

# BTI 2014 | Sri Lanka Country Report

<b>Status Index</b>	1-10	<b>5.57</b>	# 67 of 129	
Political Transformation	1-10	4.57	# 83 of 129	↓
Economic Transformation	1-10	6.57	# 36 of 129	→
<b>Management Index</b>	1-10	<b>4.24</b>	# 88 of 129	
	scale	score	rank	trend

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2014. It covers the period from 31 January 2011 to 31 January 2013. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

Please cite as follows: Bertelsmann Stiftung, BTI 2014 – Sri Lanka Country Report. Gütersloh: Bertelsmann Stiftung, 2014.

This work is licensed under a [Creative Commons Attribution 4.0 International License](https://creativecommons.org/licenses/by/4.0/).

### Key Indicators

Population	M	20.3	HDI	0.715	GDP p.c.	\$	6247.2
Pop. growth <sup>1</sup>	% p.a.	-	HDI rank of 187	92	Gini Index		36.4
Life expectancy	years	73.9	UN Education Index	0.723	Poverty <sup>3</sup>	%	23.9
Urban population	%	15.2	Gender inequality <sup>2</sup>	0.402	Aid per capita	\$	20.7

Sources: The World Bank, World Development Indicators 2013 | UNDP, Human Development Report 2013. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$2 a day.

## Executive Summary

Sri Lanka's trajectory during the past two years has been marked by continuing economic development amidst considerable deterioration in political democracy. Foreign remittances continued to rise and reached \$6 billion in 2012. They partly offset deteriorating terms of trade, and rising imports. Economic growth, which had risen to 8.3% in 2010, fell back to about 6.5% in 2011 and is expected to remain at around that level. The education level of the workforce remains high. Educational opportunities for women are excellent, though there are considerable gender barriers to female engagement in society and the economy. Private property is relatively well protected. On the other hand, there has been no significant reform of the overstuffed and relatively inefficient public sector, and illegal siphoning of funds from state ventures has continued. The budget deficit is being reduced gradually, to about 6%, and inflation, through rising again, was restricted to about 7%. Despite a rising debt burden and the failure to attract much foreign investment (annually only about \$1 billion), the country's economic prospects remain good.

The political picture is much less hopeful. The biggest challenge facing democracy in Sri Lanka is the absence of a strong opposition (the current government's modus operandi has ensured this). The country is becoming increasingly authoritarian, albeit along the lines of what political scientists would call a hybrid regime, in which democratic processes like elections are used to legitimize a government that otherwise operates in a highly illiberal fashion. The opportunity for ethnic reconciliation provided by the end of the civil war has been squandered. More significantly, political democracy is threatened by the increased concentration of power in the presidency. President Rajapaksa's regime consolidated its position with victories in local, divisional and provincial council elections in 2011 and 2012. During these elections, state agencies provided support to the ruling coalition. The 18th amendment to the constitution (September 2010) had given the president control over key appointments in the administration and the judiciary and had removed the two-term limit on presidents. The president's power was further demonstrated in 2012 – 2013 by the impeachment of the chief justice, who was seen as an obstacle to the concentration

of power by the Rajapaksa family. Criticism of the government is equated with disloyalty. Opposition news outlets are under siege, vulnerable to attacks by armed gangs. Criticism from the West has further stimulated linkages with China, Russia and Iran, who, with Japan and India, have continued to support the Sri Lankan leadership.

## History and Characteristics of Transformation

By the end of British colonial rule in 1948, the country's elite had been socialized into accepting a British-style parliamentary system, which survived several power transfers in the wake of successive defeats of the ruling party in the 1950s and 1960s. A party system developed dominated by the United National Party (UNP) and the Sri Lanka Freedom Party (SLFP). During the second half of the 20th century, the two parties combined won a steady 80% of votes and seats.

However, the political transformation to a third-world democracy met several obstacles. Political parties remained elite-dominated with minimal internal democratization. Ethnic tensions escalated, principally between the majority Sinhalese and minority Sri Lankan Tamils of the north and east. Sinhalese politicians implemented a number of policies that alienated many Sri Lankan Tamils, including the exclusion of most Tamil plantation workers in the central part of the country ("Up-Country Tamils") from citizenship in 1948, making Sinhala the only official language in 1956, and giving special constitutional recognition to Buddhism – the religion of most Sinhalese – in 1972. The largely Hindu Sri Lankan Tamils were further aggrieved by diminishing opportunities for state employment in the 1960s, and schemes intended to limit their access to some areas of university education in the 1970s. During the 1950s, Sri Lankan Tamil politicians demanded a federal system, and, in the 1970s, began a campaign for a separate state.

In the late 1970s, the more radicalized Tamil youth moved toward armed struggle. Faced with these challenges, as well as a short-lived insurgency among the Sinhalese youth in 1971, the state began to continually invoke a state of emergency, exerting greater control over the media and expanding the military forces. A new constitution in 1978 established a French-style presidential system, and new antiterrorist laws were enacted. Increasing attacks on state institutions and on the armed forces by Tamil militant groups in the 1980s, and a pogrom against Tamil civilians in 1983, made matters worse. After an armed intervention by India in 1983, the proposal of a quasi-federal system failed to resolve the issue. By the late 1980s, the state faced twin armed insurrections, one by Tamil separatist groups and another by Sinhalese Marxists. It was able to crush the latter in 1989, but the Liberation Tigers of Tamil Eelam (LTTE), which emerged as the dominant Tamil rebel group, controlled parts of the north and east of Sri Lanka and fought a civil war that lasted for 26 years until the LTTE was militarily defeated in May 2009. A basic problem in postwar reconciliation relates to the unwillingness of the ruling group to make political concessions to reconcile the minority Tamils of the north and east.

Meanwhile, reforms permitted most Up-Country Tamils to gain citizenship rights in the 1980s, and Up-Country Tamil political parties currently participate in mainstream politics. Muslim political parties have emerged in the last 20 years, and have progressed from advocating a separate Muslim province to allying themselves with one or the other of the main parties. Despite these advances, the tendency of the ruling political group to accumulate power has resulted in considerable backsliding along the path of political transformation.

The economic transformation has been more promising. The British left Sri Lanka with a colonial economy in which the state depended on the plantation sector for much of its revenue. Sri Lankan politicians maintained the well-developed health care system that they inherited, and they vastly expanded secondary education. On the other hand, they also inherited a weak industrial sector and had to make heavy investments in agriculture to reduce the country's dependence on food imports. A development model of import substitution and of economic development through public sector companies was attempted until 1977. From then on, market-oriented reforms were gradually adopted. Successive governments of different political hues have pursued privatization, public sector reforms and the liberalization of trade and capital movements. But populist opposition to these changes continues, and progress has slowed in the past few years.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

## Transformation Status

### I. Political Transformation

#### 1 | Stateness

After the final defeat, in May 2009, of the armed uprising by the Tamil Liberation Tigers, the state's monopoly on the use of physical force has not been openly challenged. While control over some areas of the north is maintained through stationing of armed forces assisted by state-supported paramilitary organizations, the military has also opened new mini camps in other parts of the country, thereby expanding military oversight across the island (and beyond what existed during the civil war). In the south, connections that some armed gangs have with governing political factions make them somewhat independent of police control.

All groups in Sri Lanka have legal access to citizenship. On the other hand, many Tamils in the north have reservations about the Sri Lankan state as it is presently constituted. They resent the symbols of the predominantly Sinhalese Buddhist state (national flag and Sinhala language) being imposed on them. The government held local elections in the north, and the main reason it has not held provincial council elections in the north is because it wants to delay civilian political control of the area.

