

# BTI 2016 | Sri Lanka Country Report

<b>Status Index</b>	1-10	<b>5.58</b>	# 62 of 129	
Political Transformation	1-10	4.67	# 81 of 129	➔
Economic Transformation	1-10	6.50	# 33 of 129	➔
<b>Management Index</b>	1-10	<b>4.55</b>	# 78 of 129	
	scale	score	rank	trend

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2016. It covers the period from 1 February 2013 to 31 January 2015. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

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**Key Indicators**

Population	M	20.6	HDI	0.750	GDP p.c., PPP \$	10527.5
Pop. growth <sup>1</sup>	% p.a.	0.8	HDI rank of 187	73	Gini Index	38.6
Life expectancy	years	74.2	UN Education Index	0.738	Poverty <sup>3</sup>	% 14.0
Urban population	%	18.3	Gender inequality <sup>2</sup>	0.383	Aid per capita	\$ 20.7

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | UNDP, Human Development Report 2014. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.10 a day at 2011 international prices.

## Executive Summary

In January 2015, Sri Lanka witnessed the unexpected defeat of the authoritarian president Mahinda Rajapaksha. While this may represent an important step towards the restoration of parliamentary democracy in this South Asian country, readers should bear in mind that this report covers the period from February 2013 to January 2015, thus coinciding with the peak of the Rajapaksha government's "electoral authoritarianism." The new government had only been in power for a matter of weeks by the end of the review period; consequently there is insufficient empirical evidence of policy changes and political learning under the new government.

In the last two years, Sri Lanka has seen continued economic development. The deterioration in political democracy evident up to the end of 2014 appears to have been checked and reversed in 2015.

Foreign remittances rose by over 10% in 2014 to \$6.8 billion, although the government reduced external reserves in the second half of 2014 in an effort to sustain the value of the rupee. Tourism continued to boom, becoming the fourth largest foreign exchange earner with arrivals rising from 1.0 million in 2012 to 1.5 million in 2014. Falling oil prices in 2014 contributed to the narrowing of the trade gap and economic growth surpassed the 7% mark in 2013 and 2014, with a rate of 6.5% expected in 2015. Inflation is under 7% and in 2013, the unemployment rate was just 4%. The education level of the workforce remains high. Educational opportunities for women are excellent although there are considerable gender barriers to female engagement in society and the economy. Private property is relatively well-protected although there are barriers to foreign ownership of companies in some sectors as well as constraints on foreign property ownership. There has been no significant reform of the overstuffed and relatively inefficient public sector. The budget deficit is gradually being reduced. However, greater investment in education, health and the environment will be needed in coming years to sustain growth. The rate of foreign direct investment in Sri Lanka, currently low, would also benefit from a review of state policies.

The dismal picture of political democracy that Sri Lanka presented in 2014 has improved substantially with the defeat of the authoritarian Rajapaksha regime. The new government has taken initial steps to restrict executive power and to address some of the factors that had pushed many Tamils into the arms of the separatist movement, although there is no clear policy of national reconciliation as yet. In the north and east of the country, effort is required to rebuild infrastructure and restore welfare services.

The change of government in early 2015 was also accompanied by a realignment of Sri Lanka's foreign relations; continuing economic links with China, Russia and Iran are now complemented by greater reliance on India and the West.

## History and Characteristics of Transformation

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

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

In the late 1970s, the more radicalized Tamil youth moved towards armed struggle. Faced with these challenges, as well as a short-lived insurgency among the Sinhalese youth in 1971, the state began to continually invoke a state of emergency, exerting greater control over the media and expanding the military forces. A new constitution in 1978 established a French-style presidential system and new anti-terrorist laws were enacted. Increasing attacks on state institutions and on the armed forces by Tamil militant groups in the 1980s and a pogrom against Tamil civilians in 1983 made matters worse. After an armed intervention by India in 1983, the proposal of a quasi-federal system failed to resolve the issue. By the late 1980s, the state faced twin armed insurrections, one by Tamil separatist groups and another by Sinhalese Marxists. It was able to crush the latter in 1989, but the LTTE, which emerged as the dominant Tamil rebel group, controlled parts of the

north and east of Sri Lanka and fought a civil war that lasted for 26 years until it was militarily defeated in May 2009. A basic problem in post-war reconciliation is reaching a consensus on arrangements to regain the trust of the minority Tamils of the north and east.

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

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

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

## Transformation Status

### I. Political Transformation

#### 1 | Stateness

The state's monopoly on the use of physical force has remained intact since the defeat of the Liberation Tigers of Tamil Ealam on 17 May 2009 which marked the end of an armed uprising that had lasted for over 25 years. Military attacks on state installations have ceased and Sri Lanka is now entirely free of active rebel forces. Notwithstanding, the state has failed to intervene in sporadic mob violence against religious minorities, including Muslims and Christians.

All groups in Sri Lanka have legal access to political rights. The military defeat of the Liberation Tigers of Tamil Ealam has left the Sri Lankan state without a viable challenger. However, in many parts of Sri Lanka, military and police activity has impinged on individual rights. Particularly noteworthy is the systematic marginalization of Tamils, especially in the militarized Northern Province, and government support of groups such as the Bodu Bala Sena (Buddhist Power Force) which have advocated violence against Muslims, claiming they threaten the majority Sinhalese Buddhist national identity. Among the Tamil minority, largely resident in the north, reservations about the Sri Lankan state remain, reflected in the 2015 presidential election; the 66% voter turnout in the northern Tamil-majority district of Jaffna was well short of the national rate of 81.5%. Anti-government protests in the north which were scheduled to take place after the presidential election were cancelled following Maithripala Sirisena's unexpected victory.

The constitution specifies that "The Republic of Sri Lanka shall give to Buddhism the foremost place," although it also safeguards freedom to have or adopt a religion of one's choice and the freedom to teach and practice one's religion in public or private. The state supports Sri Lanka's four major religions (Buddhism, Hinduism, Islam and Christianity). Until 2015, however, the full title of the minister charged with religious affairs was "Minister for Buddha Sasana and Religious Affairs,"

Question  
Score

Monopoly on the  
use of force  
9

State identity  
6

No interference of  
religious dogmas  
7

reflecting the political power of the Buddhist majority. From 2015, however, each of the four major religions has a different minister charged with administering its affairs.

