What can Sri Lanka and Africa learn from each other?[1]

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Even the title of this paper, let alone the topic, may seem a bit odd. Sri Lanka is a small island of 20 million people, and Africa[3] is a diverse continent of 47 countries and 800 million people. Furthermore, Sri Lanka is on the verge of becoming a middle-income country with human-development indicators that are comparable to rich countries, while most African countries' per-capita incomes are less than half of Sri Lanka's, and health and education levels correspondingly lower. Perhaps some of the high-performing, smaller island economies of Africa, such as Mauritius or Cape Verde, would make better comparators with Sri Lanka.

But for three reasons, this paper will compare and contrast Sri Lanka with the whole African continent. First, Sri Lanka is the land of my birth and Africa is the region I have spent most[4] of my working life studying. The paper is an attempt to bridge the personal with the professional. Second, both Sri Lanka and Africa are at a critical juncture in their histories. Sri Lanka has just ended a 25-year-long civil war, which opens up opportunities for sustained economic growth. Africa, after the "lost decade" of the 1980s, had been enjoying a period of relatively rapid economic growth until the onset of the global economic crisis; whether it can resume that growth path and accelerate it is the most important question facing the continent. Third, on closer inspection, it turns out that large parts of Africa and Sri Lanka have much in common, and many differences, both of which provide an opportunity for cross-regional learning.

The most important similarity is that both Sri Lanka and Africa have fallen short of their potential. In 1962, both Ghana and Sri Lanka had higher per capita incomes than the Republic of Korea. Today, Korea's average income is twelve times Sri Lanka's and 30 times Ghana's (Figure 1).

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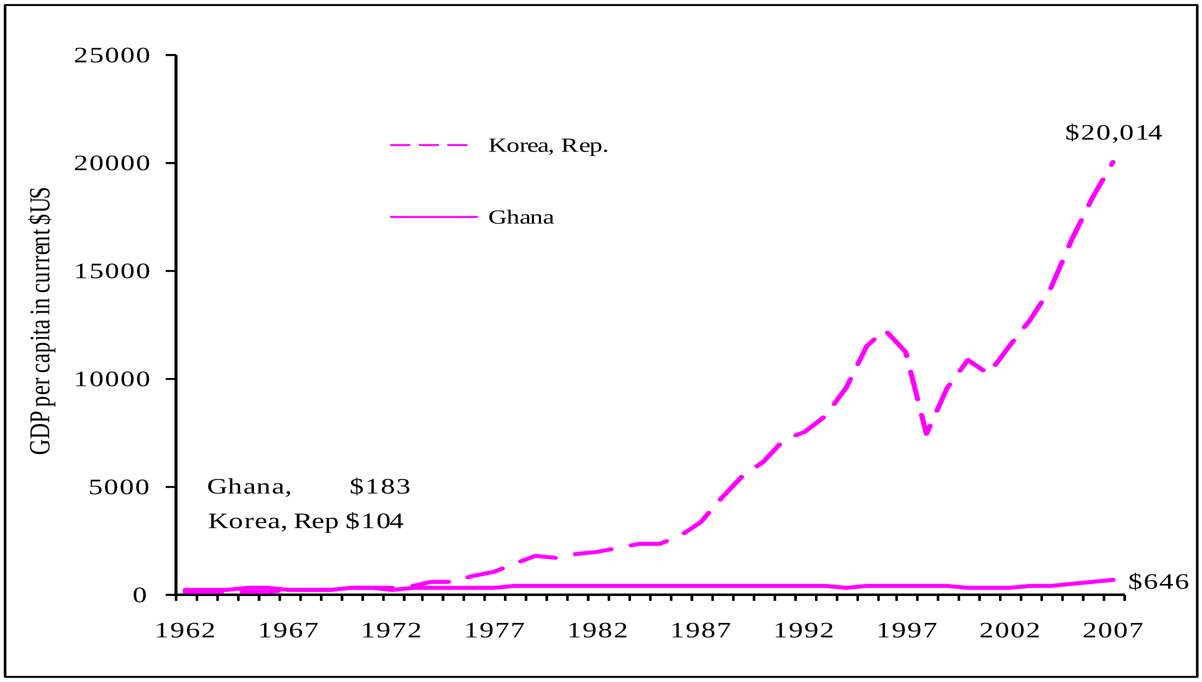
[1] Inaugural Address at the Annual General Meeting of the Sri Lanka Economic Association, Colombo, Sri Lanka, September 11-12, 2009.

