka has still not allowed foreign workers under the fourth operating method of Mode 4, which captures independent professionals – defined as self-employed persons based in the territory of the foreign country, who supply services based on a service contract with a consumer in the host country. Most recent efforts to bring foreign workers were not well received in Sri Lanka. As discussed before, bringing in foreign workers under the ETCA or the Singapore-Sri Lanka FTA was heavily criticised. The most vocal opposition came from professionals in the fields of IT and medicine. However, emerging data show that these two are among the top fields that suffer now from brain drain, affecting service delivery in the sector. Indeed, the responses to the short survey on brain drain earlier showed that 37% of the respondents agreed bringing in foreign labour would address the labour shortage in their respective sectors (while 19% reported no labour shortage in their sector). As such, given that Sri Lankans are beginning to consider foreign labour as a solution for labour shortage issues, it is perhaps timely to revisit the policy landscape to attract and regulate inward labour migration. This way, benefits of inward migration can be geared towards contributing to the daunting task of resilient growth and economic recovery in Sri Lanka.

Figure 9.8
Immigration to Address Labour Shortage – Short Survey on Brain Drain



Source: Authors' illustrations.

9.5 Recommendations for Policy Action

Designing an appropriate mix of policies to address labour and skills shortages arising from increased migration amidst Sri Lanka's economic crisis calls for identifying labour market needs and efforts at talent attraction and retention. This approach encourages the Sri Lankan diaspora abroad to engage in national recovery and development, exploring options to attract foreign workers, devise appropriate migration and regulatory policies, etc. These are discussed below.

9.5.1 Brain Drain

One way to address brain drain is through the concept of 'pay back' for the cost of human capital and loss of opportunity for another student. This could involve paying back through labour/service or financial paybacks. Many developing countries, especially in the medical field, are adopting mandatory service periods. The Philippines offers free education to medical students in public schools but requires them to work within the country for several years after graduation. Similar mandatory service programmes exist in Thailand. In Thailand, public medical school graduates must work in the country for at least three years, offering an additional incentive for those who do not practice privately. Similarly, Vietnam and Mongolia are also implementing mandatory rural service.[21]

As discussed above, in Sri Lanka, the 'payback' concept currently operates mainly in lieu of any foreign training received, and largely overlooks the cost of human capital investment. At the same time, the financial component is considered to not be comparable to the cost borne. Therefore, these 'payback' calculations need to be updated to account for human capital received in Sri Lanka or overseas as well as to make them commensurate with the market value of the cost borne. At the same time, the mechanism for collection of 'payback' needs to be foolproof to ensure that all beneficiaries of state-funded human capital development pay back in a fair manner.

In the context of payback, a heavy imbalance exists between the labour sending and receiving countries regarding the human capital development cost and benefits, especially when it involves developing Vs. developed countries. While the labour sending countries would have invested for around 17-18 years in a person, the receiving country starts benefiting from day one of the migrant's arrival in the COD, without any upfront investment in the worker. However, given that migration is an individual level decision, there is no legal or moral obligation for receiving countries to redress the sending country as to the human capital development cost of migrants. As such, often, the payback becomes the responsibility of the migrant. However, given that foreign recruitment involves covering related expenses in some instances, it is important to explore the possibility of foreign employers supporting migrants to bear this cost as well. However, this is not a one-sided affair and cannot be achieved by Sri Lanka acting alone, as it may negatively affect the competitiveness of its migrant workers in the global labour market. As such, the best approach is for sending countries to collaborate and obtain support from international organisations such as the International Organization of Migration (IOM) and the International Labour Organization (ILO) and approach receiving countries to explore such options.

21 Economist Intelligence Unit. (2017, September 6). *Preventing the Brain Drain*. Retrieved May 10, 2023, from Economist Intelligence Unit: https://www.eiu.com/industry/article/1365863120/preventing-the-brain-drain/2017-09-06any

Another way to address the brain drain is to overcome the geographical boundaries through virtual connectivity, where the respective sending country engages high skilled migrants to continue to benefit from their expertise. Modern technological advancements have enabled individuals worldwide to connect instantaneously at very low costs, and the new normal under the pandemic has provided a good beta test. For instance, Sri Lanka's health sector can continue to benefit from professionals educated in Sri Lanka and now working in developed countries to be involved in remote surgeries, mentor students, perform virtual health clinics, etc. Migrant workers in other sectors also can contribute remotely, such as in the IT and education sectors. These can result in brainstorming, synergy and positive outcomes in the long run.

Other related recommendations include exploiting the full potential of brain gain in Sri Lanka and enhancing brain circulation. Specifically, a large cohort of potential migrant workers learn the Korean language hoping to secure jobs in the Korean labour market. However, only a smaller number gain access to the Korean labour market. For instance, in 2017, 22,888 applications were issued for the Korean Language Proficiency Test, while only 5,805 left Sri Lanka in the same year for employment in Korea.[22] As such, there is a large pool of Sri Lankans with knowledge of the Korean language, and this brain gain is an untapped resource. One recommendation in this area is to discuss with Korea on better ways to use this pool of skilled workers in Sri Lanka fluent in the Korean language, perhaps in tandem with Korean investment projects in the country, etc.

Another way to tackle brain drain is to harness the potential of brain circulation and focus on attracting high skilled migrants, mainly at the time of retirement. Given the high skilled and professional nature of these migrants, they are likely to be high net-worth individuals at that time. Sri Lanka needs to offer well-crafted services and professional opportunities for these returnees to engage in after return in a manner that contributes towards the national recovery and growth efforts. For instance, end career medical doctors can be approached to provide free health clinics and surgeries in underprivileged areas as community projects and tie these with tourism sector promotion campaigns.

9.5.2 Inward Migration

Sri Lanka should initially perform a labour market assessment to understand the labour shortage sectors and skills groups. Specifically, given that research on this issue suggests that the domestic workforce may benefit from immigration as long as immigrants and the local labour pool differ in their productive endowments, it is important to do further research to open up skills shortage sectors.

Then, a careful opening up of selected sectors should be complemented by developing a strong institutional framework to regulate inward migration. As noted by the IPS,[23] the National Labour Migration Policy needs to encompass inward migration, identify a regulatory body and ensure the welfare of inward migrants. Similarly, as extensively discussed in 2018 in Migration and gender

22 Ministry of Foreign Employment. (2017). *Annual Performance Report - Ministry of Foreign Employment.* Colombo: Ministry of Foreign Employment.

23 Weeraratne, Bilesha. (2017). Retaining, Re-integrating and Attracting Talent for Growth and Competitiveness. In *Sri Lanka: State of the Economy*. Colombo: Institute of Policy Studies of Sri Lanka.

outcomes: analysis of selected policies in Sri Lanka, a solid framework is needed to determine the qualifications of inward migrants. The National Labour Migration Policy (NLMP) of 2008 is Sri Lanka's current migration policy. However, this does not cover inward migrant workers, leaving Sri Lanka without a regulatory framework to govern the immigration of workers. This lack of regulation makes it challenging to recognise foreign training, skills, and education of incoming workers, which created a backlash against initiatives such as the ETCA with India. Professional bodies in the IT and medical fields have expressed concerns that less skilled workers who fail to secure employment in India may seek opportunities in Sri Lanka. Therefore, Sri Lanka needs a comprehensive policy framework for regulating inbound migration, with a focus on protecting local workers and ensuring that foreign workers are qualified and skilled. Developing such a framework would ensure an impartial evaluation of credentials and the availability of an equally qualified pool of local and foreign talent for employers to choose from. Sri Lanka has existing mechanisms in place to recognise foreign qualifications of Sri Lankan nationals in selected professions such as medicine and law. However, these require foreign-qualified professionals to sit local examinations before being able to practice.

Additionally, new safety nets need to be introduced to protect the segments of the labour force that would be adversely affected by the inward migration of labour. For instance, given that some studies indicate that opening up for low-skilled immigrants would lead to the most intense competition among low-skilled workers and that opening up for high-skilled immigrants would have positive effects on the high-wage local workforce and small gains for the low-wage local workforce, it is important to design protective measures such as minimum wage laws to safeguard the low skilled workers who may be affected by immigration. Additionally, implementing various social welfare programmes such as housing assistance, healthcare, and education subsidies to support low-income workers, including both local and immigrant workers, would be helpful.

In addition, immigrant workers in Sri Lanka have the potential to contribute to expanding the country's income tax system. One example is the practice in Thailand, where foreign workers must obtain a taxpayer identification number within 60 days of commencing employment and enjoy tax exemptions on the first portion of their income, typically the first 100,000 Thai Baht (THB).[24] This way, Sri Lanka, too, can integrate all migrant workers into the formal economy. To achieve this, tax policies that consider factors like income level, residency status, and the specific work visa held by individuals, which facilitate the redistribution of income from higher-income to lower-income earners, fostering a fairer and more inclusive system, etc., can be incorporated. Consequently, by adopting such measures, Sri Lanka would achieve a fairer distribution of tax obligations while ensuring equal access to improved public services for all individuals in the country.

Finally, Sri Lanka has much to gain from strategically handling inward and outward migration, be it dimensions of 'brain drain' or 'brain gain.'

24 Martin, P. (2007). *The Economic Contribution of Migrant Workers to Thailand: Towards Policy Development*. Bangkok: International Labour Organization.

10. Towards an Efficient and Integrated Social Protection System

10.1 Introduction

Social protection gained even more importance following the coronavirus (COVID-19) pandemic. Renewed global interest in the subject has emphasised the necessity of well-developed and resilient social protection systems that can adequately support all to withstand such shocks. The pandemic led to a rapid expansion in social protection measures worldwide – especially cash and in-kind transfers. Parallel to the rising global interest, an increasing recognition of social protection was seen in Sri Lanka, too, from the onset of the pandemic. The pandemic led to a horizontal and vertical expansion of some of the key social protection programmes in the country. While harnessing the existing programmes to extend support to the affected groups during COVID-19 was valid, it also sheds light on various gaps and inefficiencies of the existing social protection system.

On top of the COVID-19 pandemic, Sri Lanka has been undergoing a massive economic crisis since 2022, which resulted in rapid increases in the cost of living and job and income losses for many. These multiple negative shocks have pushed many new people into poverty while pushing those already poor into deeper poverty levels. Consequently, the country has been experiencing rising levels of poverty and vulnerability and widening income inequality. In the post-Covid period, the above-explained situation has emphasised the importance of building stronger, resilient, and integrated social protection systems that can efficiently cater to the needs of all population segments.

Several initiatives have been rolled out to improve the efficiency of Sri Lanka's social protection system. These include introducing a new cash transfer programme known as the 'Aswesuma welfare benefits payment scheme', reforms to the Samurdhi programme, and efforts to integrate the social protection system by creating a central social registry and preparing a social protection policy and strategy for the country. While these initiatives reflect a positive move towards addressing gaps and improving the efficiency of the prevailing social protection system, many of these initiatives are still in their initial stages.

Against this backdrop, the chapter provides a detailed analysis of Sri Lanka's social protection system, particularly looking at its gaps and issues, potential reforms and policy choices, recent initiatives by the government to improve the system's efficiency, and recommendations to successfully implement these initiatives/ reforms. The next section discusses the gaps and issues in the social protection system that constrain the recovery from the recent crises and the long-term growth. Thereafter, the discussion analyses the policy choices to address the prevailing issues based on international literature and the related policy debates /initiatives in Sri Lanka, while the final section discusses the way forward, with some suggestions/recommendations on how these can be implemented in practice.

10.2 Setting the Context: Constraints to Recovery and Long-term Growth

The COVID-19 pandemic has significantly affected people's lives and livelihoods, particularly those from low and middle-income levels. The pandemic-induced adversities, such as job/income losses, led to a significant increase in poverty levels, reversing Sri Lanka's much-achieved progress in poverty reduction over the years. It has been estimated that over 500,000 people have fallen into poverty due to the pandemic, which led to an increase in the United States Dollars (USD) 3.20 poverty rate from 9.2% in 2019 to 11.7% in 2020 – higher than the 2016 level (11%). The estimates further reveal that extreme poverty (measured by the USD 1.90 a day poverty line) almost doubled in 2020 from the pre-pandemic level, while the poverty gap too has widened, indicating that the poor have become even poorer because of the pandemic.[1]

Aggravating these conditions, in 2022, Sri Lanka was hit by its worst-ever economic crisis since independence. The economic crisis added to the significant job and income losses. Additionally, high inflationary pressures caused rapid increases in the cost-of-living, drastically reducing the standard of living for many. These multiple negative shocks have pushed more individuals/ households into poverty while pushing those already poor further into poverty. Hence, it is likely that the existing poverty trends in Sri Lanka will continue over the next few years with only a little possibility of improvements. Indeed, forecasts by the World Bank (2023) suggest that the incidence of poverty in Sri Lanka will continue to be above 25% in the years to come. Further, estimates show that the Gini coefficient for Sri Lanka, which was already high and stood at 37.7 in 2019, increased to 38.1 in 2021 and further to 39.8 in 2022, indicating an increase in income inequality. Urban poverty has tripled in 2022 and rural poverty has doubled while over 50% of the estate population continues to live in poverty.[2]

As discussed above, the multidimensional crises in Sri Lanka in recent years have led to several adversities, including deepening and widening poverty levels, rising inequality and increasing malnutrition among children. Although various measures have been taken to overcome the economic crisis, the adverse impacts caused cannot be reversed immediately. Moreover, this is particularly the case for the poorer households that have experienced the adversities at a larger magnitude compared to households in higher income groups. As such, many new households who traditionally did not have to rely on government assistance for survival now need support. As such, providing them with adequate and appropriate support through social protection is crucial for recovery. This further stresses the need to build a strong, resilient, and integrated social protection system that can broaden the coverage and provide adequate support to all those in need.

1 World Bank. (2021). *Sri Lanka Development Update 2021: Economic and Poverty Impact of COVID-19.* Colombo: World Bank.

2 World Bank (2023). *Sri Lanka Development Update: Time to Reset.* Washington, D.C.: World Bank.

10.2.1 Sri Lanka's Social Protection System: Gaps and Issues

Sri Lanka's social protection system comprises a multitude of policies and programmes aimed at supporting different segments of the population, such as children, formal and informal sector workers, older persons, and persons with disabilities. While there are around 35 key social protection programmes,[3] the total number of programmes is much higher as various national and provincial level agencies administer several smaller programmes. Despite many programmes and policies in place, and the substantial expenditure spent by the government on social protection annually, Sri Lanka's social protection system has been far from perfect, with several gaps at the system and programme levels.

Sri Lanka's social protection system has been far from perfect, with several gaps at the system and programme levels.

Inadequate coverage is a main weakness of the existing social protection system. The system has been unable to cater to the needs of all eligible or deserving groups. For example, more than half of the 60+ population is not currently covered by the available social protection programmes like pensions, Employees' Provident Fund/Employees' Trust Fund (EPF/ETF), or cash assistance. Similarly, over 60% of the country's workforce, primarily those in informal employment, do not have access to employment-related social security benefits like paid sick leave, medical and maternity benefits, pensions, or EPF / ETF.

One main reason for the low social protection coverage in Sri Lanka is the large informal workforce which accounted for 67.5% in 2021.[4] Informal workers are often not only without access to employment-related social protection benefits. However, many of them – such as small and medium entrepreneurs and contractual workers – often tend to be excluded from the cash transfer programmes, as they may not be 'poor enough' to receive benefits under these schemes. As such, these informal workers often account for a larger portion of the so-called 'missing middle' of the social protection system. Yet, informal workers are among the most severely affected segments of economic shocks/crises across countries. In Sri Lanka too, informal workers, including small entrepreneurs and contractual workers, are among the hardest hit by the recent crises. The inability of the prevailing social protection system to support such vulnerable groups is a severe constraint in tackling rising levels of poverty and inequality and recovering from the crises.

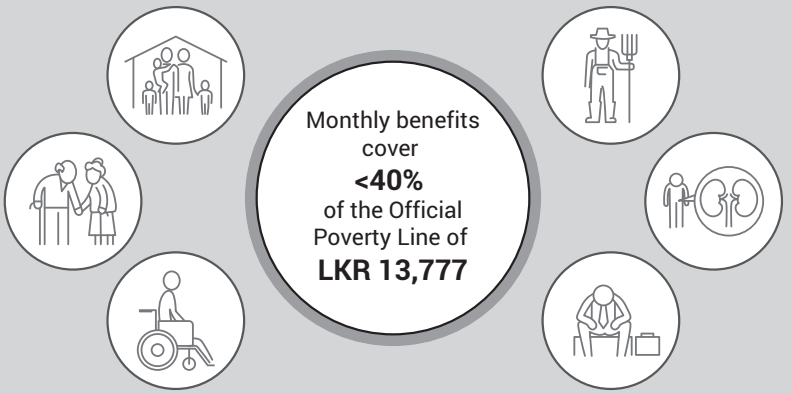
Inadequacy of coverage is also observed across many social assistance programmes like support for elders, disabled persons, and kidney patients. Although coverage of programmes for disabled persons and kidney patients has improved in recent years by absorbing those on the waitlists, some

3 United Nations Developemnt Programme and Institute of Policy Studies of Sri Lanka. (2022).*Comprehensive Landscape Mapping of Current Social Protection System in Sri Lanka*. Colombo: United Nations Developemnt Programme, Institute of Policy Studies of Sri Lanka.

4 Department of Census and Statistics. (2022). *Labour Force Survey Annual Report-2021*. Battaramulla: Department of Census and Statistics.

of these still cover only a fraction of the deserving population. This is primarily due to the limited budgetary allocations for these schemes. The Samurdhi programme, despite substantial coverage, suffers from considerable targeting errors – both inclusion errors (i.e. the inclusion of families that are ineligible for benefits) and exclusion errors (i.e. exclusion of eligible groups). This is mainly due to the lack of clear eligibility criteria to select beneficiaries and an exit mechanism.

Monthly Benefits Under Sri Lanka's Social Assistance Programmes



Source: Department of Census and Statistics, (2022).

Inadequacy of benefits is another common issue in many social protection programmes, particularly cash transfer programmes. The monthly benefits under almost all social assistance programmes are less than 40% of the minimum required expenditure per person per month to fulfil basic needs, as per the country's official poverty line (OPL), which stood at Sri Lankan Rupees (LKR) 13,777 (as of December 2022).[5] Interestingly, the maximum benefit amount provided by the Samurdhi subsidy programme (i.e. LKR 4,500 given to a family of at least four members) was also equivalent to only one-third of the minimum required expenditure per person per month as per the OPL.

5 Department of Census and Statistics. (2022). *Official Poverty Line by District – December 2022.* Retrieved July 20, 2023, from Department of Census and Statistics: http://www.statistics.gov.lk/povertyLine/2022_new

Table 10.1
Monthly Benefits under Key Cash Transfer Programmes

SP Programme	Monthly Benefits (LKR)
Samurdhi cash transfer	420-4,500
Elders' Assistance Programme	2,000
Disability Assistance Programme	5,000
Assistance for kidney patients	5,000
Farmers' pension scheme/fishermen's pension scheme	1,000-4,166

Source: Compiled based on data from UNDP and IPS. (2022), Comprehensive Landscape Mapping of Current Social Protection Systems in Sri Lanka.

Another gap in Sri Lanka's social protection system is its highly unequal distribution of resources within the existing system. Government transfers and subsidies to households accounted for about 3% of the gross domestic product (GDP) in 2022, of which about 43% was spent on pensions for public sector workers.[6] Although a disproportionately higher share of the country's social protection expenditure is spent on pensions, these benefits are enjoyed by only a small share of the country's elderly population. By contrast, over 50% of the elders have no access to any form of social protection, whether pensions, EPF, or cash transfers.

The existing social protection system is highly fragmented, with several programmes implemented by different agencies and with little or no coordination among them. This fragmented nature has led to various inefficiencies, such as high administration costs, duplication of programmes, and overlap of beneficiaries. In addition, almost all the existing social protection programmes operate using manual processes with minimal technological interventions. The lack of digital payment systems leads to delays in payment distribution, incurs higher transaction costs, and constrains the scaling up of social protection measures in emergencies. Indeed, global evidence shows that countries that had advanced digital payment systems in place before the pandemic disbursed transfers more efficiently, without delays and higher transaction costs, while complying with health guidelines.[7] Hence, it is time for Sri Lanka to move towards digitising its social protection system.

Understanding some of the potential policy choices and approaches based on international experience/literature is essential to tackle the gaps in Sri Lanka's social protection system and improve its efficiency. These are looked at in some detail in the following sections.

6 Central Bank of Sri Lanka. (2022). *Annual Report 2022.* Colombo: Central Bank of Sri Lanka.

7 Rutkowski, M., Mora, A.G., Bull, G. L., Guermazi, B., & Grown, C.(2020). *Responding to Crisis with Digital Payments for Social Protection: Short-Term Measures with Long-term Benefits.* Retrieved May 31, 2023, fromWorld Bank Blogs: https://blogs.worldbank.org/voices/responding-crisis-digital-payments-social-protection-short-term-measures-long-term-benefits

10.3 Improving Efficiency of Social Protection: The Global Perspective

International literature suggests several potential strategies/policy choices that can be useful in addressing the above-discussed gaps and issues in Sri Lanka's social protection system. This section particularly touches on two areas: (i) digitisation and integration of social protection systems and (ii) a graduation approach to poverty alleviation – i.e., a sequenced, integrated, multi-sector intervention that supports poor households to generate a sustainable form of income through livelihood development that in turn help them to move out of poverty within a specified time.

10.3.1 Digitisation and Integration of Social Protection Systems

Digitalisation in the realm of social protection has become increasingly popular in building and maintaining social protection programmes due to its ability to increase efficiency and connectivity among registries and systems, provide on-demand registration, ease of monitoring, lesser leakages, and lowered exclusion and inclusion errors.[8] Evidence from across the globe indicates how, depending on the need, various countries have benefited from digitalisation. For example, digitalisation is known to tackle costs arising from leakages and exclusion errors. In Chhattisgarh, India introduced electronic devices for its public distribution system, reducing leakages from about 53% to 9% between 2005-2012. Such cost reductions through integrating the social protection systems come from the ability to compare social registries and programmes and better coordinate multiple programmes while removing and identifying errors. Similar cases have been recorded in Pakistan, Guinea, and South Africa, where millions of dollars have been saved. Countries such as Mexico have used geospatial mapping to identify target groups in data collection, while Côte d'Ivoire used mobile data to outline poverty maps. Digitalisation has become useful in delivering services in enhancing the social security system's capacity to reach groups in the most fragile conditions. In Syria, for example, 125,000 refugees were able to receive food vouchers in the form of electronic smart cards.[9] A similar example in Zambia indicates how the choice between mobile cash, mobile wallet, or prepaid card through digitalisation has widened the accessibility to transfers for nearly 75,000 girls and women in the country.[10]

Furthermore, much of the digitalisation process integrates different social protection programames and builds comprehensive registries bringing in all beneficiaries under a united registry. Hence, gaining a keener understanding of the concept of integrated social protection systems is important.

Integrated social protection systems: Social protection programmes in many countries are still frequently fragmented, disorganised, and not implemented on a large scale due to challenges related to institutional capacity, political leadership and incentives, different time frames, and limited financial resources. Further, these social protection programmes are being conducted by several different authorities and overlooked by different Ministries. Additionally, targeted programmes often lack comprehensive databases and transparency at the formulation and delivery.

8 World Bank. (2022). *Charting a Course Towards Universal Social Protection*. Washington, D.C.: The World Bank.

9 World Bank. (2019). *World Development Report 2019: The Changing Nature of Work.* Washington, D.C.: World Bank.

10 International Monetary Fund. (2018). *Age of Insecurity: Rethinking Social Contract.* Washington, D.C.: International Monetary Fund.

For beneficiaries, such fragmentation leads to a lack of information about programmes, having to seek assistance from various office locations, and dealing with extensive documentation each time. For administrators, fragmentation can result in higher administrative costs, process duplications, and a lack of coordination in determining programme eligibility. Thus, it is necessary to adopt a system-level approach to social protection that allows for effective coordination in achieving social protection objectives.[11] This is where the concept of integration within social protection becomes essential.

An integrated social protection system is typically defined across four main areas: (i) policy coherence, including shared vision across legislation and policies, (ii) coordination across programmes (such as cash transfers and social insurance), (iii) administration (including cohesion between the numerous responsible official authorities and the inclusion of combined registries and payment systems) and (iv) evidence from integrated poverty and vulnerability analysis.[12] In brief, an integrated social protection system is meant to improve effectiveness by (i) ensuring equitable access while reducing barriers and costs of accessing social protection services, (ii) generating better administration of social protection programmes, and (iii) providing holistic tailored support with the coordination of service providers. An integrated system is also seen as a step in improving social protection's impact on reducing poverty.

Social registries are considered an integral part of a cohesive social protection system. These are beyond the usual beneficiary data collection. Social registries would ideally carry a distinct policy role as an inclusion system, an operational system, and an information system. Social registries act as a portal for individuals or families to register with social protection programmes. Under a universal approach, in registration or in forming such registries, exclusion based on certain categorical guidelines (such as gender, age, and disability) is disregarded and allows any potential individual or household to get registered. Thus, such an inclusive system would enable the authorities to have varying degrees of conditionalities, through which the whole population registered can be filtered and the target communities can be easily selected. Such a vast system also provides the policymakers with adequate information to custom-make programmes that would be effective and efficient in meeting the expected outcomes. The information collected can help plan, budget, and identify the programmes required the most by the beneficiaries.

To have such intricate processes on the data collection end for the beneficiary interface, input methods such as mobile teams, local offices, or digital service windows can be employed. Most importantly, a national system must contain institutional provisions, the type, and the capacity of the responsible parties involved so that it functions smoothly. These social registries can vary in universality depending on how they initially begin. Some systems may begin as a programme's beneficiary system, while others may start as the entry point of a much more extensive information system. Furthermore, these systems vary from country to country by the level of coverage, involvement of institutions

11 Lindert, K., Leite, P., Karippacheril, T. G., & Caillava, I. R. (2017). *For Social Programmes, Social Registries Serve as a Tool for Inclusion*. Retrieved July 20, 2023, from World Bank Blogs: https://blogs.worldbank.org/voices/social-programmes-social-registries-serve-tool-inclusion

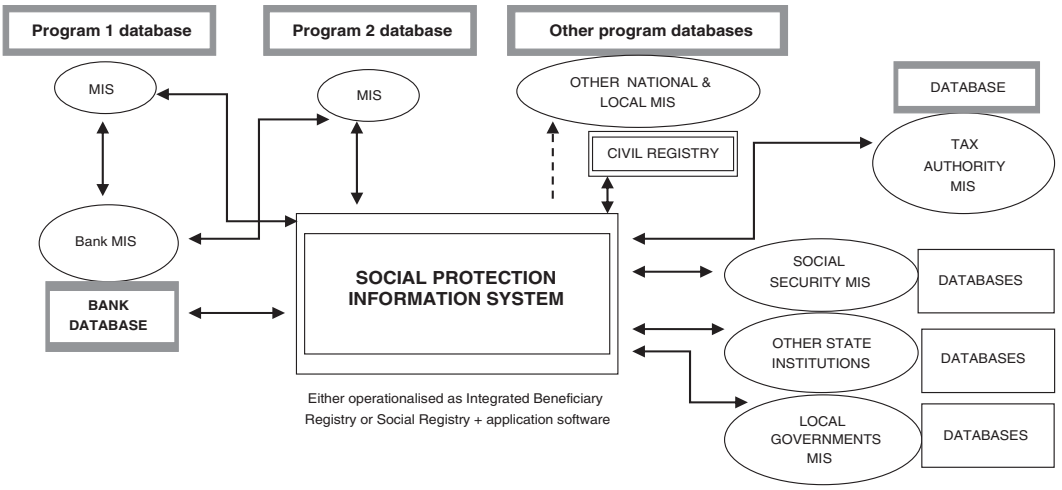
12 Oxford Policy Management. (2020). Integrated Social Protection Systems: A Review of Different Approaches. In *Synthesis Report*. UNICEF Europe and Central Asia Region in UNICEF, Europe and Central Asia Region.

and legalities, and the level of integration among programmes and within the information system. This indicates that there is no one-size fits approach to go about these systems.[13]

These social registries are a starting point in the integration process. It is only expanded into an 'information system' when incorporated with software applications that unleash its potential to link with other databases and convert data into information for analysis and decision-making purposes. Most importantly, social registries ensure dynamic inclusion when these are continuously updated and have open registration to capture the nature of poverty and people's vulnerability to shocks. If precisely done, it makes for an effective tool in battling multifaceted and dynamic poverty.[14]

Figure 10.1 illustrates how social registries can be incorporated into a larger system. This can include integration with databases from tax authorities, central and local government institutions, banks, any forms of civil data registries, etc. Data from one system to another can effectively smoothen out decision-making, beneficiary selection, and the social protection coverage of the targeted or the entire population as the country's situation demands.

Figure 10.1
Integration of Social Registries with Other Information Systems



Note: Boxes indicate databases; circles indicate MISs; bold lines indicate direct link (e.g. web service access); dotted lines indicate indirect link (batch process, CDs etc.); arrows indicate where information flows in one direction or two directions.

Source: Barca, V. (2017). *Integrating Data and Information Management for Social Protection: Social Registries and Integrated Beneficiary Registries*. Canberra: Commonwealth of Australia, Department of Foreign Affairs and Trade.

13 Leite, P., George, T., Sun, C., Jones, C., & Lindert, K. (2017). *Social Registries for Social Assistance and Beyond: A Guidance Note & Assessment Tool.*Washington, D.C.:World Bank.

14 Lindert, K., Leite, P., Karippacheril, T. G., & Caillava, I. R. (2017). *For Social Programmes, Social Registries Serve as a Tool for Inclusion*. Retrieved July 20, 2023, from World Bank Blogs: https://blogs.worldbank.org/voices/social-programmes-social-registries-serve-tool-inclusion

Due to both integration and digitalisation, and despite initial costs, countries worldwide are estimated to have earned numerous benefits.[15] Pakistan is estimated to have saved USD 248 million (Mn) owing to its integrated social registry that covers about 80% of the population and 70 different programmes. Similarly, in Argentina, a database formed by integrating 34 programmes with beneficiaries with unique identification numbers is argued to have led to savings of USD 143 Mn over an eight-year period by ridding inclusion errors revealed in the integration process when screening eligibility for various social programmes. In 2016, Thailand also eliminated 660,000 by cross-checking databases thanks to unique identification numbers and an integrated system that enabled inclusion errors in various systems to be addressed.

10.3.2 The Graduation Approach

The graduation approach, also known as 'productive inclusion, cash-plus programming, or social protection for employment', focuses on confronting multiple facets of poverty. With social assistance at its base, the graduation approach comprises a set of interventions to tackle poverty by first identifying the multidimensional nature of the problem. Thus, it builds on the premise that a single interference, like cash transfers alone will be insufficient to address poverty. The graduation programmes are essentially time-bound and usually span 18 to 36 months.

The programme is formulated in a time-bound manner to appeal to the implementers involved. The target is to support short-term consumption via direct cash or food transfers (depending on the context) while creating an environment for the beneficiary to develop their sustainable livelihood options in the long run. The programme offers key components such as social assistance (cash and in-kind), asset transfers, technical and business skills training, financial literacy training, and financial inclusion; and regular coaching and mentoring done by a trainer who visits the beneficiaries and delivers tailored support.

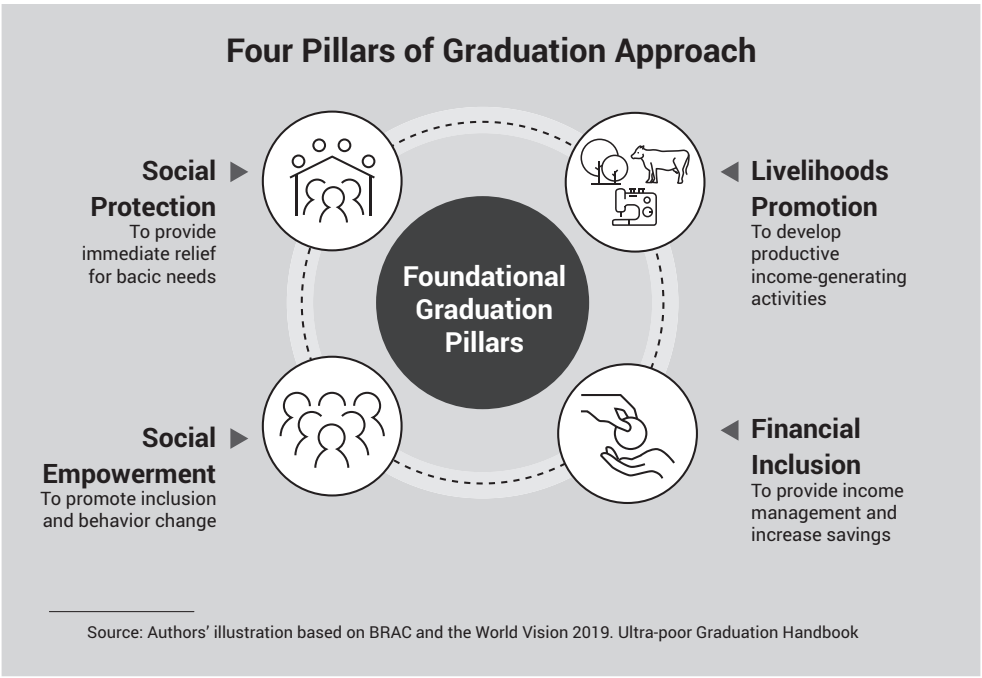
A rather important fact is that these programmes can be integrated into the existing social protection programmes. For instance, in the Philippines, an Asian Development Bank (ADB) pilot project builds upon its livelihood (Kabuhayan) programme, a conditional cash transfer for poor families. Similarly, in Pakistan, the graduation programme goes together with the cash transfer programme under the National Benazir Income Support Programme. Thus, while relying on the country context, these programmes can be initiated in ways that can complement existing poverty alleviation programmes.[16]

The main focus of the graduation approach is to deal with the root causes of poverty and work on the household capacity for survival in the socioeconomic ecosystem they belong to. This approach has been and can be refined in such a way that it promotes consistency, effectiveness, and scalability. The programme is typically built around four pillars that set the minimum standards for success. The four key areas: social protection, livelihood promotion, financial inclusion, and social empowerment (see infographic).

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15 World Bank. (2019). *World Development Report 2019: The Changing Nature of Work.* Washington, D.C.: World Bank.

16 Schelzig, K. & Rawal, P., (2020). *Testing the Graduation Approach in the Philippines.* ADB Briefs No:132. Retrieved, June 21, 2023, from Asian Development Bank: https://www.adb.org/publications/testing-graduation-approach-philippines



Source: Authors' illustration based on BRAC and the World Vision 2019. Ultra-poor Graduation Handbook

Across diverse country contexts, the graduation approach has shown positive and lasting results. A study covering Ethiopia, Ghana, Honduras, India, Pakistan, and Peru used a randomised controlled trial (RCT) methodology, comparing randomly selected beneficiaries and non-beneficiaries.[17] It finds the positive outcomes measured under a set of selected criteria have been sustained even a year later for nearly all the criteria. The positive results cover marked increases in household consumption, asset value, livestock revenue, and savings. Evidence also showcases the improvement and empowerment of women beneficiaries.

10.4 Reforming Sri Lanka's Social Protection System: Recent Efforts

Somewhat in line with the global discourse and international best practices, recently, Sri Lanka too has taken a few initiatives to improve the efficiency of its social protection system. These include efforts to integrate and digitise the country's social protection system and move towards a more time-bound approach to address poverty by introducing a new social assistance programme (known as the Aswesuma scheme) while reforming the Samurdhi programme. These initiatives are discussed briefly, while various associated challenges and suggestions/ recommendations on how to move forward are elaborated later in the chapter.

17 Banerjee, A., Duflo, E., Goldberg, N., Karlan, D., Osei, R., Pariente,W., Shapiro, J., Thuysbaert, B., & Udry, C. (2015). A Multifaceted Programme Causes Lasting Progress for the Very Poor: Evidence from Six Countries. *Science*. 348 (6236). 14 May. 1260799.

10.4.1 Reforming the Samurdhi Programme

The Samurdhi programme has been Sri Lanka's main poverty alleviation initiative since the mid-1990s. It was originally designed with the dual objectives of reducing vulnerabilities such as short-term consumption shortfalls and life-cycle-related risks and the long-term objective of alleviating poverty via livelihood development and empowerment. As such, the programme contains multiple components, including a subsidy (cash transfer) programme, a social security (insurance) scheme, a livelihood development programme, and a microfinance programme that operates through a network of over 1,000 Samurdhi community-based banks. Yet, over 75% of the total annual budget of Samurdhi has been spent on its cash transfer scheme, which covered around 1,760,485 beneficiary families in 2022.[18]

Despite being in operation for over two decades, and the substantial coverage of families, the Samurdhi cash transfer programme has continued with several shortcomings that have failed to be resolved over time. Substantial targeting errors, including inclusion and exclusion, have been the primary defect. It has been estimated that only about 40% of households in the poorest decile receive Samurdhi cash transfers, while many in the richer deciles receive these benefits.[19] The main contributory factor for the prevailing targeting errors is the absence of well-defined eligibility criteria to select beneficiaries for the programme and a systematically defined exit mechanism.

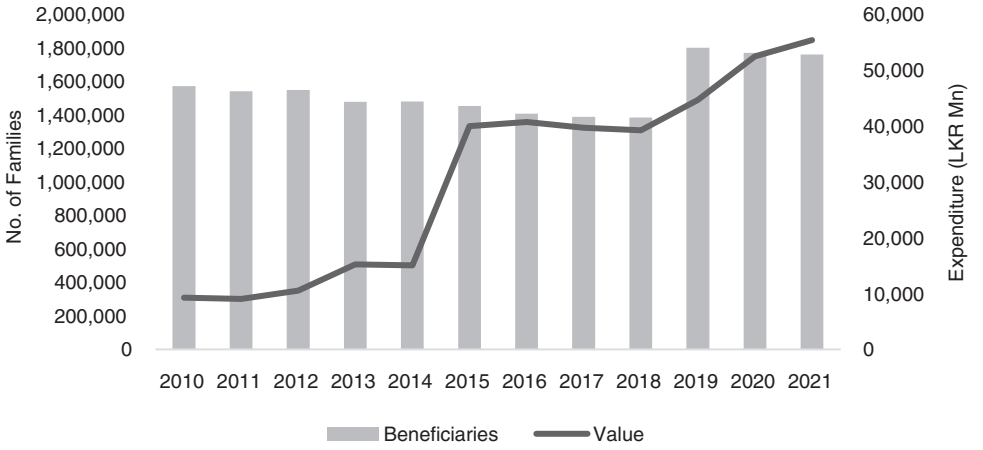
Politicisation has also been a main reason behind the existing inefficiencies of the Samurdhi programme. The lack of a clear exit mechanism and a specified duration to receive benefits have resulted in some families receiving Samurdhi benefits for over two decades. As a result, the programme has also failed to absorb the 'new' poor groups into the programme, including those who have fallen into poverty owing to the pandemic and the recent economic crisis.

Given the large number of beneficiaries that has increased further since 2019, expenditure on the Samurdhi subsidy programme has been on the rise, surpassing over LKR 50 billion (Bn) in 2021 (Figure 10.2). A notable increase in the monthly subsidy amounts in 2022, with the maximum amount (given to families of four or more members) being increased to LKR 4,500 has also contributed to the rising cost of Samurdhi. Nevertheless, the monthly subsidy amounts continue to fall well below the minimum required expenditure per person per month defined by the OPL. This implies that the Samurdhi subsidy programme has failed to provide adequate support to the poor to have a minimum standard of living.

18 Central Bank of Sri Lanka. (2022). *Annual Report 2022*. Colombo: Central Bank of Sri Lanka.

19 United Nations Developemnt Programme and Institute of Policy Studies of Sri Lanka. (2022).*Comprehensive Landscape Mapping of Current Social Protection System in Sri Lanka*. Colombo: United Nations Developemnt Programme, Institute of Policy Studies of Sri Lanka.

Figure 10.2
Beneficiaries and Expenditure of the Samurdhi Subsidy Programme, 2010–2021



Source: Compiled based on data from Central Bank of Sri Lanka (CBSL), Annual Reports (Various years).

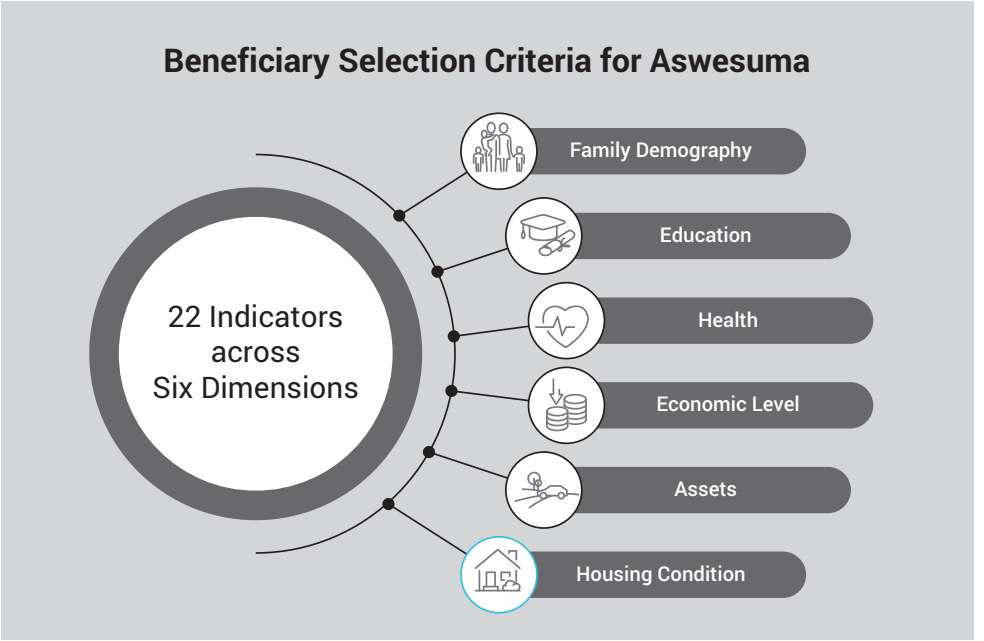
The inefficiencies of the Samurdhi programme that prolonged have called for reforms emphasising the need for an efficient poverty alleviation mechanism that could help poor families gradually move out of poverty without having to remain lifetime beneficiaries of government cash transfer schemes.

Consequently, a new cash transfer scheme, namely the Aswesuma welfare benefits payment scheme, has been designed and will operate under the Welfare Benefits Board's (WBB) purview. With the Aswesuma scheme coming into operation, the Samurdhi cash transfer programme will cease to exist. At the same time, the Department of Samurdhi Development will be entrusted with the responsibility of empowering the poor and severely poor families (identified by the Aswesuma scheme) to help them move out of poverty within a stipulated period. While related discussions/initiatives are still in their initial stages, these will likely have significant implications for the overall Samurdhi programme and Sri Lanka's social protection system.

10.4.2 Aswesuma Welfare Benefit Payment Scheme

As per the Gazette Extraordinary No 2328/13 issued in April 2023, the Aswesuma welfare benefit scheme is expected to provide cash assistance to around 2 Mn families covering four categories: severely poor, poor, vulnerable, and transitional families. Potential beneficiaries will be identified from around 3.7 Mn applicant families, details of whom have been collected and entered into a central database maintained and managed by the WBB. The beneficiary selection process uses a pre-defined set of criteria, including 22 indicators across six dimensions – i.e., education, health, economic level, assets, housing condition, and family demography. Based on information collected on the six dimensions and 22 indicators from each family, a weighted deprivation score is calculated for each family, which will be used to identify the eligible families.[20]

20 Details on the dimensions and indicators and method and formula for calculation of the Deprivation Score can be found in the Gazette Extraordinary No. 2302/03 – October 2022 (http://documents.gov.lk/files/egz/2022/10/2302-23_E.pdf



Source: Authors' illustration based on Gazette Extraordinary No. 2302/03 – October 2022.

Such a multidimensional approach to poverty that allows for various deprivations faced by the poor is often considered better than a unidimensional approach based on household income /expenditure. Moreover, this method is based on a more objective set of criteria. It can be seen as a step-up compared to the rather ad-hoc selection criteria of the Samurdhi cash transfer programme, which provided ample scope to politicise the beneficiary selection process. However, concerns have also been raised about the Aswesuma scheme and its beneficiary selection process due to targeting errors observed in the initial list of beneficiaries and possible issues associated with some indicators (e.g., housing conditions). The Aswesuma scheme beneficiary selection method also seems to have failed to capture some deserving families/individuals who do not have a permanent place to live.

Furthermore, the distinction between the four beneficiary categories covered by the Aswesuma scheme – i.e., severely poor, poor, vulnerable, and transitional families – and the cut-off points used for each category seem ambiguous. As per the Gazette Extraordinary No 2328/13, about 400,000 families identified as 'severely poor' under this scheme will receive a monthly payment of LKR 15,000 for a period of three years, while approximately another 800,000 families identified as 'poor' will receive a monthly allowance of LKR 8,500 for three years. In addition, another 400,000 families identified as 'vulnerable' will be given LKR 5,000 per month for nine months and a further 400,000 'transitional' families will be given LKR 2,500 per month for six months (Table 10.2).

Table 10.2
Aswesuma Scheme: Beneficiary Categories and Monthly Benefit Payments

Category of Beneficiaries	Time Period	Number of Beneficiaries	Monthly Benefit Amount (LKR)
Transitional families	For six months (until 31 December 2023)	400,000	2,500
Vulnerable families	For nine months (until 31 March 2024)	400,000	5,000
Poor	For three years (from 1 July 2023)	800,000	8,500
Severely poor	For three years (from 1 July 2023)	400,000	15,000

Notes: In the event, the number of members in the family is two or less than two members, only half of the above benefit amount will be paid.

Source: The Gazette Extraordinary No.2328/13 issued on 21 April 2023.

The monthly benefit amounts for the four beneficiary categories have been decided considering the poverty gap), which indicates the minimum level of support/additional income required to secure basic survival needs. As such, the monthly benefit amounts increase with the intensity of poverty/ vulnerability of the family. For instance, families identified as 'severely poor' will receive a monthly allowance that is notably higher than those received by 'poor' families, whose monthly benefits are higher than those of 'vulnerable' and 'transient' families. While differential monthly benefits based on the level of deprivation are acknowledged, the four beneficiary categories must be clearly defined and distinct from one another, as the benefit amounts received vary notably across categories. In particular, the monthly benefit amount received by the 'severely poor' families is nearly double that of 'poor' families (LKR 15,000 Vs. LKR 8,500) and three times the amount received by vulnerable families.

Upon publishing the initial list of beneficiaries selected for the Aswesuma scheme, an opportunity was given to submit any appeals and objections by households. Consequently, 982,770 appeals and 62,368 objections had been received as of mid-July 2023. Of total appeals, around 650,000 have been submitted by individuals whose names are already in the published list requesting to upgrade them to a category with a higher level of benefits.[21] Only 350,000 appeals have been received from those not included in the initial beneficiary list. These appeals and objections are expected to be reviewed before finalising the beneficiary list for the Aswesuma scheme.