Nonetheless, the previous government's reluctance to restrain Buddhist nationalists has led Muslims and Christians to fear for their religious rights. The new president, whose election was partly due to support from minority religious groups, appears more inclined to protect all religions equally.

Sri Lanka has an effective administrative structure that provides basic health and educational facilities to all regions. National and provincial agencies provide power, water, housing and other basic facilities, and implement such state policies as the fertilizer subsidy. In the north and the east, state services are slowly returning to normal. Politicization of the administration has led to an imbalance in state support for various groups. The state has worked with international agencies to raise the proportion of the population with access to clean water (94% in 2012) and sanitation (91% in 2012).

Basic  
administration  
7

## 2 | Political Participation

Elections are regularly conducted on the basis of universal suffrage through multi-party contests. While those who win elections gain office, the opposition has no access to state-owned media and, until 2015, opposition election campaigns were often disrupted by supporters of the ruling party, paid thugs or members of the state's security sector (i.e., police and army). Provincial council elections were held for six of the country's nine provinces in 2013 and 2014, with the opposition winning in the Tamil-majority Northern Province. The 2015 presidential election, which unseated an incumbent of ten years' standing who had misused the state apparatus to influence voters, has reinforced confidence in the electoral process. The relative absence of post-election violence in January 2015 was another positive outcome.

Free and fair  
elections  
6

However, the president's virtually unfettered power to appoint the Election Commission (secured by the 18th Amendment to the constitution in 2010) must be curtailed to ensure a fair election process. The Rajapaksha government used control of the administration to influence the January 2015 presidential election and the existing law needs to be reexamined to prevent similar abuses in the future.

Prior to 2015, the immediate family of the president wielded extensive influence in the polity through appointment to elective and non-elective offices. This changed with the January 2015 election, with his successor pledging to reduce the president's virtually unrestricted power to fill numerous positions. Since January 2015, democratically elected officials have been able to implement their policies. There are no extra-constitutional veto powers. The presidency remains a powerful position, retaining, for instance, command over the armed forces. His appointment of chiefs of

Effective power to  
govern  
3

the army, navy, air force and police is unchallenged. Administrative officers are subject to political pressure, including transfers. Legislators wield extensive influence over administrators in their constituencies and receive financial allocations from the national government for minor projects. It remains to be seen whether opposition officials at the local and provincial level receive the support of state agencies in enforcing their policies and regulations.

Under the laws relating to public security, the state can prevent groups from meeting in public, a power that has been increasingly exercised. Prior to 2015, gangs associated with individual politicians were known to intimidate voters, and opposition politicians participated in public life at personal risk. The Rajapaksha government persecuted numerous civil society organizations and personnel. The reporting period was a difficult time for civil society, with repression taking the form of restrictions on organization and registration, searches, and audits. Nonetheless, opposition parties and civil society groups critical of the government continued to operate relatively openly, and the new government has promised to allow greater association and assembly rights.

Association /  
assembly rights  
5

The state controls significant portions of the news media, including major newspapers and state television. There are few independent media outlets critical of the government, and before 2015, they were subject to harassment. Media companies have been attacked and numerous journalists assaulted, many fleeing the country. A degree of criticism of the government is tolerated in the English press (which is only read by about 10% of the population) but there is less tolerance in the vernacular. It is too early to determine whether the new government will permit greater freedom of expression but the early signs are positive.

Freedom of  
expression  
4

### 3 | Rule of Law

Sri Lanka has an active lawyers' association, but political appointments to the bench (at every level) and the intimidation and transfer of judges have severely limited the judiciary's independence. Corruption and political influence have undermined public confidence in the judiciary. The judiciary is not empowered to rule on the constitutionality of legislation after it is enacted, although bills can be challenged before they become law.

Separation of  
powers  
3

The president appoints judges to the Supreme Court and the Court of Appeal with minimal consultation. The right of the president to appoint the Judicial Services Commission (which administers appointments, promotions, transfers and disciplinary action among the lower levels of judiciary) has further politicized the judiciary.

The new president's pledge to restore the independence of the judiciary and to transfer some of his powers to the legislature is a positive sign which, if enacted, will represent a major step towards parliamentary democracy (similar to that which existed before 1978). However, for the period under review parliament was a rubber stamp for presidential decisions and the Supreme Court virtually an extension of the executive branch.

The parliament's impeachment of the chief justice of the Supreme Court, and her subsequent dismissal by the president in January 2013, shattered the illusion of an independent judiciary in Sri Lanka. The action against Shirani Bandaranayake came after she declared legislation proposed by the government unconstitutional. Her removal was widely seen as a political act, as was the appointment of Mohan Peiris, one of Rajapaksha's close advisors, as her successor. The new government, clearly wishing to remove a hostile chief justice, argued that Bandaranayake's removal had been illegal and re-installed her in January 2015. When she resigned after just a few days, Kanakasabapathi Sripavan was appointed in her place. Sripavan is respected in legal circles and his appointment should restore some confidence in the independence of the judiciary, but the summary removal of a Chief Justice of two years' standing has raised concerns. The wider concern is the legacy of political interference in judicial decisions at every level. Given the institutional decay experienced by the judiciary over the past 15 years, it will be some time before it is able to operate efficiently and professionally in enforcing checks and balances. An initial minimum requirement is the removal of the president's virtually unfettered power over judicial appointments.

Independent  
judiciary  
3

There is no obligation on public officials to disclose financial interests. The presence of armed forces limits civil rights in the Tamil areas in the north and east. The politicization of the judiciary and the police has led to a continuing loss of confidence. No high-ranking politician or public servant has been prosecuted for abuse of power while in office despite considerable evidence of wrongdoing. Loyalty to President Rajapaksha and his family appeared to be a guarantee of impunity under the law. There has been some effort in 2015 to investigate abuse of power by members of the former regime but public confidence will depend on the extent to which the new government is willing to curb corruption among its own supporters.

