

Economic Imperative for Peace in Sri Lanka

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The economic effects of ethnic conflict in Sri Lanka are multifarious, and any discussion on these would encompass the opportunity cost of the war (that is, the foregone income due to the war at micro and macro levels); the economic impact of the military expenditures (on both sides of the war); financing mechanisms (both national and international) of the rebel movement; and the impact of economic sanctions on rebel territory. This paper focuses on some of the economic implications of the ethnic conflict in Sri Lanka and argues that the foregone economic growth is higher than hitherto acknowledged; that the defence expenditure has surpassed social expenditures in recent years; that the defence expenditure as a proportion of the Gross Domestic Product (GDP) in Sri Lanka is the highest in South Asia and in comparison to some other war-torn countries around the world; and that the labour-intensive military strategy pursued is economically very costly. The overall argument of the paper is that such high defence expenditures are the main cause of the economic woes of the country and therefore not sustainable in the long run. Thus, a peaceful resolution of the ethnic conflict is a *sine qua non* for the economic betterment of the country.

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It should be noted that the economic effects of ethnic conflict in Sri Lanka are a relatively under-researched area of study.¹ It is beyond the scope of this paper to discuss the plethora of economic effects of ethnic conflict in Sri Lanka, and it will focus on only a few important aspects of such effects: the relationship between economic growth and ethnic conflict; the competition between social expenditures and defence expenditures; the defence expenditures of Sri Lanka in comparison with other South Asian countries, as well as some other internal conflict-ridden countries around the globe; and the economic implications of the labour-intensive military strategy.

The aims and objectives of this paper are to:

- i. find out the trade-off between ethnic conflict and economic growth in Sri Lanka;
- ii. compare and contrast the defence expenditure with the social expenditure of Sri Lanka;
- iii. compare and contrast Sri Lanka's defence expenditure within the South Asian region and with selected internal conflict-ridden countries in the developing world; and
- iv. discuss the cost-effectiveness of the labour-intensive military strategy pursued in Sri Lanka.

The arguments in this paper demonstrate that:

- i. the trade-off between ethnic conflict and economic growth in Sri Lanka may be higher than hitherto acknowledged by other researchers;
- ii. defence expenditures have overtaken social expenditures consistently since 1995;

¹ See for instance, Nisha Arunatilake, Sisira Jayasuriya and Saman Kelegama, *The Economic Cost of the War in Sri Lanka*, Institute of Policy Studies, January 2000, Colombo; Goonetilleke, "Counting the Costs of the War", in Kumar Rupesinghe, ed., *Negotiating Peace in Sri Lanka: Efforts, Failures, and Lessons*, London: International Alert, 1998, pp. 335-45; L. M. Grobar and S. Gnanaselvam, "The Economic Effects of the Sri Lankan Civil War", *Economic Development and Cultural Change*, vol. 41 no.2, 1993, Hague, pp. 395-406; Saman Kelegama, "Economic Cost of Conflict in Sri Lanka", in R. I. Rotberg, ed., *Creating Peace in Sri Lanka*, Washington D.C: Brookings Institution Press, 1999; Wimal Rankaduwa and N. S. Cooray, "Economic Impact of Defense and Non-defense Spending: An Empirical Investigation", *Upanathi*, vol. 10 nos.1and2, Colombo, 1999, pp. 102-115; Jose Ravano, *The Economy of the Wann: An Analysis of the Impact of Restrictions*, unpublished draft report, Food Security Project for Conflict Affected Areas, Care International, Sri Lanka, 2001.

- iii. Sri Lanka's defence expenditures, as a proportion of the national income, is the highest in the region (bar Pakistan) and among selected internal conflict-ridden countries in the developing world; and
- iv. the labour-intensive military strategy pursued in Sri Lanka is economically costly.

Ethnic Conflict and Economic Growth

It is believed that Sri Lanka is an exceptional country because, despite a protracted ethnic conflict, it has achieved respectable rates of economic growth. The latest proponent of this view is Meghan O'Sullivan.² Although researchers who support this view concur that economic growth would have been greater if not for the war, they nevertheless commend the average growth of about five per cent during the period between 1981 and 2000, despite a deadly civil conflict.³ This paper differs with the proponents of this view.