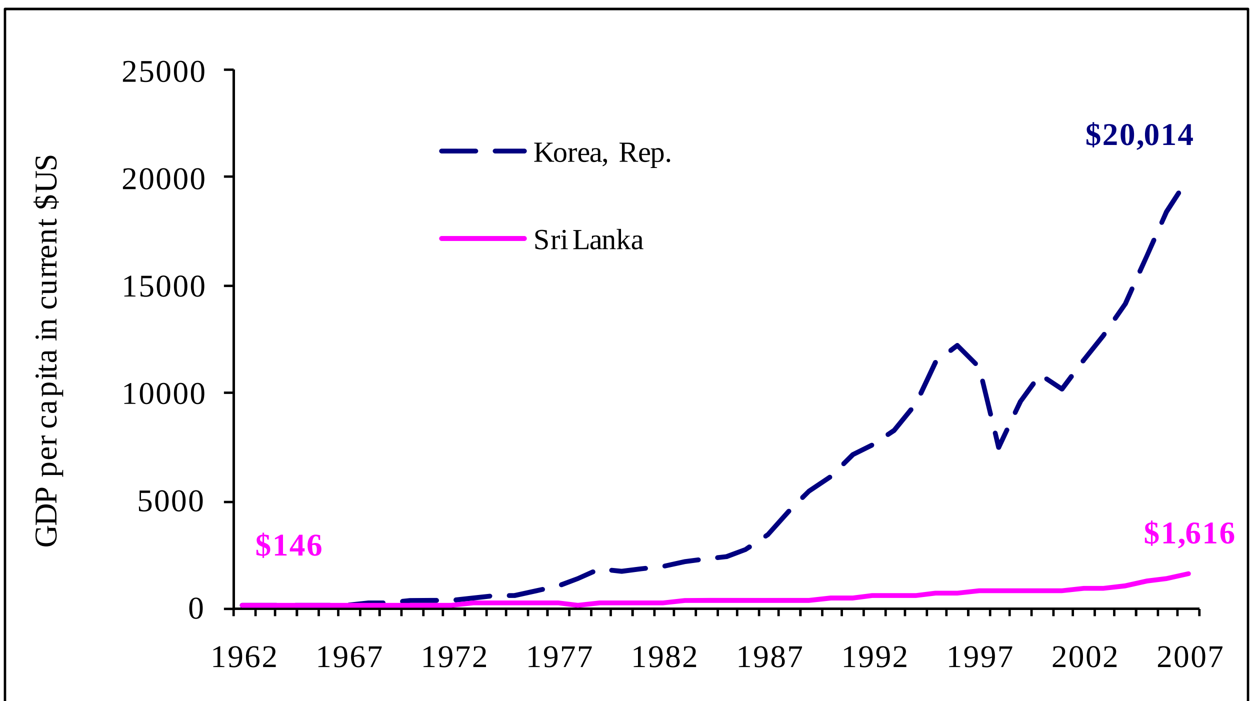
[2] Chief Economist, Africa Region, World Bank. Without implicating them, I am grateful to Claus Astrup, Mapi Buitano, Dan Biller, Naresha Duraiswamy, Naoko Ishii, Shekhar Shah and Xiao Ye for helpful comments and assistance in preparing this paper. The views expressed are mine and not necessarily those of the World Bank.

[3] Throughout the paper, Africa refers to Sub-Saharan Africa.

[4] Except for four years (2004-2008) when I was the World Bank's chief economist for South Asia.

Figure 1: Growth in Korea, Ghana and Sri Lanka





Source: World Development Indicators, World Bank

The reason this is a sign of below-potential performance is that Sri Lanka and several African countries—unlike Korea—were thought to have initial endowments that would generate rapid economic growth. In the African case, the endowment was natural resources such as oil and minerals. Africa's mineral endowment has been estimated at about $600 billion (Collier and Venables [2008]). Had this asset yielded even a 5 percent rate of return, it would have been generating an income equivalent to 7 percent of GDP every year.[5] Instead, the per capita income of Africa's natural resource producers has been growing more slowly than that of non-mineral countries (Sachs and Warner [2001]). One oft-cited example is Nigeria, whose per capita income in 1970 (before the oil boom) was[6] $913; today it is $454.

Sri Lanka does not have many natural resources, but it does have a huge asset in its human resources—reflected in the high levels of literacy and low levels of child and maternal mortality that have stood out since the 1960s. Noting Sri Lanka's high life expectancy and low child mortality rate, Sen [1981] calculated that Sri Lanka's per capita income should be about $2,684 (close to Japan's at that time) and not $130. Today, Sri Lanka's life expectancy of 72 and 78 years for men and women respectively is comparable to those of Malaysia, Mexico and Turkey, countries whose per capita incomes range from $6,500-8,000. In fact, there is no country with a lower infant mortality rate and lower per capita income than Sri Lanka (Figure 2). Lee Kwan-Yew [1998] famously observed, "When I went to Colombo for the first time in 1956 it was a better city than Singapore in the 1950s." Singapore's per capita income is now 20 times that of Sri Lanka.

