SELINUS UNIVERSITY
OF SCIENCES AND LITERATURE

CONUNDRUM OF STAGNATING ECONOMY AND WELFARE ORIENTED ECONOMIC POLICY
THE CASE OF SRI LANKA

By YASAPALA RATNAYAKE

A DISSERTATION

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Yasapala Ratnayake
Dissertation Advisor: Professor Salvatore Fava.

ABSTRACT:

Keywords: economic growth, economic stagnation and welfare economic policies.

This PhD dissertation on 'Conundrum of Economic Stagnation and Welfare Oriented Economic Policy - The Case of Sri Lanka' examines the nature of relationship between economic stagnation and welfare oriented economic policies of Sri Lana in the post independent period with special reference to the era after year 2000. The conceptual frame of the research identifies dependent and independent variables as economic stagnation and the welfare policies respectively of the incumbent governments that administrated the country from time to time.

The behavior of economic stagnation, the dependent variable, interpreted as the opposite of economic growth, represents GDP, per capita income, balance of payment, government debt, par value of local currency, unemployment, budget deficits and inflation while the welfare policies encompass the proxies including transfer payments, economic concessions, free services, protuberant public sector employment, loss making public sector enterprises and any eleemosynary program that incurs a cost to the exchequer. The intervening variables including fuel prices, world trade cycles and natural calamities are considered as constants anent the study and therefore the paper abstains from examining the impact of such exogeneous variables on economic growth.

Literature review dealt in the Chapter 02 extensively covers the theoretical underpinnings of welfarism commencing from the Classical Economic School to the modern monetarist theory with due reference to Marxism, Keynesian model, which take different stands with regard to the justification of welfare state. The theoretical review concludes with the judgement that the theories in the major stream of economics covertly or overtly do not advocate the welfare state concept in the form that it functions currently.

The research question intended to be addressed in the course of study is formulated as 'is economic stagnation of Sri Lanka caused by welfare oriented economic policies?' which has been converted into alternative hypotheses for the purpose of clarification of the parameters of the study. Since this has been designed as desk research, the researcher heavily used the secondary data sources made available by the Central Bank of Sri Lanka and the Department of Census and Statistics in addition to reports published by the World bank and the Asia Development Bank for accessing the time series data. The analysis of the secondary data in the Chapter 04 provided axiomatic evidence to uphold the hypothesis that the fiscal policies and recurrent expenditure are positively corelated and the combined impact of the relationship negatively influences the economic growth. Evidence surfaced in the course of analysis, especially in Chapter 05, points to the fact that Sri Lanka has been tilting towards long drawn stagnation commencing from year 2000 with some signs shown in the same direction at embryo level even prior to the year 2000.

Self-sustainability of the welfare state concept is critically reviewed in the Chapter 06 with the use of cross country studies including USA, Japan, communist bloc, and

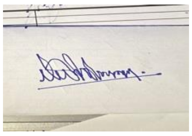
selected European countries and the findings corroborate that welfare state is a semi failure as far as original objectives of welfarism is concerned in addition to its creation of adverse social and economic problems. Chapter 07 represents a written interactive dialogue highlighting parallelism and the relationship between the stagnating economy and the welfare oriented economic policies of Sri Lanka with cross comparison of empirical data related to the thesis's conceptual frame.

In conclusion, the study finds out that the welfare policies of successive governments of Sri Lanka have steered the country towards economic stagnation in addition to the creation of leviathan government with an oversized, mollycoddled and monster layer of public sector bureaucracy.

Declaration:

This dissertation is the presentation of my original qualitative research work. Wherever contributions of others are involved, every effort is made to specify the original source and acknowledge the relevant contributors by name.

The work was done under the guidance of Professor Salvatore Fava of the Selinus University of Science and Literature.



Y Ratnayake

Date:

In my capacity as supervisor of the candidate's dissertation, I certify that the above statements are true to the best of my knowledge and the research wok fulfils the requirements of standards set out by the University for the award of PhD.

Professor Salvatore Fava

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Y Ratnayake

Table of Contents:

Page Nos.

List of Tables: Page No.

List of Figures:

Abbreviations:

AD	:	Aggregate Demand
ADB	:	Asian Development Bank
AFCD	:	Aid to Families with Dependent Children
BOP	:	Balance of Payment
CEED	:	Central Eastern European Countries
CIS	:	Commonwealth of Independent States
GDP	:	Gross Domestic product
GNI	:	Gross National Income
GOE	:	Government Owned Enterprise
IMF	:	International Monetary Fund
MC	:	Municipal Council
MEC	:	Marginal Efficiency of Capital
OECD	:	Organisation for Economic Co-operation and Development
PC	:	Provincial Council
PSE	:	Public Sector Enterprises
SE	:	Social Europe
SOE	:	State Owned Enterprises
UC	:	Urban Council
WB	:	World Bank

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CONUNDRUM OF STAGNATING ECONOMY AND WELFARE ORIENTED ECONOMIC POLICY- THE CASE OF SRI LANKA

CHAPTER 01- INTRODUCTION

1.1. Background to the Study:

1.1.1. Prelude:

Controversy among different schools of economists never ends as to whether state is primarily responsible for the current welfare of the masses or welfare should be generated as a spillover effect of economic growth of a country. As Wordsworth submits(*I*) that the Government exists to provide for the needs of the people, and when it comes to choose between profits and property rights on the one hand and human welfare on the other, there should be no hesitation whatsoever in saying that government is (*we are*)[1] going to place the human welfare consideration first and let property rights and financial interests fare as best they may.[2] For the purpose of contrast a statement made by Margaret Thatcher, Prime Minister of UK of the yore expressing a diametrically opposite view to the first statement, on the same subject quotes that the problem with socialism (*welfarism*)[3] is that you eventually run out of other peoples' money.[4] The subject itself looks like a Pandora's box.

It is an uncontestable proclamation to make that one of the most important characteristics of human development is the accessibility to a satisfactory and sustainable standard of living. The recipe of the "economic miracle" of many countries that have high standard of living, in fact, is simple and quite obvious as all these countries have gone through the cycle of high and sustained development of national economy accompanied by low unemployed population rate and above average growth of income and consumption. There is axiomatic evidence that economic growth paves the way for an increase in the wealth of a country as a whole, enabling a country to extend its strength in the fight against poverty and unemployment while solving the problem of disparity in income distribution as well. That is why a high level of economic growth has been concerned as a prime target of economic policy in many countries around the world irrespective of the political idiosyncrasies of the incumbent regime on the saddle of government.

1.1.2. Sri Lankan Economy:

Right from the inception, Sri Lanka has been experimenting with different economic development strategies since it received independence in 1948; however, the level of success it achieved in the endeavor is a subject of diverse opinions which makes it interesting as well as relevant to conduct an in-depth analysis both in the interest of

1 Italics show the original text.
2 Wordsworth. J. S., AZQuotes.com. Retrieved November 07, 2021, from AZQuotes.com Web site: https://www.azquotes.com/author/44257-J_S_Woodsworth.
3 Italics are researcher's alternations.
4 Thatcher M., 2021, authors/margaret-thatcher-quotes.

cognitive investigation and discovering remedial measure as a solution to the current economic quagmire encountered by the country. Proper understanding of the paradoxical economic experiments of Sri Lanka is virtually impossible without a comprehensive knowledge of its economic and political trailing at least in the past two decades.

Being a mixed economy, Sri Lanka's economic activities hinges upon both the private sector and the state sector that perform an active role parallelly in the production process in the economy. The successive political regimes that governed the country since the year 1948, the year of receiving independence from Britain, have launched multimillion dollar worth of investment projects ranging from free trade zones to large scale land development and hydropower generation ventures. The country's financial network is well developed and in good shape, so that both foreign and local financial institutions function in the economy playing their expected role. From the inception Sri Lanka has adopted the free market ideology with some insignificant deviations accompanied by changes of political regimes, in particular with the control by regimes leaning on left oriented political ideology.

However, this can be construed as a slight deviation from the economic strategy pursued by the British who converted Sri Lanka into a large commercial plantation-based economy with extensive utilization of land for tea, rubber, coconut, cinnamon and other commercial crops. The economy that evolved in Sri Lanka under British rule was predominantly oriented towards agriculture, with plantation agriculture being the major contributor to the nation's growth. The three plantation crops—tea, rubber, and coconuts—accounted for thirty percent of the gross domestic product in 1948 and the bulk of the output was exported. Manufacturing was left behind as an insignificant activity in the economy. Banking, commerce and the physical infrastructure were, for the most part, used only to support plantation agriculture. Nearly all foreign exchange earnings were derived from the plantations. The country depended on imports for nearly three-fourths of its food requirements and almost all of its manufactured goods which manifested a remarkable deviation from the situation of the pre British era dominated by subsistence agriculture.

Sri Lanka by definition is a mixed economy, in which both the private sector and the state sector parallelly engage in the production process. Foreign investments are encouraged by all the regimes as a principle of policy which resulted with the establishment of several free zones and foreign funded projects. Sri Lanka from the inception has been committed to maintain a free market ideology and governed by liberal foreign trade regimes which can be contrasted with such regimes in the world. This accounts greatly to what the Sri Lankan economy looked like during the first three decades after the country gained independence from Great Britain in 1948. Manufacturing was left as an insignificant activity, confined to limited sphere of production in the economy with no encouragement received from government.

In the 1970s, the situation started a turnaround; the Sri Lankan economy has been gradually converted into high degree of diversification; it has established rapidly growing manufacturing and service sectors while agricultural activities have been modernized, and the country has reached nearly self-sufficient in rice production. The significance of the three major export crops (tea, rubber, and coconuts) as the main source of export earnings has fallen (from 90 percent in the 1950s to 16 percent in 1999) and the position of of manufacturing in the GDP has risen (from 1 percent of exports in 1950 to 60 percent in 1999).[5] The changes that emerged in the structure of the Sri Lankan economy are a result of varying economic policy measures adopted by the government since independence.

1.1.3. Closed Economic Policy Regimes:

Development strategies that shaped the Sri Lankan economy over the last five decades may be distinguished under two eras: the first era covering the period between 1948-76, and the second era during the post-1977 period in which liberal economic policies were introduced by the political regime that came into power in the same year.

During the first era, development policy prioritized on achieving the objectives of equity and self-sufficiency in economy of the country. The policy instruments adopted to achieve economic growth were aimed at import substitution industrialization, both in manufacturing and foodstuffs. The key measures used to achieve this growth strategy were the imposition of various restrictions on imports, and the encouragement of domestic production in both agricultural and industrial sectors. Extensive social welfare programs such as price subsidies on comestibles, statutory price controls on consumer goods, price ceilings and the provision of free education and health services were the landmark strategic instruments used for achieving greater equity and economic self reliance. The welfare programs were intensified in this period with the establishment of statutory bodies in support of implementation of welfare programs which resulted in achieving significant improvements in the area of human development, including lower mortality rates, increased life expectancy, and high literacy rates.

However, high welfare expenditures restrained the nation's capital growth and ability to invest which resulted in slowing economic growth and causing high unemployment and low wages. During the 1951-1976 period, per capita gross domestic product grew only at an average of 0.2 percent per year. The achievements of the import substitution policies were even less noticeable and asymmetrical, except in the production of rice and subsidiary food crops. The crisis was brewing gradually with a worsening trade balance deficit; most newly established industries operated well below capacity due to a shortage of imported raw materials. This, coupled with increased government participation in industrial development, crippled the economy with low industrial growth and the modest ability of local industries to remain commercially viable. The continuation of government intervention in all spheres of economic life reached its climax at the end of the first policy era in 1977.

1.1.4. Liberalization of Economy:

The second era of Sri Lankan economic development (post-1977) earmarked a major shift towards a free market economy spearheaded by import liberalization. The strategy aimed at liberalizing the economy from excessive government controls and

5 Annual Report of the Central Bank of Sri Lanka, 1999.

the private sector being granted freedom to perform its role as the engine of growth which is diametrically different from the approach of the policy regime that was in power in pre 1977 era. Policies were redesigned to accelerate economic growth by stimulating private investment through various incentives and also to increase the country's foreign earnings by promoting export-oriented economic activities.

The liberalization policies, pursued under the watchful eye and participation of the International Monetary Fund (IMF) and the World Bank, met with success at the beginning. Stimulated by enhanced levels of foreign aid and investment, the economy registered a rapid surge of growth, recording real growth rates of about six percent per year until 1986. During the following five years, however, there was a marked deceleration of growth caused mainly by the disruptive effects of the ethnic conflict that inflicted fatal blow on economic dynamism experienced at the beginning of the new era. Under the political and economic crunch, Gross Domestic Product (GDP)grew at an annual average of 2.7 percent between 1986-1989, and at an annual average of five percent between 1990-2000 in spite of the adverse political environment prevailed during the period. However irrespective of turbulence caused by ethnic turf of the country, the economy was able to reach, during the second era, a resilient level of income in the economy with the significant growth of per capita gross domestic product more than doubling due mainly to the salubrious impacts created by trade liberalization on the economy. (from US$382 in 1975 to US$802 by 2000)6.

The transition to a free market economy based on a liberalized trade and exchange rate regime, which linked the ring fenced indigenous economy to global trading system, has brought benefits in a glut at the beginning to the Sri Lankan economy. Unemployment, a problem for decades, has declined significantly, and remains at historically low levels of 7.6percent in 2000 which recorded as 15.9 percent in 1997. Nonetheless, the high levels of inflation , fueled by the sharp deterioration of the Sri Lankan currency, combined with the mounting cost of civil war has raised the cost of living to very high levels. The soaring cost of living has made life harder for many Sri Lankans compelling the people to practice austere life style that forced them to struggle hard for satisfying their basic needs on a daily basis.

1.1.5. Signs of Economic Turbulence:

The tilt of the country towards a welfare state was clear and visible in this era with over forty five percent of the population depending on benefits granted under the income supplement programs initiated by the government. The balance of payments problem remains not only unresolved but also indicated further deterioration. The persistent trade deficit has led to increased reliance on foreign aid to meet the country's import requirements, leading to an inevitably mounting foreign debt . Foreign debt as a percentage of the gross domestic product, which accounted for twenty one percent in 1975, grew to seventy five percent in 1994, and amounted to fifty nine percent in 1998.

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6 Annual Report of the Central Bank of Sri Lanka, 2000.
7 Ibid.
8 Annual Report of the Central Bank of Sri Lanka, 2021.

The buoyant economic performance resulted immediately after liberalization with some fluctuations, did not continue with the same momentum beyond year 2000 as unhealthy cracks appeared to be developing in almost all areas of economic performance as far as country is concerned. Although GDP growth rate at constant prices recorded a vibrant 6.0 in year 2000, the same rate experienced a phenomenal decline in the following year to -1.5 (minus) percent due to adverse endogenous and extraneous factors that were in play during the particular year9. The GDP growth rate at constant price exhibited somewhat a recovery process in the subsequent years but the overall trend indicated a downturn with very unstable and erratic behavior of the economic parameters of the country. GNP at current price registered a resilient figure of 12.0 percent in 2003 showing further increases in 2005 and 2006 and culminating at 22.1 percent growth rate in 2007.

However, the steady growth rates abruptly showed a downturn in 2009 with the reported growth rate of 11.0 percent which tantamount to 50.2 percent decline over the previous year. The sharp decline in the GNP in 2009 further escalated in the next few years culminating at a negative growth rate of 0.1(-) in 2020 due mainly to human and natural factors interplaying in the economy in the contemporary period. According to the annual report of the Central Bank of sri Lanka, the average annual real GDP growth at constant prices registered a resilient figure of 9.1 percent in 2012 but towards the end of the decade in 2020 it declined to minus 3.6(-) percent in 202010.The post 2000 era, as above data bear evidence, marks a period of economic turbulence with irregular fluctuations of vital economic barometers; Irrespective of intermittent positive growth rates shown in some economic sectors, there is no uncertainty of what so ever that the country slipping towards economic downturn in the long run.

Amidst the revenue of the country showing all negative signs with the DGP growth rate plummeting slowly but steadily, the government expenditure and general social security systems continue uninterrupted gathering momentum both in terms of scope and expenditure which not only further polarizes diverging economic parameters but also, as an economic system, contested the time tested economic fundamentals accepted globally.

The economic downturn experienced by the country further acceleration in post 2000 era due to the influence of varying socio-economic factors spearheaded by the civil strife that prevailed over thirty years eating into a large chunk of national resources by way of unabated war expenditure. Real GDP growth rate recorded as 5.0 percent in 2015 continuously declined till it reached 2.3 percent in 2019 according to the statistics published by the Central Bank of Sri Lanka. In the meantime, average annual growth rate of population recorded as 0.9 percent in 2015, registered a value of 1.1 percent in 2018 which declined further in the following year showing a growth rate of 0.6 percent.

