

N.S. Cooray

Sirimal Abeyratne *Editors*

Decentralization and Development of Sri Lanka Within a Unitary State

 Springer

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Chapter 1

Introduction and Overview

N.S. Cooray and Sirimal Abeyratne

1.1 Sri Lanka in the Global Context

Nothing matters more to the long-term wellbeing of citizens of a country than its growth and development. Sri Lanka is not an exception. The material wellbeing of a country depends on its ability to produce goods and services. And this ability depends on productivity. Theoretical and empirical research on economic growth has highlighted the correlation between growth and a variety of social-economic, political and cultural variables which determine the growth.¹ It is universally desired by people, governments and international organisations that countries develop further in a sustainable manner. Sustainable development of societies' and wellbeing are determined by the allocation of resources (inputs and output) by market forces and intervention of state (Przeworski and Limongi 1993; Przeworski et al. 2009; Strange 2004). Many countries are now experimenting decentralisation or delegating state power to sub-national governments because they believe this process will enhance efficiency in service delivery, stimulate economic growth, eradicate rural poverty, strengthen civil society, deepen democracy, reduce heavy fiscal burden of the centre, and solve many different kinds of problems including

¹Interested readers may wish to read (Mankiw et al. 1992; Barro 2001; Solow 1956; Acemoglu 2008) and references cited therein for detailed literature on growth.

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environmental issues (Eaton et al. 2010; Manor 1999). Therefore, the nexus of decentralisation and sustainable development is profound and precise.

The decentralised allocation of resources and political power depend on the structure of political institutions of a country (Acemoglu and Robinson 2013; Eaton et al. 2010; Manor 1999). The structure of rules and principles of political institutions, may be national or sub-national level, within which they operate depend on many factors. The nature of political regimes, whether they be democratic or non-democratic, also affect the structure and outcome of those institutions (Acemoglu and Robinson 2012). The structures of the political economy and political institutions vary from country to country depending on three major factors: (1) the primary purpose of the economic activity of the nation; (2) the role of the state in the economy; and (3) the structure of the corporate sector and private business practices (Gilpin 2001, 149). Gilpin further argues that the purpose of economic activity in a particular country generally defines the function and responsibility of the state in that economy. For example, American Market-Oriented Capitalism provided relatively high rates of economic growth success in the U.S. in the 1980s and 1990s; Japanese System of Developmental Capitalism created enormous economic success in Japan in the 1980s; and the German System of Social Market Capitalism has been credited with bringing about the post-war economic miracle in Germany (Gilpin 2001; Johnson 1982; Jones 2012).

Decentralisation has changed values, responsibilities, methods of participation and goals of markets, states, and societies over time and across countries. In recent decades, most Western countries have been moving towards a more market-dominated and less politically- and socially-regulated model of capitalism. Some countries, including some in Europe such as Sweden and Denmark, have maintained a more socially-oriented model of capitalism with a greater degree of political and institutional regulation. In other parts of the world, such as Latin America and Asia, countries have pursued other approaches to capitalism and social development (Balaam and Dillman 2014).

Democratisation of countries leads towards more decentralisation and development. In recent years, there has been a change of nature of political regimes towards democratisation (Rodrik 2011; Piccone 2016). Today, more than four billion people live in 125 democracies, compared to two billion people in 69 democracies in 1989. The increase of democracy, including the Arab Spring democratic uprisings in the Arab world, and human rights activism over the last three decades has radically changed the equation of political economy. Piccone (2016) examines how five countries—India, Brazil, South Africa, Turkey, and Indonesia—could influence the status of the global democracy and human rights order. These countries support liberal ideology and practices. At the same time, it is worth noting the political reforms in Chile, Mexico, Philippines, Poland, and South Korea, together with democratic uprising in Bahrain, Egypt, Jordan, Libya, Saudi Arabia, Syria, Tunisia, and Yemen have taken place. Many of these democracies are implementing decentralisation.

Current global restructuring has generated a strong and growing need for regional development strategies for peripheral or lagging regions within nations

(Patnaik 2001). Therefore, empowering local governments or decentralisation to better serve both regional development and individuals is vital as socio-economic, political and cultural systems and values rapidly transform due to the spread of information technology and globalisation processes. Local governments in many advanced countries value people and seek public input in serving local citizens and developing strategies for regional development (CLAIR 2010; Mochida 2008; Thornton 2007; Turner 1999).

Decentralisation or devolving of political, fiscal and administrative responsibilities to local governments in growing number of countries is perhaps one of the most important governance and institutional restructuring processes towards empowering local government (Eaton et al. 2010; Manor 1999; Kettl 2002; Saito 2008; Turner 1999). The local government plays an important role in delivering public services because it is the closest administrative unit to the people (Scott and Alam 2011). It also serves as the most democratic administrative unit because local residents can participate in the decision-making process (CLAIR 2010). Moreover, it is market friendly because individual choice is given due consideration, and the needs and concerns of citizens are addressed (Owens and Panella 1991; Scott and Alam 2011). Adam Smith in his *Wealth of Nations* (1776) argues that in a market economy, resources are allocated through the decentralised decision of many households and firms as they interact in markets (Smith 2014). And therefore, if local governments are empowered, they promote the wellbeing of local citizens taken into their private choices. The World Bank (2004, 1) further argues that wellbeing can be improved “by putting poor people at the centre of service provision; by enabling them to monitor and discipline service providers, by amplifying their voice in policy making, and by strengthening the incentives for providers to serve the poor”. All these advocates support market preserving decentralised system of governments (or local autonomy) which constitute democracy, subsidiarity, and fiscal responsibility (Backhaus 2012; Mochida 2008).

What is happening in Sri Lanka today? Sri Lanka has been considered a model at various times in the past. It was once a model of social welfare, two-party democracy and non-alignment. It implemented universal adult franchise (the right of all adults to vote) in 1931, only three years after United Kingdom and was the first in Asia to do so. Arguably, Sri Lanka has the oldest judicial system in Asia. In 1977, Sri Lanka became the first country in South Asia to open up its economy to liberal perspectives. In the early 1990s it was a model of poverty alleviation and housing development and giving a high priority to raising human development status and producing reasonable economic growth with equity. On governance aspects, two major political parties, the right-centred United National Party (UNP) and the left-centred Sri Lanka Freedom Party (SLFP), have governed the country for almost seven decades since independence from Britain in 1948. Various governments since independence have implemented different political regimes generating dissimilar socio-economic results (Lakshman 1987, 2013). During this period, Sri Lanka also faced two insurrections (in 1971 and 1989) and a prolonged civil war for more than a quarter century from 1983 to 2009.

The current unity government of Sri Lanka is made of members of both the UNP and SLFP. Even though it has been quite difficult to differentiate the policies of these two major political parties in recent years, the right-centred UNP government has implemented more liberal and open economic policies, while left-centred SLFP government has in the past implemented different policies, perhaps more in line with the socialist approach. Pressured by the need to change the previous political regime, the two major political parties of Sri Lanka felt they had no other option but to build a common front together with other minority parties to contest the election in 2015. The UNP government introduced “market oriented policies” that followed the neo-liberal political thinking and the Washington Consensus in 1977. However, these neo-liberal policies were partially changed to “market oriented policies with human face” by the left-centred government which came to power in 1994 and ruled until 2005. The government which came to power in 2005 continued similar market-oriented policies with strong government intervention until 2015.

Being made up of members with different political perspectives, the unity government opted to pursue a social market economy under a kind of ideological reconciliation comprised of both the right- and the left-centred policies of the two major political parties. In their election manifesto, the unity government promised to achieve high economic growth, bring social progress, more democracy and good governance, reduce corrupt practices and promote reconciliation among groups that had been adversaries in the past. The government believes that changing the country’s constitution with more decentralised powers to the sub-national governments will create a conducive environment to achieve its goals. One of the objectives of this book is to provide some insights and lessons by way of sharing experiences from other countries.

1.2 State Reforms and Centre-Periphery Relation in Sri Lanka

The subject of state reforms and the relationship between central and local governments have been debatable issues since independence in 1948. In the post-colonial period, several reforms have been introduced to the state administrative system due to political, socio-economic and cultural pressures. Earlier changes were made for economic and political reasons, while recent changes were mainly introduced for ethnic reasons. Uyangoda (2013, 26) explains the process of state reforms under three distinct headings: (a) consolidation of the unitary state through centralisation, (b) reconstitution of the state in a federalist framework, and (c) compromise between unitarism and federalism in a framework of devolution. The Soulbury Constitution of 1947, the first post-independence constitution in Sri Lanka, established the foundation of the state in a unitary framework. The Constitution of 1972 provided judicial recognition to unitary state, while the Constitution of 1978 retained the unitary status. Despite many attempts since the

1950s, the country had no strong desire to introduce a decentralised system of administration until the 1970s.

From the 1970s, the democratic political system and territorial integrity of country came under threat (Ladduwahetty 2010; De Silva 1994; Abeyratne 2004). An insurrection in the south by Sinhala youth known as JVP (People's Liberation Front) in 1971 and the Tamil youth movement in the north called Liberation Tamil Tigers of Eelam (LTTE, and other groups) influenced reforms significantly. Divisional Development Councils (DDCs) were introduced immediately after the civil conflict in 1971. The United National Party (UNP) government, under J.R. Jayawardena's leadership, came to power in 1977 with a landslide victory that introduced open economic policies; the first country to do so in South Asia (Abeyratne 2004; Lakshman 1987). In the same year, Appapillai Amirthalingam installed the Tamil United Liberation Front (TULF) as the official parliamentary opposition. They advocated separatism for the Tamil regions of the country. The prolonged ethnic conflict, which lasted for a period of a quarter century from 1983 to 2009, has been one of the major political reasons for state reforms. During this conflict period, there were some proposals for self-determination of the Tamil speaking people, based on a federal structure within a united Sri Lanka (Lakshman 1987; Uyangoda 2013).

When one examines centre-periphery relation, Sri Lanka had an indigenous system of governance in which the king had absolute power. The king delegated authority from Raja sabha (Privy Council) to Gam sabhas (village courts) and Rata sabhas (district courts). The modern local government system was introduced in the second half of 19th century during British rule (Uyangoda 2013, 193). In the late 19th century the colonial government established Municipal Councils, Village Committees and Local Sanitary Boards. The grant of universal franchise in 1931 influenced the legislators to broaden the popular base of local government by establishing Village Councils in 1938, Urban Councils in 1939 and Town Councils in 1946 (Gunawardena 2010; Nawaratna-Bandara 2010).

In 1940 the State Council approved the idea of devolving the powers of central government to a second tier government. However, the idea of second tier government has been a controversial issue since 1957 as the majority community leaders opposed the "Regional Councils" bill which aimed at the facilitation of local autonomy to the leaders of minority Sri Lanka Tamils. In the 1980s the government managed to establish regional government—first District Development Councils (1980) and then Provincial Councils (1988)—evading the ethnically motivated opposition. In 1992 the establishment of Pradesheeya Sabhas marked another milestone as it received powers over social and infrastructural development.

The devolution of power, the first experiment of statutory devolution for the citizens, due to political and ethnic reasons, was undertaken by establishing Provincial Councils in 1988 (Nawaratna-Bandara 2010; Amarasinghe et al. 2010; Uyangoda 2013). It was a direct outcome of the Indo-Lanka accord signed in 1987 by President J.R. Jayawardane and Indian Prime Minister Rajiv Gandhi.

The current administrative system consists of nine provinces (second tier), 25 districts, 332 divisional secretariats and over 14,000 villages. Each province has

a separately elected unicameral political body called a Provincial Council (PC) with a Governor appointed by the country's President and a cabinet led by a Chief Minister. There are 336 Local Governments (third tier) in Sri Lanka, including 23 Municipal Councils (MCs), 42 Urban Councils (UCs), and 271 Pradeshiya Sabas (PSs). The MCs, UCs and PSs function under the Provincial Council's supervision. Divisional secretariats are the closest administrative units to local communities and coordinate village level government officers called Grama Niladari (Village Officers) and the functions of line ministries of the central government. There are also other separate governmental institutions (or agencies with different territorial boundaries) at the divisional level that function under central or provincial organisations.

However, these institutional changes have so far failed to provide benefits of having second and third tier governments. This could be attributed to the weaknesses in the formal arrangements, as well as the patron-client political culture continuously fostered since independence (Uyangoda 2013; Nawaratna-Bandara 2010; Gunawardena 2010; Samaraweera 2007a, b; Wanasinghe 1999, 2006). The solution to this issue could be found by reforming the existing regional and local governmental system following principles such as subsidiarity, accountability and multi-level governance.

1.3 Current Issues and Objectives

The current unity government of Sri Lanka came to power in 2015 with a promise to overcome corruption and bring reconciliation, development, democratic reforms, and good governance to the country. In order to achieve these goals, the unity government has selected a package of economic policies entitled Social Market Economy (SME). The SME aims to combine free enterprise, initiative and social development within a competitive economy while regulating, guiding, and establishing fairness in the private sector with government intervention.

The government is currently engaged in preparing a new constitution for the country aiming to achieve the above mentioned objectives through more devolution of power to local governments. Local governments are also market-friendly because individual choice is given due consideration, and the needs and concerns of citizens are addressed. Classical and neo-classical liberal thinkers who believe in market mechanisms argue that enhancing the social welfare of individuals should be the major objective of public policy. Therefore, empowering local governments under SME to better serve both regional development and individuals is vital as socio-economic, political and cultural systems and values rapidly transform due to the spread of information technology and globalisation processes.

However, devolving power and empowering of local administrations or citizens in Sri Lanka has many challenges. The process is quite complicated and sensitive to some political regimes that are intent on empowering the central government, rather than local or peripheral governments. The current public local governments in

Sri Lanka seem to be inconsistent, centralised, politicised and not-so-efficient systems (Waidyasekera 2012; Abeyratne 2004; Amarasinghe et al. 2010; Waidyasekera 2005; Ratnayake 1992; Institute of Professional Public Administrators 2007). The notion of devolving power to local regions, as indicated in the 13th amendment to the Sri Lankan constitution and recommended by the Lessons Learnt and Reconciliation Commission (LLRC), needs comprehensive understanding, given the vision and mission of political leaders of the country. Therefore, there is indeed a strong need, particularly in the post-war conflict, to formulate policies for reconciliation, peace building and development at all levels at local, provincial and national.

Considering the developmental, governance and reconciliatory needs and the sensitivity of central-local relations, this edited volume has the following aims: (a) to critically examines decentralisation process, and state reforms with special reference to centre-periphery relation in Sri Lanka; (b) to identify conducive and effective level of decentralisation and devolution of resources and power to provincial and local governments; (c) to examine the developmental implication of decentralisation; (d) to identify and propose a viable, effective, and autonomous local level administrative unit for Sri Lanka; (e) to find out proper revenue sharing mechanism between central and sub-national governments; and (f) to identify the appropriate role and functions of sub-national governments, including the proposed administrative unit.

1.4 Structure of the Book and Chapter Summaries

This volume is structured under three interrelated themes. The first part includes chapters on Decentralisation and Financing of Sub-National Units of Government, while part two provides papers explaining how various sectors of the economy work at deferent levels of governing structures. Part three furnishes rich international experience from Canada, Japan, Vietnam and ASEAN.

Part I: Decentralisation and Financing of Sub-National Units of Government

The first two objectives of this volume are to critically evaluate the state reforms and centre-periphery relation in Sri Lanka and to identify the effective level of decentralisation. Navaratna-Bandara in Chap. 2 on “Local Government System in Sri Lanka: A Historical Overview” attempts to achieve those two objectives. According to him, it was during the British colonial period that the local government institution focusing on facilitating the representative government and the local self-rule was first established in Sri Lanka. The devolution of government or federal system of government became one of the important focuses of the Constitutional Assembly, which approved the first Republican Constitution inaugurated in 1972. The new Constitution declared Sri Lanka as Unitary State, indirectly rejecting the federal proposal submitted by the Tamil leaders since independence. Author argues that in response to this rejection, Tamil leaders formed Tamil United Liberation

Front (TULF) in 1974 which declared the establishment of Tamil Eelam—an independent state in the Northern and the Eastern Provinces—as the ultimate political goal of Sri Lankan Tamils.

The international literature on decentralization and development are numerous. However, there are only very few articles with empirical evidence on the developmental role of sub-national governments. W.D. Lakshman in Chap. 3 on “Developmental Role and Financing of Sub-national Units of Government: The Case of Provincial Councils in Sri Lanka” explains the developmental roles of Provincial Councils (PC). The author first provides a brief account of the successes and failures of attempts at administrative and political decentralization and devolution in a postcolonial state formation until Provincial Councils were introduced into Sri Lanka’s Constitution in 1987. These Councils helped to build up and strengthen ethnic/religious harmony in the Sri Lankan multi-ethnic and multi-religious society, with a developmental rationale operating in the background. Focussing on this developmental role, the chapter examines the nature of fiscal devolution—powers of revenue raising and expenditure determination—allowed for Provincial Councils by the Constitution and often restricted by administrative action at the Centre. The continuing conflict for power between national and sub-national governments comes out in the allocation of revenue sources for Provincial Councils. They are, in the process, made to heavily depend on the Centre for financial resources to carry out their assigned activities. Economic disparities among provinces are also a factor in creating extensive disparity in the revenue raising capacity of Provinces. In addition to central government’s reluctance to part with its fiscal powers, these regional disparities create the need for financial grants from and the periphery’s dependence on the Centre imperative. The chapter concludes with a few comments about what could be done to improve fiscal autonomy of sub-national governments and thereby enhance their possible contribution to regionally balanced development.

The author provides two rationale for decentralisation or devolution. First, it is claimed that devolution facilitates and promotes regional development better than a system of centralized governance, on the one hand, by enabling policy makers to formulate policies with better and closer awareness of conditions at the grass roots level and on the other hand, by bringing public services closer to the people. Second, it is believed that devolution helps build up and strengthen ethnic/religious harmony in multi-ethnic and multi-religious societies. According to the author with greater fiscal autonomy the PCs would be able to take up larger and more extensive decision making powers, leading to PCs becoming more accountable for achieving results and people beginning to see these as useful development-friendly organizations.

If sub-national governments are to carry out decentralized functions effectively, they must have an adequate level of revenues—either raised within their geographical areas of jurisdiction or transferred from the central government—as well as the authority to make decisions about expenditures. Fiscal decentralization can take many forms, including (a) self-financing or cost recovery through user charges, (b) co-financing or co-production arrangements through user participation via

monetary or labour contributions; (c) expansion of local revenues through property or sales taxes, or indirect charges; (d) intergovernmental transfers shifting revenues collected by the central government to sub-national governments for general or specific uses; and (e) central government authorization of borrowing by and provision of loan guarantees to sub-national governments.

If decentralisation is to work properly towards developmental needs of sub-national levels, sub-national governments must have necessary resources or revenues. The revenue issue is further discussed by Asoka Gunawardena in Chap. 4 on “Intergovernmental Fiscal Framework for Local Government and Centre-Local Revenue and Expenditure Sharing: A Comparative Analysis”. The author explains the revenue sharing mechanism between the centre and sub-national levels units of government. The form and substance of decentralization has become a critical issue, specifically the form and shape of local autonomy in optimizing democracy and development. It would seem that the role of intergovernmental structuring of public finance has been neglected in carving out a role for local government in Sri Lanka and thereby the effective and equitable provision of service delivery. Issues of the assignment of taxing and spending powers at the local level in terms of the concomitant issues of fiscal balance, both vertical and horizontal, closing the gap between taxing and spending, and of revenue and expenditure sharing, are examined such that the welfare considerations of public sector service delivery would be optimized, while promoting national unity and cohesion.

Having identified a proper revenue sharing mechanism between central and sub-national governments in Chap. 4, N.S. Cooray and K.U. Chandralal in Chap. 5 on “Towards an Appropriate Public Local Government Unit for Sri Lanka” propose a new local government administrative unit suitable for Sri Lanka. The objective of this chapter is to identify and propose a viable, effective, and autonomous local level administrative unit for Sri Lanka. According to them the local government plays an important role in delivering public services because it is the closest administrative unit to the people. Devolving power and empowering of local administrations in Sri Lanka is a challenging task. Critically analysing the benefits of the Japanese local government system and the limitations and strengths of the current Sri Lankan systems, this chapter proposes merging of two overlapping local government units, Pradeshiya Sabhas and Divisional Secretariat, to create one local administrative unit that is close to local citizens. The merged unit may be called a Divisional Administrative Unit (DAU) or any other suitable name, and its geographic scope can be the same as that of the current corresponding DS. The proposed DAU contains an executive and a legislative branch. Public participation and democratic representation in local administration and regional development underlie the proposed local administration system. In addition to the right to elect their representatives, people should enjoy the right to direct participation in local administration and developmental activities. Such a right safeguards the rule of law, democratic values, ethnic harmony, and market elements. The proposed local administrative unit plays a vital role in empowering and improving the livelihood of local citizens.

Part II: Sectoral Development Under Decentralised System

If decentralisation to work effectively for regional development, policy makers should coordinate developmental needs and resource allocation at national and sub-national level. The leading sectors if properly coordinated could contribute much to the development of a country under decentralisation (Institute of Professional Public Administrators 2007; Karunanayake and Narman 2005; Ratnayake 1992; Waidyasekera 2012). Chapters in Part II of this volume focus on several key sectors of the Sri Lankan economy and explain how the sectors work under decentralisation. Chapter 6 on “Agriculture and Rural Development under Central Government and Provincial Council Setup in Sri Lanka” by Buddhi Marambe, Pradeepa Silva and Saman Athauda explain that since gaining independence in 1948, the development policy in Sri Lanka has mainly been focused on achieving the objectives of equity and economic growth. Despite gradually changing from an agriculture-based economy to an industrial-based economy over the last few decades, agriculture is a mainstay in the development agenda of the country, especially contributing to the livelihood and rural development of the population. The local government system of Sri Lanka is largely dependent and influenced by the central government and provincial councils. The governance system is aiming at strengthening the local authority administration, especially focusing on agriculture and fisheries sectors with self-sustenance as a key objective. However, the complexity of several factors that affect decentralization has made it difficult to quantifiable assessments on the overall impacts. The non-plantation agriculture in Sri Lanka, as a whole, has undergone significant transformation due to structural and governance changes in the country. Decision-making on resource allocation from the central government to the devolved structures (provincial or local governments) are critical in achieving social and economic development in the three important sub-sectors of agriculture; namely, crop agriculture, livestock (including poultry) and fisheries (including aquaculture). Decentralization of power (power transfer) to provinces and local level administration with people’s participation rather than devolution of powers (removal of power from the central government) would create a more coordinated, conducive, and a cooperative effort to overcome main issues in the field of agriculture and rural development as a whole.

Chapter 7 on “Sustainable Resource Mobilization for Community Development in Sri Lanka: LEAD Participatory Poverty Reduction Experience” by Wijitapure Wimalaratana and Dhammika P. Withanage introduce an innovative and holistic model to transform the living conditions of backward regions with community participation based on the principles of good governance. It has been tested in a few selected Divisional Secretariat Divisions in Hambantota and Monaragala districts. This study examines the impact of LEAD development model on community development in the light of its resource mobilization strategies. The necessary information for this exercise was collected from primary and secondary sources. Focus group discussions and interviewing of key informants were applied for primary information, while the secondary information was mainly received from LEAD sources and other authentic sources of the country such as the Department of Census and Statistics. Study findings suggest that the new model has made

considerable and positive changes towards sustainable community development in the areas where it was tested. The efficient and result oriented mechanism introduced in the resources mobilizing process has made a great impact in this endeavour.

Harsha Aturupane in Chap. 8 on “Public Investment in Education: Benefits, Challenges and Opportunities” provides an analysis of public investment in education in Sri Lanka. Several dimensions of education benefits are examined within an econometric framework. These include the returns to education investment, the association between education and economic welfare, inter-generational benefits of investment in education and the promotion of gender equity, and the relationship between education and poverty reduction. The economic and social benefits of education are high. Next, several dimensions of public investment in education are analysed. These cover the time trend of education investment, international comparisons of investment in education, and the pattern and composition of education expenditure. Over the period of the study public education expenditure is shown to have been low. The negative consequences of low investment in human capital is discussed. This is followed by an analysis of the institutional framework for the delivery of education services, and the incentives for performance in the system. The paper then studies the equity of public investment in education, which is shown to be high. The analysis concludes by recommending increased public investment in education, as it yields both strong economic and social benefits and enhances equity.

Women population in Sri Lanka accounts for about 52% and majority of university students are female. However, current parliament has only 13 female of out of 225 members. This is quite low when compared with worldwide average of 21.9%. Women can play an important role in development at any administrative level. Chapter 9 on “Women’s Representation and Political Engagement in Local Governments: Evidence from Sri Lanka” by Kamala Liyanage talk about equal political rights to men and women have been guaranteed by Sri Lanka and women vote more than men at any elections. However, this study shows that women have not been recognized as equal to men in the representation and in their political engagement. The women elected to the local governments in 2011 illustrate that due to their established popularity, leadership in the community and the campaign strategies they used similar to men, they won the elections. When compared to men, however, it is obvious that women are at a disadvantage due to the socio-cultural and individual factors and lack of opportunities. If politically trained women were given more nominations by the major parties the result of the election would be different. The study concludes that only structural changes would not be sufficient to improve the situation and it is equally necessary to change the mind-sets of the people.

Foreign policy of a country depends on many factors. Having recovered from prolonged ethnic conflict and also due to changes government, Sri Lanka has many challenges in its foreign policy making process. H.M.G.S. Palihakkara in Chap. 10 on “Post Conflict Foreign Policy Challenges for Sri Lanka” explains how foreign policy should be made after Sri Lanka conflict. The so-called ‘ethnic conflict’ in

Sri Lanka was famously, or even uniquely, marked by its many external dimensions. These ‘externalities’ were manifest in both the causes and effects of the conflict, as well as in conflict containment and in the many attempts made towards its resolution. For over three decades, these externalities were clear and present in the form of bilateral or multilateral interests, interference and even intervention. The ‘role players’ involved in this regard included regional (India), as well as extra regional powers (the US, EU, Japan and Norway) and a well-funded and hyper-active Diaspora. The synergetic effect of all these dynamics is that Sri Lanka is confronted with a significant inventory of foreign policy and diplomatic challenges that can impact Sri Lanka’s internal affairs, e.g. governance issues, human rights, devolution, rule of law, trade, investments etc.

Part III: Sharing Internal Experiences

One of the objectives of this volume is to draw rich international lessons from various countries. We believe that those lessons will educate Sri Lankan policy makers on how decentralization process will contribute to the development of Sri Lanka. Keiji Otsuka in Chap. 11 on “Role of Local Institutions in the Development of Industrial Clusters” explains how cluster-based industries can help regional development. Author argues that most, if not all, successful industrial development in developing countries is cluster-based, because industrial clusters have a significant advantage over non-clustered areas due to lower transaction costs arising from geographical proximity. However, industrial clusters have critical shortcomings such as information spill overs which reduce incentives to innovate, and the production of lemons, which damage brand image of the clusters. Thus, in order to promote cluster-based industrial development, the above mentioned external effects must be internalized. Based on empirical observations. The researcher argues that local institutions, e.g., trade associations and local governments, ought to play critical roles in the promotion of industrial clusters.

Chapter 12 on “Decentralization of Natural Resources Management in ASEAN” by Kaliappa Kalirajan, Kazi Arif Uz Zaman, and Gaminiratne Wijesekere argue that in many parts of the world that the natural resources management (NRM) are made at the central or divisional level. This centralized approach has resulted in inefficiencies and lack of participation by stakeholders, including the poor and vulnerable population groups who are directly affected by the NRM, by issues such as the lack of strategic links between the national and regional plans, poor coordination among agencies across national and regional administrative structures, lack of participation by the stakeholders and civil society. Decentralization of NRM is a key to address these issues and to improve and promote sustainable management of resources.

Tai Dang Nguyen in Chap. 13 on “Fiscal Decentralisation and Economic Growth: Evidence from Vietnam” explain how fiscal decentralisation has been one of the key reforms that saw central government granting more fiscal autonomy to provincial governments, who now have a greater discretion than before in collecting and distributing resources for developmental purposes in their jurisdictions. Using a newly available provincial panel dataset, this paper examines the effects of fiscal

decentralization on economic growth in Vietnam for the period 2004–2010, by applying new proxy measures of fiscal decentralisation as the ratio of different types of revenue over total expenditure of provinces. The results suggest a significant positive effect of fiscal decentralisation on provincial economic growth in Vietnam. The empirical models adopted also address the concerns of endogeneity and unobserved heterogeneity between provinces.

Wimal Rankaduwa, Azad Haider and N.S. Cooray in Chap. 14 on “Education Expenditure and Economic Growth under Decentralization: An Empirical Study of Sri Lanka and Canada” undertake an empirical investigation into the nexus between government education expenditure and economic growth in Sri Lanka during the period 1960–2015. The direct and indirect effects of government expenditure on economic growth are estimated. The impact of decentralization of education sector in 1987 on these effects are analysed. Sri Lanka’s experience under decentralization (1988–2015) is compared to the experience of Canada (1990–2014). The study finds a negative direct effect and a positive indirect effect of education expenditure on economic growth in Sri Lanka, and a positive direct effect and a negative indirect effect in Canada. The study also finds a positive direct effect and a negative indirect effect of non-education expenditure of government on economic growth in Sri Lanka. Redirecting government expenditure in favour of education, without substantially improving factor productivities in education sector, will generate a negative impact on economic growth in Sri Lanka.

Shunsuke Kimura in Chap. 15 on the “Japanese Local Tax System and Decentralization” examines the structure of Japanese local revenue and the characteristics of the Japanese local tax system. Furthermore, it examines the goal of financial autonomy through decentralization in the Japanese context. Local revenue is mainly composed of the general revenue resources in terms of quantity and quality. These revenue sources accounted for 55.0% of the total local revenue in the fiscal year 2013. Moreover, they are not earmarked for specific purposes and are essential for local autonomy. The key elements of the general revenue resources are the local taxes, the local transfer tax, the special local grants, and the local allocation tax (LAT). And as the concept of social values is becoming complicated, the reform of local tax system will be complex. However, when considering future financial autonomy, the following point is significant. The local governments are required to be more and more sensitive to community needs in the framework of financial autonomy. The relationship between sensitivity and financial autonomy must be an indispensable combination in contemporary society.

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Part I
Decentralisation and Financing
of Sub-National Units of Government

Chapter 2

Local Government System in Sri Lanka: A Historical Overview

A.M. Navaratna-Bandara

2.1 The Concept of Local Government

For the purpose of this chapter the term “local government” embraces all types of popularly elected local level governmental authorities dealing with matters concerning the inhabitants living within the areas delineated to them, whose interests cannot be served directly by the central government. Today these government authorities are treated as the local level power bases representing legally recognized sub national level governmental entities such as States, Provinces, Districts and Regions or community level local authorities elected for Cities, Towns, Municipalities, Boroughs, Communes and Villages.

Under modern circumstances the benefit of establishing local institutions elected by the local people to administer local affairs has been described in many different ways. Some have argued that these institutions facilitate the management of local affairs in conformity with the ethics of local communities by promoting the cultural and economic life of the ethnic, religious and cultural groups that make up the local population. From the point of view of citizenship, the local government institutions facilitate the right of citizens to have a sub national government to govern themselves in matters of purely local concerns. Since the local government institutions exercise the right to pass local laws or ordinances handling the local affairs, the widely held view is that the local government facilitates the local home rule for the local people.

As such these entities continue as protectors of local autonomy for the distribution of public goods and services at the local level. Thus, the right of self-determination is at the very heart of local government system. It offers the right to determine how local affairs should be addressed to the local level communities.

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Under the local home-rule principle these institutions are permitted to act promptly to deal with immediate problems and opportunities as well as find tailor solutions fitting to the local needs. Furthermore, it avoids the delay in waiting for the decision or sanction of the central government as the officers in these institutions receive greater authority to make their own decisions. Finally we could argue that home rule deters central government interference in local affairs. Thus it is an obstacle to the central authorities' attempt to penetrate into the culturally defined civil spaces at the local level.

2.2 Devolution and Local Government

The most popular academic approach to understand the granting of powers to the local authorities in the modern state is provided by the conceptual focuses on "devolution of government power" which is identified in the literature simply as political decentralization. Under devolution "the central government establishes regional governments with legally conferred legislative and executive powers in designated fields of policy and administration" (Sherwood 1969, 60–87). Therefore these devolved authorities may function within these fields as "autonomous regional units of governance outside the command structure of the central authority" (Sherwood 1969, 60–87). Further "the center relinquishes its formal authority over these functions, which have been accredited to the regional governments, and keeps little control or no direct control" (Rondinelli 1984, 133–145). Therefore through devolution the central authority can offer substantive regional autonomy for regional population for the protection of their regional identity and the development of the areas they live.

As noted by Yoram Dinstein, "regional autonomy denotes self-government (and) established in delineated portion of the territory of a state and relates to all the inhabitants within the area (Dinstein 1981, 291–303). According to Lous B. Sohn, "the concept of self-government implies that for important political or economic reasons a particular area will remain within the territorial jurisdiction of another political entity but will possess political freedom to regulate certain of its own affairs without any interference by that entity except in the case of powers which are in the common interest of both entities" (Sohan 1981, 5–22).

According to Arthur MacMahon devolution can be instituted by legislation or by the constitution. He provides two individual terms to identify the legal status of these two types of devolution: "Statutory Devolution" and "Constitutional Devolution" (MacMahon 1969, 20). In this analysis "constitutional devolution covers federalism in its many applications. It describes a situation in which power is divided between central government and territorially defined constitutional units of self-government under an agreement (the constitution) which cannot be altered by the ordinary law making procedure (MacMahon 1969, 20). Brian C. Smith in *Decentralization*, the territorial dimension of the state also discussed such federal implications in devolution and observed "it is possible for a unitary state to devolve

substantial powers to provincial government, so that a quasi-federal arrangement exists” (Smith 1985, 14). Benyamin Neuberger calls this “*devolutionary federalism*” focusing on the initiatives taken by the Nigerian central government to transform a state which had in theory been ruled as a single unit into federal state with several regional governments (Neuberger 1979, 171–188).

Leonardo Romeo notes that “regional autonomy is not effective if the system cannot facilitate regional governance which has three components, namely, Performance, Partnership and Participation (3Ps). Performance refers to the management capacity of the administrative organization and its personnel. Partnership refers to the institutional and non-institutional means facilitating partnership between public, private and non-profit sectors. Participation refers to the avenues provided for the people to participate by themselves in the formulation of public programs and their implementation” (Romeo 2000, 2–3). As such, the administrative capability (Sapru 1994, 20) provided for the regional government is much more important as the real benefit of the two components, namely, “partnership” and “participation”, are highly dependable on the “performance” of administrative organization; i.e., the competence and commitment of the administrators.

With this understanding of the concept of local government and devolution and its related dimensions, the researcher will be examining briefly the historical development of modern system of local government in Sri Lanka with special emphasis on the historical survey of devolution of government in pre and post independent Sri Lanka in the next section.

2.3 Historical Overview: Pre-independence Period

2.3.1 *Local Authorities as Managers of Local Utility Services*

It was during the British colonial period that the local government institution focusing on facilitating the representative government and the local self-rule was first established in Sri Lanka. The demarcation line for distinguishing between the establishment of local institutions to undertake the local utility services and the provision for representative institutions for local self-rule was the Constitution of 1931, which granted Universal Franchise to the people of Sri Lanka and offered partial responsibility to the national leaders.

However, the rudimentary forms of local government institutions were introduced before 1931. The objective of introduction of such institutions was administrative convenience, not local self-rule. In 1829 the Colebrook Commission which was responsible for transforming the colony into a “Colonial State” (Navaratna-Bandara 2013, 471–485) to facilitate the foreign investment in the Island recommended the formation of village committees to undertake some of the functions undertook by the traditional Gam Sabhava, the village level entity consisting of elders in the villages that existed before the arrival British rule.

The Commission found the usefulness of Gam Sabhava in order to receive the views of village elders for affairs such as the resolution of civil disputes and the handling of ordinary lawbreakers (Mendis 1956, 69–323). However, this was not implemented immediately. Some 23 years after the submission of Report of the Colebrook Commission, in 1856 the passage of Paddy Lands and Irrigation Ordinance facilitated the formation of village committees to organize certain activities relating to irrigation and cultivation, but not as envisaged by the Commission.

The Island had the experience of Municipal Councils when the Colonial government established Municipal Council of Colombo (1865), Kandy (1865) and Galle (1866). These Municipal Councils were established with legally delineated Municipal boundaries under the Municipal Council Ordinance of 1865. The establishment of these Municipal Councils became a necessity as a result of emerging issues related to health and sanitation, maintenance of streets, markets, drainage systems and law & order in the big cities.

After the establishment of these three Municipal Councils the government introduced the Village Committees Ordinance in 1871 in order to establish Villages Committees participated by village leaders on voluntary basis. Also it empowered the Governor and the Legislative Councils to establish Rural Courts, which became the lowest rung of the judiciary system. In 1861 the government implemented the Road Committees Act and established the Provincial Road Committees and the District Road Committees to administer public roads. The Sanitary Boards were established in 1892 to tackle the sanitary issues in small towns with the participation of local residence. However, these local bodies were not popularly elected representative institutions. These institutions, including the three Municipal Councils, constituted of government officials and unofficial members nominated by the Government Agents or Assistant Government Agents. The local elites were invited to the village and small town level institutions as representatives of inhabitants, while the government officials playing the dominant role.

In the 1920s the colonial government brought a new legislation to establish elected Urban District Councils, Rural District and General District Councils similar to the District Councils in England. The government established two Urban (District) Councils in 1922 and another 6 in 1926, but other bodies were not established. Later they were identified as Urban Councils, the secondary institutions to the Municipal Councils.

The above survey of historical development demonstrates that the local bodies came into being during pre-Donoughmore era, with the aim of easing the burden of central government by providing or maintaining local utility services such as water, sanitation, roads, streets and markets. Initially the solicitation of local participation by inviting the local elites into these institutions was in line with the government policy to work with the traditional elites. Later the elected principle was introduced parallel to the upgrading of limited franchise offered to the national elites to represent their interest at the Legislative Council. Therefore, the local government system that existed in the beginning cannot be identified as a mechanism for offering the local self-rule.

The Donoughmore Commissioners had visualized the expansion of participatory government to the sub national level. They presented a special chapter in their reports on Local Government. They identified the establishment of Provincial Councils at the provincial level as an apex body of the Municipal and Urban Councils and the Village Councils. The Commission wanted to elect the existing local authorities by the adult voters. The establishment of Provincial Councils was proposed as the intermediate body between the central government and these third tier governmental institutions such as Municipal Councils, Urban Councils and Village Councils (Donoughmore 1928, 152). The development of representative institutions, both, at the national and sub national levels, was recognized as a crucial element in promoting not only democracy but also national integration. They held the view that the Provincial Councils would provide the minority communities which are majority in the provinces to take part in government at the provincial level. The Commissioners recommended that the State Council to be established by the new constitution should formulate the policy framework and other modalities for the establishment of Provincial Councils (Donoughmore 1928).

The new executive arrangement created by the Donoughmore Constitution made the local government a ministerial portfolio assigned to the national leaders. Thus an Executive Committee of Local Government was established in the State Council to decide the policy program, prepare the budget estimates and take day to day decisions of the newly established Executive Department (Ministry). Mr. SAWRD Bandaranaike was elected by the Executive Committee as the Minister of Local Government. The new minister had the past track record of propagating the federal idea and proposing to have a federal system of government for Low Country Sinhalese, Kandyan Sinhalese and Tamils, identifying them as separate races. He in 1936 initiated an ambitious program by establishing the Sinhala Maha Sabha to become a national leader in future Sri Lanka. With this political background it is understandable that SWRD provided leadership to the Executive Committee of Local Government to introduce the Village Committee Ordinance in 1937, the Urban Council Ordinance in 1939 and the Town Council Ordinance in 1946 and a report on the establishment of Provincial Councils in 1940 to the State Council.

The Village Committees Ordinance was initially reserved by the Governor as it had the wording that appeared to be discriminative against the Indian Tamils living in the estate plantations as it wanted to exclude them from becoming the voters of Village Councils (Weerawardana 1951, 87). However, the compromise formulation was found in the end by removing the word "Indian Tamils" as both sides agreed to put "the persons who live in the houses provided by the plantation management". As such, the Village Committees Ordinance of 1937 was the first legal instrument which disfranchised the Tamils of recent Indian origin (or Up-Country Tamils) in Sri Lanka. The exclusion of Up-Country Tamils living in the estate plantations allowed the British Plantation Raj to keep the workers in the plantation out of local politics. The legacies of this system still appeared in the local politics even though there were measures to accommodate these people who lived inside the estates into the local representative institutions, as well as the local administration represented by the "GramaNiladari".

In 1940 the members of State Council discussed the proposal submitted by the Minister of Local Government to establish Provincial Councils as proposed by the Donoughmore Commission to supervise the third tier local authorities already established and coordinate their activities to have an integrated regional development (Hansard July 10, 1940, Col: 1366). However since the majority of members were of the view that the Province is too large to administer, in the final resolution the State Council requested the Minister to establish District Councils and not Provincial Councils, identifying the District as the unit of devolution for the second tier government. The debate surfaced issues relating to the expansion of elected local authorities and also the centralized system of decision making at national level. Some members pointed out that due to the rampant corruptions prevalent in the local authorities the Minister should be careful when providing the revenue powers to the District Councils. The opinion of one member was that “the local authorities are hopelessly corrupted.” (Hansard July 10, 1940, Col: 1366). It is worth to note that the members wanted from the Minister to avoid what they thought “the side effects of the new introduction”; namely, the overlapping of functions between the local authorities and the District Councils, since the unnecessary expansion of public service that would put a heavy financial burden on the tax payers (Hansard July 10, 1940, Col: 1366). There were allegations that the Ministers in the Donoughmore system had become “Petty Hitlers” by concentrating power in their hands. Some members wanted to take more functions from the Ministers and hand them over to the Provincial Councils (Hansard July 10, 1940, Col: 1369–1370). Many members identified the new body as an instrument to curb the powers exercised by the colonial bureaucracy settled at the “District *Kachcheri*” headed by the Government Agents (Hansard July 10, 1940, Col: 1362–1365). Therefore, one would argue that the debate on the establishment of Provincial Councils in 1940 was based on the actual experience drawn from the ground situation by the elected members to the legislature (State Council).

During 1930–1947 as the ministers were involved in intense political competition to get the upper hand in national politics, it was SWRD who really benefitted from the reforms introduced to the local authority system as he became the leading figure at the annual conferences held by the Urban Councils and Village Council leaders. Later when he formed his own political party in 1951 many Chairmen and members of local government bodies joined his new party and work for his victory in 1956. The other leaders of government had the suspicion that SWRD was expanding his political support base through the expansion of local government system. It was evident that it was due to this continuing political contest that the draft bill submitted to the Cabinet in 1947 to establish the District Councils, according to a former Minister, “was set aside” (Hansard 1940, Col: 1267). The period 1931–1947 was identified as the planting of seeds of participatory democracy. The elections of members of local authorities, as well as the national legislature, were based on the principles of ‘Universal Franchise’ and ‘Territorial Representation’. Therefore, the emergence of both “formal democracy” and “participatory democracy” became one of the legacies of constitution reforms taking place during colonial rule. The national leaders and the colonial government had the

ability to consider the need for a second-tier government purely on rational grounds. Nonetheless the political rivalries surfaced in the first cabinet of 1947 between certain individual politicians worked against its introduction before independence. In 1951 SWRD Bandaranaike identified the non implementation of his proposal to establish Provincial Councils as one of the principle issues which influenced him to resign from the government to form the Sri Lanka Freedom Party (Bandaranaike 1963, 147–149).

2.4 Historical Overview: The Post Independent Period

2.4.1 The Failed Attempt on “Statutory” Devolution

After independence the local authorities namely, Municipal Councils, Urban Councils, Town Councils and Village Councils, became the training schools for the future national political leaders and the grassroots level political power bases for organizing the vote banks for the political parties. When SWRD Bandaranaike resigned from the United National Party government and formed the Sri Lanka Freedom Party (SLFP) in 1951, many of his party leaders and organizers came from local authorities. Consequently the local authority elections became the trial battle grounds for the political parties competing for the capturing of power in the central government.

However, the ground reality was the need to reform the hierarchical arrangement between the central government and the local authorities by establishing an authority to have a coordinated district development. Although the draft District Council bill was set aside in 1947, the central government established the District Coordination Committees (DCCs) to fill the vacuum in 1950. The DCCs were consisted with the Members of Parliament, Chairpersons of Local Authorities and the Heads of Departments comprising Senior Public Officers in the District. The DCCs became the coordinating body of projects undertaken by the government at District level. The major objectives of establishment of DCCs were to bring the people’s representatives in touch with the public bureaucracy and weaken the Kachcheri System of Administration.

The Local Government Commission appointed by the government led by Sir John Kotalawela in 1955 (widely known as Choksy Commission) recommended the establishment of Regional Councils as an apex body of local authorities within the Region (a sub division of District). The Bandaranaike government which came to power in 1956 issued a Gazette notification outlining the proposal to establish Regional Councils when the Commission published its report in 1957. The Choksy Commission wanted to have indirect representation to these bodies by appointing the Members of Parliament and the Chairmen of local authorities to the Regional Councils. However, the nature and structure of Regional Council soon received new shape as it became the central focus of Bandaranaike-Chelvanaykam Pact (B-C Pact) signed in 1957. The B-C pact was signed as a compromise settlement with the

Federal Party which was about to launch a Satyagraha campaign in the North against Sinhala only Act. The B-C Pact proposed to establish elected Regional Councils and make special arrangements to establish one such council for the Northern Province and two or more councils to the Eastern Province (De Silva 1986). The real objective was to allow the Tamil majority council in the Eastern Province to join with the Northern Regional Council. Thus, there was a special clause promising to add a new provision to the draft bill allowing the Regional Councils to join together beyond the provincial boundaries subject to the approval of Parliament. Both parties agreed to grant the Regional Councils the power to select the allottees of colonization schemes and use Tamil as the language of administration in the Northern and Eastern Provinces (De Silva 1986).

The B-C pact created a political controversy as the United National Party, the main opposition party and the organizations representing the majority community and the several leading Buddhist Monks protested and organized a campaign against the agreement arguing that it would lead to the division of country. They further argued that this would allow the Tamil leaders to have a clear geographical identified institutional structure to bolster their claim for the Northern and Eastern provinces as the homeland of Tamil speaking people and a separate state for those areas in the near future. The main opposition party condemned the agreement identifying it as a betrayal of Sinhalese and blamed that it would undermine the implementation of the Official Language Act which declared Sinhala as “the sole official language of the country” (Daily News, 27 July 1957). Finally the Prime Minister, without consulting the other party, decided to abandon the agreement surrendering to the pressure came from the leading Buddhist Monks. Meanwhile other signatory to the B-C fact, the leader of Federal Party was arriving in Colombo after receiving an approval to the agreement from his party congress identifying it as “...an interim adjustment” (Silva, Managing Ethnic Tensions in Multiethnic Societies 1986).

The political controversy that erupted against the B-C fact became a turning point as it made the idea of creating second-tier government a tough issue for the government in Colombo. Consequently the successive governments just paid lip service to the idea of devolving power, though most of them gave a promise to establish District Councils at the Throne Speeches (the Policy Statements of government) from July, 1960 to 1965. The minority UNP government of 1965, which first time made the Federal Party a partner in a coalition government, brought a white paper in 1968 to establish District Councils (Proposal 1968). Meanwhile a newspaper published by a left party disclosed that there was a secret promise given to the Federal party offering a regional government to the Northern and Eastern provinces. The government faced stiff opposition from political opposition, as well as the Sinhala Buddhist nationalist forces, though the proposed system did not have powers similar to the proposed Regional Councils in 1957. The main opposition party claimed that the proposal would lead to establish a federal system as Dr N. M. Perera, leader of a Left Party stated that “we are for District Councils but not for federal District Councils” (Hansard 19 July, 1967). Finally the government abandoned the District Council proposal and the Minister

of Federal Party submitted his resignation though the FP did not withdraw its support to the government. These continuing controversies created a fear psychosis among the majority community by identifying devolution as a mechanism for dividing the country.

The devolution of government or federal system of government became one of the important focuses of the Constitutional Assembly, which approved the first Republican Constitution inaugurated in 1972. The new Constitution declared Sri Lanka as Unitary State, indirectly rejecting the federal proposal submitted by the Tamil leaders since independence. This particular legal formulation in the Constitution virtually outlawed the idea of “federal state” promoted by the Tamil leaders since 1948. The response of the Tamil leaders was the formation of Tamil United Liberation Front (TULF) in 1974 which declared the establishment of Tamil Eelam—an independent state in the Northern and the Eastern Provinces—as the ultimate political goal of Sri Lankan Tamils.

As such, after 26 years of independence when the country became a Republic severing the constitutional relationship with Britain, the political leaders of the principle minority community took refuge in ethnic secessionism which facilitated the political ideology for the emergence of Liberation Tigers of Tamil Eelam (LTTE) which brought the thirty years long civil war that ended in 2009. The constitution which was inaugurated in 1978 transforming the country’s system of government from cabinet system to a semi-Presidential system further strengthened the constitutional framework of ethnic dominance system established by the 1972 constitution.

However, the attempts to introduce devolution through a legislation approved by Parliament did not end after declaring Sri Lanka a Unitary State by both the constitutions of 1972 and 1978. In 1980, the government after having an understanding with the TULF established an elected District Development Councils (DDCs) with the MPs in the district also as ex-officio members who received the majority status in the council. The District Minister appointed by the President was given powers to appoint an executive committee from the Council and implement the development programs identified in the development plan approved by the DDC. The DDCs received funds for their development programs directly from the Decentralized Budget approved by Parliament. The functions earlier carried out by more than 300 Village Councils and Town Councils were transferred to the District Development Councils as they were abolished with the inauguration of DDCs. However, in the end the DDCs evolved as an apex body controlled by the majority of MPs in the Council. The funds received from the district decentralized budget were allocated to the projects identified by the MP within their electorates. The public utility services handled by the Village Councils and the Town Councils were neglected and the people were alienated from the decisions made for their local matters. The DDCs ceased to exist after the establishment of Provincial Councils (PCs) in 1988 by the 13th amendment to the Constitution.

The events unfolded since independence pointed to the fact that the process started in 1940 by diluting the original proposal for the establishment of Provincial Councils re-emerged in 1957, 1967 and 1980 with a territorial unit smaller to a

Province. These “statutory devolutions” identified the “Region” in 1957 and the “District” in 1967 and 1980 as the territorial unit of devolution. The adoption of the District as the territorial unit of devolution in 1967 and 1980 was in agreement with the Sinhala nationalist argument raised in 1957 that a unit of devolution based on Province would provide the political and administrative framework for the Tamil nationalists’ claim for the Northern and Eastern Provinces as the traditional homeland of Sri Lankan Tamils.

2.4.2 The Introduction of Constitutional Devolution

The establishment of Provincial Councils in 1988 was the first experiment of “statutory devolution” for the citizenry of Sri Lanka. It was a direct outcome of the Indo-Lanka accord signed in 1987 by President J.R. Jayawardane and Indian Prime Minister Rajiv Gandhi. The accord was an attempt by India and Sri Lanka to find a settlement to the ethnic problem in Sri Lanka by creating a ceasefire between the LTTE and the security forces of GOSL. The Indo-Lanka Accord was a mutual understanding between two governments regarding the burden emanating from the security concerns of both countries.

The 13th Amendment went back to the original territorial unit proposed by the Donoughmore Commission recognizing the Province as the unit of devolution. The change of territorial unit from the District to the Province took place during 1983-87 when India mediated between the GOSL and the Tamil Groups. The government of President J.R. Jayewardene was forced to accept both the Province and the temporary merger of Northern and Eastern provinces. This happened due to the tremendous pressure exerted by India which had established itself as the mediator in the conflict between the leaders of the Sri Lanka Tamils and the Government of Sri Lanka (GOSL) (Navaratna-Bandara 2010).

As such the 13th Amendment was a product of the geo-political environment in which India played the role of regional security manager and it was not the domestic actors but Sri Lanka’s Big Neighbour—India, for the sake of her national interest that played the key role in shaping the idea of Provincial Councils which became part of the Constitution of Sri Lanka. The present writer has argued elsewhere that finding a compromise solution to the Sri Lanka’s Tamil self-determination conflict became the preferred policy option for the Indian policy makers as secession and military suppression of Tamil political movement—the extreme political options in the conflict were not acceptable to them (Navaratna-Bandara 1995). This has now become an entrenched element of the Indian policy towards Sri Lanka’s ethnic conflict. Even today the strengthening of the 13th Amendment is the way out for the ethnic conflict in Sri Lanka for the Indian policy makers, though the ending of war annihilated the entire Liberation Tigers of Tamil Eelam (LTTE) leadership in 2009. On the other hand, the political resistance that emerged in 1987 against intervention and political manipulation by India in domestic politics still continues in different guises. This could be attributed

to the indifference shown by the successive governments in implementing the 13th Amendment.

However, the 13th amendment somewhat changed the constitutional landscape of local authority system that evolved in the past. The amendment provided three lists of powers similar to the Indian system to rearrange the subjects between the central government and the PCs. The Provincial List identified the subjects assigned to the PCs, the Reserved List identified the subjects reserved for the central government and the concurrent list provide the subjects that can be assigned to the PCs, but the central government also can exercise its authority though they have been assigned to the PCs. Since the devolutionary arrangement was prepared very carefully to keep the unitary nature of state intact the PCs did not receive direct authority to exercise the subjects assigned to them. The PCs have to implement the laws passed by Parliament by detailing out their implementation in the Province by passing the Statutes. That is the only way to acquire legal authority to exercise executive powers over the territory assigned to them. The government had to make practical arrangement to hand over the subjects devolved to the PCs. If it is not done by the center, the PCs cannot take the functions into their hands. On the other hand, the PCs have to use their legislative authority to pass statutes for the subjects devolved to them in order to exercise the legal authority according to their wishes. However, the PCs still lacks necessary administrative capacities to draft statutes. Consequently, for the last 27 years the PCs have produced not more than 200 statutes though a minimum of 300 statutes per PC was expected in the beginning. The tax base provided for the PCs is insufficient to maintain the recurrent expenditure of PC administration, let alone the undertaking of development functions emanating from the 36 subjects assigned to the PCs by the Constitution. The PCs are dependent on the treasury funds to be channelled through the allocations to be made in the annual appropriation bill (Amarasinghe 2010). The provincial public administration is headed by the Governor and the Chief Secretary appointed by the President and, all the administrative units are headed by the members of All Island Services which are under the control of central government institutions. The selection of All Island Services was a deliberate move as the politico-administrative leadership thought that these serviced personnel would maintain the unitary nature of the Sri Lanka State (Committee 01 October, 2001).

2.4.3 Local Authority System After the Establishment of Provincial Councils

The establishment of Provincial Councils has changed the landscape of the local authority system as the central government decided to handover the supervisory control of local authorities to the PCs following the devolutionary arrangement in the 13th Amendment. The government abolished the Local Government Administrative Service and absorbed the members of local government service into the Sri Lanka Administrative Service.

The 13th amendment to the constitution has identified the local government as a subject to be devolved to the PCs. One of the initial steps taken by the government to activate the PC system was to hand over the supervisory functions of local authorities to the PCs. Consequently the powers exercised by Minister of Local government of the Central government mainly as per the judiciary interpretations were automatically handed over to the Provincial Minister of Local Government. In 1992 the government introduced the new local authority body, the Pradesheeya Sabhas, to fill the vacuum created by the abolition of Village Councils and Town Councils in the 1980s. One of the special features that came into operation with the establishment of new institution was the new electoral system based on the Proportional Representation system introduced by the Constitution of 1978. The old electoral system facilitated the election of members from a single member constituencies (Wards) based on the simple majority system. With the new arrangement multimember constituencies were created and the election was based on Proportional Representational system. For the first time in the history of local government system in Sri Lanka the Pradesheeya Sabha received the powers to plan and implement the development programs in the area. The Local Government Institutions at the village level, which since the colonial days have been assigned the only responsibility of undertaking the utility services, now received the responsibility of handling development programs. The Chairperson of the Pradesheeya Sabha became the only Chairperson in the Local Government system who received the status of Chief Accounting Officer. A Commissioner is appointed by the Minister of Local Government at the Municipal and Urban Councils as the Chief Accounting Officer; thus the Mayors of Municipal Councils and Urban Councils are not personally handling the public funds.

2.5 Conclusion

The modern system of local government institutions is a colonial heritage. It evolved from the supportive institutions of Central government and gradually became the institutions that facilitate local self-rule. The post-independent history was dominated with the tense situations created by the attempt to establish second-tier government or sub-national level government as the issue became an integral aspect of polemic between the political leaders that belonged to the ethnic divide since 1957. The introduction of Proportional Representation into the local government institutions made the members of Local Government bodies as representatives of political parties though they were elected by the people.

When the Provincial Councils came into being without the whole hearted support of Central political leadership, the local bodies at the village level were used by the Central political leaders as a countervailing mechanism to restrict the powers of Provincial Councils. For example, the Ministry of Economic Affairs that existed until 2015 allocated funds for rural development straight to the Chairpersons of Pradesheeya Sabha who were the Chief Accounting Officers even by passing the

Ministry of Local Government. The Provincial Councils which is the supervisory body of these local government institutions become silent onlookers. The assigning of the responsibility of undertaking of development programs in their areas to the Pradesheeya Sabhas indirectly helped the central government to manipulate these lower level rural institutions against the Provincial Councils. The activities of these rural level local government institutions in the recent past is far from satisfactory as they remind us about the statement made by a member of State Council in 1940 ‘hopelessly corrupted’.

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Chapter 3

Developmental Role and Financing of Sub-National Units of Government: The Case of Provincial Councils in Sri Lanka

W.D. Lakshman

3.1 Introduction

The system of Provincial Councils (PC) in Sri Lanka, introduced by the Thirteenth Amendment to the Constitution enacted in 1987, was intended as a package of devolution of state power to a set of elected institutions covering the nine administrative Provinces of the country. There was hardly any domestic political dialogue on the subject of power devolution or any strong domestic political pressure for the setting up of this sub-national layer of government. The theoretical and empirical rationale behind any devolution package could be varied and multi-focussed. Part of this rationale would be that devolution would bring the governance processes closer to people and would tend to meet the real needs of ordinary people better than a system of centralised decision making. As a devolved system of governance, it would provide greater voice to regional/local people regarding matters of concern to them. Sub-national units, it is expected, would be able to correctly identify regional priorities in accordance with real needs of the people at the grass roots level and to provide them the required services accordingly.

The PC based devolution package in Sri Lanka, however, was more strongly guided by ethno-political reasons than by the developmental type rationale highlighted above. References to a developmental rationale in regard to the PC system, if any, were only occasional and random. Devolution through PCs¹ was the chosen

¹The 13th amendment to the constitution provided for the break-up of activities between the national and provincial governments. It introduced three lists of activities—the Provincial list including those devolved to PCs, the National government list and the concurrent list. The government at both levels could exercise authority on the activities in the last list. The concurrent list has attracted many criticisms and one of these criticisms has been that it was used by the national government to restrict the degree of devolution of power to PCs.

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political strategy to bring about some reconciliation between the majority Sinhala community and the Tamil minority that was agitating for a measure of regional self-government. When introduced in 1987 largely through Indian pressure, as per the Indo-Lanka Accord of that year, it was seen as an externally imposed political solution to the country's north-east conflict, which it was hoped, would restore lasting peace. It was ostensibly intended to serve the interests of mostly the people in Northern and Eastern Provinces. During the period of separatist—terrorist movement spearheaded by the Liberation Tigers of Tamil Elam (LTTE) however, the PC system operated in Sri Lanka without the electoral participation of the people in these regions.

The Sri Lankan system of governance as developed through the British colonial experience has come to be viewed as highly centralised. In order to manage affairs in outlying areas a system of regional administration has been in operation subject to an authority structure directly linked to the administrative centre in Colombo. In addition, a system of elected local government institutions has been in place. Further steps towards de-concentrated/decentralized administration in post-independence Sri Lanka were taken in the 1970s by introducing a system of decentralized budget. The PC system was superimposed on top of these regional administrative structures.

When the PC system was introduced, Northern and Eastern Provinces were amalgamated into one as an interim measure to satisfy the Tamil minority demands which were strongly backed by the Indian government. The decision either to make the amalgamation permanent or to restore *status quo ante* of two separate provinces was left to a referendum to be held within these two Provinces. This referendum was never held. A North—East PC was elected for the amalgamated Province in November 1988 and it operated less than 2 years. Politico-military developments eventually led to the dissolution of this North-East PC in July 1990. Except for this short period, no elected PC operated in these two Provinces until the Provincial council was elected for the Eastern Province in 2008 under very different conditions.

The few years from 2006 to 2013 witnessed some significant developments in the history of Sri Lanka's PC system. A landmark Supreme Court judgment delivered on October 16, 2006, determined that the merger of the Northern and the Eastern into one Province was unconstitutional, invalid, and illegal. Subsequently two PCs were formally declared for the two Provinces. The military wrested the control over Eastern Province from the hands of the LTTE in July 2007. Subsequently, in May 2008, the government held elections for the Eastern Provincial Council. The LTTE control over the Northern Province was eliminated in May 2009. Elections were held for the Northern PC in September 2013. The two youngest elected PCs, in Northern and Eastern Provinces, are complaining of many limitations to their functioning, particularly in terms of available human resources in its service and limited transfer of powers by the national government.

Section 3.2 of this paper presents a brief outline of the history of decentralisation of administration in post-Independence Sri Lanka and the run up to the PC system. Section 3.3 has a description and a critical review of the Provincial Councils

system. Then the paper goes into the subject of its main focus in Sect. 3.4 on issues of fiscal devolution and problems of financing PC activities. Due to various reasons, as almost everywhere in the world, in Sri Lanka too, sub-national units of government are not given authority to collect the adequate tax revenues on their own to meet their expenditure requirements. To varying degrees these PCs are made to depend on grants from the national government. The brief analysis of revenues, grants and expenditures of PCs in Section 4 shows the limitations imposed on PCs by the inadequacy of fiscal autonomy extended to them by the constitutional amendment which created them.

This issue of fiscal limits to PC autonomy have significant implications for socio-economic disparities among the nine Provinces as well. This is the subject of focus for Sect. 3.5. Problems of PCs vary significantly from one PC to another. In terms of the resource base, both human and physical, infrastructure facilities, value added generated and other socio-economic indicators, the Western Province (WP) is significantly ahead of other Provinces. As much as 60% of total Provincial Council revenue is collected by the Western PC. Provinces like the Eastern, Northern, Uva and North Central enjoy conditions of low population densities, with agriculture including fishing as the main source of income for the people. The Eastern Province has the geographical peculiarity of its elongated coast line of some 750 km. The poverty ratios and therefore, the dependence on public assistance programmes is high in all less developed regions, including the violence-affected Northern and Eastern Provinces. The other provinces are in intermediate positions between the Western and the four underdeveloped provinces noted above. As a result of these significant inter-Province differences, the need for intervention programmes of the central government remains strong. Such programmes are required to prevent further deterioration of living conditions in Provinces at lower levels of development. The paper is concluded with a few comments about how to improve the fiscal autonomy of PCs so that they could perform their developmental role more effectively.

3.2 Run Up to the Establishment of Provincial Councils

During its centuries-long ancient history, as well as during the time from the early sixteenth century up to around the so-called Colebrook Reforms of the 1830s under British colonial rule, Sri Lanka was a decentralised state—if the term “state” could be used to denote the geographical mass that was Sri Lanka during the ancient times. There were normally several “principalities” and at times when the king or the queen, ruling from whatever was the contemporary capital city, was able to bring all provincial rulers under his/her control, authority and suzerainty, the entire country became “centrally” administered. This occasional “centralisation” also, given the then conditions of transportation and communication, was quite understandably more notional than real. Coastal areas of the country were under the control of the Portuguese and the Dutch consecutively in the sixteenth, seventeenth

and eighteenth centuries. The former Dutch territories of the country were taken over by the East India Trading Company in 1776 and later in 1802 by the British Crown. The entire territory of Sri Lanka came under British rule in 1815 with the capture of the Kandyan kingdom by the British. Yet no centralised administration of the country commenced for several more decades. This centralisation process started with the constitutional and administrative reforms introduced following the recommendations of the Colebrook—Cameron Commission of the 1830s. Still, it probably took several more decades of development of the transport and communication system, the integrated national economic system, constitutional and administrative systems and domestic security arrangements for a centralised state structure to evolve. This centralised state was, however, combined with a system of “regional” administration and a rudimentary representative local government.

The centralised state structure that evolved during the British colonial period was inherited by Sri Lanka at the time of decolonization.² The politicians and administrators of the country adopted and accepted it enthusiastically and unreservedly. For a period of over two decades since political independence, the ruling political coalitions and administrators continued with the centralised system inherited from the British with single-minded commitment. To meet special needs of regions there was the well-developed and relatively simple system of regional administration headed by a network of Government Agents (GA) responsible to the central government. These GAs were in turn assisted by a subordinate network of senior officials—Assistant Government Agents, District Land Officers etc. The regional administrative headquarters called Kachcheries were located in District capitals. At the lowest grassroots level of the officialdom were the Village Headmen, later re-designated as *grama-sevaka* officers. At the political level, the required antidote to centralisation was provided by a series of elected local government institutions in a hierarchy of four different levels—Municipal, Urban, Town and Village Councils.

This centralised system of governance, with its elements of decentralisation to meet regional needs, continued more or less unchanged for several decades. Additional elements of decentralisation came to be introduced since the 1970s. The government elected in 1970, having a strong representation of many left-wing political leaders committed to planned development where the necessity of regional planning, for spatially balanced development, was stressed. Showing a clear departure from policies of earlier regimes, this government emphasised principles of people’s involvement in decision-making at the local level and decentralization of political and administrative powers.

Some of these institutional innovations, however, have been abandoned with the passage of time without leaving behind any trace. Yet, during the period of this regime an attempt was made to establish institutions to enhance people’s

²This was so in spite of the fact that towards the end of the British rule there were proposals for greater devolution of power to regional bodies. The Donoughmore Commission of 1928, for example, made several significant pronouncements on its proposals for Provincial Councils. See Bruce Matthews (1982), “District Development Councils in Sri Lanka”, *Asian Survey*, 22:11, 1117–1134.

participation in decision making at local and regional levels. One such innovation was the *People's Committee* (PC) set up by the People's Committee Act of 1971. In rural areas, PCs which were appointed jointly by a Cabinet Minister and Members of Parliament representing related areas were conceived of as a people's audit of government administration. The system of *Divisional Development Councils* (DDCs) also established by the Government of 1970–77 was the first attempt after gaining political independence to build up close links between the government administration and local community to secure active participation of the latter in regional development programmes. A system of *Agricultural Productivity Committees* (APC) was established under the provisions of the Agricultural Productivity Law of 1972. These committees, constituted through a system of Ministerial appointment and election, were linked to the central administration through a system of field assistants at divisional and district levels. The APCs were charged with the promotion, coordination and development of agricultural activities at local level. None of these institutional mechanisms for the promotion of people's participation in regional development have survived the regime change in 1977.

The 1977 regime had introduced a new institutional mechanism by the name of *District Development Councils* (DDC) under the provisions of the Development Councils Act of 1980, to ensure people's participation in the development process at village, divisional and district levels. DDCs comprising both members elected specifically for these Councils and sitting Members of Parliament representing relevant districts, were entrusted with formulation and implementation of annual development plans for their respective Districts. In this assigned function, the DDCs were assisted by two lower level bodies—the Gramodaya Mandala (GM) at village level and Pradeshiya Mandala (PM) at divisional level. A fate similar to the institutional innovations of 1970–77, noted above, fell on the DDC experiment as well.

In addition to the above institutional innovations to enhance people's participation in decision making at local and regional levels, the government of 1970–77 also introduced certain measures to decentralise power at the level of allocating central government financial resources. This produced some decentralisation at the political level as well. The *Decentralized Budget System* which operates even today was first introduced in 1973. This was to achieve some decentralization of central government power over financial management and budgetary control. Under a "decentralized budget" (DCB), a certain proportion of the national budget (then about 13%) was allocated for districts enabling district authorities to spend their respective portions according to their priorities based on local needs. The purpose of the DCB was to finance capital works "(a) of a local nature intended to generate increased production and employment in the rural sector; and (b) for which no provision has been made in the votes of any Ministry/Department under itemized works". (Circular, Ministry of Plan Implementation, 31-01-78). District level political leadership is expected to allocate the funds among electorates ensuring balanced development within the district itself. The Government Agent (GA) was appointed as the chief accounting officer for each District. A system of District Political Authority (DPA) was established in 1973. A senior politician belonging to

the ruling party was appointed as DPA for each district. The DPA became the main political body at the district level that was connected with the DCB system. The DPA was to give leadership to mobilizing popular support and cooperation for high priority government programmes, to cut through red tape in the formulation and implementation of urgent measures, and to provide for closer liaison between the administrative and political heads.

These systems were modified with the next round of political and constitutional changes. With the enactment of the 1978 Constitution, an institution called the District Minister (DM) was created, replacing the former DPA. The DM, appointed by the President, was to coordinate development activities within the district. GA acts as the secretary to the DM. The principal stated objective of the DM system also has been to facilitate popular participation in district administration through involvement of elected people's representatives.

In addition to the above changes in political, administrative and budgetary practice facilitating decentralisation, Sri Lanka has also had various decentralised programmes of rural and community development. Part of the incentive for introduction of such programmes was provided perhaps by the availability of foreign aid funding for such purposes. The most well-known and highly publicised such programme was the system of *Integrated Rural Development Projects* (IRDP) since 1978. The rationale behind IRDPs was that rural development is best achieved through coordinated multi-sectoral development plans, implemented through participation of representatives of the local population (Budget Speech, 1986, p. 29). IRDPs operated for about a decade after 1978 within 18 out of Sri Lanka's 24 administrative districts involving Sri Lankan funds marginally, but predominantly the funds from nine donor agencies including the World Bank. The system of IRDPs was concluded with the drying up of foreign finance for the purpose.³

Given rural-urban composition of the electorate and the large concentration of electoral votes in rural areas, various rural development programmes were a constant feature of the Sri Lanka's developmental approach. Since 1978 various special village development programmes, aiming at the improvement of living conditions in very remote and underdeveloped rural areas became common. These programmes were named in different ways using attractive terminology in local languages. In what follows the titles given to the rural development programmes in Sinhala, the language of the majority community, are shown. The *Village Re-awakening Movement* (VRM) initiated in 1978, was the pioneer in the above type of local development schemes aimed particularly at selected remote villages. Under this scheme, "village awakening" (*gam udawa*) activities in selected remote villages were undertaken to help the poor and underprivileged families in those villages economically, socially and culturally. Every principal political party, when in power, was known to claim credit for this type of electorally attractive programmes,

³There is a detailed factual description of the Sri Lankan movement towards administrative decentralisation and the various systems adopted for the purpose in the country case study carried out for the Food and Agriculture Organisation by Bedgar Perera on "Impact of decentralization on rural development at the local level": See <http://www.fao.org/docrep/004/ac158e/ac158e0g.htm>.

to the neglect of the contributions of preceding regimes. Thus the attractive Sinhala language name, *gam udawa* adopted by the pioneer was abandoned with regime change, with different names (e.g. *gami diriya* to mean rural courage, *gama neguma* meaning rural progress) being adopted to describe a set of similar activities undertaken for rural development. The characteristic feature of all these activities is that a measure of policy decentralisation prevailed with some autonomy given to beneficiaries and their representatives in policy making and implementation, with centralised authority retained in all essential aspects.

Part of the stimulus for the above constitutional and administrative measures of decentralisation and regional development innovations obviously was to ensure proper trickle down of the benefits of market-based developments and state sponsored initiatives to the masses of people at lower income levels and those living in distant areas. As a multi-ethnic and multi-religious society, Sri Lanka also expected from these measures the satisfaction of demands emanating from ethnic and religious minorities living in concentrated numbers in certain distant areas in the country, particularly the Tamil speaking populations in the Northern and Eastern Provinces. The agitation of the Sri Lankan Tamil minority, for a measure of autonomy in the administration of the country and in allocating budgetary funds of the state, was a constant feature of the political landscape of Sri Lanka since even prior to decolonisation. In addition to the administrative and developmental measures discussed above, there are two episodes of completely failed initiatives to bring about devolution of power; namely, the District Councils proposal first under the Bandaranaike—Chelvanayakam Pact in 1957, and the second under the Senanayake—Chelvanayakam Pact in 1965. Even the measures of de-concentration, decentralisation and rural development, noted above, some implemented fully and others partly, could not resolve or subdue the demands of the Tamil community in Sri Lanka for a measure of administrative autonomy for their regions, often articulated as their right of self-determination in areas they live in.

Interspersed with these protest movements carried out by sections of the Tamil community, there were occasions of communal violence. The bulk of these began with the responses, often violent responses, of sections of the majority Sinhalese community to minority protest movements against measures taken by the government.⁴ The year 1983 witnessed the worst and the most violent of this series of communal riots. They were also the most devastating in a number of spheres of Sri Lankan socio-political and economic life. The expression of “black July” used

⁴The incidents of communal violence in the second half of the 1950s, particularly in 1958, for example, commenced in the aftermath of minority protests against the enactment of the Sinhala Only Act (1957) making Sinhala, the language spoken by the majority community, replace English as the country’s only official language. From the point of view of the minority Tamil community, there were other irritants as well in the second half of the 1950s, arising out of official actions. On 1958 communal riots an easy reference would be: http://en.wikipedia.org/wiki/1958_riots_in_Ceylon. The available published literature in the subject of Sri Lankan ethnic conflict is vast. Asoka Bandarage (2009). *The Separatist Conflict in Sri Lanka: Terrorism, Ethnicity, Political Economy* is an easy reference for a comprehensive history of the ethnic conflict in Sri Lanka.

widely to indicate the month of July 1983 when these riots occurred is indeed very appropriate, given the damage these riots caused to critical spheres of Sri Lankan life.

The main developments in Sri Lankan ethnic relations after July 1983 were the militarisation of the Tamil protest movement and the commencement of an armed struggle, in which terrorist⁵ measures were often and extensively used, to establish a separate state of Tamil Elam in the Northern and Eastern parts of Sri Lanka. The impact this movement has had on international relations of Sri Lanka, particularly its relationships with its sub-continental neighbour India, has been extensive.

3.3 The Provincial Councils System

From the early part of the 1980s, Sri Lanka experienced a gradually intensifying civil strife based on the demand for self-government for the minority communities in the north and the east of the country. This movement became increasingly violent as time passed. The leadership in this separatist terrorist movement, as already noted, was in the hands of the LTTE. The origins of this conflict are traced to practices of perceived ethnic discrimination of the minority Tamils by the majority Sinhalese after the country won its independence from British colonial rule. It may be noted, however, that there are significant differences of opinion among scholars, as well as among the general public, about the interpretation of this discrimination thesis. Indian government had provided various forms of support to Tamil separatist groups during the initial stages of organized violence against the Sri Lankan state to win self-government for the regions concerned. Indian government support for these separatist groups was partly a reflection of the political implications for the Indian government of the presence of a large Tamil community in South India. The Indian support initially to Tamil separatist groups in Sri Lanka reflected partly the working out of India's regional and global security interests.

From 1985 onwards, the government of Sri Lanka was seen moving towards a military solution to the separatist-terrorist campaign of the LTTE. In 1986–87, the military operation against the insurgency was stepped up. The Indian media on their part intensified the call for Indian government intervention to prevent what was described as a developing humanitarian crisis in northern and eastern regions in

⁵There is no academic or international legal consensus about what terrorism means. Various legal systems and government agencies use different definitions as the term is politically and emotionally charged. I am using the word in the text to mean what the United Nations General Assembly describes as: "Criminal acts intended or calculated to provoke a state of terror in the general public, a group of persons or particular persons for political purposes are in any circumstance unjustifiable, whatever the considerations of a political, philosophical, ideological, racial, ethnic, religious or any other nature that may be invoked to justify them." (1994 United Nations Declaration on Measures to Eliminate International Terrorism annex to UN General Assembly resolution 49/60, "Measures to Eliminate International Terrorism", of December 9, 1994, UN Doc. A/Res/60/49.

Sri Lanka. Faced with the possibility of an active Indian intervention, Sri Lankan government gave up half way the military offensive against the LTTE and commenced negotiations with its Indian counterpart, leading eventually to the Indo-Lanka accord of July 29, 1987. The system of power devolution through the mechanism of Provincial Councils was the solution to the Sri Lankan ethnic problem and the separatist-terrorist struggle of the LTTE, which India virtually imposed on Sri Lanka through the 1987 Indo-Lanka Accord. There was no genuine people's movement in Provinces, other than perhaps⁶ the Northern and Eastern Provinces, demanding such power devolution. The system was established even without any serious commitment on the part of the government of Sri Lanka. The PC system was superimposed on existing decentralization mechanisms. When enacted by Parliament, the objectives of this system of power devolution were essentially ethno-political. The developmental rationale for power devolution, if any, was marginal and unintentional.⁷

It was on 14 November 1987 that this Thirteenth Amendment to the 1978 Constitution of Sri Lanka, proposing the system of Provincial Councils, was enacted. The Indo-Lanka Accord also insisted that, in an interim, the Northern and Eastern Provinces must be merged into one administrative unit to come under one Provincial Council. The Accord included provisions for a referendum to be conducted within the Eastern Province by the end of 1989 in order to decide whether the Eastern should continue to remain merged with the Northern Province. Northern and Eastern provinces were declared by the President of Sri Lanka in 1988 to have been merged into one unit administered by one elected Provincial Council. The referendum in the Eastern Province to determine whether it should remain linked with the Northern Province, however, was never conducted. Successive Sri Lankan presidents have issued proclamations annually extending the life of the "temporarily" merged entity. The merger was bitterly opposed by Sri Lankan nationalists. There was a long campaign against the merger. A Supreme Court ruling in October 2006, made in response to a case filed by a political party, had eventually produced the de-merger of the two Provinces, which these campaigners were fighting for over a long period of time. The demerger came eventually in January 2007 and provision was made to set up a Provincial Council each in Northern and Eastern Provinces.

The rationale for devolution, in principle, rests on at the least two broad groups of claims. First, it is claimed that devolution facilitates and promotes regional development better than a system of centralized governance, on the one hand, by enabling policy makers to formulate policies with better and closer awareness of conditions at the grass roots level and on the other hand, by bringing public services closer to the people. Second, it is believed that devolution helps building up and

⁶There was no mass movement even in these Provinces for such power devolution at the time, although the politically mature groups would have articulated ideas of devolved governance for their regions.

⁷Amita Shastri, "Sri Lanka's Provincial Council System: A Solution to the Ethnic Problem?", *Asian Survey*, Vol. 32, No. 8 (Aug., 1992), pp. 723–743.

strengthening ethnic/ religious harmony in multi-ethnic and multi-religious societies. It is a devolved system of governance which minority communities in Sri Lanka demanded and the PC system, by providing some form of power sharing through devolution, was viewed as capable of creating the desired harmony among different ethnic groups. As already noted, the first developmental objective was not considered with any seriousness at the time of establishment of the PCs. These objectives are however, increasingly articulated nowadays along developmental lines. The discussion in this paper of selected fiscal aspects of the PC system does not go into details of any of the ethno-political issues which initially governed the designing and launching of the PC system. The paper addresses certain fiscal issues of Provincial governance taken up for discussion from the point of view of the potential of the PCs to play a positive developmental role.

After nearly three decades of existence, the Provincial Council as a political institution has come to stay in Sri Lanka. That the PCs have a useful developmental role to play is, therefore, admitted. Provincial administrations could understand regional needs and regional potentials better than central government agencies. The PC system, therefore, would help improve regional and rural development efforts. The PC system is thought to have empowered the elected PC representatives to make better decisions for social and economic development at the provincial level. The need to minimize the economic and social differences between and within Provinces is being highlighted in respect of regional development objectives of PCs.

The Provincial Councils derive their authority and power from the Constitution and relevant Acts of Parliament. The Thirteenth Amendment to the Constitution delegates executive authority in Provinces to the Provincial Governor appointed by the President of the country, and legislative powers to the PCs. The Provincial administration runs through six principal institutions—Governor, elected Provincial Council, Chief Minister, Provincial Ministers, Provincial Public Service and Chief Secretary.⁸

The ninth schedule (see Appendix to this paper) to the Constitution lists the functions of the central government and PCs in three lists:

1. Provincial council list
2. Concurrent list and
3. Reserved list

⁸The Governor has direct executive powers deriving from the Constitution. The Governor can perform his/her functions directly or through the Board of Ministers or through officers subordinate to him/her. The function of the Board of Ministers is to aid and advise the Governor in the implementation of his/her functions. The Governor appoints the Board of Ministers, consisting of the Chief Minister and four other ministers. The Board of Ministers is collectively responsible and answerable to the PC. The Chief Secretary is appointed by the President with the concurrence of the Chief Minister. The Chief Secretary is the Chief Executive Officer and the Chief Accounting Officer of the Province.

The PCs are vested with the power to make statutes with respect to the Provincial Council list. In respect of the concurrent list, their statute making powers are subject to the approval of the Parliament. All matters set out in the reserved list are under central government authority. Of these three lists of functions, the most controversial has been the concurrent list, as the Central government has used this list to gradually reduce and restrict PC functions; thereby nullifying to a great extent the power devolution intent of those who brought the Thirteenth Amendment into the Sri Lankan Constitution.

The PC system has come under a variety of criticisms since its enactment in 1987. Some of these criticisms have been about weaknesses in the law, the weaknesses seen and analysed differently depending on the critics' ideological positions pertaining to the key issue of power devolution to regions. The other criticisms have been about how the Thirteenth Amendment was actually implemented over the past three decades. There has always been a tug-of-war for power between politicians and bureaucrats in the centre on the one hand, and the provincial politicians, those representing minority communities residing in the Northern and Eastern Provinces in particular, and provincial bureaucrats on the other. The former group was attempting to give away as little of the powers they enjoyed prior to the Thirteenth Amendment and the latter group to get as much of those powers to Provincial Council administration. There would probably be little disagreement within objective opinion—if indeed there is any such opinion—that this power struggle got resolved largely in favour of the centre, leaving the PC system largely in a disgruntled position. This has helped strengthening the widely-held argument, particularly among majority community opinion, that as they performed so far, the PCs brought into being as vehicles for a meaningful devolution of political power in the country, have on the contrary become a white elephant Sri Lanka could ill afford to maintain.

3.4 Fiscal Devolution and Financing of Provincial Councils

Providing powers of revenue raising and expenditure determination to sub-national governments is a core component of devolution or decentralization of political power. In an effective framework of fiscal devolution, expenditure responsibilities of sub-national units such as PCs, should be matched by the assignment of adequate sources of revenue or receipts for those units. How much of these receipts should come from revenues and how much from grants would depend on the extent of fiscal autonomy that is allowed to PCs in respect of spending decisions, the accepted revenue sharing principles, the basis on which central government grants are determined, the government's regional development policy stances and differences among Provinces in terms of their value-added contributions and therefore, their revenue earning capacities. The more revenue that is available to a PC, the less would be its dependence on national government grants. The two together will

determine the degree of fiscal autonomy these sub-national units enjoy. Greater this fiscal autonomy the PCs would be able to take up larger and more extensive decision making powers within areas permitted by the Constitution, leading to PCs becoming more accountable for achieving results and people beginning to see these as useful development-friendly organizations.

If sub-national governments are to carry out decentralized functions effectively, they must have an adequate level of revenues—either raised within their geographical areas of jurisdiction or transferred from the central government—as well as the authority to make decisions about expenditures. Fiscal decentralization can take many forms, including (a) self-financing or cost recovery through user charges, (b) co-financing or co-production arrangements through user participation via monetary or labour contributions; (c) expansion of local revenues through property or sales taxes, or indirect charges; (d) intergovernmental transfers shifting revenues collected by the central government to sub-national governments for general or specific uses; and (e) central government authorization of borrowing by and provision of loan guarantees to sub-national governments.⁹ The following discussion however, covers only items (c) and (d) above.

Provincial Councils were allowed, by constitutional provision, to collect their own revenues from five main sources until these provisions were changed in 2010: (i) Business Turnover Tax (BTT) on wholesale and retail sales, (ii) Stamp Duty, (iii) Court Fines, (iv) Motor Vehicle License Fees and (v) the Excise Duty. Revenue sources of PCs have been constitutionally determined as falling into 20 subject areas of taxation indicated in the Annexure. These revenue provisions in the constitution show clearly the limited nature of the scope and extent of devolution in terms of revenue sources assigned to Provinces, both by way of revenues to be raised by them and taxes collected and transferred by the Centre to PCs. Of devolved taxation, the BTT constituted the major source of collected PC revenues until 2010. Its share in collected PC revenues had increased from 49.9% of the total to 53.7% between 2007 and 2010.

However, it came under criticism that the operation of the provincial BTT and other national taxes charged on similar tax bases produced a system of dual taxation of the relevant tax bases and that it had raised the burden on tax-payers, particularly the tax burden on small and medium enterprises (SME) and consumers. With a view to avoid these tax problems, the BTT collected by Provincial Councils was abolished in 2011.¹⁰ To compensate for the resulting revenue loss of the PCs, a special revenue sharing system was introduced in the same year. Accordingly, different proportions of revenues collected by national authorities from certain taxes came to be transferred to provinces on the following basis¹¹:

⁹See the paper on Intergovernmental Fiscal Relations at: <http://www1.worldbank.org/publicsector/decentralization/fiscal.htm>.

¹⁰See para 84 of the Budget Speech for 2011.

¹¹The difference between the numbers in the last two rows in Table 3.1 indicates the size of these transfers during 2011 and 2012.

- i. 33 1/3% of the Nation Building Tax (NBT)
- ii. 100% of Stamp Duty
- iii. 70% of Vehicle Registration Fees.

The proportionate distribution of revenues collected from the NBT and the Stamp Duty among different PCs was also indicated. According to Table 3.1, the overwhelming bulk of the provincial revenue comes from taxes and other charges, including shared tax revenue after 2010. The non-tax revenue (other revenues in Table 3.1) includes mainly rental income, interest income, service charges and registration fees.

The constitutional devolution of powers in respect of selected revenue sources is intended to make devolution of powers in respect of responsibilities over devolved activities meaningful as revenues are needed to perform the devolved functions. Revenues that could be collected using devolved taxation powers are however, found to be inadequate to fund the operations of the institutions under PCs, to pay the personnel in their employment and to finance their planned investments.

The revenue raising authority devolved to Provincial Councils by the thirteenth amendment to the Constitution has been extremely limited. As a measure of the extent of fiscal devolution in terms of revenue raising powers, Table 3.2 presents the ratio of total PC revenues (with tax revenue transfers) to the country's GDP for three years, 2010–2012. In the context of a 14% ratio (2013) of national tax revenues to GDP, tax revenue sources worth less than 1% of GDP have been devolved to PCs. As another measure of fiscal devolution in terms of revenue, Table 3.3 shows that PCs are permitted to collect only around 5% of revenues which the central government collects annually.

Table 3.1 Provincial revenue collection by source 2008–2012 (Rs. million)

Revenue source	2008	2009	2010	2011 ^b	2012
BTT	15971	16079	19584	33652 ^b	197 ^b
%	52.26	54.04	53.65	15.37	0.84
Stamp duty	5837	5225	6714	9304	10,096
%	19.10	17.56	18.39	39.15	43.06
Motor vehicle license fees	3237	3495	3911	5040	5726
%	10.59	11.74	10.71	21.21	24.42
Excise duty	481	463	591	732	794
%	1.57	1.56	1.62	3.08	3.39
Court fines	990	1132	1588	1591	1907
%	3.24	3.80	4.35	6.70	8.13
Others	4045	3362	4117	3443	4728
%	13.24	11.30	11.28	14.49	20.16
Total excluding government transfers ^a	30,561	29,757	36,506	23,762	23,448
Total including government transfers ^a	30,561	29,757	36,506	46,505	50,680

Source Finance Commission

^aGovernment transfers after 2010 to cover 33 1/3% of NBT (see text for details)

^bCollection of BTT due for payment up to 2010

Table 3.2 Total provincial council revenue and GDP—2010–12 (Rs. Million)

Description	2010	2011	2012
GDP	5,604,103	6,544,008	7,582,377
Provincial Revenue	36,506	47,504 ^a	50,680 ^a
%	0.65	0.73	0.67

Sources Finance Commission and Central Bank Report—2012

^aIncluding the Government Revenue Transfers

Table 3.3 PC revenues in relation to government revenues, 2008–12 (Rs. Million)

Description	2008	2009	2010	2011 ^a	2012 ^a
Total government revenue	655,259	699,644	817,279	934,776	987,844
Provincial revenue	30,561	29,757	36,506	47,504	50,680
Provincial revenue as a % of total government revenue	4.66	4.25	4.47	5.08	5.13

Source Finance Commission and Central Bank Report—2012

^aIncluding the Government Transfers

Table 3.4 Provincial revenue and expenditure 2011–2012 (Rs. Million)

Description	Revenue ^a	Expenditure (Recurrent and Capital) ^b	Deficit	Deficit/revenue (%)
2011	46,505	149,751	103,246	215%
2012	50,680	160,777	110,097	217%

Source Finance Commission

^aIncluding Government Transfers of tax Revenue

^bIncluding development projects

The revenue-expenditure gap of PCs has been large. Table 3.4 compares Provincial revenues and expenditures in the years 2011 and 2012. Provincial expenditure exceeds provincial tax revenues (both collected directly by PCs and tax revenues collected and transferred to PCs by the centre) by over three times. Recurrent expenditure of PCs accounts for about 80% of their total expenditure. Table 3.5 shows that Provincial recurrent expenditure was about 12–13% of total recurrent expenditure of the central government during 2008–12.