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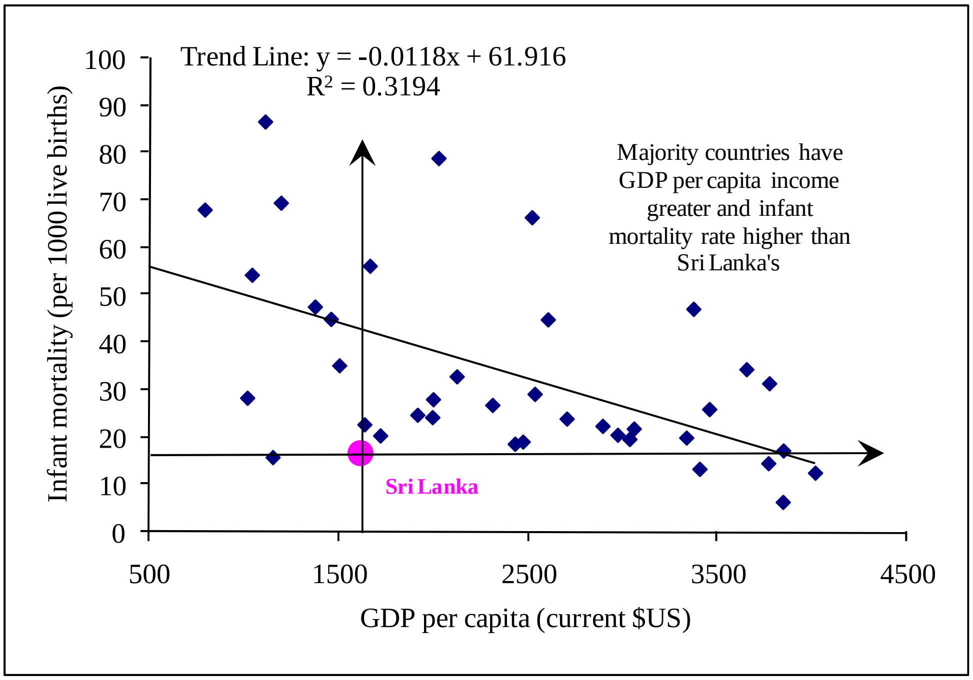
[5] Furthermore, as Collier and Venables [2008] point out, the potential assets under the ground in Africa are possibly five times this figure.

[6] All per-capita income figures are from World Development Indicators, World Bank

Figure 2: Infant mortality and per capita income



Source: World Development Indicators, World Bank

Why have Sri Lanka and Africa have failed to maximize the benefit of their assets? The answers are both similar and different. In the African case, there is a large literature showing that the presence of natural resources contributed to countries' slow growth rates. The explanations for the "natural resource curse" (Auty [1993]) fall under three broad categories. First, natural resources have been blamed for undermining export growth because they cause the real exchange rate to appreciate—the phenomenon of "Dutch disease" (Benjamin, Devarajan and Weiner [1989], Younger [1992], Rajan and Subramanian [2006]). While this may explain why African countries have not been able to develop fast-growing tradable sectors, it does not explain why their nontradable sectors (which would boom in the same setting) are also inefficient and performing poorly.

The second explanation is that in ethnically heterogeneous societies, there is a strong temptation to capture the resource rents for one's own group. When each group tries to do this, civil and armed conflict results. Collier and Hoeffler [2004] find that in countries where primary exports exceed 32 percent of GDP, the probability of civil war in any year is 22 percent. In heterogeneous societies with a dominant ethnic group, this probability doubles. The protracted civil wars in Liberia and Sierra Leone are classic examples. And civil wars are costly. On average, they reduce a country's GDP growth rate by 2-3 percentage points a year. Collier and Hoeffler conclude that, while many civil wars are started on grounds of grievance (an ethnic minority feels discriminated against), they are largely fueled by "greed."

Dutch disease and civil war cannot be the only explanations, however. Nigeria's per capita GDP was almost twice as high as it is today in 1970—two years after the end of the civil war. The third explanation for the natural resource curse stems from the observation that public expenditures in general, and public investment in particular, are systematically worse in natural resource rich countries (Gelb [1998], Auty [1993], Bevan et al. [1999]). At the aggregate level, governments tend to sharply increase investment and public spending during commodity booms (often accumulating high debt), only to find that they cannot complete, much less maintain, these investments when the price falls. Furthermore, the choice of investments is often dictated by presidential preferences rather than economic analysis (Ayogu [2000]). Several people (Sala-i-Martin and Subramanian [2003], Devarajan, Le and Raballand [2009]) suggest that the underlying reason for the mismanagement of resource revenues is that resource rents are different from other types of government revenues inasmuch as they accrue directly to the government rather than flowing through the hands of taxpayers. This difference means that citizens are less likely to hold governments accountable for public spending decisions because they do not feel it is "their money." The result is less citizen scrutiny of public spending decisions and, eventually, poorer decisions. The fact that there are several proposals to redistribute part or all resource revenues in a lump-sum fashion to citizens (Sala-i-Martin and Subramanian; Devarajan, Le and Raballand), a practice that the State of Alaska pioneered some 30 years ago[7], is testimony to the need for greater citizen accountability over public spending decisions in resource-rich states. The idea also echoes the conclusion in Bevan et al. [1999], who looked at commodity price shocks in general, and found that those governments that passed on the windfall gains to producers (by lowering export taxes for instance) had better outcomes than those that kept the gains in treasury coffers. Finally, there is now a growing body of evidence that greater citizen monitoring of service delivery leads to improved outcomes (Reinikka and Svensson [2004]).