1.1.6. Polarizing Economic Sectors:

In spite of the contracting GDP, the recurrent expenditure of government has shown a steady growth continuously after year 2000 while the capital expenditure remained consistently dormant during the same period indicating a widening budget deficit in

9 Annual Report of the Central Bank of Sri Lanka, 2021.
10 Ibid.

successive years which as a whole created adverse impact on price stability and standard of living of the people. In addition, the balance of payment situation after year 2000 has not registered a vibrant growth; instead, disturbing development at embryonic stage appeared to gather momentum in the subsequent years surfacing as an emerging economic turbulent period at the time of COVID pandemic entered the country.

The overall economic landscape that prevails in Sri Lanka is lucidly described in the Annual Report of the Central Bank, 2020 as quoted next. "The Sri Lankan economy contracted by 3.6 per cent in 2020 on year-on-year basis in the backdrop of unprecedented disturbances to socio-economic activities due to adverse impacts of COVID-19 pandemic. The pandemic itself, together with related restrictions to contain the spread of pandemic, dragged down the performance of economies all over the world and Sri Lanka was no exception. Some of the business sentiment indices compiled by the Central Bank recorded their lowest values in 2020, particularly during the second quarter, reflecting the adverse impact of the nationwide lockdown"[11].

The pandemic situation severely paralyzed economic activities for which human engagement is vital, such as construction, manufacturing and transportation, in addition to the whole ecosystem built around the tourism industry. The setback in construction and manufacturing activities caused the contraction in industry activities, while service related activities were adversely affected predominantly due to the restrictions in transportation, other personal services, and accommodation, food and beverage services activities. Meanwhile, agriculture activities also recorded a decline largely due to the pandemic-related disturbances, though the conducive policy environment supported the continuation of most agriculture activities even during the lockdown periods.

Investment expenditure contracted in 2020, mainly due to the uncertainty on the recovery timeline of the pandemic, locally as well as globally, whilst consumption expenditure recorded a slower growth. External demand also weakened during the year on the grounds of a loss of growth momentum across geographies with the pandemic. However, the rationalisation of non-essential imports curtailing the merchandise imports during the year, partly contributed to buffer the deterioration in net external demand amidst the contraction in exports.

In 2020, the national savings-investment gap as a percentage of GDP narrowed on account of the considerable contraction in investment expenditure though national savings recorded a decline of 3.6 per cent during the year, compared to 2019. In line with the adverse impact that the COVID-19 pandemic had on economic activities, the labour market exposed its long term fragilities and vulnerabilities, deepening structural issues and inequalities further. Accordingly, resulting in a loss of family incomes, the unemployment rate increased to 5.5 per cent in 2020, the highest since 2009, amidst a considerable decline in labour force mainly due to the drop in female labour force participation. Meanwhile, the unemployment rate amongst females, youth and educationally qualified persons increased considerably in 2020 aggravating the inequalities further. In addition, departures for foreign employment declined sharply

11 Annual Report of the Central Bank, 2020.

amidst the spread of the COVID-19 pandemic, while Sri Lankan migrant workers were also severely affected.[12]

1.1.7. Economy Beleaguered:

By year 2000, as it was described in the previous para, the country was fast sending danger signals from all economic subsectors including GDP, per capita income, employment rate, budget deficit, balance of payment, rate of inflation while facing the challenge of meeting the spiraling government expenditure. Another economic front government beleaguered in is the crisis of foreign exchange reserves. Sri Lanka faces a severe crunch in its foreign exchange reserves, with only enough dollars to cover less than two months of imports. By the end of July, Sri Lanka had just $2.36 billion worth of forex, compared to $6.93 billion in August 2020. The Sri Lankan rupee has depreciated by 7.5 per cent against the US dollar this year. The Central Bank of Sri Lanka recently increased interest rates in a bid to shore up the local currency,becoming the first central bank in Asia to tighten its monetary policies.[13]

The situation review conducted in the previous section bears evidence to substantiate that the country has been gradually slipping down the economic precipice since year 2000 showing all the fundamental characteristics of economic stagnation which makes it a timely requirement for conducting a diagnostic exploration, both in cognitive and practical perspectives, for understanding the process, causes and consequences involved with the phenomenon of stagnation. In the course of the present study, the author has made a concerted effort to diagnose the economic ailments of the country and ascertain whether there exists a cause-and-effect relationship between welfare driven economic policies and economic stagnation of the country as all the above evidences axiomatically suggest.

1.2. Purpose of the Study:

In the ambient of aforesaid economic situation, the main objectives of the dissertation can be viewed from two angels; one is to fulfill the academic requirements of the university for awarding PhD in economics and the other can be sub subdivided into specific four objectives as follows.

1) To examine the economic stagnation and its contributing factors in Sri Lanka with the main focus on the economic performance during the last two decades.
2) To evaluate the repercussion of welfare oriented economic policies adopted by the successive governments in Sri Lanka in the aforesaid period.
3) To assess the nature of relationship between the economic stagnation and welfare oriented economic policies with the application of descriptive research methods.
4) To enlighten the policy makers in formulating economic development policy in general through the lessoned learned from Sri Lanka and abroad.
5) To expand the cognitive boundary of knowledge on welfarism and its theoretical basis and justification.

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12 Ibid.
13 THE WEEK, (2021), Explained: Sri Lanka's economic crisis.

1.3. Significance of the Study:

A thorough survey of literature in the spectrum of welfare economic policy in Sri Lanka reveals that sufficient or comprehensive studies are not conducted in the last two decades thus creating an intellectual vacuum both for academicians and policy makers in the higher echelons of the hierarchy in development administration of government. Since far sighted and result oriented budgetary policies can be considered as the forerunner that finally determines whether a country marches towards economic prosperity or economic disaster, this study is expected to provide an in depth analysis for those who are interested in the practical aspects of development economics. The relationship between two variables, namely economic stagnation and the welfare driven economic policies, has been the subject of theoretical controversy from the very inception of scientific discussions on the role of government but a very insignificant number of studies has been conducted even at international level on the practical problems related to the phenomenon.

When economic decision making is left in the hands of politicians, who are always power conscious, it is natural that the economic policies that favor the voters are always preferred but the long-term repercussions of such policies are not withing the concern of politicians since political regimes keep on changing like what happens in a musical chair contest.

The specific feature of the government policies that were implemented by the different regimes that came into power in Sri Lanka after independence has been the intervention in socioeconomic affairs and the diversity in the process of intervention. The elected governments allocate a considerable percentage of government revenue for welfare activities from aggregate government expenditure. The main goals of government expenditure have been targeted at accelerating economic growth, uplifting the living condition of the population and achieving social development.[14] In this contest the present study explores the empirical relationship between economic growth and government welfare expenditure, with special reference to different policy regimes that governed the country after year 2000.

1.4. Scope and Limitations of the Study:

In view of the vast subject area and its ramification into numerous peripheral fields, the scope of the present study envisages to cover the contemporary economic development in Sri Lanka vis a vis its economic policies with special emphasis on the period between year 2000 and 2020. To be precise, the current study focuses its attention on the GDP, GNP, economic growth rates, problems of unemployment and other economic indicators that can be used as the judgmental basis to ascertain whether the country's economy has marched forward, backward or remained stationary over the period under reference.

As far as welfare related economic policies are concerned, the current study concentrates on the declared and documented economic policies of the incumbent

14 Wickramasiri, R S, et al, (2012), Government Welfare Expenditure and Economic Growth in Sri Lanka: A Comparative Analysis of Different Policy Regimes, Department of Economics and Statistics, University of Peradeniya.

political regimes that governed the country on the basis of political mandates bestowed on them by the people.

1.5. Definition of Terminology:

The terminology used in the current paper consists of mainly the standard subject specific vocabulary frequently employed in economics and therefore they do not refer to peculiar connotations or aberrations different from the standard usage of the terms. To be precise, the term economic stagnation refers to the prolonged period of little or no growth in an economy accompanied by periods of high unemployment, price inflation, widening budget deficits and involuntary unemployment.

The term economic policy refers to the budgetary, taxation and expenditure strategies and guidelines that can be enveloped in one group as fiscal and monetary policies, adopted by the successive governments in Sri Lanka for directing economic development towards the achievement of economic goals or mission molded in their political ideology. Welfarism, for this study, is defined as the free transfer of monetary or 'in kind' allowances disbursed to eleemosynary groups by governments of different political hues, in compliance with their development visions. Further definitions and elaborations on the terminology are included in the subsequent chapters which deal with specific subject related domains.

1.6. Structure of the Study:

The structure of the current study has been designed to present with the compilation of eight chapters altogether including an introduction as the first chapter at the beginning and a conclusion as the last chapter. Chapter 01 provides a bird's eye view of the pertinent landscape of the Sri Lankan economy that pinpoints current status of the country and its direction of movements. In between, there are six chapters arranged under the titles Literature Review, Research Design and Methodology, Economic Stagnation, Welfare Based Economic Policy of Sri Lanka, Welfare State-International Experience and Relationship Between Stagnation and Welfare Based Economic Policy of Sri Lanka and sequence of which is logically arranged.

Chapter 02 reviews the economic literature related to welfare state commencing from classical economic theories through current polemics on the subject, including Keynesianism, Marxism and Welfarism, with intention of understanding the theoretical evolution of welfare state and finding out the type of theoretical justification extended by the economic theories for the development and emergence of welfare concept.

Chapter 03 encompasses the conceptual frame of research, research questions, problem statement, research hypotheses and research methodology that are extensively referred to in the course of conducting research.

Chapter 04 includes an analytical review of the present economic status of Sri Lanka and its resemblance to the features of economic stagnation as elaborated by different scholars in the subject. The discussion covers stagnation, stagflation, secular stagnation and behaviour of main economic parameters of Sri Lanka.

The next section, Chapter 05, invigilates the welfare economic policy of Sri Lanka with due reference to recurrent expenditure, fiscal deficits, unemployment, pampered and leviathan public sector workforce, subsidies, price concessions and free services provided which all signifies that government deeply entrenched itself in the concept of welfare state.

Chapter 06 deliberates international experience of welfare state on the basis of selected countries that include Japan, European states, USA and socialist countries leaning on Marxist ideology and the objective of the researcher in this chapter is to explore the experience learned at global level on the dogma of welfarism.

Chapter 07 concentrates on exploring the relationship between economic stagnation and welfare oriented economic policy of Sri Lanka that, in a nutshell, revolves around the central theme of the research. Links between the dependent and interdependent variables of the conceptual frame are anatomized with due reference to the intricate details of proxy variables orbiting around the main topic of the research.

With Chapter 08 the presentation of the research paper moves into the terminating section that includes summary, conclusions and recommendations for future studies.

Throughout the research report, Harvard report writing style has been followed in numbering, paragraphing, footnotes, tables, headings and in preparation of bibliography.

CHAPTER 02-LITERATURE REVIEW

2.1. Economic Development Models- Historical Perspectives:

2.1.1. Chapter Organization:

This chapter is designed to include a review of historical evolution of economics as a branch of social science with special emphasis on their theoretical leaning on welfare state from the inception on the chronological basis. In addition, the chapter contains literature review on Sri Lanka's economic policy, a retrospective view of the economy during the period 2000 -2021. The justification for inclusion of this chapter under literature review hinges upon its usefulness in understanding the logical explanation on the application of welfare economic policies that are influenced by economic models which came into prominence from time to time. The concept of welfare state, although the terminology was not used in the same way, dates back to the period that the political economic theories marked their emergence even before the classical economic school came into being more than two centuries ago.

The section is divided into three main headings namely literature review on Economic Development Models and their indulgence on welfarism, Economic Stagnation and Stagflation, Welfare State- Theoretical Frame and Literature on Sri Lanka Welfare Economic Policy regimes.

2.1.2. Classical Economic Models:

Economics as a subject of scientific investigation, has made a concerted effort from the very inception to explain and identify factors that cause economic behavior of society and individuals in the form of cause and effect relationship.

Table:2.1.
Concise List of Economic Theories and Their Emerging Period.

Theory Identification	Period
1. Mercantilism	15th century.
2. Physiocracy	18th century
3. Classical Economic Theories.	1776
4.Marxism	1850
4.Welfare Economics.	1911
5. Keynesian Theories.	1930s
6. Post-Keynesian(Neo-Keynesian) Theories	1950s
7. Neoclassical Theories.	1950-1960s
8. Endogenous Growth Theories.	1980s-1990s

Source: Author's Compilation.

Apart from understanding how an economy functions, the next most important objective of economics is model building and making recommendations which as a whole is considered as normative economics; another development of the main stream of economics.

The Table 2.1 includes a concise list of main economic schools cited in chronological order enabling the writer as well as the readers to understand the logical flow of conceptual evolution in economics and the position occupied by them as against the proposed subject of research on welfare economic policies and their repercussions on the economic growth in general. All those theoretical models, if not elaborate on welfare aspects of state, at least make passing reference to the concept of inequality and poverty as a natural evil.

Classical economics or classical political economy is a school of thought in economics that flourished primarily in Britain in the late 18th and early to mid-19th century. Its main thinkers are considered to be Adam Smith, Jean Baptist Say, David Ricardo, Thomas Robert Malthus and John Stuart Mill. These economists produced a theory of market economies as largely self-regulating systems, governed by natural laws of production and exchange.[15] The founder of classical economic school, Adam Smith (1723-1790).and the economic model presented by Adam Smith is an antithetic of welfare oriented economic approach.

Among his writings, the book titled 'An Inquiry into Nature and Causes of the Wealth of Nations', considered as his magnus opus, introduced the well-known economic model, the laissez-faire economic system or unbridled market driven economic model which he interpreted as the wealth of a nation. The primary concern of the classical school of economists was clearly laid down even by the title of the book 'An Inquiry into Nature and Causes of the Wealth of Nations' that is to explore the causes for possessing a satisfactory stock of wealth by a nation. Government intervention in the economic activities a totally unacceptable and unproductive concept in Smithian economics and he firmly believed and depended on the price mechanism for activating all production and exchange activities as a self-standing system. The concept of invisible hand, another term for the price mechanism, is quite capable, according to Smith, in providing unabated momentum to regulate economic activities. The invisible hand or price mechanism was capable of overlooking the entire economy by mobilizing resources to different economic sectors, making all vital decisions pertaining to production of goods and services and finally maintaining a self-regulated equilibrium both in micro and macro-economic sectors. The driving force of the system, according to Smith, is the profit motive which is anticipated to perform the role of resource mobiliser, decision maker and determiner of a country's economic growth in a smooth operation without creating disequilibrium in the main economic system and any subsystem.

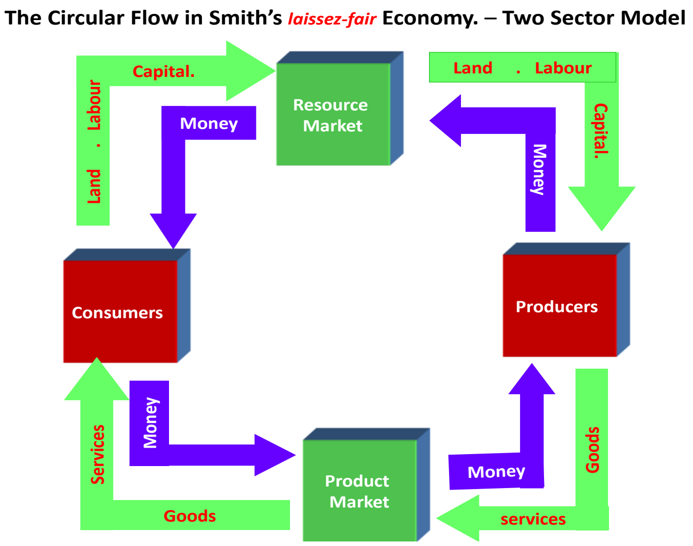
"Classical doctrine is frequently called economic liberalism. Its bases are personal liberty, private property, individual initiative, private enterprise and minimal government interference."[16]. Minimum government involvement or the laissez-faire policy is the corner stone of the classical school and this was stated as the best government governs the least. Adam Smith propagated that the economic development was the sole outcome of individual enthusiasm, division of labour and

15 Wikipedia, (2021).
16 Stanley, L. B, (2000), The Evolution of Economic Thoughts, Harcourt College Publishers.

technological advancement while the role of the government was reduced to the position of a passive observer.

Self-interested economic behaviour as postulated in classical economics refers to the selfish motive individuals possess for advancing individual benefits, satisfaction and wealth which is the natural behaviour of human beings. Producers and merchants supply goods and services to the market, driven by the desire to increase their profits, while the labourers offer their labour inputs to the producers with the intention of obtaining their payback in the form of wages. This scenario is further elaborated in the two-factor model of economy in which both producers and the households are engaged in business interactions, unrestrained by external forces, through factor market and goods market. The two-factor economic model illustrates how commodity flows and money flows move through factor markets and resource markets in a self-regulated mechanism that always maintains equilibrium in both markets.

