SRI LANKA: TRULY POISED TO GROW BEYOND THE GROWTH?

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To grow,

"As irrigators guide water to their fields, as archers aim arrows, as carpenters carve wood, the wise shape their lives"

Dhammapada - *Panditha Vagga (Chapter* IV -The Sagacious)

Generally each and every person individually and collectively directs and guides their actions to shape their lives: towards achieving a particular objective, some degree of elevation or growth defined and identified in their respective standards and contexts. Countries or nations are not an exception in this regard since 'growth', is an imperative in determining the status of many living and essential aspects of a country: national income/expenditure, employment, economic and social welfare and living conditions of the people, etc and the survival itself of a country in the existing world order. Economic growth can be simply defined as an increase both in productivity (GDP) and production per head of population (GDP per capita) and it remains one of the necessary conditions for long term development.

The World Development Report 2011 contends that it was once believed that GDP was the ultimate goal of development since it brought an improvement in all spheres of life: "The economy would be richer, jobs would be created, people would have more money, the quality of life would improve, poverty would disappear, industry would expand and life would be reproduced in the less–developed countries". Yet this optimistic scene has proved to be far from reality and many nations who experienced rapid rates of economic growth failed in materializing their assumed by-products. It has not necessarily resulted in higher incomes for workers, better health care, more housing, reduction of poverty or a more democratic or egalitarian society. In the contrary, there are many examples of rapid growth accompanied by a decline in the standard of living, increasing poverty, rising inequality and political repression. As such the Report sheds light on the fact that growth or development is a movement towards achieving a set of closely knitted economic and social goals which contribute to the economic and social welfare, freedom and justice of a country and the people.

In this context it is possible to identify economic freedom or the freedom of economic activity as a prerequisite that fuels the growth of a country. Adam Smith (1776) noted that freedom of exchange and transaction is itself part and parcel of the basic liberties that people have reason to value while Amarthya Sen (1999) contends that "freedoms are not only the primary ends of development, they are also among its principal means." The Heritage Foundation and the Wall Street Journal of United Sates of America produced an annual index, the Index of Economic Freedom in 1995 to measure the degrees of economic freedom enjoyed by nations in the world for which they adopted an approach similar to Adam Smith's 'Wealth of Nations'. Economic Freedom is measured under 10 principles or freedoms grouped into four broad categories or pillars of economic freedom and each of the economic freedom- plays a vital role in developing and sustaining personal and national prosperity.

- **Rule of Law** (property rights, freedom from corruption)
- **Limited government** (fiscal freedom, government spending)
- **Regulatory efficiency** (business freedom, labour freedom, monetary freedom)
- **Open markets** (trade freedom, investment freedom, and financial freedom)

2013 Index of Economic Freedom – *First ten world rankings*

World Rank	Country	Overall Score	Change from 2012
1	Hong Kong	89.3	- 0.6
2	Singapore	88.0	0.5
3	Australia	82.6	- 0.5
4	New Zealand	81.4	- 0.7
5	Switzerland	81.0	- 0.1
6	Canada	79.4	- 0.5
7	Chile	79.0	0.7
8	Mauritius	76.9	- 0.1
9	Denmark	76.1	- 0.1
10	United Sates	76.0	- 0.3
81	Sri Lanka	60.7	2.4

Source: The Index of Economic Freedom 2013

Defining Economic Freedom in the Index of Economic Freedom 2013, Ambassador Terry Miller and Anthony B. Kim observe that Economic freedom is the condition in which individuals can act in independence in the quest for their economic livelihood and greater prosperity. Besides it is an essential aspect of human liberty, without which a person's right to life, liberty, and the search of happiness may be fundamentally compromised. Although Smith, Miller and Kim seem to be in agreement in their references to economic freedom as a vital component of 'basic liberties that people have reason to value' human liberty especially, a person's right to life, movement and to feel secure appears to be decisive in acquiring and assuring economic freedom. Miller and Kim further denote that the highest forms of economic freedom should provide an absolute right of property ownership; full freedom of movement for labour, capital, and goods. If these rights and freedoms are constrained by insecurity, political instability and violence people will be deprived of economic freedom and naturally prefer life to labour, capital and goods challenging the growth or the development of a country.

