SRI LANKA

Poverty Assessment
Engendering Growth with Equity: Opportunities and Challenges

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Poverty Reduction and Economic Management Sector Unit
South Asia Region

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Executive Summary

1. The development story in Sri Lanka is one of mixed success. The country is on par with middle-income countries and Millennium Development Goal timetables for universal primary school enrollment, gender parity in primary and secondary school enrollment, and universal provision of reproductive health services. At the same time, consumption income poverty persists and the poor continue to face basic welfare challenges such as malnutrition.

2. A number of interrelated constraints prevent access by the poor to opportunities in more dynamic sectors of the economy. In poor rural areas and the estates economic and geographic constraints include inadequate connectivity to markets and growth centers, lack of electricity and transport facilities (infrastructure) and poor quality schools (public services). In poor urban areas constraints include inadequate access to clean water, electricity, sanitation and quality of housing. At the household level, the report assesses the cyclical nature of poverty traps caused by low levels of education, poor nutrition and underemployment (mostly associated with the informal sector). Population in the estates, North and East, and the tsunami-affected coastal areas are more likely to fall into the poverty trap cycle due to historical disadvantages or recent events like civil conflict or natural disasters.

I. Poverty, growth, and inequality trends in Sri Lanka

3. Consumption poverty reduction in Sri Lanka has been modest—about 3 percentage points (from 26 to 23 percent) from 1990–91 to 2002)—and uneven across sectors. Urban poverty halved between 1990–91 and 2002, while rural poverty declined by less than 5 percentage points, and poverty in the estates increased by about 50 percent—making this sector the poorest in the country (Figure 1). The conflict-affected North and East are excluded from these estimates, since consumption data from HIES (the official source for poverty measurement) essential to measure poverty is not available for this region.

4. The growing urban-rural gap is largely due to concentrated economic growth in Western Province. GDP grew by an average of 6.2 percent annually during 1997–2003 in Western Province, and by only 2.3 percent in the remaining provinces. Western Province’s share in national GDP increased from 40 percent in 1990 to 48 percent in 2002, while that of Uva and Sabaragamuwa fell from 16 to 11 percent. As a result, in 2002 the incidence of poverty fell to 11 percent for Western Province compared with 35 percent for Sabaragamuwa and Uva.

5. The largest poverty reduction in 2002 occurred in districts with low incidence of poverty in 1990–91 (Colombo and Gampaha in Western Province). In some districts—already

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Figure 1: Poverty headcount in Sri Lanka

Note: Excludes the North and East for which HIES data are not available,
Source: HIES (different years).

Figure 2: Poverty headcount by district, 2002


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1 Excluding the North and East. Source: Peace Secretariat using Central Bank Provincial GDP numbers.
2 Poverty headcounts in Colombo and Gampaha were 16 and 15 percent, respectively, in 1990-91, and reduced by 10 and 4 percentage points, respectively, by 2002.
among the poorest in 1990–91—poverty increased even further. Poverty in the poorest districts of Badulla and Monaragala was more than six times that in Colombo in 2002 (Figure 2).

6. **Poverty and vulnerability** (the risk of falling into or deeper into poverty) are closely linked, since the poor and those just above the poverty line are more susceptible to shocks. Figure 3 shows that the population is highly concentrated around the poverty line, implying that even small shocks can cause large increases in poverty incidence.3

7. **Current targeted welfare programs perform well below potential.** Despite a long history of publicly funded welfare programs the evidence suggests that current programs perform well below potential in protecting the consumption of the vulnerable and the poor. The largest cash transfer program, Samurdhi still misses a large proportion of the poor even though it covers more than 40 percent of the population. Also transfer amounts are small—the monthly average was a little above Rs. 90 (less than $1) per capita in 2002.4 More accurate targeting is likely to improve coverage among the poor and increase the amount of support per family to more meaningful levels, and the government is currently developing plans to improve targeting countrywide.

8. **Shocks affect those near the poverty line the most.** The tsunami that struck Sri Lanka on December 26, 2004 is likely to have worsened poverty outcomes. Although poverty numbers are not available for districts in the East hardest hit by the Tsunami on December 26, 2004, the average monthly per capita income before the tsunami in the East was close to that of the poorest provinces of Uva and Sabaragamuwa, so the impact of the tsunami is likely to have worsened poverty outcomes.5 In the South, where poverty data is available, the tsunami-affected districts have higher poverty incidences than the national average—32 percent in Hambantota, 27 percent in Matara, and 26 percent in Galle.

9. **Growth performance is below potential.** Sri Lanka’s growth performance has been below potential when compared with East Asian countries, especially given its early achievements in human development. Per capita income—comparable to that of many East Asian countries in the 1960s—is currently less than one-tenth of Korea’s, one-fourth of Malaysia’s, and one-half that of Thailand.