Figure: 2.1.
Two Factor Economy: Circular Flow.



Source: Author Compilation.

The classical model made tremendous contributions to economics by focusing analysis upon explicit economic theories or 'laws". Examples include the law of comparative advantages, the law of diminishing returns, the Malthusian theory of population, the law of market (Say's law), the Ricardian theory of rent, the quantity theory of money and the labour theory of value. The classicists believed that the laws of economics are universal and immutable."[17] The above citation provides a gist of classical economic theory with emphasis on the contents, intent and the context of the center around which the whole concept orbits.

In concluding the section, it is obvious that the description included in the section provides axiomatic evidence to the fact that classical economic school totally rejected the government intervention in economic activities and welfare oriented economic benefits, emanating from benevolent economic practices, given to the

17 Stanley, L. B, (2000), The Evolution of Economic Thoughts, Harcourt College Publishers.

masses through government sponsored or subsidized programs that contradict the uninterrupted operation of natural economic laws. Laissez-faire or otherwise known as nonintervention of government in economic activities is a cardinal principle of the classical economic school; therefore welfarism is an anathema as far as classical school is concerned. Poverty, a problem of disparity caused by inequal distribution of wealth, is not considered as a major economic issue since the economy is always at equilibrium from classical point of view. Furthermore, according to the classical economic concept, both micro and macro-economic imbalances are temporary and the invisible hand is expected to resolve sectoral imbalances in the long run.

The classical school of economists, as discussed in the above section, does not endorse the government interference in economic activities and thereby connotes that welfarism as a strategy for minimaxing economic disparities among the public is not an acceptable solution at all.

2.1.3. Marxism and its Approach to Welfare State:

The next major development in the evolution of economic theory is Marxism which, although considered as a branch of classical school, marked a diametrical deviation from the classical approach in contrast to its analysis of capitalism, surplus value of labour, class struggle and concept of dialectical materialism which finally resulted in the creation of new generation of economists under the label of socialism. Marx together with Angles were able to present their views in different publications which culminated with his magnum opus Das Kapital in 1867. “It is a foundational theoretical text in materialistic philosophy, critique of political economy….” (Wikipedia, 2021). Contrary to the main tenets of Smithian laissez-faire postulation, Marx predicted that the capitalism contained entropic forces within itself that would lead to unavoidable destruction and decay of capitalism in its evolutionary process. Marxism conceptually borrowed its mainstream theoretical frame from Hegel’s concept of dialectical materialism and remolded it to explain the inevitable conflicts between bourgeoise and proletariat which finally would result in dawning of socialism.

Marx addressed the matters of alienation and exploitation of the working class, the capitalist mode of production and historical materialism. He is famous for analysing history in terms of class struggle, summarised in the initial line introducing ‘The Communist Manifesto’ (1848): "The history of all hitherto existing society is the history of class struggles". The Marxist assault on capitalism and prediction that capitalism is doomed to be decayed entropically is totally at loggerhead with salubrious characteristics that were identified by Smith in capitalism. “Smith was euphoric about emerging capitalism as a permanent state for society…Marx saw capitalism as only a necessary evil. It was only one stage in the development of economic organization and would be superseded by a higher state where private property would not exist” (Canterbery, 1987).[18] Canterbery explains how Marxism diametrically differs from the core postulates of the classical school citing Marx’s contention on private property ownership and its distrust on capitalism in comparison to euphoric recognition of those factors by the classists.

18 Canterbery, E. R., (1987), The Making of Economics ,Wordsworth, Publication Company, Belmont, California.

Challenge posed by the Marxist philosophy to the hitherto existed and socially recognized approaches can be viewed from different perspectives.

1. State is considered as an instrument of suppression.
2. Capitalism, characterized by private property ownership and self-regulated system, is doomed to perish.
3. Class struggle inevitably culminates with the establishment of proletariat dictatorship.
4. Existence of capitalism is facilitated by surplus value accumulated in the hand of capitalists.

The impacts created by the Marxist revolution gathered momentum similar to wild fire igniting contradictory views that challenged the validity of hitherto accepted conventional approaches, both in Europe and Asia. Marx's radical views gained recognition in important social forums and political circles which compelled the economic decision makers to revisit the rationality of economic policies that were practiced uncontested over a long period of time.

In England, well recognized social elites like Robert Owen declared their willingness to experiment with new approaches due the influence exerted by Marxism.Robert Owen was a social philosopher who wanted not just to reform but to transform the world. His political philosophy labelled as utopianism is postulated on the belief that everyone works for the common good in a community; a society where everyone is equal; a place where peace and love prevail (Robert Owen Wikipedia, 20021). Throughout his lifetime (1771-1858), Robert Owen sought to transform society into this utopia, and he had minor success in doing so. However, the Marxist literature available hitherto in the published sources has not shown conclusive evidence to prove that the concept of welfare state has been totally embraced by the Marxist doctrine. Contrary to the agreement to the welfare state, according to some observers, the stand taken by the Marxism towards welfare state is somewhat ambiguous and inconclusive.

As Pearson stated in his review on the subject "The relationship between Marxism and the welfare state is complex. Since there is not one 'true' Marxism but many and since the experience of the welfare state under advanced capitalism has proved to be quite diverse, we should hardly expect to find a single and wholly consistent Marxist explanation of welfare state development. And so it proves. Some Marxists have seen the welfare state principally as a controlling agency of the ruling capitalist class. Others have seen it as the 'Trojan Horse' within which socialist principles can be carried into the very heartlands of capitalism. Again some Marxists have argued that the welfare state provides the indispensable underpinning for a market-based social and economic order, whilst others have seen it as incompatible with the longrun integrity of a capitalist economy." (Pierson, 1999). Another observer (Specker, 2021) writing on the subject of Marxist influence on the state points out that Marxists see society in terms of a conflict between economic classes. A dominant class (the bourgeoisie or 'capitalist' class) owns and controls the means of production; an industrial working class, the 'proletariat', is exploited by them. Communism was based on Marx's claim that the proletariat must revolt to throw over the old economic order.

The Marxist analysis of welfare concentrates principally on its relationship to the exercise of power. The state is to be seen either as an instrument of the ruling capitalist class, or as a complex set of systems which reflects the contradictions of the society it is part of. It is often argued that welfare has been developed to suppress the strength of working-class resistance to exploitation.

Marxism is not a single doctrine; it has come to stand for a wide range of opinions within an analytical framework that is critical of 'capitalist' society. Neo-marxists argue that the state has two main functions. The first is to improve the conditions for the accumulation of capital - that is, the chance for industries to make profits. The second is to legitimate the capitalist system, by introducing measures (like welfare policies, pensions and health services) which lead people to accept the system as it stands. The requirements of accumulation and legitimation may be contradictory, and the costs of legitimation have led to a 'legitimation crisis'. This view supports the standard contention of Marxism that welfare is an apparatus used by the state to pacify the worker resistance against capitalism.

The basic objections to marxist analyses are that the description of 'capitalism' is very limited - there is not one economic system, but many; that the role of government is misunderstood; and that the Marxist model of interpretation greatly underestimates the capacity of different societies to form different patterns of social organisation. The patterns of inequality and the structure of power are complex, and the organisation of economic production has long ceased to reflect formal ownership. Power in society is divided, and governments are among the actors. The 'welfare states' display a many different approaches, motivations and experiences. Within that range, however, states which promote the welfare of their citizens are not pretending to be more legitimate - they are more legitimate.

Marx without doubt revisited the concept of welfare state and provided a different interpretation to the whole concept branding it a dilution and diversionary strategy adopted by bourgeois to delay the inevitable destruction of capitalism resulting from proletariat struggle against the state, a tool of suppression in the hand of state as Marx stated. Furthermore, he ignited the political ideology that the proletariat was a force to reckon with by looking after its interest at least by providing subsistence level assistance, financial or vice versa, to harness their contribution to the economy.

The contributions made by Marx to the enhancement of knowledge in economic and political discipline can be summarized as follows.

1. Marx was an important participant in the struggle to establish a suitable theory of value in economics.
2. Marx was one of the first economists to note that business cycles are a normal occurrence in capitalist economies.
3. Marx accurately predicted the growth of large-scale enterprise and monopoly power. Marx highlighted the substitution effect as it applies to labour saving capital[19] (Stanley, 2000).

19 Stanley, L. B, (2000), The Evolution of Economic Thoughts, Harcourt College Publishers.

Nevertheless, the logicality and necessity of a Marxist ideological intervention in the subject of welfare state is brought into question by some critiques. In this context the views expressed by Pearson provokes further elaboration in the face of the challenging nature of facts presented by him. “Why do we need Marxist approach to the state today? For in a world which is seemingly either globalized or globalizing and which Marxism as a political project is defunct, it is tempting to dismiss Marxist attempts to theorize the state as anachronistic and purely historical interest-if that. With the nation state on the wane do we really need a theory of state anyway? And even if we think we do with Marxism in retreat why a Marxist theory of state” (Pearson,2001). This statement questions the need and ability of Marxism to perform a useful function as a theory of state since, in the writer’s perception, Marxism is defunct and moribund in the context of the role played by the modern state.

However, the writer does not address the historical role played by the political ideology of Marx in the context of empirical development that took place in many parts of the world including Russia and China which embraced Marxism as a doctrine that provided the philosophical foundation for developing strategy of governments. The realistic situation at the global level withing the 20th century and towards the first two decades of the 21st century is succinctly recorded in Wikipedia. “At the turn of the 21st century, China, Cuba, Laos, North Korea, and Vietnam remained the only officially Marxist–Leninist states remaining, although a Maoist government led by Prachanda was elected into power in Nepal in 2008 following a long guerrilla struggle”.

The early twenty first century also saw the election of socialist governments in several Latin American nations, in what has come to be known as the "pink tide”; dominated by the Venezuelan government of Hugo Chavez, this trend also saw the election of Evo Morales in Bolivia, Rafael Correa in Ecuador, and Daniel Ortega in Nicaragua. Forging political and economic alliances through international organisations.. …. these socialist governments allied themselves with Marxist–Leninist Cuba and although none of them espoused a Stalinist path directly, most admitted to being significantly influenced by Marxist theory. The afore stated narration bears evidence on the influence exerted by Marxism on welfare state and welfarism in general although Marx was far from perceiving state in any form as a tool in the hand of proletariat.

Marxist literature and review of their philosophy proves that welfare is out of the main focus domain of Marx and his concept intrinsically possesses all the hues of political nature since he predicted the inevitable formation of proletariat government, identified as socialism, which will lead to a utopian system, at the end, where self-rule or governance is considered to be the order of the day. Although Marx is not a strong protagonist of welfare state, his philosophy on the oppressed people, downtrodden masses and proletariat provided an opening for welfarism to use Marxism in support for and justification of welfare state. Indeed Marx's core critique of capitalism suggests that it is generally incompatible with state-secured forms of welfare. This critique is built upon three insights that Marx 'borrowed' from the classical political economy of Adam Smith and David Ricardo: first, capitalism is an economic system based upon the production and exchange of privately owned commodities within an unconstrained market; secondly, the value of any commodity is an expression of the amount of human labour power expended upon its production.

Nonetheless it has to be observed that the emergence of welfare states within capitalism is, at first sight, a rather surprising development in terms of classical

Marxism. It is certainly possible to reconstruct an account, consistent with some of the things that Marx said about the state, which 'explains' the emergence of state welfare provision under capitalism. It is, however, difficult to represent this as the main line in Marx's own thinking about the capitalist state which he clearly saw as a much more straightforwardly repressive apparatus in the hand of bourgeoisies.Marx awakened the awareness of the society as well as states that poverty and inequality would be developed into a major threat unless state intervened in balancing the lopsided distribution of wealth caused by free play of open market forces. Marist exposure of the impending grave threat to the existing capitalistic market system sent a strong message home to the political bureaucracy of the west which, as a response, promoted new liberalism with a view to minimizing the impacts of incoming threat by resorting to the concept of welfare state in the belief that the welfare state could cushion in the pressure through spending government money for redressing the woes of the poor.

An overall review, hither to conducted relating to literature on Marxist influence on welfare state, testifies to the fact that diverse interpretations are in existence with inconclusive opinions in respect to the degree of its influence on the creation and operation of the welfare state. However, its ideological influence on political thinking and alleviation of poverty which remained as the driving motive of the welfare state has been greatly shaped, beyond doubt, by Marxist ideology as axiomatic and empirical evidence testifies. In a gist welfare state was not born of Marxist womb but it (Marxism) performed the task of accoucheur in the process of delivery, perhaps involuntarily.

2.1.4. Welfare Economic Models:

The welfare economic school, emerging during the period 1900 and 1950, dominated in economic and policy making spheres as an alternative approach to the classical theory of economics. “The welfare economics is a branch of economic analysis concerned with discovering principles for maximizing social wellbeing.”[20] The title, the welfare economics is however very vague since all the branches of economics that have been developed hitherto from the very inception have been the results of the necessity in exploring the best solution for a particular set of economic issues related to the social wellbeing. For instance, any model of economics can be contrived as an effort for finding economic solutions to the primary issues relating to what is to be produced, how to be produced and how to distribute the output among the people provided that factors of production, necessary for producing output, are scarce while needs and wants of the society are unlimited.

The purpose and the circumstances under which the welfare economics and its proponents are positioned in a given scenario is explained by Tibor in the next citation. “Welfare economics is that part of the general body of economic theory which is concerned primarily with policy. Some people would argue that all economics issues should be concerned with policy. Without welfare economics, however, economic

20 Stanley L B, (2000), The Evolution of Economic Thoughts, Mike Roche, P 423.

theory would be a collection of techniques and the economist would be little more than a technician, a politician's handyman, who has to wait for the latter to state his aims and can merely advise him on how to go about achieving those aims. Welfare economics supplies the economist-and the politician- with standards, at least with some standards, by which to appraise and on the basis of which to formulate policy. Hence, whenever the economist advocates a policy, for example when he favors full employment or opposes government interference in economic affairs, he makes a welfare proposition."[21] In this context the role performed by welfare economics can specifically be distinguished on the following criteria.

1. Defining welfare optimally and analyzing how maximum welfare can be achieved. This can be construed as a normative role of welfare economics where policy prescription or guidance is prepared.
2. Identifying factors that impede the achievement of maximum wellbeing and suggesting ways that the impediments might be removed.

Using the above criteria, the economic scholars namely Pareto, Pigou, von Mises, Lange, Arrow and Buchanan are identified as the pioneers as well as leading protagonists of the welfare economic theory known today.[22]

Wilfredo Pareto (1848- 1923), a pioneer in welfare economic approach presented his concept 'maximum welfare' aka Pareto Optimality which could be reached when the marginal rate of substitution, a theory in consumer behaviour, of two goods becomes equal. The concept was first developed by Walras and further refined thereafter by Pareto. The initiative taken by Pareto was further enriched by Arthur Cecil Pigou (1877-1959) who published his book 'The economics of Welfare' in 1920 providing a theoretical framework for governments to implement programs that promoted welfare of citizens.[23]

Economic welfare, in the Pigovian sense, implies the satisfaction of utility derived by an individual from the use of exchangeable goods and services. Pigou perceives that economic welfare and national income are essentially intertwined. It is on this basis that he lays down two conditions for maximisation of welfare. The first condition states that welfare is said to increase when national income increases. Given the same tastes and income distribution, an increase in the national income represents an increase in welfare. Pigou contends that in most cases the national income would increase even though the disutility of work also increases.

Second, for welfare maximisation the distribution of the national income is equally important. If national income remains constant, transfers of income from the rich to the poor would improve welfare. According to Pigou, such transfers mean less to the wealthy than to the poor, as a result the economic position of the latter is raised. This welfare condition is based on the dual Pigovian postulates of 'equal capacity for satisfaction and diminishing marginal utility of income'.

21 Tibor S, (1950), The State of Welfare Economics, American Economic Association, Chicago.
22 Stanley, L. B., (2000), The evolution of Economic Thoughts, Mike Roche, Chicago.
23 Ibid.

As Pigou explicitly stated, the role of government as the provider of material wellbeing to the public is not at all uncertain. The twentieth century state owes to man not only order, peace and justice, it owes him also material wellbeing. The search for and the study of the means by which public power can provide for such wellbeing have added an important chapter to the history of political theory and the art of government.[24] Nonetheless, the question of welfare's contribution to the GDP and creation of value, its perpetuation, long term impacts and who stomach the burden of welfare cost are critical issued that still remain unaddressed in the literature of welfare state.