In fact insecurity has become a primary development challenge of our time. The World Development Report 2011 on Conflict, Security and Development highlighting devastating impacts of a persistent conflict on a country's or region's development prospects reveals that one and half billion people in the world live in areas affected by fragility and conflict. And a single low income, fragile or conflict-affected country has not achieved a single Millennium Development Goal. Similarly while much of the world has made rapid progress in poverty reduction during the past 60 years, areas that suffer repeated political and criminal violence are being left far behind, the economic growth compromised and the human indicators stagnant. The report further exposes that the traditional estimate of the economic costs of lost production ranges from 2 to 3 percent of GDP for civil war. For instance, in the Indonesian province of Aceh, the economic cost of the conflict was estimated as US$10.7 billion, more than 60 percent of it through the damage and destruction of agriculture, livestock, enterprises, and fisheries[1]. And the difficulty of reassuring both domestic and foreign investors is seen as a reason for the persistence of low growth in conflict-affected countries. Although a series of post war economic activities often follows, it would take years for investment-based activities that reflect renewed investor confidence to appear and trade can take many years to recover as a result of investor perceptions of risk. Evidently the cost of a civil war or a conflict is far greater and yet, upon restoration of peace and security these areas are capable of greatest development gains. A number of countries in the world emerged out of long legacies of conflict and have now positioned themselves for growth. Last four years saw an addition to the group and Sri Lanka became a country with a post - war era freed from the clutches of terrorism after thirty years.

[1] The World Development Report 2011 on Conflict, Security and Development. **world**bank.org

Sri Lanka had been a prosperous nation blessed by a rich cultural and religious heritage and natural resources over two millenniums amidst occasional disturbances and distresses caused by many factors: i.e. invasions, natural disasters, communal violence, economic recessions and epidemics. While the country was self-sufficient in rice, it involved in international commerce connecting the East and the West at its strategic geographical location in the Silk Road. People came and lived to trade in this tiny island which functioned as a forum for multi ethnicities, multi skills and knowledge in diverse disciplines in the backdrop of its own economic, social, cultural, religious and geographic uniqueness. In 1948, the British returned the country to its people ending more than one century of colonial regime. The post independence years of Sri Lanka were marked with the implementation of many plans and projects that promised economic growth and social development. And the leaders who came into power took various measures to uplift the lives of the people and the growth of the country and some of them failed while some proved beneficial and productive. Reviewing some aspects of Sri Lankan economic reform experience in comparison to East Asia, Lal Jayawardena (2004) asserts that "Sri Lanka's principal economic achievement was the high quality of life attained on a modest per capita income, and its most spectacular failure, the inability to translate this social sector achievement in to rapid economic growth". Jayawardana appears to prove himself right as presently the world identifies Sri Lanka as a lower – middle income economy where the Gross National Income per capita stands between $1,026 and $4,035[2] and often referred to as a 'developing country' with an average growth rate.

Interestingly many countries that have been successful in translating 'the social sector achievement into rapid economic growth' were in troubled waters during the last few years when the world economic and political landscape became turbulent. Four years after the onset of the global financial crisis, global economic growth has weakened further in 2012, pushing several advanced economies into a double dip recession, while adversely affecting economic growth in most other economies. The growth of world output is estimated to have declined to 3.2 per cent in 2012, from 3.9 per cent in 2011.[3] Oil prices fluctuated during 2012, as weaker global demand tended to push prices down, amidst heightened geopolitical tensions. Nevertheless, Sri Lankan economy, being heavily battered by a prolonged civil strife remained resilient with a healthy growth rate of 6.4% in 2012 and now the country is in the process of recovering and reviving its economy, regaining its previous strength and rebuilding the nation with a cluster of opportunities at hand.

Peaceful domestic environment featured by safety and security in the country has ensured the freedom of economic movement and thus the economic freedom and everybody seems to be ready to save, invest and transact since feeling of insecurity and fear for life is not existent any more. Therefore capitalizing on the dawned opportunities is already in place attracting both local and foreign investors to the island.