The accountability argument can shed light on another type of income that Africa has been receiving—foreign aid—whose productivity has been questioned. Boone [1996] and others have found that the billions of dollars that Africa received in foreign aid through the mid-1990s produced little in terms of economic growth or human welfare. Devarajan, Easterly and Pack [2001] show that, had Africa invested the foreign aid it received from 1960 to 1996, with a modest rate of return, its per capita income would have tripled, rather than increasing by a mere 20 percent (Figure 3). To be sure, the reasons why foreign aid may not have been productive in the past have been analyzed extensively (Burnside and Dollar [2000], Rajan and Subramanian [2006]), and there is considerable evidence that the productivity of foreign aid has been improving since the end of the Cold War (Collier and Dollar [2002]).

[7] The Alaska Permanent Dividend Program started operating in 1982. See http://www.earthrights.net/docs/alaska.html

Figure 3: Actual and predicted income per capita with foreign aid

556 *Economic Development and Cultural Change*

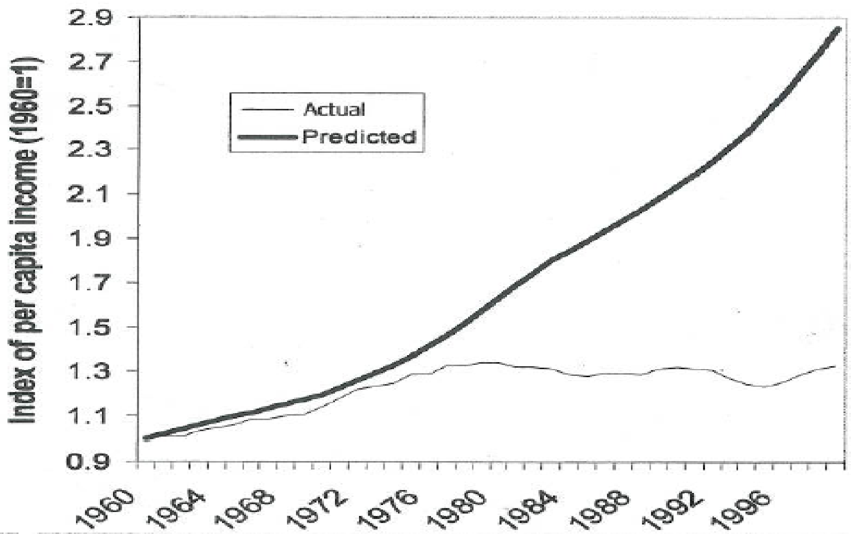


FIG. 5.—Actual and predicted per capita income in Africa with linear investment growth model.

Source: Devarajan, Easterly and Pack [2003]

But the real explanation may lie with one feature that has received insufficient attention. Foreign aid shares some of the same characteristics as natural resource rents: both accrue directly to government, with very little citizen accountability. The spending decisions out of foreign aid are only weakly linked to citizen preferences (but strongly related to preferences of citizens in donor countries). It is probably no coincidence that, as governments in low-income countries increased citizen participation in their poverty reduction strategies in the late 1990s, the effectiveness of aid improved (Devarajan, Dollar and Holmgren [2001]).

Since Sri Lanka has very few natural resources, it does not suffer from the natural resource curse. But as mentioned earlier, it does have another asset—an educated and healthy population—and it is clear that Sri Lanka's performance is not commensurate with these levels of human development. Is the relationship between this asset and the disappointing performance similar to that between Africa's asset and its performance?

First, like many African countries, Sri Lanka experienced a 25-year-long civil conflict, which has been estimated as having reduced the country's growth rate by 2-3 percentage points a year (Kelegama et al. [2004]). To be sure, the actual GDP growth rate during the conflict was quite impressive—an average 4-5 percent a year. Had it been able to grow 3 percentage points a year faster, Sri Lanka's per capita GDP today would be close to that of Malaysia.