21 The section draws from Presidential Secretariat of Sri Lanka (2023) News- *The government has increased provisions spent on welfare benefits this year – State Minister of Finance Shehan Semasinghe* –(presidentsoffice.gov.lk)- 12.07.2023 (Accessed August 06, 2023).

Table 10.3
Payments for Differently Abled Persons, Persons with CKDu, and Elders

Category of Beneficiaries	Number of Current Beneficiaries	Approximate Number of Persons Belonging to Aswesuma Family Units	Monthly Payment (LKR)
Recipients of disability benefit payment	72,000	21,000	5,000
Persons receiving support from CKDu	39,150	19,500	5,000
Beneficiaries of elderly support	416,667	250,000	2,000

Source: The Gazette Extraordinary No 2328/13 (Schedule II).

The Aswesuma scheme also intended to integrate key safety net programmes like assistance for the elderly, disabled, and kidney patients. As per the Gazette Extraordinary No.2328/13, if the identified beneficiary families have any family member entitled to receive the payments for differently abled persons, chronic kidney disease of unknown aetiology (CKDu), or payment for elders, the respective benefit amount will also be added to the Aswesuma welfare benefits payment and transferred together to the beneficiary bank account (Table 10.3). Nevertheless, due to prevailing issues related to the Aswesuma beneficiary selection criteria, consequent targeting errors and public protests, the decision to consolidate the cash assistance programmes for disabled persons, kidney patients, and elderly persons with the Aswesuma programme by standardising the criteria to identify beneficiaries has been delayed. Thus, the three programmes currently operate as before, serving their existing beneficiaries. However, using the same selection criteria to identify beneficiaries for the schemes for disabled persons, CKDu patients, and elderly persons raise many concerns. It is likely to exclude some of the existing beneficiaries of these programmes, such as those who do not have permanent addresses and those living in elderly homes, staying with/taken care of by their children, etc. Moreover, it is likely to reverse/undermine the efforts taken by the government in recent years to improve the coverage of the programmes for disabled persons and CKDu patients by absorbing those individuals who were on the waitlist.

10.4.3 Integrating and Digitising the Social Protection System

As mentioned previously, Sri Lanka's social protection system is highly fragmented, with a multitude of programmes implemented by various government agencies. This has resulted in the duplication of programmes and overlapping beneficiaries, leading to high administration costs. Moreover, many programmes continue to depend on manual processes and operate with minimal technological interventions, leading to further inefficiencies in the said system. The importance of an integrated social protection system and digitisation of programmes has been highlighted over several years,

particularly during the pandemic.[22] Integrating the social protection system requires a centralised database of potential beneficiaries, a standardised mechanism to identify beneficiaries, a single agency acting as the central coordinating body, and a clear and coherent social protection policy in place.

The importance of an integrated social protection system and digitisation of programmes has been highlighted over several years, particularly during the pandemic.

The government has taken several initiatives in recent times, aiming at integrating the social protection system. A national social protection policy (NSPP), which provides the long-term vision for the social protection sector and defines its scope, is being prepared, while a social protection strategy to provide strategic guidance on the way forward is also being drafted presently. Furthermore, as per the Welfare Benefits Act No 24 of 2002, the WBB, under the purview of the Ministry of Finance, has been established with the powers vested to develop and execute welfare benefit schemes. The WBB came into operation in 2016 and currently acts as the country's central agency for social protection.

Developing a centralised database of potential beneficiaries or applicants (registrants) is vital to an integrated social protection system. Such 'social registries', can serve as a common registration and eligibility 'gateway' for individuals/families to apply for various welfare benefit programmes. The WBB has also initiated to create a centralised database based on the information collected on around 3.7 Mn households/families (applicants for the Aswesuma scheme). The central database is an important component of the Integrated Welfare Management System (IWMS) that is being developed and to be operated under the WBBs's purview. The database/IWMS includes the national identity card numbers of individual members of these households and will include their bank account details to facilitate direct payments to their bank accounts.[23]

Currently, the government is facilitating the opening of bank accounts with regulated banks by the identified beneficiaries for the Aswesuma scheme. These bank account details can also be used for other social protection programmes in the future. This is an improvement from the payment methods used by social protection programmes thus far, where previously, the payments have been made largely through Samurdhi banks (outside the CBSL purview), post offices or collected from grama niladari (GN) officers. However, as mentioned earlier, due to some issues/concerns related to the proposed selection criteria, standardising the criteria to identify beneficiaries and integrating other safety net schemes, such as assistance for persons with disability and CKDu, with the Aswesuma scheme have been delayed.

22 United Nations Developemnt Programme and Institute of Policy Studies of Sri Lanka. (2022). *Comprehensive Landscape Mapping of Current Social Protection System in Sri Lanka*. Colombo: United Nations Developemnt Programme, Institute of Policy Studies of Sri Lanka.; This sections draws from Chapter 6 on 'Harnessing Social Protection during Pandemics', *Sri Lanka: State of the Economy Report 2020*, IPS.

23 Based on the information from the WBB.

10.5 Recommendations and Way Forward

As discussed, the government has taken some initiatives in recent years to reform Sri Lanka's social protection system and improve its overall efficiency. As most of these initiatives are still in their initial stages, it is vital to understand their possible implications and related issues and challenges and provide suggestions/recommendations for the future.

10.5.1 Aswesuma Welfare Benefit Programme

As per the Aswesuma scheme, its benefits are given for a fixed period – i.e., for three years, for the identified poor and severely poor families. Having a fixed-term scheme, in a way, would help prevent beneficiaries from treating government cash transfers as 'lifetime benefits' or 'entitlements', thereby reducing the burden on the government budget and minimising possible targeting errors.

Having a fixed-term scheme, would help prevent beneficiaries from treating government cash transfers as 'lifetime benefits'

However, some mechanism is needed to ensure that these poor families no longer need to rely on government cash assistance for survival at the end of the three years. This may require providing them with livelihood support and other assistance (parallel to the Aswesuma payments) to help them create sustainable income-generation opportunities, which in turn, enable them to move out of poverty. As discussed previously, the 'graduation approach' or the 'cash plus approach' has shown positive results in many countries worldwide. This approach has also been under discussion in Sri Lanka in recent years and can be used as an effective approach to help poor families to move out of poverty. This will be discussed further in the section on Samurdhi reforms.

Moreover, a systematic mechanism is needed to monitor the existing beneficiaries at regular intervals and to identify new beneficiaries (e.g., 'new poor') who may need government support for survival. The application and selection process should be repeated annually to enable the inclusion of new potential beneficiaries. Importantly, information on beneficiaries and other applicants must be updated on a regular (annual) basis. As mentioned before, the benefits under the Aswesuma scheme are meant to be for three years. However, some poor families, particularly severely poor families, may require government assistance even after this period. Moreover, as mentioned before, there may also be 'new poor' families by that time who may require government assistance to fulfil their basic needs. Given the substantial costs of the Aswesuma scheme, the continuity of it beyond the three-year period and financing thereof must be well thought of.

Transparency is also key to ensuring the scheme's success and minimising leakages and other inefficiencies. Various measures have been taken to improve the transparency of the Awesuma, such as the involvement of the local level officials through the committees set up at divisional levels in the beneficiary verification and the appeal process, making the beneficiaries' names available publicly. This can be considered an improvement compared to the previous welfare programmes

like Samurdhi. However, transparency can be improved further in several aspects, particularly in the selection criteria related to the four beneficiary categories. Given the notable differences in the benefit amounts and the duration of benefits across categories, the four categories of beneficiaries have to be clearly defined to ensure the credibility and transparency of the scheme.

The four categories of beneficiaries have to be clearly defined to ensure the credibility and transparency of the scheme.

Furthermore, awareness of the Aswesuma welfare benefit scheme among the public, including the (potential) beneficiaries and applicant families, remains rather inadequate. Raising awareness of the new scheme and its entire process at all levels of its implementation, including the beneficiary selection and eligibility criteria, grievance and appeal mechanism, payment distribution, monitoring and evaluation, and exit mechanism, is crucial to enhance transparency and avoid leakages. Raising awareness at the grassroots level can be done through the committees set up at the divisional level as well as through the key officials at the divisional level, including the GN officers, Economic Development officers (EDOs) as well as Samurdhi Development officers (SDOs).

10.5.2 Towards a Digitised and Integrated Social Protection System

As previously discussed, several digital initiatives, including developing a centralised database and efforts to build an IWMS with a digital payment system are taking place in the social protection sector. While these initiatives reflect a positive move towards integrating and digitising the social protection system, taking measures is vital to resolve any pending issues related to the selection criteria, data accuracy etc., and integrate the key safety net programmes such as schemes for the elderly, disabled, kidney patients etc., to the system. Further steps can also be taken later to link other safety net programmes to this system – e.g., scholarships and other in-kind support programmes. This will also require digitising beneficiary registries of these programmes and linking them to the IWMS. Such an integrated system can also play an important role in times of crises/emergencies in identifying potential beneficiaries for emergency relief. Furthermore, it is imperative to enhance capacity at the national and subnational levels to maintain, update and manage the central database and IWMS. This would require substantial capacity – human and financial – for their successful implementation and sustainability.

While technology/digitisation plays a key role in improving the overall efficiency of social protection systems, it is not to say that digitisation of social protection is without perils. Digitalisation of social protection in countries like Sri Lanka can face the potential risk of exclusion of vulnerable segments such as the elderly, disabled and extremely poor, or those in remote rural areas, who may not have the digital literacy or access to required technology. Thus, it is imperative to remain sensitive to these vulnerable groups who are likely to get further marginalised in the digitalisation process. Therefore, a hybrid system can be recommended in the initial stages of the integration and digitisation process, where the beneficiaries have relevant officials to assist them in registration, the appeal and grievance

process, and even at the point of receiving transfers. The committees set up at the divisional level and key officials at the village/divisional level can play a key role in this regard.

Furthermore, it should be noted that if an integrated system uses a single-entry point to gather data and use that data to connect across various welfare programmes, there is a possibility of exclusion errors that can run through programmes due to any errors at the entry point. Updating information collected from the applicants regularly (at least annually) is also important to minimise such errors and any further inclusion and exclusion errors.

10.5.3 Reforms to the Samurdhi Programme

Following the initiation of the Aswesuma scheme, the Samurdhi cash transfer programme will cease to operate. Concurrently, the Samurdhi social security scheme, funded through deductions made from the monthly cash transfers, is also likely to halt. The Department of Samurdhi Development will be entrusted with the responsibility of empowering the 'poor' and 'severely poor' families (identified in the Aswesuma scheme) as its primary role, to assist them to move out of poverty within a three-year period. Therefore, the role of the Samurdhi programme is likely to be confined to its long-term objective of alleviating poverty through livelihood development and empowerment. It will have a limited role in its short-term objective of reducing vulnerabilities like consumption shortfalls and life cycle-related risk. The latter is expected to be fulfilled through the Aswesuma scheme.

Economic and social empowerment: Given Samurdhi's widespread network of around 1,086 Samurdhi community-based banks that have been engaged in providing loans and savings facilities to low-income families, and the network of over 20,000 SDOs who have years of experience in working with low-income families in facilitating Samurdhi's cash transfer scheme as well as its livelihood and the microfinance schemes, the Samurdhi programme can be considered as having the capacity and foundation to support economic and social empowerment of the poor. The Samurdhi Livelihood Development Division has also been involved in providing livelihood support for many years in areas like agriculture, industries, and fisheries, and has also initiated discussions and conducted training on the 'graduation approach' in recent times. Yet, empowering around 1.2 Mn families (about 800,000 poor and 400,000 severely poor families) within three years would still be an enormous challenge for Samurdhi that requires substantial financial and human resources and both horizontal and vertical coordination among a multitude of potential partners – Ministries, departments, private sector entities as well as subnational level bodies and key officials at the divisional and district levels.

While the Department of Samurdhi Development can lead in empowering the poor, it will require an integrated approach that coordinates at the national as well as the subnational levels with several other Ministries, departments, and other organisations involved in subject areas related to social and economic empowerment. These may include but are not limited to, the Ministry/Department of Agriculture, Ministry of Fisheries, Ministry of Industries, Ministry of Livestock and Animal Production, and Ministry of Tourism.

The discontinuation of the Samurdhi cash transfer programme is likely to have negative implications for the Samurdhi banking network.

The SDOs can play a vital role in the empowerment process, taking the lead in identifying the needs/potential support areas for the identified beneficiary families and facilitating their access to required services (e.g., technical services, training, inputs, marketing facilities and others). Committees comprising 5-6 key officials, including SDOs, GN, EDOs and agriculture officers, can be set up at each GN division to facilitate the empowerment process. The committee can support raising awareness of the empowerment process, identifying the needs of individual families and facilitating access to required services. Further, the committee can also regularly monitor and evaluate the progress of the identified families.

To support sustainable income generation among poor families, providing them with cash or in-kind support, required training, market linkages, and other business development services, depending on individual needs, is vital. Samurdhi banks, too, can play an important role by facilitating loans for additional capital requirements for the identified livelihood activities.

While making use of the Samurdhi programme and its existing resources to empower poor families and help them to move out of poverty is desirable, it is also important to take measures to mitigate any negative implications that may arise from the changes to the Samurdhi programme following the introduction of Aswesuma.

Samurdhi banking network: The discontinuation of the Samurdhi cash transfer programme is likely to have negative implications for the Samurdhi banking network. Samurdhi cash transfers are primarily disbursed through the Samurdhi banking network, hence its discontinuation probably affect the functioning of the Samurdhi banks and their sustainability in the long-term. While individual Samurdhi banks operate as self-supporting units, they also reinvest a portion of funds as a profit-generating entity. The banks grant loans against savings from Samurdhi beneficiaries and their families. It has been a common practice among many Samurdhi beneficiaries to use at least part of the monthly cash transfer they receive to settle their loan instalments or to meet the required compulsory savings to be eligible for a loan from the bank.

However, when the Samurdhi cash transfer programme ceases to operate, those beneficiaries who are not selected to receive benefits under the new scheme may have less incentive to pay back the loans already taken from Samurdhi banks. Moreover, some of them may even want to withdraw their savings, as Samurdhi banks may no longer serve them any purpose. If a large group of beneficiaries tends to do so in a selected bank, this can even affect the sustainability of the banks.

In the above context, it is vital to issue clear guidelines/instructions detailing how to address and manage such circumstances to ensure the sustainability of Samurdhi banks. Moreover, strengthening the regulations of Samurdhi banks would be a necessary improvement. In this regard, the government has initiated discussions on bringing Samurdhi Banks under the purview of the CBSL. However, several challenges and constraints may need to be addressed to move forward. First, Samurdhi

'banks' operate as independent entities. Thus, supervising over 1,000 Samurdhi banks can be quite challenging for the CBSL and may require improving existing resources/capacity. Moreover, it may require a special legal mechanism. Currently, Samurdhi banks operate under a special Act of Parliament. If these are to be regulated by the CBSL it is still unclear as to its licensing process – e.g., under the Microfinance Act or amending the current Act.

Social security fund, lottery fund and compulsory savings: The discontinuation of the Samurdhi cash transfer programme will also affect other components/funds maintained by Samurdhi. Under the Samurdhi cash transfer programme, a series of compulsory deductions are made on a beneficiary's monthly cash transfer amounts and are transferred to various funds (e.g. compulsory savings fund, social security fund, and the housing lottery fund). With the discontinuation of cash transfers, these funds will not have any new money coming in thus affecting the continuation of the funds and respective schemes.

Compulsory savings under Samurdhi have often been criticised for being inaccessible to beneficiaries (until they reach the age of 60 or on special circumstances such as for medical reasons) and for the lack of transparency on the fund. Hence, halting the compulsory savings scheme can be considered an appropriate decision. However, the Samurdhi social security programme (or the insurance scheme) that provides coverage in the event of death, hospitalisation, childbirth, or marriage of a family member, has been seen as beneficial by many poor families. Therefore, it can be recommended to continue this scheme or to design a similar one under the new Aswesuma scheme.

Furthermore, in the event the social security scheme and the compulsory savings scheme are halted, it will also bring about the question of what will happen to the existing amounts in these funds, and how these will be used. The social security fund and the lottery fund can perhaps be used for the empowerment programme that will be designed to support the identified poor and severely poor families. However, the compulsory savings should ideally be allowed to be withdrawn at least by the beneficiaries who are not covered by the new welfare benefit scheme and who meet the usual eligibility criteria for the withdrawal of these savings (e.g., medical purposes or after reaching 60 years of age.). Clear guidelines /instructions need to be issued particularly regarding the withdrawal of compulsory savings.

10.6 Conclusion/Summary

Sri Lanka's recent economic hardships have led to several adversities, including deepening and widening poverty levels and rising inequality. This has reemphasised the need for building a strong, resilient, and integrated social protection system that can broaden the coverage and provide adequate support to all those in need. Despite the multitude of social protection programmes in Sri Lanka, the existing system has several shortcomings – low coverage, the inadequacy of benefits, targeting errors, and the fragmented nature of the system – that constrain the recovery from the recent crises and impede the country's long-term growth.

The government has taken some initiatives in recent years, aiming at improving the efficiency of the country's social protection system. These include initiatives to integrate and digitise the social protection system and move towards a more time-bound approach to address poverty by introducing a new welfare programme while reforming the Samurdhi programme. While these initiatives reflect a positive move towards addressing some of the existing gaps in the system, they are still in their initial stages and face several challenges, which need to be addressed to enhance transparency, credibility and ensure their successful implementation.

11. Policy Options to Drive Sri Lanka's Renewable Energy Sector

11.1 Introduction

One of the biggest challenges in the global energy sector is meeting the growing energy demand with a minimum environmental impact, particularly by limiting global warming and reducing air pollution. Besides, non-renewable energy sources are depleting, indicating a resource limitation in the coming century. Hence, renewable energy (RE) technologies and supporting policies to effectively deploy RE technologies played a prominent role in global energy policies and decarbonisation strategies over the past decades. Currently, this energy transition is accelerating due to increasingly ambitious climate change (CC) and energy policies, technological advancements, and recent energy security challenges.

The transition from fossil fuels to RE was proposed in global CC pledges, mainly as a CC mitigation strategy to reduce greenhouse gas (GHG) emissions. The Paris Agreement of 2015 is a legally binding international treaty on CC adopted by 196 countries to limit global warming to 1.5°C above pre-industrial levels.[1] Adopting RE to the energy mix helps achieve the emission targets effectively across many economic sectors such as industry, building, transport, and agriculture. These emission targets are stated in each country's nationally determined contributions (NDCs). Similarly, the net zero emissions (NZE) by 2050 shows the pathway to go net zero by 2050 for the global energy sector. This is a normative scenario set by the International Energy Agency (IEA),[2] consistent with the NDCs and the United Nations Sustainable Development Goals (SDGs), the SDG 7 goals of the RE sector. With these collective efforts, global RE contribution reached 17.7 % by 2019, indicating a 1.6% annual average growth rate from 2010-2019.

However, RE deployment accelerated in 2022 mainly as a policy response to the impacts of the global energy crisis, which peaked with the Russian invasion of Ukraine in 2022.[3] The high reliance of European countries such as the United Kingdom (UK) on Russian natural gas and Russia's decision to ban exports to the North Atlantic Treaty Organization (NATO) countries created a supply shortage globally. Due to these, the demand for gas and other fuels rose in the world market. According to the IEA, the high fossil fuel prices have contributed to around 90% of the electricity price hike during the crisis.[4] Global fossil fuel consumption subsidies doubled in 2022, escalating to USD 1 trillion (Tn) compared to 2021.

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1 United Nations Framework Convention on Climate Change. (2015). *The Paris Agreement.* Retrieved July 20, 2023, from UNFCC: https://unfccc.int/process-and-meetings/the-paris-agreement?gclid=Cj0KCQjw9deiBhC1ARIsAHLjR2BTWE477U_MhuSqOKN9DrHmfevBAnyyxz5TdFAmRI8zeuZ0uTp5nCsaAk-TEALw_wcB

2 International Energy Agency. (2022). Net Zero Emissions by 2050 Scenario (NZE). In *Global Energy and Climate Model Documentation*. Retrieved July 20, 2023, from International Energy Agency: https://doi.org/https://iea.blob.core.windows.net/assets/2db1f4ab-85c0-4dd0-9a57-32e542556a49/GlobalEnergyandClimateModelDocumentation2022.pdf

3 REN21. (2023). *Renewables 2023 Global Status Report, Renewables in Energy Demand.* Retrieved July 20, 2023, from: REN21: https://doi.org/https://www.ren21.net/gsr2023-demand-modules

4 International Energy Agency. (2023). *The Global Energy Crisis Pushed Fossil Fuel Consumption Subsidies to an All-time High in 2022. Commentary.* Retrieved July 20, 2023, from International Energy Agency: https://www.iea.org/commentaries/the-global-energy-crisis-pushed-fossil-fuel-consumption-subsidies-to-an-all-time-high-in-2022.

Unlike before, these developments have prompted governments to focus more on energy self-reliance. For Sri Lanka too, guided by its main policy document on the energy sector – the National Energy Policy 2019 – recent global shifts and priority settings have had crucial implications for its energy development plans. The National Energy Policy 2019 was developed with due consideration to Sri Lanka's commitments to NZE, NDCs, and SDG 7. Hence, going net zero by 2050 and achieving 70% of the electricity energy mix from RE and no capacity additions of coal plants are identified as the major policy goals of the energy sector. Moreover, the government appointed a committee to review these policies to develop an energy sector roadmap (2023-2033) to achieve these targets. Against this background, this chapter explores global RE sector developments and Sri Lanka's position in reaching the 70% RE targets and economic benefits.

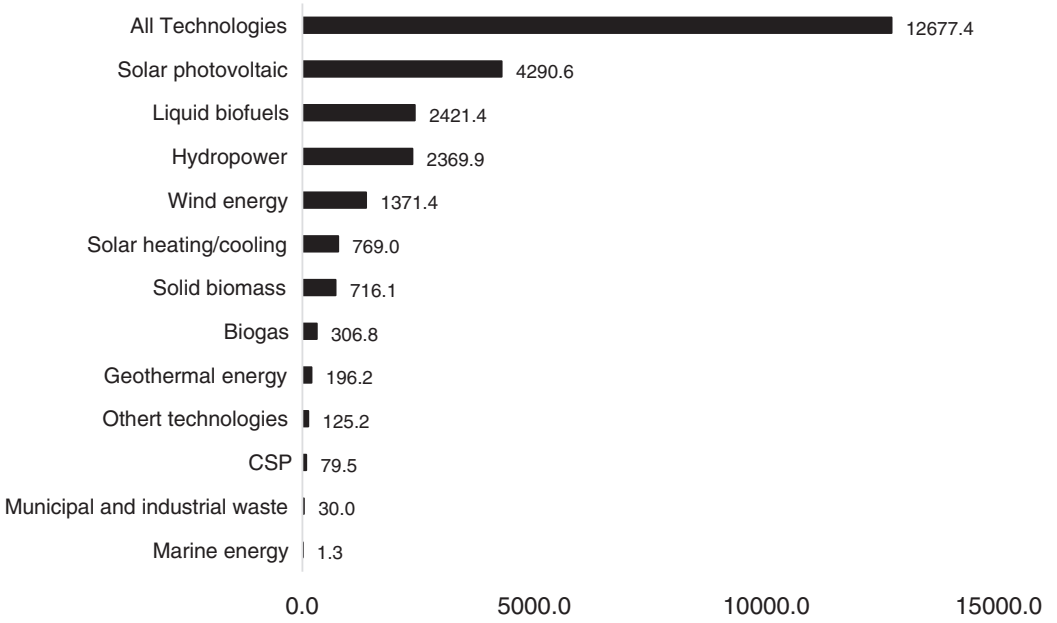
11.2 Global Developments and Policy Landscape

Recent policy responses to accelerate energy self-reliance have spanned worldwide. The European Union (EU) adopted the REPowerEU plan with provisions to increase RE by another 5%, setting obligations to install rooftop solar on public buildings by 2025, and expanding renewable hydrogen use in the steel industry with an investment commitment of United States Dollars (USD) 222 billion (Bn). Similarly, China's five-year plan for global RE capacity additions, and the Inflation Reduction Act adopted by the US, and India's plan for renewable hydrogen with a USD 2.3 Bn subsidy programme are among notable global policy responses. Global clean energy investment increased by 10% in 2022 relative to 2021, amounting to USD 1.4 Tn.[5]

Advancing these plans will require considerable efforts on the part of governments. Nearly 80% of the global energy mix comprises fossil fuels at present. Therefore, meeting NZE by 2050 remains an ambitious target compared to the climate pledges targets by 2030. The expected transition to clean energy reveals a new global energy economy with the rapid development of RE technologies such as solar, wind, and electric vehicles (EVs) and a range of other new technologies, such as electrolysers for green hydrogen. It is anticipated to create new markets worth USD 650 Bn and nearly 14 million (Mn) employment opportunities (Figure 11.1) by 2030. Nearly one-third of the emission reduction targets of the NZE scenario from 2020-2030 are expected from RE. Against this backdrop, countries are speeding up efforts to increase clean energy manufacturing to meet the overlapping policy objectives of climate pledges (NDCs), energy pledges (NZE), energy security and to compete in the new global energy economy.

5 International Energy Agency. (2023). Energy Technology Perspectives. In *Energy Technology Perspectives*. July 20, 2023, from International Energy Agency: https://doi.org/10.1787/9789264109834-en.

Figure 11.1
RE Employment by Technology, 2021



Source: IRENA. (2023). *Data. Renewable Energy Employment by Country, All World*. Retrieved July 20, 2023, from IRENA: https://www.irena.org/Data/View-data-by-topic/Benefits/Renewable-Energy-Employment-by-Country.

This energy transition is considered a new industrial era for clean energy technology manufacturing where the nexus of climate, energy, and industry policy come together. Today, solar photovoltaic (PV), wind, EVs, and batteries have grown into massive manufacturing operations while other technologies are emerging. Therefore, every country has to identify opportunities to benefit from and the risks to address in the new energy economy. Notably, it is impractical for many countries to compete in all the segments of the RE supply chain unless there exists a competitive advantage. For instance, current clean energy supply chains consist of mining, production of materials, manufacturing, and installation of technologies. Mining is associated with resource endowments such as lithium, copper, and nickel, while production materials include cement, aluminium, and plastics. A skilled labour force, access to low-cost RE, availability of a large local market, and spillovers from existing industries are some possibilities of having competitive advantages.

Similarly, there are risks associated with these global supply chains which make the entire supply chain vulnerable. The geographical concentration of critical materials such as lithium, cobalt, copper, and nickel pose similar risks to the energy security the world is experiencing today unless recycling technologies and new technologies are developed. For example, Congo provides 70% of the cobalt, while three countries supply nearly 90% of the lithium. The prices of these materials hiked in 2022 due to rising demand and energy costs. Therefore, the current global supply chain is vulnerable to policy dynamics, price hikes, company policies, natural disasters, technical failures, and various other factors in the supplying countries. Critical minerals, such as lithium, are proven to

Every country has to identify opportunities to benefit from and the risks to address in the new energy economy. It is impractical for many countries to compete in all the segments of the RE supply chain unless there exists a competitive advantage.

be adequate to meet two-thirds of the projected NZE target by 2030, even with the expansion of mining capacities, which has lead times and other uncertainties. Crucially, 60% of the mass-manufactured technologies, such as solar PV, wind systems, and batteries, and 40% of electrolyser manufacturing are concentrated in China.[6] Europe and North America remain net importers, while China remains a net exporter of these technologies.

Clean energy technology supply chains also contribute to GHG emissions due to the unavailability of low-emission technologies for material production and technology manufacturing. These technologies are still developing in North America and Europe. Necessary infrastructure developments such as distribution lines, transmission grids, storage facilities, and transportation would demand more resources. For example, copper production is projected to rise by 20% in 2030. The skill gap by 2030 is projected to be 8 Mn for manufacturing batteries and EVs , and another 4 Mn for manufacturing and installing solar PV, wind, and heat pump systems. Thus, a supportive policy mix is equally important to operate in the new energy economy. Indeed, China's dominance in the global market is attributed to its supportive industry policies, trade policies, workforce, and low-cost energy and materials.

11.2.1 Sri Lanka's RE Policy Context

Sri Lanka's national energy policy 2019 is the main policy document on the energy sector. It was developed considering the NZE, NDCs, and SDG 7 objectives. Hence, going net zero by 2050 and achieving 70% of the electricity energy mix from RE and no capacity additions of coal plants are the major policy goals of the energy sector. Increasing the share of RE through the optimum use of indigenous RE sources to attain sustainability and resilience in the energy sector is one of the ten pillars around which the energy policy is developed. Further, it aims to reduce pressure on foreign exchange and enhance the engagement of local communities in the energy industry. Eight strategies are proposed to achieve these objectives:

- Long delays encountered in renewable energy development will be reduced through a centrally coordinated project approval process.
- Renewable energy investments for electricity generation will be realised through a competitive scheme to reduce costs and facilitate wider investor participation.
- Transmission infrastructure will be strengthened to improve the absorption of electricity generation from renewable sources.
- Distribution infrastructure will be upgraded with smart grid technologies to facilitate renewable energy-based distributed generation.

6 International Energy Agency. (2023). Energy Technology Perspectives. In *Energy Technology Perspectives*. Retrieved July 20, 2023 from International Energy Agency: https://doi.org/10.1787/9789264109834-en

- Research will be conducted to overcome the adverse impacts of renewable energy absorption to the power system from intermittent sources such as wind and solar energy.
- Effective forecasting technologies for wind, solar, and rainfall will be introduced so that the optimisation of renewable resources could be realised.
- Energy storage solutions will be encouraged for firming intermittent renewable sources, voltage and frequency regulation, local grid support, peak shaving and improving grid resilience.
- Innovative financing schemes and financial instruments involving both public and private enterprises will be introduced to encourage renewable energy development.

Going net zero by 2050 and achieving 70% of the electricity energy mix from RE by 2030 with no capacity additions of coal plants are the major policy goals of the energy sector.

NDC1 and NDC5 accommodate Sri Lanka's updated NDCs in the RE sector in the electricity (power) sector.[7] The NDC1 focuses on enhancing RE contribution in the electricity generation mix by solar PV (rooftop, small-scale, and large solar PV), wind, hydro, and sustainable biomass with an additional RE capacity addition of 3,867 megawatts (MW) by 2030. It considers that 2,917 MW of capacity additions are conditional, requiring external technical and financial support. The NDC5 considers research and development (R&D) activities for non-conventional renewable energy (NCRE) sources that are not yet commercialised and to develop grid-supporting infrastructure such as storage solutions and smart grid technologies as conditional measures. The other NDCs of the electricity sector cover demand-side management with energy efficiency equipment and technologies, transmission and distribution energy efficiency, and shifting from fuel oil to natural gas. The target of GHG emission reduction from the electricity (power) sector is 25% of the business-as-usual (BAU) scenario. However, 20% of the emission reduction targets depend on external technical and financial assistance.

The Climate Prosperity Plan (CPP) is a national investment strategy to prosper in a climate-insecure world with the main focus on energy, finance, and resilience goals. Other than RE generation, the CPP expects to enhance RE use in the transport sector which is the largest emitting contributor (48%), including road and rail transport. Further, CPP promotes energy efficiency equipment and technology to improve overall energy efficiency by 40% in 2030.

7 Ministry of Environment. (2021). *Sri Lanka Updated Nationally Determined Contributions*. Retrieved July 20, 2023, from Ministry of Environment: http://www.climatechange.lk/CCS2021/UpdatedNDCsSriLanka2021.pdf.

Table 11.1
Timeline for Key RE Targets in CPP 2022

RE Target	2025	2030	2035	2040
70% of renewable energy in electricity production		√		
80% of outstanding renewable energy potential financed			√	
90-100% of outstanding renewable energy potential financed				√
Contribute to grid connection partnership in South Asia		√		
Leverage the latest innovative technology (e.g. waste to energy maximisation, wave technology etc.).	√			

Source: United Nations Framework Convention on Climate Change. (2022). *Climate Prosperity Plan.* Retrieved July 20, 2023, from United Nations Framework Convention on Climate Change: https://unfccc.int/sites/default/files/resource/SriLanka_LTLEDS.pdf

Implementing energy sector policy decisions comes under the purview of the Ministry of Power and Energy (MOPE). The Ceylon Electricity Board (CEB), the Sustainable Energy Authority (SEA), and the Public Utilities Commission of Sri Lanka (PUCSL) function under the MOPE in RE sector decision-making. Electricity is the main form of direct energy generated from RE resources. At the same time, a few technologies are used for thermal energy generation in industries and household water heating.

According to the country's electricity sector structure, the CEB is a monopoly in the generation, transmission, and distribution functions which are vertically and horizontally bundled. Currently, generation is being unbundled horizontally with private sector participation, while distribution is slightly unbundled, with Lanka Electricity Company (Pvt) Ltd (LECO) handling nearly 12% of the distribution. However, the overall transmission is handled by the CEB.

The CEB annually revises and issues the Long-Term Generation Expansion Plan (LTGEP), which provides its generation and investment strategies and forecasts. According to the Sri Lanka Electricity Act, No. 20 of 2009, a new power plant cannot be established unless it is included in the CEB's LTGEP. The CEB annually revises the LTGEP and approves new power plants. The recently developed LTGEP for the period 2023-2042 accommodates plans for reaching the 70% RE target by 2030 and maintaining it beyond 2030 without coal power plant additions. In doing so, it considered incorporating solar, wind, mini-hydro, biomass, and battery and pumped storage infrastructure development. The present value of the cost of this scenario is estimated to be USD 18,872 Mn. A Long-Term Transmission Development Plan (LTTDP) is parallelly being developed to facilitate capacity additions to the grid. Meantime, the CEB and SEA have taken steps to prepare a Renewable Energy Development Master Action Plan (REDMAP) to identify the activities and responsible agencies to reach the RE targets through a definite roadmap (2023-2033) as proposed by a Cabinet sub-committee report of December 2022.[8]

8 Parliament of Sri Lanka. (2022). *National Energy Potentials, Strategies and the Roadmap for Next Decade. Cabinet Sub-Committee Report. December 2022.* Retrieved July 20, 2023, from Parliament of Sri Lanka: https://www.parliament.lk/uploads/documents/paperspresented/1676276796040548.pdf

Considering the government's need for rapid development of RE to meet the policy commitments and to cut down energy costs and import dependency, the CEB has incorporated variable renewable energy (VRE) into the LTGEP. Solar and wind resources are considered in the VRE incorporation. The CEB and the SEA have completed the initial mapping of the RE resources in the country and have identified the potential areas of RE resources (Table 11.2). For example, initial steps were taken to implement 100 MW ground-mounted and floating solar plants in Siyambalanduwa, Hambantota and Trincomalee. Similarly, North-Western and Northern parts of the country are identified for on-shore and off-shore wind power generation, while Mannar and Pooneryn are identified for large wind power parks. Anuradhapura, Veravill and Puttalam are the other areas identified for wind power generation.

Table 11.2
Classification of RE Zones

Power Project	Identified Potential Locations
Solar Park Developments (Ground Mounted/Floating)	Southern, North Eastern, Northern and Eastern Regions (Hambantota, Trincomalee, Monaragala, Valachchenai, Iranamadu, Kilinochchi, Pooneryn)
Wind Park Developments	Northern & North Western Regions (Mannar, Pooneryn, Puttalam, Anuradhapura)
Pumped Storage Power Projects	Victoria-Wewathenna in Kandy, Maha Oya-Aranayaka in Kegalle
Natural Gas Power Projects	Kerawalapitiya, Muthurajawela
Battery Energy Storage	Integrated with large solar parks, Standalone Utility Scale

Source: Compiled based on CEB, 2022. LTGEP 2022.

The Cabinet sub-committee report focuses on Energy Park projects in VRE development. The sub-committee report also recommends facilitating private sector investments, establishing new management for potential land acquisition, enhancing the grid capacity to absorb capacity additions, storage facilities development, financial assessment for RE, and providing financial incentives such as low-interest loans. Further, it proposes expanding the solar rooftop programme from 600 MW to 1000 MW by 2025 with solar PV systems.

Promoting off-grid with RE investment and battery storage among consumers is identified as a solution to peak shaving until the transmission capacity is developed. Therefore, the policy proposes providing guidelines for technical and safety requirements and battery disposal. For improving the sustainable biomass use in the plantation sector industries, establishing fuelwood plantations and facilitating the transportation of fuel wood are proposed. According to the Electricity Act 20 of 2009, the transmission function is performed only by the CEB. However, facilitating private sector investments in the transmission sector is identified in developing the transmission facilities. Moreover, financial and regulatory feasibility analysis of grid interconnection between India and Sri Lanka is

recommended for sector development. In terms of promoting RE utilisation, promoting EVs and establishing a franchise-based network of RE charging stations, particularly solar PV, is proposed with private sector investments.

However, intermittent supply is an inherent issue in RE resources such as solar and wind. For instance, solar power generation occurs during the daytime and fluctuates during the day with the sun and weather conditions. On the other hand, peak demand occurs during the nighttime. The duck curve is a graphical representation of electricity demand from the grid during a day when solar power production is high, and grid demand is low. Wind power is seasonal, peaking from May to September with excess energy generation. This excess energy is curtailed to retain the balance in the system. Some solutions to mitigate the loss are battery storage, pumped hydro, microgrids, time-of-use rates, and demand management. Therefore, measures to mitigate VRE curtailment are crucial. In the base case scenario, around 4.3% of the RE is estimated to be curtailed by 2030 and nearly 8% by 2040.[9]

To overcome the limitations of these VRE resources related to the intermittency of supply, sophisticated resource forecasting methods, pump and battery storage systems, and small grid systems are considered in the expansion planning (Table 11.3). The expected capacity additions collectively exceed the anticipated NDC targets (3,867 MW by 2030). Further R&D is being undertaken to address grid absorption capacity and other system inefficiencies.

Apart from the above, a few hydropower plants are being commissioned (Broadlands, Moragolla and Uma Oya) and potential plants have been identified in Gin Gaga and Thalpitigala areas.

Table 11.3
RE Capacity Additions in Base Case Scenario, 2023-2032

RE Source	Capacity Additions
Hydro	348 MW
Solar	4,705 MW
Wind	1,825 MW
Biomass	200 MW
Battery Energy Storage	400 MW
Pumped Storage	1,400 MW

Source: Compiled based on CEB, 2022; LTGEP, 2022.

Owing to the prevailing financial capacity of the government and the CEB, financing for the investments required is expected to be raised from diverse sources. The LTGEP considers sources such as individual private funding, joint ventures, public-private partnerships (PPP), government-to-government (G2G) facilities, green bonds, and other foreign sources. Hence, the timely implementation

9 Ceylon Electricity Board. (2023). CEB Generation Plan. *Long Term Generation Expansion Plan (LTGEP) 2023-2042.* Retrieved July 20, 2023, from Ceylon Electricity Board: *https://www.ceb.lk/publication-media/planing-documents/121/en*

of these plans depends on attracting external funding. Any implementation delay would incur supplementary power purchasing at a higher cost. According to the CEB, offering a grace period longer than its construction period also contributes to implementation delays of large power plants. Other uncontrollable risk factors of realising the base case plan for RE are hydrological conditions that affect hydropower generation and variation in supply and demand.

The last five-year annual average expenditure on thermal fuel oil was roughly LKR 41 Bn.

11.2.2 Current Status of Sri Lanka's RE Sector

In 2021, the RE composition in the electricity generation mix was nearly 51%, with the main contributor being hydro generation (33.7%) and other renewable energy (ORE) generation (17.5%).[10] The share has varied with the hydrological conditions and ORE capacity additions over time (Figure 11.2a). Hence, the average cost of a unit of electricity in Sri Lanka depends on the hydrological conditions and the global fuel price owing to its energy mix. The unit cost of electricity varies among different energy sources (Figure 11.2b). The least cost is reported for hydroelectricity followed by coal, for which Sri Lanka has reached its potential limits. The highest cost is reported for thermal fuel electricity, for which Sri Lanka needs the least cost options. Nearly, 16-34% of the electricity was generated from fuel oil during the 2017-2021 period. The last five-year annual average expenditure on thermal fuel oil was roughly LKR 41 Bn. The suppliers are the independent power producers (IPPs) and the CEB-owned power plants, respectively.

Figure 11.2a
Electricity Generation Source

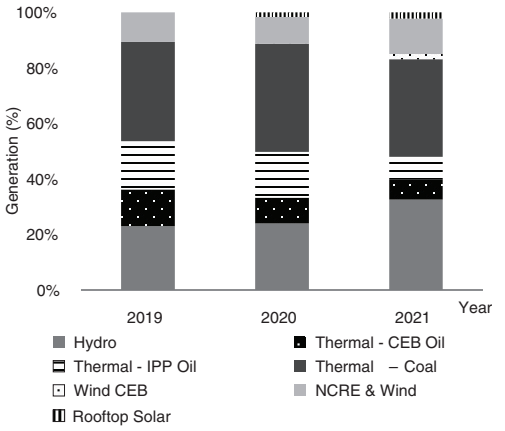
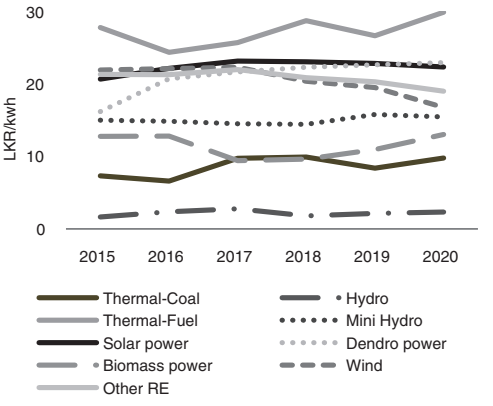


Figure 11.2b
Unit Cost of Electricity



Source: Authors generated these Figures from CEB Sales and Generation Data Books (2015-2021).

10 Ceylon Electricity Board. (2021). *Annual Report 2021*. Retrieved July 20, 2023, from Ceylon Electricity Board: https://www.ceb.lk/publication-media/annual-reports/123/en

The CEB has analysed four policy-constrained scenarios for the energy sector (Table 11.4). According to these, the total present value of the cost estimates and the carbon mitigation potential were more or less the same for the three scenarios. The incremental cost for carbon dioxide (CO2) reduction is estimated to be around USD 34/CO2 Ton, while the High Voltage Direct Current (HVDC) scenario shows a lower value (USD 29.95/CO2 Ton) owing to energy imports from India. The current LTGEP is based on the base case scenario.

Table 11.4
Proposed Policy Scenarios for the Energy Sector

Scenario	Description	Total Present Value Cost (USD Mn)	Capacities
Base Case Scenario	Achieving 70% RE by 2030, maintaining 70% RE beyond 2030 and no coal fired plant additions throughout the horizon.	18,872	Renewables 13,826 MW Natural Gas 3,080 MW Coal – Battery Energy Storage Systems (BESS) 3,365 MW Pumped Storage Power Plants (PSPP) 1,400 MW
	Achieving 70% RE by 2030, attempt to further increasing RE share up to 80% by 2040 and no coal-fired plant additions throughout the horizon.	n/a	
HVDC Interconnection	Achieving 70% RE by 2030, maintaining 70% RE beyond 2030, no coal-fired plant additions throughout the horizon and considering cross-border interconnection with India.	18,883 - 19,024	Renewables 13,826 MW Natural Gas 2,680 MW Coal – BESS 3,365 MW PSPP 1,400 MW HVDC 500 MW
Nuclear Power Development	Achieving 70% RE by 2030, maintaining 70% RE beyond 2030, no coal-fired plant additions throughout the horizon and considering nuclear power development beyond 2040.	18,986	Renewables 13,826 MW Natural Gas 2,580 MW Coal – BESS 3,365 MW PSPP 1,400 MW Nuclear 600 MW

Source: Ceylon Electricity Board. (2022). *CEB Generation Plan. Long Term Generation Expansion Plan (LTGEP) 2023-2042.* Retrieved July 20, 2023, from Ceylon Electricity Board: https://www.ceb.lk/publication-media/planing-documents/121/en.

11.3 Transitioning to an Optimum Energy Mix

Countries have mostly optimally utilised conventional RE sources such as hydropower and biomass in their energy mix, considering the low cost, maturity of technologies, and self-reliance. However, the capacity of these energy sources alone is inadequate to meet the rising energy demand while meeting the climate pledges and NZE targets. Hence, investments in non-conventional RE (NCRE) technologies such as solar, wind, wave, and geothermal were enhanced, considering the abundance of those in many parts of the world. Solutions are developed with the progress of technologies to overcome energy curtailments owing to oversupply. RE technologies are still developing to improve stability and efficiency through smart grids and storage facilities. Indeed, the cost of producing a unit of energy has declined over time the diffusion rate is rising.[11]

Recent RE development of solar photovoltaics, wind, and the early development of hydropower technologies generate energy in the form of direct electricity,[12] which is the most acceptable form of modern energy. However, nearly one-fifth of the world's energy consumption is in the form of electricity. Therefore, incorporating RE in other energy-intensive sectors, such as transport and heating, is vital to enhance RE use in a wide range of sectors.

