

Sri Lanka Development Forum:
The Economy, the Tsunami and
Poverty Reduction

May 16-17, 2005



Poverty Reduction and
Economic Management Sector Unit
South Asia Region

Abbreviations

ADB	Asian Development Bank	JVP	Janatha Vimukthi Peramuna
BOC	Bank of Ceylon	LTTE	Liberation Tigers of Tamil Eelam
BOI	Board of Investment	MDGs	Millennium Development Goals
CBSL	Central Bank of Sri Lanka	MFA	Multi-Fiber Agreement
CCD	Coast Conservation Department	MTBF	Medium Term Budget Framework
CCPI	Colombo Consumer Price Index	NGOs	Non Governmental Organizations
CEB	Ceylon Electricity Board	PB	People's Bank
CPC	Ceylon Petroleum Corporation	PC	Provincial Council
DFID	UK Department for International Development	PRS	Poverty Reduction Strategy
ETF	Employees Trust Fund	SEMA	Strategic Enterprise Management Agency
EU	European Union	SLFP	Sri Lanka Freedom Party
FAO	Food and Agriculture Organization	SME	Small and Medium Enterprise
FDI	Foreign Direct Investment	SOE	State-Owned Enterprise
FMRA	Fiscal Management Responsibility Act	TAFREN	Task Force for Rebuilding the Nation
FTA	Free Trade Agreement	TEWA	Termination of Employment of Workermens' Act
GDP	Gross Domestic Product	UN	United Nations
GOSL	Government of Sri Lanka	UNDP	United Nations Development Programme
GST	General Sales Tax	UNF	United National Front
ICA	Investment Climate Assessment	UNFPA	United Nations Population Fund
ILO	International Labour Organization	UNICEF	United Nations Children's Fund
IMF	International Monetary Fund	UPFA	United People's Freedom Alliance
IT	Information Technology	US	United States
JBIC	Japan Bank for International Cooperation	USAID	US Agency for International Development
JICA	Japan International Cooperation Agency	VAT	Value Added Tax
		WHO	World Health Organization

GOVERNMENT FISCAL YEAR

January 1 - December 31

CURRENT EQUIVALENTS

(Exchange Rate Effective as of April 22, 2005)

Currency Unit = Sri Lankan Rupee

US\$ 1.00 = Rs. 99.80

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Acknowledgements

This report was prepared by Rocio Castro and Princess Ventura (SASPR) with advice from Ijaz Nabi (SASPR) and Peter Harrold (SACSL). Oxana Bricha (SASPR) and Malathi Ratnayaka (SACSL) assisted in the formatting and distribution of the report.

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Introduction

This report is intended to inform the discussions of the May 16-17, 2005 Sri Lanka Development Forum, which will focus on the tsunami, the economy, and the broader development agenda. It is also hoped that the report will contribute to the national debate on these issues and serve as an input to the Government's Poverty Reduction Strategy (PRS), a draft of which will be presented at the Forum.

The tsunami disaster that hit Sri Lanka on December 26, 2004 caused enormous losses in terms of lives, infrastructure and economic assets. As the country embarks on recovery from this disaster, it is important to understand the prevailing economic conditions as they will have a bearing on the scope and potential impact of proposed interventions. It is also important that post-tsunami reconstruction does not detract from and is consistent with the poverty reduction agenda for the country as a whole.

Section 1 provides an overview of recent economic outcomes and the status of reforms. Attesting to its resilience, Sri Lanka quickly recovered from the 2001 downturn and restored growth rates averaging 5 percent annually. However, the relative peace enjoyed since the ceasefire in February 2002 has not led to higher growth. Growth has been uneven. The services sector has been the main driver, while industry has recovered more gradually from the 2001 downturn, and agriculture has stagnated. Sri Lanka's below-potential growth performance can be largely attributed to remaining structural constraints, including weaknesses in the macroeconomic framework. More recently, the hike in international oil prices combined with expansionary policies have led to rising inflation and widening macroeconomic imbalances. Meanwhile, Sri Lanka's past growth pattern has not been adequate for significant poverty reduction beyond the urban areas.

Section 2 presents an analysis of the impact of the tsunami, financing needs and implementation issues for the reconstruction phase. Although the human and asset losses from the tsunami were extensive, the impact on output and GDP will be limited because the sectors affected only represent a small part of national production. While large aid flows have already been mobilized, particularly from private donations, implementation remains a challenge due to absorptive capacity constraints. In particular, there is a need to ensure that fiscal and monetary policies underpinning the recovery effort are consistent with the restoration of a sound macroeconomic framework.

Section 3 discusses poverty trends and priority reforms for meeting the Millennium Development Goal (MDG) on poverty reduction. An analysis of past growth and poverty trends shows that much of Sri Lanka's skewed growth record and ensuing income inequality is a reflection of the unfinished reform agenda. Important strides have been made in trade liberalization and private sector development, which explain the country's resilience to adverse shocks, including the prolonged conflict. However, significant challenges remain. These include containing the fiscal deficit and public debt to sustainable levels, increasing export diversification against the backdrop of the abolition of the Multi-Fiber Agreement (MFA), and reviving non-plantation agriculture and the rural economy. Critical for both growth acceleration and poverty reduction is the achievement of permanent peace. It is also essential that policy reversals be avoided so that gains from past reforms can be further strengthened.

In sum, despite strong growth in the wake of adverse shocks, too many Sri Lankans are still poor. The tsunami is a painful reminder of this fact, as a lot of the victims are poor (which is why the impact on GDP is mild). Therefore, reconstruction efforts are needed to address the plight of the poor in the affected areas. There is however a risk that exclusive focus on the tsunami will delay reforms that are vital for up-lifting the poor in the rest of the country. The Development Forum would have succeeded if it helps to bring consensus between the government and the development partners on the range of measures that are critical to accelerating growth and reducing poverty in Sri Lanka.