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INCOME DISTIBUTION AND INCIDENCE OF POVERTY IN SRI LANKA

Ajith Dissanayaka
University of Kelaniya, Kelaniya, Sri Lanka.
Corresponding Email: ajith@kln.ac.lk

Abstract

The purpose of this paper is to examine the income distribution disparity and poverty in Sri Lanka after the policy reforms in 1977, and compare it with the pre-policy reform period. Income distribution in Sri Lanka has been examined, by using both Central Bank Consumer Finance and Department of Census and Statistics Survey's data. The data from the two sources, and from two surveys from the same source, cannot strictly be compared owing to the differences in the methodology used. Data suggests that a trend of more equitable distribution of income has emerged after 1963 up till about 1977. Subsequently, a reversal trend has emerged and the distribution of income has moved to a more unequal trend up until the 1990s. Last decade data, 2010/11, suggests that a reversal trend is slowly emerging though some inconsistency in the data is suspected. This may prove that Kuznet Curves are even true for the Sri Lankan economy. The study identifies that there is a two-way causality between income distribution disparity and the level of poverty.

Keywords: Income Distribution Disparity, Policy Reforms, Poverty, Trade Liberalization.

1. Introduction

Trade liberalization in a developing country, according to the conventional wisdom, must lead to more equitable distribution of income (World Bank, 1997). The reason for such liberalization is that it permits some economies to more align with its comparative advantage, which lies on the labour intensive industrialization, in labour surplus economies. However, in Sri Lanka according to the survey conducted by both the Central Bank and the Department of Census and Statistics, until very recently, income distribution after the policy reform in 1977, has shown a tendency towards greater inequality.

According to Kuznet (1955), a rapidly developing economy's initial income distribution gets skewed, but, subsequently, the distribution becomes more dispersed. This type of Kuznet Curves has been found in almost all rapidly developing economies. However, the speediness and magnitude of worsening income distribution depend on the strategy adopted. Skeweness can be minimized, if labour intensive technology is adopted. Do the latest figures in Sri Lanka support the Kuznet Curve version of income distribution?

Trade liberalization in Sri Lanka was unorthodox in many aspects (Wickramasinghe, 1994). Imports and domestic sectors were liberalized, but the export sector, in particular non-traditional export sector, was discriminated as the import substitution (IS) activities received more incentive than what non-traditional exports could receive. With the introduction of Board of Investment (BOI) in late 1980s, and the adoption of International Monitory Fund (IMF) and International Bureau of Rural Development (IBRD) sponsored restructuring five-year package, liberalization of the export sector, in particular the manufactured export sector, was intensified.

The concept of poverty, which is presented in two different forms, is not easy to define. One is absolute poverty, defined on the basis of income received by or expenditure made by an individual or household. If an individual or a household obtains sufficient income or spends sufficiently to consume a predetermined minimum level of energy, such an individual or a household is not poor. Absolute poverty implies non availability of resources to obtain minimum calories to maintain health and working capacity in accordance with the prevailing food culture of the community.

Relative poverty, on the other hand, is measured by the deviation from a predetermined group, invariably the mean income class. If the number of classes or people falling below this predetermined class increases over time, incidence of relative poverty gets worsened and vice versa. However, a certain degree of ambiguity remains with regards to the conceptualization and estimation of poverty. No definite level of income can be determined which ensures a given energy level, as sometimes different combinations of commodities can ensure the same level of energy. Wastage at different stages is high so that actual quantity which guarantees the minimum energy level cannot accurately be estimated.

In addition, the distribution of different groups below the poverty line creates another problem. If a poor person passes the poverty line by having been able to command sufficient resources, the head count method would indicate that there is a reduction in poverty. What happens if a person improves his income but that is insufficient for him to cross the poverty line? The Head count method indicates that there is no change in poverty. For this problem, Sen (1999) introduced a different method of calculation, an ordinal approach to measure poverty.

Considering the aforementioned scenario, the purpose of this paper is to examine the income distribution disparity and poverty in Sri Lanka after the policy reforms in 1977, and compare it with the pre-policy reform period.

