

Economic Freedom in Sri Lanka

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1. Introduction

Economic freedom is an essential ingredient of democracy like political freedom. Yet economic freedom is less understood compared to political freedom. Though the concept of economic freedom gained momentum with the ascendancy of neo-liberal economic paradigm since the early-1980's in the United States and United Kingdom (which later spread to the rest of the world) there was hardly any yardstick developed for the measurement of economic freedom only in the mid-1990's a composite index to measure economic freedom was established after several years of groundwork.

The objectives of this paper are quite modest and attempt to answer the following questions:

- What is economic freedom and how can it be measured?
- What is the state of economic freedom in Sri Lanka?
- What are the deficiencies in the measurement of economic freedom in Sri Lanka?

2. Economic Freedom: An Introduction

According to Gwartney and Lawson (2003: 5) "the key ingredients of economic freedom are personal choice, voluntary exchange, freedom to compete, and protection of person and property". A country's adherence to such economic freedom is measured by the Economic Freedom of the World (EFW) index developed by the Fraser Institute based in Vancouver, Canada. The EFW index is based on 38 variables (including 18 survey-based variables derived from the International Country Risk Guide and the Global Competitiveness Report) and was available for 123 countries in 2001, the latest available year. The EFW index has a scale of 0 to 10 - zero depicting no economic freedom at all and 10 depicting highest economic freedom.

In 2001 the top ten countries in terms of economic freedom were Hong Kong

TABLE 1: Economic Freedom Rating in South Asia

Country	1970	1975	1980	1985	1990	1995	2000	2001
Bangladesh	N.A.	3.8	3.7	4.1	4.6	5.4	5.5	5.6
India	5.0	4.4	5.2	5.0	4.9	5.6	6.1	6.1
Nepal	N.A.	N.A.	5.7	5.3	5.3	5.2	5.6	5.7
Pakistan	4.7	3.8	4.6	5.1	5.0	5.6	5.5	5.4
Sri Lanka	N.A.	N.A.	4.9	5.1	5.0	6.1	6.1	6.3
World Average							6.3	6.4

Source: Gwartney and Lawson, 2003: 3, 46, 91, 115, 123 & 142

Note: N.A. = Not Available.

(8.6), Singapore (8.5), United States (8.3), New Zealand (8.2), United Kingdom (8.2), Canada (8.1), Australia (8.0), Ireland (8.0), Switzerland (8.0) and Netherlands (7.8). The bottom ten countries were Myanmar (3.8), Democratic Republic of Congo (3.9), Zimbabwe (4.0), Algeria (4.2), Guinea-Bissau (4.4), Republic of Congo (4.5), Ukraine (4.6), Romania (4.7), Malawi (4.8) and Central African Republic (4.9) (Gwartney and Lawson, 2003: 11). The world average economic freedom rating was 6.4 in 2001 (Table 1).

3. Economic Freedom: The Case of Sri Lanka

In South Asia economic freedom indices are available for the largest five countries, viz. India, Pakistan, Bangladesh, Nepal and Sri Lanka. Sri Lanka had the highest economic freedom rating in South Asia (6.3) during 2001, the latest year for which data is available. This may not be surprising because of the fact that Sri Lanka was the first country in South Asia to open up its economy in 1977. But, in 1980 Nepal (5.7) and India (5.2) had higher ratings than Sri Lanka

(4.9). In 1985 and 1990 Nepal (5.3) had higher ratings than Sri Lanka (5.1 & 5.0 respectively). Nevertheless, since 1995 Sri Lanka (6.1, 6.1 & 6.3) has had the highest ratings though in 2000 India (6.1) and Sri Lanka (6.1) had equal rating. Yet economic freedom in Sri Lanka during 2000 and 2001 (6.1 & 6.3 respectively) were slightly less than the world average of 6.3 and 6.4 respectively (Table 1).