10. **Growth has been slower and income per capita substantially lower in regions outside Western Province.** Western Province fares better than the rest of the country in terms of human development outcomes, but these differences are not as sharp as the differences in growth and income, suggesting that factors other than the availability of human capital also play a role in constraining growth in lagging regions.

11. **Inequality is increasing.** In addition to disparities in growth between the Western Province and the rest of the country, the slow pace of poverty reduction in Sri Lanka is also linked to rising inequality among income groups. Average per capita consumption grew by 50 percent for the richest consumption quintile but by only 2 percent for the poorest quintile.6 The Gini coefficient of per capita consumption in

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3 Sources of risk at the household level include sickness and death of a family member and unemployment at the household level. At the community level risks include drought, crop failure, and other natural disasters (World Bank 2006c, draft).


5 CFSES 2003–04.

6 World Bank staff calculations based on DCS HIES 1990 and 2002.
Sri Lanka (higher Gini indicates higher inequality) increased at an annual rate of 2 percent, much higher than for East Asian comparator countries with the exception of China (Figure 4). Thus, for every 1 percent annual growth in GDP per capita, the poverty headcount ratio declined by 0.4 percent in Sri Lanka, compared with 0.9, 1.4, and 2.6 percent in Korea, Vietnam and Thailand, respectively.

12. Rising inequality hinders poverty reduction. Had consumption distribution remained unchanged from 1990–91, the 30 percent growth in average consumption by 2002 would have reduced poverty by more than 15 percentage points nationally instead of the observed 3 percentage points. At the average rate of per capita consumption Gini increase of the past decade (2 percent annually) and continuing GDP growth at the average rate over the past two years (5.7 percent annually), the poverty headcount in 2015 is likely to be 15 percent, well short of the Millennium Development Goal of halving poverty between 2000 and 2015. Sri Lanka will need to grow at 10 percent annually to achieve this target. If the Gini coefficient remains unchanged at the 2002 level, however, a 5.7 percent rate of annual GDP growth will be sufficient to reduce the poverty headcount to 8 percent by 2015.

II. The correlates of poverty: household characteristics and spatial factors

13. Poverty is strongly associated with attributes of individuals/households such as education attainment, employment status, and family size. After individual differences are accounted for (in a multivariate regression of the probability of being poor), the likelihood of being poor also depends on a range of spatial factors, such as poor regional growth and employment opportunities, and the availability of infrastructure, such as roads and electricity.

A. Household and individual specific factors

14. Larger households, especially those with children, are more likely to be poor. Households with a member working abroad, however, have a significantly lower likelihood of being poor.

15. The human development challenges that face Sri Lanka differ from those that face most developing countries. Primary enrollment and literacy are near-universal in Sri Lanka. Similarly, basic indicators of health—fertility, infant and child mortality, immunization rates, life expectancy, and maternal health—are uniformly high across income groups. Good basic indicators in health correlate well with the high literacy of mothers in Sri Lanka.

16. Low education attainment is strongly associated with poverty (Figure 5). In 2002, well over 30 percent of households with heads with schooling up to and including grade 5 fell under the poverty line, compared with less than 10 percent for heads who completed at least grade 9. Regression analysis shows that a household is significantly less likely to be poor when the head has an education at the A-level and above.

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7 In case of Sri Lanka, since HIES was not conducted in 2000, the reference year is 2002.
8 Assumes population growth rate of 1.2 percent. These projections are based on the approach proposed by Bourguignon (2003) to estimate growth elasticity of poverty under certain restrictive assumptions about the current distribution of consumption.
9 Please note the per capita consumption measure is unable to account for economies of scale in consumption and age of family members, and therefore tends to underestimate the welfare of larger households.
17. Disaggregated data on school enrollments show disparities among income groups. Educational attainment is significantly lower among children of poor households. Net enrollment for grades 10–13 among the lowest income quintile (31 percent) is only one-half that of the richest quintile (60 percent) and the net tertiary enrollment rate for the lowest quintile (2 percent) is less than one-sixth that for the richest quintile (13 percent).

18. The low quality of education acts as an additional handicap for the poor in remote areas. Nationally, students display a low skill level in first languages, English, and mathematics, and these indicators are even lower for nonurban children. Absenteeism of teachers (about 20 percent nationally) is also higher in nonurban schools. The poor quality of education has led to a rapid increase in the use of private tutors, and another urban-rural and rich-poor gap: CFSES (2003–04) shows that private tuition is used less by nonurban children, and twice as often by students in the highest income quintile than those in the lowest quintile.

19. Rich-poor gaps in health include low birthweight, malnutrition among preschool children, poor nutritional status of adult women, and incidence of communicable diseases such as tuberculosis and diarrhea. Food availability, dietary awareness, and access to safe water and sanitation are often linked to income/consumption poverty (Table 1).