According to the NZE targets, green hydrogen produced from water using RE is considered a potential clean energy source in the future. It is also at its initial development stages in many countries. Nuclear energy (NE) is considered a stable, cheap, clean, and climate-friendly energy source. However, countries such as Germany, which has been using it for over 60 years, have completely moved away from NE by 2023, considering the potential high risk to people and the environment, which would exist for generations. The possible risks of plant accidents and radioactive waste management, finding waste disposal sites,[13] and reliance on Russia for Uranium were some of the greater concerns of the German government, prompting a move for more coal energy and plans for expanding safe RE sources such as wind and solar in the energy mix. Similarly, countries such as Denmark, Italy, Austria, and Switzerland have moved away from NE. Still, countries like the UK, Ukraine, the US, Japan, China, Finland, and France are expanding their NE capacities due to its advantages, such as being a climate-friendly, safe, and affordable energy source.[14] The World Nuclear Association (WNA) considers NE a low-carbon, resilient and affordable energy source that can support economies in post-COVID recovery and recommends including it in energy transition plans and policies.[15] However, NE as a safe and socially acceptable RE source remains questionable since it is evaluated based

11 Ang, T., Salem, M., Kamarol, M., Das, H. S., Nazari, M. A., & Prabaharan, N. (2022). A Comprehensive Study of Renewable Energy Sources: Classifications, Challenges and Suggestions. *Energy Strategy Reviews,* 43, 100939: https://doi.org/10.1016/j.esr.2022.100939

12 International Energy Agency. (2022). *Fuel and Technologies: Renewables.* Retrieved from July 20, 2023, from International Energy Agency: https://www.iea.org/fuels-and-technologies/renewables

13 This section draws from information accessed July 20, 2023, from World Nuclear Association: https://world-nuclear.org/information-library/nuclear-fuel-cycle/nuclear-waste/storage-and-disposal-of-radioactive-waste.aspx

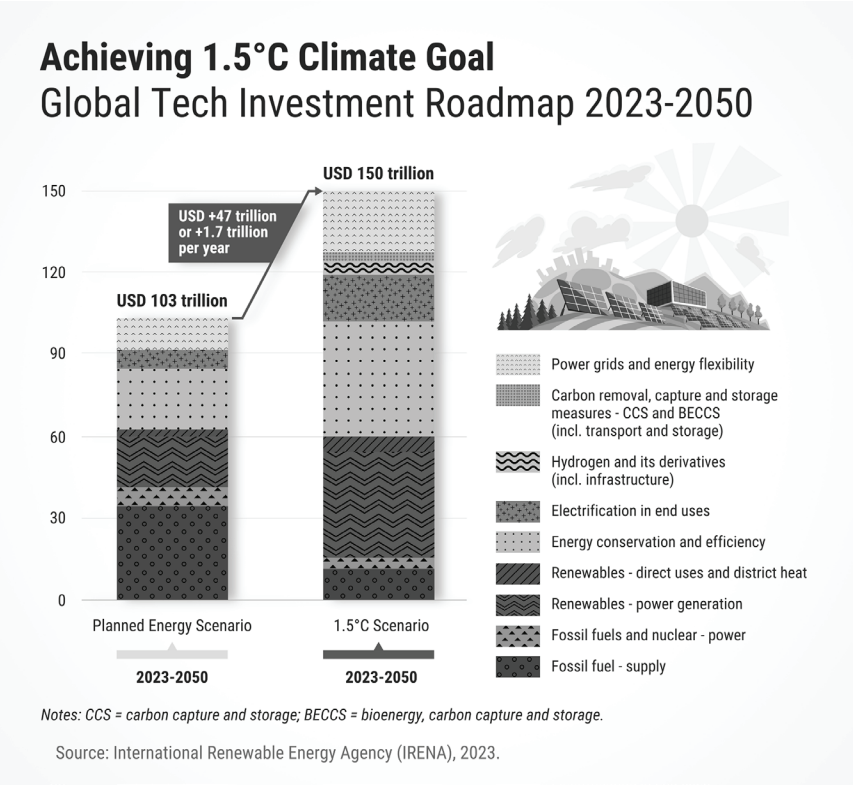
14 CNN. (2023). *'A New Era': Germany Quits Nuclear Power, Closing its Final Three Plants.* Retrieved July 20, 2023, from CNN: https://edition.cnn.com/2023/04/15/europe/germany-nuclear-phase-out-climate-intl/index.html

15 World Nuclear Association. (2020). *Building a Stronger Tomorrow: Nuclear Power in the Post-pandemic World.* Policy Papers. Retrieved July 20, 2023, from World Nuclear Association: https://world-nuclear.org/getattachment/Our-Association/Publications/Policy-papers/Building-a-stronger-tomorrow/building-a-stronger-tomorrow-report-061020.pdf.aspx.

on the precautionary principle, while the WNA requests policymakers and regulators to go by an all-hazards approach where both costs and benefits to society are weighed.[16]

Increasing the RE share in the energy mix, especially in electricity generation, is central to meeting the emission targets in the Paris Climate Agreement of 2015. Therefore, countries are adopting different policy measures to expedite RE deployment to reach emission targets by 2030. According to the International Renewable Energy Agency (IRENA), the energy transition is off track. It falls short of the 1.5^{0} C pathway, leading to emission gaps in NDC and NZE targets.[17] It further states that most of the climate pledges are yet to be translated into national strategies and plans and need to be implemented through policies and regulations while sufficient funding is required.

The total investments required to achieve the 1.5^{0}C scenario and the planned investment are illustrated in Infographic 1. However, new capacity additions in the energy sector are predominantly RE from 2020 to 2022, with more than 80% of the energy installations. Moreover, these investments are confined to a few countries and a few technologies, such as solar PV and wind, while the investment is around one-third of the required. The IRENA highlights the necessity to extend funding for other technologies such as biofuel, geothermal, and hydropower. Moreover, funding for other energy-consuming sectors, such as transport and heating, for more RE investments is identified as vital.



Notes: CCS = carbon capture and storage; BECCS = bioenergy, carbon capture and storage.

Source: International Renewable Energy Agency (IRENA), 2023.

16 World Nuclear Association. (2021). *Recalibrating Risk Putting Nuclear Risk in Context and Perspective.* Retrieved July 20, 2023, from World Nuclear Association: https://world-nuclear.org/getmedia/bdfff1aa-1a50-4793-9362-a95119b2307d/recalibrating-risk-report.pdf.aspx.

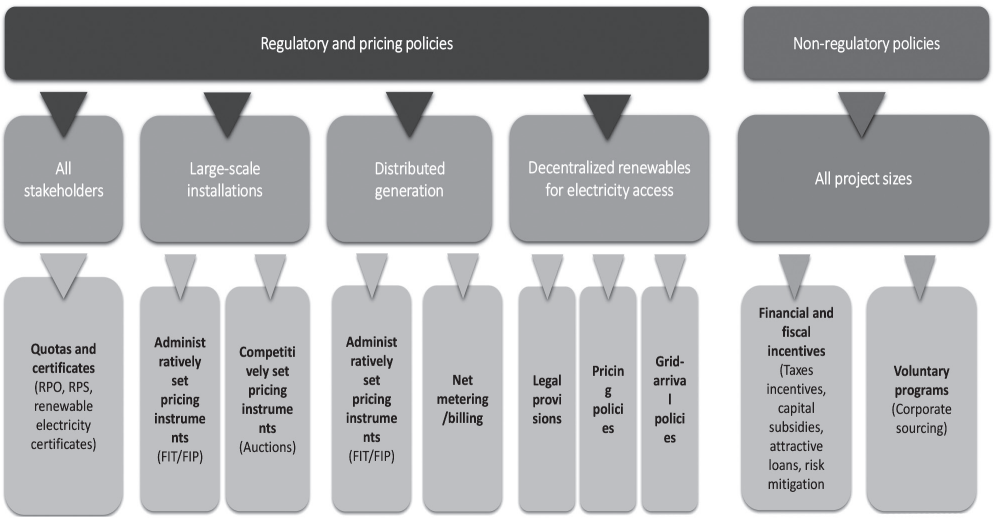
17 IRENA. (2023). *Review of the Forthcoming Report of World Energy Transitions Outlook 2023: 1.5°C Pathway.* Retrieved July 20, 2023, from IRENA: www.irena.org/publications.

Supporting policies were in place for RE diffusion in most developed countries even before the 1980s to operate at niche market levels. Later, since around 2000, many developing countries also introduced RE-promoting policies due to a plummeting in the cost of solar photovoltaic (PV) and wind technologies.[18] However, the effectiveness, equity, and economic efficiency of these policies are not yet well understood with limited empirical evidence, especially in developing countries. Therefore, choosing the RE sector policy instruments is key for developing countries for an effective transition.

11.3.1 RE Policy Instruments: Auctions Vs. Feed-in Tariffs (FITs)

RE targets in the sector motivate investments. These targets are translated into actions through supportive policies. Power sector policies can be categorised into two: regulatory and pricing policies and non-regulatory policies (refer Figure 11.3).[19] The types of policies also evolve with the type of technology, maturity of the technology, scale and cost reduction. Quotas and certificates are used to regulate the scale of production. For solar PV, fixed FITs with assured grid connectivity were used initially. Later, with technology maturity and cost reductions, large-scale installations were supported by auctions. Additionally, more decentralised and small-scale applications such as rooftop solar are scaled up when supportive policies are available. Non-regulatory policies such as financial and fiscal incentives and voluntary programmes also play a vital role in the sector.

Figure 11.3
Classification of Power Sector Policies



Note: FIT and FIP denote Feed in Tariff and Feed in Premiums, respectively.

Source: IRENA, IEA and REN21. (2018). *Renewable Energy Policies in a Time of Transition*. Abu Dhabi and Paris: IRENA, OECD/IEA and REN21.

18 Bersalli, G., Menanteau, P., & El-Methni, J. (2020). Renewable Energy Policy Effectiveness: A Panel Data Analysis Across Europe and Latin America. *Renewable and Sustainable Energy Reviews,* 133, 110351.

19 IRENA, IEA and REN21. (2018). *Renewable Energy Policies in a Time of Transition*. Abu Dhabi and Paris: IRENA, OECD/IEA and REN21.

Around 2,963 RE policies are recorded worldwide in the IRENA policy database. Those come under ten policy types, namely: payments, finance, and taxation (403), payments and transfers (326), targets, plans and framework legislation (173), regulation (158), grants (155), strategic plans (136), Feed-in Tariff (FIT) premiums (105), performance-based payments (103), taxes, fees and charges (83), and finance (66). Policy types vary among countries and among technologies. For example, India has 79 types of policies for the RE sector, while China has 147. Most policies are for solar PV, solar, and wind. This is owing to the increased adoption of these technologies due to maturity and cost reduction. Table 11.5 shows the strengths and weaknesses of different policy instruments used in the RE sector.

Table 11.5
Strengths and Limitations of Renewable Power Policy Instruments

Technology	Strengths	Limitations
Targets for medium or long term	Provide clear direction and signals to consumers and the industry.	Highly dependent on continued political commitment. Not effective on their own, need policy measures for implementation.
Quotas and obligations (e.g. RPS, RPO, RO)	Help enforce mandatory and binding targets by assigning an entity responsible for achieving them. Can be scaled up by starting with a low percentage and then increasing year on year.	Require monitoring and compliance measures and a system for penalising shortfall. In most cases, must be tied to a system of tradable certificates and other mechanisms.
Tradable certificates	Market-based mechanisms that provide additional revenue to generators	Require compliance and enforcement mechanisms for a functional market.
Administratively set pricing instruments (FIT)	Limited risk of developers. Suitable for markets with low level of renewable energy development and for small-scale projects. Hedge against energy and electricity price volatility by introducing fixed-price supply into electricity supply mix.	Complexity of tariff setting and adjustment, especially when cost structures change dynamically. Challenges associated with market integration as the share of variable renewables increases.

Technology	Strengths	Limitations
Administratively set pricing instruments (FIP)	Enable market integration of renewable energy. Provide incentives to produce electricity when supply is low.	Risky for generators when the electricity market price is low and risk of windfall profits when the market price is high (without floor and cap). May impose additional costs on producers, including transaction, balancing, forecasting and scheduling.
Competitively set pricing instruments (auctions)	Flexibility in design and potential for real price discovery.	Risk of underbidding and driving small/new players out of the market.
Net metering/billing	Can deliver savings both to the end-consumer and the system as a whole. Help reduce transmission and distribution losses, congestion, and peak demand of the system.	May jeopardise a system's cost recovery and create cross-subsidisation among those customers who self-consume and those who do not in case distributed generation levels are high. Risk that retail tariffs do not accurately reflect the actual value of electricity at each location and time period.
Financial incentives (e.g. grants, tax credits, investment subsidies)	Increase the affordability of technology and can help address higher capital costs barrier	Support levels can be subject to frequent changes due to shifting political priorities. Does not always relate to the quantity of electricity produced.
Voluntary programmes	Enable development at no involuntary additional cost to the government or consumers	Require awareness programmes. Not necessarily factored in the planning.

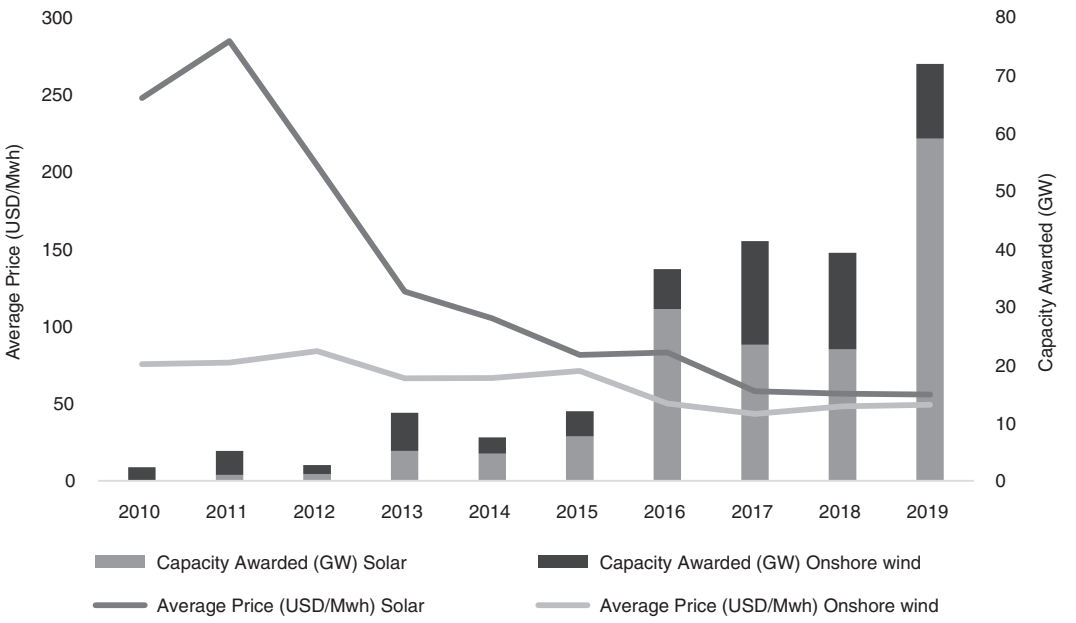
Source: IRENA, IEA and REN21. (2018). *Renewable Energy Policies in a Time of Transition*. Abu Dhabi and Paris: IRENA, OECD/IEA and REN21.

Auctions can be used to achieve other policy objectives other than a low price.

The most widely used policy instruments in the RE sector are FIT systems and auctions. From 2005 to 2017, FIT was widely used while auctions were gradually adopted by countries for large projects, especially with the development of solar PV and wind power technologies and their increasing cost competitiveness. The main advantage of a FIT system is offering a stable income for the generators and the bankability of RE projects. However, the most challenging part is finding the right tariff level due to information asymmetry. An inefficient tariff can discourage generators when it is set at a lower rate, while a higher rate can affect the consumers and the government.

According to IRENA, currently, auctions are the most widely used policy instrument in the RE sector over FIT systems (Figure 11.4). Accordingly, nearly 97% of solar PV and wind technologies was auctioned in more than 50 countries in 2017 and 2018. Nearly half were newcomers, including African and Central and West Asian countries.

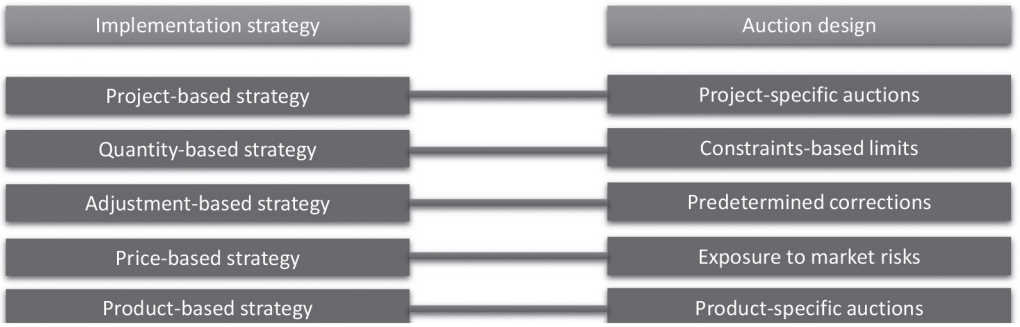
Figure 11.4
Global Trends in RE Auctions



Source: IRENA. (2023). *Data.Policy, Renewable Energy Auctions.* Retrieved July 20, 2023, from IRENA: https://www.irena.org/Data/View-data-by-topic/Policy/Renewable-Energy-Auctions.

Auctions can be used to achieve other policy objectives other than a low price. For example, auctions can incorporate criteria for timely completion, integrating wind and solar power and facilitating a just and inclusive transition. However, more strict guidelines would hinder the participation of small-scale producers and, thereby, the inclusiveness of the objective. Therefore, at the auction designing phase, inclusion of small and newcomers, job creation and community development can be considered. These can be incorporated by setting local content requirements and winner selection approaches, as adopted by countries like Morocco and South Africa. Figure 11.5 shows the implementation strategies and relevant auction designs described by IRENA.

Figure 11.5
Implementing Strategies and Relevant Auction Designs

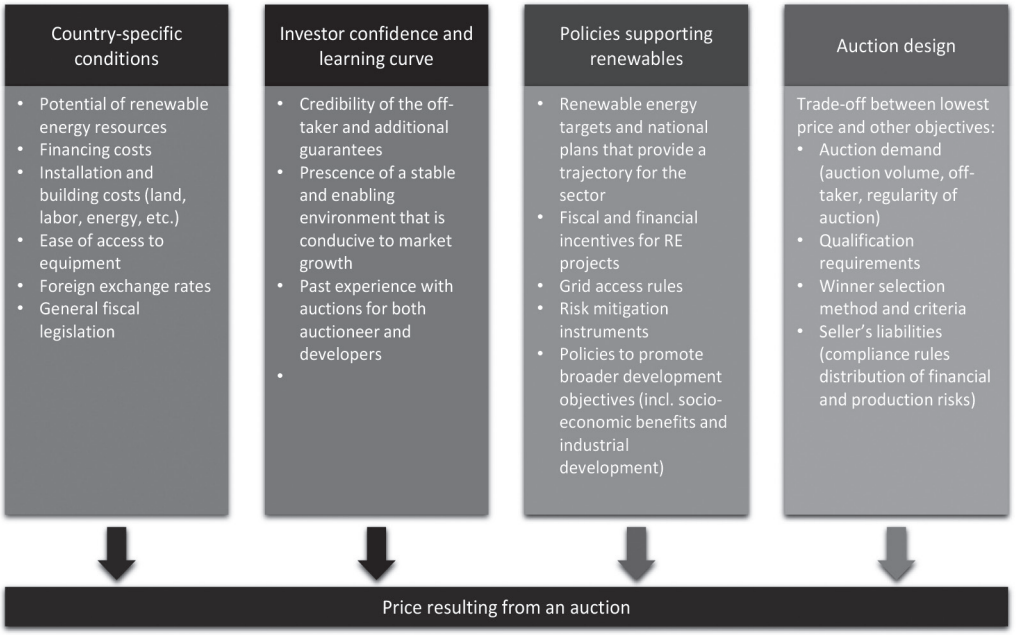


Source: IRENA,2019. Renewable energy auctions: Status and trends beyond price.

Although auctions are known to be effective in achieving a wider range of objectives, risks are associated with the auction process too. It can be at the bidding stage with fewer bidders to assure competition, at the contracting stage due to underbidding or under contracting, underbidding at the construction stage, or deviations from the objectives at the operational stage.

Figure 11.6 shows the factors affecting prices generated from auctions. These are categorised into four, namely: country-specific conditions, investor confidence, supporting policies, and auction design.

Figure 11.6
Factors Affecting Prices from Auctions



Source: IRENA,2019. Renewable energy auctions: Status and trends beyond price.

11.3.2 Comparative Country Contexts

Assessments on RE policies, in particular for developing countries, are limited. Among developing countries, Central and South America and African countries are progressing ahead of South Asian countries in RE deployment. RE policies can be evaluated based on four criteria, namely: effectiveness, efficiency, equity and institutional feasibility.[20]

Among developing countries, Latin American countries took the initiative in adopting promotion policies. A comparative study of 20 Latin American and 30 European Union (EU) countries over 20 years has shown that public promotion policies are positively and statistically significant in RE investment.[21] Other than supporting policies, the structure and dynamics of energy markets, macroeconomic factors, and institutional and political factors influence RE diffusion in countries. Policy effectiveness was stronger in the EU than in Latin America, attributed to the temporal difference in policy implementation and selection of policy instruments.

20 Po, K. (2014). *Evaluating Renewable Energy Policy: A Review of Criteria and Indicators for Assessment.* Retrieved July 20, 2023, from IRENA: https://www.imperial.ac.uk/media/imperial-college/research-centres-and-groups/icept/Evaluating_RE_Policy.pdf

21 Bersalli, G., Menanteau, P., & El-Methni, J. (2020). Renewable Energy Policy Effectiveness: A Panel Data Analysis Across Europe and Latin America. *Renewable and Sustainable Energy Reviews,* 133, 110351.

Tax incentives alone were insufficient for an effective RE deployment, evident from a few Latin American countries. Auctions were the main instrument in Latin America, while FIT was prominent in EU countries. But, country-specific policy measures were observed in both regions. For example, in large Latin American countries, institutional conditions were supportive in implementing auctions while FIT was prominent in smaller economies. Similarly, some EU countries adopted auctions. Brazil and Argentina adopted FIT and moved to auctions as FIT was unsuccessful. Indeed, Brazil is a pioneer in successfully implementing systematic auctions as a policy instrument in the energy sector, with many improvements from time to time.[22] Thus, supportive policies such as FIT and auctions are essential for RE sector investments, which reduce investment risks, while tax incentives alone are insufficient to promote RE investments. However, tax incentives can be used to complement either price or quantity instruments.

The energy sector decision making can be highly vulnerable to politicisation and rent seeking behaviour. A comparative study involving Belgium and the Netherlands has shown that RE deployment is hampered by a country's abundance of petroleum resources.[23] To address these issues, specific policy measures are required to tackle the rent-seeking by corporate vested interests, avoid rent capturing by politicians and to provide adequate incentives to diversify the sector. The magnitude of having transparent, stable, and consistent policies for the RE sector to achieve the expected outcome is noteworthy.

In the Asian context, China became a major RE player in the global market, mainly for solar PV since 2007.[24] However, China's local development was slow. A FIT system was adopted in 2011, offering long-term guaranteed purchase prices for producers that saw a successful capacity expansion from 290 MW to 77 GW by 2016. Three regions were identified based on solar irradiation and the tariff rates were adjusted based on the same, offering a lower rate for the high irradiation region. Due to the high NPV/IRR rates, installations were expedited, increasing the PV waste. Hence, the FIT was modified to include a quota system to minimise PV waste in less developed areas where the transmission lines were not connected to the consumption centres in other regions. However, the quota system was ineffective in limiting the installation capacity since the investment return rates (like NPV/IRR) rose with the declining system costs. Hence, an annual revision of tariff rates was introduced instead of the prevailing 30 months while maintaining the 8-12% IRR values. Further, new quotas were issued on par with the ultra-high voltage (UHV) transmission line expansions to prevent PV waste. The conflict with conventional energy producers is expected to rise with more solar PV penetration in the future. However, the future market is expected to be a free electricity market where producers are free to provide a flexible service. Hence, market reforms are in progress, allowing direct purchase for large-scale users and replacing the fixed prices set by the government.

22 Tolmasquim, M. T., de Barros Correia, T., Porto, N. A., & Kruger, W. (2021). *Electricity Market Design and Renewable Energy Auctions: The Case of Brazil. Energy Policy*, 158, 112558.

23 Ahmadov, A. K., & Van Der Borg, C. (2019). Do Natural Resources Impede Renewable Energy Production in the EU? A Mixed-Methods Analysis. *Energy Policy,* 126, 361-369.

24 Ye, L. C., Rodrigues, J. F., & Lin, H. X. (2017). Analysis of Feed-In tariff Policies for Solar Photovoltaic in China 2011–2016. *Applied Energy*, 203, 496-505.

Globally, India is the fifth largest generation capacity for solar PV and fourth in wind power generation in 2022.[25] Electricity is government-owned or highly regulated in India. Under the Jawaharlal Nehru National Solar Mission, India first adopted a nationwide FIT system to trigger RE development in 2010. In Gujarat, for instance, solar rooftop installation in urban areas was highly successful and exceeded the expected capacity with the rapidly declining cost of solar PV. Since the enhanced supply exceeded the grid absorption capacity, the policy direction was changed to an auction system with a fixed quantity, a form of reverse auction where suppliers offer prices to win the bid.[26] Consequently, the tariff rates dropped by 50% compared to the FIT system.

However, finding the correct tariff rate is difficult since producers do not reveal it, while high tariff rates burden the state electricity distribution companies and lower tariff rates discourage suppliers. Therefore, auctions or regulator-designed tariffs may work since it assures the payment due for suppliers. In the Indian FIT system, higher rates were offered in the first 12 years, while lower rates were proposed for the next 13 years. Thereafter, a sliding tariff rate was introduced in 2015, which was annually cut by 7% from that of the previous year. Under the same mission, a reverse auction was introduced in 2010 with a 25-year power purchase agreement which became very successful, reaching the expected capacity additions and a low price in the global price range. In addition, subsidies were offered to RE producers during the initial years. Elsewhere in India, the most popular policy instrument is auctions.

A study has been conducted among EU countries to evaluate the impact of different auction elements on achieving efficiency, which is indicated by the low prices awarded.[27] The results suggest that competition was significant. Hence, if low prices or cost efficiency is the sole objective of having auctions, policymakers should avoid limiting the auctions to small-scale suppliers and impose a ceiling price. Solar PV is recommended for small-scale projects, while on-shore wind is recommended for large-scale project auctions. The study also found that quotas tend to increase the price.

11.3.3 RE Policy Discussions in Sri Lanka

Sri Lanka is currently in the process of expediting RE deployment through several policy revisions and initiatives. The near-term goal is to meet the climate pledges by 2030, as indicated in the NDCs. The country is attempting to explore external funding from various sources to fill the financing gaps for necessary investments in generation and transmission. Among those, the Asian Development Bank (ADB), the World Bank (WB), and Japan International Cooperation Agency (JICA), and United States Agency for International Development (USAID) are assisting with the power sector reforms, a prerequisite for IMF funding for the country's economic recovery. JICA has assisted in forming the

25 IRENA. (2023). *Data. Capacity and Generation, Country Rankings*. Retrieved July 22, 2023, from https://www.irena.org/Data/View-data-by-topic/Capacity-and-Generation/Country-Rankings

26 Asian Developement Bank. (2021*). Feed-In Tariffs Vs. Reverse Auctions: Setting the Right Subsidy Rates for Solar. Development Asia.* Retrieved July 22, 2023, from Asian Development Bank: https://development.asia/insight/feed-tariffs-vs-reverse-auctions-setting-right-subsidy-rates-solar

27 Anatolitis, V., Azanbayev, A., & Fleck, A. K. (2022). How to Design Efficient Renewable Energy Auctions? Empirical Insights from Europe. *Energy Policy,* 166, 112982.

CEB reform secretariat and a transition plan will be delivered in 2024. Meantime, the country is in the process of passing a new electricity Act for institutional reforms in the power sector.

Discussions are underway on regional grid integration with India using a marine cable by 2030. The WB is providing technical and business expertise to the CEB in this process. However, this would first facilitate imports, while future expectations deal with imports and exports. The EU has implemented an integrated network of power among its member states. Similarly, possibilities have been identified for the South Asia region. India involves in cross-border power trade with Nepal, Bhutan and Bangladesh.[28] In the SAARC region, Sri Lanka's electricity prices are similar on average but slightly below the prices in Pakistan and India while considerably above those of Bhutan, Bangladesh, and Nepal (Figure 11.7a). The world median price lies between the prices in the US and China, which are lower than the Sri Lankan prices (Figure 11.7b).

Figure 11.7a
Electricity Prices in the SAARC Region

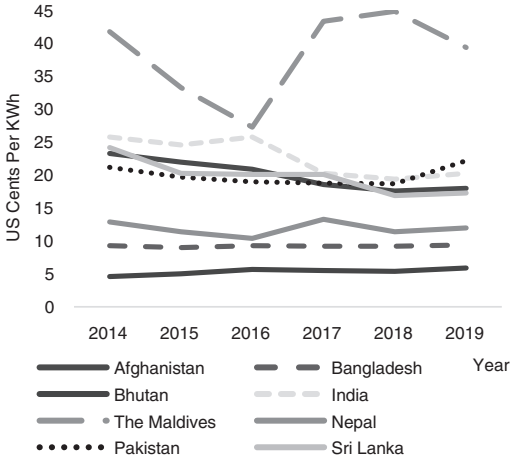
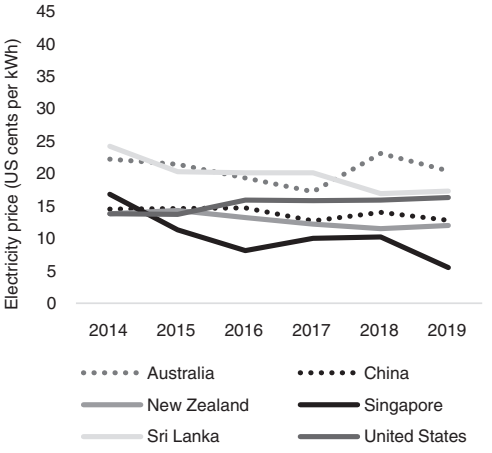


Figure 11.7b
Electricity Prices in Selected Countries



Source: World Bank. (2023). *Price of Electricity (2014-2019).* Retrieved July 10, 2023, from World Bank: https://data.worldbank.org/.

Additionally, Sri Lanka is negotiating with the Indian investors for large-scale RE projects for solar PV and wind, which are facilitated by the electricity amendment Act to remove the existing ceiling. Local investors are also encouraged in the process. The current procurement procedure is auctions/ competitive bidding, which facilitates an efficient pricing mechanism. A FIT is adopted for rooftop solar provided by small-scale producers at the household level. However, considering the country's economic status, most of the investments so far are in the form of government-to-government, mainly with India and one project with Korea for floating solar. The LTGEP and the CPP have considered options for benefitting from other innovative financing mechanisms available for Sri Lanka globally.

28 Alam, F., Chattopadhyaya, S., Chowdhury, H., Ahsan, S., Tasneem, Z., Hossain, A., ... & Hoque, E. (2022, November). *Collective Energy Security, Economic Prosperity and Mitigation of Climate Change in South Asia*. In AIP Conference Proceedings (Vol. 2681, No. 1). AIP Publishing.

Apart from these, there are hindrances to be addressed. At the implementation stage, delays are encountered in getting approval for RE projects, given the involvement of several government institutions such as the Central Environmental Authority, the Department of Forest Resources and Wildlife, the Ministry of Lands, the Department of Archaeology, etc. Further, the lack of parallel transmission infrastructure development is a limitation in absorbing the power to the grid. These procedural delays have already been identified and the relevant authorities have made suggestions.

11.4 Recommendations for Policy Action

The main issues in the RE deployment in Sri Lanka are implementation delays, insufficient parallel infrastructure development, a monopoly market structure, transparency, financing gaps, lack of awareness, and technical expertise. Selecting the correct and safe energy mix is equally important. For example, the NE scenario of the LTGEP needs technical expertise, lead time for plant establishment, a feasible location, social acceptance and risk factors which can be detrimental to a small economy.

Capacity building of government officials in the relevant institutions to source funding is important to exploit such opportunities for climate finance, green bonds, and emission trading.

Energy sector reforms are being identified as crucial for developing a free market structure for electricity and other energy-consuming sectors, such as transport and industries, to operate as sustainable institutions. This is recommended by the IMF and is being implemented by the government. Moreover, this is vital to expedite the RE deployment constrained by implementation delays in generation and transmission expansion plans. The CEB has included RE targets in the LTGEP in compliance with climate pledges in 2030 and considered developing a transmission expansion plan to absorb the RE. Unbundling of electricity sector functions would facilitate solving most of the inefficiency and financing issues. For instance, Brazil took measures to operate transmission and distribution functions as natural monopolies with open access to stakeholders.

Financing the expected RE development through various local and international sources is crucial for the timely implementation of the RE targets. This is highlighted in LTGEP and the CPP of Sri Lanka. Currently, Sri Lanka is expediting its efforts to attract foreign investors for RE investments. Besides the energy sector, RE usage in the transport and industry sectors is also potentially facilitated through private and external funding and incentives. Capacity building of government officials in the relevant institutions to source funding is important to exploit such opportunities for climate finance, green bonds, and emission trading.

Making institutions responsible for implementing the relevant commitments is important for the effective and timely implementation of plans. Various strategies need to be implemented to increase RE deployment. For example, off-grid solar is a successful solution for enhancing electricity access when the transmission capacity is underdeveloped. It enhances the inclusion of various segments of

society, extending a wider benefit. Providing or encouraging using of battery storage in households would minimise energy curtailment and assist in peak shaving. If the suppliers are paid higher tariff rates to supply during the peaks, more households would invest in storage facilities. Further, rooftop solar saves land, which is an increasingly limited resource in the country, and saves the ecosystems.

Environment licensing and getting approval from various institutions would be strenuous and discourage investors and incur additional implementation delays. If this process could be facilitated by a single department of a responsible institution such as the SEA or through a committee with the participation of relevant authorities, the efficiency of the process would improve.

Public awareness of RE technologies and technical expertise for stakeholders/key actors and skill development through relevant educational institutions such as Technical and Vocational Education and Training (TVET) is essential for carrying out proper maintenance, installation, and other relevant activities through skilled employees. Recycling and RE waste management are other developments. The international job market is expanding for RE sector professionals to which Sri Lanka can cater.

Sri Lanka is adopting auctions for RE projects other than G2G options. Hence, offering technology-based and scale-based auctions and enhancing competition would provide reasonable consumer prices (efficient) while enhancing inclusion. Good governance and transparency are vital to minimise rent-seeking in RE investments.

Sri Lanka being a RE-abundant and fossil fuel-dependent country, expanding the RE capacity would yield multiple benefits amidst its current economic status. The present plans include adequate capacity additions to reach a 70% RE target by 2030 in the electricity mix. However, private and international funding and technical expertise need to support financing and technical gaps. The climate pledges, SDG 7 and NZE scenarios have highlighted the importance of assisting developing countries where energy poverty and energy scarcity have become critical for livelihoods and development. For example, out of the 25% emission reduction targets by 2030, 20% of the emission reduction depends on external assistance.

12. Genetically Modified Organisms (GMOs): The Answer to Food Security?

12.1 Introduction

Amid Sri Lanka's worst economic crisis, nearly 3.9 million (Mn) people (17% of the population) are considered to be moderately food insecure,[1] and poverty is projected to remain at over 25% in the coming years (as measured at United States Dollars [USD] 3.65 per capita, 2017 purchasing power parity).[2] The world is in a permacrisis and the global supply chain crunch marginalises developing countries. Aside from global food price inflation, Sri Lanka's food insecurity was exacerbated by restrictions on food imports, a sharp drop in agricultural production owing to a rash fertiliser ban and shortages, as well as depleting household income from job and income losses. The risks of undernourishment and malnutrition, especially in young children, have risen as a result.

With over 80% of its food requirements being produced domestically, Sri Lanka's domestic food production sector plays the main role in addressing food security in the country. The domestic food production sector is dominated by paddy, with other field crops such as cereals, tubers and pulses (potatoes, manioc, sweet potatoes), oil crops (soya beans, ground nuts) and condiments (onions, chilli) being important commodities in terms of food security. Notwithstanding the drop in crop production owing to a haste fertiliser ban, Sri Lanka's agriculture sector does suffer from wide variations brought on by climate changes (floods and droughts), and pest and disease-related challenges. A scarcity of land and other resources means the only possibility of boosting productivity is by improving agriculture inputs using modern agriculture technology.

With over 80% of its food requirements being produced domestically, Sri Lanka's domestic food production sector plays the main role in addressing food security in the country.

In this context and as highlighted in international literature, genetically modified organisms (GMOs) – plants, animals, and microbes – can support food security through increased crop yields, enhanced nutritional content, and improved resistance to pests, diseases, and environmental conditions.[3] Genetic modifications create crops (also known as biotechnology or transgenic crops) that are more resistant to drought, require fewer pesticides, or have enhanced nutritional profiles, which can benefit

1 Food and Agriculture Organization and World Food Programme. (2023). *Special Report: FAO/WFP Crop and Food Security Assessment Mission (CFSAM) to the Democratic Socialist Republic of Sri Lanka.* Retrieved June 5, 2023, from https://reliefweb.int/report/sri-lanka/special-report-faowfp-crop-and-food-security-assessment-mission-cfsam-democratic-socialist-republic-sri-lanka-25-may-2023-0

2 World Bank. (2023). *Sri Lanka Development Update: Time to Reset.* Retrieved June 2, 2023, from World Bank : https://thedocs.worldbank.org/en/doc/64a39c836b5aff415ca339ae14a1afbc-0310062023/original/Sri-Lanka-Development-Update-April-2023-final.pdf

3 Food and Agriculture Organization. (2002). *The Process of Genetic Modification*. Retrieved March 10, 2023, from Food and Agriculture Organization: https://www.fao.org/3/Y4955E/y4955e06.htm#TopOfPage

producers and consumers. Genetically modified (GM) crops grown are specially developed to help farmers prevent crop losses, with the value of genetic modification in agronomy already being widely accepted worldwide. Today, the area cultivated with GM crop species exceeds 190 Mn hectares (Ha) worldwide, justifying a marked 112-fold increase in cultivated areas between 1998-2018, with the cultivated areas increasing annually.[4] With this development, nearly 45 countries so far have provided approvals for GM crops.[5]

Despite the many apparent benefits, there is continued debate on GMOs. Some argue that GMOs generate health risks, including toxicity, allergenicity, genetic hazards, and unintended environmental and ecological consequences. It is argued that GM seeds create 'super-weeds' and 'super bugs' over time that become resistant to herbicides and pesticides, as well as risks of antibiotic resistance.[6] Further, the risks can spread as GM technologies become public goods that can easily be reproduced. Apart from these, issues of equity and equality can emerge. For instance, smallholder farmers in developing countries who do not have protection for their plant varieties and with weak contractual agreements may be adversely affected if multinational companies (MNCs) dominate biotechnology and related international proliferation of intellectual property rights (IPRs). There could be issues with income distribution among farmers too. Overall, the impacts of GMOs will depend on the institutional setting, including farmers' access to suitable seed varieties, credit, information, and other input and output markets.

In Sri Lanka too, intense discussions and debates have been ongoing regarding GMOs. Indeed, it was the first country in the world to ban GMO imports, as far back as 2001. However, in 2006, the ban was lifted with a labeling requirement if products contained 0.5% or more (of the volume) of GMOs. The GMO content in a product was revised to 0.9% or more in June 2023 in order to comply with the labeling requirement. Several policy-related steps such as conducting risk assessment, approvals of competent authority etc., were also taken. In 2005, the Ministry of Mahaweli Development and Environment formulated a National Biosafety Framework and the National Policy on Biosafety, which was approved by the Cabinet of Ministers in the same year. These continue to be the present governing policies in Sri Lanka concerning biosafety. In 2014, a draft Biosafety Act was compiled, and modified in 2018, while a National Biosafety Framework 2018 was also drafted. Disappointingly, these drafts are pending enactments after a lapse of five years. The considerable delay in approving the relevant legislation appears due to insufficient technical capacity and weaknesses in the country's functional administrative and operational system.

In light of the above facts, this chapter explores the potential role of GMOs in strengthening Sri Lanka's food security options. It explains the global rise of GMOs and the status quo in Sri Lanka, while analysing the policies and strategies other developing countries adopt to maximise the benefits

4 The Royal Society. (2023, June 2)). *What GM Crops are Currently Being Grown and Where?* Retrieved March 10, 2023, from The Royal Society: https://royalsociety.org/topics-policy/projects/gm-plants/what-gm-crops-are-currently-being-grown-and-where/

5 The International Service for the Acquisition of Agri-biotech Applications. (2020). *Pocket K No.16: Biotech Crop Highlights.* Retrieved March 10, 2023, from Isaaa Inc: https://www.isaaa.org/resources/publications/pocketk/16/#:~:text=Pocket%20K%20No.,million%20farmers%20in%2029%20countries.

6 Zhang, C., Wohlhueter, R., & Zhang, H. (2016). Genetically Modified Foods: A Critical Review of their Promise and Problems. *Food Science and Human Wellness, 5*, 116–123.

of GMOs. After assessing the GMO-related policy discussions in Sri Lanka, the chapter provides some policy recommendations to enhance the use of GMOs in the domestic agriculture sector.

12.2 The Global Rise of GMOs

Also named Living Modified Organisms (LMOs) or Transgenic Organisms, GMOs are produced by using modern biotechnological tools, gene technology or with the support of recombinant Deoxyribonucleic acid (DNA) technology. The genetic material (DNA/gene) in a plant, animal or microorganism is altered in a manner that does not happen in a natural environment.[7] In this process, genes can be isolated, duplicated and transferred into the DNA/gene of unrelated organisms, whereby the artificial creation of these technologies produces plants, animals, insects, and microbes. The commonly seen are GM food, GM crops, GM animal feed and GM ingredients are used for processed products. GM crops are also named transgenic crops or biotech crops, developed using biotechnology techniques. Thus, biotechnology uses living organisms or their products to modify human health and the environment.

The top five countries with the highest GM crop cultivation are the US, Brazil, Argentina, Canada, and India.

The history of genetic modifications goes back to 1944, when scientists discovered that genetic materials can be transferred between different species.[8] The same source revealed that three independent research groups produced the first GM plants (antibiotic-resistant tobacco and petunias) in 1983. After obtaining approval from the Food and Drug Administration (FDA) in the United States (US), the first GM food (Flavr Savr tomato) was introduced in 1994 to the US market. Interestingly, the tomato was the first to have been genetically modified to slow its ripening process, delaying softening and rotting. Since then, several GM food and GM crops have followed suit and entered the market.

Since its first commercialisation in 1996, the push for GM crops stemmed worldwide, perceived as providing several benefits to farmers and consumers. Presently, the top five countries with the highest GM crop cultivation are the US, Brazil, Argentina, Canada, and India. In the US, farmers use GM crops as these are specially developed to resist certain damaging insects, tolerance to certain herbicides, and resistance to some plant varieties.[9] Presently, over 90% of corn, cotton, and soybean acreage in the US is cultivated with GM seeds/crops. Indeed, more than 50% of the arable lands in the US, Brazil and Argentina grow GM crops.[10]

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7 World Health Organization. (2014, May). *Food, Genetically Modified*. Retrieved April 5, 2023, from World Health Organization: https://www.who.int/news-room/questions-and-answers/item/food-genetically-modified

8 Zhang, C., Wohlhueter, R., & Zhang, H. (2016). Genetically Modified Foods: A Critical Review of their Promise and Problems. *Food Science and Human Wellness, 5*, 116–123.

9 US Food and Drugs Administration. (2022). *Why Do Farmers in the U.S. Grow GMO Crops?* Retrieved June 7, 2023, from US Food and Drugs Administration: https://www.fda.gov/food/agricultural-biotechnology/why-do-farmers-us-grow-gmo-crops

10 The Royal Society. (2023, June 2). *What GM Crops are Currently Being Grown and Where?* Retrieved June 7, 2023, from The Royal Society: https://royalsociety.org/topics-policy/projects/gm-plants/what-gm-crops-are-currently-being-grown-and-where/

Over the past 20 years, GM crops have offered farmers in adopting nations various economic, ecological, and human health advantages.

However, in Europe, to date, only one GM crop has been approved for cultivation – an insect-resistant maize variety that is also grown in only a few countries in the region, such as Spain, Portugal, the Czech Republic, Romania and Slovakia. Further, the cultivation area in the above-mentioned countries is less than 1% of the total arable land in the respective country. Additionally, the European Union (EU) has implemented a strict regulatory system to govern the production, consumption, and importation of GM food and feed crops. Also, no GM crops have been approved so far for human consumption, such as fresh fruit or vegetables owing to perceived health and environmental risks, etc. This highlights that the debates on GMOs are ongoing and the scientific uncertainty and ethical concerns have played out differently in the EU and the US since the mid-1990s for institutional and ideological reasons.[11]

Having recognised the need to meet the increasing food demand, the debate on using GMOs produced through modern biotechnology and releasing these for commercial purposes has moved to tackling regulatory issues. The Cartagena Protocol on Biosafety was introduced in 2000 to provide a better legal framework for GMOs using biotechnology. It also aimed to protect and guide the exchange of GMOs and their use and handling while concurrently providing sufficient protection for biodiversity conservation, its sustainable use, and human health. The agreement was effected in 2003, with nearly 170 countries, including Sri Lanka, as signatories to this protocol.

Over time, several studies suggest that over the past 20 years, GM crops have offered farmers in adopting nations various economic, ecological, and human health advantages.[12] Developing countries such as India, China, Pakistan, South Africa, and the Philippines have adopted this technology expecting benefits for farmers and consumers. The regulatory system in approving, experimenting and importing approvals differs from country to country. However, the main objective of all these regulations remains intact, which is to ensure the safety of GM crops for humans, animals, and the environment.

With global population growth, rising demand for food is a persistent challenge. For most countries, it means boosting crop yields on cultivated lands or expanding the arable area. It is estimated that at present, the increase in crop yield is less than 1.7%, whereas the annual increase in yield must be around 2.4% to meet the demands of population growth.[13] In fact, the Food and Agriculture Organization (FAO) forecasts that the arable land area available for food production per person will decrease from 0.242 Ha to 0.18 Ha by 2050.[14] Therefore, the viable option is increasing productivity

11 Peterson, M., & White, P. A. (2010). *The EU-US Dispute Over Regulation of Genetically Modified Organisms.* Retrieved June 5, 2023, from International Dimensions of Ethics Education in Science and Engineering: https://scholarworks.umass.edu/cgi/viewcontent.cgi?article=1007&context=edethicsinscience

12 Azadi, H., Taheri, F., Moggaddham., S.M., Siaman, N., Goli, I.,… Witlox, F. (2022). Genetically Modified Crops in Developing Countries: Saviour or Traitor? *Journal of Cleaner Production, 371*. Retrieved June 12, 2023, from Sciencedirect: https://www.sciencedirect.com/science/article/abs/pii/S0959652622028827

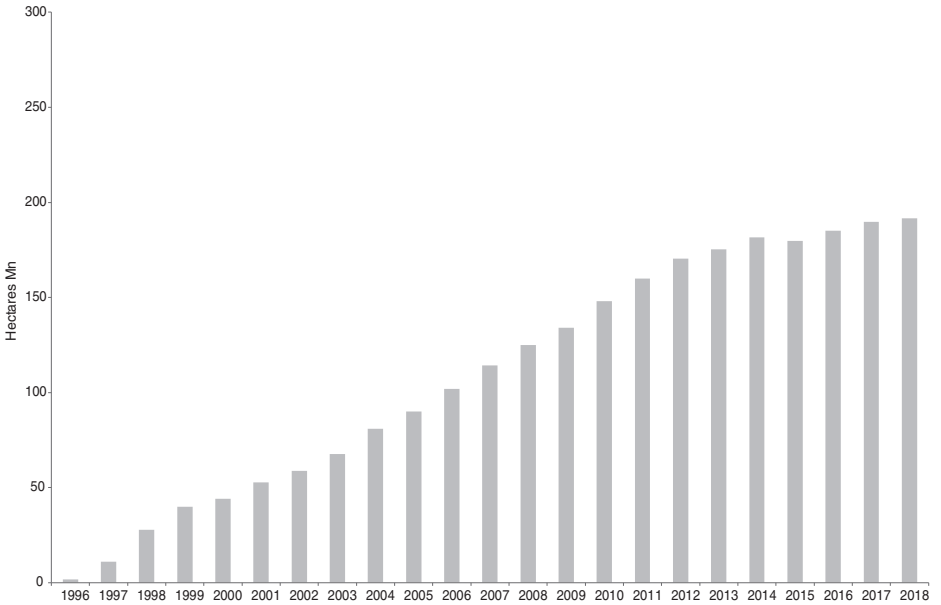
13 *Ibid.*

14 Zhang, C., Wohlhueter, R., & Zhang, H. (2016). Genetically Modified Foods: A Critical Review of their Promise and Problems. *Food Science and Human Wellness, 5*, 116–123.

for higher yields with improved agriculture inputs – fertiliser, weed and pest controls or with the genetic improvements of crops and animals.