Sri Lanka had a very restrictive and inward looking economy between 1970 and 1977. Unfortunately the economic freedom index of Sri Lanka for 1970 and 1975 are unavailable. It would have been certainly far below the 1980 rating because of nationalisation of the plantation sector, price and exchange controls resulting in parallel markets for commodities and foreign currencies, high import tariff rates and high income, property and wealth taxes *inter alia*. Although economic freedom rating for 1970 and 1975 are unavailable data for certain components of the economic freedom index are available. For example, for 1970 some sub-components of the 'Size of Government', 'Access to Sound Money' and 'Freedom to Exchange with Foreigners' are available while for 1975 in addition to the foregoing some sub-components of the 'Regulation of Credit, Labour and Business' are available (see Gwartney and Lawson, 2003: 142).

Though Sri Lanka tops in economic freedom within South Asia it lags behind Southeast Asian countries barring Indonesia (Gwartney and Lawson, 2003: 11). Sri Lanka's top position in South Asia in terms of economic freedom is buttressed by the facts that it has the highest economic growth rate, per capita income, life expectancy, literacy rate, access to safe sanitation facilities and safe water in South Asia (Mahbub ul Haq Human Development Centre, 2003:228-231).

In terms of the ranking of economic freedom indices Sri Lanka was in the 70th position in 1980 that improved to 64th position in 2001 (out of 123 countries). Sri Lanka's position fluctuated between the lowest 74th (in 1990 to highest 57th (in 1995) during the period 1980 and 2001 (Table 2). Economic freedom

index of Sri Lanka is unavailable for 1970 and 1995. However, as argued above it would have been lower than that in 1980.

As a corollary to the top position in terms of economic freedom rating Sri Lanka was at the top in terms of ranking of countries according to the degree of economic freedom within South Asia in 2001. However, in 1980 Nepal and India were well ahead of Sri Lanka and in 1985 and 1990 only Nepal was ahead of Sri Lanka. Since 1995 Sri Lanka had the best ranking (jointly with India in 2000 (Table 2).

Again, Southeast Asian countries (barring Indonesia) were ahead of Sri Lanka during 2001 (Gwartney and Lawson, 2003: 11). The comparison of economic freedom ranking overtime may be misleading because the number of countries incorporated in the exercise has been growing. For 1970 only 53 countries were rated, which increased to 70 countries for 1975, 102 countries for 1990 109 countries for 1985, 113 countries for 1990 and 123 countries for 1995, 2000 & 2001. Whilst the number of countries incorporated in the exercise

increased Sri Lanka's position improved, which means Sri Lanka had fared much better than the ranking in Table 2 would show. For example, in 1980 Sri Lanka was in the 70th position out of 102 countries but in 2001 it was in the 64th position out of 123 countries. That means, in 2001, Sri Lanka's position improved by more than 6 places (than reflected in Table 2).

It is important to note that the ratings and ranking of each component and sub-components differ from the aggregate ratings/ranking given in Tables 1 & 2. That is, though overall Sri Lanka seems to top in economic freedom within South Asia since 1995 in certain components and sub-components of the index, it lags behind some other South Asian countries (see Gwartney and Lawson, 2003: 46, 91, 115, 123 & 142).

TABLE 2: Economic Freedom Ranking in South Asia

Country	1970	1975	1980	1985	1990	1995	2000	2001
Bangladesh	N.A.	69	98	93	93	79	92	91
India	41	58	59	73	80	74	70	73
Nepal	N.A.	N.A.	39	60	64	86	89	89
Pakistan	48	69	76	68	74	74	92	101
Sri Lanka	N.A.	N.A.	70	68	74	57	70	64

Source: Gwartney and Lawson, 2003: 46, 91, 115, 123 & 142
Note: N.A. = Not Available.

4. Economic Freedom Index of Sri Lanka: A Critical Evaluation

Sri Lanka was the trendsetter in economic liberalisation and reform in the South Asian region having embarked on opening up its economy in 1977. After the first wave of economic liberalisation throughout the 1980's Sri Lanka embarked on a second wave of economic liberalisation beginning 1990. The positive results of this second wave of liberalisation are reflected in the economic freedom index, which increased from 5.0 in 1990 to 6.1 in 1995 (Table 1).