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[2] World Development Report wdronline.**world**bank.org/**world**bank/a/**incomelevel**
[3] Central Bank Annual Report 2012

Positioning for growth

- **Favourable and flexible government policies**

Liberalizing many areas of the economy, the government of Sri Lanka has implemented and strengthened many policies and strategies to encourage international investment such as relaxation of foreign exchange controls, introduction of regulatory reforms in the fields of banking and finance laws and securities and exchange laws. For instance, total foreign ownership is permitted across almost all areas of the economy and no restrictions on repatriation of earnings, fees, capital, and on forex transactions relating to current account payments exist.

In this process efforts are made to attract investment to target sectors in which Sri Lanka possesses a strong foundation for growth as well as areas where it is nationally important to develop. The diversification of Sri Lanka's industry and services is promoted with special focus on advanced technology and value addition by offering incentives to induce high value investment. The government has made necessary amendments to the tax system of the country that the overall tax regime for all sectors will be less complex and at a lower rate across the economy.

Target Sectors Actively Promoted by Sri Lanka

1. Export Oriented Manufacturing
2. Export Oriented Services
3. Tourism, Tourism-related Projects
4. Infrastructure Projects
5. Higher Education/Skill Development
6. Value Added Strategic Projects
7. Agriculture (Agro Processing, Fish-based Industry, Dairy)
8. Establishment of Industrial Estates, Special Economic Zones, Knowledge Cities.

Such prudent measures taken to meet the expectations of and cater to the needs and requirements of local and foreign investors will lead to more investor confidence and more capital flows.

- **Investment protection**

A number of mechanisms that are in place have made the country a safe haven for the investors. Article 157 of the Constitution of Sri Lanka guarantees the safety of investment protection treaties and agreements approved by the Parliament by a two thirds majority. And other transparent investment laws such as existence of a transparent and sophisticated legal and regulatory framework covering all prerequisite business law enactments and bilateral investment protection agreements with 27 countries and double taxation avoidance agreements with 38 countries have contributed immensely in fostering foreign direct investments and creating a compelling and safe investment environment in the country.

Investors are further safeguarded against expropriation and non-commercial risks by the Multilateral Investment Guarantee Agency (MIGA), an investment guarantee agency of the World Bank, in which Sri Lanka is a founder member. And the island's investment friendly environment is reaffirmed by the Index of Economic Freedom – 2012, according to which the country has been ranked 81 of 179 countries.

- **Rapidly developing infrastructure**

An efficient and superior system of infrastructure would be instrumental for the growth of a country as it draws attention of foreign investors who generally seek to maximize the profits and productivity of business via reduction of customary costs. In line with this requirement of development and growth, an ambitious programme of physical infrastructure development to completely upgrade the sea, air, road, and power and telecom backbone of the country is in progress.

- **Sea Port and Airport Development**

Sri Lanka has voiced its intentions to develop the country as a leading regional aviation, navigation and trading hub in South Asia. Therefore, the development of maritime and aviation transportation is at the forefront of the government's infrastructure development agenda. The focus of these developments is to expand the capacity and improve the efficiency of existing ports through modernization and construction of new ports and airports in strategic locations. Expansion and construction of seaports and airports are in progress.

- **Development of the road network**

A large portion of the road network in the country especially in the North and East Provinces which was in a devastated condition during the last few decades due to the conflict has already been upgraded and rehabilitated reducing the time and energy consumption in transportation. Further investment in the improvement of the road network has become an urgent necessity for Sri Lanka as it connotes a major determinant factor in attracting new investments to the country. Accordingly, road development has been given prominence focusing on the construction of highways, widening of highways, reduction of traffic congestion, road maintenance and rehabilitation and bridge rehabilitation and reconstruction.

- **Power & Energy**

Development of power and energy sector is yet another aspect that requires attention under infrastructure development agenda and long term strategies have been introduced with active participation of the private sector, as a key component. And major power projects in progress such as **Norochcholai Coal Power Project, Upper Kothmale Hydro Power Project and Trincomalee Coal Power Project** are under way to increase the national grid from 2817 MW to 4732 MW by 2016 and to reduce the cost of generation by harnessing the latest clean coal technology.