Prosecution of  
office abuse  
3

The law specifies protection of civil rights. In practice, however, the politicization of the judiciary and the police have ensured differential enforcement of these rights. In the north and east, Tamils are subject to abuse by officials, include denial of equal access to justice, to due process under rule of law, to personal privacy and liberty, or the right to conduct meetings; their land is also subject to confiscation. They have limited recourse in these situations. Elsewhere in the country, almost 100 instances of threats, intimidation and violence carried out against Christians and Muslims by Buddhist groups were reported in 2013 alone.

Civil rights  
4



The lack of violence against supporters of the losing parties following the January 2015 presidential election represented a welcome change, which was accompanied by hopes for greater protection of civil rights under the new regime.

#### 4 | Stability of Democratic Institutions

Until the end of 2014, the coalition led by President Rajapaksha held a two-thirds majority in the legislature, and the amended constitution gave him the power to appoint key officials in the judiciary and elsewhere. The ruling party also controlled legislatures in every province except the Northern Province, and virtually all local government organizations. This resulted in an authoritarian structure.

Performance of  
democratic  
institutions  
3

The high degree of secrecy surrounding the formation of a coalition of diverse groups led by Maithripala Sirisena indicated considerable fear of repression. However, Sirisena's victory in the January 2015 presidential elections has opened up the possibility of greater democratization.

The institutional structure remains insufficiently decentralized. The new government has agreed to devolve some powers to the provincial councils but the management of conflict between political groups at the national and local levels remains a challenge.

This assessment is hindered by a lack of survey data. The last known survey for South Asia in 2005 indicated stronger support for democracy in Sri Lanka than in other countries in the region.

Commitment to  
democratic  
institutions  
3

The smooth transfer of power in January 2015 does indeed indicate a commitment to democratic procedures, as does the 81.5% voter turnout. President Rajapaksha is alleged to have considered a coup when he sensed looming electoral defeat. That the coup never transpired may suggest that, despite Rajapaksha's arrogation of power through coopting of individuals, there were limits to the lengths important stakeholders would go in support of the president and his family.

#### 5 | Political and Social Integration

The significant change of recent years has been the gradual erasure of differences in policy and support bases between the two major parties, the United National Party (UNP) and the Sri Lanka Freedom Party (SLFP). The numerous points of intersection between the two major parties has exposed them as patronage-based groups relying on allegiance to their leaders. There is little contrast in terms of social policy and both parties are socially rooted in a Sinhalese Buddhist base. However, there is polarization between the two major parties, on the one hand and, on the other, the ethnic minority parties with whom they form alliances of convenience. One positive move came in January 2015 with the formation of the National Executive Committee

Party system  
6

which is tasked with advising the president and which includes representatives from every major political party.

Overall, party organization is undemocratic and centers on personalities and patronage. Party branches generally become active at election time, when they mobilize voters.

Sri Lanka's Buddhist groups have been the most vocal and influential in the country. Given Sinhalese Buddhists' aggressive promotion of their own interests, minority religious groups have been on the defensive and largely focused on maintaining civil and religious liberties. ILO reports indicate that trade union membership continues to drop and currently represents less than 10% of all workers. Many unions are affiliated with political parties. Employers' federations are influential in pushing economic reforms. Numerous NGOs are actively engaged in assisting poorer sections of society and fostering ethnic harmony, but they lack leadership and prior to 2015 organizations dependent on external grants were denounced as "foreign agents." The previous government persistently vilified independent associations which questioned its governance. Numerous NGOs have been forced to disband or reduce operations because the government has curtailed their resource bases or refused to grant their personnel visas, sometimes turning down whole organizations seeking entry into the country. To date the new government appears to be pursuing a more tolerant policy but the new regime contains numerous figures who complied with the restrictive policies of the former government.

Interest groups  
5

There is no recent data concerning support for democracy in Sri Lanka. Commentators saw the low turnout in 2013 provincial elections as evidence of disillusionment, but the latest provincial council election, in November 2014, saw 76% of registered voters heading to the polls, and an even greater turnout of 81.5% in the January 2015 presidential election. There is no reason to doubt that Sri Lankans value their franchise in free and fair elections. Nonetheless, there is widespread disapproval of democratic institutions seen as corrupt and subservient to the interests of the ruling elite rather than the average citizen.

Approval of  
democracy  
n/a

There is no reliable survey data on inter-personal trust but extensive social networks exist in Sri Lanka. Many of them are based on religious affiliations and center on temples, mosques or churches. Social organizations in rural areas tend to focus on assistance to neighbors in times of need. In urban areas, the upper and middle classes participate in organizations such as the Lions Club, Jaycees and the Rotary Club. The poorer sections of urban society work with religious leaders, often replicating rural patterns of organization. Trade unions are concentrated in the plantations and among urban wage earners. There have been some post-civil war efforts aimed at promoting social cohesion in eastern Sri Lanka but the results are difficult to quantify.

Social capital  
5

## II. Economic Transformation

### 6 | Level of Socioeconomic Development

Question  
Score

Socioeconomic  
barriers

6

Sri Lanka is a middle-income country whose per capita GNI (Atlas method) rose from \$2,260 in 2010 to \$3,170 in 2013. From a 2009 base of \$4,778, the PPP GDP per capita rose to \$7,419 in 2010 before reaching \$9,738 in 2013. In 2012, Sri Lanka led the region in the HDI (.715) and was 92nd in the world. In 2010 the World Bank estimated the proportion of people living on less than \$2 a day was 23.9% (the best result in South Asia) and this must have improved because the poverty headcount as measured by national poverty lines fell from 8.9% in 2010 to 6.7% in 2013. There has been extensive investment in the Southern Province, the political base of former President Rajapaksha, but even five years after cessation of hostilities, the poverty rate remains high in the districts most affected by the civil war (Kilinochchi 12.7%, Mannar 20.1%, Mulaithivu 28%, compared to the national rate of 6.7%). Similarly, poverty in the plantation areas largely inhabited by the Tamil minority remains above the national norm, but there has been some progress in reducing it.

