

# Economic Growth, Income Distribution and Social Equity in Sri Lanka<sup>1</sup>

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## **Abstract**

In this paper an attempt is being made to discover and discuss the current theoretical concerns on the issue of economic and social equity. Secondly, an analysis on economic inequality and its journey from early 1970s to 2010 is presented. Thirdly, policies attempted to bring about a greater equality and its implications and their outcomes are examined. The time dimension and inequalities in terms of opportunities, abilities, and spatiality are measured using historical and current data available through income and expenditure surveys. The impact of economic transition from closed to open model on income distribution and the impact of prolonged civil conflict on spatial dimensions of economic and social inequality is also investigated.

Also, the claim which is widely made known by the Central Bank, that following the current growth trajectory, the per capita GDP would be raised to US\$ 4000 by 2015 from the current level of US\$ 2922 (2012) is examined using the current statistical evidences. The analysis suggests that, if the “head and shoulder” pattern of economic growth becomes a sustained feature, it is highly unlikely to expect a significant improvement in the prevailing pattern of income distribution, at least during the near future.

**Keywords:** Economics; Economic Growth; Economic Inequality; Income Economics; Social Equity

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*1. This paper is based on a study conducted by the author an earlier version of the paper was presented at Economists Association, Colombo, Sri Lanka.*

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## **Introduction**

Economic inequality has existed for many historical periods in different dimensions and its nature, causes, and importance are open to a wider debate. As economic inequality deals with the disparities in the distribution of economic assets and income, different societies have varying perceptions of what is equitable. Although there is a consensus that extreme inequality of income, wealth, or opportunity is unjust and that efforts should be made to increase the income of the poorest segment of the society, there is little agreement on the desirability of greater income equality (International Monetary Fund [IMF], 1998). According to Organization for Economic Corporation and Development [OECD] (Clift, 2011) growing inequality breeds social resentment and generates political instability. It also fuels populist, protectionist and anti globalization sentiments.

The ongoing discussion on economic inequality is broadly divisible to reflect two key theoretical concerns as equality of outcome and equality of opportunities. The issue is also debated under utilitarian and moral grounds. Equality as oppose to inequality has been considered as one of the important issues in development and many attempts have been made to uncover the main elements of equality as it deals largely with moral values (Johns, 2009). In classical economic literature two broad categories of measurements of inequality do exist. Sen, (1999) grouped them under categories of (a) objective and (b) normative. One set, measures the extent of inequality in terms of some objective sense usually employing statistical measure of relative variation of income. Others try to measure inequality in terms of some 'normative' notion of social welfare so that higher degree of inequality corresponds to a lower level of social welfare for a given total income (Sen, 1999).

With the inclusion of social choices into the discussion of economic inequality, the two issues are twined to the extent that any discussion on income inequity without referring to social issue looms redundant (Sen, 1999). Also the OECD remarked that "people will no longer supports open trade and free markets, if they feel that they are losing out while a small group of winners is getting richer and richer." (Clift, 2011) Similar concepts that encompass social and economic equality dealt with such issues as inclusive growth, marginalize groups, human capability development and regional dimensions of development.

A worldwide study (IMF , 2007) on the impact of globalization on income inequality, reported evidence to the effect that (a) over the past two decades income growth has been positive for all quintiles in virtually in all regions and all income groups, (b) during the recent periods income inequality has increased mainly in middle and high income countries and to a lesser extent in low income countries. Some key factors that contribute to the change in inequality over time are (a) the role of technology which favors the high skill categories. It could greatly reduce demand for lower skill activities and increase the premium of higher skill activities (b) for a given level of technology, greater access to education would be expected to reduce income inequality by allowing to be engaged in high skilled activities (c) sectorial share of employment, a move away from small scale agriculture to industry could be expected to improve income of low earning people.

### **Development Policy**

Over the past few decades, policy makers and economists have deliberated over the issue of selecting a proper policy mix to bring about a balanced socio economic development in Sri Lanka.<sup>1</sup> Out of the two sets of options which were widely supported for policy considerations, one based on the relative importance of market driven growth as it likely to trickles down to the poor. The other has been a programme of direct intervention to help the poor and deprived, through resource transfers to households. At the time of independence, the Sri Lankan parliamentary electoral politics have overwhelmed with the concept of providing state resources for the benefit of poor and deprived. During the late colonial phase of 1931-1948, the colonial government's decision to introduce the partial self rule which also served as a development prelude to the emergence of the welfare state (Jayasuriya, 2004).