- **Telecommunication Infrastructure Development**

Sri Lanka is connected to the South East Asia-Middle East-West Europe 4 (SEA-ME-WE IV) project, the submarine cable system linking South East Asia to Europe via the Indian Sub-Continent and Middle East. The project aims to take these regions to the forefront of global communication by significantly increasing the bandwidth and global connectivity of users along its route between Singapore and France. SEA-ME-WE 4 fiber optic cables provide a bandwidth capacity of 1.28 terabits per second, with a 25 year guaranteed lifespan for the technology. This revolutionary submarine cable system offers Sri Lanka an immense bandwidth advantage, and paves the way to make Sri Lanka a globally competitive business hub.

- **Improvement in the appearance of the main cities**

The upgraded outlook of the country's main cities with increased cleanliness and lush greenery has undoubtedly paved the way towards making a positive impression on the foreigners as well as the local communities constantly reminding them of the undiscovered potential and the unearthed opportunities lying in this land. Roads, sidewalks, signposts and buildings have seen remarkable improvements while recreational parks and facilities have been renovated or newly established providing ample opportunities for city dwellers to embark on healthier lifestyles. Reduction of traffic congestion through active traffic management systems, streamlining parking facilities, establishing cycle lanes, and improving public transport could reduce pollution and facilitate city beautification further.

Fruits of growth

All these efforts at regaining investor confidence and thereby recovering the conflict beaten economy of the country have brought forth impressive outcomes and a number of sectors demonstrated a promising progress. Tourism and leisure is one such key aspect that has been experiencing significant growth both in terms of arrivals and foreign exchange revenue at the wake of the return of peace and normalcy. The massive infrastructure development drive currently in progress signals the country's potential in maintaining a high and sustainable growth in the medium and long term. While the quality of students, level of English and literacy, and the proximity to India reflect that Sri Lanka is in an ideal position to develop into a high value added IT services provider.

- **Colombo Stock Exchange**

An efficient and a well developed capital market would simultaneously reveal the inherent potential in fostering the growth of a country by inviting the investor confidence and is a culmination of the degree of the growth achieved by a particular country being rewarded by the confidence of investors.

Recovering from the protracted conflict, capital market industry of Sri Lanka has grown rapidly within a short span and the post war surge in economic growth has established the Colombo Stock Exchange (CSE) that operates the only share market in the country as one of the best performing markets regionally and globally since 2009. CSE continues to attract significant foreign capital resultantly rewarding fundamentally strong companies with higher valuations. With a market capitalization of Rs.2.2 trillion and 287 listed companies, CSE recorded a 9.8% turnover velocity and a net foreign inflow of Rs. 37 billion in 2012. Yet its current market capitalization to GDP, which is 30%, compared to a regional average of 48% leaves room for further growth reflecting that capital market is yet to be a key attribute in Sri Lankan economy.

Market Capitalization to GDP (%)

Year	Bangladesh	Vietnam	Sri Lanka	Indonesia	Thailand	Philippines	Singapore	Malaysia
2012	15.1	23.2	28.7	45.2	104.8	105.5	150.8	156.9

Source: data.worldbank.org

Evidently the Sri Lankan capital market and many other aspects recovered as well as improved to a greater extent demonstrating the dividends of peace, political stability and security and thereby escorting a cluster of opportunities for the country and its government to ensure economic freedom. Of course, people have chosen to be active participants of the economy more than ever as life is not threatened any longer. So the country raced forward, says the 2012 Annual Report of Central Bank of Sri Lanka. "The economy grew by 6.4 per cent in real terms in 2012 amidst the slow recovery in global demand and the multi-pronged policy measures introduced to strengthen macroeconomic stability", And admits that "the Sri Lankan economy is expected to continue on a high growth path benefitting from improved infrastructure facilities and favourable macroeconomic fundamentals". All these factors seem to provide Sri Lanka with a prospectus of growth and correctly identifying this potential Sri Lanka has voiced a number of interests to be accomplished with prudent measures and mechanisms.