Reflecting these changes over time, a steady increase is evident in land acreage under GM crops. For instance, the latest available data suggests that nearly 190 Mn Ha of GM crops were cultivated by almost 17 Mn farmers in 29 countries by 2018 (Figure 12.1). Indeed, giant strides with a 112-fold increase were reported in cultivated areas between 1998-2018, indicating that GM crops are the fastest-adopted crop technology in the history of modern agriculture. Nonetheless, on a global scale, the area under cultivation for GM crops has remained stagnant since 2015.

Figure 12.1
GM Crop Cultivation Area by Volume, 1996-2018



Source: Based on data from The International Service for the Acquisition of Agri-biotech Applications (2020) and The Royal Society (2023).

As mentioned previously, a handful of countries dominate GM crop production globally. Since GMO technology was first developed in the industrial world, GMO crop cultivation was initially greater in industrial countries than in developing countries. From a low base until around 2002, it reached nearly 50% growth in industrial countries before decelerating to an average of 10-20%. Industrial countries continued to dominate GMO crop cultivation until around 2012, after which such cultivation in developing countries grew faster, especially in countries such as China, India, Vietnam, the Philippines, and Colombia.[15]

15 The International Service for the Acquisition of Agri-biotech Applications. (2020). *Pocket K No. 16: Biotech Crop Highlights in 2019*. Retrieved March 10, 2023, from Isaaa Inc: https://www.isaaa.org/resources/publications/pocketk/document/Doc-Pocket%20K16-2020.pdf

The most cultivated GM crops are soybean, maize, cotton, and canola, followed by a few other crops, such as wheat, rice, papaya, banana, etc. Available data suggest that regarding global production of some of these key crops, nearly 74% of soybean, 31% of maize, 79% of cotton, and 27% of canola are generated from GM crops.[16] The popularity of GM in these crops is justified by the special features introduced to modify their gene characteristics. As mentioned, most of these crops are resistant to roundup or glyphosate herbicides. The advantage of herbicide-tolerant crops is that these can be planted and survive in a weedy field, as the weeds can be controlled with herbicide. This reduces the need for ploughing, land preparation costs, etc., which form a considerable portion of agricultural land preparation and maintenance, further adding to the food production cost. Further, insect resistance crops using Bacillus thuringiensis (Bt) toxin, which can counter harmful insects, have been introduced into many crops. Over 90% of the cotton planted in the US, India, China, Australia, and South Africa are GM varieties containing the Bt toxin gene.[17]

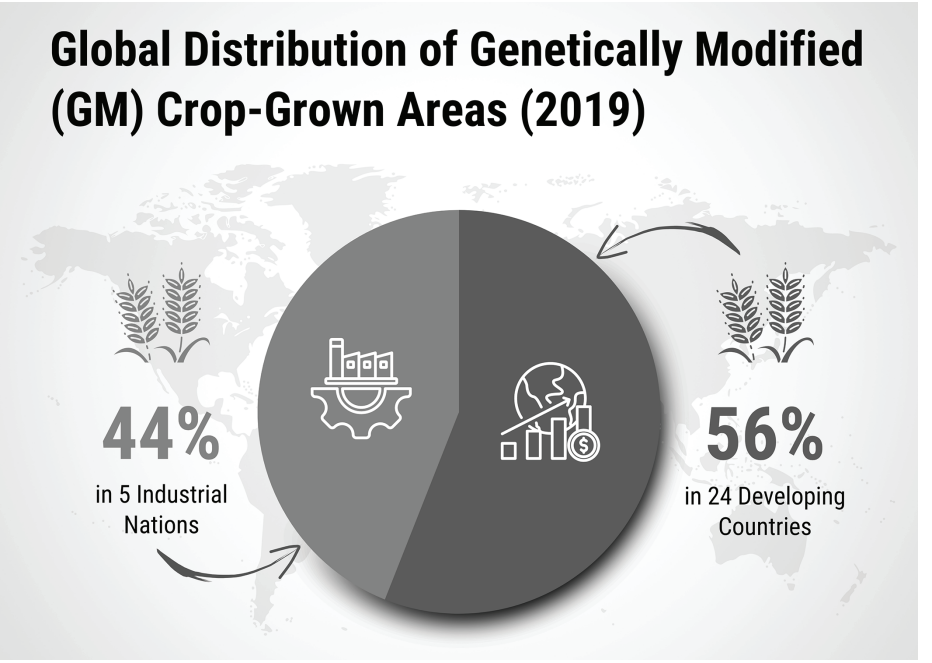
Figure 12.2
World Map of GM Crop Cultivation



Source: The Royal Society. (2023). *What GM Crops Are Currently Being Grown and Where?* Retrieved June 10, 2023, from The Royal Society: https://royalsociety.org/topics-policy/projects/gm-plants/what-gm-crops-are-currently-being-grown-and-where

16 The International Service for the Acquisition of Agri-biotech Applications. (2020). *Pocket K No. 16: Biotech Crop Highlights in 2019*. Retrieved March 10, 2023, from Isaaa Inc: https://www.isaaa.org/resources/publications/pocketk/document/Doc-Pocket%20K16-2020.pdf

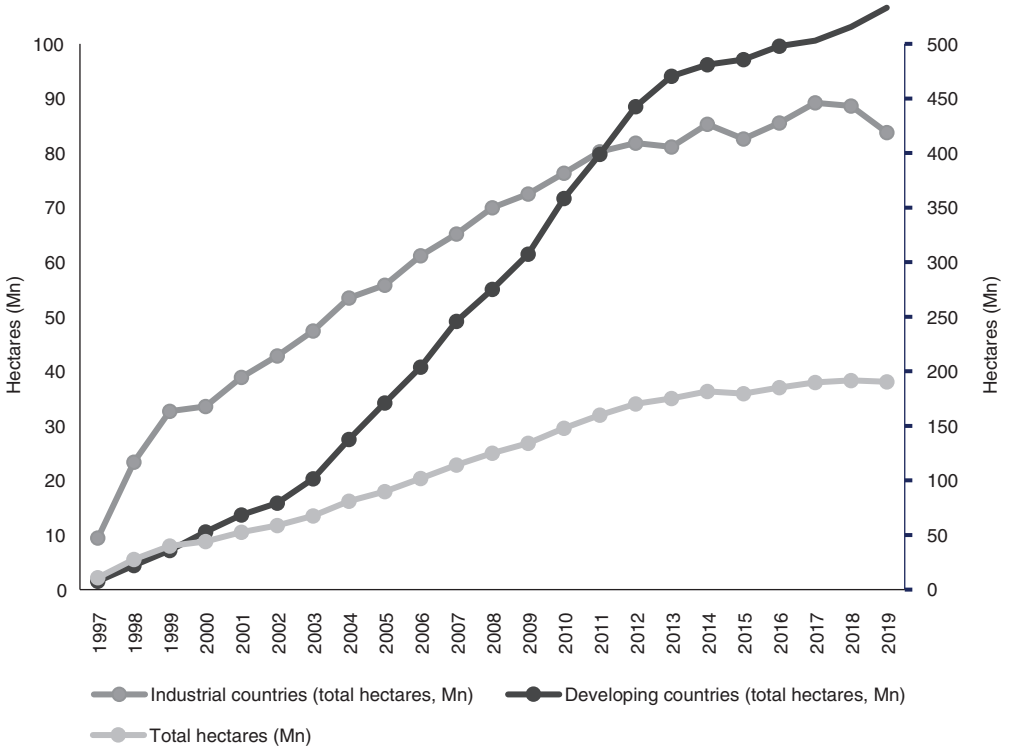
17 Brookes, G., & Barfoot, P. (2020). *GM Crop Technology Use 1996-2018: Farm Income and Production Impacts.* Retrieved June 9, 2023, from PubMed: https://pubmed.ncbi.nlm.nih.gov/32706314



Source: The International Service for the Acquisition of Agri-biotech Applications. (2020). P*ocket K No. 16: Biotech Crop Highlights* in 2019. Retrieved March 10, 2023, from Isaaa Inc: https://www.isaaa.org/resources/publications/pocketk/document/Doc-Pocket%20K16-2020.pdf

Figure 12.2 depicts that developing countries in Asia, South America and Africa have emerged as large cultivators of GM crops. In 2019, nearly 56% of total GM crop grown areas were in 24 developing countries, and 44% were from five industrial nations. This pattern may continue as the Southern countries adopt GM crops and commercialise these, including essential staple crops such as rice (Figure 12.3).

Figure 12.3
GM Crop Cultivation in Industrial and Developing Countries, 1997-2019



Source: Based on data from The International Service for the Acquisition of Agri-biotech Applications. (2020).

China is the largest GM crop producer in the Asian region. The main crops grown are Bt cotton and Bt papaya, alongside others such as GM corn, soybeans, and tomatoes. The Philippines, Vietnam, and Japan are some of the other countries which produce GMOs in the Asian region, with Japan being one of the world's largest GM food and feed importers.[18] The Philippines was the first Asian country to provide commercial clearance to GM biofortified golden rice, including several vitamins, focusing on addressing malnutrition and Vitamin A deficiency.

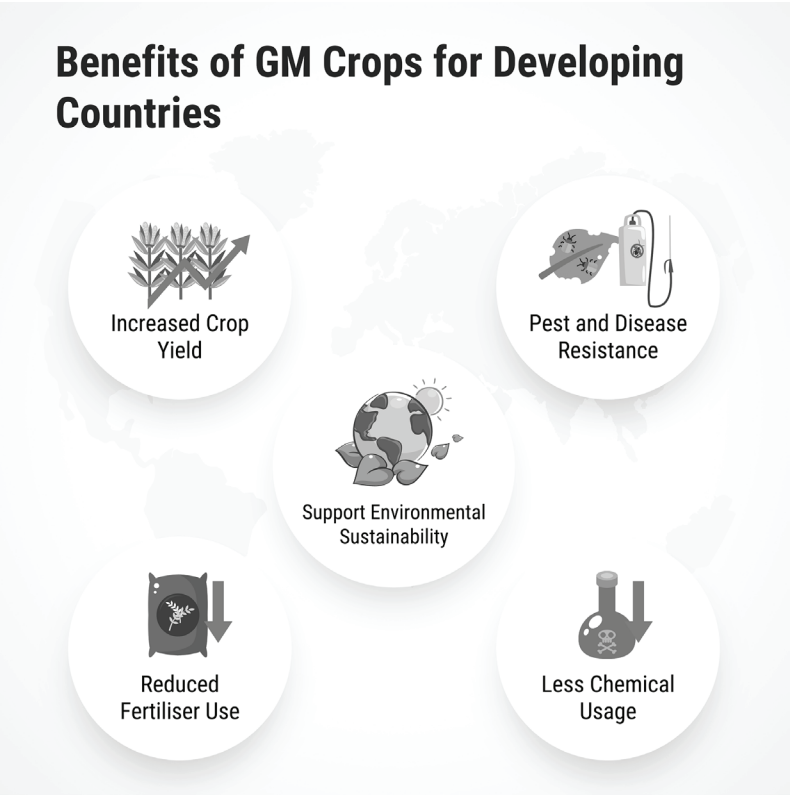
In South Asia, India has cultivated GM crops, Bt cotton, since 2002 and is presently the world's second-largest cotton producer. Several other field trials on GM crops, such as Bt Brinjal, Bt rice etc., are ongoing in India. However, due to several farmer protests and institutional and regulatory issues, crops such as Bt brinjal, and Bt rice have not yet been commercialised.[19] However, Bangladesh approved Bt brinjal in 2013. Other counterparts, such as Pakistan and Nepal, are conducting field trials on GM crops.

18 GRAIN. (2022). *GMOs in Asia: What's Happening and Who's Fighting Back?* Retrieved April 3, 2023, from GRAIN: https://grain.org/en/article/6863-gmos-in-asia-what-s-happening-and-who-s-fighting-back

19 Kumari, K., Choudhury, N., & Govind, M. (2021). *GM Crops in India: Present Status-A Review.* Retrieved April 3, 2023, from Researchgate: https://www.researchgate.net/publication/356391880_GM_Crops_in_India_Present_Status-A_Review

12.3 Are there Economic Benefits for Developing Countries?

A substantial body of literature suggests that GMOs increase crop yield, help to develop crops which are more resistant to pests and diseases, use less fertiliser for crop cultivation and need fewer chemicals for crop preservation, etc. These benefits are argued to provide a strong case for addressing the issue of agricultural productivity, a point of concern for many developing countries. Furthermore, GM crops are also said to enhance the related products' nutrient composition, improving food quality. In addition, these are also deemed to support environmental sustainability.



Source: Zhang, C., Wohlhueter, R., & Zhang, H. (2016). Genetically Modified Foods: A Critical Review of their Promise and Problems. *Food Science and Human Wellness, 5, 116–123.*

For instance, early studies that examined impacts on farm incomes found evidence of positive outcomes. One such study during 2006-2012 suggests that farm incomes almost tripled globally compared to the previous ten years.[20] More than 42% of the economic gain is attributable to increased yields due to advanced genetics and resistance to pests and weeds. More recent studies appear to substantiate these findings.[21] Significant net economic benefits are found when examining the global production value of using GM crops (soybeans, corn, cotton, and canola) technology in agriculture at

20 Zhang, C., Wohlhueter, R., & Zhang, H. (2016). Genetically Modified Foods: A Critical Review of their Promise and Problems. *Food Science and Human Wellness, 5*, 116–123.

21 Brookes, G., & Barfoot, P. (2020). *GM Crop Technology Use 1996-2018: Farm Income and Production Impacts.* Retrieved June 9, 2023, from Pubmed: https://pubmed.ncbi.nlm.nih.gov/32706314/

the farm level. It also reveals that 72% of the gains are derived from yield and production, while 28% are from cost savings. Interestingly, 52% of the economic gains are attributed to farmers in developing countries and 48% to those in developed countries. Most importantly, in terms of investment, for each extra USD invested in GM crop seeds (relative to the cost of conventional seed), farmers have gained an average of USD 3.75 in extra income. In developing countries, the average return was much higher at USD 4.41 for each extra USD invested in GM crop seeds, while it was USD 3.24 for developed countries.

Thus, developing countries do stand to benefit. Using meta-analysis of 40 empirical studies covering eight developing countries (Argentina, Burkina Faso, China, India, Indonesia, Pakistan, South Africa, and the Philippines), the evidence indicates that genetic modification technology has enhanced the socio-economic and environmental efficiency of farmers in developing countries.[22] With a focus on the farm-level economic consequences, productivity effects, the environmental impact of changes in pesticide and herbicide use and nuanced outcomes were also noticeable. A higher income for GM farmers is reported in 24 studies, whereas two studies in India found that farmers' income declined due to the higher cost of GM seeds and necessary irrigation facilities. Moreover, one study done in China concluded that there was no difference between the income levels of GM growers and conventional crop growers. Overall, the economic effects are considered to be 'positive' in 59% of studies. At the same time, the social impacts – GM crop production on farmers' health and well-being – are also seen to be positive in the meta-analysis. The study further highlights that legal and administrative challenges and limited access to relevant information are the main dilemmas farmers face in dealing with GM crops in developing countries.

Moreover, there are other benefits of improved food quality. Genetic engineering technology in South Africa is sufficiently capable of producing foods with necessary minerals and vitamins cost-effectively.[23] Seemingly, research findings also support sustainable environmental practices. Globally, GM crops are said to result in a 37% decrease in using chemical pesticides while increasing overall crop yields by up to 22%.[24] These positives – where GM crops are viewed mostly as a saviour technology at the farm level, both environmentally and economically – underpin the challenges of meeting rising food demand. Indeed, the FAO estimates that conventional agriculture practices alone will be insufficient to sustain the global nutritional and food demand by 2050,[25] whereby the role of GM crop commercialisation can play an essential role.

Despite the notable increase in GM crop production over the past two decades and socio-economic gains at the country level, worries are mounting on GM food safety and associated health risks that persist amongst scientists, consumers and farmers. The lack of understanding of technology

22 Azadi, H., & Taheri, F. G. (2022). Genetically Modified Crops in Developing Countries: Saviour or Traitor? *Journal of Cleaner Production, 371*.

23 Muzhinji, N., & Ntuli, V. (2020). Genetically Modified Organisms and Food Security in Southern Africa: Conundrum and Siscourse. *GM Crops & Food*, 25-35.

24 Gbashi, S., Adebo, O., Adebiyi, J.A., Targuma, S., Tebele, S., Areo, O.M., … Njobeli, P. (2021). Food Safety, Food Security and Genetically Modified. *Biotechnology and Genetic Engineering Reviews, 37*(1), pp. 30-63

25 Food and Agriculture Organization. (2018). *The Future of Food and Agriculture- Alternative Pathways to 2050*. Retrieved March 10, 2023, from Food and Agriculture Organization: https://www.fao.org/3/I8429EN/i8429en.pdf

and the asymmetry of information remains a problem. If the public is not convinced, tapping into the potential benefits of GM crops and GM food becomes more challenging. It is so true in both developed and developing countries. The latter, however, face further challenges if doubts prevail on whether they can adopt these new technologies on their own, given the required investments that raise questions over affordability. Therefore, these countries may be compelled to rely on foreign investment; a few MNC market players have already invested in developing countries. A prerequisite is strong intellectual property rights (IPR) protection. MNCs will hesitate to invest in developing countries if the IPR protection is not adequately strong, as they tend to earn fewer profits. At the same time, domestic players will also look to protect local seed varieties and farmers' rights to obtain seeds at a reasonable price, for instance, where the IPR ecosystem plays a central role. However, a properly developed legal and administrative regulatory system could address most barriers scientists, consumers and farmers face.

If the public is not convinced, tapping into the potential benefits of GM crops and GM food becomes more challenging.

Empirical evidence suggests that improved institutional support will contribute to addressing concerns regarding GMOs through proper regulations.[26] However, public support and acceptability are necessary, especially related to the science and risk procedures guiding the development of GMOs. Biosafety regulatory systems and extension education networks are also needed to ensure information transparency about the risks and benefits of GMOs are accessible and widely disbursed.[27]

12.3.1 Regulatory Policies and Strategies on GMOs

As previously discussed, agricultural biotechnologies, and especially transgenic crops, have the potential to boost food security in developing countries by offering higher incomes for farmers and lower priced and better-quality food for consumers. Their success stories result from adopting various strategies and regulatory enactments to promote GMOs and minimising existing barriers. Important lessons can be learnt from global success stories for a country like Sri Lanka that still faces impediments in matching these successes.

China: The Regulations on the Safety of GMOs were issued through Decree No. 304 by the State Council of the People's Republic of China in 2001. The development of GMO safety regulations underwent four stages: exploration (1993-2000), development (2001-2010), improvement (2011-2020) and current (2021-present) stage.[28] During the exploration stage, Bt cotton was approved for cultivation. During the development stage, China listed a series of administrative measures which covered almost all the fields related to GMO safety when the basic regulatory system was established. Regulations

26 Qaim, M. (2010). Benefits of Genetically Modified Crops for the Poor: Household Income, Nutrition, and Health. *New Biotechnology, 27*(5), pp.552-557.

27 Carzolia, A., Aboobuckera, I., Sandallc, L., Lübberstedt, T., & Suzaa, W. (2018). Risks and Opportunities of GM Crops: Bt Maize Example. *Global Food Security, 19*, pp.84-91.

28 Liang, J., Yang, X., Jiao, Y. Wang, D., Zhao, Q., Sun, Y., Li, Y. Wu, K. (2022). *The Evolution of China's Regulation of Agricultural Biotechnology.* Retrieved March 10, 2023, from Springer:: https://link.springer.com/article/10.1007/s42994-022-00086-

have been further strengthened during the improvement stage to address the controversial issue of GMO safety. From 2021, a few additional revisions have been made, including new regulations on gene-edited crops, forming a relatively complete regulation and law system for China.

Measures on the administration of labelling of agricultural GMOs in China as well as the guidelines, were revised in 2017 and again in 2022. These changes were made to accommodate consumer safety concerns. Even though Chinese consumers generally exhibited a higher acceptance rate towards GMOs than consumers in other countries early on, the perceptions of GM food safety have changed significantly over time. For instance, in the early 2000s, only 13-16% of respondents considered GM food unsafe for human consumption; by 2012, this percentage had risen to 45%.[29] Conversely, the percentage of respondents perceiving GM food as safe for consumption declined from over 35% to a mere 13% in the same period.

The Ministry of Agriculture formulated the implementation and regulations on the safety assessment of agricultural GMOs (imports and labelling). To oversee the safety administration of agricultural GMOs, the State Council established a joint Ministry conference system. This conference comprises officials from relevant departments such as agriculture, science and technology, environment protection, public health, foreign trade and economic cooperation, and inspection and quarantine. Its responsibilities include decision-making and coordination of major issues related to the safe administration of agricultural GMOs. A National Biosafety Committee (NBC) is established to handle the safety assessment of agricultural GMOs. The NBC consists of experts involved in biological research, production, processing, inspection, and quarantine concerning agricultural GMOs. Additionally, experts in the fields of public health and environmental protection are also members of the committee. The Ministry of Agriculture assumes the responsibility for nationwide supervision and administration of the safety of agricultural GMOs.

India: The Indian regulatory framework is designed to ensure that both the development and use of GMOs are done in the public interest and do not negatively influence small farmers and rural populations. For this purpose, the Indian government has a complex regulatory framework in place that involves numerous Ministries and departments. The Ministry of Environment, Forest, and Climate Change is the main regulatory body responsible for approving GMOs. The Genetic Engineering Appraisal Committee (GEAC) is the primary authority responsible for monitoring GMOs and their discharge into the environment.

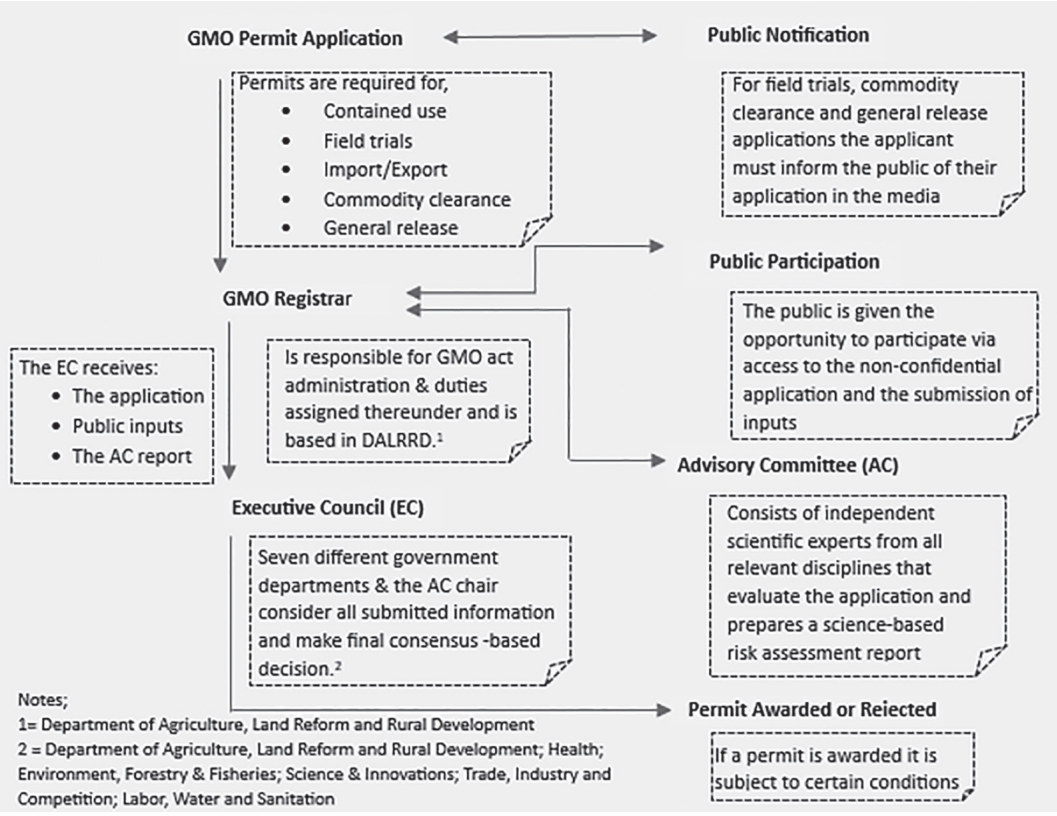
The GMO regulatory process undergoes various stages in India, including risk assessment, field trials, and commercialisation. As the regulatory framework's adherence to the precautionary principles stated in the Cartagena Protocol on Biosafety, GMOs are only authorised after an in-depth investigation of their possible effects on human health and the environment. The requirement for GMO product labelling is one of the main regulatory tools utilised in India to address GMO objectors. All food items containing GMOs must be labelled, and the label has to indicate that the product

29 Huang, J., Qiu, H., Bai, J., and Pray, C. (2006). *Awareness, Acceptance of and Willingness to Buy Genetically Modified Foods in Urban China*. Retrieved June 10, 2023, from PubMed: https://pubmed.ncbi.nlm.nih.gov/16469414/

contains substances that have undergone genetic modification. These labelling standards comply with all relevant international standards, including the Codex Alimentarius. Labelling GMO products helps ensure that the public is aware of the presence of GMOs in their food and enables consumers to make informed decisions about the food they consume.[30]

South Africa: Genetically Modified Organisms Act, No. 15 of 1997, regulates GMOs in South Africa. The Act states the measures to promote the development, production, use and application of GMOs. By and large, South Africa is considered to have a robust, representative and well-experienced biosafety regulatory system that imposes strict compliance measures on the production and marketing of GMOs.[31] Figure 12.4 sets out the GMO application procedure in the country, which goes through the Executive Council, GMO Registrar and an Advisory Committee.

Figure 12.4:
South Africa's GMO Permit Application Process



Source: Biosafety South Africa. (2021). *How Are GMO's Regulated in South Africa?* Retrieved July 18, 2023, from Biosafety Organization: http://biosafety.org.za/information/know-the-basics/regulation-of-gmos/how-are-gmos-regulated-in-south-africa

30 Sudha Rani, M., Satish, Y., Rani, C., Prasad, N., Bharthi, S., Sri Lakshmi, B., & Rathna Kumari, S. (2018). History, Status and Impact of Genetically Modified. *International Journal of Chemical Studies, 6*(5), 2735-2739.

31 Department of Science and Technology, Republic of South Africa. (n.d.). *GMO Regulation and Use in South Africa.* Retrieved June 9, 2023, from Biosafety_SA: https://bch.cbd.int/protocol/outreach/online%20forum/Infographic%20GMO%20regulation%20&%20use%20in%20SA%20Oct16.pdf

Diverse country experiences suggest that implementing a proper regulatory framework is crucial. Regulatory frameworks can be broadly classified as process-oriented or product-oriented, with countries like China and India following the former. Most developing countries have a comprehensive, well-established legal framework and efficient approval system. However, developed countries such as the US and Canada do not have federal legislation as a general framework to regulate GMOs. Depending on the purpose of the GM product, whether it is for human, animal and/or environmental use, the authorisation and regulation come under various authorities or standards under the Food and Drug Administration, the Animal and Plant Health Inspection Service, or the Department of Agriculture and/or the Environmental Protection Agency.[32]

12.4 GMOs and the Sri Lankan Status Quo

Sri Lanka's agriculture sector produces approximately 80% of its food requirements locally, while wheat, sugar, fish and milk products account for nearly 65% of the total food imports of the country. The total agricultural land in the country has fluctuated over the last two decades, and at present, is estimated to be stagnant at around 45% of the country's total land area.[33] The movement of labour out of agriculture, and the rising cost of capital pose productivity challenges to the domestic agriculture sector. Thus, owing to the scarcity of land, labour and capital resources, the only way to meet Sri Lanka's rising food demand is by increasing productivity with a more efficient use of resources.

Diverse country experiences suggest that implementing a proper GM regulatory framework is crucial.

Amidst these challenges, climate change and its impacts pose growing threats to the Sri Lankan agriculture sector. Drastic changes in rainfall, rain patterns, droughts and temperature impact agricultural productivity. Such climate shocks and changes in weather patterns substantially and adversely affect agriculture to a greater extent in Sri Lanka than in other countries. One reason is that Sri Lanka's main food crop paddy cultivation depends on rainfall and its distribution. The country experienced its worst drought conditions in 2016, resulting in a 40% decline in paddy production in the following year.[34] Further, crops have been adversely affected by several pest and weed diseases. Faced with this growing set of problems, GM crops that offer better resistance to climatic changes, pest tolerance, and high nutritional values would be an effective solution, albeit with stronger regulatory mechanisms to minimise any adverse impacts.

Sri Lanka was the pioneer globally in banning GMOs in 2001 due to overwhelming pressure from environmentalists and conservationists. However, in 2006, the government passed an Extra-Ordinary

32 Rozas, P., Kessi-Pérez, E., & Martínez, C. (2022). *Genetically Modified Organisms: Adapting Regulatory Frameworks for Evolving Genome Editing Technologies.* Retrieved April 9, 2023, from PubMed: https://pubmed.ncbi.nlm.nih.gov/36266673/

33 The World Bank. (2020). *Data*. Retrieved April 5, 2023, from World Bank:: https://data.worldbank.org/indicator/AG.LND.AGRI.ZS?locations=LK

34 Gunaratne, M., Radin Firdaus, R., & Rathnasooriya, S. Y. (2021). *Climate Change and Food Security in Sri Lanka: Towards Food Sovereignty.* Retrieved April 5, 2023, from Nature: https://doi.org/10.1057/s41599-021-00917-4

Gazette to the Food Act of 1980,[35] allowing GM food importation to the country. In June 2023, the amendment to the 2006 regulation has increased the threshold level from 0.5 % -0.9 % (of the volume) for labelling requirement. Further, as a signatory to the Cartagena Protocol, Sri Lanka developed a National Biosafety Policy and National Biosafety Framework in 2005. In 2014, a Biosafety Act was drafted and submitted to the Attorney General's (AG's) Department. Again in 2018, under the National Bio-safety Framework Project implemented by the Ministry and Environment and FAO, some elements of the draft Biosafety Act were revised with the support of stakeholders and placed before the AG's Department once again. What this shows is that over time, Sri Lanka has taken several steps in line with the Cartagena Protocol – to provide protection for the importation of GMOs, the adverse effects of biotechnology, technology transfer issues, etc. – but these are yet to become functional.

Unlike many of its neighbours in Asia, Sri Lanka currently does not produce any GMOs although at the laboratory level, research is underway, especially on GM crops. Experiments are being conducted on jasmine flowers and paddy. In the latter case, research is underway to develop a paddy seed, a high-yield crop with the qualities of salinity and resilience to droughts and deceases. Others include research on transgenic development of chillies, and related research on other field crops such as finger millet, onion, and maize.

Sri Lanka's failure to proceed to commercialisation of GM crops is argued to be the combined effects of technical, financial, and regulatory barriers. For example, regardless of ongoing testing at the laboratory level on GM crops, without proper approval of the different safety assessments, scientists cannot conduct field trials using them. Additionally, very few labs have the facilities to conduct GM crop testing. Moreover, Sri Lanka does not have proper testing facilities at the ports-of-entry/exit to test for genetically engineered (GE) products. Laboratories have limited GE testing capacity and are not accredited. This means that the country has lost many opportunities to benefit from the application of new technologies, not only to ensure better food security but also other economic gains across industries. As discussed previously, experiences in neighbouring countries point out some potential benefits.

As stated by the scientists in the field, the main barrier for GMOs is the delay in passing the new draft Biosafety Act, which was again placed with the legal draftsmen in 2021. In terms of IPR protection, Intellectual Property Act, No. 36 of 2003 provides sufficient protection for plant varieties and farmers' rights. As per the IPR Act, it is possible to patent GMOs. However, provisions in the Act allow regulators to deny patents upon the recommendation of other relevant authorities. A draft Plant Breeders Rights Act attempts to comply with obligations under the Trade TRIPs Agreement. However, the practical implementation gaps are undetected yet.

Generally, intense public pressure can urge the government to avoid any complacency and take prompt decisions. However, there is also no public pressure to hasten regulatory enactments in the local setting. Consumer awareness and attitudes towards GMOs in Sri Lanka is very low, even after 20 years of introducing GMOs to the country. For example, the first research study done on GM food

35 This section draws from Control of Import, Labelling and Sale of Genetically Modified Foods Regulations of 2006.

acceptance in Sri Lanka revealed that most consumers are unaware of GM foods and perceive GM foods as risky to human health.[36] Here, a significant negative relationship existed between identifying GM foods as risky to health and buying GM food products.

A limited number of consumer perception surveys substantiate these findings. A study with nearly 800 participants disclosed that the average awareness of the Sri Lankan public on GM food was 96%.[37] Although most respondents had received information about GM foods through the media, most of them rejected GM foods for fear of health-related side effects. A key recommendation of the study is the need for educational programmes on GM foods for the Sri Lankan general public to clarify potential misconceptions and spread awareness.

12.4.1 GMO-related Policy Discussions in Sri Lanka

As noted, during the past 20 years Sri Lanka has also worked towards implementing policies regarding importing and producing GMOs, but progress achieved so far to finalise and implement them has been very slow. On GM food, the Control of Import, Labelling and Sale of GM Foods Regulations of 2006 and its amendments in 2023 are in place, but Sri Lanka has not yet passed laws dealing with GE products. As a signatory to the Cartagena protocol, Sri Lanka developed the National Policy on Biosafety and National Biosafety Framework in 2005. These are the guiding documents for biosafety regulations in the country to establish a system of legal, technical and administrative mechanisms under the Ministry of Environment.

The National Policy on Biosafety is an important element of this framework and provides for safe application of modern biotechnology; further, it ensures that no adverse effects would result on conservation and sustainable use of biological diversity in the country as well as human health and environment. To do this, it aims to regulate transboundary movements through the use of relevant policies, regulations, technical guidelines, and the establishment of management bodies and supervisory mechanisms. According to the policy, the relevant legislation is to be applied by a National Competent Authority (NCA) and Sectoral Competent Authorities (SCAs) to regulate GMOs.[38]

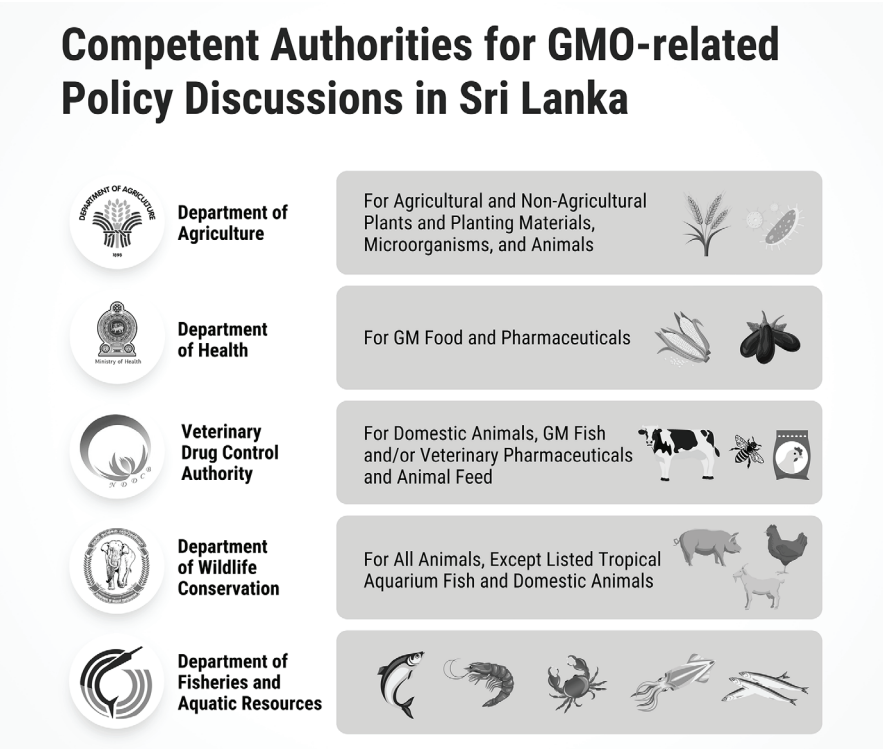
However, the proposed draft Act does not include GM feed. This is likely to be an essential component in the near future, especially for animal feed. Moreover, according to the field experts, the proposed Act does not cover the area mentioned in Article 26 of the Cartagena Protocol on Biosafety which is the socio-economic impact of GMOs. Further, when importing and producing GMOs, the parties need to consider socio-economic impact on the conservation and sustainable use of biological diversity, especially regarding the value of biological diversity to indigenous and local communities. However, these aspects are not mentioned in the draft Act.

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36 Karunagoda, R., & Senarath, S. T. (2012). *Consumer Attitude Towards Labelling of Genetically Modified Foods in Sri Lanka.* Retrieved May 10, 2023, from Reserachgate: https://www.researchgate.net/publication/264857554_Consumer_Attitude_towards_Labeling_of_Genetically_Modified_Foods_in_Sri_Lanka

37 Sajiwani, J., & Rathnayaka, U. (2014). Consumer Perception on Genetically Modified Food in Sri Lanka. *Advances in Research*, 846-855.

38 Sri Lanka Biosafety Cleaning House. (n.d.). *Related Laws and Regulations*. Retrieved April 18, 2023, from Sri Lanka Biosafety Cleaning House: http://lk.biosafetyclearinghouse.net/laws.shtml



Source: Sri Lanka Biosafety Cleaning House. (n.d.). Related Laws and Regulations. Retrieved April 18,2023,from Sri Lanka Biosafety Cleaning House: http://lk.biosafetyclearinghouse.net/laws.shtml

Similar to how this issue is resolved in other countries, the National Biosafety Framework has identified a few competent government authorities to regulate each subject area. These include the (i) Department of Agriculture for agricultural and non-agricultural (e.g. forest species, ornamentals) plants and planting materials, microorganisms, and animals, (ii) Department of Health for GM food and pharmaceuticals, (iii) Veterinary Drug Control Authority (Department of Animal Production and Health) for domestic animals, including fish, birds, bees, and any other domesticated or wild animals kept in captivity, GM fish and/or veterinary pharmaceuticals and animal feed, including GM feed ingredients, (iv) Department of Wildlife Conservation for all animals, except listed tropical aquarium fish and domestic animals (GM fish are not in the excluded list), and (v) Department of Fisheries and Aquatic Resources.

However, all these crucial recommendations remain at a draft stage until the country passes the draft Biosafety Act. Despite submitting the draft Act to the AG's Department in 2014, the Ministry of Environment obtained approval from the Cabinet to introduce a new Biosafety Act with some revisions. The new Act is expected to regulate and monitor the applications of modern biotechnologies, including all genetic engineering, LMOs and related products that pertain to food consumption, research, commercial production, and imports and exports. The new Biosafety Act also details procedures for approving, monitoring, and enforcing penalties for violations. The revised Act is with the Legal Draftsman's since 2018 and its enactment is still pending.

Box 12.1
Draft Biosafety Act (New)

The new draft Biosafety Act (Modified in 2018) will provide the powers relating to the risk assessment of the possible adverse effects of GMOs on biodiversity conservation, sustainable use and human health.

The main provisions relating to GMOs are as follows:

- The approving institution, its responsibilities, and duties
- The methodology of granting approval
- The methodology for monitoring
- Powers for putting the Act into effect
- Powers relevant to formulating regulations

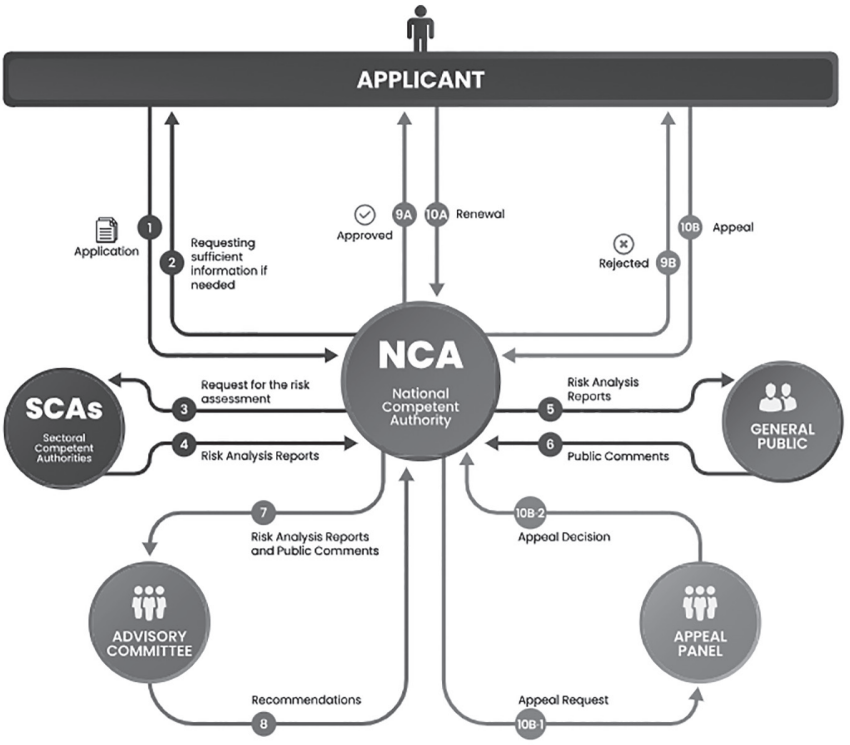
The draft Biosafety Act has been prepared with the objective of regulating the following activities (selected):

- The research and development activities in the laboratories associated with GMOs
- Field studies conducted under safe condition
- The impact and release to the environment of GMOs, which have been produced for research, food and the production of animal feed
- Export
- Exchange of GMOs between institutions

The draft Act does not regulate the GMO materials used as human or animal food not possessing the ability to germinate or not having the capability to produce offspring, research studies carried out in the laboratories of government institutions, or research work carried out without commercialisation objectives.

Further, according to the draft Act, any person intending to carry out research, import and use of GMOs, or want to release GMOs to the environment, etc., should apply using the Act's attachment to the local institution and the procedure is explained below.

Most importantly, the proposed Act will ensure that a scientific risk assessment is carried out before releasing any GMO to the environment.



Note: Currently National Coordinating Committee on Biosafety (NCCB) is acting as the advisory committee.

Source: Sri Lanka Biosafety Cleaning House. (n.d.). *Regulatory Process*. Retrieved July 17, 2023, from Biosafety Cleaning House: http://lk.biosafetyclearinghouse.net/regulatory_process.shtml

Sri Lanka has also prepared 'Guidelines for the Conduct of Confined Field Trials of GM Plants' in 2021. Additionally, 'Guidelines for Institutional Biosafety Committees' (IBSC) was developed as a guideline for entities that conduct research or activities involving GMOs/LMOs on the setting up of an IBSC in compliance with the National Biosafety Framework and other related government regulations and policies to safeguard human health and the environment.

In summary, Sri Lanka has been unable to pass relevant laws that deals with genetically engineered products. Inefficiencies in the overall process bear testimony to these. As mentioned before, the new National Biosafety Act draft is with the Legal Draftsman's Department and requires approvals from the AG's Department, the Cabinet, and the Parliament. Even though Sri Lanka is lagging in passing laws, the main components in the new draft are similar to those of other countries as well as the procedures like the approval process, selecting competent authorities, etc. Aside from the regulatory aspects, much more must be done to promote GMOs and strengthen the country's institutional capacities. Currently, only a handful of agencies fund biotechnology research in Sri Lanka, including the National Science Foundation (NSF), the Sri Lanka Council for Agricultural Research Policy (SLCARP), and the National Research Council (NRC). To encourage private investments in biotechnology, one of the main aspects is the need for enforcing proper IPRs to protect inventions, plant varieties, seed varieties, etc. Sri Lanka has IP laws that could support these investments, but improving its implementation and enforceability are mandatory.

12.5 Policy Recommendations to Enhance the Use of GMOs in Sri Lanka

As previously noted, GMOs can provide solutions to address food insecurity and other related socio-economic issues in Sri Lanka by introducing insect-resistant, herbicide tolerant, nutritionally enriched food and crops. However, effective regulatory and monitoring systems are important to ensure the safety of consumers and farmers. As highlighted by international experiences, countries have adopted various policies and strategies to monitor and regulate the production, imports and exports and consumption of GMOs and related activities to maximise benefits.

As in many other countries, Sri Lanka allows imports and consumption of GM food under the Food Act, No. 26 of 1980 implementing provisions for control of GM imports, mandatory labelling and sale of GM food since 2007. However, no permission has been granted to grow GM crops for food or feed purposes. If GM foods are marketed in Sri Lanka, these must be adequately labelled to communicate reliable information to consumers on genetic modifications effectively. Apart from the perspective of food safety, this is part of consumer rights as well. To date, no importer has obtained approval to import GM food to Sri Lanka. Therefore, no labelled GM food products are currently available in the local market. Regarding GM crops, Sri Lanka can continue with the laboratory level experiments until the Parliament passes the National Biosafety Act. In line with different regulatory approaches taken for approving GM products – where regulatory frameworks are broadly classified as process-oriented or product-oriented – Sri Lanka's draft regulations align with those in China and India that are process-oriented with more emphasis on the overall approval process. This indicates about the comprehensiveness of the draft.

Whilst the legislative process works its way through, and gaps in the draft Act proceed – such as the exclusion of GM feed, requires the inputs of the Department of Animal Production and Health. Additionally, other related areas, which are the main parts of the total picture need to be carefully tackled. More public and institutional support is needed to understand the socio-economic benefits for society, especially the poor farmers on a larger scale. The international evidence suggests that GM crops, in particular, can have significant income-increasing and poverty-reducing effects. Furthermore, the economic results so far suggest that farmers in developing countries can benefit from GM crops with proper institutional setup. Thus, it is of utmost importance to incorporate the socio-economic consideration in the draft Act.

Not only will regulations work, but the acceptance of consumers and their attitude toward GMOs is a critical driver in perceiving its risks and benefits. Public knowledge in Sri Lanka on GMO laws and regulations is comparatively low. Creating awareness is an integral part of the Cartagena Protocol on Biosafety Article 23. It states that "Parties need to promote and facilitate public awareness, education and participation concerning the safe transfer, handling, and use of biological diversity, also considering risks to human health. In doing so, the parties shall cooperate, as appropriate, with other states and international bodies."

Cultivating and sustaining trust among institutions and collaborations for scientific research are key to gain better knowledge and communications. Here, too, Sri Lanka has to strengthen its technical know-how and capacities. Gaps exist in one crucial area, such as laboratory facilities, and addressing these must be prioritised to help produce and test GMOs. Essentially, the standards of identified laboratories must be upgraded. At present, only five such labs have been identified. Publicly funded research and institutional support will remain limited and must be complemented by greater private-sector efforts. Since Sri Lanka is still at an early stage of conducting trials on using advanced biotechnology to produce GMOs domestically, a robust IPR regime must be in place. Even though the existing IPR law protects patents, farmers' rights, plant varieties etc., effective implementation is still weak. Without a robust regulatory environment, attracting private investors to enter into contractual agreements will be much harder, especially with multinational GM seed companies.

