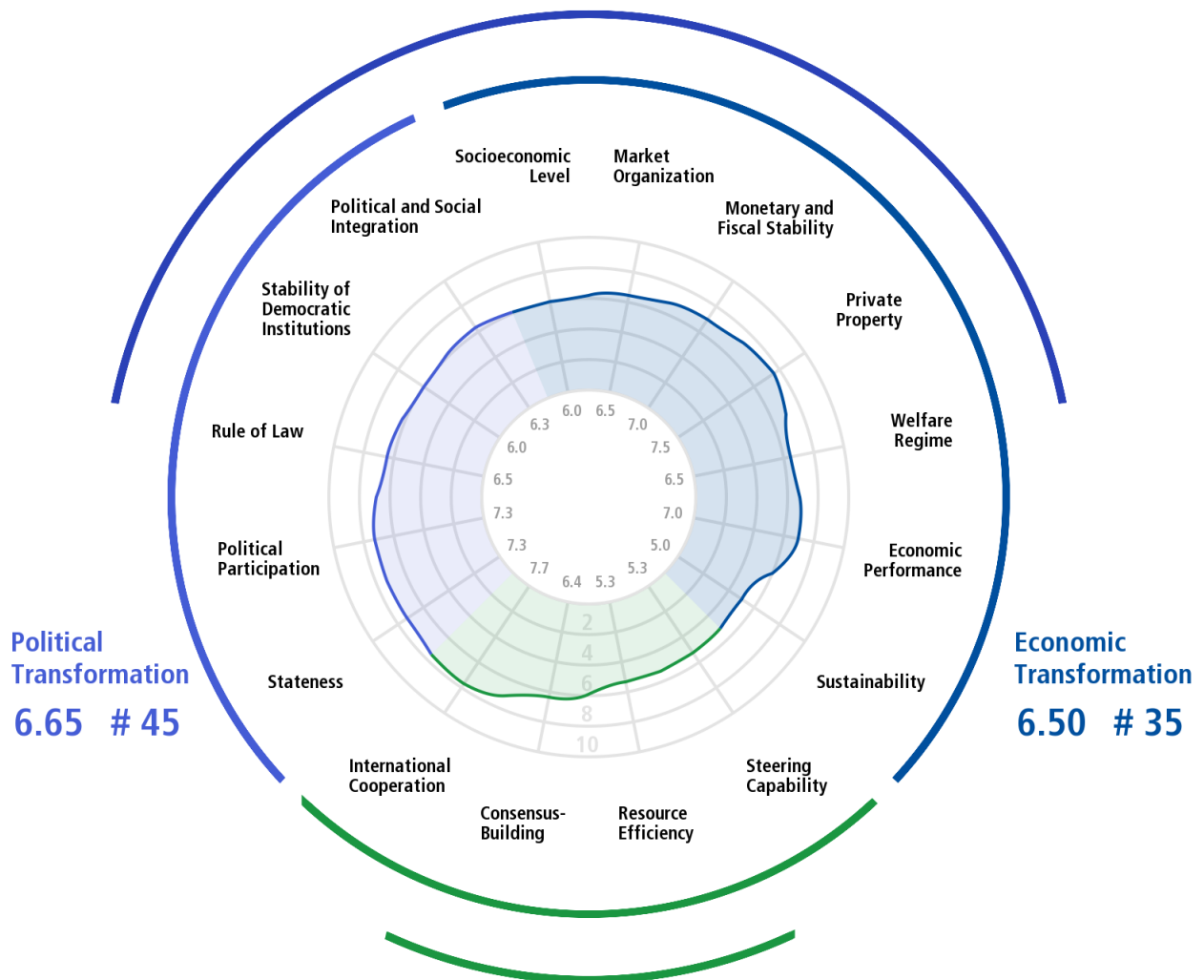


# Sri Lanka

## Status Index

**6.58 # 38**

on 1-10 scale out of 137



**Political Transformation**  
**6.65 # 45**

**Economic Transformation**  
**6.50 # 35**

## Governance Index

**5.45 # 47**

on 1-10 scale out of 137

This report is part of the **Bertelsmann Stiftung's Transformation Index (BTI) 2020**. It covers the period from February 1, 2017 to January 31, 2019. The BTI assesses the transformation toward democracy and a market economy as well as the quality of governance in 137 countries. More on the BTI at <https://www.bti-project.org>.

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**Key Indicators**

Population	M	<b>21.7</b>	HDI	<b>0.780</b>	GDP p.c., PPP \$	<b>13450</b>
Pop. growth <sup>1</sup>	% p.a.	<b>1.0</b>	HDI rank of 189	<b>71</b>	Gini Index	<b>39.8</b>
Life expectancy	years	<b>76.6</b>	UN Education Index	<b>0.756</b>	Poverty <sup>3</sup>	% <b>10.1</b>
Urban population	%	<b>18.5</b>	Gender inequality <sup>2</sup>	<b>0.380</b>	Aid per capita \$	<b>13.9</b>

Sources (as of December 2019): The World Bank, World Development Indicators 2019 | UNDP, Human Development Report 2019. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.20 a day at 2011 international prices.

## Executive Summary

The period under review covers 20 months under a coalition government, a constitutional crisis and a few months when the president and the prime minister, leading different political parties, jockeyed for position. There was little political progress under the coalition government. The Office of Missing Persons was set up to investigate extra-legal disappearances and initiated some investigations. Parliament approved legislation to set up the Office of Reparations, but this is yet to be operationalized.

The recommendations of the Consultation Task Force on Reconciliation Mechanisms (CTFRM), appointed by the prime minister, languished. When local government elections were held in February 2018, both governing parties were trounced by the new Sri Lanka Podujana Pakshaya (SLPP), which owed allegiance to former President Mahinda Rajapaksa. The SLPP gained 42% of the vote and control of 231 out of 340 local government bodies. Continuing differences between Maithripala Sirisena, leader of the Sri Lanka Freedom Party (SLFP) and Prime Minister Ranil Wickremesinghe, leader of the United National Party (UNP) paralyzed the government. On October 26, 2018, the president finally attempted to ameliorate the situation by dismissing the prime minister and replacing him with former President Mahinda Rajapaksa. When Sirisena realized that Wickremesinghe continued to command a majority in parliament, he sought to illegally dissolve parliament. However, the Supreme Court nullified parliament's dissolution and the president had to reappoint Wickremesinghe as prime minister, which he did on December 16, 2018. Differences between the two continue. The prime minister's proposals for constitutional reforms supported by minority parties seem unlikely to receive sufficient support to be enacted. There is thus no immediate prospect for further ethnic reconciliation.

On the economic front, Sri Lanka has seen slower development, with just over 3% growth in 2017 and 2018. Foreign reserves have fluctuated somewhat, but were around \$6 billion in January 2019. Foreign remittances by Sri Lankan workers declined slightly, but tourism continued to grow with the number of visitors increasing to 2.3 million in 2016. By early 2019, inflation had risen to 7%.

The unemployment rate remained at 4.1%. Public debt is 76% of the GDP. The basic literacy level of the workforce remains high. Educational opportunities for women are excellent, although there are considerable gender barriers to female engagement in society and the economy. The female participation rate in the workforce has risen very slowly to just over 35% in 2018. One might note, however, that the informal sector makes up some 60% of the economy and that this sector is often omitted in statistics. Private property is relatively well-protected, although there are barriers to foreign ownership of companies in some sectors as well as constraints on foreign property ownership. The public sector remains overstaffed and relatively inefficient, despite some moves toward public-private partnerships. The budget deficit is gradually being reduced by more efficient tax collection and the extension of the scope and rate of the value-added tax. There are signs of greater investment in education. However, there are regional disparities in economic development, and foreign trade is impeded by para-tariffs.

Continuing economic links with China, Russia and Iran are now complemented by better relations with India and the West.

## 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. This system survived several power transfers in the wake of successive defeats of the ruling party in the 1950s and 1960s. A party system developed with the United National Party (UNP) and the Sri Lanka Freedom Party (SLFP) as the two major parties. During the second half of the twentieth century, the two parties combined won a steady 80% of votes and seats. The left and minority ethnic groups such as the Tamils and Muslims were represented by a multiplicity of small parties, some of which participated in coalition governments.

However, political transformation of Sri Lanka to a democracy has met with several obstacles. Political parties remained elite-dominated with minimal internal democratization. The establishment of a French-style presidential system in 1978 provided opportunities for the strengthening of executive power, which reached its apogee in the period of 2005 to 2014. However, in reaction to this, a constitutional amendment enacted in 2015 has restricted presidential power.