The constitution specifies that "the Republic of Sri Lanka shall give to Buddhism the foremost place," although it also safeguards freedom to have or adopt a religion of one's choice and the freedom to teach and practice one's religion in public or private. The state financially supports all major religions in Sri Lanka (Buddhism, Hinduism, Islam and Christianity), but the minister for religious affairs is titled Minister for Buddha Sasana and Religious Affairs, reflecting the political power of the Buddhist majority. In April 2012, a mosque was attacked by a Buddhist mob in central Sri Lanka, and in September and December, newly established evangelist Christian churches in southern Sri Lanka came under physical attack by Buddhists. While the police intervened in these cases, religious minorities are concerned that the state (in collusion with some among the Buddhist clergy and military) would favor Buddhism. State schools teach pupils the religion of the parent (Buddhism, Christianity, Hinduism or Islam). Some Buddhist monks are also using political connections to

Question  
Score

Monopoly on the  
use of force  
9

State identity  
6

No interference of  
religious dogmas  
7

take over state lands in predominantly Tamil areas in the north and, in the main, many religious minorities live with a sense of insecurity.

Sri Lanka has an effective administrative structure that provides basic health and education facilities to all areas. Central and provincial agencies provide power, water, housing and other basic facilities, and implement state policies. However, expenditure on education as a percentage of GDP has remained just over 2%, about half the average of developing countries. In the north and the east, while basic power and water services have been restored in urban areas, the rebuilding of state services including health care and education has been slow since the end of the civil war in 2009.

Basic  
administration  
7

## 2 | Political Participation

Elections are regularly conducted on the basis of universal suffrage. Local government elections in municipal, urban and divisional councils were held in stages in April, July and October 2011. The ruling United Peoples Front Alliance (UPFA) won majorities in 272 of the councils, in contrast to the main opposition UNP's 31. The UPFA won about 60% of the vote in the Sinhalese-majority areas. However, the Tamil National Alliance (TNA) won in the north and currently controls 32 local councils. The provincial elections in September 2012 in three provinces saw the ruling UPFA win decisive victories in two of the Sinhala majority provinces (gaining about 60% of the votes cast). In the ethnically mixed Eastern Province, the UPFA won only 32% of the vote but was able to form a government with the support of its ally, the Sri Lanka Muslim Congress (SLMC), which gained 21% of the vote.

Free and fair  
elections  
5

While the UPFA has strong support in the country and probably would have won in the Sinhalese-majority areas in fair elections, the electoral contests of 2011 and 2012 were by no means fair or free. Death threats to independent editors, police raids on Web sites critical of the government, and the abduction and intimidation of journalists have severely constrained opposition politics. State-owned media actively supports the government in power and publishes information critical of opponents. Elections for the Tamil majority Northern Provincial Council, in which the UFPA is expected to lose, have been postponed indefinitely.

The immediate family of the president wields extensive influence in the polity through appointment to elective and nonelective office. The president and his immediate family in the country control much of the country's budget, and no major change in policy or implementation in any ministry gets implemented if they oppose it. The president is the commander-in-chief of the armed forces and has been able to appoint his choices of chiefs for the army, navy, air force and police without question. The 18th amendment to the constitution, enacted in September 2010, enables the president to make a variety of appointments to administrative and judicial offices.

Effective power to  
govern  
3

Administrative officers are transferable and subject to political will. The impeachment and subsequent replacement of the chief justice, in January 2013, is widely attributed to her refusal to rule favorably on a proposed law. The president and the first family control much of what happens in the country because they enjoy the right to effectively veto almost anything, even if the matter does not fall within their jurisdiction constitutionally. In that sense, the executive currently enjoys more power to govern than any other that has held office in the country.

Under the laws relating to public security, the state can restrict public meetings and has increasingly used this power. For instance, on 10 December 2011, a group of 42 activists from the south were arrested in Jaffna to prevent them from attending an event to mark International Human Rights Day. Gangs attached to individual politicians intimidate voters, and opposition politicians participate in politics at personal risk. Opposition parties and civil society groups critical of the government continue to operate openly. However, civil society groups are increasingly under threat and are targeted in various ways (restrictions on organization and registration, police raids, attacks by mobs, and audits). Most of those targeted also happen to be those who speak out in favor of minority groups and nonpartisan governance. Foreign organizations and foreign-funded organizations considered critical of the government or concerned about minorities' plight are monitored and their visas regulated, which in turn has compromised some of these organizations' ability to work together in challenging problematic government practices.

Association /  
assembly rights  
5

The state controls significant portions of the news media, including major newspapers and state television. There are few independent media outlets critical of the government, and those that do criticize the government are often targeted. Media organizations have been attacked and many journalists have also been assaulted (with many fleeing abroad). Some criticism of the government in the English-language press is tolerated (as only about 10% of the population reads the English-language press), but there is less leeway for the press in local languages. Since November 2011, all Web sites dealing with Sri Lanka have been forced to register with the state. On 29 June 2012, offices of two Web sites (Sri Lanka Mirror and Sri Lanka X News, the latter a UNP opposition party Web site) were raided and employees charged under Article 120 of the penal code, which imposes up to two years in prison for those convicted of inciting criticism against the president or government. In February 2013, a journalist working for an English-language newspaper critical of the government was shot and wounded while at home. Self-censorship has become the standard modus operandi for most journalists, and many of them refuse to print anything related to the defense secretary for fear of retaliation.

Freedom of  
expression  
4

### 3 | Rule of Law

The separation of powers is very limited. President Mahinda Rajapaksa is minister of defense and urban development; finance and planning; ports and highways; and law and order. His coalition has held 144 of the 225 seats in the legislature since April 2010. Of the legislators, 92 became part of the executive on appointment as ministers or deputy ministers. With the assistance of a few opposition defectors and minority parties, the ruling coalition can secure a two-thirds majority.

Separation of  
powers  
3

The president is empowered to appoint the chief justice and the judges of the Supreme Court, the president and the judges of the Court of Appeal, the Judicial Service Commission (other than the chairman), the Election Commission, the Public Service Commission, the National Police Commission, the Human Rights Commission, the Permanent Commission to Investigate Allegations of Bribery and Corruption, the Finance Commission, the Delimitation Commission, the attorney-general, the auditor-general, the parliamentary commissioner for administration (or ombudsman), and, subject to consultations with five specified legislators, the secretary-general of parliament. Political interference in the operation of the administration is routine, and recruitment to state agencies (except in the case of professionals, such as doctors) is carried out almost entirely through political recommendations. The January 2013 impeachment of the chief justice, after she ruled a key piece of legislation unconstitutional, was yet another blow to the separation of powers. In many instances, decisions made by cabinet ministers get overturned by individuals who are part of the first family, and sometimes cabinet ministers refuse to make decisions if they think this may undermine their standing with members of the first family. The large number of ministers and deputy ministers whose responsibilities overlap partly contributes to the poor separation of powers.