A point to be noted further is that a very large share of these recurrent expenditures is earmarked for social (e.g. health and education) services. Around three fourths of the total recurrent expenditure of PCs goes for payment of salaries and wages of the employees recruited by PCs and those transferred by government to serve PCs (Table 3.7). The bulk of these salary payments is for education and health workers in PC service. All this adds an important element of inflexibility to Provincial recurrent expenditures. In contexts of limited devolution of revenue raising powers, this expenditure inflexibility makes revenue deficits in PCs extremely difficult to handle without the assistance of the central government. PC revenue deficits have been over twice the size of their annual revenues (Table 3.4).

Table 3.5 Provincial and central government recurrent expenditures compared, 2008–2012 (Rs. Million)

Year	Government recurrent expenditure	Annual % increase	Provincial recurrent expenditure	Annual % increase	Provincial share %
2008	743,710		103,451		14
2009	879,575	18	112,019	8	13
2010	952,297	8	118,918	6	12
2011	1,029,248	8	130,356	10	13
2012	1,117,931	9	139,381	7	12

Source Annual Budget Estimates

Table 3.6 Total provincial expenditure—2008–2012 (Rs. Million)

Year	2008	2009	2010	2011	2012
Recurrent Expenditure (Rs. Mn.)	103,451	112,019	118,918	130,356	139,381
%	86	84	83	87	87
Capital Expenditure (Rs. Mn.)	16,745	21,156	24,574	19,395	21,395
%	14	16	17	13	13
Total Expenditure (Rs. Mn.)	120,196	133,176	143,492	149,751	160,777

Note Figures include Development Projects

Source Finance Commission, General Treasury and Provincial Councils

Table 3.7 Personal emoluments in provincial recurrent expenditure 2008–2012

Year	Personal emoluments (Rs. 000.)	%	Other recurrent expenditure (Rs. 000.)	%	Total recurrent expenditure (Rs. 000)
2008	79,288,347	76.64	24,162,755	23.36	103,451,102
2009	86,553,314	77.27	25,466,076	22.73	112,019,390
2010	92,049,175	77.41	26,868,683	22.59	118,917,858
2011	100,939,588	77.43	29,416,065	22.57	130,355,653
2012	106,750,832	76.59	32,630,570	23.41	139,381,402

Note Including Transfers to Local Government

Source Finance Commission

Clearly, to meet their recurrent and capital expenditures, PCs depend on financial transfers from the national government by way of grants. Provincial capital expenditure that remained around 18–19% of total Provincial expenditures prior to 2008, dropped to 14% in 2008. The ratio has increased again to 16–17% in 2009–10, but declined to 13% in 2011–12 (Table 3.6). Limitations of revenues and grants together in respect of financing investment activity are clear from the above analysis. This appears to make PCs rather irrelevant in public action needed to promote capital formation in the development of agriculture, industry, services and infrastructure facilities.

The constitutional devolution of powers in respect of revenue sources is intended to make devolution of powers in respect of functional responsibilities meaningful, as revenues are needed to perform the devolved functions. Revenues that could be collected using devolved taxation powers have been found however, to be inadequate to fund the operations of the institutions under PCs, to pay the personnel in their employment and to finance their planned investments. Grants from the central government to PCs are therefore indispensable if the devolution process is to become meaningful. These grants are intended to fill the estimated gaps between the provincial needs and the estimated revenue collections.

The Constitution requires that if adequate funds cannot be raised provincially to meet the provincial fiscal needs, the centre ought to apportion amongst the provinces the required resources in order to achieve balanced regional development. Of the two major sources of provincial finance—(i) government revenues transferred by the central government to provinces through various grants and (ii) the revenues collected either by PCs themselves at the provincial level or those collected by central government and transferred to PCs at certain ratios—the former are substantially bigger than the latter. The Constitution has provided for the Finance Commission to guide and manage the transfer of funds from the Centre to PCs and to regulate centre-province relations in the area of provincial finance. The Commission performs two main functions in carrying out its statutory functions:

- a. It determines the fiscal needs of the provinces on the basis of an analysis of needs carried out and submitted by the PCs and national policy directives and priorities. The Commission informs the government of such needs for allocation of adequate funds from the annual government budget.
- b. It apportions transferred funds among the provinces with the objective of achieving balanced regional development.

The apportionment of funds allocated from the annual budget should then meet the needs of provinces in such a way as to reduce inter- and intra-provincial disparities. In the process of allocation and apportionment of funds to provinces, the Commission uses three forms of grants: the block grant, the criteria based grant and the province-specific development grant.

The block grant (BG) is intended to meet recurrent expenditure needs of provinces, of which salaries and wages of provincial staff constitute the major category. It also includes transfers to local authorities to meet their recurrent expenditure, of which again salaries and wages of local authority staff constitute the bulk share. The criteria based grant (CBG) is intended to finance the capital expenditure of PCs to improve provincial socio-economic conditions, thereby reducing regional disparities. The funds provided under this grant are available to the provinces for discretionary spending on development. The province specific development grant (PSDG) is mainly for financing development projects of a capital nature. Special attention is paid to infrastructure development under different devolved subjects. The Finance Commission and respective provincial authorities would examine the provincial development plans to determine whether these plans are likely to address

Table 3.8 Governmental grants to PCs (Rs. Million)

Year	2010	2011	2012
Government Transfers ^a or Grants	104,314	109,656	101,678
Total Expenditure of PCs	143,492	149,751	160,777
Transfers as a % of expenditure	73	73	63

Sources Finance Commission, General Treasury and Provincial Councils

^aExcluding tax revenue transfers (see text for details)

the provincial needs and are within the national development policy framework of the government. PSDGs are allocated on the basis of this review. For each investment, measurable results (output, outcome and impact) are identified, and periodical monitoring and evaluation made accordingly.

Grants from the central government to PCs are identified separately from tax revenue transfers.¹² The computation of revenue deficits of PCs in the foregoing discussion was based on revenues including these tax revenue transfers. The indispensability of grants from the central government is thus abundantly clear if the devolution process is to become meaningful. Table 3.8 shows the total volume of grants the central government had provided to PCs from 2010 to 2012. The ratio of grants to total PC expenditure that remained around 75% during the pre-2012 period, declining to 63% in 2012. When the proportion of PC expenditure financed by government grants dropped in 2012, the total tax revenue collected increased by 6.7%, pushing the total Provincial expenditure up by 7.4%. It is difficult to surmise however, that the trends embodied in the 2011–12 data would continue towards bringing about a gradual decline in the dependence of PCs on government grants. Anyway, without a significant increase in revenue sources, constitutionally opened up for PCs, no perceptible increase can happen in the revenues PCs can collect and thus a significant increase in the degree of fiscal autonomy enjoyed by PCs.

3.5 Regional/Provincial Disparities

The nine Provinces in Sri Lanka are disparate regions. The administrative and commercial capitals are located in the Western Province. It also has the largest concentration of urban areas in the country and also of educational and health institutions. The Western Province is estimated to contain 29% of the country's population, producing 43% of the country's GDP (Table 3.9). The GDP contribution of the other provinces, as per 2012 data, varies between a low of 4% in the Northern Province and a high of 11.5% in the Southern Province. Corresponding to

¹²As noted, these are the revenues collected by the central government from three taxes and charges—NBT, Stamp Duty and Vehicle Registration Fee. The revenues from these taxes are transferred to PCs in the ratios indicated earlier in the text.

Table 3.9 Distribution of population and GDP by province

Sri Lanka and provinces	Population Distribution and urban share of population 2012		GDP Share (%)		Rate of unemployment (%)
	Province share of population %	Urban %	2011	2012	2013
Sri Lanka	100	18.2	100	100	4.4
Western	29	38.8	44.2	43.4	3.9
Central	13	10.5	9.8	9.8	4.6
Southern	12	10.6	11.0	11.5	5.6
Northern	5	16.7	3.7	4.0	5.2
Eastern	8	25.1	5.8	6.3	4.3
North Western	12	4.1	10.0	9.6	3.7
North Central	6	4	4.7	4.7	3.3
Uva	6	5.5	4.5	4.5	3.2
Sabaragamuwa	9	6	6.2	6.1	5.8

Sources Central Bank Report 2013 and Department of Census and Statistics

the highest income share of the Western Province, the urban share of its population also is at its highest at 40%. This may be contrasted with the national urban share of 18%. There is clear disparity among provinces in the distribution of health and educational facilities and infrastructure facilities. The wealth of information that is being collected and analysed regularly about living conditions and poverty among people shows Sri Lanka's high overall achievements in terms of MDGs providing the country its well-known outlier status within the developing world. However, there is variation of average poverty levels from one Province to another and also co-existence of pockets of high poverty incidence, together with provincial averages of low headcount ratios. Another social indicator with a national average of 4.4%, but subject to varying Provincial averages, is the rate of unemployment.

The Finance Commission computes a Composite Index to measure the rank of different Provinces in terms of their average socio economic attainment in terms of selected criteria like per capita income, poverty headcount ratio, neo-natal mortality rate, low weight births, student enrollment, learning achievements at selected school grades, number of houses without electricity, length of roads of selected categories, etc. Table 3.10 presents these composite indices (CI) and the rank of each Province in terms of the CI.

One justification of devolution of power is that devolved systems of governance would bring decision making closer to people. When decisions affecting the lives of the people are taken by authorities that are closer to them and are more knowledgeable about their problems and needs, the decision outcomes are generally believed to be more capable of improving people's living conditions than in the case of a strongly centralized system. Devolution could, it is also believed, minimize regional disparities in economic achievement. Though systems of power devolution are demanded and often recommended as mechanisms to reduce prevailing regional disparities, such prevailing disparities themselves can work towards

Table 3.10 Composite indices for apportionment of funds—2014

Province	CI scores	Rank
Western	0.141776	1
Central	0.125506	2
Sabaragamuwa	0.119396	3
Southern	0.119078	4
Eastern	0.105971	5
North Western	0.105490	6
Uva	0.105193	7
Northern	0.092487	8
North Central	0.085104	9

Source Finance Commission

frustrating the devolution objective of moving towards more balanced regional development. In the case of Sri Lankan PCs, the prevalence of significant Provincial disparities has been noted. One significant outcome of this is the extensive disparity also in revenues that different PCs are able to raise (Table 3.11), thus reducing their capacity to implement effective programmes of development to achieve regionally balanced development. Widely divergent, therefore, is the tax potential or fiscal capability of these PCs, defined as the ratio of revenues they raise to their expenditures. The Western Provincial Council, being the most economically advanced and therefore having the strongest tax base, collects a little over half of total revenue collected by all nine PCs put together. The tax base varies considerably from one Province to another, but this variation is particularly strong between the Western Province and every other Province. Because of higher revenues collected, the Western PC was able to finance 76% of its expenditure from its own collected revenues in 2011 and 68% in 2012. The relevant ratio for 2012, for example, in respect of the four least developed of the nine Provinces—Northern, Eastern, Uva and North Central—were respectively, 11.6, 12.0, 17.3 and 19.5%. The second highest percentage after the 68% of the Western PC was as low as 26% with the average for all PCs remaining at 31.5%.

Revenue collection differences among PCs are affected by administrative capability differences among PCs as well. The land area subject to the jurisdiction of non-Western PCs is very large and extensive. The best example for this is the Eastern PC, with its very large north-to-south spread. The available human resources and administrative arrangements for revenue collection have often proven grossly inadequate. As in many other cases, the Western PC enjoys an advantage over other PCs also in respect of the capacity to raise revenues. Most of the BTT revenues of PCs (before 2011) were collected by the Western PC. Revenue sharing between the Centre and PCs, as well as among individual PCs, is a major fiscal issue to be addressed. There is diversity of opinion on the question of what revenue sources should be opened up to PCs. At one extreme, there is the opinion in favour of extending the powers of taxation constitutionally permitted to PCs beyond the present list of 20 subject areas listed in the Appendix to the paper. At the other extreme, there are those who argue against assigning whatsoever authority

Table 3.11 Differential fiscal capability of provincial councils, 2011-12

Province	2011				2012				
	Revenue	Expenditure		Revenue as % of total expenditure	Revenue	Expenditure		Revenue as % of total expenditure	
		Recurrent	Capital			Total	Recurrent		Capital
Western	24,958	28,616	4,335	32,951	26,353	31,358	7242	38,600	68.3
Central	4192	16,926	2319	18,365	4203	18,000	2415	19,098	22.0
Southern	3837	15,681	2039	17,720	4671	16,344	1479	17,823	26.2
Northern	1268	11,402	1223	12,625	1556	12,292	1087	13,379	11.6
Eastern	1713	12,075	1390	13,465	1721	12,754	1637	14,391	12.0
North Western	4371	16,556	1697	18,253	4882	17,314	1235	18,549	26.3
North Central	2087	8196	3314	11,510	2510	8904	3961	12,865	19.5
Uva	1779	10,097	1610	11,707	2169	11,255	1303	12,558	17.3
Sabaragamuwa	2300	11,687	1468	13,155	2616	12,477	1036	13,513	19.4
Total	46,505	131,236	19,395	149,751	50,681	140,698	21,395	160,776	31.5

Source: Finance Commission

of taxation to PCs. Between these extremes there are those who favour sticking to the status quo and those who favour a reduction in areas opened up for PC revenue raising effort. Indeed what the central government did in 2011 was to reduce revenues directly raised by PCs and to decide to transfer certain proportions of selected taxes collected by central government tax authorities to PCs. It has anyway been the accepted position that PCs in less developed areas where revenue potential is low must be provided with more funds as grants than the PCs with greater revenue potential. Revenue sharing between the Centre and the PCs and allocation of national grants among PCs constitute a subject area which demands close attention. Working out a rational and development-friendly basis for doing this is a very complex process and depends on many variables. The issues involved need to be resolved through a carefully worked out political process.

3.6 Improving Fiscal Autonomy of PCs

It would be correct to assume that PCs prefer to be able to meet their fiscal needs as far as is possible from dependable sources of funding and in respect of their revenues, to enjoy a degree of autonomy subject to accountability. That would provide them with a measure of freedom and autonomy from the central government, so that they could take objective assessments about needs of their Provinces and formulate development agendas for their Provinces independently of the politics at the level of national government. If the future political processes in the country lead to an allocation to the PC system a clearly laid down developmental role as a sub-national layer of governance, then the PCs ought to be able to become financially more independent of the Centre. Financial autonomy obviously is one of the major components of relative freedom and autonomy of a sub-national unit of government. The concept of financial autonomy used here covers both revenue raising powers of PCs and their right to receive grants from the centre. If a reasonably autonomous, pro-developmental, efficient and accountable sub-national layer of government were to emerge from the present structure of PCs, then an improvement in the degree of their financial independence and autonomy must be facilitated. This requires that subject areas for revenue-raising by PCs through taxation and other means be clearly specified and principles for the allocation of national government grants among PCs clearly laid down so that each PC would be able to forecast their total incomes with reasonable clarity. Part of the policy action required to achieve the above objective would involve some constitutional reform but most of it can be achieved through administrative action.

The system of PCs in Sri Lanka, as already highlighted, emerged as a solution to the “ethnic problem” which dragged the country’s north-east into a violent separatist conflict with extensive impacts in all other regions of the country as well. After the military defeat of the LTTE in 2009, public opinion in the country as a whole seems to support a system of devolution that is acceptable to the Tamil minority in Northern and Eastern Provinces, in order to resolve the post-war issues

of reconciliation between the minority Tamil and the majority Sinhalese communities and to address the issue of restoring lasting ethnic peace. PCs are the institutional mechanism that is available, with or without change in their architecture, to address these issues. In addition, the developmental role of sub-national governments comes to be highlighted with every failing of centralized governance that comes to light. A greater developmental role for PCs, more refined and more clearly articulated, is likely to emerge in the country's future political discourse. Increasing the fiscal autonomy and expanding revenue capacity of PCs beyond what has been provided for in the Thirteenth Amendment to the Constitution is likely to form a part of this extensive political debate about devolution of power to Provinces. No serious attempt, though, has yet been made to bring about any significant level of fiscal devolution. There has been a process of general erosion of the constitutionally allocated powers of PCs as a result of national government action over the years. This has occurred in respect of taxation powers as well. The best example from the taxation field is the BTT, divested to PCs initially, but taken away by the central government in 2010.

The national government and all sub-national governments raise their revenues from one common base, namely the multifarious economic activities carried out in the country. The agents engaged in these economic activities are found in areas falling into the jurisdictions of the national government in one sense and the Provincial Councils in another sense. Governance systems everywhere would therefore, find it almost impossible to divide this common tax-base between national and sub-national levels in such a way as to make the sub-national governments self-contained in the financing of their activities. Comparative global data thus show that sub-national governments almost everywhere in the world are dependent, to varying degrees, on national government transfers in the form of grants. This way, the PCs in Sri Lanka too share with the national government the revenues raised by the latter. Once it is admitted that part of PC finances ought to come from the national government in the form of grants, and the subject areas of PCs' responsibility are determined, it becomes the duty of the national government to transfer to PCs the funding that is required to fulfil those responsibilities. Funding that is required through national government transfers would be equal to total expenditures needed to perform the functions expected of PCs minus what the PCs raise themselves through taxation and other means.

While accepting this position in principle, the goals of devolution demand that the national government should devolve some taxation powers as well to PCs making them financially more autonomous than they are today. Some revenue sources, perhaps more than in the ninth schedule of the Thirteenth Amendment to the Constitution, must be opened up for Provincial taxation, while at the same time helping these sub-national entities to improve their technical tax administration capabilities. The PCs today, perhaps with exception of the Western PC, generate very small tax revenues and to increase their tax revenues to a significant level would therefore take a lot of time and effort. Without a clear-cut change in the attitudes and perceptions of the national political and bureaucratic establishments towards devolution of power, and a widespread and effective political movement in

favour of devolved governance, even minor institutional changes are possible towards improvement of the tax and other revenues of PCs. The present overwhelming dependence of PCs on the Centre for financial grants is therefore, likely to continue for some time. The change that can be effected relatively easily would be to firmly establish the principle that the PCs have a constitutionally granted right to receive required funding for their programmes from the central government through financial grants. If PCs are to be expected to take on developmental functions on a more extensive basis, then the national government ought to expand the funds that are transferred to PCs as financial grants. The prevailing fiscal scenario is on the one hand, one of a declining trend in the proportion of GDP collected as tax revenues. On the other hand, the central government also has been expanding its activities requiring expansion in both recurrent and capital expenditures. Allocating increased amounts as grants to PCs is unlikely to become a welcome option before any government.

Although the bifurcation of tax authority between the national government and PCs creates problems, PCs ought to be encouraged to maximize their revenue collection efforts without depending passively on central government grants. Furthermore, the very objective of devolution demands that PCs should be made to exercise some taxation powers as well. No doubt, there is widespread feeling of antipathy on the part of the tax paying public towards having dual or multiple tax authorities. This can be minimized by improving tax administration at both levels of taxation. Tax authorities should not be taking decisions pertaining to tax liabilities of people with no reference to one another and with no mutual co-ordination. National and Provincial tax authorities can develop systems that facilitate exchange of information and coordination between the two jurisdictions. Moreover, the relevant authorities should take action to improve PC administration at several levels, including Revenue Collection, so that the PCs could function effectively as useful sub-national units of governance. Reform action in regard is required in several areas:

- Infrastructure strengthening, IT system
- Human resource development
- Information gathering and analysis
- Information exchange and sharing between revenue authorities at different levels.

Such action should improve the revenue collection capacity of PCs and eliminate some of the major problems observed.

Improvements in fiscal autonomy of PCs however, require to be achieved in harmony with the interests and requirements of the Sri Lankan state, ensuring particularly a degree of harmony between national and provincial taxation. The achievement of harmony between revenue measures at the two levels is of significance for holistically progressive tax effort. This is of particular significance in the present global, as well as national context, where the accepted norm is one of low tax rate environment. Since the early stages of the PC system, taxpayers in Sri Lanka have been critical of their having to pay taxes at both national and

sub-national levels on, allegedly, the same tax base. This would promote the national government to allow its tax authorities to take over the responsibilities for the total tax effort in the country, ensuring however, that adequate institutional and other mechanisms are devised to facilitate the transfer of adequate volumes of revenues from the centre to PCs to meet the constitutional requirements of devolved governance. From the PCs' point of view, however, this would imply an erosion of whatever little fiscal autonomy given to them by the Thirteenth Amendment. The action taken by the central government in 2010 in withdrawing the PCs' right to collect the BTT from their areas of jurisdiction has been shown as an erosion of the provincial tax base by national government and an action that is against the principles and the very spirit of devolution of powers. Although it appears that PC administrations would like to be able to raise their revenues, it is doubtful whether the PCs have so far been very effective or innovative in optimizing their revenue collections from permitted sources of revenue.

The issues involved here go much beyond the division of subject areas for central and for provincial taxation. Taxation and its incidence and impact on tax payers are subjects of profound significance in matters of promoting accumulation for growth. Taxation affects investment incentives for private capital, whether domestic or foreign. The key role in physical and social infrastructure investments is being played in Sri Lanka today by state capital. The achievement of the objective of acceleration of economic growth would depend heavily on private capital to be invested in directly productive activities aiming at domestic and export markets. In the current context of close global integration, Sri Lanka will be competing for private capital for productive investment with investment locations in comparable parts of the rest of the world.

Domestic taxation at two levels, national and sub-national, is likely to have two different types of reactions from prospective investors. Firstly, these investors may view two tax authorities, charging different taxes on what is after all the same base, as lowering profitability and as an unnecessary irritant. Acting on this basis, the investors may prefer a single tax system and a single tax authority that is common to every PC in the country. Secondly, different PCs could view differential taxes among different PCs as a mechanism that can be used to entice investors to a given PC area in preference to other areas. Given the small size of Sri Lanka, the available capital looking for investment locations in the country would also be limited and would not be large enough to be spread over all regions. To be able to offer incentives competitively to investors could be a useful facility for sub-national layers of government even in Sri Lanka, although each PC, because of its very small size, will not be very diversified in terms of what can be offered to investors. The question of what would be the best tax policy option in this scenario, uniform throughout the country or divergent by PCs is a matter that would have to be decided on many factors other than the issues of fiscal autonomy for sub-national governments.

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Annexure

Thirteenth Amendment to the Constitution

Extract from Ninth Schedule

- Provincial Council List
 1. Planning—implementation of provincial economic plans
 2. Education
 3. Local government
 4. Housing and construction
 5. Roads
 6. Social services and rehabilitation
 7. Agriculture and agrarian services
 8. Rural development
 9. Health and indigenous medicine
- 10. Land
- 11. Irrigation
- Concurrent List
 1. Planning
 2. Higher education
 3. National housing and construction.
 4. Acquisition and requisitioning of property.
 5. Social services and rehabilitation
 6. Agricultural and agrarian services
 7. Health
 8. Co-operatives
 9. Irrigation
 10. Fisheries
 11. Employment
 12. Tourism
 13. Trade and commerce
 14. Price control
 15. Drugs and poisons
 16. Protection of the environment

- Reserved List

1. National policy on all subjects and functions
2. Defense and national security
3. Foreign affairs
4. Posts and telecommunications
5. Justice insofar as it relates to the judiciary and the courts structure
6. Finance in relation to national revenue
7. Foreign trade
8. Ports and harbors
9. Aviation and airports
10. National transport
11. Rivers and waterways
12. Immigration and emigration and citizenship
13. Elections
14. Census and statistics
15. Professional occupations and training
16. National archives
17. All Subjects and functions not specified in list I or list III.

Subject Areas PCs are Constitutionally Permitted to Tax

1. Turnover taxes on wholesale and retail sales within such limits and subject to such exemptions as may be prescribed by law made by Parliament;
2. Betting taxes, and taxes on prize competitions and lotteries, other than National Lotteries and lotteries organized by Government of Sri Lanka;
3. License taxes, arrack, toddy rents, tapping license fees, and liquor license fees;
4. Motor vehicle license fees within such limits and subject to such exemptions as may be prescribed by law made by Parliament;
5. Dealership license taxes on drugs and other chemicals;
6. Stamp duties on transfer of properties, such as lands and motor cars;
7. Toll collections;
8. Fines imposed by courts;
9. Fees charged under the Medical Ordinance;
10. Fees charged under the Motor Traffic Act;
11. Departmental fees in respect of any of the matters specified in this List;
12. Fees under the Fauna and Flora Protection Ordinance;
13. Fees on lands alienated under the Land Development Ordinance and Crown Lands Ordinance;
14. Court fees, including stamp fees on documents produced in court;
15. Regulatory charges under the Weights and Measures Ordinance;
16. Land revenue, including the assessment and collection of revenue, and survey and maintenance of land records for revenue purposes;

17. Taxes on lands and buildings, including the property of the State to the extent permitted by law made by Parliament;
18. Taxes on mineral rights within such limits and subject to such exemptions as may be prescribed by law made by Parliament;
19. Licensing fees on the possession transport, purchase and sale of intoxicating liquors;
20. Other taxation within the Province in order to raise revenue for provincial purposes to the extent permitted by or under any law made by Parliament.

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Chapter 4

Intergovernmental Fiscal Framework for Local Government and Centre-Local Revenue and Expenditure Sharing: A Comparative Analysis

Asoka Gunawardena

4.1 Introduction

The ideal State is usually characterized as both democratic and developmental in governance context, underpinned by equity, inclusiveness and broad based participation. Since the 1970s, the history of conflict in Sri Lanka suggests that the governance of development had created disparities in access to social and economic opportunities. Reflecting on the emergent gaps in social integration, conflict, social distance of the government machinery from the people whom it was expected to serve, creating a divergence of democracy and development in its practice. The form and substance of decentralization has become a major issue today in the design of an inclusive state structure, the structure of an effective public sector, and the scope and content of intergovernmental arrangements.¹ This chapter examines the aspect of intergovernmental structuring of public finance for local government in Sri Lanka that could provide a unified approach to democracy and development.

The issue is complex as the form and substance of decentralization itself, and could be approached from the perspective of the centre or that of the local government, formulating the issue in terms of broadest national welfare or widest local welfare. While these alternate approaches will produce different public sector expenditure patterns, it is pertinent to note that in a heterogeneous society interests of the constituencies are at the centre and the local government are bound to be different, leading to conflict as to what and how of development. The critical point

¹Marga Institute, Powers and Functions of Local Government, Study undertaken for National Peace Council, 2012, Etul Kotte, Sri Lanka.

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at issue then is the form of decentralization, i.e., the nature and scope of local autonomy. While distributive policies constitute the central modality for managing conflict, it is generally recognized that the ability of local governments to effectuate distributional goals is largely limited. The primary rationale for local autonomy would, therefore be, to provide their constituents with what they want and are willing to pay for, in a responsive and accountable manner.

This raises issues regarding the assignment of taxing and spending powers at the local level in terms of the concomitant issues of fiscal balance, both vertical and horizontal, closing the gap between taxing and spending, and of revenue and expenditure sharing, such that the welfare considerations of public sector service delivery will be optimized. However, the effectiveness of public sector service delivery is not only providing public services efficiently, but also equitably across the national territory. Under conditions of decentralization and local autonomy, the question arises as to whether such structuring of public finances achieves equity across local jurisdictions, such that there is cohesion in terms of national unity and development. This takes into account the inherent dichotomy of subsidiarity and solidarity that arises with local autonomy in revenue and expenditure and national redistribution.² This is the twin challenge that confronts the design of decentralization and the role of local government in moving towards a vision of a shared future that is interdependent diverse, just and equitable.³

4.2 Local Autonomy and Sharing Revenue and Expenditure Responsibilities for Development: Review of Issues

Thus, decentralization has implications for the fiscal structure of the state, impinging upon who gets what services where and pays for them. It raises a whole set of issues relating to the nature of relationships between the centre and the local in terms of their fiscal relations within the framework of an effective public sector. The critical question is under what conditions the local autonomy responds positively to assignment of taxing and spending powers in enhancing performance and accountability of local jurisdictions characterized by asymmetries in context and capacity to exercise their powers and functions. It is important that the ensuing relationship between the local and the centre is sustained and not undermined by local autonomy.

²See Bird and Ebel (2002).

³See Lessons Learnt and Reconciliation Commission (LLRC) (November 2011), Recommendation 9.231.

4.2.1 Development and Local Autonomy: Issues of Expenditure and Revenue Responsibilities

The justification for local provision of goods and services rests on the premise that welfare is enhanced beyond what is possible under more uniform national provision. While the specific bundles of goods and services provided at different levels of government will differ in time and place, the efficiency presumption is that the allocation of resources for the provision of public services should be located at the lowest level of government that is able to take into consideration the relevant costs and benefits. Horizontal equity in development is to be achieved through redistribution, to be worked out from the centre. However, it is increasingly recognized that local governments can have distinct advantages in identifying the poor and understanding their multidimensional characteristics on account of their proximity to people.

The issue of local autonomy is then about the form of involvement of local government in the conduct of development programs, whether under delegation, de-concentration or devolution. Under devolution the responsibility to design and implement development programs is entirely the responsibility of local governments, at least in part funded by their own resources. Whereas delegation and de-concentration cannot be considered to be true models for local government in so far as they do not exercise discretion in expenditure, their accountability is to the central government. In the devolution model of local government, there is greater responsibility on the part of local government for design and implementation of development programs, as well as accountability to the citizens.

While noting the popular dictum that finance follows function, the general experience is that local governments do not get assignments of revenue that match expenditure responsibilities. There is also the question of what sources of revenue make good sense at the local level. However, while local governments under devolution require revenue discretion in order to fully benefit from fiscal decentralization, there seems to be a general reluctance on the part of central governments to provide significant levels of revenue autonomy. This leads to the situation of imbalance between revenue and expenditure in local governments.

4.2.2 Fiscal Arrangements for Local Autonomy: Issues of Efficiency and Equity

The decentralization of expenditure and tax responsibilities leaves different jurisdictions with different fiscal capacities in that they can provide given public services to their citizens only at different tax rates. This would mean that the potential benefits available to citizens would differ and it can result in the inefficiencies in the inter-jurisdictional allocation of resources, leading to iniquitous treatment of citizens across jurisdictions. At the same time, the exercise of fiscal responsibilities by

local jurisdictions can lead to distortions in the free flow of goods and services, labour and capital between them. Similarly, expenditure responses to imbalances can lead to differences in program design resulting in distortions in the allocation of resources across jurisdictions. These situations arising from revenue inadequacy is addressed through equalizing transfers to equalize fiscal capacities across the jurisdictions.

Intergovernmental transfers thus constitute a distinctive and significant policy instrument in fiscal decentralization, the primary justification for which is on equity grounds. Transfers can be conditional (where restrictions are placed on their use by the recipient) or unconditional where lump-sum amounts are made available for use according to the discretion of the recipient. When conditional grants take the form of matching grants (financing a part of the recipient's expenditure), it is usually employed to provide local services that generate benefits for residents in other jurisdictions. Unconditional grants typically address equalization purposes, based on an equalization formula usually depends on need and capacity of the local jurisdiction, so that larger shares of such transfers would go to those with greatest fiscal need and least fiscal capacity.

4.2.3 Local Autonomy: Issues of Performance and Accountability

There are many reasons for adopting local autonomy. Literature suggests that the search for the right balance in the division of powers between different levels of government is not always the primary reason for decentralization.⁴ The reasons are very much country specific. What is efficient from an economic point of view may not be politically sustainable. However there is no doubt that moving decision making closer to people must have in place adequate arrangements to allow such local jurisdictions to exercise control over fiscal, regulatory and administrative matters—fiscal and administrative decentralization. Local autonomy in respect of fiscal and administrative matters is necessary for effective decision making at local levels.

Thus, a balance is necessary between political and economic considerations, if local autonomy is to perform. As noted earlier the economic case for decentralization is based on economic efficiency, the provision of local goods and services that are differentiated according to local needs and circumstances resulting in higher levels of welfare than through centrally determined and more uniform service deliveries across all jurisdictions. However, the case for economic efficiency of local government rests on the presumed responsiveness of local governments to their respective constituencies.

⁴Shah and Theresa (2004).

As pointed out, the political basis for decentralization rests on participation of people and making for greater accountability in the performance of local governments. However, it is generally believed that such participation is confined to the local elite groups who are likely to pursue their own self-interest. Indeed the most important potential gain from decentralization arises from the participation of, especially the poor, in the political process and local decision making. While enabling to remove social and institutional barriers, such participation brings service providers closer to the poor, potentially enhancing people's control over services.⁵

There are certain conditions that must be fulfilled if local governments are to have the capacity to perform effectively. First, local authorities need their own independent sources of revenue, with the important issue of balance in the vertical structure of revenues. In this regard the role of intergovernmental transfers is important, without undermining local autonomy and vitality of local governments. Importantly, central financing does not make for responsible local decisions with no real economic costs to the local jurisdiction associated with these decisions. The second important condition is the nature of own revenues, that local taxes do not produce distortions in the flow of economic goods and activities and are tied to benefits to produce the right signals concerning costs to the local community arising out of local decisions. Thus, modalities of financing the local provision of goods and services are fundamental to ensuring the performance and accountability of local autonomy.

Thus, decentralization is in the nature of a contract though rarely spelled out in all its details and implications. The fundamental problem in developing countries is that the institutional supports necessary for decentralization to work are not in place.

4.3 The Intergovernmental Fiscal Framework for Local Government and the Nature and Scope of Centre-Local Sharing of Resources

Local authorities constitute the primary jurisdiction for the provision of public services in a multi-level system of government constituted at national, provincial and local levels. Sri Lanka moved on to a multilevel system with the establishment of Provincial Councils in 1988 as a regional tier of government reconstituting the extant centre-local governmental relationship as a multi-level one. The role and function of local finance was subsumed within the framework of the new multilevel intergovernmental system. While radically altering the form of decentralized government, ensuing intergovernmental arrangements was set within the framework of centralized practice severely restricting autonomy of local government.

⁵See Govinda Rao (1988).

4.3.1 *The Multi-level System and the Nature and Scope of Local Autonomy*

Local government had been established in Sri Lanka by law⁶ with a mandate for “the regulation, control and administration of all matters relating to public health, public utility services and public thoroughfares and generally with the protection and promotion of the comfort convenience and welfare of the people”. The 13th Amendment to the Constitution (1987) in establishing Provincial Councils with legislative, executive and fiscal powers, radically changed the status of local government. Local government was constitutionally recognized and became the third tier of government with a constitutional guarantee of existing powers and provision for enhancement of powers by the provincial council through a provincial statute.⁷

The introduction of Provincial Councils as an intermediate tier, constituted a hierarchy of governance roles at national, provincial and local levels. The ensuing multi-level governance structure has created a polycentric service delivery system at the local level. It includes an array of national, provincial and local organizations with complementary mandates providing public services through a hierarchy of development plans where national plans are implemented through de-concentrated local agents.⁸

The resulting system of governance has marginalized local government in the regulation, planning and financing of public services.

Thus, powers and functions of the national and provincial and by implication local, are defined constitutionally.⁹ On paper local authorities are responsible for the provision of a range of local services. However, the de facto exercise of functions

⁶Municipal Councils Ordinance (1947), Urban Councils Ordinance (1939), Pradeshiya Sabha Act (1987).

⁷Thus item 4 of the Provincial List on Local Government specifies the scope of the assignment as follows:

4.1 Local authorities for the purpose of local government and village administration, such as Municipal Councils, Urban Councils and Pradeshiya Sabhas except that constitution, form and structure of local authorities shall be determined by law;

4.2 Supervision of the administration of local authorities established by law, including power of dissolution (subject to such quasi-judicial inquiries into the grounds for dissolution, and legal remedies in respect thereof, as may be provided by law, and subject to provisions relating to audit as may be provided by law);

4.3 Local authorities will have powers vested in them under existing law. It will be open to a Provincial Council to confer additional powers on local authorities but not take away their powers;

⁸The delivery of public utility services such as electricity, water, gas, roads and housing formerly the responsibilities of (urban) local authorities have since been taken over by central agencies Health and education are the responsibility of the central and provincial agencies with limited participation of public health and sanitation. Roads are the responsibility of all three levels of government, national, provincial and local.

⁹The thirteenth amendment to the Constitution demarcated the competences of national and provincial through three lists, Reserved (subjects retained at the centre), Provincial (subjects assigned to the provinces) and Concurrent (an area of shared competences).

constitutes a complex adjustment between power sharing imperatives of centralization and de-centralization. De-concentrated central agents deliver services in areas assigned to provincial and local governments making for agency competition and overlap in development roles, responsibilities and activities.

Thus, the provision of local services has an inter-governmental fiscal context, in terms of national, provincial and local responsibilities. The roles, responsibilities and relationships of national, provincial and local have set the limits of devolved provision and determine the basis for allocation of resources and achieving local development outcomes. The ensuing situation of revenue and expenditure of national, provincial and local levels sets out the size of provincial and local levels in the structure of public service provision. The respective shares of revenue and expenditure of the three levels of government over the period 2009–2011 is shown in Table 4.1.

The role and responsibility of local government in the multilevel system is not only miniscule, but is also largely static.

4.3.2 Expenditure and Revenue Domain of Local Government

As noted above, the thirteenth amendment to the constitution, while assigning the supervision of the administration of local authorities to provincial councils, guaranteed their extant powers, entrenching the fiscal basis of local government. Local authorities derive their financial powers from the establishment of a “fund” under the respective laws, for managing the financial operations arising from the powers vested in local government to receive and expend funds.¹⁰ Together, the taxing and spending powers provides for the competence and the autonomy of the primary tier to function as a provider of local public services.

The mandates of local authorities, as set out in their respective laws, comprise of specified duties and permissive powers. Specified duties of local authorities extend to those functions specified and required to be provided under the respective laws. These services that local authorities are required to provide comprise of the three core areas of public health, public thoroughfares and public utility services. Permissive powers are those functions in respect of which a local authority may take action by passing by-laws. Hence the scope of service delivery is defined by both specified duties and permissive powers and the extent to which local authorities have sought to demarcate their area of operation through by-laws,¹¹ as well as programmes and projects for the delivery of ensuing services. Within the

¹⁰Municipal Fund for Municipal Councils (Section 185), a “Local Fund” for Urban Councils (Section 158) and “Pradeshya Sabha Fund” for Pradeshya Sabhas (Section 129).

¹¹Local authorities are empowered to make by-laws as may be necessary for the purpose of carrying out the principles and provisions of the respective laws.

Table 4.1 Intergovernmental shares of revenue and expenditure—2009–2011 (Rs. Millions)

Level of government	2009		2010		2011	
	Rev	Exp	Rev	Exp	Rev	Exp
National	699,644 (94.27%)	1,201,927 (88.60%)	817,219 (94.06%)	1,290,205 (88.04%)	949,917 (94.46%)	1,400,099 (88.25%)
Provincial	29,443 (3.96%)	130,260 (9.60)	36,829 (4.23%)	145,491 (10.01%)	40,990 (4.07%)	157,373 (9.92%)
Local	13,015 (1.75%)	24,429 (1.80%)	14,735 (1.69%)	28,405 (1.95%)	14,687 (1.47%)	29,009 (1.83%)

Source Central Bank and Ministry of Local Government

Table 4.2 Expenditures of LGIs—2011 (Rs. Millions)

Expenditures/LGIs	Recurrent expenditure			Capital expenditure	Total
	Personnel	Other	Total	Capital	
Municipal Councils	5,857,145	4,904,996	10,762,141	1,285,906	12,048,047
Urban Councils	1,856,923	1,061,105	2,918,028	972,024	3,890,052
Pradeshiya Sabhas	4,615,571	2,741,380	7,356,951	5,713,807	13,070,758
Total	12,329,639	8,707,481	21,037,120	7,971,737	29,008,857

Source Ministry of Local Government and Provincial Councils

framework of their respective mandates all local authorities follow a “programme framework” extending over a set of standard service provision “programmes” in health services; physical planning, public thoroughfares, land and buildings, water supply, public utility services, and civic amenities. Service delivery activities are undertaken according to the availability of resources.

Local Government Expenditure: The comparative recurrent and capital expenditure situation of local government bodies in 2011 is presented in Table 4.2.

The pattern of local government expenditures as between recurrent and capital demonstrates its nature and scope. Overall, recurrent costs account for 72.5% of total local government expenditure in 2011, out of which personal emoluments account for 58.6% of recurrent costs. The share of personal emoluments is highest at approximately 62.78% of recurrent costs in respect of Pradeshiya Sabhas. However, the situation changes in respect of capital costs of local service delivery. Overall capital costs account for approximately 27.5% of total local government expenditure, out of which Pradeshiya Sabhas account for a share of approximately 71.7%, while Municipal Councils and Urban Councils account for approximately 16.1 and 12.2% of total capital expenditure. In terms of each category, capital costs account for 43.7% in respect of Pradeshiya Sabha expenditure, 25.0% in respect of Urban Councils and 10.7% in respect of Municipal Councils. Thus there is greater engagement of local bodies in development expenditure on the part of Pradeshiya Sabhas than Municipal Councils and Urban Councils.

Table 4.3 Per Capita expenditures by type of local authority: 2011

LGI/expenditure category	Municipal councils	Urban councils	Pradeshiya Sabhas
Total recurrent expenditure	Rs. 4180	Rs. 1575	Rs. 464
Personnel costs	Rs. 2275	Rs. 1002	Rs. 291
Operational costs	Rs. 1905	Rs. 572	Rs. 291
Capital expenditure	Rs. 499	Rs. 524	Rs. 360

Source Based on Ministry of Local Government Data

The above expenditures work out on a per capita basis as follows (Table 4.3).

Thus, on a per capita basis, both recurrent and capital expenditures are highest in Municipal Councils, followed by Urban Councils and lowest in Pradeshiya Sabhas, thereby widely reflecting different capacities to operate and sustain local service delivery.

Local Government Revenue: The revenue assignment of local government comprises of tax and non-tax powers to raise incomes to meet expenditures.

- a. Revenue collected from sources assigned to local authorities by way of rates, taxes and any user fees that may be charged for services provided.
 - The main tax revenues assigned to local authorities comprise of property rates and acreage taxes, trade licenses and entertainment taxes,
 - The main non-tax revenues available to local authorities include rentals, license fees, fees for services (fees for services include registration fees, statutory fees, fees for building applications, warrant costs and penalties),
- b. Revenues assigned to local authorities but collected by the provincial council, comprised of stamp duties and court fines.
- c. In addition, local authorities receive allocations of funds under national and provincial programmes for specific items of capital expenditure.

Further local authorities are empowered to borrow funds. (Section 191) A statutory body dedicated for providing loans to local authorities has been established for providing finances to local authorities. The main focus of the Local Loans and Development Fund (LLDF) was granting and administering loans for investment in infrastructure development and revenue generating projects (Table 4.4).

Overall own revenue, both collected by the local bodies (Self-Generated Revenue—SGR) and collected by provincial councils and transferred to local bodies (Assigned Revenue), account for 41.2% of all income received by local bodies. The share of own revenue is highest for Municipal Councils at 54.2%, with shares of 43.4% in respect of Urban Councils and 30.3% for Pradeshiya Sabhas. The share of directly self-generated revenue is significantly less at 45.3% for Municipal Councils, 37.6% for Urban Councils and 22.5% for Pradeshiya Sabhas.

Table 4.4 Financing of LGIs—2011 Rs. Millions

Sources/LGIs	Own revenue			Revenue grant	Other revenues ^a	Capital receipts	Total receipts
	Self-Generated Revenue	Assigned Revenue	Total				
Municipal Councils	5,387,314	1,050,288	6,442,522	4,299,614	603,660	540,646	11,886,448
Urban Councils	1,580,049	242,452	1,822,501	1,323,674	331,850	713,122	4,191,117
Pradeshya Sabhas	3,379,865	1,160,315	4,540,180	3,335,213	944,326	6,149,007	14,968,726
Total	10,347,228	2,457,975	12,805,203	8,958,501	1,879,842	7,402,775	31,046,501

^aSource Ministry of Local Government and Provincial Councils

^aOther revenue is classified as an assorted set of incomes generated by local authorities that includes interest, sales, refunds, advertising and VAT repayments. It is significant that overall other revenues account for approximately 6% of total local government income in 2011

Table 4.5 Per Capita revenues by type of local authority: 2011

LGI/Source of revenue	Municipal Councils	Urban Councils	Pradeshya Sabhas
Total Own Revenue	Rs. 2502	Rs. 983	Rs. 286
Self-Generated Revenue	Rs. 2092	Rs. 852	Rs. 213
Assigned Revenue	Rs. 407	Rs. 130	Rs. 73
Other Revenue	Rs. 234	Rs. 179	Rs. 59
Revenue Grant	Rs. 1670	Rs. 714	Rs. 210
Capital Receipts	Rs. 210	Rs. 179	Rs. 388
Total Income Generated	Rs. 4616	Rs. 2055	Rs. 943

Source Based on Ministry of Local Government Data

The pattern of SGR income differs in respect of the Urban Local Authorities (ULAs), i.e., Municipal Councils and Urban Councils and Pradeshya Sabhas.¹²

Local government revenues on a per capita basis are presented in Table 4.5.

Thus per capita revenues of local government present widely differing fiscal capacities to provide services between the different types of local government institutions. It is noteworthy that Pradeshya Sabhas record higher per capita capital receipts than own revenue, demonstrating a dependence on ad hoc allocations especially from central programmes.

Revenue-Expenditure Gap: The overall operational status of income and expenditure of local government is presented in Table 4.6.

While local government records an overall operating surplus of 06.56%, approximately 93.14% of the surplus accrues to Pradeshya Sabhas. The operating surplus for Urban Councils amounts to 7.18% of income and for Pradeshya Sabhas 12.67% of income. It is noted that local authorities are required to prepare balanced budgets and estimated income meeting estimated expenditure. An operating surplus suggests poor readiness to disburse items of budgeted income (Table 4.7).

The overall revenue-expenditure gap is approximately 49.4%, and is highest for Pradeshya Sabhas at approximately 60.1%, Urban Councils at 44.6% and lowest for Municipal Councils at approximately 41.5%. While the revenue potential is higher in the case of ULAs, it is pertinent to take note of the comparative levels of capital expenditure of local authorities with capital costs of Pradeshya Sabhas at a high of 43.7%, when compared with Urban Councils at 25% and Municipal Councils at 10.7%. These levels of expenditure are largely explained by the amount of capital receipts received by each type of local authority. As far as Pradeshya Sabhas are concerned the operational surplus requires to be reconciled with the high revenue-expenditure gap.

Horizontal Imbalances: There are significant imbalances in the fiscal situations of local authorities inter and intra provincial level, as well as inter and intra

¹²Tax revenues are the major sources of SGR for ULAs while non-tax revenues provide the larger share of SGR of Pradeshya Sabhas. Tax sources offer greater potential for generating revenue in ULAs as the total jurisdiction is declared for purposes of levying property rates whereas in Pradeshya Sabhas property rates are levied only from the "built-up areas".

Table 4.6 Operational status of local government—2011 (Rs. Millions)

Financial Operation/LGI	Revenue	Expenditure	Surplus/Deficit
Municipal Councils	11,886,448	12,048,047	(161,599)
Urban Councils	4,191,117	3,890,052	301,066
Pradeshiya Sabhas	14,968,726	13,070,758	1,897,968
Total	31,046,501	29,008,857	2,037,644

Source Ministry of Local Government

Table 4.7 Revenue-Expenditure Gap—2011

Revenue-Expenditure/LGI	Revenue	Expenditure	Gap
Municipal Councils	7,046,182	12,048,047	(5,001,865)
Urban Councils	2,154,351	3,890,052	(1,735,701)
Pradeshiya Sabhas	5,484,506	13,070,758	(7,586,252)
Total	14,685,049	29,008,857	(14,323,808)

Note Revenue includes self-generated, assigned and other, excludes capital receipts and revenue grants that constitute transfers

categories. Table 4.8 presents the local authorities with the highest and lowest financial operational levels in Municipal Councils, Urban Councils and Pradeshiya Sabhas in each of the Provinces.

From a fiscal capacity point of view, local government presents wide variations in the income-expenditure situations, both across the three types of local authorities, as well as within each type of local authority. The wide variation in fiscal capacities points to widely varying bundles of local services in terms of what services and at what levels of provision. This situation brings to the centre the scope of the intergovernmental fiscal framework in equalizing the financing local government services across jurisdictions with widely differing fiscal capacities and development needs.

4.3.3 Intergovernmental Fiscal Framework for Local Government

The intergovernmental financing of local government include both financial transfers to meet the imbalances arising from the fiscal capacities of local authorities to finance local services, as well as channelling of allocations for spending as agent on services provided by them. While the extant revenue for financing local government are guaranteed by the thirteenth amendment in the post provincial council decentralization situation, the extant schemes for transfers have been superseded by the intergovernmental fiscal arrangements introduced for financing provincial councils. The Thirteenth Amendment provided for the allocation of funds to

Table 4.8 Horizontal imbalances in fiscal operations of local authorities—2011 (Rs. Millions)

LGI/Province	Municipal Councils	Urban Councils	Pradeshiya Sabhas
Western	Colombo: Revenue 3,992,844 Expenditure 5,441,268	Maharagama: Revenue 170,234 Expenditure 192,284	Kelaniya: Revenue 115,207 Expenditure 201,158
	Kaduwala: Revenue 115,453 Expenditure 201,898	Minuwangoda: Revenue 20,418 Expenditure 42,002	Agalawatta: Revenue 12,979 Expenditure 22,994
Southern	Galle: Revenue 99,783 Expenditure 290,809	Tangalle: Revenue 13,297 Expenditure 96,365	Pasgoda: Revenue 10,375 Expenditure 103,396
	Matara: Revenue 98,421 Expenditure 190,098	Hambantota: Revenue 13,427 Expenditure 33,928	Lunugamwehera: Revenue 3,248 Expenditure 21,341
Central	Kandy: Revenue 122,240 Expenditure 707,143	Nawalapitiya: Revenue 355,287 Expenditure 916,193	Dambulla: Revenue 31,886 Expenditure 74,724
	Dambulla: Revenue 7039 Expenditure 33,292	Talwakele-Lindula: Revenue 7351 Expenditure 25,594	Ambagamuwa: Revenue 1644 Expenditure 14,012
Northern	Jaffna: Revenue 132,929 Expenditure 406,777	Vavuniya: Revenue 70,275 Expenditure 105,909	Nallur: Revenue 35,684 Expenditure 133,422
		Velvettiturai: Revenue 4030 Expenditure 21,290	Musali: Revenue 2285 Expenditure 9116
North Western	Kurunegala: Revenue 143,102 Expenditure 355,279	Kuliyapitiya: Revenue 44,540 Expenditure 81,204	Wariyapola: Revenue 60,967 Expenditure 228,030
		Puttlalam: Revenue 44,813 Expenditure 41,813	Mawatagama: Revenue 2763 Expenditure 16,109
North Central	Anuradhapura: Revenue 87,161 Expenditure 171,762	—	Tamankaduwa: Revenue 44,004 Expenditure 196,049
			Rambewa: Revenue 4,397 Expenditure 7624
Uva	Badulla: Revenue 69,479 Expenditure 147,797	Haputale: Revenue 10,378 Expenditure 27,871	Wellawaya: Revenue 16,421 Expenditure 33,396
	Bandarawela: Revenue 51,307 Expenditure 147,797		Uva Paranagama: Revenue 7005 Expenditure 13,358
Sabaragamuwa	Ratnapura: Revenue 86,841 Expenditure 288,213	Kegalle: Revenue 55,804 Expenditure 118,269	Gallgomuwa: Revenue 10,920 Expenditure 141,764

(continued)

Table 4.8 (continued)

LGI/Province	Municipal Councils	Urban Councils	Pradeshiya Sabhas
		Embilipitiya: Revenue 14,540 Expenditure 20,980	Bulathkohupitiya: Revenue 3258 Expenditure 14,756
Eastern	Batticaloa: Revenue 45,521 Expenditure 156,207	Trincomalee: Revenue 76,445 Expenditure 122,385	Korale Pattu: Revenue 14,838 Expenditure 48,863
	Akkaraipattu: Revenue 10,311 Expenditure 17,229	Eravur: Revenue 4627 Expenditure 21,583	Lahugala: Revenue 1540 Expenditure 5440

Note Based on information from Ministry of Local Government

Provinces as being “adequate to meet the needs” of the provinces from the annual budget. (Article 154 R3 of the Constitution).¹³

The Thirteenth Amendment does not provide for transfer of funds to local authorities and hence the scheme of fiscal transfers to Provinces does not explicitly provide for transfers to local authorities. Transfers to local authorities comprise of a single grant, referred to as “Revenue Grant”, and are incorporated in the “Block Grant” to the Provinces. The grant is for the purpose of reimbursement of allowances paid to Chairman and Members, as well as salaries and wages paid to staff employed by local authorities. Therefore, financial transfers to local authorities are for meeting personnel costs of service provision; in fact the major part of recurrent expenditure. The design of the Revenue Grant is in the nature of a non-matching conditional grant (being for the specific purpose of meeting personnel costs). While most of the local authorities incur personnel costs out of their own revenue, the revenue grant takes note of only personnel holding positions that are approved by the central government and hence meets different proportions of total personnel costs of local authorities.

There are several problems with the revenue grant as a transfer system.

- a. The fiscal transfer system does not address the expenditure needs of local authorities directly. On the one hand, the Revenue Grant is embedded into the Block Grant to provinces in meeting the recurrent costs of local government expenditure needs. Thus, local government is not recognized as a distinct sphere of service provision under the Constitution; hence the intergovernmental fiscal framework does not assess the imbalance, i.e., the need at the level of the primary tier of service provision.

¹³Transfers to Provinces comprise of four grants, Block Grant—an unconditional transfer to meet the gap between assessed recurrent expenditure needs of the Provinces and the estimated revenue collection target for each financial year; Criteria-based Grants—Formula-based block transfer for development expenditures of the Provinces; Province-specific Development Grant—Conditional transfer for provincial infrastructure; Transfer in lieu of Business Turnover Tax—A compensatory transfer in lieu of Business Turnover Tax taken administratively over the by the Central Government since 2011.

Table 4.9 Adequacy of revenue grant—2011

Costs/LGI	Rs. Millions		
	Personnel Costs	Revenue Grant	Surplus/Deficit
Municipal Councils	5,857,145	4,299,614	1,557,531
Urban Councils	1,856,923	1,323,674	533,,249
Pradeshiya Sabhas	4,615,871	3,335,213	1,280,658
Total	12,329,639	8,958,501	3,371,138

Source Ministry of Local Government

- b. Further, the Revenue Grant is provided to meet the cost of personal emoluments paid to the chairman/mayor, members and the staff of local authorities. The grant is required to meet the costs of personal emoluments of staff whose positions have been approved by the central government, following a process of assessment of staffing needs of local bodies according to their current operational needs. Thus, local bodies find the need to hire additional staff, to meet personnel requirements not met by the central government approval of positions and numbers. The assessment of staffing needs is not designed to provide for personnel requirements for the provision of a standard package of minimum local services horizontally.¹⁴ The assessment recognizes current operational levels, but does not allow planning for future needs. The transfer mechanism is therefore static and control oriented. The input-based conditionalities on which the grant is designed does not provide for enhancing accountability or performance.
- c. As shown by Table 4.9, the revenue grant does not meet the total needs of personnel costs of local government with the ULAs recording the larger gaps. Additional personnel costs are required to meet personal emoluments of staff recruited by the local authorities, for positions that are not approved by the central government and the costs are met from own revenue. It reduces the funds available for undertaking new and expanded delivery of services. The grant does not meet the norm of adequacy.
- d. Thus, there is an overall deficit in respect of personnel costs which is met by own revenue. As the single item of intergovernmental transfer for local government, the Revenue Grant accounts for only 78% of total personnel costs, making personnel costs spill over into the use of own revenue. In respect of Municipal Councils, the revenue grant met approximately 73% of personnel costs, 72% in the case of Urban Councils and 86% in the case of Pradeshiya Sabhas.

The utilization of revenue is shown in Table 4.10.

¹⁴Local authorities usually do not engage in planning, it is the budget that constitutes the annual plan of work. They lack a medium-term perspective.

Table 4.10 Utilization of local government revenues—2011

Cost Item/LGI	Recurrent Expenditure			Revenue			Surplus/ Deficit
	Personnel	Other	Total	Own	Other	Total	
Municipal Councils	1,557,531	4,904,996	6,462,527	6,442,522	603,660	7,046,182	583,655
Urban Councils	533,249	1,061,105	1,594,354	1,822,501	331,850	2,154,351	559,997
Pradeshya Sabhas	1,280,658	2,741,380	4,022,038	4,540,180	946,326	5,486,506	1,464,468
Total	3,371,138	8,707,480	11,379,720	12,805,203	1,879,842	14,687,039	3,307,589

Source: Ministry of Local Government

Overall 77.48% of the revenues of local government (including assigned revenues and other revenues) are spent on recurrent costs of services provided. The situation in respect of the different local government institutions in regard to the share of revenue spent on recurrent expenditure is 91.71% for Municipal Councils, Urban Councils at 73.96% and for Pradeshiya Sabhas at 73.30%. The revenue surplus on recurrent financial operations accounts for approximately 11.40% of total local government expenditure. However, the surplus available for Municipal Councils amounts to approximately 4.84% of total annual expenditure, while in the case of Urban Councils the surplus amounts to 14.39% in the case of Urban Councils and 11.20% in respect of Pradeshiya Sabhas.

- e. The central government transfers do not provide for capital expenditure needs. The rationale for reimbursement of staff costs by way of central government transfers was to provide for a measure of horizontal equalization of recurrent expenditure needs of service delivery operations by meeting personnel costs. The rationale presumed that the funds made available through the revenue grant would complement self-generated revenue in enhancing fiscal capacity of local government to provide for a local development programme to improve and expand service delivery operations for local authorities. According to Table 4.10 the surpluses available to local authorities for development expenditures is overall 11.40%.
- f. Thus, there is a question of the adequacy of the intergovernmental fiscal framework to create fiscal capacity of local government for development expenditures. The horizontal imbalances in the fiscal capacities of local authorities, across the types of local authorities and within each type, must also be taken into account in assessing adequacy.

Allocation of funds for capital expenditure is presented in Table 4.11.

The revenue surplus so created accounts for 41.47% of total capital expenditure of local government, working out to shares of 45.38 in respect of Municipal Councils, 57.59 in respect of Urban Councils and 25.63% in the case of Pradeshiya

Table 4.11 Allocation of funds for capital expenditure—2011

Rs. Millions					
Fund Status/LGI	Funds for capital expenditure			Capital expenditure	Surplus/deficit
	Revenue Surplus	Capital Receipts	Total		
Municipal Councils	583,655	540,646	1,124,301	1,285,906	(161,605)
Urban Councils	559,997	713,122	1,273,119	972,024	301,095
Pradeshiya Sabhas	1,464,468	6,149,007	7,613,475	5,713,807	1,899,668
Total	3,307,589	7,402,775	10,010,895	7,971,737	2,039,158

Source Ministry of Local Government

Sabhas. In the absence of service delivery planning targets, it is not possible to make any assessment of the adequacy of the current levels of capital expenditure by local government. However, a comparison of the respective shares of capital expenditure and the per capita spending levels would seem to suggest low levels of local government capital spending. Thus, Pradeshiya Sabhas spend 43.7% on capital expenditure working out to a per capita capital expenditure of Rs. 360, Urban Councils spend 25.0% on capital expenditure for a per capita expenditure of Rs. 524, and Municipal Councils spending 10.7% on capital expenditure record a per capita expenditure of Rs. 499 on capital items.

4.3.4 Nature and Scope of Expenditure and Revenue Sharing

Thus, the current design of the intergovernmental fiscal framework raises the critical question of its relevance to provide for local autonomy in terms of the fiscal capacity of local government. The intergovernmental fiscal framework for local government finances have approved personnel costs of recurrent expenditure of service provision. However, such financing leaves only a margin of 11.40% for development expenditures of local government which works out to 4.84% for Municipal Councils, 14.39% for Urban Councils and 11.20% in the case of Pradeshiya Sabhas. This situation raises the question of the adequacy of centre-local revenue sharing through the revenue grant to meet development expenditure needs of local government.

Availability of adequate resources for capital expenditure needs has been a major gap in the scheme of financing available for local authorities. As already noted the intergovernmental fiscal framework for local government does not provide transfers for capital expenditure. For a predictable programme of capital expenditure, the local authorities must therefore rely on a surplus of income over recurrent expenditure. While this is implicitly intended in the scheme for revenue grants (meeting personnel costs so as to allow an adequate surplus of revenue for development expenditures), the reality is that the financial operations of local government institutions do not leave a significant balance of finances for capital expenditure. However, several programme sources, whether through transfer of allocations to local government or directly through alternate local agencies outside of local government, provide for capital spending in areas of local government services within respective local authority jurisdictions.

a. Transfer of allocations to local government institutions

The post-provincial council framework of inter-governmental service delivery relations has given rise to several programme arrangements for revenue and expenditure by way of capital receipts made out to local government institutions.

Indeed, capital receipts have turned out to be the main sources of funds for capital expenditure of local authorities. These are:

National:

- i. Financial provisions from Decentralized Capital Budget (DCB) allocated by Members of Parliament.¹⁵
- ii. Allocations from programmes under National Ministries, notably the Ministry of Economic Development (Maga Neguma for rural roads).¹⁶
- iii. Allocations from foreign funded programmes targeting local government services.¹⁷

Provincial:

- i. Allocations under the Province Specific Development Grant (PSDG)

While overall capital receipts account for 92.8% of actual capital expenditure, such funding accounts for approximately 42.0% of capital expenditure in respect of Municipal Councils, 73.3% in the case of Urban Councils, and approximately 107.6% for Pradeshiya Sabhas. In fact, the share of capital receipts received by Pradeshiya Sabhas amount to 83.0% of total received by all local government institutions. Such allocations are negligible for ULAs Municipal Councils receiving 7.3% and the share of Urban Councils being 9.7% of total capital receipts.

While all local authorities receive allocations for capital expenditure from central and provincial sources, these are entirely at the discretion of the relevant agency and do not constitute a regular financing programme. They are ad hoc and depend entirely upon the discretion of the granting authority. As demonstrated in practice there is no predictability of the amounts of such allocations or of the allocations themselves. Hence capital receipts as a mechanism for resource sharing do not create local autonomy for meeting local development needs on the part of local government institutions.

b. Direct programme spending in local authority service areas

There are several areas of programme spending in the area of local government services that are delivered directly by central providers outside of local government budgets, notably in infrastructure and public utilities (water, electricity and housing). These are local services where expenditures are incurred by central providers financed by cost recovery for operation and maintenance and central government

¹⁵Decentralized Capital Budget (DCB) is a programme for the provision of fixed amounts of financial allocations to Members of Parliament for capital works of a local nature. It was first introduced in 1974 as the fiscal mechanism to provide financial space for central parliamentarians to engage in local level development activities.

¹⁶There are several nationally implemented programmes providing local services. The “Maga Neguma” road development programme funds local roads that are the responsibility of local government.

¹⁷Foreign funded programmes are executed centrally. There are several programmes that target local services funded through local government institutions.

grants for capital investments. The responsibility for such services lies with the central providers and accountability for the quality and quantity of services delivered through local sub-offices is upwards to the heads of respective operations, usually a public enterprise. Accordingly, while taking responsibility for specific items of local services, direct provision does not coordinate vertically or horizontally with local government and hence does not promote local autonomy in the provision of such services. Furthermore, differing service delivery jurisdictions and information gaps between the central providers and local government does not allow coordination of service provision.

c. Agency-based spending in local jurisdictions

Units of territorial administration of the central government, the district and the division, have provided alternate administrative mechanisms for channelling local spending, virtually competing with local government in providing for local services.¹⁸ While the division and the local authority areas correspond geographically, divisional coordination has sought to bring about greater complementarity and partnership between the division and local authority in the provision of local services. The mechanism for coordination seeks to provide for a measure of expenditure sharing in the provision of local services. However, the division as the central government's agent for most nationally budgeted development programmes has emerged in a competitive relationship with local government, rather than expenditure sharing partnership at the local level. It is noteworthy that the two structures are fundamentally different one from the other with different competences and accountabilities.

d. Local government coordination for sharing expenditure

Expenditure sharing between local government bodies is rare, or virtually non-existent. In this context, the recent initiative to establish a metro region authority for the greater Colombo urban local authorities is noteworthy.¹⁹ While the Urban Councils Ordinance provides for joint action by mutual consent, it is noteworthy that such joint action and coordination has not occurred so far. Several factors account for absence of co-sharing between neighbouring local authorities in the provision of services.

- The practice so far has been to approach area coordination sectorally, whereby the coordinating authority must have a sector location in an appropriate Ministry adopting special purpose institutional arrangements.

¹⁸The division constitutes the unit of administrative operations for most central government as well as provincial development activities. The division performs a dual role, linking the dual system of sub-national government, the central and provincial systems. It is accordingly vested with statutory authority and agency functions of central government agencies hitherto performed at the district level. The Divisional Secretary also functions under delegation from the Governor of the province in carrying out executive functions of the provincial council administration.

¹⁹The proposal to create a Metro Authority for five local bodies, Colombo MC, Sri Jayawardenapura MC, Dehiwala-Mt. Lavinia MC, Kollonnawa UC and Kotikawatta-Mulleriyawa UC.

- Provincial councils responsible for the supervision of the administration of local authorities have so far not been innovative in promoting local government co-sharing of expenditures.
- The competitive context in which local authorities operate does not create conditions conducive for co-sharing partnerships between local authorities.
- The resource constraint in which local authorities find themselves operating would not leave adequate surpluses to be invested for joint activities.

Local government coordination for co-sharing expenditure, whether between local authorities or between local authorities and provincial or national level providers, is yet to be explored.

4.3.5 Performance of the Intergovernmental Fiscal Framework in Financing Local Government Service Provision

From the perspective of local autonomy for development what is at issue is the extent to which the intergovernmental fiscal framework creates capacity in local government to finance local services efficiently and equitably. This is about the availability of sufficient sources of revenue that would adequately take care of expenditure responsibilities. It is in this regard that the role of intergovernmental transfers and revenue and expenditure sharing become important, without undermining local autonomy and vitality of local governments. The general experience is that such central financing does not make for responsible local decisions with no real economic costs to the local jurisdiction associated with these decisions. Modalities of financing the local provision of goods and services are fundamental to ensuring the performance and accountability of local autonomy. The foregoing analysis of the functioning of the intergovernmental fiscal framework for local government suggests several shortcomings as a policy instrument for efficient and equitable service provision. These are examined in the next section.

4.4 Intergovernmental Context of Local Government Expenditure and Revenue Responsibilities in Sri Lanka: Issues

Thus, local government operates within an environment of inherited limitations of resources. Indeed, local government, as the devolved sphere, functioned within the framework of centralized planning, financing and implementation of development programmes prior to the establishment of provincial councils in 1987. Introduction of a regional tier of devolution was worked out within the framework of centralized

practices.²⁰ It resulted in a dichotomy of functions and structures for regulation and planning of development, thereby creating two institutionalized sets of roles and responsibilities; one based on the exercise of devolved power (comprised of the provincial councils and the local government institutions) and the other based on the exercise of de-concentrated central authority (at the sub-national level whether directly through local offices of sector agencies or indirectly through central agents at district and the divisional levels). Dualistic financing of local services has severely constrained intergovernmental resource flows to local government, and undermined local autonomy and marginalized local service delivery roles and functions.

4.4.1 Defining Centralized Distribution and Local Allocation: Issues of Multi-level Responsibilities

Thus, the multilevel system has worked in a heavily centralized manner as demonstrated by the shares of national, provincial and local expenditure, without clear demarcation of roles and responsibilities in the provision and delivery of services. While the starting point for the demarcation of public finance roles and responsibilities between different levels of government is the recognition of the advantages of locating distribution at the centre and allocation at the local. The Sri Lankan situation is defined by the absence of clarity in how distribution and allocation functions are assigned and shared between national and local levels. Thus, existing intergovernmental arrangements for financing public sector service delivery raise many issues of demarcation of multilevel responsibilities in a manner that enhances capacity and autonomy of local government.

a. Subsidiarity and the functional responsibilities

The first logical step in a system of intergovernmental finance is the vertical demarcation of functional responsibilities for different levels of government. In Sri Lanka, the vertical demarcation of functional responsibilities has tended to follow historical adjustments in regard to subjects and functions at the national and local, leaving a residual set of service delivery responsibilities with local government. This is further exacerbated when the extant functional responsibilities of the provincial tier is brought into the scenario of the allocation of vertical functional responsibilities in government, presenting a de facto picture where local service delivery responsibilities are exercised out of all three levels. Thus, resources allocation responsibilities in respect of local services are undertaken at the national level in the form of sectoral or cross-sectoral redistribution programmes. The vertical allocation of functional responsibilities does not follow a subsidiarity principle within the framework of comparative advantages of national, provincial

²⁰See Gunawardena and Laxman (2008).

and local levels in undertaking public finance responsibilities especially relating to the distribution and allocation of resources. This situation leads to several inefficiencies in the vertical dimension of intergovernmental finance.

b. Fiscal efficiency and resource allocation

The efficient provision of government services requires that government satisfy the needs and preferences of taxpayers as best as possible. This is best achieved by the “subsidiarity” principle in assignment of intergovernmental responsibilities. Responsibility for the provision of services should be at the lowest level of government compatible with the size of the “benefit area” associated with those services. The services assigned to local government meets with this criterion. Nor are local government assigned responsibility for services with wider benefit areas which would result in the inefficient under-provision of services. The issue of fiscal efficiency and resource allocation in the provision of local services is the fragmentation of responsibility for local services across the multilevel system that prevents a unified approach to addressing needs in a responsive manner. Additionally, these service deliveries are financed out of general taxes and are not linked to costs of provision via fees, service charges, or local taxes.

c. Gap between recurrent and capital expenditures

The concentration of recurrent and capital expenditure in respect of local services between local and national independently of the level of government responsible for the provision of the services is reflected in low levels of capital expenditure by local government. Efficiency criterion would require responsibilities for capital infrastructure that should be placed at the level of government responsible for the delivery of the specific services, including the operation and maintenance of those facilities. This will encourage a more efficient use of resources. Only the capital infrastructure facilities actually desired by subnational governments will be built and subnational governments will have an interest in maintaining and repairing the capital infrastructure.

d. Vertical fragmentation and programme co-sharing

It is important to note that the actual assignment of functional responsibilities is often quite different from what it appears to be in the “formal” assignment established by law or practice. Thus, in the case of education, local government has responsibility only for pre-schools. It is to be noted that policy and regulation in regard to preschools is located at the central and provincial level. There is no clear modality for financing pre-school buildings, staff and quality inputs, while staff appointments are at the level of local government. Similar issues arise in other sectors such as public health. While ideally all inputs for the delivery of a particular service should be simultaneously decided by one single authority, co-sharing of responsibilities for a single service is inescapable. Co-sharing of responsibilities may not be a problem when particular functions and tasks in a common area are clearly assigned to different levels of government.

e. Financing poverty alleviation/social protection.

A further area of inefficiency is the marginalization of local government in regard to the marginal service delivery responsibilities for social protection and welfare. While it would be inappropriate to fund social protection and social welfare through local governments out of general budgets, they have a comparative advantage for the efficient delivery of these services. In fact, while poorer local governments would be unable to provide such services at an appropriate level, the preferred best practice would be for central funding of programmes that are locally delivered.

f. Provision of public utilities

As already noted public utilities fall within the service delivery mandate of local government. However, they are funded and delivered from the centre without any role and responsibility for local government. General practice is for these services to be provided by corporate entities dependent upon or regulated by local government with full-cost-recovery pricing.

g. Vertical fiscal gap and bridging revenue-expenditure gaps

Vertical fiscal imbalance arises because many of the taxes that are appropriately assigned to subnational governments from a conceptual point of view cannot easily be administered in a way that implements this assignment. It is especially difficult to find taxes that can be implemented in a way that provides subnational governments with marginal sources of own revenues. As noted earlier, neither revenue sharing nor tax sharing provides marginal sources of own revenues for subnational governments. The likelihood of vertical fiscal imbalance explains the earlier emphasis on subsidiarity in taxation: the view that subnational governments should generally be assigned any tax that they can administer (or that can be administered for it) that is not inappropriate for their use.

4.4.2 Horizontal Imbalances and Gaps in Development Linkages: Issues of Policy and Program Coordination

The second aspect of the intergovernmental context of local government expenditure and revenue is the wide horizontal asymmetries in fiscal capacities. The question is how far the intergovernmental fiscal framework has enhanced local government autonomy and accountability in ways that they are able to, while fulfilling own direct service responsibilities to use their spending power to fulfil national and local efficiency and equity objectives. The revenue grant neither enhances autonomy, nor creates accountability in regard to the ways in which resources are deployed to fulfil either national or local efficiency or equity objectives. The design of intergovernmental transfers should be guided by clarity in achieving objectives by such transfers and sharing of resources.

Reducing regional fiscal disparities: The local government in Sri Lanka demonstrates wide horizontal disparities. The approach of the revenue grant to reducing fiscal disparities across local government is one of funding salaries of personnel employed by local bodies. As already noted this does not lead proactively to enhancing fiscal capacity for service delivery. The development challenge in Sri Lanka is to bring within the service delivery system those that are currently excluded through regional imbalances in access to services, opportunities for economic participation and governance for equitable human development.²¹ The revenue grant does not provide for equalization across local government jurisdictions for local service provision. An important part of the problem of resource transfers is the level of central funds flowing to local levels through national programmes implemented outside of local government. There is a need for a holistic approach to financing local services in a manner that equalizes fiscal capacities across local government jurisdictions.

Setting national minimum standards: Local government does not share a set of service delivery standards, nor has the central or provincial governments so far introduced policies that guarantee desired minimum levels of provision for certain services at the local level. National standards can be enforced in several ways such as enticing local governments with a matching grant program. But national standards may also be enforced by denying full receipt of block grant money unless certain minimum expenditures and provisions established by the central government are met. Programs in which national standards may be required include not only social welfare, but also education, health, sanitation, and the environment. But restrictions should be imposed sparingly to protect local autonomy which, in general, is very desirable.

Influencing local priorities: The intergovernmental transfer system comprised of the single grant for reimbursement of personal costs of service provision, neither enhances local autonomy nor enables the central control to deliver on national objectives. A more comprehensive system of intergovernmental transfers using a combination of general transfers (unconditional grants) and earmarked transfers (conditional grants) is required in order to enhance local autonomy (though requiring local capacity and accountability) and to give the central government more control to meet its objectives.

Fiscal equity, social justice and unity: A well designed intergovernmental fiscal regime should bind the various players in the intergovernmental system for an efficient and responsible provision of public services in an equitable and stable way. Such a system may also provide a combined sense of national-solidarity and “place equity” through a well-designed system of transfers. It would include conditional and unconditional grants that can address issues of both vertical and locational equity. An essential component of such a system would be an institutional structure to provide for periodic adjustments to meet changing circumstances, and serve as a

²¹See UNDP 2012.

forum for the resolution of the disputes that inevitably arise in any functioning intergovernmental system. This is not the case in Sri Lanka.

4.4.3 The Expenditure and Revenue Role of Local Government: Issues of Marginalization

Thus, the expenditure and revenue roles of local government are inadequate for any meaningful engagement in the provision of local public services. There are both questions of design and of practice. While creating capacity to match local services with local preferences is at the core of the design of local autonomy, it is important to position local government within the multi-level system as an equal partner in development. An enhanced role for local government is imperative in the post-war context of Sri Lanka²² which requires bringing the local authorities out of their marginalization by enhancing their autonomy, as well as accountability. It is in this context that the intergovernmental fiscal regime requires to be reviewed.

Thus, the current intergovernmental fiscal regime for financing of local government is inadequate for any significant deepening of their role and functions. There are several policy issues that arise.

The first is about the conditions that would facilitate local government move out of resources dependency to a more efficient model of service delivery. The intergovernmental fiscal regime for local government has proved to be restrictive.

- The shares of recurrent and capital expenditure of local government confine service delivery responsibility to operation and maintenance with only a marginal engagement in development.
- Local authority financial operations take place within the framework of central controls, especially the central determination and approval of staffing. It undermines responsibility and accountability of local authorities for local government.
- Revenue share of local government has shown a downward trend suggesting weakness in revenue base, as well as revenue performance.
- Increasing demand for services calls for accessing finances from new and innovative sources. Local authorities seem reluctant to move on to such sources in financing local services.²³

²²Powers and Functions of Local Government: The Operational Context, Study undertaken by Marga Institute for the National Peace Council reviewing the role of local government in the post-war context, Mimeo, 2013.

²³Overall borrowings have accounted for less than one and half percent of local government finances.

- The horizontal imbalances in fiscal capacities require central fiscal support to ensure maintenance of minimum standards of services. Local authorities with a weak fiscal base are becoming increasingly dependent upon central government transfers for meeting the salaries and wages of staff.
- The central transfers financing local authority expenditures by meeting costs of salaries and wages are creating perverse incentives that restrict choices for the delivery of services and in turn affecting efficiency of service delivery operations.

The second is about the increasing trend for central players to spend on local infrastructure often directly or through de-concentrated agents of the central government. Even where such spending is channelled through the local authority, there is no discretion in terms of decisions regarding the purposes for which such funds are used and usually takes place outside its budgeting process.

The third is about incentives to bring about a meaningful effort to improve revenue collection. Incentives in this regard could be created by moving on to performance-based modes of financing local government. Especially important would be the creation of incentives for local government; especially urban local authorities to use external sources for financing service deliveries.

The fourth is about incentives to change. The limitations in functions, finances and functionaries at the municipal level currently make for incentives that are of a short-term nature. A shift to a performance-based model of local government management can, therefore, be achieved only through system-wide reforms tailored to the different needs and capacity of Sri Lanka local authorities.

The fifth is about the implications for local government budgeting in moving from a routine and historical budgeting to one of financing service provision. This would involve promoting the more efficient and sustainable models of financing service delivery and infrastructure with the introduction of user fees and private sector participation.

4.5 Redefining the Nature and Scope of Expenditure and Revenue Sharing for Local Government

The fundamental purpose of revenue and expenditure sharing is to correct fiscal imbalances that occur in the fiscal arrangements for managing the economy through the tendency to assign revenue to the central government and expenditure to local levels. The tax assignment has been such that growth of revenue at the central level is far quicker than at local levels. While the resulting fiscal imbalances can result in less than adequate capacity for local government service delivery, it is important to note that fiscal imbalances are also related to the assignment of expenditure responsibilities which can be subject to change. In the absence of specific

expenditure assignment, it is revenue availability that dictates the responsibilities of local government. The correction of such imbalances should be carried out in manner that is least restrictive of local autonomy in responding to local needs and demand for services.²⁴

4.5.1 Rationalizing Distribution and Allocation: Achieving Clarity

In this regard the assignment of expenditure responsibilities across different levels of government is critical to ensuring autonomy of local government. The subsidiary principle based on the responsibility for public finance functions, especially distribution and allocation, largely prescribes the assignment of expenditure responsibilities to different levels of government. However, the ensuing rules do not always yield an unequivocal answer.²⁵ What is considered the best assignment can change over time due to changes in costs, technology and preferences? While the role and responsibilities of local government must take note of the dynamism in service delivery situation, especially arising from policy considerations in regard to distribution, it is necessary at any given point of time to have a concrete assignment of expenditure responsibilities that could be considered optimal. Revenue and expenditure sharing arrangements should be able to address need for change over the medium term.

A specific issue in the local service delivery scenario is the concurrent operation of many operators outside the local authorities, undermining the role, responsibility and relevance of the elected local government sphere in meeting the needs of the respective jurisdiction. There is a need for mechanisms for greater horizontal expenditure sharing which requires a unified approach to local development. It would involve inter-agency coordination of expenditure at the local level, defining not only financing responsibilities for specific areas of service provisioning, but also defining the nature and scope of the decision-making responsibilities of the different agencies in regard to provisioning and delivery of services.

Such an arrangement goes beyond the popular notion of coordination as a clearinghouse for agency actions on to inter-agency expenditure sharing for specific outcomes. This would involve establishing a local government financial pool funding available for financing service deliveries in defined local jurisdictions. It would be demand driven and minimize duplication and overlap in funding on the one hand, and enhance responsiveness of service deliveries to meet local development needs on the other hand. Such an arrangement would enable decentralizing

²⁴The operation of the fiscal regime for local government restricts autonomy, especially the scheme of intergovernmental fiscal transfers.

²⁵Some public services, e.g., primary education and primary health services, may be of a local nature by the size of their benefit area, but because of their relevance in welfare and income redistribution they may also be considered a responsibility of the central government.

capital expenditure responsibilities to support service delivery outcomes. This may be the only effective way to allow small local governments to fulfil their capital investment responsibilities.

4.5.2 Decentralizing Expenditures: Output-Based Transfers

Decentralizing expenditures requires addressing horizontal fiscal imbalances in financing local service delivery. As a first step towards enhancing accountability, transfers for correcting fiscal imbalances could be designed around performance target oriented to set national minimum standards. Output based transfer offer an alternative to fiscal need compensation, which as international experience suggests, is complex and complicated. Output based transfers enhance results based on accountability. Such fiscal transfer arrangements require continuous review and periodic revision.

4.5.3 Enhancing Fiscal Capacity: Equalization Transfers

There is a clear need for equalization of fiscal imbalances across local authority types and jurisdictions. On the one hand the revenue grant was found to be both inefficient and perverse.

Transfers to local governments require special considerations as local jurisdictions vary in population, size, area served and the services provided i.e., urban versus rural. There is a need to classify local governments by population size, municipality type, and urban/rural distinction and have separate transfer formula for each class of municipalities. Some common elements of such transfer schemes are amounts per municipality, per capita, service area and fiscal capacity. Fiscal capacity should take into account revenue bases and expenditure needs. The grant funds would then vary directly with service area, but inversely with fiscal capacity. The scheme could be worked out for each type of local authority using national average standards for each type. Introduction of such a scheme of equalization transfers involves the creation of a financial pool should ensure that local authorities do not receive less than current entitlements.

4.5.4 Intergovernmental Partnerships: Minimum Standards and Policy Coordination

The intergovernmental transfers should guarantee desired minimum levels of provision at least for specific services such as environment, health, sanitation and

social welfare at the local level. National standards can be enforced through matching grant arrangements, as well as establishing minimum expenditures and provisions. The delivery of minimum standards would usually involve well defined sectoral policies. This will require comprehensive functional reviews of the priority local service sectors.

4.5.5 Embedding Autonomy for Local Government: Intergovernmental Fiscal Regime

Responsive local government requires control over its fiscal operations, allowing choice in the level of public spending. An important aspect of such autonomy is the tax assignment. Local governments must have enough “own” revenues to finance the services they provide. Even if such a government must rely on grants from a higher-level government, it may reasonably be considered to have own revenues, provided the grants are determined in an objective way and are guaranteed by the constitution or legislation of longstanding. By comparison, own revenues may not exist in any real sense, if grants are made at the sole discretion of the higher government, perhaps on an ad hoc, arbitrary, and unpredictable basis, and even well into the fiscal year and subject to renegotiation.

4.6 Conclusion: Challenges of Intergovernmental Fiscal Arrangements for Local Autonomy and Development

Decentralization, whatever its form, changes the fiscal structure of the state and hence would impact on the nature and scope of state activities. Therefore, decentralization makes for political and economic challenges. Some degree of local autonomy is necessary to meet the challenges, political accountability and economic efficiency. Since transfers account for a large part of subnational finances everywhere, their design is a critical factor in the success of decentralization.

Transfers perform three key functions in correcting fiscal imbalances. First, they fund the services local governments provide on behalf of the central government. Second, they ensure that equity is taken care of especially where programs administered by local government to redistribute income or when there are large income differences across jurisdictions. Third, the transfers determine the sectoral composition of local expenditure when earmarked or disbursed in the form of matching grants. The design of a transfer scheme must take into account three variables. The amount to be distributed, criteria for distribution among jurisdictions, and conditionalities imposed on the use of transfers.

Some basic governance principles are fundamental to an effective system of transfers. Transfers should be determined as openly, transparently, and objectively

as possible. They should be kept reasonably stable from year to year so that local governments can plan their budgets. And they should be distributed on the basis of predetermined rules, which need to be kept as simple as possible. Simplicity, transparency, and predictability would help eliminate uncertainty and bargaining that can undermine intergovernmental fiscal relations.

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Chapter 5

Towards an Appropriate Public Local Government Unit for Sri Lanka

N.S. Cooray and Kanda Uda Chandralal

5.1 Introduction

Many countries are now experimenting decentralisation of political, fiscal and administrative responsibilities to sub-national governments (or local governments) because they believe this process will enhance efficiency in service delivery, stimulate economic growth, eradicate rural poverty, strengthen civil society, deepen democracy, reduce heavy fiscal burden of the centre, and solve many different kinds of problems including environmental issues (Eaton et al. 2010; Manor 1999; Scott and Alam 2011). The local government also serves as the most democratic administrative unit because local residents can participate in the decision-making process. It is also market friendly because individual choice is given due consideration, and the needs and concerns of citizens are addressed. Classical and neo-classical liberal thinkers who believe in market mechanisms argue that enhancing the social welfare of individuals should be the major objective of public policy.

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If empowered with proper decentralisation, local government also serves as the most democratic administrative unit because local residents can participate in the decision-making process (CLAIR 2010). Moreover, it is market friendly because individual choice is given due consideration, and the needs and concerns of citizens are addressed (Owens and Panella 1991; Scott and Alam 2011). Adam Smith in his *Wealth of Nations* (1776) argues that in a market economy, resources are allocated through the decentralised decision of many households and firms as they interact in markets (Smith 2014). And therefore, if local governments are empowered, they promote the wellbeing of local citizens taken into their private choices. The World Bank (2004, 1) further argues that wellbeing can be improved “by putting poor people at the centre of service provision; by enabling them to monitor and discipline service providers, by amplifying their voice in policy making, and by strengthening the incentives for providers to serve the poor”. All these advocates support market preserving decentralised system of government (or local autonomy) which constitutes democracy, subsidiarity, and fiscal responsibility (Backhaus 2012; Mochida 2008).

However, devolving power and empowering of local administrations or citizens in Sri Lanka has many challenges. The process is quite complicated and sensitive to some political regimes that are intent on empowering the central government, rather than local or peripheral governments. The current public local governments in Sri Lanka seem to be inconsistent, centralised, politicised and not-so-efficient system (Abeyratne 2004; Amarasinghe et al. 2010; Waidyasekera 2005; Ratnayake 1992; Institute of Professional Public Administrators 2007). The notion of devolving power to local regions, as indicated in the 13th amendment to the Sri Lankan constitution and also as recommended by the Lessons Learnt and Reconciliation Commission (LLRC), needs comprehensive understanding given the vision and mission of political leaders of the country. Therefore, there is indeed a strong need, particularly in the post-war conflict, to formulate policies for reconciliation, peace building and development at all levels-local, provincial and national. The current unity government of Sri Lanka came to power in 2015 with a promise to overcome corruption and bring reconciliation, development, democratic reforms, and good governance to the country.

Considering the developmental, governance and reconciliatory needs and the sensitivity of central-local relations, this chapter has the following aims: (a) to briefly examines local government systems in Japan and Sri Lanka; (b) to propose a viable, effective, and autonomous local level administrative unit for Sri Lanka taken experiences from Japan; (b) and to identify the role and functions of the proposed administrative unit.

The chapter is organised as follows: Following this introduction, Sect. 5.2 explains data and methodology while Sect. 5.3 provides an overview of current local level government systems in Sri Lanka. Section 5.4 attempts to identify a proper local level administrative unit for the country, while Sect. 5.5 discusses the functions and financial aspects of local governments in Japan and Sri Lanka. In the final section, some policy inferences are drawn.

5.2 Data and Methodology

The methodology of research include extensive literature survey, field visits, focussed interviews and surveys. Many field visits and extensive interviews are conducted in Japan and Sri Lanka with a view to get first-hand information of current local government systems and their roles in delivering services and development to the local community. Our field tours in Japan include Minami Uonuma City, Niigata Prefectural Government Office, Yamato Town Office, Shiozawa Town Office, and Uonuma Town Office.

In Sri Lanka, we undertook many field visits and interviews covering Eastern, Southern, and Western Provinces of Sri Lanka. Other meetings include officials of the Ministry of Finance and Planning, Finance Commission, Central Bank, Pradeshiya Saba and Divisional Secretaries. We also benefited from informal meetings and discussions with more than 65 Sri Lankan students who were studying at the International University of Japan (IUJ) under Japanese Government scholarships and other funding sources. Many of them are government officers from Sri Lanka Administrative Service, Accounting Service, and Planning Service with first-hand experience in local governments. Those field tours, interviews together with the extensive literature survey facilitated our research process to identify an appropriate institutional unit for empowering local governments.

5.3 Public Local Administrative System in Sri Lanka: An Overview

The Sri Lankan administrative system consists of 9 provinces, 25 districts, 332 divisional secretariats and over 14,000 villages. Each province has a separately elected unicameral political body called a Provincial Council (PC) with a Governor appointed by the country's President and a cabinet led by a Chief Minister. There are 335 Local Governments in Sri Lanka, including 23 Municipal Councils (MCs), 42 Urban Councils (UCs), and 271 Pradeshiya Sabas (PSs). The MCs, UCs and PSs function under the Provincial Council's supervision. Divisional secretariats are the closest administrative units to local communities and coordinate village level government officers called Grama Niladari (Village Officers) and the functions of line ministries of the central government. There are also other separate governmental institutions (or agencies with different territorial boundaries) at the divisional level that function under central or provincial organisations.