20. Inadequacies in nutrition and education affect lifelong earnings and trap households in a cycle of low capability and poverty. The higher incidence of poverty among the less-educated and the fact that the poor are less likely to participate in higher levels of education perpetuates the vicious cycle of poverty.

21. The correlation between unemployment and poverty for the population as a whole is weak, but the presence of an unemployed youth is associated with a higher probability of the household being poor. More than 75 percent of the unemployed are between 15 and 29 years of age.10 Youth unemployment is especially high among school dropouts, who in turn are more likely to belong to poor households. A household is also more likely to be poor when at least one member is employed in an elementary occupation (mostly in the informal sector).11 Since underemployment is often a feature in the informal sector, this finding supports the commonly held view that underemployment and poverty are closely linked. Individuals with lower education attainment tend to be employed in elementary occupations. Education is thus an important underlying factor linking labor market outcomes with poverty. Also, consistent with the pattern of agricultural stagnation discussed later, employment as an agricultural worker increases the likelihood of poverty.

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Table 1: Health outcomes by wealth quintiles and sector (percent)

<table>
<thead>
<tr>
<th>Quintile/sector</th>
<th>Children under-weight</th>
<th>Children w/ diarrhea</th>
<th>Women with low body mass index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poorest</td>
<td>47.4</td>
<td>7.6</td>
<td>37.3</td>
</tr>
<tr>
<td>Richest</td>
<td>11.1</td>
<td>4.5</td>
<td>10.0</td>
</tr>
<tr>
<td>Urban</td>
<td>17.8</td>
<td>5.7</td>
<td>12.7</td>
</tr>
<tr>
<td>Rural</td>
<td>31.0</td>
<td>7.8</td>
<td>23.1</td>
</tr>
<tr>
<td>Estate</td>
<td>45.7</td>
<td>7.6</td>
<td>47.7</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>29.3</td>
<td>7.3</td>
<td>22.9</td>
</tr>
</tbody>
</table>


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Figure 5: Poverty headcount by education attainment of household heads, 2002 (percent)

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11 Elementary occupations in the informal sector include wage labor in agriculture, fishing, mining and construction, street vendors, domestic helpers, and garbage collectors.
B. Spatial or location-specific factors

22. **Spatial characteristics at the district and DS division levels emerge as strong correlates of poverty.** Households—identical in all characteristics—can have very different likelihood of being poor depending on where they are located. A household located in a DS division with the average characteristics of Colombo district is 7 percent more likely to be non-poor than a similar household in a DS division with the average characteristics of Monaragala district. This highly stylized example illustrates the uneven pattern of poverty incidence can be partly explained by the location of the household.

23. **Poverty is concentrated in areas where connectivity to towns and markets, access to electricity and average educational attainment are relatively low, and agricultural labor is an important source of employment.** Location attributes are highly correlated with each other, which indicate the many-sided nature of challenges faced by poor areas. Remote areas with poor connections to markets and cities are more likely to have lower access to electricity and lower average educational attainment.

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**Figure 6:** (a) Poverty estimates for DS divisions (b) Accessibility index at DS division level

Note: The accessibility index is calculated for every point as the sum of the population totals of surrounding cities and towns inversely weighted by the road network travel time to each town. This map shows the mean of the access values for all points that fall into a given DS unit. The index is a measure of potential market integration reflecting the quality and density of local transportation infrastructure, including 185 cities and towns in the analysis.

Source: Poverty map from DCS 2004; accessibility map based on staff calculations.

24. Multivariate analysis finds that the probability of a household being poor falls by 2–3 percent with every unit increase in the accessibility index. Figure 6 vividly portrays the association between the accessibility index (potential for market integration using distance and availability of roads from towns and markets) and poverty estimates at the DS division level, and is based on the poverty maps produced by DCS. The probability of being poor is also greater when the household is located in a district with a higher proportion of household heads with only primary education and with low electricity usage.

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III. The impact of internal migration—a consequence of rising regional inequality

25. **Migration offers upward economic mobility to those in economically marginal areas.** Migration can affect cross-regional inequality by shrinking wage gaps between regions as people move in response to wage differences, and promote development in lagging regions through remittances sent back to the
migrants’ place of origin. However, migration can also perpetuate regional imbalances, for example when the more educated gravitate toward fast-growing cities.

26. Internal migration has almost doubled between 1996–97 and 2003–04 (from 15 to 29 per 1,000 households). The primary migration destination is Western Province, which includes the Colombo urban area. This trend is consistent with the expanding wage gap between Colombo and the rest of the country, even in elementary occupations (informal sector). The overall economic benefits of migration from rural and remote areas to Colombo are large and have increased over the past decade. In 2003–04, 81 percent of internal migration was by job seekers. A substantial share of household consumption expenditure—around 26 percent—came from remittances in 2002 (using HIES 2002).