While there are many causes of the Sri Lankan conflict, there is considerable evidence that the conflict took a violent turn when groups of educated Tamil youth felt that their opportunities for employment and further education were becoming limited (Tambiah [1986]). And the country experienced two episodes of conflict among Sinhalese youth, in 1971 and in the late 1980s, many of whom were also frustrated by the lack of jobs. In short, Sri Lanka's inability to provide productive employment to its educated youth has contributed to the history of violent conflict, which in turn has undermined economic growth in the country.

Second, even if we put aside the conflict for a moment, there is no question that Sri Lanka has been unable to absorb its educated youth into the productive labor force. The reasons are many, but at least some of them have to do with public policy. Until the late 1970s, decades of "statist" policies had led to very little private-sector growth. Most employment prospects were in the public sector or agriculture, two low-productivity areas. When the economy was liberalized in the early 1980s, there was significant private-sector employment and growth, especially in the light-manufacturing sector in the Western Province (World Bank [2004]). Yet this has not been enough to absorb the large number of young people entering the labor force. Nor has Sri Lanka, despite its stock of potentially high-skilled workers, been able to significantly break into the higher-skilled service exports, such as the information technology industries that are thriving in nearby India. A recent study (World Bank [2007]) indicates that Sri Lanka has not been keeping up with the requirements to enter the knowledge economy in terms of the quality and relevance of its research institutions.

While there are many reasons why Sri Lanka has not yet been able to go beyond the first round of manufacturing-led export growth, four are particularly salient. First, infrastructure has been a constraint to expanding manufacturing and service industries (Castro and Devarajan [2006]). The sorry state of the country's electricity sector, not to mention transport and water, all prevent an employment-intensive export boom from taking place. Second, there is considerable evidence that labor regulations impede employment growth. Sri Lanka has some of the most restrictive labor regulations in the world[8]. The average severance pay is 150 weeks. With these restrictions, the incentive for employers to hire workers in the formal sector is very weak (World Bank [2004]). Consequently, there are a large number of small, informal firms (hiring less than

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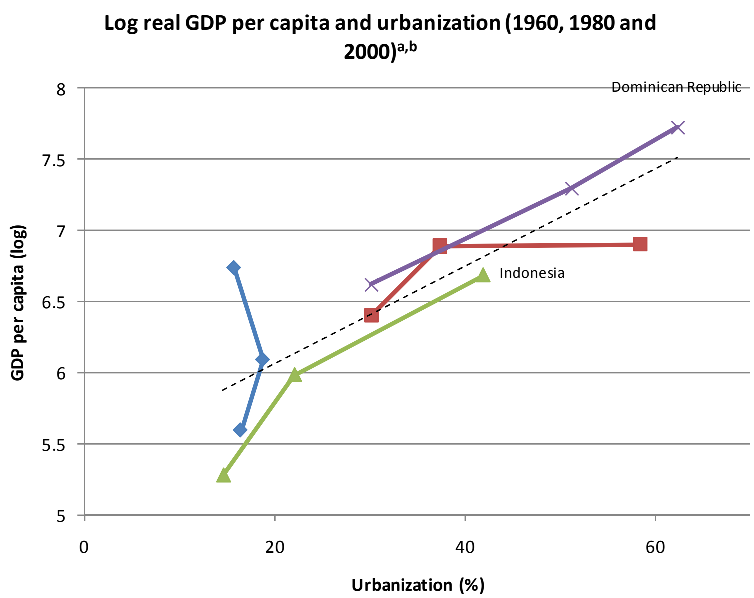
[8]Sri Lanka is ranked 105th out of 183 countries in the 2010 *Doing Business Report*.

15 workers—which is the point at which the labor regulations start binding) that are then unable to exploit economies of scale and expand technology, necessary ingredients for expanded employment. Third, agricultural productivity remains low. Every East Asian country that has achieved sustained, long-term growth has done so by increasing agricultural productivity, thereby releasing labor to work in industry and, eventually, in services. By contrast, in Sri Lanka, an unusually large number of people continue to live in rural areas (Figure 4), eking out a living growing paddy and other low-value crops. And one of the reasons productivity is low is that land regulations in Sri Lanka require many farmers to grow only paddy; and constrain them from leasing their land or even using land as collateral for acquiring other assets.