In the post-colonial period, several amendments have been made to the administrative system due to political, socio-economic and cultural pressures (see Tables 5.1 and 5.2). Earlier changes were made for economic and political reasons, while recent changes were mainly introduced for ethnic reasons. Despite many attempts since the 1950s, the country had no strong desire to introduce a decentralised system of administration until the 1970s. Political insurrection in 1971

Table 5.1 Evolution of local government system in Sri Lanka

Institutes	Salient feature
Indigenous system of local government	Gam Sabhas and Rata Sabhas
Modern local government introduced in the second half of 19th Century	Municipal Council Ordinance (No 17 of 1865) Sanitary Boards (1892), Local Boards (1898) Government Agent acted as the Mayor or the Chairman
Local government under Donoughmore (1932)	Department of Local Government Local councils were reconstitute into four: (1) Village Committee (VCs, later Village Councils), (2) Town Councils (TCs), (3) Urban Councils (UCs) and (4) Municipal Councils (MCs) Bureaucratic representation in local councils was replaced by elected functionaries. The “District Administration” was retained for the purpose of spatial coordination of public services
Regional Council (1957) and District Councils (1968) were introduced	Purpose was to introduce decentralization for development
The District Development Councils (DDCs) were established in 1983 replacing VCs and TCs	District Minister as the Chairman of the Executive Committee and GA as the Secretary of the Council
In 1987, District Development Councils (DDCs) were discontinued and Provincial Councils (PCs), Pradeshiya Sabha (PS also known as Regional Councils) were introduced	PSs take the role of DDCs. From 1987, the local government constitute Divisional Secretariats (DSs), Municipal Councils (MCs), Urban Councils (UCs) and Pradeshiya Sabhas (PSs). This shows a dual administration at the local level. The DSs function under the Central Government while MCs, UCs and (PSs) under the Provincial Councils (or governments). They are under supervision of the Department of Local Government, as one of the devolved subjects specified in the 13th Amendment to the Constitution

Source Compiled by the authors using information from Gunawardena (2010, 193)

influenced reforms heavily. Divisional Development Councils (DDCs) were introduced immediately after the civil conflict in 1971. They aimed to minimise regional unemployment by utilising available local resources. DDCs failed to achieve their objectives because they suffered from numerous constraints, such as weak service delivery and financial and management incapability. In 1973, the government introduced the District Political Authority (DPA) system with the financial support of the Decentralised Budget (DCB). Under the DPA, political leadership for local administrations was introduced. The initiative was considered to be the first attempt to introduce political leadership to divisional administrations.

Table 5.2 Public local administrative and other functional units in Sri Lanka

Organisation	Number of organisations	Average population per unit	Average land area (km ²)
Local governments	335	60,489	195.85
Divisional Secretariats	332	61,035	197.62
Police Stations	401	50,533	163.62
MOH Divisions	332	61,035	197.62
Agrarian Services	610	33,219	107.56
Zonal Education Offices	67	302,444	979.25

Source Adopted from <http://www.statistics.gov.lk>

However, the DPA system was abolished in 1977 and a new District Minister (DM) system was introduced. A District Minister, elected from the district as a member of parliament, was supposed to lead the district development activities with the appointed Government Agent (GA) and his staff. However, three years later, District Development Councils were again established in the District Development Act of 1980.

In 1987, the Sri Lankan government introduced the 13th amendment to the Sri Lankan constitution, which established Provincial Councils (PCs). Under the PC system, financial decentralisation was introduced in an attempt to provide more efficient service delivery at the subnational level. Other than provincial development activities, education, health, rural development, law enforcement and other various powers were given to the PCs. Although the PCs system was not properly co-ordinated with the district level structures functioning under the national ministries, PCs were allowed to use Divisional Secretariats for local activities. PCs were also granted supervision over local governments, without degrading the powers given to local governments by the relevant laws. Local political and administrative units were unchanged by the PC system. For a short period of time, local governments and divisional secretariats came under the supervision of provincial councils while divisional secretaries were working as secretaries of the local government. However, due to various concerns, this system was terminated and divisional secretariats were again supervised by the central government.¹

The PC system has been criticised due to its many administrative failures. First, PCs are unable to co-ordinate government structures at the district and divisional levels. Second, scarcity of financial resources constrains innovative development programmes and the maintenance of recurring expenditures. Third, a high degree of

¹Former President Ranasinghe Premadasa introduced this system and later changed it due to resistance from bureaucrats.

centralisation restricts the smooth functioning of the PC as the centre simultaneously maintains central agencies at the local level.

The **districts of Sri Lanka** are divided into administrative sub-units known as *divisional secretariats*. These were originally based on the feudal **countries**, the *korales* and *ratas*. They were formerly known as ‘D.R.O. Divisions’ after the ‘Divisional Revenue Officer’. Later the D.R.O.s became ‘Assistant Government Agents’ and the Divisions were known as ‘A.G.A. Divisions’. Currently, the Divisions are administered by a ‘Divisional Secretary’, and are known as ‘D.S. Divisions’.

5.4 Towards an Appropriate Public Local Government Unit for Sri Lanka

Sri Lanka has a rather confusing and overlapping local administrative system. The Pradeshiya Saba (as a local government political entity) functions with its own staff under an elected mayor or chairman, while the Divisional Secretariat (as an administrative unit) functions separately, undertaking general administrative activities with staff appointed by the central government. According to the surveys and interviews we undertook in Sri Lanka and Japan, both PSs and DSs provide social services such as elder care, childcare, technical services and some development services, including rural infrastructure development and maintenance. Some of these activities are overlapping, and the overlap very often creates conflict among local level politicians and administrative institutions. It is clear that an absence of clear demarcation of responsibilities creates confusion, inefficiency, and coordination failure.

Local health departments (MOHs), agrarian departments (Govi Jana Sewa Madyasthanaya), police stations, and education departments (zonal or divisional) function separately under Sri Lankan central or provincial governments. We propose, with some adjustments, to absorb those separate bodies into our proposed local administrative unit (LAU). This is quite similar to the system Japan currently implements.

Table 5.3 shows various distances for basic service delivery from divisional governments in Sri Lanka. Access to public services in rural areas and estates is inconvenient when compared with urban areas. Because government offices are located in varying areas of the divisions, it takes longer to reach certain government offices providing services than it does to reach others. Travelling to various places to obtain services, given limited transportation options, is more difficult for people who live in the rural and estate sectors. However, divisional secretariats and local governments (MCs, UCs, and PSs) are located fairly close to each other, and people are able to reach them without much difficulty (Table 5.4).

It is obvious from the above discussion that there are different levels of local government structures currently functioning in Sri Lanka. Some of them have

Table 5.3 Distribution of local authorities in Sri Lanka

Province	District	Local authorities			Total	DS
		MC	UC	PS		
Central	Kandy	1	4	17	22	20
	Matale	2	0	11	13	11
	Nuwara Eliya	1	2	5	8	5
Eastern	Ampara	2	1	17	20	19
	Batticaloa	1	2	9	12	14
	Trincomale	0	2	11	13	11
North Central	Anuradhapura	1	0	18	19	22
	Polonnaruwa	0	0	7	7	7
North Western	Kurunegala	1	1	19	21	30
	Puttalam	0	2	10	12	16
Northern	Jaffna	1	3	13	17	15
	Mannar	0	1	4	5	5
	Killinochchi	0	0	3	3	4
	Mulativu	0	0	4	4	6
	Vavuniya	0	1	4	5	4
Sabaragamuwa	Kegalle	0	1	11	12	11
	Ratnapura	1	2	14	17	17
Southern	Galle	1	2	17	20	19
	Hambantota	1	1	10	12	12
	Matara	1	1	15	17	16
Uva	Budulla	2	1	15	18	15
	Moneragala	0	0	10	10	11
Western	Colombo	5	5	3	13	13
	Gampaha	2	5	12	19	13
	Kalutara	0	4	12	16	14
9	25	23	41	271	335	330

Source http://www.clgf.org.uk/default/assets/File/Country_profiles/Sri_Lanka.pdf

Key: *MC* Municipal Councils, *UC* Urban Councils, *PS* Pradeshiya Sabhas, and *DS* Divisional Secretariats

overlapping geographical boundaries. The number of local governments (PSs, UCs, and MCs) is almost the same as the number of DSs. This means that local governments and DSs have the same territorial boundaries even though they are independent from one another.

Overlapping responsibilities and functions are the most significant characteristics of the service delivery process. The 13th amendment creates a great opportunity for both central and provincial councils to exercise concurrent powers (123)(123)(123). Because there are no legal barriers for the divisional secretariats, they implement some services similar to those of the local governments. The overlap is most evident with regard to welfare and development activities. It is common for both the central

Table 5.4 Mean distance to the nearest place of facility by poverty status and by sector—2006/07

Place of facility	Sri Lanka		Urban		Rural		Estate	
	Non poor	Poor	Non poor	Poor	Non poor	Poor	Non poor	Poor
Bus Halt	0.5	0.7	0.1	0.3	0.5	0.7	0.9	1
Pre School	0.5	0.7	0.1	0.3	0.6	0.7	1	0.9
Primary School	1	1.2	0.5	0.8	1.1	1.2	1.2	1.4
M.V/M.M.V./N.S.	2.5	3.5	2.7	1	2.7	3.5	4.7	5
Hospital	6.6	7.7	7.1	3.6	7.1	7.9	9.4	8.8
Maternity Home	5	6.2	5.6	2	5.6	6.5	5.6	5.8
Government Dispensary	3.9	5.1	4.3	1.9	4.3	5.2	5.3	5.7
Clinic (Maternity/Infancy)	2.5	3.3	2.6	1.5	2.6	3.3	4.4	4.2
M.O.H. Office	6.7	8.9	2.1	2.1	7	8.4	16.5	16.5
M.C./U.C./P.S.	7.3	10.1	2.6	2.8	7.7	9.7	16.7	17.4
Divisional Secretariat	7.5	10.1	3	3.2	7.7	9.3	19.3	19.5
G.N. Office	0.7	1	0.5	0.6	0.6	0.9	1.8	1.9
Post Office	1.6	2.2	0.6	0.7	1.6	2.2	3.7	3.6
Bank	3.5	5	1	1.1	3.8	5.2	6	5.7
Agrarian Service Centre	6.5	7.8	5.2	5.4	6.3	7.1	14.1	14.9

Source <http://www.statistics.gov.lk/poverty/reportnew-Final.pdf>

and provincial governments to use both divisional secretariats and local governments for these activities. It should be noted that current local governments contribute little to regional economic development.

Japan has a two-tiered system consisting of central and local governments. The local governments are classified into two types: (a) ordinary local governments (including 47 Prefectures and 1788 Municipalities) and (b) special local governments (including Special Wards, Municipal Cooperatives, Property Wards and Local Development Corporations). Local administrative units are formed in Japan based on geographical conditions, population size, degree of centralisation of power, and content of local administrative services. The autonomy of local administrative systems is guaranteed by the constitution adopted in 1946, and they function as well-established democratic systems. Japan's local governments do not simply operate as administrative units of the central government. They are incorporated as independent political and administrative entities within their respective jurisdictions and have a responsibility to carry out constitutionally guaranteed functions related to almost all day-to-day needs of their residents. The following Fig. 5.1 explain the structure of Japanese local public administration.

Organization of Local Public Entities

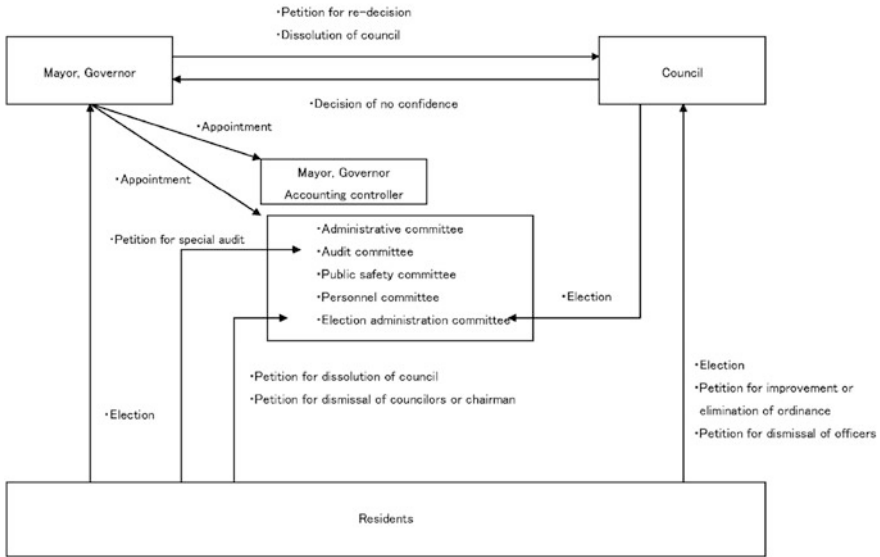


Fig. 5.1 Source CLAIR (2010)

On the basis of our experiences, field visits, interviews conducted in Sri Lanka and Japan, and also from extensive literature surveys of other countries, it is possible to identify an appropriate administrative unit for Sri Lanka. We propose combining PSs and DSs. The proposed Local Administrative Unit (LAU at the divisional level) would comprise two branches: a legislative branch and an executive branch. The legislative branch would be responsible for preparing plans for local development and service delivery, budgeting, and introduction of local ordinances. Elected members (similar to the current PS system in Sri Lanka) of the local administrative unit fall into this branch and would function as public representatives. The number of the councillors would be set by law and would depend on the population size of the unit. The chief executive of the LAU, perhaps a mayor, would be directly elected by the local citizens for a fixed term and would be the chief executive of the executive branch, implementing the policies formulated by the legislative branch. Prospective candidates for the mayoral position would not submit nominations affiliated with any political party because it might be difficult for a person to be independent in office once supported by a particular political party.

The current Provincial Council in Sri Lanka has five ministries. Consistently, our proposed LAU would consist of about five divisions (including, for example, education, health, development, election, information etc.) covering regional development and service delivery. The heads of those divisions would be government officers and would perform independently of one another. The current

zonal Director of Education would be the head of the Division (or Board) of Education of the LAU. The mayor would ensure the overall consistency of governmental operations and would hold the power to convene special meetings of the legislature and send bill proposals, such as draft budgets. The mayor would also manage office staff by appointment and dismissal. To prevent the accumulation of power in one particular agency or person, power would be allocated to separate committees created for various functions, allowing authorities to carry out their duties independently. For example, an education committee would have the overall responsibility to handle its own affairs. These administrative committees would be established based on the concept of pluralism and each would handle its assigned duties within its respective jurisdiction. Members of these committees or boards would be appointed by the chief executive with the consent of the legislature. The Board of Education would be responsible for managing the educational institutes of the division. In Japan, besides the education board, there are several boards for major public services, such as public safety, elections, and health.

The provincial councils and our proposed LAU would be mutually independent entities without any hierarchical relationship in terms of administrative functions. Provinces would be designated to encompass the LAU that most closely provides for the day-to-day needs of its people. Provinces would set guidelines and administer advice to local governments to maintain uniformity within the province. Arrangements would also be made to provide a clear division of responsibilities according to the “principle of subsidiarity”. As much responsibility as possible would be delegated to local governments, followed by delegation to the provinces and, finally, to the supreme (central) government. However, in practice those institutes would execute their responsibilities in an integrated manner rather than using an isolated individualistic approach.

5.5 Functions and Finances of Public Local Government Administration: Lessons from Japan

Having discussed an appropriate local government unit for Sri Lanka in the previous section, this section discusses the functions and financial aspects of Japanese local government systems, with the goal of establishing a model for the proposed LAU. In Japan, the government system provides a clear division of duties between the national and local levels. Legal authority had been established by specific local government autonomy law enacted in 1999 aiming to promote decentralisation of governmental activities. This act guarantees a clear division of responsibilities between the national and local levels, preventing any possible overlap. While the central government handles national interests, local governments are given almost exclusive administrative authority in their regions and exercise it independently and

comprehensively. Based on national interests, national policies are formulated by the central government. Moreover, local governments are given as much responsibility as possible for delivering services related to the day-to-day needs of their citizens. Main responsibility for local or regional development in Japan (more or less) falls under local administration.

Local governments handle two types of duties: “local autonomy functions” and “statutory entrusted functions”. Statutory entrusted functions are functions that reserve original responsibility for the central government, but impose responsibility for implementation on local governments (CLAIR 2010: p. 15). Therefore, strong central government intervention can be observed with respect to statutory entrusted functions. Some functions, such as the maintenance of national roads, are statutory entrusted functions, while others are local autonomy functions. Responsibilities of municipalities are based on the provision of basic public needs. Affairs relating to residence, family registration, town planning, street addresses, public safety, public health, waste management, provision of water, welfare facilities (such as health insurance schemes), maintenance of public places (such as parks), public roads and management of elementary and junior high schools are the major responsibilities of municipalities.

As an independent authority, our proposed LAU would raise its own funds to carry out its functions. In this regard, the Japanese experience is informative. Independent financial management is considered a basic requirement of any organisation. Despite a close relationship with the central government, Japan’s local governments maintain autonomy regarding fiscal operations within their jurisdiction. Tax autonomy of the local governments provides latitude to organise revenue sources. The concept of fiscal federalism is guaranteed and is considered to be the major requirement for effective decentralisation. Figure 5.2 shows revenue sources and their allocation to the different layers of government. The total amount of tax revenue in 2013 was 86.6017 trillion yen, of which national taxes accounted for 59.2% and local taxes, 40.8%. However, the finally 35.7% of this income was allocated to the national government while 64.3% was allocated to local governments. This is because about 40% of the taxes collected as national tax are redistributed to local governments through systems such as the local allocation taxes, local transfer taxes, and special grants to local governments.

According to Fig. 5.3 in 2012, the revenue of municipality consisted of local tax (32.7%), local allocation tax (16.0%), national treasury disbursements (15.8%), local government bonds (9.3%), and other revenue sources (22.3%). These data suggest that local governments in Japan enjoy their own income sources and are therefore less dependent on central government funds. Because national treasury disbursements depend on the financial situation of the local governments, local governments have control of their expenditures. Moreover, this system guarantees the independent operation of local government activities.

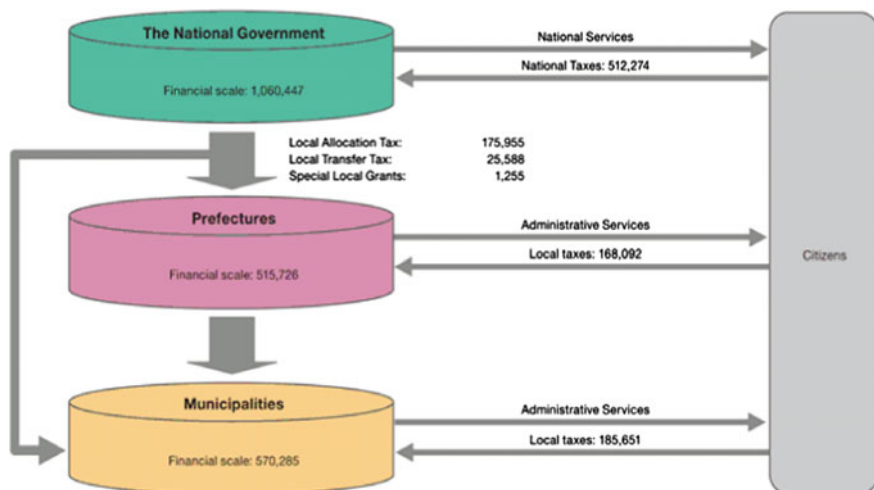


Fig. 5.2 Structure of local finance in Japan (Unit yen100 millions, FY 2013). Source <http://www.metro.tokyo.jp/ENGLISH/ABOUT/FINANCIAL/financial01.htm>. Accessed on 24 December 2016

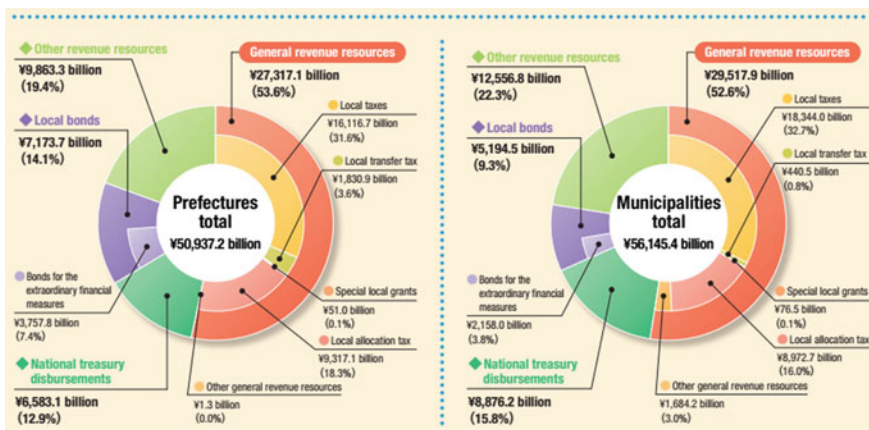


Fig. 5.3 Revenues breakdown of prefecture and municipality (FY 2012)

5.6 Concluding Remarks and Policy Implications

This paper discusses local government systems in Sri Lanka and Japan and proposes a proper public local government unit for Sri Lanka. And the finding suggests that current local governments Pradeshiya Saba (PS) and Divisional Secretariat (DS) in Sri Lanka lack clarity and division of functions. This has resulted in confusion, inefficiency and conflicts among regional political leaders and

government officials. We also find that in Japan, decentralisation of fiscal allocation to local governments through Local Allocation Tax Programme (LATP) implemented since the 1950s have contributed to governance and development at local level. Empirical evidence suggest that empowering the local government through decentralization is currently been implemented in over 80% of developing countries.

Critically analysing the benefits of the Japanese local government system and the limitations and strengths of the current Sri Lankan systems, this study proposes merging PSs and DSs to create one local administrative unit that is close to local citizens. The merged unit may be called a Divisional Administrative Unit (DAU) or any other suitable name, and its geographic scope can be the same as that of the current corresponding DS. The proposed DAU contains an executive and a legislative branch. Public participation and democratic representation in local administration and regional development underlie our proposed local administration system. In addition to the right to elect their representatives, people should enjoy the right to direct participation in local administration and developmental activities. Such a right safeguards the rule of law, democratic values, ethnic harmony, and market elements. We believe that our proposed local administrative unit plays a vital role in empowering and improving the livelihood of local citizens.

Currently, central and provincial governments in Sri Lanka use existing divisional secretariats as their local agencies. Therefore, amalgamation of PSs and DSs at the divisional level seems appropriate. This may be a more viable form of devolution than devolving power to district and provincial units because politicians have deep suspicion of those units, particularly the provincial level as a the unit of devolution of power. The current Government Agent, at the district level, can be part of the provincial system by being the district coordinator of the PC. The present activities of the central government's departments may also be absorbed by the proposed LAUs and PCs.

National politicians and bureaucrats of the central government may think that they are entitled to great resources and power; however, local level politicians and bureaucrats believe the opposite. The central government believes local administrations to be inadequately equipped, less productive, and inefficient. It may also believe devolving autonomy to local units to handle their own affairs might lead to more corruption at the local level. There is also a general misperception among some officials that devolution efforts of provincial councils have failed. Our proposed LAU may face some other challenges. A majority of bureaucrats who represent various governmental departments at the local level may not wish to work under elected politicians, fearing a further politicisation of public administration. Instead of political leadership, bureaucrats desire capable government officers. Despite all unjustified negative mind sets, public services should be improved and reforms are urgently needed because the current system is too politicised and less efficient.

Sri Lanka desperately needs regional development, peace and reconciliation of governance at the local, regional and central level. Local citizens are capable of assessing and satisfying their needs if they are empowered to do so. We believe that

our proposed local administrative unit plays a vital role in empowering local citizens, achieving the above-mentioned goals and improving the livelihood of citizens. One can argue economic or public policies may not work efficiently unless and until citizens are freed from undue politicisation. Another approach to empowering people at the local level is to elect members of local government councils on a non-political party basis. Bureaucrats and technocrats at the local level are there to help citizens, not to make decisions on their behalf.

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Author Biographies

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Part II
Sectoral Development under Decentralised
System

Chapter 6

Agriculture and Rural Development Under Central Government and Provincial Council Setup in Sri Lanka

Buddhi Marambe, Pradeepa Silva and Saman Athauda

6.1 Introduction

Sri Lanka is an island in the Indian Ocean located at the southern tip of the Indian Subcontinent, with a total area of 65,610 km², including 2905 km² of inland water bodies. The maximum width east-to-west is 240 km and length in north–south direction is 435 km. It is located between 5°55′ to 9°5′ North latitudes and 79°42′ to 81°53′ East longitudes and hence has an equatorial climate. The country has a wide range of topographic features with three distinguishable elevation zones within the island: the Central Highlands, the plains, and the coastal belt. Most of the island’s surface consists of plains between 30 and 200 m above sea level. In the southwest, ridges and valleys rise gradually to merge with the Central Highlands, giving a dissected appearance to the plain. A 1,620 km long coastal belt at about 30 m above sea level consists of scenic sandy beaches indented by bays and lagoons. Administratively, Sri Lanka is divided into 25 districts in nine provinces.

Sri Lanka became an independent state in 1948, after 443 years of colonial rule by the Portuguese (1505–1658), the Dutch (1658–1796) and the British (1796–1948). The British colonial period saw the establishment of a strong, centralized administrative system, and the foundations were laid for the modern local

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government setup. In 1972, Sri Lanka introduced a republican form of government under the name Democratic Socialist Republic of Sri Lanka. Since 1978, Sri Lanka is governed by the Constitution of the Democratic Socialist Republic of Sri Lanka (as amended), with a nationally elected Executive President, a Parliament consisting of 225 members, and a Cabinet of Ministers from within parliament functioning at national level.

Sri Lanka consists of a multi-ethnic, multi-cultural and multi-religious society. The Population of the country in 2015 was 20.966 million. Of which 18.2% live in the urban sector, 77.4% in the rural sector and 4.4% in the estate sector. The average annual population growth rate from 1981 to 2012 was 1.1%, amounting to a 37.1% increase of population during the said period. The population density of Sri Lanka was 334 in 2015 (DCS 2015). The economically active population in Sri Lanka, who are 15 years or more, amounts to 7.86 million. Majority of the population in Sri Lanka is Sinhalese (74.9%), followed by Tamils (15.3%) and Sri Lanka Moor (9.3%). Other ethnic groups are; namely, Burgher, Malay, Sri Lanka Chetty and Bharatha form 0.5%. The highest percentages of Sinhalese, Tamil and Sri Lanka Moor population are reported from Southern province (95.0%), Northern Province (93.8%) and Eastern province (36.9%), respectively.

Almost 70% of the Sri Lankan population is Buddhist, followed by Hindus (12.6%), Islam (9.7%), Roman Catholic (6.2%) and other religions (1.4%). The literacy rate of the population aged 10 years and above in Sri Lanka is 95.7% (males 96.9% and females 94.6%). The highest literacy rate is reported from the Western province and the lowest from the Eastern province. The largest ethnic group, the Sinhalese are concentrated mostly in the southern part of the country, while the largest minority group, the Sri Lankan Tamils of South Indian origin, is concentrated mostly in the North. The Indian Tamils, were brought to Sri Lanka under British colonialism to work on the tea plantations in the central hills. Other very small communities are the Burghers, (of Portuguese and Dutch descent), and the *Veddhas*, who were the original indigenous inhabitants of Sri Lanka, before the advent of the Sinhalese. The majority of Sinhalese adhere to the Buddhist religion, while most Tamils are Hindus, with Christians of different denominations being found among both Sinhalese and Tamils. Muslims are followers of Islam. Linguistically, the Sinhalese speak the Sinhala language, while Tamils and Muslims speak the Tamil language. English is spoken by a considerable proportion of all communities.

6.2 Sri Lankan Economy

The Sri Lanka's economy grew at an annual average of 4.5% since independence (1950–2013). However, there were significant differences in economic growth rates during this period due to various reasons. A summary of such analysis from 1970 onwards is shown in Table 6.1.

Table 6.1 The growth Gross Domestic product (GDP) of Sri Lanka during different time periods

Period	GDP growth (%)	Reason
1970–1977	2.8	Droughts, insurrection, state control of economy, food grain shortages, oil price hike, unfavourable terms of trade, unfavourable international relations
1978–1984	8.2	Policy reforms, more liberal economy
1985–1986	5	Internal security situations, ethnic violence
1987–1989	2.2	Internal security situations, ethnic violence
1990	6.2	Restoration of law and order
1991–1993	5.5	Restoration of law and order
1994–1999	5.2	Deterioration of internal security conditions, drought
2000–2004	4	Energy crisis, Terrorist war in the North and East, crippled tourism
2005–2009	7	Upsurge of economy (despite LTTE war)
2010	8	End of LTTE war, upsurge in construction, tourism, other services (communication, trade, banking and finance)
2011	8.4	End of LTTE war, upsurge in construction, tourism, other services (communication, trade, banking and finance)
2012	6.4	Global recession, withdrawal of GSP+ concession quota by EU, adverse weather
2010–2015	6.4	Policy thrust for reconstruction and growth, but with limitations due to weakened export market and larger trade deficits

In the period 1951–1976 Sri Lanka had an average per capita Gross Domestic Product (GDP) growth of 0.2% per year (CBSL—various issues). In this period Sri Lanka had an unfavourable trade balance and new established industries operated well below capacity due to a shortage of imported goods. The lowest rates of growth were during 1970–77 and 1987–89 when the average annual growth was only 2.8 and 2.2%, respectively.

The National Output and Expenditure Analysis (CBSL—various issues) classifies “agriculture sector” in Sri Lanka as a composite of two main components; namely, (1) agriculture, livestock, forestry and (2) fisheries. The first component has ten subsectors which includes paddy, other food crops (OFC), livestock (including poultry), and forestry. Because of this complexity, statistics in the “agriculture sector” could always be misleading. The predominantly agricultural economy of Sri Lanka that prevailed at the time of independence has now been transformed into a more diversified one. This diversification was gradual till the late 1970s, and gained momentum later. Agriculture that contributed 41% of GDP in 1950, accounts for only about 7.9% of GDP in 2015 (Fig. 6.1). At the time of independence, manufacturing that consisted mainly of processing tea, rubber and coconut, accounted for 16% of GDP. The most notable feature of the structural change in GDP contribution that occurred is that manufacturing and services started making a higher

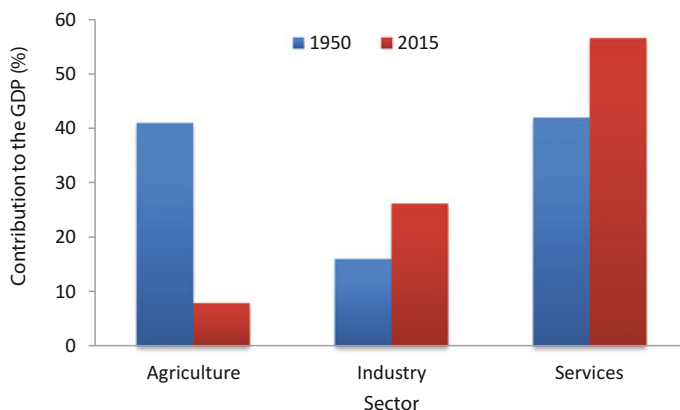


Fig. 6.1 Contribution of main economic sectors to the GDP of Sri Lanka in 1950 and 2015 (CBSL—various issues)

contribution to GDP than agriculture. In 2015, industry contributed nearly 26.2% of GDP and the contribution of services increased to 56.6% of GDP.

Since gaining independence from the British Colonial rulers in 1948, the development policy in Sri Lanka was mainly focused on achieving the objectives of equity and economic growth. To reach an economic growth, Sri Lanka restricted imports and encouraged domestic production. Various welfare programs including price subsidies on food, statutory price controls on consumer goods and the provision of free education and health services in order to achieve equity. However, the high welfare expenditures restrained the capital growth of the country and the ability to invest, slowing economic growth and resulting in high unemployment and low wages. However, the welfare programmes implemented were able to achieve improvements in human development. In 2015, Sri Lanka was ranked 73 in the UN Human Development Index (UNDP 2016), which is higher than any other country in South Asia, and grouped in the high human development category.

The growth in the gross domestic product (GDP) of Sri Lanka was 4.4% in 2016, which was lower than that observed in 2015 (4.8%). Overall agriculture activities contracted 4.2% in 2016 owing to inclement weather throughout the year. Rice sub-sector has declined drastically by 31.0%, tea by 11.2%, rubber by 10.7%, other cereals by 10.5%, fruits by 3.7%, vegetables by 2.1% and oleaginous fruits by 0.6% in 2016. However, freshwater fishing grew 9.9%, spices by 6.4% and animal production by 6.3% in 2016 (DCS 2017). The projection of 5% growth in 2017 and 2018 (ADB 2017; Table 6.2) has been made despite the downside risk that a prolonged drought could affect growth in the 2017. Inflation will continue to be moderate in 2017 and 2018.

Table 6.2 The estimated economic growth in Sri Lanka

Selected economic indicators	2017 (estimated)	2018 (estimated)
GDP Growth (%)	5	5
Inflation	6.0	6.0
Current account balance (as a share of GDP)	-2.2	-2.2

Source (ADB 2017)

6.3 Agriculture Sector of Sri Lanka—An Overview

Agriculture sector registered a growth of 7.9% for the year 2015, though it contracted in 2016 owing to bad weather. Sri Lanka has a dietary concentration on one staple commodity (i.e. rice), and also has a static food basket composition. Dietary composition in 2005–07 is similar to 1990–92 period indicating 56% of cereals 3% pulses, 3% fruits and vegetables, 3% dairy and eggs and 11% sugar among others. Sri Lanka's per capita consumption of fruits and vegetables remains far below the required average daily intake. In the long run, hunger vulnerability can be lowered by raising agricultural productivity for a diverse set of both competitive and sustainable crops, and promoting dietary diversification. The opening up of the North and the East, which are mainly agriculture producing areas, should increase the availability of fruits and vegetables. The contribution of the livestock sector (including poultry) to GDP of Sri Lanka only about 0.6% (DAPH 2015). Livestock rearing is spread throughout the country with concentrations or absence of animals in some areas due to cultural, market and agro-climatic reasons. Livestock alone is not a flourishing enterprise in Sri Lanka. Almost all the livestock operators except some poultry farmers are basically crop farmers with livestock as a secondary activity. Dairy is the priority sector for development followed by poultry, which has expanded significantly in recent years.

Rice: Development of the rice sub-sector was crucial to the economy of Sri Lanka as, apart of being considered a staple food, a large number of rural families being employed in rice sub-sector. There was a need to increase rice production to ensure food security and economic stability, as Sri Lanka for years had been dependent on imports for many years. Thus, much of the development effort has focused on infrastructure such as irrigation schemes, land settlements and support services such as agricultural research, extension and education, fertilizer subsidies, and floor prices for output in order to increase rice production to achieve self-sufficiency and food security. As a policy goal in achieving self-sufficiency in rice, Sri Lankan government removed the wheat imports subsidy in 2004 and a duty was added on wheat imports (USDA 2012). Currently, with new areas of paddy cultivation in the North (after the war) and better management, average yield has improved and domestic supply is self-sufficient subjected to vagaries of weather. The 2011/12 paddy production was a record high, leading to increased consumption and ballooning stocks. Sri Lanka also donated 7500 mt of rice to the World Food Programme in 2011, signalling a shift from a rice deficit country to a rice surplus

country. The paddy production grew by 23.3% in 2015 mainly due to favourable weather and contributed to 11% of the agricultural GDP and 0.9% of the total GDP of the country (DCS 2016).

Other Food Crops: Though priority had been given to rice as the staple food, OFCs are also important crops for food and agro industries. They are a source of protein, vitamins, minerals and fibre, having a high potential to alleviate malnutrition and to sustain food and nutrition security. Some OFCs are part of traditional Sri Lankan meals and formulated food supplements for children and pregnant women. They are commonly grown traditional crops in the farming systems of the dry and intermediate zones of the country. There is no significant private sector participation in cultivation and seed production of most of the OFCs except perhaps for maize. Poor quality seeds invariably lead to heterogeneous quality low yields, which is the most direct gap attributed to the poor performance of the OFC sub-sector. Contract growing by the private sector has resulted in increased production of maize in recent years, and for the first time, 10,000 mt of maize was exported in May 2012 (FAO 2012). Among the other food crops sector in Sri Lanka, which covers highland Crops, the vegetable and fruits recorded a growth of a 24.9% and 5.1% in 2015, respectively (DCS 2016).

Dairy: Cattle is reared in all agro-climatic zones in Sri Lanka. In the upcountry, mid country and Jaffna district, cattle are reared mainly for milk, while in wet and intermediate zones it is multipurpose. In the dry zone, cattle are also a source of welfare for financial urgencies. The rearing systems of cattle vary in different agro-climatic zones. During 2012–2014, the milk production recorded an increase from 9.8% to 15.8% as dairy farming was re-initiated in the Northern and Eastern Provinces, with many of the traditional farmers returning to their usual profession. However, the sector faced an unexpected drawback in 2015 where the growth was only 4% due to disease outbreaks. The top 12 districts having large cattle populations are in the dry zone, except for one district in the intermediate zone. The cattle in these districts are low productive local or exotic zebu types, which are not the best for milk. Thus, a large resource base contributes marginally for the national development goal of increasing milk. Importing milk products, especially powdered milk, is a major foreign exchange expenditure item in the national budget.

Poultry: The poultry industry is one of the most developed industries in Sri Lanka. From being a backyard industry, it has emerged as a dynamic industry within a short time period. As a result, eggs and chicken meat are accessible to a larger population in the country. The industry has had rapid growth with private sector participation, especially in the broiler sector and relatively less in the layer sector. Chicken meat was declared as an essential food commodity in 2006. The chicken meat production has increased by 9% and the egg production by 3% in the year 2015 while commercial poultry feed production has also increased by 24% supporting the expansion of the industry.

Fisheries Sector: The share of fisheries to the GDP of Sri Lanka was 1.8% in 2014 (NARA 2014) with a stable contribution of inland (0.2%) and marine fisheries (1.6%). The workforce in the fisheries sector in Sri Lanka, including the support services, amounts to one million people. Approximately one fifth of the skilled

fisheries workers are females. Sri Lanka is both an importer and exporter of fish/fish products. On 26 December 2004, the 80% of the fisheries sector was devastated by the tsunami tidal waves that hit two-thirds of the coastline of the country. The fisheries sector in Sri Lanka has two broad sub-sectors namely, (1) marine sub-sector and (2) inland and aquaculture sub-sector. Fish from the marine sub-sector accounted for more than 87% of fish produced in 2014 (NARA 2014). It is the dominant sub-sector in terms of production, employment and fishing fleet strength. The contribution from inland and aquaculture sub-sector has been low however, since 1980, fish culture in seasonal village tanks, marine shrimp culture in coastal earthen ponds and live ornamental fish exports have reached commercial dimensions while the cage culture, mollusk and seaweed culture are yet to be developed. Sri Lanka has an extensive freshwater and brackish water resource to sustain viable fishing activities. The total area of the inland water bodies in the country is about 489,000 ha. These include irrigation reservoirs, seasonal tanks, and brackish water resources such as estuaries, lagoons or marshes. Fish marketing is handled almost exclusively by the private sector. Government has set up the Ceylon Fisheries Cooperation (CFC) primarily to cushion the prices. Sri Lanka exports prawns of all forms such as whole, shell-on, raw, frozen headless, cooked and deveined. Fish exports include fresh and frozen products, which are mainly tuna species; yellowfin tuna and skipjack tuna being the most important. Other exports are prawns, lobsters, crabs, sea cucumbers, shark fins, squid, cuttlefish, and other forms of shells.

6.4 Administrative Setup in Sri Lanka—Power Devolution

The governance structure of Sri Lanka has evolved over centuries with the influence of foreign invasions. An indigenous system of local government has prevailed in the form of Village Councils (*Gamsabhas*) before the advent of the colonial powers (Leitan 2010). The Provincial or a District Administrative Structure (*Kachcheri* System) was introduced by the British rulers who operated in Sri Lanka since 1796, where the centralized authority of the government was diffused throughout the country. The functioning of government was vested with a Government Agent (GA) under the *Kachcheri* system where a GA was appointed for each province, later for each district, and operated through subordinate officials down to the village level. Under this administrative system, the *Gamsabhas* seem to have lost their image and vitality. Although an attempt was made by the British colonial government to re-introduce local councils (in the form of village councils), municipal councils, road committees and sanitary boards in urban areas, these were identified as extensions of the administration rather than as a revival of the *Gamsabha* system. In 1931, with the introduction of universal franchise, four types of local authorities, namely, Municipal Councils (MCs), Urban Councils (UCs), Town Councils

(TCs) and Village Councils (VCs). They were established with inadequate powers and finances, while the *Kachcheri* and field unit of government departments were in operation in other areas. These four administrative units were in operation in Sri Lanka until 1980, when the system of Development Councils (DCs)/District Ministers was established for each district under the provisions of the Development Councils Act No. 35 of 1980. Thereafter, the MCs and UCs continued to operate in urban areas, while the TCs and VCs were abolished (Leitan 2010). The Development Councils (Amendment) Act No. 45 of 1981, made provision for two other types of bodies, the *Pradeshiya Mandalas*, and *Gramodaya Mandalas* at two lower levels of the administrative system. The DCs took over the functions of the abolished TCs and VCs, with additional functions being vested in them under the Act. Fifteen development functions including agriculture, agrarian services, rural development, fisheries, small and medium scale industries, health services, irrigation within the district, were decentralized to the district level, with the DC being called upon to prepare and implement a District Development Plan in relation to those subjects.

The 13th Amendment to the Constitution (1987) and the Provincial Councils Act No. 42 of 1987 made constitutional and legal provision for the establishment of Provincial Councils (PCs), within Sri Lanka's unitary constitution. As a result, the DCs and *Pradeshiya Mandalas* were abolished, while legal provision was made to retain *Gramodaya Mandalas*, which are non-functional at present. *Pradeshiya Sabhas* Act No. 15 of 1987 brought in a system of elected *Pradeshiya Sabhas* (PS) in addition to MCs and UCs in urban areas, consisting of a number of villages, and vested with the legislative and executive authority in relation to their functions specified under the Act. As at 2014, Sri Lanka's institutions of local governance consisted of 23 MCs, 41 UCs and 271 PSs (<http://www.lgpc.gov.lk/>).

The enactments related to decentralization specify the powers and functions (under 'List 1'), their limitations (pertaining to functions on the Reserved List, 'List 11'), those powers on which both the centre and provinces can legislate under 'List 111' (the Concurrent List), the role of the Provincial Governor, their revenue sources, the Finance Commission, the Provincial Public Service and the Provincial Public Service Commission. Some of the major economic services devolved to the PCs include agriculture and agrarian services, animal husbandry, fisheries (within territorial waters), land development, and irrigation, except (inter-provincial irrigation). Some of the functions, such as police and land administration have not been devolved, and still remain with the central government. The Reserved List includes national policy on all subjects and functions, defense and national security, foreign affairs, posts and telecommunications, ports and harbours, aviation and airports, etc., while the 'List 111' contains functions such as agriculture and agrarian services, health, social services, etc. Thus, the management and operation of devolved functions come under the PCs, policy is determined by the central government.

The administrative structure of Sri Lanka at present consists of the District level at which the GA functions, the Division level at which the Divisional Secretary operates, and the village level at which *Grama Niladhari* (or village level official)

have been appointed. The vertical administrative structures that have been developed are answerable to the line Ministries, and carry out the devolved powers listed under the functions and authorities vested under them.

6.5 Decentralization of Development Activities

The PC is elected through general election and is headed by a Board of Ministers with the Chief Minister in charge, and supported by Provincial Secretaries headed by the Chief Secretary. The executive administration of the PC is divided into five technical ministries for devolved subjects, i.e. agriculture, livestock, irrigation, industry, roads, transport and health and education. The major components of the decentralized planning and coordination are found at four levels (Perera 2001):

(a) Provincial Development Policy, Strategy and Programme—will set out priorities in the province on a sectorial, area and group basis. It will lay down the policy framework within which planning activities at divisional level will take place. The strategy will be in the form of five-year rolling plans with annual programmes for implementation.

(b) District Development Programme—will coordinate government programmes and provincial programmes, bringing together government activities regarding national programme and provincial activities planned at divisional level. The programme will work toward balanced development of the district, in the form of an annual programme.

(c) Divisional Development Plan—will consist of village development plans emanating from village organizations, divisional level projects and village development efforts funded from the Decentralized Capital Budget. It will be a three-year rolling plan with an annual implementation programme, incorporated in the District Development Programme.

(d) Village Development Plan—will consist of village level projects and activities to be identified through direct consultation between the village level organization and the community. They will be drafted with an assigned order of priority assigned to meet the felt development needs of the village and will be a three-year rolling plan.

Since 1977, the existing decentralized planning-administrative structure was further strengthened by the new Constitution (UNESCAP 2003). The decentralized budget was further expanded. The Department of Agriculture under the Ministry of Agriculture was regionalized on an agro-ecological region basis, especially with respect to research functions, in addition to its District level structure pertaining to extension and seed supply functions. Field workers in agriculture have significantly increased in numbers. Extension/Research priorities are decided at the district/regional level at a joint forum named the Regional Technical Working Group (RTWG) and later to the Provincial Technical Working Group (PTWG), which is the well-established extension-research link in the agriculture sector (i.e. crop agriculture). However, no research in the field of agriculture (crops, livestock

and poultry, and fisheries) is carried out by the PCs of Sri Lanka (Weerakoon 2010). Further, the District Agriculture Committees (DAC), an administrative set up chaired by the District Secretaries in 25 districts of Sri Lanka, also have a research-extension dialogue prior to planning, plan and project implementation in the respective districts.

6.6 Linking Central and Provincial Administrative Setups

In the constitution of Sri Lanka, the item 4 of 'List I' of the Ninth Schedule gives a clear indication on the autonomous nature of local authorities where the central (national) government agrees on a national local government policy and determines the form, structure and constitution of local authorities. The supervision of the management of local authorities is the responsibility of the PCs. This demarcation of power and authority, although clear, is not totally adhered to division of power between the central government and the provincial councils, due to other legal provisions.

Under the constitution, the President appoints the Governor and the Chief Secretary of the Province. Most of the key officials such as secretaries of provincial Ministries and provincial Commissioners are seconded from the Central Government to the provincial public service. The process of dissolution of a local authority has to be done through a legally accepted procedure. Basically the Ministers in the PCs should be satisfied that sufficient proof is available to take action against the local authority through a report obtained from a retired judicial officer within three months on the allegations made against the local council. The power to suspend the respective councils and *Sabhas* is also provided for in law. When a Mayor is removed, the Minister has to appoint a Special Commissioner to manage the affairs of the municipal council. Although the local authorities are supposed to be democratic administrative units, they are not fully autonomous, as the PCs can pass powers, functions and responsibilities on to local authorities under various statutes, but cannot reduce constitutional powers of local authorities. More powers could be granted to local authorities if necessary; the PCs of North Western Province and Central Province have already given additional powers to local authorities engaged in development activities in their respective areas.

The chief ministers of the PCs organize regular conferences in which the national-level Minister for Local Government and PCs participates as the central government representatives. Meetings are also held between representatives of the sector/line ministries, the provincial chief secretaries, and the secretaries of the Provincial Public Service Commission. The national-level Ministry of Local Government also holds monthly coordinating meetings with the provincial commissioners and other organizations working in the local government sector. The Sri Lanka Institute of Local Governance, set up under the Act No. 31 of 1999, also has a facilitating role by providing professional support to both PCs and local authorities, as well as research support to the national ministry for the formulation of policies on local government.

6.7 Agricultural Economy of Sri Lanka—The Traditional Approach, Indigenous Knowledge and Related Institutional Arrangement

Indigenous knowledge associated with the practice of agriculture and irrigation has survived in Sri Lanka for over 2000 years due to the unique institutional system that supported it (Upawansa and Wagachchi 1999). This institutional system organized as a hierarchy had the village (the smallest unit) as the base. Each village, which had a village chief (*Gamarala*) was governed by a village council (*Gamsabha*). A number of villages formed the next hierarchical level 'Korale'. The larger divisions were identified as 'Disawas'. The King stood at the apex of the pyramid with unlimited power. Village temples and 'Devalas' with their priests and the *Ayurvedic* practitioners also enjoyed a certain degree of power in the traditional governance system. The 'Pirivena' was the only formal education institute and was attached to a Buddhist temple, while religion was taught by Buddhist priests. The other three pillars in the traditional knowledge system, namely medicine, astrology and ritualism, were taught by masters (*Gurus*).

Foreign invasions at different time periods resulted in the gradual disappearance of the indigenous knowledge systems and the institutional structure that supported it. The *Gamsabha* was abolished in 1832, and the *Gamarala* was replaced by an officer called the *Vel Vidane* in the 1860s, whose functions were limited to the cultivation of paddy. The other main components of the farming system such as highland crops cultivation and livestock farming were neglected. Modern technologies started replacing the more sustainable traditional technologies and agriculture in the villages were consequently governed by the bureaucrats who were mainly from outside the villages. The Waste Lands Ordinance No. 1 of 1897, introduced by the British colonial rulers enabling them to purchase land at low prices, was an enormous blow to indigenous agriculture. This led to the establishment of coffee plantations and later tea and cocoa plantations. The communal or cooperative efforts were destroyed, and mutual exchange of labour was replaced by introducing paid labour to village agriculture, thereby converting agriculture into an economic pursuit, moving away from being 'a way of life'.

6.8 Agricultural Economy—Evolution Under Centralized and Decentralized Administrative Systems of Sri Lanka Until the End of 20th Century

Farming in a sustainable, productive manner has been a hallmark of every human tradition that has endured history. Agrarian societies with long histories possess the credibility of having sustained themselves successfully under the rigour of survival in a natural world. Having no access to fossil fuel driven technologies, traditional

farmers relied on agriculture based on renewable energy sources, which was internal to a society or region. Expansion of farming was constrained by the environment and ecosystem of each area. The advent of fossil fuel changed all this. The gasoline to power tractors, the biocides and fertilizer salts produced by fossil oil enabled agricultural productivity to transcend environmental constraints. In this context, the chapter deals with the non-plantation agriculture sector that includes annual crops, livestock and poultry, and fisheries.

6.9 Pre-independence Era—Early 20th Century

A land hunger has continued to prevail in the country since pre-independence in Sri Lanka (Bastian 2009), where the population has increased beyond the limits of subsistence, and the production of food was not adequate to feed the increasing population. Since 1940s, the food security issue has attracted the attention of the country's policy makers, who made an attempt to tackle the agricultural problem by a land policy, land alienation and an irrigation restoration policy. However, no major efforts were made to deal with the root causes of the problem such as landlessness, agricultural stagnation and decline in productivity. Policies since the establishment of Land Commission of 1927, were directed towards appeasing the land hunger where the cultivator was provided with the necessary minimum of land for cultivation, with the idea that the farmer will continue to remain in traditional agriculture. Though there was the need to correct obsolete forms of tenure and ownership, the important needs were cheaper credit, better marketing facilities, etc. Such basic ideas guided the agricultural development policy in the post-independence period. The policy was to increase agricultural production through colonization schemes and settlement of farmers in different parts of the country. With the growth of the plantations based on cash crops, traditional agriculture that was the life-blood of the peasantry of the country from ancient times was neglected, which was part of the colonial economic strategy. This neglect of the Sri Lanka's peasantry resulted in the virtual destruction of the traditional agriculture.

6.10 Harmonizing Strategies of Pre- and Post-independence Era

This British land policy had a devastating effect on the Kandyan peasantry interfering with the agricultural productivity in the area of traditional agriculture. Thus, the Kandyan Peasantry Commission was appointed in the 1950s to study the problem of dispossession of people's land and the resulting landlessness (Leitan 2010). A number of recommendations were thus made for the rehabilitation of the Kandyan peasantry resulting in a link to an overall economic development strategy of the country. However, the whole rehabilitation programme was treated as a

social welfare programme while economic considerations were ignored. Thus, the rehabilitation of Kandyan peasantry as a part of an agricultural development plan was neglected. Though measures were taken to address such questions as economic-holdings, the consolidation of holdings and the land tenure reforms were not integrated to an overall agricultural development plan, through which surplus population could be removed from land. The government then realized that Sri Lanka's agrarian structure could not support the increasing population.

Since 1956, several important agricultural development policies and acts were introduced to break-away from the earlier policy of land settlement in the dry zone, and identifying the need to transform the agrarian relations in the rural sector and grow more food. The Paddy Lands Act No. 1 of 1958 was introduced with a view to radically alter the agrarian relations in the rural economy of Sri Lanka in order to ensure greater security to the tenant farmer and also to ensure that all paddy lands are cultivated (Herath 2006). Similarly, the Land Reform Law No. 1 of 1972 was one of the revolutionary steps in land policies of Sri Lanka where a ceiling was imposed on the ownership of land. It was a situation with a growing shortage of land for new settlement in the wet zone with an increasing cost of developing land for colonization in the dry zone. With a view to increased productivity and ensuring food security, the Agricultural Productivity Law No. 2 of 1972 was subsequently enacted to ensure the proper utilization and development of all acquired lands. In 1977, the agricultural development policy focused on the accelerated Mahaweli Development Programme. The Mahaweli Authority Act No. 23 of 1979 was passed and the 'Accelerated Mahaweli Programme' was implemented, thus opening up new lands for new farmers and the landless. The Agrarian Services Act No. 58 of 1979 replaced the Agricultural Productivity Law, which led to setting up of Agrarian Services Committees to oversee the efficient management of all agricultural lands. Later, the Agrarian Development Act No. 46 of 2000 replaced the Agrarian Services Act No. 58 of 1979 enabled the tenant cultivators to become owner operators.

During the early 1970s, the district emerged as an important sub-national unit for administration and development. At the same time, the district also form an appropriate units for project planning for rural development. Recognizing the inadequacy of the many development efforts, which had been made for solving the poverty problems, the government introduced the idea of a more comprehensive thrust in some districts in the 1970s. This soon came to be known as the Integrated Rural Development Strategy operationalized in selected districts named as Integrated Rural Development Projects (IRDP).

The main objectives of the national Integrated Rural Development (IRD) efforts were to widen economic opportunities and enhance the general standard of living in rural areas, focus on development efforts, especially to meet local needs and to encourage local institutions, reduce inter- and intra-district disparities and thereby promote balanced growth, encourage quick response, mutually supportive low-cost productive investments along with necessary institutional improvement, assist in removing constraints and contribute to better utilization of district resources, and improve the planning process in districts. The IRDP introduced a whole new

planning concept into the district development. It has also been able to mobilize and divert substantial resources into local development. The concept of the Sri Lanka IRD, as outlined in the guidelines, is determined by the rural scenario with its population characteristics and structural poverty problems. The basic elements of the concept were (a) Rural development through social change, (b) Human development, people's participation and institution building, (c) Poverty alleviation, and (d) Resource and economic development while mitigating disparities between groups, genders and potential entrepreneurs.

During the immediately post-independence era, Sri Lanka enjoyed balance of payment surplus owing to the boom of demand for cash crops, i.e. rubber and tea. The foreign exchange earnings were sufficient for the purchase of food, especially rice and other commodities needed for the country. Country's policy did not need any shifting of platform of agriculture to industry or any diversification of economy. However, the favorable economic conditions continued only till late 1950s where the country faced the deterioration of balance payments and increase of unemployment. This situation directed the policy makers to establish agricultural and industrial projects. The main focus of agricultural projects was to bring self-sufficiency in rice. Successive governments in the post-independent era followed almost the same objective and strategy in directing economic policies, which include land settlement in the dry zone. This step aimed at reducing unemployment and population pressure, and increasing food production. These projects and ventures were mostly under government patronage. Up to 1970s the state monopoly dominated all the trade and distribution.

Achieving the cherished goal of becoming self-sufficient in rice has been the key policy related to agriculture by successive governments since gaining independence in 1948. The country achieved this goal in 2010. These landmarks in agricultural policy made a vital contribution towards the development of Sri Lanka. However, the governments have not fully succeeded in guiding the evolution of a dynamic and sustainable agricultural policy, which could address the issues of poverty, as well as the production of enough food for the growing population. Though several policy changes were made in the last several decades, the country's agricultural sector has failed to produce enough food locally, resulting in the importation of food. It is well known that Sri Lanka was able to escape the world food crisis of 2008, thanks to the avowed enthusiasm of the then Ministry of Agriculture and Agrarian Development that launched a massive 'Grow More Food' campaign. The programme was aimed at encouraging people to cultivate all land available. With such a concerted effort and a dynamic policy, the country can emerge out of a similar crisis in the future as well.

The availability of cheap, subsidized energy increased the productivity. Agriculture was seen as effective production-oriented breeding programmes, coupled with seed and input delivery packages. Genotypes with optimum performance characteristics for high external input agriculture became the standard for agricultural development. However, the bio-accumulative nature of these inputs were not considered and resulted in food and environmental contamination in many cases. The first public alarms on the nature of the chemical inputs were sounded in the

1960s with the publication of books such as 'Silent Spring'. As a result, people became conscious of the effect that 'new' agriculture was having on biodiversity, ecosystem health and human health.

6.11 The 13th Amendment and Consequences

Arising from the same institutional and economic reforms undertaken during 1980s i.e. removal of subsidies on agricultural inputs such as fertilizer, lowering/removal of import duty on food commodities (particularly the cash crops of small farmers), resulted in privatized seed production and imports. These measures adversely affected the small farmers and economic activities of the rural poor farmers that earlier may have contributed significantly to Sri Lanka's once positive trend in social development indicators. In addition, decentralization of powers under the 13th amendment to the constitution could be considered a major transfer of responsibilities in the form of devolution from the central Government to the provincial level. The operational units are at the district, divisional and village levels. Participation of the community in the development is guaranteed under this provision.

Provincial Councils can levy and collect taxes, receive revenue from licenses, fees, etc. Moreover, the PCs receive unconditional grants from the central Government to offset the costs of administration of the subjects devolved on them. Sectorial programmes of the provincial Ministries are also the responsibility of the PCs. In 1980s, decentralization in the form of privatization at the national level was initiated under the name of "peoplization" of commercial public enterprises. With the commitment of the government to have 'direct employee ownership' of the "peoplized" ventures, 10% of the shares in all "peoplized" state enterprises were gifted to the employees.

Sri Lanka has adopted a series of different development approaches over the years, particularly in rural areas, to correct regional imbalances and alleviate poverty. Failure of one approach has always led to experimentation with another approach. Initially, efforts were directed at implementing a number of independent rural development projects in randomly selected areas. A renewed attempt at improving coordination of regional development interventions was made when the district administrative unit (District Development Council) became the focus for development approaches. However, the domination of state monopoly in trade and distribution has led some of the livestock sub-sectors, especially poultry and swine industries, to stagnate due to the inability of importing parent stocks.

Since product processing and marketing were the state control operations, both the sections showed low pace of growth with no technological advancement of operations. Negative repercussions of the 'lagging behind' in livestock industry were clearly visible in mid 1970s where there was extensive import of livestock commodities. However, the GDP contribution of the agriculture sector, including livestock, was as high as 25% in 1975, though it was a steady decline from 41%

contribution just after independence in 1950. Gradual increase of the state sector involvement in economic activities came to a halt in 1977 when the economic liberation decision taken by the succeeding government initiated the transition of economic policies. The introduction of incentives, especially for foreign investments, brought some investments for the livestock sector, too. This boosted up the poultry sub-sector with opportunities given in feed production and hatchery establishment. The technologies brought in with such investment provided the impetus to the poultry sub-sector for its remarkable steady growth as seen at present. Currently, the poultry sub-sector is entirely handled by the private sector, except for minor involvement of the government on regulatory issues.

Though the liberal involvement of the private sector is believed to be the secret behind the growth of the sub-sector, this phenomenal growth was not visible in any other sub-sectors of livestock. The dairy industry, which is the main focus of the livestock industry in Sri Lanka, also showed the changes in its phases of growth under the liberalized economy. However, with regard to the dairy sector, the full gain of the benefit of liberalized economic condition was not realized as the farm gate price of milk was controlled by the State.

The traditional Sri Lankan agro-ecosystems has provided ideal models, by operating in a sustainable manner for millennia as co-evolved units, supporting and developing the biodiversity element of the natural landscape, to confer sustainability to the production system. Further, the traditional knowledge of rice production encompassed the whole landscape, its impact felt at the Tank (reservoir), the rice field and its supporting elements. The value and utility of the traditional knowledge base within the Sri Lankan farming community was also well expressed by the farmers themselves who were quick to grasp scientific ideas and relate them to traditional practices.

6.12 Sri Lankan Agriculture in the 21st Century

Sri Lanka has been gradually changing from an agriculture-based economy to an industrial-based one over the last few decades. The estimated economically active population (labour force) in 2010 was around eight million the total economically active population in Sri Lanka is 8.2 million, of which 64% are males and 36% are females (DCS 2015). Of the employed, 45.6% were in the service sector, 28.7% in the agriculture sector and 25.8% in industrial sector. The national average employment rate for agriculture sector is grossly understated due to downward averaging by the urban districts. In most rural districts, agriculture sector employment is much higher than the national average, including four districts with 51.7–67.1% of the population involved in agriculture. The share of industrial exports (USD) in 2015 stands at 68.4% as against 20.7% for agricultural exports (EDB 2017). Most of the poor live in rural areas and engage in agriculture related activities. Small farm size and tenure issues that prevail in the food crop sector have restricted the growth of farm incomes, leading to natural resource degradation, and perpetuate poverty.

Over half the population is below the minimum level of dietary energy consumption, with a higher prevalence of under-nutrition in rural and estate sectors than in urban areas. Agricultural productivity of small-scale farms has declined over the past decades due to climatic changes such as irregular rainfall and recurrent droughts, and negligence in maintaining irrigation infrastructure. Food security in terms of availability, accessibility and affordability is uncertain notably in the estates.

The Sri Lankan economy has gone through a structural transformation over the past three decades, despite being trapped in a costly terrorist war for more than 33 years. The non-agriculture sector including primary commodity export, which accounted for 26% in 1982 has sharply declined by 2015 as explained previously in this chapter. The smallholder plantation sector accounted for 75% of tea, 90% of rubber and 95% or more of all other plantation crops. Non-plantation agriculture has remained essentially a smallholder operation. The production structure of livestock (including poultry) and fisheries industries is relatively balanced between large scale operators and small and medium scale enterprises (SMEs). The ineffective use of domestic resources such as the vast area of sea and land resources for agriculture has increased dependence on imports for food security.

Scale of agriculture enterprises: The social development achieved by Sri Lanka during the post-independence era could be a result of successive government policies protecting and strengthening small farmer based agriculture and protecting social welfare (Fernando 2004). However, agriculture has become a less attractive income source leading to the movement of large number of farmers seeking alternate employment. The average size of a small-holding in Sri Lanka declined by 64% over the last 56 years, from 1.3 ha in 1946 to 0.47 ha by 2002 (DCS 2002), largely owing to the growing population and lack of a continued programmes to accommodate the increasing numbers. About 92% of the agricultural land area within the major and minor schemes and rain-fed areas are small-holdings below 2 ha. They are found distributed over 3.5 million distinct land parcels held by about 3.6 million rural households under a wide range of tenure forms and transactional relationships (Gamage 2000). As of 2001, approximately 1.2 million land operators had been given over 2.5 million acres of land under permits, hence over 70% of Sri Lanka's small-holder farmers operate under the Land Development Ordinance No. 19 of 1935 and over 65% of the land cultivated by small-holders is covered within the ordinance (Dharmaratne et al. 2006). The labour market being a major determinant of the farmer's behavior (WB 1996). Amongst the macro and micro-environmental factors that have led to a stagnant small-holding sector, size of the land holdings, land productivity and status of land tenure are found to be prominent and have contributed much to the low income and thereby leading to persistent agrarian poverty.

Among the livestock holdings, 99% are categorized as smallholdings. According to the Ministry of Rural Economic Affairs, the total number of farmers involved in livestock production is estimated at 700,000, and between 30–60% of gross farm income is generated from livestock activities. As estimated, 38% of the total workforce of the country is engaged in Agriculture. Out of the total population,

17.9% households own livestock and approximately 70% of them own cattle (SLIS, 1999/2000). The individuals working in agriculture, forestry and fisheries, especially those who are with very small holding size, have shown the highest poverty rates among those in elementary occupations (WB 2007). However, the poverty rates among female-headed households are lower than among male-headed households in Sri Lanka. Contribution of women in livestock management has been highlighted on many occasions (DAPH 2011), especially in dairy (Ibrahim et al. 1999) and poultry (Abeykoon et al. 2013). Dairying is not the main source of income for most of the smallholders, and in most instances, it is not the activity of the male household head in the family (Ranaweera 2009). Although nearly 40% of registered dairy co-operatives are mainly comprised of women, they are rarely represented in the management or executive committees of these organizations. However, when housewives do have a role in managing household dairy activities and dairy cooperative, a substantial improvement have been observed in the economy of the family.

The policy interventions in the non-plantation agriculture sector are basically aimed at self-sufficiency in food through productivity enhancement while safeguarding the livelihood of agricultural producers. There are many crop specific policies, most of which are paddy specific, while a limited number is common to several crops. The National Seed Policy introduced in 1996 is aimed at reducing cost of production of seed paddy, encouraging private sector participation in seed production and marketing, concentrating government involvement in breeding, testing and quality certification with the legal basis being provided by the National Seed Act No. 22 of 2003 and Plant Protection Act No. 35 of 1999. The National Agricultural Research Policy of 2012–2016 was promulgated for fostering the agricultural research system, under the Sri Lanka Council for Agricultural Research Policy (SLCARP) established under the Act No. 47 of 1987 to provide the legal and institutional basis.

Agriculture supporting services: The Agricultural credit policy and agricultural insurance policy, under which credit and insurance were provided to safeguard farmers from inherent risk, date back to the 1970s. The New Comprehensive Rural Credit Scheme of 1986 forms the basis of current subsidized agricultural credit, which is handled by the People's Bank and Bank of Ceylon. In 1995 the government also introduced a farmer pension scheme to be implemented under the same institutional set up for farmers and fisherman. Presently the agricultural insurance scheme covers paddy subsidiary food crops, betel, sugar and livestock.

The agrarian services and farmer organization policy, and Department of Agrarian Services (currently the Department of Agrarian Development) were established to coordinate all agricultural activities and provide services at grass-root level. The major objectives of the present land policy are to hold untitled land under government ownership, distribute such crown lands as smallholdings for agricultural production purposes and to prevent further subdivision of such holdings with the policy objective to achieve self-sufficiency in rice. Improvements were made over the years to alienate State land further under land entitlements granted for long-term use from 1978–1994 (*Swarnabhoomi*), 1994–2002 (*Jayabhoomi*), 2002–

2004 (*Isurubhoomi*) and since 2004 (*Jayabhoomi*) programmes, and the Agrarian Development Act No. 46 of 2000 removed the restriction partially and conditionally. In the Irrigation sector, provision of irrigation facilities to dry zone farmers has been a major development activity, commencing with the River Valleys Development in 1949. The major irrigation facilities have been brought under the purview of the Mahaweli Development programme.

The government had taken measures in terms of protecting and regulating the Agriculture sector through tariff, subsidies, price supports, credits and other forms of support such as research, extension and promotional programmes. Price support has been given for paddy and milk. Fertilizer subsidies is the major, as well as the most controversial input subsidy programme provided for the paddy farming sector in Sri Lanka for a long time. It was initiated in 1962 with the introduction of High Yielding Varieties (HYVs) as consequence of the Green Revolution (Semasinghe 2014). The fertilizer subsidy programme for paddy has continued thereafter except for few years in 1990s. Since 2005, the fertilizer subsidy has accounted for 2–2.5% of total government expenditure and the subsidy is given for all three major fertilizers; namely, Urea, Murate of Potash—MoP, and Triple Super Phosphate—TSP. The fertilizer subsidy, which was limited to rice cultivation has expanded since May of 2011 for highland crops and vegetables. As of 2015, the fertilizer subsidy is only for urea and for paddy, vegetable and coconut cultivation. Since 2005, the fertilizer subsidy has accounted for 2–2.5% of total government expenditure and the subsidy is given for all three major fertilizers. For example, the fertilizer subsidy cost increased by 200% from SLRs 11,867 million (1.66% of government total expenditure) in 2006 to SLRs 49,571 million (2.16% of government total expenditure) in 2015. Fertilizer subsidy has contributed largely to increase the average yield and paddy production has increased significantly where the country has achieved excess production in rice. A subsidy scheme also exists for new planting and replanting exists for tea, rubber and coconut small holders and for other export agricultural crops including spices. With the change in government policy, initiatives have now been taken to provide a cash grant in place of the existing fertilizer subsidy, to the value of SLR 25,000 (approx. 164 USD) per ha for a maximum extent of 2 ha per year, allowing farmers a greater flexibility in selecting farm inputs thus, increasing crop productivity.

6.13 Poverty Alleviation and Social Welfare Programmes Linked to Agriculture in Relation to Decentralization

The inability of structural adjustment programmes to address poorer segments of society has been a crucial issue over the years. As such, the Poverty Alleviation Programme (*Janasaviya*) originated in the emerging awareness of the aspirations of the poor and social tensions are not being fulfilled from a wider perspective. *Janasaviya* was a people-based programme which intended to put people first,

considered human beings as a primary resource, depended mainly on self-reliance and bottom-up approach in decision-making, culturally harmonious, and could be realized island-wide. Enhancement of capabilities through providing food security for the household during its two-year period of operation has been the method suggested to improve the quality of life of the poor in the *Janasaviya* programme. The *Janasaviya* Trust Fund, the counterpart programme, which had a holistic approach to poverty alleviation included a social mobilization process, training process, credit component, and community project component. These two were the main poverty alleviation programmes that came into operation in the late 1980s. Their impact on rural families could be assessed based on the self-development orientation, access to basic needs, participatory decision-making, village level group formation, access to formal credit, access to technical/vocational training and participation in community infrastructure development. In 1994, these programmes were replaced by the *Samurdhi* programme, which also aimed at the rural poor, but more specifically targeting rural unemployed youth.

6.14 Rural Development in Relation to Agriculture in Sri Lanka

Compared to other developing countries, Sri Lanka has high demographic status in terms of literacy, life expectancy and infant mortality ratio, which are the key indices of demarcating the development of a nation. About 20–25% of Sri Lanka's population lived below the national poverty line in 2001 (World Bank 2003), which has reduced to 6.7% in 2012/2013 (DCS 2015). Majority of those who live below poverty line reside in rural and estate sectors. According to the recent estimates there is a reducing trend in proportion of poor live in rural areas, where the poverty headcount index in 1990/1991 in the rural and estate sectors was 29.5% and 20.5%, respectively, which has decreased in 2012/2013 to 7.6% and 10.9%, respectively (DCS 2015). According to the World Bank (2003), rural poor derive incomes from a range of farm (40%) and non-farm activities (60%). Hence, most of the development plans implemented by successive governments in Sri Lanka were aimed at rural communities including the estate sector. *Janasaviya* (1989–1994), *Samurdhi* (1994–2004), *Divi naguma* (2005–2014) and again *Samurdhi* (from 2015 to-date) are few examples of main rural development programmes (including estates) implemented during the last two decades.

Rural development activities are carried out by both central government, as well as PCs through the relevant ministries. The Ministry of Economic Development has been the key Ministry in the government structure until January 2015, providing the impetus for rural development under the central government. The regional development programmes implemented by this ministry focused on rural development in all aspects including infrastructure, livelihood and spiritual improvement. According to the then Ministry of Economic Development, the development programmes representing all nine provinces were carried out through its Regional

Development Division considering the different geographical, social and economic characteristics. The regional development programmes have been designed unique to the region, with the common framework of harnessing potentials and opportunities in respective regions, promoting and encouraging regional development, minimizing inter-regional and intra-regional socio-economic disparities, and increasing the contribution by the region to national economy. The nine Regional Development programmes were (1) *Kandurata Udanaya*—Central Province, (2) *Rajarata Navodaya*—North Central Province (3) *Sabaragamuwa Arunalokaya*—Sabaragamuwa Province, (4) *Wayamba Pubuduva*—North Western Province, (5) *Pubudamu Wellassa*—Uva Province, (6) *Ran Aruna*—Western Province, (7) *Uthuru Wasanthaya*—Northern Province, (8) *Negenahira Navodaya*—Eastern Province, and (9) *Ruhunu Udanaya*—Southern Province. As livestock (including poultry), aquaculture and fisheries sectors have been identified as the sectors with great potential in the national development plan and also in the regional development programmes, it is clear that there is much room for development and promotion of the livestock industry in Sri Lanka, especially following the end of the terrorist war in 2009.

6.15 Governance in the Non-plantation Crop Production Sector in the Administrative Setup

Since independence, the government of Sri Lanka has adopted several policy measures aimed at enhancing agricultural growth, especially from low-value to high-value production. Improving productivity and international competitiveness was the main focus in many policy reforms, which mainly addressed incentive schemes, increase trade, seed distribution and market liberalization. The activities promoted were basically capturing production, processing and marketing. However, the focus was mainly towards rice and the institutional change, and the policy directives were to improve production by regulating tenancies in supporting peasant agriculture, for example the Paddy Lands Act No. 1 of 1958. Land settlement schemes in the dry zone areas, and colonization schemes including highland and Mahaweli river diversification program were the strategies adopted to this effect. The second phase of agriculture development after independence was focused on import substitution strategy, where the emphasis was on cultivation of subsidiary food crops and rearing livestock. This phase ran through almost two decades, with its first introduction in 1960s and subsequently reinforced again in the period 1970–1977 (Sandaratne 2004), with some degree of success and expansion of agriculture production beyond paddy. According to Sandaratne (2004), the regulatory features that governed agriculture development were the Land Development Ordinance No. 19 of 1935, highland colonization scheme for cash crops, village expansion scheme and youth settlement scheme implemented by successive governments. Particularly, in 1970, the import substitution was strictly followed due to the depletion of foreign exchange of the country. This boosted food

crop production in the country to a certain extent with institutional support and production subsidies. The fertilizer subsidy is one of the key elements in the support schemes. Land Reform Law No. 1 of 1972, which imposed a ceiling of land ownership, impacted both positively and negatively on the agriculture development of the country.

The next era of agriculture development of Sri Lanka began in 1978 with the liberalized policies of agricultural imports, which removed the protection offered to farmers in respect to food crops. However, some food crops were heavily protected by tariff and non-tariff barriers even under the liberalized trade policy regime in order to keep the momentum of production. All import restrictions were removed in 1996. Under the liberalized import conditions, the cheap imports depressed the farm gate prices in many crop and livestock products. The policy measures adopted were aimed at the shift from low-value to high-value production. The policy reforms included various private sector investments incentive schemes, increasing trade, seed distribution and commodity market liberalization (World Bank 2003). All agriculture policies equally affected both crop and animal agriculture during most parts of the post-independence era until 1978, as both the sectors came under the purview of the same Ministry (Ministry of Agriculture) and working Department (Department of Agriculture). The amalgamation and separation of the two subject areas (crop agriculture and animal agriculture) occurred consecutively under several subsequent governments. However, the two main components that represent agriculture were finally separated into two ministries and also to two working departments in 1979.

In the non-plantation crop production sector, the institutional arrangement is mainly focused on the Department of Agriculture managed by the Ministry of the Central Government of Sri Lanka that deals with agriculture. The Department of Agriculture is mandated to carry out research and extension of the major food crops including rice, other field crops (coarse grains), food legumes, root tuber crops, oil crops, vegetables and fruit crops. The extension activities are mainly carried out by the Provincial Department of Agriculture located in each of the nine provinces of the country (note: this aspect is discussed in detail later in this chapter). The state institutional structure (central and provincial Governments) that deals with non-plantation crop sector and their responsibilities are shown in Table 6.3.

6.16 Governance in the Livestock and Poultry Sector in the Existing Administrative Setup

Livestock and poultry sector is an important component of the agriculture economy. Though its direct contribution to the national GDP is minor, the sector has significant strength to increase rural employment opportunities, poverty alleviation and save foreign exchange earnings. The policy initiatives, development strategies and programs adopted for the sector have been directed to encourage and enhance private-

Table 6.3 State institutional structure in the central Government and provincial councils that directly deals with the non-plantation crops sector in Sri Lanka as of February 2017

Ministry	Department	Responsibility
Ministry of National Policies and Economic Affairs	Department of National Planning	Policy development, planning and implementation. Provides national perspective to policies, programmes and projects
Ministry of Agriculture	Department of Agriculture	Main institute under MOA. Responsible for maintaining and increasing productivity and production of the food crop sector. Functions include research, extension, training, seed and planting material production, regulatory services on plant quarantine, soil conservation and pesticides. Consists of subject specific technical institutes and centres, and Agricultural Schools
	Department of Agrarian Development	Agriculture Land Management. Empowered by Paddy Land Act and Agrarian Development Act
	Hector Kobbekaduwa Agrarian Research and Training Inst. (HARTI)	A socio-economic research institute for agrarian sector-related research and training of farmers, field workers and managers
	Sri Lanka Council for Agricultural Research Policy (SLCARP)	Apex body to fund and mobilize research capabilities of the National Agricultural Research System, Universities, Private Sector and others for generation and dissemination of appropriate technologies
	Sri Lanka <i>Haritha Danaw Bim Sanwardhene Madyama Adhikariya</i> (Hadabima)	Authority specifically for conserving soil of uplands in the central hills and establishing sustainable cropping systems primarily in land settlement areas of uplands
	Institute of Post-Harvest Technology (IPHT)	Develops and promotes post-harvest technology for rice/other grains, field crops, fruits, vegetables and spices
Provincial Ministries of Agriculture	Provincial Department of Agriculture	support district level agricultural development through district based staff

and state-owned activities respectively for improved production, processing and marketing of livestock products, and to supply of inputs for livestock rearing. The institutional support for the livestock and poultry sector is provided by both public and private sectors. The state sector is involved in formulating and implementing policies. The state authority that governs the sector at present is the Ministry of Rural Economic Affairs, which has the mission to 'Initiate appropriate measures to ensure

sustainable growth of the livestock sector', which includes poultry. In order to work towards this mission, the ministry functions with several line agencies that come under its purview. The Department of Animal Production and Health (DAP&H) is the main operating arm of the Ministry that is responsible for technical and scientific support for livestock and poultry production operations and carrying out monitoring and regulatory measures on production. The devolved functions of livestock and poultry development are carried out by the Provincial Departments of Animal Production and Health, which are responsible for service delivery and farmer trainings. The National Livestock Development Board (NLDB) which is responsible for the improvement of breeding stock, is another state agency established in 1973 and comes under the purview of the Ministry. In addition, the private sector provides most of the inputs needed by livestock and poultry farmers, value addition and marketing. Private sector engagement is high and critical in poultry sector of Sri Lanka. Vertically integrated setup of the poultry sector is one of the well-functioning operations in the country. However, private sector involvement is at minimum in the veterinary services and artificial breeding activities. The state institutions in the central and provincial Governments that directly deals with the livestock and poultry sector in Sri Lanka are shown in Table 6.4.

The devolution of duties and responsibilities of the livestock and poultry sector to provincial authorities has been done according to the opportunity provided by the constitution for the power devolution for the sector. However, this change in the structure brought both positive, as well as negative repercussions for the development of the sector. According to the nature of the industry, some operations need to be centralized, while some others could be decentralized. For example, implementation of the breeding policy and strategies is to be done as a centralized operation, while the activities are to be carried out at the range level directly coming under the purview of the provincial set up. In such a situation, the harmony between the tiers of structural hierarchy is the key factor that determines the success of the effort. In addition, it is evident that the extension service of the livestock sector is largely affected under the current state structure. Various contributory factors have been highlighted periodically. However, it is most likely that the lack of clear division of duties and responsibilities according to professional engagement is the critically influencing factor. This situation has been further aggravated by the complexity of the state structure where, in addition to the Ministry responsible for the subject, there are several other state agencies that have their operational arms contributing to the livestock and poultry sector. Ministries of Primary Industries, and Industry and Commerce are two good examples. In such a situation, implementation of policies, strategies and other regulatory matters become impossible unless there is a harmonized policy regime.

Table 6.4 State institutional structure in the central Government and provincial councils that directly deals with the livestock and poultry sector in Sri Lanka as of February 2017

Ministry	Department	Responsibility
Ministry of National Policies and Economic Affairs	Department of National Planning	Policy development, planning and implementation. Provides national perspective to policies programmes and projects
Ministry of Rural Economic Affairs (MREA)	Department of Animal Production and Health (DAP&H)	Main institute under MLRCD. Mandated areas are: Dairy, poultry, swine, goats, animal health, animal breeding, and veterinary research. Has subject specific technical institutes and centres and Farm Schools
	National Livestock Development Board (NLDB)	Statutory body to manage and conduct business of 30 livestock and integrated farms
	Milco Ltd.	Government owned company, successor to National Milk Board, the major milk processor
	Sri Lanka-Libya Agriculture and Livestock (Co.) Ltd.	Established to perform agricultural and livestock projects and to import inputs and machinery
	Mahaweli Livestock Enterprises Ltd.	An enterprise to enhance income, employment and welfare in Mahaweli System "H"
Ministry of Agriculture	Sri Lanka Council for Agricultural Research Policy (SLCARP)	Apex body to fund and mobilize research capabilities of the National Agricultural Research System, Universities, Private Sector and others for generation and dissemination of appropriate technologies
Provincial Ministries of Livestock	Provincial Dept. of Animal Production and Health (PDAPH)	Attends to DAPH's devolved field level functions

6.17 Governance in the Fisheries Sector in the Existing Administrative Setup

Under various laws and Acts, the PCs have been assigned with a considerable amount of responsibility on water resources management and fisheries, which have been discussed in this chapter. Even though fisheries is not included in the PCs list, it does appear in the concurrent list. The 13th amendment to the constitution devolved certain extent of powers to the PCs (referred to as concurrent list I and III of 13th amendment to the constitution of Sri Lanka) that included irrigation, other than those irrigation schemes within the inter-provincial areas and Inland fisheries. In the case of fisheries, power vested on PCs included development or improvement of

infrastructure facilities, productivity improvement and marketing promotion, institutional capacity development and good governance practices. As for aquaculture activities, the PCs were vested with powers for promotion of reservoir fisheries in perennial and seasonal tanks, pond fish/shellfish culture and product marketing. However, fish breeding is not under the purview of PCs since the establishment breeding policy and maintenance of broodstock fish is a duty of central government. Nevertheless, PCs can have the authority to establish mini-hatcheries for growing cultivable fish (both finfish, shellfish) after receiving of seeds from central government breeding stations belonging to the National Aquaculture Development Authority (NAQDA). However, the ornamental fish industry has utilized a certain extent of liberty compared to food fish culture in Sri Lanka.

Activities within the designated coastal zone come under the authority of Department of Coast Conservation (CCD), but PCs can implement fisheries and aquaculture related activities in collaboration with CCD. Although, Fisheries and Aquatic Resources Act No. 2 of 1996 provides responsibility for management, regulation, conservation and development of fisheries and aquatic resources in Sri Lanka to the Department of Fisheries and Aquatic Resources (DFAR), PCs have provision for banning the use of destructive fishing gear, declaration of fisheries reserves and licensing system for all inland fishing operations. This also include provisions to manage designated fisheries, if such managements is done by registered stakeholder committees (i.e. Fisheries Cooperative Societies) as the subject area of cooperative management is under the purview of PCs according to power devolution by the 13th amendment. In addition, if any PC has empowered provincial legislation concerning the allocation of power vested on central Government to its PC by an Act for its own administrative body (e.g. North Western Province Environmental Authority) according to the 13th amendment, it has such authority to implemented activities within the province. However, construction and management of fishery harbor and anchorages and other shore facilities come under the purview of Ceylon Fishery Harbor Corporation (CFHC), while the protection of certain categories of endangered animals and plants, threatened species of corals, fish, turtles and their nesting habitats and all marine mammals in Sri Lanka waters come under the Department of Wildlife Conservation (DWLC). Hence, PCs activities on marine and coastal fisheries and mariculture have been restricted, except for freshwater fisheries.

Development of coastal and brackish water aquaculture, and freshwater aquaculture come under the purview of NAQDA of Sri Lanka. Even though the freshwater fisheries comes under the PC's according to the 13th amendment, rest of the activities foresaid in coastal and brackish water aquaculture cannot be performed by each province unless their own legislations are formulated by the provincial act or as a collaborative project with central Government. Further, the controlled commercial exploitation of forest resources, including mangroves comes under the Department of Forest, while marsh and swamp comes under the Sri Lanka Land Reclamation and Development Corporation (SLRDC) of the central Government. Hence, the activities related to fisheries, aquaculture and capture-based aquaculture where the fish seeds, juveniles are collected from such

resources cannot be performed without permission from the central Government. Therefore, PCs need to establish their own policy framework and legislation *via* passing the relevant Act. The items listed in the concurrent list of the 13th amendment and the descriptions thereof are not comprehensive. As far as possible, an attempt must be made to reconcile entries in the lists I, II and III of the Ninth Schedule of the Constitution and the court must avoid attributing any conflict between the powers of the Centre and the Provinces. The state institutions in the central and provincial Governments that directly deal with the fisheries sector in Sri Lanka are shown in Table 6.5.

Apart from the directly linked authorities/institutions shown in Tables 6.3, 6.4 and 6.5, there are several other line ministries and agencies that contribute to production, processing, marketing, capacity building, etc., in the non-plantation crops, livestock and poultry, and fisheries sectors. Among them, Ministry of National Policies and Economic Affairs and Mahaweli Development Authority of Sri Lanka (MASL) have considerable shares of contribution. Higher education institutes, especially the Faculties of Agriculture and the Faculty of Veterinary Medicine and Animal Science in the state Universities are providing the much needed manpower for the development of these sectors.

6.18 Evolution in the Agriculture Extension in Sri Lanka Under Central Government and Provincial Council Setup

Extension programmes in the agriculture sector in Sri Lanka has commenced during the colonial regime of the Dutch in the 17th century with the expansion of cinnamon crop aiming at the export market. During the 18th and 19th centuries, the British further developed the system by the introduction of Botanic Gardens at Peradeniya and Gampaha with the aim of spreading out of coffee, tea and rubber. Subsequently, it evolved as the Department of Agriculture (DOA) in 1912. Besides the commodity development approach was also focused on and research institutes were initiated for tea, rubber and coconut being the major exports of the country for foreign earnings. In this extension approach the institutes were expected to carry out research and development of their relevant crops and also to impart the research findings to the planters or plantation companies. Sugar cane and cashew had joined this group in a later stage. With the need to cater to the requirement of the farmers/growers, new extension arms were added to these institutes such as the Tea Smallholdings Authority for tea, the Rubber Controllers Department for rubber, and the Coconut Cultivation Board and the Coconut Development Authority for coconut. These institutes are still functional in the field of extension. These extension approaches are demand driven and client-focused as these crops are export-oriented, except sugar cane.

Table 6.5 State institutional structure in the central Government and provincial councils that directly deals with the fisheries sector in Sri Lanka as of February 2017

Ministry	Department	Responsibility
Ministry of National Policies and Economic Affairs	Department of National Planning	Policy development, planning and implementation. Provides national perspective to policies programmes and projects
Ministry of Fisheries and Aquatic Resources Development (MFARD)	Department of Fisheries and Aquatic Resources (DFAR)	Management, regulation, conservation of fisheries and aquatic resources. Oversee the development of fisheries industry and assist fisher community to increase their production and uplift their socio economic aspects.
	Ceylon Fisheries Corporation (CFC)	Commercial organization, guiding and promoting fish production and trade for the consumer and producer
	Ceylon Fishery Harbours Corporation (CFHC)	Statutory body to deliver fishery harbour-related services and supportive infrastructure, modern facilities for fishing, and up grading harbours
	National Aquatic Resources Research and Development Agency (NARA)	A statutory institute for carrying out and coordinating research, development and management activities of aquatic resources. Also development and sustainable utilization of living and non-living aquatic resources
	National Aquaculture Development Authority (NAQDA)	Main state sponsored organization mandated for development of aquaculture and inland fisheries sector. Has subject specific technical training centres
Ministry of Agriculture	Sri Lanka Council for Agricultural Research Policy (SLCARP)	Apex body to fund and mobilize research capabilities of the National Agricultural Research System, Universities, Private Sector and others for generation and dissemination of appropriate technologies

Due to the importance of conservation of forests and the protection of wildlife, the Department of Forest and Wildlife, which conducted research and extension on those subjects, was established during the British colonial era. Eventually, this department was divided into two departments; namely, the Department of Forest (DF) and the Department of Wildlife Conservation (DWLC), considering the national requirement and those are in operational presently. The DFAR leads the

extension of fisheries sector in this country. The NARA and NAQDA support the research and extension of the fisheries sector, especially in fresh waters. New trends in the field of agricultural extension also took place with the establishment of MASL under Mahaweli River Development Scheme in 1970s. In accordance with the Mahaweli Authority Act No. 23 of 1979, all agricultural development activities including extension in the Mahaweli development area come under the jurisdiction of MASL. Hence, the MASL has a network to impart crops and livestock knowledge to farmers in the Mahaweli Area.

In the early 20th Century, the DOA was responsible for conducting research and extension of both crops and livestock (including poultry) in the country. Thereafter based on the national requirement for a separate department, the DAP&H was introduced to support livestock and poultry sector development. Subsequently, the Department of Export Agriculture (DEA) was introduced for spices and beverage crops and later the Department of Royal Botanic Gardens (DRBG) for floriculture. These institutions have continued to conduct research and extension of the responsible areas. Currently, many departments and institutes are involved in agriculture extension in Sri Lanka in the light of national requirement. However, as the DOA still deals with many crops such as rice, pulses, grains, oil crops, yams, fruits and vegetables, this section pays more attention to the agriculture extension carried out by the DOA and the linkages with research and the role of provincial set up in agriculture extension.