27. Poverty incidence in the origin district is strongly associated with recent migration to Colombo. Census (2001) indicates that a large number of migrants come from poorer districts and districts in the North and East. Thus poverty seems to act as a “push” factor inducing households from economically disadvantaged areas to migrate. However, migration is more likely to be undertaken by the better-educated. Figure 7 shows that average education among migrants is much higher than those in their district of origin. This indicates that the better availability of jobs in Colombo acts as a “pull” factor for educated or skilled workers from lagging regions.

28. Migrants are also likely to be better-educated than long-term residents of Colombo. Migrants to Colombo City are almost twice more likely to have tertiary-level education than nonmigrants already living in Colombo City. Similarly, the proportion of migrants working in elementary occupations is much smaller than that of nonmigrants. When the household head is a migrant, the household is also more likely to have good housing conditions and amenities. Therefore, urban poverty is unlikely to be a direct consequence of the rural poor flooding urban centers.

29. Migration out of remote and lagging regions is more likely among the better-educated. It is clear that improving education in remote areas can empower the poor with better choices to improve welfare. But over-agglomeration in Colombo created by the inflow of migrants is leading to congestion and infrastructure bottlenecks and limiting the potential for economic growth. Furthermore, strains on basic city services tend to be concentrated in already underserved settlements, thus reducing the welfare of the poor disproportionately. Cross-country analysis on the relationship between economic growth and urban concentration suggests the optimal “urban primacy” for Sri Lanka (the share of the main urban center of the country in total urban population) at 25 percent. Estimates for urban primacy for the greater Colombo area is considerably above this level at 35–50 percent, putting the estimated “cost” of over-

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12 CFSES 1995–96 and 2003–04. These estimates are likely to understate migration, since migrants in these surveys exclude those who have migrated along with their entire household.

13 CFSES 2003–04. Over the same period, external migration fell marginally from 63 to 60 per 1,000 households, but remittances from abroad grew at 11 per cent in 2003. This report focuses on internal migration because of its close link with widening regional inequalities within Sri Lanka, as well as the current lack of information on the impact of external migration. The latter will be analyzed in detail in an upcoming trade study for Sri Lanka.

14 See Henderson (2000). There are many country-specific characteristics that significantly affect the relationship between urban primacy and economic growth, but are not necessarily incorporated in a cross-country exercise such as this.
agglomeration at more than 1 percentage point in annual GDP growth. The development of alternate urban growth centers would better utilize the economic potential of migration to urban areas.

IV. Poverty in selected sectors and regions

30. Poverty is more prevalent in the estate and rural sectors and is likely to be a serious problem in the conflict-affected North and East. The unique circumstances in conflict-affected areas deserve special attention, especially as more empirical data for this region becomes available, although geographical coverage of household surveys remains incomplete. Poverty in the estate sector remains endemic and is related to issues that are specific to the sector, and thus worthy of special attention. The rural sector is home to most of the poor (88 percent), which implies that significant poverty reduction can only occur when key factors restricting incomes in this sector are addressed.

A. Social and economic conditions in the conflict-affected North and East

31. Over two decades of conflict in the North and East have had far-reaching economic and social repercussions for the country. Over 65,000 people have died, nearly a million citizens have been displaced, private and public properties and economic infrastructure have been destroyed, local economies and community networks have been disrupted, and health and educational outcomes have deteriorated. The macroeconomic impact of the conflict is estimated at 2-3 percent of GDP growth annually.

32. The conflict-affected regions lag behind the rest of the country in availability of economic infrastructure, access to financial services, and key human development outcomes. Only 46 percent of the population in North and East has access to safe drinking water, compared with 62 percent for the rest of the country, and less than one-half of households have access to water seal toilets (Table 2). In the North and East 26 percent of children had low birthweight compared with 18 percent for the rest of the country and 46 percent of children aged 3–59 months were underweight compared with 29 percent for the rest of the country. The literacy rate in Eastern Province is the lowest for the country. Per capita incomes for Northern and Eastern provinces, however, appear similar to those for other provinces with the exception of Western Province, probably because significant inflow of remittances has safeguarded incomes to a certain degree (Table 2). These figures are, however, based on data that do not cover the entire North, including some of the likely poorest areas, and do not take into account spatial price differences that affect comparisons of incomes between provinces.