Sri Lanka's youth literacy rate (ages 15-24) of 98% leads the region, as does the overall literacy rate of 91.2%. School attendance is high in all areas, with no gender inequalities, although the quality of instruction varies greatly. Religion has no discernible impact on education except that the literacy rate for Muslim women is slightly lower than average. The percentage of the rural population with access to clean water was 93% in 2012 but those living on plantations have less access, despite recent improvements.

Interpersonal income inequalities remain high although they appear to have improved: the 2010 Gini Index stood at 36.4 having been as high as 40 in 2002. Poor infrastructure has slowed progress in rural areas despite overall growth rates of more than 6% in recent years. Low child mortality and high female higher education levels have not translated into greater equity in economic participation and more decision-making power for women although the country's standing in the Gender Inequality Index improved slightly from .412 in 2010 to .402 in 2012.

Economic indicators		2005	2010	2013	2014
GDP	\$ M	24406.3	49565.6	67206.1	<b>74941.2</b>
GDP growth	%	6.2	8.0	7.2	<b>7.4</b>
Inflation (CPI)	%	11.6	6.2	6.9	<b>3.3</b>
Unemployment	%	7.7	4.9	4.2	-
Foreign direct investment	% of GDP	1.1	1.0	1.4	<b>1.3</b>
Export growth	%	6.6	8.8	5.9	-
Import growth	%	2.7	12.6	-0.3	-
Current account balance	\$ M	-650.1	-1075.0	-2540.6	<b>-2018.2</b>
Public debt	% of GDP	90.6	81.9	78.3	<b>75.5</b>
External debt	\$ M	11471.7	19898.2	25167.8	-
Total debt service	\$ M	422.4	1396.3	1805.3	-
Cash surplus or deficit	% of GDP	-7.0	-7.2	-	-
Tax revenue	% of GDP	13.7	12.9	-	-
Government consumption	% of GDP	13.1	15.6	13.1	-
Public expnd. on education	% of GDP	-	2.0	-	-
Public expnd. on health	% of GDP	1.8	1.6	1.4	-
R&D expenditure	% of GDP	-	0.16	-	-
Military expenditure	% of GDP	2.6	3.1	2.7	<b>2.5</b>

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | International Monetary Fund (IMF), World Economic Outlook, October 2015 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2015.

## 7 | Organization of the Market and Competition

The government allows 100% foreign investment in any commercial, trading or industrial activity other than a few regulated sectors which are subject to approval by relevant government agencies, such as air transportation, coastal shipping, large-scale mechanized gemstone mining, lotteries, and the military hardware. Foreign ownership in excess of 40% must be approved on a case-by-case basis in certain areas such as the production for export of goods subject to international quotas, growing and primary processing of tea, rubber and coconut, timber-based industries using local timber, mass communications and deep-sea fishing. Foreign investment is not

Market-based  
competition

8

permitted in non-bank money lending, pawn-brokering, retail trade with capital investments of less than \$1 million, and coastal fishing.

There are no plans to take over privately owned enterprises. Administered pricing keeps the cost of energy low. The currency is linked to the US dollar but is allowed to float within limits. It has been estimated that the informal sector represents a value-add to the Sri Lankan economy of 40% of GDP. An economic census conducted by Sri Lanka's Department of Census and Statistics in 2013-14 indicated that over three fifths of businesses in the informal sector were managed by single individuals and that only a fourth of such businesses (excluding state run enterprises) were located in urban areas. Local entry barriers to such enterprises are minimal.

The only monopolies in place relate to state-owned businesses (e.g., energy, ports). The state controls some wages and prices, including the price of petroleum, water, power, and bus and rail fares. Although the Consumer Affairs Authority may investigate the effect of anti-competitive practices on consumers, Sri Lanka's law does not empower it to investigate the existence of monopolies or to examine mergers or acquisitions that have already taken place. Pre-merger notifications are not mandatory. Therefore, investigations of mergers may only be undertaken for utilities which fall under the purview of the Public Utilities Commission, or for companies listed on the Colombo Stock Exchange, which may be reviewed by the Securities and Exchange Commission of Sri Lanka.

Anti-monopoly  
policy  
7

Sri Lanka, a member of WTO since 1995, has a relatively transparent, low-tariff trade system. The average weighted tariff was 6.9% in 2010, and 6.7% in 2012. Imports into Sri Lanka are also subject to a number of other charges: excise duty, Export Development Board Levy between 1% and 35%, value-added tax of 12% (VAT), Social Responsibility Levy (1%), the Ports and Airports Development Levy of 5% (PAL), the Nation Building Tax (3%), and port handling charges. Excise duties are levied on tobacco products, oil products, aerated water, liquor, beer, motor vehicles and certain household electrical items. Sri Lanka applies policies to encourage exports of goods and services. They include a temporary importation for export processing scheme (TIEP), and a manufacture-in-bond scheme. Enterprises located in export processing zone benefit from tax holidays, duty-free imports and concessionary land prices. Exporters of non-traditional goods exporting at least 80% of their production also enjoy a number of tax concessions, including a preferential income tax rate on profits from these exports, and a tax holiday. Export duties are levied on vein quartz and an export tax is levied on cashew nuts, raw hides, metal scrap, natural rubber, coconut products and tea. The 2013 merchandise trade-to-GDP ratio was 41.8, which indicates strong integration into world markets.

Liberalization of  
foreign trade  
8

Sri Lanka's banking sector remained stable with banks' capital-to-assets ratio at 8.2 in 2013. The central bank has issued a format for the publication of audited accounts and for the quarterly and annual publication of financial statements. The total risk-

Banking system  
7

weighted ratio required is 10% and the core capital ratio is 5%. The banking system has public confidence and has been profitable. However, Sri Lanka's definition of capital adequacy only takes credit risk into account and there is no explicit charge for market risk. Furthermore, the former government used state-owned and private banks for local borrowing and financing of state enterprises (with banks often persuaded to conform to the government's interests rather than their own). Additionally, the non-performing asset ratio rose from 3.6% in 2012 to 5.2% in 2013. Regulations permit 100% foreign control of banks, insurance companies and stockbrokerages. Currently there are 24 commercial banks in operation in the country. Two of the local commercial banks are state-owned, holding around 30% of banking sector assets. Many Sri Lankan banks are small.