Different dialects of welfare economics transpired from the long-extended polemic over whether or not economic welfare in both Paretian and a broader sense of the term can be maximized under a system of socialism. In this debate, an emerging contributor was Ludwig von Mises (1881-1973).25 Ludwig contended that the same types of economic calculations that guide resources to their highest valued use under capitalism must be made by the socialistic planner who desires to maximize consumer welfare. Socialism, stated by von Mises, cannot duplicate the functions of capital allocation and entrepreneurship required to mobilize resources efficiently in a dynamic situation. His views are poles apart from those who contend that a socialist planning apparatus can be instructed to duplicate similar actions to those that result under competitive market system.[26]

'The capitalist system is not a marginal system; it is an entrepreneurial system… nobody has ever suggested that the socialist commonwealth could invite the promoters and speculators to continue their speculations and then deliver their profits to the common chest…. One can only play speculations and investment."[27] It can be construed, by the review of different ideological intricacies, that there is no unison among the protagonists of welfare state in relation to its operational mechanism, benefits and how it exactly differs from socialism.

The next important scholar contributed to the paradigm of welfare state is Oscar Lange who, in an article entitled "On the Economic Theory of Socialism", published in 1937, set forth his views under the caption of market socialism. Market socialism, as postulated by Lange, is characterized by (1) private ownership of consumer goods and free choice of consumption from available goods, (2) free choice of occupation and (3) state ownership of the means of production. This system of economy appears to be in agreement in most parts with the Marxist ideology which was further elaborated with empirical or operational details in the Communist Manifesto.

As Philip Newman stated, Oscar Lange "delivered the coup de grace to the antisocialist critics" but the euphoria did not last long as critics were able to find dents in the theory and brought to the focus of the fallacies of assumptions.[28] Additions to the welfare economic thinking continued further with some substantial and sometimes with cosmetic deviations to the main tenets of the original theoretical frame and in this perspective Kenneth Arrow (1921) and James M Buchanan (1919) are considered as doyens who stand out in the economic landscape.

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24 Pigou, A. C., (1954), Some Aspects of the Welfare State, Sage Journals.
25 Stanley L B, (2000), The evolution of Economic Thoughts, Mike Roche, Chicago.
26 Ibid.
27 Ludwig von Mises, (1966), Human actions: Treaties on Economics, Chicago, Henry Regnery,
28 Philip C Newman, (1952), The Development of Economic Thoughts, Englewood Cliffs,, Prentice Hall.

The main enigmatic issue still remained unaddressed or indecisive is whether Marxists or protagonists of welfare state have been able to provide a plausible alternative, in the long run, to the driving force of classical economics, the invisible hand, in their much-sophisticated economic models for mobilizing both producers and consumers under the welfare state. Both Marxist and welfare state schools have not offered a rational explanation on how the role played by the human nature driven by egocentric objectives can be replaced with philanthropic and society focused economic apparatus under the welfare state. Nowhere in the economic literature sufficient and long-lasting evidence has been presented to prove that the "economic man" concept of the forefather of modern economics, Adam Smith, can totally be discarded into oblivion in recognition of "social mam" concept of welfare school of economics in absolute certainty. In this context views presented by Caroline Gerschlager is further supportive of the afore said statement. "According to standard economic theory, the basic characteristics of an agent are rationality and self-interest (Hirshleifer 1985, p. 54). Typically, economic man is characterized by self-interested goals and a rational choice of means. The assumption of the economic man's persistently pursuing matters of self-interest has played a major part in the characterization of individual behaviour in economics for a very long time. The origins of the self-interest postulate are often traced to Adam Smith (1776), and it is frequently asserted that the father of modern economics saw human beings as tirelessly fostering their respective self-interests."[29]

However, the writer moves into a different ambience of explanation in the subsequent sections of the article criticizing the concept of homo economicus. "Although self-love is the principal motivation for exchange in Adam Smith's account of sympathetic exchange, the concept of economic man as perceived by modern economics is not yet obvious in Smith's oeuvre. Smith's insights into the functioning of social life also reveal that the agent is motivated not only by self-love but also by self-delusion. It is in this sense that any comparison with modern economic man seems misplaced."[30]

The arguments postulated against economic man concept is a caricature of polemics since common human behaviors of deception, cheating, dishonesty and similar socially unacceptable conducts are brought into focus in support of challenging the economic man concept which in fact mires the argument beyond comprehension. Economic man or homo economicus is considered to be a rational being who distinguishes social evils from the inalienable rights of man encompassing the ability to demarcate the line separating boundary of selfishness and socially forbidden and legally punishable activities. Although the deceitful behavior, as some critics erroneously tagged on to the economic man concept to attack its foundation of validity, the reasoning is totally on wrong footing, if not ridiculous. The "economic man" is considered to be genetically different from "criminal man" concept created by opponents of classical theory to befog the economic man concept.

The concept of economic man must be understood in conjunction with the management concept of rational man to grasp the meaning of the term economic man as assigned by Smith. The concept of economic man, contrary to superficial arguments brought forward by the protagonist of welfare state, is a natural extension

29 Caroline G, (2005), Beyond economic man: Adam Smith's concept of the agent and the role of deception, CAIRN.INFO.
30 Ibid.

of the Darvin's theory of evolution in the context of economic behavior. In this context, Richard Dawkins in his renowned book titled "The Selfish Gene" explains the intrinsic relationship between man, including other living beings, and its selfish oriented behavior as a phenomenon emanating from genes.[31] In view of the facts cited above, a challenge to the economic man concept should first disavow the validity of Darwinism since the classical theory is the natural extension of theory of evolution to economics.

Furthermore, the welfare state is inseparably imbedded into the concept of social responsibility which, when applied to business entities, means that apart from profit making, business organizations are expected to play benevolent provider's role as far as public is concerned. As Milton Freedman very specifically articulated "there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception fraud."[32]

Government's role as a provider of economic benefits, goods and services to the secluded eleemosynary communities needs not provoke a hornet attack type protest from any quarter but the pertinent issue is how the provider carry out the expected task and who provide the provider the wherewithal necessary for the task. The question of how ethics and morality can be applied to human experience is a vexed one; ethics and responsibility. Though philosophers have discussed abstract ethical dilemmas for most of recorded history, there appears to be no universal answers to resolve human problems and the varied approaches of philosophers have led to the development of ethical frameworks that may be applied to any abstract situation.

The answer to an ethical question may differ depending on which moral framework or theoretical apparatus is used for justification of ethical arguments. For this reason, taking complex and abstract ethical theories and applying them to the decision-making processes of company directors can lead to unresolvable arguments in boardrooms, restaurants, shareholders meetings, scholarly journals and, of course, the media.[33] The prolong controversy on the role of welfare state continues with proponents and opponents infusing their respective views with new vigor inconclusively. However, the pertinent basic issues raised by the current writer still remain unanswered irrespective of the ferocity of the polemic intercourse.

Along these lines, Williamson(1991), in his theory of transaction-cost analysis, argued that agency problems increase when managers act on behalf of non-shareholding stakeholders, and added that the central relationship between shareholders and managers will be distorted when the additional concern for stakeholders added into the relationship. Similarly, Fama and Jensen argued that shareholder value maximization should be priority for corporate managers—not the stakeholder welfare. However, the business view has been increasingly challenged by many circles in recent years, leading management scholars to develop theories that reconcile the business view with societal approaches.[34]

31 Richard D, (1889), The Selfish Gene, Oxford University Press, UK.
32 Milton Freedman, (1970), The New York Times Archives, P.17.
33 Peter, P., at el., (2021), Milton Freedman on Social Responsibility, lucidmanager.org.
34 The Arthur W Page center, (1921), Public Relations Ethics, www. pagecentertraining.psu.edu.

The conclusion that can be derived from scholarly discussions on the welfare state is that the state, being considered as the ombudsman of citizens, ought to behave like a caretaker to minimize the grievances of eleemosynary clusters of the society by levying taxes on the affluent higher income layers of the society. This argument, in spite of its popularity, appears to be contrary to the theoretical underpinnings of both economic man concept as well as Darwinian theory of natural evolution. Eduard Bernstein, a reformist social democrat, was skeptical of the welfare state and social welfare legislation. While Bernstein viewed it as something helpful for the working class, he feared that state aid to the poor might sanction a new form of pauperism. Ultimately, Bernstein believed that any such policies should be of secondary concern to the main social democratic concern of tackling capitalism as the source of poverty and inequality.[35]

Although there appears to be cracks in the theoretical underpinnings of welfare state, is has not only become popular with the ruling polite and the ordinary masses alike due mainly to its instrumentality for providing free economic facilities which gratify the needs of both eleemosynary elements as well as political elite although they possess divergent survival objectives.

As Karl Marx has presented in his detailed analysis, the welfare state is an apparatus designed and created by the bourgeois to steal away the steam from the proletariat struggle against capitalist economic system. This argument although flawed in certain circumstances, appears to be uncontestable when historical records of political events are examined as to how welfare policy has been used, as Marx proclaims, to eliminate the nascent political movements arising against the ruling parties in Germany. The concept of ‘state socialism’, espoused by Bismarck (1884), in Germany provides a classic example to prove that Marx is absolutely right in the light of political events that took place in Germany during the last two decades of 1800s. State Socialism (German: *Staatssozialismus*) was a set of social programs implemented in the German empire that were initiated by Otto von Bismarck in 1883 as remedial measures to appease the working class and detract support for socialism and the Social Democratic Party of Germany following earlier attempts to achieve the same objective through Bismarck's Anti-Socialist Laws.[36] In fact Marx papers to have focused on the actual ground realities prevailed in Europe in shaping his criticism of state and its relationship with welfarism.

2.1.5. Keynesian Economics and Welfare State.

The history of social policy in the last hundred years would be significantly incomplete without giving full account of the dramatic influence of John Maynard Keynes who severely contradicted and challenged the hither to existed economic dogmas in the context of their incapability of offering effective solutions to unprecedented and

35 Jackson, B., Social Democracy, (2008)," The New Palgrave Dictionary of Economics. Second Edition. Palgrave Macmillan.
36 Bismarck, Otto (15 March 1884). Bismarck’s Reichstag Speech on the Law for Workers’ Compensation. German History in Documents and Images. Retrieved 27 December 2019.

aggravating economic woes that were experienced in many economies in Europe derailing the smooth movement on the economic track between the first and the second world wars.

With the Great Depression in the 1930's and, there after, World War II in 1939, the classical paradigm was completely abandoned due to its failure to explain why the self-regulated system did not function as it was envisaged . It was now the belief that governments needed to play a role in regulating their economies and that the laissez faire paradigm could not operate with only an "invisible hand". A real visible hand needed to serve as a countervailing force to control economic cycles and any speculative abuse.

Economic realities in Europe were in jumble and the conceptual foundations of economics existed hitherto rendered helpless to explain the causative factors that attributed to the economic mayhem of the period which as a whole paved the way for Keynes to enter the realm of economic intellectualism equipped with a new set of theoretical tools that look like sound and convincing. To present his economic paradigm, Keynes had published in 1936 his magnum opus in economics: "The General Theory of Employment, Interest and Money"; which was considered a turning point in economic paradigms. This paradigm encompassed both economic theory and policy, and, for more than thirty years, it would dominate the economic policies of most capitalist nations. In the United States, Keynesian economics was dominant even before the war, and continued with Roosevelt until the end of the Carter administration. Then, Milton Friedman, with his monetarist ethos, brought back neoclassical economics, which became the preferred view of the Reagan administration and thereafter.

Keyne's deviation from the classical paradigm encompassed a rebuff of all previous assumptions. Stated in a nutshell the main tenets of Keynesian theory include: supply cannot generate its own demand (Say's law) because prices and wages are inflexible moving downward; this is because monopolies and unions tend to protect their positions. Moreover, workers are in illusion with money wages –nominal pay– instead of thinking in terms of real wages, purchasing power; thus, since the wage price function is inflexible, the economy could not self-adjust to the right price and cost of labour, and, therefore, full employment and full capacity could not be reinstated. For this reason, an equilibrium level of income as a function of supply and demand, may be reached at less than full employment, even much less, such as in the Great Depression. Then, relative to monetary policy, interest rates are not a reliable tool to manage flows of investment since many factors –some capricious psychological issues such as speculation– affect the decision to invest, where to invest or leave the funds to idle in money balances. Related to this, there is the income-motive, the business-motive, the precautionary-motive and, the most important: the speculative-motive liquidity-preference function, which determine that rather than spending in consumption or saving as opposed to investing, there is the other possibility of the speculative demand of money; to speculate in the bond market. Thus, monetary policy working through the interest rate cannot alone solve a state of unemployment or depression. Fiscal policy must then take a central role. It is under this rationale that Keynes proposed that public investing, through taxation or public debt in the form of bonds, would need to be used as the central element in an entire program of discretionary policy. In the face of dismal failure of the laissez-faire economic prescriptions, Keynes suggested that state intervention is not optional but an essential reality in a system where self-regulation ceases to operate with dynamism under paradigms of market imperfections and rigidities.

In this context, the two-factor economic model, hither to functioned in line with the Smithian model, was further modified by Keynes by emphasizing the pivotal role played by government, instead of allowing invisible hand of the classical model, in making necessary interventions and adjustment when the invisible hand is dormant or dysfunctional.

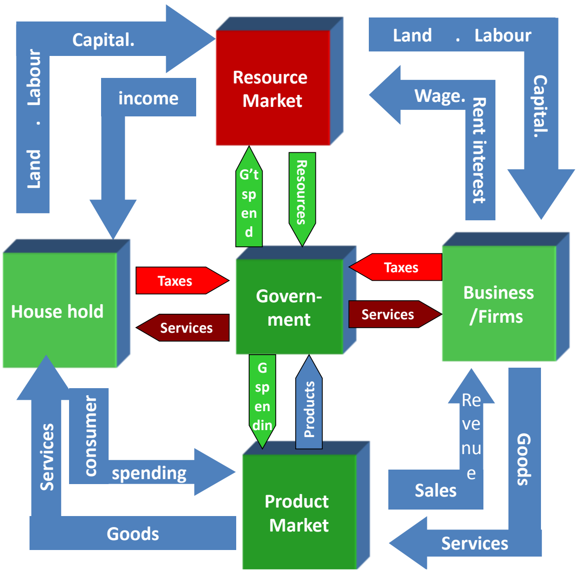
However according to some scholars there is no reasonable justification for identifying Keynes together with the protagonist of the welfare state. “It is simply unreasonable to claim that [the] growth in government is the *logical* consequence of Keynes’s views on the functions of government, as distinct from those of his followers” (Peacock,1999). “Keynes was concerned that expansionary fiscal policies should not give rise to mounting budget deficit” (Dimsdale, 1988).

Showing a significant deviation from the classical economic model, Keynes emphasized the responsibility of the government in minimizing the disequilibrium in economy, both sectoral and total, by manipulating fiscal policy and monetary policy through taxation and interest rate adjustment. It is under this rationale that Keynes proposed that public investing, through taxation or public debt in the form of bonds, would need to be used as the central element in an entire program of discretionary policy. In fact, Keynes proposed that governments must act as compensatory agents at all times to ensure full employment by way of a broad array of programs in discretionary fiscal policy, which assures checks and balances in every aspect of the capitalist economy. As to what is to be done in good times, Keynes proposed that, as tax revenues increased, public deficit should be reduced. In practice, this was more difficult to do and tended to generate inflation, as public spending, many times because of political interests, would increase the money stock, which is to be deliberated on subsequent chapters.

The main theoretical contention of Keynes is built on the vital role anticipated to be performed by the effective demand, required to be stimulated by the state using public expenditure when it performs below the required velocity, which may work through multipliers and multicycles io increase employment, investment and vibrancy of the whole economy. The need for decreasing unemployment through the discretionary fiscal policies is the core concept of Keyes, but the free disposal facilities in the forms of finance and/or comestibles has never been in the box ofpolicy paraphernalia prescribed by Keynes, though his thesis has been sometimes misinterpreted other way around.

Keynesian influence on fiscal policy and the role of government is well illustrated in the Figure 2.2 in which a third sector is added to the classical economic model of two factor theory where a dynamic role is assigned to government in the place of the invisible hand that is driven by the desire of individuals as well as firms to earn maximum level of profits.

Figure:2.2
Three Factor economic Model



Source: Author Compilation.

Since laissez-faire model failed to explain the phenomenon of depression that occurred in the 1930s, the need for developing an alternative model was felt very urgent and the result is the emergence of Keynesian model in which the 'invisible hand' of the Smithian model is replaced with the much visible hand of government that plays not only the role as a regulator of the economy but also as the manipulator of market forces when they do not perform the expected tasks in the economy. In the three-factor model, as depicted in Figure 2.2, government function is identified as the rudder of a ship that is assigned the responsibility of changing the direction of the 'state ship' through proper management of fiscal and monetary policies. As Keynes foresaw equilibrium of the economy at below full employment level is to be anticipated since demand and supply functions are sometimes operated below optimum level due to intricacies associated with the two independent variables.