Additionally, ethnic tensions escalated after 1948, 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. Examples of such measures are the exclusion of most Tamil plantation workers in the central part of the country 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 with 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. New anti-terrorist 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. An offer of a quasi-federal system following Indian armed intervention in 1987 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 post-war reconciliation is reaching a consensus on arrangements to reconcile the minority Tamils of the north and east.

Meanwhile, reforms permitted most plantation Tamils to gain citizenship rights in the 1980s, and Tamil political parties representing them currently participate in mainstream politics. Muslim political parties that had emerged in the last 20 years and had advocated a separate Muslim province have begun to ally themselves with one or the other of the main parties. However, sporadic violence against Muslims, in both Tamil majority and Sinhalese majority areas, have made them apprehensive about their future in Sri Lanka, particularly in view of recent developments in Myanmar.

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, although there were some moves toward a more protectionist economy in 2005 to 2015. The current government is open to more trade liberalization and export-oriented growth, but populist opposition to such policies continues.

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

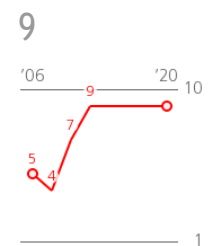
The state's monopoly on the use of physical force is unchallenged. However, there are a few signs that armed opposition to the state has not been entirely abandoned. In June 2018, two persons were arrested in Mullaitivu District while transporting explosives and separatist flags. At the same time, police forces have demonstrated an inability or reluctance to intervene immediately in civil riots in which majority Buddhists are involved, as, for example, in the case of civil violence against Muslims in Digana in March 2018. There was also an incident in Kilinochchi in November 2018, in which two policemen were killed by a former LTTE cadre. In April 2019, after the end of this report's review period, Islamist terrorists conducted a series of attacks on Christian churches, indicating that Sinhalese-Tamil frictions are not the only source of cultural conflict and extremist violence in Sri Lanka.

All groups in Sri Lanka have legal access to political rights. Nonetheless, Sri Lanka is a deeply divided society. For more than 80 years, the country has been marred by ethno-religious and linguistic tensions. Relations between Sinhalese (about 75% of the population, mostly Theravada Buddhists), Sri Lankan Tamils (11%, mostly Shaivite Hindus), Sri Lankan Moors, (about 9%, mainly Sunni Muslims) and Indian Tamils (4%) are severely polarized. Linguistic and religious cleavages largely superimpose and reinforce each other, giving rise to sharp identity politics. Accordingly, most Sinhalese and Tamils alike equate the Sri Lanka "nation" with the Sinhalese community, from which other ethnic groups are de facto excluded.

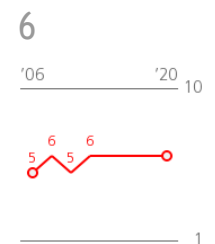
The current political leadership of the Tamil minority in the north and east, as represented by elected representatives in the center, publicly accepts the Sri Lankan state, while campaigning for more devolution of power. While support for a separate state remains among some Tamils, the debate has largely shifted to devolution, reducing the involvement of military forces in minority areas and the restoration of confiscated land to civilians. The policy of reconciliation with minorities supported by the government has not resulted in any significant constitutional or legislative safeguards for minorities. At the same time, civil violence in March 2018 against Muslims has increased feelings of insecurity among many in that group.

Question  
Score

Monopoly on the  
use of force



State identity



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. State funds support Sri Lanka’s four major religions (Buddhism, Hinduism, Islam and Christianity). Nonetheless, aggressive rhetoric by some Buddhist nationalists against Muslim and Christian minorities has continued. The Sinhalese majority tends to equate Buddhism with national identity. Buddhist-Sinhalese extremists argue that Sri Lanka is a Buddhist homeland, which excludes Tamils and other minorities or at least marginalizes other religious groups.

Sri Lanka has an effective administrative structure that provides basic health and educational facilities to all regions. National and provincial agencies provide power, water, housing and other basic facilities, and implement such state policies. By 2015, 96% of people had access to an improved water source and 95% to sanitation. However, due to history and political influence there is an imbalance in the provision state facilities in health and education in various areas. For example, the percentage of untrained teachers serving in 2017 in state schools in the rural district of Badulla was double the national average.

## 2 | Political Participation

Elections are regularly conducted on the basis of universal suffrage through multi-party contests. A survey in February 2016 revealed that a vast majority (about 96%) felt totally or somewhat free to exercise their vote. The response was virtually the same in minority and majority groups.

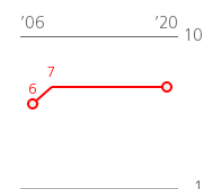
The opposition has limited access to state-owned media. However, non-state-controlled media are often openly critical of the government. The election management agency is professional. Registration and vote counting mechanisms are fair. Polling centers are located in accessible places.

The 2018 local government elections conducted throughout the country saw an opposition party win a majority in 231 out of 340 local government bodies. This has further reinforced confidence in the electoral process. However, provincial council elections, long overdue, continue to be postponed by the government.

Democratically elected officials have been able to implement their policies. There are no extra-constitutional veto powers, but the military and the Buddhist establishment have influential voices. For instance, leaders of the Buddhist clergy have effectively insisted that the constitution should retain a clause decreeing a special place for Buddhism. Administrative officers are subject to political pressure and may be subject to transfers to less desirable locations if they resist such pressures. Legislators wield extensive influence over administrators in their constituencies and receive financial allocations from the national government for minor projects. Credible public accounts of efforts to bribe legislators to change party allegiance in October 2018 reduced faith in the political process.

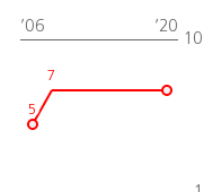
No interference of religious dogmas

7



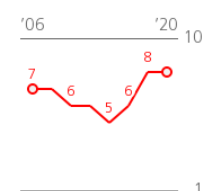
Basic administration

7



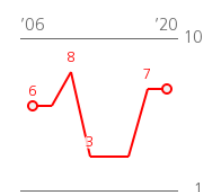
Free and fair elections

8



Effective power to govern

7



Opposition parties and civil society groups critical of the government continued to operate relatively openly. Public protest gatherings are organized by opposition groups in all areas. Nevertheless, under the laws relating to public security, the state can prevent groups from meeting in public, a power that inhibits the exercise of free association in the north where there is a large military presence. In 2017 and 2018, there were several reports that journalists working in “high security” areas close to army encampments in the north were detained and questioned.

A survey in February 2016 revealed that while 90.8% of majority Sinhalese felt free to join any political party they wished, only 72.9% of Tamils and 68.5% of Muslims felt the same. However, there was a decrease in the percentage of Sri Lankans who felt free to protest or attend a demonstration against social injustice. While 56% in 2013 and 69.4% in March 2015 expressed that they were free to do so, this figure dropped to 52.4% in February 2016.

The new government made considerable progress in fostering democracy by allowing media outlets critical of state policies to freely express their views. In a February 2016 survey, 59.6% of Sri Lankans said that they are completely free while 25% indicated that they are somewhat free to express their feelings about politics, irrespective of where they are and in whose company they are. These figures were slightly higher among members of the Sinhalese community and somewhat lower among minorities.

While the state controls some major media outlets, there is scope for expression of a diversity of opinions. For instance, access has been restored to on-line news outlets, including those controlled from overseas, although one e-news outlet critical of the president was banned in November 2017. Many sensitive topics, including the occupation of private land by the military, are reported openly, unlike under the previous regime. However, journalists reporting on such topics have been subject to occasional harassment. The scope for free exchange of opinions seems more restricted in parts of the north, where there is a large presence of security forces. Open criticism of the military remains rare.

### 3 | Rule of Law

The separation of powers was challenged by the actions of President Maithripala Sirisena in late 2018. Having fallen out with his coalition partner, Ranil Wickremesinghe, leader of the UNP, he dismissed Wickremesinghe from the post of prime minister and appointed former President Mahinda Rajapaksa as prime minister on October 26, 2018. This was despite the fact that Wickremesinghe had the support of the majority of members of parliament. The president also prorogued parliament for a few weeks to enable Rajapaksa to gain support from defecting UNP supporters. Wickremesinghe refused to give way and when parliament met, he won a vote of confidence. The president then attempted to dissolve parliament and call for new

Association /  
assembly rights

7

'06 '20 10



1

Freedom of  
expression

7

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1

Separation of  
powers

6

'06 '20 10



1



elections. The Supreme Court unanimously ruled that dissolution was unconstitutional under the 19th Amendment to the constitution, which specified that the president was prohibited from dissolving parliament without its consent for four and a half years after the date of the previous parliamentary election. The fifty-day constitutional crisis ended when Rajapaksa resigned and President Sirisena reappointed Wickremesinghe prime minister. This crisis established the supremacy of the rule of law. However, it also shook the public's confidence in politicians with regard to their willingness to disobey the law relating to the separation of powers.