The DOA followed the Training and Visit (T&V) System from 1970s to 1980s, in which the Village Extension Worker (*Krushu Viyapathi Sewaka*; KVS) was the primary contact point of the farmers. In late 1980s this system was first disrupted with the 13th Amendment to the Constitution of Sri Lanka as agriculture extension was announced as the fully devolved subject, which became the responsibility of the PCs. As a result, the DOA had to hand over agriculture extension activities to the PCs, so that research-extension linkage was affected, as agriculture research remained with the DOA but agriculture extension to the PCs. Even though this breakage was not conducive for development, the DOA managed to maintain a good relationship through different round-table conferences with PCs. In addition to the research-extension dialogue held at the PTWGs, the District Directors of Agriculture (DDA) appointed since 2012 under the Irrigation (Amendment) Act No. 48 of 1968, have taken over the total coordination of agriculture activities at the district level administration in Sri Lanka. The DACs chaired by the respective District Secretary (DS) make decision in relation to overall aspects of agriculture (i.e. non-plantation, plantation, livestock and poultry, fisheries, etc.) at this second level administration of the country through a research-extension dialogue. The DDAs are appointed by the Ministry of Agriculture of central Government, and they are responsible to liaise and coordinate agriculture-related activities among the administrative units in the central, provincial and district levels. The effectiveness of this new setup is still to be assessed fully, however, the system is evolving and successfully supporting the agriculture development projects and programmes in some districts of Sri Lanka as at present.

Three different kinds of irrigation systems, namely major, minor and rain-fed, are available in Sri Lanka. According to the 13th Amendment of the Constitution,

the major irrigation systems are under the central Government and managed by the Department of Irrigation (DI). In this context, the DOA is responsible for agriculture extension in those commanding areas referred to as Inter-Provincial Extension Areas. Crop production systems under the systems that are rainfed and supported by the minor irrigation schemes are with the PCs, who carry out extension activities in those areas. In the late 1980s, agriculture extension was fully affected with an urgent government decision to absorb all those officers to the public administration system to improve the welfare of the public. This removal urged the farmers to make contact with the Agriculture Instructor (AI) who does not work at the village level but at an upper level called Agrarian Service Centre (ASC) to find solutions for their problems related to agriculture. One AI cannot reach many farmers for consultation as his/her commanding area is too large. This situation gradually widened the gap between the farmer and agriculture extension. At present, it is a major challenge for imparting modern agriculture technology to farmers.

All AIs are educated at the level of obtaining either an agriculture diploma or agriculture degree and are located at the ASCs. The activities of the AIs are supervised by the Assistant Directors (ADs) who possess an agriculture degree or in some cases a post-graduate qualification in the field of agriculture, and are in charge of a segment of an administrative district. A Deputy Director (DD) with an agriculture degree or post-graduate qualification in agriculture is in charge of the district under the supervision of Provincial Director (PD) who has the same academic qualifications but located at Provincial Level. When it comes to the DOA setup, the Director (Extension & Training) is the supervisor of the DD.

Private agriculture extension is seldom for crops, livestock and poultry in Sri Lanka. However, private advisory services for plantation crops (tea, rubber and coconut) are emerging significantly. For poultry, the private sector is highly engaged in a buy-back system. Farmers are provided with day-old chicks and after 2–3 months the grown birds are purchased by the contracted party from the farmers. During this period, all information necessary to rear the chicks such as necessary feed, medicine and other utilities, are given to farmers. Similar contract-grower system is available mainly for rice and maize farmers through certain companies. Some private companies are now involved in purchasing vegetables for super markets through a contract-growing system while providing material inputs and technical knowhow for cultivation.

Currently, the DOA has taken initiatives to expand an extension system electronically through the “Cyber Technology Extension” programme, which is now in operation in selected areas as a pilot project. In this method, a computer facility is made available in the ASCs and those computers are linked to a main data base through the internet. Farmers have been given access to contact a technically qualified officer *via* internet at the ASCs to further upgrade their knowhow on particular subject matter in a crop. The Government of Sri Lanka (GOSL) has pledged support to expand this system to cover the entire country. A larger group approach such as producer groups and farmer cooperatives are emerging steadily in supporting the agriculture extension.

Overall, the agriculture extension with reference to non-plantation sector is weak due to many reasons such as the effect of decentralization, removal of KVS, lack of staff, etc. (Hathurusinghe 2010). Hence, the GOSL has adopted many strategic approaches to make the available systems efficient and effective whilst introducing more productive methods as the current agriculture extension hinders the growth of the agriculture sector. Many significant agriculture extension and education policies were introduced in the latest agricultural policy declared on 3rd September 2007 in its Chap. 12. These are as follows (in reference to Chap. 12).

12.1 Reorganize and strengthen existing extension system to disseminate innovation and information to the farming community.

12.2 Introduce modern Information Communication Technology (ICT) for effective information dissemination to the farming community.

12.3 Ensure active participation of farmers and other community based organizations as partners in the dissemination and use of updated technologies through an effective research and extension linkage.

12.4 Redesign and modernize the curricula and courses in the Schools of Agriculture and other agriculture-related training institutes to meet the current and future demands of the agricultural sector.

12.5 Provide opportunities for agricultural scientists and farmers for skill development through local training and foreign training.

The Ministry of Agriculture has recently initiated activities to update the National Agricultural Policy and has already developed the policy framework. The new policy framework has identified seven strategic areas where policy interventions will be made in the future, namely, (a) increased production and productivity, (b) ensured food safety, (c) environmental friendliness, (d) agribusiness, (e) socio-economic aspects, (f) knowledge management, and (g) general (legal and regulatory) (<http://www.agrimin.gov.lk/web/index.php/en/special-messages/717-agriculture-policy>). Moreover, the SLCARP has prepared the National Agricultural Research Policy (NARPol) for the period 2012–2016, and the National Priorities for research and development in different disciplines including agricultural extension. Currently the SLCARP is preparing the NARPol for the period 2017–2021 (<http://www.slcarp.lk/policy.php>). Appropriate policies are available even at present for addressing the existing issues in the agricultural extension but sound programmes and projects with specific strategies are still to be developed. All stakeholders need to realize the importance of such programmes/projects and take possible steps to ensure that agriculture extension will become the most efficient and effective delivery system to contribute to the growth of the agriculture sector in Sri Lanka.

6.19 Conclusions

The well-established local government system in Sri Lanka is largely dependent and influenced by the PCs and central Government due to operational requirements. The attempts to further strengthen administration in the local authorities, especially

focusing on agriculture, livestock and poultry, and fisheries sectors, will depend on the availability of resources to upgrade planning skills in local authorities, reinforcing organizational structure, proper networking, development of procedures and human resources, effective coordination at the grass-root and provincial levels, and enhancing revenue generation for self-sustenance.

The process of decentralization or the transfer of responsibilities from the central Government to the institutions in Sri Lanka has taken place during different periods prior to and after independence. Some units or lower administrative units have not existed for long, but the impact of their developments have sustained to some degree in the rural sector. Due to the complexity of factors affecting decentralization, quantifiable assessments of its success are difficult to achieve. Changes in the ruling government (central Government) have brought in significant changes to the decentralized structures that are operational at provincial level. Intended policy changes in the future, as well as any other developments, may reverse, promote or weaken a sustained change that occurred previously, unless good governance and effective coordination are in place. This review shows a gradual trend towards devolution of powers in relation to decision making and programme implementation in crops, livestock and poultry, and fisheries sectors for the benefit of the people of Sri Lanka, keeping in line with the macro-economic policies of the successive governments. In total, some areas of regulations and implementation have been strengthened by the devolved governance, however, some critical subject areas such as extension have weakened.

The separation of Ministries that are responsible to develop crop agriculture, livestock (including poultry), and fisheries sectors seems to be the biggest drawback to overall development in these sectors and achieving sustainable food security. Such division at the highest administrative and policy making level has enabled multiple agencies at both central Government and PCs by providing services in the agricultural sector and the rural infrastructure to support the respective sector, even though with duplication of responsibilities and resources. These factors have impacted negatively on the overall management and implementation of developmental activities in the country in relation to food security, as a great deal of energy and time have been spent in responding to the multiple layers of authorities at central and provincial levels. It is important for the ruling GOSL to bring these three important subjects under one Cabinet Portfolio (Ministry) with three permanent Secretaries looking after the academic interests.

The non-plantation agriculture in Sri Lanka, as a whole, has undergone a significant transformation due to structural and governance changes. Decisions made on resource allocation from the central Government to the devolved structures (PCs or local governments) are critical in achieving social and economic development in the three sectors. Economic development and plan implementation on devolved subjects should be guided by the Ministries responsible for finance, economic development, and policy and plan implementation within the generic framework based on national planning parameters, policies and targets. The PCs should do its best to achieve national targets in non-plantation agriculture (crops) defined in national policies and may conduct research relevant to agriculture in the provinces,

in collaboration with the DOA of the central Government. Moreover, the PCs should promote agriculture for the market place with value additions involving the food industry and engage in agricultural enterprises. Agrarian services could also be a matter for the provinces to liaise with the central Government. Livestock (and poultry) development should be a priority for the PCs under the national policies. The PCs in association with district and divisional administrations should take more efforts to promote incorporation of livestock to farming systems and encourage entrepreneurs to engage in value-added products of livestock resources. Promotion and regulation of inland fisheries, fish cultivation and ornamental fish industry are also subject areas for the PCs under the guidelines of national policies, while the demarcations between inland and offshore fishing is a matter for the central Government. Decentralization of power (power transfer) to provinces and local level administration with people's participation rather than devolution of powers (removal of power from the central Government) would have created a more coordinated, conducive, as well as cooperative effort to overcome these main issues in the field of agriculture.

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Chapter 7

Sustainable Resource Mobilization for Community Development in Sri Lanka: LEAD Participatory Poverty Reduction Experience

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Chapter is based on a survey carried out by the authors for CARE in 2013.

7.1 Introduction

Sri Lanka has a total area of 65,610 km² (25,332 sq miles) with whole coastline of 1340 km (833 miles). The maximum length and width of the country is 435 and 225 km respectively. Administratively the island is divided into 09 Provinces as the first tier and 25 Districts as the second tier. A district is again divided into number of Divisional Secretary (DS) divisions and it is subdivided into Grama Niladari (GN) divisions, the smallest administrative division. There are 330 DS divisions and 14,022 GN divisions in the country. Most of the time, the GN consists of two-three villages. In addition to that, the country has 23 municipalities and 41 town councils (Department of Census and Statistics 2012/2013). Sri Lanka has gradually transformed from a low income country to a lower middle income country over the past six decades since gaining political independence in 1948. Per capita GDP of the island was US\$114 in 1950 and this has increased to US\$3625 by 2014, adding around US\$55 to per capita income every year during this long period of time (CBSL 2014).

Poverty has been the most disturbing socioeconomic issue in Sri Lanka for generations. A number of initiatives have been taken to address this issue since political independence. These initiatives range from short term relief activities such

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as food aid, public work programs, midday meal for schoolchildren through long term livelihood development initiatives such as land distribution for cultivation, irrigation facilities for dry areas, agricultural input subsidies, guaranteed prices for agricultural products, free education and free health facilities. In addition to those initiatives, a number of devoted macro level poverty reduction and income generation strategies such as *Janasvaviya* (1989), *Samurdhi* (1995), *Gemidiriya* (2004) and *Divi Negumahave* (2011) been implemented. In addition to central government, local government bodies have involved with these activities for quite some time until INGOs (International Non-Governmental Organizations) became stake holders of poverty reduction and livelihood development initiatives in the country, especially since 1980s.

Overwhelming majority of poverty reduction strategies implemented since political independence has followed the top down approach. The poor community members simply have become either idle receivers or just onlookers of ongoing projects meant for them, rather than becoming a responsible and active partner of the resource mobilization and development process. The progress of such programs was obviously below the expected level and the sustainability has not been a core component of almost in every program. Similarly, such programs have mostly concentrated on the food requirements of the poor people rather than focusing on holistic approaches to address the scores of socioeconomic issues in a poverty ridden society. As a result of such salient weaknesses, poverty has remained side by side with poverty reduction strategies for years.

The CARE (Cooperative for Assistance and Relief Everywhere) has been in Sri Lanka since 1956 as a leading development agency focusing on maternity and child health care in those early days and later on its activities were expanded to community skill development and good governance to remove the root causes of poverty and related issues. The integrated development program of CARE mainly focuses on target community groups living in three different geographical areas: poor communities living in dry areas, civil war affected people in Northern, North Central and Eastern provinces and poor people living in tea, rubber and coconut plantations of the island.

Local efforts for Empowerment and Development Project (LEAD), a Geneva based OAK Foundation funded innovative poverty reduction strategy, was implemented in the Southern dry areas between 2005–2013 time period under the broadly known Participatory Rural Appraisal (PRA) strategy. The CARE emphasized improving the living standards of poor communities in dry areas of the country under this project. It initially emerged as a rehabilitation initiative of Tsunami affected least developed Hambantota district in 2004 and later on its activities were expanded into poverty stricken Moneragala district in 2008. By the end of 2012, the LEAD project was involved with 1700 households in 170 villages of those two districts. The project strives to ensure the sustainable livelihoods to promote overall human development, while sticking to the principle of community governance.

The CARE wound up its LEAD project by August 2013 after eight years of operation. The project promoted a holistic approach to address multitudes of socioeconomic, administrative, political and environmental issues experienced by

rural communities in backward regions in the country. The project targeted Hambantota and Moneragala administrative districts as test grounds to check the viability of its grassroots level development model.

The main objective of this paper is to evaluate the effectiveness of mobilizing resources for sustainable community development in rural Sri Lanka under the LEAD Project. The specific objectives of the paper are to identify and evaluate the mechanism employed by the LEAD model to demand and acquire public and private resources, to assess the effectiveness of this model in promoting the sustainable community development and to identify the strategies to improve the efficiency of the model further as a mechanism for sustainable community development in backward areas of the country.

7.1.1 Participatory Rural Appraisal (PRA)

The style of planning prevalent in the sixties and the seventies and even thereafter has often been characterized by the “top-down” approach, so that decision making is usually centralized. There was little or no consultation with local communities and consequently insensitive to local needs and unsuitable to realize the local requirements properly (Tong 1985). Rural development is the participation of people in a mutual learning experience involving themselves, their local resources, external change agents and outside resources (Nyerere 1968). Poor people usually organize at local level; therefore actions are needed to strengthen their capacity to influence policy at the state and national levels by linking organizations (Bank 2000/2001).

Participatory Rural Appraisal is a specific form of Rapid Rural Appraisal (RRA), a research techniques developed in the late 1970 and early 1980s by the researchers in the international development as an alternative and compliment to conventional sample survey (Alam 2012). There was growing dissatisfaction among development experts about formal surveys and their biasness towards the typical field visits (Chambers 1994). It was necessary to find an alternative approach to understand the ground reality. Participation was considered as a way of harnessing existing physical, economic and social resources of rural people in order to achieve the objectives of development programmes and projects (Oakley 1991). PRA has often been used as a means of facilitating the development of community—led action plans (Rietbergen-McCracken 1998). Participatory mechanisms can also provide voice to community members, especially those from poor and excluded segments of the society (Bank 2000/2001). PRA aims to assess a situation or a problem as quickly as possible, without sacrificing the basic prerequisites of a community (Narayanasamy 2009).

PRA process focuses on an entire rural community, on particular sectors or stakeholder groups in a community or on an organization. The approach aims to incorporate the knowledge and opinions of rural people in the planning and management of development projects and programmes. For many organizations

involved with development projects, PRA is not only a tool which enables development planners to learn about rural conditions and consult with local people but also development planners can come up with more appropriate and better development plans. Similarly, PRA is also regarded as an exercise which transfers the role of planning and decision-making, traditionally taken over by government institutions and development agencies, to community itself. In this interpretation of PRA, outside experts and development workers are no longer the people who have the principal responsibility for analysing and interpreting information and coming up with proposals or ideas for development. Instead, their role in PRA is to encourage local people to carry out their own analysis, come to their own conclusions and design their own development programmes. These would then be facilitated and supported by the relevant agencies as required. PRA allows local people to present their own priorities for development and get them incorporated into development plans.

PRA uses specific techniques to encourage greater involvement among people and to enable them to take the leading role in appraising conditions and identifying solutions. Visualization techniques such as Venn diagrams, matrix ranking, and matrix scoring are highly used by a PRA team to make contact with communities and learn about them. Therefore, they can get a better understanding of local conditions, and the focus of the activity becomes the encouragement of local people to use these tools to carry out their own analysis of their livelihoods, conditions and environment.

An important goal of PRA is to encourage self-reliant development, with much of the responsibility for the management and implementation of development activities devolved to local people themselves. This can greatly improve the efficiency of development work and eliminate many of the problems regarding proprietorship of development activities at the community level. An activity generated by a PRA will usually be managed by the community and the benefits will be clear to them. Participation in PRA by local development workers, (whether from NGOs, government or other agencies), can greatly increase the motivation and level of mobilization in support of the project or programme of which it is part.

PRA can help to ensure better understanding and commitment by local workers and it can assist in forming better links between communities and the agencies and institutions concerned with rural development.

The local community members under PRA have a voice in the design of projects. They are also more likely to design activities which make full use of existing resources. Greater commitment from the community can also mean greater mobilization of community resources for development and less reliance on outside inputs. This can take the form of labour inputs, savings or time devoted to management functions. This combination of effects will generally lead to more sustainable development activities which are less reliant on support from outside agencies and is technically, environmentally and socially appropriate to local conditions.

7.2 Data Collection Method

The necessary information for this paper was collected from two major sources as primary and secondary sources. Primary data was collected mainly by interviewing community members receiving LEAD project benefits. In addition, service providers including traders, public officials, informed individuals, and community leaders were interviewed. Focus group discussion method was widely applied to collect information from community members, while other relevant individuals were interviewed based on a general questionnaire. Field observation was also employed to collect information as a supplementary primary data source.

Only the Hambantota District was chosen to collect primary information, even though the project has been implanted in two districts, including Moneragala district. This is due to two main reasons. One is the limited extent of project coverage in the Moneragala district and the other is the project duration in that district being small compared to the Hambantota district; as a result project impact is minimal in the Moneragala district.

Stratified random sampling method was applied to select 24 villages from Hambantota District for the field survey. All the villages with project impact were stratified into three groups taking into account the coverage of project components. Accordingly, villages with the coverage of four components as livelihood, infrastructure, social and environment development were brought under group one; coverage with three components were brought under group two and the coverage with two components were brought under group three. Eight villages were selected from each group randomly and the name list of villages conveyed to the LEAD Hambantota office to organize community meetings, field observations and to interview the key informants.

The number of community members who participated in focus group discussion ranges between 12–15 persons representing the gender, race, and religion and age diversity. This approach was appropriate, since as individual ideas expressed in the gatherings were complementary to each other and there was no need to protect the confidentiality of information among participants. Similarly, discussions on agreements and disagreements by group members had helped to unearth much hidden information about the project implementation and results achieved.

Project officials, public officials, members of INGOs (International Non-Governmental Organizations) and the corporate/cooperative sector, vendors, other input/service providers and community leaders were interviewed as key informants. A common question guide with some flexibility was employed for this purpose. Field observation as a data collection technique was used to collect information on the impact of the project interventions. Suitable locations were recommended by Key informants for this purpose. Ideas developed through field observations were recorded immediately to avoid the possibility of distortion and unintentional misrepresentation of information.

In case of secondary data, the project publications were extremely useful. There is a sufficient secondary data base to examine almost every aspect of the project

from its inception to this date. Those publications, as well as unpublished information, were instrumental in painting a clear picture about the project and its progress.

7.3 Socioeconomic Setup of Two Districts

Sri Lanka has maintained a rural sector biased dwelling pattern since time immemorial and this trend will continue even into the middle of this century. The percentage of rural population was at 84.7% in 1950 and this has marginally gone up to 84.9 by 2010 and it is estimated that even in 2050 this figure would be around 66% (DCS and UN). Major socioeconomic issues of the country are still markedly visible in rural areas of the country as a result of this trend. If a viable development model is implemented in rural Sri Lanka, it is not difficult to address many problems experienced by this sector. Prudently formulated resource acquisition and mobilization model would be essential in this endeavour.

The population density of Sri Lanka has steadily gone up and the island has become one of the territories with highest population density in the world. The socioeconomic problems of the country will aggravate further as a result of this demographic character, so that social discontent will not be averted, if these problems are not addressed in advance in a sustainable manner (Table 7.1).

Districts of Hambantota and Moneragala have become a home to 5.1% of the island's total population by 2013. Population density, however, is high in Hambantota district while it is very low in Moneragala district, so that intensive farming is suitable for the former and extensive for the later. Even though the age group structure of the two districts mostly conform to national figures, Moneragala carries a marginally high labour force and low adult population, so that the dependency ratio in that district is comparatively low (Table 7.2).

Water availability is essential to improve the living standards of community development strategies and it is better in Hambantota district compared to national averages, even though further development is needed to meet the total requirements in the district. Moneragala district stands far below the national averages, as well as to Hambantota statistics. It is essential to prioritize availability of water for the community in any development project.

Table 7.1 Population—2013

Location	Total	Percentage	Growth	Density/m ²	Age group (%) 2012/2013		
					0–14	15–59	60 and above
Sri Lanka	20,263,700	100	0.71	327	25.9	60.6	13.6
Hambantota	448,100	2.9	1.17	243	27.0	60.5	12.5
Moneragala	596,600	2.2	1.5	83	26.4	61.9	11.7

Source DCS—Population Census 2012/2013 and HIES

Table 7.2 Water availability 2012/2013

Location	Access to water		Drinking water		Bathing and washing	
	Within premises (%)	Outside premises (%)	Sufficient (%)	Not sufficient (%)	Sufficient (%)	Not sufficient (%)
Sri Lanka	79.9	20.1	92.8	7.2	88.8	11.3
Hambantota	84.6	15.4	93.7	6.3	89.4	10.6
Moneragala	72.9	27.1	79.5	20.5	60.4	39.6

Source DCS, HIES 2012/2013

Table 7.3 Education 2012/13

Location	Level of education (% as total)						Mode of transport to school (% as total)	
	No schooling	Up to grade 5	Passed grade 6–10	Passed O/L	Passed A/L	Special education	Walking	Other
Sri Lanka	3.7	24.7	43.6	15.5	12.4	0.1	40.7	59.3
Hambantota	5.5	27.0	44.3	14.3	8.7	0.1	38.6	61.4
Moneragala	5.7	28.0	46.7	12.0	7.6	0.1	46.3	53.7

Source DCS, HIES 2012/2013

Education plays a pivotal role in ushering a society through a higher ground of socioeconomic development. Figures of Table 7.3 suggest that the overall country situation, as well situation of two districts is not bad, even though further improvement in this sector is essential.

Table 7.4 shows that health conditions of Moneragala district is better, even though the district is far below in many other development characteristics. This situation is also contradictory to income, poverty and water availability of the districts. Health conditions in Hambantota are unacceptably below to national averages even though the district has sufficient facilities to maintain a decent life style in many aspects.

Table 7.4 Health conditions

Location	Health conditions as % of total population			Food consumption
	Obtaining OPD health care (one month)	Stayed at hospital as a patient	Suffering from chronic illness/disability	Food ratio (%)
Sri Lanka	17.4	8.4	14.2	37.8
Hambantota	21.7	11.4	17.5	37.9
Moneragala	20.1	11.7	13.7	49.7

Source DCS, HIES 2012/2013

Table 7.5 Labor force and literacy information 2014

Location/District	Employment composition			Literacy rate	Unemployment rate
	Agriculture	Industry	Service		
Hambantota	39.3	26.7	34.0	89.1	6.4
Moneragala	56.9	13.0	30.1	91.4	4.5
Sri Lanka	28.5	26.5	45.0	93.3	2.7

Source DCS, Labor Force Survey 2014

Table 7.6 Principal type of lighting (%)

Location	Electricity	Kerosene	Solar power
Sri Lanka	90.2	9.0	0.7
Hambantota	93.0	6.7	0.3
Moneragala	77.6	17.1	5.1

Source DCS, HIES 2012/2013

Food ratio of Hambantota is par with national figures, while it is high in Moneragala, reflecting the high poverty level and low income in the district (Table 7.5).

Literacy rates of both districts are well below the counterpart national averages. Unemployment rate of Moneragala is not available, while its Hambantota value is marginally higher than the national unemployment rate (Table 7.6).

Availability of electricity for lighting purpose is higher than the equivalent national figures in Hambantota district, while it is considerably below in Moneragala districts compared to both national and Hambantota figures (Table 7.7).

The median income of Hambantota is higher than the national average of Sri Lanka. Income distribution is better-off in both districts compared to the country scenario. The head count poverty ratio of Hambantota is well below the national average, while the Moneragala figure is more than double the country average (Fig. 7.1).

Poverty headcount ratio in Hambantota is considerably below the equivalent national figure. It belongs to the economically prosperous few districts of the island.

Table 7.7 Per capita income and income distribution 2012/13

Location	Per capita income (monthly) Rs.		Income inequality				Gini coefficient	Head count poverty %
	Mean	Median	Richest 20%	Poorest 20%	Middle 60%	Poorest 40%		
Sri Lanka	11,819	7881	52.9	4.5	42.6	13.7	0.48	6.7
Hambantota	11,821	8338	50.4	5.3	44.3	15.0	0.45	4.9
Moneragala	9406	6011	57.8	3.4	38.9	11.0	0.53	20.8

Source DCS, HIES 2012/2013

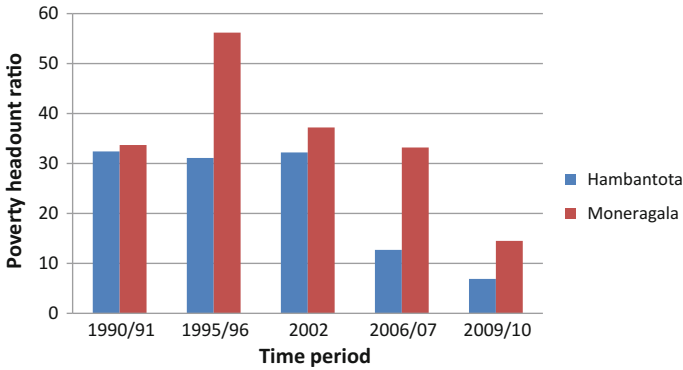


Fig. 7.1 Poverty headcount count ratios in two districts where LEAD model tested. *Source* Department of Census and Statistics

Moneragala, however, still records very high poverty level in the country. This district belongs to the 3rd highest poverty recording district in the island, next to Batticaloa and Jaffna.

Historical poverty figures suggest that both Hambantota and Moneragala belonged to high poverty category in 1990/91. The poverty level of Hambantota, however, has gone down markedly in the past twenty years or so and now it stands with the lowest poverty level districts in the island, while the Moneragala district still stands with the highest poverty ridden district category. The mega investment projects and the presence of many NGOs developmental work has contributed in a big way to reduce poverty in Hambantota (Table 7.8).

In addition to rural socioeconomic issues, there are regional imbalances in development in the country. In 2005, the western province of the island received 50.8% of the GDP while the Southern and Uva provinces where Hambantota and Moneragal districts located received 8.9 and 4.5% respectively. By 2010, the western province share has gone down to 45.1%, while the Southern province’s share has marginally improved to 10.7 and the share of Uva provinces stood at the same level.

Economic backwardness is the most crucial factor in creating social discontent more often than not in rural areas of the country. The status of living standard is serious in districts where the poverty level is high. High headcount poverty index, among number of other backward economic characteristics, has been recorded in Moneragala and Hambantota districts in 1990/91. These two districts recorded 2nd and 3rd highest poverty ratios respectively in the island during this period of time. After two decades, the poverty situation of Hambantota district has considerably improved, while the performance of Moneragala district has not been attractive by 2009/10. Hambantota has managed to improve its island ranking position from 3rd to 13th, while Moneragala has only managed to improve its position from 2nd to

Table 7.8 District poverty headcount ratio and poverty rank

District	Household income and expenditure survey period						Poverty rank	
	1990/91	1995/96	2002	2006/07	2009/10	2012/13	1990/91	2009/10
Colombo	16.2	12.0	6.4	5.4	3.6	1.4	16	17
Gampaha	14.7	14.1	10.7	8.7	3.9	2.1	17	16
Kalutara	32.3	29.5	20.0	13.0	6.0	3.1	4	13
Kandy	35.9	36.7	24.9	17.0	10.3	6.2	1	11
Matale	28.7	41.9	29.6	18.9	11.5	7.8	10	7
Nuwaraeliya	20.1	32.1	22.6	33.8	7.6	6.6	15	12
Galle	29.7	31.6	25.8	13.7	10.3	9.9	8	11
Matara	29.2	35.5	27.5	14.7	11.2	7.1	9	8
Hambantota	32.4	31.10	32.2	12.7	6.9	4.9	3	13
Jaffna					16.1	8.3		2
Vavuniya					2.3	3.4		18
Batticaloa				10.7	20.3	19.4		1
Amapara				10.9	11.8	5.4		5
Trincomalee					11.7	9.0		6
Kurunegala	27.2	26.2	25.4	15.4	11.7	6.5	11	6
Puttalam	22.3	31.1	31.3	13.1	10.5	5.1	14	10
Anuradhapura	24.4	27.0	20.4	14.9	5.7	7.6	13	15
Polonnaruwa	24.9	20.1	23.7	12.7	5.8	6.7	12	14
Badulla	31.1	41.0	37.3	23.7	13.3	12.3	6	4
Moneragala	33.7	56.2	37.2	33.2	14.5	20.8	2	3
Ratnapura	30.8	46.4	34.4	26.6	10.5	10.4	7	10
Kegalle	31.2	36.3	32.5	21.1	10.8	6.7	5	9

Adapted source Department of Census and Statistics

Table 7.9 GDP at current factor cost price, population and poverty

Province	Percentage of provincial GDP (current factor cost price)				Population 2013	Poverty Headcount Index 2012/2013
	2005	2010	2011	2012		
Western	50.8	44.8	44.2	43.4	28.6	2.0
Southern	8.9	10.7	11.0	11.5	12.2	7.7
Sabaragama	6.4	6.3	6.2	6.1	9.5	8.8
Central	8.5	10.0	9.8	9.8	12.7	6.6
Uva	4.5	4.5	4.5	4.5	6.2	15.4
Eastern	4.7	6.0	5.8	6.3	7.7	11.0
North Western	8.9	9.5	10.0	9.6	11.7	6.0
North Central	4.3	4.8	4.7	4.7	6.2	7.3
Northern	3.0	3.4	3.7	4.0	5.2	10.9
Sri Lanka ^a	100	100	100	100	100	6.7

Source Department of Census and Statistics and Central Bank of Sri Lanka

^aFigures may not total 100% due to rounding

3rd. However, Moneragala district would have been the most poverty stricken district of the island, if former civil war affected districts were not included into the list in the recent past.

7.4 Structure of LEAD Model

Development strategies in Sri Lanka have been a controversial area for quite some time as desired goals have not been delivered by these strategies in the past few decades. Now it is widely accepted that development cannot be achieved and sustainable unless people's participation is made central to the development process. PRA has been instrumental in rural development in backward territories in the recent past. It is an offshoot of the broad concept of participatory development strategy for backward areas with non-literate and vulnerable communities. PRA leads community members to understand and analyse their backward economic setup by drawing maps and diagrams and imitating plans to change their backward situation. This is a people centred, people initiated and people driven approach with limited external guidance and support.

PRA is basically applied as a mechanism to mobilize human capital of a community with available other resources and services in and around a small social grouping. The LEAD community development model basically relies on the vision of reducing poverty through Community Driven Development (CDD) and good governance principles. On the one hand, the LEAD model focuses on the local public administration, while empowering the local communities to make use of this administrative structure to demand resources and services to meet their real needs. On the other hand, LEAD provides poor households and community groups to start up financial assistance and develop their capacity and competence to establish sustainable livelihood and income generation activities. Ultra-poor households unidentified by the village community are given an onetime grant to make them par with the average poor households of the village.

The ultimate objective of the LEAD model is to improve the living standards of backward communities in a sustainable manner. The level of poverty and vulnerability are the two basic criteria applied in identifying the backward village (social grouping or neighbourhood), the meso level implementing unit of the model. The village community members were encouraged to form small groups after an awareness program conducted LEAD officials with external resource personals. These groups identified major problems of the village, as well as the available resources and services to solution to the problems.

A Village Development Plan (VDP) was prepared by those small groups with their findings. It is the centre of gravity of the LEAD model in prioritizing the needs of community members for resource and service mobilization. The community needs of the plan would vary from livelihood development projects through water supply, environmental issues to infrastructural development such as roads, bridges, and electricity supply.

The required resources and services to meet these needs again vary from financial resources through human and material resources; services provided by the public officials, NGOs and private sector. These resources and services are sought within the village itself and outside of the village to meet the needs of the plan. Good governance, poverty alleviation and sustainable community development are the basic three basic pillars of the model.

VDP triggers the community to take leadership and ownership of their own village development. It motivates the community members to work together to realize a shared vision that they collectively agreed upon while they concentrate on household level economic gains. Once the VDP is prepared, it is shared with relevant local government authorities including the Pradeshiya Sabha and the District Secretary to design proposals for development. The process brings public officials closer to the community and delivers their services efficiently. It also ensures the accountability of public service and the community members are in a position to scrutinize duties of local officials more closely. Similarly, it encourages service providers to become more responsive to the different needs of different communities. In the long run, the responsive service delivery system ensures the utilization of limited public resources more effectively and efficiently.

Once the VDP is ready, its implementing responsibility is taken over by the Village Operating Unit (VOU) and Rural Coordinating Committee (RCC). The VOU is an elected body consisting of the members of CBOs (Community Based Organizations), representatives of the Poorest of the Poor (POP), and the representatives from marginalized and vulnerable groups. Priority setting, designing and executing of small local projects, receiving and disbursement of funds, monitoring the project progress and liaison with service agents are the main tasks of VOU. The members of VOU are responsible to the village community and they work in transparent manner. RCC, the second tier committee, consists of all VOUs of the village and grass root level public officials. The RCC mainly consists of Grama Niladhari (GN), Samurdhi Officer (SO), Agricultural Research and Production Assistant (ARPA) and two to three members from every VOU.

The VOUs send their development proposals through the RCC to state and non-state agencies to demand resources and services. The RCC also prepares a GN-level Development Plan (GNDP) and seeks resources and services from the public and private sector to implement the components of GNDP to meet the needs of entire GND.

The 2nd and the 3rd tier committees of LEAD models are Divisional Monitoring Committee (DMC) and District Advisory Committee (DAC). The Divisional Monetary Committee (DMC) is a multi-stakeholder and multi-sectoral consultation and decision making forum where community representatives are able to engage with different service agents and demand resources and services to meet their needs. All key community and DS level administrative officials are required to participate in this forum and respond to the various queries of community representatives. This forum is chaired by DS secretary and all the key community and DS level administration officials participate in this forum. The other component of the model

is District Advisory Committee (DAC) at the district levels, the highest administration in a district.

Firstly, the structure of LEAD model persuades community mobilization in terms of implementing awareness programs, identifying the resources and development problems, resources gaps, and drawbacks. Secondly, it provides strategies to acquire public and private resources and services. Thirdly, it assesses the effectiveness of the utilization of resources and services on a sustainable manner, while improving the living standards of community members.

Under the top bottom approach that was in operation in Sri Lanka prior to the LEAD model, the top level officials were not aware of the availability of resources and the community needs in villages even though they had the authority to make decisions. With the initiation of LEAD model, village communities have made decisions regarding resources and services in a more democratic and transparent manner. Therefore, resources and services could be utilized better for community development. Since community representatives continuously participate in each level up to District level, the voice of the village community is heard at higher administration levels in the District.

The *SevaPiyasa*, the service cabin at GN administration comes under the model, brings all important grass root level public officials—Grama Niladhari (GN), Samurdhi Officer (SO), Agricultural Research and Production Assistant (ARPA) etc. under one roof. The “*Seva Piyasa*”, a new concept of the model, is built with the LEAD financial support and the voluntary labour of the villagers. It is convenient for both grass root officials and community members. Now officials have office space to deliver their duties efficiently with dignity, while this office is located within the GN division where community needs are addressed.

The community members are trained to approach the relevant public officials to acquire resources and services needed for rural development. Ordinary community members have developed their personality to deal with top public officials after the project.

As a holistic model, LEAD goes beyond the mere economic boundary of the community. It addresses psychological, environmental, infrastructural, educational, drug addiction issues initiated by the community, and resolved with the support of LEAD. The following table gives information about a few problems experienced by two districts.

7.4.1 Socioeconomic Issues and LEAD Model

A number of socioeconomic issues common to many backward areas of the country, are visible in two districts where LEAD Project was implemented. These issues range from no proper livelihoods generating income to meet family requirements, poverty, weak infrastructural facilities, environmental issues, scarcity of irrigation and drinking water, insufficient cultivable lands and other inputs, ageing agricultural assets, poor transport and communication facilities, insufficient

Table 7.10 Selected major problems faced by villages in the two districts 2007

Type of issue		Hambantota (No. of villages)	Percentage	Monaragala (No. of villages)	Percentage
i.	Infrastructure problem	88	25.4	60	33.5
ii.	Livelihood problem	94	27.2	60	33.5
iii.	Environmental problem	73	21.1	13	7.3
iv.	Physiological problem	91	26.3	46	25.7
Total		346	100	179	100

Source LEAD database

institutional capacity and agricultural extension services, shortage of storage facilities, lack of credit facilities, unavailability of efficient public and private services and no opportunities for new generations.

The following table summarizes some of those issues visible in Hambantota and Monaragala under 4 themes. These problems are related to each other, even though they are brought under separate sub themes for the sake of simplicity, so that a holistic approach is suitable to address these issues with community participation as well as service providers from grassroots to the top. Acquiring and utilization of financial and material in a prudent manner with community participation is a prime need in addressing those issues (Table 7.10).

All problems have more or less equally spread in fairly developed Hambantota district, while infrastructural and livelihood problems are markedly visible in the less developed Monaragala district. Environmental issues are at a negligible level in Monaragala, while those issues are at a high level in Hambantota. Psychological problems are equally high in both districts. The seriousness of those issues varies over time and space in both districts, so that prioritization of the problems is not similar in different villages.

Severity of the problems as shown in Table 7.9 had reduced commendably at the end of the project as satisfactory sustainable solutions were given to those problems with the participation of community members. Village communities had prioritized their problems in VDPs and remedies were found them accordingly. They found resources from a number of sources such as the project itself, public funds, private donations, and support from other NGOs for the projects. Similarly, community members have contributed in labour, materials, and money in implementing a number of projects.

Sevapiyasa, the GN level service cabin, was instrumental in finding answers to most of their problems productively and efficiently. Now the community members have received an easy and guaranteed access to grass root level public officials such as GramaNiladhari, Samurdhi Official, Agricultural Extensive Service Official, Midwife and others under one roof in the village itself. These public officials are

Table 7.11 Selected infrastructural issues in Hambantota and Moneragala Districts 2007

Problems	Hambantota (No. of Villages)	%	Moneragala (No. of Villages)	%
Lack of electricity facilities	19	8.6	36	22.4
Poor access road and transport facilities	50	22.7	49	30.4
Lack of sanitary facilities	17	7.7	05	3.1
Land related issues	14	6.4	02	1.2
Lack of drinking water facilities	38	17.3	46	28.6
Issues related to irrigation and water	18	8.2	03	1.9
No permanent housing facilities.	20	9.1	04	2.5
Lack of multipurpose building facilities	16	7.3	14	8.7
Lack of education and related infrastructure	18	8.2	02	1.2
Other problem	10	4.5	00	00
Total	220	100	161	100

Source LEAD Database

also now happy and content as they have their own small office complex with the GN level itself. This novel concept was introduced from the LEAD model (Table 7.11).

Among all infrastructural issues, poor access roads and transport facilities stand at the top of both in the Hambantota and Moneragala districts. It is followed by lack of drinking water in those districts. Road and transport facilities are essential to go beyond the subsistence economic environment and to promote livelihood potentials. The local economic integration, division of labour and specialization are strengthened by road and communication facilities. Improvement of living standards is beyond reach without sufficient and uninterrupted supply of drinking water. Issues relating to irrigation and water are not priorities, even though the both districts mostly located in the dry zone in the island. Overwhelming majority of people in rural dry areas depend on agriculture and irrigation water supply is essential to ensure sustainable livelihoods for rural people in the island (Table 7.12).

Illegal alcohol production and use is the major contributory factor for psychological problems in Hambantota, while weak organization and leadership skills are the major contributory factor for psychological problems in Moneragala. Strangely, lack of lands and land ownership is the second largest contributory factor in Moneragala, even though it is one of the least population density districts in the island. Education and related issues contribute to a high percentage in both districts for psychological issues.

Table 7.12 Cause for psychosocial problems 2007

Contributory factor	Hambantota (No. of Villages)	Percentage	Moneragala (No. of Villages)	Percentage
Lack of unity	18	7.8	4	3.1
Education and related issues	42	18.3	16	12.6
Lack of income generating opportunities	18	7.8	9	7.1
Health care and related issues	13	5.7	7	5.5
Gender and unequal resource distribution	25	10.9	14	11.0
Illegal alcohol production and use	47	20.4	6	4.7
Domestic conflicts	06	2.6	00	0.0
Lack of religious related facilities	06	2.6	4	3.1
Weak organization and leadership skills	27	11.7	25	19.7
Poor GoSL extension services	09	3.9	16	12.6
Lack of lands and ownership	07	3.0	18	14.2
Other	12	5.2	08	6.3
Total	230	100.0	127	100

Source LEAD data base

Even though there were considerably high domestic conflicts prior to the introduction of LEAD, those problems have reduced sharply with the introduction of the model. In addition to this, there was lack of unity among villagers owing to outsider encroachment and property disputes. But the formation of small groups under the LEAD has helped to reduce conflicts improving harmonious relationship among community members. The LEAD model conducted various training programs which have shown good results in many instances for these achievements.

Households' low income has adversely affected school going children before the LEAD. This situation has changed considerably along with the introduction of RLF (Revolving Loan Fund) loans of the model and the subsequent rising income of those households. The community health problems have also been resolved with the introduction of LEAD model as a result of awareness programs and easy access to health facilities in government hospitals.

7.5 Mobilizing of Resources and Services Under LEAD

Mobilizing of resources and services is a key component in livelihood development and poverty reduction at village level through regional and national level. Insufficient resources and services reflect only one aspect of the poverty and related issues and it has been over emphasized most of the time as a major constraint of poverty reduction strategies. Therefore, insignificant attention has been paid to the mobilization of already available resources and services at grass root level in backward societies in many parts of the world. The LEAD model has been used an innovative approach to mobilize already available resources while providing an initial push for a big change. Community members of a village are guided to tap underutilized or unutilized local resources and services to create livelihood opportunities and reduce poverty under the project. Awareness and training programs are conducted at village level by the project to empower the powerless poor people who initiate village development at gross root level. Initial financial assistances are provided by the project without inculcating dependency syndrome among poor community members.

Lack of knowledge and awareness has hindered the mobilizing of resources and services to a great extent according to the information gathered in the field. In addition, backward community members were unorganized and not in a position to negotiate and bargain with resource and service providers even at grass root level. They also did not have one voice on their needs. The village development plan has prioritized their needs and training and awareness programs have strengthened their voice. The Rural Coordinating Committee (RCC) introduced by the project follows up the progress work in progress/request made.

Table 7.13 summarizes resources and services mobilized under LEAD project. Initial push for mobilization of resources and services was given by the project, while complementary contributions came from number of other sources such as public sector, I/NGOs, private sector other than INGOs, CBOs and individuals. Community members have approached these supplementary sources to implement village development plans (Table 7.14).

As observed in the field survey findings, village communities were in a comfortable position to negotiate with private and public agencies to mobilize essential resources and services to continue their achievements under the project. The overwhelming majority of community members had developed the confidence that would be enable community members to sustain their achievements even after winding up the LEAD Project.

Table 7.13 Mobilizing of resources and services

Resources		Services	
Financial resources	Other resources	Public sector	Private sector
Grants and loans (LEAD)	Lands and buildings	Grass root level administrations	Training and awareness programs (LEAD and others)
Public funds	Machineries, and equipments	Service provisions such as health and extension services	Marketing and input providing
Funds from other INGOs	Seeds, plants, animal and poultry	Marinating law and order	Dissemination of knowledge and information
Corporate sectors grants and loans	Raw materials	Training and awareness programs	Counselling and guidance (LEAD and others)
Other grants and loans including private donations	Other resources including private donations of lands, machineries etc.	Other service deliveries such as education, environment protection	Donation of free labour and other expertise

Source LEAD publications

7.6 Mobilizing Resources

Resources have been allocated for 828 micro projects during a six year time period in four DS divisions of Hambantota and Monaragala Districts under LEAD projects. The total amount of money spent for those projects stood at 333 million rupees. In addition to CARE, the project beneficiaries, other agencies and individuals have contributed to these projects as well.

The majority of have been allocated to Madulla DS division of Monaragala district, while an equal number of projects, the next highest given to Sooriyawewa and Tissamaharama DS divisions of Hamabantota district. The least number of projects were given to Hamabantota DS divisions. Altogether 71% of total projects have been allocated to Hambantota district and 29% allocated to Monaragala district.

70% of total project funds have been allocated to Hamabantota district, while Monaragala has been given 30%. The largest individual DS division level allocation has been given to the Madulla of Monaragala and the smallest share has gone to Hambantotata DS division (Fig. 7.2).

The LEAD has not taken full responsibility in implementing projects. It has encouraged community members to contribute to projects, while tapping supplementary sources to find the balance of the project cost. The maximum contribution

Table 7.14 Mobilizing of resources and services 2006–2012

DS Area	Number of the project	Total Cost of Micro projects (Rs.)	CARE Contribution (Rs.)	Beneficiary contribution (Rs.)	Other Agency contribution (Services)	Other support (Rs)
Hambantota	177	68,278,469	43,930,752	21,757,217	28,465	2,562,034
Sooriyawewa	207	89,854,710	41,910,664	33,432,771	818,718	13,692,557
Tissamaharamaya	207	75,451,809	44,427,773	25,898,596	na	5,125,441
Madulla	237	99,253,110	61,830,912	34,488,301	2,232,800	701,097
Total	828	332,838,098	192,100,100	115,576,886	3,079,983	22,081,129

Source LEAD Records

Fig. 7.2 DS wise project distribution. *Source* LEAD Records

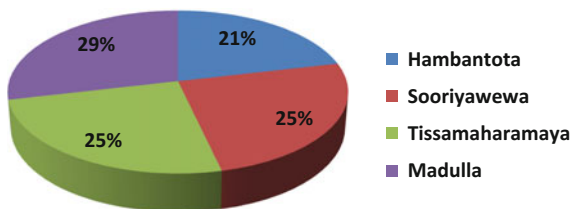
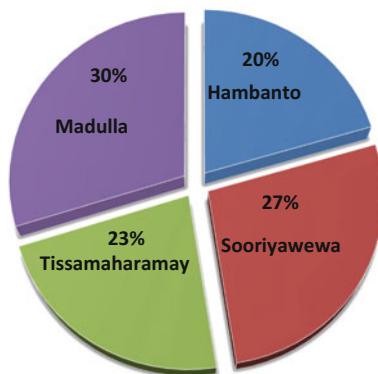


Fig. 7.3 Distribution of micro project funds. *Source* LEAD Records



of LEAD, 32% of the total cost of projects, has been given to Madulla DS division, while the minimum, 22%, was given to Sooriyawewa DS division (Fig. 7.3).

The LEAD has promoted participatory development approach in promoting all development projects. The poorest of the poor was only given one time outright grant to overcome the chronic poverty. The beneficiary families have also been selected with the recommendations of the village community members, so that the only qualified ultra-poor families were given onetime grants (Fig. 7.4).

The village community members, other individuals and agencies have contributed for micro projects. In a way, community members have developed

Fig. 7.4 LEAD contribution as a percentage of total project cost

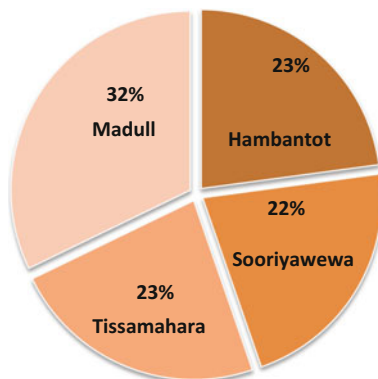
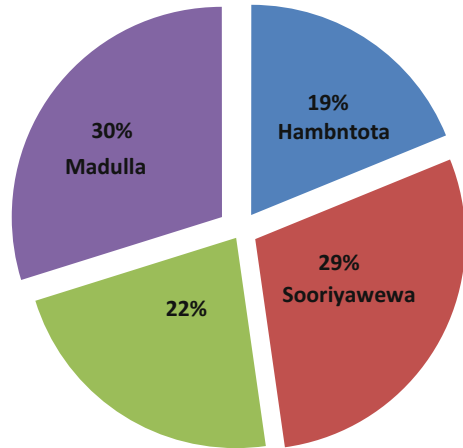


Fig. 7.5 Beneficiary contribution as a percentage of total project cost. *Source* LEAD Records



self-reliant perception in operating projects for themselves, while strengthening collective responsibility and ownership of the projects (Fig. 7.5).

Community members have also successfully negotiated with other agencies and individuals in acquiring resources for micro projects. Community members of Madulla, the poorest DS division where LEAD project was implemented, have made the highest percentage of contribution to micro projects, while the lowest percentage of contribution has come from the Hambantota DS Division.

Private sector involvement in resource allocation was further enhanced under the LEAD project. Firms and individual investors from distance areas, including Colombo, were guided to invest resources in project areas on the basis of win-win condition where both community members and private sector players get benefits. The business community provided inputs to communities while purchasing their outputs at a premium price. Marketing issues, as well as issues relating to the input scarcity of the project areas, were addressed successfully under this initiative.

7.7 Mobilizing of Services

The smallest unit of administration of Sri Lanka is Grama Niladhari Division (GND). It mostly consists of a few villages, the smallest traditional social groupings of the country. The grass root of the administration is the villages of a GN division. Sri Lanka has a fairly good service delivery system that ensures the delivery of services at all levels of the administrative structure. Such public officials as GramaNiladhari (GN), Samurdhi Officer, Midwife, Public Health Inspector (PHI), Agriculture Inspector (AI), and Agriculture Research and Production Assistant (ARPA) are working at the grass root level regularly. The wellbeing of the community members critically depends on service delivery efficiency of those officials. A number of other specialized agencies such as the Coconut Development Board,

National Housing Development Authority, Ceylon Electricity Board, Road Development Authority, Sri Lanka Transport Board, Departments of Irrigation, Livestock Development Board etc. are also involved with grass root level administrative activities intermittently. Their service deliveries are important to the community mostly on project basis.

The community members who participated in focus group discussions expressed dissatisfaction about the public service delivery system prior to the LEAD project. The GN, ARPA, and Samudhi Niladhari should live close to the service providing villages, even though they used to live far away from those villages. As a practice, most of those grass root level officials did not visit their service areas regularly, so that community members had to travel a long distance to meet them spending considerable time and money. With all these difficulties, such officials did not provide a satisfactory service to the community members. The situation was worse when it came to specialized public agencies, as their offices were located in the regional city centres or capital city. It was very difficult for villagers to meet them and discuss their issues. The community members have not even received replies to their request/complain letters from those agencies. The agency officials have not shown any interest in visiting villages to provide their services/expertise such as conducting training programs or to distribute seeds and seedlings provided by the government for the poor people.

Seva Piyasa (the rural service cabin) was introduced to the village under the LEAD Project and it was built up with the active participation of the village community members for the use of GN, ARPA, and Samudhi Niladhari. They are the most essential grass root level officials for the daily life and livelihood activities of the communities. The Seva Piyasa has also become a welcome relief to grass root level officials as most of them do not have office facilities. Now village communities can meet those officials within their villages itself on a regular basis. Officials are also delivering their services with great satisfaction and commitment (Table 7.15).

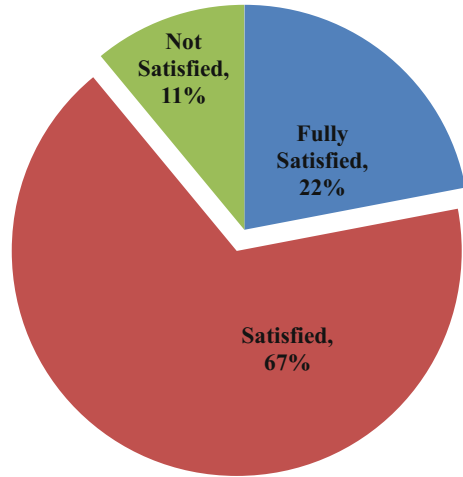
LEAD survey conducted on community satisfaction of the public sector service deliveries based on 239 respondents has shown remarkable achievements in service deliveries, illustrating that community satisfaction of public sector has improved to a great extent. 89% of respondents has maintained that either they are 'fully satisfied or satisfied'. The number of responds who belonged to 'medium satisfaction' and 'not answered' stood at zero, while 'not satisfied' was just 11% (Fig. 7.6).

Table 7.15 Community satisfaction of service deliveries

Level of satisfaction	No. of respondent	Percentage (%)
Fully Satisfied	52	22
Satisfied	159	67
Medium Satisfied	0	0
Not Satisfied	28	11
Not answered	0	0
Total	239	100

Source Client perception survey, CARE International, July 2009

Fig. 7.6 Community satisfaction of service deliveries. *Source* Lead



Under the LEAD, new community institutions such as the VOU, RCC and Divisional Coordinating Committee (DCC) were formed at grass root level and these were instrumental in delivering services of all public officials to the village communities. The voice of the village communities is now properly heard not only by grass root level officials, but by officials of other service providing agencies as well. LEAD has also properly empowered village community members and their new institutions to deal with these officials effectively. It was revealed at the FGDs that officials of both categories deliver their services more efficiently than ever before. The RCC and DCC created under LEAD obtain information about the new initiatives taken by the government for their wellbeing as well as the responsible officials/agencies to implement such initiatives. Now government officials are friendly with the village community members who attend their requests and even send replies to their letters. Now the communication methods are formalized as well. CBOs stationary is used to send letters by registered post, copies are sent to relevant other agencies/parties and carbon copies are maintained in CBO lockers. Issues relevant to ‘unattended’ or ‘unanswered requests’/‘complains’ are raised at high level official meetings by the representatives of the village communities, so that most of community members are met under LEAD model.

Access to financial services is essential to develop the local economy. The poor who do not have access to formal financial institutions often fall prey to the local money lenders who demand prohibitive high interest rates for their loans. Formation of credit groups/small groups under LEAD have prevented the poor from falling victim to the vicious brackets of informal money lenders.

Formation of RLF could be cited as an effective means of providing capital to poor beneficiaries for commencing/expanding their Income Generating Activities (IGAs). A number of positive, as well as negative aspects in relation to the revolving funds were observed during the study. Although the project initially aimed at disbursing funds through VOUs, it was evident that registration of VOUs

takes a longer time than expected. In such a context the project has allowed already existing societies/associations that are registered under appropriate authorities to get involved in disbursing the funds. This clearly demonstrates that the project has adopted flexible approaches in adapting to constraints imposed by the surrounding environmental conditions and learns through its experiences.

Focus group discussion highlighted that until the introduction of LEAD project, almost all the Samurdhi beneficiaries have participated in the community level projects under that program, while others have not received that experience. Almost all the participants admitted that either themselves or their family members have contributed free labour and other materials such as food items and drinks for free labour providers, building materials for community projects such as road constructions, renovation of irrigation canal systems and drinking water supply projects. The community services and resource mobilization seems to be high in the construction of “Sevapiyasa”. At Mahawelikada Ara CBO members said that the total cost of the “Sevapiyasa” construction was in the region of Rs. 1,255,000/= and the community contribution in the form of bricks, sand and the free labor was around Rs. 1,085,000/=. Similarly, members of the CBO at DiyabendiEla said that the total cost of the “Sevapiyasa” building in their GN division was Rs. 598,000/= and the community contributions in the form of free labour, building materials, and foods and drinks was around Rs. 240,000/=.

7.8 Key Findings on LEAD in a Nutshell

The research team made a brief examination on the overall performance of LEAD and its impact on poverty reduction and sustainable rural development while working on the resource and service mobilization of the model.

- i. LEAD project has been able to establish an inclusive structure at the community level for mobilizing resources and services.
- ii. The model has successfully created space for the voice of marginalized communities to be voiced in the acquisition resources and services.
- iii. The model has cultivated the culture of common ownership and responsibility of resources and services mobilization.
- iv. Grass root level leaderships have been created to negotiate with resources and services providers.
- v. Village development planning strategy has prioritized village development needs on consensual basis to mobilize resources and services.
- vi. The LEAD model has been instrumental in enhancing community access to diverse services, both in public and private sectors.
- vii. Communities have proven their capability in implementing development projects successfully by utilizing acquired resources prudently.

- viii. Community cooperation is high in identifying and implanting Infrastructural needs such as roads, bridges, water projects, sanitary facilities, irrigation tank rehabilitation, digging agricultural wells.
- ix. VOUs have played a significant role in providing livelihood supports for the village communities.
 - x. Emergence of new village leadership is visible in acquisition and utilization of resources and services.
 - xi. Improved relationships between community leaders and the rural functionaries in mobilizing resources and services.
 - xii. RCCs have created a platform for healthy interactions between rural leaders and public agencies such as Coconut Development Board, National Housing Development Authority, Mahaweli Authority, Road Development Authority, etc. in mobilizing resources and services.
 - xiii. Resources and services mobilization for the GND level development projects have been more systematized.
 - xiv. Involvement of VOU and RCC have led to build the Sewapiyasa (Service Cabin) with low cost but in high quality and it has become a turning point of grass root level public sector service deliveries.
 - xv. The model has been instrumental in establishing seed capital at rural level which has facilitated access to credit for marginalized groups.
 - xvi. Community members' assets and income have increased and poverty has reduced.
 - xvii. With the introduction of LEAD model, the mode of delivery of services has changed. The traditional supply driven service system as changed to a demand driven service system.
 - xviii. The LEAD model has influenced the fair and equitable distribution of services and resources within communities/GNDs.
 - xix. The VOU and RCC process has paved the way for community leaders to participate in decisional forums even at divisional and district level.
 - xx. Community has been empowered to survive without external support.

7.9 SWOT Analysis

7.10 Suggestions to Improve Resource and Service Mobilization

Legal empowerment of LEAD model at grass root level and Institutionalizing the VOUs/RCCs under four layers (Table 7.16).

Layer One: GND Representation of the Community

Community representatives shall be selected to RCC democratically on non-political basis. Determine the process to be adopted in electing representatives

Table 7.16 SWOT on resources and services mobilization of LEAD

Weaknesses	Opportunities
<ul style="list-style-type: none"> • Promoting existing inefficient public institutions for service deliveries <p>Public officials are transferred from time to time. New comers are not exposed to the model</p> <ul style="list-style-type: none"> • The focus unit of the model is a small village with homogenous stagnating social groupings with limited resources and skills • There is no convergence relationship with similar models such as <i>Samurdhi</i>, <i>Gemidiriya</i>, <i>Divineguma</i> operating in villages • Short training and awareness programs have a limited impact on resource and service deliveries 	<ul style="list-style-type: none"> • Rural communities, public officials, political leaders welcome the LEAD resource and service delivery mechanism • Participatory public service mobilizing mechanism from bottom to top resolves community issues • Model has a flexibility to share resources and services with other INGOs, public institutions, private sector and individuals • Other components of the model can be implemented efficiently by resource and service mobilization efficiency
Opportunities	Threats
<ul style="list-style-type: none"> • As a new model, there are opportunities for re-structuring, re-adjusting and reformulating of the mobilization strategies • Resource and service mobilization mechanism has a direct impact on reducing poverty and improve the living conditions • Community members can plan the mobilizing strategies • Mobilization mechanism can be replicated in other regions/countries with similar setup • Mobilizing mechanism can be implemented with a limited external resources and services 	<ul style="list-style-type: none"> • Highly politicized and highly bureaucratic environment block the efficiency of mobilizing mechanism. • No opportunities for intra village mobilizing mechanism • Small village unit is not attractive to the large players in the private sector • Model concentrates on traditional activities rather than tapping the emerging opportunities • Do not pay attention to future opportunities and changes

to RCCs from VOUs. The number of representatives shall be decided by number of villages and size of population. Chairman and other positions of the RCC shall be elected by the representatives of RCC **on rotating basis**. They are responsible to VOU and the community.

Layer Two: DSD Level Representation of the Community

One administrative body shall be created by combining Pradeshiya Sabha and DS division secretariat to create Divisional Development Council (DsDC). RCC shall be represented at DsDC by its chairman.

Layer Three: District level representation of the community

All RCC chairmen at DsDC shall select 5 members to represent them at District level on rotating basis. DISTRICT DEVELOPMENT COUNCIL (DDC) shall be formed by combining district level administration and selected community members from DsDCs.

Layer Four: Provincial level representation of the rural community

Three community members from each District shall represent Provincial Development Council (PDC) on rotating basis.

i. Empowering of the Rural Coordination Committee (RCC):

RCC is a GN level committee consisting of the representatives of Village Operating Units (VOUs) from every village within the GN division. In addition to community representatives, such grass root level public officials as Grama Sewa Niladhari, Agricultural Instructor, Agricultural Research and Production Assistant, Family Health Officer/midwife and Samurdhi Niladhari are the other members of the RCC. Those public officials are not responsible to the community representatives of VOUs although their efficiency and devotion for the purpose carry a huge weight in achieving the targets of Village Development Plans (VDPs). Therefore, empowerment of RCC legally is essential to mobilize resources and services at grass root level.

ii. Expansion the membership of RCC:

Private sector participation is essential to achieve the targets of village development plan, so that the representatives from the private sector, such as banking, input providers, industry, wholesalers, transporters, be nominated by VOU/village communities to the RCC.

Religion is still strong in developing countries including in Sri Lanka and the village level religious leaders have a strong voice among their followers/village communities. Active representative/s from the village monastery/temple/church/mosque be appointed to the RCC by VOU/village communities to the RCC as advisors. Where necessary representatives from the local police station, school, hospital etc. be invited to some of the meetings, though they are not permanent members.

iii. Strengthening good governance practices further:

Awareness/training programs are essential to reform civil society, public sector, and private sector to promote access to public information, transparency and good governance. The community members should be aware of the funds allocated for their wellbeing by the state, as well as other organizations and project implemented under their labels, actual cost spent for such projects and the distribution of benefits among community members etc. This can be initiated at the RCC and expanded to other tiers of the administration step by step.

Irrespective of the members of VOU/RCC, all community members of the village should have access to information regarding village development projects and other relevant areas such as resource available in the village, village service providers, environmental and social issues. Copies of a wall newspaper (Biththi Puvathpatha) containing a summary of information may be demonstrated at Seva Piyasa and other suitable places such as village religious place and cooperative shop.

iv. Market needs assessment:

Resource and service allocation under the village development plan is not aligned with the macro/meso level performance such as production, consumption and

product prices in the market, so that small producers are not in a position to absorb the adverse impacts of price shocks of input and output markets. Products/services prioritized in the VDP mostly target the saturated local/national markets where sufficient growing demand is not available for their products. There is no secured demand and guaranteed price for agricultural and other traditional products of village communities. Dissemination of local and national level supply (production)/demand (requirement) information among community members would be useful to expand their products in a sustainable manner. Alignment of the village initiatives with regional/national economic environment is essential for this purpose.

v. Impart knowledge on future needs of the village/economy:

The Village development plan is prepared by the community focusing on their current needs in the village and resource and service allocation are made accordingly. Sufficient attention is not paid to the changes in consumption pattern, as well as changing requirements of the village and the economy. For example, ageing population and needs of new generations are not properly targeted due to their limited knowledge.

A training/awareness programs focusing on national and regional socio-economic, environmental, and industry/services information would be useful for this purpose. Information collected by the Department of Census and Statistics, Central Bank, HARTI, Ministries of industry, fisheries, tourism would be useful in this endeavour.

vi. Vocational training for new generations:

New generations have a different mind setup and the parental livelihoods are their last choice for many instances. Young people belonging to school dropouts and school leavers categories are common in every village without direction for a productive future. They would be given locally and globally marketable vocational training either at public or private sector training institutes with sufficient future prospects. It is possible to organize training fairs with relevant service providers at divisional and district level.

vii. Making traditional livelihoods more attractive:

Introducing of simple tools and machineries, targeting lucrative markets with the participation of state and private sectors, propagation of high productive methods and inputs, changing the attire and vocational names would be useful in this endeavour.

viii. Intra village development components:

Identifying the complimentary and competitiveness of village livelihoods and other economic activities are useful to maintain the sustainability, good quality and high productivity in the long run. Occasional district/provincial level meetings of village representatives would be useful to identify sources of cheap/quality raw materials, markets for their products, new inputs, and better production methods. The most suitable products for every village/division would also be identified at those

meetings. Similarly, it is possible to invite industrialists, service providers, and exporters to these meetings, so that intra village producers can supply large quantities of most profitable and quality products to well established buyers at high rates.

ix Guaranteeing the quality, quantity and continuity:

These three principles are essential for sustainable livelihoods for village communities. Quality consciousness is virtually absent among many producers in the country, so that they should be given thorough training and awareness to change the mind set to meet this requirement. A guaranteed sufficient quantity of products should be available to consumers, as well as producers/wholesalers/exporters who use these products as inputs of their businesses. To maintain the continuity, an agreed quantity of a product should be delivered regularly. Intra village development components are essential to meet the quantity and continuity conditions.

x. Act locally, think globally

It would be essential to make the village community to act locally with the feeling that they are living in the global age, so that they have new opportunities, challenges and obligations. They have access to the global market, if they choose the right product and right strategies. Similarly, they have to compete not only in the global market but also in the local market with global products. There are international product standards and regulations in the global age and they range from environmental and labour standards through subsidies and other regulatory matters. Village communities will have more opportunities and higher income, if their products are tied up with global producers and suppliers. Facilitation for meetings between the village community representatives and global players at district/provincial level would be useful in this endeavour. A certain villages can be transformed into export promotion villages with the support of local chambers, in addition to global players.

7.11 Conclusion

LEAD is a grass root level development model that follows the bottom-up approach. It has been implemented as a test model in Hambantota and Moneragala districts of Sri Lanka for nearly five years. A large number of villages of the former have been selected, while a small number of villages from the latter were selected for the project as well. Hambantota is prosperous in many areas of socioeconomic development, when compared with many other districts in the country. This district has achieved a remarkable transformation within a short period of time due to a number of contributory factors. It has been the most favoured destination for giant public investments in the past few years. In addition, a number of NGOs are

operating in the District, focusing on improving the living standards of backward communities. In contrast, Moneragala is still a highly backward district in the island, even though many INGOS are operating in the district.

As a holistic development model, LEAD has made a great effort to address a number of socioeconomic and environmental issues faced by backward village communities of Hambantota and Moneragala. Now people are aware of most of their strengths and weaknesses as a result of awareness programs, applying the Participatory Rural Appraisal method, followed by preparation of village development plans, identifying ultra-poor people, forming small groups, involving with infrastructure development projects, and engaging in livelihood development activities. With this experience, they are now in a fairly strong position as individual households, as well as members of a village, to address their problems. They are also in a strong position to bargain with and push through grass root level public officials to deliver their service meant for them.

In the LEAD project areas, agriculture is the dominant sector of the economy on which more than 90% of households depend for their livelihoods. Its performance affects the hunger, poverty, income distribution, food security, rural development and socio political stability. Agricultural production has increased and the community income and food security level have also improved to a great extent due to LEAD intervention. In addition to crops for household consumption, small producers now target the local weekly fairs and agricultural product outlets. The commercialization of the production, introduction of new products and expanded distribution networks have created new avenues for the small producer. Some buyers now come to farm gates to collect products at reasonable rates. The surplus agricultural products from project areas enter distant markets; therefore, the agriculture sector is able to get the benefits from the growing income of more developed areas of the country. Opportunities are being opened to community members to engage in agri-businesses as well

In addition to the crop cultivation; cattle keeping, poultry farming and fisheries have also shown a tremendous upward trend as a result of LEAD intervention. Non-agricultural activities such as food making, brick making, furniture work, dress making, and retailing have made considerable progress in the recent years.

LEAD community awareness and training programs cover a number of essential components to ensure socioeconomic harmony and improvement of living standards of backward communities. These include community empowerment, skill development, book keeping and management, development planning, and environmental awareness, so that foundation is laid down for sustainable development with community participation.

Small producers have straightforward access to services and inputs providers through the "Sewapiyasa" and other channels introduced by the model. Resources and services delivery negligence, disruptions and delays have been minimized to a great extent. A better conducive environment has been created for small producers to exploit their limited resources to generate high income and to lead a better life without external handouts. Public officials, especially the grass root level officials,

are happy with the new structure created under the LEAD. Now they can deliver their services in a friendly environment with community members than in the previous confrontation environment.

LEAD has given priority to develop small scale infrastructural facilities in rural villages rather than targeting large scale infrastructure project. Those projects such as rural roads, culverts, irrigation canals, buildings, and bridges provide direct benefits to community members, as well as the ownership perception. Resources and services for such projects have been contributed by LEAD, community members, public sector, other NGOs, and individual donors. The objectives of such infrastructural faculties were to enhance the community income generation ability and to improve their accessibility for essential facilities. Poor access roads and transport facilities, lack of irrigation water and lack of drinking water have been the most sticking infrastructural problems in LEAD project areas.

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Chapter 8

Public Investment in Education: Benefits, Challenges and Opportunities

Harsha Aturupane

8.1 Introduction

Education has become a vitally important factor in the economic performance and social well-being of countries in the modern world. The key characteristic that distinguishes high-income countries from middle-income and low-income countries is the human capital content of their production processes and products. Economic activities and outputs have become increasingly knowledge and skill intensive in recent decades. Moreover, the importance of knowledge and skills is increasing at an accelerating pace. Among advanced countries, for instance, the single most important factor influencing economic performance is the education level of their populations (Hanushek and Welch 2006). Among middle-income and low-income countries, too, economies that can draw on a well-educated population enjoy considerable economic benefits (Patrinos and Psacharopoulos 2011).

Investment in education is also known to produce a wide range and variety of social benefits. These include improving economic equity and reducing poverty; enhancing inter-generational social mobility; instilling the values and patterns of behavior required for a socially cohesive society; creating the enlightened citizenry needed for a well-performing modern liberal democracy; and promoting family health and child nutrition. Many of these benefits have been identified and documented in the case of Sri Lanka as well (MOE 2005, 2011; Aturupane et al. 2013a). The achievement of social goals through investment in education also constitutes an important element of the overall national education policy framework (Aturupane 2009; MOE 2012).

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8.2 Economic and Social Benefits of Investment in Education

Investment in education has a positive and significant impact on earnings of both men and women in Sri Lanka. Among men, investment in human capital has a favourable effect on earnings across all levels of education. This is seen in Table 8.1, where all the education coefficients in the regression analysis presented are positively signed and statistically significant, and rise monotonically from basic education to postgraduate education. Among women, investment in human capital has a favourable effect on earnings from lower secondary education upwards. Again, this can be seen from Table 8.1, where the education coefficients in the regression analysis presented are positively signed and statistically significant, and increase with each level of education, from basic education to postgraduate education. The impact of education on earnings is stronger among female workers than among male workers from the GCE upwards. This is likely due to self-selection effects, as there is a greater likelihood that the more able women are entering the labour market, while among men, nearly all working aged individuals would be participating in the labour market. These findings are consistent with the idea that investment in human capital is an important factor determining the labour market performance of individuals.

Table 8.1 Education and earnings by gender, 2012, least squares estimates of augmented mincerian earnings functions

Variable	Male		Female	
	Coefficient	T Statistic	Coefficient	T Statistic
Constant	8.837	166.166	8.528	148.180
Primary incomplete	0.032	0.616	-0.046	-0.934
Primary education	0.155	3.035	0.008	0.153
Basic education	0.338	6.601	0.247	4.577
GCE_OL	0.573	10.983	0.645	11.688
GCE_AL	0.766	14.437	0.899	17.069
Graduate	0.997	16.386	1.067	18.787
Postgraduate	1.208	12.861	1.298	16.048
Experience	0.037	19.986	0.033	12.800
Experience squared	-0.001	-17.591	-0.001	-11.077
Urban sector	0.110	7.409	0.178	7.513
Estate sector	-0.228	-10.475	0.073	2.302
Adjusted R squared	0.281		0.377	
Sample size	8492		3986	

Source Computed from labour force survey data

Note The base category for education levels is no education. The base category for sectors is the rural sector

The experience variables display the familiar pattern of earnings functions, rising up to a maximum in late middle-age and then declining thereafter, among both men and women. The earnings functions also show that urban men and women earn more than their counterparts in the rural sector. This is a normal finding, as jobs in urban areas offer better scope for higher levels of human capital. In the estate sector, while men earn less than male workers in the rural sector, women earn more than their rural counter parts. The latter findings is likely to be the result of more secure and steady employment for women in the unionized estate sector.

Education attainment and earnings are positively associated in Sri Lanka. Earnings increase continually as the education levels of individuals rise (see Fig. 8.1). A man with primary education earns 17% more per month than a male with no schooling. Among individuals who have completed basic education, a man earns 40% more than a male worker with no education, and a woman earns 28% more than a female worker who is not educated. The earnings of both men and women increase further at each level of education. Among individuals who have completed the General Certificate in Education Ordinary Level (GCE O/L), men earn 77% more than uneducated male workers, and women earn 91% more than uneducated female workers. Among individuals who have completed the General Certificate in Education Advanced Level (GCE A/L), men earn 115% more than uneducated men, and women earn 146% more than uneducated women. The greatest gains are seen among men and women who have completed higher education. Male university graduates earn 171% more per month than uneducated men, and female university graduates earn 191% more per month than uneducated women. Male university graduates earn 171% more per month than uneducated men, and female university graduates earn 191% more per month than uneducated women. The greatest gains are seen among men and women who have completed higher education. Male university graduates earn 171% more per month than uneducated men, and female university graduates earn 191% more per month than uneducated women.

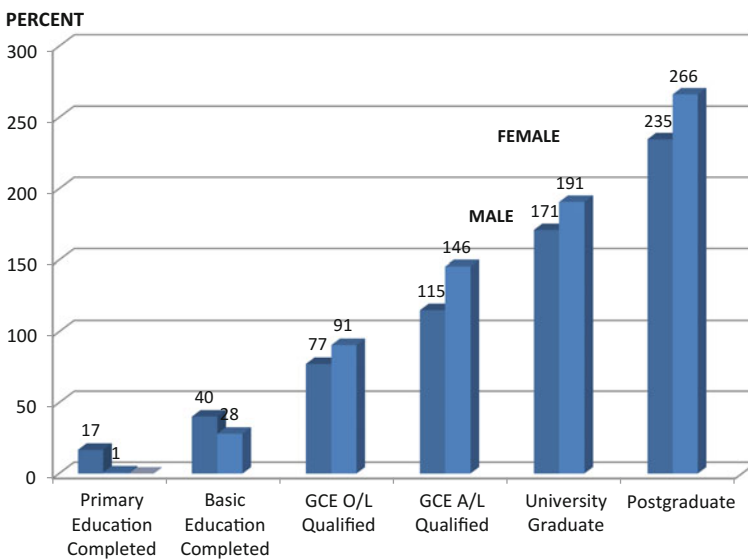


Fig. 8.1 Impact of education on earnings, male and female workers, 2012. *Source* Derived from the earnings functions in Table 8.1

women. Postgraduate educated men earn 235% more per month than uneducated men, while postgraduate educated women earn 266% more per month than uneducated women. Overall, these findings clearly demonstrate that men and women benefit from investment in education.

The rates of return to education are positive and considerable, at the secondary and higher education levels. Among primary educated workers the returns to education are positive but slight, at just 2% for men and 1% for women, respectively (Fig. 8.2). Individuals who have completed basic education receive somewhat better returns: 6% for men and 8% for women. However, among individuals who are secondary educated or higher, returns to education are greater. GCE O/L qualified men earn returns of 12%, while GCE O/L qualified women enjoy even higher returns at 20%. Among GCE A/L qualified individuals, men receive a return of 10%, while women earn a return of 13%. Among university graduates the returns to education for both men is 12% and for women 8%. At postgraduate level the returns to education are very high, with men enjoying rates of return of 21% and women receiving returns of 23%.

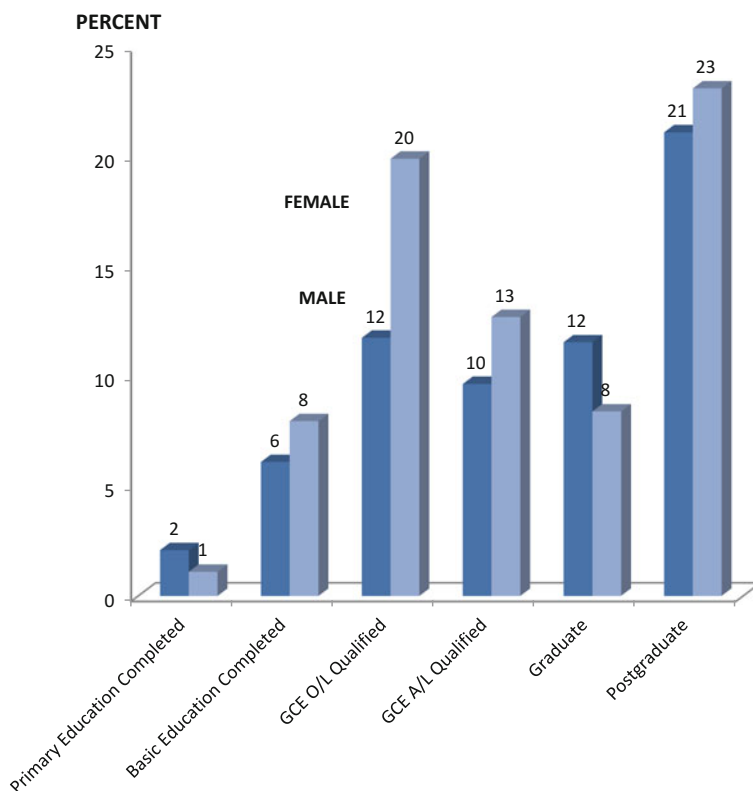


Fig. 8.2 Private rates of return to education, male and female workers, 2012. *Source* Derived from the earnings functions in Table 8.1

This pattern of returns to education is consistent with the fact that the supply of primary and basic educated human capital in Sri Lanka is high, so that returns to education at these levels are small. At secondary education level and higher education level, however, the supply of educated labour is lower, and returns to education are high. In addition, workers could be using their educational certificates at secondary education and higher education levels to signal their quality, while employers may be using these certificates to screen potential employees for quality. Overall, the pattern of returns to education is consistent with economic theories of human capital and of signalling–screening in labour markets with asymmetric information.

8.3 Inter-generational Benefits of Investment in Education and the Promotion of Gender Equity

The inter-generational benefits of investment in education and on gender equity are clear and significant. Figure 8.3 presents information from an econometric analysis of education attainment covering several decades (Aturupane and Deolalikar 2011). In early years, such as the period prior to 1926, education attainment in Sri Lanka was relatively low. On average, men had four years of schooling and women had three years of education. Over time, as the education system expanded and grew, the education levels of both boys and girls improved. Interestingly, the pace of improvement was greater among girls. Thus, among the population born in the mid-1960s and onwards, the education levels of women has exceeded the attainment of men. There are several reasons for the increase in education attainment among both men and women over time. These include greater

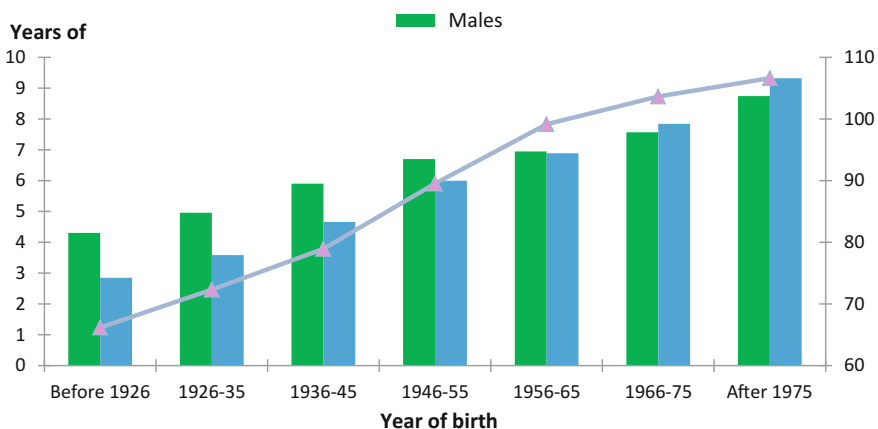


Fig. 8.3 Average years of completed schooling for persons aged over 20 years, by sex and year of birth. *Source* Aturupane and Deolalikar (2011)

awareness of the importance of human capital among policy makers, as well as the general population; and in the case of girls' education, changing views on the rights and responsibilities of women. However, one extremely important reason has also been the inter-generational benefit of education. Educated parents generate greater demand for education for their children. Therefore, investment in education in earlier generations has contributed to the rise in education levels of subsequent generations, as well as the increase in education attainment of girls and women.

8.4 Education and Poverty Reduction

Education attainment and poverty reduction are closely associated in Sri Lanka. Figure 8.4 shows the association between the education levels of household heads and the incidence of poverty of households. The poverty rates of households demonstrate a continuous decrease as the education levels of household heads increase. The incidence of poverty among households with uneducated heads is 46%. In households where the head had completed primary education, the incidence of poverty falls to 31%. Among households with heads who have a moderate level of secondary education, the poverty rate is 18%. In households with heads who have completed the GCE O/L, the incidence of poverty declines to 7%. Among households with heads who have GCE A/L education, the poverty rate is only 2%. In households where the head has either a university degree or higher qualification, the prevalence of poverty is a mere 1%. This positive relationship between the education level of household heads and the level of poverty operates through a number of channels. For instance, households with more educated heads normally have more stable jobs and greater earnings. They also usually have lower fertility rates and family sizes, which in turn contribute to reduced poverty levels.

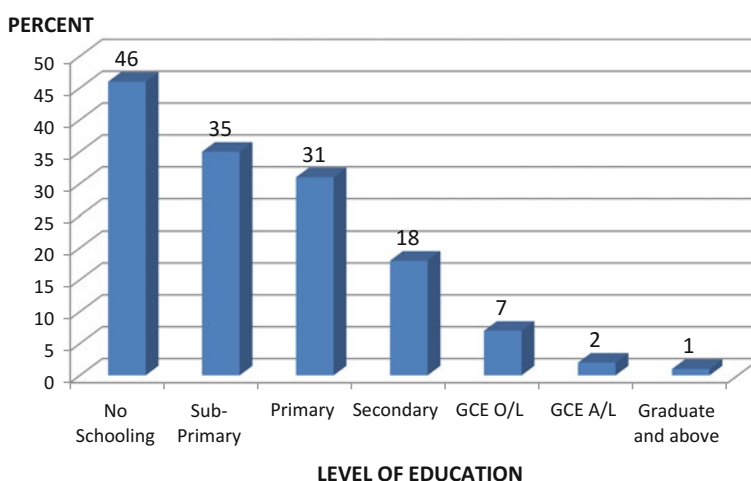


Fig. 8.4 Poverty incidence by education level of household head. *Source* Gunewardena (2007)

8.5 Human Capital and Economic Welfare

Education has a strong and clear effect on economic welfare in Sri Lanka. Figure 8.5 shows the relationship between education attainment and the economic prosperity of individuals and households. This association is clearly and strongly positive. As the education levels of the principal income earners of households increase, the effect on economic welfare grows stronger. Households in which the principal income earner is primary educated have 16% higher consumption levels than households where the principal income earner is not educated. Households in which the principal income earner has completed basic education enjoy 31% higher consumption levels than households where the principal income earner is not educated. Households in which the principal income earner has completed GCE O/L education enjoy 69% higher consumption levels than households in which the principal income earner is not educated. Households where the principal income earner is GCE A/L educated have 119% better consumption levels than households where the main income earner is uneducated.

Households in which the principal income earner is a graduate enjoy 190% higher consumption levels than households in which the principal income earner is not educated. Finally, households in which the principal income earner has post-graduate qualifications enjoy 224% higher consumption levels than households in which the principal income earner is not educated. There are multiple channels that enable more educated households to enjoy higher levels of economic welfare. More educated individuals usually have access to better quality occupations, with stable jobs and higher flows of earnings. In addition, educated individuals are generally

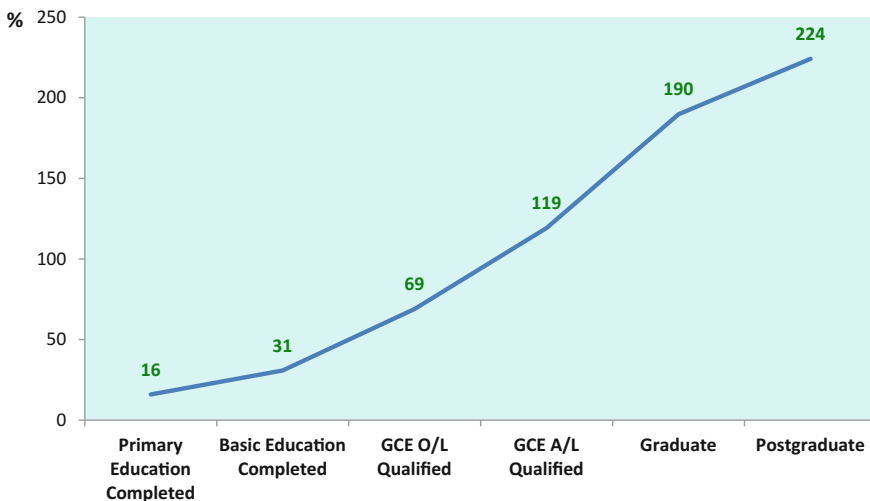


Fig. 8.5 Economic welfare by education level of the principal income earner of a household. Source Himaz and Aturupane (2011)

more able to make rational decisions on consumption and investments. Overall, investment in human capital is an important determinant of the economic welfare of households.

Individuals in the upper welfare groups systematically enjoy higher incremental welfare gains, for the same level of education from middle school to the end of senior secondary education, than individuals in lower welfare groups (Himaz and Aturupane 2011). Several countries in Europe and Latin America have similar findings in the context of studies of returns to education, with individuals in higher income groups better able to benefit from investment in human capital than individuals in the lower income groups (World Bank 2008). There are a variety of reasons for this type of finding. For instance, individuals from the upper welfare groups may have attended better quality schools, so that they have a higher quality stock of human capital. They might also be more able and motivated, and therefore able to utilize their human capital in the labour market more effectively. To the extent that the greater incremental welfare gains to the higher welfare groups are the result of higher quality education institutions. Therefore, public investment in education needs to focus on improving the quality of schools attended by the children of the lower welfare groups, in order to promote equality of opportunities.

The effect of human capital on economic welfare has been increasing over time. Table 8.2 shows the effect of education on economic welfare during the period 1990/91 and 2006/7. This effect has risen for all categories of education, except primary completed, over this period. In grades 1–4 the incremental effect of education has increased from 2.9% in 1990 to 3.6% in 2006/7. At grades 5–7 the incremental effect of education has fallen marginally from 1.7% in 1990 to 1.6% in 2006/7. In grades 8–10 the incremental effect of education has grown from 3.3% in 1990 to 4.0% in 2006/7. At the level of GCE O/L completed, the additional effect of education has increased from 11.5% in 1990 to 12.8% in 2006/7. At the level of GCE A/L completed, the incremental effect of education has increased from 10.5% in 1990 to 13.0% in 2006/7. Among university graduates the additional effect of education has risen from 10.8% in 1990 to 14.0% in 2006/7. This statistics illustrate the increasing significance of education over time, especially at the levels of GCE O/L, GCE A/L and university education, in the economic welfare of households. The observed pattern, which shows that higher levels of education have become more important than the lower levels of education in more recent years, supports the notion that economic activities have become more knowledge intensive, so that the returns to knowledge-based skills have increased.

Table 8.2 The time trend of the incremental impact of education on economic welfare, 1990–2007

Years of education	1990/91 (%)	2006/7 (%)
Grades 1–4	2.9	3.6
Grades 5–7	1.7	1.6
Grades 8–10	3.3	4.0
Completed GCE O/L	11.5	12.8
Completed GCE A/L	10.5	13.0
Graduate	10.8	14.0

Source Himaz and Aturupane (2011)

8.6 Public Investment in Education

The government spent approximately LKR 97 billion (USD760 million) on general education through the Ministry of Education and the Provincial Councils in 2012 (see Table 8.3). Recurrent expenditure was around LKR 87 billion (USD 680 million) and capital expenditure was about LKR 10 billion (USD78 million). The share of recurrent expenditures, is high at 90%, while the share of capital expenditures, is low at about 10%. This pattern of a substantial share of the government education budget, around 90%, being devoted to recurrent education expenditure has been a feature of the general education system in recent years. The most important reason for this pattern is the low student teacher ratio in the country, and the consequently high expenditure on personal emoluments.

Government expenditure on higher education through the Ministry of Higher Education was approximately LKR 24 billion in 2012 (USD188 million) (see Table 8.4). Higher education recurrent expenditure was approximately LKR 16 billion (USD122 million) and capital expenditure LKR 8 billion (USD64 million). The share of the recurrent budget was about 65%, and the share of the capital budget approximately 35%. The large share of the capital budget is the result of construction programs in the higher education sector, including universities and the Advanced Technological Institutes (ATIs) of the Sri Lanka Institute for Advanced Technological Education (SLIATE).