2. Income Distribution Before and After the Policy Reform

A number of surveys have been conducted in Sri Lanka on this regard since 1953 by the Central Bank and the Department of Census and Statistics in Sri Lanka. According to their findings, a sharp drop in the share of the income received by the two lowest, the fifth and the highest income deciles, can be observed from 1953 to 1963; middle income receivers' position has improved during the same period; thereafter until 1973, income distribution in Sri Lanka has moved towards greater equality. This again is unconventional as Sri Lanka has adopted IS strategy during this period. Table 1 below gives the different deciles of population with their respective shares of the total income, from 1955 to 2014.

According to earlier figures calculated two decades ago, in 1985, the share of lower income decile has fallen dramatically, from 1.4% to 0.4%, a fall of 71%, and in 1990/91 the share of the lowest income decile, has again increased dramatically to 1.6%. According to more recent figures, in 2010, the share of the lowest decile has gone down, from 1.1% to 0.3%, a fall of 65%, and in 2014 the share of the lowest income decile, has again increased dramatically to 1.5%. However, this was about 88% of the highest percentage ever received by this decile in 1973, i.e., 1.8% of the total income. This increase in the share of the lowest decile may be the result of poverty alleviation programme initiated during the latter part of 1980s and the expansion of employment opportunities for low income people. In 1985, the share of the highest decile increased dramatically from 33.8% to 49.3%, an increase of 46% from 1981 value. This gain in the highest decile is at the cost of all the other deciles, as none of them showed any increases in its share over 1981. However, in 1990/91, it is only in the eighth decile that the share of the income has fallen marginally from their corresponding value of 1985. In all the others but one, the highest shares were larger. The share of the highest decile fell dramatically, by 21% from 49.2% to 40.5%. If these figures are correct, the income distribution in Sri Lanka again is heading towards a more equitable path.

The percentage of the population living below the average income level in 1990/91 was 70%. This has remained almost unchanged from 1985. It is pertinent to recognize the fact that both in 1985 and 1990/91, the figures presented here are based on the surveys conducted by agovernment departments.

The share of the total income received by the higher decile in 1953 was 28 times that of the lowest decile which rose to 33.5% in 1963. However, a dramatic drop in this quotient can be seen in 1973; it fell by 50% to 16.66. A sudden spurt in this quotient can be seen again in 1978/79, an increase by 95% to 32.5 in more recent years it stood around 25. This suggests that a dramatic reduction in inequality has been observed between the 1963-73 period. Unfortunately, we do not have data for any other year of the import substitution (IS) regime, after 1973. Hence, no concrete assessment of the movement of this quotient can be made over the entire IS period. The next available figures refer to 1978/79, which refer to second and third years of the new policy regime. However, as has shown in later years, the reversal trend emerged after the 1977 reforms; this quotient rose by 95% to 32.5 within a matter of five years.

Gini Coefficient crystalizes the distribution of income into one figure, hence the movement of its value is a better indicator to measure changes in the distribution of income. The Gini ratio in 1953 was 0.50 for income receivers. This fell to 0.49 in 1963 and a dramatic fall of 16% was recorded between 1963 and 1973 to 0.41. In 1978/79, the Gini ratio rose again to the previous value of 0.49. Further increase in the value of Gini ratio can be found in 1980/81 to 0.52. The Department of Census and Statistics in its Labour Force and Socio-Economic Survey shows that the Gini ratio was 0.58 and 0.43 for total household income, the corresponding figures were 0.42 for the former and 0.31 for the latter in 1981, which suggests an increase of about 40% in its value within a four-year time.

However, Household Income and Expenditure Survey of 1990/91 from the same source bring a different value of Gini ratio for 1985 as 0.46 for households. Nonetheless, the value of the Gini ratio presented for 1990 in the same source is 2.3% higher 0.47. According to the Central Bank, it was pointed out that the 1995/96 Consumer Finance Sample Survey are the Gini ratio rose 0.49 and further increase in the value of Gini ratio can be found in 2000/01 to 0.51. After five years, 2005/06 value of the Gini ratio 0.47 and 2010/11 same source is 0.41. According to more recent figures, in 2016 Central Bank Annual report indicated the Gini ratio as 0.42. A confusing picture arises from these figures as the income received by the lower deciles have improved their positions and also the share of the highest decile has fallen dramatically, during the later 1980s period. Hence, there are no reasons to believe that the Gini ratio in fact has increased during this period.