- **A per capita income beyond US $ 4000**

Sri Lanka already being graduated from a low income country to a lower – middle income country, envisages attaining upper – middle income status by 2016. Countries in the world experienced many issues upon reaching the middle income level ensnaring them in the 'middle income trap'. In this prospect, lessons are many to be learned from the countries that succeeded in avoiding the 'middle income trap' as well as the countries that remain stuck in the trap for decades. The Republic of Korea, for instance, sets an example by formulating and implementing the necessary strategies to overcome the trap. Improving connectivity and linkages, higher productivity, stable macroeconomic conditions with export promotion and complementary policies in the area of education and financing with high concentration on research and development are the reasons behind their success. If Sri Lanka is determined to escape the trap, prudent, consistent and dynamic economic policies that would stimulate the private sector investment such as diversification of economic activity to enhance the resilience of the economy against external shocks, improving specialization in selected areas where the economy is identified to have a comparative advantage, supporting human capital and entrepreneurial skill development to maximize the productivity of domestic human resources would come in to assistance.

- **An economic hub**

Sri Lanka is not a stranger to the meaning and associations of economic hub with its strategic location on the Silk Road that connected the East and the West of the 'ancient world'. The country's wish to be an economic hub by the expectations of the 21st century and the 'modern times' seems realistic and possible since the necessary condition and constructive opportunities are on stage at this promising moment. Yet it requires harnessing the full potential of these rewards: infrastructure developments, location advantage and natural resources supported by a strong human capital base and enabling institutional environment. Policies should be directed on facilitating service exports correctly identifying the tremendous growth potential in services such as Information Technology/BPO activities, health and education, shipping and aviation-related services.

- **Increase in FDI**

A further escalation in foreign inflows to the government and the private sector is highly expected to produce significant results in country's macroeconomic fundamentals, investment climate, investor confidence, exchange controls, infrastructure facilities and liquidity conditions. The apt environment needed for this course is already in place while the process of translating it into reality requires more momentum backed by correct measures to assure policy orientation, strengthening the stability of foreign exchange market and reduction of vulnerability to external shocks. Sri Lanka's strong economic growth is attracting foreign capital but foreign direct investment inflows remain modest with rated peers, leading to rising external indebtedness.

The Central Bank of Sri Lanka reveals that the country has received US $ 537mn worth FDI in the first half of the year 2013 creating a deficit of US $ 1.34bn to reach the given target of US $ 1.5 bn. Even though the country's records of FDIs are commendable and comforting that we are on the right track towards growth, the rising reliance on FDIs would not sound promising and sensible. This tendency could be a source of vulnerability especially when the advanced economies choose to limit global funding. As such, mobilizing more domestic funds is fundamental in funding and fuelling the expected growth.

The savings investments gap in Sri Lanka though stood at 4.2% in 2012 recording a further decline gives a minute picture of the still vulnerable nature of the country's economy and growth borne by the constant need to seek resort in external financing as the funds generated from the internal sources are inadequate. The following table presents the decrease in the savings and investment gap as well as the increase in domestic savings over the past three decades.

Average Savings and Investment Rates of Sri Lanka (as a % of GDP)

	1980-89	1990-99	2000-12
Domestic Savings (1)	12.9	16.0	16.6
Net Factor Income from Abroad(2)	-2.1	-1.5	-1.4
Net Private Current Transfers (3)	4.6	5.1	6.9
National Savings(1+2+3)	15.5	19.6	22.1
Investment (private and public)	26.2	24.9	26.3
National Savings & Investment Gap	**-10.7**	**-5.3**	**-4.2**

Source: Central Bank of Sri Lanka

Gross Domestic Savings (% of GDP) of selected countries – 2008 -2012

Singapore	Bhutan	Malaysia	Indonesia	India	Sri Lanka	Bangladesh	Nepal	Pakistan
49	40	37	37	28	16.6	15	10	4

Source: data.worldbank.org

Beyond the growth…

- **Poverty**

Unarguably the country is on the way forward; towards attaining a high economic growth with many achievements already being added to the list. The country boasts of two international airports, two international ports, an expressway with few more under construction and mostly improved road network etc. People linger freely in newly constructed recreational areas in Colombo and suburbs. Yet the above tables signal some error in the country's unprecedented sense of optimism about its future. The first table indicates that the average domestic savings of Sri Lanka during 2000 to 2012 remains 16.6 per cent recording only a 0.6% growth than the period from 1990 – 99 which is marked with utter political instability, albeit political and economic stability is considered a popular factor that encourages people to save. Thus it is not an understatement that Sri Lanka is still low on national savings which hinders desperately the needed domestic investment in both physical and human capital. Essentially, lack of new investments is an obstacle in surging the economy's productivity and income thereby completing the vicious circle of poverty of Sri Lanka. Unexpectedly and somewhat unbelievably we are at the beginning; poverty and alleviation of poverty being on the agenda for decades. This same logic applies to the people as economists generally assume that people's inclination to save grows with their income. If so, the question arises as to why the willingness of Sri Lankan people to save has not grown when their income has appeared to be grown as the country is stepping forward amidst 'favorable macroeconomic fundamentals'. Clearly, some aspect of the mechanism has gone wrong: the fruits of the flourishing economy have not cascaded down to the lower strata of the society.