Figure 4: Urbanization in Sri Lanka and other middle-income countries



Source: UN World Urbanization Prospects: The 2007 Revision Population Database, World Development Indicators

But if Sri Lanka has such a literate population, and is a democracy, how can there be so many policy failures? Why can't the electorate hold politicians accountable for policies that benefit the citizens? This is of course a fundamental question, on which much has been written in general (Keefer and Khemani [2004]). In the Sri Lankan context, I would suggest two reasons. First, interest groups, even if they do not represent the majority, have been able to block these reforms because of their power in coalition governments. The labor unions (like labor unions all over the world) will be opposed to reform of labor regulations; unions operating power utilities will block power sector reform (and occasionally turn off the lights in Colombo to show their clout). Finally, land reform has never made it on the agenda as long as political parties with strong rural constituencies are in the coalition. But even this doesn't answer the question of why the electorate, especially one that is so well educated, does not vote for reforms that are in their interest. This takes us to the second reason: the general lack of an evidence-based public debate on economic policy in the country. As a consequence, the electorate is insufficiently informed about the costs and benefits of various policies. A cursory glance at the newspapers and television in Sri Lanka reveals very little information about the impact of various policies; the discussion is mainly rhetorical. I would conjecture that there is more discussion and information about policy in the newspapers of some African countries (Uganda and Tanzania are good examples) than in Sri Lanka, even though a much larger share of the population in Sri Lanka is literate. In Ghana, when they introduced a major economic reform program in 1983, the finance minister went on television to explain the program (Devarajan, Dollar and Holmgren [2001]). Uganda and Tanzania organized village meetings around the country before embarking on their reforms in the late 1980s. At a minimal level, there is considerable evidence that better information leads to better outcomes (Reinikka and Svensson [2004]).

Like African countries, Sri Lanka has also received large amounts of foreign aid, although the share of aid in GDP has declined significantly. While it is not clear that aid has exacerbated the "weak accountability" problem identified above, there is a related issue with aid in Sri Lanka that deserves mention. There is a long tradition in Sri Lanka of economic policy being discussed with aid donors and their representatives, and not as long a tradition of policy being discussed with the general Sri Lankan public. Saman Kelegama's book, *Economic Policy in Sri Lanka* documents the history of policymaking in the country, written by the architects of the policies. Each chapter describes the discussions these policymakers had with the World Bank and IMF representatives. Nowhere in the book is there a mention of discussing policy changes with the general public.

Unlike the case of the natural resource curse in Africa, therefore, it appears as if Sri Lanka's inability to make full use of its human capital is not due to the human capital itself, but due to a series of policy and political market failures that constrain the country from reaching its full potential. In short, there is no "human resource curse."

There is, however, one aspect of Sri Lanka's health and education system that may contribute to the gap between potential and achievement. Sri Lanka is one of the best examples of how central-government-financed and –provided health and education can deliver exceptional results. To this day, private schools are almost nonexistent in Sri Lanka (at least officially), and there is very little contracting out of health and education services by the public sector: almost everybody delivering these services is a public sector employee. This is in stark contrast to other low- and middle-income countries, such as Bangladesh, India or the Democratic Republic of Congo, where a significant portion of health and education is provided by the private sector, be it financed by the public or private sector. In Sri Lanka, since the central-government model performed so well, there was little incentive to deviate from it. By contrast, in other countries such as India or Uganda, the central government model is not delivering, which is why there is so much pressure to consider alternatives. But the Sri Lankan system has been successful at delivering only the "first-generation" human development outcomes: basic literacy, high enrolment rates, and low child and maternal mortality rates. When you look beyond these indicators, Sri Lanka does not appear to be performing so well. For instance, the quality of education is surprisingly low. Less than one-third of primary school students had a working knowledge of their own language and arithmetic; only ten percent had a working knowledge of English (Figure 5, World Bank [2004]). And the system that brought child mortality rates down does not seem to be able to cope with the huge increase in non-communicable diseases.

Figure 5: Learning outcomes in Sri Lanka

Table 2.11. Primary Education Learning Outcomes by Province, 2003

Province	Proportion of students achieving mastery of their first language (Sinhalese or Tamil) %	Proportion of students achieving mastery of mathematics %	Proportion of students achieving mastery of the English language %
Western	51	52	20
Central	34	33	8
Southern	43	44	13
North-Eastern	23	25	5
North Western	42	43	9
North Central	36	41	8
Uva	34	35	8
Sabaragamuva	40	43	10
Sri Lanka	37	38	10

Source: *National Assessment of Grade 4 Cognitive Achievement, National Education Research and Evaluation Center, University of Colombo.*