33. The Cease–fire Agreement signed in February 2002 and subsequent cessation of hostilities spurred economic recovery in the North and East. Real GDP growth in Northern Province increased four-fold to about 13 percent while that of the Eastern Province doubled to 10 percent from pre-cease–fire (1997–

Table 2: Selected provincial indicators, 2003–04

<table>
<thead>
<tr>
<th>Province</th>
<th>Income per capita (Rs.)</th>
<th>Transfers as share of income</th>
<th>Literacy</th>
<th>Access to water seal toilet</th>
</tr>
</thead>
<tbody>
<tr>
<td>Western</td>
<td>6,603</td>
<td>16</td>
<td>96</td>
<td>90</td>
</tr>
<tr>
<td>Central</td>
<td>3,548</td>
<td>17</td>
<td>89</td>
<td>74</td>
</tr>
<tr>
<td>Southern</td>
<td>3,279</td>
<td>18</td>
<td>93</td>
<td>88</td>
</tr>
<tr>
<td>Northern*</td>
<td>3,741</td>
<td>16</td>
<td>96</td>
<td>90</td>
</tr>
<tr>
<td>Eastern</td>
<td>3,162</td>
<td>17</td>
<td>89</td>
<td>74</td>
</tr>
<tr>
<td>North-West</td>
<td>4,139</td>
<td>20</td>
<td>94</td>
<td>86</td>
</tr>
<tr>
<td>North-Central</td>
<td>4,003</td>
<td>15</td>
<td>93</td>
<td>73</td>
</tr>
<tr>
<td>Uva</td>
<td>2,769</td>
<td>14</td>
<td>93</td>
<td>73</td>
</tr>
<tr>
<td>Sabaragamuwa</td>
<td>2,996</td>
<td>14</td>
<td>92</td>
<td>82</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>4,326</td>
<td>18</td>
<td>93</td>
<td>80</td>
</tr>
</tbody>
</table>

*Excludes Kilinochchi, Mannar, and Mullaitivu.


15 Given the limitations of a cross-country regression, this number is speculative. At the same time, it is a useful illustration of a broader point that Colombo urban area is overconcentrated, which in turn imposes economic losses on the country.


(2001) to post-cease–fire (2002–03) years. Unemployment fell from 13 to 9 percent in the North and from 16 percent to 10 percent in the East from 2002 to 2004, while the national unemployment rate dropped only marginally from 8.8 to 8.3 percent.

34. **Significant constraints to sustaining high growth in the North and East remain.** These include (i) poor availability and access to financial services, (ii) poor access and quality of economic infrastructure (roads, telecommunications, and water), (iii) time restrictions on the use of the A9 highway, (iv) fishing restrictions, (v) limits on mobility in certain areas such as Jaffna, and (vi) outmigration of the better-educated to the rest of the country or abroad. The tsunami of 2004, as mentioned above, is likely to have aggravated the poverty challenges in the hardest-hit Eastern Province.

35. **The cease–fire since 2002 has presented the North and East region with the longest semblance of normalcy and peace in recent years.** Initial studies have shown significant peace dividends for the North and East. The sustainability of growth in the region and prospects for significant poverty reduction will depend on whether durable peace is achieved and the institutional constraints mentioned above are addressed.

**B. Poverty in the estates**

36. **The poverty headcount in the estates increased between 1990–91 and 2002 and is now 7 percentage points higher than the national average** (Figure 1). The story in the estates—home to only 5 percent of the country’s population—seems to be one of stagnation, rather than a drastic fall in welfare. A high concentration of consumption per capita within a narrow interval around the poverty line implies that small shifts can result in large swings in poverty, and the large increase in poverty headcount occurred due to a slight shift in the consumption distribution (Figure 3). A comprehensive Estate Household Survey and qualitative study were conducted to examine the determinants of estate poverty in depth and discern patterns among types of estates by size, location, type of crop (tea or rubber), and management (regional plantation company, privately owned and state owned). An Asset Index (AI) score was used as a proxy for household wealth.

37. **Estate households with more earners and with better-educated household heads tend to be better-off.** Possession of National Identity Cards (NICs) among household heads is also associated with significantly lower AI-poverty rates, and those with NICs have better opportunities to earn outside the estates. Ownership of NICs is particularly low among youth (age 16–19), which is probably related to the degree of isolation of households and estates, and, in turn, their increased vulnerability to poverty.

38. **More than 40 percent of estate households rely solely on estate wages for earned income.** The AI-poverty rate is highest among households with wage incomes from only one source, be that within the estate or outside it. Regression analysis shows that while wage employment outside the estates is not associated with significantly higher welfare or earnings, households that receive income from enterprises tend to fare better. Therefore, **diversifying to occupations beyond wage employment—particularly to income from enterprises—is associated with higher welfare, a pattern that also holds for the rural sector (see below).**

39. **The “ideal” diversified livelihood portfolio of an estate household would include remittances from household members working overseas.** Consistent with countrywide trends, estate households that receive remittances from overseas migrants tend to be better-off. Internal migration to urban areas, with or without remittances, does not seem to matter significantly for estate households’ wealth or AI-poverty.