A major challenge to the independence of the Sri Lankan judiciary arose in November 2012 when the legislature began to impeach Chief Justice Shirani Bandaranayake. Justice Bandaranayake had been appointed to that position in May 2011 by President Rajapaksa and was the first female chief justice in Sri Lanka. The judiciary is not empowered to rule on the constitutionality of legislation after it is enacted, though bills can be challenged before they become law. In the second half of 2012, the Supreme Court considered challenges from several groups on the constitutionality of a bill (commonly called the Divineguma bill) which authorized a single ministry controlled by Basil Rajapaksa, a brother of President Mahinda Rajapaksa, to spend about \$614 million on poverty alleviation and development. The court initially declared that this legislation required the assent of all nine provincial councils and (when that was obtained) ruled that some clauses of the proposed bill required a two-thirds majority in Parliament and a referendum. Soon after, impeachment proceedings against the chief justice commenced through a parliamentary committee. The

Independent  
judiciary  
3

Supreme Court ruled that the process used for impeachment was illegal, but the chief justice was impeached in January 2013 and replaced by a former attorney-general. The bar association protested to no avail. The chief justice's husband, who had held the post of chairman, National Savings Bank, was also vilified by the state press. These developments followed an attempted abduction in October 2012 of Manjula Tilakaratne, secretary of the Judicial Services Commission, which was attributed to his resistance to political interference in judicial disciplinary proceedings. Political appointments to the bench (in all courts) and the intimidation and transfer of judges (mostly in the lower courts) have diminished the judiciary's independence. Overall, the judiciary suffers from an executive mindset, thanks to personnel from the attorney-general's office being appointed to the upper courts. "Telephone justice" is also said to be rife, with individuals from the executive's office or AG's office calling justices (including those on the Supreme Court and appellate court) and telling them how to rule in certain cases.

Inefficiency, anomie and corruption are widespread at all levels of government, as is the impunity with which such practices and human rights violations are perpetrated. No high-ranking politician or public servant has been prosecuted for abuse of power while in office, despite evidence that seemed to warrant prima facie cases. There is no practice relating to disclosure of financial interests while in office. The judiciary has ruled that the president cannot be prosecuted for abuses of power while in office. Politicians associated with the ruling coalition are accused of numerous criminal activities, including drug-trafficking, murder and rape. Their party positions and closeness to the first family, however, allows them to act blatantly.

Prosecution of  
office abuse

3

Civil rights are guaranteed in the constitution and Sri Lanka has acceded to U.N. conventions on human rights, including the Convention against Torture and the Optional Protocol to the Convention on the Elimination of All Forms of Discrimination against Women. The Ministry of Child Development and Women's Affairs (MCDWA) has sponsored several programs. On the other hand, Sri Lanka has not ratified the 2000 U.N. Protocol to Prevent, Suppress and Punish Trafficking in Persons, Especially Women and Children. Sexual violence against women is on the rise. In 2011, 281 cases of rape of women were reported. Sex with a child under 16 is considered rape in Sri Lanka, and, in 2011, 1169 cases of rape of children under 16 years were reported. In addition, 604 cases of grievous sexual harassment of children were also reported during that year. There were very few prosecutions. Allegations of extrajudicial killing by Sri Lankan forces during the last stages of the civil war had led to the appointment of a local Lessons Learnt and Reconciliation Commission (LLRC), which gave its final report in December 2011. There has been no perceptible implementation of its recommendations. The secretary-general of the U.N. appointed a panel of experts on the violation of human rights during the final phases of the civil war, and that panel held both the Sri Lankan armed forces and the

Civil rights

3

Liberation Tigers of Tamil Ealam responsible for human rights violations. The Sri Lankan government has rejected these findings and has stalled further investigations.

Meanwhile, activities of armed paramilitary forces limit civil rights in the Tamil areas of the north and east. To a lesser extent, political gangs restrict expression of views in the Sinhala areas.

In a September 2011 survey of values by the Asia Foundation, 23% of Hindus, 15% of Catholics and 13% of Muslims said that they were free to express religious opinions only amongst friends and relatives or nowhere at all. Among Buddhists, only 1% gave this response.

#### 4 | Stability of Democratic Institutions

The president has powers to appoint key officials including those in the judiciary. The ruling party controls the national legislature, all provincial legislatures and most local government organizations. Therefore, vertical friction among institutions is minimal. On the other hand, there is very limited separation in policy-making, and financing is insufficiently decentralized to lower tiers. The concentration of power at the presidential level has reduced the effectiveness of other democratic institutions. Developments in 2012 – 2013, including the impeachment of the chief justice, have moved the polity to a more authoritarian format in which the president and his family members make the key decisions.

Performance of  
democratic  
institutions  
3

The biggest challenge facing democracy in Sri Lanka is the absence of a strong opposition (the current government's modus operandi has ensured this). The country is becoming increasingly authoritarian, albeit along the lines of what political scientists would call a hybrid regime, in which democratic processes like elections get used to legitimize a government that otherwise operates in highly illiberal fashion. While the government as a whole would not qualify as antidemocratic, the first family has overseen the weakening of state institutions and operates as an impediment to instituting a more liberal democracy (because all it is interested in is arrogating power and eventually creating a Rajapaksa dynasty). It is this clique within the government that controls nearly 70% of the country's budget and its major institutions that happen to be antidemocratic (even as they use democratic processes like elections to legitimize their authority).

Commitment to  
democratic  
institutions  
3

#### 5 | Political and Social Integration

The Department of Elections recognized 64 political parties as eligible to nominate lists for elections in 2012. However, many of them contested as part of two broad coalitions led by the ruling UPFA and the UNP. The exception is the coalition known as the TNA, which has its support base among the Tamils of the north and east. The

Party system  
6

two largest parties, the Sri Lanka Freedom Party (SLFP), which is the principal component of the UPFA, and the opposition UNP, are dominated by Sinhalese Buddhists. In the past few years, the SLFP has successfully outflanked the Sinhalese nationalist People's Liberation Front of Sri Lanka (Janatha Vimukthi Peramuna, JVP) and has encouraged defections from the UNP. Because polarization is low in terms of social policy, individual politicians from both major parties seem comfortable in changing party allegiance to gain political office. With large banks of voters loyal to the two major parties, voter volatility is moderate. Party organization continues to be undemocratic and centers on personalities and patronage. Party branches become active only at election time and act mostly to mobilize client voters.

In 2012, there were 1397 registered Non-Government Organizations (NGOs). Religious interests such as groups of Buddhist monks and the Catholic Church are vocal, with Islamic and Hindu groups being less active. Given the strong representation of Sinhala Buddhists in power, minority religious groups have begun to accommodate to the status quo. With the rise of the service sector and the growth of manufacturing in free trade zones, trade union membership has continued to drop and currently includes less than 20% of all workers. Many unions are affiliated with political parties. Employers' federations are influential in pushing economic reform.

NGOs mostly engaged in supporting poorer sections of society, and in the creation of ethnic harmony, are required to be registered with the government. The supervision and registration of NGOs, which had been placed under the Ministry of Health, Highways & Social Services since the inception of the requirement in 1996, was transferred to the defense ministry in April 2010. NGOs dependent on foreign grants have come under attack as "foreign agents" when these associations were critical of government policy. NGOs who want to work in the country have been refused permission and groups have been forced to disband or operate at less than optimum levels because the government has curtailed their resource bases or refused to grant personnel visas to enter or stay on in the country.

Overall, NGOs, including unions, operate with the full knowledge that they could be the targets of government sources should they challenge the regime's core preferences.

The 2005 survey on the State of Democracy in South Asia concluded that support for democracy in Sri Lanka was higher than in any other country in the region, at 86%. Support was stronger among the more educated and the urban dwellers and strong among minorities. Voters sometimes accept personal risks in order to participate in elections, and democratic procedures are widely regarded as the only legitimate means of gaining power; but democracy is often subverted in practice. The use of state apparatus by those in power to discredit critics and influence election results in the past few years could well have undermined faith in democracy. There is no recent survey of support for democracy in Sri Lanka, but some evidence of disillusionment

Interest groups

5

Approval of  
democracy

n/a

is evident in continuing low turnout (between 60% and 65%) in the provincial and local elections of 2011 and 2012. That noted, rising economic prosperity, coinciding with soft authoritarianism, could change expectations over time and call into question the need for and efficacy of democratic institutions. All indications point to a declining trust in the police, the bureaucracy and the legal system. They indicate that the level of trust is lower among the ethnic minorities and the disempowered sections of the Sinhalese.