To begin with, the official economic data of Sri Lanka is unreliable due to a variety of reasons. However, due to the absence of alternative data, it is necessary to rely on such imperfect data. The average annual growth of the real GDP during the 19-year period of ethnic conflict (i.e.1983-2001) was pegged at 4.35 per cent, whereas in the 19-year period prior to the ethnic conflict (i.e.1964-1982), it was 4.55 per cent (Table 1). These figures reveal that the average annual conflict-time growth rate was marginally lower than the average annual pre-conflict growth rate. With profound economic liberalisation since 1977, the economic growth rate in the 1980s and 1990s should have been higher than the previous two decades, but this was not the case. The primary reason for this relatively low growth rate

² Meghan O'Sullivan, "Sri Lanka: Civil Strife, Civil Society, and the State 1983-1995", in Stewart, Frances and Valpy Fitzgerald, eds., *War and Underdevelopment*, Volume II, Oxford: Oxford University Press, 2001.

³ See for instance, Arunatilake, et al, *The Economic Cost of the War in Sri Lanka*, p. 5; Godfrey Gunatilleke, et al, *The Cost of the War: Economic, Social and Human Cost of the War in Sri Lanka*, Colombo: National Peace Council, January 2001, p. 5; Rankaduwa and Cooray, "Economic Impact of Defense and Non-defense Spending: An Empirical Investigation", pp. 102-115.

during the post-liberalisation period can be attributed to the negative effects of the ethnic conflict since 1983.

The average annual conflict-time GDP growth rate of 4.35 per cent is an over-estimation because, since 1990, the national income accounts of Sri Lanka do not include the North and East province. As the Government lost control of vast areas of the North and East province to the Liberation Tigers of Tamil Eelam (LTTE), the socio-economic data gathering in that province became impractical. Most of the statistical tables in the Department of Census and Statistics, as well as Central Bank publications have a footnote mentioning that the North and East province is excluded.

It is reasonable to conjecture that the North and East province would have experienced a negative growth since 1990, when the civil war intensified. If the supposedly negative growth rates of the North and East province were added to the positive growth rates of the rest of the country, the overall growth rates would have been lower than the official figures of the Central Bank used in Table 1. The conflict-time economic growth rates may, consequently, be considerably lower than the pre-conflict rates despite economic liberalisation. Thus, the notion that the Sri Lankan economy has been resilient in spite of a deadly conflict could be a myth.

According to the Keynesian economic theory, public expenditure, especially investment, (including in the defence sector) has the potential to boost economic growth. That is, military expenditure could have a positive impact on economic growth.⁴ However, this theory would hold only if the country concerned has an armament industry and that such public expenditure in the defence sector is during peacetime. This is not the Sri Lankan case, since the country does not have an armament industry to boost economic growth. Further, the rising public expenditure in the defence sector has been during wartime, and the direct and indirect negative impact of the war on the economy

⁴ Jean-Pierre Benoit as cited in Saadet Deger, "Military Expenditure and Economic Development: Issues and Debates", in Lamb, Geoffrey and Valeriana Kallab, eds., *Military Expenditure and Economic Development: A Symposium on Research Issues*, Discussion Paper no. 185, Washington, D.C: The World Bank, 1992, pp. 37-38.

has overshadowed the positive impact of public expenditure on the war effort. Hence, the necessary conditions for military expenditure to boost economic growth are absent in Sri Lanka. For example, the purchase of military hardware during peacetime would contribute to economic growth in the form of investment in the defence sector. But, during wartime such investment in military hardware may have a depreciation rate of 100 per cent because the lifetime of such hardware could be just a matter of days. Hence, investments in military hardware during wartime could be classified as recurrent expenditure (consumption) rather than capital expenditure (investment) or both.⁵

Table 1
Conflict-Time and Pre-Conflict Economic Growth

1983-2001 (19 years of ethnic conflict)	4.35 %
1964-1982 (19 years prior to ethnic conflict)	4.55 %

Source: Central Bank of Sri Lanka, *Annual Report 2000*, Special Statistical Appendix Table 7, Colombo.

Defence Expenditure versus Social Expenditure

The data on defence expenditures of most developing countries are unreliable; usually they are an underestimation. There are, of course, legitimate methodological problems in the measurement of defence expenditures.⁶ Besides, there are also deliberate attempts to camouflage such expenditures to ostensibly maintain secrecy, with this latter trend quite widespread in countries at war (within or without). Sri Lanka is a country where defence expenditure data is unreliable due to both these reasons.⁷

⁵ Somnath Sen, "Military Expenditure Data for Developing Countries: Methods and Measurement", in Lamb, Geoffrey and Valeriana Kallab, eds., *Military Expenditure and Economic Development: A Symposium on Research Issues*, Discussion Paper no. 185, Washington, D.C: The World Bank, 1992, p. 17.