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18 Peace Secretariat using CBSL data.
20 AI-Poverty Rate is defined as the percentage of households whose AI scores lie below the 30th percentile. The 30th percentile was used since the poverty headcount for the estate sector is 30 percent.
21 Enterprise incomes come from nonagricultural businesses and from sales of crops, livestock, and livestock products.
This is partly because the rationale for internal urban migration is not limited to short-term earnings, but rather includes the expectation of future opportunities, and access to networks and skills development.

40. **Higher poverty among estate households is associated with the remoteness or lack of useable year-round roads linking the estate to the nearest town.** Nearly 42 percent of estate households cannot use the road to the nearest town at all times of year. Another social factor that emerged from the Estate Survey was alcoholism. About 80 percent of estate respondents mentioned alcoholism as a problem, and 75 percent of community informants reported no improvement over the last 15 years. The increased availability of illicitly produced alcohol was perceived as aggravating the problem.

41. **No clear picture emerges as to why consumption poverty in the estates stagnated or worsened slightly over the past decade.** One trend in employment and diversification data for the period 1996–97 to 2003–04, consistent with higher poverty, is a fall in the average number of income earners in estate households (from 2.3 to 1.7 per household). This may reflect a growing dislike for estate work by youth. The qualitative survey found youth avoid estate work in favor of remaining unemployed until the right opportunity outside estates came their way.

42. **A majority of households interviewed in the Estate Survey reported an improvement in their household conditions in the last 15 years, despite the overall deterioration in the conditions of the estates.** This difference in perceptions is partly explained by the increasing role of nonestate employment among estate residents, which may partly de-link the condition of the estate from that of the household.

43. **Many aspects of health, education, and housing have improved in the estate; and this is also corroborated by the perceptions of respondents to the Estate Survey.** Nevertheless, the estates lag well behind the rest of the country on key indicators of health and education. For example, 37 percent of estate children are stunted compared with 14 percent of rural children; and 48 percent of estate mothers have low body mass index (BMI) compared with 23 percent of rural mothers (DHS, 2000). Qualitative interviews indicated dissatisfaction with the quality of health services. Access to hospital care is a serious concern in remote estates; survey respondents reported an average one-way travel time of more than an hour to the nearest hospital. Households perceived an overall improvement in access to education over the past 15 years, but the cost and quality of education and teacher shortages were frequently raised as concerns.

44. **Nearly 30 percent of the population in the estate sector is poor but only 13 percent of the households interviewed reported receiving cash transfers from government welfare programs.** The actual coverage rate in the estates contrasts sharply with the Samurdhi coverage rate for the rest of the country (40 percent). Coverage by other social programs—with the sole exception of sanitation—also appears to be low. Programs in childcare, early childhood development services, housing, training and awareness, and microcredit reach less than 15 percent of the households sampled in the Estate Survey.

45. **Poverty traps in the estate sector and remote, rural areas of Sri Lanka share many characteristics, including a lack of connectivity and access to infrastructure to lack of education.** Internal and external migration rates and participation in self-employment for the estates, although improving over time, are well below the rates for the rest of the country (CFSES). A long history of isolation of these communities has contributed to inadequate networks and mobility beyond the estates. Even when estate residents are able to find work in outside jobs or migrate to urban areas, the opportunities are limited due to lower education attainment.

46. **Qualitative analysis indicates that a root cause of persistence of poverty in the estates is the unique organizational structure of estates.** Historically, the estates have employed resident workers who originally came from a foreign country; and even today, much of the labor is provided by a resident workforce. The relatively unchanged estate organizational structure is found to contribute to a sense of marginalization, leads to isolation, and adversely affects economic decisions of households. The long-term future of the sector appears to be in moving away from resident labor structure and toward a
standard employer-employee relationship. For this to work, however, the commercial viability of estates has to improve to support higher labor productivity and wages.

C. The challenge of rural poverty

47. Poverty reduction in the rural sector—home to 80 percent of the population and about 3.5 million of the country’s poor—has been stymied by stagnation in the agricultural sector. Nearly 58 percent of the rural population depends on agricultural, at least partially, for their livelihood. Agriculture GDP growth slowed from 2.8 percent during the 1980s to 1.6 percent during the 1990s and to 0.9 percent during 2002–04, while national GDP has been growing annually by 5 percent since the 1990s.

48. Households dependent on agriculture tend to be poorer (Figure 8). Nearly 24 percent of rural agricultural households are poor, compared with only 16 percent of nonagricultural households. In the poorest province of Uva, the poverty rate for agricultural households (34.3 percent) is double that for nonagriculture households (16.9 percent) (Figure 8), yet agriculture comprises 53 percent of GDP in Uva. Even in Western Province, where agriculture makes up only 3 percent of provincial GDP, and where market access and economic infrastructure are substantially better than elsewhere, 15 percent of households engaged in agriculture are poor compared with 9 percent of those engaged in other activities (Figure 8). According to CFSES (2003–04), the average monthly income of those engaged in agriculture is only 60 percent of that in industries and less than one-half of that in services.