The unanimous decision by the Supreme Court on December 12, 2018, maintaining that the proclamation issued by the president on November 9 to dissolve parliament and call for a General Election was ultra vires and unconstitutional, revived the reputation of the judiciary. The court's judgment came at a time when Sri Lanka's constitutional and democratic processes were under severe strain. The acceptance of the verdict by all parties led to the resolution of a dangerous political crisis.

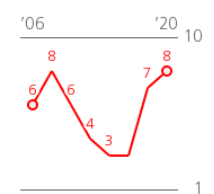
While the judiciary has clearly become less susceptible to executive control, it has continued to have challenges in ensuring accountability of politicians and officials in power and in enforcing regulations that impact on economically powerful interests. The low levels of the judiciary continue to be subject to political pressure and are hampered by a politicized police force upon which the court system often depends for evidence. Judges at these levels could use more training than they have.

A number of public officials in the previous administration have been subject to legal prosecution since early 2015. These prosecutions have slowly made their way through the courts under established laws and procedures. In 2018 and 2019, legal proceedings against naval officers, including the former commander of the navy, began in relation to abductions of children of wealthy business families in 2008, who were killed after money had been extorted from the families. Allegations of corruption of officials and politicians who have been in power since early 2015 are also being addressed. The former governor of the central bank, Arjuna Mahendran, appointed by the current prime minister, was named as a key suspect in a treasury bond scam that allegedly caused a loss of \$11 million from public institutions. Mahendran's son-in-law, who was in jail for a year in 2018 in connection with this investigation, was granted bail in January 2019.

The law specifies protection of civil rights but long delays in the court system limit the effectiveness of the judiciary in addressing grievances. In the north and east, while the situation has improved, Tamils are occasionally subject to abuse by officials, and the denial of to personal privacy and liberty. They have limited recourse in these situations. Prosecutions of police abuses and hate crimes in the last few years have sent a positive message. However, the state has perpetuated religious violence against Christians and Muslims by being tacitly involved in incidents or by failing to act promptly against perpetrators. Allegations of torture continue especially of those in police custody, although reported cases have declined in the last five years. In June

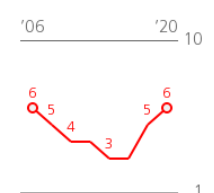
#### Independent judiciary

8



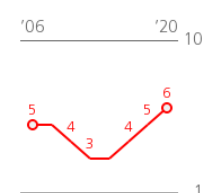
#### Prosecution of office abuse

6



#### Civil rights

6



2017, an Office of Missing Persons was opened following the enactment of a law regarding this matter in 2016. This investigative agency is supposed to help family members trace the fate of the thousands of people who have “disappeared,” but progress has been very slow. Consensual same-sex conduct is still criminalized under the penal code. While the minimum age for marriage is 18 years, there is an exception for Muslim women who can get married at the age of 12 with the consent of a Muslim qazi (judicial officer). The state set up a new procedure according to which transgender people can change the gender on their documents if they have a report from a mental health professional, but there is scant evidence that this procedure is in use.

#### 4 | Stability of Democratic Institutions

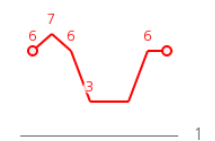
The institutional structure remains insufficiently decentralized. Plans to revise the constitution to provide more devolution of power have been adversely affected by political infighting. Bitter political conflicts between the legislature, where the UNP-led coalition has majority support, and the president, who leads the rival SLFP, have been counterproductive. Proposals to amend the constitution to devolve more power to the provincial councils have met with resistance. The administration remains subject to political pressure with recruitment (except in the case of professionals, such as doctors and engineers) subject to recommendations by politicians.

All major political parties, interest groups and civic organizations profess a commitment to democracy. The actions of the president in late 2018, dismissing a prime minister who had a majority in the legislature and dissolving parliament in contravention to the constitution, indicated a readiness to undermine democratic institutions for personal gain. Populist agitation by people on both sides of the dispute that resulted in demonstrations and violence indicated a readiness to operate outside traditional democratic institutions. The refusal of the armed forces to take sides in the dispute allowed for resolution of the constitutional crisis through the judiciary. Acceptance of this resolution through democratic institutions by all concerned strengthened the legitimacy of democratic institutions. A survey in March/April 2016 indicated that 80% of the population trusted the judiciary and the administration, but that trust in political parties had fallen to 37% and confidence in the legislature to 48%.

Performance of democratic institutions

6

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Commitment to democratic institutions

6

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## 5 | Political and Social Integration

Overall, party organization is undemocratic and is dependent on personalities and patronage. There was substantial realignment in the party system during the period under review. The ruling right-wing United National Party (UNP) contains a group within it that seeks to gradually usher in a new leader in place of Prime Minister Ranil Wickremesinghe. The UNP won only 29.4% of the total vote in nationwide local government elections in February 2018. The Sri Lanka Freedom Party (SLFP), based on rural Sinhalese Buddhist support and led by the president, fared even worse when a coalition led by it won only 12.1% of the vote. The apparent winner in the shake-up was the newly organized Sri Lanka Podujana Peramuna (SLPP), formed to support former President Mahinda Rajapaksa. This group won 40.4% of the vote and seems to have appealed to the same base as the SLFP. Clearly, voter volatility is high.

Nineteen political parties are represented in the legislature. Over 40 other groups are registered as political parties. However, political party fragmentation is more limited than these statistics suggest, because electoral coalitions form under the leadership of one or another of the major parties.

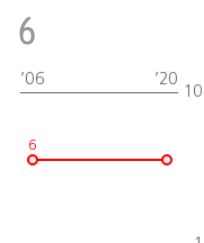
There are major differences on the devolution of political power between the major parties and the parties representing the Tamil minority in the north and east.

Sri Lanka's Buddhist groups continue to be the most vocal and influential in the country. However, although extremist Sinhalese Buddhist views are occasionally articulated at the local level, there is an active conversation on ethnic reconciliation. Trade union membership is low (less than 10% of all workers), but in urban areas and in the plantations, labor unions are powerful. Numerous NGOs are actively engaged in assisting poor segments of society.

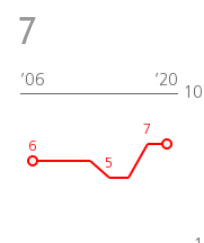
An amendment to local electoral law to reserve 25% of all seats for women was first applied in local elections on February 10, 2018. This raised the representation of women in local government from a low 2%. Its full implications on the influence of women in politics are not yet clear.

A survey in March/April 2016, compared to previous parallel surveys, indicated a decline in trust in government institutions, with 48% of respondents indicating some or a great deal of trust in parliament and 36.5% indicating no trust. Only 37% indicated that they trusted political parties while 48% stated they had no trust in them. The level of satisfaction in central government institutions was higher among ethnic minorities than in the majority community, although this may no longer be true for the Muslim community after enduring mob violence in 2018. Trust in the armed forces, although higher than in 2015, was still low among minority Tamils (around 50%) in contrast to the high confidence in the army by the majority Sinhalese (89%).

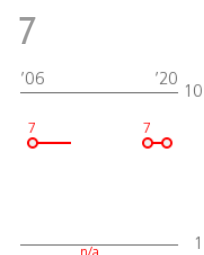
### Party system



### Interest groups



### Approval of democracy

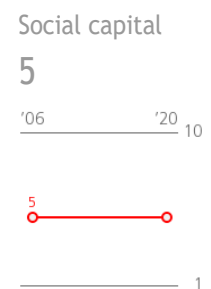


Trust in the police in February 2016 had fallen to 63.5% (partly due to a decline in support among Muslims and Sinhalese) in contrast to 73.5% in 2013.

In contrast, the courts and the administrative service enjoyed high levels of trust (around 80%).

A 2016 survey indicated a much higher level in trust of non-governmental organizations (NGOs) among minority Tamils (over 73%) and Muslims (65%) than among majority Sinhalese (35.3%). However, these statistics might reflect the pre-2015 government's campaign against externally funded NGOs.