The level of trust is also low among Muslims. In many instances, minorities, but also disempowered people among the Sinhalese, avoid dealing with the police. This is especially so if their grievance is against someone with influence. All concerned have less faith today in the island's institutions and have little good to say about their political representatives, and this is perhaps one way to gauge approval of democratic norms and process in the absence of concrete current survey data.

Social networks are based on religious affiliations and center on a temple, mosque or church. A 2011 Asia Foundation Survey reported that 80% of respondents state that their religious leaders are "very well respected," compared with 12% who give the same rating for politicians, 32% for local government officers and 47% for teachers. These perceptions are similar across the four major religious groups. The survey also indicated high regular attendance at places of worship, hinting at cohesive religious communities. Social organizations in rural areas tend to concentrate on helping neighbors facing a crisis. In urban areas, the upper and middle classes participate in organizations such as the Lions Club, Jaycees and the Rotary Club. The poorer sections of urban society continue to work with religious leaders, often replicating rural patterns of organization. Trade unions have more than a million members but are concentrated in plantations and among urban wage earners. A major challenge is the rehabilitation of trust and social cohesion among those affected by the civil war. A four-year, seven million dollar United Nations Development Programme effort to ensure access to justice and to build trust and confidence in minority areas ended in December 2012; an evaluation of its impact is yet to come. An ongoing project in eastern Sri Lanka supported by the European Union through the German Agency for International Cooperation (Deutsche Gesellschaft für Internationale Zusammenarbeit, GIZ) has established 150 local committees to voice the concerns of women and underrepresented groups.

Social capital  
5

## II. Economic Transformation

### 6 | Level of Socioeconomic Development

Question  
Score

Socioeconomic  
barriers  
6

Sri Lanka is now a middle-income country, having reached a per capita GDP of \$2,835 in 2011, according to World Bank figures. This is almost double that of neighboring India and almost four times that of Bangladesh. Despite the challenges posed by the international economic slowdown and continued inflation, GDP growth in 2011 was 8.3% and is expected to exceed 6.5% in 2012.

Sri Lanka's literacy rate of 90.6% leads the region. Sri Lanka leads the region on the Human Development Index (HDI) with a score of .69, although it is ranked 97th out of 181 countries measured. The latest World Bank poverty estimate relates to 2007, and, even according to those figures (29.7%), Sri Lanka's rate is better than that of Nepal, India and Pakistan. School attendance is high in all areas with no gender inequalities, although the quality of instruction varies greatly. Religion has no discernible impact on education except that the literacy rates of Muslim women are slightly lower than others. Safe drinking water and modern sanitation are available to only 65% of workers living on plantations, although this represents a 50% rise over the past few years.

Evidence in the Household Income and Expenditure Survey of 2009 indicates that residents in the plantation sector (largely Tamil) have a poverty rate that is 50% above the national level, and that the economic destruction caused by the civil war in the north and east – inhabited largely by Tamils – will take some years to repair. Interpersonal income inequalities remain high: The 2007 Gini Index stood at 40.7 and is likely to have risen further by 2013. Civil conflict, inflation and poor infrastructure have slowed progress in rural areas. Low child mortality and high female higher-education levels have not translated into greater equity in economic participation and more decision-making power for women. Men hold over 60% of employment in the organized sector and, on average, earn more than twice as much as women.

There is much infrastructure development taking place, but this appears to be associated with the large kickbacks such projects generate for ruling politicians. The predominantly Tamil areas in the northeast have been neglected, especially when it comes to development, and attempts by foreign donor agencies to support livelihood programs in the Northern Province often encounter hurdles.

Economic indicators		2009	2010	2011	2012
GDP	\$ M	42066.2	49565.5	59186.9	<b>59421.4</b>
GDP growth	%	3.5	8.0	8.2	<b>6.4</b>
Inflation (CPI)	%	3.5	6.2	6.7	<b>6.8</b>
Unemployment	%	5.9	4.9	-	-
Foreign direct investment	% of GDP	1.0	1.0	1.6	-
Export growth	%	-12.3	8.8	11.0	-
Import growth	%	-9.6	12.6	20.0	-
Current account balance	\$ M	-214.7	-1075.0	-4615.4	-
Public debt	% of GDP	-	-	-	-
External debt	\$ M	17856.8	21153.3	23984.1	-
Total debt service	\$ M	1418.1	1401.1	1313.4	-
Cash surplus or deficit	% of GDP	-8.9	-7.2	-6.4	-
Tax revenue	% of GDP	12.8	12.9	12.4	-
Government consumption	% of GDP	17.6	15.6	14.8	-
Public expnd. on edu.	% of GDP	2.1	2.0	2.0	-
Public expnd. on health	% of GDP	1.6	1.6	1.5	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	3.6	3.1	2.9	<b>2.4</b>

Sources: The World Bank, World Development Indicators 2013 | International Monetary Fund (IMF), World Economic Outlook 2013 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2013.

## 7 | Organization of the Market and Competition

Market competition in Sri Lanka is stable. Discrimination against foreign investors is very low, with up to 100% investment allowed in most industries and in a number of service activities, including banking, insurance, finance, construction, mass transportation, telecommunications and information technology, and petroleum distribution. However (with some exceptions), foreign investment under \$1 million is prohibited in areas of retail trading and non-bank lending, and, in some sectors, foreign investment exceeding 40% is subject to screening and approval. State-administered pricing applies only to a few products, such as petroleum-based fuels, and a few basic foods like bread and milk powder. From 2011, start-up companies

Market-based  
competition

8

that invest between \$5,000 and \$10 million dollars in sectors to be specified received a five-year tax holiday. However, the Revival of Underperforming Enterprises and Underutilized Assets Act of November 2012 has raised some concerns among foreign investors. While this act is ostensibly aimed only at 37 named enterprises, it has opened the possibility of expropriation of foreign assets. State involvement and consequent political influence in banks and finance companies have also raised concerns. Sri Lanka has a managed floating exchange rate that allows market forces to determine exchange values subject to increasingly rare interventions by the Sri Lankan Central Bank. The Sri Lankan rupee is convertible for current account purchases and remittances of profit, but there are restrictions on capital investment overseas by Sri Lankan enterprises. The top income tax rate is low, at 35%, and the top corporate tax rate, which was 35%, was reduced to 28% in 2012 (except for tobacco, alcohol and casinos, for which the rate is 40%). Firms involved in fisheries or in making seeds or planting material have been exempt from income tax for five years.

There are a number of state-owned monopolies in areas such as energy and the ports. The state also controls some wages and prices, including the prices of petroleum, water, power, bus and rail fares. Although the Consumer Affairs Authority may investigate the effects on consumers of anticompetitive practices, Sri Lanka's law does not empower it to investigate the existence of monopolies or to examine mergers or acquisitions that have already taken place. Pre-merger notifications are not mandatory. Therefore, investigations of mergers may only be undertaken for utilities which fall under the purview of the Public Utilities Commission, or for companies listed in the Colombo Stock Exchange, which may be reviewed by the Securities and Exchange Commission of Sri Lanka. Also, when politically influential state agencies embark on economic enterprises (e.g. airlines), there is a reluctance to compete with them. The growing militarization taking place in Sri Lanka has seen the military, which was not demobilized following the defeat of the LTTE, move into various business activities so as to compete with private entities. While the military has hardly monopolized these sectors, its subsidized involvement weakens free competition. Continued expansion of such activities could pose future problems to rules governing fair competition.