Keynes postulates that such situations should not be allowed to perpetuate unattended; instead, the government deploys fiscal policies including taxation and budgetary policies on one hand and monetary policies such as interest rate on the other hand to wean off forces of disequilibrium for achieving a satisfactory level of economic growth at which effect of malicious disturbing forces of the economy is pacified.

Nevertheless, in any case, in a democracy, governments are obliged, in principle, to provide conditions for full employment, and in Keynes economic philosophy, to this endeavour, direct support of the unemployed is necessary to maintain aggregate demand regulate the nihilistic forces, excesses and contradictions of capitalism that emerge in the and establish a minimal platform for a Welfare State. This, of course, was something dreaded by the conservative forces because the government must intervene through taxation and other forms to control and economic cycle.

As against being supportive of the welfare state, Keynes presented his theory to protect the capitalist world from the depressive conditions of the 1920s and 1930s, characterized by:

1) Mass unemployment,
2) The collapse of commodity prices,
3) Large competitive currency devaluations with protectionist beggar-thy-neighbour policies,
4) Deflation and
5) Stock exchange crises (Alvaro, 2001).

In fact Keynes proposed that governments must act as compensatory agents at all times to ensure full employment by way of a broad program of discretionary fiscal policy, which checks and balances every aspect of the capitalist economy. Keyes emphasizes that the simultaneous equilibrium in both the money market and the goods market is essential for economic stability and his logical explanation of the process of reaching long term market stability is presented in the well-articulated IS- LM model which became a whole mark apparatus in the study of macroeconomics in the subsequent years. The solution offered by Keynesian approach inter alia is the stimulation of effective demand through government intervention by the application of fiscal and monetary policies as supplementary measures in situations where endogenous market forces are not vibrant enough to produce expected dynamism in consumption and investment functions.

The position occupied by the Keynesian model vis a vis classical economic paradigm is very often explained in uncertain and ambiguous manner. There is no agreement to date among the economists about what constitutes the revolutionary elements in Keynesian's work. (Canterbery, 1987). According to a well-researched publication on Keynesian revolution, "The revolution was solely the development of a theory of effective demand: i.e., a theory of the determination of the level of output as a whole" (Klein, 1966).

However, in fairness to the Keynesian school, the contributions made by Keynes to the expansion of macro-economic theory is extended over a wider spectrum of knowledge including consumption and investment multiplier concept, IS-LM analysis, aggregate demand and role of interest rate in the economy which are recognized even by the harsh critiques of the model as landmarks in Keynesian economics. "Keynes geared economic theory to policy making. Word wars, worldwide depressions and the growing complications of modern life undermines laissez-faire. …. Keynes provided both an explanation of fluctuations and a program to mitigate them. The role of economists and economic analysis in shaping the direction of government policy was thus greatly increased." (Stanley, 2000). The connotation of the statement is that the Keynesian ideology, wittingly or unwittingly, encouraged the practice of government intervention increasingly in matters of economic decision making contrary to the advocated policy of classical economists.

Perhaps it can also be argued that Keynesianism has been purposely misinterpreted by welfare leaned policy regimes to justify their approaches tagging them to theoretical underpinnings of Keynes. However, the controversy seems to be further deepened as some scholars believe that the state intervention, as prescribed by Keynesian ideology, is what leftists leaned governments practice in many parts of the world which is tantamount to the obstruction of market forces in their natural interplay. Keynes in fact did not seek the end of capitalism, quite the opposite. He desired to save it and make its progress, its development. Rejecting the laissez-faire doctrine, he proposed a regulated capitalism, whose market disfunctions were dealt with through state intervention. Keynes's economic policy proposals extensively suggested regular state economic intervention to regulate economic activity and, consequently, reduce unemployment and mitigate the unequal distribution of income and wealth. State economic interference was seen by Keynes as indispensable to 'stabilize the instability' inherent to capitalism.

Still, Keynes's major goal regarding state economic intervention remained an unanswered question. Would his final goal only be the stabilization of the economic system? Keynes's intentions were even greater. He hoped to push capitalism to a superior level, at which it would prevail what he understood as economic development."(Fabio et. Al. 2020) The mystery of Keynesian role as the creator of the welfare state is further deepened, as it is evident from the previous narrations of the same chapter.

"Keynes's work on behalf of national reconstruction and the reduction of unemployment was fundamentally social in character in observing the psychology of social renewal and inclusion as well as establishing minimally adequate living standards for all." (UNRISED, 2002). The view expresses by the UNRISED paper goes a further step beyond the position of promoter of the welfare state but also identifies Kayne's ideology moving parallel with socialism which propagates the alleviation of poverty and redistribution of income. As it has been stated in the UNRISED report "Keynesianism therefore had two particular effects. One was in re-directing international economic development within a more disciplined relationship between market and state - including setting up the Bretton Woods institutions. The second effect of Keynesianism was in increasing the momentum in favour of establishing welfare states in Europe."[37]

Based on the above analysis, it can be stated that Keynes suggested an economic model in which economic interventions deem to be playing a critical role in adjusting the lapses that could not be rectified by the seamless open market operations as suggested by the classical model. The Keynesian model in this context perceives that disequilibrium in the economy is caused by declining aggregate demand, therefore prescribed the stimulation of aggregate expenditure (AE) or GDP, as shown in the formula below, by the intervention of government (G) through fiscal and monetary policy action when consumption and investment (I) perform a dormant role in the economy; nevertheless the model does not specifically prescribe that government intervention should take the form of free transfer of government funds to eleemosynary groups of the society .

$$AE = C + I + G + (X - M).$$

An overwhelming majority of scholars who reviewed Keynesian model does not support the stand taken by the above writer in toto, but still they do not vehemently deny that Keynes ideology has exerted no influence on the formation of the welfare

37 UNRISED, (2002), Social Policy and Development, , Geneva, p.11.

state. As John Robinson points out, in a world where the equilibrium is the normal order of the day, Keynesianism has absolutely a moribund phenomenon. “For a world that is in equilibrium, there is no difference between the future and the past, there is no history and there is no need for Keynes.”[38] However, the pertinent question is whether the world is in perpetual equilibrium or ever reach static equilibrium in the vortex of continuous change taking place with leap and bounds.

In this context, the mediocre position between the two extreme interpretations on the impact of Keynes on the welfare state can be conveniently comprehended if one looks into the tasks bestowed upon Keynes under the prevailing circumstances in the contemporary period. Being a bureaucrat in the British government, the task entrusted to him was to find a lasting solution to the economic downturn accompanied by the high rate of unemployment which was considered as an immediate priority. In that perspective, Keynes being assigned with the responsibility of solving a pressing economic problem was more concerned about finding an empirical solution rather than developing a scholarly economic model; which resulted in the writing of the General Theory of Money, Interest and Employment.

In the extensive literature survey conducted on Keynesian economic model in this section no conclusive evidence has been revealed to testify that he prescribed transfer payment to the eleemosynary social groups, in the mode it has been carried out in modern welfare states, to eliminate inequality or social discrepancies, by increasing present consumption at the cost of future economic growth. However, the Keynesian postulate of the necessity for government intervention in managing the effective demand as a supplementary strategy when market forces are not sufficiently dynamic made an ever-lasting impact on the creation of modern welfare state. Although Keynesian position is inexactitude on welfarism, developing countries in Asia and other parts of the world currently maintain deficit budgetary practice in conjunction with expansionary fiscal policies that are in line with the Keynesian recipe for stimulating effective demand.

2.2. Economic Stagnation and Stagflation:

2.2.1. Introduction to Stagnation:

Literature survey on the subject of economic stagnation is a tall order in the sense that varying definitions, subdivisions of the body of knowledge into peripheral areas and the scope of the subject itself are the issues that must be grappled by any researcher who ventures into a mapping up of this subject area.

To begin with, a research article published by Rodger in 2016 provides a lucid but very informative description on the origin as well as areas of special concentration of each theory available up to the time of publication on stagnation; presented in chronographic sequence. Lawrence Summers (2014,2015) has argued that we might be facing a situation of secular stagnation: a long period of low growth amounting to something beyond a regular cyclical downturn. Thomas Piketty (2014), in a book that attracted even more notice than Summers’s article, drew attention to the trend towards

38 John Robinson, (1970), “What Has Become of the Keynesian Revolution?”,2d ed, Chicago University Press. P.91.

increasing inequality and its consequences. These are both ideas that have generally been excluded from macroeconomics. Secular stagnation has for many years been considered empirically irrelevant and theoretically problematic, whilst economists have in general opted to refrain from discussing distributional issues, which raise welfare issues that are hard to treat without making political or ethical value judgments that few economists are comfortable making. The typical dynamic stochastic general equilibrium (DSGE) model used in modern macroeconomics abstracts from income distribution by analysing the behavior of a representative agent, and whilst imperfect competition may allow for unemployment, few macroeconomists took seriously the idea that long-term stagnation might be a serious possibility."[39] The article critically examines the causes of stagnation in the context of natural economic paradigms that are caused by the mismanagement of demand side and supply side economics. Three pertinent issues related to stagnation are raised by the writer in his article.

1. What is meant by the term secular stagnation?
2. Does stagnation involve output lagging persistently below full capacity or does it involve a slowdown in the growth rate of productive capacity?
3. Is there a connection between inequality and any tendency towards stagnation?

Before the examination of the theoretical underpinnings and the factors that contribute to the stagnation in different countries, it is more appropriate to deliberate on the general terminology used in identifying the behavior and typifying of stagnation.

In general nomenclature, economists described stagnation as economic slowdown, low growth rate accompanied by high rate of inflation, that occur in the trade cycle as a short run or prolonged phenomenon in different countries. Under stagnation in an economy, the total output tends to be either declining, flat, or growing slowly. Persistent unemployment is also recognized as a salient characteristic of a stagnant economy. Stagnation results in flat job growth, no wage increases, and an absence of stock market booms or peaks. In economic literature different terminology is used to identify the type of stagnation on the basis of the factors that cause the stagnation. Parallel with the term stagnation, another term has been coined by economists to describe a similar economic downturn referred to as stagflation. As Krugman states "To describe the unusual macroeconomic conditions of 1974- 1975 economists coined a new word that has since become commonplace: stagflation, a combination of stagnating output and high inflation. Stagnation was a result of two factors.

1. Increase of commodity prices that directly raised inflation while at the same time depressing aggregate demand and supply.
2. Expectations of future inflation that fed into wages and other prices in spite of recession and rising unemployment."[40]

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39 Rodger E B et al, (2016), Theories of Stagnation in Historic Perspective, European Journal of Economic Policies: Intervention, Vol. 13 No. 2.

40 Paul R K et al, (2000), International Economics, Theory and Policy, Addison Wisely Longman, Singapore, P. 579.

Economists have analyzed the occurrence of stagnation in the following widely different circumstances:

1) Stagnation during certain stages of the business cycle in industrial economies. This type of stagnation is temporary, for it marks a transition in the cyclical process.
2) Stagnation in the advanced stages of economic growth. This is a more permanent stagnation. It plays an important role in the classical analysis of economic maturity marked by the advent of the “stationary state” and in the Keynesian analysis of the “secular stagnation” of an advanced capitalist economy.
3) Stagnation in poor, underdeveloped countries. Here stagnation may persist because the economy is dominated by unchanging traditional patterns of economic and social life, which have remained untouched by outside forces and in which there is no incentive to change. Or it may persist if the economy is in the grip of certain types of “vicious circles” that defeat all efforts to advance and that hold the economy in a state of “static equilibrium” at low levels of income. This type of stagnation is analyzed in the theories of the economic development of poor countries.

4) Stagnation in economies facing difficulties in adapting to changed external circumstances, suffering from the aftermath of severe shocks such as wars and plagues, from gross maladministration of economic affairs, or from political instability. This type of stagnation is discussed more by economic historians than by economists.

5) Stagnation of economies that seem to be suffering an inexplicable decline in enterprise and “vigor.”

The last two types of stagnation, unlike the first three, are not due to inherent characteristics of the economic system but are the consequence of external changes or internal decline, which may have occurred for either economic or non-economic reasons, or both.[41]The discussion up to now elucidates that economic stagnation surfaces in different variants depending on the economic structure and vulnerability to the exogeneous pressure faced by a given country and its duration is determined on the basis of soundness of country’s economic fundamentals and fiscal management strategy adopted by the government as counter measures against stagnation.

2.2.2. Typology of Stagnation:

Cyclical Stagnation:Stagnation sometimes occurs as a temporary condition in the course of an economic cycle or business cycle. This could happen as a growth of recession or a stalled recovery from a full recession. A business cycle is completed when it goes through a single boom and a single contraction in sequence. The time period to complete this sequence is called the length of the business cycle. A boom is characterized by a period of rapid economic growth whereas a period of relatively stagnated economic growth is a recession. These are measured in terms of the growth of the real GDP, which is inflation-adjusted.

41 Stagnation, Encyclopedia.com, 2021.

In a typical economic growth cycle, four types of fluctuation are identified in relation to the steady growth line extrapolated horizontally.

1) Expansion: The first stage in the business cycle is expansion. In this stage, there is an increase in positive economic indicators such as employment, income, output, wages, profits, demand, and supply of goods and services. Debtors are generally paying their debts on time, the velocity of the money supply is high, and investment is high. This process continues as long as economic conditions are favorable for expansion.
2) Peak: The economy then reaches a saturation point, or peak, which is the second stage of the business cycle. The maximum limit of growth is attained. The economic indicators do not grow further and are at their highest. Prices are at their peak. This stage marks the reversal point in the trend of economic growth. Consumers tend to restructure their budgets at this point.
3) Recession: The recession is the stage that follows the peak phase. The demand for goods and services starts declining rapidly and steadily in this phase. Producers do not notice the decrease in demand instantly and go on producing, which creates a situation of excess supply in the market. Prices tend to fall. All positive economic indicators such as income, output, wages, etc., consequently start to fall.
4) Depression: In economic terminology, depression is defined as a major downturn in the business cycle characterized by sharp and sustained declines in economic activity; high rates of unemployment, poverty , and homelessness ; increased rates of personal and business bankruptcy; massive declines in stock markets; and great reductions in international trade and capital movements. A depression may also be defined as a particularly severe and long-lasting form of recession, where the latter is generally understood, relative to a national economy, as a period of at least two consecutive quarters of decline in real (inflation-adjusted) GDP, or gross domestic product. According to the National Bureau of Economic Research, which maintains records of the cyclical peaks and troughs in U.S. economic activity dating to 1854, a recession is “a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales,” while a depression is “a particularly severe period of economic weakness” that is commonly understood to last from the onset of economic decline to the return of normal economic activity.[42]

In the Figure 2.3, the straight line in the middle is the steady growth line. The business cycle moves about the line marking fluctuations in a cyclical pattern.

Structural Stagnation: A stagnant economy can also result from longer-term, power among structural conditions that are inherent in economic sectors such as agriculture, mining, manufacturing and many other sub spheres in a country. When stagnation occurs in a stable economy, it can be much more permanent than when it results from economic shocks or in the course of a normal business cycle.

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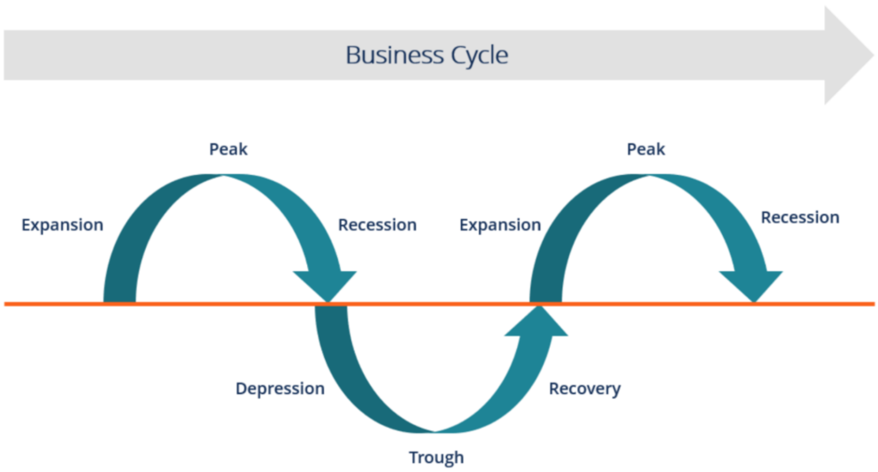
42 Britannica, (2021), Depression Economics. www///.

Stagnation is not a phenomenon confined only to developing countries but also can exist in an advanced economy with economic maturity. Mature economies are characterized by slower population growth, stable economic institutions, and slower economic growth rates. Classical economists refer to this type of stagnation as a stationary state, and Keynesian economists consider it as the secular stagnation of an advanced economy. Institutional factors, such as entrenched incumbent special interest groups who oppose competition and openness, can induce economic stagnation. For example, Western Europe experienced this type of economic stagnation during the 1970s and 1980s, dubbed Euro sclerosis.
In developed countries, recessions and stagnations, like conjoined twins, are characterized by falling output and employment; at the opposite end of the spectrum is an “overheating” economy, characterized by unsustainably rapid economic growth and rising inflation. The situation in underdeveloped countries very often demonstrates a different behaviour showing prolong recession with no turning back to normalcy in the foreseeable future.