By June 2013, the Colombo Stock Exchange listed 287 companies with a capitalization of \$18.6 billion. The All Share Price Index was 7298 on 1 January 2015, having risen 30% in the previous year.

## 8 | Currency and Price Stability

Inflation, as measured by the Colombo Consumer Price Index, was 6.9% in 2011 but climbed slowly to 7.5% in 2012 before falling back to 6.9% in 2013. Falling oil prices represented a further restraint on inflation in 2014. The increase in inflation followed the Central Bank of Sri Lanka's reduction of the average weighted prime lending rate charged by commercial banks to 7.1% in December 2014. The budget deficit for 2015 is projected to fall from the 2014 rate of 5.2% to 4.6% of GDP. The Sri Lankan rupee held steady at around 130 to the US dollar during 2013 and 2014 after gravitating to 110 to the dollar in the two preceding years. Although the central bank does not operate independently of the government, its recent policies have helped to reduce Sri Lanka's inflation. The change of government in January 2015 raised doubts about the accuracy of figures published by the central bank up to that point although there has been no specific evidence of deliberate data falsification.

Anti-inflation /  
forex policy  
8

The prospects for macroeconomic stability are mixed. The commodity trade deficit is offset by a continual inflow of private remittances (which increased by a further 10% in 2013) and the decline in the price of oil.

Macrostability  
5

Government consumption as a percentage of GDP has continued to fall from the recent peak of 17.6% in 2009 to 13.5% in 2012 and 13.1% in 2013. Government policies have thus helped to keep inflation in check. The budget deficit has gradually declined from -7.2% of GDP in 2010 to -4.6% in 2015.

Nonetheless, increased borrowing (largely for infrastructure projects) has raised public debt as a percentage of GDP from 61.7% in 2010 to 88.9% in 2014. The debt service ratio will rise in coming years from the 2013 level of 11.9% of GDP. Even

more significantly, the external debt rose by 42% between 2010 and 2013 and reserves are a declining percentage of the external debt. There is no discernible progress towards consolidation of the external debt.

## 9 | Private Property

Property and acquisition rights are adequately secured in the industrial and service sectors. Ownership and sale of land are safeguarded, although land registration procedures are cumbersome and subject to inordinate delays (nine procedures and 51 days). However, the former government has forcibly appropriated land in low-income districts of Colombo and refused to return lands in the north-east seized by the military, ostensibly for security purposes. In January 2015, the new president initiated a process to restore private property occupied by the armed forces, which is a step in the right direction. Corruption and undue influence over the judiciary could restrict the enforcement of rights in specific cases. Private land ownership is limited to 50 acres per person. Legislation approved in October 2014 prohibits (with retrospective effect to January 2013) the transfer of land ownership to foreigners or – with some narrow exceptions – to companies with at least 50% foreign ownership.

There is no restriction on the repatriation of profits or dividends of foreign companies although certain sectors of the economy are barred to foreign investors. Remittance of management fees, royalties and licensing fees are also permitted for companies with majority foreign investment approved under Section 17 of the Board of Investment (BOI) Act. Stock market investments can be remitted without prior approval from the central bank. Investment returns can be remitted in any convertible currency at the market rate while foreign investors may invest in foreign currency-denominated bonds.

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

The regulatory requirements for the establishment of new businesses are limited and the average time to establish a new business in 2014 was estimated by the World Bank at 13 days. Factors inhibiting the establishment of new enterprises include unofficial charges by public officials, low-level hostility from the bureaucracy and cumbersome procedures for business registration. The new government is reviewing ways to reduce regulations that impede investment.

There are no plans to take over privately owned enterprises. The private sector plays an important role in the economy, especially in finance, internet technology, the production of clothing and tea, and tourism. However, both local and multinational

Property rights

7

Private enterprise

7

companies complain that an increasing government role in business is impacting the investment climate. In particular, the Sri Lankan military has expanded into activities traditionally reserved for the private sector, including air services, tourism, agriculture and construction. Legislation approved in October 2014 prohibits (with retrospective effect to January 2013) the transfer of land ownership to foreigners or – with some narrow exceptions – to companies with at least 50% foreign ownership. However, the government allows 100% foreign investment in any commercial, trading, or industrial activity other than a few regulated sectors.

## 10 | Welfare Regime

Sri Lanka's HDI remains higher than that of many countries with higher per capita GDP because of its long-standing and comprehensive welfare programs. The state has promoted a number of poverty alleviation programs. These include the Samurdhi program subsidy (increased in the 2015 budget), a nutrition allowance program, and social security and pension programs. The new regime has increased the poverty allowance paid to poor senior citizens and added a new nutrition allowance at childbirth.

Social safety nets

7

Life expectancy at birth has risen marginally from 73.6 in 2006 to 74.1 in 2012. Prior to 2015, however, state investment was focused more closely on infrastructure than on strengthening social safety nets. State welfare expenditure in health as a percentage of GDP, for example, has declined from 1.9% in 2006 to 1.3% in 2012. The 2015 budget raises this to 3%.

Basic provision of education is comprehensive, with state or state-assisted schools providing education free from grade 1 to grade 12, but there is a shortage of teachers in foreign languages and in technical subjects. Tertiary education is not well funded. President Sirisena pledged in 2015 to increase spending on education from the current low level of less than 3% of the GDP. The rural population and the majority of those in urban areas currently have no insurance coverage for natural disasters.

The emergence of a coalition government with strong minority support in 2015 has opened up the possibility of a more equitable distribution of state benefits to all groups, including the Tamils in the north and east.