Table 8.3 General education expenditure: ministry of education and provincial councils, 2010–2012

Type of expenditure	2010	2011	2012
Total education expenditure	86,231	90,202	96,743
Recurrent education expenditure	79,414	82,181	86,731
Capital education expenditure	6817	8021	10,012

Source Ministry of Finance and Planning, Budget Books, various years

Table 8.4 Higher education expenditure: ministry of higher education, 2010–2012

Type of expenditure	2010	2011	2012
Total education expenditure	20,112	23,188	23,745
Recurrent education expenditure	11,993	13,199	15,617
Capital education expenditure	8118	9989	8128

Source Ministry of Finance and Planning, Budget Books, various years

8.7 Investment in Education in International Perspective

Government expenditures on education in Sri Lanka are modest when compared to middle income countries and other developing nations. Public education expenditure as a proportion of GDP was 2.0%, and as a percentage of the government budget 12.9%, in 2011 (Table 8.5). This is the second lowest share of public investment in education as a proportion of GDP among the group of comparator East Asian, South American and South Asian countries shown in Fig. 8.6; and one of the lowest shares of public spending on education as a share of the government budget among the same set of countries shown in Fig. 8.7. Public investment in education in Sri Lanka is lower than in East Asian countries such as South Korea, Malaysia, Thailand and Singapore. It is also shown in Table 8.5 that of South American countries such as Argentina, Brazil, Bolivia, Colombia and Costa Rica, Sri Lanka has relatively low public investment in education. Public investment in education is low in Sri Lanka when compared to many other South Asian countries

Table 8.5 Education expenditure as a percentage of GDP and total government expenditure, Sri Lanka and selected other countries, 2011 or nearest year

Country	Public education spending as a percentage of GDP	Public education spending as a percentage of government spending	Education recurrent expenditure per student as a share of GDP per capita
Sri Lanka	2.00	12.87	8.53
Malaysia	5.13	21.30	19.17
Thailand	5.79	29.47	18.61
South Korea	5.05	15.77	22.12
Singapore	3.30	22.70	n.a
Argentina	5.78	13.95	18.85
Brazil	5.82	18.12	21.11
Bolivia	7.60	24.62	n.a
Costa Rica	6.28	23.06	n.a.
Colombia	4.49	14.93	15.95
Russia	4.10	11.94	19.69
India	3.32	10.50	13.01
Bangladesh	2.23	14.11	10.75
Pakistan	2.37	9.93	11.67
Nepal	4.72	20.22	15.60
South Asia	2.85	11.04	n.a
Low and middle income	4.53	17.33	n.a
Upper middle income	5.04	16.71	n.a

Source UNESCO Statistics

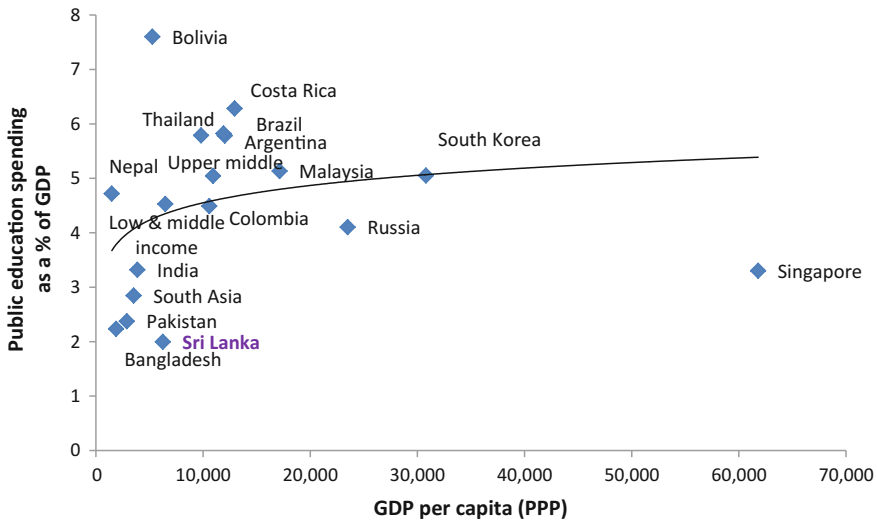


Fig. 8.6 Public investment in education as a percentage of national income, 2011 or nearest year. *Source* Education Statistics and World Development Indicators (World Bank)

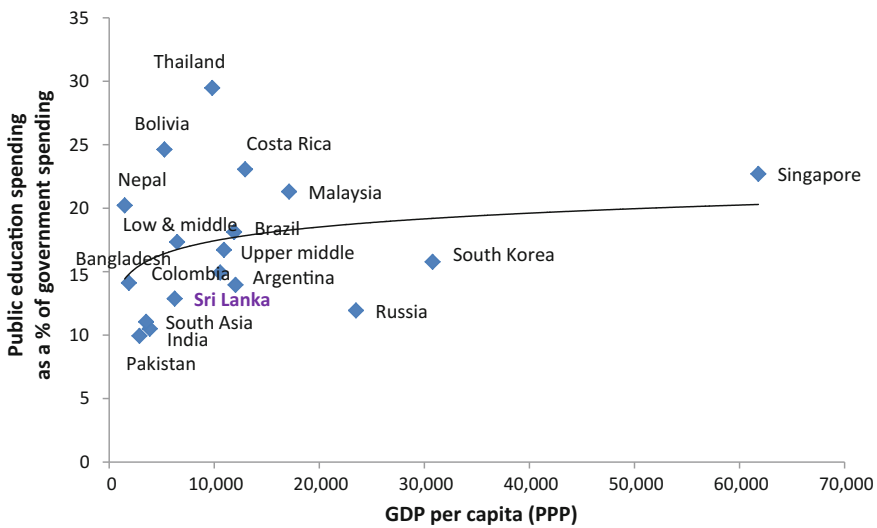


Fig. 8.7 Public investment in education as a proportion of the government budget, 2011 or nearest year. *Source* Education Statistics and World Development Indicators (World Bank)

as well. Public investment in education is also lower than the share of investment among lower-middle income countries, as well as upper-middle income countries. Lower-middle income countries spend approximately 4.5% of GDP and 17% of government expenditures on education. Upper middle-income countries invest

about 5.3% of GDP and 16% of government expenditures on education. The comparatively small share of national income and government expenditure on education in Sri Lanka also results in relatively low recurrent expenditures per student. Public investment in education in Sri Lanka is well below the comparator countries shown in Table 8.5 per student, particularly in relation to East Asian and South American middle-income countries such as South Korea, Malaysia, Thailand, Argentina, Brazil, Colombia and Costa Rica.

There are many reasons for the small share of public education investment in Sri Lanka. These include: (a) low teacher salaries, with Sri Lankan teachers receiving salaries considerably less, as a proportion of national income per capita, than teachers in other Asian countries such as South Korea, Malaysia, Thailand, India, Pakistan and Bangladesh, and also below those of the comparator countries in South America; (b) the development of the capital stock of schools during the 1950s–1980s, which reduced the requirement for large-scale investment in the construction of new schools and new basic infrastructure such as classrooms; (c) the competition for resources from a broad array of investments in public infrastructure and other social services, including universal free health care and safety nets; and (d) substantial expenditures on defence and public order. The latter is likely to decrease, over time, as the military conflict in the Northern and Eastern Provinces ended in 2009. Such a decrease would provide fiscal space for the government to increase investment in education, along with any other priority sectors.

Under-investment in education can have multiple negative consequences for the performance of an education system. Low investment in the recurrent education budget means that the country's ability to spend on quality processes is limited. These quality processes would include the professional development of teachers and teacher educators, the management and leadership skills of school principals and education administrators, and the delivery of on-site academic and managerial support services to schools. In addition, the ability of a country to provide incentives for better teacher deployment in disadvantaged areas becomes constrained. Low investment on recurrent education expenditures also results in low salaries for teachers and university academics. This, in turn, weakens the quality of staff joining the teaching profession and university academia. Universities also suffer from brain drain when personal emoluments are low. In addition, the ability to meet the operating and maintenance costs of capital education investment is constrained.

Low investment in the capital education budget means that the ability of a country to develop a stock of modern education assets, spaces and equipment is limited. Such assets and spaces include classrooms adapted to the use of technology, IT laboratories, language laboratories, activity rooms, multi-purpose rooms, libraries and science laboratories. Modern equipment would include IT equipment, science equipment, technology equipment, and teaching-learning material across the range of the curriculum. Also, low investment means that the ability to replace equipment and technology becomes limited. Overall, the ability of the education system to deliver a high quality education experience for children is constrained by the low level of public investment in education.

8.8 The Norm-Based Unit Cost Resource Allocation Mechanism

Sri Lanka introduced a new resource allocation mechanism called the Norm-Based Unit Cost Resource Allocation Mechanism (NBUCRAM) during the early 2000s. The purpose of the NBUCRAM was to establish an equitable and rational basis for the allocation of resources to schools. According to the NBUCRAM the recurrent budget is allocated based on norms which include student-teacher ratios for the teacher budget, estimated learning costs for different subjects and grades, the number of pupils in schools, and the grade levels covered by the various types of schools (Aturupane and Abeygunewardene 2002). The capital budget is allocated on a stock-adjustment principle, where over time the capital stock of schools are enhanced from their present levels until they reach desired levels, given norms for physical facilities, equipment and technology. A grant for quality inputs and processes which would flow directly to schools was included in the program to accelerate resource utilization and to facilitate greater sensitivity to the local needs of school. This NBUCRAM improved the equity of resource allocation and utilization in the primary and secondary education sector. In particular, children from low-income households benefited from this initiative (Arunatilake and Jayawardena 2010; Balasuriya 2011).

8.9 The Decentralized System of General Education Service Delivery

Sri Lanka has a combination of centralized and decentralized systems for the delivery of primary and secondary education services. The central government and provincial functions for general education are summarized below.

Central Government Functions and Responsibilities

The central government is responsible for the following functions:

- The formulation of national education policy.
- The establishment of the school curriculum.
- The curricula of teacher education institutions.
- The establishment of service conditions for the four education services: the teachers service, the principals service, the education administrators service, and the teacher educators service.
- The human resource management of education administrators, school principals and school teachers at the national level.
- The publication and distribution of textbooks, and the approval of textbooks produced by the private sector.

- The provision of national level incentives, such as school uniforms and transport subsidies, to increase school attendance.
- The administration of professional development programs and courses for principals, school section heads and teachers.
- The public examinations.
- Quality assurance functions and responsibilities.
- The administration of national schools.
- National level planning, monitoring and policy analysis.

The organizational structure of the central education agencies is presented in Fig. 8.8.

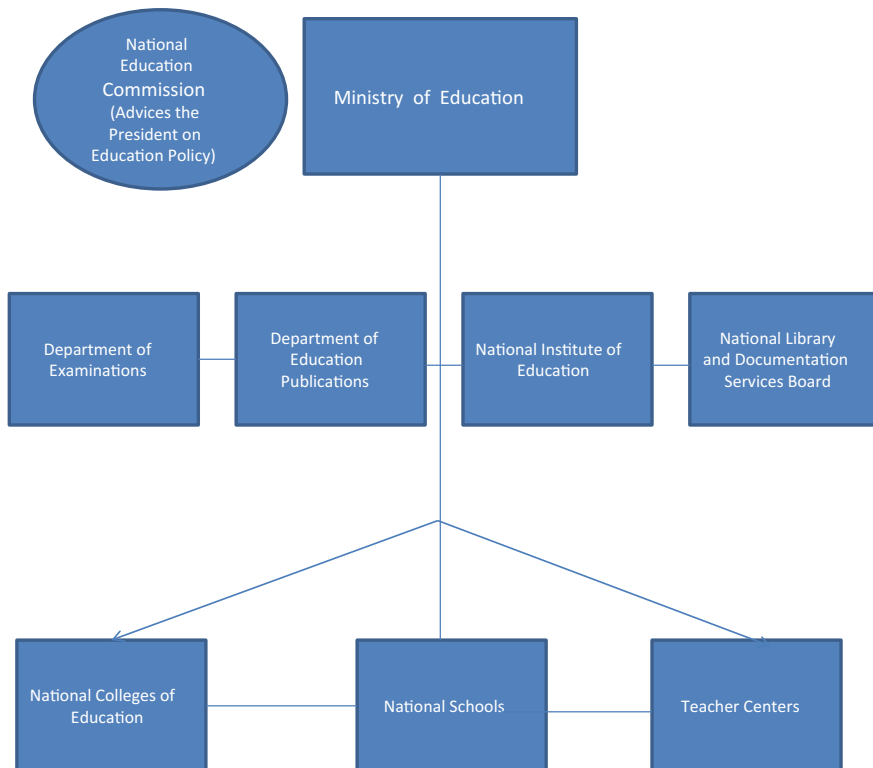


Fig. 8.8 Organizational system of the central ministry of education and agencies

8.10 Provincial Council Functions and Responsibilities

The Provincial Councils play an important role in the delivery of general education services. About 9070 schools (96% of government schools) are administered by the nine provincial councils and their intermediary education agencies, the zonal education offices and divisional education offices. The Provincial Councils are responsible for:

- The formulating of provincial education policy, within the overarching framework of national education policy.
- The preparation and implementation of provincial education sector development plans.
- The human resource management and development of education administrators, school principals and school teachers at the provincial level.
- The administration of provincial schools; and
- Provincial level monitoring.

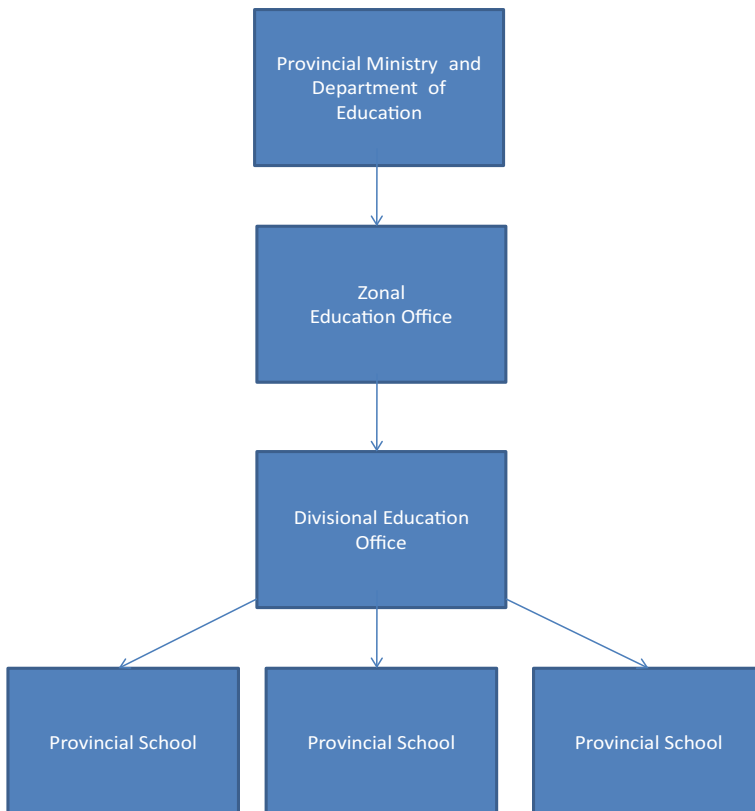


Fig. 8.9 The organizational framework of the provincial education system

The organizational structure of the provincial education agencies is presented in Fig. 8.9.

The sub-provincial level contains two administrative tiers: education zones and education divisions. There are 97 education zones, with each zone containing, on average, 100 schools. There are 315 divisions, with each division containing, on average, 30 schools. The main functions and responsibilities of education zonal offices cover human resource management of education administrators, school principals and school teachers, and the provision of facilities and equipment, for schools within their zones. Zonal officials also prepare and implement education development plans at the zonal level. Divisional education offices chiefly help schools through technical support activities, such as on-site advisory services, and monitoring.

8.11 The Institutional Framework for the Delivery of Education Services

The institutional framework for general education contains the basic organizational foundation for the delivery of education services between the Central Government agencies and the Provincial Councils. Several of the administrative characteristics of good first stage public service institutions are available. These include: (a) input-oriented line-item budgeting; (b) legal cadres of government education officials, such as education administrators, school principals, teachers, and teacher educators; (c) scope and opportunities for the professional development and career progress of administrative, teaching and technical staff; and (d) cash accounting systems. In addition, characteristics of good second stage public service institutions, such as an institutionalized performance auditing system within a supreme audit institution, the Auditor General's Department, and an internal audit within the education sector, are also present.

8.12 Incentives for Performance Within the General Education Sector

The system of incentives faced by the key agents within this institutional framework has a strong influence on the performance of the education system. These key agents include central education officials; provincial, zonal and divisional education officials; education administrators; teacher educators; curriculum developers; textbook writers and publishers; school principals; and school teachers. Government organizations typically contain both explicit and implicit performance incentives through a reward system, such as appointments to positions of higher status and income, promotions up the career ladder of the service, greater levels of

responsibility, higher job security, more interesting and stimulating work, and lower supervision. These types of performance incentives exist, in principle, at all levels of the general education system. For example, high performing teachers can become school principals, teacher educators, curriculum developers or education administrators. Capable and competent school principals can be promoted to positions of responsibility in divisional, zonal or provincial education offices. Good provincial and zonal education officials can obtain positions in the national Ministry of Education.

8.13 Regional Patterns in General Education

There are about 9900 government schools, with an enrollment of approximately 4 million students, and around 223 thousand teachers. The distribution of these schools by province is given in Table 8.6. The number of students varies between around 938 thousand in the densely populated Western Province to about 249 thousand in the Northern Province. The average school size in the country is 404 students per school, but with a range between 702 students per school in the Western Province to 263 students per school in the Northern Province. The student teacher ratio is 17 students per teacher, which is a relatively low student teacher ratio.

The pattern of student performance in national assessments of learning outcomes is given in Table 8.7. In the English Language, the highest performing provinces are Western, Central, Southern and Sabaragamuwa. The lowest performing provinces are Eastern, North-Central, Northern and Uva. In mathematics, the best performing provinces are Western, Southern and North-Western and Sabaragamuwa, while the weakest provinces are Uva, North-Central and Eastern. In science, the highest

Table 8.6 Government schools, enrollment and teachers, by province, 2012

Province	Number of schools	Number of students	Number of teachers	Average school size	Student teacher ratio
Western	1337	938,340	42,531	702	22
Central	1497	526,157	31,627	351	17
Southern	1103	510,814	29,310	463	17
North-Western	1213	478,894	28,014	395	17
Northern	944	248,720	14,825	263	17
Eastern	1063	386,001	20,757	363	19
North-Central	776	265,859	15,133	343	18
Uva	858	278,359	19,060	324	15
Sabaragamuwa	1114	370,942	22,068	333	17
Sri Lanka	9905	4,004,086	223,325	404	18

Source Ministry of Education, School Census

Table 8.7 The regional pattern of grade 8 learning outcomes, 2012

Province	English language		Mathematics		Science	
	Mean	Standard deviation	Mean	Standard deviation	Mean	Standard deviation
Western	45	23	55	21	44	21
Central	44	25	51	21	41	22
Southern	43	23	55	21	47	22
North-Western	41	25	53	22	42	21
Northern	36	24	51	21	38	20
Eastern	32	24	48	21	38	23
North-Central	33	22	47	19	41	20
Uva	38	17	46	20	37	20
Sabaragamuwa	43	19	53	21	43	21
Sri Lanka	40	23	51	21	42	21

Source National Education Evaluation Center (NEREC), University of Colombo

performing provinces are Southern, Western and Sabaragamuwa, while the lowest performers are Uva, Northern and Eastern. The Western, Central, Southern, North-Western and Sabaragamuwa Provinces, which are relatively wealthy and educationally developed areas of the country, consistently show superior performance in the national assessments of learning outcomes. Regions such as Uva, North-Central, Northern and Eastern Provinces are educationally less developed, and the weaker learning outcomes are a reflection of this situation. The variations in the performance of students on learning outcomes across provinces and regions in Sri Lanka have been identified in previous studies, too (Aturupane 2008).

Public investment in education among the provinces, which seeks to promote balanced regional growth, has an equity orientation. Poorer and educationally more disadvantaged provinces receive greater resources, on a per student basis, than wealthier and educationally more advanced provinces. This is evident in Figs. 8.10 and 8.11, which shows public investment in education among provinces in relation to the proportions of students passing the GCE O/L and GCE A/L examinations. According to the information in Fig. 8.11, the highest per student investment is in the Northern Province, which has the lowest GCE O/L pass rate. Other Provinces with relatively weak performance at the GCE O/L examinations, such as the Uva Province, has comparatively high public spending on education per student. In contrast the province with the highest GCE O/L pass rate, the Western Province, has the lowest per student public investment in education. According to the information in Fig. 8.11, again the allocation of public education resources is generally progressive. Provinces with weaker performance, such as Eastern and Central, and disadvantaged regions, such as the Northern Province, receive greater resources per student than wealthier regions such as the Western Province.

These outcomes are the result of direct government policy to allocate greater resources for poorer regions. However, it should be noted that the pattern of resource allocation is not fully progressive: some provinces with relatively better

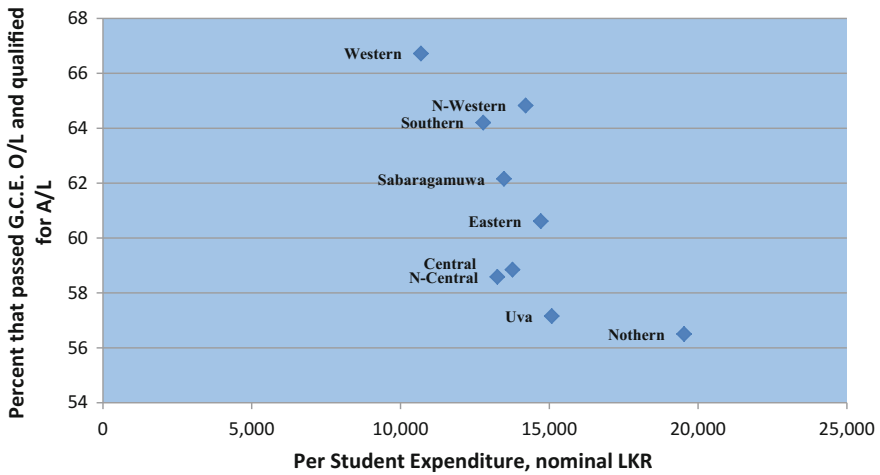


Fig. 8.10 Public investment in education in relation to GCE O/L examination performance. *Source* Calculated from Ministry of Education and Ministry of Finance and Planning statistics

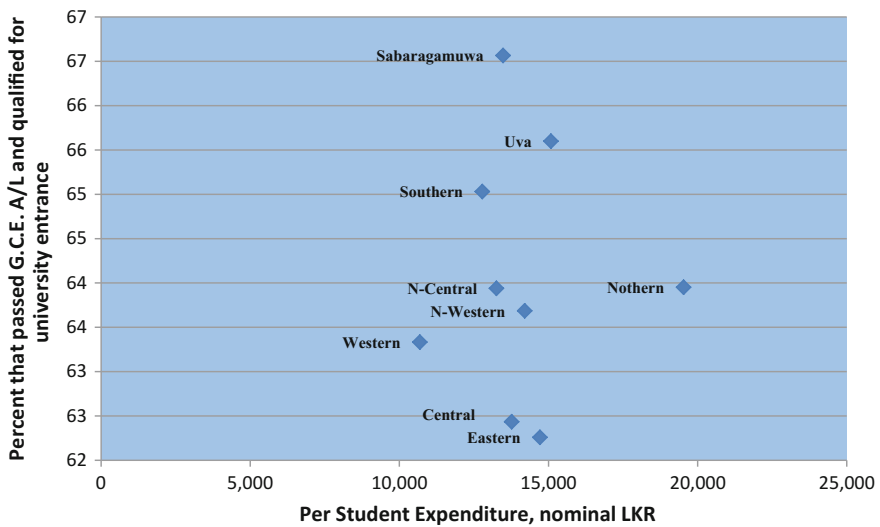


Fig. 8.11 Public investment in education in relation to GCE A/L examination performance. *Source* Calculated from Ministry of Education and Ministry of Finance and Planning statistics

performance, such as the North-Western Province, have higher per student public education spending, especially at the GCE O/L stage. But it should also be observed that it is not possible to link spending fully to equity based on performance at examinations. There are many elements at play in the determination of

examinations performance, over and above the volume of resources invested. Overall, among the regions there is a high degree of equity in public education investment.

8.14 Empowerment of Schools in Sri Lanka

The Government of Sri Lanka has an innovative initiative called the Programme for School Improvement (PSI) to empower schools and local school communities (MOE 2005; Perera 2006). This initiative was influenced by policies in developed countries, such as the U.S.A., the U.K., Australia and Canada, as well as developing countries in East Asia and South Asia, to devolve managerial power and responsibility to schools. The objective is to strengthen the delivery of education services by enabling schools to become increasingly self-managing, with strong community involvement.

The PSI was introduced on a pilot basis in 2006, and was very popular among school communities, including principals, teachers, parents and local community members. Among this group support for the PSI has been nearly universal. In particular, schools principals and teachers state that they feel more empowered and motivated. This echoes results from school-based management initiatives in countries such as Hong Kong, China (Dimmock and Walker 1998) and Israel (Gaziel 1998) where, principals and teachers expressed perceptions of greater empowerment, commitment and achievement-orientation. Local school community members also felt that they experienced greater voice and influence in the management of schools after the introduction of the PSI. This is similar to results in countries such as El Salvador where, local community members communicated a sense of greater efficacy and commitment towards the school (Sawada and Ragatz 2005).

The PSI showed a positive impact on learning outcomes of student in Sri Lanka. A rigorous impact assessment, based on a randomized evaluation and conducted over the period 2006–2008, found that participation in PSI was associated with a significant increase in the mathematics and English language test scores of primary school (grade 4) students (World Bank, EFA-FTI 2011). This is an important finding, as improvements in learning outcomes through school-based management policies are not universal. There are, however, other countries that have experienced favorable outcomes, including El Salvador, Kenya, Mexico and Nicaragua (Barrera-Osorio et al. 2009).

Several factors have contributed to the positive results of school-based management in Sri Lanka (Aturupane et al. 2013b). The leadership provided by dynamic and well-motivated schools principals is of central importance. In addition, greater teacher and parental involvement in the education process, both at school and in homes, is very important. Also, school development committees raised resources, both financial and in-kind, for their schools. Further, the government, with support from donors such as the World Bank, provided grants to schools.

These funds were used for curriculum-related activities such as the purchase of children's story books for the library, and trips by school children to places of cultural and historical interest. In addition, the increased resources were used for co-curricular and extra-curricular activities such as literary events and drama, and athletics, games and sports.

School principals and teachers communicated that the involvement of parents, past pupils and local community representatives stimulated and invigorated their schools. Parents were encouraged by the opportunity to be involved in the administration of the schools, and considered that it gave them greater commitment towards the education of their children. Past pupils of schools viewed their assistance as "returning something" to the schools in which they had been educated (World Bank, EFA-FTI 2011).

The Government of Sri Lanka, based on the success of the PSI pilot, has deepened and scaled-up the PSI (MOE 2012). This is a promising new area for the future development of the general education sector (Aturupane et al. 2013b).

8.15 Conclusions and Recommendations

Sri Lanka enjoys high economic and social benefits from investment in education. However, in recent years, public investment in education has been relatively low. The country will need to increase the flow of resources into the education sector to develop the general education and higher education systems. Middle-income countries with economies more developed than Sri Lanka in East Asia, Latin America, and Eastern Europe, devote substantially more resources to education. In order to invest sufficient resources in modern equipment and technology, and to enable Sri Lankan students to acquire the skills and expertise needed for modern knowledge-intensive economic processes, the country will need to raise investment in education.

The provinces, with their internal education administration tiers such as zones and divisions, have a major role to play in the delivery of education services in the current policy environment. Strengthening the provincial and sub-provincial levels, with adequate resources, is very important for the equitable development of the education sector, as the majority of children from poor and low-income households attend provincial schools. Greater policy attention also needs to be given to the poorer provinces, to promote the balanced development of the national education system.

The empowerment of schools through the Programme for School Improvement is also a promising initiative to take forwards. In particular, it would be useful to provide greater fiscal powers and responsibilities to schools. Sri Lanka has been successful in initiatives involving school level spending, such as the Norm-Based Unit Cost Resource Allocation Mechanism (NBUCRAM). Policy makers can build on these successes to provide school-based learning enhancement grants to schools.

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Chapter 9

Women's Representation and Political Engagement in Local Governments: Evidence from Sri Lanka

Kamala Liyanage

9.1 Introduction

The Constitution of Sri Lanka (1978) guarantees all women the fundamental rights to equality. “No citizen shall be discriminated against on the ground of race, religion, language, caste, sex, political opinion, place of a birth or any one of such grounds” (The Constitution of Democratic Socialist Republic of Sri Lanka 1978, 12 (2)). Furthermore, it also recognizes equal political rights for men and women. Sri Lanka has ratified the International Covenant on Civil and Political Rights (1966) and the Convention on the Elimination of All Forms of Discrimination against Women (1981), which stresses that men and women should have equal rights in all sphere of life. Moreover, Sri Lanka has guaranteed women's rights by issuing the Women's Charter in 1993. In this context one can be very positive about the equal political rights of Sri Lankan women which have been legally guaranteed.

Achievements of Sri Lankan women in terms of literacy, education, health, physical quality of life and life expectancy are remarkable. Sri Lanka has a Human Development Index (HDI) for women which is praiseworthy and is often cited as a model for developing countries (Hand-book on Sex Disaggregated Data: Sri Lanka, 2003). In the professional sphere, many Sri Lankan women have reached the top level, e.g. Chief Justice of the Supreme Court, Solicitor General, General Managers of national banks, Commissioner of Inland Revenue, Department of Labour, Post Master General, Vice Chancellor and Secretaries to the Ministries. Moreover, Sri Lanka produced the first women prime minister in the world (1960) and the top most positions of the government—the presidency and the premiership—were held

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by two women at the same time (1994–2004). However, one of the more striking features in this commendable record is the gap between these achievements and their under-representation in the sphere of politics.

9.2 Objectives

Several studies on women and politics in Sri Lanka have been done by various individuals and groups (De Alwis 1995; De Alwis and Jayawardena 2001; De Silva 1979, 1985, 1995; CENWOR 1994; Gomez and Gomez 2001; Jayawardene 1995; Kamalawathie 1984; Kiribamune 1998; Kodikara 2009; Leitan 2000; Liyanage 1992, 1996, 1998a, b, 2000, 2001, 2002, 2003, 2006; Mettananda 1981; Wijesekara 1995) and they have highlighted various problems faced by women in the sphere of politics. However, very limited studies have been done so far on women in local governments in Sri Lanka, (Kiribamune 1994; Liyanage 2004, 2005; Thambiah 2002; Leitan and Gunasekera 1998). This is a significant lacunae because typically individuals with political ambitions start their political careers in local governments and then move up. Thus understanding the participation or the lack thereof women in local government politics in Sri Lanka will help us better understand why they are under-represented at the two upper tiers—provincial and national levels of politics.

The present study has four major objectives: (a) to analyse and evaluate the results of the last (2011) local elections; (b) to analyse the strategies adopted by winning and non-winning candidates, both male and female in 2011 or in previous local elections; (c) to examine and identify the obstacles and challenges faced by Sri Lankan women in the local level political arena and (d) to suggest some recommendations for potential women candidates to plan their election campaign strategies for the next local elections.

9.3 Methodology

To gather information for this study, during the first five months after the local elections in 2011, interviews with 26 female candidates (7 successful candidates, 13 defeated candidates and 6 candidates who were not given the nomination tickets), 19 male candidates (14 successful candidates and 5 defeated candidates), 6 administrators, 4 journalists, 9 civil society activists and the coordinator of the Human Rights Commission (Central Province) were conducted. Sixteen case studies were done with 11 female elected local representatives and 5 defeated female candidates.

Furthermore, Focus Group Discussions (FGDs) were held in 15 *Pradesheeya Sabha* (Village Council) divisions, from Feb. 2010 to July 2011:

Local Govt/Pradesheeya Sabha divisions	Number of participants
Udunuwara	18
Pathadumbara—Wattegama	20
Ambagamuwa	18
Nuwara Eliya—Lindula	20
Kandy—Gangawata Korala	19
Matale	19
Yatinuwara	20
Gampola—Udawalpala	18
Hatton	20
Harispattuwa—Poojapitiya	20
Dambulla—Nawula	19
Galewela	18
Pallepola	19
Kotmale	18
Ukuwela	21

The FGDs consisted of male and female elected representatives of local governments, candidates, male and female applicants for nominations, local level administrators, party local leaders, Women's Development Officers (WDOs), party supporters and activists, religious leaders, human rights activists, election monitoring officers and local election officers, local journalists, community leaders and active members of *Kantha Samithis* (Village Women's Society), and voters who were knowledgeable on this issue. In identifying the key informants for interviewees and members of the FGDs,¹ assistance was given mainly by some Chair Persons of local governments, Divisional Secretaries and the WDOs.

9.4 Political Representation of Women: Feminist Arguments

The gross lack of adequate representation of women in all spheres of influence in public life reflects a significant loss of human resources to the nation. Also, it raises serious questions about the validity and reliability of the decision-making process

¹All interviews and FGDs were conducted based on five main questions: Why is it necessary to have women representatives in the local elected government? What are the reasons for women candidates to be defeated? What were the strategies used by male candidates who won the local election? What were the strategies used by the female candidates who won the local election? What strategies should be used by female candidates to win the next local election?

itself. Several arguments have been put forwarded by feminist political scientists to support the equal representation of women in public bodies. The presence of women already in elected bodies is evidence of the existence of equality between men and women in our society and hence strengthens the legitimacy for equal rights and equal opportunity. It also will promote participatory democracy, democratic political systems, institutions and processes, good governance and peace. It is a matter of distributive justice that women should have a share in positions of power and authority commensurate with their demographic weight or their contribution to society. It also will guarantee or assure equal citizenship and rights to women. It is a matter of social utility that the pools of talents from which public bodies are recruited should be effectively doubled and that the decision-making process should be enriched by, e.g. the nurturing experience of women. Besides, by participating at decision-making levels, women will be able to make qualitative changes in their lives and to develop their leadership skills as well. It is important for women as a group that women should be well distributed in positions of power and authority. It is also important because it provides role models for individual women by making them more satisfied with their leadership role and their contribution to the nation. Moreover, women's participation in politics will give them more confidence to work with society at large. It is important for women as a group, distinguished by their reproductive role (whether potential or actual), to be represented by those who share such a role so that they will protect their interests. The increase of the number of women in political institutions can create positive attitudes towards conventional politics. Democratic, sincere, flexible, committed, hard-working, thrifty and less corrupted women can create more women-friendly political institutions and processes. This will contribute to the change in the nature of political institutions and the political culture (Boutilier 1970; Currel 1973; Valence 1979; Kohn 1980; Norris 1987). According to the concept of gender and development, women should be given opportunities to plan and implement development strategies. Only then can a country achieve sustainable development (Boserup 1970; Whitehead and Bloom 1992).

9.5 Experiences of Women in Local Governments

Local governments have been considered as training grounds for future political leaders. In ancient Sri Lanka, there were local and regional governments but no evidence is available about women's participation in those institutions. During the British colonial period the Sri Lankan local government system was revised and a new system was introduced in 1865 (Leitan 1979). According to the Municipal Council Ordinance of 1865, first the Colombo Municipal Council was established and later Kandy and Galle Municipal Councils were established. In the late 19th and the beginning of the 20th Century Sanitary Boards, Local Boards and Village Councils were established by the British colonial rulers. In 1920 The Village Council Ordinance was introduced and changes were made to the old

village councils. However, women were not given the limited franchise and they did not represent the local governments.

The Donoughmore Commissioners realized the necessity of reviving the local government system in Sri Lanka and recommended an Executive Committee of Local Administration responsible for local government. Though universal suffrage was introduced to both women and men in Sri Lanka in 1931, local government elections were conducted on the basis of universal suffrage after 7 years. This was done through an Ordinance of 1938 which introduced significant changes in local bodies (de Silva 1995).

By the era of independence in Sri Lanka there were four types of local governments, viz. Municipal Councils, Urban Councils, Town Councils and Village Councils (Warnapala 1993). In 1981 Gramodaya Mandala was introduced to village areas but it was not a successful experiment (Kamalawathie 1984). In 1987 Provincial Councils and *Pradesheeya Sabhas* were introduced and the government decided to retain the existing Municipal and Urban Councils. Though the local government system changed from time to time, women's role in them was minimal. The first female representative in local government in Sri Lanka was Dr. Mary Rutnam, who was elected to the Colombo Municipality in 1937. In 1949 Ayesha Rauff was elected to the Colombo Municipal Council and she continued her political life by contesting several times to the Municipality. She later became the Deputy Mayor of the Colombo Municipality.

In 1979 Chandra Ranaraja became the Deputy Mayor of Kandy municipality and later she was elected as a Mayor. Nalin Thilaka Herath too was elected as the Mayor to the Nuwara Eliya Municipality in 1996. Mrs. R.E. Jayathileke, Nirupa Karunaratne and Kanthi Kodikara have served as Chair Persons of Urban Councils. After the 2011 local elections (until 2015) one woman was selected as the Chair-person of an Urban Council and another as a Vice Chair-person and eight women were selected as Chair-persons of *Pradesheeya Sabhas*.

While the percentage of Sri Lankan women's representation in the parliament has been below 6% since 1977, the percentage of Provincial councils has been below 5% since its inception in 1987. The percentage of women's representation in local governments (Municipal and Urban Councils and *Pradesheeya Sabhas*) was 1.9% in 1997, 1.8% in 2004 and 1.9% in 2011.

Thus, the local governments have not served as good training grounds for women politicians in Sri Lanka. As Robert Kearney pointed in 1981: "Prospects for service in local government bodies are so limited for women almost to the point of non-existence. The small number of women in local government is a significant impediment to women's access to national politics" (Kearney, July 1981). It has also become an impediment to improve women's status mainly in rural areas in Sri Lanka (Liyanage 2002).

Several studies (Kiribamune 1994; Liyanage 2004, 2005; Thambiah 2002; Leitan and Gunasekera 1998; Kodikara 2009) have identified major obstacles that prevent women from taking part in local politics. These studies reveal that lack of confidence of women regarding their political leadership, lack of political experiences and training mainly due to the gendered socialization process, lack of support

of the political parties, media, community and voters, violence against women and character assassination, financial problems mainly due to high cost of elections, attitudes of the society towards women's political leadership and patriarchal values and cultural taboos and the weakness of the proportional representative system as major practical impediments faced by women in entering local politics.

9.6 Efforts of Government and Non-governmental Organisations (NGOs) to Address These Issues

After the 1970s some women's NGOs, activists and female academics influenced the political parties to take necessary actions to solve some of these problems faced by the women. As a result, both the major parties (United National Party (UNP) and the Sri Lanka Freedom Party (SLFP) and the coalition—*Samagi Peramuna* included some of the women issues into their election manifestoes (1977) and promised to solve them if they obtained the governing power. At all general elections, which came after this, both major parties and some smaller parties such as the *Jantha Vimukthi Peramuna*, and the socialist parties, incorporated women's issues and relevant promises to their election manifestoes. In 1994, 12 women's organizations jointly issued a Women's manifesto which calls for the introduction of quota for 33% representation women at local government levels. This manifesto was presented to major parties at general elections of 1994, 2000, 2004 and 2010 by women's groups. Though both the major parties promised to increase the number of women in the election nominations, it has not become a reality. This is true even when Sirima Bandaranaike and Chandirka Kumarathunga were in power. Probably most women who were or have been in politics were/are women who benefitted from family connections and had/have no genuine desire to help women.

Recently some NGOs and few government organizations have paid some attention to awareness raising and leadership training programmes for aspiring women to run mainly for local elections. In 1985 a 'Centre for Training of Rural Leaders' was established in Embilipitiya. This conducted mainly leadership programmes for youth, but not exclusively for women. After the early 1990s the Department of Rural Development, the Local Government Training Centre, Sri Lanka Institute of Local Governance, South Asia Partnership—Sri Lanka, Centre for Women's Research, Friedrich—Ebert Stiftung, Konrad Adenaur Stiftung, Muslim Women's Research and Action Forum, too paid some attention to women leadership trainings programmes. In the late 1990s the Sri Lanka Foundation Institute and the Asia Pacific Forum on Women, Law and Development also organized several workshops to give political training to women. The National Committee for Women, Women's Bureau, *Sinhala Kanthabivurdhi Sanvidhanaya*, Agromat, National Peace Council and National Democratic Institute too trained some women mainly for local elections (Liyanage 2004; Kodikara 2009). In the late 2000s, Viluthu—Center for Human Resource Development—Jaffna,

Association for War Affected Women, Women and Media Collective, Women's Education and Research Center, Sarvodaya Women's Movement, International Movement Against All Forms of Discrimination and Racism (IMADR), Women's Development Center (Badulla), Women for Peace and Good Governance (WPGG)²—Kandy, Women's Resources Center (Kurunegala), Sinhala-Tamil Rural Women's Network, Socio Economic and Environment Development Organisation (SEEDO)—Monaragala, Mothers and Daughters of Lanka organized some training programmes for women activists in rural areas. The majority of these programmes were short-term and covered a range of sessions: such as concept of gender, women's rights, good governance, advocacy and lobbying, media and campaigning, networking, Building leadership skills and qualities, government structure of Sri Lanka and the local government system etc. Some of these organizations organized visits to local government offices or party offices with the objective of creating understanding of the functioning of them to women trainees. Some used media and poster campaigns to raise public awareness on this issue.

9.7 Data Analysis: The Necessity of Women Being Represented in Elected Bodies

Majority of the FGD respondents (95%) said that it was necessary for women to be represented in all levels of elected bodies. The reasons the majority gave for their response are given below. Women who constitute half of the Sri Lankan population have needs and interests that differ from that of men's. Some members of the FGDs stated that Sri Lanka being a democratic country right to represent elected bodies is a right given equally to all men and women. A female Deputy Mayor of a Town Council said that "Women are also citizens of this country and equal rights of both male and female are constitutionally guaranteed. Therefore, women should have equal rights as men enjoyed in political representation. At elections many women play various subordinate roles and support male candidates. That is not sufficient and they also should be considered as first class citizens of this country by giving them the opportunity to represent in elected bodies." Furthermore she said "Experiences, views and opinions of men and women are sometimes different.

²The WPGG implemented a 4 year (2009–11) project (funded by Women Defining Peace (WDP)—a project funded by the Canadian International Development Agency (CIDA), World University Service of Canada and Cowater International) with 238 *Kantha Samithis* in the Central Province, on Increasing Women's Representation in Local Governments. It trained 87 identified women community leaders to run for the 2011 local elections, conducted 38 awareness raising programs on concept of gender, women's rights and importance of women's political representation, influenced political parties to obtain nomination tickets at the 2011 elections, supported women candidates to run for the election and organized 43 mobilisation meetings at local levels to increase the voter base of women. However, with all these efforts, only 7 women in the Central province won the local election.

They look at the same issue in different approaches and find or suggest different solutions. Therefore, I think having both women and men in all decision making levels is an essential factor in achieving democracy, good governance and sustainable development. If any country excludes women from the main stream politics that will never be able to achieve those”.³

Many respondents of FGDs and interviewees felt that women face issues related to access to drinking-water, garbage, un-authorized building constructions, public toilets, day care centres, domestic violence, drugs, alcohol and security. Such problems can be understood better by a woman; they are more sensitive to issues related to women, as well as children. Thus it is important to have female candidates mainly in local elected bodies. A Chairman of a PS said “there is only one female member in our *sabhawa* and she discusses mainly on problems faced by women, for example issues related to drinking water, garbage, un-authorize building constructions, public toilets, day care centers, domestic violence, drug and alcohol and security. Before she comes we really have not paid much attention to such issues. Now we realize the importance of women’s presence. Another male member of the same PS said that having women in all decision making bodies is a timely need in Sri Lanka because they have gained achievements in various areas and play active roles in society.”⁴

Moreover, many interviewees (around 86%) from the *Pradeshheya Sabha* claimed that, since most of the functions of the *Pradeshheya Sabha* are connected to the lives of women and children, it is important to have female candidates as part of it. They also claimed that women from the villages of the country suffer more than men due to the lack of infrastructure facilities, poverty, violence etc. These women need the support of female leaders. Sri Lanka being a democratic country has to represent both men and women equally in elected bodies. Women need to be respected as citizens of the country. Having both women and men in all decision making levels is an essential factor in achieving democracy, good governance and sustainable development. Progress of the country cannot be achieved by ignoring more than half the population’s interests and necessities. Moreover, since women in Sri Lanka have gained achievements in various areas, many interviewees (around 73%) felt that it is high time that they are given a chance to be part of decision making bodies.

A female Provincial Council member said that “Women have different biological and social roles. Therefore, they are more sensitive to the issues related to women and children and it is not only their rights but also their duties to represent their needs and interests. Then only the status of women and children can be improved”.⁵

³The information was extracted from FGDs conducted in Yatinuwara PS division on 5th April, 2010.

⁴The information was extracted from FGD conducted in Akurana PS, on 7th Dec. 2010.

⁵An interview done with a female Provincial Council member—Central Province, on 10th March 2010.

Including women in elected bodies can be an initiative to change the patriarchal structure of these bodies and of the society itself. The majority of the respondents (71%) claimed that women in Sri Lanka have been suppressed, oppressed, marginalized, subordinated and exploited due to the patriarchal culture since the beginning of its history. Giving them equal opportunity to participate in elected bodies can be an essential step to change the nature of society. Having female leaders in the political body of the country will be an encouragement and an inspiration for younger women to take up roles that are usually considered 'un-womanly'. This idea was given by around 69% of the respondents of the FGDs.

An observation made during the interviews and the FGDs was that the majority of the respondents also felt that the different characteristics and behaviour patterns of a woman can be of assistance to the nature of the political culture of the country. That is to say, more than 50% of the interviewees claimed that the presence of a woman in a local elected body can create a more 'decent' and less violent atmosphere. Also, many claimed that women are protectors of the family, society and the nation and thus, their contribution to the politics of the country is important. Many female and some male respondents mentioned that women are different; they are socialized in a different manner and their experiences are also sometimes different. Therefore, they behave differently and it will change the nature of party politics in Sri Lanka. One chairman of a PS said "When a woman is in the *sabhawa*, our men behave nicely and they are more decent. Even one woman can change the whole atmosphere of the *sabawa*. I think we may have less corruption, less thuggery and more democracy and transparency in the *sabawa*, if we have more women."⁶ A similar view was emphasized by a female vice chair-person of a Town Council in the following manner. "Women should be represented in all elected bodies. If women are representing in these bodies the functioning of them and the nature of politics will be better. Did you notice how the elected male members are behaving in the Parliament? It is very ugly that aggressive and violent nature will be changed and male will be little more disciplined if more women are there".⁷

A Chairman of a PS pointed out that "Women are a great asset for us; they are more committed and thrifty. In the Patha Dumbara area most of the social welfare activities are done by women and many CBOs are led by women. Majority of the functions of the PS are connected to the lives of women and children. Therefore, I believe that there should be more women members in all PSs. In Sri Lanka village level women suffer more than men due to lack of infrastructure facilities, poverty and violence etc. If we have at least few women in the PS they can pay more attention to their own issues."⁸ Another Chairman pointed out: "women protect the family, society and the nation. According to my evaluations about 80% of votes

⁶An interview done with the Chairman of the Wattagama *Pradesheeya Sabhawa* on 7th Dec. 2010.

⁷An interview done with the vice chair-woman of the Kadugannawa Urban Council on 6th April, 2011.

⁸The information was extracted from FGD conducted in Patha Dumbara division on 22nd April, 2010.

received by me are given by women. If they can contribute to the social, economic and cultural development of the country they definitely can contribute their service to politics too. Since women can speak to other women's hearts or can read their minds very easily, can behave openly with them, have closer relations with them, and represent their problems better than men do. Therefore women should be represented in all levels of decision making bodies". An opposition leader of the same PS stated that "Our women work harder than men do. Many men are just idling. Women are more committed and they are more sensitive to issues in rural areas. Women generally are scared of corruption and violence. I think women can do a lot to change the present political context in Sri Lanka".⁹

9.8 Women's Minimal Presence as Representatives in Local Governments

In Sri Lankan local governments, the percentage of women's representation in 1991 (first election after the 1987 Constitutional amendment) was 1.7 in 1997—1.9, in 2006—1.8 and in 2011—1.9. While 4465 men were elected in 2011, only 87 women could win the elections. It is the lowest percentage among South Asian countries. The highest number of women (30) was elected by the Western province and the next (11 women) highest was elected by the Northern Province. The Central and Eastern province each elected 9 women, Southern province had 7 women, North Western had 6 and North Central, Sabaragamuwa and Uva provinces each had 5 women representatives. Among them one woman was selected as the Chair-person of an Urban Council (UC) (Kanthe Kodikara—Maharagama UC) and another woman as the Vice Chair-person of an UC (M. Fawaina—Kadugannawa UC). Eight women were selected as Chair-persons of *Pradesheeyasabhas* (MedaDumbara, Gomrankadawala, Manmunei, Nallur, Walikamam, Weligepola, UvaParanagama and Rideegama).¹⁰

9.9 Challenges Faced by Women at Last Local Elections (2011) in Sri Lanka

The majority of women applied for election nomination in 2011, stated at interviews that difficulty in obtaining the nomination was the main obstacle to expose their skills in politics. Nomination tickets are usually difficult to obtain for men as

⁹The information was extracted from FGD conducted in Ambagamuwa division on 29th April, 2010.

¹⁰The information was provided by Ms. Hemanthi Gunasekera and Sunethra Arawwawala, Federation of Sri Lanka Local government Authorities, Colombo.

well, mainly due to nepotism. However, due to women's gender status they are pushed into a more disadvantage positions. A female candidate who applied for nomination at 2011 local elections pointed out that "I have been with the Sri Lanka Freedom Party (SLFP) for more than three decades. When the party was in difficult situations I supported *Methiniya* (Madam Bandaranayake) and Anura Bandaranayake. In 1978 I was imprisoned due to my political activities but I did not give up them. I submitted applications for seven local and provincial council elections. I came to know this time I would be given nominations and went to Temple Trees to sign my application. However, I was informed that my name was removed by the party organizer, who felt insecure. I do various social activities but they do nothing. Recently they wanted to open a bar in our town but we worked against it and influenced some leaders of the government, including the President of the country. As a result, they could not open it. They know if we are elected they can't do such things—that is why they deleted my name".¹¹

An elected female member to *Pradesheeya Sabha* (2011) also gave a similar story. "I gave my service to the United National Party (UNP) for last 18 years. I worked as the President of *the Lak Vanitha* and *Srama Shakthi Sanvidhana*¹² in my area. When I went for interviews to obtain nominations, members of the selection board appreciated activities done by me. However, due to the internal conflicts of the party organizer with a female Provincial Council member that I closely associated, my application was turned down. I heard that the party leader and one deputy leader too influenced the party organizer to change his decision. However, finally nomination was given to a sister of the organizer".¹³

Two women candidates who challenged their party and got nominations through an independent group said that major problems they faced were getting nominations and political violence during the campaign. One said "Both of us were promised by our party leader and his wife too, since we have been with that party since our childhood. Our family members are also very active supporters. But until the last minute we were cheated—when the selected nominees were about to leave for Colombo to sign the nominations we rushed to his office. Then he asked a man to resign voluntarily but nobody came forward. We argued but nothing changed. We knew that the independent groups are not popular in Sri Lanka, but we decided to challenge him and joined an independent group. Unfortunately, a powerful Member of Parliament in our area did not allow us to organize at least one meeting. Our posters were destroyed and supporters were threatened. On the day of the election his thugs did not allow us to go to the counting centers—we think that our votes were robbed."¹⁴

¹¹The information extracted from an interview done with a female candidate who applied for nominations in 2011, in Hatton—on 29th April, 2011.

¹²Community Based Organisation which is supported by a female Provincial Council member in Yatinuwara area.

¹³The information was extracted from an interview conducted with a female UNP activist in Menikdiwela on 30th April, 2011. This candidate crossed over the party and won the election in 2011.

¹⁴Information was extracted from interviews done with two female candidates of Udapalatha on 28th April, 2011.

Another female candidate who challenged her party gave a similar story in this way. “I worked for the SLFP for 17 years and served as the secretary to the *Kantha Bala Mandalaya* in my electorate. During the presidential, parliamentary, and provincial elections I took the leadership to establish women’s groups and to mobilize them to get their votes for the party candidates. The present Deputy Minister in our area knew about all these activities and asked me to apply for nominations. I applied for the last provincial council election but he informed that his brother who comes from Japan should be given the chance this time and mine will be considered next time. I kept quiet but later continued the support. Then I applied for the Municipal election, this time he told me that his second brother who comes from Italy should be given the chance...”¹⁵

A story given by another female applicant also proves that factor. She said that “I have been working with the SLFP since 1996 and assisted the party, mainly during elections. I took the leadership to establish women’s caucuses in many villages, and to organize women’s meetings. Also went to thousands houses with candidates during the election campaigns. Thus my activities also contributed to win the last Presidential, parliamentary and provincial elections. Several ministers, MPS and senior party leaders encouraged me to run for local elections and gave me hopes too. I did various social-welfare activities and, presented 15 files with the relevant documents. The Interview board told me that I have earned highest marks and they advised me to collect some funds and to prepare the posters and pamphlets etc. But as usual I was cheated, at the last minute I was told that due to the high competition I was not selected. I was shocked, very disappointed and stopped assisting the People’s Alliance (PA) candidate in my electorate. However, I decided to assist another PA candidate in a different electorate since he told me that he would help me in the future. Then the serious thing was that I was threatened by the thugs.”¹⁶

Another female candidate said that “our organizer is an authoritarian fellow who does not listen to leaders or voters. He gave the first preference to his son and then gave nominations to three other close political associates. But the nomination list was filled by including ‘dummies’ because he just wanted to make his son the chairman of the PS. He purposely did not give nomination to women because he was scared about us.”¹⁷

Thus, these types of cheating women candidates are quite common in Sri Lanka. But the most unfortunate is very few women challenge such parties and the women activists of the parties also do not make any voice against these unfair practices.

The majority (around 82%) of the male interviewees also expressed similar views. One Chair Person of a PS said that “the party organizer give the nomination first to the former PS elected members, then to the relatives of the leaders, next to

¹⁵Information was gathered from an interviews done with a woman who applied for candidacy in Matale—on 20th April 2011.

¹⁶Information gathered at interview done with a female candidate in Gangawata Korale—on 19th March, 2011.

¹⁷Information was gathered from an interview done with a female candidate in Maskeliya—on the 22nd March, 2011.

very powerful candidates who have assisted the party in various ways, and to the youth. Finally, women have no place and every time they are cheated".¹⁸

According to a male Chairman of a PS that it was very difficult even for a man to obtain nominations. He explained his experiences to us in this way. "I have applied 11 times for nominations and I got it only last time. There are many vicious things and under cuttings happen during the nomination procedure. I think whether a male or female candidate, one must be patient. The most important thing is not to leave politics after such failures, but to continue our social work and gain popularity, build leadership and establish closer relations with the decision makers of the party. Once you enter the game you can continue it if you are smart/clever".¹⁹

Another major reason for women's failure given by the interviewees and Focussed Group Discussions (FGDs) is lack of **long term experience and leadership in the society**. The majority of male respondents, especially the winning candidates who have more than 15 years of experience, claimed that women are often defeated as they **have no experience in political activities and find it difficult to invest their time and energy on gaining popularity, acceptance and recognition in society**. The majority of them felt that women can be successful only if they start from grass root level and play the role of a leader in political organizations, trade unions etc. It is only if their voice is heard that they will be recognized as leaders. Also, women are supposed to be responsible of their households. Thus they do not find enough time to do the activities those are to be done as a candidate of an election.²⁰

Around 73% of respondents stated that women **lack experience in party politics** and they are less committed. One male member of the PS said "Women are not courageous, not committed enough, they just enjoy their subordinate positions in this patriarchal culture. They consider themselves just as women and confine their lives to families/homes. They must take the challenges to win the elections and to survive in the political world".²¹

Many members of the FDGs (75%) and interviews emphasised that due to **the lack of senior women leaders support and mentoring**, women could not win the elections. Generally junior male politicians are mentored by senior male politicians and juniors have established effective network among persons of various strata due to these relationships with seniors. But regarding junior women politicians, such informal mentoring and networking with seniors are minimal. A male party official said that "the women in parliamentary (except one) do not pay any attention to this issue. They are not at all worried about other women in this country and they just want to enjoy the privileges that they have. Most of the male leaders are groomed

¹⁸The information was extracted from an interview conducted with a Chair Person of a PS at Wattegama, on 7th April, 2011.

¹⁹The information was extracted from and interview done with a Chair Person of a PS in Ambagamwa on 24th April, 2011.

²⁰Information gathered from a Provincial Council Member in Kandy—on 12th March, 2011.

²¹Information gathered from FGD's conducted in the Central province—on 12th June, 2011.

by senior leaders of their parties, but can you identify at least few women who were pushed into politics by senior women? That is pathetic.”²²

A similar view was given by a Chairman of a PS too. He pointed out that “many senior political women in Sri Lanka have not been much successful in their career, because they have entered the political arena immediately after the absence of a male member of a political family. Therefore, they have not been able to keep special political records in the Sri Lankan political history. Furthermore, they have not contributed positively to build the image of other political women in Sri Lanka. Nor have they encouraged other women to enter politics.”²³ Though it is hard to fully agree with this statement, their lack of support is visible in increasing women’s political representation.

According to many members of the FDGs and interviewees (73%) the **violent political culture has become a serious impediment to women’s success in the 2011 local elections.** The special characteristics of Sri Lankan party politics are losing voters’ trust in politics and politicians, voters’ dependence on the material support given by the candidates, severe competition among candidates, violence, threats, thuggery and distrust about the present election system. According to a former Secretary to the Ministry of Women’s Affairs, this has become a major factor which negatively influenced women candidates. She said that “I see the Sri Lankan political culture as the biggest impediment to women’s political success. Violence, threats, male domination and lack of party organizer to give nominations also have been negative factors for women’s representation”. She said that many party organizers say that they want to give nominations to the “winning horse”, but she further questioned, without giving the chance how they can say whether women are winning horses or not?²⁴

All most all the women candidates pointed out about the nature of violence that they faced. Some were threatened, not allowed to organize meetings, followed by motor bicycles when they went out, cut out and posters were destroyed, spread various rumours about them, damaged their houses and property. One female candidate elaborated: “I was threatened by a very powerful politician in that area and asked not to organize any political meeting in that area. I had planned to have several meetings but due to the fear I could not organize at least one. This particular political leader had send two boys in a bike to follow me whenever I go out of my home. It was really scary.”²⁵

In the present **Sri Lankan culture** the voters expect material support from the candidates and their popularity depends on the items they distribute. Inviting the voters to residences of candidates and distributing food, clothes, money, house-hold items and agricultural equipment etc. have become a common practice in Sri Lanka,

²²Information gathered from FDGs conducted in the Central province—on 12th June 2011.

²³Information gathered from an interview done with a Chair-person of the Wategama PS—on 20th May 2010.

²⁴Interview done with a Secretary to the Ministry of Women’s Affairs, on 11th Sep. 2010.

²⁵Interview done with a woman candidate in Doluwa—on 23rd March, 2011.

though it is unethical and illegal according to the elections laws. Some years back this was limited to the national elections, but now the local candidates follow the same 'tradition' as well. Ninety one percent of the respondents said that "women do not distribute food or any other material among the voters, therefore they are not popular. Nowadays the voters expect such things. There are voters who voted for Rs. 1000, packet of rice and a tea-shirt. Some male candidates spent around 15–20 lakhs on such propaganda. But women can't do it since they do not have such a large amount of money."²⁶

Another hindering factor for women's representation, according to many (around 87%) respondents, is not distributing alcohol among the supporters and voters. One female candidate said that "There are many men around a male candidate, mainly after the nomination day. Every evening they enjoy alcohol and food. The voters think that such candidates are powerful and vote for them. Generally, women candidate give tea at political meetings and tea is not attractive to such men".²⁷

This factor is proved by a statement given by a Chairman of a PS. He pointed out, "When I went from house to house during the election campaign, I always went with 20–25 supporters and it shows our power or strength. Then only your leadership is recognised. But you have to treat them generously, otherwise they won't come with you. I know it is difficult for a woman to have such supporters."²⁸

Character assassination of women too was a serious negative factor which influences their success. Seven women candidates of the WPGG group faced such problems. A chairman of a PS said "According to our culture, men can have sexual relations with anybody and having extra marital affairs is not questioned by the society. But it is prohibited for women—sexual freedom is not given to women when women do politics they have to associate closely with men. You know when a woman candidate is a competitor, men spread various rumours on that woman. The society believes such stories and it will definitely create problems for her. In such situations women try to limit their activities. It is a big disadvantage to them. Therefore, women should be very careful about their character."²⁹

All the women interviewed, and around 83% of the respondents of the FGDs, consider the **Proportional Representative (PR)** system which was introduced to Sri Lanka in 1978, as one of the major barriers for mainly women to win the elections. According to this system, it is extremely difficult for a candidate to cover a large area during his/her election campaign. Also, candidates are expected to organize processions and demonstrate their power during the nomination days. In this competition, women are pushed into more disadvantaged positions mainly due

²⁶Information gathered from FGDs done in Matale, Kandy and Nuwara Eliya—on 19th, 23rd, and 22nd respectively.

²⁷An interview done with the vice chair-woman of the Kadugannawa Urban Council on 6th April, 2011.

²⁸Information gathered from an interview done with a Chair-person of the Wategama PS—on 20th Sep. 2010.

²⁹Information gathered at the FDG conducted in Yatinuwara—on 26th March, 2011.

to lack of funds, experience, skills, and networking. A female candidate said that “it was very difficult even for a man to cover the total area of the electorate—many men have funds and man power, so they use various devices and cover the area during the campaign. But women are quite disadvantageous since they do not have similar experiences, skills, networking, man power and funds. Though some women do social activities, yet they have not established their leadership and popularity in such a vast area. Furthermore, they have not built the trust between them and patrons who donate fund for elections.”³⁰

A male chairman of a PS said “The PR system is very competitive and even the male candidates in the same party are fighting against each other. I think it is a major hurdle for women to win the elections. The men who show their power (economic or mussel) can win easily. For example, even among men, those who can organize processions with at least 50–60 vehicles and demonstrate their power during the nomination day are the winners. Many women do not have or do not like to waste resources for such things since they are generally thrifty. Thus, in the present electoral system women candidates do not have capacity to win the elections and the voters just consider them as jokers.”³¹

Lack of funds is another major reason given by about 74% of the interviewees and respondents of FGD’s for the defeat of women in elections. To gain the trust and win the confidence of the society, candidates of an election need much financial support. The families of the female candidates are not as supportive as they would be for a male candidate. Also, there is lack of or no trust established between the women candidates and the patrons who donate the funds for elections. They do not believe that women candidates can make good leaders.

According to many members of the FDGs and interviewees (73%), the violent political culture has become a serious impediment to women’s success in last local elections. The special characteristics of Sri Lankan party politics are losing voters’ trust in politics and politicians, voters’ dependence on the material support given by the candidates, severe competition among candidates, violence, threats, thuggery and distrust about the present election system. All most all the women candidates of the local elections pointed out about the nature of violence that they faced. Some were threatened, not allowed to organize meetings, followed by motor bicycles when they went out, posters were destroyed, spread various rumours about them, damaged their houses and property. Thus they are completely discouraged to go further with their political career.

Many respondents highlighted some **cultural factors** as barriers for women’s success in running for elections. The image of the woman the Sri Lankan culture portrays through various devices of the media suggests that women are vulnerable and fragile beings, and they belong to the domestic sphere of a home. Thus they are

³⁰Information gathered at an interview done with a female PS Chair person in the Central province—on 19th March, 2011.

³¹Information gathered at an interview done with a Vice Chair-person of a PS in the Nuwara Eliya district—on 2nd April, 2011.

not suitable for politics which is considered a man's job. The minute a woman takes a so-called 'masculine' job, she is considered as 'unwomanly' and rude. Women are not supposed to go out at night and do canvassing, and if they do so, most of them face character assassination. The cultural factor was taken as a major barrier to women's political success by about 73% of respondents.

A male journalist in a FGD said that "the contribution given to the society by our women is generally not recognized or respected. The Sri Lankan culture has created a weak and flexible (*siyumeli*) woman—the media shows programmes related to cooking and beauty culture and never portrays women as leaders. The religious leaders also keep women in subordinate positions. The family and school too contribute to establish traditional gender stereotypes. Therefore, both society and women consider politics as a masculine field and confine themselves to so called feminine jobs".³² In Sri Lanka many women have entered national and provincial politics after the assassination of their male members of the family and they used kinship to gain and establish their popularity.

Women candidates have got less support from families compared to males, according to the gathered information. A member of a PS said "My mother, wife and the other members of the family were very supportive. All my brothers took the leadership in processions and meetings. My wife went from house to house in areas where I could not visit. Since she is a teacher, I think she was able to collect many votes. My mother and daughters always looked after the home front. Every night there were at least 25–30 men for dinner but they managed. Without their support I would not win the election. I know very many women may not have such advantages."³³

Five women who followed the political training given by the WPGG were not allowed by the male members of their families to apply for nominations and another four took the decision without considering the objection. The rest of the women were supported by their family members, but it is not similar to the support given to men. Some women candidates even had family disputes due to neglecting the families, during their campaigns. A husband of a candidate showed his unwillingness in this manner. "Before entering politics, she was a nice wife—ours is a love marriage and we did well. But after she starts politics she does not feed children, she comes home late and I have to wait until she comes—no food or I have to cook for children. They are not washed, their nails are not cleaned, and home-works are not done. Above all now she does not respect me, she does not listen to me, at-least she does not give me my dinner plate which was done by her for years."³⁴

Some women candidates did not want to discuss such issues with their husbands and to share the family responsibilities. One woman said "I know that is my duty to feed my children and give them a hot meal/rice. My elder son said if *amma*

³²Interview done with a journalist on 29th March, 2011.

³³Interview done with an elected member of the Kandy Municipal Council on 19th March, 2011.

³⁴An interview with a husband of a PS elected member on 19th March, 2011.

(mother) wins the election people will win, if *amma* is defeated we will win. This disturbs me and I have to give priority to my family.”³⁵ This statement shows that some women do not like to challenge the traditional roles given to them and they consider them as their natural duties. Therefore, some women were in a disadvantage position compared to men in spending time on canvassing.

Majority (78.3%) of the Tamil respondents think that the up country Tamil women suffer more than the women of the other ethnic groups due to poverty, lack of recognition, lack of education and lack of infrastructure etc. Their view is that the Tamil women are struggling to continue their life and they have no time or opportunities to get involved in politics. Five respondents who represent the Up Country Peoples’ party stated, “Due to poverty, estate women are struggling to live. They are multi-burdened. They do not have time even to have a meal and they take their lunch while working or walking. They do not have a proper knowledge on politics and time to spend on public activities.”³⁶

9.10 Strategies Adopted by Male Candidates to Win the Local Elections

Majority of the winning male candidates (90%) stated that the most important strategy that they used to win local elections is, building trust and confidence among voters in their electorate by working with them for a long period of time. They are provided with funds from various organizations and people to build wells, toilets and provide material such as exercise books, pencils, clothes etc. for school children. They attend all public activities in their community or village. They encourage people, especially the youth, to participate in *shramadana* campaigns. Such activities help the male candidates to establish a close relationship with people; the confidence and trust between the candidate and the voters are established. When it comes to winning the trust of the people, the male candidates feel that it is a more effective strategy to win the trust of those who have a low income, e.g. pavement vendors, three-wheeler drivers, *Samurdhi* grantees etc. The candidates build houses and improve the living condition in other ways for such people and win their vote. Some Muslim male candidates revealed that they used their ethnic identity to gain more votes in the Muslim populated areas.

Establishing close relationships with national, as well as local party leaders, is another important strategy. Many respondents (67%) felt that the “blessings of the leader’ is very important. They also stated that whether they like it or not, they have to maintain a good relationship with the party leaders. Or else the leaders have the capacity to use their power to ruin the candidate’s political life. Thus having a good ‘friendly’ relationship with the leaders, mainly with the electorate organiser of the

³⁵An interview with a female candidate in Akurana on 19th March, 2011.

³⁶Information gathered from a FDG conducted in Hatton on 22nd March, 2011.

party is essential. They must be invited to public events, candidates must attend the meetings that they participated in, and must praise their leadership. It is only then that the person will be considered an eligible candidate.

Pre-campaign plans are essential to win an election. Some winning male candidates shared their experience of starting to strengthen their public relations, collecting funds, identifying issues in the area and preparing attractive pamphlets even before they received nomination tickets. Attending religious and social activities is also something most of them did to win the hearts of the people. Organising small meetings prior to the elections and identifying the needs of the electorate is the strategy they used. The majority of the winning male respondents stated that first they made possible development plans for their areas according to the identified needs. Then they organised small meetings and presented that plan to the people with a vision.

Getting the support of the youth is another important strategy. Some respondents (34.1%) said that when they have the support of the youth, the youth help them by spreading messages through SMS, through the internet and other forms of the latest technology. Messages spread fast and thus, it is a major advantage for the male candidates.

Many male candidates said that as candidates they should be simple, humble and nice to people and they should not be arrogant. They consider that as an important strategy. Nevertheless, 2 religious leaders, 2 human rights activists, 3 local journalists, 12 party supporters and 16 voters who attended the FGDs claimed that male candidates use violent ways such as threatening the agents of other candidates, chasing them away, giving alcohol and other material rewards to the election officers and police officers and bribing counting officers as strategies to win elections. Six elected male members, including two chair persons of Prdesheeya Sabhas, mentioned about such activities and emphasized that without using such strategies it was difficult to win the elections.

9.11 Strategies Adopted by Female Candidates Who Won the Election

An observation made while discussing the strategies used by female candidates who saw victory in the 2011 local election is that all their most effective strategies are similar to the most effective strategies used by the winning male candidates as well. Seeing that such strategies worked out well for the male candidates, it can be said that if all the female candidates had used or had the opportunity and the luxury to use the strategies mentioned below, the number of successful male and female candidates could have been almost equal.

All 7 female candidates who won the 2011 election in the Central Province said that the most effective strategy is taking part in the activities of their society and helping people. This strategy, like the winning male candidates pointed out,

helps to gain the trust of the people. The support of their family is an important reason for the success of the female candidates and all successful women appreciated their family support. From providing funds, to giving them space to do what they wish for their political campaign, the families remain supportive and encouraging. This gives confidence to the women and thus helped them win the election. Due to the support of the family, some successful female candidates were able to develop a close relationship with the leaders of the party as well. This proved to be helpful because, as it was mentioned by the male candidates, developing a good relationship with the party leader is important to win an election.

Pre-campaign planning was another successful strategy used by the winning female candidates. They made plans months before the election and thus, gained the trust of the people who voted for them and made them win.

9.12 Strategies for Women to Win the Future Local Elections

The majority of the members of the FDGs pointed out that it is important to take more systematic initiatives in organizing as common groups to win a quota system prior to the next local elections. Some even blamed Sri Lankan women's organizations for not taking the leadership to organize men and women nationally. Since the new local government revision act has not been passed by the legislature, the members suggested the researcher to meet the Executive President, the Prime Minister and important Ministers, the Leader of the Opposition and the leaders of the main political parties and to raise their awareness on the importance of women's political representation and to convince them to have more women in elected bodies. Similarly the suggestion was to join with the other social organizations, religious leaders, trade union leaders, student leaders, professional bodies and other influential persons to influence the decision makers directly and indirectly.

Some civil society leaders and media persons said that many do not understand the importance of women's representation as the discussion has not gone beyond the academic and some women leaders. Thus it is important to take initiatives to spread the importance of women's representation through media and other devices. 89% of the respondents pointed out that during the war women in this country contributed much in various ways, but it was not recognized. They said that women have to join the men, especially the ones who are sensitive towards women's issues, and have a coalition. They also suggested to demand from all the parties to have a quota/ percentage for nominations equal to the number of female members of the particular party. Furthermore, women members of parties need to join together and demand for an equal number of nominations for women.

Several *Pradeshheya Sabha* chairmen and members came forward with the suggestion to form an organization of the women who did not get nominations, spread news about the organization, and discuss the issues. During the last election

applications of many women were rejected by party organizers in the electorate, despite being promised by some national or district level leaders. Many members of the FDGs claimed that women, mainly women who were cheated by male leaders, need to organize themselves and to challenge the unfair decisions of the party organizer if it happens in the future. Creating a woman friendly atmosphere in political sphere and especially in the *Pradeshheeya Sabha* administration and ways to improve the lives of Sri Lankan women, are issues that need to be discussed, according to them.

A strong suggestion for women candidates in future elections came from many members of the FGD to continue their social—cultural work and to build up their leadership and popularity further. About 73% of the male *Pradeshheeya Sabha* members mentioned the difficulties faced and the long period of time that they had to spend on social activities. Some said that their applications for nominations were rejected more than 10 times but they did not lose their interest. They realized the weak points they had and continued their work in a more effective manner. Therefore, their recommendation for women is to continue their social work and build more close relations with the society. Seventy three percent of respondents pointed out that women should establish close relationships with both male and female political leaders, and especially with the party electorate organizer. It is only then that they would get the chance to run for the elections.

Majority of the chair persons and members of the *Pradeshheeya Sabas* were of the opinion that women should attend the *Pradeshheeya Saba* monthly meetings and learn how it works, how to make a plan, budget, how to collect income and how to develop the area. By such activities, women will be exposed to practical knowledge in politics, which is essential for them to win elections. Many respondents also felt that women's attitude towards politics as a masculine job or as 'dirty' should be changed. Changing the attitude would help them attend meetings and gain some interest in it.

Several male leaders emphasised that women aspiring to run for next local elections should definitely meet the women political leaders in their area and be their mentees. Many men have entered politics because of their close associations with big political leaders. They mentor them and show them the path toward. Similarly women should work with women leaders and do social and cultural activities, invite them for their meetings, and learn how they behave, and speak and learn about their strategies used to win the elections.

Furthermore, some FGD members said that if nominations are not given to women purposely, the women's organization in the area should come together and organize demonstrations or any other influential activities, without having any party bias. Such strong demonstrations can be successful.

Another strategy proposed by most of the members of the FDGs (71%) was to plan the election campaign at least four months beforehand and implement it in a systematic way. They need to make the campaigns look attractive and show enthusiasm and confidence to win the trust of the people. Before implementing the plan they should identify active and reliable group of supporters and allocate the *gramasevavasam* among them. Also inviting at least one or two party leaders to their meeting will be an advantage.

Almost all the FGD members said that resources for the election campaign are a must. Several female, as well as male elected members said that the candidate should start collecting funds as early as possible. Another recommendation given by the FDGs is to increase women's knowledge on counting procedures and how to protect their votes. Members of the *Pradesheeya Saba* gave suggestions such as, requesting election monitoring organizations to assist them, to force the election officers of the area to implement the laws strictly, to train their counting representatives and to also select very reliable people for that job.

Many members of the FDGs said that women do social activities but they never teach their women folk the importance of women being part of elected bodies. Thus they suggested women candidates to raise awareness on the issue for the next three years, before the 2015 local elections. Not only women, but also men need to understand the importance of the women's presence in elected bodies. Thus awareness should be raised amongst both men and women. The Sri Lankan society still believes that men perform better than women in politics. This is the traditional view and thus it is important to change this attitude of the society.

Many respondents (73%) felt that formal political training should be given to women below 35 years because they can get nominations easily. Also, it is essential to establish a separate political academy for women or include more women trainees to party political academies. Such training should motivate the women and improve their self-confidence and leadership skills.

9.13 Conclusion

This study shows that women have not been recognized as equal to men in the political representation and mainly as candidates. They face more difficulties than men to win the local elections. Some strategies used to win the elections by women are different from that of men and it is mainly due to women's individual, cultural and structural/institutional reasons. Though the trained community leaders in the Central Province have been empowered to challenge the age old patriarchal set up of the political parties by joining the independent groups and obtaining nominations, the study illustrates that it was hard for the majority of them to win the 2011 elections. However, women who have been elected to the local governments show that due to their established popularity and leadership in the community through their long term social, cultural and economic activities and the closer relationship with some party leaders, support given by the family and pre-planned campaign movement they won the elections. Women who had similar leadership skills, qualities and experiences have not won the elections due to the lack of other factors. When compared to men it is obvious that the factors which help to win the elections for both men and women are quite similar, but due to the socio-cultural and individual factors and lack of opportunities, the men are at an advantage. If the trained women were given the nominations by the major parties the result would be different. Therefore, it can be concluded that without having a structural policy for

women to obtain nominations, only the political training and other forms of support will solve at least a part of the problem. Remedies such as greater awareness, and political training for women will not produce quick results. But Quotas will help to solve that part of the issue. The Parliament of Sri Lanka passed the 2012 No. 22 local Elections (Amendment) Bill on 9th Feb. 2016 and it states that one fourth of members of local governments (MC, UC and PS) should be women. According to this, a political party or independent group is required to submit three nomination lists for a local body, two for the purpose of electing members through the first past and the post system and the proportional representative system and the other to nominate women in respect of wards.

According to the percentages of votes a party/group received, the women members are selected from the second list. For example, if one party receives 50% of total votes by its general list, it gets 50% members from women's list. Before 2015 Sri Lanka elected 4465 local councillors and according to the 2016 amendment, the total number will be 6619 (70% (5092) simple majority system and 30% (1527) PR system-total elected 6619) and 2206 women members will be nominated.³⁷ The Act has not given a specific criterion for selecting women to this nomination list and it may be used by parties to include their women family members and relatives to local elected bodies. However, since the government has been planning to amend this act also it is yet hard to predict its results. The best way to fill the gap between men and women's representation in the local government of Sri Lanka is by introducing actual elected quotas and not just including nominated women into local bodies.

However, it is noteworthy to mention that on one way at least by granting women to function as nominated representatives of local bodies they will be able to learn the game and can develop their political skills to run for future local elections. Also, by incorporating women in local bodies the recognition of their representation and legitimacy of women's presence in elected bodies will be strengthened. However, the quota itself will not solve the problem and the awareness raising of voters, leadership building of women candidates, supporting them in election campaigning, and giving them more opportunities for net-working also should be taken into serious considerations.

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³⁷The author is grateful to Ms. Gayani Premathileke, Legal Officer, Ministry of Provincial Councils and Local government for giving me this information (on 4th March, 2016).

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Chapter 10

Post Conflict Foreign Policy Challenges for Sri Lanka

H.M.G.S. Palihakkara

10.1 Introduction

Any discussion of post-conflict foreign policy challenges for Sri Lanka, would greatly benefit from an examination of the intra-conflict diplomatic issues that confronted country, especially in the terminal phase of the military operation against the LTTE (The Liberation Tigers of Tamil Elam or Tigers as they were widely known). This perspective is necessary to facilitate a proper evaluation of the post conflict diplomatic challenges. It may be noted that the term “conflict” is used here contextually. This is so because precision about terminology referring to Sri Lanka’s problem is not easily achieved, i.e., whether it is an ethnic conflict; a terrorist problem; a communal issue; a civil war; a counter insurgency operation or even a humanitarian operation, as it was described towards the latter part of the military campaign in 2009. Leaving this rather complex discussion aside, one could perhaps be satisfied with the term “conflict”, from the perspective of this chapter.

Sri Lanka’s conflict has been a highly externalized process. This external dimension was manifest in different forms for over three decades, and has assumed new meaning and somewhat disturbing proportions in the post conflict period. There has been intrusive external influence and intense external scrutiny over the conflict, as well as many attempts at its resolution. This ‘externality’ has spilled over into the post conflict period as well. What are the factors that had contributed to this unique and often unsavoury phenomenon?

Adapted **excerpts** from the Prof J.E. Jayasuriya Memorial Oration by H.M.G.S. Palihakkara, 14 Feb 2012. SLFI, Colombo.

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The principal contributor is a consistent pattern of leadership failures in Sri Lanka for which all successive Governments and all 'democratic' political parties since independence must bear responsibility. When domestic processes fail to find solutions to internal problems, external prescriptions become inevitable. Space is created for external forces to advocate and even impose solutions for the latter's political or strategic convenience; be it from a regional power or from extra regional powers.

Another factor is the large and vocal expatriate community or 'Diaspora' that remained very much focused on Sri Lanka's conflict from the outset. A significant and continuous outflow of people, both economic and asylum migrants from Sri Lanka since the 1983 communal violence, has led to the creation of a substantial influence or 'lobby' group, especially in the Western hemisphere and in India. Irrespective of whether they had well-founded or ill-founded fear of persecution here in Sri Lanka, what is of significance here is that they have become a very influential and vociferous opinion-making body, even impacting on the electoral fortunes of politicians in their respective host countries.

Thirdly, the so called "peace process" in Sri Lanka—the failure of which since 2002 had eventually led to the military activity that culminated in the elimination of the LTTE—took this 'externalization momentum' a step further. This process brought in the involvement of Norway as the facilitator and a group of Western countries known as 'the Co-chairs' in an oversight role for the 'peace process' since 2002. This external involvement in the Ceasefire Agreement brokered by Norway and the subsequent ups and downs of the peace talks with the Tigers entailed a great deal of foreign involvement in what were hitherto considered as essentially internal affairs of Sri Lanka.

Next, the Indian factor. India was indeed a major 'role player' in internationalizing the Sri Lanka situation and providing intrusive military and intelligence inputs thereto in the pre-1983 and the post 1983 periods. This 'good neighbourly' influence and 'brotherly' guidance will most likely continue. In the post conflict era, it will perhaps manifest in more non-military and more sophisticated forms. It may continue not only bilaterally, but also through multilateral means as was evident in Geneva since the end of the armed conflict in 2009. This intrusiveness can grow in intensity and frequency, especially if a consensual political process does not take root in Sri Lanka to capitalize on the soldiers' success over the LTTE, with a view to ensuring a sustainable post conflict peace building endeavour based on reconciliation and compromise within and among the political fault lines on both sides of the ethnic divide. Any student of Sri Lanka's traumatized ethnic history would know that this is the only insurance policy against external meddling, bilaterally or multilaterally.

Another development that brought about further visibility to the conflict in Sri Lanka among the external interest groups and States, was an emerging trend among local political parties to enmesh the country's foreign relations with local politics, by canvassing domestic governance issues abroad for the purpose of parochial

electoral strategies at home. Mischievous or ill-informed politicians, both within and outside the 'governing circles', must bear responsibility for this self-defaming practice over the years.

The unfortunate synergy of all these developments tended to create many situations which gave a negative image of Sri Lanka, in sharp contrast to what the country stood for before — a model Third World democracy with egalitarian ethos and socio-economic achievements that placed Sri Lanka quite high on the human development index ladder, way above her GDP punching weight.

One must also bear in mind that in a shrinking world where the forces of globalization and the power of IT are at play, no country remains an island anymore. No one can survive, let alone prosper, even in splendid isolation. For a variety of reasons, a conflict anywhere, be it internal or inter-state, will be a matter for attention everywhere as evidenced by the still unfolding events in the Middle East. Real time television, web cams, internet, remote sensing technologies, and robust armies of investigative journalists work synergistically to bring conflicts, humanitarian emergencies and all manner of man-made scandals and tragedies instantly to the drawing rooms of millions of homes all over the world. Impactful contributions from various social networking web sites have led to dramatic political upheavals in some Middle Eastern countries, signifying that States find it difficult to keep abreast of, let alone keep under control, what was hitherto known as matters of exclusive domestic jurisdiction.

When the Government of Sri Lanka began its military activity against the LTTE, after it became clear that the LTTE was not seriously interested in a negotiated solution, the Sri Lanka situation was, therefore, already under intense international attention.

It was in such an evolving international back drop that the Sri Lankan security forces approached the terminal phase of its military operation. The LTTE had taken over 300,000 Tamil civilians as virtual hostages, and exploited these innocent victims as human shields, exposing them to LTTE's own fire and to the crossfire between the two sides. Given the humanitarian dangers that loomed large, the ensuing situation was considered by the key international players as one that is ripe for international 'humanitarian' intervention in order to bring the conflict to an end through negotiations. This was the prevailing Western (or 'international') sentiment notwithstanding the precautionary humanitarian measures taken by the security forces and the exercise of maximum restraint to minimize civilian casualties and other collateral damage. The LTTE resorted to the abhorrent practice of holding such a large number of civilians as hostage in order to blackmail the internationally sanctified notion of 'civilian protection' for their cadres' safety. They also employed un-trained and underage cadres in the battle, used suicide bombers, mostly among the unsuspecting civilians who were crossing over to the government lines and in fact fired at those civilians who were trying to leave. In this scenario of imminent and massive blood-letting and in view of the LTTE's blatant disregard of all the calls by national and international leaders and bodies like the United Nation

Security Council to free this human shield, the LTTE remained intransigent in its refusal to let the people go. They banked on the cynical strategy that the human shield was the sole last resort security available to their cadres and top leaders. Many international figures cautioned of an imminent 'blood bath' on the beaches of 'Puthumathalan' on the Eastern sea board of Sri Lanka. The LTTE and its Diaspora lobby further dramatized this by threatening 'a collective suicide' on the beach.

This was an unprecedented foreign policy challenge for Sri Lanka. Firstly, this was the first time the Sri Lanka situation figured at the UN Security Council. In fact this was the first time any issue pertaining to Sri Lanka's internal affairs, especially its security and integrity, had figured in the UN Security Council. The Council is the only organ of the UN which can issue a legally binding directive to halt a military operation in its tracks, like it did to Israel concerning its operation in Gaza (around the same time in 2009). The concern for the Sri Lanka Government was that such a mandatory directive would have left room for the LTTE leadership to find a way out to re-group, re-arm and resume their terrorist campaign for Eelam. There was, therefore, understandable apprehension that what happened in 1987 to stop the Vadamarachchi operation against the LTTE could happen again in 2009. While the former of course was due to bilateral pressure from Sri Lanka's neighbor, India, a regional power, the latter would have been a multilateral decree with the blessings of the Permanent Members and other States who constitute the UN Security Council. Since such a directive could be legally binding, it would be qualitatively different from other similar calls, including a resolution in the Human Rights Council in Geneva which can be only recommendatory in nature. The challenge for Sri Lanka at that time was to prevent the UN Security Council from issuing such a decree and leave no room for an external enforcement operation to be initiated in Sri Lanka. The country was able to successfully prevent this from happening by employing a multi-pronged strategy that harmonized military, humanitarian and diplomatic action. This strategy envisaged the provision of humanitarian support, assistance and protection to the people victimized by the LTTE on the one hand, and facilitated effective strategies of preventive diplomacy in Sri Lanka, as well as at the UN Security Council in New York, on the other. There was no resolution or any other decree passed by the UN Security Council directing or constraining the Government's action to bring the conflict to an end.

This was undoubtedly a major multilateral diplomatic challenge that confronted Sri Lanka since independence in 1945. Any mandatory external intervention under the fiat of the UN Security Council could potentially have resulted in adverse far reaching implications for the fundamentals of the Sri Lankan nation state, i.e. its territorial integrity and sovereignty of her people. Having successfully achieved the diplomatic task of preventing intervention during the conflict, Sri Lanka found itself confronted with more difficulties in handling the less complex diplomatic dimensions of the post conflict peace building task. This dilemma is seen in even sharper relief in the light of the significant effort undertaken by the Government; especially in the fields of resettlement, rehabilitation, livelihood, infrastructure development etc. It is in this context that the following areas are selected for discussion.

10.2 Challenge of Reconciliation and Accountability

One of the key post-conflict issues that has been projected here and abroad is the debate on accountability or the question of compliance with International Humanitarian Law (IHL) during the terminal phase of the military operation. The journalistic short-hand usually poses this complex question as the ‘war crimes’ issue. The Government did establish a Commission on Reconciliation (LLRC—the Lessons Learnt and Reconciliation Commission) which addressed a broad range of issues that straddled the conflict and post-conflict period, including the ‘humanitarian law issues’ relevant to the conduct of the ‘war’. However, certain lobby groups abroad, particularly the Diaspora elements sympathetic towards the LTTE and their political constituencies in certain countries, have sought to side-step or even undermine this larger domestic reconciliation effort—an effort that encompasses both reconciliation and humanitarian law aspects. The most vocal Diaspora backed effort seemed to focus mainly on the humanitarian law aspects. They have called for an international scrutiny of the magnitude of the humanitarian and human rights issues that were manifest in the last stages of the conflict, and the relevant accountability aspects. The pressure for such an inquiry has become greater, precisely because Sri Lanka was able to prevent action by the UN Security Council to halt the military operation and thereby provide room, wittingly or otherwise, for the LTTE to remain a key player in a possible negotiation attempt later. This is a challenge that needs to be handled in a careful and calibrated manner in which policies and institutions relevant to governance, the rule of law and diplomacy must work with each other, rather than work at the expense of each other. On the one hand, Sri Lanka needs to safeguard her national interests, aspirations of her people of all communities and our image and reputation as a long standing democracy. On the other hand, Sri Lanka needs to work with all countries, especially with those who may disagree with the Govt. on certain issues, in order to project the country as a venue for secure investment and good business during the post-conflict period. It is imperative to preserve the independence of the local accountability mechanisms and to show to those who voice their concern on accountability issues, that the Government is serious about addressing them. Most importantly, the Government needs to show the victims of the conflict, be they victims of LTTE terrorism or of the military operations, that the Government is sensitive and responsive to conflict related grievances, as well as their root causes. This is the prudent way of meeting the current challenge posed by the critics of Sri Lanka. Hurling abuses at critics is not the way forward. Diplomacy is all about dealing with people with whom you disagree or agree to disagree. And it is not a zero sum game of cultivating one or one set of friends at the expense of another.