There are active local and national self-help organizations among all groups based on religious affiliations. Local non-denominational organizations are sometimes active on the village level. Levels of trust seem to be based more on cultural and professional affinities than on a common bond of citizenship.



## II. Economic Transformation

### 6 | Level of Socioeconomic Development

In 2017, Sri Lanka clearly led the South Asian region in the HDI (0.770), which figure had risen slightly from 0.759 in 2013. In 2016, the World Bank estimated the proportion of people living on less than \$3.10 a day (PPP) in Sri Lanka was 9.5% (the best result in South Asia). However, the pace of poverty reduction has slowed in recently and regional disparities remain. A recent study recorded that in 2017 the poverty rate for the Tamil-majority Northern Province was 7.7% in contrast to the national rate of 4.1%. The poverty rate also remains high in some rural districts (e.g., Moneragala) in the south. Similarly, poverty in the plantation areas largely inhabited by the Tamil minority remains above the national norm, although there has been some progress in reducing it. There are also large numbers of poor in urban areas.

Sri Lanka's youth literacy rate (ages 15–24) of 98% leads the region. School attendance is high in all areas, with no gender inequalities, although the quality of instruction varies greatly across urban and rural areas. Religion has no discernible impact on education except that the literacy rate for Muslim women is slightly lower than average. The percentage of the population with access to clean water was 96% in 2016 and the percentage with access to sanitation was 95%.

However, interpersonal income inequalities remain high: the Gini Index stood at 39.8 in 2016 up from 39.2 in 2012. Investments in infrastructure (major roads and ports) in recent years have yet to pay commensurate dividends. 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, although the country's standing in the Gender Inequality Index improved to 0.354 in 2017 from 0.376 in 2015. The percentage of females participating in the labor market was 35.9% in 2015, slightly from 33.4% in 2014. However, the labor market participation rate for women with university degrees was over 80%.

Economic indicators		2015	2016	2017	2018
GDP	\$ M	80604.1	82401.0	88019.7	<b>88900.8</b>
GDP growth	%	5.0	4.5	3.4	<b>3.2</b>
Inflation (CPI)	%	3.8	4.0	7.7	<b>2.1</b>
Unemployment	%	4.7	4.4	4.2	<b>4.4</b>
Foreign direct investment	% of GDP	0.8	1.1	1.6	<b>1.8</b>
Export growth	%	4.7	-0.7	7.6	<b>0.5</b>
Import growth	%	10.6	7.9	7.1	<b>1.8</b>
Current account balance	\$ M	-1882.8	-1742.4	-2309.0	<b>-2813.7</b>
Public debt	% of GDP	78.5	79.0	77.4	<b>83.3</b>
External debt	\$ M	43925.1	46646.3	50760.2	<b>52626.0</b>
Total debt service	\$ M	3551.0	3323.7	4210.3	<b>7394.3</b>
Net lending/borrowing	% of GDP	-7.6	-5.3	-5.4	-
Tax revenue	% of GDP	12.4	12.2	12.4	-
Government consumption	% of GDP	9.0	8.5	8.4	<b>9.0</b>
Public education spending	% of GDP	2.2	3.5	2.8	-
Public health spending	% of GDP	1.7	1.7	-	-
R&D expenditure	% of GDP	0.1	-	-	-
Military expenditure	% of GDP	2.6	2.1	2.1	<b>1.9</b>

Sources (as of December 2019): The World Bank, World Development Indicators | International Monetary Fund (IMF), World Economic Outlook | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database.

## 7 | Organization of the Market and Competition

The state allows 100% foreign investment in any commercial, trading or industrial activity other than a few regulated sectors such as air transportation, coastal shipping and military hardware, which are all subject to approval by relevant government agencies. Foreign ownership in excess of 40% must be approved on a case-by-case basis in certain areas such as the production for export of goods subject to international quotas, growing and primary processing of tea, rubber and coconut, timber-based industries using local timber, mass communications and deep-sea fishing. Foreign investment is not permitted in non-bank money lending, pawn-brokering, retail trade with capital investments of less than \$1 million and coastal fishing. Obstacles to starting a new business declined in the period under review. Starting a business required only seven procedures and could be completed in nine days in 2019 as compared to nine procedures taking 11 days in 2014. The cost of starting a business as a percentage of gross national income (GNI) per capita fell to 9.4% in 2019 from 20.7% in 2014.

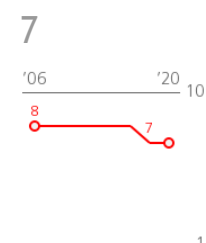
There are no plans to take over privately owned enterprises. Administered pricing keeps the cost of energy low and extends to several basic foodstuffs. The currency is linked to the U.S. dollar but is allowed to float within limits. It has been estimated that the informal sector represents almost 60% of the Sri Lankan economy. Informal businesses are managed mostly by single individuals, and only one-fourth of such businesses (excluding state-run enterprises) were located in urban areas. Local entry barriers to informal enterprises are minimal.

Two hundred state-owned businesses (e.g., energy, ports) have monopolistic control over many areas of the economy. Employment in central government, provincial government, statutory bodies and state enterprises fell from 15.1% of the total workforce in 2015 to 14.4% of the total employed population in 2017. The state controls some wages and prices, including the price of petroleum, water, power, and bus and rail fares.

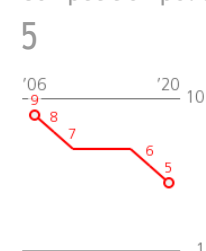
The legal framework for Competition Policy in Sri Lanka is not well developed. Consumer Affairs Authority Act No. 9 came into force in April 2003, with the objectives of providing better protection for consumers through the regulation of trade and the prices of goods and services, protecting traders and manufacturers against unfair and restrictive trade practices, promoting competitive pricing wherever possible and ensuring healthy competition among traders and manufacturers of goods and services. The abuse of dominance is prohibited; however, there is no classification of behaviors that constitute such an abuse. Moreover, there are no merger regulations in Sri Lanka.

Although the Consumer Affairs Authority may investigate the effect of anti-competitive practices on consumers, Sri Lanka's law does not empower it to

### Market organization



### Competition policy



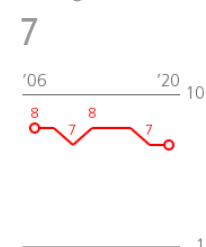
investigate the existence of monopolies or to examine mergers or acquisitions that have already taken place. Pre-merger notifications are not mandatory. Therefore, investigations of mergers may only be undertaken for utilities that fall under the purview of the Public Utilities Commission or for companies listed on the Colombo Stock Exchange, which may be reviewed by the Securities and Exchange Commission of Sri Lanka.

Sri Lanka, a member of WTO since 1995, has a relatively low official tariff system and its most favored nation applied simple average tariff in 2017 was 9.3%. However, imports into Sri Lanka are also subject to a number of other charges: excise duty, Export Development Board Levy between 1% and 35%, value-added tax of 15% (VAT), Social Responsibility Levy (1%), the Ports and Airports Development Levy of 5% (PAL), 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. These para-tariffs make Sri Lanka a protectionist country.

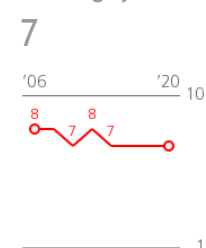
Incentives for export include a temporary importation for export processing scheme (TIEP), and a manufacture-in-bond scheme. Enterprises located in export processing zone benefit from tax holidays, duty-free imports and concessionary land prices. Exporters of non-traditional goods exporting at least 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, raw hides, metal scrap, natural rubber, coconut products and tea. The 2017 merchandise trade-to-GDP ratio was 25.2 (down from 41.8 in 2013).

Sri Lanka's banking sector remained stable though the banks' capital-to-assets ratio rose to 8.4 in 2017 from 8.2 in 2014. The central bank has a format for the publication of audited accounts and for the quarterly and annual publication of financial statements. The total risk-weighted ratio required is 10% and the core capital ratio is 5%. The banking system has public confidence and has been profitable. However, Sri Lanka's definition of capital adequacy only takes credit risk into account and there is no explicit charge for market risk. Furthermore, the former government used state-owned and private banks for local borrowing and financing of state enterprises (with banks often persuaded to conform to the government's interests rather than their own). The non-performing asset ratio declined from 4.2% in 2014 to 2.5% in 2017. Regulations permit 100% foreign control of banks, insurance companies and stock brokerages. Currently there are 26 commercial banks in operation in the country. Two of the local commercial banks are state-owned, holding around 30% of banking sector assets. Many Sri Lankan banks are small.