⁶ Geoffrey Lamb and Valeriana Kallab, eds., *Military Expenditure and Economic Development: A Symposium on Research Issues*, Discussion Paper No. 185, Washington, D.C: The World Bank, 1992.

⁷ Muttukrishna Sarvanathan, "The International Monetary Fund in Sri Lanka: A Critical Dialogue", *Contemporary South Asia*, Oxford, vol. 11 no.1, March 2002, pp. 77-87.

Moreover, Sri Lanka's defence budget does not include disability benefits and pensions of soldiers, which is a further source of underestimation.

The Central Bank publishes only the annual recurrent and capital expenditure of the Ministry of Defence. There is no way of obtaining the breakdown of such expenditure. Nor does the Ministry of Defence publish an annual Administrative Report like other Government Ministries and Departments, which provide a detailed breakdown of expenditures by each Ministry. Defence procurements also do not follow the usual cabinet tender procedures laid down for public sector procurements. The Customs Department does not publish the entire imports of military hardware and equipment. Even the Ministry of Finance (Treasury Department) does not have details on defence procurements. There is, thus, no transparency or accountability in the public expenditures on defence. It would not be surprising if even the Auditor General has little knowledge of the expenditures of the Ministry of Defence. The foregoing anomalies in the documentation of defence expenditures are a serious concern to the research community.

There are, further, a number of other heads under which camouflaged military expenditures occur in the Sri Lankan context, and these include:

- the deflection of foreign aid to the war effort. According to anecdotal evidence, heavy vehicles and equipment from donor funded infrastructure projects are occasionally diverted for the use of the Army, especially during times of major military offensives. These will unavoidably have an economic cost in terms of the delay in the implementation of such infrastructure projects, and are in fact indirect military expenditures that should be classified as such.
- the upkeep of the former Tamil rebel groups such as the Eelam People's Democratic Party (EPDP), Eelam People's Revolutionary Liberation Front (EPRLF), People's Liberation Organisation of Tamil Eelam (PLOTE), Tamil Eelam Liberation Organisation (TELO), etc., remains a mystery. These rebel groups have been and are rewarded financially

and in kind for their allegiance to the state security forces.⁸ It is also reported that these former rebel groups are provided with concessionary bank finance through the state banks to run their business enterprises.⁹ Further, leaders of some of these groups are also provided contractual appointments in the public sector. All these payments in kind should be accounted for in the defence budget.

- at times of major military battles, wounded soldiers are treated in both military and civilian hospitals. The military hospitals are run under the Defence Ministry budget and the civilian hospitals by the Health Ministry budget. Strictly speaking, the cost of treating the wounded soldiers in civilian facilities should be borne by the Defence Ministry.

The foregoing are just a few examples of the camouflaged military expenditure in the Sri Lankan ethnic conflict. Hence, the actual defence expenditures in the country would be considerably higher than the Central Bank figures used here. Despite the anomalies in the data on defence expenditures, however, these are used here because of the lack of alternative data.

The defence expenditure, which was minuscule in the pre-conflict period, has shot up enormously since the early 1980s. For example, the defence expenditure shot up from LKR (Sri Lanka Rupee) 16 billion in 1991 to LKR 77 billion in 2000, i.e., a nearly fivefold increase in just a decade (Table 5). In the past few years, defence expenditures have become the single largest component of public expenditure (barring public debt repayment) by the Government. Despite the protracted civil conflict, the total social expenditure exceeded the defence expenditure until about the early 1990s. However, since 1995, the defence expenditure, as a proportion of the total public expenditure, has consistently far exceeded the total social expenditure (Table 2).

In 1995, the civil war entered a vicious phase with the strategy of 'war for peace' or 'peace through war'. One of the outcomes of this strategy is the acceleration of defence

⁸ This information was derived from conversation the author had with some members of the former rebel groups who cannot be identified for obvious reasons.