Figure: 2.3.

Stages of the Business Cycle.



Source: Business Cycles, 2021.

In such economies, stagnation persists due to the lack of change in political or economic institutions where there is no incentive to adapt and grow. Additionally, emerging or underdeveloped economies may get stuck in a static equilibrium due to economic or institutional factors, such as a resource curse or predatory behavior by local elites.

Cultural and population characteristics can also contribute to economic stagnation.
Figure 2.3 illustrates the different phases of business cycle that includes three stages such as expansion, peak and recession. Below the horizontal line appears the negative perspectives, depression and trough, which cause a turbulent period in the economy of the country that goes through the business cycle.

A low-trust culture can handicap economic performance by discouraging adherence to contracts and property-rights. A population with (on average) lower conscientiousness, lower general cognitive ability, or high rates of endemic, debilitating disease can experience slower economic growth as a result.

Economic Shocks: Specific events or economic shocks can also induce periods of stagnation. These may be very short lived or long lasting effects, depending on the specific events and the resilience of the economy. War and famine, for example, can be external factors that cause stagnation. An unusual increase in global oil prices or large-scale catastrophe of agricultural crop due to pestilence for instance causes such economic shocks, the effect of which is generally short lived if a country possesses the recovery mechanisms propelled by sound economic fundamentals.
In the same way a sudden increase in oil prices or fall in demand for a key export could also induce a period of stagnation for an economy. However, some economists, who favor Real Business Cycle Theory, would consider such periods essentially the same as cyclical stagnation.

The term secular stagnation refers to a market economy with a chronic (secular or long-term) lack of demand. Historically, a booming economy with low unemployment and high GDP growth (i.e., an economy at or above capacity) would generate inflation in wages and products. However, an economy facing secular stagnation behaves as if it is operating below capacity, even when the economy appears to be booming; inflation does not appear. In a healthy economy, if household savings exceed business investments, interest rates fall; lower interest rates stimulate spending and investment, which bring savings and investments into balance. However, an economy facing secular stagnation may require an interest rate below zero to bring savings and investment into balance. The surplus of savings over investment may be generating price appreciation in financial assets or real estate. For example, the U.S. had low unemployment but low inflation in the years leading up to the Great Recession , although a massive housing bubble developed.

Secular stagnation: The concept of secular stagnation dates back to the Great Depression, when some economists feared that the United States had permanently entered a period of low growth. *The Economist* explained in 2018 that many factors may contribute to secular stagnation, by either driving up savings or reducing investment. Households paying down debt (i.e., deleveraging) increase savings and are spending less; businesses react to the lack of demand by investing less. This was a major factor in the slow U.S. GDP growth during 2009-2012 following the Great Recession. Another possible cause is income inequality, which shifts more money to the wealthy, who tend to save it rather than spend it, thus increasing savings and perhaps driving up financial asset prices. Aging populations (which spend less per capita) and a slowdown in productivity may also reduce investment. Central banks face a difficult dilemma; whether they raise interest rates to ward off inflation (e.g., implement monetary policy austerity) assuming the economy is in a cyclical boom, or assume the economy (even if temporarily booming) is in secular stagnation and therefore take a more stimulative approach are important issues that require attention.

Stagflation: Stagflation is a term used by economists to define an economy that has inflation, a slow or stagnant economic growth rate, and a relatively high unemployment. Stagflation compared to stagnation is an economic situation where slow economic growth or stagnation, or even recession, coexists with high inflation. Normally periods of high economic growth are characterised by price rise. Economic growth drives incomes of corporates and employees which in turn results in more demand for goods and services. This leads to inflation and becomes a reinforcing loop.

The reverse situation is experienced during periods of recession, which is usually accompanied by deflation. In contrast, stagflation is a situation where incomes shrink and yet prices rise. The US and UK underwent similar economic characteristics of stagflation in the 1970s. The current situation of Sri Lanka very likely resembles all major characteristics of stagflation with declining personal income and spiraling price escalations of commodities.

2.2.3. Causes and Effects of Stagnation – Theoretical Underpinnings:

In a world that has become addicted to easy monetary policy as the panacea to all economic ills, stagflation would be like blocking the jugular vein. The aim of easy monetary policy is to stimulate the economy by storking demand. But if slow economic growth is accompanied by price rise, then the challenge is that the problem cannot be addressed by cutting interest rates and quantitative easing and money printing,which can be contrasted to adding fuel to fire.

Stagflation in the US in 1970s was attributed to three factors — the oil supply shock, poor policy decisions by the Nixon government like high import tariffs and removal of the gold standard, and accommodative monetary policy. In the US, the Federal Bank balance sheet has doubled to nearly $8 trillion in 18 months. This apart, the world is also going through supply shocks driven by delayed supply responses in some commodities and shortages of key components like semi-conductor chips in key industries. Tariff wars and protectionism — policy decisions that are inflationary, have also been in play in the last couple of years. Connecting those salient characteristics , it is possible to arrange all the three main factors that caused the 1970’s stagflation, supply shocks, government policy decisions and ultra-accommodative monetary policies.

The pain of economic slowdown, high inflation and high unemployment in the US due to stagflation was ended by the ‘Volcker shock’. US Fed Governor Paul Volcker facing the risk took the politically difficult decision of sharply increasing the Fed rate to fight inflation. This solved stagflation, but only after causing a recession in 1981.

Various factors are thought to have given rise to the Great Depression, whose primary cause was a dramatic decline in spending, or aggregate demand. They included the U.S.stock market crash of 1929, also called the Great Crash, a sharp decline in U.S. stock market values in 1929 that contributed to the Great Depression of the 1930s. The Great Depression lasted approximately ten years and affected both industrialized and nonindustrialized countries in many parts of the world,which headed to a devastating effect on consumer confidence throughout the country; banking panics, which caused many banks to fail and thereby greatly reduced consumer spending   and business investment.

The contractionary monetary policy of the Federal Reserve (the central bank of the United States also stifled spending and investment and led to deflation. The international gold standard, which served to spread the U.S. downturn to other countries; and protectionist policies in several countries, including the United States, whose cumulative effect was to reduce international trade are the immediate contributing factors to the great depression. Beginning in the 1930s, countries around the world implemented policies designed to prevent another downturn on the scale of the Great Depression and to moderate the worst effects of ordinary recessions as well. The changes included increased government regulation of the financial and banking industries, the use of expansionary monetary and fiscal policies to stimulate economic growth , and direct government assistance to the poor and unemployed.

In respect of the theoretical underpinnings of stagnation, Summers emphasizes the role of aggregate demand in creating the conditions under which stagnation is likely to be a recurring problem. Against this is the argument, represented by Gordon (2014; 2015), that stagnant growth is a supply-side phenomenon. He argues that the gap between actual and capacity output is falling, and that the problem is a slowdown in productivity growth.[43] As elaborated by Hobson and Mummery, high savings were being invested in capital goods that were being used to produce more goods than could be sold, given the low level of consumption. It was an argument about the balance between the flow of spending and productive capacity.[44]

A diverse view was presented by Hansen, with the coining of new term "secular stagnation, the basic notion behind 'Secular Stagnation' is that the capitalistic economy is basically characterized with instability.[45] Therefore, the responsibility of government encompasses the creation of a coordinating mechanism between the economic sub sectors through state intervention that requires acceleration of government expenditure in the sectors of the economy which are nor self-propelled as anticipated by the open economic system. The followings are the salient features of his thesis:

1) The fall in the birth rate will affect the process of economic growth. In this way, the economic motivation will come to an end and the economy will experience stagnation.

2) The economic motivation and development will also be influenced by fall in autonomous investment due to fall in population. Again the discovery of new resources will also become difficult.

3) The population of a country, the number of its people, and the people itself play an important role in the economic life and in economic fluctuations.

The other economists like Mathews, Gordon, Handerson and Kurihara have also supported Hansen. They are of the view that the fluctuations in supply of labor play an important role in the determination of time schedule of trade cycles. After 1930's Great Depression a thinking developed in US and UK that they cannot only face short run unemployment, but they can also experience the depression and crisis relating to long run period. This may occur due to fall in marginal efficiency of capital (MEC) in long

43 Rodger E at el, (2016), Theories of Stagnation in Historical Perspective, European Journal of Economic Policies: Vol. 13 No. 2.
44 Ibid.
45Hansen, A.H., (1921), Cycles of prosperity and depression in the United States, Great Britain and Germany: a study of monthly data, 1902–1908. Madison: University of Wisconsin Studies in the Social Sciences and History.

run. The economic growth in long run is attributed to rise in per capita income. While the stagnation shows that in long run the per capita income has become constant or it has fallen down, or it increases less than earlier.

According to Hansen, when such all happens, the capitalistic economies fail to maintain that high level of income and employment which could be possible due to the potential resources of the economy and technical progress. The secular stagnation theory is concerned with the Maturity stage of capitalistic economies, where the savings increase at the level of full employment but the net investment falls. As a result, the economic activities shrink. The short run crisis and depressions become acute and tense. The boom and prosperities are weaker and short-lived whereas the depressions are stronger and long-lived. Hansen further says that the sick type of revivals die even in their infancy while the depressions become powerful and more powerful. Consequently, the problem of unemployment gets acute day by day.

Thus, according to this theory a developed and mature economy may experience 'Deflationary Gap'**.** And in case of long run, the determined level of income may be at below full employment level of national income. In such situation, there will be unemployment and the level of the output of the economy will be far less than that output which could be possible because of the resources of the economy. In such situation the level of income may be less than earlier, or the increase in output of the economy may be very slower46.

Secular Underdevelopment Equilibrium:

At the secular under employment level, equilibrium may occur due to two reasons:

1) At full employment level the investment is not capable enough to offset the savings.
2) The propensity to consume remains more or less constant.

Because of these reasons such a level of equilibrium will come into being where unemployment will grow in the economy. This situation will last for a longer time. And when unemployment or under employment lasts for a longer period of time it is given the name of secular stagnation equilibrium.

As OECD Economics Department Working Papers explains, secular stagnation arises as a situation when policy interest rates bounded at zero fail to stimulate demand sufficiently, due to low or negative neutral real interest rates and low inflation, and when ensuing prolonged and subdued growth undermines potential growth via labour hysteresis and discouraged investment. Obtaining firm evidence is complicated by considerable uncertainties surrounding estimates of economic slack and its impact on inflation, crisis-related hit to potential output and neutral interest rates.

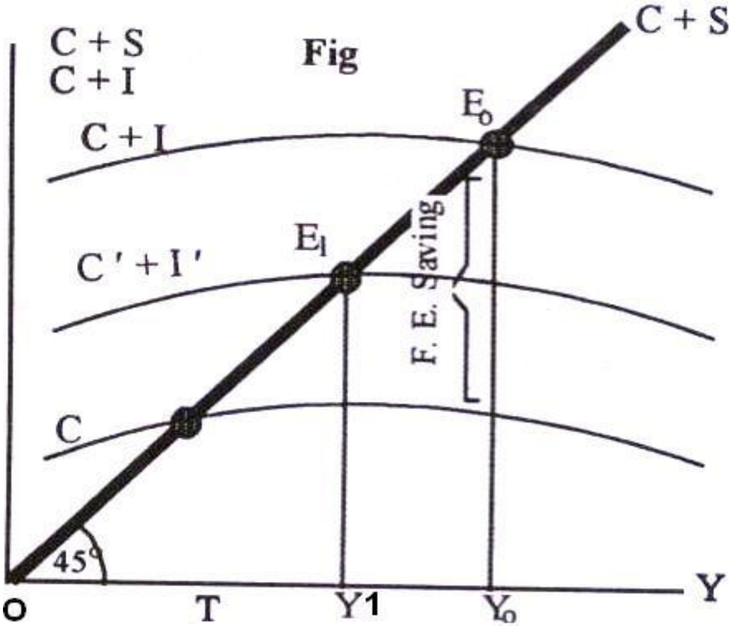
46 Hansen, A.H., (1921), Cycles of prosperity and depression in the United States, Great Britain and Germany: a study of monthly data, 1902–1908. Madison: University of Wisconsin Studies in the Social Sciences and History.

However, signs of secular stagnation are most evident in the euro area, particularly in the vulnerable members, in contrast to the United States and the United Kingdom, where evidence is less firm. Japan is arguably in the advanced stage of secular stagnation that started almost two decades ago. In countries with symptoms of secular stagnation, more monetary and fiscal stimulus should be accompanied by structural reforms to boost potential growth and neutral rates.[47]

As shown in Figure2.4, Juxtapose that the point E_o represents full employment equilibrium level of National Income (NI). Here the AD curve (C + I) is capable enough to offset the savings which are being made at Y_o level of NI (assumed to be full employment level). In other words, here the investment of full employment is equal to savings of full employment. Because of many a reasons, the investment decreases - as shown by the curve $C^/ + I^/$.This intersects C + S curve at E_1leading to the income level of OY_1. This level of income is lower than Y_o. Because of fall in income the people will get unemployed.

Figure:2.4.

Secular Stagnation Equilibrium.



Source: Author Compilation.

Therefore, in order to maintain the income of full employment either the savings will have to be decreased or investment will have to be increased. If savings decrease the

47 OECD Economics Department Working Papers, (14 October,2014), Secular Stagnation: Evidence and Implications for Economic Policy.

consumption will increase and AD will not fall and the economy will go on operating at full employment. In this way, the secular stagnation could be minimaxed or preempted.

As suggested by the Keynesian model, it may be a moot point to question whether government's infusion of money, by way of social security expenditure, in economically dormant sectors leads to the reduction of the level of unemployment. In a society where propensity to consume is very high, the increased government expenditure by way of social security assistance accelerates the already bloated consumption elevating normal inflation to hyperinflation.

According to the Keynesian model, most of the suboptimized operations in an economic system are attributed to the insufficient effective demand, therefore as Keynes suggests the solutions are to be designed to stimulate the ineffective demand through government intervention. Furthermore, he stresses that when an economy reaches full employment level, factor prices tend to increase due to supply side pressure built up in the factor marke.

A pre-retirement for a long-term equilibrium in an Economy, Keynes states, both money market, monetary sector and real market sector, are required to reach equilibrium simultaneously.

According to Hansen, because of fall in MEC the level of investment comes down. The decrease in investment ultimately generates unemployment and stagnation. Not only Hansen, but also the orthodox economists like Smith, Ricardo, Marx, J.S. Mill and modern economists like Schumpeter, Harrod and Domar maintain similar views that in capitalistic economies the rate of profits has a tendency to fall down. As a result, the capitalistic system will face stagnation and crisis.

A similar situation is identified by Smith and Ricardo's models of economic growth which state that after economic maturity an economy enters into 'Stationary State'. While Marx and Schumpeter's model conclude with the "Demise of Capitalism". Again, according to Harrod- Dorma (HD) model it is difficult to maintain equilibrium at full employment.[48] This particular status in the economy can be observed in developed countries in Europe and America where growth rate remains at very low level that negatively impacts on the nethermost stratum of the society with widening gap of income distribution.

It is obvious from the above review that stagflation is a recurring economic phenomenon accompanied by business cycle in developed as well as developing countries; however, if the situation remains over a prolong period without being gradually subdued then it becomes an infection in the economic health of a country that can reach a point of no return without painful economic surgery is applied.

48 The Harrod-Domar model is a Keynesian model of economic growth. It is used in development economics to explain an economy's growth rate in terms of the level of saving and of capital. It suggests that there is no natural reason for an economy to have balanced growth.

Keynesian View on Secular Stagnation:

Keynes himself did not present any theory regarding secular stagnation. However, he agreed with the postulation since a fall in population would cause investment to decrease. To meet this situation, either the rate of interest will have to be decreased or consumption expenditures will have to be increased. Moreover, Keynes says as an economy gets affluent the gap between actual and potential output will increase. In such situation the defects of capitalistic system will come to lime light. In affluent societies the MFC becomes weakened as well as the attraction in investment opportunities comes down because of concentration of capital in a few hands.

In view of the literature available in this polemic, Keynes' and Robinson's contribution to the knowledge on secular stagnation and its causes is succinctly described as follows.

1) The exogenous factors like technology, increase in population, and discovery of new regions and markets.
2) The endogenous factors like concentration of industries and growth of monopolistic competition.
3) The social changes in the society as govt's control over the businesses and pressure of trade unions.

In addition to the theoretical polemics discussed above, the literature survey finds the the following theoretical reasons causing the existence of secular stagnation.