The production of GM crops alone will not solve the challenges of agricultural productivity, food insecurity, climate change, etc. Still, when combined with other measures, biotechnology is a vital tool to address some of these issues.

POLICY BRIEFS

13. Poverty Alleviation in a Multidimensional Crisis

13.1 Introduction

Despite the deadline to achieve the 2030 Agenda for Sustainable Development approaching closer, the Sustainable Development Goals (SDGs) seem far from reach relative to 2-3 years ago. While the global community's interest in SDG achievement has not drifted away, the numerous adverse shocks experienced in recent years have diverted focus and pushed the SDGs to a backseat. The reason is that most countries have been in mere survival mode due to the unanticipated nature of the concurrent setbacks of recent times. Countries worldwide have faced multiple adversities following the coronavirus (COVID-19) pandemic, trade disruptions, the Russia-Ukraine war, high inflationary pressures, and the greater occurrence of natural disasters such as flooding, earthquakes, heatwaves, etc. Apart from these global challenges, developing countries have faced additional obstacles, such as record-high debt levels, domestic currency depreciations and rapid escalations in the cost-of-living to name a few. As such, although setbacks have been experienced worldwide, the magnitude of their impacts is felt differently between the developed and developing world.

With these misfortunes pushing more people into poverty and deepening the vulnerabilities of the existing poor, the progress made towards poverty reduction has reversed. Nearly 685 million (Mn) people worldwide were estimated to be living in extreme poverty by the end of 2022, with projections suggesting this figure to only drop slightly to 574 Mn individuals (7% of the world population) by 2030.[1] Estimates suggest that attaining sustainable development goal (SDG) 1 (end poverty in all its forms everywhere) and its target 1.1 of ending extreme poverty is unlikely to be achieved by the previously established 2030 deadline.[2]

574 Mn individuals (7% of the world population) are estimated to be living in extreme poverty by 2030.

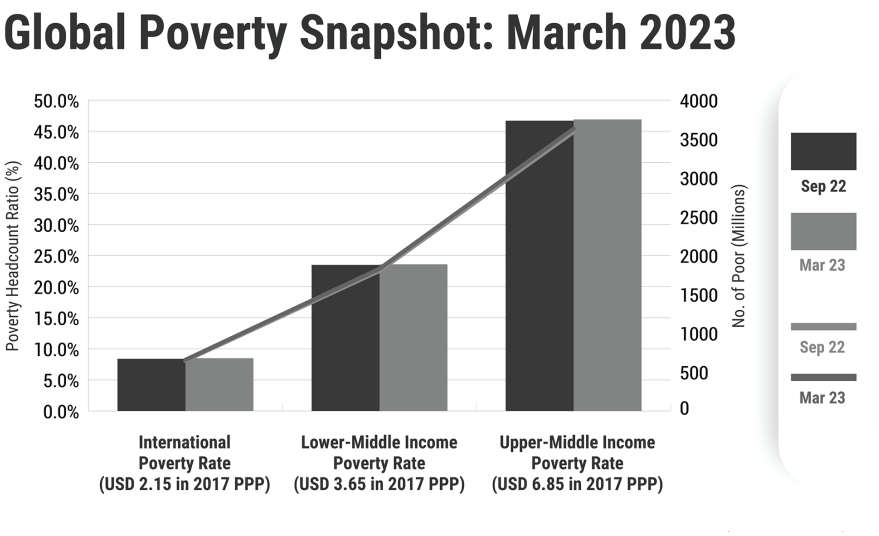
In light of these circumstances, this policy brief aims to analyse the poverty situation in Sri Lanka along with broader socio-economic aspects of the rise in poverty. It outlines the current state of global poverty, its impacts on the poor and vulnerable, and evidence of Sri Lanka's rising poverty levels. Some global solutions aimed towards reducing poverty are discussed thereafter, emphasising on efforts to address the cost-of-living crisis and fiscal policy options primarily targeted to support the poor and vulnerable in the short-term. Possible policy solutions for poverty reduction are discussed next, focusing on both immediate action and those supporting a country's long-term growth and development, including a discussion on possible poverty reduction financing methods.

1 World Bank. (2022). *Poverty and Shared Prosperity 2022: Correcting Course*. Washington, D.C: World Bank. doi:10.1596/978-1-4648-1893-6. License: Creative Commons Attribution CC BY 3.0 IGO.

2 *Ibid.*

13.2 Global Poverty Status

Updated global poverty estimates suggest the number of individuals in extreme poverty (United States Dollars (USD) 2.15 per day) as of March 2023 to be 659 Mn individuals worldwide.[3] This is a rise in the number of extreme poor by 11 Mn persons compared to estimates from the latter part of 2022. This is largely driven by the rising poor across South Asia, the Middle East and North Africa (MENA) regions. At the USD 3.65 poverty rate, 1,831 Mn people are in poverty as of early 2023. This is a 0.1% increase in the poverty headcount ratio – from 23.5% in September 2022 to 23.6% in March 2023 – which accounts for an additional 28 Mn individuals facing poverty.



Source: Baah, S. K., Aguilar, R. C., Diaz-Bonilla, C., Fujs, T., Lakner, C., Nguyen, M. C., & Viveros, M. (2023, March 29). *March 2023 Global Poverty Update from the World Bank: The Challenge of Estimating Poverty in the Pandemic.* Retrieved May 10, 2023, from World Bank. World Bank blogs: https://blogs.worldbank.org/opendata/march-2023-global-poverty-update-world-bank-challenge-estimating-poverty-pandemic

The many negative shocks have pushed more people into poverty and increased the vulnerability status of the borderline poor, inevitably placing them at greater risk of falling into poverty owing to the slightest degree of distress. Moreover, the increasing intensity of the situation aggravates adversities for certain segments of people and traps them in a vicious cycle. Estimates accounting for the immediate shocks on household income due to the effects of food and energy price inflation reveal that over 51 Mn people could slip into extreme poverty in 2022.[4] Also accounting for the existing poor, this translates to around 675.5 Mn individuals worldwide living in extreme poverty (9% of the

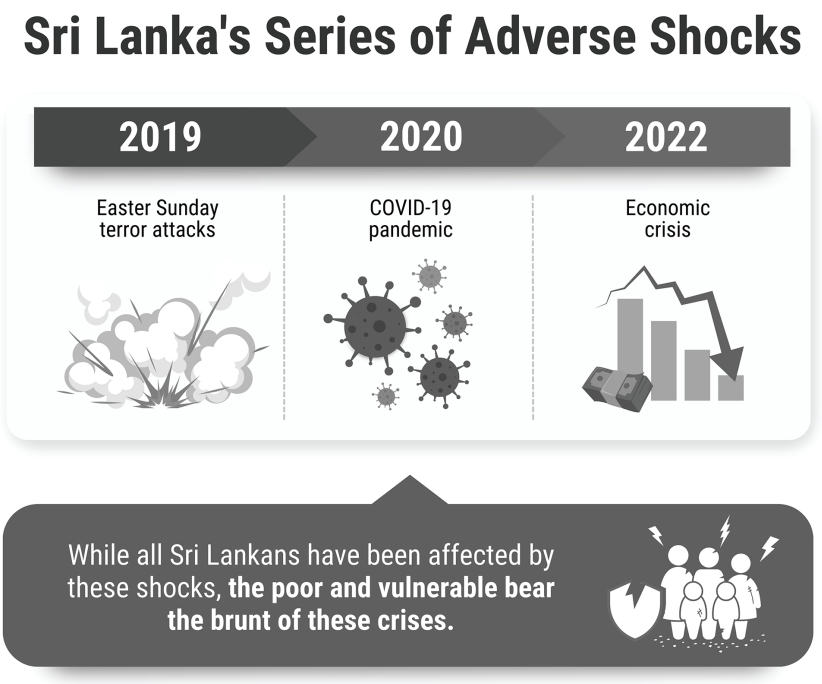
3 Baah, S. K., Aguilar, R. C., Diaz-Bonilla, C., Fujs, T., Lakner, C., Nguyen, M. C., & Viveros, M. (2023, March 29). *March 2023 Global Poverty Update from the World Bank: The Challenge of Estimating Poverty in the Pandemic.* Retrieved May 10, 2023, from World Bank Blogs: https://blogs.worldbank.org/opendata/march-2023-global- poverty-update-world-bank-challenge-estimating-poverty-pandemic

4 Below the USD 1.90 per day poverty line (previous extreme poverty rate).
United Nations High-level Political Forum on Sustainable Development. (2022). *Addressing the Cost-of-living Crisis in Developing Countries: Poverty and Vulnerability Projections and Policy Responses. New York:* United Nations Development Programme.

world population). Projections at the lower-middle income poverty rate reveal that an additional 20 Mn people may be pushed into poverty due to the short-term impact of food and energy price escalations.[5]

13.2.1 Ripple Effects on the Poor

A rise in poverty affects all aspects of life. Its impacts are substantial for those affected by multiple adverse shocks consecutively, with no time for recovery. Pandemic-induced learning losses are bound to influence knowledge and skill accumulation among children, consequently affecting their earning potential in the long-term. This is more so for children from poor households due to a lack of access to multiple resources such as digital devices and distance learning opportunities. Estimates suggest that learning poverty in low-and-middle-income countries (LMICs) has increased by 33%, with over 75% of 10-year-olds in South Asia lacking minimum literacy.[6] The concurrent adversities also risk poor children not returning to school as they are compelled to support their families instead. In Pakistan, for instance, 7.6 Mn children have dropped out since the onset of the pandemic.[7] As for the working-age population, the loss of opportunities coupled with the inability to catch up to incomes reduced / lost entirely amplified due to uneven recovery and successive negative shocks.



Source: Compiled by the author based on various sources.

5 At the USD 3.20 per day poverty line (previous lower-middle income poverty rate).

6 Schady, Norbert., Holla, Alaka., Sabarwal, Shwetlena., Silva, Joana., & Chang, Andres Yi. (2023). *Collapse and Recovery: How the COVID-19 Pandemic Eroded Human Capital and What to Do About It.* Washington, D.C.: World Bank. doi:10.1596/978-1-4648-1901-8.

7 *Ibid.*

At the household level, inflationary pressures are affecting consumer spending and leading to a rise in the cost-of-living. In Bangladesh, blackouts were imposed to minimise energy consumption due to the country's inability to meet the energy demand.[8] The soaring cost-of-living is deteriorating living standards, deepening food insecurities and rising inequalities. More and more low-income households are struggling to deal with the consequences of poverty and adopting multiple coping strategies to merely stay afloat. Similar evidence is found in Sri Lanka since the country is currently undergoing simultaneous setbacks.

13.2.2 Evidence from Sri Lanka

Sri Lanka has been experiencing adverse shocks continuously since 2019. The Easter Sunday terror attacks in 2019 were followed by the COVID-19 pandemic in 2020. Just as Sri Lanka was en route to recovering from the pandemic, in early 2022, the country plunged into the worst economic crisis in its independent history. These shocks have impacted the lives and livelihoods of all Sri Lankans, irrespective of demographic status. However, as with any crisis, the poor and vulnerable are among the hardest hit.

Households have been affected in more ways than one. Import restrictions led to soaring food and medicine costs and supply shortages; very high levels of inflation, especially concerning food prices, coupled with the depreciation of the domestic currency, resulted in a drastic decline in the real value of income, thus affecting purchasing power. This left households scrambling to afford essentials, with poorer groups having to adopt drastic coping mechanisms. For example, the 66% hike in electricity tariffs earlier this year largely affected lower-end consumers and left them self-imposing power cuts due to unaffordability. Pertaining to food consumption, low-income families are likely to have reduced their portion sizes, substituting for cheaper and less nutritious alternatives or skipping meals entirely. This is bound to have grave repercussions in the long term, such as increased child malnutrition, reduced earning potential among the working-age population and adverse health conditions for the elderly.

8 Schady, Norbert., Holla, Alaka., Sabarwal, Shwetlena., Silva, Joana., & Chang, Andres Yi. (2023). *Collapse and Recovery: How the COVID-19 Pandemic Eroded Human Capital and What to Do About It.* Washington, D.C.: World Bank. doi:10.1596/978-1-4648-1901-8.

Box 13.1
Sri Lanka's Growing Urban Poor

A considerable share of urban dwellers in Sri Lanka live in poverty. Pre-pandemic data reveal that 217,500 of the total 3.64 Mn Sri Lankans residing in the urban sector were poor. Urban poverty in Sri Lanka has since increased as effects of the pandemic were unevenly borne by the poor followed by adversities such as the rise in the cost-of-living induced by the economic crisis. World Bank estimates suggest that urban poverty tripled from 5% to 15% in 2022.

Poverty in Sri Lanka by Sector, 2019

	No. of Poor Population	Mean Household Income (LKR)	Mean Household Expenditure (LKR)
Sri Lanka	3,042,300	76,414	63,130
Urban	217,500	116,670	95,392
Rural	2,500,600	69,517	57,652
Estate	324,200	46,865	38,519

Source: Poverty Indicators 2019, Department of Census and Statistics (DCS), Sri Lanka.

According to the DCS poverty indicators for 2019, the urban sector represents the lowest poverty share in Sri Lanka at 7% compared to 82% in the rural sector and 11% in the estate sector. However, it is important to acknowledge the high cost-of-living in urban areas along with the greater degree of inequality within the sector, especially among the average urban resident and those living in slum/shanty dwellings.

Individuals belonging to slum communities are a large part of the composition of urban poor. Although residents of the urban sector, they continue to live in poor quality, overcrowded housing with access to minimum wage jobs, low levels of job security and no official channels of unemployment benefits. Hence most of these households lack access to affordable healthcare, housing, education, proper sanitation facilities etc. Following Sri Lanka's multidimensional crisis, such individuals are facing greater adversities and are being pushed further into poverty. Hence, while poverty alleviation programmes traditionally focus on the rural poor, addressing issues regarding the growing levels of poverty and inequality among the urban population is noteworthy.

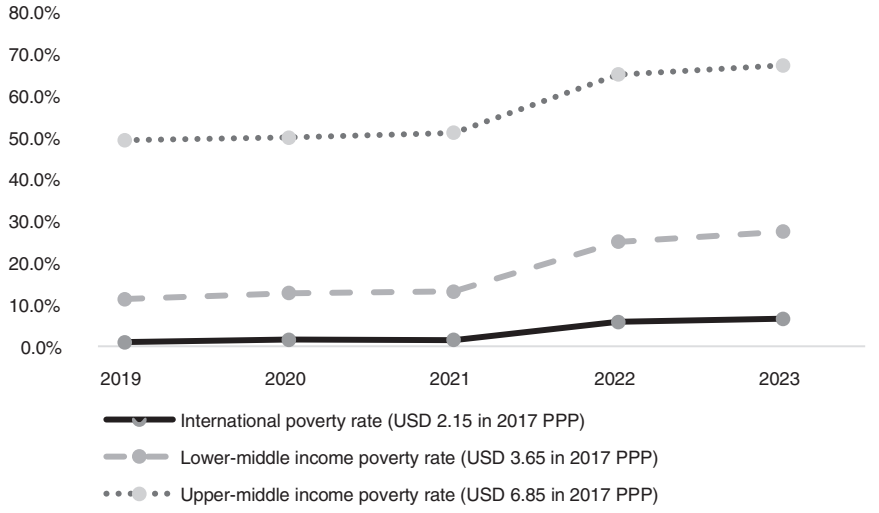
Sri Lanka's current economic crisis is affecting individuals at all levels, leading to a drastic drop in living standards and reversing progress made towards poverty alleviation. Since the onset of these shocks, more people have fallen into poverty while pushing the existing poor deeper into poverty. Estimates

Sri Lanka's socio-economic outlook in the near-term is a cause of serious concern, with poverty forecasted to continue above 25% until 2024.

suggest that in 2020 alone, 300,000 new poor were created due to COVID-19.[9] Poverty is estimated to have nearly doubled from 2021 to 2022, with around 2.7 Mn individuals falling below the poverty line within a 12-month period. At the sectoral level, half the estate sector population live in poverty as of 2022.

Gender-disaggregated estimates reveal that although male and female-headed households experienced a similar degree of poverty in 2019 (11.3%), the impact on female-headed households has been higher by 2022 (24.8% and 28.6% for male and female-headed households, respectively). With 2022 recording the highest share of poverty since 2009, it is estimated that over 25% of Sri Lankans currently live below the poverty line, while another 11.3% of the population live within 20% above the poverty line.[10] The considerably high cluster of non-poor households just above the poverty line positions them at a high risk of backsliding into poverty following future shocks or vulnerabilities. As with poverty, inequality too has widened, with the Gini Index increasing to 39.9 in 2022 (from 37.7 in 2019). Given this context, Sri Lanka's socio-economic outlook in the near-term is a cause of serious concern, with poverty forecasted to continue above 25% until 2024.[11]

Figure 13.1
Poverty in Sri Lanka



Source: World Bank. (n.d.). *Macro Poverty Outlook for Sri Lanka: April 2023 - Datasheet (English).* Macro Poverty Outlook (MPO). Washington, D.C.: World Bank Group.

9 At the updated poverty rate for lower-middle income countries (USD 3.65 per day in 2017 PPP). Walker, R., & Abeygunawardana, K. (2022). *Sri Lanka Development Update: Protecting the Poor and Vulnerable in a Time of Crisis.* Washington, D.C.: The World Bank.

10 *Ibid.*

11 *Ibid.*

13.3 Global Policy Agenda for Recovery

Effective policy decisions are critical with economies worldwide suffering from multiple setbacks. At this juncture, policymakers are tasked with implementing policies that strike a balance between supporting the people in the short-term while also ensuring economic growth and recovery in the long-term. The urgency for sustainable and inclusive policymaking is more significant for poorer countries with weaker economic and financial positions, to meet any major impediments over the next few years.

Both monetary and fiscal policy interventions are pivotal in lowering poverty and establishing sustainable economic growth. Since the primary focus of this discussion is poverty reduction and sound fiscal policies are a crucial tool for alleviating poverty, this section examines fiscal policy options available for recovery in detail with an emphasis on short-term action.

13.3.1 Fiscal Policy: Cash Transfers Vs. Subsidies

Fiscal policies are a key policy tool utilised by governments to protect vulnerable groups and as a driver of economic growth. Sound fiscal policies can positively impact poverty and inequality in the short, medium, and long-term. It is especially critical in times of crisis, as was evident during COVID-19, with policymakers worldwide having implemented various fiscal policy responses to minimise the pandemic's socio-economic impacts. Evidence suggests that such interventions have had favourable impacts on poverty, food security, labour market and health outcomes. Microsimulations in LMICs reveal that in the absence of fiscal responses, poverty would have been 2.4% higher on average due to the pandemic.[12]

Fiscal policies are a key policy tool utilised by governments to protect vulnerable groups and as a driver of economic growth. These can positively impact poverty and inequality in the short, medium and long-term.

Transfers and subsidies to firms and households were a popular fiscal response to COVID-19. Since the pandemic impacted almost all aspects of the economy, many governments focused on universal assistance over targeted relief, with subsidies being the preferred means of universal assistance. Subsidies were implemented by around 93% of low-income countries (LICs) and only 76% of high-income countries (HICs). Universal transfers were less popular among LICs, with only around a tenth implementing these.[13]

The timeliness factor that plays a vital role in providing emergency assistance makes subsidies a more logical solution in terms of implementation (fewer targeting errors, lower administrative and execution costs) for optimal short-term impacts. However, it is vital to factor in the costs associated with supporting more beneficiaries than those needing support, especially since subsidies are inclined to

12 World Bank. (2022). *Poverty and Shared Prosperity 2022: Correcting Course*. Washington, D.C.: World Bank. doi:10.1596/978-1-4648-1893-6. License: Creative Commons Attribution CC BY 3.0 IGO.

13 *Ibid.*

benefit richer groups more than the poor. For example, in the world's poorest economies, over 50% of subsidy benefits were enjoyed by the richest 20%.[14] Given the widespread impacts of the pandemic, there is a likelihood that these costs may have been set off. Although subsidies may be a popular option for extending universal support given the broader coverage and easy implementation, direct transfer (targeted) may be a better policy option for supporting the poor. With targeted transfers, the fiscal burden on governments is lower. Further, cash transfers specifically assign the decision-making power on how to spend the money to beneficiaries, allowing them to utilise the money depending on individual household needs.

Arguments against the provision of cash transfers claim that giving monetary allowances to people without any underlying conditions tends to reduce the value of money as it is not 'earned'. They can also tend to claim lower labour market participation rates as a culture of reliance on government assistance arises. If cash transfers are targeted properly, only those most deserving of assistance will receive them. This will include only the most vulnerable households, who may largely utilise this money to purchase essential items such as food, medicine, etc. Without such support, these groups may risk severe consequences such as starvation. Hence, supporting them through cash transfers is unlikely to make individuals lazy and dependent on government support but rather motivate them to work towards earning a living wage to overcome existing hardships and strive to achieve better living standards. Further, using cash transfers as an emergency policy response tool during crises, such as COVID-19, can be justified since they provide households with some cushioning to cope with unanticipated shocks. In any case, these issues can be eliminated by providing conditional cash transfers. However, this may not always be possible when supporting the poor and vulnerable during times of crisis, as they may require unconditional cash transfers due to their inability to meet any underlying conditions given the circumstances.

13.3.2 Responding to the Cost-of-living Crisis

Many countries worldwide are currently experiencing dramatic increases in their cost of living. If left unaddressed, continuous inflation can substantially lower purchasing power, leading to declining living standards, increased poverty, and rising inequalities. Several policy options exist to ease the cost-of-living crisis, some more effective than others.

Identifying sectors with the highest inflationary pressures is an important measure that would help directly address inflation within sectors by tackling its root causes (supply chain disruptions, extreme weather conditions, etc.). Although measures such as imposing price ceilings have been proven to create further shortages, regulations can be put on how fast prices of certain essentials such as medicine can rise. These will prevent consumers from being exploited through unnecessary price markups. For example, extreme price markups on face masks and sanitisers were seen during COVID-19 due to excessive global demand and limited suppliers. Since these were essential items at the time, having some form of price control could have enouraged new suppliers to enter the market and neutralise the upsurge in prices.

14 World Bank. (2022). *Poverty and Shared Prosperity 2022: Correcting Course.* Washington, D.C.: World Bank. doi:10.1596/978-1-4648-1893-6. License: Creative Commons Attribution CC BY 3.0 IGO.

The demand for pay increases is a common occurrence during times of rising prices. While increasing salaries and wages to cope with the rising cost-of-living is necessary, this option can also lead to a wage-price spiral in the event of persistent escalations in both. Although governments have their hands tied to some extent over combating inflation – especially the cost of essentials such as food – they can respond by providing some form of economic relief. Relief efforts primarily need to focus on the poor as they are amongst the worst affected due to rising prices since a large share of their household income is spent on food, housing, energy, etc. Furthermore, as the demand for essentials tends to remain inelastic, the price hikes imply that an even larger proportion of a low-income individual's budget is now spent on these. Under such circumstances, supporting and shielding the poor from sinking further into poverty is imperative. A far-sighted approach is essential through government interventions such as fiscal policy responses – cash/in-kind transfers and subsidies in the short-term, skill development and job retention/creation initiatives in the medium-term and improvements to education, healthcare, infrastructure, etc., in the long-term.

13.4 Policy Options for Poverty Reduction

Extending government support to the poor and vulnerable facing multiple shocks is essential to ensure their lives and livelihoods remain intact. Still, extending support amid an economic crisis, as in the case of Sri Lanka, is tricky in the face of limited fiscal space. While government interventions are integral in supporting the poor and vulnerable, policy decisions must be introduced with care while balancing both immediate support for the people and economic recovery. Hence, action by policymakers is significant at this point in time and needs to be adeptly implemented.

13.4.1 Targeted Support

Microsimulations reveal that fiscal policy responses introduced during COVID-19 helped lessen the pandemic's impact by half in Sri Lanka.[15] As evident from the previous section, cash transfers are a widely accepted policy tool frequently used in supporting the poor and vulnerable. Nevertheless, considering Sri Lanka's limited fiscal space, several challenges exist. The success of cash transfers primarily depends on three key factors: targeting, adequacy and the timeliness of responses.[16] Hence, an effective provision of cash transfers entails identifying those who deserve assistance the most and immediately providing them with reasonable monetary support.

Given the current financial constraints, beneficiary identification criteria must be narrowed to include the poorest and most vulnerable families. In this context, the criteria should probably include conditions for identifying and selecting households facing catastrophic situations, such as extreme poverty and starvation. The most efficient beneficiary selection mechanism would be to utilise existing social protection programmes. However, since all existing beneficiaries in such programmes cannot be supported, critical groups must be identified and given priority within these programmes while also

15 World Bank. (2022). *Poverty and Shared Prosperity 2022: Correcting Course*. Washington, D.C.: World Bank. doi:10.1596/978-1-4648-1893-6. License: Creative Commons Attribution CC BY 3.0 IGO.

16 *Ibid*.

including any new poor who do not belong to the existing programmes. While this process may initially require additional administrative costs and much time, it will be a cost-saver at the time of benefit disbursement. Typically, this process may also generate some resistance from existing beneficiaries who are bound to be left out of the immediate aid process. Nevertheless, firm decisions must be made given the tough circumstances.

An alternate beneficiary identification approach would be utilising the information gathered from fresh surveys. Such a process commenced in 2022. While this survey can provide the latest beneficiary information and help in accurate targeting, the only downside is the time taken to process survey data and identify eligible beneficiaries. If delays occur, the payment disbursement will take longer, putting highly vulnerable groups at greater risk. Attention must also be given to ensure the process is cost-friendly while deriving accurate results. Given the prevailing crisis, households traditionally excluded from government assistance programmes are also likely to be in need due to the drop in per capita incomes and high cost-of-living, etc. While these groups should be targeted in the long-term, policymakers must direct resources towards supporting those most in need in the short-term.

Once the most vulnerable groups are identified, they must be provided with a reasonable monetary allowance for a pre-determined timeframe such that they are alleviated from immediate risk. Upon understanding the needs of the selected households, policymakers can decide if the transfers are more effective as cash or in-kind (for example, a pack of food/ dry rations to support poor households due to high food inflation). The transfer size and duration must be determined based on the degree of risk families face. These decisions must also account for the fund availability and the number of at-risk beneficiaries requiring government assistance.

The final step is the disbursement of benefits to the identified beneficiaries. This must be done in a swift and secure manner. As evident during the pandemic, reaching beneficiaries is highly effective through digital systems such as direct deposits of cash transfers to beneficiary bank accounts. During the COVID-19 emergency assistance programme, most disbursements were made via Samurdhi banks. The same procedure can be repeated, as most identified households are likely to have bank accounts in Samurdhi banks at their village level, as they may already be recipients of existing assistance programmes. If direct deposits cannot be made for any identified beneficiaries, they can be channelled through the Grama Sevaka Officers at the village level. However, these families should be encouraged to open bank accounts for future convenience.

Targeted assistance of this nature would ensure the most vulnerable receive significant support to sustain themselves rather than a wider group of beneficiaries receiving minimal support. For example, the Sri Lankan Rupees (LKR) 5,000 cash transfers granted as COVID-19 relief benefited all existing beneficiaries of assistance programmes, waitlisted recipients and other additionally identified vulnerable households. While this helped soften the immediate impact of the pandemic for many families, it was insufficient to assist a family in overcoming their vulnerability status. However, given the pandemic's unanticipated shocks, extending support to a larger group of beneficiaries was necessary. Given the nature of the economic crisis and the rising cost-of-living, resources must be allocated considering the overall objective of supporting families to sustain their lives and livelihoods without

relying on government assistance in the long-term. In this regard, providing a family of four in dire poverty a sum of LKR 15,000-20,000 per month for a minimum period of 4-5 months will help them meet necessary minimum expenses and even save a small sum of money per month. Over time, the family will have a higher possibility of elevating their status from extremely poor to above the poverty line (or at least to near poor status). Thus, the family is better off receiving the said assistance over LKR 5,000 per month, which will likely be spent entirely on essentials. Hence, adequately supporting a targeted group can result in better beneficiary outcomes.

Poverty alleviation requires a combination of short, medium, and long-term measures. While ensuring the poor do not fall deeper into poverty is a priority in the current climate, if these measures are not supported by action focusing on overcoming poverty in the long term, immediate efforts are futile.

Once identified households are mitigated from immediate risk, horizontal expansion of cash transfers is possible. At this stage, a lesser amount than what was originally provided can be extended to a wider network of beneficiaries. Since this would also include the original high-risk group, it is important to accurately determine the parameters for assistance. The purpose of doing so is to ensure everyone receives sufficient support without the likelihood of facing high-risk conditions again. It is also possible to make the transfers conditional from this point forward. For example, monthly cash transfers can be provided to a family, conditional upon all young children in the household attending school regularly. Conditional cash transfers of this nature support both current and future poverty reduction.[17] In this instance, policymakers can also set a timeline for the duration of cash transfers upon which beneficiaries are reassessed. This can motivate recipient households to actively work towards improving their lives and livelihoods during the limited timeframe the government support is provided.

As per a recent Gazette (No. 2328/13) issued by the government, some measures discussed above have been considered to provide additional support to identified poor and vulnerable groups. Accordingly, beneficiaries are categorised into several groups based on their poverty status and those facing higher vulnerabilities are provided with an increased monthly allowance for an extended period. While this is an initiative in the right direction, how it will materialise can only be seen upon implementation. If executed correctly, this will support the poor and vulnerable to overcome any immediate risks and help sustain themselves to a certain extent over time.

13.4.2 Investments for the Future

Targeted assistance aims to direct fiscal spending towards those most in need to provide short-term relief. Generally, poverty alleviation requires a combination of short, medium, and long-term measures. While ensuring the poor do not fall deeper into poverty is a priority in the current climate,

17 Loeser, J., Özler, B., & Premand, P. (2021, May 10). *What Have We Learned About Cash Transfers?* Retrieved May 10, 2023, from World Bank: https://blogs.worldbank.org/impactevaluations/what-have-we-learned-about-cash-transfers

if these measures are not supported by action focusing on overcoming poverty in the long term, immediate efforts are futile.

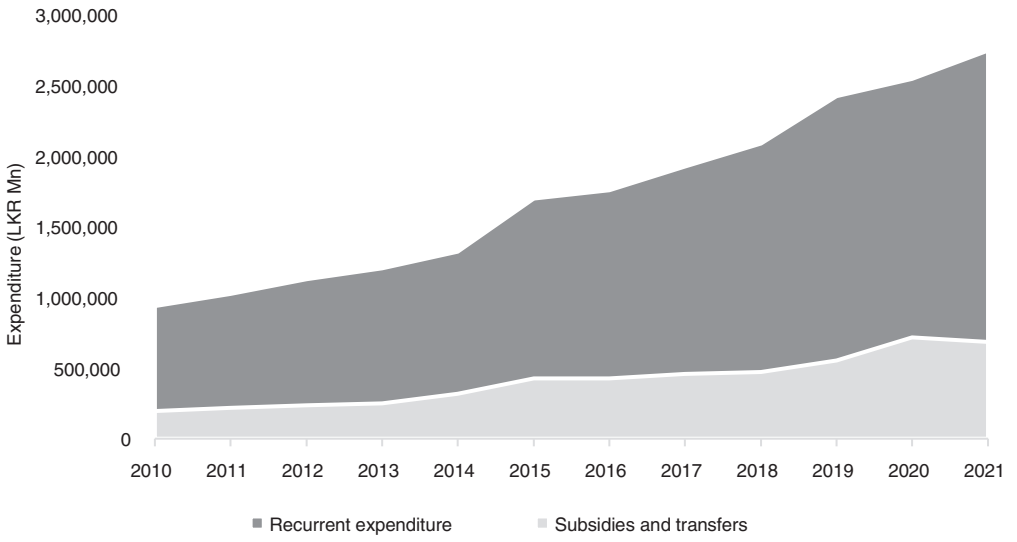
Investments in infrastructure, sustainable food production, healthcare and education are essential for achieving the overall goal of poverty reduction. Such investments support human capital development, which can, in turn, support the country's overall growth. For example, upgrading the existing school curriculums to meet modern-day demands will help students be on par with international standards, thereby creating a generation of highly talented individuals. Providing flexible work schedules, remote work opportunities, affordable childcare facilities, etc., will encourage more women to enter the workforce, thus increasing female labour force participation rates. Although such investments are costly in the short-term, these usually generate a high return on investment (ROI) over time. If future-focused investments – especially in terms of social infrastructure – are not done today, Sri Lanka will continue facing dire consequences against future crises as well.

Estimates suggest that direct cash transfers of around LKR 202 billion (Bn) to the poor are needed for Sri Lanka as of 2022 to address poverty.[18] This amount has undoubtedly increased with the spillover impacts of the economic crisis. This is indeed a tricky situation for Sri Lanka as the economic crisis has restricted the country's spending capabilities as well as widened the need for social safety. The limited fiscal space raises the question of how the government should allocate resources to support poverty reduction.

Where possible, the reallocation of government spending is one viable option for policymakers to consider in this regard. Evaluating the possibility of reallocating spending from one unit to another (across Ministries / programmes) can help align with the country's immediate priority of overcoming the economic crisis by minimising public expenditure to reduce the prevailing budget deficit. Analysis of government expenditure over the past decade shows that over 20% of recurrent expenditure goes toward providing subsidies and transfers (Figure 13.2). This share has increased in more recent years, albeit somewhat modestly, given the budgetary limitations and the unanticipated nature of the multiple shocks.

18 Walker, R., & Abeygunawardana, K. (2022). *Sri Lanka Development Update: Protecting the Poor and Vulnerable in a Time of Crisis.* Washington, D.C.: The World Bank.

Figure 13.2
Expenditure on Subsidies and Transfers, 2010-2021



Source: Ministry of Finance, Economic Stabilisation & National Policies Sri Lanka. (2022). *Annual Report 2021.* Colombo: Ministry of Finance, Economic Stabilisation & National Policies Sri Lanka.

The composition of expenditure on transfers and subsidies shows that an overwhelming share (88% in 2022) goes toward providing subsidies and transfers to households. Pensions comprise most of this expenditure (43% of transfers to households). The considerable annual spending on pension payments – largely on the non-contributory Public Servants Pension Scheme (PSPS) – burdens public finances, especially considering the growth of Sri Lanka's ageing population. Therefore, it is vital to consider revisions to the existing pension system in Sri Lanka, among others, given the urgency to consider all options to achieve a more sustainable fiscal position. Reforms of this nature will contribute towards reducing government spending. Further, spending reallocations can help align with the country's immediate priorities, such as overcoming the ongoing economic crisis. In light of the above, it is important to conduct a comprehensive assessment of the budgetary allocations of individual spending units (each subsidy and transfer programme, for example) prior to making decisions regarding spending reallocations. This will ensure no unit goes underfunded whilst releasing additional spending to support the poor and vulnerable.

13.5 Conclusion

Poverty reduction has been reversed globally due to concurrent negative shocks. While recovery has been uneven, it has shed light on the need for better and more resilient systems, policies, etc., especially in the developing world. Thus, the global community must work together to support the poor and vulnerable to ensure they are not left behind and existing disparities do not widen beyond repair.

As mentioned in the previous sections, evidence shows that strong fiscal policy interventions played a key role in minimising the adverse impacts of COVID-19 on poverty worldwide. Given Sri Lanka's prevailing economic crisis, it is imperative to strengthen existing fiscal policy interventions to ensure optimum efficiency and effectiveness. If the poor and vulnerable are not adequately supported throughout the crisis, they are likely to be further financially and economically handicapped, contributing to intergenerational poverty, among several other tribulations over time. Resetting Sri Lanka will require good governance efforts and sound policy measures to be in place. Hence, policy decisions made over the next 12-24 months are critical for Sri Lanka. These will ensure the country's future trajectory in terms of recovery or further distress.

Policy decisions made over the next 12-24 months are critical for Sri Lanka. These will ensure the country's future trajectory in terms of recovery or further distress.

While fiscal policies largely help cushion the immediate impacts of adverse shocks, these are not the entirety of the solution. Fiscal policy interventions must be combined with investments that support human capital development by focusing on education and health and supporting the poorest and the most vulnerable groups. Thus, measures to support the latter in the short-term need to be coupled with investments that support long-term growth, these go hand in hand. At this point, Sri Lanka is at crossroads. Therefore, policy decisions taken over the next few months must confirm that the country's overall well-being and development are prioritised. A combination of short and medium to long-term focused action are prerequisites to ensure Sri Lankans are supported at present, and the country is better prepared to overcome future shocks.

14. Fostering Green Finance for a Sustainable Future

14.1 Introduction

Building a sustainable future is a pressing global imperative. In a setting where environmental concerns are a pressing issue, financial derivates on green financing are gaining the spotlight globally. As a developing nation, Sri Lanka, too, is confronted with numerous environmental challenges that demand immediate attention. Given the severe economic downturn and related financial constraints to address crucial environmental issues, alternative financing strategies must be carefully considered.

Green financing is such a strategy, presenting a unique method to finance environmental initiatives and sustainable development projects. In contrast to conventional financing approaches prioritising economic gains, green financing entails directing financial investments towards environmentally sustainable goals. Allocating financial resources to advance the utilisation of renewable energy, enhance energy efficiency and energy optimisation, establish sustainable infrastructure, and manage waste and other sectors that prioritise environmental sustainability are some popular areas. Indeed, the aftermath of the Russia-Ukraine war saw energy prices soaring that generated renewed debates centred around the issue of green financing – as opposed to 'brown financing' investments in coal. Against these developments, this policy brief examines the potential for green financing in Sri Lanka's context amid the current economic downturn. Moreover, it discusses possible mutually beneficial outcomes for the economy and the environment.

14.2 Recent Global Developments and Green Financing

Geopolitical tensions and subsequent disruptions in gas and oil supplies have heightened uncertainties and underscored the vulnerability of traditional energy sources. Ukraine is a crucial transit route for Russian gas exports to Europe. Consecutive disruptions to supply as well as supply channells, coupled with the subsequent gas and oil price hikes, have had far-reaching adverse effects on energy markets worldwide. As a result, the International Energy Agency (IEA) reveals that renewable sourcing received an impetus. Discussions already underway in the European Union (EU) had suggested limiting its dependence on fossil fuels from Russia by 2027. A key means of achieving this is to increase the proportion of renewable energy sources in the EU's final energy consumption.

The energy supply uncertainties have had a profound impact on investor sentiment. Investors have been prompted to re-evaluate their investment strategies to account for heightened risks from disruptions in energy supply chains and the broader implications for global economic stability. In view of its perceived reliability and domestic availability, certain countries have witnessed a renewed push for coal as an alternative energy source. Noticeably, several countries like Italy and Germany,

with significant coal reserves, have made intensified efforts to expand coal production and infrastructure. This trend has raised concerns among environmental advocates, given the associated environmental and climate impacts of coal usage.

Green financing is regarded as a constituent of the green economy, an economic framework that fosters a positive correlation between economic growth and environmental and social welfare.

Technological developments are also spurring interest in green financing. For example, recent advancements in the transportation industry, such as the transition to electric vehicles, is one such area. The IEA in 2023 notes that the market for such vehicles underwent significant growth in recent years, with the global quantity of electric vehicles in circulation estimated to have spiralled from nearly zero to 10 million (Mn) between 2010 and 2022. Other areas favouring this move include interest in investing in producing liquid biofuels to reduce carbon emissions in the transport sector and heavy industries.

It is projected that achieving a global net zero emissions status by 2050 will necessitate a capital investment equivalent to 1.5% of the gross domestic product (GDP).[1] Green financing instruments are geared to fulfil some of this, generating profitable returns while also promoting ecologically beneficial results. With much optimism, some estimates expect the green finance sector to generate a direct economic impact of United States Dollars (USD) 36 billion (Bn) towards the global GDP in 2030, with an expected increase to a sizeable USD 61 Bn by 2050.[2]

However, recognising the long-term sustainability and environmental implications of such developments warrants careful consideration. Policymakers, investors, and energy stakeholders must navigate these challenges while promoting a transition to cleaner and more sustainable energy sources.

14.2.1 What is Green Financing?

Green financing is regarded as a constituent of the green economy, an economic framework that fosters a positive correlation between economic growth and environmental and social welfare. This results in growth disassociated from environmental externalities or even exhibits a positive correlation with the environment. Here, green financing of projects and activities that aim to reduce carbon emissions and other negative environmental impacts are typically identified as forming three components – i.e. green financial system, financing of green investments and financing of public green policies.[3] Green financing, sustainable financing and climate finance are three distinctive concepts, but these

1 The Energy Transitions Commission. (2023). *Financing the Transition: How to Make the Money Flow for a Net-Zero Economy.* London: The Energy Transitions Commission.

2 Oxford Economics. (2023). *The Global Green Economy: Understanding and Capturing the Opportunity.* London: Oxford Economics. Oxford: Oxford Economics.

3 Lindenberg, N. (2014). *Definition of Green Finance.* Retrieved May 16, 2023, from Convention on Biological Diversity: https://www.cbd.int/financial/gcf/definition-greenfinance.pdf

are interconnected (see infographic). Green financing is a component of sustainable financing, while climate finance falls under the pillar of green financing.

Box 14.1
Green Financing Options

Various types of green financing options are available in the market, including green bonds, green loans, green equity, green microfinance, and green insurance.

- Green bonds: Fixed-income financial instruments used to raise capital for environmentally sustainable projects. The proceeds from green bonds are used to finance projects such as renewable energy, energy efficiency, and sustainable transport.

- Green loans: Loans granted to finance green projects. These are similar to traditional loans but come with specific criteria related to environmental sustainability.

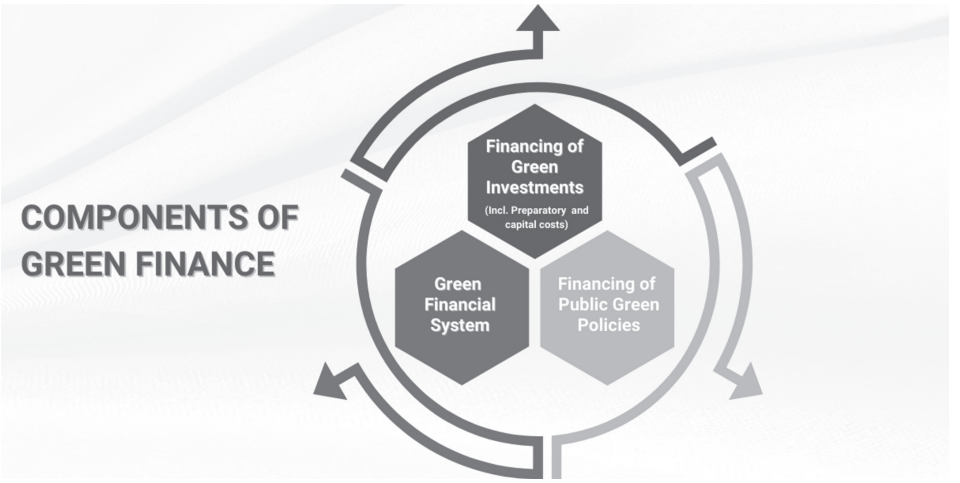
- Green equity: Equity investments made in environmentally sustainable projects or companies. Direct investments can be made in companies that are developing or implementing sustainable projects or through investment funds that focus on green projects.

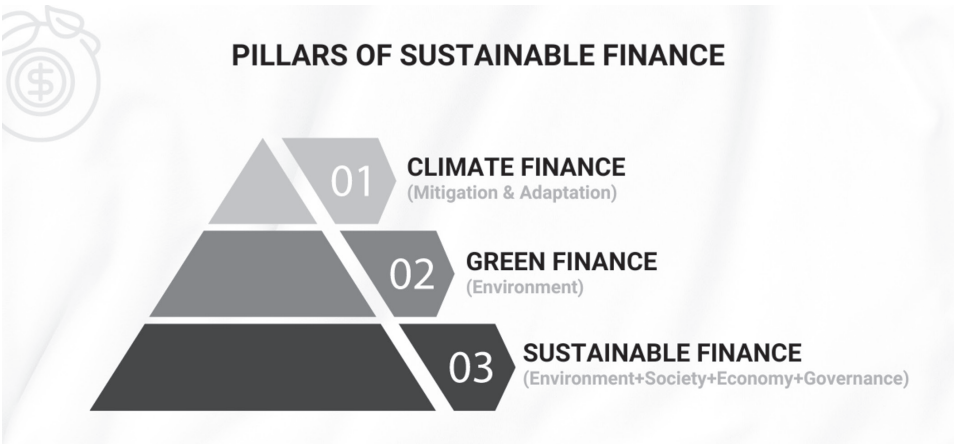
- Green microfinance: Provision of microfinance services to finance environmentally sustainable projects or activities. These projects may include sustainable agriculture, renewable energy, and sustainable water management.

- Green insurance: Insurance products that cover environmental risks or promote environmental sustainability. For example, green insurance may cover losses resulting from environmental damage or promote adopting sustainable practices.

Source: Compiled by the author based on various sources.

Issuance of green bonds is evident worldwide, from giant to smaller economies. International Finance Corporation (IFC) issued its first Green Masala Bond in 2015, raising approximately USD 3 Bn to finance renewable energy and clean transportation projects in India. The success of IFC's green bond in India led to subsequent issuances, including a USD 500 Mn green bond by the Indian Railway Finance Corporation in 2017, as reported by the Climate Bonds Initiative (CBI). Similarly, the IFC reports that Bangladesh issued its first green bond in 2019 to finance climate-resilient infrastructure projects, raising approximately USD 30 Mn. In early 2023, India initiated another green bond to raise around USD 2 Bn for initiatives that promote climate change mitigation, safeguarding the environment, and preserving biodiversity.





Source: Compiled by the author based on various sources.

Several other developing economies, too, have exhibited their dedication towards sustainable financing. In 2016, Fiji accomplished the feat of being the inaugural emerging market to release a green bond, which garnered a sum of USD 50 Mn aimed at enhancing climate resilience. In 2020, Egypt issued a sovereign green bond worth USD 750 Mn to fund environmentally-friendly projects related to sustainable water management and clean transportation. In 2021, Indonesia and Colombia issued sustainability and green bonds, respectively, to provide financial support for sustainable projects. The sustainability bond was aimed at backing the Sidrap Wind Farm project in Indonesia, while the green bond issued by Colombia intended to support a range of sustainable initiatives.

Similarly, ranked as the second largest economy in the world, China has emerged as a leader in the global green bond market, issuing the largest volume of green bonds globally. China's green bond market has grown rapidly since its inception in 2016, reaching a USD 200 Bn cumulative total in issued green bonds at the end of 2021, wherein in 2021 alone amid the pandemic, China issued USD 68.2 Bn. The proceeds from China's green bonds have been used to finance various sustainable development projects, including renewable energy, energy efficiency, and pollution control.