Sri Lanka has a relatively transparent and low tariff trade system. The average applied Most Favored Nation tariff was 11.3% in 2010. Imports into Sri Lanka are also subject to a number of other charges: excise duty, Export Development Board Levy of 1% to 35%, value-added tax (VAT) of 12%, Social Responsibility Levy (1%), the Ports and Airports Development Levy (PAL) of 5%, the Nation Building Tax (3%), and port handling charges. Excise duties are levied on tobacco products, oil products, aerated water, liquor, beer, motor vehicles, and certain household electrical items. Tariffs on motor vehicles and a few other products were raised in 2012. Sri Lanka applies policies to encourage exports of goods and services. They include a temporary

Anti-monopoly  
policy

7

Liberalization of  
foreign trade

8

importation for export processing (TIEP) scheme, and a manufacture-in-bond scheme. Any enterprise located in an export processing zone gets tax holidays, duty-free imports, and concessionary land prices. Exporters of nontraditional goods exporting at least 80% of their production also enjoy a number of tax concessions, including a preferential income tax rate on profits from these exports, and a tax holiday. Export duties are levied on vein quartz and an export tax is levied on cashew nuts, rawhide, scrap metal, natural rubber, coconut products and tea.

Despite a global crisis, Sri Lanka's banking sector remained stable due to regulatory action. The total risk-weighted ratio required is 10% and the core capital ratio is 5%, though this takes into account only the credit risk and there is no explicit charge for market risk. All banks need to comply with minimum regulatory liquid asset ratios of 20% of its total liabilities (excluding liabilities to the central bank and shareholders). The Finance Business Act, No. 42 of 2011, has further enhanced state supervisory and regulatory powers over licensed finance companies. Regulations permit 100% foreign control of banks, insurance companies and stockbrokerages although foreign ownership of banks covers only about 12% of the total assets. The rate of non-performing loans is about 5%, though this rose slightly in 2012. Currently, there are 26 commercial banks in operation in the country. Ten of these are locally incorporated and the rest are branches of foreign banks. Two of largest commercial banks are state-owned and they hold about 35% of banking sector assets. Four other large private banks hold another third of the assets. There are ten merchant/investment banks and seven venture capital companies. There is some evidence of political pressure designed to influence policies of private banks in matters such as the location of branch banks. However, the banking sector as a whole is stable, and, in 2012, it adopted new accounting standards and limited its exposure to loans granted for margin trading.

Banking system

7

## 8 | Currency and Price Stability

Inflation as measured by the Colombo Consumer Price Index was 6.7% in 2011 and is estimated to be around 7.4% in 2012. This was a result of effective measures taken by the Central Bank of Sri Lanka, which reduced the average weighted inter-bank lending rate charged by commercial banks from 19% in January 2009 to just over 8.25% in January 2011. However, that rate had risen to 13.75% by January 2013, suggesting that inflation will remain well over 7% in 2013. The Sri Lankan rupee was allowed to float in 2012 and fell 16.3% against the dollar to end at Rs125 per dollar. It is expected to depreciate slightly in 2013. Although the Central Bank of Sri Lanka is not operating independently of the government, its recent policies have helped to stabilize the country's inflation.

Anti-inflation /  
forex policy

7

Government consumption as a percentage of GDP fell in 2011 to 15%, as compared to 15.6% in 2010. Extensive subsidies, overstaffing of the public sector and a limited tax base remain major fiscal challenges. External risks include limited opportunities for market growth – especially after the EU terminated its preference tax concessions for Sri Lanka in 2009 – and a dependence on remittances (estimated in 2012 at \$6 billion) from Sri Lankans abroad.

Sri Lanka's current account deficit, which was -\$214 million in 2009, swelled to -\$10,750.3 million in 2010. It rose to -\$46,154.2 million in 2011. In February 2012, the government introduced a comprehensive package of measures to rein in the current account deficit and reduce the reserve loss. Monetary and credit policy was tightened, petroleum and power prices were increased, and the rupee was allowed to depreciate. This improved the foreign currency reserve position, but foreign debt rose by over 30% in rupee terms in 2012 due to the depreciation of the rupee. By the end of 2012, the debt burden was around 83% of GDP, and Sri Lanka's external reserves were enough to pay only for just over four months of imports. The budget for 2013 thus included further cuts in subsidies for petroleum. Nevertheless, a projected annual economic growth rate of over 6% and a young population are factors in favor of Sri Lanka's macroeconomic stability. At the same time, one needs to consider here the high defense budget amidst increased militarization (and lack of demobilization). Also, the number of not very transparent loans, from China especially, for infrastructure projects is a matter of concern.

## 9 | Private Property

Property rights are protected by law. However, corruption and undue influence on the judiciary could restrict the enforcement of rights in specific cases. The Revival of Underperforming Enterprises and Underutilized Assets Act of November 2012 provides for expropriation of specified properties by the state. It has raised many concerns as a possible precedent. Land registration procedures remain cumbersome and on average take two months to complete even when the purchase is without legal issues. In the Tamil north and east, local landowners have found it very difficult to regain land taken over by the defense ministry. Private land ownership is limited to 50 acres per person. Within Colombo, individuals who have lived on properties for decades (albeit sometimes without deeds) are seeing their properties being bulldozed by the Urban Development Authority (which is headed by Gotabaya Rajapaksa and is merged with the defense ministry) as part of beautification projects. Private properties have also been partly demolished in some areas to widen roads, with such operations usually being overseen by the military and carried out without prior warning. In the past, foreign investors have been able to purchase land, but the president in his 2013 budget speech announced that, starting in 2013, they would not be allowed to purchase land for tourist ventures. One hundred percent foreign

Macrostability

6

Property rights

7

ownership is permitted in most industrial and a number of service sector activities, including banking, insurance, finance, construction, mass transportation, telecommunications and information technology, and petroleum distribution. There is no restriction on the repatriation of profits or dividends of foreign companies, and stock market investments can be remitted without prior approval from the Sri Lankan central bank. Investment returns can be remitted in any convertible currency at the market rate, while foreign investors may invest in foreign-currency-denominated bonds. Remittance of royalties, licensing fees and management fees are permitted for companies with majority foreign investment approved under Section 17 of the Board of Investment Act.

While the regulatory requirements for the establishment of a new business are limited, the average delay of over a month is inordinate. Recent studies of regions within Sri Lanka have identified several factors inhibiting the establishment of new enterprises, including unofficial charges by public officials, the lack of a business-friendly attitude in the bureaucracy, and opaque and cumbersome procedures for business registration and licensing. On the other hand, over 95% of manufacturing and agricultural production is currently in private hands, with state-owned enterprises concentrated in the service sector, such as electric power generation and passenger transport. The Rajapaksa government has rejected the further privatization of state enterprises, including state-owned banks and electrical utilities. Instead, it seeks to retain ownership and management of these enterprises and to make them profitable. Recent changes liberalizing investment opportunities have provided more incentives for foreign investment, raising Sri Lanka's ranking to 81st of 185 economies (from 96th in 2012) in the 2013 World Bank Starting a Business rankings. However, legislation in November 2012 provided for state takeover of 37 nonperforming assets privatized in the past. The takeover included the Sevanagala Sugar Industries, owned by a key official in the opposition party.