Access to public services is open to all by law. There are however, inequalities in practice. The gender gap in educational enrollment or achievement is minimal, with literacy among females at 92.6% as opposed to 90.0% for males and enrollments in primary and secondary levels also comparable. However, men dominate the more lucrative levels of employment in both the public and private sectors and the average wage of females in the higher reaches of the formal sector is less than that of men. There are regional and urban-rural disparities in the quality of the education system

Equal opportunity

5



despite continuing efforts to develop magnet schools. Access to financial resources is limited for the poorer sectors of society, despite the state's encouragement of micro-lending. Access to opportunity has been severely limited in areas of conflict in the north and east, which has affected large numbers of the Tamil minority as well as Muslims and some Sinhalese in the recent past, and there has been little improvement in minorities' access to jobs (especially within the state system). It is too early to assess whether political changes in 2015 have led to greater equality of opportunity.

## 11 | Economic Performance

The Sri Lankan economy has performed very well in recent years. The end of both the global recession and the civil war led to a growth rate which peaked at 8.2% in 2011. After falling to 6.3% in 2012, the 2013 growth rate reached 7.3% and 7.7% in 2014. This rise was fueled by improved production in rice, tea and other products, and a revival of fisheries. Growth in construction, agricultural products and apparel led to double-digit growth in exports. The trade gap narrowed in 2014 and both remittances from Sri Lankans working abroad and tourist arrivals rose substantially. The fall in oil prices in 2014 was a boon to Sri Lanka but tea exports in 2015 may be adversely affected by poor economic conditions in Russia, Iran and Syria, countries which together account for around 50% of Sri Lanka's tea exports.

Output strength  
8

Inflation, as measured by the Colombo Consumer Price Index, rose to 7.5% in 2012 before falling back down to 6.9% in 2013. It is likely to rise again in 2015 if the promises made during the January 2015 presidential election are kept. In addition, the increase in commercial and non-concessionary borrowings from external sources in recent years is likely to increase the country's debt payment burden in the near future.

Gross capital formation as a percentage of the GDP rose from 27% in 2010 to 30% in 2012 and 2013, and net FDI has fallen from 1.6% of GDP in 2012 to 1.4% in 2013 although it picked up in 2014. Tax revenue as a percentage of GDP has fallen in recent years from 12.9% in 2010 to 12.0% in 2012.

The budget deficit has also declined from -7.2% of GDP in 2010 to -6.1% in 2012 though it is likely to rise in 2015 if the promises made in the January 2015 presidential election are kept.

Unemployment fell to 4% in 2013 (5.7% in 2010) but youth (15-24) unemployment is 17.3% and participation of women in the labor force remains at a low 30%.

## 12 | Sustainability

The encroachment of natural reserves and continued deforestation (despite logging restrictions imposed in 1999) has resulted in soil erosion and other adverse effects on biodiversity. The provision of free water for agriculture has contributed to high usage. Air and water pollution has worsened in urban areas and development pressures have also led to the reclamation of estuarial, lagoon and marsh waters, and the unrestricted disposal of untreated sewage, leading to major pollution problems. Recycling of garbage in urban areas is inadequate. Industries create environmental contaminants that pollute freshwater bodies. Environmental concerns tend to take a back seat to growth considerations. Environmentally sustainable growth gets only scant attention and is not reflected in the institutional framework. On paper at least, Sri Lanka has national policies on the environment (2003), wetlands (2005) and biosafety (2005), but they often remain unenforced due to political pressure or personal influence.

Environmental  
policy  
4

The existing system of education is comprehensive, with gross enrollment at 98% at the primary level and 99% at the secondary level (2012). The adult literacy rate (16 and over) is 91% (2010). But with total education expenses at 2.7% of GDP in 2012 and with virtually all education run by the state, there are wide disparities in facilities between urban and rural areas. Facilities are poor in the war-damaged north and east. Tertiary education continues to fall behind in quality. Private tertiary institutions provide post-secondary diplomas and link programs with foreign universities. The government has expressed support for the expansion of this sector while also continuing to enlarge the state structure, increasing the allocation for education in its interim budget. R&D expenditures are particularly low (0.16% of GDP in 2010). Modern infrastructure is limited to certain areas such as major cities, tourist centers and industrial zones.

Education policy /  
R&D  
5

# Transformation Management

## I. Level of Difficulty

Sri Lanka currently has an aging population with the age dependency ratio (dependents to working age population) rising from 49 in 2011 to 51 in 2013. Sri Lanka does not have exploitable oil or coal resources. Recent historical experiences of communal tensions and civil war which – allied with poor political management (nation-building) – pose considerable structural constraints on the political process of democratic transformation.

Structural  
constraints

6

These facts are balanced by a number of positive factors. Sri Lanka has a good geographical location, a literate labor force and a basic (though inadequate) system of internal transport. Improved water supply has reduced the incidence of pandemics. Welfare policies have reduced extreme poverty though there is still much to be done, particularly in the north and east.

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

Civil society  
traditions

5

The previous government's attacks on NGOs and the media weakened faith in democracy. NGOs appear to have been revived by the opposition victory in the presidential elections and the ensuing peaceful transition. Civil associations, which had taken an active role as guardians of civil and minority rights, despite the hostility of the previous government, appear to have been vindicated.

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

Treatment of ethnic and religious minorities worsened under the previous government; during the period under review, Sinhalese Buddhist extremist groups operated with impunity. The success of a multi-ethnic coalition in the 2015 presidential election and the absence of post-election violence has raised hopes that

Conflict intensity

7

ethnic tension might be waning. However, the citizenry remains divided and minorities fearful. Given the island's demographics (dominated by Sinhalese Buddhists) and the proven ability of Sinhalese and Tamil extremist groups to mobilize followers in support of divisive, mono-ethnic causes, there is reason for apprehension. Much will depend on the extent to which the rhetoric of reconciliation is backed up by equitable treatment on the ground.

## II. Management Performance

### 14 | Steering Capability

During the period under review, policy measures were generally prioritized according to the needs of President Rajapaksha and his coterie, and distribution of patronage to supporters. The election of President Maithripala Sirisena has changed this situation in several ways. His commitment to reducing the power of the executive, if fulfilled, will reduce the capacity for strategic planning beyond electoral cycles. The coalition of ethnic groups and political parties supporting the new regime is also less politically cohesive than Rajapaksha's government, another barrier to long-term planning.