Diplomacy is also about seeking common ground where none seems to exist. This is especially so when such common ground may eventually bring benefits to the nation, not only in terms of investment and economic activity, but also in the form of its image and reputation as a civilized society—a society where peaceful dissent is seen as an enriching experience and an exciting democratic challenge and not an act of treachery or treason—a polity where equity and egalitarian ethos prevail in governance and society. Sri Lanka’s sovereignty is best protected in this

manner rather than sloganeering it to unreceptive audiences. The Government has done well by establishing an independent mechanism for reconciliation (LLRC) and pledging to implement its recommendations. It must get on with this task without adopting a minimalist approach, since it is important to show that the nation, having emerged from an injurious and costly conflict, still retains the strength of character and the political will to introspect- to look at its own track record and fault lines and see what course corrections should be made. This message is the one Sri Lanka can and should market in meeting this challenge, rather than marketing a message of infallibility cast in a notion of sovereignty which is slowly but surely fading away.

10.3 Challenge of Sovereignty

Defending the sovereignty and territorial integrity is fundamental to the foreign policy of any independent nation. Sri Lanka and her diplomats are no exception. This is because the notion of sovereignty is the bedrock on which the nation state system of the current world order lies. In the wake of the soldiers' success in May 2009, there has been a resurgence of the sentiment of asserting Sri Lankan sovereignty. This is justifiably so, considering the nearly three decades of terrorism inflicted by the LTTE upon the sovereignty and integrity of the nation in both diplomatic and territorial terms.

The soldiers and the political leadership provided by the Sri Lankan President enabled the country to free herself from this manifest threat to her sovereignty and integrity. The nation reasserted the jurisdiction of the elected Government throughout the island thereby exercising the sovereignty vested in the people as enshrined in the Constitution. However, can we, as citizens, safeguard our sovereignty so valiantly re-established by the soldiers, simply by sloganeering it?

There are several aspects to reflect upon. Firstly, sovereignty cannot merely be preached but must be exercised. It is a fundamental tenet of sovereignty that the Government and its security agencies must have the monopoly of the use of force within its jurisdiction and no other entity within or outside the country can be allowed to impair that authority, thereby undermining the rule of law. When a Government is unable to or unwilling to exercise that authority for whatever reason, certain crimes go unpunished; certain offenders enjoy impunity and certain investigations waver. When that happens, the principle of asserting the monopoly of the use of force and upholding the rule of law will be undermined and correspondingly, the exercise of sovereignty will be impaired.

It is, therefore, imperative that illegal carriers of arms and irregular groups who undermine the rule of law and tarnish the good name of the legitimate security forces be brought to book thereby, consolidating the sovereignty rescued by the soldiers. A vigorous program of punishing offenders and upholding the rule of law is required for meeting this challenge.

Another consideration is that like everything else in the world of Einstein's physics, sovereignty too is not absolute. Although in the post-civil war era of Europe,

the popular belief was that sovereignty was almost absolute as enshrined in the 'Peace of Westphalia' Treaty, that 'belief' has not been matched in practice. Moreover, the forces of globalization and technology, especially IT and connectivity explosion throughout the world, have rendered sovereignty very much a porous concept.

Consequently, in the modern world, a nation's sovereignty can be safeguarded only to the extent that it learns to live with other nations in an inter-dependent way, and not in an isolationist way. Sovereignty has thus become a truly relative concept. Sri Lanka has also signed international Treaties and other agreements, each of which requires the country to share with other countries and multilateral institutions, reports on and rationale for some of our sovereign decisions. This certainly is not a subjugation of our sovereignty to anyone else. On the contrary, this is an act of exercising sovereignty and expression of the strength of character of the system to be transparent, accountable and reasonable—first to ourselves and then to others. Article 3 of Sri Lanka's Constitution encapsulates this neatly. The idea propagated by some that human rights and sovereignty are mutually exclusive or are on a collision course is therefore laughable. They are in fact mutually supportive. **Sri Lankans should be proud that they have a Constitution that enshrines such a holistic and dynamic idea of sovereignty.**

Similarly, Sri Lanka being a member of multilateral bodies that look into the reports of other member states, has an equal right to observe and comment on others' reports which are also expressions of the sovereign rights of those countries. In the modern context, the notion of sovereignty is therefore used as a tool for dignified engagement and not as a pretext for combative disengagement or unilateral isolation. Sri Lanka has always been up front in presenting herself to the outside world and has had a diplomatic profile quite disproportionate to its territorial or demographic attributes and military or economic clout. As a resurgent nation brimming with hope following the elimination of a terrorist menace, Sri Lanka should look forward to asserting her sovereignty amongst her people and exercising it with other nations. This can be achieved most effectively when the country is at peace with itself and invest her military gains in sustainable political and socio-economic processes. Harmonizing a multi ethnic and multi religious society without pandering to elements of polarization is the way forward in this regard. Projection of this wholesome approach as the articulation of our sovereignty is indeed a priority task for Sri Lanka's foreign policy establishment. This is both doable and desirable.

10.4 Challenge of Human Rights

Sri Lanka faces a diplomatic challenge concerning her human rights record. As to whether the kind of diplomatic pressures Sri Lanka has been under on this score is justifiable or not, or whether this smacks of double standards or conspiracies, could indeed be the topic of an interesting debate. However the fact remains that it has become almost ritualistic for certain countries to predetermine their bilateral dialogue with Sri Lanka, focusing on human rights. The latest additions to this list of

intrusive interlocutors were India and Malaysia who voted for and abstained respectively, on one of the Resolution ‘against’ Sri Lanka in Geneva. The media have reported on many other bilateral discussions where Sri Lanka’s interlocutors invariably refer to human rights concerns in the country and even suggested progress on human rights as conditions for dialogue and business in other areas e.g. commerce, security and even people to people contact.

Several considerations are relevant here. First of all, Sri Lanka need not be defensive on human rights. Human rights problems exist in all countries. Addressing human rights concerns is good in itself. There is no need or in fact no basis to suggest or consider human rights as a Western concept. Many ‘non-Western’ developing countries of Asia and Africa voted for the Universal Declaration of Human Rights (UDHR) at the inception of the United Nations. Human Rights are very much a part of our constitutional obligations. The letter and spirit of our Constitution clearly signify that the elected government’s job is not to defend its human rights record but to defend human rights. And many of the core values embedded in the Sutras preached by the Lord Buddha if put together, will constitute a great Bill of Rights predating and perhaps even surpassing the Universal Declaration of Human Rights—the genesis of the modern human rights regime. Sri Lanka also had freely and voluntarily subscribed to about two dozen international Covenants on human rights. These accessions indeed represent the exercise of our sovereignty. It is our sovereign right to commit ourselves to such obligations. Therefore, the best way to reverse an adversarial relationship deriving from human rights issues, is to remove human rights concerns from such bilateral agendas. In other words, prevent human rights problems from becoming foreign policy problems.

There are two ways of achieving this objective. Firstly, by empowering our domestic mechanisms to promote and facilitate the full and effective implementation of our constitutional obligations on human rights and ensuring that our system of administration of justice is enabled to judge independently and robustly. Secondly, we can broaden our bilateral diplomatic discussions beyond a single issue agenda (of human rights) into other areas of common interest e.g. regional cooperation, environment, terrorism, human and arms trafficking, non-proliferation, economic cooperation etc.

If we continue to argue that human rights problems are not unique to us and therefore no one should talk about that, it is simply not prudent or smart diplomacy. Whilst it may constitute a good political poetry for local consumption, it may, in the long run, militate against Sri Lanka’s own interests, (especially business and economy) our own image building and in fact the very longevity of the elected government.

10.5 Challenge of ‘Diaspora’

The phenomenon called the ‘Diaspora’ has raised many issues as far as Sri Lanka’s foreign policy interests are concerned. ‘Diaspora’ is said to represent a ‘people’ denied of a homeland—legitimate or otherwise. The highly diverse Sri Lankan

expatriate community may not fit that description since that community consists of a multitude of migrant groups, e.g. economic migrants, asylum seekers, those who may have well founded, or ill-founded fear of persecution etc. However, for reasons discussed earlier, the word 'Diaspora' has become virtually synonymous with a vast array of external lobby groups, both pro LTTE and anti LTTE, as well as pro government and anti-government. The Diaspora came to the fore around 1983. However there was little research and even less policy attention about how the Diaspora works, let alone how it can be handled. The activities of the Diaspora was clearly demonstrated by certain events where some groups were able to embarrass Sri Lanka and her President in London twice over. Additionally, certain elements of the Diaspora who tried, but failed, to get the UN Security Council to pass a resolution ordering the Sri Lanka Government to stop the military operation, have resumed their campaign to put Sri Lanka in the dock as it were, in the post-conflict period. The incidents in London could only be pilot projects of what could be a sustained and embarrassing campaign. Such a campaign, if successful could deny the country, the vital economic and political support in terms of aid, FDI and other business opportunities needed for Sri Lanka to invest the decisive military success it secured in a programme of sustainable prosperity for all its people. Certain Diaspora groups may still harbor the ambition of resurrecting a 'shadow' LTTE abroad, when in fact the soldiers were able to overcome the 'real' LTTE at home.

Accordingly, it will be in Sri Lanka's interest to engage the Diaspora in two ways: first, by engaging the elements in the Diaspora who do not want to see the re-emergence of the abhorrent ideology and the institutional framework of the LTTE and second, by launching clearly visible and responsive policies, programmes and projects to address the real concerns of the conflict victims, especially the minorities. The desirable course of action for the Sri Lankan Government is to undertake such efforts not as a response to any foreign pressures bilaterally or multilaterally, but as a response to the people's grievances aired through domestic mechanisms like the LLRC. When local actions progressively become responsive and relevant to minority grievances, the hostile Diaspora will become correspondingly irrelevant. And the constructive Diaspora will become progressively assertive. Thus the domestic reconciliation process will advance and external efforts at polarization again will fade away. The host governments will listen less to the Diaspora and more to the Government of Sri Lanka. The Diaspora's adverse impact on government's foreign policy endeavours will correspondingly diminish.

The contrary seems to be happening in the post conflict era. — a sharp contrast to what transpired in 2006 when the Govt. was able to get an EU-wide consensus to list the LTTE as a terror outfit and virtually ban it in Europe. That achievement by the Sri Lankan government was even more significant in diplomatic terms as it was achieved at a time when the LTTE was 'engaged' in negotiations with the government through foreign facilitation. It was also achieved despite strong counter lobbying by the Diaspora and a few Govts. against such a ban directed at a 'peace talking LTTE'. This was a clear case of the Government's ability to pursue sophisticated diplomacy entailing objectives that seemed superficially divergent (banning LTTE while negotiating with it), but internally consistent (ban to serve as

a negative incentive to LTTE and listing to be lifted after LTTE disarmed!). As events unfolded, peace talks did not succeed but the diplomatic strategy of piling up external pressure on LTTE succeeded. It was followed by strictures on the TRO (The Tamil Rehabilitation Organisation)-the fund raising arm of the LTTE. In fact, the Europe-wide LTTE 'listing' remains the most successful anti LTTE diplomatic achievement by GOSL achieved without much political fanfare. This 'listing' on the LTTE has endured the vagaries of relations between the GOSL and Western countries and was resilient in the face of consistent legal and political attempts by the LTTE lobby groups to undermine and undo it in Europe.

Thus, a preventive diplomacy strategy can be conceived to address and negate the concerns articulated by the Diaspora and their host countries, based on the comprehensive set of recommendations made by the LLRC on that score.

10.6 Institutional Challenges

Before delving into the specific institutional issues relevant to diplomacy, it would be useful to note that the overall concern is to restore and re-empower the public service institutions in the country as a whole. It is of paramount importance that the creeping degradation of the public institutions is arrested and their capacity to act as a systemic framework of checks and balances essential for governance, be restored. The flagship institution of any Nation's foreign policy structure is its Foreign Ministry. The career Foreign Service constitutes its crew. It would be useful for the government of Sri Lanka to assess objectively if the crew capacity has been optimally used to tackle the growing inventory of Foreign Policy challenges. The career officer's corps at the Foreign office include some very able professionals who have contributed to some of the significant foreign affairs achievements for the country. To cite a few; the massive post Tsunami coordinating effort, including the GSP + facility (where the Foreign Service and the Commerce service worked hand in hand and which was achieved without the kind of choking political difficulties being experienced in its renewal), the unprecedented airlift of thousands of our nationals from the war zone in Lebanon in 2006, the annual diplomatic effort at the UN and European multilateral venues since the late 80s to deter intrusive Resolutions on Sri Lanka; successful preventive diplomacy effort at the UN security Council without alienating any country to pre-empt un-solicited interventions in Sri Lanka during the anti-LTTE operation in 2009; a sustained and painstaking diplomatic effort to get a European consensus to list LTTE as a terror outfit despite counter lobbying by a powerful group of countries and by a multi-million dollar Diaspora. It is important to note that no political delegations visited any foreign capitals to lobby for this ban. This certainly saved tax payers money and probably saved the ban as well!

What is significant about the effort of these diplomatic officers was that they did not put up bill boards on the road sides announcing victory and claiming credit. Having got the LTTE 'listing', the next objective was the ban on TRO, restrictions

on fund raising, barriers on trafficking, Hawala banking and other illicit money trails, etc. Usually, diplomatic effort is discreet business. One cannot have a high decibel strategy and nor can one boast about victory. Boasting brings about two problems. It makes your diplomatic counterpart on the 'losing side', an enemy. It can also embarrass your diplomatic friend who supported you by placing them in a spot vis a vis their own bilateral partners. Sometimes in diplomacy, the greatest success is the absence of something e. g an adverse Resolution condemning your country, especially if the Resolution does not lend support to the difficult and complex constructive processes under way in the country concerned. It is also not advisable to advertise that absence or boast about it as you would signal to your adversary to work harder next time to get a Resolution!

Like in all services, all may not be well with the Foreign Service. There may be the fringe of the normal curve- the miscreants in the woodwork. That is the irrelevant minority and there are disciplinary tools available to deal with them. The large majority in the Foreign Service are hard-nosed professionals who have national interests at heart. Many of them have joined the service from the rural heartland of the country. I know that personally having served with them during some critical periods in our national affairs. The Government of Sri Lanka will be well advised to use this knowledge experience judiciously and not lose it unwisely. Such a policy will stand in good stead in meeting the challenges ahead.

10.7 Challenge of Consensus

A challenge that has assumed significantly new dimensions relevant in the foreign policy arena is the task of domestic consensus building on foreign policy. Following independence, Sri Lanka initially had a tradition of a broad based bipartisan approach to foreign relations. During the last 20 years or so, however, especially since the 1983 communal violence, vital foreign policy issues have become susceptible to parochial political discourse at home. The significant outflow of people from Sri Lanka following the deplorable events of July 1983, the progressive externalization of the conflict and the Sri Lanka political parties tragically exploiting these national issues for short term electoral advantage have all contributed to the unravelling of this consensual approach to foreign policy issues. It was no longer possible, therefore, to decouple a highly externalized ethnic issue from an electorally politicized ethnic issue at home. As a result, we have seen the rather disturbing practice of local politicians taking up a range of governance issues with foreign countries and foreign organizations as the very same politicians were either unable or unwilling to agree on solutions to those same issues locally.

The regrettable outcome of this practice was that successive Governments have been obliged to deal with a host of domestic governance issues with bilateral and multilateral interlocutors. All political parties and all successive governments have contributed to this unfortunate situation. It is so unfortunate that at one point, when the security forces were able to entrap the LTTE leadership into a small area of the

No Fire Zone on the Mathalan coast and when the LTTE held 300,000 people as a human shield, a query arose as to why all democratic political parties in Sri Lanka did not see it fit to issue a unanimous joint call through the Parliament or through some other political forum calling on the LTTE to free these people and lay down arms. Even at that critical hour, once again Sri Lankan politicians failed abysmally to summon the necessary political will to reach such a consensus. It was said that had here been such a unanimous call from the democratic establishment of Sri Lanka against what is perceived to be one of the most ruthless terror outfits in the world, relevant international entities may have been ready to support that unanimous call. Once again, as events unfolded this was not to be. It is, therefore, important that Sri Lanka's political establishment gets back to the path of bipartisan foreign policy making of the past rather than allow vital foreign policy interests to be dissipated in parochial electoral politics.

It is relevant to consider the examples of Sirimavo-Shastri pact (October 1964) and the former Indian Opposition Leader Sushma Swaraj's visit to Sri Lanka (April 2012) to appreciate how ancient Sri Lanka and modern India practiced bipartisanship. Prime Minister Sirimavo Bandaranaiyaka phoned the then Opposition Leader Dudley Senanayaka from New Delhi before she placed her signature on the Sirima- Shastri Pact in order to obtain 'Dudley's blessings' as she put it. (The historic bilateral Pact sought to resolve the vexing issue of the persons of Indian origin in Sri Lanka) Mr. Dudley Senanayaka not only concurred, but had said that he would move the Bill in Parliament to get ratification—a great show of statesmanship and bipartisan spirit of the highest order to safeguard national interest—something sadly lacking today. The Congress led Indian Government sent the BJP led Opposition leader Ms. Sushma Swaraj to Sri Lanka in early 2012' on a good will visit! The senior BJP leader not only commissioned the Congress funded Railway track, every word she officially expressed here, echoed what the Congress Foreign Minister Krishna had stated during his previous visit to Sri Lanka. The objective should have been to clear any student of foreign relations, - a lesson for the confused politicians in Sri Lanka that both the Government and the Opposition in India speak from a 'single Brief' when it comes to India's Sri Lanka policy! But this bipartisan message has apparently got lost in the self-serving polemics of adversarial politics in Sri Lanka.

10.8 Future Challenges

Governance and foreign policy are functionally linked. So are the attendant challenges. When governance is in deficit, diplomacy cannot accrue merit all by itself. The converse is also true. Image building abroad cannot be significantly different from the Rule of Law image we create for ourselves domestically.

As the Sri Lankan nation emerges from a costly and traumatic conflict, introspection at three levels will help move the reconciliation process forward.

At the apex level, the top leadership of all sides on the political and ethnic divide must reflect on as to why successive leaderships failed to build a culture of consensus on critical national issues. They must also introspect as to how they can bring about consensual democracy as against the currently prevalent culture of adversarial politics in Sri Lanka.

At the community level, the civil society and its 'organizations' must reflect carefully on how to build bridges between national interests and their institutional interests without compromising their advocacy principles.

Thirdly, at the level of the individual, the citizens can and must find ways to use their franchise to educate their political leaders on the need to make course corrections towards consensus building on national issues. We must so educate politicians in order to save our children from another round of bloodletting. When you get your governance act together, getting your foreign policy act together will be less of a problem. It is the job of the foreign policy maker to sensitize those who govern, to this stark reality. This may be quite a challenge but one that must be taken up.

The LLRC Report contained a number of practical and doable recommendations. For reasons best known to them, the then Govt was unable or unwilling to adopt more than a minimalist approach to its implementation. Had it been implemented in good faith the alleged human rights problems would not have become diplomatic problems for the country. If implemented in good faith and in a time bound manner, these measures can, even now, move the process of confidence building and accommodation at these three levels. To do this, however, all political leaders, especially those entrusted with the business of governance in particular, must manifest maturity by demonstrating that they are wise, able to introspect and that they can collectively forge political will. This unfortunately is not a substance that any LLRC can generate!

Author Biography

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Part III
Sharing Internal Experiences

Chapter 11

Role of Local Institutions in the Development of Industrial Clusters

Keijiro Otsuka

11.1 Introduction

The last four decades have witnessed a large number of successful examples of industrial development in Asia, but possibly an equally large number of failures in other developing countries; particularly in Sub-Saharan Africa and to some extent in South Asia. While the governments of developing countries have been eager to realize industrial development for the last several decades, development economists have failed to establish commonly accepted strategies to develop industries.¹ Probably this is due partly to the failure of import substitution policy and partly to the commonly accepted neoclassical presumption that “industrial policy” does not work, thus governments use minimum in order to promote industrial development beyond the provision of infrastructure such as roads, electricity, and communication systems.

Such a presumption, however, is incorrect to the extent that the government is able to address major market failures better than any private or non-market institutions or to support such institutions’ corrective functions without causing a serious government failure. A major market failure arises from high transaction costs incurred by manufacturing firms (e.g., assemblers and parts-suppliers) and between manufacturers and traders, particularly in developing countries, which are attributed to asymmetric information and imperfect contract enforcement (e.g., Akerlof 1970; Williamson 1985; Hart and Moore 1990). An obvious institution

¹There are, however, exceptions; e.g., Cimoli et al. (2009), Lin and Monga (2010, 2011), and Page (2011).

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counteracting this problem is industrial clusters, in which the transacting parties are located in close proximity to reduce transaction costs (Becker and Murphy 1992).

Industrial clusters are not a panacea, however. Its favorable effects are lessened by market failures other than transaction costs. While information spill-overs are considered as an advantageous feature of industrial clusters, they reduce incentives to innovate. This issue is critical, because according to a majority of cases studies of cluster-based industrial development by Sonobe and Otsuka (2006, 2011, 2014), whether industrial clusters successfully develop or continue to stagnate for a long period depends on the success or failure of innovations. There is a room for collective action or local governments, which possess down-to-earth knowledge of industrial development to correct such market failures. A related issue is the inadequacy of managerial human resources of firms in developing countries, as has been increasingly recognized in the recent literature (e.g., Bruhn et al. 2010). Sonobe and Otsuka (2006, 2011, 2014) observe that entrepreneurs' managerial human capital plays a critical role in industrial development, as it affects innovations. More recent waves of randomized experiments demonstrate that the majority of entrepreneurs in developing countries have inadequate knowledge about standard management practices (e.g., Bloom and van Reenen 2010). As with ordinary human capital, investment in managerial human capital is likely to be socially sub-optimal due importantly to inaccessibility to finance. Authors argue that the government or non-market private institutions should promote innovations and facilitate managerial human capital accumulation.

Secondly, there is potential of producing lemons or low-quality products in the cluster by using inappropriate technologies or inferior materials and inputs. Such behavior is hazardous for enterprises which produce high-quality products, because consumers often rely on the reputation of particular clusters when they make decision to purchase commodities. Thus, selling low-quality products has negative externality on the image of the clusters. This creates space for local institutions to correct market failure.²

The purpose of this article is to formulate an effective cluster-based industrial development policy for low-income countries based on empirical literature on the development of industrial clusters in developing countries and the economic history in modern Japan. I believe that the engine of such development is technological progress, including both innovation accompanied by the process of constructive destruction and less drastic, but practically important improvements in production methods and management (e.g., Schumpeter 1912; Solow 1956; Romer 1986; Grossman and Helpman 1991). The author agree with Gerschenkron (1962) and Deming (1994), among many others, that the major source of technological progress is the application of the appropriate knowledge of technology and

²There is much evidence, based on randomized controlled and natural experiments (e.g., De Mel et al. 2008), that small and medium firms in low-income countries are faced with severe credit constraints. We argue that the provision of low-interest loans to credit-constrained firms is effective if it is targeted to innovative entrepreneurs.

management imported from developed countries to productive activities.³ Such technological progress usually accompanies quality improvement of infrastructure.

This chapter especially discusses the development of industries in low-income economies. In such economies, the application of imported knowledge to production and management is new and accordingly difficult for most enterprises, and improvements in production and management that seem simple to developed country enterprises often contribute substantially to productivity gains. This chapter, therefore, uses the term “improvement in production and management” (IPM) to describe the result of the application of such knowledge with the connotation of innovation. In Sect. 2, the author begins by discussing how to promote the initiation of new appropriate industries, followed by the discussion of how to sustain the industrial development with a view to stimulating IPM in subsequent development stages. After reviewing the historical development of weaving clusters in Japan in Sect. 3, the author discusses in Sect. 4 how to broaden the scope of the analysis developed in Sect. 2. Section 5 concludes the paper by recapitulating the proposed industrial development policy.

11.2 A Review of Sonobe-Otsuka Model of Cluster-Based Industrial Development

11.2.1 A Model of Cluster-Based Development

More often than not, labor-intensive manufacturing industries, such as the garment, leather-shoe, weaving, metal processing, and furniture industries, are clustered in developing countries. Such observations indicate that the industrial cluster provides strong advantages for enterprises over non-clustered areas. According to Marshall (1920), the advantages of industrial clusters or agglomeration economies are: (1) information spillovers or imitation, (2) the division and specialization of labor among firms producing parts, components, and final products, and (3) the development of skilled labor markets. If a firm is located outside the cluster, it cannot quickly learn new useful ideas developed by other firms, must incur high transaction costs in the procurement of intermediate products, and would face difficulties in finding workers with specialized skills.

In practice, there are both dynamically growing and stagnant industrial clusters. Sonobe and Otsuka (2006, 2011, 2014) argue that there are basically three patterns of the development processes, including dynamically growing and stagnant clusters

³By now, this view has been widely accepted by development economists and other experts. Indeed, Japanese development since the Meiji era provides a vivid example of rapid economic development based on technology imports (e.g., Ohkawa and Rosovsky 1973; Otsuka et al. 1988; Hamada et al. 2011). In their textbook on development economics, Hayami and Godo (2005) argue that successful technology transfer from developed to less developed economies is the key to the successful development of the latter.

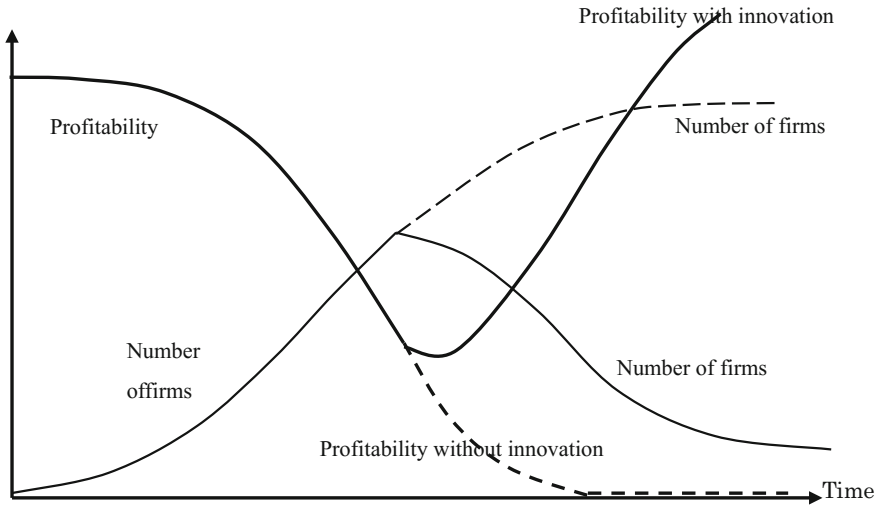


Fig. 11.1 An illustration of the development paths of industrial clusters in terms of changing profitability and the number of firms

(Sonobe and Otsuka 2006, 2011, 2014). Their model is designed to explain these diverse patterns of cluster development by focusing on the roles of entrepreneurship and innovations. In this subsection, we review their model.

In most cases, the pioneers of new industries imitate the production of imported products. If the production is easy but marketing is difficult, like the garment business, former traders are often the pioneers. On the other hand, if the production is technically complicated, like machinery production, engineers tend to be the pioneers.⁴ Those who have worked for large enterprises and foreign firms are often the leading pioneers. Thus, marketing and technological knowledge acquired by work experience is a critical factor affecting entrepreneurship at the early stage of cluster development.

To initiate a new business, the pioneer must exert great efforts to establish new production methods, find new sources of materials, and cultivate new marketing channels. Once the new business is established, the pioneer receives sizable entrepreneurial profits, despite the low quality of his or her products, because of the sizable demand for inexpensive products from poor domestic consumers. This profit attracts a swarm of imitators to the industry. Many of them are spin-offs, i.e., the former employees of the pioneer, produce the same low-quality products by using the same low-quality inputs and sell their products on the same local markets as the pioneer. In this way, an industrial cluster is formed almost without exceptions, as illustrated by the increasing number of firms in the early phase of development as shown in Fig. 11.1.

⁴Such shift of jobs by traders and engineers is consistent with the prediction of Hidalgo et al. (2007) that the industrial compositions evolve only gradually.

Since the profits are reasonably high at present, entrepreneurs are not particularly interested in introducing new ideas and knowledge. Hence, productivity and product quality hardly improve, but the cluster expands in terms of the number of firms and the total output. This phase of industrial development is termed the “quantity expansion” phase.

As a cluster expands, an increasing number of traders buying products and supplying materials come to the cluster, which makes production and transactions in the cluster more convenient. Moreover, some firms specialize in the production of parts and components; in other words, the division of labor between assemblers and part-suppliers and between manufacturers and traders increases with the market size (Stigler 1951; Ruan and Zhang 2009). In the transaction of final products and parts, transaction costs may arise from asymmetric information about the quality of goods and from imperfect contract enforcement. At this stage of development, however, the problem of asymmetric information regarding the quality is not serious because all the products and parts produced and transacted are standard and of uniformly low quality. The problem of imperfect contract enforcement is reduced by the community mechanism supported by the environment of the cluster in which people know each other and in which information regarding unscrupulous behavior can spread quickly, as in rural communities. In the authors view, industrial cluster is an artificially created institution to reduce the transaction costs.⁵

As the entry of new firms unaccompanied by any improvement in product quality and productivity continues, the increased supply of their products will eventually lower the product prices, increase the input prices, and, hence, reduce profitability. This process, illustrated by Fig. 11.1, takes place in the later period of the quantity expansion phase of cluster development. The declining profitability will induce entrepreneurs to seek more profitable products (Aghion et al. 2005), which should be of higher quality and differentiated from the inferior products of other firms.

Such an endeavor, however, does not necessarily bear fruit. While a firm may successfully improve product quality by using high-quality materials and employing skilled workers, consumers may not immediately perceive the improved quality and, hence, the new product may fail to command a high price in the market. This firm incurs losses as the cost of production is much higher than before. Akerlof (1970) points out that branding and quality guarantees are effective countermeasures to this problem. Since brands may be stolen, however, branding may have to be protected legally or collectively by producers, or supplemented with the use of exclusive sales agencies and other distribution methods (Sonobe et al. 2004). Since the improved products contain differentiated parts and components and since such intermediate goods embody new ideas, it is also important to establish trust-based, long-term subcontracting relationships with parts suppliers. In addition, to enter the high-quality segment of the market, product quality must be

⁵Hayami (e.g., 2009) argues that the community mechanism is effective for the enforcement of contract-based transactions in rural communities.

strictly controlled. If these changes are successfully implemented, production can be expanded profitably (see point “E” in Fig. 11.1). As the firm size is enlarged accordingly, the management of cash flows, inventory, and labor will assume greater importance. Good management is not an easy task for entrepreneurs in the cluster, as they have operated only small organizations and may be unaware of how to improve management. Innovative entrepreneurs are highly educated, as they must have the capacity to carry out multifaceted innovations simultaneously.

The case studies by Sonobe and Otsuka (2006, 2011, 2014) also find that these innovative entrepreneurs took advantage of the availability of a variety of human resources useful for innovations in the cluster, such as traders, engineers, designers, and accountants, who gathered in the clusters in the quantity expansion phase. Thus, it is justified to state that the innovation under study is a product of a new “combination” of existing resources, referring to Schumpeter’s expression in the context of innovation (1934).⁶

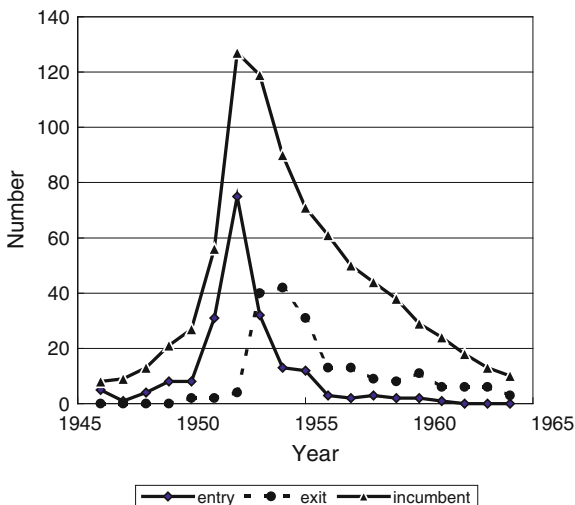
If entrepreneurs’ attempt to improve production and management fail, this will lead the cluster to a long-run equilibrium with low profitability, in which firms struggle for survival (see the dotted curves in Fig. 11.1). While such “survival clusters” abound in SSA, many industrial clusters in Asia have succeeded in innovations and followed a path leading to the dynamic development of the industry with a smaller number of much larger firms, as illustrated by the solid curves in Fig. 11.1. The dynamic development phase that begins with successful innovations could be termed the “quality-improvement” phase.

An increasing number of firms attempt to imitate the first innovation in the cluster, and some of them further improve production and management practices. Those firms undertaking continual innovations or improvements will grow steadily, whereas firms that fail to keep pace with growing firms will be forced to exit the industry or will be merged with growing firms. While the number of firms in the cluster will decrease as a result of exits and mergers, the value of total production and employment of the cluster will continue to grow, and the products will be sold in larger markets, including export markets. Continual innovation is achieved by inflow of expertise from outside of the cluster globally. More concretely, innovative entrepreneurs acquire new knowledge of technology and management by visiting foreign countries frequently to participate in trade fairs and training programs, sending workers abroad for training, and inviting foreign experts. They may also be able to learn from subsidiaries of foreign firms operating within their countries.

Entrepreneurs and policymakers in East Asia are keen on learning from the successful experiences of advanced neighboring countries. Although statistical evidence is limited, it is generally understood that Taiwan (China) and South Korea utilized technology and management know-how from Japan in the 1970s and 1980s when their economies grew rapidly. Later Indonesia, Malaysia, and Thailand followed the same strategy. More recently, China has been learning from Taiwan

⁶The innovation here refers not only to breakthrough leading to “creative destruction” but also to useful improvements.

Fig. 11.2 The number of operating enterprises, entries, and exits in the motorcycle industry in Japan



(China), Korea, and Japan. At present, Vietnam, Laos, and Cambodia are learning from China, among other countries. By contrast, the importance of learning from abroad is not clearly recognized by leaders in SSA with only a few exceptions.⁷ Learning from advanced countries seems to be mandatory for less developed countries to catch up by means of innovations.

Figure 11.2 demonstrates the rapid changes in the number of firms in the development process of the motorcycle industry in postwar Japan (Sonobe and Otsuka 2006). In the peak year of 1952, the number of enterprises reached 127. The rising phase until 1952 was associated with the rapid entry of new enterprises. Since then the new entry began to decline and practically ceased in the late 1950s, and the rapid exit of enterprises followed. In subsequent years, the exit continued steadily, resulting in the decreasing trend of the total number of enterprises, which eventually reached only the four giant enterprises. According to Sonobe and Otsuka, low-quality motorcycles were produced before 1952, when innovative new model “super cub”, was produced by Soichiro Honda, a founding entrepreneur of the Honda Company. This case clearly emulates the model of cluster development by Sonobe and Otsuka.

The question may be raised as to whether it is possible to skip the quantity expansion phase and enter the quality improvement phase from the beginning of cluster development. The answer is affirmative judging from the experience of the spectacular development of the export-led garment cluster in Bangladesh (Mottaleb and Sonobe 2011). In Bangladesh, the garment industry now has more than 5000 manufacturing firms, employs roughly four million workers directly, and ranks

⁷Some enterprise managers in East African countries, however, are learning from other countries by employing technicians and managerial advisers from Europe and the U.S. and by visiting European countries and the U.S.

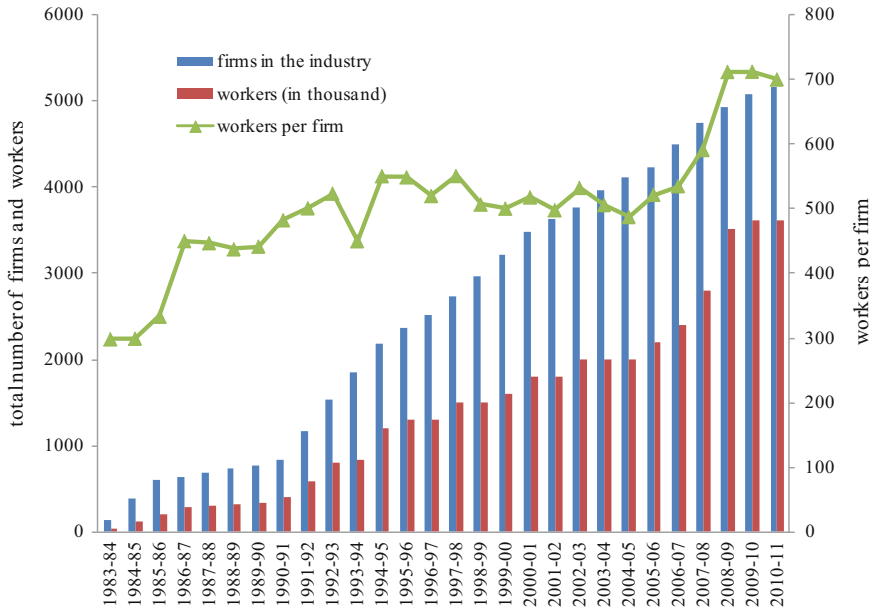


Fig. 11.3 Growth of the garment industry in Bangladesh. *Source* Bangladesh Knitwear Manufacturers and Exporters Association (2012), ‘History of Development of Knitwear of Bangladesh’, Bangladesh, BKMEA

among the world’s largest producers of garment items, as is illustrated in Fig. 11.3. It must be emphasized that the average firm size was as large as 300 workers per firm already in the early 1980s and that it has reached 700 workers on the average by 2010.

The export-oriented garment production in Bangladesh dates from 1979, when a newly established firm, Desh, entered a technical co-operation agreement with the then leading garment exporter, Daewoo, in Korea. These firms teamed up because both were positive that the creation of a cadre of professionals would allow the latent comparative advantage of Bangladesh in garment production to materialize. The agreement sent 130 young university educated employees of Desh to Korea for intensive training for eight months in production skills, management skills, and international procurement and marketing at Daewoo’s factory. Within a few years, however, almost all the trainees had left Desh to start their own garment businesses. The garment industry in Bangladesh has since continued to grow rapidly over three decades with the continual learning of technology and management from abroad. Since products are exported to international markets, profitability would not have declined substantially even if the quantity of domestic production increased significantly. A critical observation is that if potential entrepreneurs can acquire appropriate production, management, and marketing skills and knowledge through training, they can produce high-quality exportable products from the beginning. This is the third type of cluster-based development according to Sonobe and Otsuka.

11.2.2 Endogenous Evolution Versus External Shocks

In the original Sonobe-Otsuka model examined above, innovations are induced to take place responding to declining product prices and profitability of producing low-quality products, which are endogenously generated by the quantity expansion of the clustered firms. Product prices, however, decline for other reasons. For example, Sonobe and Otsuka (2011) themselves refer to the cases of the leather shoe industry in Ethiopia and the electric fittings industry in Pakistan, where product prices declined sharply due to the massive imports of cheap products from China. Entrepreneurs in these cases face the choice of either bankruptcy or restoration of profitability by means of innovations. Actually these industrial clusters succeeded in improving the product quality and reducing imports from China.

Furthermore, Nadvi (1999) reports that producers in the cluster of surgical instrument production in Pakistan successfully improved the quality of their products when the US banned the import of low-quality surgical instruments for sanitary reasons. Similarly, Tewari (1999) finds that the collapse of the Soviet Union, which has a high demand for low-quality, low-priced garment products, stimulated clustered garment firms in India to improve the quality of their products in order to market their products in North America and Europe, where only high-quality products are in demand.

Thus, not only declining product prices internally generated by market forces, but also exogenous shocks, which reduce incentives to continue to produce low-quality products, seem to enhance incentives to innovate for the survival of enterprises in the industrial cluster. In other words, the industrial clusters have potential capacity to innovate when the incentive structures or market environments change in favor of producing higher-quality products.

11.3 Lessons from the Historical Development of the Weaving Clusters in Japan

11.3.1 Is Sonobe-Otsuka Model Relevant for Japanese History?

In the course of modern economic development in Japan since the late 19th century, new modern industries, such as the cotton spinning industry (Otsuka et al. 1988), successfully developed. At the same time, the modernization of indigenous industries, such as the silk and cotton weaving industries (e.g., Hashino and Otsuka 2013a, b), took place based on the introduction of new technologies from Western countries. The indigenous industries were mostly clustered by small and medium-size enterprises located in rural areas.

Thus, the cluster study is critically relevant for the study of modern Japanese economic history. Such historical study has an advantage over most contemporary studies of industrial clusters in developing countries since long-term development process can be analyzed. Its major limitation is the lack of data on characteristics of individual entrepreneurs.

In order to examine the relevance of Sonobe-Otsuka model, author employs a simple decomposition analysis of growth in industrial production in which the value of production (Q) is decomposed into the number of firms (N), the employment per firm (L/N), and labor productivity (Q/L) by using the following relationship:

$$Q = N \times (L/N) \times (Q/L).$$

Taking logarithm, the above equation can be rewritten as

$$\text{Ln}(Q) = \text{Ln}(N) + \text{Ln}(L/N) + \text{Ln}(Q/L).$$

Using this relationship, changes in logarithm of indices of Q, N, L/N, and Q/L are shown in Figs. 11.4 and 11.5 for Fukui and Kiryu, respectively.⁸ It should be noted that indices in this figure are set to be unity in 1890 in Fig. 11.4 and in 1900 in Fig. 11.5.⁹ If the quantity expansion takes place, growth in Q will be explained primarily by growth in N, while firm size (L/N) and labor productivity (Q/L) are expected to be unchanged. On the other hand, if the quality improvement takes place, growth in Q will be explained primarily by growth in L/N and Q/L, whereas N is likely to decline.

Habutae production in Fukui prefecture started in 1887 when local people learned the production method from Naohiro Koriki, an engineer in the Kiryu silk weaving district located 500 km away, who was invited by Fukui prefectural government for training.¹⁰ It was three-week training in Fukui city, capital city of the prefecture, in which around 200 people participated. Kiryu was the first exporter of *habutae* around 1877 and several prefectures including Fukui introduced the production method of *habutae* from Kiryu. The Kiryu cluster, however, concentrated on the production of more sophisticated products, such as *kimono* and *obi*, rather than *habutae* (Hashino and Otsuka 2013a).

According to Fig. 11.4, growth in real value of production is explained by the growth in the number of firms in the period from 1890 to 1908 in the Fukui weaving cluster, whereas firm size and labor productivity did not change appreciably. Hand looms were exclusively used in this period and the number of small scale firms

⁸“Firms” include (1) workshops employing more than 10 workers, (2) workshops employing less than 9 workers, (3) weaving manufactures-cum-contractors, and (4) out-weavers.

⁹Production data pertain to production of not only silk fabrics but also other fabrics including cotton, linen and rayon, even though the former were by far the most important. In Kiryu, the data on the number of firms are not available before 1990.

¹⁰Unfortunately, the content of training and characteristics of participants are not well reported.

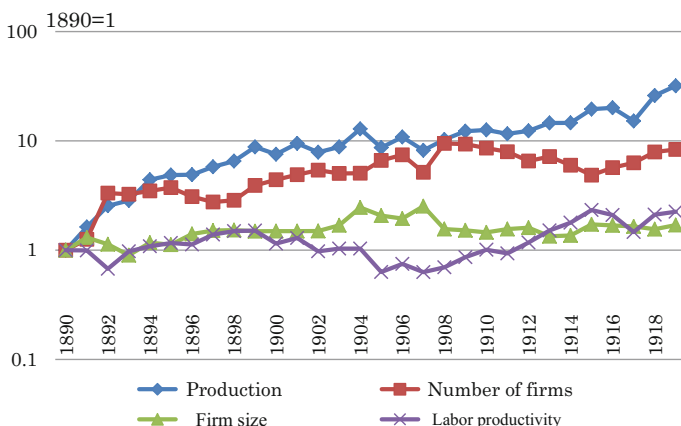


Fig. 11.4 Changes in production, the number of firms, average firm size and labor productivity in the Fukui cluster, 1890–1919 (index, 1890 = 1.0). *Source* Fukui Prefecture (1889–1900) for data from 1890 to 1900; Fukui Prefecture (1901) for data in 1901; Fukui Prefecture (1902–1919) for data from 1902 to 1919. *Notes:* For the deflator, we used the price index for textile products in Ohkawa et al. (1967), pp. 192–3

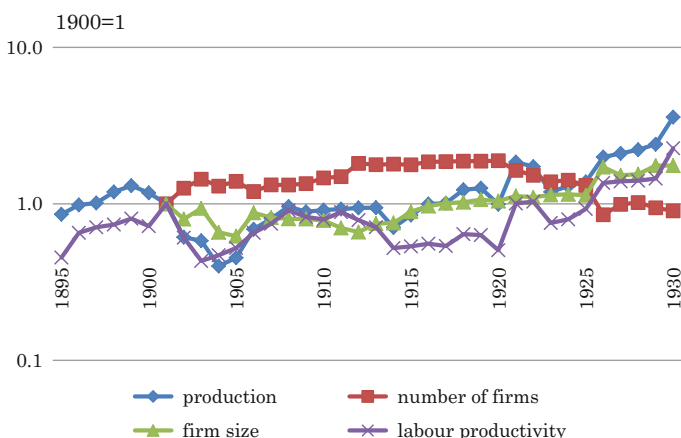


Fig. 11.5 Changes in production, the number of firms, average firm size, and labor productivity in Kiryu cluster, 1895–1930 (index, 1890 = 1.0). *Source* Hashino and Otsuka (2013a)

employing five to ten workers increased (Hashino and Otsuka 2013b). Hashino and Otsuka (2013b) also observed the small difference in labor productivity and *habutae* prices between Fukui city, which is the center of production, and surrounding counties, these observation suggests the ease of imitating *habutae* production technology. Such observations are consistent with the quantity expansion phase discussed in the Sonobe-Otsuka model.

The development after 1909 is distinctly different from the earlier period: production increased due to growth in labor productivity, whereas the number of firms initially decreased and then increased and the firm size remained essentially constant. The production of *habutae* was dominant except for the late 1910s and the quality improvement of mention product would not have been large.¹¹ Thus, the phase after 1909 is inconsistent with the quality improvement phase proposed by Sonobe and Otsuka.

Figure 11.5 shows the case of Kiryu from 1895 to 1930. Although there were production cycles, the real amount of production in 1920 was identical to that in 1900. The number of firms increased, even though firm size remained unchanged and labor productivity declined. This can be explained partly by the increasing number of small-scale out-weavers; members of farm households who used hand looms, and accepted putting-out contracts offered by merchants partly by the collapse of large, modern factories (Hashino and Otsuka 2013a). As far as the traditional sector relying on the out-weaving systems was concerned, not only the number of firms, but also the production increased. It appears that the development of the traditional sector in the Kiryu cluster could be characterized by the quantity expansion until 1920.

Somewhat similar to the case of the Fukui cluster after 1909, the production increased due to the increase in labor productivity in the Kiryu cluster after 1920. Unlike Fukui, the number of firms declined and the firm size increased. On surface, this case appears consistent with the quality improvement phase. What happened in this period was, however, not the quality improvement, but rather the shift to simpler and cheaper products (Hashino 2007). Labor productivity began increasing around 1908–09 in Fukui, but around 1920–21 in Kiryu. The question is why such differences emerged.

The answer seems to lie in the difference in the timing of the shift from hand looms to power loom, as shown in Fig. 11.6. The adoption rate of power looms increased considerably around 1910 in Fukui, precisely when labor productivity began increasing. In Kiryu, the power looms were adopted widely in the 1920s, which corresponds to the period when labor productivity increased. In other words, the major innovation was the introduction of power looms, which contributed to the growth in production and labor productivity. According to Hashino (2007) and Hashino and Otsuka (2013a, b), wage rate increased substantially before power looms were widely adopted. Since power looms had been available earlier, the adoption of power looms may have been the choice of technology responding to increasing wage rate, rather than innovation. Yet, Minami et al. (1982) point out that the quality of domestically produced power looms improved and their prices

¹¹Complaints about the low quality of *habutae* in European markets were serious issue in the early 20th century, which may be taken to indicate that the quality of *habutae* improved later than in the 1910s. According to the Consular Reports which informs bad reputations of *habutae* exported from Fukui, main quality problems were in coarse weaving, bad scouring, lack of uniformity, and false inspection ways, which needed collective efforts both by local government and private sector for quality improvement (Hashino 2010).

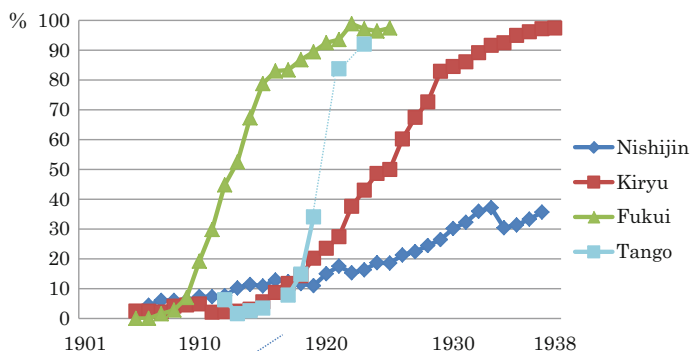


Fig. 11.6 Changes in the adoption rate of power looms by weaving cluster. *Source* Hashino and Otsuka (2013c). *Sources* For Nishijin, Kiryu, and Fukui, see Makino (1996), p. 21. For Tango, we used *The Yearbook of Statistics of Kyoto Prefecture* (from 1912 to 23)

declined. Regardless of whether it is the outcome of technology choice or innovation, what is important for our purpose is that the introduction of new production process had an impact on the number of firms; furthermore, productivity or profitability was similar to the prediction of the Sonobe-Otsuka model regarding the quality improvement as shown in Fig. 11.1.

An anomaly observed in Fig. 11.6 is that the adoption of power looms was slowest in Nishijin, which is the most advanced silk-weaving cluster, and fastest in Fukui, which is the least advanced cluster. Kiryu cluster was in-between. Such difference can be explained by the difficulty in substituting skilled labor by advanced machines or by the ease of substituting unskilled labor by machines. As was mentioned earlier, *habutae* is simple silk fabric that can be carried out by unskilled labor. Since Fukui had no strong tradition of weaving industry, only unskilled labor was available; which implies that it had a comparative advantage in the unskilled labor-intensive *habutae* production. In contrast, Nishijin had long tradition of silk weaving and, hence, was endowed with a skilled labor force capable of producing such highly complicated products as *kimono* and *obi* by using hand looms. Thus, Nishijin had a comparative advantage in the skilled labor-intensive production of high-quality *kimono*. It appears that Kiryu produced relatively simple and cheap *kimono* and products amenable to production by power looms.

It is also interesting to observe from Fig. 11.6 that the adoption rate of power looms was as high as 92% in Tango in Kyoto prefecture, which is another silk weaving cluster producing silk crepe, i.e., undyed intermediate products for *kimono*, for weaving firms in Nishijin under sub-contracts. As a result, the real value of production of silk fabrics in Kyoto prefecture as a whole, including Nishijin and Tango, continued to increase, even though Nishijin's production did not increase

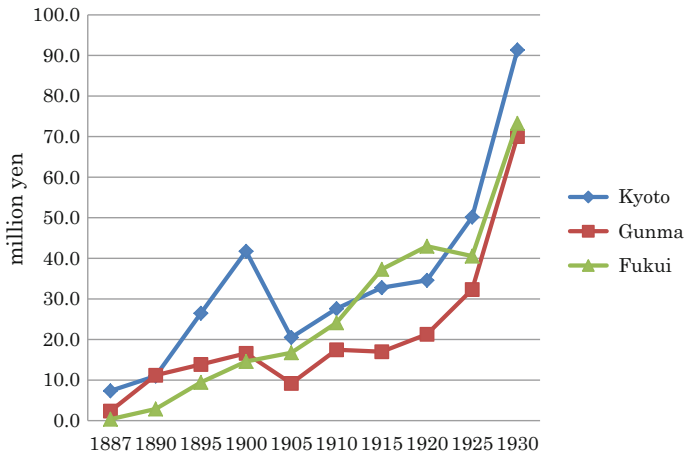


Fig. 11.7 Changes in the real value of fabric production by major prefecture. *Sources* Noshomu Sho (Ministry of Agriculture and Commerce) *Noshomu Tokei Hyo [Statistical Yearbook of Agriculture and Commerce]* (selected years)

dramatically (Fig. 11.7).¹² It can be also confirmed that the value of production in Fukui increased particularly rapidly from 1905 to 1915 when power looms were rapidly introduced, whereas the value of production in Kiryu increased with rising rate of adoption of power looms in the 1920s.

11.3.2 Role of Collective Action

According to Hashino and Kurosawa (2013), trade associations were formed in indigenous clusters of the silk weaving industry in the late 19th century Japan. Such associations performed at least two major functions: (1) to protect the name brand of the cluster or the reputation as a cluster of high-quality producers and (2) to introduce new technologies from abroad. The first function is important, because consumers rely not necessarily on the reputation of a particular firm or firms, but often more importantly on the collective reputation of industrial cluster. The locations of clusters, such as Nishijin, Kiryu, and Fukui, played the role of brands in Japan. The associations established training institutes to introduce new technologies, inspected the quality of products, and sent products to the exhibitions. They also received overseas consular reports which contained information about the reputation of their exported products through the Ministry of Agriculture and Commerce. Since collective learning of new ideas is precisely the function that

¹²We suspect that the value of production in Tango was double counted in the total production in Kyoto, because gross value of production rather than value added was reckoned.

attempts to internalize external economies associated with information spillovers, this is likely to stimulate innovations. Collectively controlling the quality of products produced is the activity beyond the agglomeration economies envisaged by Marshall, but it ought to play a critical role in increasing the profitability of production. In some silk weaving clusters, the same dyestuffs chosen by the trade association had to be used by all member firms of the association to assure the uniform quality of all products produced in the cluster (Hashino 2007).

According to Hashino (2012), many trade associations in silk weaving clusters in Japan established training institutes in the 1880s in order to prevent the production of inferior-quality products due to the misunderstandings of western dying technology and to restore the brand of the clusters. They also requested the prefectural governments to provide subsidies for training and requested the Ministry of Agriculture and Commerce through the prefectural governments to send specialists to the training institutes. Later, the informal training institutes were transformed into formal technical schools managed by the Ministry of Education. Such development makes sense, as local producers know what kinds of new knowledge, skills, and information are needed to upgrade their products, and local governments are in a favorable position to respond to such local demand.

In addition, we should not forget the critical roles played by local experimental stations, which were mostly established by prefectural government for the development of weaving clusters.¹³ Its importance is now commonly recognized by economic historians (Yamazaki and Abe 2012). For example, local experimental station in the Enshu cluster promoted its development by importing new technologies in order to reduce risk for local producers. Abe (1991) points out that the experimental station in Imabari cluster trained engineers, instructed weavers, developed higher-quality new products, and promoted marketing activities. Abe also refers to the activity of experimental station in the Banshu cluster, which enabled local producer to switch their products to exportable pre-dyed fabrics (Abe 1989). In the Bingo cluster, the station played an important role in sales promotion, as well as support for product innovations to produce higher-quality fabrics (Yamazaki and Abe 2012).

Local governments played important roles not only in rural areas, but also in large cities in Japan. The center of industrial development in Japan before World War II was Osaka, where different categories of technical educational organizations and research institutes were established by the Osaka municipal and prefectural governments, in order to support the development of small and medium-size enterprises (Sawai 1999, 2012). Many such enterprises were clustered, and undoubtedly the graduates from technical schools and trainees at the research institutes contributed to the development of industrial clusters by introducing new technologies. In other words, industrial clusters in Japan might have been quite

¹³In Kyoto, city government began supporting experimental station in 1916, which was originated from the institute established by Nishijin trade association in 1908. The first president of the institute was Naohiro Koriki who visited Fukui city for teaching *habutae* production.

different from the Anglo-Saxon industrial clusters which were characterized by competitions among producers (Abe 2012). Sonobe and Otsuka (2006) point out that it was challenging for high-quality producers of electric appliances in Wenzhou in China to establish the reputation of high-quality producers because “made in Wenzhou” used to be synonym of the low-quality products. According to Ruan and Zhang (2009), trade associations were spontaneously created in Zhejiang province to control the quality of products in the industrial clusters, particularly by suspending the operation of inferior-quality producers. According to Fleisher et al. (2010), some local governments in Zhejiang province set up quality inspection centers to randomly check product quality to filter out inferior products and producers. Nadvi (1999) reports that in the Sialkot surgical instrument cluster in Pakistan, the trade association provided information on markets, technology, and other relevant issues to members by means of training and inviting foreign buyers, and mobilized the state to adopt supportive programs for the cluster, in order to improve the quality of products.

To sum up, the collective action of producers in the cluster to jointly learn from outside aims to stimulate and facilitate innovation, while collective control of product quality represents efforts to shift the profit curve upwards by assuring the quality of products.

11.4 An Extension of Sonobe-Otsuka Model

While we believe that the Sonobe-Otsuka model of cluster-based industrial development is a useful framework to understand the long-term development process, we would like to argue that there is much room for further extension of the model. First of all, while Sonobe and Otsuka focus on the product innovations, process innovations or the choice of production technology must be taken into account as well. As was observed from the review of the development of industrial clusters in modern Japanese history, the process innovations are likely to bring about changes in the number of firms and productivity or profitability similar to the product innovations illustrated in Fig. 11.1. To the extent that factor prices, particularly wage rate are endogenously determined, the choice of labor-saving technology can be easily incorporated into the endogenous model of cluster development.

Secondly, clearer attention should be paid to the role of trade association in introducing new technology and management knowledge and protecting the name brand of industrial clusters (Hashino and Otsuka 2017). Since information spillovers or imitations make the social benefit of innovation greater than private benefit, incentives to innovate remain sub-optimal socially if innovations are carried out by individual producers. Thus, the collective research and training activities organized by the trade association are credible. Similarly, the trade association can undertake quality control for the collective benefits arising from the protection of name brand of the cluster. If the trade association successfully internalizes the

collective benefits, more path-breaking innovations would take place earlier in the manufacturing process and enhance the profitability to a greater extent. Consequently, it may be worth-while to explore the conditions under which the trade association works effectively for the development of industrial clusters.

Thirdly, the role of local government may have to be considered in depth, as it has grassroots level knowledge of industries and, hence has the potential to provide effective support for the development of industrial clusters. Sawai (1999) argues that competition among local governments induced the successful application of local industrial policies in various locations in prewar Japan. Similarly Hashino (2012) points out that the success of training institutes in some industrial clusters provided a significant stimulus to the establishment of similar institutes in other industrial clusters in prewar Japan. Zhang (2012) suggests that many successful industrial policies for cluster development originate from the local level in China, due at least partly to competition among local governments. If producers and workers in a locality realize the successful industrial development in other localities, they will complain to the local policymakers. If local policymakers want to keep their offices or want to raise their reputation as reliable leaders, they are likely to respond to the demands of the local people. This seems to be an important mechanism underlying the successful development of industrial clusters in Japan and China.¹⁴ Providing autonomy to local governments, strengthening their capacity to support the cluster development, and stimulating competition among local governments may be an integral part of the effective strategy to develop industrial clusters. Such aspect may have to be considered in the Sonobe-Otsuka model.

Finally it must be pointed out that although modeling may not be necessary, cluster study must recognize the importance of comparative advantage and appropriate technology choice as determined by factor endowments and factor prices. Historical studies on the development of industrial clusters in Japan clearly attest to the critical roles played by comparative advantage in determining the fate of the development of industrial clusters.

11.5 Concluding Remarks

This article reviewed the essence of the Sonobe-Otsuka model of cluster-based industrial development in developing countries and the major findings from case studies of industrial clusters in modern Japanese history, in order to examine the relevance of the Sonobe-Otsuka model for understanding the historical development of industrial clusters in Japan. We found that both studies commonly

¹⁴In the case of the formation and development of the potato producing and processing cluster in Gansu Province in China, it was the local government that introduced potatoes for commercial production, assisted the formation of trade associations to facilitate marketing, built wholesale marketplaces, and undertook research and extensions (Zhang and Hu 2013).

emphasize the importance of innovations in the development of industrial clusters, thereby providing new perspectives beyond the static Marshallian agglomeration economies. While Sonobe and Otsuka (2006, 2011, 2014) focus on the role of entrepreneurship and the effects of product innovations, Japanese historical studies pay attention to the role of trade associations and local governments, as well as process innovations.

Such different perspectives seem to stem partly from the differences in the reality of industrial clusters between contemporary developing countries and economic history in modern Japan and partly from the availability of data. It may well be that many industrial clusters in developing countries fail to develop because of the lack of active trade associations and the absence of support from the local governments. Closer attention to the roles of trade associations and local governments in the cluster studies may shed new lights on the success and failure of the development of industrial clusters in developing countries. Case studies of industrial clusters in developing countries also suffer from the absence of long-term data. In fact, they usually depend on the survey data that cover relatively short periods of time. While advantage of historical studies lies in the possibility to examine long-term development processes, its shortcoming is the lack of detailed data on production of firms and characteristics of entrepreneurs. Thus, in general, the role of entrepreneurship, as well as the importance of education and work experience cannot be analyzed since it is difficult to assess statistically the production performance of firms employing different production methods and producing different products.

There is no question from the above discussions that contemporary and historical studies of industrial clusters are highly complementary. Therefore, further efforts to synthesize the two strands of the studies are expected to deepen our understanding of the success and failure of cluster-based industrial development.

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Keijiro Otsuka is a Professor of Development Economics at Kobe University. He visited the World Bank from April 2011 to May 2012 to participate in the Core Team of *World Development Report 2013—Jobs*. He has been conducting a large number of survey-based comparative case-studies on diverse microeconomic issues of land reforms, natural resource management, industrial development, and agricultural development between Asia and sub-Saharan Africa. He received his Ph.D. in Economics at the University of Chicago in 1979, was previously a post-doctoral fellow at the Economic Growth Center at Yale in 1979, formerly chairman of board of trustees of International Rice Research Institute (2004–07), and President of International Association of Agricultural Economists (2012–15). He has served as the editorial board members of various international journals, including *Economic Development and Cultural Change*, *Global Food Security, Environment and Development Economics*, *Agricultural Economics*, and *Asian Development Review*. He received the Purple Ribbon Medal from the Japanese government in 2010 and became a Fellow of Agricultural and Applied Economics in 2013. He is co-author or co-editor of 23 books (plus 8 Japanese books) and 128 articles in refereed international journals.

Chapter 12

Decentralization of Natural Resources Management in ASEAN

Kaliappa Kalirajan, Kazi Arif Uz Zaman and Gaminiratne Wijesekere

12.1 The Preamble

The ASEAN region, with a land area of 4.5 million km², account for nearly 3% of the world total land mass. This region has a population over 605 million of which 45% live in urban areas. The region has 60% of the peatland areas of the world (25 million ha.). The region's natural resources of water, forests, oceans, and soil provide economic activities and livelihoods for its inhabitants. Most countries in the ASEAN region are served with river systems such as the Mekong River Basin, and Lake Toba. The region has a long coastline that measures about 173,000 km in total. The region is blessed with abundant freshwater resources, particularly Brunei Darussalam, the Lao PDR and Malaysia have the highest water resource per capita. Indonesia, Malaysia, and the Philippines are rich in biodiversity, and these countries together represent around 80% of global biological diversity (Roberts et al. 2002). About 65% of the world's coral species is located in the 'coral triangle' encompassing parts of Indonesia, Malaysia, and the Philippines, which is one of the most economically productive marine regions in the world (Suuronen et al. 2013). The forest cover in the ASEAN region is about 45% and provides a natural habitat for some 40% of all animal species on earth.

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Among the ASEAN countries Myanmar, Cambodia and the Lao PDR are agriculture-based countries with a high proportion of GDP coming from the agriculture sector. Brunei Darussalam and Singapore are the most urbanized countries in the region and the contribution of the agriculture sector to GDP in these countries is less than 5%. In between these two extremes Indonesia, Malaysia, Philippines, Thailand and Viet Nam are at different stages of transformation. Overall, the ASEAN region has shown positive economic growth in the last few decades consistently. For example, before the global financial crisis, during 2000–2007, the real GDP of the ASEAN economies has increased by 6%, and is expected to grow on average by over 5% during 2014–18, as projected by the OECD and depicted in Table 12.1. Some countries in the region, such as Lao PDR, Cambodia, and Indonesia are projected to increase their real GDP over and above the ASEAN average. Indonesia, Philippines, Thailand and Viet Nam are now within the middle-income group of countries, as defined by the World Bank, with Malaysia is approaching the upper end of that range. The scenario simulation of the OECD study revealed that Malaysia is likely to become a high-income country in 2020, Thailandians 2026, Indonesians 2042 and both the Philippines and Viet Nam could become high-income countries after 2050 (OECD 2013).

Increasing population and rapid economic growth in the ASEAN countries, combined with the existing social inequities, have exerted mounting pressures on the natural resources both in individual ASEAN member countries (AMCs) and in the region. Countries in the region are also subjected to transboundary environmental issues such as air, water and land pollution, urban environmental degradation and the depletion of natural resources. These forces have led to an increased consumption of resources and generation of disposable waste. Despite an

Table 12.1 Annual percentage change and projected change in real GDP growth, ASEAN

Country/group	2000–07	2012	2018	2014–18
<i>ASEAN-6</i>				
Brunei Darussalam	–	1.0	2.4	2.3
Indonesia	5.1	6.2	6.1	6.0
Malaysia	5.5	5.6	5.3	5.1
Philippines	4.9	6.8	5.9	5.8
Singapore	6.4	1.3	3.1	3.3
Thailand	5.1	6.5	5.3	4.9
<i>ASEAN-4 (CLMV countries)</i>				
Cambodia	9.6	7.2	7.1	6.8
Lao PDR	6.8	7.9	7.5	7.7
Myanmar	–	–	7.0	6.8
Viet Nam	7.6	5.2	6.0	5.4
ASEAN-10 ^a	5.5	5.5	5.6	5.4

Source OECD (2013)

^aExcluding Myanmar

abundance of natural resources, the ASEAN countries are facing the challenge of keeping a balance between environmental sustainability and economic development (Anbumozhi 2010). Indonesia and the Philippines in the region are particularly prone to natural disasters such as typhoons, storms, and flooding. The other AMCs are not immune to these disasters, however. Between 1970 and 2010, it was estimated that people exposed to flooding doubled and people in cyclone-prone areas in the region rose from 72 million to 121 million (UNDP, UNESCAP/ADB 2013). AMCs are diverse in their levels of developments. Therefore, priorities for Natural Resource Management vary across these countries and their emphasis is different according to the level of risks involved. Despite these differences in national priorities, each country in the ASEAN region has placed emphasis on sustainable development in a decentralized framework as part of their development plans.

12.1.1 Natural Resources Management and Its Significance

Natural Resources Management (NRM) encompasses not only the planning of land use, water and soil management, maintaining air quality, biodiversity conservation and ecology, but the contemporary environment economists also incorporate the issues like ensuring the future sustainability of industries covering agriculture, mining, tourism, fisheries, and forestry. Natural resource availability, in general, is the function of the demand and supply of resources. The demand side shows an ever-increasing trend, resulting from the countries' continual efforts, for higher economic growth and betterment of human lives. On the contrary, the supply side is more or less unpredictable and restrained from sudden abundance restoration. These would result in a potential scarcity of natural resources which poses the risk of reaching a *point of no return* in environmental degradation, with time. This would not only result into a depleted ecosystem, but also act as a source of threats of over-exploration attempts for new resource stocks that would damage the environment's long-term sustainability. The impact is not confined within the national boundary; rather, a significant portion of this affects beyond the geographical boundaries and ultimately becomes a global concern. Increasing concern over the complex dimensions of natural resource dynamics has induced the paradigm transition of global policies focusing more on sustainable and resilient environment in recent times. Hence, efficient and effective natural resources management have become crucial for ensuring sustained development and a better future for the region.

Though government institutions play a major role in developing strategies to manage the natural resources, and the development of partnership between government institutions and the local communities play a critical role in nurturing and sustaining the effective implementation of natural resource management policies. The main objective of this decentralized approach is to enhance local participation

in natural resource management decision-making to overcome ingrained structural rigidities. The decentralized approach of management unlocks the existing inertias that reflect a lack of inclusiveness and equity in managing natural resources through the implementation of projects at field level, oriented to disseminating power within local communities. In the Asian region, countries like China and India have successfully involved the local communities in the management of natural resources. It is in this context, how the ASEAN countries have been involving the local communities in the decentralized framework in managing natural resources is examined in the following pages.

Originating in 1967, ASEAN has been thriving for accelerated economic growth, social progress, regional peace and stability through mutual understanding, trust, and cooperation among the member states. Over time, it has enhanced its scope and horizon of activities. In this process, with a view to achieving the sustainable development, while promoting clean and green environment through protecting the natural resource base of the AMCs and the region as a whole, ASEAN Socio-Cultural Community (ASCC) Blueprint adopted in 2009 incorporated '*Ensuring Environmental Sustainability*' as one of its six broader characteristics. Eleven different elements with a total of 98 action plans were set to accomplish the goal of these characteristics. Some of the action plans exerted the responsibility to individual member states, while the others required a consorted cohesive effort from all the members. The ASEAN Secretariat is in charge to monitor and review the implementation of the ASCC Blueprint.

A Mid-Term Review (MTR) was called into evaluate the progress and the effectiveness of the implementation activities both at national level of each member country and also ASEAN bloc. Assessment was based on primary data, documents, and interviews with concerned stakeholders throughout June–August, 2013. ASCC scoreboard, adopted in February 2012, provides a quantitative assessment of the achievement of goals and targets for each AMCs, while the implementation-focused monitoring system helps to analyze the procedural implications of the ASCC Blueprint.

12.1.2 Objectives of This Study

The objective of this study is to analyze the performance of NRM of each AMC on the basis of MTR with special attention to decentralized governance. Based on the review, an analytical framework will be proposed with relevant modification, direction for the future, and corresponding way forward to improve the decentralized management approach. Some guidelines on time-bound short and long run action plans will be suggested. Another important focus will be on developing standardized concrete indicators or benchmarks that may be used for measuring the NRM activities within a common framework for all ASEAN countries.

12.2 Regional Policy Framework on Environmental Sustainability

Overall, the ASEAN strategies for natural resource management are incorporated in 11 priority areas outlined in the ASCC Blueprint (2009–2015). These priorities focus on climate change in general and particularly on the sustainable development of water, forests, air, coastal, and marine resources.

For each of the priority areas, the ASCC Blueprint has identified the Subsidiary Organizations (SO) that are responsible for the implementation and collection of data on selected priority areas. These SOs act as working groups and develop programs, objectives, targets, and indicators to measure the progress of work for the relevant areas. The ASCC Blueprint has also assigned a Lead Country (LC) which is responsible for strategic direction and overall responsibility relating to the program. The ASEAN Secretariat is responsible for areas that have not been assigned to a specific SO and LC. The following table outlines the priority areas specified in the ASCC Blueprint with the Subsidiary organization and Lead Country for each priority area (Table 12.2):

The SOMDP manages reporting, sharing of information across sectoral bodies and monitoring results. The ASEAN Heads of Statistical Offices Meeting (ASHOM) is responsible for statistical coordination within ASEAN and the

Table 12.2 ASCC blueprint: priority areas, subsidiary organization, and lead country

Priority area	Subsidiary organization	Lead country (2013–2016)
D.1. Addressing global environmental issues	AWGMEA	Thailand
D.2. Managing and preventing Transboundary environmental pollution (Transboundary and Transboundary movement of hazardous wastes)	AATHP	ASEAN secretariat
D.3. Promoting sustainable development through environmental education and public participation	AWGEE	Brunei Darussalam
D.4. Promoting environmentally sound technology		Indonesia
D.5. Promoting quality living standards in ASEAN cities/urban areas	AWGESC	Cambodia
D.6. Harmonizing environmental policies and databases	ASEAN Secretariat	ASEAN Secretariat
D.7. Promoting the sustainable use of coastal and marine environment	AWGCME	Philippines
D.8. Promoting sustainable management of natural resources and biodiversity	AWGNCB	Myanmar
D.9. Promoting the sustainability of freshwater resources	AWGWRM	Malaysia
D.10. Responding to climate change and addressing its impacts	AWGCC	Viet Nam
D.11. Promoting sustainable forest management		

Source ASEAN Cooperation on Environment website, <http://environment.asean.org/about-us-2/> accessed on 3 August 2017

publication of statistics to measure the progress of the ASEAN region's achievement of Millennium Development Goals (MDGs). From an independent NRM purview, it is revealed that some of the elements set under the characteristic of 'Ensuring Environmental Sustainability' in the ASCC Blueprint 2009–2015 seem to overlap with the core idea of natural resources management. For example, prevention of trans boundary environmental pollution, hazardous wastes, haze, promotion of environmentally sustainable cities, and climate change issues reflect the 'multifaceted aspects' of natural resources management, while the promotion of coastal and marine environment, biodiversity, water resource management, and sustainable forest management reveal the 'specific aspects' of natural resources management. Though some positive trends are shown for most of the AMCs' performances in adopting and executing the action plans, the MTR and the ASCC Scorecard depict the fact that, not all the AMCs have been on par in successfully implementing the ASCC Blueprint.

12.2.1 Current Issues

Overall, the ASEAN Roadmap identified some systemic issues that act as barriers to the attainment of the Millennium Development Goals (MDGs), which were identified from workshop deliberations, and consultations with individual AMCs. These issues are equally applicable to non-MDG indicators used in areas included in the ASCC Blueprint.

Currently, achievements of targets are stated using three different ways: (a) absolute or proportional change between the baseline year and the current year and the level of change depends on the level recorded in the baseline year; (b) achievements are expressed either as rates or percentages; and (c) achievements are based on general statements. Also, in assessing achievements the major focus is on outputs rather than outcomes, though outcomes may provide valuable information on program achievements. In spite of the presence of large disparities between geographic areas there is no sub-national or decentralized focus. Therefore, all indicators need to be disaggregated by sub-national areas and by age and sex for relevant indicators.

12.2.1.1 Data Collection and Reporting

The MTR reveals some of the facts on the challenging aspects of data collection and reporting on sustainability of environment. It seems that the collection, processing, and reporting of the large volume of data by the AMCs mounted considerable burden on the respective statistical body and other reporting agencies, some of which are mostly considered to be overburdened with work. For example, the number of indicators recommended for use in NRM alone exceeded 50, and most of these are new and are, in addition to the few environmental sustainability indicators,

included (Goal Number 7) in the MDG framework. Specifically, concerning water resources alone there are 24 quantitative indicators and 18 qualitative type indicators each. AMC is expected to report whether or not any specific services/legislations are available for specific water-resources. There are many other areas covered in the blueprint which require data to produce indicators.

While the relevant subsidiary bodies normally consult AMCs and relevant agencies in developing the monitoring indicators, there are some member countries that are yet to develop their capacity to provide such data for compiling indicators. Even in some cases, when data are supplied they are either incomplete or are subject to a significant margin of errors. For example, the feasibility study endorsed by the ASEAN Heads of Statistical Offices Meeting (2010) found that out of the 60 MDG indicators, only 27 indicators were usable and of good quality, which were comparable across AMCs. It was also noted that several data items reported by some AMCs needed substantial adjustments and imputations before they were used for compilation of relevant indicators.

In order to monitoring the progress of achievements it is natural to ask for more data. However, having to compile and report on many indicators could burden statistical organizations, which would be counterproductive in some countries. The present emphasis on the number of indicators, in few cases, seem to have adverse effects on timely submission for reporting. Accountability and transparency issues are also being challenged through this process.

12.2.1.2 Implementation of Policies and Programs

There are few challenges that the AMCs had to face in implementing the policies and programs for NRM. Important areas of challenges are:

- **Alignment between national and sectoral plans**

Development plans, strategies, targets and timelines on environmental sustainability and NRM of few AMCs are not aligned compatibly with the overall national plans and strategies. Accordingly, in some cases, national plans are not reflected in sectoral plans or vice versa. These kinds of policy imbalances are very difficult to correct, as the 'ASEAN Way' is not to interfere with each other member's domestic (national) policies. Here, the building up of social capital and political capital in the form of social awareness, understanding, and cooperation across members is needed.

- **Decentralized involvement of all stakeholders**

In activities relevant to the attainment of respective targets, some stakeholders including professional bodies, civil society organizations and NGOs and the private sector seem not to be involved intensely. These stakeholders are in some ways interested in the activities that are directly or indirectly relevant to them.

- **Information sharing**

The ASCC blueprint recognizes the importance of relying on existing databases and best practice manuals developed within ASEAN. There is also the need for

academic and research institutions to undertake extensive research, particularly on the updating of best practices of NRM and to exchange the results on NRM among the member countries.

- **Institutional and legal reforms**

Instituting effective reforms with respect to institutional and administrative structures and legal framework is an issue to address for most of the AMCs. These reforms are required to build an enabling environment for NRM.

- **Coordination and partnership**

Another issue that frequently emerges as a significant problem, is the lack of effective coordination across agencies. For example, the responsibility for the supply of clean water and the provision of sanitary facilities is divided between multiple agencies. Coordination across these agencies is essential for effective implementation and efficient monitoring of progress.

12.3 Future Directions

Based on the comprehensive assessment on MTR of the ASCC Blueprint, and analysis of the respective NRM of the ASEAN member countries, some guidelines for the future are presented in the following sections.

12.3.1 Newer Perspective: Natural Resources Management for Better Life'

Changing socio-ecological and political dynamics seems to have a profound influence on the implications of recent global and regional policies. As a result, it is revealed that all economic development agendas are getting linked to socio-welfare and human development goals over time. In this process, the ASCC Blueprint adopted in the Cha-Am Hua Hin Declaration on the ASEAN Roadmap stated its primary goal as “*to contribute to realizing a people-centred and socially responsible society*”. However, the embodiment of human welfare was not explicit and consistently evident in most of the agendas and action plans adopted under the characteristic termed ‘*Ensuring Environmental Sustainability*’. Especially, the NRM, which is closely linked with human lives and livelihoods, could have given more emphasis to this particular issue. Therefore, for strengthening the NRM in ASEAN for the post-2015, a key focus could be explained as ‘*Natural resources management for better life*’, where all the policies and action plans should be linked with the continual welfare of human lives and livelihoods within the society, while protecting the environment and thriving for the sustainable management of natural resources in the region.

In this context, it is worth noting that the United Nations, in its Sustainable Development Goals (SDG), which will replace the Millennium Development Goals for the post-2015 period, put more emphasis on the inclusion of people in the proposed agendas. It states:

People are at the centre of sustainable development and, in this regard, in the outcome document, the promise was made to strive for a world that is just, equitable and inclusive and the commitment was made to work together to promote sustained and inclusive economic growth, social development and environmental protection and thereby to benefit all, in particular the children, youth and future generations of the world. (Open Working Group 2014: 1)

Therefore, the above-mentioned aspect of post-2015 NRM in ASEAN would also help the member states to achieve the targets of SDG, whose priority areas and the broad objectives outlined in the draft SDG of the Open Working Group (OWG) of the United Nations appear comparable with the ASEAN priorities and the post-2015 development agenda of the AMCs. Further, it is important to note that the SDG framework is designed on the view that the regional and individual priorities should take precedence over global priorities. This will allow flexibility for the AMCs to define their own decentralized routes to development within the global framework for sustainable development outlined in the Open Working Group (OWG) report approved by the United Nations General assembly.

12.3.2 Reshaping the Blue Print: The NRM Perspective

The existing ASCC Blueprint has incorporated many of the issues concerning NRM. However, the issues are not framed in a very cohesive way. In fact, only one specific element (Number 8) under the characteristic referred to as '*Ensuring Environmental Sustainability*' has incorporated the term 'natural resources'. Furthermore, one action plan under this element is aimed to combat against land degradation, while all the remaining action plans focused merely on biodiversity issues. Though the NRM issues like water resource management, forest management, coastal and marine environment management, and haze pollution management are dealt under different elements in this blueprint, few other issues such as proper land use, soil management, and the quality of air management are not discussed in a broader framework. Moreover, the other dimension of NRM that deals with the future sustainability of industries comprising agriculture, mining, and tourism was not included in this current roadmap.

12.3.2.1 The Elements

For strengthening the NRM activities in ASEAN, it is so vital to treat the NRM issues more specifically and concretely. This demands strengthening NRM

activities in ASEAN, the rearrangement of the existing framework of ASCC on NRM. The format could be reframed with some reorganization in terms of defining and categorizing the elements and designing time-bound action plans for each element.

Following arrangement of the elements can be considered:

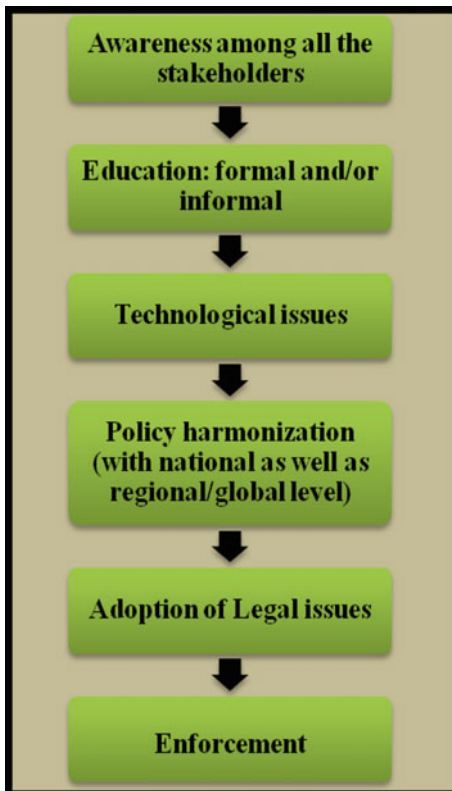
1. Resource-based elements (at the national level)
 - Usage of land.
 - Inland water resources management.
 - Ensuring the quality of soil.
 - Ensuring the quality of air.
 - Sustainable forest management.
 - Sustainable management of biodiversity.
 - Promoting the sustainable use of coastal and marine resources.
 - Ensure environmental quality of life.
 - Future sustainability of agricultural industry.
 - Sustainable extraction and use of energies and minerals.
 - Promoting green and sustainable tourism.
2. Resource-based elements (at the regional level)
 - Transboundary haze pollution management.
 - Transboundary movement of hazardous wastes.
 - Joint management of transboundary protected areas.

12.3.2.2 Action Plans

Action plans should be designed on short-term, as well as long-term basis. The plans should preferably be SMART i.e. Specific, Measurable, Achievable, Realistic, and Time-bound. Country's present status in terms of the advancement towards environmental sustainability, relevant institutional development, socio-political settings and consumer preferences should be considered for effective formulation of action plans for NRM. To accommodate the goals set by SDG for post-2015, action plan for ASCC can be designed in accordance with those relevant targets of SDG. For proper implementation of NRM, the sequential methodology of action plans may be set for each element (where applicable) as mentioned in Fig. 12.1. It implies that the foundation of widespread knowledge on each natural resource is the key for NRM.

At the earliest stage, the building up of the awareness on NRM issues among the respective stakeholders is necessary, since it will provide the required platform for further enhancement of action plans through formal education and technological specialization. Prior to the adoption of legal framework on NRM issues, harmonization of policies (both at national level, as well as regional/global level) must be ensured. While it is acknowledged that the harmonization of policies among AMCs

Fig. 12.1 Chronological action plans for implementing NRM in ASEAN countries.
 Source Authors



poses difficulties for implementation due to the different stages of development of AMCs, there is need for consorted efforts to build ‘political capital’ in the form of improving political will among the policymakers of AMCs. Nevertheless, the enforcement of the adopted action plan under that legal frame is the ultimate stage. Table 12.3 refers to the probable focus areas of natural resources, programs or action plans, and institutional development at different phases of NRM implementation. It is important to note that, along with natural resources and programs, institutional development should be given adequate emphasis from the early phase of NRM implementation. Institutions, as we know, are the rules of the game that reduce the uncertainties through shaping the interactions among the stakeholders. Hence, the simultaneous development of an institutional framework is as important as the other basic elements of NRM.

Planning for NRM requires a different approach than any other conventional centralized economic planning. Since every small locality or area has different environmental characteristics with the diverse nature of local demands, the local communities would better affiliate with the challenges, prospects, and the way forwards associated with the NRM policy for that region. A bottom-up or the

Table 12.3 Key focus areas at different phases of NRM

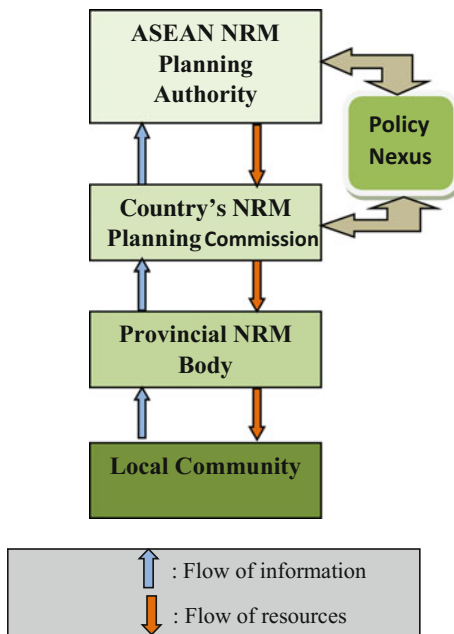
Phase	Focus areas of natural resources	Focus areas on programs/plans	Focus areas of institutional development
Basic Foundational	Baseline assessment on natural resources	Awareness, skill and knowledge development	Need assessment and designing NRM institutional framework
Short run	Immediate priorities to face the disastrous state of natural resources	Enhanced NRM involvement within communities and relevant stakeholders	Design institutional rules and capacity building issues
Medium term or intermediate	Maintenance or improvement of the states of all natural resources	Enhanced capacity and adoption of sustainable NRM practices across the broader ranges	Enhanced network among relevant institutions and modification/harmonization of activities
Longer run	Natural resources conservation	Capacity to manage sustainable NRM activities independently as well as cohesively by respective stakeholders at all levels	Establishment of well-managed institutional settings with continuous thrive for innovation and connectivity with global NRM bodies

Source Authors

decentralized approach is, therefore, recognized as a more effective way in NRM planning. Flowchart in Fig. 12.2 depicts the ‘bottom-up’ or the decentralized approach for the NRM policy formulation. Since the wellbeing and livelihoods of the local community rely on the vigour and productivity of the environmental settings they lived, it is, therefore, assumed that those locals have better information on the current state and the condition of the natural assets. It is also expected that with the practical understanding and experience regarding the potential integration of the management of production and conservation across land and water boundaries, the local community can contribute to identify the challenges and opportunities of their local NRM system.

Such information, along with the customized recommendation on NRM policy measures from the local community, would help in formulating an effective and compatible policy framework for the regional level. Consequently, the government would analyze all the information and policy recommendation received from different decentralized parts of the country. At the same time, it would also share the policy nexus with the ASEAN Socio-Cultural Community (ASCC) Blueprint aligned with the vision and set goals. Amalgamating all together, the government can determine the priority issues and formulate the NRM policy with some spatial NRM set of actions. Accordingly, the resources required for proper and timely implementation of those action plans can be allocated through the top-down ladder.

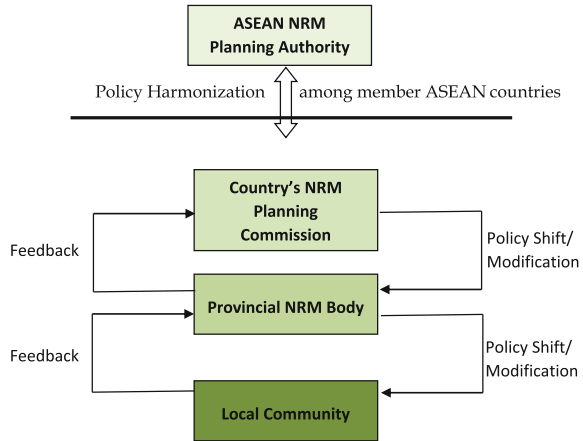
Fig. 12.2 Decentralized bottom-up approach of NRM policy formulation. *Source* Authors



12.3.3 Monitoring and Evaluation of NRM

Concerning the policy implications of NRM, ‘Adaptive approach’ is extensively used in some of the developed countries, such as Australia, with great success. It is, in general, a *learning by doing* process to address the risks and uncertainties innate within the erratic systems like natural ecosystems and socio-economic environments. This approach would be more useful in adopting a resilient framework of NRM for region like ASEAN since it could manage the complex interactions that exist within the diverse socio-economic and environmental systems of AMCs. Flowchart in Figs. 12.2 and 12.3 shows the basic structure of the adaptive NRM model under the ‘decentralized bottom-up’ approach. Feedback on policies and action plans on NRM are transmitted from the local community to province, and then from province to country. Receiving the feedbacks from each country, ASEAN may rearrange and harmonize its existing policies. Accordingly, the AMCs can re-strategize their priority agenda for future national NRM policy while keeping the ASEAN vision in mind. The national policy would then be implemented with some modification and customization at provincial, or subsequently, at the local community level. Thus, the decentralized approach to natural resource management is applied not only within each member country, but also across countries when ASEAN is taken as a regional centralized entity.

Fig. 12.3 Decentralized policy feedback process.
Source Authors



Efficient adaptive management of NRM, however, requires the following interconnected features in tandem:

- A scientific approach that can ensure access to accurate and relevant information about natural resources that explicitly reveal the current understanding regarding the nexus among its performance-related hypotheses. This would help anticipating the probable implication of a proposed action plan of the NRM.
- Robust and continual monitoring of the system (both natural resources’ conditions as well as programs’ performances) with respect to the goals and objectives of NRM, conducting concrete evaluation and using the evaluation outcome for improving further understanding of the issues.
- Redesign and necessary adjustments in action plans, programs and even the structure of the existing NRM system in accordance with the evaluation of the outcome.

12.3.3.1 Two Areas of Monitoring

Monitoring is so vital in the case of the adaptive approach towards NRM since it ensures the quality control of natural resources and programs’ performance through evaluation function that plays the key role for continuous improvement. Two broad areas of NRM monitoring are as follows:

- **Natural resources (asset) condition:** to monitor the changes in the state of natural resources along with portraying the trends of their condition using set indicators and benchmarks.
- **Programs’ performance:** to scrutinize the outcomes of the NRM programs or action plans and to analyze the role and nexus of the people, institutions, methodologies, and policies for the outcome of the program.