The socio economic policy choices at the time of Independence were heavily influenced by electoral politics as well as ideas of Fabian socialists. Selecting policies for adoption therefore required a consensus building among different ideological segments. Many have consented to one of the two broad policy options i.e "growth later and wealth distribution now and Growth now and wealth distribution later-, Sri Lanka' opted for the first option. The choice appears to be oblivious as many politicians supported the advocacy of laissez-faire attitudes in

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1. Notes and memos of various visiting economics at the Planning Secretariat, Colombo 1959.

matters of economic policy during the early days of electoral politics. Thus its early promise of new departures in political activity was never fulfilled (De Silva, 1981). The initial policy choices have paid dividends where the outcome indicators of those welfare policies have elevated the country to “an outlier in respect of many social development indicators” (Bhalla & Glewwe, 1986) and the debate on the merit of policy choices continued into later years with added interest. (Sen, 1986)

The essence of development as perceived is that it must entail sustainable and self reliant process of improving the quality of human life in terms of need satisfaction in food, shelter, health care, education and access to information; command over resources, access to economic opportunities; and safeguards against violation of individual and collective rights (Peiris, 2006). The policy of the government (Mnistry of Finance and Planing, 2005) as annunciated is to accelerate the growth rate not only to secure its place in the region as the newly emerging economy but also to increase that the country's economy is capable of providing better livelihood for all citizens, including those who are in abject poverty.

Sri Lanka's' long-term commitment to implement support led security policies had showed the way to better achievements of social development indicators and has become a test case (Anand & Kandbur, 1991). The option given to the poor to have access to productive assets such as land that provide them with a resource to harnes economic benifits rely on their absolute advantage, that is labour. This option was tested during the land reforms in early 1970s with limited and largely negative results. (Ministry of Land ,Land Development and Mahaweli Development, 1988).

### **Measuring Inequality**

Economic liberalization initially unlocks the rigidities in markets and opens up opportunities for the poor to have greater access to employment hence increased the annual income growth of the poor. The evidence suggests the reduction of poverty accelerated during the early years of market liberalization.

Measuring income inequality in Sri Lanka has commenced during the uneventful post independence low growth regimes in early 1950,'s. The Sri Lanka case indicates that Income inequalities persist even under a greater welfare distribution system which the lower in-

come groups of the society benefited the most. Labour market imperfections and the distribution of other factor rewards and relative prices may have affected the distribution of income amongst different segments of the society. Universal access to free education, health care and food distribution has benefited even the middle income groups. Thus those who established command over a bigger segment of resources, appear to have retained the greater share of income (Lakshman, 1997). Shown in Table 1.

**Table 1: Income Distribution 1953 - 1978**

| Item                                     | 1953 | 1963 | 1973 | 1978 |
|--|------|------|------|------|
| Mean Income Per Month (Rs)               | 108  | 134  | 228  | 574  |
| Median Income Per Month (Rs)             | 68   | 83   | 180  | 352  |
| age of Income Received by<br>Lowest 10 % | 1.5  | 1.2  | 1.8  | 1.5  |
| Lowest 40 %                              | 13.0 | 12.0 | 15.1 | 12.3 |
| Highest 10 %                             | 42.5 | 39.2 | 30.0 | 39.0 |
| Gini Coefficient                         | 0.5  | 0.49 | 0.41 | 0.49 |

Source: Central Bank of Sri Lanka, Annual Reports

At the time of political independence, the share of income retained by the top 10 % of income earners was as high as 42.5 % 1953, while the lowest 10 % to had 1.5 % share of total income. In the intervening years with the introduction of some progressive policy reforms the share of income retained by the top 10 % declined gradually to 39.2 % in 1963 and 30.0 % in 1973. However, as anticipated the share of income of the bottom 10 % has not increased substantially. Initially, the share of income reduced to 1.2 % in 1963, before increasing to 1.8 % in 1973. With the opening up of the economy in 1977 show a quick reversing of the trend of income distribution where the income share of the top 10 % returned in 1978 to pre reform level.

The relative calm prevailed during early years of independence tainted with the imminent changes in local political and economic landscape in early 1970s. Policy changes introduced in response to the formation of international oil cartels and consequent increase in the price of crude oil, affected the trade patterns of the country. Consequentially the price hike of all imported commodities burdened the balance of payment and the government compelled to 'lay foundation for an irre-

vocable transition of the economy to a socialist one' (Ministry of Land, Land Development and Mahaweli Development, 1988). The increased food prices in international markets required the government to curtail imports coupled with a crop failure attributed to the delay of monsoon rain, created a shortage of essential food items in domestic markets.

Apparent failure to raise foreign exchange at concessional rates in international money markets which affected the import of food and other essential goods, the government compelled to opt for more inward looking a closed economic model (Hewavitharana, 2009). The essential ingredients of that policy were (a) imposition of capital levy, (b) compulsory savings scheme 1971/1972 to 1975/1976 and (c) higher income tax rate from 65-80% for individuals and 60 % for companies. With restricted trade and little investment in intermediate goods, the growth of the economy was altered and unemployment begins to rise.