These particular initiatives underscore the growing acknowledgement of the significance of green financing in tackling ecological predicaments. Raising private capital for environmental priorities not only facilitates the fulfilment of countries' obligations under the Paris Agreement but also serves as a source of motivation for other nations. It demonstrates the feasibility and economic viability of sustainable investment. Similar to green bonds, blue bonds are debt securities issued to finance or refinance projects related to ocean conservation and sustainable use of marine resources. These can be used for sustainable fisheries, marine conservation, and coastal zone management in the country. According to the World Bank, Seychelles, the small island nation in the African continent, launched the world's first sovereign blue bond in 2018 for USD 15 Mn to fund the responsible utilisation of marine resources. Similarly, the Bank of China issued the first blue bond in Asia to safeguard the oceans.

Driven by various global events like the Russia-Ukraine war that are mounting global concerns in the energy sector, such as overreliance on fossil fuels and related adversities, emerging markets have adopted green financing to finance sustainable development initiatives emphasising the energy sector.

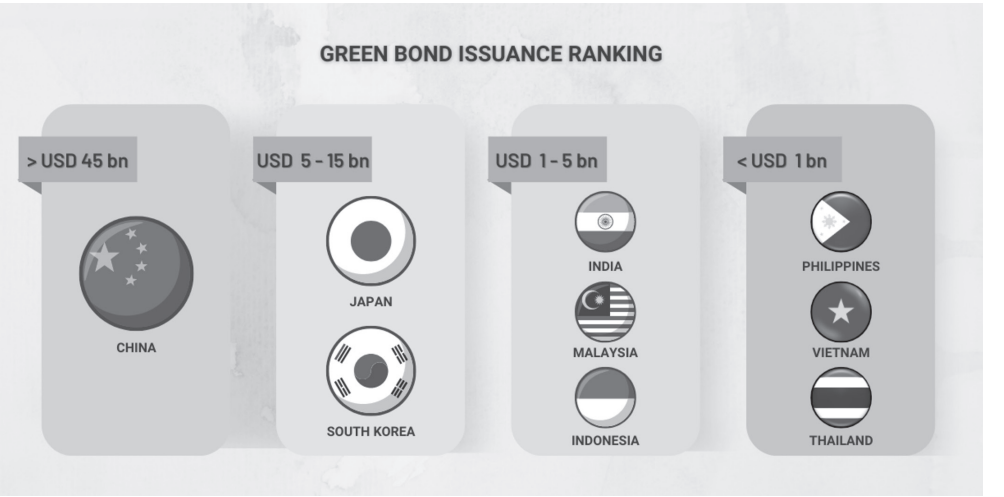
Private sector participation includes green equity and green loans. This refers to equity investments made by private investors in environmentally sustainable projects or companies that promote environmentally sustainable practices. Green equity investors are typically institutional investors who are willing to invest long-term capital in sustainable projects. This is particularly beneficial for projects with long payback periods or requiring significant upfront investments. Additionally, green equity investors often bring a wealth of expertise and experience to sustainable projects, which can result in synergies, help to improve project outcomes and diversify risks. Nevertheless, green equity investments may be riskier than other forms of green financing, as these typically carry higher risk and require a longer-term investment horizon.

Banks and other financial institutions typically offer green loans which are similar to conventional loans in terms of structure and repayment terms but with a specific focus on environmentally sustainable projects. These can be advantageous and fitting for small and medium-sized enterprises (SMEs) with slender access to other forms of financing. Green loans also offer the potential for lower borrowing costs, as some financial institutions offer lower interest rates for sustainable projects. The main drawback of green loans is that these cannot be applied as a blanket solution for all types of sustainable projects, particularly those requiring significant upfront investments or have long payback periods. Additionally, all financial institutions may not offer green loans, which could impede its availability for certain projects or borrowers.

Driven by various global events like the Russia-Ukraine war that are mounting global concerns in the energy sector, such as overreliance on fossil fuels and related adversities, emerging markets have adopted green financing to finance sustainable development initiatives emphasising the energy sector. Since 2016, 19 emerging market governments have issued bonds with the purpose

of financing initiatives aimed at mitigating the effects of climate change.[4] In 2021, the global green bond market grew exponentially, a giant leap reaching USD 269.5 Bn in 2020, up from USD 3 Bn in 2019.[5] Since then, the issuance of green and sustainable bonds has garnered significant traction on a global scale, with the cumulative amount raised reaching USD 2.5 trillion (Tn) as of early 2023. Developing countries, too, are employing green financing to entice capital investment in sustainable infrastructure, renewable energy, and other ecologically conscious endeavours (Box 14.1). Figure 14.1 illustrates the green bond issuance rankings in South Asia in 2022.

Figure 14.1
Green Bond Issuance Rankings in 2022, South Asia



Source: Author's illustration using CBI (2022) data based on Climate Bonds Initiative. (2022). *Sustainable Debt: Global State of the Market 2022.* Retrieved May 16, 2023, from Climate Bonds Initiative: https://www.climatebonds.net/files/reports/cbi_sotm_2022_03d.pdf

14.2.2 Debunking 'Greenwashing': Myth Vs. Reality

While green financing has emerged as a promising mechanism to support environmentally sustainable projects and businesses, some concerns have been raised regarding the financial viability and potential risks associated with green financing.

First, green financing is deemed to be financially unviable. The critics contend that many projects do not generate sufficient revenue or returns to justify the investment, making it challenging for investors to recoup their investment. Accordingly, studies on green bonds, a popular form of green financing, point out challenges in achieving market uptake due to concerns about the low financial returns

4 World Bank. (2023, April 01). *From India to Indonesia, Green Bonds Help Countries Move Toward Sustainability*. Retrieved May 16, 2023, from World Bank: https://www.worldbank.org/en/news/feature/2023/04/10/from-india-to-indonesia-green-bonds-help-countries-move-toward-sustainability

5 Climate Bonds Initiative. (2021, January 24). *Record $269.5bn Green Issuance for 2020: Late Surge Sees Pandemic Year Pip 2019 Total by $3bn*. Retrieved May 16, 2023, from Climate Bonds Initiative: https://www.climatebonds.net/2021/01/record-2695bn-green-issuance-2020-late-surge-sees-pandemic-year-pip-2019-total-3bn

associated with green projects. In a recent study conducted by Brandon, et al. in 2022, researchers were keen to understand whether a relationship existed between institutional investors who committed to being responsible in investing through the Principles for Responsible Investment (PRI) and the environmental, social, and governance (ESG) performance of their investment portfolios. Here, they found that institutional investors outside of the US who signed the PRI tended to have higher ESG scores in their portfolios compared to those who did not sign. However, in terms of investors within the US, their ESG scores were similar to non-signatories at best, and sometimes even lower if they had performed poorly, focused on individual clients, or joined the PRI at a later stage. This suggests that US signatories' involvement did not significantly improve the ESG performance of the companies they invested in. The researchers identified several reasons for this, including the influence of commercial interests (as the struggle for business survival intensified by uncertainties and economic pressures due to the COVID-19 pandemic and the Russia-Ukraine war, respectively), uncertainties about fiduciary responsibilities, and the less mature state of the ESG market in the US. Overall, the findings indicate that while international signatories of the PRI show better ESG performance, US-based signatories face challenges in meeting their responsible investment commitments.

While green financing has emerged as a promising mechanism to support environmentally sustainable projects and businesses, some concerns have been raised regarding the financial viability and potential risks associated with green financing.

While some green projects face financial challenges, many successful green financing projects have achieved financial viability. Studies show that green financing lowers long-term financial risks associated with environmental degradation and climate change. For example, a study by the European Bank for Reconstruction and Development (EBRD) disclosed that investing in green infrastructure could lead to significant financial savings and benefits in the long run, including reduced costs associated with air pollution, water scarcity, and climate-related events.[6] Such benefits can also attract new investors and enhance the reputation of companies and governments that prioritise sustainability.

Second, critics of green financing argue that there is a lack of standardisation and transparency in the green financing market. This makes it difficult for investors to assess the risks associated with green projects, resulting in a lack of investor confidence and reluctance to invest. Further, the IFC has recognised the need for more transparency and standardisation in the green bond market to enhance investor confidence and market uptake.

While there may be a lack of standardisation and transparency in the green financing market, efforts to address this issue and improve market conditions are ongoing. For instance, the CBI has developed a set of standards and certification schemes for green bonds to enhance transparency and ensure

6 Ahlemeyer, V. (2023, March 27). *New EBRD Projects Approved by InvestEU Investment Committee*. Retrieved May 16, 2023, from European Bank for Reconstruction and Development: https://www.ebrd.com/news/2023/new-ebrd-projects-approved-by-investeu-investment-committee-.html

that the funds raised are used for environmentally sustainable purposes. Additionally, regulatory bodies such as the Securities and Exchange Commission, including that of Sri Lanka, are scrutinising guidelines for issuing green bonds to ensure these issuers meet certain environmental standards.

Moreover, studies conducted by scholars like Serafeim in 2020 suggest that investors increasingly value environmental and social performance, which can lead to better financial performance in the long run. This indicates that green financing may be financially viable, even if the returns are not immediately evident or the magnitude of returns is not significant. Interestingly, some recent studies in 2020, like the one conducted by Deschryver & De Mariz have shown that green bonds can offer competitive returns compared to conventional bonds.

Third, critics of green financing argue that a risk exists regarding 'greenwashing', where companies or projects falsely claim to be environmentally sustainable to attract green financing. This can result in misallocating funds towards projects that do not truly contribute to environmental sustainability. Regrettably, a study by the Global Sustainable Investment Alliance (GSIA) in 2021 discovered that the lack of a standardised definition of green projects could lead to confusion and greenwashing. Besides, it is not uncommon to see certain funding projects/strategies in some corporates masked as green financing or a window dressing for corporate social responsibility (CSR) initiatives to boost the corporate image.

While greenwashing is a concern, measures are being taken to address this issue. For instance, as mentioned earlier, the CBI's set of standards and certification schemes provide investors with greater assurance that green bonds are being used to finance genuinely environmentally sustainable projects. In addition, the development of third-party verification and reporting mechanisms, such as the Green Bond Principles and the Sustainability Bond Guidelines, are being implemented to provide more transparency and accountability in the green financing market.[7] These measures can help ensure that funds are directed towards truly environmentally sustainable projects.

Fourth, critics argue that the lack of regulatory oversight in the green financing market can lead to potential risks for investors. It is acknowledged that the absence of a clear legal framework or a weak framework with ambiguities for green bonds can result in uncertainties for investors and potential risks such as lack of disclosure and inadequate monitoring.

While regulatory oversight is important, the efforts made so far to establish clear guidelines and frameworks for green financing are worth noting. The IFC's Green Bond Principles provide voluntary guidelines for issuers of green bonds to ensure transparency and accountability. These initiatives aim to assure investors of the environmental impact of green projects. Further, regulatory bodies worldwide are also implementing policies to support the growth of green finance. For example, the EU's Sustainable Finance Disclosure Regulation (SFDR) requires financial institutions to disclose information about the environmental impact of their investments. The SFDR also provides a framework to classify sustainable investments and set minimum sustainability standards for financial products.

7 International Finance Corporation. (2021). *Green Bond Principles: Voluntary Process Guidelines for Issuing Green Bonds*. Washington, D.C.: International Finance Corporation.

Finally, some critics of green financing argue that it can be susceptible to market fluctuations and economic downturns. According to them, green bonds may be less resilient to economic shocks than conventional bonds, which can result in lower investor confidence and market uptake.

While green financing may be affected by market fluctuations and economic downturns, evidence suggests that green projects may be more resilient to such shocks than traditional investments. One study finds green infrastructure investments, such as renewable energy and public transportation, to provide stability and resilience to countries during economic crises.[8] Additionally, green bonds have demonstrated relatively stable performance during market volatility, with some studies suggesting that these may even outperform traditional bonds during market stress.[9] Therefore, the argument that green financing is more susceptible to economic risks than traditional investments may not stand up to scrutiny.

14.3 Sri Lanka's Green Financing Options Amidst an Economic Downturn

Due to its unique geography and social demographics, Sri Lanka is confronted with various environmental challenges. The main concern is climate change impacts, which result in rising sea levels, erratic weather patterns, and frequent natural disasters like floods, landslides, and droughts. Deforestation is another major challenge propelling soil erosion, biodiversity losses, and rising greenhouse gas (GHG) emissions. Sri Lanka also faces significant challenges in managing waste and pollution, particularly in urban areas. The country has also been recently subject to a severe maritime calamity that underscores the possibility of future catastrophes.

Sri Lanka's economic crisis and related fiscal constraints that entail a redirection of resources constrict the allocation of funds for environmental initiatives, as is the case in most other sectors.

Sri Lanka's economic crisis and related fiscal constraints that entail a redirection of resources constrict the allocation of funds for environmental initiatives, as is the case in most other sectors. Additionally, as public expenditures are prioritised to meet short and medium-term goals, environment-related concerns may be relegated to the back burner.

Simultaneously, sovereign credit rating downgrades and loss of investor confidence restrict access to foreign direct investment (FDI) inflows and other forms of global financing. As a country heavily

8 Contractor, D., Balli, F., & Hoxha, I. (2023). Market Reaction to Macroeconomic Anouncements: Green Vs Conventional Bonds. *Applied Economics, 55*(15), 1637-1662. Retrieved May 16, 2023.

9 Hacıomeroglu, H., Danış¸oglu , S., & Güner, Z. (2022). For The Love of the Environment: An Analysis of Green Versus Brown Bonds During the COVID-19 Pandemic. *Finance Research Letters, 47*(A), 1-8. Retrieved May 16, 2023, from https://pdf.sciencedirectassets.com/273054/1-s2.0-S1544612322X00044/1-s2.0-S1544612321005274/main.pdf?X-Amz-Security-Token=IQoJb3JpZ2luX2VjEBYaCXVzLWVhc3QtMSJGMEQCIGUFxQo1wE9lbVqAGBqdyGwGjHL1Inx8ft7GIbmPriwCAiBS7vUUmmzIXyoU1sqcIjOxXbpTqsSF4E1INxn5sIcmZiqy.

dependent on external financing to facilitate developmental initiatives, including environmental sustainability, this loss of access is harder for Sri Lanka. During downturns like public spending, the private sector will likely prioritise short-term economic considerations at the expense of long-term environmental sustainability. In challenging operating environments for firms at large, their contribution towards environmental initiatives may also be lower than expected.

In policy terms, too, environmental challenges may go unaddressed. Governments and the public, probably focus primarily on overcoming their near-term challenges, with meagre attention paid to tackling environmental issues – which frequently necessitate extended-term strategising and financial commitments.

14.3.1 Green Financing Climate in Sri Lanka

Several guides and initiatives are already available to promote green financing in Sri Lanka. One of the key guides is the Roadmap for Sustainable Finance compiled by the Central Bank of Sri Lanka (CBSL), which guides banks and financial institutions on integrating environmental and social considerations into their lending practices. It covers a range of issues, including climate change, renewable energy, water management, and biodiversity conservation. Supplemented by the Sri Lanka Green Finance Taxonomy 2022, also developed by the CBSL, this outlines strategies for mobilising green finance, promoting sustainable investments, and developing green financial products and services.

Sri Lanka's Green Finance Taxonomy is benchmarked against well-established global taxonomies like the EU's taxonomy regulation and China's Green Industry Guidance Catalogue.

On the one hand, Sri Lanka's Green Finance Taxonomy is benchmarked against well-established global taxonomies like the EU's taxonomy regulation and China's Green Industry Guidance Catalogue (Table 14.1). While these share the common goal of directing financial flows towards environmentally sustainable activities, notable dissimilarities are evident in its respective approaches. The EU's taxonomy regulation sets strict criteria for defining environmentally sustainable activities across multiple sectors, focusing on their contribution to climate change mitigation and adaptation. On the other hand, Sri Lanka's Green Finance Taxonomy encompasses a broad range of sectors and emphasises the facilitation of financing options. China's Green Industry Guidance Catalogue primarily targets industrial sectors and promotes the development of green industries. While scope, coverage, and implementation variations may exist, these frameworks collectively contribute to advancing sustainable finance and fostering a greener global economy.

Table 14.1
A Comparison Sri Lanka's Green Finance Taxonomy with the EU's Taxonomy Regulation and China's Green Industry Guidance Catalogue

Taxonomy	Coverage of Sectors	Environmental Performance Thresholds	Institutional Arrangements
Sri Lanka Green Finance Taxonomy 2022	Energy	Emission intensity	Central Bank of Sri Lanka
	Waste and recycling	Resource efficiency	Ministry of Finance
	Transportation	Water and air quality	Ministry of Environment
	Buildings and construction	Biodiversity conservation	Other relevant Ministries
	Agriculture and forestry		
	Financial services and investments		
European Union Taxonomy Regulation 2021	Energy	Carbon footprint	European Securities and Markets Authority
	Waste and recycling	Water and air pollution	
	Transportation	Resource efficiency	
	Buildings and construction	Biodiversity and ecosystem preservation	
	Agriculture and forestry Manufacturing and industry		
	Financial services and investments		
	Energy and environmental protection	Carbon emissions reduction	Ministry of Ecology and Environment
China Green Industry Guidance Catalogue 2020	Cleaner production	Water and air pollution control	
	Clean energy	Efficient resource utilisation	
	Eco-environment		
	Green upgrading of infrastructure		
	Green services		

Source: Author's illustration based on a desk review of policy documents.

Sri Lanka's green financing policy climate exhibits encouraging advancements contrary to frameworks of other emerging economies. An analysis of the green financing frameworks of peer economies, namely Indonesia, Malaysia, Bangladesh, Pakistan and India, offers valuable insights into potential areas for Sri Lanka to improve its own green financing framework (Table 14.2).

Table 14.2
Comparison of Sri Lanka's Green Financing Climate with Peer Asian Countries and with the EU

Framework	Strengths	Weaknesses	Alignments	Synergies
Sri Lanka	Recent introduction of green bond regulations	Need for further alignment with international standards	Developing regulatory framework for green financing	Potential knowledge-sharing with India, Malaysia, and Bangladesh
India	Robust green bond market with a diverse range of issuers	Lack of standardised taxonomy	Alignment with international green bond standards	Collaboration with Sri Lanka and Bangladesh on taxonomy standards
Malaysia	Well-established green sukuk market	Limited coverage of non-Islamic financial products	Alignment with international sukuk standards	Exchange of best practices with Indonesia and Pakistan
Indonesia	Extensive experience in issuing green bonds	Need for stronger enforcement mechanisms	Alignment with international green bond standards	Potential collaboration with Malaysia and Bangladesh
European Union	Comprehensive and detailed taxonomy regulation	Complexity and potential challenges in implementation	Adoption of common EU taxonomy across member states	Knowledge-sharing with Sri Lanka, India, and Malaysia
Bangladesh	Active participation in the green bond market	Need for greater transparency and reporting standards	Alignment with international green bond standards	Collaboration with Sri Lanka, India, and Pakistan on reporting
Pakistan	Growing interest in green financing and sustainable projects	Limited market infrastructure and awareness	Efforts to align with international green financing norms	Exchange of experiences with Malaysia and Indonesia

Source: Author's illustration based on a desk review of policy documents.

Some encouraging developments at the local level are praiseworthy. The private sector, too, has taken steps to promote green financing in Sri Lanka. The Colombo Stock Exchange (CSE) launched the Sustainable Stock Exchange Initiative in 2017, encouraging listed companies to disclose information on environmental and social issues and adopt sustainable practices via its sustainability guidance. Several commercial banks have introduced green finance products and services. According to Sri Lanka Sustainable Energy Authority, the Green Buildings Code encourages the construction of energy-efficient buildings. The National Fund for Environmental Management has been established to provide funds for projects related to biodiversity conservation, waste management, and climate change.

Despite these efforts, challenges remain in implementing these policies and action plans effectively. Limited financial resources, weak regulatory frameworks, and inadequate capacity-building remain significant barriers to achieving intended goals. Furthermore, ensuring effective coordination between key actors like government agencies and stakeholders at all levels is vital to achieve green financing objectives in Sri Lanka.

14.3.2 Green is the New Black: Feasibility and Potential Benefits of Green Financing

In 2018, green investments in Sri Lanka could generate an estimated USD 18 Bn in new business opportunities by 2030, according to the IFC.

In 2018, green investments in Sri Lanka could generate an estimated USD 18 Bn in new business opportunities by 2030, according to the IFC. The potential sectors of investment included green buildings (USD 8.4 Bn), waste management (USD 3.5 Bn), urban water (USD 2.7 Bn), renewable energy (USD 2.5 Bn), agriculture (USD 964 Mn) and transport infrastructure (USD 326 Mn). These assumptions will clearly change due to recent adverse economic conditions and a prolonged recovery period. Indeed, it is claimed that Sri Lanka's current debt dynamics will diminish its appeal for green financing investors. Nevertheless, various counter-arguments exist to this particular viewpoint.

Distinct investors frequently extend green financing from those who furnish conventional debt financing. Green financing typically originates from investors who possess a particular inclination towards financing environmentally sustainable projects and are willing to accept offering a reduced rate of return on their investment in comparison to conventional lenders. Thus, Sri Lanka has the potential to attract a novel cohort of investors keen on sustainable investment prospects.

Countries with elevated debt levels have often effectively secured green funding. Araujo revealed that Mexico's debt-to-GDP ratio exceeded 50% in 2022, but it successfully issued green bonds and

Countries such as Sri Lanka, Ecuador, and Seychelles are seeking debt-to-nature swaps, which enable countries facing debt challenges to alleviate their financial burdens in return for their commitment to conserving the environment.

garnered substantial investment. Despite its considerable debt burden, Argentina issued its inaugural green bond in 2019.[10]

However, significant discrepancies exist between high debt burdens and debt defaults. While no specific examples are available of countries with debt defaults immediately benefiting from green financing for recovering from defaulting status, in certain instances, countries facing economic challenges and debt distress have turned to green financing as part of their broader debt restructuring or recovery efforts. One such example is Ecuador, which has received support from international financial institutions to develop green projects, such as renewable energy initiatives and sustainable infrastructure. While these efforts may not directly address the debt default situation, it demonstrates how countries can leverage green financing to foster sustainable development and attract investment, which can contribute to their overall economic recovery.

Countries such as Sri Lanka, Ecuador, and Seychelles are seeking debt-to-nature swaps, which enable countries facing debt challenges to alleviate their financial burdens in return for their commitment to conserving the environment. This may entail restructuring debt payments to reduce the annual government expenditure or providing improved interest rates and payment conditions. Indeed, a proposed agreement worth Euro 960 Mn is said to be considered by Sri Lanka.[11]

Thus, despite the ongoing economic weaknesses, Sri Lanka would benefit from pursuing green financing options. Green financing in renewable energy, energy efficiency, and sustainable transportation can help ease the country's dependence on imported fossil fuels. It can also create green jobs; investing in solar power projects, for instance, can create jobs in solar panel installation, maintenance, and repair. Green financing can assist Sri Lanka in meeting its international commitments to climate change mitigation and adaptation under the Paris Agreement and the Sendai Framework for Disaster Risk Reduction. These include a pledge to reduce GHG emissions and improve resilience to climate change impacts. In promoting sustainable practices and technologies, green financing will support GHG emission reductions, improve air and water quality, and protect natural resources such as forests and wildlife. Similarly, such financing for energy-efficient buildings can help cut carbon emissions, while sustainable agriculture practices can help reduce deforestation and land degradation.

10 Climate Bonds Initiative. (2019). *Latin America & Caribbean Green Finance State of the Market.* Washington, D.C.: Climate Bonds Initiative.

11 Euronews. (2022, November 27). *Ecuador, Seychelles, Sri Lanka: The New Deals that Take from National Debt to Give to Conservation*. Retrieved May 16, 2023, from Euronews: https://www.euronews.com/green/2022/11/27/ecuador-seychelles-sri-lanka-could-these-countries-solve-their-nation-debt-through-conserv

14.3.3 Available Green Financing Options

Green financing options in Sri Lanka include government initiatives, international funding, and private sector participation (Table 14.3). These options provide a range of opportunities for investors to support sustainable development projects in the country.

Table 14.3
Comparison of Green Financing Options in Sri Lanka

Green Financing Options	Benefits	Drawbacks
Government Initiatives	Incentives and tax breaks for investors; Strong policy framework for sustainability	Lack of adequate resources and financing; Slow implementation of policies
Green Bonds	• Low risk for investors • Guaranteed returns • Support from government initiatives • Address climate change • Sustainable projects	• High cost for issuers • Difficulties in certification • Unclear guidelines and standards
Green Loans	• Fixed interest rates • Lower interest rates for sustainable projects • Support from government initiatives • Easy access to funds • Reduce environmental impact	• High cost for issuers • Difficulty in obtaining loans • Limited availability
International Funding	Access to large-scale funding for sustainable projects; Expertise and technical support from international organisations	Stringent eligibility criteria for funding; High borrowing costs
Climate Investment Funds (CIF)	• Support for developing countries • Focused on clean energy and climate resilience • Collaboration with international organisations	• Limited funding • Stringent requirements
Green Climate Fund (GCF)	• Focus on developing countries • Address climate change and sustainable development • Collaboration with national and international organisations	• Stringent eligibility criteria • Lengthy application process

Green Financing Options	Benefits	Drawbacks
Private Sector Participation	Flexibility and innovation in financing; Partnership opportunities with government and other stakeholders	Limited availability of green financing options; Risk of market fluctuations and economic downturns
Green Equity	• Promote sustainable investments • Long-term growth potential • Potential for high returns • Address climate change • Flexible investment options	• High risk for investors • Volatile market conditions • Limited availability
Green Loans	• Lower interest rates for sustainable projects • Flexible repayment terms • Support for sustainable projects • Reduce environmental impact	• High risk for lenders • Limited availability • Strict eligibility criteria

Source: Author compilation based on a desk review of policy documents.

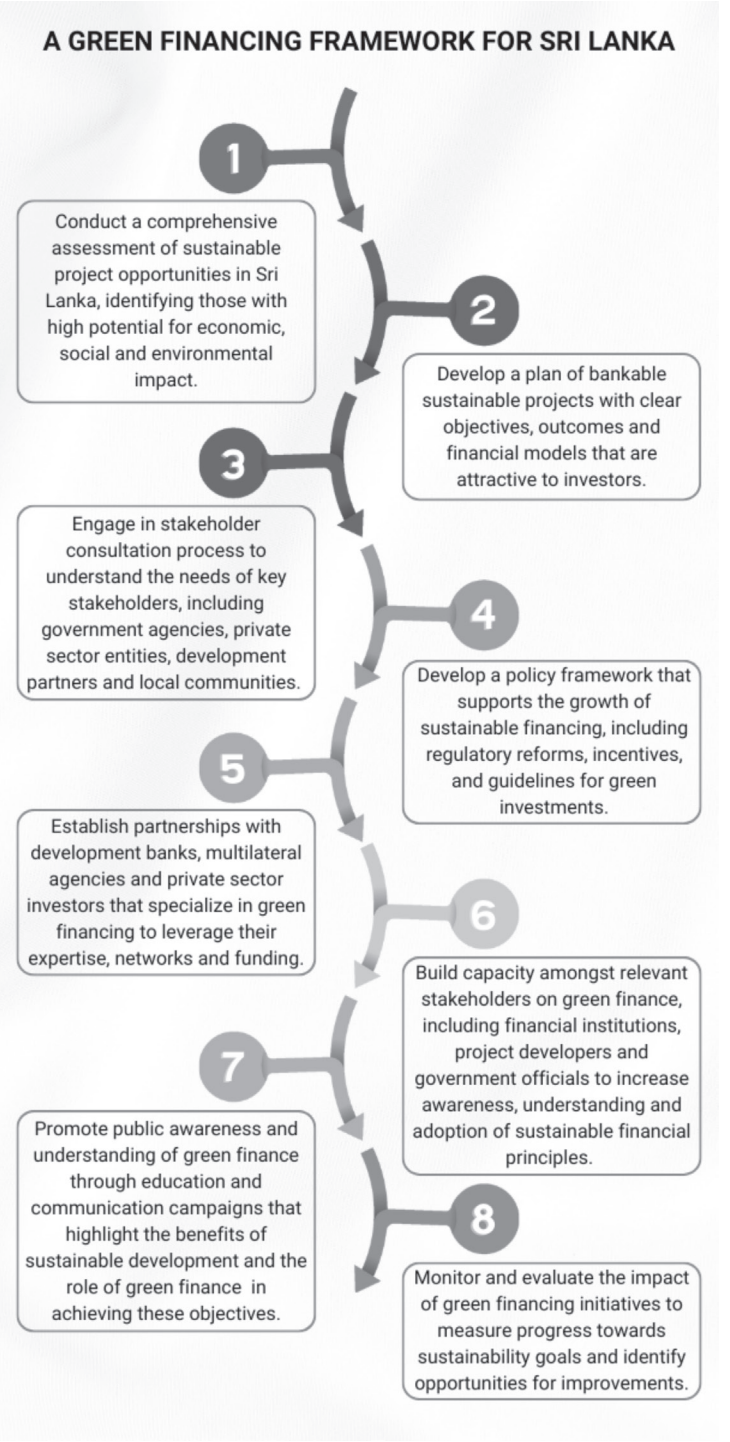
Government interests include green bonds and blue bonds, with the CSE enabling the issuance of green bonds by such companies in April 2023. Sri Lanka can adopt several best practices to obtain and sustain green financing options. First and foremost, a clear regulatory framework should be in place to guide the issuance and use of green bonds, including using proceeds, reporting requirements, and third-party verification. This can increase transparency and provide confidence to investors.

International funding includes platforms such as climate investment funds (CIF) and Green Climate Fund (GCF) that support green financing initiatives. The CIF is a multilateral funding mechanism aimed at supporting developing countries in their efforts to mitigate and adapt to climate change by providing concessional loans and grants. A constraint is its limited funding capacity. In Sri Lanka, the CIF has supported several projects related to renewable energy, energy efficiency, and climate adaptation. In the same vein, the GCF also provides grants, loans, and equity to finance projects but suffers from funding restrictions. It has also supported several projects related to renewable energy, energy efficiency, and climate adaptation in Sri Lanka.

14.3.4 Navigating Barriers to Green Financing

Despite the growing interest in green financing, several challenges and barriers exist concerning its implementation in Sri Lanka. These include a lack of awareness, capacity constraints, and regulatory issues, among others. Several innovative interventions can be implemented to address these (Figure 14.2).

Figure 14.2
A Green Financing Framework for Sri Lanka



Source: Author's illustration based on International Finance Corporation (2019). *Green Bonds Development in Bangladesh – A Market Landscape.* Dhaka: International Finance Corporation.

Creating awareness and capacity building: One of the primary challenges for Sri Lanka is the lack of understanding of the benefits of green financing and awareness of green financing options among stakeholders, including investors, project developers, and policymakers. This results in a reluctance to invest in sustainable projects. To overcome this, targeted awareness-raising campaigns, training programmes, and capacity-building initiatives to educate stakeholders on the potential of green financing need to be initiated.

Capacity constraints – lack of technical expertise, financial literacy, and institutional capacity – make it challenging to develop and manage sustainable projects, as well as access and manage green financing must be duly addressed. Cultural and social barriers, including attitudes towards sustainability, traditional business practices, and social norms, may exist. Capacity-building initiatives, including training programmes, workshops, and mentoring, can support addressing these constraints and enhancing stakeholders' skills and knowledge. Partnerships with international organisations and financial institutions with experience in green financing, such as the CBI's Climate Bonds Training Academy, can assist in this regard.

Building a stronger regulatory framework: Regulatory issues also pose a significant challenge to implementing green financing. The absence of clear guidelines, standards, and regulations for green financing can result in a lack of investor confidence, as well as difficulties in assessing the risks associated with sustainable projects. For instance, the CBSL introduced a green finance taxonomy in 2022, but more work must be done to address disclosure, certification, and monitoring. The framework should also indicate incentives for financial institutions and project developers to invest in green projects. For instance, the EU has implemented a comprehensive regulatory framework for green financing, which includes a taxonomy for defining sustainable economic activities, a green bond standard, and a disclosure regulation for sustainability-related information. Nevertheless, the taxonomy is debated wherein legal action was initiated by Austria in 2022 against the European Commission about the Commission's determination to incorporate nuclear and natural gas within its green investment taxonomy.[12]

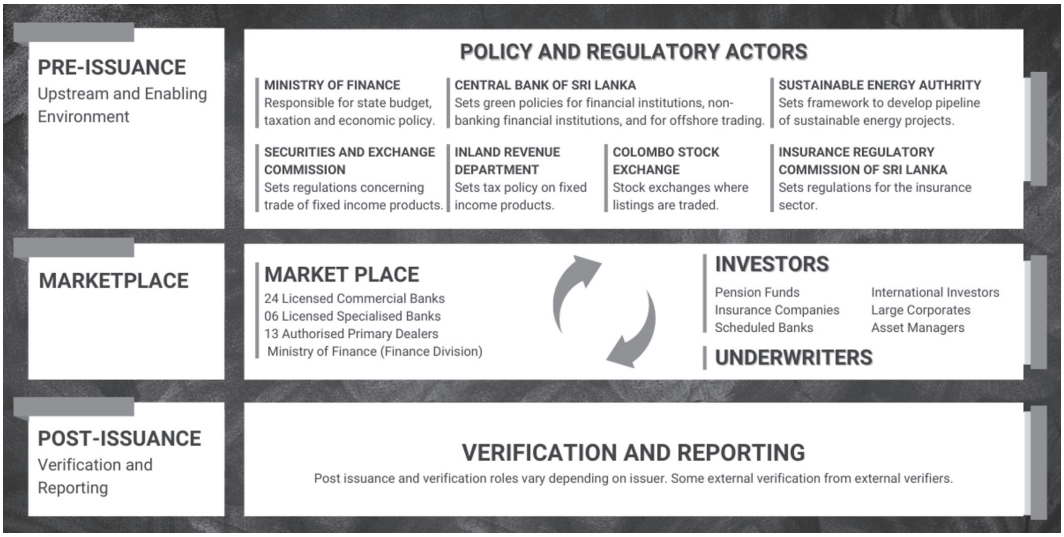
Engaging in public-private partnerships: Given that the initial investment required for sustainable projects can be significantly higher than for traditional projects, it aggravates difficulties in attracting investors and securing financing. These projects often require advanced technology, such as solar panels or wind turbines, which can be expensive to purchase and install. The dearth of skilled labour in Sri Lanka can add to the overall costs. Some of these projects may also require implementation on a larger scale than traditional projects to be economically viable, leading to higher upfront costs. Innovative financing mechanisms, such as blended finance, to leverage public and private sector resources may be required to lower the financial burden on investors. For example, in Indonesia, the government established a green investment facility that provides risk-sharing arrangements and technical assistance to private investors.[13]

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12 Nevertheless, the taxonomy is being debated wherein a legal action has been initiated by Austria in 2022 against the European Commission in relation to the Commission's determination to incorporate nuclear and natural gas within its green investment taxonomy.

13 Climate Bonds Initiative. (2022). *Green Infrastructure Investment Opportunities: Indonesia - Green Recovery.* Washington, D.C.: Climate Bonds Initiative.

Figure 14.3
Proposed Stakeholder Collaboration Framework



Source: Author's illustration based on International Finance Corporation (2019). *Green Bonds Development in Bangladesh – A Market Landscape.* Dhaka: International Finance Corporation.

Sri Lanka, too, can establish a green bond guarantee scheme, under which the government provides a guarantee to financial institutions that issue green bonds, reducing their risk and incentivising them to invest in green projects. Occasionally, governments can encourage private entities to carry out green bond guarantee schemes. For example, the Green Guarantee Company (GGC) is a pioneering financial initiative that aims to leverage blended finance and guarantees to facilitate increased climate finance flow into developing nations such as Indonesia, the Philippines, Brazil, and Trinidad and Tobago, amongst others.[14]

Introducing green financing certification: A green financing certification scheme is recommended to mitigate greenwashing and raise investor confidence. Such a scheme would provide a standardised certification process for green projects, ensuring they meet established environmental and social standards. This can be accomplished through partnerships with international organisations with experience certifying green projects. For instance, the CBI has developed a certification scheme for green bonds that sets standards for using proceeds and managing environmental risks.[15]

While global benchmarks and standards are essential for foreign investors relying on established international frameworks, ensuring that the certification scheme aligns with the local regulatory environment and priorities is equally important. This enhances investor confidence, policy coherence, relevance to local context and local participation. Incorporating global benchmarks within the

14 Green Climate Fund. (2021, October 29). *Green Guarantee Company (GGC)*. Retrieved May 16, 2023, from Green Climate Fund: https://www.greenclimate.fund/document/green-guarantee-company-ggc

15 Climate Bonds Initiative. (2018). *Climate Bonds Standard & Certification Scheme.* London: Climate Bonds Initiative.

local regulatory framework is a delicate balance to be achieved. These must be then incorporated into existing documents and regulatory frameworks and duly enacted to demonstrate the country's commitment to robust and transparent green financing practices.

14.4 Conclusion

Green financing can play a crucial role in addressing Sri Lanka's environmental challenges while simultaneously supporting the sourcing of alternative financing to mitigate tight fiscal constraints. First and foremost, the government needs to develop a comprehensive regulatory framework apart from the green financing taxonomy that addresses crucial aspects such as disclosure, certification, monitoring, and incentives for financial institutions and project developers. This framework should prioritise transparency, accountability, and credibility in green financing, thereby mitigating the risk of greenwashing and ensuring the integrity of sustainable investments. This policy brief emphasises the importance of enhancing clarity for both foreign and local investors in the context of green financing in Sri Lanka. Clear and transparent regulations, frameworks, and certification processes are crucial to provide clarity and instil confidence among investors.

In addition, the establishment of a green financing certification scheme is advised. As mentioned before, this scheme would provide a standardised certification process for green projects, ensuring they meet established environmental and social standards. Collaborating with experienced international organisations in certifying green projects such as the CBI and the IFC, can offer valuable insights and help align the certification scheme with global best practices. However, it is crucial to ensure that the certification scheme also aligns with the local regulatory environment and priorities, acknowledging the unique context of Sri Lanka. To foster effective implementation, coordination and collaboration among various stakeholders is vital. This includes the involvement of key actors like government agencies, financial institutions, project developers, and investors. Furthermore, striking a balance between aligning with international best practices and considering the local context is crucial in the realm of green financing. While international benchmarks and standards provide valuable guidance and credibility for foreign investors, tailoring these frameworks to align with the local regulatory environment and development priorities is equally important.

15. Revisiting Land Succession and Inheritance Reforms in Sri Lanka

15.1 Introduction

A country's land succession laws have critical implications for its economy. This is especially valid for countries where agriculture continues to play a major role as a source of livelihoods and employment. Succession decisions have a bearing on proper land management and thereby, on land productivity.[1] Given that the choice of land operators can influence the profitability and sustainability of farming, adequate attention to agricultural land succession is necessary when planning and executing land development strategies in agriculture. However, ageing farmers find succession planning increasingly challenging due to the evolving trends in urban migration and the availability of wider options for off-farm employment for potential successors.

In Sri Lanka too, the succession of paddy land is a crucial factor in a family's decision concerning heirloom farming, i.e. to carry on the custom of handing a farm down through generations. Prevailing land succession policies and the regulatory framework involve specific policies to deal with subdivision units for lands, land fragmentation, land sales, etc. The emphasis is tilted to ensure food security and economic development, but it is also vital to recognise and address any associated costs that arise from these policies. These can arise from various challenges that hinder agricultural land's productive use, perpetuate inequality, and impede sustainable development. Neglecting these issues, including landlessness, gender disparities, and complexities in land ownership resulting from informal land transactions, can have profound and interconnected implications.

Sri Lanka's densely populated areas increasingly exert pressure on available agricultural land. However, a narrow focus solely on productivity without considering the issue of landlessness could lead to a large chunk of the population being deprived of access to land for their livelihoods. It not only impacts their well-being, but also poses risks to social stability and economic progress. Furthermore, the persistence of gender disparities in land ownership due to traditional inheritance practices undermines efforts to promote gender equality and empower women. Limited access to and control over agricultural land curtails women's economic independence, decision-making power, and overall welfare.

Existing land succession policies and regulation loopholes also induce unethical and informal land transactions, often without proper documentation or registration, bypassing the formal process. This creates uncertainties and disputes amongst individuals and communities and can be a key source of discouraging investments in agriculture. Within this backdrop, this policy brief examines the key challenges related to land succession in Sri Lanka, highlighting its impacts on farmers and their families, as well as on the overall agricultural sector to provide insights into future policy reforms for effective agricultural land succession.

1 Chiswell, H. M. (2014). The Importance of Next Generation Farmers: A Conceptual Framework to Bring the Potential Successor into Focus. *Geography Compass,* 8(5), 300-312.

15.2 Evolution of Land Succession and Inheritance Laws

Ownership and title issues concerning land in Sri Lanka are typically influenced by a complex historical background that dates back to pre-colonial and colonial rule and subsequent land reforms. In its pre-colonial state, the king was in charge and also the exclusive owner of all land in the country. However, the king had little power over inherited lands since these were granted with a condition of services to the kingdom known as "*Rajakariya.*"[2] Under colonial rule, the British enacted the Crown Land Encroachment Ordinance (CLEO) No. 12 of 1840 to force people to give up additional lands because they felt the acreage needed to develop the plantations was insufficient. Many rural areas lacked formal land records, leading to ambiguities and disputes over land ownership. Furthermore, the British colonial authorities often failed to recognise or respect the customary land rights of indigenous communities, resulting in dispossession and marginalisation.[3]

By the early 20th century, challenges arose with the collapse of the dry zone irrigation system, lack of concern for paddy cultivation, displacement of subsistence farmers, population overcrowding in the wet zone, and food shortages. Consequently, the first Land Commission was established in 1927 to redistribute land to landless peasants and promote agricultural development.[4] A Land Development Ordinance (LDO) No. 19 was enacted in 1935 to retain state lands in trust for all citizens and alienate the lands for peasants' benefit. Under this ordinance, lands were given to farmers as permits and later converted to grants such as *Swarnabhoomi*, *Jayabhoomi*, *Isurubhoomi*, and *Ranabima.*[5] However, these reforms were not without complexities in land ownership, as the land was distributed through various mechanisms. These include state-owned land, permits, land grants, and leasehold tenures imposing certain restrictions on land usage and transfer.

Under the LDO, beneficiaries were allowed to cultivate the lands, but the rights to sell, lease, mortgage, and abandon land were controlled. The LDO served as the government's guide in deciding how to distribute lands to the first generation of settlers. Later on, land subdivision was restricted, allowing a subdivision of cultivated lands only up to a minimum subdivision unit. Thus, landholders cannot divide ownership of the lands and pass it on to more than one successor in smaller pieces; rather, it must be passed on as a whole to a single successor.

Another important rule in the LDO is the priority given to certain inheritors in the succession process. Priority is given to the spouse whether a successor has been nominated or not by the landholder.

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2 Silva, K. T., Sivapragasam, P. P., & Thanges, P. (2009) *Caste Discrimination and Social Justice in Sri Lanka: An Overview.* Working Paper Series. Vol. 3(6).

3 Abeysinghe, A. (1978). *Ancient Land Tenure to Modern Land Reforms in Sri Lanka,* Volume 1: Ancient Lanka to British Period. Quest Series 51. Colombo: The Center for Society and Religion.

4 Peebles, P. (1990). Colonisation and Ethnic Conflict in the Dry Zone of Sri Lanka. *The Journal of Asian Studies,* 49(1), 30-55.

5 Rathnayake, D., Weerakkody, R., Dharmawardhana, T., Buhary, R., & Dissanayaka, A. (2021). *Land Development Ordinance in Action.* Research Report No: 244. Colombo: Hector Kobbekaduwa Agrarian Research and Training Institute.

After the spouse's death or if the spouse remarries, the nominated successor can inherit the land. If no successor has been nominated, the title to the land went to the elder son as a priority. Over time, the settlers realised that the restrictions outlined in the LDOs were challenging, so they began engaging in informal land transactions for future generations. The lack of effective land administration systems and inadequate record-keeping further compounded the challenges of establishing clear ownership and title.

Box 15.1
Succession Procedure as per LDO 1935 and Amendments

LDO 1935

- Priority is given to the spouse whether a successor has nominated or even not by the landholder.
- After the death of the spouse or if the spouse fails to succeed the land, then the nominated successor can succeed the land.
- Only the spouse or one of the blood relatives mentioned shall be nominated as the successor.
- If no successor has been nominated, the title to the land shall devolve in the order of priority in which they are respectively mentioned in the subjoined table.
    - (i) Sons. (ii) Daughters. (iii) Grandsons. (iv) Granddaughters. (v) Father. (vi) Mother. (vii) Brothers. (viii) Sisters. (ix) Uncles. (x) Aunts. (xi) Nephews. (xii) Nieces.
    - The older being preferred to the younger where there are more relatives than one in any group.

Land Development (Amendment) Act, No. 11 of 2022

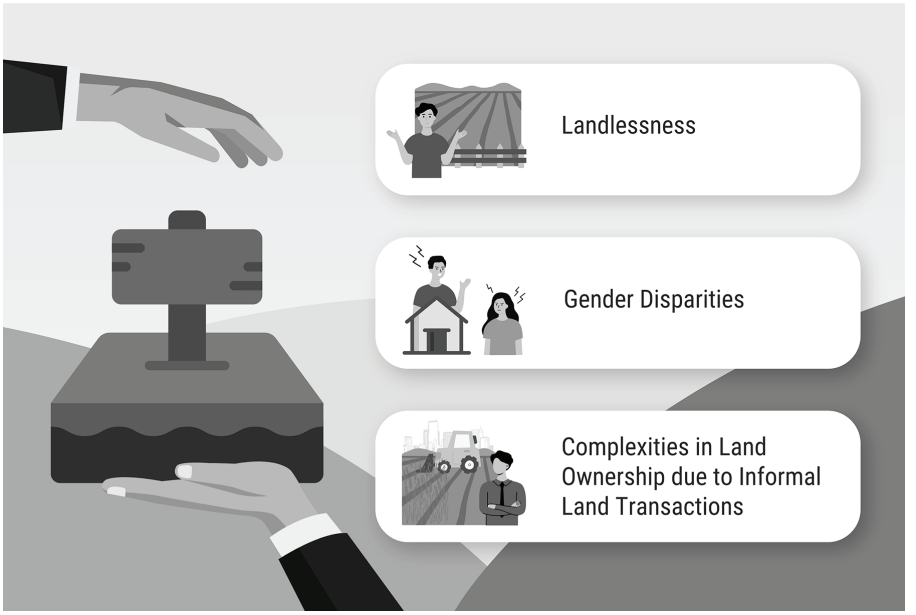
- i) If someone on the list of potential successors mentioned in the list is responsible for developing the land, they will be given priority over the older person to take over the property.
- ii) If there are multiple people on the list of potential successors who have developed the land, they will be given priority to take over the property.
- If a family member who is supposed to inherit the property does not want it, the property will go to the next family member in the list of succession.
- The Divisional Secretary can choose who should inherit the property based on specific guidelines and rules. The guidelines and rules will be determined by the local authority and other laws related to property ownership. The Divisional Secretary will make a decision based on the relevant information presented to them.