Private enterprise

8

## 10 | Welfare Regime

Sri Lanka's HDI continues to be above that of many countries with higher per capita GDP because of its longstanding and comprehensive welfare programs. The Rajapaksa presidency has promoted a number of poverty alleviation programs, which are estimated to cost \$108 million in 2012. Life expectancy at birth in 2010 was 74.7 years – the highest in the region. Free health care has been implemented for over half a century but is challenged by financial constraints, with the Sri Lankan state spending only 1.3% of GDP on health. The high incidence of malnutrition among children, the reemergence of communicable diseases such as malaria and swine fever, and a demographic transition that has led to greater demand for care of the elderly are problems that need attention. Basic provision of education is comprehensive, with state or state-assisted schools providing education free from grade one to grade 12,

Social safety nets

6

but there is a shortage of teachers in foreign languages and in technical subjects. Tertiary education is not well funded. The rural population and most in the urban sector currently have no insurance coverage for natural disasters, disability and old age although a government-sponsored internal development authority and relief program (so-called “Samurdhi”) social security program has been launched to prevent poor families from falling into poverty due to childbirth and unexpected incidents such as deaths and hospitalization.

Many of the welfare programs that have been set up in the northeast since the war ended have been funded by foreign governments and NGOs, not the Sri Lankan government. For instance, the United Nations High Commissioner for Refugees (UNHCR, also known as the U.N. Refugee Agency) spent \$27 million in 2012 to help with civil status documentation, access to legal assistance, shelter and infrastructure, and the reintegration of displaced persons. The number of displaced persons needing help has fallen from its peak of about 400,000 in 2009 to less than half that, but the UNHCR estimates that about 90,000, mostly in the north, have been unable to return to their homes, after three years of displacement.

Access to public services is open to all by law. There are, however, inequalities in practice. The gender gap in educational enrollment and achievement is minimal, with literacy among females at 92.2% as opposed to 89.1% for males, and enrollments in primary and secondary levels comparable. However, men dominate the more lucrative levels of employment in both the public and private sectors, and the average wage of females in the higher reaches of the formal sector is less than half that of men. There are regional and urban-rural disparities in the quality of the education system despite continuing efforts to develop a number of elite rural schools. Access to financial resources is limited for the poorer sectors of society, despite the state’s encouragement of micro-lending. Access to opportunity has been severely limited in areas of conflict of the north and east, which has affected large numbers of minority Tamils and Muslims and some Sinhalese in the recent past, and there has been little improvement in terms of access to jobs for minorities (especially within the state system). Public officials often continue to demand that those who seek government services do so in Sinhala (the majority community’s language) and not Tamil. With state employment mainly based on patronage, and most ministers holding plum portfolios belonging to the Sinhalese Buddhist community, minorities especially face entrenched discrimination when seeking state employment.

Equal opportunity  
5

## 11 | Economic Performance

The Sri Lankan economy is expected to continue to grow, though at a slower pace. Its growth rate of 8.3% in 2011 is expected to slow to 6.5% in 2012 and beyond. The per capita purchasing power parity (PPP) GDP, which was \$4,778 in 2009, is expected to be well over \$6,000 in 2013 despite the depreciation of the rupee. This

Output strength  
8

rise was fueled by increased state expenditure on infrastructure, increased production of agricultural products, and a revival of fisheries, although the production of tea was adversely affected by drought in 2012. The European Union purchases about a third of Sri Lanka's exports but garment exports to the EU declined in 2012 partly due to the withdrawal of the Generalized System of Preferences (GSP) Plus market access benefit by the EU. However, the local market has continued to stimulate production. Tourism has revived since the end of open conflict with an annual growth rate of about 20%.

Inflation as measured by the World Bank Consumer Price Index was 6.7% in 2011, is expected to be about 7.4% in 2012, and is likely to remain in single digits in 2013.

Gross capital formation rose to 36.5% of GDP in 2011 (from 27.8% in 2010), partly due to a massive investment on roads and ports financed by loans from China. This should decelerate after the program ends in 2015. Foreign investment remained anemic at about \$1 billion due to the global recession and questions relating to competition in the market from state enterprises. However, the Colombo Stock Exchange (CSE) had a good year in 2012 with 287 companies representing 20 business sectors and a market capitalization of \$173 billion.

Unemployment (excluding the north) fell to 4.9% in 2010 (from 5.9% in 2009), and while it should fall in 2011 due to extensive public projects, the statistics might not change because the 2011 data for the war-torn north are likely to be included in the national figure for the first time in years. The rising commodity trade deficit is compensated for by a continuing inflow of private remittances (which increased from \$4.1 billion in 2010 to \$6 billion in 2012) and multilateral loans. The 2011 budget deficit was 6.9% of GDP and it is likely that the 2012 and 2013 deficits will remain around 6% following fiscal reforms. Overall, the Sri Lankan economy performed well.

## 12 | Sustainability

The encroachment of natural reserves and continued deforestation (despite logging restrictions imposed in 1999) has resulted in soil erosion and other adverse effects on biodiversity. The inability of the politicized police to resist such actions worsens the situation. The provision of free water for agriculture has contributed to high usage. Air and water pollution has worsened in urban areas, and development pressures have also led to the reclamation of estuarial, lagoon and marsh waters, and the unrestricted disposal of untreated sewage, leading to major pollution problems. New industries create environmental contaminants that pollute freshwater bodies. Environmental concerns tend to take a back seat to growth considerations. Ecologically sustainable growth gets only scant attention and is not reflected in the institutional framework.

Environmental  
policy

5

The existing system of education is comprehensive, though gross enrollment at the primary level fell slightly to 98.8%. Enrollment at the secondary level remains at 87.1%, and tertiary enrollment at 15.5% is below that of India. Literacy among females at 92.2% as opposed to 89.1% for males. However, with total education expenses under 2.1% of GDP (less than half the average in developing countries), and with virtually all education run by the state, there are wide disparities in facilities between urban and rural areas. Facilities are poor in the war-damaged north and east. Tertiary education continues to fall behind in quality. A few private tertiary-education institutions provide postsecondary diplomas and link programs with foreign universities. R&D expenditures are very low (0.11% of GDP in 2008) compared with over 2% in Organisation for Economic Co-operation and Development (OECD) countries. The policy of getting university freshmen to participate in military-administered disciplinary training, and the practice of branding primary- and secondary-school principals with military ranks (following a military-administered training program), are signs of the increased militarization that the country is undergoing and how it has not even spared the educational establishment. Recent strikes by university professors also highlight the highly disgruntled environment within the country's university system.

Education policy /  
R&D

5

## Transformation Management

### I. Level of Difficulty

In terms of structural constraints on the political process, the difficulty is medium. Sri Lanka does not have exploitable oil or coal resources. Continuing poverty in areas outside the Western Province, particularly in the plantations and in the north and the east, leaves sections of the poor excluded from the benefits of economic growth, and although current state policies are aimed at benefiting the rural poor, disparities between poor and rich seem to be rising. Recent historical experiences of communal tensions and civil war pose considerable structural constraints on the political process of democratic transformation.

Structural  
constraints

6

On the other hand, Sri Lanka has a good geographical location, an equatorial climate with a high average rainfall, an educated labor force, rich fishing resources, large unexploited iron ore deposits, and a basic (though inadequate) system of internal transport. Much of the needed structural reform needed for an open economy has already been accomplished, with relatively broad consensus.