Some progressive policies introduced during the pre independent era influenced the equitable distribution of some basic essentials which helped the poor segments of the society to maintain decent living standards during periods of stress. Embryo of the current social welfare state seeded with the establishment of a plethora of state sponsored programmes and a number of government agencies to implement food production, storage, grading, pricing and distribution during the Second World War years of 1940-1944. Those policies intended to cushion the consumer against market vagaries and to assure the implementation of the fair distribution of food at regulated prices. Though some economists have described these policies as eating the fruit before planting the seed, (NPC<sup>2</sup>) they captured the imagination of some parliamentarians and a decision has been taken to extend the implementation of most welfare programmes beyond the second world war years. The untargeted welfare policies diverted most of the state resources to implement the re distributive justice, leaving little to be used for development activities.

The socio economic impact of the post war social welfare policies was viewed with a view to assess the social cost benefits of the vastly expensive ration food distribution system in the country (Dreze & Sen , 1989)<sup>3</sup>. By taking into account the relative importance of wealth

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2. Unpublished Notes of the visiting economists, Planning Secretariat, Colombo

3. Sri Lanka can at all afford to have programmes of public support in any way comparable with those of countries many times richer

distribution implemented thought quantity rationing of food. Visariya (1981) developed measurements of inequality of income and expenditure for different sectors and suggested a ranking criteria for the identification of the poor. First, an imputation of the value of the free rice ration distributed to consumers lowers the indices of inequality. Secondly, inequality measures derived from the distribution of individuals according to either the Per Capita Income (PCI) or Per Capita Expenditure (PCE) of their households are all lower than those based on the distribution of households according to their Total Household Income (THI) or Total Household Expenditure (THE) respectively. Thirdly, if one prefers to compare the distributions of households with the alternative ranking in terms of PCI and THI, the differences between the inequality measures are even larger, with the indices based on per capita ranking once again lower than the alternative.

Income inequality measured by the Gini coefficient was at its lowest in 1973 and since then income distribution has become more unequal with the Gini coefficient for spending units changed from 0.35 in 1973 to 0.47 in 1986/1987 and reduced to 0.43. in 1980/1981 Table 2. Gini coefficients for the survey years of 1973 and 1986/1987 represent the immediate pre and post economic liberalization periods where pre liberalization period characterized by greater wealth distribution coupled with implementation of inward looking tariff policies. Closed economy with price controls, quota restrictions and quantity rationing of food, benefits the poor. In contrast opening up of the economy coupled with import tariff liberalization, improved the choices of the consumer and some inferior and expensive local products gradually lost their share in the market.

**Table 2 : Gini Coefficient of Mean Income**

| Item                  | Census Year |           |      |      |           |
|-----------------------|-------------|-----------|------|------|-----------|
|                       | 1980-1981   | 1990-1991 | 2002 | 2005 | 2009-2010 |
| Household Income      | 0.43        | 0.43      | 0.47 | 0.47 | 0.49      |
| Household Expenditure | --          | --        | 0.36 | 0.40 | 0.37      |

Source : Household income and expenditure surveys-1981 to 2009/2010  
Department of census and statistics-Sri Lanka

It is evident that income inequality which has been high during 1953-1978 (Kurukulasuriya, 1982) period has reversed its trend during 1980s and maintained that to early 1990s a period marred by increasing civil conflict and other social disturbances. Nevertheless large resource inflows which came in the form of loans and grants contributed to the construction of infrastructure under Mahaveli development programme. During the same period government offered incentives to investors who favored to establish industries in industrial free trade zone setup near Colombo. Those new initiatives coupled with other investment programmes of the government generated additional employment opportunities for the unemployed youth. It may also be noted that even though the relative shares of income of the high income groups have increased, there is a possibility that the absolute incomes of all groups have also increased, thus improving the living conditions of all segments of the population.

The share of income of the higher 20 % of the population had declined from 52.3 % to 49.4 % between 1986/1987 and 1996/1997 and the share of the lowest 20 % of income receivers had increased from 5 % to 5.7 %. It appears that the income transfer scheme under the social welfare net is protecting the income of the poorest from falling. The progressive tax and other policies of successive governments since independence have affected negatively on the share of income retained by the richest 10 % of income receivers of the country. However the debate on the impact of policy change on inequality has re-emerged and one section argued that the post 1977 policies have not been detrimental to equity objectives and may offer more promise than those which they replaced (Pyatt, 1987).