#### Liberalization of foreign trade



#### Banking system





By January 2018, the Colombo Stock Exchange listed 297 companies with a capitalization of \$15.8 billion. The All Share Price Index has not shown much change in the past two years and was \$6,062 on January 1, 2019.

## 8 | Monetary and fiscal stability

Successful policies implemented by the state limited inflation, as measured by the Colombo Consumer Price Index, to 7.7% in 2017, slightly higher than in previous years. Despite interventions by the central bank, the value of the rupee against the U.S. dollar declined steadily, slipping from 150 rupees per U.S. dollar in January 2017 to 180 rupees per U.S. dollar in March 2019. This was due mostly to global economic forces, which promoted an outflow of foreign investment and the consequences of internal political turmoil. Foreign direct investment remains below 2% of the GDP. Although the central bank does not operate independently of the government, its policies have not been overtly political.

Public debt as a percentage of the GDP grew slightly to 79.6% in 2017 from 77.6% in 2015. There was continued progress toward more efficiency in revenue collection. Although some items were exempted from VAT, the increase of the tax from 11% to 15% together with greater efficiencies in collecting revenue is predicted to reduce the annual government budget deficit from 7.4% of the GDP in 2015 and 5.5% in 2017 to 4.8% in 2019. Government consumption in 2017 was only 8.5% of the country's GDP.

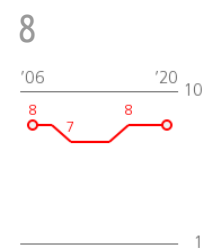
The state also continued to examine losses in state-owned enterprises, many of which are inefficiently run or (like the Ceylon Electricity Board and the Ceylon Petroleum Corporation) are burdened with prices set by the state at below cost levels.

Challenges to fiscal stability remain substantial. The current account balance was \$-2.3 billion in 2017, up from \$-1.9 billion in 2015. External debt continued to increase. External total reserves, which had risen to \$7.9 billion in October 2018, fell by \$1 billion during the constitutional crisis (October to December 2018).

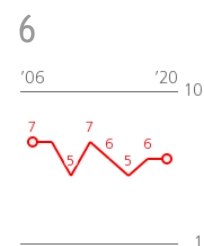
## 9 | Private Property

Property rights regarding acquisition, benefits, use and sale are well defined in the industrial and service sectors. Private land ownership is limited to 50 acres per person. Ownership and sale of land are safeguarded, although land registration procedures remain cumbersome and subject to inordinate delays (nine procedures and 51 days). The civil courts have played a role in safeguarding property rights. According to a 2019 report by Human Rights Watch, tens of thousands of acres of land occupied or confiscated by the central government are still held by the security forces. The government claims that in the past 10 years, since the end of the civil war, about 80% of the confiscated land had been returned to its former owners, mostly Tamil peasants

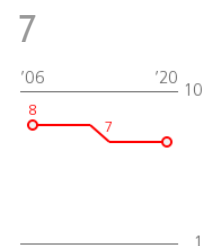
### Monetary stability



### Fiscal stability



### Property rights





and villagers. However, the Human Right Watch report states that, according to the Adayaalam Center for Policy Research, a Jaffna-based advocacy group, about 30,000 acres of land in the northern Mullaitivu District, an area that experienced heavy fighting, has still not been returned.

There is no restriction on the repatriation of profits or dividends of foreign companies although certain sectors of the economy are barred to foreign investors. Remittance of management fees, royalties and licensing fees are also permitted for companies with majority foreign investment approved under Section 17 of the Board of Investment (BOI) Act. Stock market investments can be remitted without prior approval from the 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.

The Arbitration Act No. 11 passed in 1995 implemented the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards meaning that arbitral awards made abroad are enforceable in Sri Lanka (and vice versa) if the counterpart is based in a signatory state.

Starting a business required only seven procedures and could be completed in nine days in 2017 as compared to nine procedures taking 11 days in 2014. This is the fastest in the region. Factors inhibiting the establishment of new enterprises include unofficial charges by public officials, low-level hostility from the bureaucracy and cumbersome procedures for business registration.

The private sector plays an important role in the economy, especially in finance, internet technology, the production of clothing and tea, and tourism. The government allows 100% foreign investment in any commercial, trading, or industrial activity other than in a few regulated sectors. Sri Lanka has one of the largest state-enterprise sectors in South Asia. In a 2016 report, the Advocata Institute criticized the lack of transparency in the finances and operations of public sector firms, which, according to the same report, suffered a cumulative loss of about \$9.3 billion from 2006 to 2015. During the same period, however, the sheer number of SOEs increased from 107 in 2009 to 245 in 2015 (latest available data), and the number of SOE employees almost doubled from 140,000 to 261,000.

Private enterprise

8



## 10 | Welfare Regime

Sri Lanka's HDI remains higher than that of many countries with higher per capita GDP because of its long-standing and comprehensive welfare programs. The state has promoted a number of poverty alleviation programs. These include the Samurdhi program subsidy, a nutrition allowance program, and social security and pension programs. The new regime has increased the poverty allowance paid to poor senior citizens and added a new nutrition allowance at childbirth. However, some of these allowances are experiencing erosion from inflation.

Life expectancy at birth has risen marginally from 74.9 years in 2014 to 75.3 in 2016. State expenditure on health as a percentage of the GDP remains low at 2.0% in 2016. However, the infant mortality rate dropped to 6.8 per thousand births in 2017 (from 7.4 in 2015).

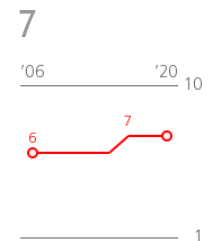
Basic provision of education is comprehensive, with state or state-assisted schools providing education free from grade one to grade 12, but there is a shortage of teachers in foreign languages and in technical subjects. Tertiary education is not well funded, although state funding for education rose substantially in 2016. The rural population and the majority of those in urban areas currently have no insurance coverage for natural disasters.

There is an effort to ensure an equitable distribution of state benefits to all groups, including the Tamils in the north and east but statistical evidence of progress is scarce.

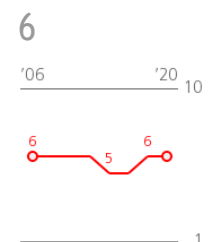
Access to public services is open to all by law. There are, however, inequalities in practice. The main issue of (in)equal opportunities is horizontal inequality between members of different religious and linguistic ("ethnic") groups. While non-Sinhalese enjoyed preferable access to economic, educational and political opportunities during the colonial period, reflected in marked socioeconomic inequalities between Tamils and Sinhalese, the post-independence governments employed policies aimed to benefit the Sinhalese. This resulted in a reversal of the horizontal inequality patterns of the colonial period during the post-colonial period. Almost three decades of civil war further widened the gap between Tamil Hindus and Buddhist Sinhalese. Often forgotten is the widespread discrimination against and lack of equal opportunities for Sri Lanka's Muslims. While reliable data is hard to find, several studies seem to suggest that Moors are among the most disenfranchised and marginalized groups in Sri Lankan society.

With respect to gender relations, World Bank data for 2017 indicates that there is no gender gap in educational enrollment at the levels of primary and secondary education. There are more females than males enrolled in tertiary education and a Gender Parity Index at 1.0 in primary education. UNESCO estimates of the female literacy rate in 2017 was 91% in comparison to the male literacy rate of 93%.

Social safety nets



Equal opportunity



However, the labor force participation rate for Sri Lankan women age 15 years and older was 36% in both 2015 and 2016, in contrast to 75% for men of the same age in both years. Men dominate the lucrative levels of employment in both the public and private sectors. While females with qualifications and experience comparable to men earn similar wages in the upper strata of the public sector, the average wages and incomes of all female workers is substantially less than that of males.

There are regional and urban-rural disparities in the quality of education despite continuing efforts to develop magnet schools.

Enrollment in tertiary education is far below that of neighboring India. 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 somewhat limited in areas of former conflict in the north and east. This has affected the Tamil minority as well as Muslims and some Sinhalese in the north and east. Access to jobs in the state system (except for professionals such as engineers) continues to depend on political connections. Non-citizens are not eligible for public employment. Refugees and asylum-seekers need to receive specific permission to work in Sri Lanka.