⁹ This information was derived from an interview the author had with a state bank official who wanted to remain anonymous.

expenditure and the deceleration of social expenditure. Thus, since 1995, the gap between defence expenditure and social expenditure widened considerably, particularly in the last two years (Table 2). This would have a profound negative impact on the human and social development indicators of Sri Lanka, which historically had an impressive record within the developing world.

Table 2
Defence/Social Expenditures as a Proportion of Total Public Expenditure (%)

	Defence Exp	Social Expenditure				
		Total	Education	Health	Poverty	R&R
1991	11.2	11.2	3.5	2.4	5.3	
1992	12	13	5.4	3.1	4.5	
1993	10.9	9.9	4.3	1.9	3.7	
1994	12.9	12.8	4.5	2.6	5.7	
1995	14.3	12.7	3.5	5.2	2	2
1996	17.7	13.5	4.2	5	3.2	1.1
1997	16.8	12.6	4.2	4.7	3	0.69
1998	16.9	12	4.7	4	2.5	0.8
1999	16.4	12.7	5	4.8	2.6	0.27
2000	17	9.8	3.8	3.9	2	0.14
2001	14.2	9.3	2.6	3.8	2.4	0.47

Source: Central Bank of Sri Lanka, *Annual Report*, various years.

- Notes:
- (a) Education includes higher education as well.
 - (b) Health includes indigenous medicine and social services as well.
 - (c) Poverty alleviation programmes are Janasaviya (1991-1994) and Samurdhi (1995-2001).
 - (d) R&R means Rehabilitation and Reconstruction of the North and East.
 - (e) From 1991 to 1994 R&R and Poverty are clubbed together.

Defence Expenditure in a Comparative Perspective

Not only has the defence sector of Sri Lanka been competing with the social sectors for public funds since 1995, it is also the case that Sri Lanka has been the largest spender on defence, as a proportion of its GDP, compared to some other internal conflict-ridden countries around the world (since 1995) and the second

largest in South Asia. According to Table 3, Sri Lanka has been the second largest spender of its GDP on defence in South Asia, after Pakistan, between 1991 and 2000. Sri Lanka spent nearly three per cent of its GDP on defence in 1991, which shot up to nearly five per cent in 2000 (Table 3).¹⁰

The data for Sri Lanka in Table 3 are, once again, a considerable underestimation. According to the Central bank of Sri Lanka, defence expenditure, as a percentage of the GDP during 1996-2000 was 6.6 per cent, 5.7 per cent, 6.2 per cent, 5.4 per cent, and 6.8 per cent, respectively.¹¹ The Stockholm International Peace Research Institute (SIPRI), drawing from national statistics, compiles these data. Of course, just as the Sri Lankan data is unreliable, the data for other countries may also be unreliable. However, since SIPRI uses a common methodology to standardise the national data, such methodological infirmities would not affect the international comparison, as particular sources of error could be common to all the countries under consideration.

Pakistan has been the largest spender on defence as a proportion of its GDP in South Asia, during the decade between 1991 and 2000. Pakistan is not a comparable country to Sri Lanka for two reasons. Firstly, the Army has ruled Pakistan for most part of its post-independence history. Even during intermittent civilian rule, the Army played a major role in governing the country. Historically, therefore, Pakistan's defence expenditures have been quite high. Secondly, Pakistan has a territorial dispute with India (both have fought three major wars since independence), and hence the added justification for high defence expenditures. If we leave Pakistan aside, consequently, Sri Lanka becomes the largest spender on defence as a proportion of its GDP in the region over the last decade. Notwithstanding the fact that Bangladesh, India, and Nepal all have their own share of internal conflicts, their defence expenditure has remained far below that of Sri Lanka during the years under consideration (Table 3).

¹⁰ Data for year 2001 is still not available.

¹¹ Sarvanathan, "The International Monetary Fund in Sri Lanka", p. 78.