Inequality of income distribution widened over the years where the top quintile of household income distribution increased their share to 55.1 % in 2006/2007. This reversed trend continues with little change 54.1 % in 2009/2010. All Household income shared by the poorest quintile 20 % in 2009/2010 remained largely unchanged at 4.5 % compared to 4.4 % in 2006/2007. There are no significant changes of the income shares of rest of the quintiles between 2006/2007 and 2009/2010.

The quintile dispersion measured using 20:20 ratio of income<sup>4</sup> distribution is a reminiscent of distribution of income across households. The quantity dispersion ratio indicates that the household in the top 20 % earn 12 times more than the bottom 20 % . Thus Sri Lanka has maintained a comparatively large gap in income inequality.

**Table 3 :Household Income by Quintile 2009 / 2010**

| Item                                | Lowest 20% | Low-Mid 20% | Middle 20% | Mid Upper 20% | Upper 20% | Overall |
|-------------------------------------|------------|-------------|------------|---------------|-----------|---------|
| Household Income Per Month (Rs)     | 8211       | 16062       | 23880      | 35552         | 98575     | 36451   |
| Percentage of Income                | 4.5        | 8.8         | 13.1       | 19.5          | 54.1      | 100     |
| Cumulative Percentage of Income     | 4.5        | 13.3        | 26.4       | 45.9          | 100       |         |
| Cumulative Percentage of Population | 20         | 40          | 60         | 80            | 100       |         |

Source: Household income and expenditure survey-2009/2010, Department of census and statistics-Sri Lanka

Reviewing incidence of household inequality at national rural urban and estate sectors across surveys sheds more information of the nature and the direction of migration of income inequality over time.

### **Reduction of Poverty, Inequality - Pro Poor Policies**

In pursuit of poverty reduction, successive governments since independence have introduced a number of public sector programmes aiming at mitigation of poverty with limited success. With changing economic realities in the country the emphasis on direct transfer of resources to households, increased access to free education and health care has been reduced and adopted the strategy of expansion of labour market. Arguably both strategies have contributed toward a better distribution of income among the target group (Department of

4. The ratio compares how much richer the top 20 % of population are to the bottom (poorest) of a given population. For example 20:20 gap in Sweden is 4 times, UK 7 times and US 8 times. This methodology has been adopted by UNDP in the Human Development Indicator reports.

Census and Statistics- Sri Lanka, 2010)<sup>5</sup> Thus it has been argued that the growth has indeed trickled down: that is food subsidies have been replaced by labour income (Pyatt, 1987).

Recent estimates of incidence of headcount poverty indicate that the proportion of households in consumption poverty has declined from 26.1% in 1990/91 to 22.7% in 2002 - a marking decline in absolute poverty by about 13% in a decade. During this period rural poverty declined from 29.4% to 24.7%, while poverty in the estate sector has increased from about 20.5% to 30.0%. Poverty in the urban sector declined from 16.3% to 7.9% during the corresponding period. Thus, low-income households in the estate sector who exclusively living on wage labour have benefited less from the adopted policies under the free trade regime.

The next five years during 2002-2007, incidence of poverty has dropped sharply by 33 %, from 22.7 in 2002 to 15.2 % in 2006/2007. The market reduction of poverty by 36 % in the rural sector attributed largely to the national decline of headcount poverty. The declining trend of headcount poverty has continued further in the next four year period between 2006/2007 and 2009/2010 and the incidence of headcount poverty declined dramatically by 41 % nationally<sup>6</sup>. This period begins immediately after the tsunami recovery programme and improved farmer income<sup>7</sup>, increased rural wages together with declining unemployment<sup>8</sup> may have contributed conjointly for the sharp fall of the incidence of headcount poverty<sup>9</sup>. However the benefits of growth percolates to the poor at a slow phase and growing inequality held back

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5. Unemployment as a percentage of the labour force declined from 15.9 percent in 1990 to 7.6 percent in 2000 and 4.3 percent in 2011. (Department of Census and Statistics – Sri Lanka)

6. Official poverty line is fixed at a welfare level of a person who meets a certain minimum nutritional intake (2030 Kilo calories, per day) in 2002 (thereafter changed to 2006/07 in June 2011)) prices. Poverty line thereafter obtained by updating the poverty line adjusted for inflation. Poverty line per capita expenditure per day Rs 47.4 in 2002, Rs 71.4 in 2006/07 and Rs 108.3 in 2011.(parity rate Rs/US\$= 113.90)This is roughly equivalent to US \$ 1 a day measurement which measures the category of ultra poor. (Department of Census and Statistics, Colombo)

7. Paddy prices increased from Rs 13.89/kg in 2006 to 33.89/kg in 2009

8. Unemployment declined from 15.9% of the labour force in 1990 to 7.6% in 2000 and 4.3% in 2011.

9. Food inflation far exceeds the normal inflation during recent years for instance price of rice av. 34.52 Kg in 2006 and 66.10 a kg in 2009 an increase of 91% . Weight given to food is 46.7% of total. However extreme poor families expend more than 80 percent of their total income for food.

the reduction of poverty during 1990's. The recent data indicates that increasing income inequality during the last decade is receding, the challenge of accelerating growth outside the western province remain to be resolved.