Another important index which could shed some light on to the movement of the distribution of income is the share of the total income received by the lowest 40% of the population. The highest share of the total income received by this group was in 1973, 19.29% of the total income. A declining trend can be seen thereafter, from 1978/79 to 1981/82 from 16.06% to 15.32% and around 7% of income receivers in 1985/86 and in 1990/91 a turnaround took place, as it stood at 13%, same values as that in 1953. The worst situation for the poorest 40% was found in 1985, in which year this group got only 7% of the total income.

These figures can be compared with those of some selected low income developing countries. In Bangladesh, the lowest 40% received 23.7% in 1985/86. In India, in 1983, 20.4% of the total income went to this group. In Pakistan, in 1984/85, 19% was received by this group. In fact, Sri Lanka recorded the lowest share of income received by the lowest 40% of the population; among the low income economies, as reported by the World Development Report 1992. (Share of the lowest 40% in Sri Lanka is given as 11%). After the 2000s, income distribution figures were positive in Sri Lanka economy compared with the above countries. At Bangladesh lowest, 40%, received 21.8% in 2000, in India 19.2% and Pakistan in 18.7%. Sri Lanka lowest 40% received 16% in year 2010 and 2015 same group received 18.2% of the total income went to this group.

A general consensus among the economists is that the import substitution policies would lead to inequitable distribution of income (Little, 1970). However, Sri Lanka was unique in the sense that IS policies were accompanied with a very comprehensive egalitarian welfare package from the state. For example, free or subsidised food, free education, almost universal free state medical services. In addition to this welfare package, more direct measures to reduce income distribution inequalities, such as ceiling on ownership and rent chargeable on dwelling houses, land reforms and price control of basic food items, were also implemented in the 1970s. All these were responsible for bringing about a more equitable distribution of income during the IS.

The turnaround of the existing trend of more equitable distribution of income is to be seen from 1978/79. The exact year of reversal cannot be determined from these figures. However, if circumstantial evidence is accepted, i.e. the change in economic policy after the policy reforms, it can be proved that this turnaround has taken place sometime after 1977. Reasons being, that the welfare package was cut into bones after 1977. The price control was lifted. New industries which started after 1977 were mostly large scale units with high capital intensity. A large number of small and domestic industries went out of production after the policy reforms (IDB, 1983).

The reasons for further increase in disparities in income distribution in recent years were the removal of most of the retained subsidies, in particular subsidy on fertilizer and agricultural credit. The inflationary trend has pushed up wages of the agricultural workers and the small farmers were unable to hire outside labour as it was more expensive thus, substituted family labour. This increased unemployment and under-employment among the landless agricultural workers. Government policy of wages continued to attract foreign investment and prevented the wages from rising to beat the inflation. This resulted in falling of real wages. Income tax rate has lowered consistently leaving the income of the rich at a higher level.

Highest disparity in the urban sector was the result of high rent on real estate, high profit rates on service ventures and high unemployment. The impact of the modernized share market permitted a large number of hitherto non investing middle class people to investment in private industries. The 'share boom' which spurt the market price of shares by manifold, increased the income of the shareholders, who are mainly urban upper and middle classes.

3. Sectoral Differences

Table 2 shows the shares of each quintile of income receivers in 1973, 1978/79, 1985/86, 1990/91, 2005/06 and 2010/11 urban, rural and estate sectors. The income inequality in the urban sector has increased from 1973 to 1978/79; it is only the top quintile in this sector, which improved its relative share. The lowest quintile in the estate sector received a greater share than their counterparts in urban or rural sectors. Income from property was an important source of income for the high income category in the urban sector. After the policy reforms in 1977, rent in urban property accelerated and the imputed income of the owner-occupied dwelling houses increased. This partly explains the high disparity income distribution between urban and the other two sectors and also increase in the income of the highest quintile in the urban sector.