The broad socio-economic priorities of the government do not differ substantially from those of its predecessor. The appointment of Ranil Wickremesinghe as prime minister may signal greater links to the private sector to which his United National Party has close links. It is likely that continued investment in infrastructural projects such as highways will be complemented by increased funding of health and education. The fall of the Rajapaksha family provides an opportunity for more participatory decision making, while the governing coalition's reliance on minority support may also lead to more equitable distribution of resources to the north and east.

Prior to 2015, the government of President Rajapaksha pursued greater executive power through patronage. State agencies became increasingly politicized and corrupt. The state initiated a few major infrastructure projects, often using foreign loans (e.g., the Hambantota port project and the reconstruction of road networks) but information released after the 2015 presidential election indicates that there had been a degree of wastage and overspending on these projects.

The previous regime did introduce policies to benefit the rural poor, including pensions for workers in the informal sector and price controls for food staples and agricultural inputs, but implementation tended to favor groups that were supportive of the regime. The declared policy objectives of the new President are much more focused on democracy and decentralization.

Question  
Score

Prioritization  
4

Implementation  
5

It was a persistent refusal to learn political lessons that led to the defeat of President Rajapaksha. Although his party lost out in the Northern Province elections, his regime made little or no effort to reach out to the Tamil minority as a whole, instead concentrating on securing the support of a few Tamil politicians by offering ministerial positions and other forms of patronage. The failure to protect Muslims and Christians led to an erosion of support within these groups. The regime also failed to draw lessons from its reduced majority after the 2014 Uva provincial election and went ahead with its gamble on early presidential polls in 2015. The new government has expressed a desire to reach out to all groups but populist politics remain an important force in decision-making.

Policy learning  
5

Economically, the Rajapaksha administration concentrated on major infrastructure projects and populist policies which assisted poorer members of the community which, though effective, favored political loyalists. The new administration appears to be moving toward more equitable distribution of resources but it is too early to judge the success of their efforts.

## 15 | Resource Efficiency

The public sector is overstaffed and the appointment of new public officials is politicized with the exception of a minority of specialized professionals such as doctors. Once appointed, public officials are protected in their positions, though they can be subject to transfer to undesirable locations. Auditing of state agencies is routine but there are continuing instances of state resources falling into private hands. Elected local and provincial assemblies have legally defined spheres of activity but do not have adequate financial resources. The reforms promised by the new president, if implemented, would limit politicization of the administration. The budget deficit has fallen from 8% of GDP in 2011 to 5.2% in 2014 but the external debt has grown substantially.

Efficient use of  
assets  
5

Policy coordination through the administration is well-established; many central ministries have branches at the provincial level with coordination provided by civil servants. Prior to 2015, political control of the administrative structure by the president's family ensured minimal competition and friction among the 61 ministries. On the other hand, this system undermined the autonomy of provincial and local governments. The new regime has the administrative machinery for implementing policy but seems more inclined to heed feedback. The Sri Lankan administrative structure requires further reform to ensure transparency and equity in the implementation of policy.

Policy  
coordination  
6

Corruption is deeply embedded at every level of the polity and administration. There is no prosecution of corrupt politicians in power. Public procurement systems are notoriously open to bribery and there is virtually no accountability of officeholders in the form of asset declarations or conflict of interest rules. State spending is audited, but party financing is not regulated. The media occasionally highlights glaring instances of questionable decisions. The defeat of the corrupt Rajapaksha, and the new regime's pledge to limit corruption in 2015, provides cause for hope.

Anti-corruption  
policy  
4

## 16 | Consensus-Building

Prior to 2015, President Rajapaksha's regime paid lip service to democracy while simultaneously undermining it, by disrupting elections and compromising judicial independence. Following Rajapaksha's defeat, all major groups, including many of his erstwhile supporters, advocate the restoration of democratic norms. The military has kept out of politics, while religious leaders of all faiths have expressed support for democratic values.

Consensus on goals  
5

The two major parties (SLFP and UNP) agree on the long-term strategic goals of poverty alleviation through state welfare and subsidies within a market-based economy. The UNP is more vocal in its support of the market economy but currently depends on the support of the SLFP in Parliament and with the new regime containing so many remnants of the former government, it is uncertain how far it will go in its advocacy of the market economy. The Marxist party JVP advocates state intervention in the economy, but its popular support has dwindled considerably. Minority Tamil and Muslim ethnic parties are primarily concerned with protecting the interests of their respective groups.

Under the Rajapaksha regime, the major threat to democracy came from the ruling party itself: elections were disrupted, the public service politicized and the independence of the judiciary undermined. The military has not interfered in economic and political policy-making. Trade unions are weak in all but a handful of sectors (e.g., power, transport, tea production).

Anti-democratic  
actors  
5

The successful transfer of power to a broad-based coalition in early 2015 is widely perceived as a victory for pro-democracy forces. However, the new government contains numerous prominent defectors from the old regime who remained silent while President Rajapaksha undermined democracy.

The major challenge is reconciliation between Tamils and the state. One positive sign is the appointment of a civilian to succeed a former military officer as governor of the Tamil-majority Northern Province. However, there is still much work to be done, including the return of land in the north and east appropriated by the armed forces, open discussion of civilian casualties in the closing phase of the civil war in 2009 and the devolution of power to minority-dominated areas. The state has been partially

Cleavage /  
conflict  
management  
5

successful in moderating class conflict but this came at the cost of escalating ethno-religious divisions. The Up-Country Tamils in the central part of Sri Lanka also see themselves as an economically oppressed group. Muslims, who make up almost 8% of the population, have become fearful of assaults on their identity and interests by majority Buddhists seen in attacks on mosques in 2013 and 2014. There have also been attacks on Christian churches. The new government has promised a more inclusive policy but the governing coalition contains elements that have little sympathy for minority concerns.