**Table 4 : Incidence of Poverty by Economic Sectors**

| Sector     | 1990<br>1991 | 1995<br>1996 | 2002 | 2006<br>2007 | 2009<br>2010 | Percentage<br>Change between<br>2006/2007-<br>2009/2010 |
|------------|--------------|--------------|------|--------------|--------------|---|
| Urban      | 16.3         | 14.0         | 7.9  | 6.7          | 5.3          | 14.9  |
| Rural      | 29.4         | 30.9         | 24.7 | 15.7         | 9.4          | 40.1  |
| Estate     | 20.5         | 38.4         | 30.0 | 32.0         | 11.9         | 62.8  |
| All Island | 26.1         | 28.8         | 22.7 | 15.2         | 8.9          | 41.4  |

Source: Department of census and statistics-Sri Lanka, survey reports 1990 to 2010

However the sharp fall of incidence of poverty during a period characterized by the escalation of internal civil conflict, global food and fossil fuel price hikes, global financial meltdown and high domestic inflation raise some doubts on the robustness of the national poverty line. These inaptnesses show the way to cast aspersion on the poverty line, it self. However it is worth mentioning that the present poverty line measures only the ultra poverty<sup>10</sup> based on US \$ 1 a day concept. The debate on constructing a poverty line to reflect the real consumer needs in a rapidly advancing economy is continuing without reaching consensus.

Apparent inadequacy of policies of the state to address income inequality led the government to pursue the concept of pro poor growth as an effective measure to reduce the inequality during the process of growth (Papanek, 2004). The extent to which growth is pro poor depends on how much a chosen measure of poverty changes. The process will lead to better distribution of resources and improving living standards. Pro poor growth means the falls more than it would have, if income had grown at the same rate (Ravallion, 2004).

The available evidence suggests Shown in Table 4 that the impact of unguided growth neither does increased income of the poor

10 . "Ultra Poverty" defines as a person while spending 80 % or more of his income on food, yet acquires less than 80% of his daily calorie requirements.

nor reduces inequality and therefore growth alone is not expected to reduce the income distribution gap between the rich and the poor. The relationship between the annual per centage change in the GDP per capita and corresponding annual per centage change in income of poorest 40 % of the households through 1953 to 2002, for example, show a weak and low correlation.

Changes of the economy measured in terms of annual per centage growth of GDP Shown in Table 5 are therefore not entirely an unexpected manifestation. Sri Lanka at no time in its recent history had a consistent high growth regimes, instead had shown an isolated: high or peak year as head and shoulder pattern<sup>11</sup> in the midst of an average GDP growth of around five percentage points. As indicated by the Central Bank of Sri Lanka (2013) the average percentage of GDP growth realized during the period of 2000 to 2012 has been 5.6 % with a peak of 8.3 % in 2011.

A study by Gustav Papanek for USAID (2004) found that erratic growth in Sri Lankan economy during 1953 to 2002 failed to show a systematic pattern in the relationship between Growth and Poverty.

**Figure 1: Annual GDP Growth 2000-2012**



The relationship between economic growth and poverty points to an influence of an independent variable for the annual per centage change in income of the poor, besides the GDP growth.

11. Head and shoulder movement of prices i.e., "rise to peak and subsequently decline and rise again but not to the second peak level".

**Table 5 : The Relationship Between Growth and Poverty Sri Lanka**

| Period     | Annual Change in GDP Per Capita | Annual Change In Income of Poorest 40% |
|------------|---------------------------------|--|
| 1953 -1963 | 0.4                             | 0.8                                    |
| 1963 -1973 | 1.8                             | 4.4                                    |
| 1978 -1979 | 2.5                             | 0.8                                    |
| 1969 -1970 | 2.4                             | 2.3                                    |
| 1978 -1979 | 3.2                             | 0.1                                    |
| 1981 -1982 | 3.2                             | 0.1                                    |
| 1986 -1987 | 2.3                             | 1.0                                    |
| 1985 -1986 | 1.9                             | 0.6                                    |
| 1990 -1991 | 1.9                             | 0.6                                    |
| 1986 -1987 | 3.2                             | 4.3                                    |
| 1996 -1997 | 3.2                             | 4.3                                    |
| 1990 -1991 | 3.3                             | 4.3                                    |
| 1996 -1997 | 3.3                             | 4.3                                    |
| 1995 -1996 | 2.2                             | 0.6                                    |
| 2002       | 2.2                             | 0.6                                    |
| 2002-2005  | 3.4                             | NA                                     |
| 2006 -2007 | 6.4                             | 0.6*                                   |
| 2009 -2010 | 6.4                             | 0.6*                                   |