Table 3
Defence Expenditures as a percentage of the GDP 1991-2000

Country	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
South Asia										
Bangladesh	1	1.1	1.2	1.2	1.3	1.2	1.2	1.2	1.3	1.3
India	2.5	2.3	2.4	2.3	2.2	2.1	2.2	2.2	2.4	2.4
Nepal (a)	0.9	0.9	0.9	0.9	0.8	0.8	0.8	0.8	0.9	0.9
Pakistan	5.8	6.1	5.7	5.3	5.3	5.1	4.9	4.8	4.6	4.5
Sri Lanka	2.8	3.0	3.1	3.4	5.3	5.0	4.2	4.2	3.6	4.5
Conflict-ridden										
Colombia	2.5	2.6	2.5	1.9	2.1	2.5	2.8	2.2	2.5	2.3
Myanmar	3.2	3.4	3.5	3.5	3.7	3.5	2.7	2.3	2	1.7
Philippines	1.3	1.3	1.4	1.4	1.6	1.5	1.5	1.4	1.2	1.2
Sierra Leone	1.8	2.5	2.6	2.5	2.4	2.0	1.0	0.8	1.6	1.4
Sudan	2.8	2.5	2.8	2.5	1.7	0.9	1.0	2.2	2.6	3.0
Uganda	2.2	1.5	1.8	1.6	1.5	1.8	1.9	2.1	2.1	1.8

Source: Stockholm International Peace Research Institute, The SIPRI Military Expenditure Database, Stockholm.
http://projects.sipri.se/milex/mex_data_index.html

Notes: (a) expenditures on paramilitary forces are excluded.

The more appropriate countries to compare with Sri Lanka are the countries that are afflicted by a vicious internal conflict/civil war. Accordingly, the defence spending (as a proportion of GDP) of Sri Lanka is compared with Colombia, Myanmar, Philippines, Sierra Leone, Sudan and Uganda between 1991 and 2000. The result is unambiguous. Between 1991 and 1994, Sri Lanka was the second largest spender on defence after Myanmar; after 1994, however, Sri Lanka has been the largest spender. Another important feature to remember is that Sri Lanka's defence spending is significantly higher than its competitors (Table 3).

What is the rationale of comparing data on defence expenditures as a proportion of GDP? GDP is a country's total income. Like individuals or households who have to allocate their income to different categories of expenditures, a country allocates its income to different competing expenditures. That is, a country is required to allocate its income among different sectors according to their priority. On an average, Sri Lanka has spent almost four per cent of its GDP on defence during the decade from 1991-2000 (Table 3). The total public expenditure of Sri Lanka as a proportion of the GDP in 2000 was nearly 40 per cent. That is, Sri Lanka has spent 10 per cent of the contribution of its total public expenditure to GDP in 2000 towards defence during this period, which is quite excessive.

In sum, the regional and international comparisons of the various countries under consideration reveal that Sri Lanka's defence expenditure is the largest among comparable countries. This trend does not augur well for the country's economy in the long run.

Another set of data from South Asia is presented to further confirm Sri Lanka's lead in the development of the defence sector in the region (Table 4). This data covers the period 1985-1998 and provides a profile of the longer-term development of the defence sector in the region, and Sri Lanka's lead position in that developmental process.

Sri Lanka's total defence expenditure of USD 730 million in 1998 was the third largest after India and Pakistan. Though in absolute terms Sri Lanka's defence expenditure is ranked third, it has the largest defence expenditure in relation to the population

and physical size. The annual rate of increase in defence expenditure between 1985 and 1998 was the highest in Sri Lanka at 10 per cent, which is double that of the second highest in Nepal (five per cent). Sri Lanka spent 4.8 per cent of its GNP on defence in 1998, which was the largest in South Asia (marginally higher than that of Pakistan, the second largest). Likewise, Sri Lanka's defence expenditure per capita, at USD 39, was the highest in South Asia in 1998. Further, the 81 per cent increase in the number of armed forces personnel in Sri Lanka between 1985 and 1997 was the highest in South Asia (almost double that of the second highest, Nepal). As a corollary, the number of soldiers per 1,000 populations in Sri Lanka was six in 1998, the highest in the region. Moreover, the Military Holdings Index of Sri Lanka in 1998 at 889 was the largest in South Asia (taking 1985 as the base year), almost five times that of Bangladesh (the second largest) (Table 4).

This set of data further confirms the priority given to military development in Sri Lanka in the past two decades, which is a serious concern to peace-loving citizens. Though some may justify this skew in terms of the protracted civil conflict, it is also necessary to note that most other South Asian countries (like India, Pakistan and Bangladesh) also experience vicious internal conflicts. Besides, no matter how acute the internal conflict is, a country cannot spend on defence beyond its means. Money does not necessarily win wars. This argument is further augmented below.