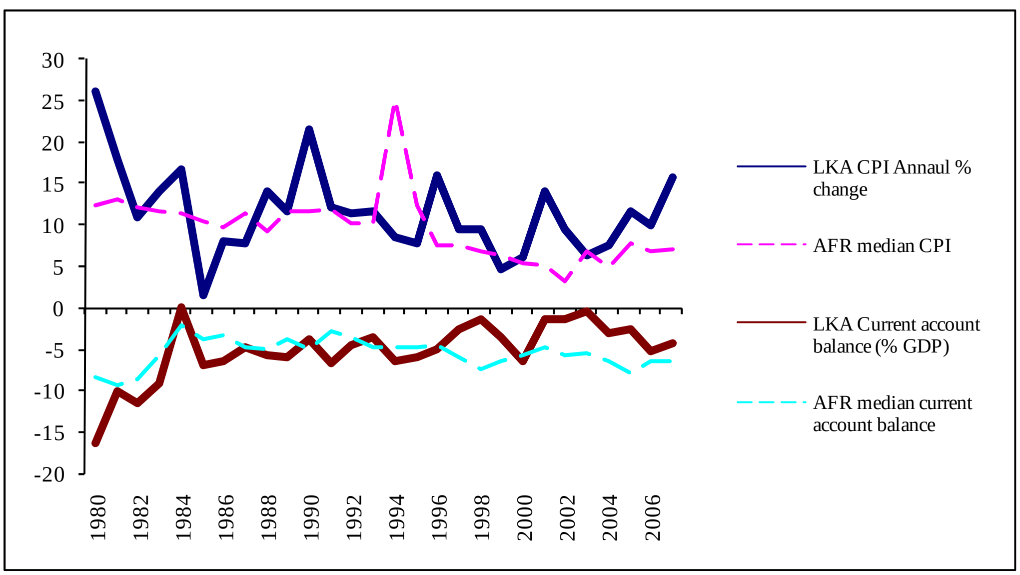
One explanation for this phenomenon is that the central-government model is well-suited to delivering on the first-generation human development goals—primary enrolment and primary health—but ill-suited to tackling the second-generation problems of quality and non-communicable diseases. An arm's-length government system can get students enrolled. But to make sure they learn, a more individual approach is needed. Teachers need the flexibility to adjust to students' learning abilities and backgrounds. And parents (who are well-positioned to monitor whether the student is learning) need the ability to hold teachers and schools accountable for the quality of education. Similarly, reducing child mortality involves mass campaigns (against malaria, diarrhea, etc.). But tackling non-communicable diseases requires behavioral change (cutting smoking, losing weight, taking exercise) and an insurance system that will help contain costs. All these go beyond the central-government model. The education and health systems have to become much more client-focused. But this is very difficult to do in a system that is considered a success. The entrenched interests in the system—teachers' and medical unions—will resist change. Thus, the only sense that Sri Lanka suffers from a "human resource curse" is that it may be a prisoner of its own success.

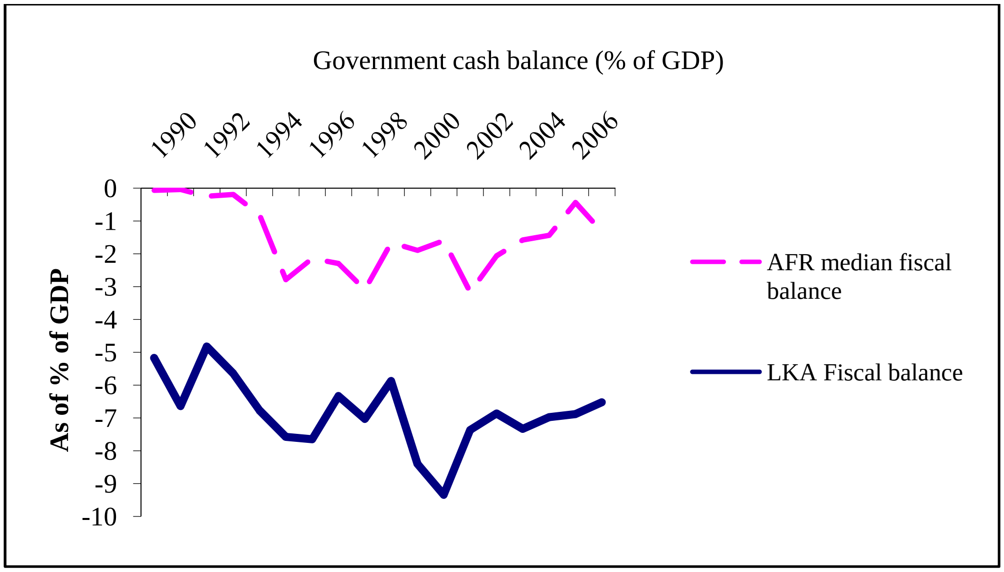
To be sure, there has been reform in both the education and health sectors of Sri Lanka, and all of it has been in the direction of greater client focus (greater autonomy to local education councils, etc.) However, this change should have come long ago, so Sri Lanka could have benefited from the opportunities that a skilled population has in an era of globalization.

There is also a parallel with the Dutch disease problem of natural resources and foreign aid mentioned earlier that afflicts Sri Lanka. Lacking employment opportunities at home, many Sri Lankan workers migrate abroad, sending back remittances to the tune of 8 percent of GDP. These remittances in turn can cause the same pressure on the real exchange rate that natural resource revenues or foreign aid does. We have here the makings of a low-level equilibrium trap. Because there are few export-oriented, employment-intensive industries in the country, workers migrate abroad, sending back remittances that further reduce the competitiveness of the export sector, causing even more workers to migrate, and so on.