Note : *Per capita GDP grew from US\$ 1421 in 2006 to US\$ 239 in 2010 68.8% and with an annual GDP growth rate of 6.4 % in current prices.*

Source: *Independent calculation 2002-2005-2006/2007-2009/2010 using Central Bank Annual Reports Pro Poor Growth A Guide to Policies and Programmes (USAID, 2004)*

Papanek infers that a long term and consistent high growth is a prerequisite for reasonably acclaimed income distribution and equity. Supporting this claim in a recent IMF study by Berg and Ostry (2011) remarked that the empirical literature on growth and inequality however has missed a key feature of growth process in developing countries namely its lack of persistence. They argue that the length of growth is vital for income distribution and reduction of inequality. Taking data from an extensive survey Ravallion (2007) infers that among growing economies inequality increases about as often it fell.

A study on the ramification of adoption of pro equality growth policies in developing countries illustrate that in contrast to the popular argument that inequality will rise more or less inevitably as poor economies grow, there is little or no correlation in inequality and rates of economic growth. The choice of policy options for economic development though considered imprudent at the time of its adoption, the evidence unrevealing suggests that policies aimed at helping the poor accumulate productive assets – especially policies to improve schooling, health, and nutrition – when adopted in a relatively no distorted framework, are important instruments for achieving higher growth (Bruno et al., 1996) .

### **Spatial Inequality in Development**

Since the opening up of the economy during the latter part of 1970's, inequality has been on the rise. Inequality measures by Gini coefficient has been relatively low during the periods of closed economy while the inequality begins to rise with the gradual opening up of markets since the latter part of 1970's. The evidence from a recent survey (Department of Census and Statistics- Sri Lanka, 2010) reveals that Gini coefficient of mean household income (mean=0.48) for urban rural and estate sector to be 0.54, 0.46 and 0.41 respectively and indicates that highest inequality is shown in the urban sector followed by rural and estate sector. The following survey indicates that the mean household income inequality marginally increased to 0.49 and for urban, rural estate sectors are 0.48, 0.49 and 0.43. Though disparities of Gini ratios varies between districts ie., Ratnapura 0.57 and Jaffna 0.37 the average ratio remain unchanged. With the improvement of living standards of the western Province income disparity in Colombo District declined from 0.53 in 2006/2007 to 0.45 in 2009/2010 while in Gampaha District income disparity increased from 0.44 to 0.51 during the corresponding period.

Household income and expenditure Survey (HIES) of 2006/2007 shows that the 4.8 % share of income received by poorest 20 % while the richest 40 % received 73.2 %. A decade earlier the poorest 20% received 5.7 % share of income while the richest 40 % received 70.1 %. The trend continues and in 2009/2010 the share of income received by the lowest 20 % of the households declined to 5.5% from 5.7 % in 2006/2007 while the 40 % of the households in the top of the income distribution increased their share to 74.4% from 70.1 % in 2006/2007. The data indicates that 80 % of total household income in

the country left to share only 45 % of the total household income of the country.

Income inequality has a rural urban divide, appear across provinces, particularly between the western province and rest of the provinces and a marked divide between north and east cluster of districts and rest of the country. Inequality between rich and the poor are also widening. The province wide comparison of Gini coefficient shows that the highest inequality of 0.51% is from Central and followed by Sabaragamuwa 0.50% and the Eastern province reported the lowest 0.33%.

It has been noted that the reduction of poverty is gradually reporting from nonwestern province districts. Nevertheless information is scratchy to make a meaningful assessment of poverty levels in the conflict affected north and eastern provinces. A few observed disparities between the western province and rest of the provinces are shown in Table 5.

Restrained movement of investors with Intensification of civil conflict since 2004, affected the expansion of industrial and service sector activities outside the western province led to the development of an economic enclave, leaving little or no high growth in the periphery. This promoted the regionalization of wealth as well as concentration of growth to a few selected sectors and industries. Outcome of those developments reflected in the regional distribution of income. Majority of wealth creation has concentrated in the western province.

Available evidence points to an increase in the regional inequality in development since the open up of the economy in late 1970s. The evidence available also suggests that the development programmes in the past helped the rich to get richer while the poor reaped little or no benefits from many of those policies of the government.