Table 1: Sri Lanka: Relative Income Distribution Data, 1953-2010/11

Decile	1953	1963	1973	78/79	81/82	85/86	90/91	95/96	00/01	05/06	10/11
Lowest	1.51	1.17	1.80	1.20	1.40	0.40	1.60	1.43	1.45	1.79	1.81
Second	3.56	2.70	3.17	2.56	3.10	1.10	3.20	3.12	3.22	3.47	3.87
Third	3.56	3.56	4.38	3.60	4.40	2.00	3.90	3.45	3.13	3.56	4.01
Fourth	4.37	4.57	5.70	4.76	7.40	3.60	5.00	4.69	4.65	4.37	5.21
Fifth	5.71	5.55	7.10	5.93	5.80	4.90	6.10	6.17	6.15	6.54	6.79
Sixth	6.31	6.82	8.75	7.29	8.10	6.80	6.93	7.12	7.03	6.79	8.04
Seventh	7.94	8.96	10.56	9.20	8.60	8.10	8.27	9.13	8.79	9.09	10.21
Eighth	10.39	11.46	12.65	11.23	13.70	11.10	10.27	11.34	11.37	12.32	11.56
Ninth	14.16	16.01	15.26	15.26	13.70	12.70	14.10	14.16	14.09	13.51	12.18
Highest	42.49	39.24	29.28	39.05	33.80	49.30	40.58	39.39	40.12	38.56	36.32
Gini Co.	0.50	0.49	0.41	0.49	0.52	0.58	0.47	0.49	0.51	0.47	0.41

Source: Central Bank of Sri Lanka- Consumer Finance Surveys, Department of Census and Statistics (various years).

In 1985 highest inequality of income distribution was found in the urban sector. In 1978/79 too, the same picture was to be found and according to consumer finance surveys (CFCs), a similar trend had been observed even in 1953, 1963 and 1973 surveys. Understandably, this was due to the heterogeneity of the groups living in that sector. In 1985, nearly 80% of the income receivers, in the urban sector received a mean income less than the mean income of all income receivers. The corresponding figures for rural and estate sectors were 70 and 60 percent respectively.

This in 1990/91 increased marginally in the urban sector to 80.7%. The corresponding figures for rural and estate sectors in 1990/91 were 63% and 54% respectively. In 1990/91, nearly 77% of the urban households received an average income less than the average for the whole of the urban sector, which was almost the same in 1985/86. The corresponding percentages for the rural and estate sectors were 64% and 52% respectively.

Table 2: Mean Income Received by Each Quintile of Income Receivers by Sectors

Year	Quintile	Urban Sector		Rural Sector		Estate Sector	
		%	Cu.%	%	Cu.%	%	Cu.%
1973	Lowest	5.39	5.39	5.35	5.35	7.51	7.51
	Second	10.78	16.17	11.60	16.95	11.73	19.24
	Third	16.15	32.32	16.95	33.90	14.90	34.14
	Fourth	22.36	54.68	23.39	57.29	20.65	54.79
	Highest	45.32	100.0	42.71	100.0	45.21	100.0
	Lowest	3.34	3.34	3.49	3.49	7.73	7.73
	Second	8.49	11.83	8.60	12.09	13.21	20.94
1980/81	Third	13.24	25.07	14.11	26.20	16.79	37.73
	Fourth	19.26	44.33	20.82	47.02	22.22	59.95
	Highest	55.67	100.0	52.98	100.0	40.05	100.0
	Lowest	1.21	1.21	1.41	1.41	1.81	1.81
	Second	5.24	6.45	5.64	7.05	12.04	13.85
1990/91	Third	9.29	15.74	12.22	19.27	18.09	31.94
	Fourth	16.81	32.55	21.28	40.55	23.41	55.35
	Highest	67.45	100.0	59.45	100.0	44.65	100.0

	Lowest	1.40	1.40	1.52	1.52	5.91	5.91
	Second	6.11	7.51	8.07	9.59	18.32	24.23
2000/01	Third	11.12	18.63	13.45	23.04	20.17	44.40
	Fourth	15.20	33.83	25.27	48.31	25.78	70.18
	Highest	66.17	100.0	51.69	100.0	29.82	100.0
	Lowest	2.21	2.21	2.27	2.27	6.01	6.01
	Second	8.23	10.44	9.21	11.48	18.67	24.68
2010/11	Third	13.21	23.65	15.45	26.93	22.06	46.74
	Fourth	16.76	40.41	23.63	50.56	23.43	70.17
	Highest	59.59	100.0	49.44	100.0	29.83	100.0

Source: Department of Census and Statistics, Labor Force and Socio-Economic Survey and Household Income and Expenditure Survey.