Finally, there is another similarity between Sri Lanka and Africa that has contributed to the gap between potential and reality in economic performance: macroeconomic management. African countries have had a long history of high fiscal and current account deficits, inflation, overvalued exchange rates, and debt—all of which undermined growth (Collier and Gunning [1999]). Sri Lanka, similarly, has over the past two decades had the highest inflation and fiscal and current account deficits in South Asia. A comparison between Sri Lanka and the African median shows that the two had similar current account deficits and inflation rates, but Sri Lanka's fiscal deficit has been consistently higher than Africa's (Figure 6).

Figure 6: Macroeconomic balances in Sri Lanka and Africa





Source: World Development Indicators, World Bank

While Sri Lanka has been able to maintain a reasonable growth rate during these periods of macroeconomic imbalances, the stop-go policies that such imbalances trigger have certainly contributed to its inability to generate sustainable employment for its relatively high-skilled population. These macroeconomic imbalances have also made it much more difficult to adjust to adverse external shocks, as Sri Lanka is discovering during the current global recession.

Interestingly, after decades of macroeconomic instability, following the HIPC process, African countries (with some exceptions like Zimbabwe) have pursued prudent macroeconomic policies for over a decade now. The average inflation rate in the continent has dropped by half since the early 1990s. There is some evidence that these macroeconomic reforms have been sustained (as opposed to earlier ones that were reversed). One reason could be that the reforms emerged from a domestic political consensus, rather than being imposed by external actors (Devarajan, Dollar and Holmgren [2001]). In both Ghana and Uganda, the major macroeconomic reform programs were developed from a series of widespread consultations with various stakeholders from throughout the country. And the fact that this macroeconomic stance has generated rapid growth—Africa's growth is now equal to that of developing countries outside China and India—has created political support for even more reforms, and for maintaining macroeconomic stability. Thanks to a decade of macroeconomic stability, many African countries were able to run moderate countercyclical policies in response to the global crisis. The fear that many people (myself included) had that the crisis will undermine support for economic reform in Africa, because the payoffs to reform were suddenly diminished, has not been realized. Most countries are continuing with their earlier reform programs, and some are even accelerating reforms.

In Sri Lanka's case, while the country has not experienced a major macroeconomic crisis (except perhaps in the early 1980s), it has often been on the brink of a crisis, only to be rescued by a favorable external shock—a pattern that led a former World Bank vice-president to declare, "I'm convinced that God is a Sri Lankan." If most African countries can maintain macroeconomic stability for over a decade and a half, despite numerous adverse shocks during the period, it is possible that Sri Lanka, too, will experience a decade of macroeconomic balance in the coming years.

Concluding remarks

What are the lessons that Sri Lanka and Africa can learn from each other? First, the fact that each place has an asset that they have not been able to fully exploit should be a sobering lesson. In Sri Lanka, one often hears, "If only we had some natural resources, we would be so much richer." And Africa is certainly constrained by its low level of human development. The lesson is that it is not sufficient to simply have these assets. You have to manage them, and manage the rest of the economy to make full use of them.

The second lesson is about how to manage these assets. With both natural resources and human resources, there are no technical solutions to their management. Rather, the challenge is to make sure that there is adequate accountability by citizens of politicians so that the decisions that affect the use of these assets are in the citizens' interest. The challenge is particularly difficult because there are intrinsic characteristics in both natural resources and human resources (not to mention foreign aid) that weaken this accountability. If natural resource rents accrue directly to the government, citizens have fewer means or even incentives to hold governments accountable for their use. Publicly financed and provided health and education systems that deliver first-generation outcomes such as primary enrolment and child survival are particularly ill-suited to deliver the second-generation outcomes (that require greater accountability to beneficiaries), but reform of a system that appears to be successful is politically very difficult.

Finally, how can accountability be strengthened? Here the lessons from citizen monitoring of service delivery outcomes, information campaigns, and town meetings to discuss economic policy changes can have a bearing on the sustainability of the outcome. The open dissemination and exchange of evidence-based information is one of the most powerful ways that a citizenry can hold the state accountable.

As I mentioned in the introduction, both Sri Lanka and Africa are facing significant opportunities to get on a path of sustained economic growth and poverty reduction—Sri Lanka because of the end of the conflict, Africa because of its recent growth turnaround. Both have a history of underachieving relative to their potential, so success is not guaranteed. But a comparison of the two histories reveals what needs to be done—strengthen accountability of politicians by citizens—so that these two places can seize this historic opportunity and embark on a period of rapid economic growth and poverty reduction.

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