Civil society is only of limited use in overcoming Sri Lanka's structural constraints. Civil associations have taken an active role as guardians of civil and minority rights and have earned the increasing hostility of the government. However, with the end of the civil war, external donor support for some of the most important civil society organizations has been reduced. Faith in democracy may have weakened in light of the various assaults conducted by the government on NGOs and the media over the past few years and the passage of the 18th Amendment. Patron-client ties are strong, and trust in state institutions is limited. There are numerous local religion-based organizations working on public welfare, but trade unions have been in decline, partly because of the changing face of employment, but also because workers have seen political influence as a more effective way of gaining benefits.

Civil society  
traditions

4

The end of the civil war in May 2009 has greatly reduced open conflict, but it has left an ethnically divided citizenry and apprehension among many Tamils. The government's attempts to colonize the northeast with transplanted Sinhalese settlers and the creation of army camps throughout former LTTE areas have led to concern among Tamils and Muslims and generated continued ill feeling among minorities. The establishment of new political structures that rebuild trust will be challenging in

Conflict intensity

6

a context where the minority Muslim community is also increasingly conscious of its identity and where Christians feel threatened by the more militant Buddhists. The coalition government at the center has representatives of all these groups but appears to emphasize development as a panacea for the country's problems and thereby distance itself from the need to deal with ethnic reconciliation (especially given the brutal manner in which the civil war ended). Sinhalese Buddhist nationalist groups continue to mobilize along ethno-religious lines. Reconciliation has been hindered by the Sinhala Buddhist rhetoric of those in power and the lack of concrete steps towards reconciliation with minorities.

## II. Management Performance

### 14 | Steering Capability

President Rajapaksa's government has clear political, economic and social goals and the capability to attain them. However, regime priorities have more to do with securing power than achieving normative democracy and a socially responsible market economy. On the political front, the objective of consolidating a political stranglehold on power was achieved through electoral success at the presidential and parliamentary elections; the 18th Amendment to the constitution, which ended the restriction of a president to two terms in office and gave the president effective power to appoint those he wished to key positions including those in the judiciary; and the successful impeachment of the chief justice in January 2013. On the socioeconomic front, the priorities are also clear. The Divineguma Act centralizes the execution of numerous economic and poverty-alleviation policies under the control of the Economic Development Ministry, led by the president's brother, Basil Rajapaksa. Privatization is explicitly ruled out and the importance of having a sound regulatory framework for public-private partnerships is emphasized. Steps towards building ethnic harmony have been hobbled by the regime's policies aimed at outflanking its more radical Sinhala Buddhist challengers.

The state has the capability to implement its policies, but these policy priorities are not to promote democracy and a market economy. The liberalization of rules for foreign investment has ended. President Rajapaksa announced a prohibition of foreign purchase of land for tourist enterprises effective in 2013, and the 2012 expropriation of a few previously privatized state enterprises reflects a desire for more state control. Many of the major improvements to infrastructure have been through bilateral agreements with countries such as China, which are not overly concerned with democracy or a market economy. The government has been adept at carrying out infrastructure projects, and, in the main, there is strong support for such

Question  
Score

Prioritization  
4

Implementation  
4

projects (notwithstanding all concerned knowing about the kickbacks associated with them). Much of this development, however, has been centralized so that provincial council assemblies have little say in what happens within their areas. This development is also taking place with little if any input from other institutions (legislative and cabinet), leading to a lack of transparency and problematic bidding procedures. There is limited progress towards making the state sector less corrupt and more efficient.

The leadership's learning record is poor, particularly in the area of politics. The opportunities opened for national reconciliation after the end of open conflict have been squandered. Recommendations by the LLRC panel appointed by the government have not resulted in action, and the Rajapaksa government has totally rejected the findings of the U.N. panel on the events in the concluding stages of the civil war. The lesson learned with respect to political discourse seems to be that the use of power to silence opponents is effective. This is evidenced by interference in the judiciary and obstacles placed in the way of the press. On the economic front, the policies relating to inflation and budget deficits seem to be somewhat more responsive to expert advice, although those in political control seem to have refused to accept the continued privatization policy urged by some experts.

Policy learning  
5

## 15 | Resource Efficiency

The public sector is overstaffed and the appointment of new public officials is politicized with the exception of a minority of specialized professionals such as doctors. Once appointed, public officials are protected in their positions, though they can be subject to transfers to undesirable locations. Auditing of state agencies is routine, but there are continuing instances of leakages of state resources into private hands. The budget deficit was 6.9% in 2011 and is projected to fall to 5.8% in 2013. By January 2013, the public debt burden was about 83% of GDP and rising. Elected local and provincial assemblies have legally defined spheres of activity, but the government push to centralize activity was evidenced by the Divineguma Bill which proposes to centralize many poverty-alleviation and economic development programs.

Efficient use of  
assets  
4

Policy coordination through the administration is well established; many central ministries have branches at the provincial level with coordination provided by civil servants. On the other hand, this has undermined the scope of provincial and local governments due to limited vertical policy integration and the implementation of central government policies even in areas that are supposed to be devolved to the provinces. The establishment of 61 separate ministries in the center has increased the scope for conflict, redundancies and friction, although the increased centralization drive of the presidency has ensured prioritization in some areas. In short, what often

Policy  
coordination  
5

gets implemented is what the president and his family want implemented, but this has also led to more purposeful implementation of projects in some instances.

Corruption is deeply embedded at every level of the polity and administration. There is no prosecution of corrupt politicians in power. Public procurement systems are notoriously open to bribery and political influence. There is virtually no accountability of officeholders in terms of asset declaration and conflict of interest rules. State spending is audited, but party financing is not regulated. The media occasionally highlights glaring instances of questionable decisions, but most allegations of corrupt practices are not investigated with any rigor. The president's family holds key positions of authority, and corruption charges are used as a weapon against those who are not compliant, as evidenced by the charges against the chief justice.

Anti-corruption  
policy  
4

## 16 | Consensus-Building

The two major parties (SLFP and UNP) agree on the long-term strategic goal of a market-based economy. However, the party in power, the SLFP, has placed greater emphasis on poverty eradication led by the public sector, and, more recently, has initiated some protectionist measures such as increased custom duties. Despite continued formal commitments to democracy, the SLFP leadership has also proved willing and able to restrict democracy to crush opposition. This has led to reduced trust and cooperation. These repressive norms may well have been absorbed by the opposition UNP, whose members were not generous to political opponents when they were in power either. Minority Tamil parties are clearly disillusioned by the government's reluctance to negotiate on the devolution of power.

Consensus on goals  
4

The impeachment of the chief justice has sent a strong signal to the judiciary that those who do not comply with government wishes will face dire consequences. The president has appointed the commanders of the armed forces and they are not likely to interfere in economic and political policymaking. Trade unions are weak except in a few sectors (e.g., power, transport, tea production). The prospect that reformers will overcome antidemocratic forces is remote because the major threat to democracy comes from the ruling clique made up of the Rajapaksa family. The first family has overseen the weakening of state institutions and operates as an impediment to instituting a more liberal democracy. It has become difficult for opposition groups to organize electoral campaigns due to harassment by the ruling party. The only silver lining is that the ruling party has tolerated isolated opposition victories in local and divisional elections, and the election machinery itself has not been politicized.