The mean income of the richest quintile in the urban sector was markedly higher than the mean income of the rest, suggesting that the rent of the owner occupied houses is still a significant factor and all high income economic activities are still concentrated in this sector. The expansion of the services sector, especially the financial institutions, must have been responsible for this situation. The average income of the urban richest group in 1990/91, was almost double that of the rural highest income group. Another striking thing found in the relative distribution of income among sectors was that the relative importance of the urban sector improved from 28.2% in 1981 to 35.6% in 1985. This position must have further improved in 1990/91, as the highest increase in mean income between 1985 and 1990 was found in that sector.

The highest rate of increase in average income between 1980 and 1990 was found in the urban sector with 11.3%, 57% in the rural sector and 55% in the estate sector, according to the Department of Census and Statistics. This shift of high mean income towards the urban sector is the result of expansion of services sector, particularly banking and other financial services in the urban sector in recent years and also the sky rocketing of house rent. Expansion of economic activities to the other areas after the policy change was very slow. However, it can be surmised that the current position may be slightly different, as a large number of garment factories have moved into the rural sector in last few years, during 1990s and thereafter. The figures for the earlier years are not available.

In the rural sector, the share of the lowest quintile has decreased from 5.39% in 1973 to 3.34% in 1980/81. The income of the higher quintile rose by 24% to 52.98% during the same period. The average income received by the rural sector during this period increased in absolute terms as a result of increase in productivity in paddy cultivation. However, this has not improved the economic position of landless labourers. In 1980/81, 21% of the income receivers waere from casual employment in the agricultural sector, but their contribution to rural income was only 10%. This sheds some light on to the cause of high disparity in distribution of income in the rural sector.

In 1990, the rural sector recorded the lowest ever share to the lowest quintile, 1.4% in 2000. This position improved marginally to 1.5%. However, the share of the highest quintile fell by 10% to 53% in 1990 from 59% of the total in 1990. In all the other quintiles, 2000 shares were higher than the respective 1990 values.

In the estate sector, the highest quintile received less income in 1980/81 than what they received in 1973. The emerging crisis in the tea estates must be the reason of fall in income of the highest quintile. The mean income for the lowest quintile was higher than that in 1973 owing to a sharp increase in estate wages between 1973 and 1980/81. High female activity rates and narrowing of the wage differentials between male and female wages in the estates too, have contributed to this situation. Income distribution in the estate sector in 1990 worsened at a considerably higher rate than in other two sectors.

Another interesting feature is that in 1980/81 the mean income of the poorest 60% of the estate sector income receivers was higher than that of the rural and urban sector income receivers. This suggests that the income position of the poorest people in the estate sector was better than that of the rural counterparts as a result of recent wage increments. Wage income is the most important source of income in this sector. However, despite this higher share of the total, actual income received by the group was significantly lower; the mean income of the deciles falling in to this category in the estate sector was significantly lower than corresponding income of the other two sectors.

Estate sector too recorded the lowest ever share of the lowest quintile in 1985 with 1.8% of the total income. In 2000, this improved to 5.9% an increase of 228%, remarkable achievement. This was mainly due to dramatic rise in the wages during the latter part of 1990s. The highest quintile share fell dramatically in 2000, from 44% to 31%, a fall of nearly 30%. This probably reflects the crisis in the tea estates where apparently the profit rates have taken a downward turn.

4. Incidence of Poverty

According to a study published in Asian Development Review (ADR), the poverty level in Sri Lanka has persisted over 1970s and 1980s, with a slight drop in 1970s. As shown in the article, poverty was highest in the rural sector with about 25% of the population suffering from absolute poverty and lowest was in the urban sector. The Incidence of poverty in 1986/87 was between 28-32%.