Table 4
Military Development in South Asia

	India	Pakistan	Bangladesh	Nepal	Sri Lanka
Defence Expenditure 1998 US\$ millions in 1993 prices	10,600	2,810	450	40	730

Defence Expenditure 1985-1998 Annual % increase	3.0%	2.3%	3.0%	4.7%	9.9%
Defence Expenditure 1998 As a percentage of GNP	2.5%	4.6%	1.0%	0.8%	4.8%
Defence Exp per capita 1998 US\$ in 1993 prices	10.8	21.5	3.6	1.7	39.2
Armed Forces Personnel % increase 1985-1997	-7.2%	17.5%	24.8%	45.7%	80.5%
Number of Soldiers Per 1,000 population 1998	1.18	4.5	0.98	2	6.1
Military Holdings Index 1998 (a) 1985 = 100	142	144	198	160	926

Source: Mahbub-ul-Haq Human Development Centre, Human Development in South Asia 2001, Karachi: Oxford University Press, 2002, pp. 174.

Note: (a) Military Holdings Index is based on the aggregate number of heavy weapons a country has, such as combat aircraft, artillery, ships, and tanks.

Labour-Intensive Military Strategy

A salient feature of the ethnic conflict in Sri Lanka is that the military strategy adopted by the Sri Lankan Government has been overwhelmingly labour-intensive. This strategy has overburdened the economy. A breakdown of Sri Lanka's defence budget into recurrent and capital expenditures from 1991 to 2001 is provided in Table 5. Accordingly, 80 per cent of the defence budget during 1991-2001 went into recurrent expenditure and only 20 per cent into capital expenditure. This is an indication of a labour-intensive military strategy pursued by successive Governments.

Only during the peak years of military activity, such as in 1995, 1996 and 2000, did the capital expenditure increase marginally in comparison to the recurrent expenditure (Table 5).

Table 5
Defence Budget 1991-2001(LKR Million)

Year	Recurrent Expenditure	Capital Expenditure	Total Expenditure
1991	12,609 (81%)	3,054 (19%)	15,663
1992	15,627 (87%)	2,369 (13%)	17,996
1993	17,677 (85%)	3,105 (15%)	20,782
1994	21,989 (86%)	3,538 (14%)	25,527
1995	25,815 (74%)	9,156 (26%)	34,971
1996	33,117 (72%)	13,168 (28%)	46,285
1997	35,094 (76%)	10,874 (24%)	45,968
1998	45,314 (79%)	11,832 (21%)	57,146
1999	44,632 (82%)	9,601 (18%)	54,233
2000	57,841 (75%)	19,313 (25%)	77,154
2001	52,537 (77%)	15,977 (23%)	68,514

Source: Central Bank of Sri Lanka, Annual Report, various years.

Note: Recurrent and capital expenditure as a proportion of the total expenditure is given in brackets.

The civil war in Sri Lanka has been one of competition for control of territories between the warring parties, i.e., the state security forces and the LTTE. Control of areas in the North and East province seems to be the objective of military strategy, rather than defeating the enemy. This strategy of controlling territories requires vast human resources. Hence, the labour-intensive military strategy has increased the number of personnel in the armed forces manifold during the past two decades (Table 4, row 5). The Army, Air Force and Navy, which were just ceremonial forces in the early 1980s, have been transformed into fighting forces over the past two decades.

According to a Defence Ministry source, at present, there are about 300,000 personnel in the Police, Army, Navy, and Air Force of Sri Lanka. This is about a quarter of the total number of personnel in the public sector. In 2001, the total number of public sector employees was nearly 1.2 million. Out of the 300,000 personnel in the various Forces, only about 75,000 are in the Police, and the rest are in the Armed Forces. The total number of personnel in the Police and Armed Forces comprises almost two per cent of the total population (18.7 million) and five per cent of the total labour force (6 million) of Sri Lanka in 2001. That is, for every 62 persons in Sri Lanka, there is one person in the Security Forces (including the Police), which is a very high ratio (in other words, there are 16 security personnel per 1,000 people).

Labour in the public sector (including in the Armed Forces) is expensive in Sri Lanka. Though salaries in the public sector are relatively lower than in the private sector, public sector employees do not pay income tax and enjoy a generous non-contributory pension. That is, public sector employees in Sri Lanka do not pay income tax and do not make any contribution to the state pension. Yet, they are entitled to receive 90 per cent of their salary at the time of retirement as pension, which is one of the most generous pension schemes in the developing world. It is worthwhile mentioning that in India (for example) public sector employees do pay income tax and do contribute to the state pension fund.