Anti-democratic  
actors  
4

The government has signally failed to seize the opportunity to build ethnic reconciliation since the end of the civil war in 2009. It has pursued two contradictory policies. On the one hand, it has relied on measures for resettlement of refugees and efforts to rebuild the economies of the north and east to gain the support of Tamils

Cleavage /  
conflict  
management  
5

and Muslims. On the other hand, it tries to build political support among Sinhala Buddhists by claiming to protect their rights against claims of minority groups. The regime is thus not averse to using extant cleavages to promote its agenda. It vilifies its opponents as LTTE stooges, as pro-Western and antinational. The threat of a revived LTTE is also used to justify militarization and the military's continued presence in the Northern Province. The state continues to protect all places of religious worship and its rhetoric on poverty alleviation reduces class tensions. However, its refusal to accept any responsibility for the deaths of civilians at the last stages of the civil war has worsened ethnic distrust. According to a 2011 survey conducted by the Asia Foundation, 90% of Buddhists in Sri Lanka believe that people of all religions are treated equally in the government job market, compared with only 66% of the Muslim minority and 45% of the Hindu minority.

The political leadership does not make specific efforts to encourage the participation of civil society in the political process, but it tries to manage civilian groups who seek to intervene in politics. Several journalists have been intimidated and electronic media outlets disrupted during the review period. For instance, in June 2012, police raided the offices of two opposition news Web sites, arresting staff members and confiscating equipment. At least five other critical Web sites were blocked. Intellectuals who criticize state policies do find outlets in the media, but also find themselves under attack by state-controlled media. Professional associations and interest groups are able to influence the state only in areas such as education and economic policy.

Civil society  
participation  
3

Sri Lankan armed forces were accused of torture, executions, and denial of civil rights during the last stages of Sri Lanka's civil war. Some video evidence of extrajudicial killings raised troubling questions. President Mahinda Rajapaksa appointed the eight-member Lessons Learnt and Reconciliation Commission (LLRC) in May 2010 to investigate whether any people, groups or institutions bear responsibility for the conflict, and suggest measures to prevent such conflicts from happening in the future, and to mete out restorative justice to the conflict-affected. The report was presented to the government in 2011, but no action has been taken. The government has also refused to accept the March 2011 Report of the Secretary General's Panel of Experts on Accountability in Sri Lanka which dealt with allegations of violation of international humanitarian and human rights laws during the last stages of the civil war. In short, the current government has refused to take into account the causes or grievances that led to the ethnic conflict and instead continues to claim that the country hardly had an ethnic problem, it merely had to deal with a terrorist problem (in the form of the LTTE), which it handily defeated. Most dispassionate observers consider reconciliation to be impossible without adequate accountability for the manner in which the civil war ended.

Reconciliation  
2

In a broader context both the majority Sinhalese and the minority Tamils see themselves as victims of historical acts of injustice, the former during colonial times

and the latter in the period since independence. The continuing ethnic divide (which extends to a lesser extent to the Muslims) hinders progress toward reform goals.

## 17 | International Cooperation

The Sri Lankan state has worked successfully with the IMF and World Bank in the past decade and continues to do so. The IMF provided a bailout loan of \$2.6 billion in 2010 – 2012, and it is reported that Sri Lanka will request an additional \$1 billion in 2013. World Bank-financed projects in the areas of education (\$100 million), flood control (\$213 million), roads (\$100 million) and resettlement of displaced people (\$48 million) were approved in 2011 and 2012.

Effective use of support

6

Sri Lanka's readiness to work with the West in development has become more limited due to Sri Lanka's refusal to link human rights issues with trade concessions and aid. On the other hand, Sri Lanka has developed stronger connections with China, which had provided \$440 million in loans and credits in the first seven months of 2012 and pledged another \$1055 million in loans. Japan and India also provide loans and grants (mostly development assistance in the war-torn north). Iran emerged as a source of funds, though it was still behind the Netherlands as a donor. All of this denotes a move away from dependence on the West and fits well with the regime's efforts towards economic development without democratic evolution.

The Sri Lankan state is seen as a credible partner by multilateral lending organizations such as the World Bank because of its good performance in development projects and the continued fiscal reforms. It is much less credible in its record on protection of human rights, press freedom and democracy. International NGOs are often seen by the Sri Lankan government as subversive.

Credibility

6

Sri Lanka has excellent relations with its neighbors. Free-trade agreements with India and Pakistan have significantly lowered tariff barriers and encouraged trade. The value of two-way trade between Sri Lanka and India has grown from about \$650 million in 2000 to well over \$3 billion dollars by 2010. Two-way trade with Pakistan grew more slowly, to reach \$200 million by 2010. Over 250,000 Sri Lankans visited India in 2011, and over 150,000 Indian tourists visited Sri Lanka in that year. Sri Lanka is a member of the South Asian Association for Regional Cooperation (SAARC) and continues to develop educational and economic links with its neighbors. However, fishing disputes, the lack of progress in developing cooperation with the Tamils of the north and east (who have the sympathy of Tamils in South India) and a 2013 budget change on customs duties on less costly motor vehicles (mostly imported from India) have proved irritants in relations with India.

Regional cooperation

8

## Strategic Outlook

There are two areas in which Sri Lanka's policies might be encouraged.

**Economy:** The Sri Lankan state has demonstrated its ability to deal with shocks including the recent global recession and therefore is likely to be able to deal with rising oil prices in 2013. Inflationary pressures have been kept under control, although inflation is likely to rise to over 7% in 2013. Private individual remittances, mostly from the Middle East, have kept rising, but the level of foreign investment has been poor. Further transparency and efficiency in the legal and administrative framework will reduce the transaction costs of business enterprises and promote investment.

**Investment on Infrastructure:** Sri Lanka has made relatively good use of loans and grants offered by international bodies and friendly countries such as China, Japan, Russia, India and Iran to achieve progress in this area. For instance, Chinese loans were used to build a new international port at Hambantota in the south and for investments on roads, bridges, water supply schemes, irrigation and power. Indian aid was used for a project to build 50,000 houses in the war-torn north. An Asian Development Bank loan partly funded the Southern Expressway, which is expected to be complete in 2013. However, the government has been criticized for lack of transparency on some deals it attempted to make with foreign investors. A well-known example of a deal that fell through was an attempt to sell a valuable stretch of state property in Colombo to a Chinese company.

There are several areas in which policy changes are recommended.

**Reconciliation:** Ethnic reconciliation and a political settlement relating to the devolution of power is a key issue. The refusal of the government to negotiate further decentralization of power with the leaders of the Tamil minority of the north and east has led to a missed opportunity. President Rajapaksa has a secure majority in the legislature and popular support among the majority community, and therefore is in a unique position to build a consensus on the issues of minority rights and the devolution of power.

**Democracy:** The concentration of power in the Sri Lankan presidency has led to the increased politicization of the administration, the police and the armed forces. In the past year, there has been further attenuation of the independence of the judiciary, and this has economic costs (reluctance to invest) as well as political consequences. In the absence of a change in policy in this area, the international community should be prepared to deal with a country that experiences democratic regression in the near future as President Mahinda Rajapaksa's family seeks to further consolidate its power.

**Environment:** Environmental issues should be linked to sustainable development. The government needs to engage the private sector, NGOs, civil society and other stakeholders in extensive talks

to build a development policy consensus that pays greater attention to environmental concerns. Sixteen of Sri Lanka's coastal lagoons – which make up half of the country's wetlands – are classified as threatened. This is mostly due to development for tourism and recreational purposes, fisheries, fish farming, industrial development, unrestricted disposal of untreated sewage, large-scale sand mining, and housing. Growing population pressure and some cultivation and clearing practices have led to enhanced vulnerability to natural disasters, such as landslides and floods. Existing legal instruments under the National Environmental Act and its amendments need to be fully utilized and strengthened.