Prior to 2015, the political leadership made no specific efforts to encourage the participation of civil society in the political process; on the contrary, it suppressed civilian groups which sought to intervene in politics. Professional associations (such as the Bar Association), intellectuals and media professionals critical of state policies were under constant pressure from the state, with several journalists leaving Sri Lanka in fear for their lives. Nonetheless, they did find outlets in the media and on the Internet, playing a key role in shaping public opinion in the 2015 presidential election campaign.

Civil society  
participation  
3

Under the new president, there seems to be a greater openness to dialogue but the extent to which this will play out is not yet clear.

The death toll in Sri Lanka's civil war is estimated at 80,000; the end of hostilities in May 2009 led to debate about atrocities during the war and charges of extra-legal actions by Sri Lankan armed forces during the concluding stages. The eight-member Lessons Learnt and Reconciliation Commission (LLRC) appointed by the Sri Lankan government in May 2010 to investigate responsibility for the war and suggest measures for restorative justice and conflict prevention was criticized by international actors as a defensive measure. The LLRC report released in December 2011 suggested safeguarding of political and linguistic rights, inclusion of minorities in development and compensation for injury or loss of life. Progress in implementing these recommendations has been very slow. Meanwhile, a panel of experts appointed by United Nations Secretary General Ban Ki-moon (without the Sri Lankan government's cooperation), concluded that up to 40,000 civilians were killed, mainly as a result of deliberate artillery bombardment by the army. In November 2014, the UN's High Commissioner for Human Rights, Zeid Ra'ad Al Hussein, rebuked Sri Lanka for impeding investigations.

Reconciliation  
2

The change of government in early 2015 has improved chances of reconciliation, with the new regime accepting the recommendations of the LLRC and promising to work with Tamil political leaders who command the majority in the Northern Province's legislature. The new president's National Executive Committee includes representative of all ethnic groups. Nevertheless, the new regime may not be entirely open in dealing with events at the close of the civil war. New president Maithripala Sirisena was interim Minister of Defense in 2009 while one of Sirisena's key

supporters, Sarath Fonseka, was army chief during that time. The new president has stated that he would oppose any international investigation, a position which could hamper reconciliation efforts.

## 17 | International Cooperation

The pattern of external assistance has continued the transition begun almost a decade ago when Sri Lanka moved from reliance on the West to increasing reliance on new lenders such as China and India as well as international agencies such as the IMF and World Bank. Chinese loans have been used primarily for infrastructure projects (such as ports and roads) while Indian investment has largely been directed to housing and oil exploration. World Bank-financed projects are mostly in the areas of education, irrigation, roads and healthcare, with loans averaging over \$300 million per year in the four-year period to December 2014, rising to \$564 million in 2014. In light of its reduced inflation and improving foreign reserves, Sri Lanka has not requested new assistance from the IMF.

Effective use of support

6

All of this indicates a pattern of decreasing dependence on the West, corresponding with the previous regime's goal of economic development without democratic evolution. The new government's reappraisal of major infrastructure projects funded by interest bearing loans suggests a more prudent evaluation of return on investment.

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

Credibility

6

It is much less credible in its record on protection of human rights, press freedom and democracy. International NGOs are often seen by the Sri Lankan government as subversive forces.

Sri Lanka has good relations with its neighbors, although increased Chinese investment in infrastructure projects is a cause of concern within the Indian government. The southern Indian State of Tamil Nadu has consistently criticized Sri Lanka's refusal to offer meaningful devolution to the Tamil minority in the north and east. Sri Lanka participated in the 18th Summit of the South Asian Association for Regional Cooperation in December 2014 and agreed to a framework on energy cooperation with other member states. The change of government in 2015 promises more openness with the country's South Asian neighbors, particularly in the area of transport and new educational and economic links.

Regional cooperation

8



## Strategic Outlook

Prior to 2015, state efforts were focused more on infrastructural capacity than the social and human aspects of development. The change of government raises the hope that corruption and misallocation will be curtailed and development focused on reducing tensions in society.

The Sri Lankan state has made continued progress toward a market economy. Inflationary pressures have been kept under control. Substantial private remittances from expatriate workers (\$6.8 billion in 2013) ensure the external current account is healthy and low oil prices are likely keep it that way in 2015. Further transparency and efficiency in the legal and administrative framework will reduce the transaction costs of business enterprises and promote investment.

In the area of social justice, Sri Lanka's emphasis on reducing rural poverty is a good start towards sustainable development. Sri Lanka has made good use of loans and grants offered by international bodies and friendly countries to achieve progress but much remains to be done. Improving law and order, and ensuring better access to the judicial system should be part of this vision. Of equal importance is the improvement of education quality and access.

There are several areas in which policy changes are recommended:

**Reconciliation:** Ethnic reconciliation and a political settlement on devolution of power remain key issues. The Sri Lankan government's slow implementation of the recommendations of the Lessons Learnt and Reconciliation Commission and its refusal to work with the UN secretary general's panel investigating human rights violations in the civil war, as well as its disputes with the EU on human rights guarantees, have inspired little confidence among Sri Lanka's minorities. However, the new regime has made tentative steps towards rebuilding trust, promising to devolve more powers to the nine provinces and return land occupied by armed forces. President Sirisena and Prime Minister Wickremesinghe must seize the initiative in building consensus on the issues of minority rights and devolution.

**Political Democracy:** Rajapaksha's concentration of power in the executive compromised the independence of the judiciary and politicized the administration, the police and the armed forces. The new government has pledged to reverse these trends, an opening that should be supported by the international community.

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

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

to build a development policy consensus that pays greater attention to environmental concerns. There is increased awareness of the dangers of rising sea levels, with several of Sri Lanka's major urban areas located in coastal areas. Sixteen of Sri Lanka's coastal lagoons – representing half of the country's wetlands – are classified as threatened. This is mostly due to development for tourism and recreational purposes, fisheries, fish farming, industrial development, unrestricted disposal of untreated sewage, large-scale sand mining and housing. Growing population pressure and certain cultivation and clearing practices have resulted in greater vulnerability to natural disasters such as landslides and floods. Existing legal instruments need to be fully utilized and strengthened.