**Table 6: Provincial Disparities**

| <b>Shares of the National Income</b> | <b>Western Province</b>  | <b>Rest of the Provinces</b>   |
|--------------------------------------|--|--|
|                                      | 45% of the Production, 28% Population  | Balance 55% Share by the other 8 Provinces (About 10% or Less for a Province)  |
|                                      | Nearly 2/3 of the Economy in Services  | Over 1/3 of the Economy in Agriculture   |
| <b>Economic Growth</b>               | 6.3% (1997-2006) Annual Per Capita Income 1996-US\$1,167 2006-US\$ 2118 Growth 6.1% (1997-2000) A Middle Income Country  | 3.6% (1997-2006) Annual Per Capita Income 1996 US\$520, 2006 US\$ 838 Growth 4.9% (1997-2006)  |
| <b>Equity of Growth</b>              | Poverty Declined from 19% in 1990 to 8% in 2006/07<br>Gini (Disparity) ratio is High 0.41 (2006-07) and Stable<br>Per Capita Expenditure Growth >40% 1997-2002 | Poverty Incidence in 2006 at 18.4%, More than Double that of Western Province<br>Disparity low but Unstable<br>Per Capita Expenditure Growth at 20% for the Provinces from 1997-2006 |
| <b>Unemployment</b>                  | 5.7%   | 6.9%   |

*Source: Ministry of Finance and Planning, Central Bank of Sri Lanka, Department of census and statistics various HIES reports 1990-2007*

Incidence of unemployment declined appreciably over the years and the level of poverty headcount ratio declined, nevertheless the level of hard core poverty and vulnerability remains at unacceptably high levels. Quality of life of the majority of the people live outside the western province and in rural and estate sector has improved at a slower phase compared to the observed changes in the western province and in urban areas. However it appears to have less evidence to suggest that the economic growth has produced greater number of well paid jobs. Thus reducing unemployment does not provide evidence to better equality in income distribution among the poor.

Unplanned growth initiatives and the increasing share of the service sector activities in the open economy led to the overly growth

of the port city of Colombo in the western province. Setting up of a free trade zone to attract export led investments in the island pulled the skilled and unskilled workers to factories located in the free trade zone. The initial advantage held by the western province has consolidated and expanded by accounting for 51.4 % of the share of annual GDP in 2004 leaving other eight provinces to share the balance 49 %. A slow shift of share of the GDP has shown during the last eight years where the dominant share held by the western province declined by 12 % during 2004 to 2009. Share of GDP held by southern and North Western province with attracting new production investments increased to 10.2 % and 10.3 % respectively leaving the conflict torn areas to retain a meager share of only 3 to 5 % of GDP.

**Table 7 : Share of GDP by Provinces**

| Province / Year | 2003 | 2004 | 2005 | 2006 | 2007 | 2009 |
|-----------------|------|------|------|------|------|------|
| Western         | 49.7 | 51.4 | 50.8 | 50.1 | 48.4 | 45.1 |
| Southern        | 9.9  | 8.9  | 8.9  | 10.0 | 10.5 | 10.2 |
| Sabaragamuwa    | 6.0  | 6.4  | 6.4  | 6.1  | 6.3  | 6.3  |
| Central         | 8.6  | 9.2  | 8.5  | 8.8  | 8.9  | 9.6  |
| Uva             | 4.1  | 4.3  | 4.5  | 4.3  | 4.5  | 4.6  |
| Eastern         | 6.1  | 4.9  | 4.7  | 4.9  | 5.0  | 5.8  |
| North Western   | 9.2  | 8.5  | 8.9  | 9.1  | 9.6  | 10.3 |
| North Central   | 3.7  | 3.6  | 4.3  | 4.0  | 3.9  | 4.8  |
| Nothern         | 2.8  | 2.9  | 3.0  | 2.8  | 2.9  | 3.3  |

Source: Central Bank of Sri Lanka, Annual Reports

Concentration of wealth creation activities in the Western Province continue unabated. However with the heavy investment projects moving out of the western province, the relative share of the GDP in the western province has reduced marginally during 2003 to 2009. Since no major investment projects with the capacity to create large employment opportunities shifted to non western province districts, it is difficult to assess the improvement of the growth process and employment creation in those areas. Though investments on infrastructure have moved to the north and the eastern provinces since the secession of hostilities, the socio economic outcome of those investments are yet to be evaluated<sup>12</sup>.

12. Northern road and rail road improvement, Jaffna water supply project, Oluvil port, coastal road network connecting south with Monaragala, Arugam bay, Ampara, Batticoloa and trincomales has been completed.

## **Inequality in Opportunities**

Expansion of basic human capabilities, including such freedoms as the ability to live a long life, to read and write, to escape preventable diseases, to work outside the family irrespective of gender, and to participate in collaborative as well as adversarial politics not only influence the quality of life but also affected the opportunities they have to participate in economic expansion. However within the conventional development policy regime, room for inequality persists and continuum of insensitive policies may lead to a worsening of social and economic inequalities in the country.