12.3.3.2 Indicator for Performance Measurement

Indicators are essential for proper monitoring and assessment of the situation. Since there are two broad areas of monitoring, the indicators may also be grouped accordingly:

- (1) Indicators for the status of natural resources
- (2) Indicators to assess the programs' performance

Some key aspects for effective indicators:

- (a) Indicators must be measurable and meaningful.
- (b) The definition of each factor used for the indicator must be explicitly described in the blueprint. Even for assessing the programs' performance, the action plan should not only concentrate on the initiation or completion of that program, rather the appropriateness, impact, effectiveness, efficiency and legacy aspects of the program must also be defined. (Refer to Box-1 for guideline)
- (c) For comparison between targeted and actual status or performance, some benchmark must be set, both by the national authority and ASEAN as a regional body.

In this NRM Framework, three types of targets can be considered:

- i. Immediate or short-term targets (usually set the aim for 3–5 years)
 - ii. Longer-term targets (usually for 5–10 years)
 - iii. Aspiration targets (this is the ultimate ideal target i.e. best possible)
- (d) Harmonization is very important from a regional perspective. It must be ensured that similar indicators are used in all ASEAN countries with this purpose of NRM.
 - (e) Based on the priority or severity of the status or performance measures, frequency of assessment may be determined.

Box-1 Evaluation of a Program's performance

Appropriateness:

- To what extent is the program aligned with the needs of the intended beneficiaries?
- To what extent is the program compliant with recognized best practice processes in the field—e.g. the type, level and context of associated activities?

Impact:

- In what ways and to what extent has the program or initiative contributed to changing natural resources' condition, management practices and institutions?

- What, if any, unanticipated positive or negative changes or other outcomes have resulted?
- To what extent were the changes directly or indirectly produced by program interventions?

Effectiveness:

- To what extent have the planned activities and outputs been achieved?
- Are current activities the best way to maximize impact or are there other strategies that might be more effective?
- To what extent is the program attaining, or expected to attain, its objectives efficiently and in a way that is sustainable?

Efficiency:

- To what extent has the program attained the highest value out of available resources?
- How could resources be used more productively and efficiently?
- What could be done differently to improve implementation, and thereby maximize impact, at an acceptable and sustainable cost?

Legacy:

- Will the program's impacts continue over time and after the program ceases?
- How should the legacy be managed and by whom?

Source Commonwealth of Australia (2009).

Most of the key NRM indicators are considered as the global best-practiced indicators and are used by some developed countries and organizations including OECD, WTO, USDA NRCS, and WB. It is worth noting that few of the indicators require advanced techniques and tools to implement in the short term. Therefore, constant efforts involving not only the concerned government departments but also national/regional universities and research institutions should be made by the AMCs in this regard to strengthen their NRM system in the long run.

12.3.4 Reporting System for NRM

Reporting system of NRM can be categorized in two levels; national and regional levels. It is expected that both level would complement each other and would improve over time in terms of transparency, accountability, and effectiveness. Adaptation and subsequent synchronization of reporting system is so vital in this regard.

- (a) **National Level:** The reporting system is important for dissemination of the development status of the NRM factors to all relevant stakeholders. At the national level, this report, which is prepared under a decentralized framework, could provide effective performance assessment for all levels from the key policymakers of the country to the local level implementer. Furthermore, such a report would help in identifying performance issues that require action to develop and analyze management options, evaluate and recommend adjusted management options. Such reports should be published at regular intervals, preferably more than once in a year.
- (b) **Regional level:** Reporting of NRM issues at regional level requires the accomplishment of reports from all ASEAN countries on time. Reports received from all AMCs must be well synchronized and compatible with the requirement of ASEAN. The report should be published at the earliest time after collecting all AMCs' reports so that quick policy adjustment can be made possible. Such reports should not only analyze the performances of AMCs, but it should also predict the potential areas of concern in the near future so that preventive or precautionary measures can be taken. Based on the reports, ASCC Blueprint for post-2015 may keep provision for regular prudential modification in the existing models and methodologies

12.3.5 Coordination Among Respective NRM Bodies

NRM governance, in general, has multidimensional challenges. In an effective NRM system, there exist multiple levels for policy implementation, multiple players with different calibres as policy implementers, numerous policy instruments, and complex multi-organizational settings for implementation of those policies. For example, in the case of water supply, there are different agencies responsible for different areas, such as urban, islands, and rural without much coordination among them. A concerted effort and coordination are, therefore, the keys to successful implementation of NRM activities. It is, however, more challenging under the adaptive approach of NRM, especially within a bigger regional framework like the ASEAN.

Division of responsibilities for different jurisdiction of activities on NRM should be specifically assigned for each of the following layers in a decentralized framework:

- ASEAN
- Country
- Province
- Local Community
- Individual

Bellamy and McDonald (2005) model can be considered in this regard.

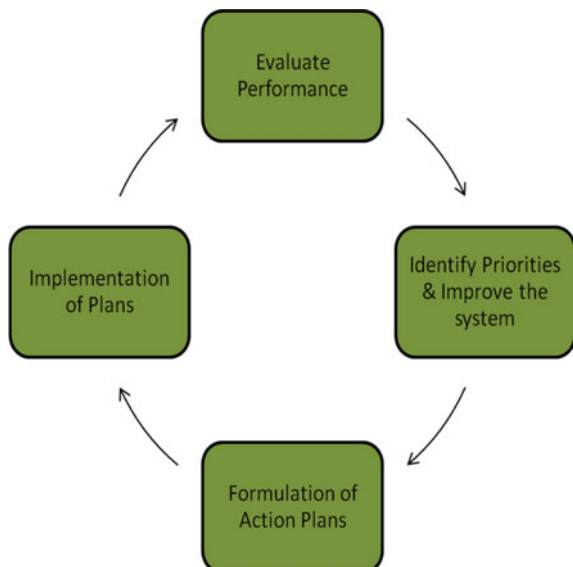
- Increased collaboration among government, local government, different agencies, civil society, media, and citizens in terms of dialogue, debate, and social involvements;
- Improved democratization in decision making, preferably under a decentralized framework;
- Encourage individual emancipation and moral development while ensuring accountability for collective decisions.

An integrated and systemic national approach (for each AMCs) to NRM should be incorporated. When the concerted efforts from each country get in order, ASEAN as a whole can be managed in a more coordinated way. Protocol on enforcement of the trans-boundary haze pollution agreement needs to be created. There should be more sectoral cooperation. Currently in most AMCs, only the environment minister is involved. The agreement should be raised to the Prime Ministerial level in order to have broader participation. The initiative should also include indigenous population and private sectors. Further, the ASCC should have an outcome-oriented scorecard for which further research and analysis need to be instituted and implemented.

12.4 Concluding Suggestions

Improvement in NRM results from frequent monitoring, learning, and adaptation. To ensure that the NRM continues to improve, the whole system needs to operate in a continuous improvement cycle as shown in Fig. 12.4.

Fig. 12.4 Continuous improvement cycle for NRM.
Source Government of South Australia (2012)



In the NRM context, a learning environment is important, which should be conducive enough to encourage all the stakeholders to investigate the effectiveness of their role and policies in the process of sustainable decentralized management of natural resources. With this self-evaluation of performances, the strategies may be refined and rearranged to improve the system. Accordingly, a new set of action plans may be formulated and passed across those stakeholders once again, with the emphasis on the decentralized governance structure. Importantly, as argued above, the ASCC should have an outcome-oriented scorecard as in AEC; not just the action-oriented score card.

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Chapter 13

Fiscal Decentralisation and Economic Growth: Evidence from Vietnam

Tai Dang Nguyen

13.1 Introduction

Over the past few decades, decentralisation has been one of the major reforms undertaken in both developed and developing countries. In the context of increasingly greater demand by citizens for better public services and liberalisation of cross-border investments, sub-national governments have been granted a greater degree of autonomy in political, administrative and fiscal authority. For Asian emerging market economies including China, Indonesia, India and Vietnam, this reform has been implemented successfully.

The theoretical literature suggests that greater devolution of fiscal authority to lower levels of government may contribute to the increased quality of public service provided at those jurisdictions. Fiscal decentralisation facilitates the transfer of power from central to local governments, which generally have better local knowledge and therefore would provide public services to effectively meet the needs of local constituents. It can also help create competition among local governments, which contributes to improving governance efficiency and effectiveness.

The improved quality of governance enables better policy in infrastructure (both physical and human capital) to attract more financial investment from both domestic and foreign investors to a particular jurisdiction. As a result, fiscal decentralization can potentially improve development outcomes such as higher foreign direct investment (FDI), exports, provincial gross domestic product (GDP), and health and educational outcomes.

Although decentralisation programs have been experimented and implemented at various degrees in many countries, there has not been much convincing empirical

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evidence of its effect, be it positive or negative, on local development at the sub national levels.

For the case of fiscal decentralisation in Vietnam, the literature is really sparse. Given the country's high economic growth rate in recent years, considered as one of the emerging economic stars, the question about the likely contribution of the fiscal decentralisation reform program to its economic performance warrants attention. This question is even more interesting in the context of Vietnam's unitary one party-state political system, which can make it more susceptible to some of the adverse aspects of decentralisation. A credible answer to address this question would have important implications not only for policy makers in Vietnam, but also bring valuable lessons that can be applied to other developing countries.

The current paper looks to provide evidence on the effect of fiscal decentralization on economic growth in provinces across Vietnam. The key question is: What is the effect of fiscal decentralization on economic growth across provinces, controlling for heterogeneity of provinces and potential endogeneity of fiscal decentralization?

As a contribution to the literature, this paper has used a newly available panel dataset, and new measures of fiscal decentralisation. Using a panel dataset covering 64 provinces in Vietnam for the 2004–10 period, the paper provides evidence that fiscal decentralisation has a positive and statistically significant effect on economic growth across country's provinces.¹ By applying fixed effect and GMM models, the paper accounts for heterogeneity of provinces and addresses the potential endogeneity of fiscal decentralization.

The rest of the paper is organised in the following sections. Section two provides a brief summary of theoretical models on fiscal decentralisation and empirical findings. The next section gives a brief introduction of the current state of fiscal decentralisation in Vietnam. In section five, methodology and data are presented. Empirical results are given in section five and section six concludes.

13.2 Fiscal Decentralisation—Theoretical Models and Empirical Findings

Oates provides an excellent summary of the basic theoretical framework underlying the fiscal decentralisation literature (also called “theory of fiscal federalism”), which includes “assignment of functions to levels of government, the welfare gains from fiscal decentralisation, and the use of fiscal instruments” (Oates 1999, p. 1121).

Oates (1999) argues that the basic principle of fiscal decentralization is that public services should be provided by the lowest level of government. Imperfect information gives rise to a justification of how public service can be better delivered at the local level by local authority rather than by a central planner. As these

¹Vietnam currently has 63 provinces after Ha Tay province was merged into Hanoi in 2008.

information asymmetries exist, local governments usually have better knowledge of both local preferences and cost conditions than the central government. Also, it would be difficult for a centralised government to provide differentiated public goods to citizens in all local jurisdictions without incurring considerable cost. In addition to the lack of local information and knowledge, political constraints often put a limit on the capacity of central governments to provide unequal levels of public services in different localities. Therefore, on the grounds of economic efficiency, the decentralized provision of public goods is favoured.

Another advantage of a decentralised system of public goods provision over a centralised one is that it can promote competition among local jurisdictions. According to Tiebout (1956), local authorities, as public service providers, compete with one another in attracting citizens, who are mobile and can choose their place of residence, to their jurisdictions. This competition among local authorities may eventually lead to increase in quantity and quality of public service delivered across jurisdictions.

Besides better understanding of local needs, lower levels of governments are directly accountable to their local constituents and under constant pressure to improve their functional efficiency and effectiveness. As a result, better local governance and more effective allocation of resources to improve local public goods such as infrastructure and human capital development would potentially bring about faster economic growth.

Although theoretical framework for fiscal decentralisation has been well established, the empirical evidence has been rather mixed. Davoodi and Zou (1998) investigated a cross section of 46 countries over the period 1970–1989 and concluded that fiscal decentralisation did not have a positive impact on growth. In contrast, Lin and Liu (2000) found evidence to support a positive impact of fiscal decentralization on economic growth for China using a panel of provincial level data from 1970 to 1993. Kalirajan and Otsuka (2012) find that fiscal decentralisation in India has promoted development “equitably across its states, particularly through health and education expenditures aimed at improving human capital development.” Faguet and Sánchez (2008) provide evidence that education outcomes have benefited from decentralisation in Bolivia and Colombia. Meanwhile, de Mello (2000) examines evidence from 30 countries and argues that problems with intergovernmental fiscal coordination may worsen fiscal deficit problems leading to macroeconomic instability.

For the case of Vietnam, Nguyen and Anwar (2011) found that revenue decentralisation has a positive effect, while expenditure decentralization a negative effect on economic growth. The study used fixed effect model on a panel of data from 1997 to 2007. However, the paper did not address the possible issue of endogeneity. Fixed effect can control implicitly for time-invariant unobserved factors. But, if explanatory variables are correlated with the error terms (unobserved time varying variables), the estimated coefficient would be inconsistent. What this paper actually shows is that the greater the share of a province in total budget revenue, the greater is the growth rate of that province. Without addressing the endogeneity of the provincial share of total budget revenue, the reverse relationship,

that is higher growth rate in a province leads to higher share of that province's revenue, may actually be the case in place.

13.2.1 Fiscal Decentralisation in Vietnam

Fiscal decentralisation history: Administratively, Vietnam's 64 provinces are categorised into 6 regions. Every province has a People's Committee, the provincial executive authority and People's Council, the provincial equivalence of the National Assembly. The country is geographically, historically and culturally diverse. Three economic centres include Hanoi in the Northern part, Danang in the Central part and Ho Chi Minh City in the Southern part. Further away from these centres, provinces are less economically well off. Poorest provinces are mainly located in the mountainous areas in the North-eastern and North-western, and in central parts of the country.

Started in the mid-90s, fiscal decentralisation in Vietnam may have been motivated from top down, as well as bottom up. On the one hand, the magnitude and complexity of public service delivery to meet greater demand have prompted the central government to delegate more tasks and expenditure accordingly to subnational governments. On the other hand, some well off provinces, which are growing faster than the rest, have pushed for greater discretion in budget and fiscal matters through special rules. Currently, Hanoi and HCMC enjoy a special arrangement in revenue sharing with central government. Danang is one of the rising star provinces in recent years and also trying to pursue this direction.

Vietnam's fiscal arrangement: Provincial level governments have full discretion as to how to assign revenue and expenditure to governments at lower levels (districts and communes). Martinez-Vazquez (2005) argues that the assignment of revenue and expenditure at district and commune levels should have been more defined in State Budget Law rather than at the discretion of provincial level. Nevertheless, it can be assumed that provincial governments, being responsible for the local development and accountable to their local citizens, may potentially do a better job at allocating resources and improving welfare for the locals than the central government. As a result, it would make sense to see the evidence through analysing the provincial level data.

Although provinces have not been granted authority to determine tax rates, they have been entitled to retain fully some of the locally collected taxes, as well as share revenue of some other taxes with the central government. This obviously allows provinces to have a greater discretion in how to spend this decentralized revenue (both fully assigned and shared revenue).

A majority of provinces are not self-sufficient, having to rely on shared revenue and central transfer to fund their expenditures. The exceptions include better endowed provinces such as Hanoi, HCMC, and Binh Duong. The extent to which these provinces rely on each of the three types of revenue can provide an indication of how pro-active they have been under the current decentralisation arrangement.

i. Central-level fully assigned

With this source of tax revenue, provinces act as tax collecting agents for the central government. In each financial year, the central government sets revenue targets for every province. Taxes assigned totally to central government include oil tax, taxes on special consumption good, duties on imports, etc.

ii. Shared revenue

A number of revenue sources are shared between provinces and central government. The general formula for determining sharing rates at the beginning of stability periods is as follows²:

$$R = \frac{TE - OR}{ER}$$

The sharing rate (R) is determined by the difference between total expenditure (TE) and own source tax revenue (B), divided by the estimate of shared tax collections (ER) in the province. If the RHS is greater than one, sharing rate is equal to 100%. This means that a province can keep the entire revenue from shared sources. If $0 < \text{RHS} < 1$, the sharing rate is determined by the above mentioned formula.

More economically vibrant provinces can retain a smaller share of the shared taxes or their sharing rates are lower. In the first stabilisation period, 49 provinces had sharing rate of 100%, while 53 provinces had that in the second stabilisation. That is, the majority of provinces had their expenditure exceeding their own-source revenue, and had to take extra revenue through shared revenue and transfer from the Central government.

In reality, provinces may have incentives to overestimate their spending and underestimate their own-source or fully assigned revenue, so that extra funding to finance the deficit will come from shared revenue and possibly central transfer. That way, apart from the own-source revenue, provinces would receive more money from central government than if more realistic estimates are made. At the same time, provinces may also have an incentive to produce a low estimate of shared tax collections, so as to keep a greater portion of the revenue shared with central government. Provinces are entitled to keep up to 30% of all shared revenue actually collected in excess of the estimated amounts. This is yet another incentive that makes provinces more likely to produce a lower estimate of their shared revenue. They can keep 30% of whatever excess revenue they collected that exceeds the estimate.

iii. Provincial level fully assigned (own source revenue)

This source of revenue indicates a province's capacity to raise revenue locally and fund its activities. The share of this type of revenue in total revenue is normally

²Nguyen-Hoang and Schroeder (2010)

low for a large number of provinces. This also means that a majority of provinces rely on shared revenue and central transfer.

A province' decentralized revenue is the total of its shared revenue and own source revenue. This revenue represents the effective resources raised locally to fund a province's expenditure excluding any direct assistance from the central government.

iv. **Central transfer:**

There are two types of transfer. The first is balancing transfer, which is unconditional and available to poor provinces for equalizing purposes. The other is specific target transfer, which is conditional transfer and available to all provinces.

Determinants of fiscal decentralisation in Vietnam: According to Wu and Wang (2013), the literature has identified transfer dependency, economic development, population size and population density, and openness to trade and foreign direct investment as some of the key determinants of fiscal decentralisation.

Economic growth can be a driver for fiscal decentralisation. As their income rises, provinces may want to have a bigger say in how much revenue they can keep and how much and what to spend. On the one hand, as income increases across provinces, there's been greater demand for public services. On the other hand, increased magnitude and complexity of public service delivery requires this work to be further delegated to subnational governments rather than being concentrated in the hand of the central government.

In Vietnam, the legal framework for fiscal decentralisation was further institutionalised and clarified with the issuance and enforcement of the State Budget Law (SBL) in 1996 and its amendment in 2002. The 2002 SBL provides a clearly defined legal framework for the determination of revenue and expenditure assignment to each level of government from central, provincial, district to communes. Sources of revenue and expenditure mandates are set out for each level of government. One feature of note is the granting of full authority for provincial governments to make decisions on the level of decentralisation at districts and communes governments. Although according to the SBL budgets of lower level governments are part of the upper level government, a provincial budget needs to be first approved by the respective People's Council, a local body equivalent to the National Assembly at the central level.

Development of budget system in Vietnam during period 2004–2010: In Vietnam, the state budget is a unified budget of governments at all levels from local to central. There are three subnational levels of government in Vietnam, which include those at provincial, district and commune levels. At lower levels of government, annual budgets are prepared by the respective People's Committees and must be approved by the People's Council. As a local budget is approved by the People's Council, it is then consolidated into the budget of government at higher level.

Budget planning in Vietnam is structured by stability periods, each of which normally lasts four or five years. During a stability period, governments at all levels adhere to the sharing rates that have been agreed upon for shared sources of revenue. These sharing rates stay relatively stable during this period and are the bases for determining tax revenue that are shared between central and provincial governments.

Based on the intergovernmental transfer relationship, there are 2 types of provinces: the subsidised provinces and contributing provinces. Subsidised provinces are the ones that receive central transfer to cover the gap between revenue and expenditure. These provinces' assigned duty is to reduce the reliance on transfer over time. Most of provinces in Vietnam fall into this group. The other group, the contributing provinces, usually transfer a large percentage of locally collected revenue to the central government. These provinces have the duty to increase the contribution rate to the State/Central budget.

Incentives are in place to encourage provinces to increase their revenue collection and contribution to the State Budget. Reward to provinces that exceed the revenue targets for central shared revenue is not more than 30% of the difference between estimate and actual central shared revenue. For example, Ho Chi Minh City is entitled to 70% of marginal increase in revenue from shared sources compared to target level and 30% of marginal increase in revenue assigned 100% to central level compared to set target level. In contrast, provinces getting balance transfers enjoy 100% of shared revenue sources (Fig. 13.1).

During the period 2003–2012, shares of both subnational level governments' revenue and expenditure in State budget saw a clear upward trend. In contrast, the share of central transfer to subnational level governments relative to total provincial

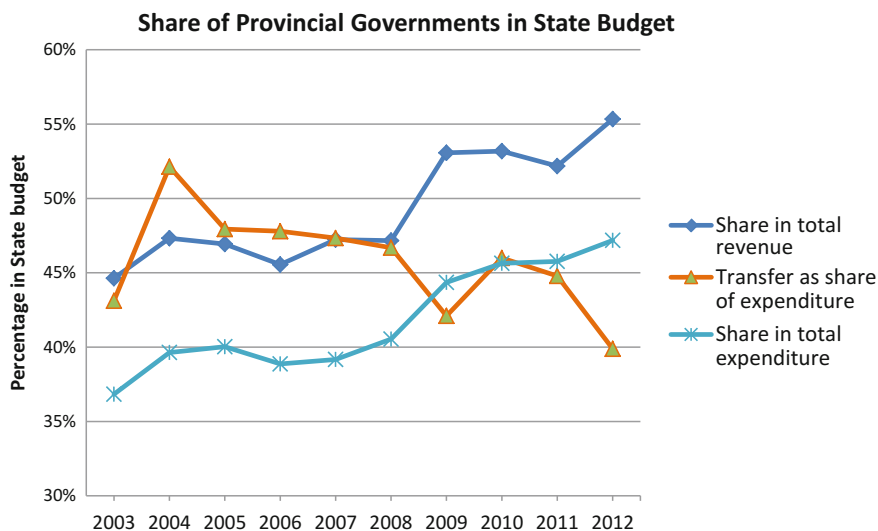


Fig. 13.1 Share of provincial governments in state budget

expenditure is clearly decreasing. These trends indicate an increasingly greater discretion in revenue and expenditure allocation for provinces, as well as a smaller dependence on central transfer. This evidence also supports the general agreement that there has been a higher degree of fiscal decentralisation in Vietnam.

A closer look at the composition of State budget revenue helps reinforce this point. The greater decentralisation may be better reflected in trends of shared revenue and own source revenue. At national aggregate level, shared revenue assigned to provinces has increased in share of total revenue collected, while shared revenue assigned to central government has a decreased share over time. There may be three reasons for this. First, it may be that more provinces were allowed to keep 100% of the revenue raised from shared sources. Second, the sharing rate for provinces that have sharing rate less than 100% has increased over time, i.e. they could keep a larger share of this source of revenue than before. Third, the provinces with sharing rate of 100% have increased their total revenue collected from this source (Figs. 13.2 and 13.3).

Revenue assigned 100% to central governments has an increasing share over time. As a major part of this revenue came from taxes on imports and given the trade deficits during the sample period, the greater share of this type of revenue can be understandable. Meanwhile, provinces' own source revenue has seen a declining share. This shows that growth in own source revenue has been slower than that in shared revenue and revenue assigned to the central government.

During the period, share of balance transfer in total local revenue at a national level has stayed relatively stable around 10%. Total transfer has also stayed around 25% of total local revenue.

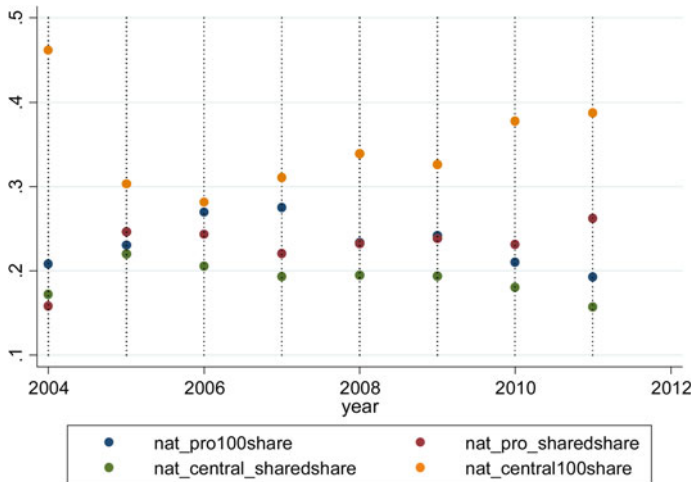


Fig. 13.2 Composition of total state budget revenue by revenue type

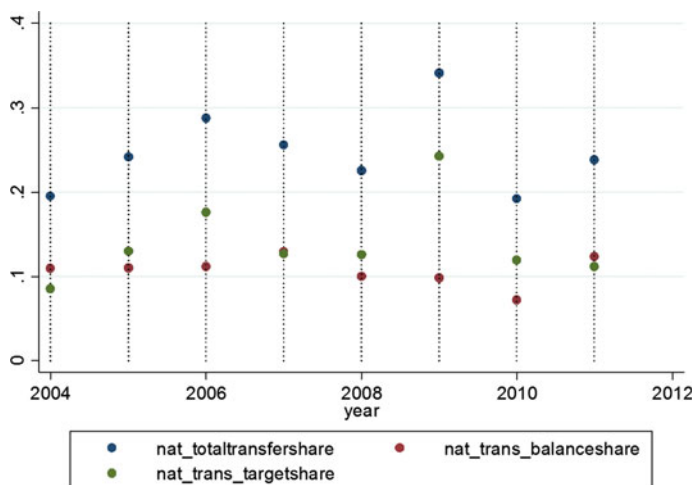


Fig. 13.3 Share of transfer in total provincial revenue

13.3 Methodology and Data

13.3.1 Fiscal Decentralisation Measurement

At the national level, it would be informative to compare the relative size of the central government and subnational governments. Some indicators include ratio of total provincial expenditure and total public expenditure, ratio of total provincial revenue and total public revenue, and the provincial—central share in different types of revenue.

Both previous cross-country and within-country studies often adopted provincial share of total national revenue (expenditure) as measure of revenue (expenditure) decentralization. Although these measures of fiscal decentralisation may reflect the relative scale to which resources are allocated to subnational jurisdictions, what they truly measure is only the magnitude of tax revenue or public expenditure at the sub-national levels rather than the real degree of subnational governments' autonomy in fiscal matters.

The measures of fiscal decentralisation adopted by Nguyen and Anwar (2011) are provincial share in total provincial expenditure (expenditure decentralisation) and in total provincial revenue (revenue decentralisation). While these measures were commonly used as measure of decentralisation in cross-country studies, they do not appear to be appropriate for a specific country study. Simply using a province' share in total provincial expenditure is to focus on the relative size of

provinces, not necessarily their respective degree of decentralisation. As a result, the appropriateness of these proxies is questionable.

More recently, Vo (2009) proposes a Fiscal decentralization index (FDI) that is equal to the geometric mean of the fiscal autonomy and fiscal importance of SNGs, that is ratio of own source revenue and province's expenditure multiplied by ratio of province's expenditure and total provincial expenditure.

Following a similar approach as Vo (2009), at the provincial level, the current paper adopts a measure of fiscal decentralization that takes into account the degree of fiscal autonomy and independence of provinces. More specifically, it is measured by the capacity of a province to fund its expenditure by own source revenue, shared revenue source and decentralised revenue, and less by transfer from central government. These proxies include the following:

- Own source revenue/total provincial expenditure
- Shared revenue/total provincial expenditure
- Decentralized revenue/total provincial expenditure (where, decentralized revenue = own source revenue + shared revenue)
- Composite index:
 - Revenue as share of expenditure * Share in total subnational revenue

Using different proxy measures of fiscal decentralisation may help with addressing the common concern that concept of decentralisation is not treated adequately in most studies in spite of its intrinsic multi-dimensionality. The current literature has seen a variety of measures used such as share of sub-national regions' revenue (expenditure) in total national revenue (expenditure), and marginal retention rate of excess revenue (Lin and Liu 2000).

Model specification: The main goal of the model is to examine whether variations in degree of fiscal decentralisation (as proxied by ratio of revenue over expenditure) over time and across provinces may have a significant impact on economic growth of a province.

The provinces' economy is assumed to have a neoclassical production function. The major factors of the economy include capital, labour, technology with fiscal decentralisation being an element contributing to technological and institutional progress.

Hypothesis: The key hypothesis to be tested is: Fiscal decentralisation has contributed positively to provincial economic growth in Vietnam. More specifically, the question is whether having higher own-source revenue raised by a province as share of its expenditure would lead to higher economic growth in that jurisdiction. If the answer is yes, one possible explanation may be that as a province enjoys a higher degree of decentralisation granted by the central government, they will become more proactive and effective in allocating resources to promote local development.

If the results prove otherwise, this would mean that greater autonomy has prompted provinces to act less responsibly and become less efficient and effective in

making growth-enhancing policies. This would imply some potential problems of corruption and ineffective allocation.

Growth-decentralisation nexus:

Following Davoodi and Zou (1998), assuming the neoclassical production function augmented by fiscal decentralisation, a province's economy can be characterised by:

$$Y_t = K_t^\alpha (FD_t)^\beta (A_t L_t)^{1-\alpha-\beta}$$

$$\ln Y_{it} = \ln K_{it}^\alpha (A_{it} L_{it})^{1-\alpha-\beta} (FD_{it})^\beta + \theta X_{it} + \varepsilon_{it}$$

$$\ln(y_{it}) = \frac{\alpha}{(1-\alpha-\beta)} \ln(k_{it}) + \delta_t + \frac{\beta}{(1-\alpha-\beta)} \ln(FD_{it}) + \theta \ln(X_{it}) + \varepsilon_{it}$$

where: $0 < \alpha < 1$, $0 < \beta < 1$, and $(\alpha + \beta) < 1$

- Y growth rate of real gross provincial product per capita
 FD ratio of central transfer to total expenditure—indicating how much of its expenditure is financed from transfer; transfer/recurrent expenditure—indicating how much of its recurrent expenditure can be financed by transfer; transfer/capital expenditure
 K Capital investment: growth rate of real provincial non-state investment
 L Labour growth rate: is the growth rate of labour in the private sector

Population growth: growth rate of total population of province i at time t

Other control variables: growth rate of real export value, human capital (percentage of skilled labour)

Under a fixed effect model, the following regressions are employed to ascertain any potential impact of fiscal decentralisation on provincial economic growth:

$$Y_{it} = a_1 FD_{it} + a_2 P_{it} + a_3 POP_{it} + a_4 L_{it} + a_5 X_{it} + a_6 BT_{it} + a_7 VA_{it} + \eta_i + \lambda_t + \varepsilon_{it}$$

Where:

- Y Growth rate of real gross provincial product per capita
 FD Fiscal decentralisation. The key measure of fiscal decentralisation adopted is the ratio of own-source revenue and total provincial expenditure, which measures the capacity of provinces in raising their own resources for their activities.
- FD1: Own source revenue/total provincial expenditure
 - FD2: Shared revenue/total provincial expenditure
 - FD3: Decentralized revenue/total provincial expenditure.

In addition, composite measures of fiscal decentralisation are constructed by interacting FD1, FD2, and FD3 with the share in total subnational revenue. This measure can account for both the financial capacity and autonomy of provinces.

Other control variables that vary across provinces and can change over time include those that are theoretically expected to contribute to economic growth.

- POP Population growth: Based on neoclassical economic theory, population is considered to have a negative impact on growth. The reason is that a larger labour force means a lower capital per unit of effective labour, resulting in a lower marginal product of labour and eventually lower output growth. In fact, population growth varies across provinces in Vietnam
- P Inflation, annual provincial consumer price index growth rate.
- L Private labour growth, measured by the annual growth rate of labour in the private sector in a province. As this variable is also highly correlated with provincial foreign direct investment and non-state investment in general, it can act as a proxy for private investment growth (both foreign and domestic).
- X_{it} Growth rate of real export value
- BT Growth of balancing transfer: is an annual growth rate of central transfer to a province for equalizing purposes.
- λ_t Time fixed effect. This variable can help control for macroeconomic trend that affect all provinces in a similar manner. Examples of these effects are central government policies such as monetary policy, industrial policy, etc.
- η_i Province fixed effect. This variable would account for the differences across provinces that do not change over time or do so very slowly, if any at all.
- ε_{it} Idiosyncratic error term.

The diversity of provinces calls for controlling of the size effect, initial conditions, etc. A fixed effect model can account for those time invariant factors. “Another advantage of the panel over the cross-section regression is the alleviation of the endogeneity problem through the inclusion of lags of regressors as instruments” (Ding and Knight 2009).

Possible sources of endogeneity: Omitted variables: Other variables may affect both fiscal decentralisation and development outcomes and drive the difference between provinces, e.g.: human capital, varied effects of special targeted programs (different from national targeted programs), factors affecting all provinces but with varying effects across provinces in each period—need to control explicitly—macroeconomic variables, the impact of central government’s spending via line ministries’ allocation, etc.

Reserve causal relationship: Development outcomes may drive fiscal decentralization—FDI or exports revenue may affect the process of determining expenditure and transfer to some provinces. As such, a province that is more wealthy can have more tax revenue to finance their spending, also meaning a greater degree of autonomy.

Nevertheless, it can be argued that the adopted measure of fiscal decentralisation is exogenous. In determining estimate of expenditure allocation, budgeting is done on a per capita basis and key geographical variations, which are relatively fixed or

slow to change. Also the sharing rates are determined once and often stay stable during each stability period. This indicates that the formula for expenditure and revenue assignment to provinces is not influenced by a province's economic growth.

As another robustness check, dynamic panel data regressions are carried out using the system GMM or Arellano and Bond estimator, which can help address the endogeneity concerns.

Data: The current study utilises a unique unbalanced panel dataset of provincial level tax revenue and expenditure for the 2004–2010 period from the Ministry of Finance of Vietnam. Thanks to this comprehensive actual provincial budget dataset, it was possible to construct key variables used in the above specified models.

The three key types of revenue for provincial governments include own-source revenue, shared revenue, and decentralised revenue. These variables are then used to generate three different proxy measures of fiscal decentralisation in Vietnam. The Appendix provides a detailed description of tax revenue assignments to local governments in Vietnam as stipulated in SBL 2002. Given that the current literature mostly uses share of local expenditure in national total as proxy for fiscal decentralisation, this dataset is a contribution of the current paper, one of the first to construct and utilise more refined measures of fiscal decentralisation for Vietnam.

Total provincial expenditure is used as the common denominator for each of the three measures of fiscal decentralisation. This expenditure is the combined spending of all provincial and sub-provincial level governments in each province.

The dependent variable, growth rate of real per capita provincial product, and other control variables including inflation rate, annual growth rate of population, and the growth rate of labour in the private sector are obtained from the Vietnam's General Statistical Office (Table 13.1).

Table 13.1 Description and mean values of variables

Variable	Description	Mean value
Y	Growth rate of real per capita GDP (%)	0.0993802
FD1	FD1—Own source revenue/total provincial expenditure (%)	0.2813551
FD2	FD2—Shared revenue/total provincial expenditure (%)	0.2643747
FD3	FD3—Decentralized revenue/total provincial expenditure (%)	0.5457298
P	Inflation (CPI) (%)	0.1114674
POP	Population growth rate (%)	0.0082407
L	Growth rate of private sector labour force (%)	0.1150958
X	Growth rate of real export value (%)	0.2086083
VA	Growth rate of industrial added value (%)	0.1707149
BT	Growth rate of balancing transfer (%)	0.1141214

For the second and third measure for fiscal decentralisation, namely the ratios of shared revenue and decentralised revenue, respectively, to total provincial expenditure, a number of provinces show values greater than one; which means their revenue is more than sufficient to cover their spending. This is understandable for cities/provinces such as Hanoi, Danang, Binh Duong, etc. in years when they saw an unexpected increase in tax revenue. The excess revenue after covering all expenditures is normally put into their reserve fund.

Growth rate of labour in the private sector has an average of 11.5% and maximum of 50.9%, reflecting its role as one of the key drivers of provincial economic growth, especially during the booming years around mid-2000s.

In the actual regressions, the current sample has included only 48 provinces, excluding those with unreasonably low values of own-source revenue. During the sample period, there are 8 provinces that are either merged with or split from other provinces. For purpose of consistency, these provinces are excluded from the regression sample. They include Hanoi, Ha Tay, Can Tho, Hau Giang, Dak Lak, Dak Nong, Dien Bien, and Lai Chau. Also, since a major share of GDP of Ba Ria Vung Tau is from oil revenue, which is a revenue source assigned totally to the central government, this province is not included in the sample.

13.4 Results

Fixed effect models

Fixed effect models account for the unobserved heterogeneity of provinces such initial conditions, geographical features, and local culture. These models help explain best the within variation of each province. The sample for models 1 and 3 in Table 13.2 include 48 provinces out of 64 provinces. In models 2 and 4, the sample is further reduced to 43 provinces. The rationale for this is that some new provinces are either split from or merged with another province, they are removed from the sample to ensure the consistency of data over time. Adjusted R-square obtained from least squares dummy variable regression for model (1) is 0.2796.

Table 13.2 Real provincial per-capita growth regressions (FD1)

Independent variables	Fixed Effect Model			
	FE1	FE2	FE3	FE4
FD1 (own-source revenue/total expenditure)	0.165*	0.171*	0.165	0.179*
	(0.10)	(0.10)	(0.10)	(0.10)
Inflation CPI	-0.463***	-0.528***	-0.524***	-0.558***
	(0.16)	(0.16)	(0.16)	(0.16)
Population growth rate	-0.614***	-0.628***	-0.630***	-0.604***
	(0.16)	(0.16)	(0.15)	(0.15)
Share of vocational students (log)	-0.002	0.002		
	(0.01)	(0.01)		

(continued)

Table 13.2 (continued)

Independent variables	Fixed Effect Model			
	FE1	FE2	FE3	FE4
Growth rate of per capita non state capital	0.002 (0.01)	0.005 (0.01)		
Growth rate of real export value	0.032* (0.02)	0.029* (0.02)	0.032* (0.02)	0.029* (0.02)
Growth rate of balancing transfer	0.037** (0.01)	0.034** (0.01)	0.039*** (0.01)	0.036** (0.01)
Constant	0.080 (0.05)	0.101* (0.05)	0.096*** (0.02)	0.093*** (0.02)
Growth rate of labour in private sector	0.057* (0.03)	0.066** (0.03)	0.062** (0.03)	0.073** (0.03)
Year effects	Yes	Yes	Yes	Yes
Number of observation	231	220	239	226
Number of group	48	43	48	43
Adjusted R-square	0.2796	0.2892	0.2820	0.2820
F	5.943	8.668	7.814	10.152

Notes *, **, and *** indicate statistical significance at 10%, 5% and 1% levels. Robust standard errors are in brackets. FD1 is ratio of own-source revenue and total expenditure

Table 13.2 shows results for fixed effect regression of real provincial GDP per-capita growth. In model 1, the main variable of interest, fiscal decentralisation, has a positive sign and is statistically significant at 10% level. This implies that on average, the higher degree of fiscal decentralisation of provinces has contributed positively to their economic growth. The first column of Table 13.2 shows a coefficient of 0.165 suggests that, *ceteris paribus*, a 1% increase in fiscal decentralisation will lead to a 0.165% increase in provincial growth rate.

Most other explanatory variables are statistically significant, except for the share of vocational students and growth rate of per capita non-state capital. As expected, growth in exports, growth in private sector labour force and growth in central transfer have positive contributions to provincial income growth. One may wonder about the role of central transfer. The positive effect of central transfer may not come as a surprise since a majority of the provinces receive and partly rely on balancing transfer from the central government. However, the insignificant effect of provincial share of vocational students (a proxy for human capital) and growth rate of per capita non-state capital (a proxy for private capital) is, to some extent, a puzzle. Nevertheless, one possible explanation is that their effects are already captured by the other variables, including growth of exports and private sector labour.

Column two in Table 13.2 are results of model FE2, which has the same specification as FE1, but an adjusted sample that excludes split or merged provinces. The estimated coefficient on fiscal decentralisation is still statistically significant at 10% level and has increased in magnitude from 0.165 to 0.171.

To check the sensitivity of the models' specification to the two insignificant variables, the share of vocational students and growth rate of per capita non-state capital, models FE3 and FE4 are estimated without these variables. The regressions results are reported in two last columns in Table 13.2. Comparing models FD3 and FD4 with the first two models, the statistical significance and magnitude of fiscal decentralisation variable, as well as other variables, hardly vary. In model FE4, magnitude of FD variable even increases in magnitude to 0.179.

Across the four models in Table 13.2, the economic significance of fiscal decentralisation is noteworthy. Fiscal decentralisation is estimated to have the largest positive effect on provincial economic growth, which is greater than that of export growth, private sector's labour growth, or central transfer growth.

Tables 13.3 and 13.4 show the results of regressions with alternative measures of fiscal decentralisation. The fiscal decentralisation variables and other key independent variables remain statistically significant. In terms of magnitude, the

Table 13.3 Real provincial per-capita growth regressions (Fiscal decentralisation proxy 2)

Independent variables	Fixed Effect Model			
	FE5	FE6	FE7	FE8
FD2 (shared revenue/total expenditure)	0.1965** (0.074)	0.1900** (0.079)	0.2021*** (0.074)	0.1970** (0.079)
Inflation CPI	-0.4668*** (0.134)	-0.5210*** (0.135)	-0.5262*** (0.133)	-0.5497*** (0.138)
Population growth rate	-0.6616*** (0.162)	-0.6711*** (0.165)	-0.6780*** (0.147)	-0.6492*** (0.151)
Growth rate of labour in private sector	0.0668** (0.030)	0.0756** (0.029)	0.0720** (0.028)	0.0823*** (0.028)
Share of vocational students (log)	-0.0024 (0.009)	0.0011 (0.009)		
Growth rate of per capita non state capital	0.0020 (0.010)	0.0044 (0.011)		
Growth rate of real export value	0.0287* (0.015)	0.0257* (0.015)	0.0278* (0.015)	0.0257* (0.015)
Growth rate of balancing transfer constant	0.0361*** (0.012)	0.0331*** (0.012)	0.0380*** (0.012)	0.0346*** (0.011)
	0.0760 (0.051)	0.0984* (0.050)	0.0921*** (0.017)	0.0939*** (0.018)
Year effects	Yes	Yes	Yes	Yes
Number of observation	231	220	239	226
Number of group	48	43	48	43
Adjusted R-square	0.3130	0.3197	0.3177	0.3284
F	6.483	8.783	8.165	9.974

Notes *, **, and *** indicate statistical significance at 10%, 5% and 1% levels. Robust standard errors are in brackets. FD2 is ratio of shared revenue and total expenditure

Table 13.4 Real provincial per-capita growth regressions (Fiscal decentralisation proxy 3)

Independent variables	Fixed Effect Model			
	FE9	FE10	FE11	FE12
FD (decentralised revenue/total expenditure)	0.1329** (0.053)	0.1310** (0.054)	0.1347** (0.053)	0.1356** (0.054)
Inflation CPI	-0.4851*** (0.146)	-0.5444*** (0.148)	-0.5454*** (0.144)	-0.5731*** (0.149)
Population growth rate	-0.6580*** (0.162)	-0.6702*** (0.165)	-0.6727*** (0.149)	-0.6453*** (0.151)
Growth rate of labour in private sector	0.0626** (0.030)	0.0716** (0.029)	0.0665** (0.028)	0.0777*** (0.027)
Share of vocational students (log)	-0.0029 (0.009)	0.0006 (0.009)		
Growth rate of per capita non state capital	0.0024 (0.010)	0.0049 (0.010)		
Growth rate of real export value	0.0292* (0.015)	0.0262* (0.015)	0.0283* (0.015)	0.0261* (0.015)
Growth rate of balancing transfer constant	0.0365*** (0.013)	0.0336** (0.013)	0.0385*** (0.012)	0.0351*** (0.012)
	0.0560 (0.058)	0.0786 (0.057)	0.0757*** (0.022)	0.0761*** (0.022)
Year effects	Yes	Yes	Yes	Yes
Number of observation	231	220	239	226
Number of group	48	43	48	43
r ² _b	0.3115	0.3203	0.3151	0.3291
F	6.197	8.382	7.991	9.888

Notes *, **, and *** indicate statistical significance at 10%, 5% and 1% levels. Robust standard errors are in brackets

coefficient for fiscal decentralisation with shared revenue over total expenditure as a proxy has the largest value at 0.197 (model FE8). The broader proxy of fiscal decentralisation, ratio of decentralised revenue and total expenditure, has a coefficient of 0.1356 (model FE12). Overall, the effect of fiscal decentralisation on provincial economic growth is statistically significant and robust to all three alternative measures.

13.4.1 Composite Indicator of Fiscal Decentralisation

To further account for multiple dimensions of fiscal decentralisation, a composite indicator is employed in the provincial gross product per capita regressions. Following Vo (2009), the composite indicator of fiscal decentralisation takes both

the financial capacity and level of fiscal autonomy of provinces into account. The composite indicator of fiscal decentralisation is calculated according to the formula:

$$FDI = \sqrt{\left(\frac{OR_i}{E_i}\right) * \left(\frac{R_i}{\sum_{i=1}^{64} R_i}\right)}$$

where:

- FDI Fiscal decentralisation indicator
 OR_i Own source revenue of province i
 R_i Total revenue of province i
 E_i Total expenditure of province i .

Table 13.5 Real provincial per-capita growth regressions (Composite FD indicator)

Independent variables	Fixed effect model		
	Model 1	Model 2	Model 3
FDI1	2.1970** (1.014)		
FDI2		1.6384*** (0.568)	
FDI3			1.4329*** (0.462)
Inflation CPI	-0.5113*** (0.139)	-0.5091*** (0.131)	-0.5081*** (0.133)
Population growth rate	-0.6078*** (0.146)	-0.6309*** (0.142)	-0.6263*** (0.141)
Growth rate of labour in private sector	0.0696** (0.030)	0.0755** (0.028)	0.0727** (0.028)
Growth rate of real export value	0.0268* (0.015)	0.0255* (0.014)	0.0255* (0.014)
Growth rate of balancing transfer constant	0.0343*** (0.012)	0.0340*** (0.011)	0.0338*** (0.011)
	0.0565 (0.034)	0.0795*** (0.021)	0.0640*** (0.024)
Year effects	Yes	Yes	Yes
Number of observation	226	226	226
Number of group	43	43	43
Adjusted R-square	0.3252	0.3352	0.3383
F	9.623	10.401	10.411

Notes *, **, and *** indicate statistical significance at 10%, 5% and 1% levels, respectively. Robust standard errors are in brackets

Table 13.5 shows regressions with three alternative composite measures of fiscal decentralisation, which was constructed by taking the square root of ratio of revenue over expenditure interacted with share of province's revenue in total subnational budgetary revenue. All three composite fiscal decentralisation variables are statistically significant at least at the 5% level. The coefficient for FDI1 has a value of 2.197, meaning that a 1% increase in FDI1 would lead per capita provincial income to rise by to 2.197%. The magnitude of the FDI coefficients should be interpreted differently from those in Tables 13.2, 13.3 and 13.4. As the relative financial capacity of a province is measured by its share in total subnational revenue, it will need to outperform others in the country in order to improve this ratio,

Table 13.6 Generalised Method of Moments Models

Dependent variable: Growth rate of real GDP per capita			
Independent variables	GMM models		
	Model 1	Model 2	Model 3
Lag of growth rate of real per capita GDP	-0.2784 (0.217)	0.1651 (0.124)	0.1716 (0.115)
FDI	0.6822 (0.523)	0.3590*** (0.131)	0.3636*** (0.128)
Lag of FDI	1.5385 (1.033)	-0.0994 (0.115)	-0.1006 (0.117)
Inflation (CPI)	-0.6037*** (0.197)	-0.2757** (0.116)	-0.2801** (0.115)
Population growth rate	-0.6627** (0.282)	-0.9883*** (0.310)	-0.9943*** (0.315)
Growth rate of private sector labour force	-0.0146 (0.093)	0.0922 (0.060)	0.0926 (0.059)
Growth rate of real export value	0.0127 (0.018)	0.0028 (0.013)	-
Growth rate of industrial added value	0.0707*** (0.026)	0.0927*** (0.022)	0.0948*** (0.020)
Growth rate of balancing transfer	0.0098 (0.017)	-	-
Constant	-0.3737 (0.329)	0.0173 (0.046)	0.0163 (0.046)
Year effects	Yes	Yes	Yes
N	149	186	186
N-group	42	50	50

Notes *, **, and *** indicate statistical significance at 10%, 5% and 1% levels, respectively. Robust standard errors are in brackets. FDI1 is the ratio of own-source revenue and total expenditure

which is a challenge to many provinces. As a result, with provinces' relative financial capacity being taken in account, the impact of any reforms in fiscal decentralisation may bring greater rewards in terms of growth enhancement. This may help explain the greater economic significance of FDI variables compared with those in previous regressions.

13.4.2 Dynamic Panel Estimation Results

Table 13.6 shows the results of the General Method of Moments models, where a lag of the dependent variable is added to the right hand side and fiscal decentralisation variable FDI treated as being endogenous. Specification tests show that all models satisfy the requirement that the error terms are serially uncorrelated.

From both model 2 and 3, it is clear that the fiscal decentralisation variable, ratio of own source revenue over expenditure, has a positive sign and statistically significant. This result is consistent with those of the fixed-effect models presented above. For other determinants of growth, while growth rate of labour in the private sector is statistically insignificant, and growth rate of industrial added value add is positive and strongly statistically significant in all three models (Table 13.6).

As a positive effect of fiscal decentralisation on economic growth is supported by the data, another question is the possible mechanism through which this effect is realised. There are three channels, direct and indirect, that may be in place (Martinez-Vazquez and Robert 2003). First, greater provincial autonomy in resource allocation can lead to improvement in public service delivery such as infrastructure and law and order. Second, fiscal decentralisation provides incentives for provinces to promote the private sector activities. Third, local governments' spending can improve local human capital through better educational and health-care services.

13.5 Conclusion

The current paper empirically examines the effect of fiscal decentralisation in Vietnam using a fixed effect model on a provincial panel dataset for the period 2004–2010. By using a range of alternative measures of fiscal decentralisation, the paper shows that fiscal decentralisation has a significant and positive effect on provincial economic growth in Vietnam during the sample period. The results are further confirmed by GMM models to address the endogeneity concerns. In spite of the possible adverse consequences of decentralisation (Bardhan 2002), the positive effect of fiscal decentralisation on economic growth, on average, has so far outweighed any potential adverse effects in Vietnam. This finding has important policy implications. With the evidence of its growth enhancing effect, reforms in fiscal decentralisation should be further pursued and strengthened in Vietnam.

A. Revenues divided in percentage between the central budget and the local budgets:

- a) The value added tax, excluding the value added tax on import goods as provided for at Point a, Clause 1 of this Article;
- b) The enterprise income tax, excluding the enterprise income tax of the units which apply the entire-branch accounting as provided for at Point d, Clause 1 of this Article;
- c) The income tax on high-income earners;
- d) Tax on transfer of profits abroad, excluding tax on overseas transfer of profits from oil and gas domains as provided for at Point e, Clause 1 of this Article;
- e) The special consumption tax on domestic goods and services;
- f) The petrol and oil charges.

B. The sources of local budget revenues shall include:

1. Revenues enjoyed 100% by the local budgets:
 - a) Land and house tax;
 - b) Natural resource tax, excluding natural resource tax collected from oil and gas;
 - c) The license tax;
 - d) The land use right transfer tax;
 - e) The agricultural land use tax;
 - f) The land use levy;
 - g) The land rent;
 - h) Proceeds from the lease and/or sale of State-owned houses;
 - i) Registration fees;
 - j) Revenue from construction lottery;
 - k) Retrieval of local budget capital at economic organizations, revenue from the local financial reserve funds, income from contributed capital of the localities;
 - l) Non-refundable aid of international organizations, other organizations and individuals in foreign countries, provided directly to the localities;
 - m) Charges, fees, revenues from non-business activities and other revenues payable into the local budgets under the provisions of law;
 - n) Revenue from public land funds and other yields from public properties;
 - o) Money mobilized from organizations and individuals according to the provisions of law;
 - p) Voluntary contributions of organizations and individuals inside and outside the country;
 - q) Local budget remainders as provided for in Article 63 of this Law;
 - r) Other revenues as prescribed by law;
2. Revenues divided in percentage between the central budget and the local budgets under the provisions in Clause 2, Article 30 of this Law;
3. Additional allocations from the central budget;
4. Revenues from investment mobilization for construction of infrastructure projects as provided for in Clause 3, Article 8 of this Law.

Fig. A.1 Assignment of tax revenue sources by level of government. *Source* Vietnam's 2002 State Budget Law

For future studies, several directions can be considered. Firstly, it would be informative to study the interaction between fiscal decentralisation and other institutional reforms, and whether these reforms have helped improve the governance quality. Secondly, further analysis can be done to dissect the various impact of fiscal decentralisation on growth across the distribution of provinces. Finally, it would be interesting to examine empirically the welfare effects of fiscal decentralisation such as poverty reduction and mechanism for realisation of these effects.

Appendix

See Fig. A.1

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Chapter 14

Education Expenditure and Economic Growth Under Decentralization: An Empirical Study of Sri Lanka and Canada

Wimal Rankaduwa, Azad Haider and N.S. Cooray

14.1 Introduction

The nexus between education and economic growth has been widely analysed from various perspectives, such as the human capital approach and the multiplier analysis. A small subset of these studies have examined the relationship between public education expenditure and economic growth. Most often their focus was on the overall net effect of education expenditure on economic growth. As a consequence, they failed to examine possible positive or negative, direct and indirect effects of education expenditure on economic growth. They also, in general, failed to produce results that can help formulate clear policy prescriptions for effective allocation of public funds and other economic resources for promoting economic growth.

The role of government education expenditure in Sri Lanka's socio-economic development has been widely discussed in the policy debates. Yet, the question, whether government education expenditure significantly promotes or hinders economic growth in Sri Lanka, still remains an unsettled issue, mainly due to the lack

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of empirical research on the subject that addresses the issue scientifically. The main purpose of the present study is to undertake an empirical investigation into the relationship between government education expenditure and economic growth in Sri Lanka. The focus of the present study will be on estimating the direct and indirect effects of government education expenditure on economic growth within the framework of an aggregate production function, which incorporates government education expenditure as a factor of production, in addition to capital and labour as inputs into the model. The model is formulated following the earlier studies by Feder (1982), Ram (1986) and Mintz and Huang (1990, 1991), which analysed the effects of exports, government expenditure and defense spending on economic growth, respectively. The model estimated in this study makes it possible to assess the direct and indirect effects of government education expenditure on the level of output growth. The education sector generates a direct effect on growth by absorbing limited productive resources from the rest of the economy. Whether the direct effect is positive or negative depends on the inter-sectoral relative factor productivities of education and other sectors of the economy. Relatively higher factor productivities in the education sector generate a positive productivity effect which is considered as the direct effect in the present study. The education sector also generates an indirect effect on growth through its externality effects on the other sectors of the economy. For instance, an expansion of education sector may generate higher demand for outputs of the other sectors and thereby generate externalities that affect overall economic growth positively. It is also possible that the expansion of education sector through increased government spending may entail crowding out effects that generate a negative externality effect on the non-government sector of the economy. The estimated indirect effect accounts for the net externality effect, which can be either positive or negative.

The present study investigates the experience of Sri Lanka from 1960 to 2015, during which the country maintained an active welfare state. The constitutional and political reforms of 1987, transformed the hitherto centralized education sector into a relatively more decentralized system, which may have had serious consequences on the efficacy of the allocation of resources and thereby on economic growth. Therefore, an attempt is also made in the present study to examine the impact of decentralization on the relationship between education expenditure and economic growth. In addition, Sri Lanka's experience under decentralization is compared to the experience of Canada which has a highly decentralized system of education using the same framework of analysis.

The remainder of this paper is organized as follows. Section 14.2, presents a brief review of literature on the subject. An overview of the data on government education expenditure and output (GDP) growth in Sri Lanka and Canada are presented in Sect. 14.3. Section 14.4 presents a description of the models, methodology and data used. The penultimate section, Sect. 14.5 presents an analysis of estimated results. A summary and conclusions are presented in the last section.

14.2 A Brief Review of Literature

As stated earlier, empirical research on the nexus between government education expenditure and economic growth in Sri Lanka is limited both in number and quality. In the vast theoretical literature on education and economic development of Sri Lanka, only a very small number of studies have focussed on the factual impact of aggregate education expenditure or its components such as consumption and investment expenditure on economic growth (see for example Ganegodage and Rambaldi 2011; Ranasinghe and Ichihasi 2014; Kesavarajah 2014). However, a number studies that examined the experience of selected groups of countries have included Sri Lanka in their samples (see for example Maitra and Mukhopadhyay 2012, Mallick et al. 2016). These studies, in general, found evidence to support the hypothesis that government education expenditure makes a positive contribution to economic growth. However, none of these studies made an attempt to estimate possible direct and indirect effects of government expenditure on economic growth.

Empirical research on the economic impact of government expenditure on education, in general, has generated at least three divergent views on its' net growth effect. One view argues that government expenditure on education leads to increases in purchasing power, and aggregate demand, and improvements in human capital and thereby generates positive direct and indirect effects, which outweigh the negative effects. Therefore, the net effect on economic growth is positive (see for example Mariana 2015; Mercan and Sezer 2014; Mekdad et al. 2014). According to this view, an increase in government expenditure on education generates a positive net effect on economic growth. The second view maintains that the net effect is negative as the government education expenditure reduces savings, "crowds out" private investment, and retards potential growth of output. According to this view, increases in education expenditure result in a negative impact on economic growth, at least in the short run. The third view argues that education expenditure has no robust significant positive or negative net effect on economic growth (see for example, Blankenau et al. 2007). Given the plausibility of these arguments, one cannot simply rule out the existence of positive, negative or zero net growth effect, without a thorough empirical investigation into the direct and indirect effects of education expenditure on economic growth in any country or region.

14.3 An Overview of Sri Lankan and Canadian Data

Sri Lanka has been hailed as a welfare state that achieved an outstanding record of social development in the developing world, through a favorable allocation of fiscal resources to a variety of social services such as education, and health over a long period of time. The national education system has played an important role as one of the three pillars of this welfare state (Jayasuriya 2000). Figure 14.1 shows how

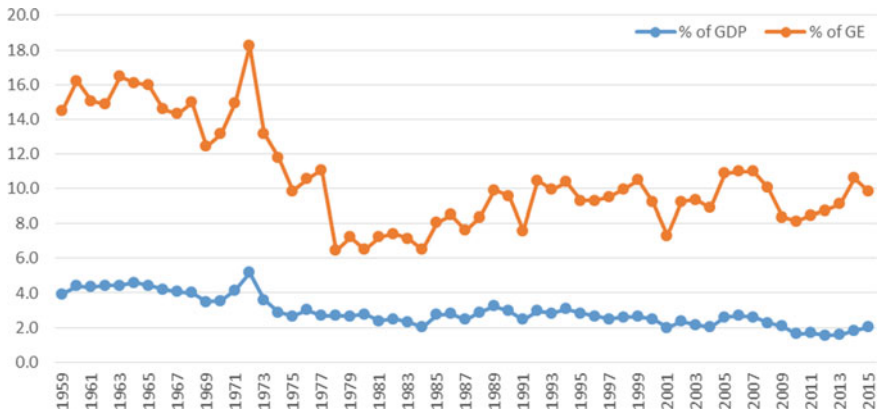


Fig. 14.1 Education expenditure as a percentage of government expenditure (GE) and GDP in Sri Lanka. *Source* Authors' Calculations based on Central Bank of Sri Lanka data

government education expenditure, as a percent of total government expenditure and GDP, changed over time during the period from 1960 to 2015.

As Fig. 14.1 shows that government education expenditure accounted for 16.2% of total government expenditure in 1960, which was equivalent to 4.4% of GDP in that year. As a percentage of total government expenditure, education expenditure displayed a declining trend during the period from 1960 to 1980, and an increasing trend thereafter, during the period from 1981 to 2015. Education expenditure as a percentage of GDP declined over time displaying a declining trend between 1960 and 2015. As a consequence, the percentage has decreased from 4.4 to 2% between 1960 and 2015. Recently, there has been a growing political pressure on Sri Lanka's policy makers to reverse this trend and raise government budgetary allocations on education to a level that amounts to six percent of GDP annually, tripling the proportion that accounts only for less than 2% of GDP at present. Faced with a myriad of economic challenges, policy makers have so far expressed only a cautionary interest in substantially raising expenditure on education, partly due to their concern that directing more resources into social services such as education may generate negative consequences on economic growth. Classified under the category of social services in the Central Bank of Sri Lanka's functional classification of government expenditure, the expenditure on education is generally considered by many as less conducive to economic growth than the expenditure on economic services. They maintain that the pursuit of a welfare state in Sri Lanka has been responsible for mediocre record of economic growth over a long period of time, and thus there has been a trade-off between Sri Lanka's 'welfarism' and economic growth. Conversely, a section of researchers and policy makers believe that there has been a mutually reinforcing complementarity between 'welfarism' and economic growth, as opposed to a tradeoff between the two in Sri Lanka (see for example, Osmani 1994).

As stated earlier, the main purpose of this study is to investigate the effect of government education expenditure on economic growth in Sri Lanka, from 1960 to

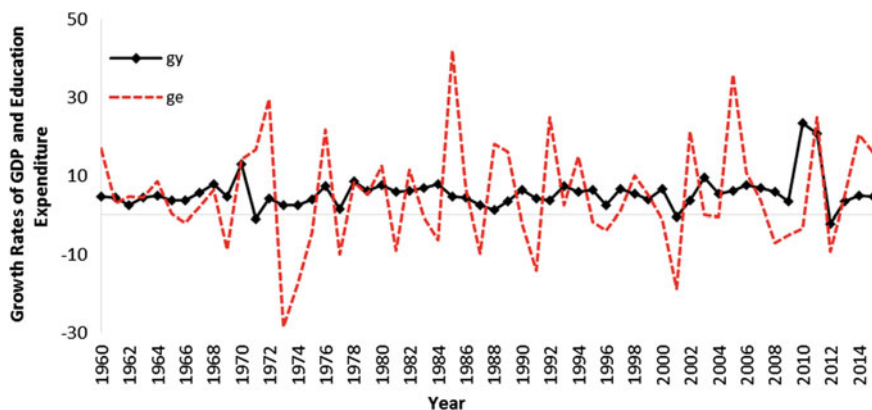


Fig. 14.2 Growth rates of education expenditure (ge) and GDP (gy) in Sri Lanka. *Source* Authors' Calculations based on Central Bank of Sri Lanka data

2015, during which Sri Lanka maintained an active welfare state. The constitutional and political reforms of 1987, transformed the hitherto centralized education sector into a relatively more decentralized system. Such policy regime changes as decentralizations can inflict serious consequences on the efficacy of the allocation of resources and thereby on economic growth. As Fig. 14.1 shows, the share of education expenditure in total government expenditure has continued to increase over the period of post decentralization (i.e., 1988–2015). The growth rates of education expenditure and GDP, both in real terms, are displayed in Fig. 14.2. The growth rate of education expenditure displays a greater short-term volatility relative to the growth rate of GDP. As such, it is difficult to discern a clear relationship between the two growth rates from the figure. It is also difficult to assess whether there has been a significant impact on the relationship between the two growth rates due to the decentralization in 1987. Therefore, in this study, an attempt is also made to examine the impact of decentralization on the effect of education expenditure on economic growth using the estimated models.

Over the last three decades, the world has witnessed a global trend towards decentralization of education systems in both the developed and developing countries for improvements in socio-economic outcomes of education. However, fiscal decentralization has not always generated positive effects on economic growth, as Rodrigues-Pose and Ezcurra (2011) found out in the case of OECD countries during the period from 1990 to 2005. World Bank (2004) emphasized the need for further reforms to improve the efficiency in Sri Lanka's education sector. Canada has one of the most decentralized systems of education in the world (see Dunleavy 2007; Jones 2014). Figure 14.3, displays Canadian data for the period 1990–2014, on the government education expenditure comparable to Sri Lankan data presented in Fig. 14.1. Canada has devoted about 19–21% of total government expenditure to the education sector during this period. As a percentage of GDP, the government education expenditure accounted for about 4% throughout the period.

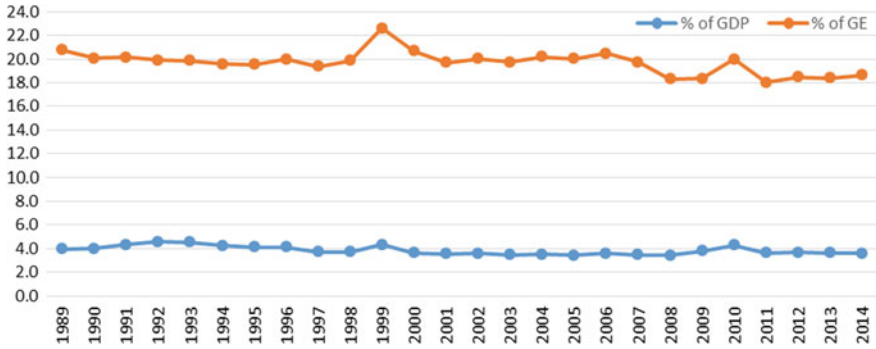


Fig. 14.3 Education expenditure as a percentage of government expenditure (GE) and GDP in Canada. *Source* Authors’ Calculations based on Statistics Canada data

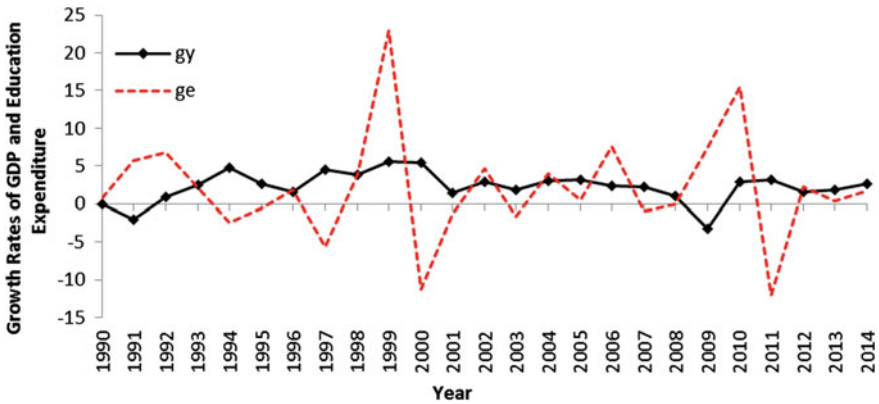


Fig. 14.4 Growth rates of education expenditure (ge) and GDP (gy) in Canada. *Source* Authors’ Calculations based on Statistics Canada data

Compared to Sri Lanka, the education spending as proportions of total government expenditure and GDP have been less volatile over the period 1990–2015. Note that the proportions of government education expenditure in Canada are twice the respective proportions of Sri Lanka, at present.

The growth rates of education expenditure and GDP, both in real terms, comparable to the Sri Lankan data presented in Fig. 14.2, are displayed in Fig. 14.4, for Canada, for the period 1990–2014. Like in the case of Sri Lanka, the growth rate of education expenditure displays a greater short-term volatility relative to the growth rate of GDP. As such, it is difficult to discern a clear relationship between the two growth rates from the figure in the case of Canada, as well.

For a comparative analysis of the experience of Sri Lanka during the post decentralization period of 1988–2015, the authors have analyzed the empirical data for Canada for the period from 1990 to 2015 within the framework of the model employed in this study.

14.4 The Model, Methodology and Data

The model estimated in this study is an adaptation of a model which has been widely employed to investigate the nexus between military spending and economic growth. The origins of the model can be found in Feder (1982) and Ram (1986). In an attempt to investigate the relationship between exports and economic growth, Feder (1982) developed a two-sector production function model of an economy which comprises of exports and non-export sectors. Ram (1986) adapted the Feder's model to examine the relationship between government expenditure and economic growth. In the model developed by Ram (1986), the economy comprises of government and non-government sectors. Mintz and Huang (1990, 1991) extended the Ram (1986) model to develop a three-sector model by disaggregating the government sector into military and non-military sectors. This extended model became widely popular in the studies of military spending and economic growth (see for example DeRouen 1995; Heo 1996, 2010; Mintz and Stevenson 1995). We have modified the extended model to incorporate government expenditures on education and non-education into the model, as described below.

The model assumes that the economy is comprised of a government sector and a non-government sector. The government sector is divided into two subsectors as education and non-education sectors. Thus the aggregate output (Y) is the sum of education output (E), non-education output (N) and non-government output (P).

$$Y = E + N + P \quad (14.1)$$

Each of the sectoral outputs depends on the levels of two primary resources, labour (L) and capital (K), allocated to each sector and the inter-sectoral productivities of a given resource are different. In addition, the non-government sector's production function includes the outputs of education and non-education sectors as inputs because of the externality effects generated by the two subsectors on the non-government sector. Formally, the model is given by the following set of equations.

Sectoral production functions are:

$$E = f_e(L_e, K_e) \quad (14.2)$$

$$N = f_n(L_n, K_n) \quad (14.3)$$

$$P = f_p(L_p, K_p, N, E) \quad (14.4)$$

where, the subscripts e , n and p refer to education, non-education and non-government sectors of the economy. L_i and K_i , $i = e, n, p$, are labour and capital allocated to the sector i , respectively. Allocation of L , and K are given by:

$$L = L_e + L_n + L_p \quad (14.5)$$

$$K = K_e + K_n + K_p \quad (14.6)$$

The ratios of sectoral marginal productivities of labour and capital are given by:

$$(\delta N / \delta L) / (\delta P / \delta L) = (\delta N / \delta K) / (\delta P / \delta K) = 1 + \lambda_n \quad (14.7)$$

$$(\delta E / \delta L) / (\delta P / \delta L) = (\delta E / \delta K) / (\delta P / \delta K) = 1 + \lambda_e \quad (14.8)$$

where λ_n and λ_e account for the productivity differentials between each of the education and non-education sectors and the non-government sector. A negative λ_e indicates that marginal productivities in education sector are lower than those of the non-government sector.

The following growth equation can be derived from the production functions and the Eqs. 14.7 and 14.8. (see Mintz and Huang 1990, 1991).

$$\begin{aligned} \mathbf{GY} = \alpha_1 \mathbf{GL} + \alpha_2 (\mathbf{I/Y}) + [(\lambda_n / 1 + \lambda_n) + \theta_n] \mathbf{GN}(\mathbf{N/Y}) \\ + [(\lambda_e / 1 + \lambda_e) + \theta_e] \mathbf{GE}(\mathbf{E/Y}) \end{aligned} \quad (14.9)$$

where \mathbf{GY} is the growth rate of total output, \mathbf{GL} is the growth rate of labour force, $(\mathbf{I/Y})$ is the investment output ratio, \mathbf{GN} is the growth rate of non-education output, \mathbf{GE} is the growth rate of education output. The terms θ_e and θ_n represent the externality effects generated by education and non-education sectors on the non-government sector, respectively.

With the assumption that the output elasticity of non-government sector with respect to each of the education and non-education sectors is constant, the following growth model can be derived from Eq. 14.9.

$$\begin{aligned} \mathbf{GY} = \alpha_1 \mathbf{GL} + \alpha_2 (\mathbf{I/Y}) + \alpha_3 \mathbf{GN}(\mathbf{N/Y}) + \alpha_4 \mathbf{GN}(\mathbf{P/Y}) \\ + \alpha_5 \mathbf{GE}(\mathbf{E/Y}) + \alpha_6 \mathbf{GE}(\mathbf{P/Y}) \end{aligned} \quad (14.10)$$

Furthermore, the coefficients α_4 and α_6 are the elasticities of non-government output with respect to non-education and education outputs, respectively. They are the measures of indirect or externality effects of non-education and education outputs on the non-government sector respectively. The coefficients $\alpha_3 = (\lambda_n / 1 + \lambda_n)$ and $\alpha_5 = (\lambda_e / 1 + \lambda_e)$ are the direct effects of non-education and education spending on economic growth rate, respectively. The coefficient α_1 is the elasticity of non-government output with respect to labour and α_2 is the elasticity of non-government output with respect to capital stock, respectively.

Adding a constant term α_0 and a stochastic error term \mathbf{u} to the Eq. 5, results in the following econometric formulation of the model.

$$\begin{aligned} \mathbf{GY} = & \alpha_0 + \alpha_1 \mathbf{GL} + \alpha_2 (\mathbf{I/Y}) + \alpha_3 \mathbf{GN} (\mathbf{N/Y}) + \alpha_4 \mathbf{GN} (\mathbf{P/Y}) + \alpha_5 \mathbf{GE} (\mathbf{E/Y}) \\ & + \alpha_6 \mathbf{GE} (\mathbf{P/Y}) + \mathbf{u} \end{aligned} \quad (14.11)$$

The model takes into account both the direct and indirect effects of education and non-education spending on economic growth. The education sector generates a direct effect on growth by absorbing productive resources. The direct effect can be either positive or negative depending on the inter-sectoral relative factor productivities of the education and non-government sectors of the economy. The education sector also generates an indirect effect on growth via its externality effects on the non-government sector of the economy. The estimated coefficient accounts for the net effect of all positive and negative externalities on the non-government sector, which can be either positive or negative.

An alternative version of the model that allows estimating direct and indirect effects is given by the following equation (see Heo 2010):

$$\begin{aligned} \mathbf{GY} = & \alpha_0 + \alpha_1 \mathbf{GL} + \alpha_2 (\mathbf{I/Y}) + (\lambda_n/1 + \lambda_n) \mathbf{GN} (\mathbf{N/Y}) + \theta_n \mathbf{GN} \\ & + (\lambda_e/1 + \lambda_e) \mathbf{GE} (\mathbf{E/Y}) + \theta_e \mathbf{GE} + \mathbf{v} \end{aligned} \quad (14.12)$$

In this version of the model, θ_e and θ_n are the externality effects of education and non-education expenditure, respectively.

The preceding models (Eqs. 14.11 and 14.12) are estimated using the method of Ordinary Least Squares (OLS) method and the annual time series data covering the period 1960–2015 for Sri Lanka, and 1990–2014 for Canada. The data for Sri Lanka are obtained from various reports of the Central Bank of Sri Lanka (Central Bank of Sri Lanka 2010, 1990–2016). The data for Canada are obtained from various data tables of Statistics Canada (Statistics Canada 2016). In the case of Canada, the growth rate of labour force is used in place of \mathbf{GL} . The growth rate of population, a popular proxy in the related literature, is used in place of \mathbf{GL} for Sri Lanka. All the other variables used are measured in real terms. Prior to estimation of the models, all of the data series are tested for unit roots using the Dicky-Fuller unit root tests.

14.5 Analysis of Results

Results of the Augmented Dicky-Fuller (ADF) unit root tests performed on the data series used for model estimation are reported in Table 14.1 for Sri Lanka and Canada.

As reported in Table 14.1 all the data series are integrated of order 0, $I(0)$, and satisfying the stationarity requirement when the entire sample period is considered. In general, any linear combination of a set of $I(d)$ variables is also $I(d)$, however it can also be integrated of an order less than d . (see Gujarati and Porter, p. 747).

Table 14.1 Unit root test results for Sri Lanka and Canada

Variable/data series	Sri Lanka			Canada
	1960–2015	1960–1987	1988–2015	1990–2014
GY	-6.356606* _i	-5.946223* _i	-4.221274* _i	-3.32192** _i
I/Y	-3.701326** _{it}	-2.794404	-0.713048	-1.06662
GL	-4.413400* _i	-3.942438* _i	-2.532564**	-2.7999*** _i
GN	-8.823450*	-6.452487*	-4.640972*	-2.30031**
GE	-7.431960*	-5.306357*	-4.941628*	-5.80306*
GN(N/Y)	-3.981665 *	-6.106828*	-4.850961*	-2.2700**
GN(P/Y)	-8.808072*	-6.633580*	-4.599919*	-2.3067**
GE(E/Y)	-7.334177*	-5.209811*	-4.802172*	-5.61393*
GE(P/Y)	-7.343647*	-5.286356*	-4.869704*	-5.84437*

Notes *, **, ***Significant at 1%, 5% and 10% level of significance respectively. While “i” represents the unit root results with constant term included and “it” represents the unit root results with constant term and a time trend are included

Table 14.2 Estimated OLS results of model 1 (Eq. 14.11) for Sri Lanka

Variable	Full sample 1960–2015		Sample 1960–1987		Sample 1988–2015	
	Coefficients	S.E	Coefficients	S.E	Coefficients	S.E
I/Y	0.2766**	0.1135	0.1689*	0.0967	0.3833	0.2802
GL	1.5812**	0.7812	0.4255	1.0419	2.7417**	1.4526
GN(N/Y)	-0.2227	0.2927	-0.0882	0.3321	-2.2674	2.2504
GN(P/Y)	0.1866	0.1685	0.1151	0.2105	0.6932	0.6752
GE(E/Y)	-2.8031	4.1713	-1.7144	4.6382	-8.9899	14.421
GE(P/Y)	0.1322	0.1836	0.1162	0.2383	0.2180	0.5057
Constant	-0.0328	0.0341	0.0062	0.0325	-0.0617	0.0817
R²	0.25		0.30		0.33	
Adj. R²	0.16		0.09		0.14	
D.W	1.77		2.71		1.39	

Notes *, **, ***Significant at 1%, 5% and 10% level of significance, respectively

Based on the results reported in Table 3.1, we considered all of the series to be integrated of order 0, I (0), (i.e., level stationary), and as a consequence, any linear combination of these variables for Sri Lanka and Canada are also I (0). As such, we conclude that models estimated would not produce spurious results for Sri Lanka, and Canada.

Estimated results of the two models, namely Eqs. 14.11 and 14.12, for Sri Lanka using the method of Ordinary Least Squares (OLS) for the period of full sample and two sub-sample periods are reported in Tables 14.2 and 14.3, respectively.

The entries in Tables 14.2 and 14.3 are not satisfactory in terms of the statistical significance of the coefficients, or explanatory power of the model. The diagnostics on the residuals from the models seem to indicate possibly problems of heteroscedasticity. The results of two tests of Heteroscedasticity,

Table 14.3 Estimated OLS results of model 2 (Eq. 14.12) for Sri Lanka

Variable	Full sample 1960–2015		Sub-sample 1960–1987		Sub-sample 1988–2015	
	Coefficients	S.E	Coefficients	S.E	Coefficients	S.E
I/Y	0.2881**	0.1149	0.1802***	0.0982	0.3697	0.2468
GL	1.6097**	0.7912	0.4834	1.0511	2.6704***	1.2838
GN(N/Y)	-0.4612	0.4458	-0.2403	0.5306	-2.9449	2.5712
GN	0.1999	0.1609	0.1273	0.2013	0.6732	0.5811
GE(E/Y)	-1.9536	4.4975	-0.1513	4.1672	-12.0187	16.311
GE	0.0668	0.1428	0.0242	0.1506	0.2386	0.4225
Constant	-0.0375	0.0345	0.0022	0.0327	-0.0572	0.0725
R²	0.25		0.29		0.33	
Adj. R²	0.15		0.08		0.14	
D.W	1.77		2.68		1.39	

Notes *, **, ***Significant at 1%, 5% and 10% level of significance, respectively

Table 14.4 Results of the tests of heteroscedasticity

	Sri Lanka					
	1960–2015		1960–1987		1988–2015	
	Model 1	Model 2	Model 1	Model 2	Model 1	Model 2
<i>B-P-G test</i>						
F-Stat	0.616939	0.646231	0.366425	0.275119	1.037267	1.007553
LM test	3.933306	4.106362	2.653591	2.040551	6.401093	6.258712
SESS	16.89363*	17.14181*	3.939584	3.067738	12.66847**	12.59283**
<i>White test</i>						
F-Stat	0.674356	0.625201	0.878145	2.003989	0.733934	0.540485
LM test	17.36788	16.47432	22.24323	25.14797	21.37953	19.71141
SESS	74.59539*	68.77123*	33.02283***	37.80711**	42.31244*	39.66031**

Notes *, **, ***Significant at 1%, 5% and 10% level of significance, respectively

namely Breusch-Pagan-Godfrey (B-P-G) and White tests, are reported in Table 14.4. According to these results the presence of heteroscedasticity cannot be unambiguously ruled out. In response, the two models are estimated using the method of Weighted Least Squares (WLS) as a remedial measure. The regression results of that exercise are reported in Tables 14.5 and 14.6.

Estimated results for Sri Lanka reported in Tables 14.4 and 14.5 are the results obtained by the method of Weighted Least Squares, which was used as a remedial measure to correct for heteroscedasticity that may have resulted from sharp fluctuations in some data series. The entries in the tables show that the method of WLS yielded superior results than the results produced by the method of Ordinary Least Squares. This method produced similar results for the two models that do not differ significantly for the period of post-decentralization in Sri Lanka (i.e., 1988–2015). The results from model 2 are better than those from the model 1 for the period

Table 14.5 Estimated WLS results of model 1 (Eq. 14.11) for Sri Lanka

Variable	Sample 1960–2015		Sample 1960–1987		Sample 1988–2015	
	Coefficients	S.E	Coefficients	S.E	Coefficients	S.E
I/Y	0.144**	0.067	0.13990*	0.03911	0.18226	0.24911
GL	1.511*	0.547	-0.702	0.554	2.250	1.377
GN(N/Y)	0.459*	0.136	-0.101	0.141	2.922**	1.204
GN(P/Y)	-0.241**	0.093	0.138	0.096	-1.122*	0.304
GE(E/Y)	-26.803*	4.340	5.563	5.824	-57.770*	7.927
GE(P/Y)	1.133*	0.167	-0.200	0.253	2.125*	0.279
Constant	0.00059	0.02148	0.02929**	0.01355	-0.00385	0.07499
R²	0.67		0.84		0.85	
Adj. R²	0.63		0.79		0.81	
D.W	1.94		2.39		1.84	

Estimated WLS results of model 2 (Eq. 14.12) for Sri Lanka

I/Y	0.09985	0.07692	0.16621*	0.03866	0.09623	0.24019
GL	1.071***	0.597	-0.721	0.505	1.972	1.311
GN(N/Y)	0.361	0.226	-0.269	0.209	4.133*	1.437
GN	-0.113	0.091	0.150***	0.082	-1.103*	0.284
GE(E/Y)	-29.405*	5.843	10.832**	4.533	-74.498*	9.292
GE	0.876*	0.162	-0.296**	0.135	1.998*	0.242
Constant	0.01473	0.02435	0.02359***	0.01295	0.02398	0.07252
R²	0.61		0.86		0.86	
Adj. R²	0.56		0.82		0.83	
D.W	2.11		2.31		1.87	

Notes *, **, ***Significant at 1%, 5% and 10% level of significance, respectively

Table 14.6 Estimated OLS results of model 1 (Eq. 14.11) and model 2 (Eq. 14.12) for Canada (1990–2014)

Variable	Model 1		Model 2	
	Coefficients	S.E	Coefficients	S.E
I/Y	-0.1544	0.2290	-0.1397	0.2251
GL	0.6213	0.4723	0.6500	0.4648
GN(N/Y)	-10.6072***	5.0902	-10.8918***	6.0116
GN(P/Y)	1.6746	1.0417		
GN			1.3980	0.9853
GE(E/Y)	34.2378**	11.8968	37.2131*	12.4269
GE(P/Y)	-1.6654**	0.6021		
GE			-1.4640*	0.5068
Constant	0.04276	0.0359	0.0402	0.0353
R²	0.64		0.65	
Adj. R²	0.52		0.53	
D.W	2.05		2.06	

Notes *, **, ***Significant at 1%, 5% and 10% level of significance, respectively

1960–1987. However, we note that the results from the model 1 are slightly better than those from model 2 for the full sample period (1960–2015) in terms of the explanatory power of the model (i.e. R^2 and adjusted R^2).

Estimated results of the two models, indicate that the productivity and externality effects of education expenditure are both significant at the one percent level of significance for the full sample period (1960–2015), and the post decentralization period of 1988–2015. Further, the results show that the productivity effect is negative and the externality effect is positive for the full sample period and the post decentralization period. In contrast, the estimated productivity and externality effects for the pre-decentralization period of 1960–1987, are positive and negative, respectively. These results indicate that the externality effect of education expenditure has improved and turned positive under decentralization but the productivity effect of education expenditure has turned negative. The results also indicate that the productivity and externality effects of non-education expenditure of government, in general, are positive and negative respectively, for the periods of 1960–2015 and for the sub-period 1988–2015. The productivity effect of non-education expenditure has improved under decentralization, while the externality effect has not. In terms of the magnitude, both the direct and indirect effects of education expenditure are relatively larger than those of the non-education expenditure. These results clearly indicate that a redirection of government expenditure in favour of the education sector, without substantial improvements in factor productivities within the education sector, will hamper economic growth in Sri Lanka.

Estimated results of the two models for Canada for the period 1990–2014 using OLS are presented in Table 14.6. The results obtained for the same period for the two models by WLS are reported in Table 14.7. The OLS results reported in Table 14.6 for the two models are similar in terms of the explanatory power of the

Table 14.7 Estimated WLS results of model 1 (Eq. 14.11) and model 2 (Eq. 14.12) for Canada (1990–2014)

Variable	Model 1		Model 2	
	Coefficients	S.E	Coefficients	S.E
I/Y	-0.382612*	0.050595	-0.39597*	0.122591
GL	0.3799*	0.1143	0.4625***	0.2583
GN(N/Y)	-20.7163*	2.2108	-21.6660*	4.6815
GN(P/Y)	3.3845*	0.5031		
GN			2.8847*	0.8125
GE(E/Y)	33.1489*	2.9822	34.0888*	3.4076
GE(P/Y)	-1.5960*	0.1383		
GE			-1.3312*	0.1352
C	0.084112*	0.007969	0.084834*	0.020061
R^2	0.91		0.91	
Adj. R^2	0.88		0.88	
D.W	1.74		1.72	

Notes *, **, ***Significant at 1%, 5% and 10% level of significance respectively

models, the magnitudes of the comparable coefficients and their statistical significance. However, the WLS results reported in Table 14.7 for the two models are relatively better than the OLS results.

The WLS results from the two models do not differ significantly in terms of the magnitude of the estimated coefficient, their levels of significance. All of the estimated coefficients except the coefficient of labour variable, which measures marginal product of labour in non-government sector, are statistically significant at one percent level of significance. It is noteworthy that the two models are equally satisfactory in terms of the explanatory power and other reported diagnostic statistics.

Since Canada has a highly decentralized sector of education, the results reported in Table 14.7 can be more suitably compared to the results for the post decentralization period (1988–2015) of Sri Lanka. Such a comparison reveals that the productivity and externality effects of both education and non-education expenditures have opposite signs for the respective coefficients. In sharp contrast to the results for Sri Lanka, the productivity effect of education expenditure is positive for Canada, while the externality effect of education expenditure is negative. Unlike in the case of Sri Lanka, the estimated productivity and externality effects of non-education expenditure for Canada are negative and positive, respectively. According to these results, the education sector has relatively higher factor productivities than the non-government sector, while the government non-education sector has relatively lower factor productivities relative to the non-government sector. However, the expansion of education sector generates a negative impact on the non-government sector, while the expansion of government non-education sector generates a positive impact. Given the fact that Canada is a developed market economy, the crowding out effects of higher government education expenditure may be reflected in the negative indirect effect of government education expenditure in Canada. Notwithstanding, the experience of Canada clearly demonstrates that the relative factor productivities can be higher than those of the non-government sector and government education expenditure can generate a positive direct effect on economic growth under a decentralized system of education.

14.6 Summary and Conclusions

The purpose of the present study is to undertake an empirical investigation into the role of government education expenditure in economic growth in Sri Lanka during the period 1960–2015.

The study adapts a widely popular production function model in the studies of military spending and economic growth to study the relationship between education expenditure and economic growth in Sri Lanka and Canada. The model incorporates the direct effect that emanates from the productivity differential of the government education sector and an indirect effect that results from externalities generated by the government education expenditure on the rest of the economy.

The study focusses on the impact of decentralization of Sri Lanka's education sector in 1987, on the direct and indirect effects of education expenditure. The experience of Sri Lanka during the post decentralization period (1988–2015) is compared to the experience of Canada, which has a highly decentralized system of education in the world. The results demonstrate that Government education expenditure is a significant factor in economic growth in Sri Lanka. It generates a negative direct effect and a positive indirect effect on economic growth. The factor productivities in the government education sector are considerably lower than those of the non-government sector in Sri Lanka. During the period of post decentralization, the productivity gap between the education and non-government sectors have further increased, indicating that the decentralization has failed to bring about a more efficient allocation of resources in order to raise productivity in the government education sector. The non-education sector generates a positive direct effect and a negative indirect effect on the non-government sector, whose magnitudes are lower than those of the education expenditure. However, the relatively higher positive indirect effect during the period of post decentralization, compared to the previous period, indicates that the externality effect has substantially improved following the decentralization in Sri Lanka.

Education expenditure is also a significant factor in economic growth in Canada. However, the Canadian results stand in sharp contrast to the Sri Lankan results for the period under decentralization. The estimated positive direct effect for Canada, clearly indicates that the factor productivities can be higher than those of the non-government sector under a decentralized system of education. Given the fact that Canada is a developed market economy, the crowding out effects of higher government education expenditure may be reflected in the negative indirect effect of government education expenditure in Canada. The differences in the respective direct and indirect effects of government education expenditure between Sri Lanka and Canada may reflect the institutional and structural differences of the two economies.