1) The paradox of thrift.
2) The income inequalities which promoted savings.
3) The increased corporate savings, the increase in the ratio of dividends and the growth of insurance business which increased savings.
4) The population declined in Europe and US which reduced investment.
5) Because of fall in population and non-discovery of new regions etc. the expenditures will not have to be made on means of transportation, bridges, canals and power houses etc. As a result, the investment will decrease.
6) Along with growth of capital the MEC will decrease. This will discourage new investment.

Because of growth of capitalism the demand for capital saving technology also increased which decreased investment. As with the growth of atomic technology the demand for hydrow and thermal plants has been decreased.

1) The inventions and innovations reduced employment or encouraged unemployment. Again, with the passage of time the space race expenditures and defense expenditures are decreasing. With this all investment is decreasing.
2) The external trade sector problems are rising; the exports are not increasing; the climate for foreign investment is not improving; and the flow of foreign aids and loans is decreasing. Consequently, the investment and expenditures remain low.

Because of all the above mentioned reasons, either the savings increase or investment decreases, capitalistic economy is positioned in an economic dilemma that surfaces in the form of secular stagnation in a cyclical pattern.

2.2.4. Alternative Theories of Stagnation:

Hansen's was not the only theory of stagnation. A similar notion could be derived from the idea, widely used in the 1930s, that there were 50-year “Kondratiev” cycles in economic activity.[49] A Kondratiev downturn might, till the upturn, be hard to distinguish from secular stagnation. So too might the lulls between Schumpeterian waves of innovation. But this was as much a description of the problem as an explanation. Apart from the Marxian approach supported by Paul Sweezy and Klein, Schumpeter and Steindl put forward distinct explanations of the lack of dynamism of capitalism. Steindl, like Schumpeter, was concerned with the potentially depressing consequences of the shift of capitalism from competition to oligopoly. Whereas Schumpeter's *Capitalism, Socialism and Democracy* (1942) was widely read, Steindl's *Maturity and Stagnation* (1952) did not attract much attention until the 1970s, and then mostly by heterodox economists. The timing of Steindl's book did not help, as the American economy, stimulated by spending on the Korean War, was experiencing a period of economic growth. Whereas Steindl took Hansen (along with Kalecki) as a starting point, Schumpeter (1942, 1943) rejected what he called Hansen's “theory of vanishing investment opportunity”. Instead, Schumpeter (1943) argued that the capitalist process itself produces “anti-capitalist policies”: a distribution of political power, an attitude of the public mind, and an orientation of the political sector that “are at variance with its own law of life.”

Instead of searching for causes “which are in themselves puzzling and mysterious problems, like the development of technology and the trend of population”, Steindl (1952) looked at the growth of oligopoly as the explanation of the apparent decline in the rate of growth of the American economy since the end of the nineteenth century. According to his microeconomic model, this should be accompanied by increase in profit margins and fall in effective demand in relation to capacity.

Hansen (1954) wrote a largely positive review of Steindl (1952). He identified three types of stagnation theory: (i) theories based mainly on exogenous factors (technological progress, population, and new territories), represented by Hansen's own analysis and “perhaps also that of Harrod”; (ii) theories based on changes in social institutions (increasing state intervention, growth of the labour movement, non-competitive structures) and their impact on the “arterial sclerosis” of capitalism, as represented by Schumpeter (1942); and (iii) theories based on endogenous microeconomic factors such as the development of imperfect competition and oligopoly and their impact on income distribution and excess capacity, as represented by Steindl. This explained why Hansen looked to fiscal policy for the solution whereas Schumpeter and Steindl looked to changes in the price system.

It appears from the above historical narration that the concept of ‘stagnation’ is somewhat murky in particular with regard to its causes and its modifications;

49 The European Journal of the History of Economic Thought, Volume 28, Issue 5.

nevertheless, the majority of writers is in agreement that stagnation is caused by declining demand, dormant investment and fiscal mismanagement by monetary authorities in different countries.

2.2.5. Economic Stagnation in Sri Lanka:

The main sources of information on economic performance of sri Lanka are confined to a few government institutions including Central Bank of Sri Lanka, Department of Census and Statistics and limited mummer of research articles and books published by a limited number of scholars who were engaged in research in their personal capacity. Saman Kelegama writing on the economic growth of Sri Lanka sates “When Sri Lanka (then Ceylon) received independence in 1948 it appeared to be one of Asia’s most promising new nations…. Sri Lanka inherited from British a prosperous export sector organized along commercial lines, high education level in relation to other Asian countries and stable macro economy.”[50]

In post independent era, as Kelegana points out, the economic situation of the country gradually deteriorated which was characterized by the deficit in the balance of payment, increasing burden of debt, and dormant performance in the manufacturing sector. The situation was further aggravated in the 1970’s with the implementation of inward centered economic strategies. “The early 1960s strategy for dealing with the foreign exchange crisis was the gradual isolation of the economy from external market forces. It was the beginning of a standard import-substitution industrial regime, with all the controls and restrictions associated with such a regime. Nationalization and state intervention in economic activities were common during the early 1960s strategy for dealing with the foreign exchange crisis which resulted in the gradual isolation of the economy from external market forces. Nationalization and state intervention in economic activities were common during these years. With the capacity to import severely constrained, the need to develop means of earning, or saving more foreign exchange was even more urgent during 1948-60. Yet progress along either line continued to be slow; in part because export industries and import-substitution industries themselves continued to be heavily dependent on imported intermediate capital goods. The import-substitution industries did little to relieve the foreign exchange crisis, and the average growth rate during this period (1960-65) was 3.6 percent.”[51]

Kelegama goes into details by comparing Sri Lankas’ economic performance in the spectrums of foreign trade, infrastructure development, electricity supply and balance of payment and postulates that Sr Lanka lagged behind many South East Asian countries in respect of their contemporary advancement in the same economic atmosphere. The lackluster overall performance of the Sri Lanka economy till the year 2000 attributed to multiplicity of factors encompassing 1) lack of a long-term vision; 2) welfare policies; 3) uncertainty in the key economic sector 4)the policy of export pessimism; 5) lack of openness in the economic regime; and 6) lack of external assistance.[52] It is noteworthy to pay special attention to the second reason cited above;

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50 Saman Kelegama, (2000), Development in Independent Sri Lanka: What Went Wrong? Economic and Political Weekly, Vol. 35, No. 17.
51 Ibid.
52 Ibid.

the welfare factor, which siphoned off the bulk of scarce economic resources for the sake of achieving popular social goals rather than future oriented economic goals.

The Key economic indicators related to the post 2000 period cannot be interpreted as signs of vibrant economic growth or rejuvenation of the economy although civil war in the country came to an end in 2009.

Table:2.2

Macro-Economic Indicators.

Description	2015	2016	2017	2018	2018
1. GDP Growth	5.0	4.5	3.6	3.3	2.3
2. Inflation	2.2	4.0	6.6	4.3	4.3
3. Money Supply Growth(M2b)	17.8	18.4	16.7	13.0	7.0
4. Unemployment Rate.	4.7	4.4	4.2	4.4	4.8

Source: Central Bank of Sri Lanka.[53]

GDP growth, registered at five percent in 2015, reached a very low level of 2.3 percent in 2018 due to the influence of endogenous and exogeneous factors experienced by the country; the result of the steady decline has a tendence to produce equally or stronger negative influence on the GDP per capita since growth of average annual population remained at the same level. As per the provisional estimates of the (department of Census and Statistics) DCS the sri Lankan economy contracted by 1.6 percent, year on year, during the first, quarter of 2020 reflecting the combined impacts of disruptions caused by COVID 19 related lockdowns, subdued global demand amidst the pandemic and adverse weather conditions.[54] COVID 19, the reasons for the ailing economy as proclaimed by the Central Bank of Sri Lanka is contested by independent economic critics who attribute the problem to the deep rooted and structural inconsistencies of long habitat, both political and natural, that have eaten into the body economics of the country.

Even before the pandemic began, the 2019 Easter bombings paralysed Sri Lanka's lucrative tourism industry and, just as it was recovering from the attacks, the COVID-19 pandemic hit, leading to mobility restrictions and other containment measures, nationally and internationally.

Considering the worsening economic situation, international rating agencies have expressed concerns for Sri Lanka's ability to service its huge foreign debt as the country's foreign reserves fell sharply in 2020.

Table:2.3.
GDP world Comparison.

Region/ Country	Real GDP Growth Percentage					
	Average 2002-2011	2015	2016	2017	2018	2019

53 Central Bank of Sri Lanka, (2020), Sri Lanka Socio Economic Data, Colombo.
54 Central Bank of Sri Lanka, (2020), Recent Economic Developments, Colombo.

1.World.	4.1	3.5	3.4	3.9	3.6	2.9
2. Advanced Countries.	1.7	2.3	1.7	2.5	2.2	1.7
-USA	1.8.	2.9	1.6	2.4	2.9	2.3
- Japan	0.6	1.2	0.5	2.2	0.3	07
-Germany	1.1	1.7	2.2	2.5	1.5	0.6
3. Emerging Developing Europe	4.8	0.9	1.8	4.0	3.2	2.1
4.Emerging and Developing Economies	6.5	4.3	4.6	4.8	4.5	3.7
5. Emerging and Developing Asia	8.6	6.8	6.8	6.7	6.3	5.5
- China	10.7	6.9	6.8	6.7	6.3	5.5
- Indonesia	5.7	4.9	5.0	5.1	5.2	5.0
- India.	7.7	8.0	8.3	7.0	6.1	4.2
6. Sri Lanka	6.2	5.0	4.5	3.6	3.3.	2.3
7. Latin American and the Caribbean	3.6	0.3	-0.6	1.3	1.1	0.1
8. Middle East and Central Asia.	5.6	2.6	5.0	2.3	1.8	1.2
9. Sub Saharan Africa.	5.9	3.2	1.4	3.0	3.3	3.1

Source: IMF, World economic Outlook,2019.

"Prior to this, the economy and availability of government funds were already in severe pressure, as Sri Lanka struggled with revenue collection. In addition, the local currency came under pressure and fell to a record low, only to be bailed outby a $660 million loan from China."[55] For the purpose of verifying the validity of the counter argument, the afore inserted data in Table 2.3 pertaining to the economic performance of selected countries for the concurrent period provides a basis for comparative review of the overall situation.

The Table 2.3 depicts the key economic indicators of a cross section of selected countries including advanced economies, emerging and developing countries, Latin American and the Caribbean countries and Sub- Saharan African countries for the period 2015 and 2019.

It is evident from the Table 2.3 that the economic downturn in Sri Lanka, in terms of GDP growth rate in real value, inlayed in 2015, long before the pandemic started, which continued unabated till the eve of pandemic onset. Repercussion of the decline in GDP reflected on the GDP per capita income in 2020 spreading ripple effects in the total economy with contraction of both service and manufacturing sectors. "GDP per capita was estimated at rs. 683,106 (US dollars 3,682) in 2020, compared to Rs. 688,573 (US dollars 3,852) in 2019. The decline in GDP per capita in rupee terms was mainly on account of the contraction in GDP at current prices, while the decline in GDP per capita in US dollar terms was a combined outcome of the contraction in GDP at current prices and the weakening of domestic currency against the US dollar on an annual average basis. Meanwhile, GNI per capita was estimated at Rs. 664,620 (US dollars 3,582) in 2020, compared to Rs. 668,748 (US dollars 3,741) in 2019."[56]

The available resources of the economy at current prices contracted by 5.1 per cent in 2020 in comparison to the growth of 4.1 per cent recorded in 2019. In this regard, GDP, which is the domestic resources, as well as the imports representing the external

55 Jeewathan, S., A., (2021), Surging Crisis in Sri Lanka, Asia and The Pacific Policy Society.

56 Central Bank of Sri Lanka, (2020), Annual Report, P.36.

resources contracted in 2020, compared to the previous year. Both domestic and external resources contracted during the year at constant prices as well. Considering the utilization of the available resources at current prices, the most resources were utilized for consumption purposes, which accounted for 66.0 per cent of the total resource utilisation in 2020. However, a slight decline was recorded in the share of resources utilised for investment purposes which was 20.5 per cent in 2020. Further, the share of resources utilised for export purposes also declined. Meanwhile, the resource utilization at constant prices contracted mainly due to the decline in consumption and investments during the year.

Consequently, national savings as a percentage of GDP decreased to 23.9 per cent in 2020. Further, despite the contraction in national savings, the national savings-investment gap narrowed to 1.4 per cent of GDP in 2020, from 2.1 per cent of GDP in 2019, due to the considerable decline in investment expenditure. All the economic parameters indicated ghoulish signs predicting further deteriorations in the next few years. Rate of unemployment among younger members of the population, in particular female population, has gone up to an unusually high rate which are considered as a harbinger of further problems that surface as social unrest, migration, politicization of the issue and increase of dependent population over the years. Rate of unemployment of the country classified by age group reported at 5.7 percent in the year 2020 which is considered to be high in comparison to the rate of unemployment experienced by developing and developed countries in the word. The unemployment rate upto the third quarter of 2000 remained below the 1999 level, as both private sector and public sector employment grew. The rate of unemployment, which had declined from 15.9 per cent in 1990 to 8.9 per cent in 1999, was 7.7 per cent during the first three-quarters of 2000. However, the declining trend of unemployment appears to be ceased in 2012 showing a slight upward movement in the following years.

Another moot point as far as sources of employment is concerned, the Sri Lankan government has become a leviathan in occupying the position of the largest employment provider to the labour force.

In the meantime, the rate of unemployment as shown in Table 2.4 registered an upward movement 1n 2020 due to contraction of manufacturing and business operations in the country. Table 2.4 illustrates a skewed pattern of unemployment indicating a high concentration of unemployment in the age group 15-24 years which again highlighting the highest unemployment rate of 36.3 percent of females in the same age group. In the age group of 25-29, the male unemployment level is recorded as 7.1 percent while the same for female repeatedly registering a high unemployment rate of 18.9 percent in year 2020.

Table: 2.4.

Number of Unemployed and Unemployment rate by level of education – First quarter 2020.

Age group (Years)		Unemployment Rate (%)		
	Sri Lanka	Sri Lanka	Gender	
	Number		Male	Female
Sri Lanka	483,172	5.7	3.7	9.6
15—24	266,743	26.8	21.1	36.3
25—29	94,561	11.6	7.1	18.9
Over 30	121,867	1.8	0.8	3.8

Source: Sri Lanka Labour Force Survey 1st Quarter – 2020.

High unemployment rate among the population segments of economically active labour force is a clear indication of the restrictions on the expansion of the economy that renders it incapable of providing more employment to the younger people who enter the labour market after completion of their school career.

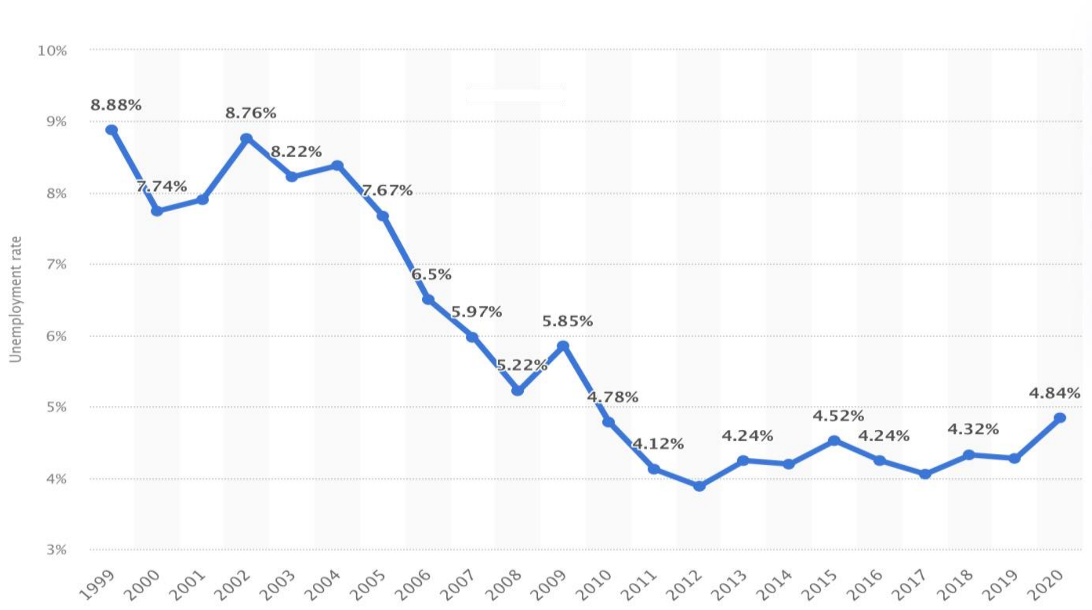
A research study conducted by William in1991 stresses "We believe that unemployment is generated in part by queuing for high-wage government jobs. We suggest that one reason the unemployed do not take other employment while queuing may be a perceived or real government preference for hiring the unemployed.
If our interpretation is correct, replacing government's hiring preference for the unemployed with a normal preference for workers who have demonstrated ability in previous work experience would reduce unemployment. A substantial fraction of the currently unemployed youth would begin actively seeking employment which would supply them with the requisite job experience to obtain government employment.[57]

Unemployment in any form plays the role of messenger informing in advance that severe crises loom over horizon that include inter alia social unrest, increase of dependent labour force, decline of per capita income which pose a fatal threat to the very foundation of economic stability. The economic date base of the country belonging to the contemporary period has already shown repercussions of high unemployment by way of out migration, frustration among youths and increase of antisocial activities.