The average life expectancy of a person in Sri Lanka is currently approximately 70 years.¹² If a person joins the Armed Forces at the age of twenty, the state has to pay salary, various allowances, pension, and widow/widower pension on account of that person for more than 50 years. This is a big burden on the economy. This burden is set to become more acute with a rapidly ageing population in Sri Lanka. By year 2010, about 20 per cent of the Sri Lankan population is expected to be over 60 years old.¹³

Despite lower salary scales in the public sector relative to the private sector, labour in the public sector is very costly as a result of low productivity. The public sector in Sri Lanka is overstaffed

¹² Mahbub-ul-Haq Human Development Centre, *Human Development in South Asia 2002*, Karachi: Oxford University Press, 2003, p 228.

¹³ Central Bank of Sri Lanka, *Annual Report 2002*, Colombo.

and inefficient. In addition to the basic salaries, many public sector employees (including Police and Armed Forces personnel) are paid overtime payments and allowances such as 'risk allowance', which adds up to a reasonable take home pay package. In other words, although gross incomes of the public sector employees and the private sector employees may show a big difference, the difference in net incomes may, in fact, be far less.

Despite the high economic cost of the labour-intensive military strategy adopted in Sri Lanka, the outcome of the civil war has been disappointing. This calls for a fundamental rethink on this military strategy. An analogy may be drawn from the experience in Afghanistan. The United States, with its technological superiority, accomplished in a few months what the former Soviet Union could not do with its labour-intensive military strategy for over a decade in Afghanistan. While there may be a cue here for Sri Lanka, this does not imply that Sri Lanka could or should emulate the US strategy. For one thing, Sri Lanka cannot compete with American technology. More significantly, for a poor country like Sri Lanka, a capital-intensive military strategy can be just as prohibitive as the present labour-intensive one, because, as mentioned above, capital investments in the defence sector could have a 100 per cent depreciation rate and thus become recurrent expenditures.¹⁴ Besides, since Sri Lanka does not have a defence industry, physical and technological capital has to be imported, and all this would be very costly. However, investment in human capital rather than unskilled labour for the police and armed forces may pay better dividends.

The labour-intensive military strategy has resulted in a high defence budget trap because, even during peacetime (such as the current one), the Government is unable to make substantial cuts in defence spending, since salaries, overtime payments and various allowances (such as 'risk allowance') continue to be paid. The budgeted defence expenditure for year 2002 was LKR 67,445 million, which is expected to absorb almost 20 per cent of the

¹⁴ Sen, "Military Expenditure Data for Developing Countries: Methods and Measurement", p. 17.

total public expenditure earmarked for the fiscal year. Thus, the anticipated 'peace dividend' in the aftermath of the indefinite cease-fire agreement has not materialised to any considerable extent.¹⁵

Conclusion

The Sri Lankan economy is in dire straits. For the first time in its post-independence history, the country recorded negative growth during year 2001. Sri Lanka's total public debt in 2001 was greater than the GDP of the country. The annual Government revenue was not sufficient even to meet the Government's annual recurrent expenditures. Furthermore, annual Government revenue is not sufficient even to make repayments on public debt. That is, public debt repayments have to be made with borrowed money.

One of the primary reasons for this predicament of the Sri Lankan economy is the galloping defence expenditure. The most important cause of the galloping defence expenditure is the labour-intensive military strategy pursued by successive Governments. In comparison to many internal conflict-ridden countries, Sri Lanka's defence expenditure is the largest in the world. Despite this record expenditure on defence, Sri Lanka has been less successful than some other countries in combating internal conflict. A poor country like Sri Lanka cannot afford to spend such a high proportion of its national income on defence for long.

After nearly 20 years of ethnic conflict, the time is opportune to do some soul-searching about the hitherto pursued military option to resolve this conflict, and the prevailing and persistent military strategy. The current state of the economy dictates a peaceful resolution of the long drawn-out ethnic conflict in Sri Lanka. Only a peace strategy can lift the island out of this economic quagmire.

¹⁵ Muttukrishna Sarvanathan, "Doing Business in the North and East Province of Sri Lanka: Problems, Opportunities, and Challenges", Paper presented at the seminar on 'Peace Process and the Business Community' jointly organised by the Centre for Policy Alternatives and the Ceylon Chamber of Commerce, Colombo, June 20, 2002.