49. HIES data shows skewed and limited improvement in incomes in rural areas, especially among agricultural households. The poorest 7 percent of rural and 10 percent of agricultural households suffered a decline in real income between 1995–96 and 2001–02. Only 19 percent of agricultural households experienced an income increase greater than 10 percent. Raising agricultural productivity is therefore imperative for reducing rural poverty. Existing studies indicate that policies to ease farmer access to improved technologies and ensure sustainable use of water and adjustments in existing trade and land policies can facilitate higher productivity.

50. The growth of the rural nonfarm sector has significantly contributed to a reduction in rural poverty. The nonfarm sector has become increasingly important in rural areas, generating 67 percent of rural employment in 2003. Nearly 52 percent of the average rural household’s income came from nonagricultural wages and self-employment in nonfarm enterprises (HIES, 2002). Even for households engaged in agriculture, the share of nonfarm income in their total income exceeded that of agricultural income. The relative importance of nonfarm income is higher for paddy farmers (probably because paddy

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22 DCS HIES 2002.
23 Staff calculations based on data from Central Bank Annual reports, various years.
24 Sectoral contribution to provincial GDP from Central Bank data (2004).
25 See, for example, World Bank (2003) and World Bank (2004c).
26 Of the estimated 620,000 rural nonfarm enterprises scattered throughout the country, most are in manufacturing (41 percent) or trading (38 percent). The average rural enterprise is a microenterprise employing about 2.4 workers including hired labor, family members, and the relatively young, with an age of about 9 years.
has lower value and its cultivation requires less labor days than most crops) and lower for farmers growing crops like tea, rubber, fruit, and vegetables. Among rural households owning and operating a nonfarm enterprise, the poverty rate is 13 percent, compared with 23 percent for households without a nonfarm enterprise. The monthly income per capita for households operating a nonfarm enterprise is 20 percent higher than households without such income.

51. **Limited employment expansion in the agricultural sector means that poverty reduction will critically depend on the rate at which the rural nonfarm sector can absorb workers from the growing labor force.**\(^{27}\) Major obstacles for rural nonfarm enterprises include poor transportation, problems with accessing finance and the cost of finance, access and quality of electricity, and marketing difficulties.\(^{28}\) The high correlation of location-specific characteristics (like accessibility and electricity use) with the pattern of regional poverty in Sri Lanka (section II) reinforces this view. Addressing these constraints will improve opportunities for the estate population as well, since employment in enterprises is associated with higher earnings in the estates.

**V. Concluding remarks**

52. **Poverty reduction has been slow due to widening inequalities among income groups and across regions, and because growth is concentrated in Western Province.** More inclusive economic growth will require easing specific constraints affecting particular sectors, regions, and groups, but priorities critical for all include improving the quality of education, access to infrastructure like electricity, connectivity to markets and urban centers, and access to finance for microenterprises. These improvements will expand opportunities for the poor and those in lagging regions in terms of moving to higher paying occupations, setting up or expanding microenterprises, or migrating to work in modern industries. Since many of these opportunities are created in the urban sector, poverty reduction will require better and simultaneous coordination between rural development strategies and urban planning and development.

53. **Policies to address poverty reduction must address multiple dimensions simultaneously.** The President’s Manifesto—Mahinda Chintana—with its focus on improving the road network, access to electricity and access to finance outside Colombo is consistent with the needs of lagging areas and sectors identified in this report as drivers of change to accelerate growth and poverty reduction. Improving the connectivity of poorer and remote areas to markets will be particularly important, as illustrated by the resurgence of economic growth in the North and East following the opening of the A9 highway to Jaffna.

54. Table 3 summarizes key cross-cutting and sector/region specific findings along with their implications for the way forward in terms of policy priorities and knowledge gaps for future analysis. The analytical underpinnings for these conclusions are found in the chapters that follow.

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\(^{27}\) In 2003, 82 percent of the total labor force of roughly 7.2 million workers was in rural areas, and nearly 106,000 people join the labor force every year.