Source: Food and Agriculture Organization of the United Nations. (2018). *Land Development Ordinance 1935 (No. 19 of 1935)*. FAOLEX No: LEX-FAOC013623. Retrieved July 10, 2023, FAOLEX: https://faolex.fao.org/docs/pdf/srl13623.pdf

However, according to the recent Land Development (Amendment) Act No. 11 of 2022, if multiple relatives are in a group, the older relative will be chosen first, irrespective of gender. If multiple family members of the same age are equally qualified and willing to take over a property, the decision on who will receive the property will be made by the Divisional Secretary in the respective area where the property is located. The recent amendment of the Land Development (Amendment) Act, No. 11 of 2022, has provided an opportunity for female successors as well to inherit agricultural lands lowering gender disparities. However, still much potential lies in nominating a male successor due to traditional customary laws and social norms.

15.3 Impacts of Existing Policies on Land Succession in Sri Lanka

Sri Lanka's Land Succession Policies:
Challenges in the Existing Framework



Source: Based on the Succession Procedure described in the Land Development Ordinance 1935.

15.3.1 Fragmentation and Subdivision of Agricultural Land

After thirty years of the formation of settlements, a sizeable 45% to 60% drop in land sizes could be seen, and farming lowlands with an extent of 0.25 acres became usual.[6] It was revealed that when all other productivity-affecting factors are held constant, land productivity declines when a

6 Chandrasiri, S. (2009). *Labour Market Trends and Informal Sector f The Economy.* Sri Lanka Economic Journal, 2(1), 89–106; Wanigaratne, R.D. (1995). *Informal Tenure Conditions in Irrigated Settlements in Sri Lanka: A Review of Empirical Research Evidence.* University of Wisconsin: Land Tenure Centre.

farmer cultivates more plots, plots far from home, and irregularly shaped plots. Overall farm productivity increases to a minimum farm size of 1.708 hectares (Ha) and declines thereafter.[7] Due to the rising population pressure and the unemployment threat, the relatives of the settler families subdivided and cultivated areas that were not allowed to be subdivided. The rule of minimum subdivisions has been disregarded by farmers leading to land fragmentation. Studies conducted on major settlement plans reveal that hidden fragmentation or informal subdivision among numerous children has occurred, worsening living circumstances for both the first and second generations of settlers.[8]

Even though fragmentation and subdivision are restricted considering the productivity and sustainability of agricultural lands, inadequate provisions for land inheritance contribute to landlessness and poverty among vulnerable groups in Sri Lanka.

This fragmentation has several detrimental consequences. Fragmentation makes it arduous for farmers to adopt modern practices, leading to low agricultural productivity and an inability to meet growing demands. It also hampers the implementation of sustainable land management practices, hindering conservation efforts and long-term sustainability. Additionally, fragmented land holdings limit agricultural investment and access to credit, making it hard for farmers to modernise and expand their operations.[9] Also, it exacerbates and widens social and economic inequalities among farmers, favouring wealthier farmers with larger plots and impeding the livelihoods of small-scale farmers. The absence of clear rules and guidelines for land subdivision among heirs often leads to the fragmentation of agricultural holdings, resulting in scattered and economically unviable plots.

Even though fragmentation and subdivision are restricted considering the productivity and sustainability of agricultural lands, inadequate provisions for land inheritance contribute to landlessness and poverty among vulnerable groups in Sri Lanka. Landless labourers, sharecroppers, and small-scale farmers face significant challenges in securing land tenure and accessing productive resources, leading to poverty and a lack of opportunities to improve their livelihoods. Landless labourers work on farms owned by others, often without secure tenancy rights. It will make them vulnerable to exploitation and insecure employment conditions. Sharecroppers, who cultivate land owned by others, also lack legal recognition and protection, resulting in unequal power dynamics and limited incentives for long-term investments.[10] This can also raise warnings about the low productivity of land and its related adverse effects. These challenges perpetuate social and economic inequalities, hinder rural development, and require legal reforms to provide secure tenancy rights and access to resources for these vulnerable groups.

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7 Wickramaarachchi, N.C., & Weerahewa, J. (2018). Relationship between Land Size and Productivity: Empirical Evidence from Paddy Farms in Irrigation Settlements of Sri Lanka. *Sri Lanka Journal of Economic Research*. 5(2), 125–142.

8 Weerahewa, J., Hemachandra, D., & Pushpakumara, G. (2021). Land Regulations, Tenure, and Land Use of Sri Lanka: A Historical Analysis on Agricultural Lands. In *Examining International Land Use Policies, Changes, and Conflicts* (pp. 139-161). IGI Global.

9 Niroula, G. S., & Thapa, G. B. (2005). Impacts and Causes of Land Fragmentation, and Lessons Learned from Land Consolidation in South Asia. *Land Use Policy*, *22*(4), 358-372.

10 Alban Singirankabo, U., & Willem Ertsen, M. (2020). Relations between Land Tenure Security and Agricultural Productivity: Exploring the Effect of Land Registration. *Land*, *9*(5), 138.

15.3.2 Gender Inequality

Gender inequality was another significant challenge until recently within the legal framework governing agricultural land succession and inheritance rights. Although the new amendment has allowed female successors, traditional inheritance practices in Sri Lanka, as in many other countries, often favour male heirs, perpetuating a patriarchal system that marginalises women and restricts their access to and control over agricultural land.

Although the new amendment has allowed female successors, traditional inheritance practices in Sri Lanka, as in many other countries, often favour male heirs, perpetuating a patriarchal system that marginalises women and restricts their access to and control over agricultural land.

Gender inequality in land ownership disproportionately affects women, limiting their empowerment, livelihoods, and agricultural development. Traditional practices favour male heirs, leading to exclusion or smaller land shares for women.[11] This inequality hampers women's access to productive resources and agricultural decision-making, impeding women's ability to invest, adopt improved practices, and contribute to innovation. It also contributes to poverty and vulnerability, as land ownership provides economic security. Without land, women face greater risks of poverty, food insecurity, and dependence on others. Gender disparities in land ownership perpetuate discrimination and social exclusion, restricting women's economic opportunities and women empowerment as well as reinforcing traditional gender roles. This undermines their agency, economic independence, and participation in decision-making and economic activities. Empowering women with secure land rights and providing them with equal access to resources can enhance agricultural productivity, household welfare, and broader social and economic development.

15.3.3 Informal and Unregistered Land Transactions

Another significant ownership and title issue in Sri Lanka is the prevalence of informal and unregistered land transactions. Historical practices, cultural norms, and a lack of awareness about the importance of formalising land transactions often drive these transactions. Informal land transactions create challenges by undermining land tenure security, limiting access to formal financial services, and prolonging social and economic inequalities. These transactions lack proper documentation, making it hard to establish ownership and leading to disputes.[12] These also hinder access to credit

11 Rossier, R., & Wyss, B. (2007). Gendered Interest and Motivation of the Younger Generation in Agriculture and Farm Succession. *Gender Regimes, Citizen Participation and Rural Restructuring* (pp. 193-216). Emerald Group Publishing Limited.

12 Chandrasiri, J. K. M. D. (2010). *Impact of Informal Land Transations in Settlement Schemes in Sri Lanka*. Colombo: Hector Kobbekaduwa Agrarian Research and Training Institute.

for agricultural investments and other ventures that require collateral. Vulnerable groups, including women and marginalised communities, are particularly affected due to limited resources and legal assistance, exacerbating their vulnerability to exploitation through fraudulent practices and unfair transactions. The impact of ownership and title issues on various stakeholders is significant. Individuals and communities may face the risk of eviction, displacement, and loss of livelihoods.[13]

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The legal framework surrounding land ownership and title transfer in Sri Lanka is intricate and fragile and comprises various laws, regulations, and customary practices. The primary legislation governing agricultural land ownership is the LDO of 1935, which provides for land registration and transfer. However, the LDO has been subject to amendments and revisions over time, leading to a fragmented legal framework. Other laws, such as the *Thesawalamai* law (traditional law in Northern Sri Lanka under Dutch colonial rule in 1707), are also applicable to specific regions in Sri Lanka, and the Muslim law further adds to the complexity of land ownership and title issues.[14] Furthermore, the lack of a comprehensive and centralised land administration system creates challenges in ensuring accurate and up-to-date land records. Land ownership records are often fragmented across multiple institutions, such as land registries, local authorities, and government agencies. Inconsistencies, errors, and gaps in land records make establishing clear ownership and title impractical, leading to disputes and legal complexities.[15]

15.4 Agricultural Land Succession Issues: Some Research Evidence

Much research on agricultural land succession focuses on gender disparities in transferring farm assets to future generations. In contrast, others have investigated the effect of birth order in succession decision-making, etc.[16] As explained before, the evidence broadly reveals that specific social norms and customs exist in transferring family assets to future generations, of which, engagement in family

13 Wickramaarachchi, N. C., & Weerahewa, J. (2016). Land Tenure Security, Land Investment and Land Productivity in Sri Lanka. *Sri Lankan Journal of Agriculure Science*, *53*, 1-18.

14 Fonseka, B. (2010). *Landmines and Land Rights in Sri Lanka*. Geneva: Geneva International Center for Humanitarian Demining.

15 Samad, M. (2005). Water Institutional Reforms in Sri Lanka. *Water Policy*, *7*(1), 125-140.

16 Suess-Reyes, J., & Fuetsch, E. (2016). The Future of Family Farming: A Literature Review on Innovative, Sustainable and Succession-oriented Strategies. *Journal of Rural Studies*, *47*, 117-140.; Pessotto, A. P., Costa, C., Schwinghamer, T., Colle, G., & Dalla Corte, V. F. (2019). Factors Influencing Intergenerational Succession in Family Farm Businesses in Brazil. *Land Use Policy*, *87*; Sheridan, A., Newsome, L., Howard, T., Lawson, A., & Saunders, S. (2021). Intergenerational Farm Succession: How Does Gender Fit?. *Land Use Policy*, *109*; Arends-Kuenning, M., Kamei, A., Garcias, M., Romani, G. E., & Shikida, P. F. A. (2021). Gender, Education, and Farm Succession in Western Paraná State, Brazil. *Land Use Policy*, *107*; Shahzad, M. A., Abubakr, S., & Fischer, C. (2021). Factors Affecting Farm Succession and Occupational Choices of Nominated Farm Successors in Gilgit-Baltistan, Pakistan. *Agriculture*, *11*(12)

farming has a strong influence on being selected as a future successor. Education level of the child has a significant negative relationship with both decisions; decision of the parent to select the particular child as the future successor as well as the decision of the child to take over the farm.[17] Considering children's financial stability and income security, parents decide the child to which the land should be transferred.

Thus, several factors govern the successor selection for the farmland, and they might be related to the farmer, farm, successor, and environmental characteristics. Land transfer between generations is not a hassle if the landowner has only one child. However, often the farmer must choose one descendant to transfer the land if there are several children. Here, children's characteristics play a major role. Limited research has been conducted in the Sri Lankan context to examine the influence of successors' traits on their likelihood of being chosen as the farmland's successor, and these mostly investigate the role of gender as a determining factor.

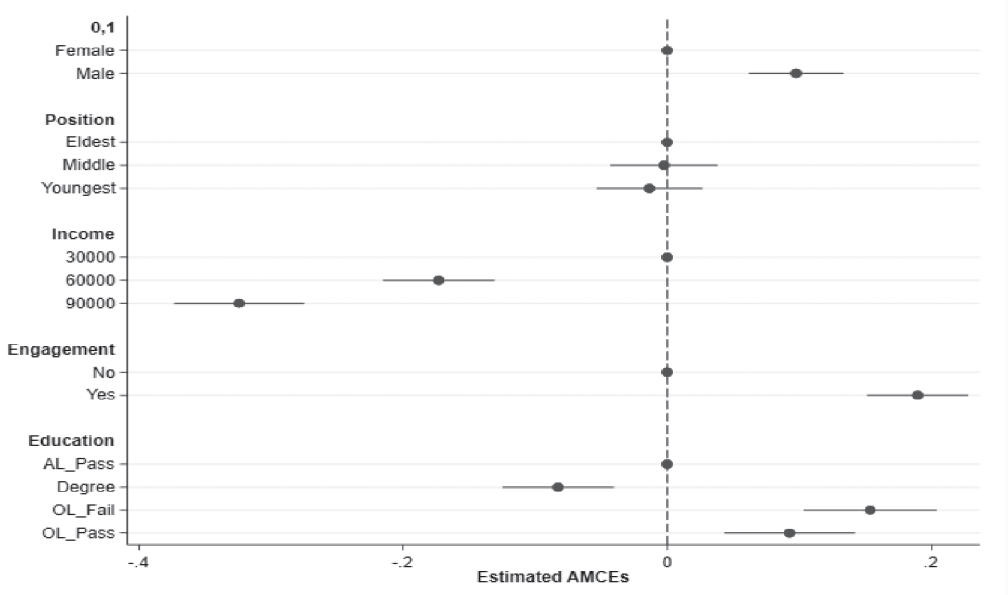
To better understand the successor characteristics affecting the choice of family farm succession decision of the current operator for paddy lands in Sri Lanka, a study was conducted on the succession of agricultural lands under the LDO.[18] The findings suggest that a child's gender, birth order, level of education, income, and involvement in paddy farming influence the decision of the landowner-operator to select a particular child as a successor. Sticking to cultural norms means it is socially acceptable in Sri Lanka for a male successor to be considered more suitable for carrying on a family property than a female successor. As such, a gender bias in paddy land succession still remains. Indeed, the results suggest that being a male child increases favourability while the effect on females is also positive but less favourable.

17 Simeone, M. (2005). *The Generational Turnover in Agriculture: Theoretical Problems and Empirical Evidences*. 94th Seminar of the European Association of Agricultural Economists. Ashford, United Kingdom, 9–10 April.

18 Silva, P.S.H., Hemachandra, D., & Weerasooriya, S. A. (2022). *Successor Characteristics Affecting the Choice of Intra - Family Succession Plan of Paddy Land Owner*. Proceedings of 11th Sri Lanka Economic Research Conference (SLERC) – 2022 (pp. 88-92). Sri Lanka Forum of Univerisity Economists. http://www.slfue.org/images/eusl/FINALPROCEEDING2022.pdf

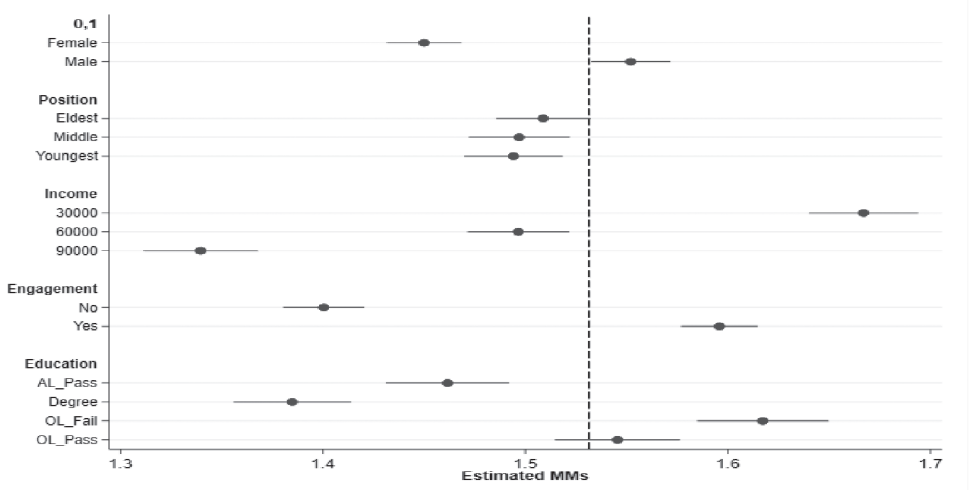
This study was conducted in 2022 before the recent Land Development (Amendment) Act, No. 11 of 2022 revised the land succession laws similar to study recommendations. A choice-based conjoint analysis was done and the choices were made according to the attributes; gender, birth order, education level, income level, and the engagement for farming. The number of respondents is 150 paddy landholders randomly selected from 13 villages in the dry zone (Anuradhapura District) of Sri Lanka.

Figure 15.1
Change of Probabilities for being Selected as the Successor (AMCEs)



Source: Based on author's own estimates.

Figure 15.2
Marginal Means



Source: Based on author's own estimates.

Several societal conventions also influence how birth order affects the succession process. In some parts of Sri Lanka, a family's property is passed down to the eldest male child, but in other areas, it is passed down to the youngest male child. Rarely are the younger female children chosen as the heir to ensure their financial security. As a result, birth order will be a determinant when selecting a successor

for paddy lands. Again, the findings indicate that the eldest receives the highest favourability, followed by the middle and the youngest.

Education and financial standing can also impact the choice of a successor. Additionally, the beliefs of parents influence. On the one hand, parents may believe that a less educated child should be given property to give that child some security. On the other hand, educated children may earn financial stability via their educational success and may form plans to migrate to areas with better prospects. Some parents may believe that an educated child would be better able to manage these properties and hence choose them as a successor. The research results reveal that when a child is more educated, there is a lesser chance of being selected as the successor. The same remains true for income levels; the higher the income, the lesser the chance of being selected as the successor. Financially secure offspring may not be chosen as potential successors since they can live on wages. If they are selected, it may be because they can invest more to improve the property. Engagement in farming activities also plays a significant role in choosing the successor. Parents would like to transfer the lands to the child already involved in and supporting farming activities.

A comparison between attributes suggests that the most favourable feature is income, followed by education, engagement, gender, and last, the position in the family. Thus, certain characteristics of a given successor appear to be favoured by landowners in selecting a successor. Although birth order and gender had been given priority in deciding the successor according to Sri Lankan laws held until March 2022, the actual preference of parents appears to prioritise a child's engagement in farming activities, income status, and education level. However, according to Sri Lankan land laws, such characteristics were not generally considered in the succession process. Thus, this kind of research was useful in revisiting land laws for better allocation of farmland in the country to improve living standards while enhancing land productivity and sustainability.

15.5 Way Forward and Conclusions



Source: Compiled by the author based on various sources.

15.5.1 Tackling Fragmentation and Subdivision of Agricultural Lands

To address the issue of fragmented land holdings and improve agricultural productivity, the government should introduce policies and incentives that promote voluntary land consolidation among small-scale farmers. These can be achieved through mechanisms such as land pooling, joint farming arrangements, and the establishment of land consolidation funds.

By consolidating fragmented plots, farmers can create larger and more viable farming units, benefiting from economies of scale, minimising unnecessary subdivisions resulting in scatter plots, improved mechanisation, and efficient resource utilisation. These lead to increased productivity, reduced production costs, and improved market access. To support land consolidation efforts, the government should provide financial support and technical assistance to farmers. This includes ensuring that farmers are aware of the benefits of land consolidation and have access to the necessary resources. By educating them about the advantages and providing them with the tools and knowledge needed for successful consolidation, farmers can be empowered to undertake the process.

Comprehensive and centralised land use planning is essential to guide the rational use of agricultural land. This involves identifying areas suitable for agriculture, promoting cluster farming, and discouraging

the conversion of agricultural land for non-agricultural purposes. By investing in the development and regular updating of land use plans, considering critical factors such as soil suitability, water availability, ecological considerations, and market demand, the government can ensure that agricultural land is used effectively and sustainably. Effective land use planning leads to maximum productivity while minimising environmental degradation and further fragmentation.

15.5.2 Dealing with Gender Disparities

Addressing gender disparities in land ownership and inheritance rights is essential. Reforms should promote equal rights for women, ensure their access to land, and recognise and protect their customary land rights. Measures can include financial support, training, and preferential access to government land allocation schemes. Cultural and social barriers limiting women's access should be addressed through awareness campaigns and capacity-building initiatives backed by sound policymaking. Women should be educated about their land rights, legal entitlements, and channels to redress grievances and options available for pursuing justice. Their participation in decision-making processes should be encouraged through involvement in agricultural activities, leadership in farming associations, and representation in land committees. The government should also facilitate joint ownership and registration of land titles in the names of both spouses to ensure equal rights and access to land for women.

By implementing these measures, the government can enhance land use efficiency, improve agricultural productivity, strengthen land registration, create viable farming units, and promote gender equality in land ownership and inheritance. Collaboration with key stakeholders, such as farmer organisations, agricultural cooperatives, and land administration authorities, is crucial for effective implementation of these policies.

15.5.3 Addressing Informal Land Transactions

To strengthen land ownership and ensure clear titles, the government should focus on improving the land registration system. This includes streamlining procedures, digitising records, and establishing online platforms for easy access to land information. Comprehensive awareness campaigns should aim to educate individuals on the benefits of formalising land transactions, such as improved security and access to credit. Mechanisms for regularising informal transactions should be developed, along with simplified procedures. Dedicated legal aid services and capacity-building programmes should support fair outcomes in land transactions.

Addressing the issue of existing fragmented land systems requires establishing a transparent and efficient land bank system. The land bank would facilitate the identification, acquisition, and redistribution of fragmented land parcels, connecting landholders willing to lease their land with farmers seeking to expand their operations. Fair incentives for landholders, equitable access to land, and the allocation of consolidated plots based on farmers' specific needs and preferences should be

prioritised. Adequate resources, including personnel, technology, and financial support, should be allocated to ensure the effective establishment and management of the land bank.

In summary, this policy brief highlights the challenges and potential solutions related to agricultural land succession in Sri Lanka. The issues of fragmented land holdings, informal land transactions, and gender disparities in land ownership require focused attention and comprehensive policy measures. The current legal framework governing agricultural land succession and inheritance rights in Sri Lanka faces several challenges that hinder agricultural land productivity, perpetuate inequality, and impede sustainable development. The fragmentation and subdivision of land, gender inequality, landlessness and poverty among vulnerable groups pose significant obstacles to the agricultural sector's growth and development. Addressing these challenges requires comprehensive legal reforms that promote equitable land distribution, empower women, protect the rights of vulnerable groups, and enhance agricultural productivity and rural livelihoods.

16. Involving the Private Sector in Quality Vocational Education

16.1 Introduction

With Sri Lanka's youth unemployment (age 15-24) at a pre-crisis level of 21.5% in 2019 is on the rise and around five times higher relative to the general unemployment rate,[1] the role of vocational education in providing an effective ssolution is high on the national reform agenda. Mostly, there appears to be a degree of 'unattractiveness' associated with vocational education, whereby it is viewed as a 'side line' or a secondary option for those who do not excel in general education. Unsurprisingly, the enrolment rates for vocational education, therefore, are considerably lower than for general pupils. Accordingly, despite the school dropout level at the General Certificate of Education Ordinary Level (G.C.E. O-Level) and G.C.E. Advanced Level (A-Level) ranging from 70,000 to 100,000 students during the last decade,[2] the percentage of students enrolled in vocational programmes from the upper secondary education level is reported at 7.9% (2018) in contrast to the 100.3% (2018) gross enrolment ratio at the upper secondary education level.[3]

The poor uptake of vocational education in Sri Lanka is due to a host of structural weaknesses in the design and delivery of Technical and Vocational Education and Training (TVET) in the country. The overwhelming involvement of the public sector, the fragmented nature of agencies, the poor quality of training on offer, etc., are some of the main drawbacks. Given that TVET remains a crucial policy choice as a solution for youth unemployment, youth entering the job market without training and the generation of self-employment opportunities, policy interventions to rectify these structural weaknesses are a priority. Such interventions are also timely as Sri Lanka included a technical stream at the A-Level examinations to provide greater flexibility and options in developing its human resources. This policy brief examines the structural issues that affect the performance of the TVET sector and policy options based on world experience and country-specific conditions.

16.2 Structural Issues in Sri Lanka's Vocational Education System

In comparison to key benchmark countries, Sri Lanka exhibits a considerably lower level of students in vocational education among general pupils and a higher level of youth unemployment (Figure 16.1). When benchmarked against Germany (a success story in vocational education), India (a regional giant), and a few other countries that are considered to have a strong vocational education system,

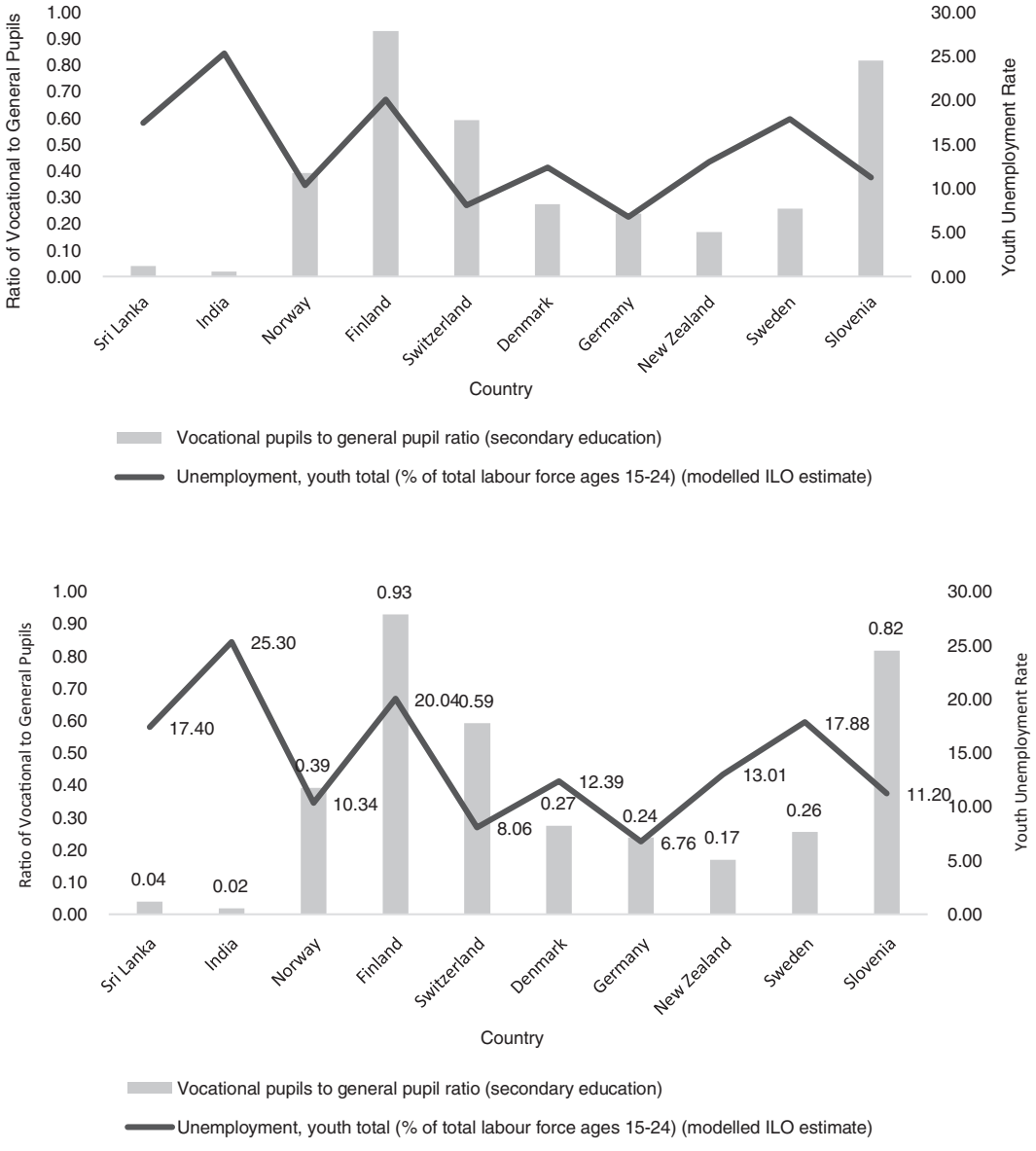
1 Department of Census and Statistics. (2019). *Sri Lanka Labour Force Survey.* Battaramulla: Department of Census and Statistics.

2 National Human Resources Development Council of Sri Lanka. (2020). *Statistical Bulletin on Education*- 2020. Colombo: Ministry of Public Services, Provincial Councils and Local Government.

3 UNESCO-UNEVOC. (n.d.). *TVET Country Profiles- Sri Lanka.* Retrieved June 8, 2023, from UNESCO-UNEVOC: https://unevoc.unesco.org/home/Dynamic+TVET+Country+Profiles/country=LKA

apparently, there is much room for improvement in Sri Lanka. At the outset, certain structural issues that affect the performance of the TVET sector need to be understood.

Figure 16.1
Ratio of Vocational to General Pupils (Secondary Education) Vs. Youth Unemployment Rate, 2017



Source: Author compilation based on The World Bank. (2023, April 27). *Data Bank- World Bank Development Indicators*. Retrieved April 20, 2023, from The World Bank: https://databank.worldbank.org/source/world-development-indicators#

Lack of a governance structure: TVET in Sri Lanka is primarily provided by three sectors – government, private, and other non-government actors. As of 2023, out of 1,156 active Tertiary and Vocational Education Commission (TVEC) registered institutions, 49% are private and 46.4% are government. Further, out of 3,237 accredited courses, the government provide 77.8%, whereas the private sector provides only 18.6%.[4]

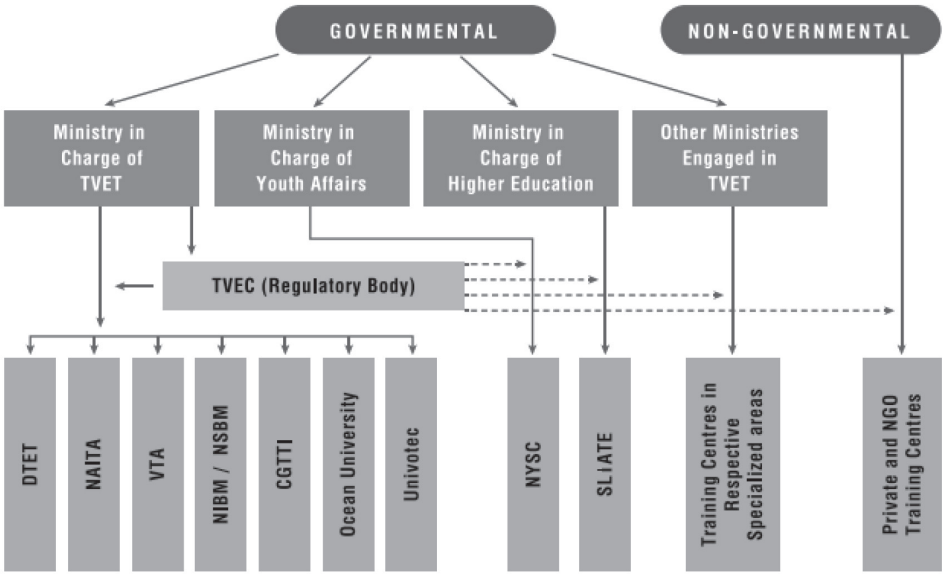
The public sector TVET provision consists of more than 30 statutory boards and 22 Ministries. The Ministry of Skills Development and Vocational Training (MSDVT) is the apex body in the public sector and is responsible for approximately 70% of the publicly provided training. These services are channelled through several agencies, each of which has its own boards and procedures. The most important institutions (in terms of size, recognition and the service provided) among these are the Department of Technical Education and Training (DTET), the National Apprentice and Industrial Training Authority (NAITA), the Vocational Training Authority (VTA), the Ceylon German Technical Training Institute (CGTTI), the University of Vocational Technology (UNIVOTEC), National Institute of Business Management (NIBM)/National School of Business Management (NSBM), and the Ocean University. The MSDVT together with TVEC formulate policies, coordinate institutions within its purview, manage programme administration, and conduct monitoring and evaluation. The remaining 30% of the public training which involves specialised training is offered by other Ministries like the Ministry of Health, the Ministry of Tourism, etc.[5]

A comprehensive institutional framework of the TVET sector is illustrated in Figure 16.2. National Vocational Qualification (NVQ) levels 5 and 6 will be designed or modified based on labour market demand, the mandate, and the capability of respective training institutions.

4 Tertiary and Vocational Education Commission, Ministry of Education. (2023, February 8). *TVET Information Dashboard*. Retrieved February 20, 2023, from Tertiary and Vocational Education Commission, Ministry of Education: https://www.tvec.gov.lk/?page_id=2764

5 Dundar, H., Millot, B., Riboud, M., Shojo, M., Aturupane, H., Goyal, S., & Raju, D. (2017). *Sri Lanka Education Sector Assessment: Achievements, Challenges, and Policy Options.* Washington, D.C.: World Bank Group.

Figure 16.2
Institutional Framework of the TVET Sector



Notes: DTET: Department of Technical Education and Training; NAITA: National Apprentice and Industrial Training Authority; VTA: Vocational Training Authority; CGTTI: Ceylon German Technical Training Institute; UNIVOTEC: University of Vocational Technology; NYSC: National Youth Service Council; SLIATE: Sri Lanka Institute of Advanced Technological Education.

Source: Tertiary & Vocational Education Commission. (2022). *Corporate Plan 2022-2026.* Colombo: Tertiary & Vocational Education Commission.

It is observed that various training centres are established within close proximity to each other, delivering the same or similar courses, and consequently resulting in duplication and overlapping of services. For instance, Jaffna and Anuradhapura Colleges of Technology are classic examples providing similar courses to offer a Certificate in Computer Hardware, Certificate in Building Career Skills, National Certificate in Engineering Craft Practice (Gas & Arc Welder), Certificate in Machining etc. This leads to underutilisation of the limited available resources. Hence, some courses are conducted even without the optimal number of students. This is mainly due to the lack of guidelines on optimising the available resources to achieve the TVET sector objectives, and the lack of coordination between training networks. Ideally, these courses need to complement rather than compete, allowing centres to specialise in niche areas and become centres of excellence. This would also allow the return on investments (ROI) to improve as the courses can then function with optimal student numbers.

Besides, certain public institutes tend to deviate from the said guidelines and mandates complicating the TVET development. For example, the Technical and Vocational Education (TVE) Act empowers the NAITA to organise apprenticeship training in partnership with the industry. However, NAITA provides industrial training at both regional and national levels in their training centres, duplicating the roles of DTET and VTA. Similarly, the process gets complicated as many institutions provide similar training programmes at different levels under several Ministries.[6]

6 National Education Commission. (2018). *National Policy on Technical and Vocational Education.* Colombo: National Education Commission.

Issues with the NVQ system and lack of relevance of the curricula: NVQ was initiated in 2005 as a qualification accreditation system based on the occupational requirements to establish a qualification for youth entering the labour market that could be easily recognised by employers. The system should preferably update the curricula continuously reflecting the dynamic labour market requirements. However, many constraints exist within the NVQ system such as the slow progression of updating the curricula, non-inclusion of all trades and soft skills in the curricula, and the lack of acquiring industry feedback on the development and validation of NVQ-related documentation.[7] Hence, these lags hinder fully utilising the NVQ system for recruitment, wage setting, and promotion of employees in the private sector, while it is set to be mandatory for public sector institutions.

Many constraints exist within the NVQ system such as the slow progression of updating the curricula, non-inclusion of all trades and soft skills in the curricula, and the lack of acquiring industry feedback on the development and validation of NVQ-related documentation.

Further, some private agencies deviate from procedures outlined in the NVQ operational manual regarding the selection of sectors for developing National Competency Standards (NCSs). This is primarily owing to the influence of societal demand surpassing labour market demand. Such ad hoc measures create incompatibilities within the NVQ system, leading to credibility issues.

Issues with on-the-job training: Many constraints prevail related to on-the-job training, including the lack of facilities and unappealing working environments, lack of hygiene and occupational health and safety measures, insufficient stipend/allowance, lack of supervision, and inconsistency in guiding the trainees.[8] As a consequence, many trainees dropout of the system, which means they fail to proceed beyond the NVQ level 3.

Limited private sector engagement: According to the study of Dundar et al., (2017), the private sector accounts for approximately 30% of total TVET enrolments. Moreover, the private sector TVET consists of sole proprietorships, incorporated companies including chambers, private partnerships, and non-governmental organisations (NGOs) assisted by local and overseas charities and donors. The role of the private sector is limited to consultation in the largely supply-driven system. Employers are minimally involved in the design and delivery of training programmes. Industry representatives take part in TVET boards and other committees at a minor level in an ad hoc manner. Hence, there is little influence over the decisions and subsequent voicing of private sector requirements. Indeed, the lack of involvement of the private sector is one main impediment to the weak orientation of the NVQ system to meet labour market demands, along with the limited use of the NVQ system and restricting avenues for realising its potential among private sector employers.

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7 Dundar, H., Millot, B., Riboud, M., Shojo, M., Aturupane, H., Goyal, S., & Raju, D. (2017). *Sri Lanka Education Sector Assessment: Achievements, Challenges, and Policy Options.* Washington, D.C.: World Bank Group.

8 Daily FT. (2019, December 10). *TVET Sector Transformation Vital to Address Lanka's Workforce Shortage: Ernst & Young*. Retrieved March 30, 2023, from Daily FT: https://www.ft.lk/HR/TVET-sector-transformation-vital-to-address-Lanka-s-workforce-shortage-Ernst-Young/47-691292

Key actors are responsible for enhancing areas under their purview. The private sector is crucial in benchmarking performance, training instructors for specific services, developing curricula, and providing part-time trainers. Their involvement is critical not only to make the course content more relevant and focused, but also to provide private sector recognition of the certificates and diplomas. Employers' contribution is also vital in conducting labour market assessments, offering industry training opportunities for both graduates and trainers and participating in collaborative training programmes. Such inclusion will make the NVQ certification accredited and recognised in recruitment, wage setting and career development of employees.

Indeed, the lack of involvement of the private sector is one main impediment to the weak orientation of the NVQ system to meet labour market demands, along with the limited use of the NVQ system and restricting avenues for realising its potential among private sector employers.

Mismatches in demand and supply of skills: Faced with high youth unemployment, vocational education can be considered one of the best options to integrate youth into the labour market. However, there are hurdles to overcome. A study by the Asian Development Bank (2015) found that about 28% of the unemployed in Sri Lanka had undergone TVET training, arguing that despite their skills, this reveals skills-jobs mismatches and a shortage of talent for promoting innovation and creativity.

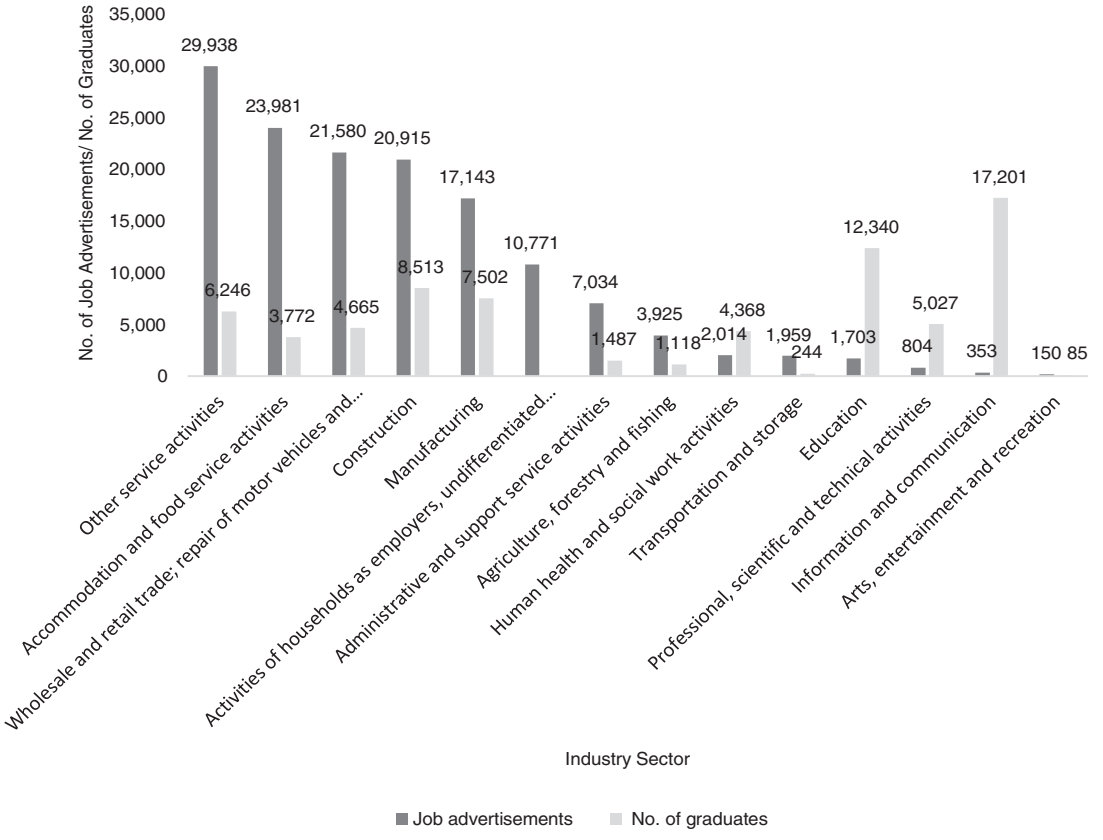
It is often suggested that societal demands from youth, parents, and other stakeholders have influenced the TVET provision. Such demand has led to an imbalance and irrational provision of TVET courses leading to unemployment and underemployment of TVET graduates. According to a survey conducted by the TVEC,[9] the most demanding occupations related to vocational training recently have been cooks, waiters, drivers (heavy vehicles), construction craftsmen (masons), welders, bakers, etc. The demand for careers in nursing and caregiving has also been rapidly rising due to the ageing population globally. Additionally, job availability also exists in the areas of light engineering, agriculture, tourism, and hospitality.

However, according to the Labour Market Information Bulletin of the Tertiary and Vocational Education Commission (2021), most graduate output has been prominent in the areas of information and communication technology (ICT) technicians, beauticians, hairdressers, and preschool teachers. This is mainly owing to the provision of private sector training in services of ICT, hairdressing and beauty culture, hospitality, paramedical professions, etc. Private sector training tends to concentrate on the above service areas to avoid heavy investments required for industry or manufacturing sectors, as implied in the policy document by the National Education Commission (2018).

9 Tertiary and Vocational Education Commission. (2021). *Labour Market Information Bulletin- Volume 02/'21-December 2021.* Colombo: Ministry of Education.

Figure 16.3 depicts job advertisements indicating labour market demand and the number of graduates in registered public and private sector training institutes indicating labour market supply. On the one hand, it is clear that some sectors like ICT, education, professional and scientific and technical activities may result in unemployment or underemployment due to the over-supply of graduates compared to the labour market demand. On the other hand, sectors like accommodation and food services, wholesale and retail trade, repair of motor vehicles and motorcycles, and manufacturing experience a shortage in skilled labour supply. Despite a high youth unemployment rate, the skills gap in certain sectors requires serious remedial measures for timely implementation.

Figure 16.3
Job Advertisements Vs. Number of Graduates, by Industry Sector, 2021



Source: Author compilation based on Tertiary and Vocational Education Commission. (2021). *Labour Market Information Bulletin- Volume 02/21-December 2021.*Colombo: Ministry of Education.

Lack of capacity to monitor the labour market and TVET outcomes: Currently, the TVET sector has limited capacity for regular labour market assessment on dynamic demands and needs of employers. There is no systemic monitoring system in place to track or report the quality or relevance of TVET in meeting industry skills requirements, particularly across middle and higher-level skills. Under these circumstances, current assessment systems are driven by academic curricula and examinations,

hence are not linked with workplace requirements or demonstrated mastery over specified skill sets. This poses a challenge to anticipate the labour market changes and incorporate changes into the TVET system. In addition, a study by Dundar et al., in 2017 reveals that the TVET sector suffers from a dearth of information on overall educational outcomes regarding the performance of graduates, programmes, and centres which extends to staffing, teacher performance, programme financing, and graduate employability. Consistent quality and performance standards should be applied to ensure that users have clarity on the consequent skill sets of training programmes, with clear industry endorsement to improve graduate employability.

Inadequate quality of service provision: According to the Skills Toward Employment and Productivity (STEP) survey,[10] firms identified TVET skills as the third most vital factor for their operations and growth. However, firms question the quality of programmes offered by the TVET institutions. This could be primarily due to a lacuna in qualified human resources to conduct the curricula and inconsistent quality in training provision. According to the STEP survey, more than 50% of the firms have indicated that they do not receive suitable graduate profiles to consider for employment in line with their requirements. A similar percentage of firms have cited that the TVET programmes do not offer practical skills/training, hence do not produce workers with up-to-date knowledge of material, methods, and technology. Currently, those employed have more than the required skills for low-skilled occupations but do not possess the skills to qualify for high-skilled occupations, as employer perceptions.

Some major reasons for the lack of qualified human resources are unattractive salaries which are not on par with market rates, few performance incentives, and minimal career progression structures that hamper staff retention. Besides, the lack of up-to-date instructional material, equipment, and facilities exacerbates the issue. A few instructors have industry experience and in-service training, contributing to an under-skilled and unstable teacher base. Hence, most of the institutions rely on contracted instructors.

Limited financing for TVET: Public TVET institutions are financed mainly by the Treasury. In 2019, less than 1% of the government budget was spent on the TVET sector. This is hardly sufficient to finance over 500 public institutions providing salaries, materials, machinery, equipment, and energy impeding the training of staff and inspectors.[11]

16.3 Private Sector Role in Providing Quality TVET

Among the many policy discussions on improving the TVET sector's performance, the most recent is the National Policy on Technical and Vocational Education in 2018. However, there is considerable room for improvement concerning private sector involvement, on-the-job training, and rationalisation of TVET provision.

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10 Dundar, H., Millot, B., Riboud, M., Shojo, M., Aturupane, H., Goyal, S., & Raju, D. (2017). *Sri Lanka Education Sector Assessment: Achievements, Challenges, and Policy Options.* Washington, D.C.: World Bank Group.

11 Arunatilake, N. (2023, February 2). *Improving TVET Outcomes in Sri Lanka: Better Partnerships with Non-State Actors Can Help*. Retrieved April 24, 2023, from UNESCO: https://world-education- blog.org/2023/01/31/improving-tvet-outcomes-in-sri-lanka-better-partnerships-with-non-state-actors-can-help/

In pursuing such reforms, many positive lessons can be learnt from global best practices. Among the vocational education systems worldwide, Germany stands out as a success story, with low youth unemployment at just above 6%. It is considered a world-class model – a company-based vocational training system and a well-functioning decentralised arrangement where firms, unions, and governments liaise seamlessly. Harmonising employers, trade unions, states and the federal government working through industry-wide commissions create a platform for the standardisation of content, practices, curricula, and professional qualifications at the federal level. Each entity has a specific set of competencies, and these produce detailed statistical documentation for evaluation purposes. This process ensures that the training programmes remain efficient and relevant. Further, the consensus between employers and unions at the company, industry, and national levels facilitates that the transferred competencies are not just confined to one company but encompasses an entire trade and increases the mobility of trained employees between companies. Furthermore, Germany is acclaimed for its dual system of vocational training where students spend about two days a week in school to learn theory, and the other three days in business, gaining hands-on experience for an average of three years. This approach has turned Germany's apprentices into skilled workers and is an integral part of its top-notch standards in manufacturing and services and is seen as a key factor in the country's successful export-led economic model. Most importantly, the German vocational education system is not merely a 'side line' for those who dropout of the general education system, but a system that allows flexibility to switch tracks and return to general education.[12]

Building a strong foundation for private sector engagement within the TVET sector is essential. This is feasible in many ways: enhancing incentives for employer participation in the TVET sector, creating a platform to obtain industry feedback in developing and validating NCSs and NVQ, including those recommendations in action plans and conducting collaborative training programmes. The higher the intensity of harmonising with the private sector, the better the course content will be to match labour market requirements and bridge skills mismatches. Concurrently, improved partnerships will support the private sector overall growth.