The findings of this study highlight the importance of formulating policies and strategies to improve direct effect and enhance the indirect effect for faster economic growth in Sri Lanka. Raising factor productivities within the education sector is the most promising strategy for improving both the direct and indirect effects of the government education expenditure in the economy. However, according to the findings of this study, a redirection of government expenditure in favour of the education sector, without substantial improvements in factor productivities within the education sector, will hamper economic growth in Sri Lanka. In the face of increasing pressure for raising education expenditure, it is important that the authorities identify and rectify the inefficiencies that are responsible for lower factor productivities in the education sector, prior to taking measures to drastically increase government expenditure on education.

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Chapter 15

Japanese Local Tax System and Decentralization

Shunsuke Kimura

15.1 Introduction

In Japan, the local governments are given the authority to levy local taxes. The local tax revenue is the core revenue source among the various sources of local revenue.

What are the characteristics of Japanese local tax system in the context of the decentralization? And in the age of decentralization what are the goals of local tax system? This paper examines the structure of Japanese local revenue and the framework of Japanese local tax. Furthermore, it examines the characteristics of the local tax system and the relationship between national taxes and local taxes. Moreover, this paper examines the goal of financial autonomy in the context of Japan.

15.1.1 Structure of Japanese Local Revenue

Overview of Japanese Local Revenue: The local revenue resources are mainly composed of the general revenue resources in terms of quantity and quality. These general revenue resources account for 56.1% of the total local revenue in FY2014 (Fig. 15.1).

Moreover, they are not earmarked for specific purposes and are essential for local autonomy. The key elements are the local taxes, the local transfer tax, the special local grants, and the Local Allocation Tax (LAT hereunder).

The local taxes include an assortment of public levies. The local governments have the right of taxation: the authority to levy, collect, receive, and use taxes.

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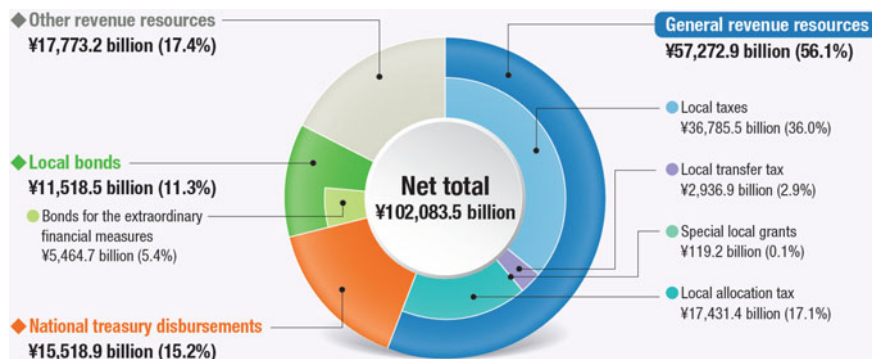


Fig. 15.1 Composition of local revenue (FY2014 Settlement). (Source White Paper on Local Public Finance, 2016, Ministry of Internal Affairs and Communications)

The local transfer tax is a group of taxes that are collected as national taxes and directly transferred to the local governments. As a matter of taxation convenience, the central government acting on behalf of the local public bodies collects these taxes, which are regarded as local government revenue resources in the basic sense.

The special local grants are distributed for reducing the burden of local governments with regard to child allowance, compensation for a decrease in individual inhabitant tax according to the tax reduction for home loans and so on. LAT is an allocation of financial resources made by the central government to each local body in order to equalize the local revenue sources by reducing disparities and to guarantee the systematic management of local finances.

Among the various general revenue resources, the local taxes and LAT are the key resources. Before going into details about the local taxes, this chapter presents an outline of LAT in the next section.

15.1.2 Outline of LAT

Background: As of 2014, Japan had 47 prefectures and 1,718 municipalities; they are quite diverse regarding aspects of the population and geographic size.¹ Figure 15.2 shows the size variation among the prefectures.

The prefectures in metropolitan areas (Tokyo, Kanagawa, Saitama and Chiba) and those in the traditional industrial regions (Osaka, Aichi, Hyogo and Fukuoka) have large populations. Those nine jurisdictions have populations in excess of five million. The largest jurisdiction is Tokyo, whose population is about 13 million,

¹Shunsuke Kimura, *The Regional Administration in Japan*, Routledge, 2017 (Kimura 2017 hereafter), p. 39.

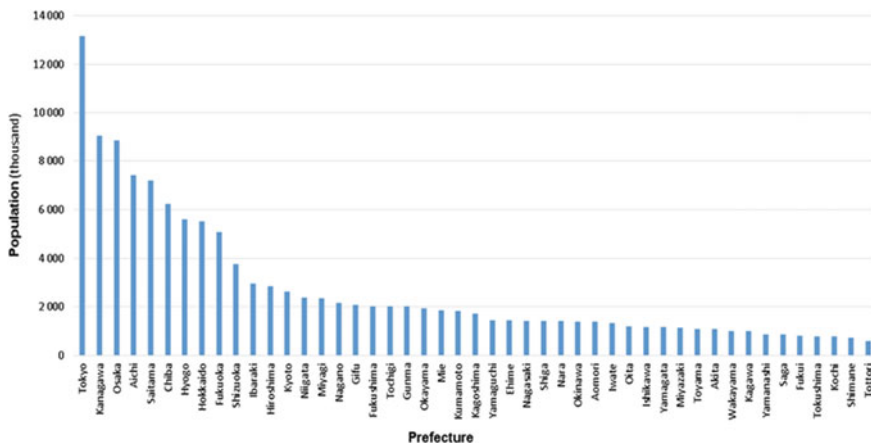


Fig. 15.2 Populations of the prefectures (October 1, 2010)

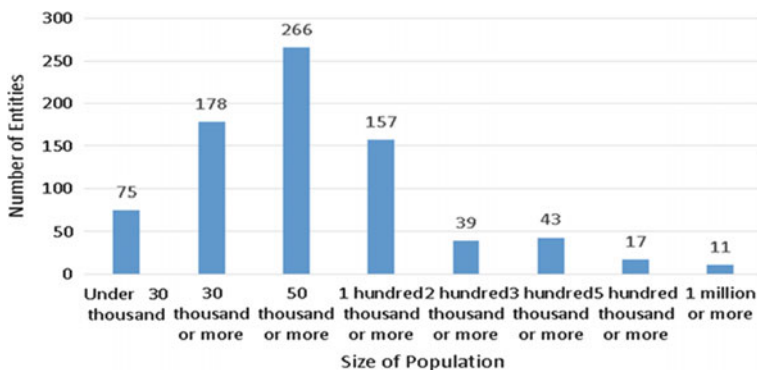


Fig. 15.3 Distributional situation of cities by population size (October 1, 2010)

which is 22 times the size of Tottori prefecture, the smallest prefecture, with population of five hundred eighty eight thousand.

On the other hand, in remote rural areas far from urban centers there are small prefectures with population less than one million: Tottori, Shimane, Kochi and so on. Even among the cities there are great differences (Fig. 15.3).

There are eleven big cities with population greater than one million; all of them are designated cities. On the other hand, there are seventy five small cities with populations less than thirty thousand.²

These salient differences are caused by factors such as natural conditions, administrative distinctions, and the extent of industrial concentration. The diversity in geographic size is similar. These differences remain crucial issues for local

²Kimura (2017), p. 41.

governments. One of those issues is differences of amounts of taxable objects in each jurisdiction: this fact provides the disparities of sizes of tax bases among local public entities.

Objective: On the basis of these disparities, the objective of LAT is to strengthen the self-dependence of local governments by equalizing the financial resources and by ensuring the systematic operation of local administration through the establishment of allocation standards for LAT, without impairing the autonomy of such local public bodies. LAT has two functions:

(A) Financial equalization function

LAT aims to rectify the disparities among the financial capabilities of local governments by distributing the local allocation tax appropriately.

(B) Financial resource guarantee function

This function can be divided into two levels.

1. Macro-level financial resource guarantee function³

LAT guarantees revenue resources for local public bodies as a whole. The annual amount of LAT is set in such a manner as to guarantee the local financial revenue at the macro level through the national budgetary process.

2. Micro-level financial resource guarantee function

LAT guarantees financial resources for individual local public bodies. LAT is distributed to those local bodies whose standard financial requirements exceed the standard financial revenue. A reasonable amount of financial resources for the performance of standard public services is secured through these distributions.

Characteristics: The characteristics of LAT are as follows:

- (A) LAT money constitutes revenue resources that are specifically intended for the local governments and are shared by them. LAT can be thought of as a local tax collected by the national government on behalf of the local authorities. This tax constitutes financial resources that local public bodies share and that are specifically meant for their use.
- (B) LAT provides general revenue resources for the local governments. The national government does not decide how the funds are spent or does not

³The actual amount of LAT has reached around seventeen trillion yen in recent years. Local finances are currently in debt to the extent of two hundred trillion yen. In this financial crisis situation, how to guarantee local revenue is a crucial agenda item: the national government has set the total sum of LAT in order to secure sufficient revenue each year as an important decision-making tool. As a result of such policy-making decisions, the actual size of LAT has remained stable. Source; Shunsuke Kimura, "Decentralization and Local Public Finance in Three Asian Countries—Overview of General Revenue-", *Decentralization in Asian Countries—Reviewing the Present and Designing the Future (4th International Research Meeting Report)*, National Graduate Institute for Policy Studies, 2015, pp. 104–105.

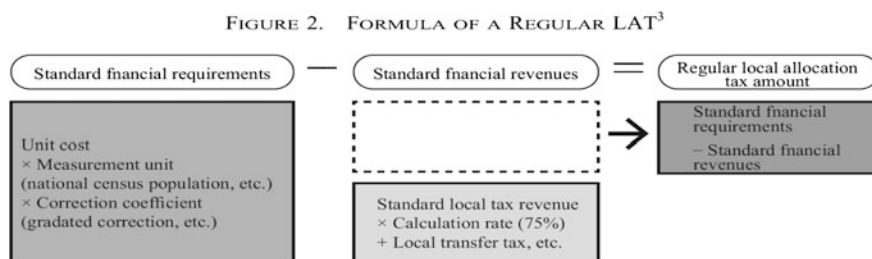


Fig. 15.4 Formula of a regular LAT. (Source White Paper on Local Public Finance, 2016)

impose any conditions regarding their use; the utilization of these funds is left to the independent decision of the local authorities.

LAT is a scheme that corrects the gap between the scale of national tax revenues and that of local tax revenues. The former is larger than the latter; however, the local fiscal expenditure is greater than the national fiscal expenditure (see Fig. 15.13). In this financial framework, LAT has a crucial role as a financial transfer from the national government to the local governments.

Mechanism: LAT is paid annually to the local bodies according to the formula given in Fig. 15.4.

LAT is composed of a regular LAT and a special LAT. A regular LAT is a basic fund, and a special LAT is a complementary fund. These two funds are calculated separately for each local body. The amount of regular LAT of a local body can be obtained from the difference between its standard financial requirements and its standard financial revenue. In other words, this system is designed for “compensating for disparities in fiscal resources and needs” (Mochida 2008).⁴

Next, what are the effects of LAT? Figure 15.5 presents a model of the effects of LAT.

The standard financial requirements of village A, town B, and city C are 10 billion yen. The standard financial revenue of A is the smallest (3 billion yen), while that of B is 6 billion yen and that of C is the largest (12 billion yen). In this case, village A, the poorest local body, gets 7 billion yen, the largest amount of LAT. Conversely, city C, the richest body, receives no LAT.

Which local body gets the significant benefit through LAT? This scheme is highly advantageous to those local public entities whose financial grounds are weak. Figure 15.5 shows the ratio of LAT to the total revenue in the municipalities.

Effect: As noted above, LAT is allocated advantageously to the financial weak local public entities; LAT functions as financial equalizing system.

⁴Nobuki Mochida, “Fiscal equalization transfer”, *Fiscal Decentralization and Local Public Finance in Japan*, Oxford, 2008 (Mochida 2008 hereafter), p. 103.

FIGURE 3. MODEL OF EFFECTS OF THE LAT⁴

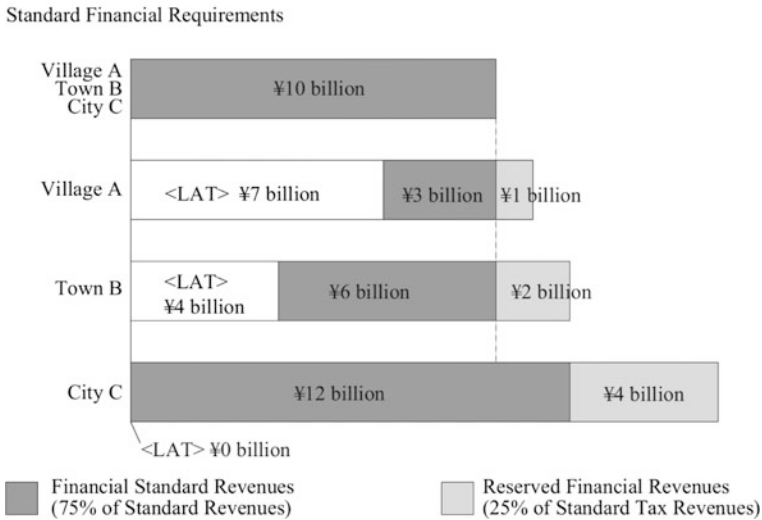


Fig. 15.5 Model of effects of the LAT. The figure was created is made by the author

Among the prefectures the size of local tax revenue of Tokyo is much larger than those of the other prefectures; Tokyo is given no regular LAT in accordance with the formula described above. On the other hand, much amount of LAT are allocated to the rural prefectures (Fig. 15.6).

More than one third of the general revenue is LAT for the rural small prefectures such as Tottori, Kochi and Shimane (Fig. 15.7).

The ratio of LAT is 38.7% in the group of towns and villages whose population is less than ten thousand; this is the smallest group among the municipalities (Fig. 15.8).

This ratio is larger than that of any other group. This fact shows the importance of the role that LAT plays, especially in the small local bodies. “Using this formula, the national government can transfer funds that will fill the gap between each region’s fiscal need and fiscal capacity to ensure that an authority with reasonable tax effort will be able to provide a reasonable level of public services”.⁵

In other words, LAT has been an essential support for the Japanese national minimum for as much as 1,718 (as of April of 2014) local bodies with viable sizes and natural conditions.

⁵*Ibid.*

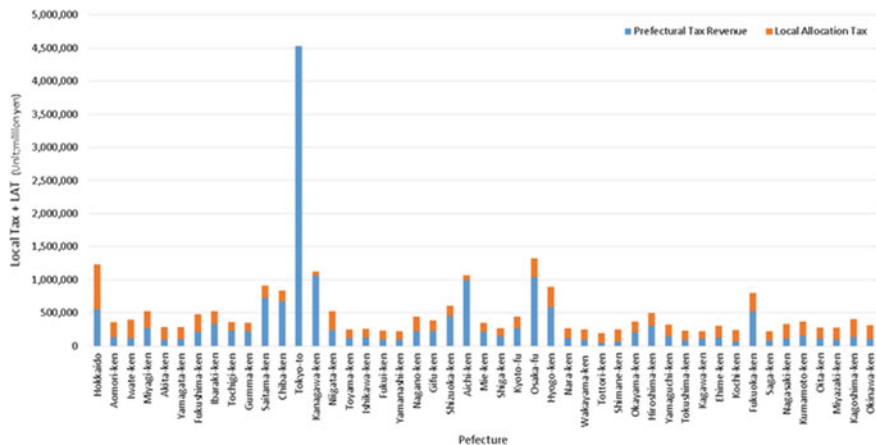


Fig. 15.6 LAT and prefectural tax revenue (Prefectures, GY2013)

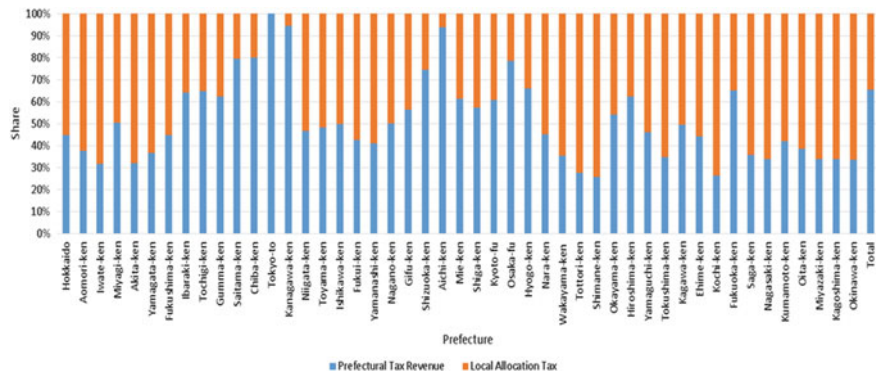


Fig. 15.7 Composition ratio of LAT and prefectural tax revenue (Prefectures, FY2013)

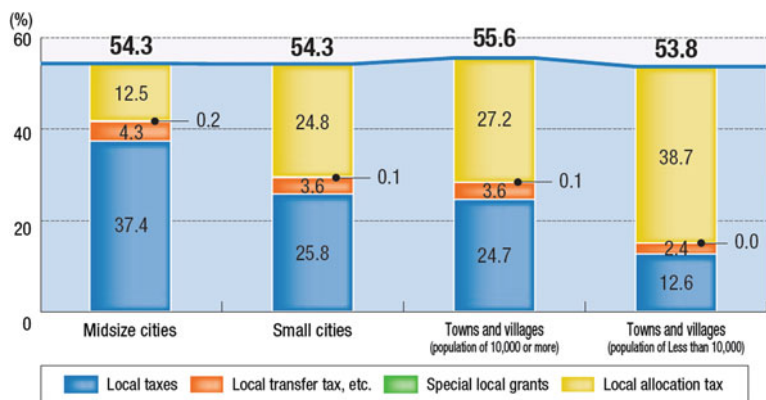


Fig. 15.8 Ratio of total revenue composed of general revenue resources for municipalities (FY2014 Settlement). (Source White Paper on Local Public Finance, 2016)

15.1.3 *Framework of Japanese Local Tax*

1. Framework

Legal framework: The legal framework of the Japanese local tax system is stipulated by the Japanese Constitution. The Art. 94 of the Constitution stipulates that “[I]local public entities shall have the right to manage their property, affairs and administration and to act their own regulations within law.”

Further, the Art. 10, Sec. 2 of the Local Autonomy Law (LAL hereunder) stipulates the following: “According to the Law, inhabitants have their rights to receive equally public services offered by local public entities where they live and have their own shares of their community.”

This article stipulates that inhabitants should share the cost of the public services that are provided by the local government. This is called the “burden-sharing” principle, and it is the key concept of Japanese local administration.

Based on this concept, the Art. 223 of LAL stipulates the following: “According to the Law, ordinary local governments have their power to levy and collect local taxes.” Under the Constitution and LAL, the Local Tax Law (LTL hereunder) regulates the local tax system. LTL is the basic national law that stipulates the types of taxes and the means of taxation. Under this legal framework, both prefectures, as well as municipalities are given the authority to levy and collect local taxes in Japan.

Local tax and local autonomy: Why would the residents pay their share for their own community? Because they believe that they can place their trust in their local governments. Why would they believe that? One reason is that the local governments ensure that they have free will in deciding what public service they shall provide to the residents. The necessary financial revenue sources that are not earmarked are the key for ensuring free will.

This is the context of the relationship between local tax and local autonomy. For the local government to be able to function in accordance with the spirit of local autonomy, it is important that it has the authority to levy taxes and to acquire them on its own.

Without this authority, local governments would accept excessive interferences by the national government in exchange for financial aid. Therefore, the authority of a local government to levy taxes is an indispensable element of local autonomy. This can be termed the “principle of financial autonomy.”

Significance of local tax: The local tax has two essential features. The first is that the local tax belongs to the general revenue sources among the various local revenue resources. The general revenue sources are not earmarked for any specific purpose and can be used for any kind of expense of the local governments. They comprise of local tax, LAT, local transfer tax, and several non-earmarked grants. The local tax is a core source among them.

The general revenue sources have two important advantages.

1. The local government can use these funds for any use at its complete discretion. The local government levies and collects all the tax under its authority. The central government has no influence on the local government's decision-making.
2. The local government can make flexible use of the general revenue sources. Japanese local governments have to respond to abrupt financial needs. They need to have additional funds for emergency restoration, appreciated cost of public works, and so on, even in the middle of a fiscal year. In such situations, the local government compiles the supplementary budget, and flexible sources such as the general revenue sources are actually essential in such cases.

The second feature is that the local tax belongs to the independent revenue sources among the local revenue resources. The independent revenue sources are the ones that the local governments can collect under their authority. They are local tax, rents, fees, and donations. On the other hand, the dependent revenue sources are the ear-marked grant, LAT, the local transfer tax, local bond and so on.

The independent revenue sources have two important advantages.

1. The authority to collect these revenues rests with the local governments. Therefore, they can use them for any uses independently; there is no room for the influence of the national government.
2. Independent sources bring in more stable revenue for the local governments as their revenue policies are not affected by the national government's fiscal policy. These features are quite important for the local revenue. The local tax has all the advantages needed for the local revenue, and its revenue sizes are bigger than those of other kinds of local revenue. Therefore, the local tax plays a core role as both a general revenue source and an independent revenue source.

“Where local autonomy is the aim, local taxes should be the most important source of local revenue” (Steiner 1965).⁶ This indicates that there is an important relationship between local tax revenue and local autonomy. A local government should be able to finance its public needs. Given such a framework, the citizens can select the chief executive (governor/mayor) who is responsible for the quality of public services. Therefore, the size of the local tax revenue should be further expanded in order to advance local autonomy.

⁶Kurt Steiner, *Local Government in Japan*, Stanford, 1965, p. 263.

15.1.4 Scheme of Local Tax System

(A) LTL (Local Tax Law)

LTL specifies the kinds of taxes that local governments may levy, the tax base, and the “standard rate,” the “maximum rate,” or the “fixed rate” of such taxes.

Since the tax base is fixed in LTL, the bases of such taxes are consistent across the country’s various jurisdictions. LTL stipulates the taxation requirements under the various tax headings and the procedures for levying and collecting tax in a uniform manner.

(B) Taxation by law

Local taxes must be levied and collected on the basis of the bylaws enacted by each local assembly. A taxation by law stipulates the tax headings, the objects of taxation, taxation criteria, rates of taxation, and other matters related to levying and collecting tax. The local government must act in accordance with the bylaws. The local governments in Japan must establish taxation bylaws and taxation regulations that are in accordance with the stipulations of LTL, and they must levy and collect taxes based on these bylaws and regulations.

(C) Setting tax rates

Given the principle of financial autonomy, it would be inappropriate for everything related to local taxation to be regulated in a uniform manner by national laws. Therefore, the most important matters, including tax rates, are decided by the tax bylaws.

On the assumption of that standard tax rates are shown by the central government “Standard tax rates” are the rates that local governments should normally follow when levying taxes, but which do not necessarily have to be followed when financial circumstances or other necessary matters are taken into special consideration. These are the rates used as the basis for calculating the basic financial revenue when the amount of LAT is determined by MIC.

Given that standard tax rates are the rates that are set when calculating the tax burden of the people as a whole (including national taxes and local taxes) or when considering matters such as the distribution of revenue sources between the central government and the local governments, these rates do have a significance. Due to these factors, standard tax rates have a considerable effect on the actual tax rates set by the local governments.

However, the local government can set a rate that exceeds the standard rates. This is called “tax levy in excess of the norm.”

FIGURE 5. SYSTEM OF THE LOCAL TAXES⁹



Fig. 15.9 System of the local taxes. Source Data of MIC

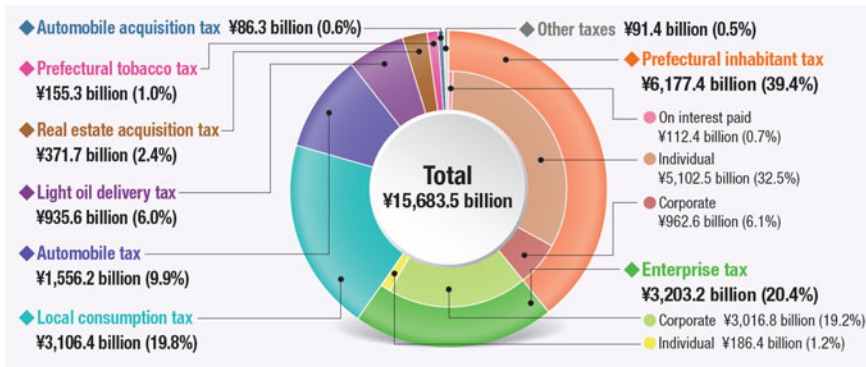
Situation: There are various Japanese local taxes. Prefectures have the authority to collect prefectural taxes, and municipalities have the authority to collect municipal taxes (Fig. 15.9).

Among the various taxes, inhabitant tax and enterprise tax are the principal taxes. These taxes constitute 59.5% of the total prefectural taxes (Fig. 15.10).

15.2 Relationship Between National Tax and Local Tax

In this chapter, we look at the relationship between Japanese national tax and local tax. An international comparison would help us understand the features of the Japanese tax system.

Composition of Revenue from Prefectural Taxes (FY2014 Settlement)



Composition of Revenue from Municipal Taxes (FY2014 Settlement)

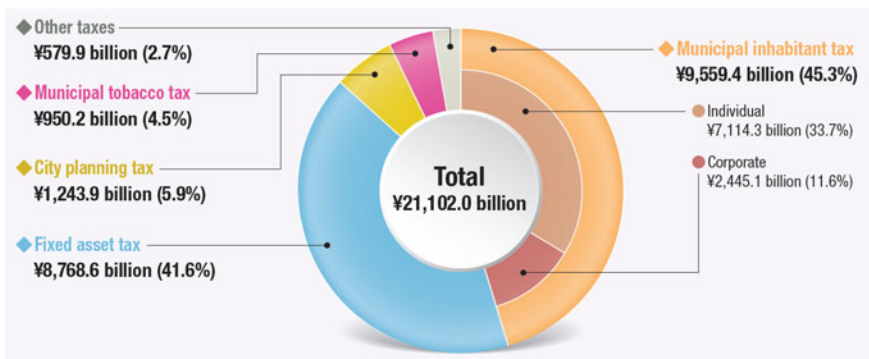


Fig. 15.10 Composition of the local taxes. (Source White Paper on Local Public Finance, 2016)

15.2.1 Outline

(A) Tax levy system

In Japan, the central government, the prefectures, and the municipalities collect taxes independently.⁷ Each agency has its own staff. The tax staff of the local governments are specialists/authorities on tax. Table 15.1 shows the number of tax staff.

The ratio of tax staff to the total number of general administration staff in prefectures is 9.4%, and the ratio is 18.2% in municipalities. Distribution of local civil servants is shown in Fig. 15.11.

⁷The National Tax Administration Agency, Prefectures, and Municipalities are the independent tax agencies, but they cooperate with each other in sharing the information necessary for tax collection.

Table 15.1 Number of Staff (April, 2012)

Organization	National Tax Administration Agency	Local government	
		Prefectures	Municipalities
Number of staff (Person)	56,194	16,397	67,499

Source Data of MOF and MIC

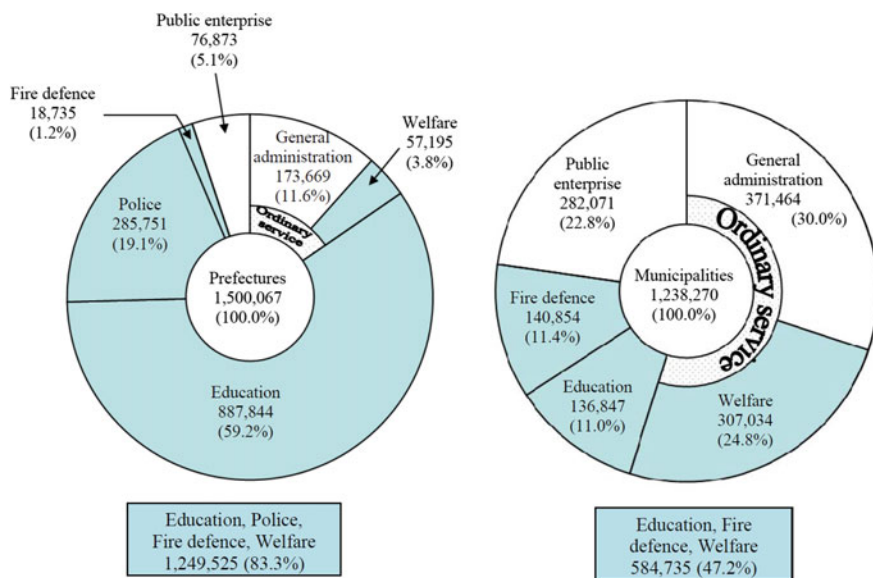


Fig. 15.11 Distribution of local civil servants in regular positions (as of April 1, 2012 Number of Staff). (Source Data of MIC)

Thus, the sections that levy tax have significant roles, especially in municipalities. Therefore, cultivating human resources is a crucial issue for each local administration.

(B) Tax base structure

Table 15.2 presents the classification of Japanese national taxes and local taxes according to the types of tax bases.

Japanese local taxes are quite well-encompassing, and the tax items levied on the three types of tax bases (income, asset, and consumption) are of an extensive range and the right combination.

There are various tax bases for the sub-national government taxes in different countries such as income, social security contributions, payroll and workforce, property, goods and services, and so on. The local tax bases in Japan are income, asset, and consumption.

Table 15.2 National taxes and local taxes

	National taxes	Local taxes		National taxes	Local taxes
Income taxation	Corporation tax Income tax	Individual business tax Individual resident tax Corporate resident tax Corporate business tax Interest-based prefectural inhabitant tax Dividend-based prefectural inhabitant tax Prefetural inhabitant tax based on capital gain from stock transfer	Consumption taxation	Consumption tax Liquor tax Tobacco tax Special tobacco tax Gasoline tax Local road tax Liquefied petroleum gas tax Motor vehicle tonnage tax Aviation fuel tax Petroleum and coal tax Promotion of power-resources development tax Customs duty Tonnage dues Special tonnage dues	Local consumption tax Local tobacco tax Light oil delivery tax Automobile acquisition tax Golf course utilization tax Bathing tax Automobile tax Light vehicle tax Mineral products tax Hunting tax Mine-lot tax
Taxation on assets, etc.	Inheritance tax/Gift tax Registration and licence tax Stamp Tax	Real property acquisition tax Fixed asset tax City planning tax Business Office tax Special landholding tax, etc.			

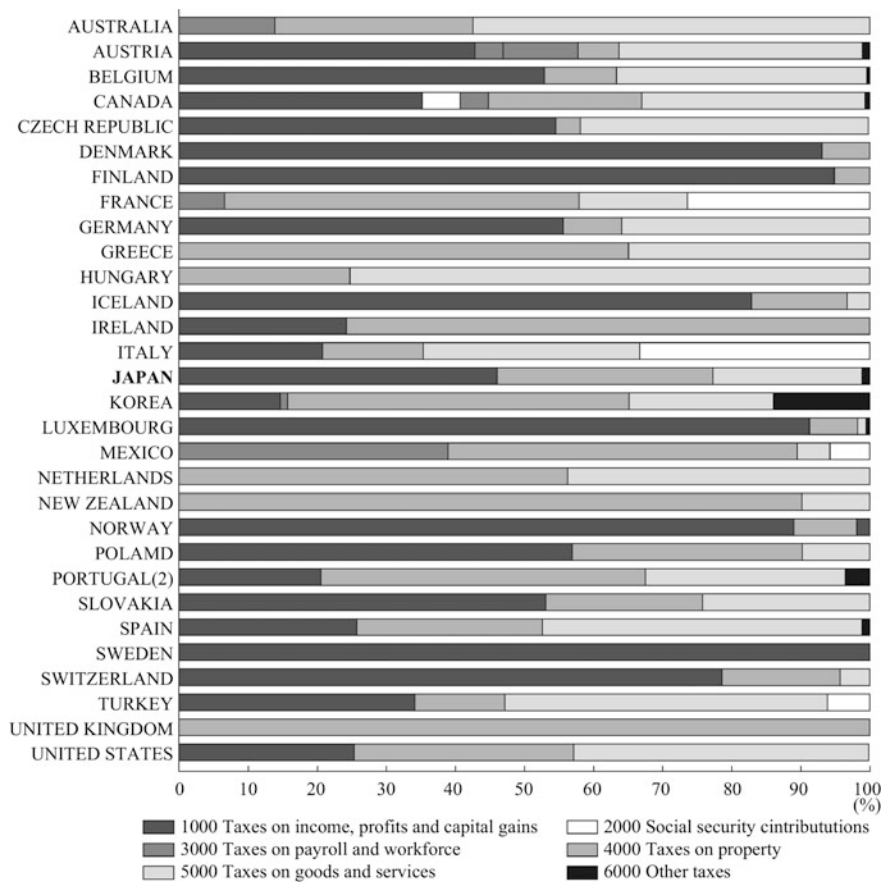
Source Web site of the Ministry of Finance (MOF) (<http://www.mof.go.jp/jouhou/syuzei/siryou/001.htm>)

Figure 15.12 shows the structure of the sub-national taxes in countries belonging to the Organization for Economic Co-operation and Development (OECD) in 2005. Figure 15.13 shows the situation more simply in 2012.

These figures indicate that there are several models of taxation. Countries such as Germany and Finland have a structure in which taxes on income account for a large share of the total tax revenue. Countries such as the U.K. and New Zealand have a structure in which taxes on asset constitute the major portion of the total tax revenue.

Japan has the third taxation model; the tax bases are income, asset, and consumption of goods. “Industrialized countries with high local expenditure either diversify the local tax composition (as in the case of Japan) or rely heavily on local income tax (as in the case of Nordic states)” (Takahashi 2012).⁸ Following the

⁸Masayuki Takahashi, *Fiscal Decentralization and Development*, Palgrave Macmillan, 2012, p. 20.



Notes : 1. This refers to only those taxes which are classified as sub-central government taxes. Social security contributions paid to social security funds are excluded.
 2. 2004 figures

Fig. 15.12 Structure of state and local government tax receipts, 2005. (Source Data of OECD)

recommendation of the Shoup mission,⁹ which proposed the enrichment of local taxes in Japan in 1949, the Japanese local tax system has shown signs of progress.¹⁰ One of the outcomes of this progress is the diversification of the tax bases. Such diversification would lead to a comprehensive tax system.

⁹The Mission which was headed by Professor Carl Shoup, a taxation authority, visited Japan in April 1949. The Mission made the intensive studies and presented *the Report on Japanese Taxation by the Shoup Mission* in August 1949.

¹⁰Osamu Koike, "Local Governance and National Development", *Comparative Studies of Public Administration*, EROPA Local Government Center, 1998, p. 64.

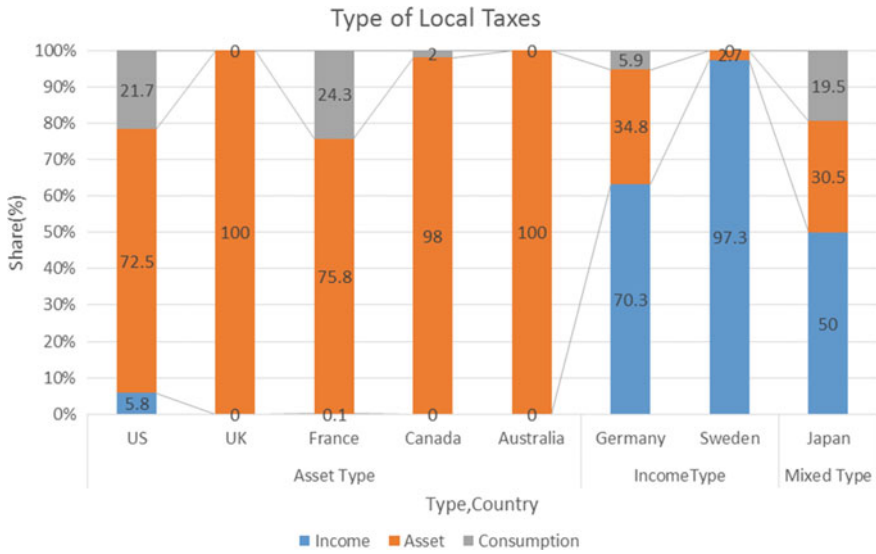


Fig. 15.13 Structure of state and local government tax receipts, 2012. (Created by Author using data (2012) of MIC)

1. Size of local tax revenue

The ratios of the state/local tax revenue to the total tax revenue are considerably different among the countries (Fig. 15.14).

Figure 15.14 shows that Japanese local tax revenue accounts for 43% of the total tax revenue, which is much higher than the corresponding ratio in European

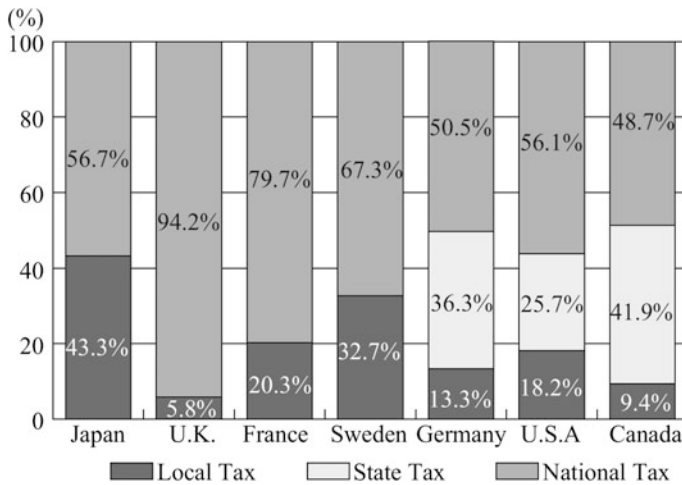


Fig. 15.14 Ratio of state/local tax revenue to total tax revenue (2007). Source Data of MOF

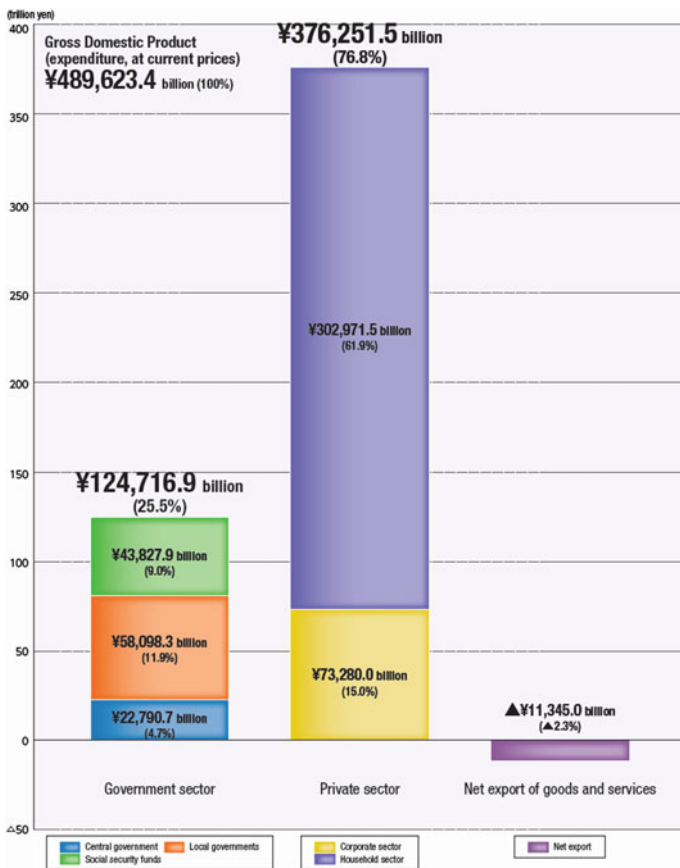


Fig. 15.15 Size of governmental expenditures (FY2014 settlement). (Source White Paper on Local Public Finance, 2016)

countries. These data show that Japanese local tax revenue is a capital resource for the government’s public services.

2. Relationship between revenue and expenditure

Figure 15.15 shows the relationship between the expenditure of the central government and that of the local governments.

The size of local governmental expenditure is about two and a half times that of the central government. The expenditure of Japanese local governments forms 11.9% of the country’s GDP in FY2014 and that of the central government is only 4.7%.¹¹

¹¹The prefectures and municipalities manage many public functions in Japan. In other words the responsibilities discharged by local governments cover all their internal administrative needs

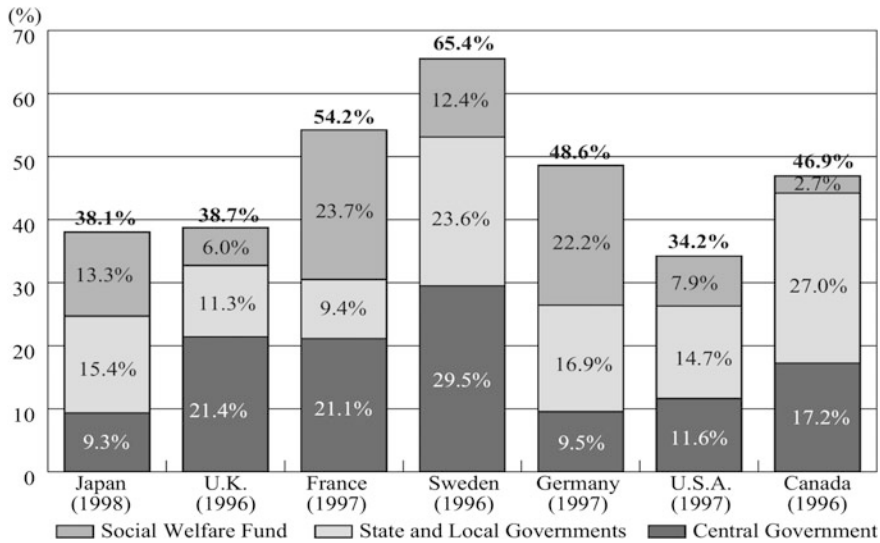


Fig. 15.16 Ratio of government expenditure to GDP. (Source Data of MOF)

When we compare the ratio, the ratio of the central government expenditure is much lower than the corresponding ratio in European countries (Fig. 15.16).

“In a comparison of OECD countries, Japan looks rather like a decentralized country” (Tajika 2006).¹² This is a remarkable feature of the Japanese local finance system.

In the standpoints of the share of local expenditure in the total governmental expenditure and the share of local servants in the total governmental servants, Japan seems to have developed in the decentralization in a sense; it indicates higher rates (Fig. 15.17).

Under LAL, prefectures, as regional governments, are defined to be the jurisdictions that comprehend the municipalities, and they manage regional affairs, communications and coordination relating to municipalities.

On the other hand, municipalities, as basic local governments, have roles regarding matters that are not dealt with by their prefectures. The major responsibilities allocated at the three governmental levels are summarized in Table 15.3.

Based on those allocation, the expenditure of the Japanese local governments is in fact remarkably large compared to that of the national government. This is

(Footnote 11 continued)

except for matters of diplomacy, defense which are managed by the central government. Therefore, Japan’s local governments have extensive budgets requiring significant amounts of money. Source: Kimura (2017), pp. 30–31.

¹²Eiji Tajika and Yuji Yui, Fiscal decentralization in Japan, *Tackling Japan’s Fiscal Challenges*, (IMF, Tajika, Eiji, and Yui, Yuji “Fiscal Decentralization in Japan”, Tackling Japan’s Fiscal Challenges, IMF 2006).

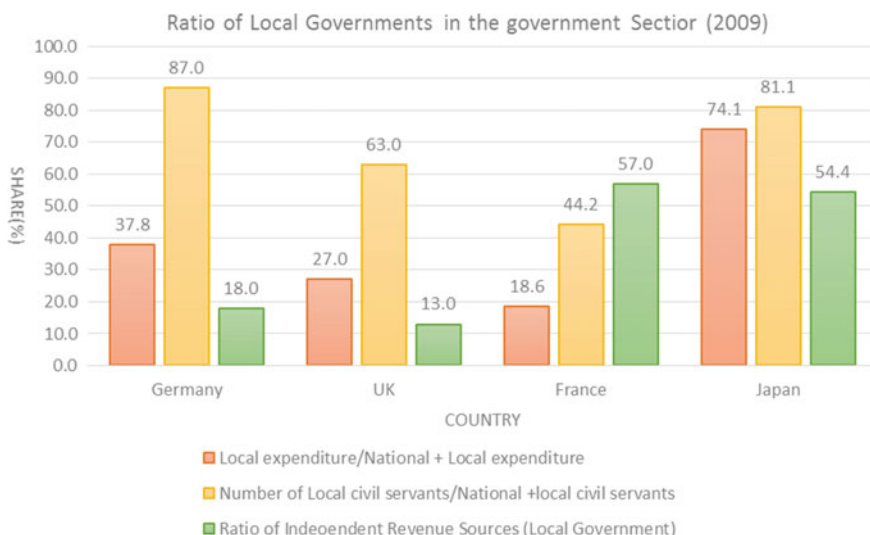


Fig. 15.17 Ratio of local governments. Created by Author, using Norbert Kersting et al. Local Governance Reform in Global Perspective, VS, 2009, p. 21

because the Japanese local governments are covering numerous kinds of public services and considerable expenditures in each kind as shown in Fig. 15.18.

“The majority of expenditures are done at the local level” (Mochida 2008).¹³ The local government’s expenditure accounts for a large part of public services, especially in the field of school education, public welfare, and land development.

It is important to note the ratio of revenue and expenditure. Figure 15.19 shows this ratio in countries.

Balanced ratio of revenue and expenditure would be ideal. However, when the expenditure exceeds the revenue, inter-governmental finance transfers (such as national grants and LAT) are required.

Japan has a remarkable gap between revenue and expenditure compared to other countries. As regards this, it is pointed out that the decentralization in Japan is not adequate yet. “Despite this high rate of spending through local governments, it would be inaccurate to characterize Japan as a decentralized system because a considerable amount of decision-making authority has tended to rest with central units” (Mochida 2001).¹⁴

From the standpoint of the balance between the revenue and the expenditure in both of the central government account and the local government total accounts, researchers have a critical issue. Figure 15.20 shows the Japanese finance structure in fiscal year (FY) 2014.

¹³Mochida (2008), p. 21.

¹⁴Nobuki Mochida, Taxes and transfers in Japan’s local finances, *Local Government Development in Post-war Japan*, Oxford, 2001, p. 86.

Table 15.3 Allocation of the public affairs among the governments

	Basic, safety	Education	Welfare, sanitation	Social infrastructure	Industry, economy
Central	Diplomacy Defense Judicature Criminal punishment	University Subsidy for private school (university)	Pension Social insurance License for doctor Approval of medicine	Highway National road (designated section) First-class river Airport	Currency Banking regulation Customs Regulation on transportation Regulation on Telecommunication Economic policy
Local prefecture	Police	High school Salary/Personnel of Elementary/junior high school Subsidy for private school (others) Sports facility Cultural facility	Livelihood assistance (area of town/village) Child welfare Elderly welfare Health center	National road (other section) Prefecture road First-class river (designated section) Second-class river Port Public housing Urban planning	Vocational training Support for small businesses
Municipality	Fire defense Family register Resident register	Elementary/junior high school Kindergarten Sports facility Cultural facility	Livelihood assistance (city) Child welfare Elderly welfare Nursery care insurance National health insurance Water supply Sewerage Waste disposal Health center (specific city)	Municipal road Small river Port Public housing	Regulation on agricultural land use

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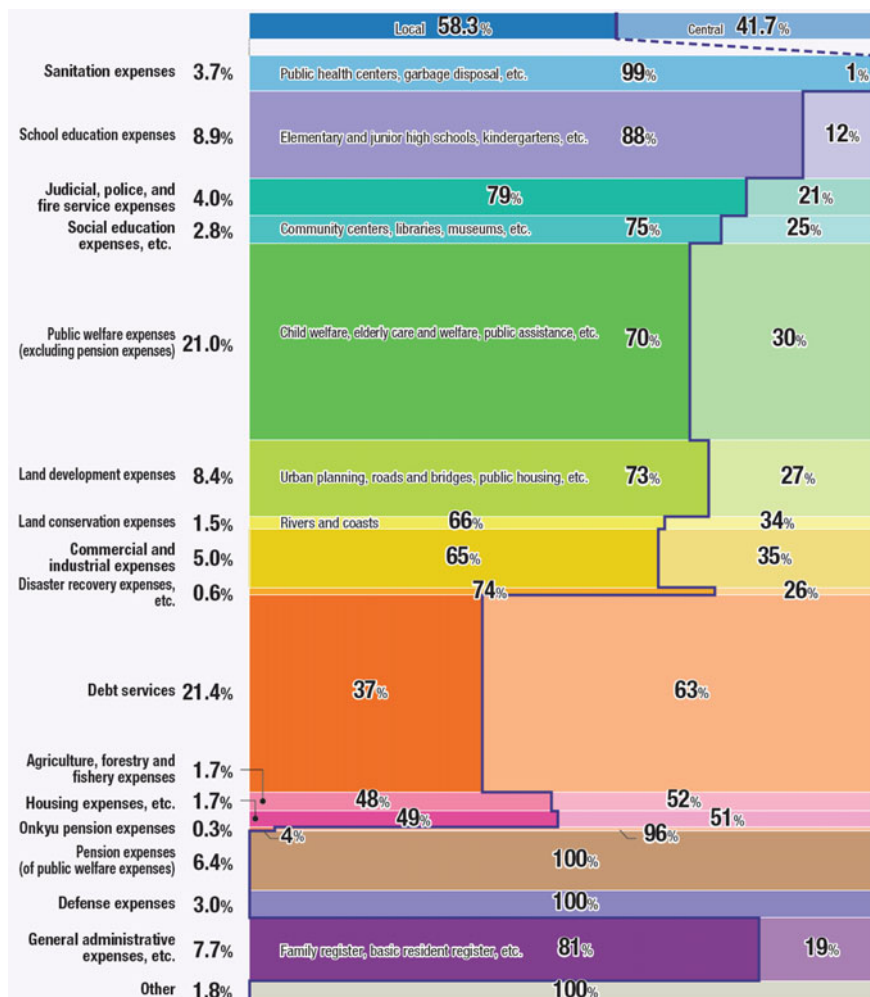


Fig. 15.18 Share of expenditures by function of central and local governments (FY2014 Settlement). (Source White Paper on Local Public Finance, 2016)

The ratio of local expenditure to the combined total of national and local expenditure was 58.3%. The total tax revenues for the central and local governments was 93.9 trillion yen, of which the total local taxation was 36.0 trillion yen. This shows that local tax revenue accounts for no more than 38.4% of the total tax revenue.

What makes it possible for local government expenditures to exceed those of the central government, despite the fact that local tax revenues take up no more than 38.4% of the total tax revenue? This can be explained by the transfer of funds from the central government to the local governments in the form of national treasury subsidies, LAT, and local transfer tax. Of these financial transfers, national treasury

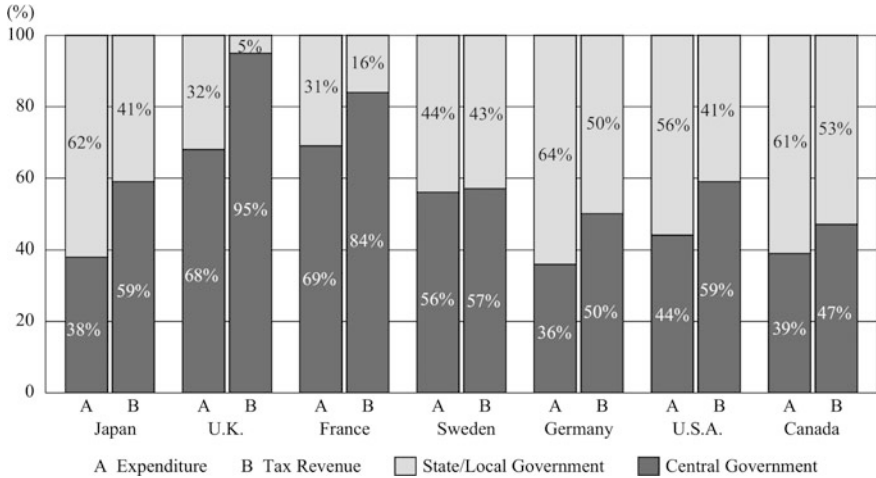


Fig. 15.19 Ratio of national government and state/local government expenditure and tax revenue (1998). (Source Data of MOF)

◎ Distribution of Revenue Sources between National and Local (Fiscal Year 2014)

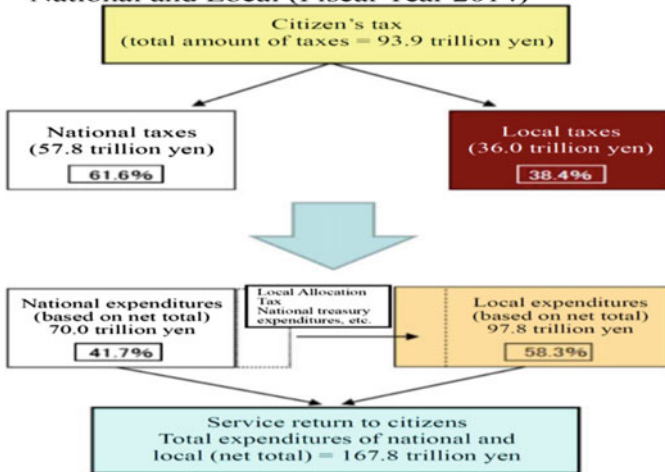


Fig. 15.20 Structure of fiscal gaps (FY2014 settlement). (Source Data of MIC)

subsidies are restricted in how they can be used; hence, the decision-making related to these subsidies is in the hands of central government.

In this kind of revenue structure, the relationship between the benefits and the burdens for local residents in terms of the administrative services of local governments is unclear. Moreover, cost consciousness becomes weaker. Therefore, it is

very important to secure and strengthen local taxation in order to minimize the gap between local expenditure and local tax revenues as far as possible.

In order to achieve this, the Trinity Reform was implemented from 2004 to 2006; 2 trillion yen was transferred from the central government to the local governments. (See Section 15.3 for further details.)

15.3 Issues Related to Japanese Local Tax System

In this chapter, the current hot issues related to the Japanese local tax system are identified. These are architectural issues and are closely related to the characteristics of the Japanese tax system.

1. Disparity

In Japan, the disparity in taxes on the population and business establishments is remarkable. The local taxes on businesses are highly concentrated in urban areas in particular.¹⁵

Figure 15.21 shows the disparities among the prefectural tax revenues per capita.

Tokyo has a much larger amount of tax revenue compared to that of the other prefectures. Figure 15.22 shows the change in the disparity in tax revenue.

Over the years, as the economic situation became worse, the disparity reduced slightly; however, significant disparity continues to exist. Among the principal local taxes, the extent of the disparity between the two corporate taxes—corporate business tax and corporate residential tax—is greater than the disparity involving the other taxes.

Figure 15.23 shows the change in disparity between corporate business tax and corporate residential tax.

Following the 2008 reform, the extent of disparity of corporate business tax has become much smaller. Compared to this, the disparity of corporate residential tax has been greater than that of corporate business tax.

2. Sensitivity

Table 15.2, Figs. 15.12 and 15.13 showed the tax structures of the sub-national governments. The tax bases of Japanese local taxes are of three types: tax on income, tax on property, and tax on goods.

We should pay attention to the fact that the tax on income has the largest ratio; the aggregate sum of the residential tax and corporate tax constitutes 59.5% of the total prefectural tax revenue in FY 2013 (Fig. 15.6).

Therefore, the amount of total local tax revenue is strongly affected by the local taxes on income. Thus, the local governments are highly concerned about their prospects.

Figure 15.24 shows the trends in the prefectural tax revenues.

¹⁵See Mochida (2008), *op.ict.*, p. 28.

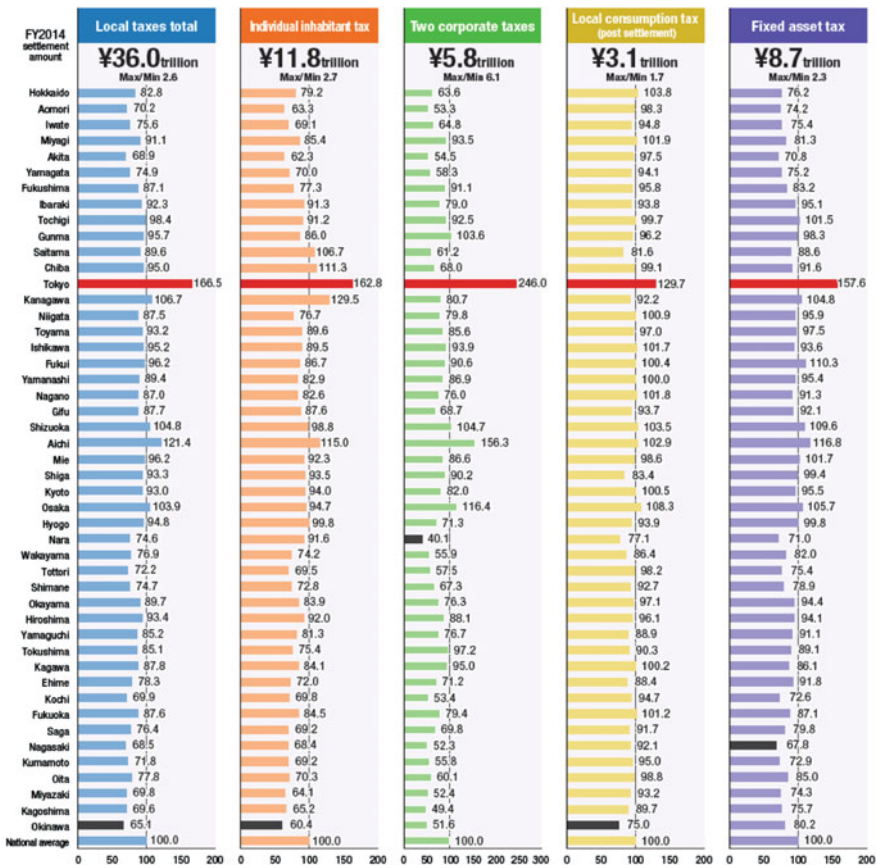


Fig. 15.21 Structure of fiscal gaps (FY2014 settlement). (Source White Paper on Local Public Finance, 2016)

The enterprise tax was 3.2 trillion yen (20.4%) in 2014, and it was a key element of the tax revenue. In a good economic situation, like in FY 2008 in particular, it amounted to as much as 5.4 trillion yen (30.2%). However, after 2009 (when the “Lehman shock” occurred), the amount dropped suddenly. As shown in Fig. 15.20, this tax is very sensitive to the economic situation. Therefore, local governments are concerned about the prospects of this tax.

3. Overlap between National Taxes and Local Taxes

Figure 15.25 indicated one issue: overlapping tax bases.¹⁶ One characteristic of Japan’s tax system is the frequent overlap of the tax bases of national taxes and local taxes. This overlap has its merits and demerits.

¹⁶Nobuki Mochida, “Local Government Organization and Finance, Japan”, *Local Governance in Industrial Countries*, The World Bank, 2006, p. 161.

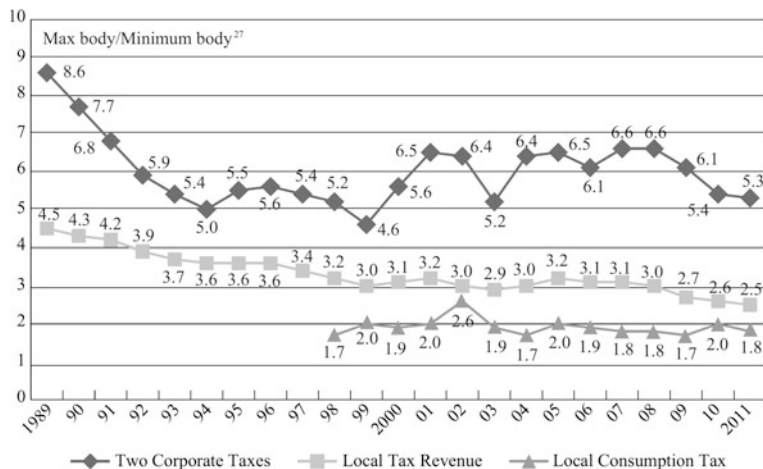


Fig. 15.22 Change in disparity in tax revenue per capita

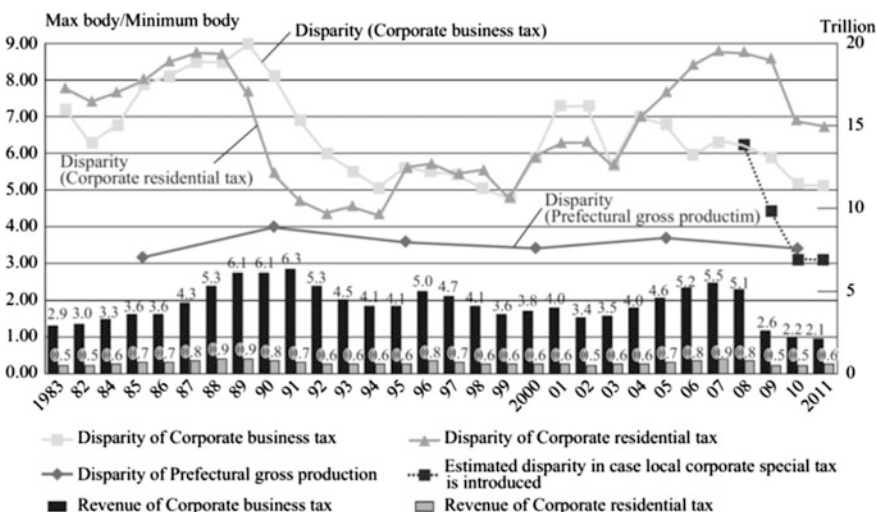


Fig. 15.23 Change in disparity of corporate business tax and corporate residential tax revenue per capita. (Source Report of Investigative Commission for Local Corporate Tax (Dec. 2012, MIC))

The demerits are as follows:

1. It might blur the benefit principle of taxation.

“A problem with the overlapping tax-base system is that the tax payer has difficulty determining how much he or she is paying to the central government” (Mochida 2006). For example, when an individual who pays both the national income tax, as well as the local resident tax levied on income, has not paid

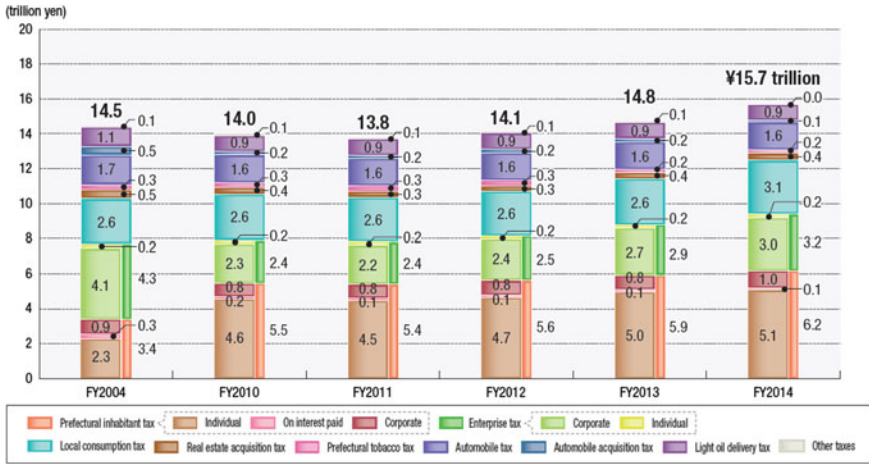


Fig. 15.24 Trends in prefectural tax revenues. (Source White Paper on Local Public Finance, 2016)

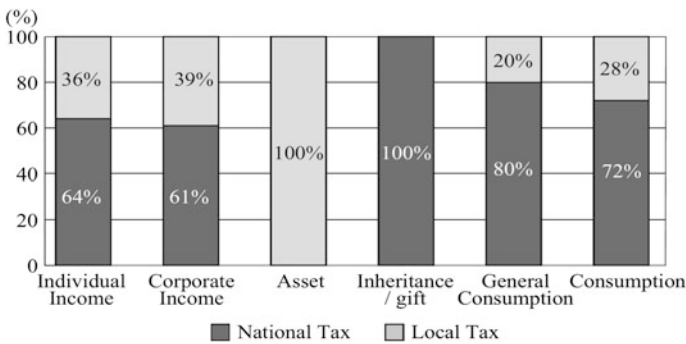


Fig. 15.25 Revenue ratio of each type of tax base (1998). (Source Data of MOF)

considerable attention to the distinction between them, it might be difficult for her/him to determine how much public service they can expect. When people consider the benefit principle of taxation a clear understanding of the tax burden is absolutely necessary.

2. It could increase the fluctuation in tax revenues.

The taxes on income account for a large portion of national tax as well as local tax. Figure 15.25 shows that the central government accounts for about 60% and the local government accounts for about 40% of the taxes on individual income and corporate income. However, these taxes on income depend on the economic situation.

Figure 15.26 shows the trend in an extended period; it shows rise and fall of the national tax revenue and the local tax revenue.

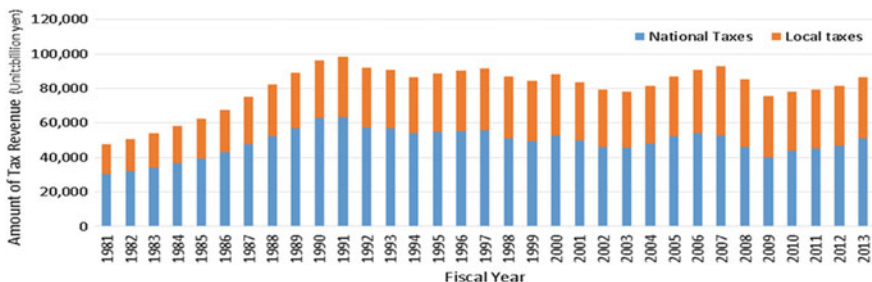


Fig. 15.26 Overview of tax revenue

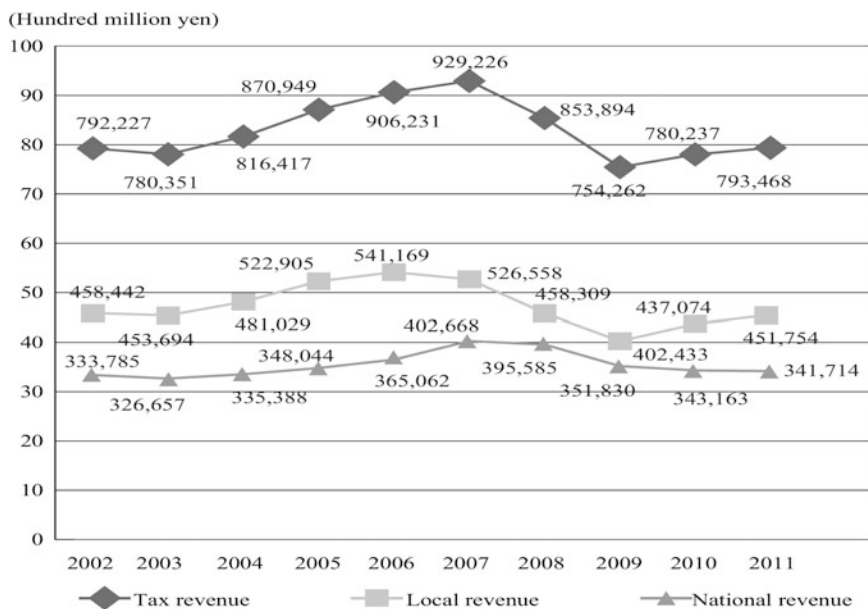


Fig. 15.27 Overview of tax revenue. Source Data of MOF

Figure 15.27 focuses the period from 2002 to 2011. When the economic affairs become severe, national tax revenue and local tax revenue fell simultaneously; this was the case in 2008. The fact that the fluctuation wave of each revenue stream is similar affected the governmental financial situation and financial policies. When the economic situation worsens, the central government and the local governments frequently have handed in economic stimulus packages in Japan. The overlap in tax bases is thought to be one of the reasons for this.

On the other hand, overlapping tax bases have the following advantages:

1. The administrative cost falls. For example, the national tax office collects the consumption tax, which includes the local consumption tax.

2. The national government can more easily draft the reform of the tax system. For instance, the government transformed a part of the local corporate business tax into the local corporate special tax (which is a national tax) in order to distribute the revenue as a local transfer tax for curbing the disparity in 2008. The local corporate special tax has been forced since 2008 and the Cabinet has decided that it goes on in 2015.

Considering these factors, these overlapping structures could be maintained but would remain controversial. What we can expect is that the next principal tax reform, which aims at reducing local revenue disparities or enhancing revenue stability, would be closely connected to transforming this overlapping structure.

4. Need to Enrich Autonomy

(1) **Tax transfers: The Trinity Reform experience**

Japan has a structure of fiscal gaps, and expanding the local revenue has been a fundamental agenda for local autonomy. Closing the gap between the revenue ratio of the local government and its expenditure ratio has been a crucial agenda in Japan. Based on this concept, the Trinity Reform was implemented in 2007.

The Trinity Reform is a package consisting of three parts. The goals of this package were as follows:

- (1) transfer tax revenue sources from the national government to local governments;
- (2) reform the national treasury subsidies;
- (3) reform LAT.

Through this reform, three trillion yen of national tax resource was transferred to local taxes (Fig. 15.28).

Figure 15.29 graphically represents tax resource transfer.

A part of resource of income tax (a national tax) was transferred to the resource of individual resident tax (a local tax). At the same time, the progressive rate of individual resident tax was changed to a flat rate.

Figure 15.30 shows the changes in local revenue compositions.

Compared to the composition in FY 2002, the ratio of local tax increased from 34.4 to 42.9% in FY 2008. These data show the remarkable outcome of this reform from the perspective of financial autonomy. However, the global financial crisis in 2008 hit the tax revenue, and the local tax revenue in 2012 came down to 34.5%.

It is possible to conclude that this transferring has a high value attached. However, the gap between local revenue and local expenditure still exists, and greater enrichment of the local tax revenue would be preferable.

(2) **Motivation to expand tax revenue**

As a relevant issue, I note the fact that Japanese local governments have a strong incentive to their expand tax revenue. Table 15.4 shows the tax levied in excess of the norm in the 2011 settlement account.

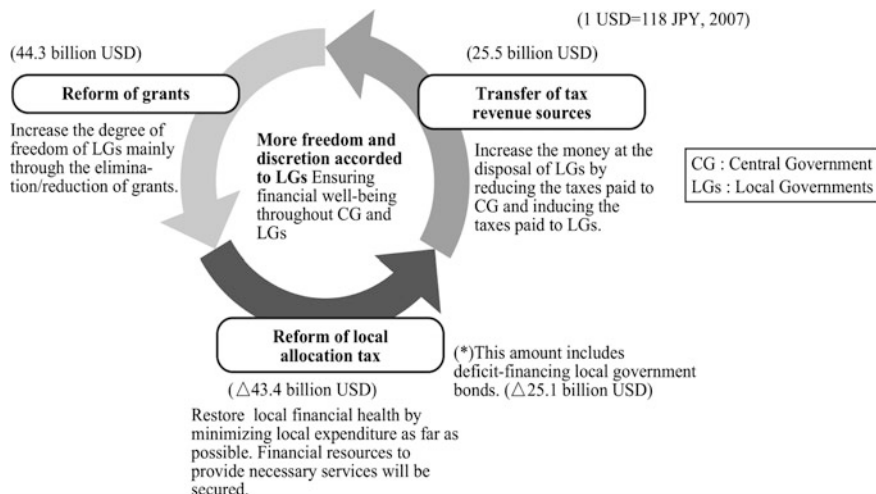


Fig. 15.28 Overview of trinity reform. (The figure was created by the author)

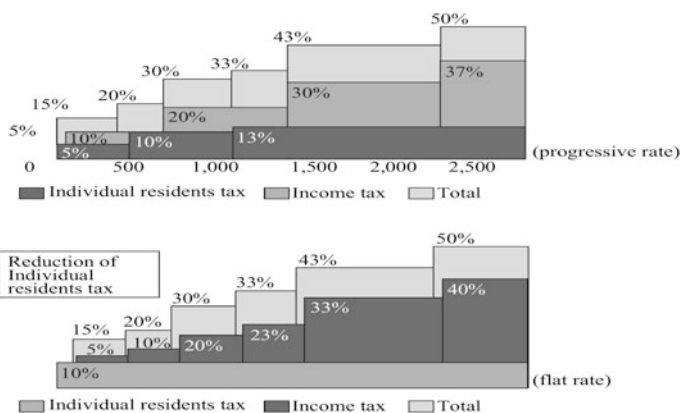


Fig. 15.29 Tax resource transfer. (Source Data of MIC)

The figure was created by the author. (Source: White Paper on Local Public Finance, 2014).

The total amount was 471.9 billion yen, which corresponds to 1.4% of the total local tax revenue. This revenue can be obtained only when the local government passes a by law that sets an exceeding rate at its discretion. The size of the excess itself is not so large; however, this excess indicates that the Japanese local governments have the motivation to expand tax revenue. In addition to this, the amount of extra-legal local taxes shown in Fig. 15.5 is 51.6 billion yen in 2010; the number of local bodies that introduced extra-legal taxes amounts to fifty six. Most local governments are planning regional development policies for attracting enterprises

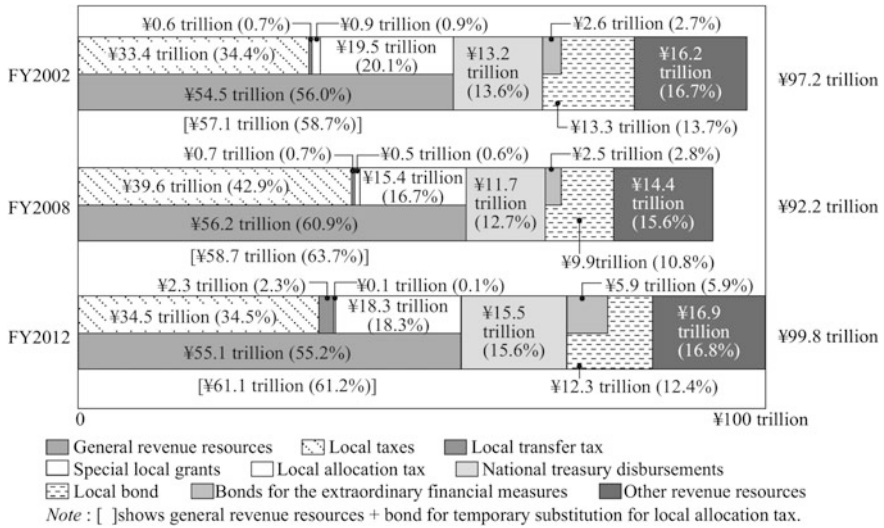


Fig. 15.30 Changes of local revenue compositions

Table 15.4 Tax levied in excess of the norm (FY2011 settlement)

Kinds of Tax		Number of local bodies levying tax	Tax Revenue (billion yen)
Prefectural inhabitants tax	Individual per capita rate	31	18.5
	Individual income rate	1	2.5
	Corporate per capita rate	31	9.4
	Cooperation-based tax	46	86
Corporate business tax		7	91.1
Automobile tax		1	13 million yen
Prefectural tax total			207.4
Municipal inhabitant tax	Corporate per capita levy	2	1.6
	Corporate income rate	2	0.7
	Corporate per capita rate	402	15.4
	Corporate tax levy	1004	210.9
Fixed asset tax		160	35.8
Light vehicle tax		33	0.7
Ministry products tax		33	10 million yen
Bathing tax		2	24 million yen
Municipal tax total			264.5
Total of tax above the norm			471.9

in order to expand the local tax revenue. These facts show that local governments have a strong motivation to expand tax revenue.

15.4 Local Tax Reforms

In recent years, Japan has implemented local tax reforms: reforms for closing the gap among the local bodies. These reforms are meant for corporate business tax and corporate residential tax.

1. Reform of Corporate Taxes

In the face of the issues related to revenue disparity, the national government implemented two significant reforms.

(1) Reform of corporate business tax

As previously discussed, the government transformed a part of the local corporate business tax into the local corporate special tax in order to distribute the revenue as a local transfer tax for curbing the revenue differences in order to deal with revenue disparity in 2008. A part of the corporate business tax (which is a local tax) was transformed into local corporate special tax (which is a national tax). Subsequently, this was distributed to the local governments as local corporate special transfer tax based on the proportion of population and people engaged as shown in Fig. 15.31.

By this method, the revenue can be more evenly distributed than by the income base. In a sense, the transformation from local tax to national tax is against the process of decentralization. However, this was adopted as a tentative measure from 2008 to 2015. This trend indicates that eliminating revenue disparity is a pressing issue for the current local administration.

2. Reform of Corporate Residential Tax

After 2008, the extent of disparity of business corporate tax was remarkably reduced through the tax reform. However, the disparity of corporate business tax

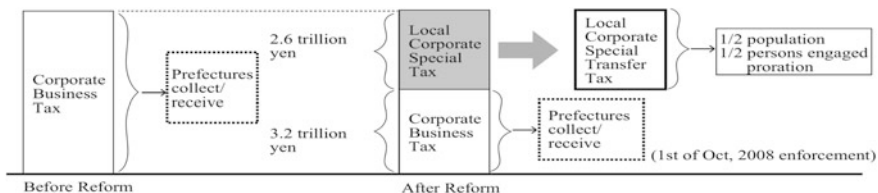


Fig. 15.31 Local corporate special tax. (Source Data of MIC)

continued. Therefore, in 2014, the local corporate tax was reformed significantly. A part of the corporate resident tax will be transformed to national tax and will be directly transferred to the local allocation tax account. Through this process, this portion would be distributed as a resource for LAT in 2014. The local corporate tax was introduced in 2014, and it was put into effect in full scale in 2015 (as shown in Fig. 15.32).

3. Characteristics of Japanese Tax Reform Strategy

Looking at the history of Japanese local tax reform, we can identify the characteristics of this strategy. The government has two approaches—an urgent approach and a long-term approach.

The urgent approach aims for early results. The reform of corporate business tax and corporate residential tax discussed earlier are representative of the urgent approach. Redressing the differences in tax revenue has been a pressing issue in the Japanese tax and finance system. Why is this a pressing issue? There are three reasons. Firstly, this issue is closely related to the local government’s finance currently. Secondly, disparities among the local bodies would have an adverse impact on the economic situation of the whole country. Thirdly, Japan has hiked the consumption tax rate, which could widen the disparities among the local bodies’ finances. Facing this urgent issue, the government gave it higher priority. The consumption Reform Action 2012 stated that “[I] local corporate special tax and local corporate special transfer tax are tentative measures and they are reexamined fundamentally.”

From a long-term perspective, stabilizing tax revenue and enriching tax revenue are important issues. Reexamining the current items of local taxes and the tax bases is required. Further financial decentralization would be required. The government would need to examine the current local tax system in the future.

In Japan, such a combination of an urgent approach and a long-term approach could be expected to continue. Tax reform is reviewed mainly by the associated ministries and parties; however, it would be preferable for the citizens to distinguish between the urgent tax issues and the long-term tax issues when we consider these reforms (as shown in Fig. 15.33).

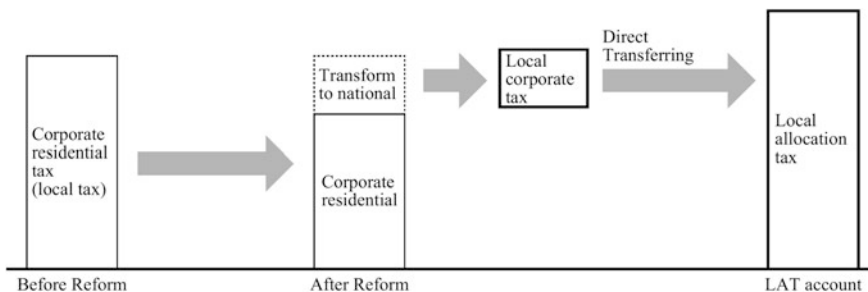


Fig. 15.32 Corporate residential tax

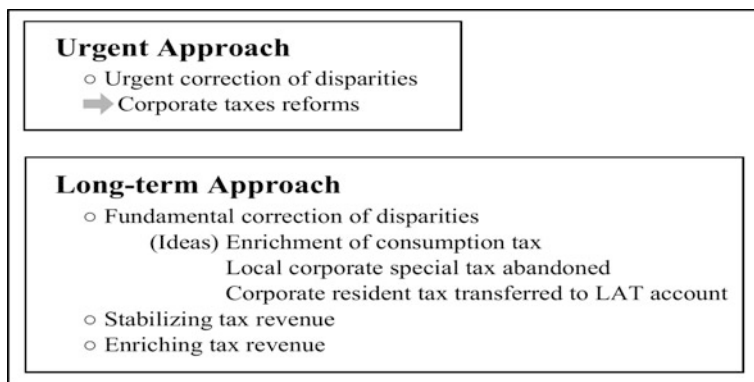


Fig. 15.33 Trends of local tax reforms. (The figure was created by the author)

15.5 Local Financial Autonomy and Goals

1. Financial Autonomy

Faced with the severe local financial situation, the government enacted the Local Finance Soundness Law (LFSL hereunder) in 2007. The objective of LFSL was set out as follows: “To establish a system of making public announcements concerning the ratios of local government finances, and to enable local governments to decide on a system for the speedy achievement of financial soundness and financial rebuilding as well as formulating plans aimed at promoting the sound management of publicly managed enterprises” (Art. 1).

By using four financial indicators, each local government would have financial self-control in order to avoid a dangerous situation. Seen in this light, such a system expects each local government to have financial autonomy. LFSL was fully enforced in 2009, and it had a marked effect on the local governments.

Figure 15.34 shows that the ordinary balance ratio¹⁷ turned down in 2010, but recently it remains mostly level.

Figure 15.35 also shows that the trend of personnel expenses, which was decreasing earlier, was driven up.

Based on these data, the local governments made efforts to attain self-control, and the spirit of financial autonomy seemed to function significantly.

¹⁷The term “ordinary balance ratio” denotes an index for identifying the elasticity of the financial structure of local public bodies. It is calculated as a percentage of the amount of general revenue sources that are used for expenditures that are ordinarily disbursed every fiscal year (such as personnel expenses, social assistance expenditure, and debt service) in relation to the total amount of general revenue sources, represented by local taxes and ordinary local allocation tax (ordinary general revenue sources), a special share of revenue decrease compensation loan, and an extraordinary financial measures loan. This index is used to see to what extent ordinary general revenue sources are appropriated for ordinary expenditures; it also shows that a higher ratio means less flexibility in the financial structure.

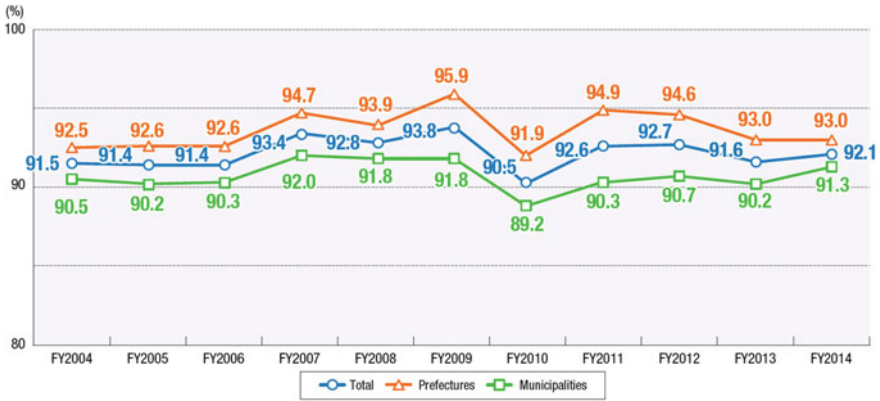


Fig. 15.34 Change in the ordinary balance ratio. (Source White Paper on Local Public Finance, 2015)

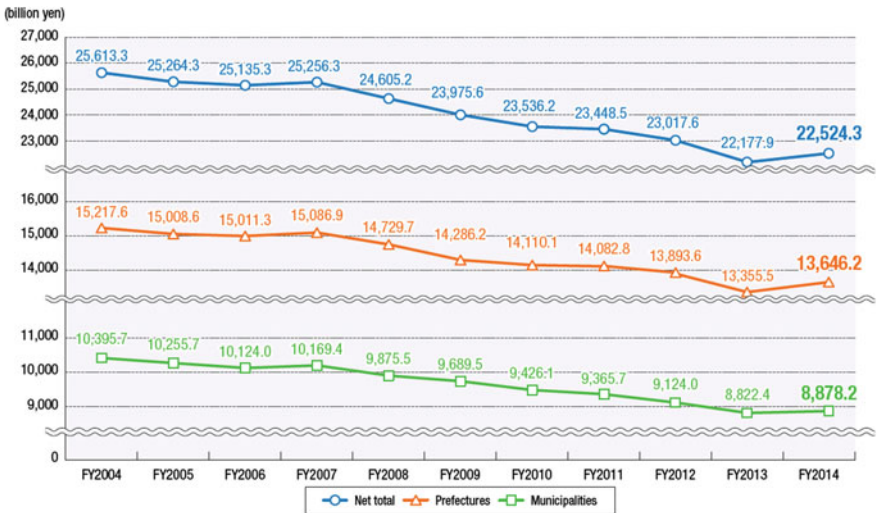


Fig. 15.35 Change in local personnel expenses. (Source White Paper on Local Public Finance, 2016)

As is shown in Fig. 15.1, local tax is the principal source of local revenue and the primary method for financial autonomy. However, the local tax system faces various issues in the current society. The current author has identified three goals for the Japanese local tax system as shown in Fig. 15.36.

The first is to reduce disparity. In a way, this is the hottest issue at present. The national government enacted several very important reforms such as the foundation of the local corporate special tax in recent years. It seems that this agenda will remain a hot issue in the years ahead.

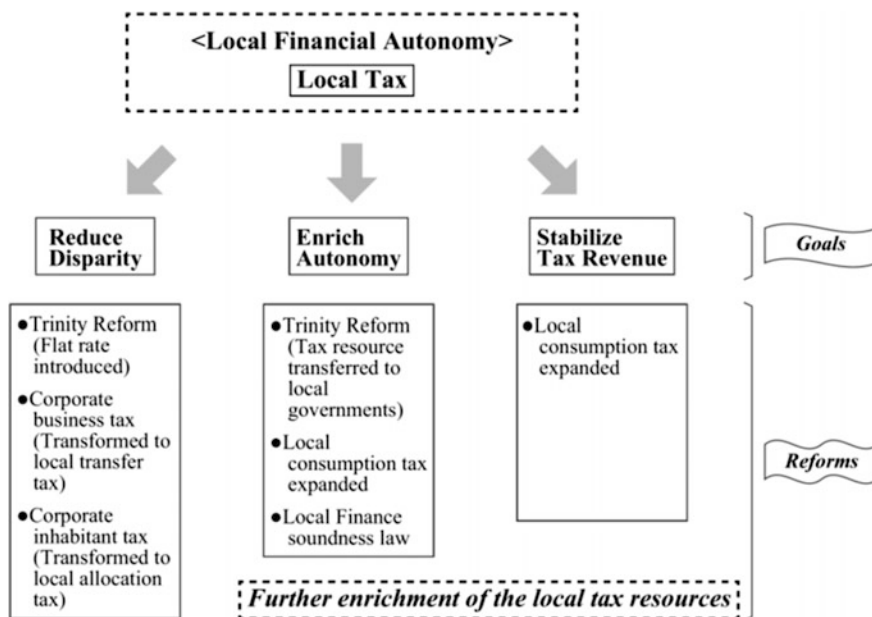


Fig. 15.36 Change of Local Financial Autonomy. (The figure was created by the author)

The second goal is to enrich autonomy. In this context, Japan implemented the Trinity Reform. The local governments will receive additional tax revenues in the form of an increase in consumption tax in 2014. However, the agenda of reducing the gap between revenue and expenditure still exists.

The third goal is to stabilize the tax revenue. This is a significant agenda. The local governments have made much of the asset tax and the consumption tax. The increase in the local consumption tax in 2014 could contribute to stability. However, the taxes on corporate income (which amount to 3 trillion yen) are still principal local taxes, and they are very elastic to the economic situation. Dealing with those elastic local taxes and ensuring greater stability for the local tax system seem to be more crucial issues.

In this paper, author presented an overview of the characteristics of and the issues related to the Japanese local tax system. As the concept of social values is becoming increasingly complicated, the reform of local tax systems will be a complex process.

However, when we consider future financial autonomy, the following point is significant: “The power to determine the tax rate and base allows local variations in fiscal burdens to be sensitive to local preferences” [Mochida]. I suggest that we should pay attention to this finding.

The local governments should be required to be increasingly sensitive to the needs of the community in the framework of financial autonomy. The relationship between sensitivity and financial autonomy must be an indispensable one in contemporary society.

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Author Biography

Shunsuke Kimura, PhD (Law) is a Professor of Meiji University. He majors in comparative study of local public finance. He joined the Ministry of Internal Affairs and has engaged in planning the drafts of Japanese local finance systems including financial policy for advancing municipal amalgamations in Japan. He also had an experience of studying administrative law at Cornell postgraduate law faculty; he holds a master of law. Since 2013, he is a member of the society for the study of decentralization of Asian countries which is sponsored by the national research fund of science and technology (Kakenhi). He is also a member of Japanese local finance academic society. His publications include many referred articles, several book chapters. Research interests include local administration, decentralization, amalgamation, union of local public bodies, international statistics affairs. Kimura is also a part time professor of Graduate Institute for Policy Studies (GRIPS). He also teaches a part-time course at National Local Autonomy College, United Nations Statistical Institution for Asia and Pacific and the other several institutions.