- **Inequality**

Yet it is worth questioning the composition of the lower strata: who is in it? It is the accepted norm that the people who make a low income are in the lower levels, and who make a high income in higher circles while middle income people remain in between. This nature of the distribution of the income needs not essentially be static or the people are not doomed to stay in their 'prescribed' levels as it is an indication of the number of the poor and the average quality of life of a country. According to the Ministry of Finance and Planning, Sri Lanka has made a steady progress in reducing poverty through a number of initiatives in action. Resultantly, the number of poor living below the poverty line has reduced from 8.9% in 2009/10 to 6.5% in 2012 while the poverty in the estate sector has declined to 6.2%. And as reflected in the Gini Coefficient, inequality in the country has reduced from 0.4 to 0.36. At a glance these data might be impressive yet misleading upon a closer and in depth analysis. The last few years have barely seen an improvement in the poverty stricken population and the inequality in distribution of income in comparison to the massive development agenda in place and the subsequent outcomes. Sri Lanka has yet to realize the strong positive relation between economic growth and poverty reduction as some countries in the world have proved with better management of the outcomes produced by a rapid economic boost.

Nevertheless an excessively equal or unequal income distribution is not advisable. An excessive equality would make an impact on the economic efficiency. With no profits and minimal differences in wages and salaries, people are deprived of the motivation required to participate in economic activities – diligent work and vigorous entrepreneurship featured by poor discipline, low initiative among workers, poor quality and limited selection of goods and services, etc. Similarly an excessive inequality adversely affects people's quality of life, leading to a higher incidence of poverty and so impeding progress in health and education. In this context, Sri Lanka can tackle the existing economically and socially flawed situation by bridging the existing gap further making it rest at a truly commendable position on par with the present growth momentum and leaving room for the people to be incentivized and go up the ladder by acquiring competitive skills and an education.

- **Education**

On the other hand education and training increases a person's economic productivity and generally an educated and skilled person would produce a higher outcome or an outcome that has a higher value in the market and they are often recognized with a higher salary and thus blessed with a higher income. This scenario tends to decrease the inequality level and reducing the poverty by concentrating the income to many hands rather than a few. Although the free education system in Sri Lanka has played its role to a greater extent by producing more middle class men and women, the country can gain much more with its education, if well-maneuvered and properly directed in line with the demand of the market. Because it is essential to lessen the numbers of those who fall out from the rest and join the unemployed list while adding more quality and productivity to the university education system of the country. Poised for growth in many aspects, the country needs a drastic change in attitudes of its people to ensure their active, enthusiastic and willing participation in realizing its future goals with less corruption, bribery, negligence and indolence.

Let them cherish with the country…

If political instability seriously impedes the efforts at economic growth and poverty reduction its absence or political stability should allow and encourage the same. Rising upon the ashes of thirty years long civil strife, Sri Lanka has come a long way within four years in re-energizing the economy and society and now has reached an important juncture in its history with a host of opportunities in hand. It is this revitalization that has produced a general air of optimism and high expectations on a better future for the country. Such hopes are not baseless at all. The past years have made the country hopeful and confident. The country is positioned to grow. Before setting out on the journey towards an economically strong and socially fit Sri Lanka and if we are truly poised to proceed beyond growth well being of the people should be given priority. As Adam Smith insists, "no society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable". Thus the strategy for growth should entail an approach to upgrade the quality of their lives as well.

Otherwise millions of people will be left out from the soaring economic growth leaving the country 'poor and miserable'. "As irrigators guide water to their fields, as archers aim arrows, as carpenters carve wood", a wise development stratagem would shape their lives and elevate Sri Lanka to 'pick mangoes in the upper branches'.