## 11 | Economic Performance

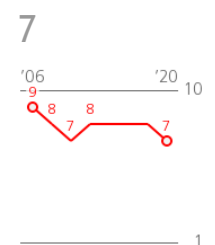
Sri Lanka is a middle-income country whose PPP GDP per capita rose from a 2009 level of \$4,778 to \$9,738 in 2013 before reaching \$12,811 in 2017. However, the World Bank estimates indicate that GDP per capita growth slowed to 3.3% in 2016 and 2.1% in 2017. Growth in these years was fueled by improved production of rice due to better weather but construction activity declined.

Exports (including apparel and light manufactures) grew. Imports rose even faster contributing to an increasing negative current accounts balance. Exports currently pay for less than 60% of imports. The trade gap was covered by remittances from Sri Lankans working abroad (which declined by 1.5% in 2018) and earnings from the tourist industry (which grew by over 10% and attracted 2.3 million visitors in 2018). However, these earnings are dependent on external factors and in view of the need to service the high external debt, the merchandise trade deficit needs to be narrowed. International ratings agencies, such as Fitch and Moody's, downgraded Sri Lanka in 2018.

Inflation, as measured by the Consumer Price Index rose to 7.7% in 2017. The current external debt is around \$53 billion.

Gross capital formation as a percentage of the GDP was 36.5% in 2017 up from 32.3% in 2014. However, the rate of net foreign direct investment was 1.6% in 2017 and is expected to drop from that level in 2018 due to a flight of foreign private investment.

Output strength



Tax revenue as a percentage of the GDP has increased in recent years (14.4% in 2018) due to the increase in the value-added tax (VAT) and better revenue collection. The annual budget deficit is projected to fall to 4.8% in 2019, although this is still below the targeted rate of 3.5% agreed upon with the IMF.

Unemployment was at 4.1% in 2017 (4.7% in 2015).

## 12 | Sustainability

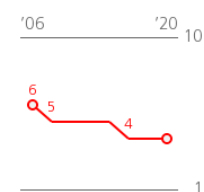
In the Long-Term Climate Risk Index released in 2019, Sri Lanka was ranked second among countries most affected by extreme weather events in 2017. Heavy landslides and floods displaced over half a million people.

The encroachment on natural reserves and continued deforestation have resulted in soil erosion and other adverse effects on biodiversity. The provision of free water for agriculture has contributed to high usage. Air and water pollution have worsened in urban areas and development pressures have also led to the reclamation of estuary, lagoon and marsh waters as well as the unrestricted disposal of untreated sewage, leading to major pollution problems. Recycling of garbage in urban areas is inadequate. Over 30 people died in April 2017 when a garbage heap collapsed on houses near Colombo. Industries create environmental contaminants that pollute freshwater bodies. Environmental concerns have tended to take a back seat to growth considerations.

On paper, Sri Lanka has national policies on the environment (2003), wetlands (2005) and biosafety (2005), but they often remain unenforced due to political pressure or personal influence. However, there has been some progress. The production of certain types of polythene and polystyrene products was prohibited in 2017. A number of manufacturing facilities producing such products without authorization were closed in 2018 and 2019. Presidential Environmental Awards designed to promote awareness of the importance of protecting the environment by recognizing enterprises that contribute to environmental protection were inaugurated in 2016 and have been awarded annually since. Three pilot projects undertaken by the state Central Environmental Authority in 2017 to improve solid waste management were completed by January 2019. Radio and TV programs have been used by the state to promote environmental awareness and encourage the planting of trees.

Environmental  
policy

4



The existing system of education is comprehensive, with gross enrollment at 100.6% at the primary level and 101.9% at the secondary level (2016). Female enrollment at all levels is higher than male enrollment. The adult literacy rate (16 and over) is 93% (2012). Education in state institutions (including universities) is offered free of tuition. Total state education expenses rose to 3.5% of the GDP in 2016. Virtually all education is run by the state. In 2017, four million students were enrolled in state primary and secondary schools. A continuing problem in primary and secondary education is the shortage of trained and experienced teachers. The number of graduates of universities and colleges of education is inadequate to fill all the teacher vacancies and a proportion of teachers leave the profession every year due to inadequate pay. There are wide disparities in facilities between urban and rural areas. Most schools do not have access to the internet.

Tertiary education with a gross enrollment of just over 20% continues to lag in quality due to inadequate funding. A few private tertiary institutions provide post-secondary diplomas and link programs with foreign universities in some fields. The government has supported the expansion of private sector tertiary education linked to foreign institutions while also continuing to enlarge the state structure. This policy has met with some populist opposition, which led to the closing of a private medical college. R&D expenditures are particularly low (0.1% of the GDP in 2013) and financed mostly by the state because (the mostly small) private companies in Sri Lanka rely on advances made in other parts of the world.

Education policy /  
R&D

6

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1

## Governance

### I. Level of Difficulty

Sri Lanka has a good geographical location and a literate labor force. The basic (though inadequate) system of transport has been improved in recent years by considerable investment in ports, airports, roads and railways. Improved water supply has greatly reduced the incidence of pandemics. Welfare policies have reduced extreme poverty, though there is still much to be done, particularly in the north and east, in rural and plantation areas and in growing urban centers.

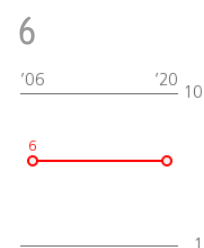
At the same time, Sri Lanka currently has an aging population with the percentage of people over 60 years of age projected to rise to 16% in 2020 and 29% by 2050. Sri Lanka does not have exploitable oil or coal resources. Recent historical experiences of communal tensions, civil war and continuing political animosities pose considerable structural constraints on the political process of democratic transformation. Sri Lanka is also highly vulnerable to the adverse consequences of global warming.

Sri Lanka enjoys a long civil society tradition, reaching back to colonial and, arguably, even pre-colonial times. Civil associations have taken an active role as guardians of civil and minority rights. At the same time, however, decades of armed conflict have prevented the emergence of strong, civil society associations that cut across ethnic cleavages and provide bridging (instead of bounding) social capital.

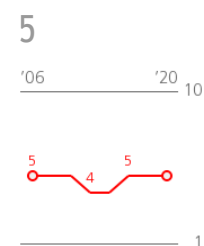
The freedom of the media has expanded in recent years and increased penetration of electronic devices (mobile cellular subscriptions for 2017 were estimated at 135 per 100 people) has led to the growth of social media.

Nevertheless, the patronage system remains strong, and trust in state institutions (such as parliament and the police) is limited. There are numerous local religious organizations that work in the fields of public welfare and advocacy, but trade unions have been in decline.

Structural  
constraints

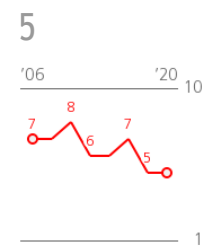


Civil society  
traditions



Tensions and fears among ethnic and religious minorities continue to exist. Riots by Buddhists against Muslims in Digana in February to March 2018 symbolized existing tensions. Local violations of religious freedoms against Muslims and Christians continue to be reported. Unlike in the recent past, however, the state condemned such actions and occasionally intervened to resolve the conflicts of religious minorities with the majority Buddhists. The number of violent incidents in the Tamil-minority north has declined sharply since the beginning of the decade. When these occurred, the media reported them, compelling attention from state agencies and politicians. At the same time, political leaders continue to mobilize cleavages along ethnic and religious lines.

Conflict intensity



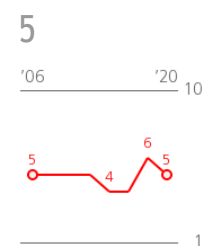
## II. Governance Performance

### 14 | Steering Capability

The government's efforts to set and maintain strategic priorities have been severely restricted by internal political conflicts. Up until October 2018, the coalition government was divided on the question of developing a more democratic and decentralized power structure and made little progress toward agreement on long-term policy. With the constitutional crisis of late 2018, resulting from efforts of the president to replace the prime minister, planning virtually ceased for over two months. With the collapse of the president's effort, the UNP government and the minority parties supporting it agreed on some long-term constitutional changes, but found themselves unable to muster the two-thirds majority to institute them. Their subsequent political efforts seemed to center on positioning themselves for the upcoming provincial elections.

Question  
Score

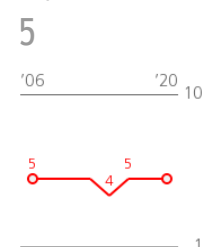
Prioritization



On the economic front, under the coalition government that lasted until October 2018, there was greater attention to the long-term consequences of state expenditure and foreign borrowing. However, privatization has progressed little. International economic developments and domestic politics have often forced the state to be reactive rather than initiate long-range economic policies.