Another study on poverty in Sri Lanka, 'Marga' put the poverty line at Rs.37 per capita per month food expenditure in 1973 prices. The study of Gunaratne (1985) determined Rs.70 per capita per month food expenditure as the poverty line in 1980/81. And this was extrapolated both ways by ADR; for 1969/70 the poverty line was estimated as Rs.21 and for 1980/81 Rs. 106. The figure for the year 1973 was Rs. 26.17. This can be further extrapolated by using the index of food expenditure to 1992 and its value in 1990/91 Rs.331, and Rs.392 per capita per month 1992. According to the Household Income and Expenditure Survey 1990/91, 59.2% of the total expenditure went for food and drinks. By using these figures, we can estimate the total expenditure of the poverty lines Rs.559.12, per capita per month, and this works out to Rs.1848.44 per household per month.

If the figures presented by 'Marga' study are extrapolated to 1990/91, the expenditure level of the poverty line is Rs.462.80 per capita per month and Rs.1527.24 per household. The extrapolation used here is a very crude method of estimating poverty because the food habits during this period have changed and the relative importance of different food items would also have changed, resulting in different levels of energy intake for the extrapolated values. The difference in the values shown by the aforementioned studies was due to the difference in the methodology of estimating expenditure, as well as the acceptance of different quantities as minimum calories requirement to qualify to be non-poor.

According to the Household Income and Expenditure Survey 1990/91, per capita expenditure range of Rs.545-623 and below accounts for about 45% of the population or more than seven million people. This suggests that 45% of the population in 1990/91 fall to the category of the absolute poor. However, according to 'Marga' estimates, only 23.8% of 3.38 million people were poor in 1990/91. This is an obvious underestimation of the incidence of poverty in Sri Lanka.

The changes in the incidence of relative poverty can be estimated by examining the changes in the percentage of population falling below the mean or average income for all in the island. If the mean income is assumed as the poverty level in 1985/86, about 70% of the population was earning an income less than the mean income for the whole Island. This means the relative poverty can be determined as 70%. A shown in the Household Income and Expenditure Survey, this percentage has remained almost constant even up until 1990/91.The relative poverty estimated by this method is highest in the urban sector with 80% in 1985/86 that fell very marginally in 1990/91 to 77%. The corresponding percentages for the rural and estate sectors in 1985 were 70 and 60 percent respectively. The figures for 1990/91 were 63 and 54 percent respectively.

If these figures are correct, the relative poverty in all three sectors have fallen from 1985/86 to 1990/91. Not only that the relative poverty has fallen in two sectors, the percentage points of the fall are also almost the same in those sectors. However, the fall in relative poverty in the urban sector is quite low compared to other sectors and it has fallen by 3 percentage points.

Conclusion

In this paper, the income distribution in Sri Lanka has been examined, by using both Central Bank Consumer Finance survey and Department of Census and Statistics Survey's data. However, it has found that these data cannot strictly be compared owing to the differences in the methodology used. Nevertheless, data suggests that a trend of more equitable distribution of income has emerged after 1963 which persisted until 1977. Subsequently, a reversal trend has emerged and the distribution of income has shown more unequal trend up until about 1990. Last decade data, 1990/91, suggests that a reversal trend is slowly emerging, though some inconsistency in the data is suspected. This may prove Kuznet Curves are even true for the Sri Lankan economy.

However, the data for more recent years came from a government department leaves some room for suspicion for their accuracy. The egalitarian policies of the 1960s and 1970s were responsible for the equitable distribution of income during the IS regime. The policy reforms in 1977 were responsible for skewing of the distribution in the late 1970s and the entire 1980 decade. If that recently emerged equalizing trend continues, the credit will go to the labour intensive economic activities and trade liberalization policies which were initiated in 1977.

The study identifies that there is a two-way causality between income distribution disparity and the level of poverty. Moreover, it has found that there are relative differences of welfare standards between urban, rural and the estate sectors, since there are significant disparities of regional development levels.

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