\(^{28}\) ADB and World Bank (2005).
| Table 3: Key findings, implications, and knowledge gaps |
|----------------------------------|----------------------------------|
| **Main findings**                | **Way forward and knowledge gaps** |
| **Basic facts about poverty and vulnerability** |                           |
| • Poverty reduction has been slow during the past decade and uneven across sectors—rapid in the urban sector, but slow or stagnant in rural and estate sectors. | • Economic growth needs to be more inclusive of lagging regions and poor households. A better understanding of the patterns and causes of poverty requires representative household data for the entire country, including the North and East. |
| • Poverty reduction has been dampened by rising inequality between as well as within sectors and regions. | • Current social welfare programs like Samurdhi perform well below their potential, primarily due to targeting problems. |
| • High concentration of population around the poverty line suggests a sizeable vulnerable population at risk of falling into poverty in the aftermath of shocks. | • A better targeting system (as currently being employed in two Northern districts) will improve the impact of Samurdhi programs. |
| **Cross-cutting issues associated with poverty and inequality** | |
| **Causes and impact of regional/spatial inequality:** |                           |
| • Poor areas characterized by low connectivity to markets and towns, low availability of electricity and human capital. Largest gaps exist between Western Province and the rest of the country. | • Improving connectivity of remote areas to market centers and infrastructure availability. |
| • Migration into Western Province has increased rapidly in recent years due to rising gaps in economic opportunities. | • International experiences suggest investing in transport infrastructure is effective to develop regional growth centers, when complemented by investments in key areas (e.g., access to finance and electricity). Further analysis is needed to identify the comparative advantages of specific investments and interventions to exploit those advantages. |
| • A high proportion of migrants originate from poorer and conflict-affected districts. | • Improving education and skills in remote areas can enhance employment choices, including the ability to migrate. |
| • The ability to migrate appears to be linked to education. Migrants in Colombo tend to be better-educated than nonmigrants at origin and destination. | • Better urban planning and quality of urban services can help reduce the costs of overconcentration and mitigate its impact on the poor. |
| • Migration adds to the growth potential in the urban center. However, overagglomeration in the Colombo urban area can limit growth potential and reduce welfare due to increased costs of congestion and strain on services. | |
| **Human development:** | |
| • Basic welfare indicators (e.g., child and maternal mortality, primary and secondary enrollments) are generally high for both the poor and nonpoor. But rich-poor gaps exist along certain dimensions that can have lifelong effects on earnings, and perpetuate poverty across generations. | • Reducing income poverty is likely to reduce malnutrition in the medium to long run. In the short term, nutritional outcomes will benefit from improving access to safe water and sanitation and nutritional awareness. |
| • Poverty is associated with higher rates of malnutrition among women and children and lower education attainment; poor children are more likely to drop out and not be enrolled at grade 10 and above. | • More analysis is needed to explain high dropouts among poor children. Key question: are dropouts explained by supply or demand side factors, or a combination of both? |
| • Quality of education, particularly outside urban areas, is an area of concern. The poor are especially affected, since they may not be able to compensate fully with private tuition. | • The quality of learning could be improved by emphasizing English and information technology skills and ensuring teacher deployment to rural areas. |
### Region/sector specific issues

#### Rural sector:
- Poverty in rural areas is higher among agricultural households, due to stagnation in agricultural incomes during the past 10 years.
- Rural nonfarm sector has become increasingly important for employment and incomes; and income from nonfarm enterprises appears to reduce poverty.
- Given limited opportunities in agriculture, poverty reduction can be improved through growth of the rural nonfarm sector to absorb workers from the growing labor force.
- Improve farmer access to technologies, trade, land and irrigation to help raise agricultural productivity.
- Obstacles to growth and the start-up of new enterprises include access to and quality of energy and transport, as well as access to finance.
- Improve access by rural entrepreneurs to markets and market information.

#### Estate sector:
- Lags behind national averages in poverty rates and human development (e.g., malnutrition and educational attainment). In the estates the concentration of consumption around the poverty line is much higher than for the country as a whole.
- Poverty is higher in estates that lack an all-season road to the nearest town. Not possessing a NIC is linked with higher poverty among households.
- Income from outside enterprises and remittances from overseas migrants reduces poverty. But the ability of estate households to diversify their sources of income is low compared with the rest of the country.
- Economic decisions and opportunities are adversely affected by marginalization from the mainstream, and the current organizational structure of estates.
- Improving connectivity to towns, coverage of National Identity Cards and quality of health and education services can help improve economic opportunities.
- Increasing the coverage of Samurdhi transfers in estates can take many above the poverty line.
- Expansion of coverage of social programs in microfinance and skills development can improve households’ ability to diversify to other income activities.
- More analysis is necessary to explore how to improve the commercial viability of estates, and move the structure toward a more standard labor arrangement.

#### Conflict-affected areas:
- The conflict-affected North and East lag behind the rest of the country in economic infrastructure and key human development outcomes.
- Remittances appear to have contributed to safeguarding income and consumption levels to a certain extent.
- The cease-fire since 2002 has spurred enough economic recovery in the North and East to increase real GDP and reduce unemployment.
- Removing constraints on the mobility of people and goods, such as on fishing and on hours of operation of the A9 highway, will yield significant economic benefits.
- Filling knowledge gaps in the patterns and causes of poverty will only be possible with more complete and representative household data.
- Sustainable peace remains a necessary precondition for sustained economic growth and poverty reduction in this region.