The major obstacles to implementation of policies are political factors and not institutional capacity.

Implementation



For example, in the period up to October 2018, ministers belonging to the two major parties (UNP and SLFP) tended to place different emphases on policies with a view to political advantage. The large size of the cabinet (45 ministers with some ministries under the prime minister and a few under the president) had also dissipated responsibility for policy implementation. Moreover, while the central government has strong representation from the UNP, that party is in a minority in the provincial councils.

The fifty-day constitutional crisis in October – December 2018, when the president tried to have Mahinda Rajapaksa replace Ranil Wickremesinghe (who had majority support in parliament) as prime minister presented a challenge to administrative officials because both Wickremesinghe and Rajapaksa claimed to be legitimate prime ministers. The resolution of the crisis with the reappointment of Wickremesinghe in December 2018 can be seen as a victory for the separation of powers. Nevertheless, differences in political priorities between the president and the prime minister hampered policy implementation even after December 2018.

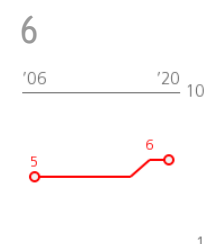
However, there have been a number of policy implementation achievements during this period. Inflation, which began to rise sharply in 2018, was brought under control. Government agencies dealt with torrential rains and flooding that displaced over 400,000 persons in 2017. Local government elections, in which opposition parties won, were held with minimal violence in 2018. The European Union formally restored GSP+ trade concessions to Sri Lanka after successful representations by the government.

The government's demonstrated ability in policy learning has shown improvement. For instance, consensus has developed among party leaders on the need to restore privately owned land occupied by armed forces during the civil war. Action has been taken to restore some of these properties to the former owners. There is also increased recognition of the need to provide political accommodation for the Tamil minority. However, opposition to devolution of centralized power by the SLFP within the coalition slowed progress. With the end of the coalition in late 2018, specific devolution proposals have been advanced. But now the government does not have the two-thirds majority in parliament to enact constitutional changes. Recognition of the need to limit budget deficits led to an increase in the value-added tax to collect more revenue. Simultaneously, adoption of good practices and of expert advice have been limited by political tensions between political parties, as well as realities on the ground. Thus, efforts to make state-owned enterprises pay their way have met with limited success.

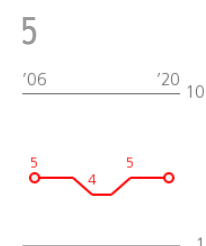
## 15 | Resource Efficiency

The public sector continues to be 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 transfer to undesirable locations. Salary raises for public servants stemming from political considerations and perks showered on politicians (i.e., being allowed to import vehicles free of customs duty) despite the rising debt suggest continuing problems. On the other hand, under pressure from international lending agencies such as the IMF, the government has commenced the process of reviewing state owned corporations from the viewpoint of economic returns. Also, agencies such as the Sri Lanka Institute of Development Administration provide training opportunities for administrators.

### Policy learning



### Efficient use of assets





Auditing of state agencies is routine but there are continuing instances of state resources falling into private hands. The budget deficit has fallen from 7.4% of GDP in 2015 to a projected 4.8% in 2019. However, external debt has grown in the last few years to over \$50 billion. Total debt service as a percentage of the country's ability to obtain foreign exchange through exports of goods, services, primary income and workers' remittances has risen to 21%.

Elected local and provincial assemblies have legally defined spheres of activity but do not have adequate financial resources. The press plays an important role in monitoring the use of resources. Despite the prevalence of corruption, the administrative structure does provide a mechanism to deliver services across the country. A survey in 2016 revealed that 80% of Sri Lankans have some or a great deal of trust in the public administration.

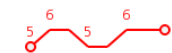
The allocation of functions to different ministries at the center is as much a product of political bargaining as an arrangement according to functionality. This impedes coordination and policy implementation. Many central ministries have branches at the provincial level with coordination provided by civil servants. However, policy coordination among the many central ministries and between them and provincial and local authorities has been challenging.

The government that took over in January 2015 pledged to end corruption. Legal prosecution of those responsible for profiting from the sale of bonds (including supporters of the current government) is a positive sign. Increased freedom of the press has also led to some moderation in the scale of corruption, at least at high levels. Unfortunately, while there has been much publicity on the extensive corrupt practices of members of the previous government and instances of missing funds, prosecution has proceeded slowly. There is widespread belief that corruption continues to be embedded in the administration. Public procurement systems are open to bribery and there is virtually no accountability of officeholders in the form of asset declarations or conflict of interest rules. State spending is audited, but party financing is not regulated. Media questioning of allocations of funds and state contracts has become a valuable corrective. The Right to Information Act of 2016 could become a valuable tool to counter corruption. A survey in October 2016 revealed that 34.5% of Sri Lankans thought the government was committed to eradicating corruption, while 40.8% did not think the government was committed to this.

Policy coordination

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Anti-corruption policy

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## 16 | Consensus-Building

The leading Tamil minority party, the Tamil National Alliance, is committed to negotiating political changes through a democratic framework. This is also true of the smaller parties that represent ethnic Tamil groups both in the north and in the central plantation areas. The leaders of Muslim political groups have also continued to be committed to a democratic structure. The ruling United National Party showed its adherence to democratic processes during the constitutional crisis of late 2018. While it organized some demonstrations and rallies, it relied on the judiciary and formal votes in the legislature to resolve issues relating to political power. At the same time, the UNP leadership appeared to be comfortable postponing provincial council elections. Unfortunately, the president and leading members of the SLFP showed an inclination to subvert constitutional provisions to gain political advantage.

The two major parties (SLFP and UNP) agree on the long-term strategic goals of poverty alleviation through state welfare and subsidies within a market-based economy. The UNP is more vocal in its support of the market economy. The SLFP is more favorable to retaining state-owned enterprises and para-tariffs that protect local manufacturers. The Marxist Janatha Vimukthi Peramuna party advocates state intervention in the economy. In terms of economic policy, minority Tamil and Muslim ethnic parties are primarily concerned with protecting the interests of their respective groups.

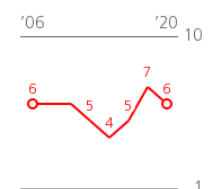
There is no armed resistance to the elected government either at the local or national level. The military has not interfered in economic and political policy-making and carefully refrained from taking sides during the constitutional crisis in late 2018. Trade unions are weak in all but a handful of sectors (e.g., power, transport, tea production).

In the Tamil north, strict security measures enforced by the police and armed forces could be seen as alienating some actors from the democratic process. Constitutional revisions with greater safeguards for human rights, which would have strengthened loyalty to the democratic political process, have been delayed.

The constitutional dispute between the president and parliament in late 2018 and early 2019 resulted from the president's attempt to appoint a prime minister who did not enjoy the support of a majority in parliament, and which would have resulted in a very serious violation of constitutional rules and practices. This seems to suggest that semi- or disloyal behavior and attitudes toward the democratic system have not changed, despite the surprising change in government in 2015 that had been greeted by many observers as a possible watershed for redemocratization and democratic deepening in Sri Lanka.

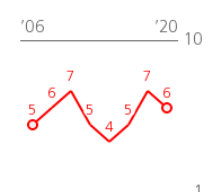
Consensus on goals

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Anti-democratic actors

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The prime minister has taken the lead in formulating constitutional amendments that would decentralize power – a key demand of the ethnic minority groups. The proposals unveiled in early 2019 include a proposal for a second chamber, with representation from the provinces, a revised system of allocation of seats to parliament, which would give more representation to the Tamil north, and enhancing the powers of provincial councils. These changes have the support of minority groups, but have been opposed by Sinhalese nationalist groups led by the SLFP.

The current government is unlikely to achieve the two-thirds support in parliament necessary to have these constitutional changes approved.

The Up-Country Tamils in the central part of Sri Lanka also see themselves as an economically oppressed group. Muslims, who make up almost 8% of the population, have become fearful of assaults on their identity and interests by majority Buddhists. There are some political groups that seek to gain advantage by continuing to attack Muslims and Christians. However, physical attacks on mosques and churches have declined after the new government chartered a more inclusive policy.

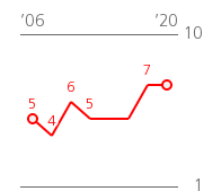
The state has been partially successful in moderating class conflict and has continued efforts to assist the poor by reducing state-imposed maximum prices on several foodstuffs.