As an emerging economy, Brazil provides some valuable lessons for Sri Lanka. It too has experienced mismatches between the demand and supply of skills. To address this, Brazil has strategically involved the private sector to bridge the skills gaps via employer-owned and managed training. Its National Industrial Apprenticeship Service (SENAI) serves as the largest institution for professional and technological education in Latin America, training more than 2.3 million (Mn) Brazilian workers for the industry each year. It is organised as a network of not-for-profit secondary level professional schools established and maintained by the Brazilian Confederation of Industry.[13] The specialised services of Serviço Nacional de Aprendizagem Industria (SENAI) cover commerce, rural areas, small enterprises, and transportation. The chambers of employers finance the training programmes through a 1% payroll levy and conduct the services independently.

12 Emmanuel, M. (2018, December 11). *Vocational Lessons from Germany and France*. Retrieved April 20, 2023, from GIS Reports: https://www.gisreportsonline.com/r/germany-vocational-education-system/

13 devex. (n.d.). *National Service for Industrial Training (SENAI)*. Retrieved April 12, 2023, from devex: https://www.devex.com/organizations/national-service-for-industrial-training-senai-48344

A comparative example from a developed country perspective can be found in Australia's Industry Skills Councils (ISCs), established to enhance private sector involvement in the TVET sector. The councils are non-profit companies financed by the government but governed by independent industry-led boards. The functions provided by the ISCs are:

- Provision of advice on workforce development and skills need to the Australian Workforce and Productivity Agency, the government and enterprises.
- Provision of integrated industry intelligence.
- Supporting the development, provision and continuous improvement of training and workforce development products and services, such as industry training packages.
- Matching identified training needs with appropriate solutions. The councils work together with enterprises, registered training organisations, employment service providers, and the government to provide work placements for the trainees in the Enterprise-Based Productivity Places Programme.
- Coordinating closely with the National Workforce Development Fund.[14]

By contrast, Sri Lanka's efforts to engage the private sector in TVET activities have been fragmented and ad hoc. One such effort was the establishment of a Sector Policy and Training Advisory Council (SPTAC), an industry committee appointed by the TVEC to obtain strategic directions on human resource development, private-public partnerships (PPPs), and to facilitate on-the-job training. A formulated strategy – National Policy Framework for Higher Education and Technical and Vocational Education – was to seek advice on identifying emerging occupations and NCSs. However, as indicated in the policy document- National Policy on Technical and Vocational Education of the National Education Commission (2018), the initiative was abandoned due to not functioning as expected.

Another strategy was initiating a Sector Skills Development Programme (SSDP) funded by the Asian Development Bank (ADB). Under this, Industry Sector Skills Councils (ISSCs) were established to function under the Ministry in charge of respective vocational training subject areas. The ISSCs are to support industry sectors such as tourism, construction, light engineering, and ICT to improve the private sector representation in aspects of training and skills development, and competency standards validation. The scope of ISSCs was further expanded to the agriculture sector. The primary objectives of these councils are to identify priority training needs by undertaking a skills gaps analysis, establish a programme of interventions to bridge or minimise the gaps, and assist with skills certification and job placement in a more market-responsive manner.[15]

A results-based lending programme was initiated to support the SSDP from 2014-2020 with extended financing from the ADB. Furthermore – the Skills Sector Enhancement Programme (SSEP) – was

14 Dundar, H., Millot, B., Riboud, M., Shojo, M., Aturupane, H., Goyal, S., & Raju, D. (2017). *Sri Lanka Education Sector Assessment: Achievements, Challenges, and Policy Options.* Washington, D.C.: World Bank Group.

15 *Ibid.*

approved in 2014. Over 250,000 youth who need training on vocational skills, 1,000 in-service workers with the opportunity of upgrading skills, and employers who are capable of recruiting skilled workers were identified as direct beneficiaries of this programme. The Japan Fund for Poverty Reduction was also introduced to complement the project by demonstrating innovative approaches to private sector participation, women's empowerment in TVET, and employment of TVET graduates. The purpose of this grant was to specifically support the ISSCs in establishing competent advisory committees in human resource development, advising the TVET sector on demand-oriented service provision, and creating linkages between industries and graduates for job placements.[16]

It is palpable that the sole government efforts have failed in certain circumstances, for instance, SPTAC, due to a lack of functioning as expected. However, foreign-funded or private sector involved committees have functioned well.

Furthermore, according to the Labour Market Information Bulletin of the Tertiary and Vocational Education Commission (2021), a grants scheme was implemented to purchase machinery, equipment, and tools for training on a cost-sharing basis to strengthen the course accreditation programme with the NVQ system within the private institutes.

It is palpable that the sole government efforts have failed in certain circumstances, for instance, SPTAC, due to a lack of functioning as expected. However, foreign-funded or private sector involved committees have functioned well. One good example is the ISSCs which even expanded to the agriculture sector, a much-needed sector for improvements. The success of the ISSCs could be primarily due to the performance-driven achievement of goals with the pressure exerted by foreign-funded parties and private sector involvement in efficient functioning. Accordingly, the following policy interventions could be considered to address the structural issues and minimise the functional drawbacks, as pointed out above.

16.4 Policy Interventions

Despite such initiatives, private sector involvement in improving the quality of TVET has been weak. This has prompted the National Education Commission (NEC) to recommend further reforms, as illustrated in the policy document of the National Education Commission (2018). These include:

- Implement a fair and sensible training quality assurance system within the NVQ framework for higher recognition of TVET service provision by the private sector.
- Implement a transparent system of providing technical and financial grants to selected private TVET providers to provide demand-driven courses.

16 Asian Development Bank. (n.d.). *Japan Fund for Poverty Reduction Grant- Demonstrating Innovative Approaches for Private Sector and Women's Empowerment in Technical Vocational Education and Training in Sri Lanka.* Manila: Asian Development Bank.

- Implement a system to share public sector TVET resources with the private sector.
- To continue the training purchase model to increase the supply of trainees in occupations in demand.
- Establish a guaranteed fund with the commercial banks for the private sector with the recommendation of the government to expand training for occupations in demand.
- Provide tax concessions for the private sector to import high-value equipment and machinery for training.
- Provide teacher training for the private sector TVET teachers with the UNIVOTEC.

Increased private sector involvement could be considered an important mechanism to minimise many structural issues facing TVET such as lack of a governance structure, curricula relevance, quality on-the-job training, public financial constraints, etc. While several policy interventions are in force to improve private-sector involvement, PPPs and collaborations have had limited success, there is much room for improvement.

Increasing private sector involvement needs significant efforts, well-defined strategies, perception of achieving targets, and seamless collaborations. This requires considerable efforts from both the government and the private sector.

Increased private sector involvement could be considered an important mechanism to minimise many structural issues facing TVET such as lack of a governance structure, curricula relevance, quality on-the-job training, public financial constraints, etc.

Improving the relevance of curricula: While policy action to improve industry involvement in building the curricula, NCSs, NVQ, etc., have been pursued, loopholes remain within the procedure. Industry feedback is obtained through ISSCs and the National Industry Training Advisory Committees (NITACs) for developing and validating the NCSs, curricula and other NVQ-related documents. Nevertheless, the developed NCSs are not presented to the relevant industry players to obtain feedback on the overall situation before validation and endorsement. Therefore, the current system lacks a standardised system to obtain overall industry feedback on developed NCSs in this setting.[17]

However, if feedback is obtained from the wider industry community, the recognition and acceptance of the NCSs and NVQ will be higher from the private sector and wider industry. Accordingly, it is important to strengthen the platforms where the industry could raise its voice and concerns and represent labour market demand. One possibility is obtaining industry views on NCSs by improving

17 National Education Commission. (2018). *National Policy on Technical and Vocational Education.* Colombo: National Education Commission.

industry representation in each respective committee. The relevant authorities could seek industry experts who are willing to participate in the committees and encourage them to provide their insights. Most importantly, their insights and perspectives must be intensely considered while including them in action plans. Obtaining industry perceptions for developing and validating NCSs and NVQ documents should be made mandatory within the overall procedure.

Increasing private sector involvement needs significant efforts, well-defined strategies, perception of achieving targets, and seamless collaborations. This requires considerable efforts from both the government and the private sector.

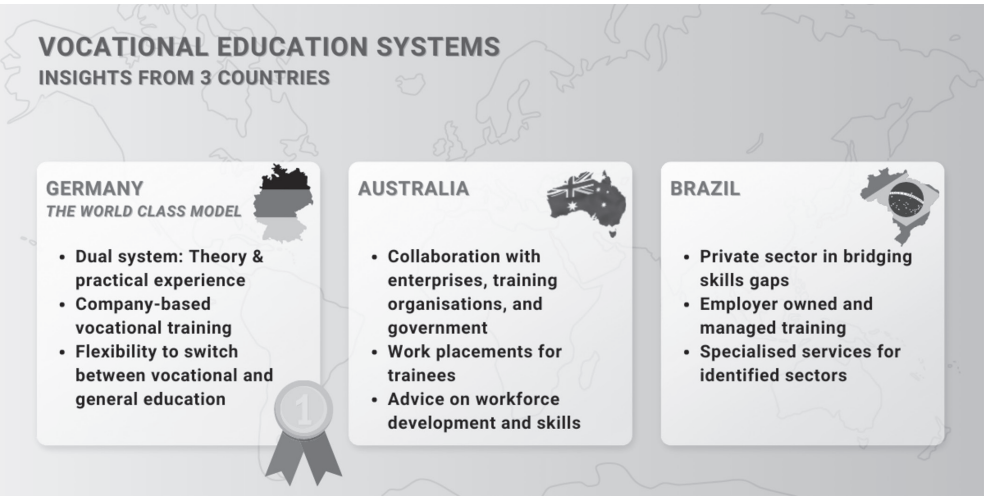
Additionally, the established ISSCs need to be strengthened, maintained and expanded to other sectors in demand. It is also important to publicly publish their performance.

Improving the efficiency of TVET provision: Given the prevailing fiscal constraints, mechanisms to enhance the efficiency of TVET provision with the available resources need to be revisited. One option is PPPs. Similar to the German system, companies could offer job placements across diverse industry sectors. This will not only ensure that the private sector partly shoulders the government's financial burden, but the private sector may also benefit as costs are partially offset by having a wider base of skilled workers. An essential first step for this process is to establish a database of private sector companies that are willing to liaise with the public sector to provide job placements. An industry cohort could also be created to share the trainees between companies such that the trainees will be competent across wider sectors, whilst the private sector can also provide industry training for the institutional instructors. It could be possible for NAITA to initiate this process as it already has collaborations with industry experts to some extent. Existing relationships need to be strengthened while expanding the network/connections with industry experts. Apart from this, it is also important to assess the quality-of-service provision of companies on their resource availability, quality of human resources, health and safety, etc. In doing so, the purpose is to maintain the required standards and retain the trainees within the placements, as many are found to abandon training due to quality issues of on-the-job training. Moreover, the salary scales of the TVET sector should be matched with market rates to attract qualified instructors to train students.

In addition, PPPs can be encouraged by providing grants where required to improve accessibility for students and training for upskilling private sector employees through UNIVOTEC and other respective institutions.

Rationalisation of TVET provision: The rationalisation of TVET provision requires an in-depth analysis of the structure, institutes, their regional locations, current course provision, resource availability, resources required, student enrolment numbers, industry demand, reasons for student dropouts, the performance of institutions, etc. The prime authority of the TVET sector, the Ministry of Skills Development and Vocational Training, could conduct this analysis. Most importantly, the results of the analysis should be published. The analysis needs to be conducted at regular intervals to standardise programmes.

Given that challenges exist in tracking the performance of institutes, it is paramount to take policy action to mandate that training institutions publish their performance reports. Accordingly, some of the centres could be specialised in niche areas while some courses may be discontinued or cease to offer based on the analysis of the rationality of the provision. Collaborations between government institutes such as NAITA, VTA, DTET, CGTTI, etc., could play a key role in sharing the resources between institutions depending on the rational provision of courses. As a part of this, staff capacity building through PPPs and international collaboration is critical.



Source: Compiled by the author based on various sources.

The rationalisation process necessarily requires the alignment of course provision with industry demand than societal demand to bridge the gap in skills mismatches and address youth unemployment. Evidence suggests that partnerships with the private sector are vital in representing industry demands, required skills and competencies. According to the report of the National Education Commission (2018), some strategies for policy consideration are:

- Information should be made available to the training providers on sectors or segments that provide a high ROI through local and foreign employment.
- An in-depth analysis should be conducted on the rational distribution of the workforce at craft, supervisory and higher levels before investing in new courses.
- Decisions on the number of courses and students to be enrolled should be made on a rational basis in line with the national development goals, labour market demand, feasibility of implementation in terms of teachers, economies of scale, and ROI.
- To consider the financial viability and sustainability as a substantial aspect in making investment decisions.
- Investments in new centres or programmes should be approved only if these are within their mandates.

- Strengthening of existing institutions in specific industries like Hotel School, Sri Lanka Institute of Textile and Apparel, Construction Industry Development Authority, Department of Agriculture, etc. These institutions need to be utilised by TVET to regulate training.
- Prospective students should be made aware of the career opportunities available within the country and overseas through an appropriate mechanism.



Source: Compiled by the author based on various sources.

On-the-job training: On-the-job training is advocated for TVET sector graduates while it is a compulsory component of the course curriculum for NVQ level 4. NAITA is empowered to place the graduates on job training at the hands-on level and administer related functions. While a system was in place to pay an allowance for students who participated in job training, this was abolished due to the government's financial constraints, as indicated in the policy document of the National Education Commission (2018). Training providers also take the initiative to find job placements for their students in their respective industries.

Many potential strategies have been discussed to improve linkages between training providers and the industry for better access and quality on-the-job training. Some of these include building and maintaining stronger cooperation between TVET providers and industries, offering part-time teaching opportunities for industry practitioners, maintaining a database of industries willing to provide job placements, encouraging industries to provide an allowance for trainees, and providing skills upgrading programmes for industry employees.[18] Global best practices point out some successful examples. For instance, in Switzerland, it is a must for companies to apply for Vocational Education and Training (VET) accreditation to assess their suitability to provide on-the-job training. Assessments rely on the availability of a suitable work environment with sufficient infrastructure and the provision of training aligned with course requirements. Generally, VET inspectors visit the companies to ascertain whether staff requirements are met and whether the institutions are suitable to provide apprenticeships.[19]

18 National Education Commission. (2018). *National Policy on Technical and Vocational Education.* Colombo: National Education Commission.

19 Daily FT. (2019, December 10). *TVET Sector Transformation Vital to Address Lanka's Workforce Shortage: Ernst & Young*. Retrieved March 30, 2023, from Daily FT: https://www.ft.lk/HR/TVET-sector-transformation-vital-to-address-Lanka-s-workforce-shortage-Ernst-Young/47-691292



Source: Compiled by the author based on various sources.

The government of Germany amended its Vocational Training Act in 2005 to introduce an alliance between the state and companies. The alliance and the consequent relations with the companies play a crucial role in updating, introducing training regulations and occupational profiles as well as ensuring the training centres provide up-to-date skills for students. Most importantly, the system ensures that the companies have a social responsibility to guide and support the youth by providing on-the-job training. With this type of process in place, companies can bear to cut recruitment costs and minimise the risks of recruiting talent from new and unfamiliar backgrounds. Notably, investments made by employers were partially offset by the productive output of trainees, allowing private investments to be sustained.[20]

16.5 Conclusion

Vocational education is seen as a crucial solution to tackle the problem of youth unemployment and youth entering the job market without training, especially in the context of Sri Lanka's current economic crisis. As a first step, due consideration should be given to integrating vocational education with mainstream education rather than treating it as a secondary option for those who do not excel in general education. Indeed, vocational education backed by a sound governance strategy can uplift its role, reputation and acceptance as well as contribute to economic growth. However, this long-term endeavour will require significant investment in policy action, time, awareness building and resources, including information. In the interim, policy interventions must be aimed at addressing root causes like structural issues that hinder the effectiveness of TVET and constrict achieving desired outcomes.

20 Daily FT. (2019, December 10). *TVET Sector Transformation Vital to Address Lanka's Workforce Shortage: Ernst & Young.* Retrieved March 30, 2023, from Daily FT: https://www.ft.lk/HR/TVET-sector-transformation-vital-to-address-Lanka-s-workforce-shortage-Ernst-Young/47-691292

These structural issues include the paucity of a governance structure, insufficient involvement of the private sector, lack of quality service provision, limited financial capacity, and problems with available on-the-job training opportunities. Crucially, stronger private sector involvement can help overcome many of these issues. Strengthening PPP engagement, increasing the representation of private sector experts within government committees, mandating the necessity of industry feedback when developing and validating NCSs and NVQ documentation, conducting collaborative training programmes with the private sector, facilitating private sector investment, enhancing international collaborations, etc., are some relevant measures.

17. Tourism in Sri Lanka: Staying Afloat and Building Back Better

17.1 Introduction

Sri Lanka's tourism industry has been repeatedly struck by a string of disasters, such as the Easter Attacks in 2019, the coronavirus (COVID-19) pandemic and the subsequent economic crisis that continues to date. As a result, the sector was unable to maintain the growth momentum after hitting an all-time high of 2,333,796 tourist arrivals in 2018. This number had drastically dropped to 719,978 in 2022, albeit substantially recovering from the 194,495 arrivals in the previous year. In 2020, tourist arrivals showed 212,274. The Socio-Economic Data published by the Central Bank of Sri Lanka in 2022 show that the gross receipts from earnings too plummeted from United States Dollars (USD) 4,381 million (Mn) in 2018 to USD 507 Mn in 2021 before recovering to USD 1,136 Mn in 2022.

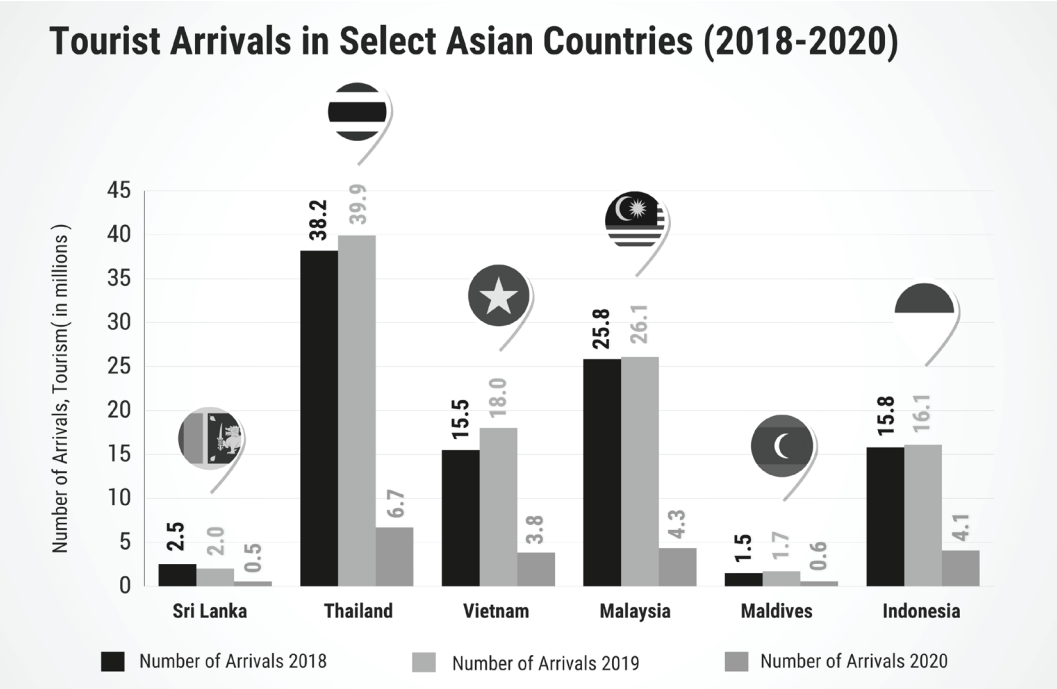
To add to the woes of Sri Lanka's tourism industry post-pandemic, the economic difficulties hit hard deepening the industry's vulnerability. Fuel shortages prolonged countrywide that rendered travel impossible. Sri Lanka Tourism Development Authority (SLTDA) requested tourist service providers to register for fuel coupons giving priority to obtain fuel. The fuel shortages also resulted in island wide power outages, which hit tourist establishments hard, going from bad to worse, where heating, air conditioning and other services as part of facilities provided in the said industry were disrupted. Civil unrest in the country rose owing to these shortages. Additionally, import restrictions, particularly imposed on selected food items, meant that hotels that sourced imported food (as part of the menu or as ingredients) faced hardships in continuing operations up keeping the same standards. Some of Sri Lanka' source markets such as Australia and the United Kingdom (UK) issued travel advisories for Sri Lanka. Sri Lanka Strategic Plan for Tourism 2022-2025, compiled by the World Bank, noted that these countries cited civil unrest, violence, fuel and power shortages, medicinal drug shortages, etc. These factors combined to halt the post-pandemic recovery – arrivals of 106,500 in March 2022 shrank to 62,980 in April 2022 and the trend continued throughout the year. Against this background, this policy brief aims to assess the global tourism landscape and Sri Lanka's challenges in positioning itself to to fully exploit its available resources.

The fuel shortages also resulted in island wide power outages, which hit tourist establishments hard, going from bad to worse, where heating, air conditioning and other services as part of facilities provided in the said industry were disrupted.

17.2 Global Tourism Landscape

Globally, tourism has not fared well in recent years, again largely owing to the pandemic. The ongoing Russia-Ukraine war and the world facing a permacrisis have also impeded travel. The Secretary General of the United Nations World Tourism Organisation (UNWTO), Zurab Pololikashvili refers to it as a triple crisis in the tourism sector – pandemic, war, and climate change, in his 2022 blog, 'Tourism: Reimagined'. While the sector value (USD 2 trillion [Tn]) grew by 41% in 2022 from the previous year, it remains well below pre-pandemic levels. As per the data provided by UNWTO, the sector value was an estimated USD 2.9 Tn, with 1.5 billion (Bn) international tourist arrivals in 2019 – this number shrank to a mere 500 Mn in 2020 before rising slightly to 960 Mn in 2022.The recent Travel and Tourism Development Index 2021 report published by the World Economic Forum estimated that the downturn in the sector has led to a giant loss of 62 Mn jobs in 2020.

In 2002, the Sri Lanka Tourist Board (present Sri Lanka Tourism Development Authority) recognised India, Indonesia, Malaysia, Maldives, Singapore, and Thailand as its key competitors in Asia[1]. Indonesia, Maldives, and Thailand have tropical climate and beaches akin to Sri Lanka. Singapore, however, has few natural resources and attracts tourists for its luxurious living and advanced services sector. India has a large economy, population, and diversity than Sri Lanka. Therefore, Indonesia, Maldives and Thailand are competitors that are perhaps most comparable to Sri Lanka's circumstances.

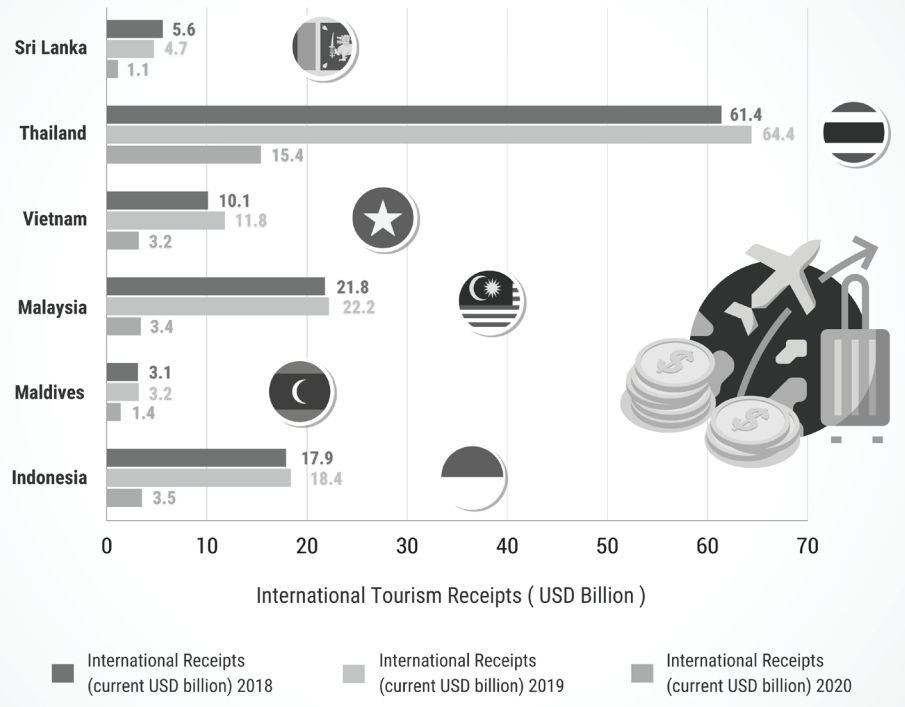


Source: World Bank. (2023). *World Development Indicators.*

1 Bentley, R. (2002). *A Competitiveness Strategy for Sri Lanka's Tourism Industry*. Washington, D.C.: US Agency for International Development.

In the case of Sri Lanka's key competitors in Asia, most saw a continued favourable climate for tourism pre-pandemic (see infographic). Sri Lanka was the exception that saw its arrivals numbers dip in 2019 owing to the widely publicised Easter terror attack in April 2019. Less than a year later with post-pandemic, all countries globally struggled unexpectedly. While Asia and the Pacific region has not yet achieved their pre-pandemic levels of tourist arrivals, and although the pre-COVID levels are expected to be realised only in 2024,[2] some countries have fared better than others. The Maldives has managed to pick up and retain its tourist arrivals at 80% of the pre-pandemic levels with a far swifter adaptation to the post-pandemic circumstances.[3] Not only did it manage to expedite the vaccination process, but its tourism sector also showed innovative approaches to rebuild the country's image as a destination which caters to quarantining, work-from-home, etc., with tagline 'isolation never looked good'. Indeed, the changing global dynamics – with most overseas travellers aged 25-44 – have presented the country with more opportunities to adapt to concepts that came into the discourse with the pandemic.

Tourism Revenue Trends in Select Asian Countries (2018-2020)



Source: World Bank. (2023). *World Development Indicators.*

2 United Nations World Tourism Organization. (2021, January 28). *2020: Worst Year in Tourism History with One Billion Fewer International Arrivals*. Retrieved July 20, 2023, from UNWTO: https://www.unwto.org/news/2020-worst-year-in-tourism-history-with-1-billion-fewer-international-arrivals

3 Mercer-Blackman, V. (2022, January 26). *The Changing Face of Tourism And Work: How Maldives is Successfully Adapting to the Pandemic*. Retrieved July 20, 2023, from World Bank Blogs: https://blogs.worldbank.org/endpovertyinsouthasia/changing-face-tourism-and-work-how-maldives-successfully-adapting-pandemic

Elsewhere, research has highlighted other features that are endemic to developing countries, rich with culture and natural resources,[4] as means of attracting global travellers. It provides countries with insights about effectively crafting coping strategies. These include traditional arts and food, cultural events, cultural-based activities, and Sri Lankan hospitality. Indeed, some of these dimensions have been adopted by the Indonesian Tourist Destination Competitive Advantage (ITDCA) model. Similarly, given the country's natural resources, culture and community, Sri Lanka should examine the viability of such concepts relevant to building a case for its tourism sector. Other countries, such as Singapore and Dubai, rely on their advanced infrastructure to attract tourists.

17.3 Sri Lanka Tourism Challenges

Sri Lanka's regular top source markets considerably changed in recent years, with China (a top source market previously) not featuring among the top ten after 2020 (Table 17.1). The traditional Western European markets such as Germany, France and the UK have continued to regard Sri Lanka as a tourism destination. Of interest is the many Russian and Ukrainian nationals who have continued to visit Sri Lanka despite the war, while arrivals from countries such as Poland spread Sri Lanka's popularity to the Eastern European tourist market. Sri Lanka has been able to retain the interest of Indian tourists and this will continue to be a key source that the sector will hope to tap in its recovery plans.

Table 17.1
Sri Lanka's Top Source Markets, 2018-2022

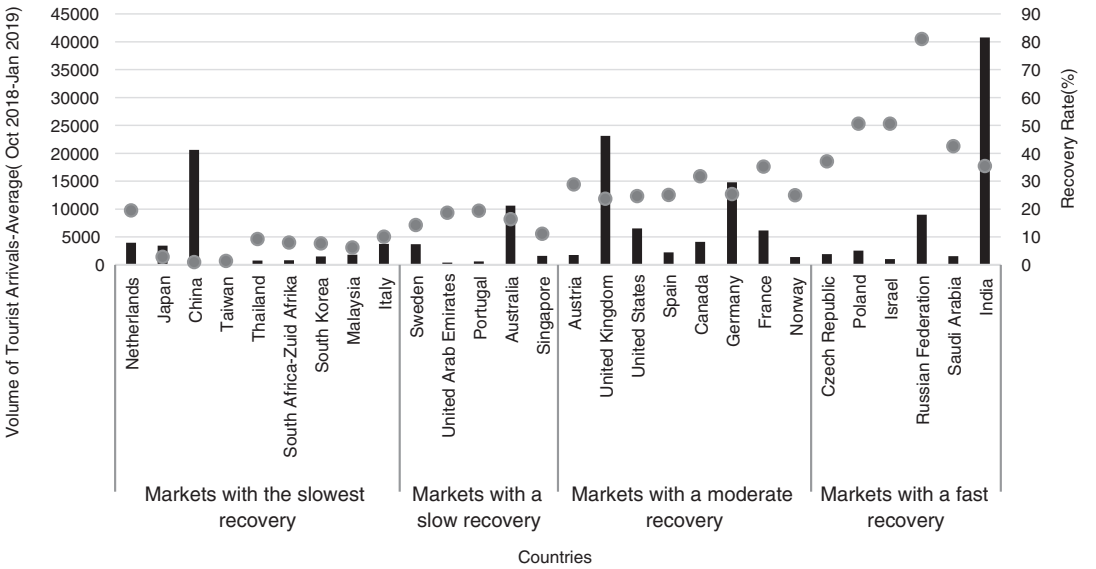
	2018	2019	2020	2021	2022
1	India	India	India	India	India
2	China	UK	UK	Russia	Russia
3	UK	China	Russia	UK	UK
4	Germany	Germany	Germany	Germany	Germany
5	Australia	Australia	China	Pakistan	France
6	France	France	France	Ukraine	Australia
7	Maldives	Russia	Australia	France	Canada
8	USA	USA	Ukraine	Maldives	USA
9	Russia	Maldives	USA	USA	Maldives
10	Netherlands	Canada	Canada	Kazakhstan	Poland

Source: Compiled based on various issues of the Annual Statistical Report, Sri Lanka Tourism Development Authority (SLTDA).

4 The study established 63 reliable indicators and 12 dimensions to evaluate the attractiveness of a tourist destination- Lesmana, H., Sugiarto, S., Yosevina, C., & Widjojo, H. A. (2021). A Competitive Advantage Model for Indonesia's Sustainable Tourism Destinations from Supply and Demand Perspectives. *Sustainability,* 1-33

Sri Lanka's Ministry of Tourism already had a Strategic Plan for 2017-2020 – proposing local community tourism, amalgamation of authoritative bodies, etc. – but its targets could not be realised post-2019. A new Strategic Plan was issued in 2022, where resilience and recovery were the key themes. The strategies pay attention to the issues of the industry's sensitivity to external shocks and recommend policies to rebuild the country's image while upskilling labour, amongst a host of other proposals. A new draft Bill to replace the current Tourism Act, No. 38 of 2005 too, was submitted in 2021 with fresh clauses to respond to emergencies. As of yet, the Bill has not come into effect.

Recovery Volume of Sri Lanka's Primary and Potential Source Markets, 2022



Note: Recovery Rate= (the average tourist arrivals from October 2021 to January 2022/ average tourist arrivals from October 2018 to January 2019) *100.

Source: Sri Lanka Tourism Development Authority. (2022, March). *Recovery Volume of Sri Lanka's Primary and Potential Source Markets*. Retrieved May 20, 2023, from SLTDA: https://www.sltda.gov.lk/storage/common_media/SLTDA_Recovery%20Rates%20Report_March%202022351208027.pdf

17.3.1 Labour Shortages

Labour issues and labour shortages are identified as a key concern in rebuilding Sri Lanka's tourism sector. Long before the current crisis, a Labour Demand Survey conducted by the Department of Census and Statistics (DCS) in 2017 found unfilled vacancies for approximately 21,000 persons in the tourism sector, with 14% of the total demand for waiters. A study on Sri Lanka's tourism industry labour force finds that large hotels struggle to attract and retain labour because of the lack of assurance on longer contracts. Permanent contracts are not awarded, especially at entry levels and low-skilled occupations such as chauffeurs, waiters, etc.[5] The problem of issuance of temporary work placements is often associated with the seasonality of the tourism sector.

5 Arambepola, C. (2021). *Workforce and Migration Patterns of Sri Lanka's Tourism Industry*. Geneva: International Labour Organization

Adding to this, a direct outcome of the economic crisis that has a bearing on the tourism sector labour issues is the momentum for outmigration, especially those with skilled labour. Citing above, Bentley's Competitiveness Strategy Report of 2002 suggest that skilled labour migration is not the most pressing issue in the industry but rather the lack of human capital in general. However, the increasing number of worker migrants will also threaten the tourism sector. Positions that are difficult for employers to recruit such as kitchen stewards (64%) and guest relations (43%) may not only worsen the current situation, but amplify the dearth of key skills that were already lacking in the general labour pool. In 2021, PricewaterhouseCoopers (PWC) published a study on the tourism sector and COVID, named 'Rapid Assessment of the Tourist Sector'. In the study, communication and teamwork skills are found to be inadequate among the tourist labour force and such soft skills (such as confidence, teamwork, adaptability, professionalism, communication) and language skills (English language and other foreign languages) will become scarcer to source.

If these persist, human resource issues too will persist. Indeed, there is a high demand for migrant tourist workers, especially in the global north. In the European Union (EU) region, foreign nationals consist of 16% of the total 13 Mn tourist sector workers. In the US, it is 19.5% and in Australia, the sector recruits the largest share of temporary visa holders[6]. Of the same study by Arambepola in 2021 on undergraduates of the Sri Lanka Institute of Tourism and Hotel Management (SLITHM) suggests that they use the training to apply for vacancies available in Australia and New Zealand to obtain permanent residency status.

Such outward migration of skilled labour is even more problematic considering that the SLITHM does not produce the required number of workers in a year. For instance, as per the 2021 PWC Report cited above, it only produced 15,208 graduates in 2019, which was far below the required skilled labour needs of 21,000 in 2017. Additionally, private bodies award certificates of training, but these rarely come under the purview of the SLTDA. Therefore, it is doubtful whether their skill sets match the industry requirements.

Sri Lanka's untapped female labour force – with a low female labour force participation rate of 34% – is one of the means to solve this problem. Currently, only 10% of workers in the tourism sector are female, while in the global market, female workers comprise 60-70% of the total tourism workforce.[7]

Retaining labour in local tourism sectors is expected to be challenging, especially for low-income countries (LICs), especially as experienced, trained workers look to migrate to developed countries.

There are labour shortages and a considerable portion of under-utilised female labour that will not come into the industry. Social stigma related to working in hotels, sexual harassment at the workplace, drugs and alcohol prevalence, long shifts and stringent working conditions have discouraged female participation in this industry. Weak English proficiency is also cited as a barrier

6 International Labour Organization. (2022). *The Future of Work in the Tourism Sector: Sustainable and Safe Recovery and Decent Work in the Context of the COVID-19 Pandemic*. Geneva: International Labour Organization.

7 *Ibid*.

for women accessing work in the sector. Whilst women can work for extra income seasonally in the local tourist spots without hindering their daily routines, their interest in pursuing a career in the tourism industry still appears to be low. The same PWC Report suggests that of those currently receiving subsidies training for the tourist sector from agencies such as SLITHM, only 15% are females. However, given the volatile nature of the tourism sector, female workers must also not be overly dependent on tourism incomes, especially considering the informal nature of most such jobs.

Improving the digital literacy of tourist vendors is also an option to address workforce gaps. Japan and Greece, for instance, have successfully implemented travel apps with information on restaurants, accommodation, etc., as well as containing digital wallets for easy and safe payment methods and reliable services for tourists.

The Sri Lankan context is not different from the rest of the world. The Travel and Tourism Development Index 2021 Report suggests that the tourism workforce laid off during the pandemic is unlikely to return to the sector as they require more socio-economic resilience, equal opportunities, flexibility, and stability. As such, recruiting and retaining labour in local tourism sectors is expected to be challenging, especially for low-income countries (LICs), especially as experienced, trained workers look to migrate to developed countries.

The Maldives has a high number of foreign workers in its tourism sector. As per a survey by the Maldives Bureau of Statistics (MBS), in 2019, of a total of 44,954 employees on the payroll of 147 tourist resorts, local employees comprised only 47%.[8] The Maldives has identified the need to adapt local labour for executive level jobs in the tourism industry, given that most locals are currently employed in entry level jobs.

The Organisation for Economic Co-operation and Development (OECD) observations published in 2020 disclosed that the job market relies on the tourism industry, with 10.5% of total employment in the Indonesian tourism sector in 2017. Whilst the pandemic has forced tourism workers to find jobs in other sectors, the expected resurgence in tourism sector growth has seen the government has already implemented a job-seeker's card for informal sector workers, whereby they can tap preferred skills and courses for training.

Improving the digital literacy of tourist vendors is also an option to address workforce gaps. Japan and Greece, for instance, have successfully implemented travel apps with information on restaurants, accommodation, etc., as well as containing digital wallets for easy and safe payment methods and reliable services for tourists. Sri Lanka's Ministry of Tourism is already exploring the introduction of a similar travel app.

8 Thashkeel, A. (2021, November 18). *Local Talent in the Tourism Industry*. Retrieved July 20, 2023, from Maldives Financial Review: https://mfr.mv/travel-and-tourism/local-talent-in-the-tourism-industry

17.3.2 Natural Resources

Sri Lanka is endowed with natural resources that are tourist attractions, such as the coastline, waterfalls, forest reserves, and wildlife sanctuaries. Maintaining and managing these resources to attract tourism sustainably is crucial, albeit concerning issues remain. An airport survey conducted in 2018 found that 68% of tourists preferred to visit Colombo, Ella, Dambulla, Kandy, Nuwara Eliya, Galle and Sigiriya as their favourite cities and Friendly People, Nature and Beach as aspects they most enjoyed in order of preference.[9] They also noted that plastic pollution is high in Sri Lanka and that the beaches and coastal waters, too, are highly polluted with polythene and plastic.

Aside from these, the overcrowding of wildlife destinations and poor waste management are other key issues threatening wildlife preservation in Sri Lanka. In a survey done on key stakeholders, 50% of the respondents observed overcrowding as the main issue.[10] High congestion, air and noise pollution, as well as the predatory behaviour of tourist guides, are other issues identified. In turn, these are argued to lead to the destruction of animal habitats and vegetation owing to unmanaged tourism. Even in the case of whale and dolphin watching, their habitats are being disrupted by the intrusive behaviour of tour guides.[11] On top of these, tour guides in Sri Lanka mostly operate at the informal level, lack skills and know-how and act lacking responsibility, unlike in other countries. These can influence tourists' perception of Sri Lanka, hence affecting their travel intention.

Such trends need to be reversed if Sri Lanka's tourism sector is to align strongly with the rising global consciousness of sustainability. Indeed, as per the 2021 Annual Report of the Central Bank of Sri Lanka (CBSL) in the post-COVID era, a notable change is evident in tourism sector dynamics, as young, tech-savvy, and environmentally conscious traveller numbers are rising. The global ecotourism market size is thus expected to expand with focused attention on sustainable tourism.

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With its natural resources and historical monuments – and lack of capital to build services similar to those in countries like Singapore – preservation of natural capital should receive high priority in Sri Lanka. The country's ranking on relevant global indices shows that its competitors in Asia do better (Table 17.2). But these countries, too, face similar problems. Popular tourist destinations in Thailand and Indonesia rank high among polluted beaches, plastic debris, etc.

9 The survey was conducted in 2018/2019 and the sample size was 5,003. The participants were given the survey forms upon departure from Sri Lanka. Source: Sri Lanka Tourism Development Authority. (2019). *A Survey of Departing Foreign Tourists from Sri Lanka: 2018-2019.* Colombo: Sri Lanka Tourism Development Authority.

10 Perera, P., Jayakody, C., Jayapali, U., & Newsome, D. (2023). Challenges and Opportunities for the Resumption of Nature Tourism in Post-pandemic Sri Lanka. *International Journal of Geoheritage and Parks,* 11, 234-246.

11 *Ibid.*

Table 17.2
Natural and Cultural Resources Sub-Index-TTCI 2019

Natural and Cultural Resources Ranks	
21	Thailand
18	Indonesia
26	Vietnam
31	Malaysia
52	Sri Lanka

Notes: The score for natural resources depends on the number of national reserves, protection of fauna, the number of heritage cities, environmental regulations, and the quality of nature.

Source: World Economic Forum. (2022). *Travel and Tourism Development Index 2021*. Cologny: World Economic Forum.

Maldives has also experienced polluted beaches in their island communities but is proactively pursuing avenues of sustainability. The government encourages tourist resorts to take up sustainable initiatives such as that of the 'Coco Collection', whereby tourists can engage in coral planting and turtle rescuing. Other initiatives include zero-waste kitchens, dining menus promoting plant-based diets, in-house water-bottling facilities, etc.[12] Indonesia also revamped its tourism policies in 2022 by formulating an Institutional Framework for Tourism Development. This was centred around concepts of resilience and recovering better. Therefore, the Ministry of Tourism and Creative Economy of Indonesia launched the 'Clean, Health, Safety and Environment Certification' process. The certification assures tourists regarding the cleanliness, sustainable practices, health and safety of the accommodations.

Sustainable management of resources has been identified as a priority for Sri Lanka in the Sri Lanka Strategic Plan for Tourism 2022-2025. The SLTDA accepts that Sri Lanka's source markets, especially tourists from the West, have little tolerance for poor waste management and marine pollution. Therefore, they have pressed the need to strengthen the enforcement capacity of the existing laws and coordinate the sustainable development of tourism. As a start, the SLTDA plans to offer the National Sustainable Tourism Destination Certificate (NSTDC) to nine selected locations in the country's nine provinces.[13]

12 Garay, E. (2022, September 30). *These Maldives Resorts are Leading the Charge on Sustainability*. Retrieved July 20, 2023, from CNN Business: https://www.cnn.com/travel/article/maldives-most-sustainable-resorts/index.html

13 United Nations Development Programme. (2021). *Sigiriya: A Sustainable Wonder to the World*. Retrieved July 20, 2023, from BioFin: https://www.biofin.org/news-and-media/sigiriya-sustainable-wonder-world

Box 17.1
Yala and Sigiriya as Sustainable Tourism Sites

Two specific locations, namely Yala and Sigiriya have been identified as strategic locations where sustainable measures can be initiated at. The Yala National Park faces tourist traffic into the animal habitats beyond control. Only allowing licensed drivers, limiting the safari vehicles entering the park during the season, regulating tourist establishments that are built close to the animal habitats are some steps that could be implemented. Any infrastructure development must not encroach the animal habitat and vegetation. Any misdemeanours with regards crowd management and waste disposal should be thoroughly vetted and penalties applied.

The SLTDA has a comprehensive checklist of required licenses and clearances to be obtained before tourist activity. According to these, development within a one-mile boundary from the reserve is prohibited in national reserves such as Yala. If an investor obtains approval from a related government agency such as wildlife conservation and cultural departments, development is possible. This gap in the law could leave room for misuse. Investors could easily go through these loopholes by forging an Environmental Impact Analysis (EIA) and securing the favour of politicians and government officials.

Since Sigiriya is a UNESCO World Heritage site, the Sigiriya Heritage Foundation Act, No. 62 of 1998, stipulates the powers to collect fees, monitor preservation, etc. The Act does not cover more detailed functions as to the surrounding environment or the local community. Any further steps to develop the location as a sustainable setup would require amendments to the Act to cover the above aspects. However, there are development regulations where the forest cover surrounding the Sigiriya rock must be preserved, and tall buildings cannot be erected around the area.

The management of Sigiriya as a destination is much more precise than Yala, where some legal provisions exist for protection. For example, it is a criminal offence to harm the frescoes of Sigiriya or the Mirror Wall and can be subject to imprisonment or fines. Also, the Central Cultural Fund declared Sigiriya as a plastic and polythene-free zone in 2019. A similar measure is successfully being implemented in the Temple of the Tooth Relic, a religious historical monument in Kandy, Sri Lanka. The regulations of the Civil Aviation Authority of Sri Lanka stipulate the distance and the altitudes to which a drone can be operated in line with those applicable to historic sites and religious monuments.

Source: Compiled by the author based on various sources.

17.4 Conclusion

Globally, the tourism sector has been deeply affected by the pandemic, but Sri Lanka has been hit worse owing to its drift to an unprecedented economic crisis thereafter. The country's top source markets also changed, compelling a rethink not only to stay afloat but explore all feasible avenues as well to rebuild better. Sri Lanka's tourism industry suffers from labour shortages and environmental pollution, issues that are also prevalent in its main competitors such as the Maldives, Thailand and Indonesia.

Reducing carbon emissions in the tourist industry is a global target and much relevant to island nations with rising sea levels. Indonesia and the Maldives endeavour to curb carbon emissions while implementing other practices such as beach cleanups and sustainable waste management. Aside from attempts to upskill labour, managing existing talent through digital technology and using information systems for job matching is also rising.

Given financial constraints to improve tourism infrastructure, Sri Lanka should focus on conserving its natural resources. Preservation of nature is easier than restoring nature, and now is the time to focus on such efforts. Capitalising on key tourist locations such as Yala, Sigiriya and marine ecosystem conservation are already in place but calls for a more focus on enforcing regulations. The Indonesian Destination Model Management System is a classic example of such efforts. Under this, the community stakeholders are consulted, and any interests and ownership of the area are roughly assessed. Thereafter, capacity building and targeted infrastructure development take place. This is followed by business and economy building – creating backward and inward linkages in the locality, business promotion and marketing of the industry. Finally, the companies must go beyond the business phase and pay attention to the community through corporate social responsibility (CSR) and ensuring transparency of their organisational policies.

Sri Lanka's economic crisis is an eye-opener to explore new strategies for growth. Further, disruptive technologies can address pain points and offer industry cost-saving solutions. A tech-savvy population is rising, and environmental-conscious travellers are increasing. Maldives has understood this trend and diverted its tourism strategy to digital-driven sustainable tourism. Sri Lankan tourism industry also needs to strategise accordingly and move onto a sustainable path.