In Sri Lanka economic liberalisation was by and large mistakenly equated with trade liberalisation. That is, the liberalisation of the external trade sector was not matched by reduction in the size and role of the state. This has, for example, resulted in double digit budget deficits for the first time since independence during the post 1977 period. These budget deficits in turn have made the total public debt greater than the GDP of the country in many years during the liberalisation period. Ironically the size of the public sector doubled between 1978 and 2000. In 1978 there were 600,000 public sector employees that increased to 1.2 million in 2000. Further, even after quarter century of economic liberalisation more than 60% of the total bank deposits are with the state banks. Moreover, the labour laws in the country are still very restrictive for entrepreneurship. Though Sri Lanka remains the most open economy in South Asia further reforms need to be undertaken in order to remove the structural and institutional impediments to economic freedom such as the foregoing ones.

Though the overall economic freedom index of Sri Lanka is fairly positive its performances in some of the sub-components of 'Legal Structure and Security of Property Rights' (military interference, integrity of legal system and protection of intellectual property), 'Freedom to Exchange with Foreigners' (restrictions on foreign capital transactions, hidden import barriers and costs of importing) and 'Regulation of Credit, Labour and Business' (time spent with government bureaucracy, price controls, impact of minimum wage, flexibility of hiring and firing and private ownership of banks) are lagging behind (Gwartney and Lawson, 2003: 142).

Further, the changes in the ratings of some of the components of the economic freedom index from one year to another are suspect. For example, Sri Lanka received 7.2 rating for 'time spent with government bureaucracy' in 2000 which declined to 4.0 in 2001. Likewise, for 'flexibility in hiring and firing' Sri Lanka received a rating of 2.9 in 2000 which jumped to 4.6 in 2001. Further, the rating for 'impartial courts' rose from 5.0 in 2000 to 6.1 in 2001. Moreover, the rating for 'protection of intellectual property' jumped from 3.5 in 2000 to 5.0 in 2001. The foregoing changes in ratings between 2000 and 2001 appear to be doubtful because there do not seem to be any considerable improvement in any of these factors in just one year. Besides the quality of the underlying statistical data on which the economic freedom index is based is wanting.

Moreover, though as per the economic freedom index, Sri Lanka enjoys considerable economic freedom (as is evident in Table 1), in reality a large chunk of the population has been deprived of economic freedom due to the civil war in the past twenty years. The secessionist struggle in the North and East Province of the country has resulted in severe erosion of economic freedom, *inter alia*. A devastating economic embargo imposed on the North and East Province since 1990 has seriously hampered productive activities (see Sarvananthan, 2003, a). This economic embargo included essential food commodities, medicines and agricultural inputs such as fertilisers, pesticides and fuel as well. Besides, arbitrary and extra legal taxes imposed by various rebel groups also impinged on the economic freedom of the masses in the North & East Province.

The Government of Sri Lanka (GoSL) unilaterally lifted the economic embargo in January 2002 prior to the signing of an indefinite ceasefire agreement with the Liberation Tigers of Tamil Eelam (LTTE) in February 2002. However, arbitrary and extra legal taxes imposed by the LTTE rebels have become further entrenched and widespread during the past 18 months. Though with the lifting of the economic embargo economic freedom of the people of the North & East Province has been restored to a considerable extent various rebel taxes impinge on economic freedom (see Sarvananthan, 2003 b).

In addition to extra legal taxes the farmers and fisherspersons in the North and East Province are faced with a monopsony which is the LTTE. After the ceasefire agreement agricultural and fishing activities have received a tremendous boost in rebel held territories. However, the rebels purchase farm and fish produce at a fixed (below market) price and transport to Colombo to sell at a higher price. Thus the rebels have taken away the freedom of the producers to market their own produce. This restriction imposed by the rebels even during peacetime impinges on the economic freedom of the people in the North and East Province.

In these circumstances fairly high economic freedom ratings received by Sri Lanka throughout the 1990's seem doubtful.

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