Professional associations (such as the Bar Association), intellectuals and media professionals critical of state policies have become free to express their views without fear for their lives. Thus, the setting of policy agendas is now shared with some sections of civil society. In certain instances, for example, in constitutional reform proposals, the input of civil society was actively sought. In the north, student groups are more vocal and active, and fishermen cooperatives and women's groups operate more boldly than they did under the previous government. On the other hand, civil society participation appears to be more limited in areas such as decision-making and policy implementation. A survey from October 2016 revealed that, although 67.5% of Sri Lankans thought that if a person was dissatisfied with government policy they should do something about it, only 38.6% thought they had a say in what the government does. The Right to Information Act does provide greater scope for the media to monitor performance, but such monitoring is not formally supported by state agencies.

The end of hostilities in the civil war in May 2009 led to debates about atrocities committed during the war and charges of extra-legal actions by Sri Lankan armed forces during the concluding stages. The report of the eight-member Lessons Learned and Reconciliation Commission (LLRC) appointed by the Sri Lankan government released in December 2011 suggested safeguarding of political and linguistic rights, inclusion of minorities in development and compensation for injury or loss of life. Progress in implementing these recommendations has been very slow. While the prime minister was willing to support a task force including both local and

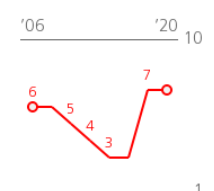
#### Cleavage / conflict management

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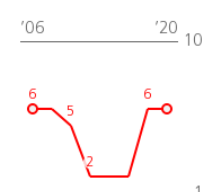
#### Civil society participation

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#### Reconciliation

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international judges to further investigate these issues, the president's opposition to this measure led to its abandonment.

The end of the uneasy coalition between the UNP and the SLFP in late 2018 has made it easier for the SLFP and its allies to take a harder line on the UNP's reconciliation efforts. The major Tamil party (TNA) continues to work with the government to ensure justice.

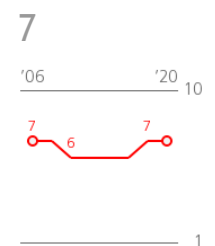
The major challenge is reconciliation between Tamils and the state. The gradual return of land appropriated by the armed forces, as well as the establishment of an Office of Missing Persons can be seen as preliminary steps toward this aim. At the end of the civil war in May 2009, the armed forces held 84,524 acres of land (private and state) in the north and east. As of 1 January 2019, they still hold 12,200 acres of state and 2,569 acres of private land. The return of occupied private land remains a key demand of Tamil groups. Other government measures, such as singing the national anthem in Tamil (supported by only 33% of the Sinhalese but over 96% of other ethnic groups according to a survey in October 2016) and providing more housing for Tamil refugees, have been favorably viewed by the Tamil leadership, which has pledged to work with the government toward a new political structure. There is also a need for closure relating to civilian casualties in the final phase of the civil war in 2009.

## 17 | International Cooperation

All indications are that the new government is open to developing a long-term strategy using external advice and aid. World Bank assistance has been sought to improve the competitiveness of export enterprises. World Bank-financed projects in 2017 – 2019 are mostly in the areas of education, irrigation, roads and health care. The readiness to examine the financial viability of state-owned enterprises (with technical assistance from the IMF) and to closely appraise projects on criteria for financial viability are welcome. The IMF has provided a three-year \$1.5 billion loan (2017 – 2019).

The pattern of bilateral external assistance has continued the transition begun a decade ago when Sri Lanka moved from reliance on the West to increasing reliance on new lenders such as China and India. Some \$6 billion in Chinese loans have been used primarily for infrastructure projects (such as ports and roads), and the newer projects (such as developing the Colombo port) seem to have potential for a favorable economic return. Indian investment has largely been directed to housing and oil exploration.

Effective use of support



The Sri Lankan state is seen as a credible partner by multilateral lending organizations such as the World Bank because of its performance in development projects.

The readiness with which the new government has engaged international organizations to address human rights concerns has promoted positive attitudes. International NGOs are now seen by the Sri Lankan government as partners in development. Sri Lanka's credibility on press freedom has improved.

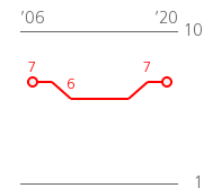
Sri Lanka has good relations with its neighbors. Sri Lanka is India's second largest trading partner in South Asia and India is Sri Lanka's biggest trading partner. Sri Lanka has made great efforts to reassure India that Sri Lanka's reliance on Chinese loans will not threaten Indian security concerns. India has assisted in infrastructure development in northeast Sri Lanka. Illegal fishing off Sri Lanka by Indian fishermen remains a source of tension, especially when Sri Lanka apprehends Indian fishing vessels. In 2015, Sri Lanka signed an agreement with India to cooperate on the peaceful use of nuclear energy and another agreement that envisages cooperation in cultural fields including performing arts, libraries and archives, publications and professional exchange.

China continues to have strong economic ties to Sri Lanka, with Chinese companies working on the Colombo Port City Project and leasing the southern port of Hambantota.

Sri Lanka also has excellent relations with other South Asian countries such as Pakistan and Bangladesh. Despite Sri Lanka's membership in the South Asian Free Trade Association, only 9% of Sri Lanka's trade is with the South Asian region. Sri Lanka is also a member of the Asia Pacific Trade Agreement (APTA). In January 2019, Sri Lanka signed a free trade agreement with Singapore, which provided for a gradual reduction in tariffs over the coming decade. The grant of GSP+ by the European Union reduces tariffs on Sri Lankan exports to the EU.

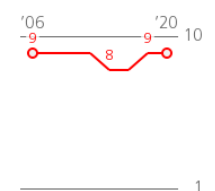
### Credibility

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### Regional cooperation

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## Strategic Outlook

The Sri Lankan state has made slow progress toward a market economy. Inflationary pressures have been kept under control, despite a rise of inflation to 7.7% in late 2018. Continuing private remittances from expatriate workers (which declined by 1% but amounted to almost \$7 billion in 2018) and continued growth in tourism (over 2.3 million visitors in 2018) have helped to alleviate the current account deficit. Nevertheless, there are substantial challenges on the economic front, including the repayment of foreign debt and interest, which are slated to amount to \$5.9 billion in 2019 alone. Ensuring export growth is crucial if the country is to finance necessary imports of consumer and durable goods. The state needs to move from export levies to other sources of revenue. More work needs to be done to reduce the transaction costs of business enterprises and to promote investment.

Sri Lanka's emphasis on reducing rural poverty is a good start toward sustainable development. Sri Lanka has made efforts to reduce burdens for the very poor, but some of the mechanisms used, such as fixing maximum retail prices of products, distort the market. Also, the Gini Index for Sri Lanka remains high.

Moreover, policies promoting more open markets (and global trade) need to be developed with caution because of the growth of populist and anti-foreign sentiment in the country.

There are several other areas in which policy changes are recommended:

**Reconciliation:** Ethnic reconciliation and a political settlement on devolution of power remain key issues. The proposals for constitutional reform proposed in January 2019 have the support of the government and minority parties, but political opposition by Sinhalese nationalists remains a formidable obstacle.

**Political Democracy:** Fairness at the polls was demonstrated by the victory of the opposition in local government elections held nationwide in February 2018. Nevertheless, a major challenge to democracy was created by the president, who dismissed a prime minister possessing the confidence of a majority in parliament and sought to illegally dissolve parliament, led to the worst constitutional crisis in Sri Lanka since its independence from British colonial rule. The acceptance by all parties of the unanimous ruling of the Supreme Court, nullifying the dissolution of parliament, resolved the crisis. However, the government needs to reinforce its commitment to democracy by ensuring that the postponed provincial elections are held as soon as possible.

**Demography:** While Sri Lanka currently has a demographic bonus due to a high proportion of people of working age, an aging population is increasing the dependency ratio. Studies have indicated a current shortage of labor in construction and agriculture. Greater efforts are required to increase female participation in the workforce, to provide better training and to enhance resources for the care of the elderly.

**Environment:** Environmental issues should be linked to sustainable development. Sri Lanka has been identified as one of the top 10 countries whose economies are most vulnerable to the effects of climate change. Some 4,000 acres of wetlands have already been destroyed due to development activities. Additionally, while there is increased awareness of rising sea levels, state and private investment in vulnerable coastal areas continues. Growing population pressure and certain cultivation and clearing practices have resulted in increasing vulnerability to natural disasters such as landslides and floods. Existing legal instruments need to be fully utilized and strengthened, and there need to be more comprehensive evaluations of the environmental implications of development projects.