Effectiveness of public programmes such as free education and health care which helped the poor to escape poverty especially those in the rural sector is eroding and the prospects of enhancing their income turn out to be bleak. In education for example while 53 % of boys in urban schools passing the General Certificate of Education Ordinary Level, the corresponding rate for rural schools was 27 %. Girls do little better than boys where the pass rate in the urban schools was 61 % compared to 34 % in rural schools. In health sector incidence of low birth weight (LBW) of new borne have reduced to 10.5 % in Colombo District while in Nuwaraeliya District, the LBW rate remains at 33.8 % which is three times greater than Colombo. These findings are not uncommon, for instance incidence of under nutrition measured using underweight shows a wide inter district variations while Gampaha district reporting as 11.6 %, the corresponding figure for Badulla is 32.8 %.

Having enjoyed the fruits of free education for more than seven decades, only 659 schools (Ministry of Education, 2008) in the country offer science subjects at General Certificate of Education Advanced Level which is mere 6.8 % in all schools. Of which less than 200 schools are able to prepare students for engineering and medical programmes at university level. Further 1854 schools have advanced level classes in commerce and arts subjects. Most of the schools having advanced level science stream are located in urban or semi urban areas. Thus many children from economically poor families in rural and estate sector failed to gain fair access to science education. The general perception is that the teachers teach inadequately in schools, where almost all children sitting for public exams are now choose to attend tuition classes to supplement school education. Thus the likelihood of children in poor families to gain entry into more rewarding academic courses such as medicine and engineering in universities

is remote. As many university aspirants of engineering and medical related subjects have to share at least part of the cost for tuition, many students for the faculties of engineering and medicine are invariably coming from relatively well-off families (World Bank, 1996). Over the years the condition have deteriorated further and the courses which offer better employment opportunities were effectively snatched by the children of middle and upper income families on affordability considerations. The emerging outlook of the publicly funded universal free education system therefore appears to have a heavy urban bias and the process effectively excluding the unaffordable poor. Thus a conduit once considered as feasible to escape poverty remain gradually distancing from the poor and non urban students. This has wider ramification on poverty reduction and income distribution.

A full pledged University to provide higher education was setup as far back as 1942. Since the number of universities providing free education increased to 17. Most of the graduates passed out from universities are unemployable and hence, expect the state to provide employment as many of them do not possess required aptitude to fit into some competitive and well paid jobs in the private sector. Observed general resistance of the university students, to acquire competency in soft skills particularly among those who are studying Arts subjects, compelled the university authorities to maintain the status quo. Delinking of commerce and management subjects from the traditional arts stream in recent years generated more enthusiasm among children and many students opted to study management and accountancy. The earning capacity of many students who graduated in accountancy and management subjects find better paid employment in the expanding market economy hence surpassed the salary expectations of medical and engineering students.

Two of the government's main objectives are to preserve Sri Lanka's edge in human capital and to ensure that the benefits of the growth are shared widely specially by the poor of all regions and sectors. Poverty reduction and employment creation are two main declared objectives of human capital development of all the governments. Increasing disparity of service delivery of two main publicly supported programmes of education and health care is a worrying factor. Available evidence suggests that the current education policy favours the urban and semi urban middle class to reap benefits unproportionately from secondary education, especially in science education. Thus rural poor are left out from "well-off sections" of the free education system.

## **Conclusion**

Sri Lanka since independence, inherited a society of highly skewed Income and wealth distribution where a few individuals command the productive assets, and most of other productive resources, including land. Free education and health care has been a conduit available for the poor in particular to receive larger social benefits. Progressive socio economic policies facilitate the improvement of income and living conditions of majority of the poor and smoothed the potential ill effects of economic Inequalities in the society. Since opening up of the economy in 1977 the economy has energised and more opportunities were opened for major segment of the society. However, the observed pattern of “shoulder to head type” of income distribution, without having additional resources committed for the improvement of social wellbeing of the less well-off, negated the hope of upward social mobility.

Though the government promotes policies which favor the employment creation and wealth distribution, the disjointed nature of those policies failed to provide adequate benefits to the majority of the masses. Policies that promote equity undoubtedly reduce poverty and unemployment which promotes social cohesion and political stability. However, many households in rural and conflict affected areas are yet to receive peace dividends. To be effective most policies require broad support from masses and from the political system which is more likely to be forthcoming when the distribution of income and resources is seen as fair. Policy on public and private sector wages, improving service deliveries, openness and transparency in decision making are all contribute positively to achieve equality.

One of the declared objectives of the growth strategy as often highlighted by the Central Bank has been to exceed the per capita income threshold of US \$ 4000 by 2015. Considering the pattern of GDP growth and investments in the economy, it seems more likely to achieve that target by 2015. The impact of that to income distribution however remains unclear.

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