57 William T et al, (1991), An Analysis of the Nature of Unemployment in Sri Lanka, National Bureau of Economic Research.

Figure:2.5.

Trend of Unemployment in Sri Lanka. 1999-2020.



Source**:** Aaron, Statista, 2021.

Since economic stagnation is a phenomenon characterized by high unemployment and low economic growth rate, a thorough analysis on those variables is warranted with the use of available literature to ascertain whether the economic vortex demonstrated by the country in 2020s are the signs of long drawn stagnation in Sri Lanka in the offing. The long-term trend and behaviour of unemployment between 1999 and 2020 encompassing a period of twenty years is depicted graphically in the Figure 2.5.

The figure 2.5 signifies a clear declining trend of unemployment from 1999 to 2012 and thereafter showing the signs of reversing the trend that continues till 2021 slowly but steadily. Increasing unemployment rate sends signals showing the cautionary grounds that policy makers tread since social tension, increase of dependent population, deteriorating standard of living are some of the adverse repercussions that would be following the foot prints of unemployment which in the long run leads to the prolong economic stagnation of the country.

Definitions of unemployment are ample and some of which are supposed to be tampered purposely by interested parties that are guided by the necessity of mitigating the gravity of the problem in the eye of the hoi polloi. The ILO in this context presents a very complex definition of unemployment. "The unemployed comprise all persons of working age who were: a) without work during the reference period, i.e., were not in paid employment or self-employment; b) currently available for work, i.e., were available for paid employment or self-employment during the reference period; and c) seeking work, i.e., had taken specific steps in a specified recent period to seek paid employment or selfemployment. Future starters, that is, persons who did not look for work but have a future labour market stake (made arrangements for a future job start) are also counted as unemployed, as well as participants in skills training or retraining schemes within employment promotion programmes, who on that basis, were “not in employment”, not “currently available” and did not “seek employment” because they had a job offer to start within a short subsequent period generally not greater than three months and persons “not in employment” who carried out activities to migrate abroad in order to work for pay or profit but who were still waiting for the opportunity to leave.”[58] The complexity involves, according to the ILO definition, in assessing the rate of unemployment is beyond imagination specially in developing countries where the data bases are very likely inaccurate, inadequate, incomplete or outdated. In the context of Sri Lanka, the problems of underemployment sub categorized as disguised unemployment, cyclical unemployment, seasonal unemployment and frictional unemployment, is rampant due the structural characteristics of economy and the heterogeneous facets of the labour force of the country.

Williams (1991) after reviewing the unemployment problem in Sri Lanka states “Sri Lanka has a significant chronic unemployment problem. Depending on time period and the definition of unemployment it varies from the low teens to over twenty percent. Nearly all of this unemployment is concentrated among young people who are looking for their first job. Unemployment duration is very long with typical spells lasting four years or more. Although past authors have blamed unemployment on over education, a closer examination shows that once sex, sector and age are controlled for the relation between education and unemployment disappears for urban youth and is significantly weakened for rural youth. We believe that unemployment is generated in part by queuing for high-wage government jobs.”[59]

A research study conducted on the basis of a sample survey by Weerasiri (2021) concludes that his study showed the probability of being unemployed is high among young females, youths who are educated up to post-secondary level, vocationally trained youths, and youths with high levels of language and digital literacy.[60] Empirical data published by the Central Bank of Sri Lanka appear to be in alignment with the findings of the aforesaid author since 18.9 percent of females between the age twenty five and twenty nine years reported to be unemployed in 2020. He further elaborates that geographical mismatch positively affected the presence of youth unemployment. Accordingly, youth unemployment is higher in the estate sector than in the rural sector. This could be affected by the premarket discriminations of education facilities, lack of language literacy, and lack of outside employment opportunities in the estate sector. Also, youth unemployment is higher in all provinces except in the Western Province.[61] Unemployment among younger sections of population, educationally qualified with employability criteria fulfilled, creates multiple issues including outmigration, brain drain of talents adding further momentum to economic downturn and stagnation.

In the context of high probability of the Sri Lankan labour force being associated with the aforesaid peculiarities, further investigations deem to be warranted for ascertaining the actual magnitude of the problem of unemployment and its impacts on the labour

58 ILO, (2015), Unemployment Definition.
59 William, D. et. al., (1991), An Analysis of the Nature of Unemployment in Sri Lanka, Journal of Development Studies, 31.4.
60 Weerasiri, A. R.P., et al., Factors influencing Youth Unemployment in Sri Lanka, Asian Journal of Management Studies, Volume I Issue I (2021) pp.49-72.
61 Ibid.

force. As previous theoretical review discloses, Sri Lankan economy indicates the major signs of being affected with long drawn economic stagnation.

2.3. Welfare State- Theoretical Frame:

Neoclassical economic theory of government policy is founded on the twin bases of liberal political theory and welfare economics. Recently these two pillars have tended to shift outwards from each other, resulting in some frightening cracks in the edifice, but for a long time they appeared harmonious. Since the 17th century, liberal theory has propounded the doctrine of individual rights and limited government in the interests of political and economic freedom. Modern proponents of liberal economic theory, such as Milton Friedman , the monetarist economist, have spelled out the functions a government must necessarily perform to fulfil these conditions, such as:

1) act as rule maker and umpire,
2) define and enforce private property rights,
3) provide a stable monetary framework,
4) prevent, so far as possible, the formation of monopolies (though Friedman is unsure whether a public monopoly is better than a private monopoly),
5) provide necessary “public goods,” that is, those goods and services, such as defense or the proverbial lighthouse, which cannot be consumed individually but necessarily “benefit” all members of that society, and compensate for the effect of glaring “externalities” in production and consumption, that is, where the action of one party harms or benefits another party.[62]

As Briggs defines a welfare state is a state in which organized power is deliberately used (through politics and administration) in an effort to modify the play of market forces in at least three directions.”[63] The directions he cites are the provision of a minimum income for all, the provision of income for specific “social contingencies” like sickness or old age, and the provision of a certain range of social services. However, this list is clearly incomplete, omitting as it does a series of indirect means of “modifying the play of market forces” by way of state legislation rather than direct state provision of benefits in cash and kind. Nevertheless, broadly conceived, the welfare state is a recognizable feature of all advanced capitalist countries, at least since the Second World War. However, any acceptable theory of the welfare state must not only explain its existence, but also possess two further observable features: 1). The similar trends at work on state welfare intervention in all such countries; 2). The immense diversify in the nature and scope of the welfare state which still persists.[64]

In an overall perspective, Ian in his research paper categorizes all welfare economic theories under three headings; 1). functionalist theories of the welfare state,2). economic theories of government policy, and 3). pluralist theories of democracy.

62 Ian., G., (1978), Theories of the Welfare State: A Critique, Sage Journals.
63 Briggs, A., The welfare state in historical perspective. Reprinted in The Welfare State, edited by C. Schottland. Harper and Row, New York, 1977.
64 Ian G, Theories of the Welfare State: A Critique, Sage Journals,1978.

There was a time, not so long ago, when the welfare state was viewed as a benchmark social accomplishment; however the colour of the welfare state faded away with the lapse of time under ferocious assault by critics of different philosophical schools. The most recent attack has been the claim that during its heyday, from the 1950s to the 1970s, the social benefit expenditures of the welfare state led to subsequent economic stagnation and persistent unemployment throughout the advanced world. As Anwar states (2003) "I outline the issues involved, discuss the methodology behind the empirical studies of six major Organization for Economic Cooperation and Development (OECD) countries (Australia, Canada, Germany, Sweden, the United Kingdom, and the United States), and present the main findings. My central finding is that social benefit expenditures were financed out of the taxes paid by recipients of these very expenditures: in other words, by and large, social welfare expenditures were self-financed, and could not have been a source of fiscal deficits or a drag on growth.[65]The position taken by Anwar is that the welfare expenditure is not a drag on the resources since the same expenditure is replenished through tax revenue. However, he does not discuss in his research paper if the best avenue to disburse tax revenue is the mobilizing the tax revenue in the gurgler of welfare expenditure.

Typology of Welfare: Although a number of earlier authors did examine the issue of welfare state typology, it is really only since the publication in 1990 of Esping-Andersen's classic study 'The Three Worlds of Welfare Capitalism' that the study of welfare state typologies has really taken off. Since then the 'welfare modelling business' (Abrahamson, 1999) has been booming and this despite Peter Baldwin's description of typologising as 'the lowest form of intellectual endeavour' (1996: 29).

New politics of welfare is a further, largely structural, approach to the analysis of the welfare state developed primarily by Paul Pierson (1996, 2001). Pierson argues that, in contrast to previous decades when the growth of the welfare state was under examination, a different approach is needed in a context of retrenchment and austerity. Pierson argues that welfare state expansion involved the enactment of popular policies but, by contrast, welfare state retrenchment requires governments to pursue unpopular policies that must stand the scrutiny of both voters and entrenched interest groups (1996: 143–4). He adopts a largely structural account of the pressures on welfare states and argues that the power resources approach does not greatly help to explain retrenchment. Pierson identifies four main 'post industrial' pressures on the welfare state: 1). the slowdown in productivity growth and 2). consequently economic growth associated with the shift from manufacturing to service employment, over time, 3)productivity improvements are the key to sustained economic growth and 4).however, the massive occupational shift which has been and is taking place in most advanced nations from manufacturing to service employment threatens to undermine that productivity growth.

While the precise levels of productivity growth in the different sectors may be open to question, Pierson argues that it is highly unlikely that services will be able to match the productivity growth typical of manufacturing. Inevitably, Pierson argues, this will lead to slower economic growth over time. This in turn will generate 'acute problems for welfare states' (2001: 86). First, slower economic growth will impact on the level of

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65 Anwar S., Who Pays for the "Welfare" in the Welfare State? A Multicountry Study, Johns Hopkins University Press, Social Research: An International Quarterly, Volume 70, Number 2, Summer 2003, pp. 531-550 (Article).

funding available (through taxation) for the welfare state. In addition, if slower economic growth leads to higher unemployment, this creates extra pressures on the welfare state. Further, the growth of service employment creates pressures on the welfare state.

Despite Pierson's nuanced approach to the issues of retrenchment, his choice of the terms 'retrenchment' and 'austerity' is perhaps somewhat problematic. It is difficult to reconcile a situation where most European countries are, in economic terms, richer than they have ever been and spending on average twenty per cent of their wealth on social protection with a situation which could be classified as 'permanent austerity'.

Service sector employment can only occur through the private sector at the price of increased inequalities in wages or through the public sector at the cost of increased budgetary pressures. Countries which do not allow an increase in wage inequalities and at the same time impose budgetary restraint are likely to constrain service employment and hence see rising levels of unemployment (Iverson, 1998). The gradual expansion, maturation and 'growth to limits' of government commitments, Pierson (2001: 88) identifies a second source of pressure as being the maturation of welfare states. Policy measures introduced in previous decades have now grown to their mature levels with consequent increases in the level of funding required. Pierson cites healthcare and pensions as the most important components of this process.

The demographic shift to an older population, Pierson (2001) argues that the well identified tendency to an ageing of the population in all developed countries will create significant pressures on the welfare state, for example, through increased healthcare and pension costs. The ageing of the population arises from increased longevity and from the fall in the birth rate, which means both that older people are living longer (and therefore that there are more of them) and also that there are fewer people in the younger age brackets. The transformation of household structures, the final key pressure identified by Pierson (2001) has been the change in household structures and the relationship between households and work. This includes a number of interrelated issues such as the massive increase in female participation in the paid labour force, falling fertility rates and a change in household structures arising both from an increase in single parenthood and the increasing tendency for single people and older people to live on their own. These changes have created pressures on welfare states which were originally designed on the basis of a traditional male breadwinner household structure. Increased female participation, Pierson (2001) argues, not only generates additional revenue for the welfare state but also creates demands for new types of public social services such as childcare. Pierson also sees the increase in lone parent households as creating pressures on welfare states, given that such households are more likely to have low incomes in the absence of state supports.

Flora and Alber (1981: 41) argued that the development of the welfare state could be analysed according to at least three different aspects: 1) the processes of differentiation of individual and household income, of working and living place which created specific labour market problems that must be solved by the state; 2). the evolution of social rights as a consequence of (or compensation for) the institutionalisation of political rights; and 3). the increasing control, substitution and supplementing of markets (and to some degree of associations) by state bureaucracies.[66]

However, the answer to the question is to examine “What should be the role of the state in developing countries?” is more complex and shrouded with the political ideology of the provider of the answer. To answer this question two approaches can be useful : the Schumpeterian and the public choice. It is obvious that one approach would not be enough to fulfil their requirements. Therefore, to select the best sides of these two approaches tantamount to an attempt to create a new perspective. It is believed that it still remains incomplete and not enough to cover all the needs of the subject, but at least it highlights some hidden issues for developing countries. Public choice scholars claimed that the distribution of resources produced by the market is socially optimal. Hence, the state should limit itself to the minimal state because the market is capable of working efficiently if there is no state intervention. For public choice theorists, the minimum state is the best state. Therefore, to be able to achieve this optimum level, slimming the state, privatising welfare and restricting government should be the policies pursued. The public choice scholars' main solution to minimize the Leviathan in all developed and developing countries, was to limit government by constitution in order to control central expenditure, revenue and debt. In that solution a smaller politic has been offered for better economics.[67]

However, Schumpeter's argument in that context is more helpful, since he claims that politics should not be viewed as a negative factor. Instead it can be seen as the product of politicians, who sell policies like their counterparts (entrepreneurs) in the economy. For Schumpeter, the development of the capitalist economy itself undermines the entrepreneurial or innovative function, which Schumpeter regards as the essential feature of capitalism, because technological progress and the bureaucratic administration of large enterprises tend to make innovation itself a routine matter. In this context the economic dilemma presented by Baumol(1960) aka ‘Baumol Disease’ seems to show somewhat relevant to the productivity expansion configuration in capitalist world under technology advancement.

David at el(2011) referring to social insurance policy, another facet of welfare state, the theories of welfare state are recategorized under different nomenclature: theories about social insurance into five categories.[68]

1) The ravages of capitalism theory argues that social insurance was born in the brutishness of capitalist life; as economic life became less stable, social insurance created a needed safety net.
2) The political legitimacy theory argues that social insurance was created to legitimize non-elected governments, by giving people a stake in the continuation of the state.
3) Wagner’s Law posits that social insurance is a luxury good; as income raises, countries want to minimize their exposure to extreme poverty.

66 Flora, P. , et. al., (1981), Modernization, Democratization, and the Development of Welfare States in Western Europe. New Brunswick and London: Transaction Books,.
67 Dilek, D, et. al, Role of the State in Developing Countries: Public Choice versus Schumpeterian Approach, Business and Economics Research Journal Volume 2, Number 1.
68 David M., et al, (2011), The birth and growth of the social insurance state: Explaining old age and medical insurance across countries, Kluwer Academic Publishers. Netherlands, 2004.

4) The demographic heterogeneity theory argues that social insurance is a transfer program created for like people; in more homogeneous countries the willingness to institute such programs will be greater.
5) The Leviathan theory argues that social insurance is created when governments have excess revenue, most commonly at the end of wars.

The typological classification of David et. al. looks intrigues but a down to earth approach since his effort mainly concentrate on the practical dimensions of the way social security systems are perceived and converted into actionable programs in many countries both in developing and developed world.

Although the theoretical schools on welfare state are congested with divergent views on the origin, evolution, modalities of operation and the depth that state should be engaged in, all the theories generally reach consensus that the one of the responsibilities of the state is to safeguard the wellbeing of the public. This situation is empirically and historically demonstrated in Europe and other developed countries if their annual average expenditure is examined temporally in contrast to the total GDP. Today, old-age programs and universal medical-care programs are not only the hallmark but also an ornament showing prosperity of developed countries. These programs are big and durable, accounting for 10 to 15 percent of GDP. As several countries have shown in recent years, changing these programs is a political boomerang or suicide. Furthermore, these major social programs are surrounded by a series of more minor ones, ranging from insurance for unemployed workers, cash and medical payments for people disabled at work, and cash payments for those whose earnings are temporarily low. In 2018, the total expenditure on social protection benefits in the EU amounted to EUR 3 606 billion, or 26.7 percent of GDP.In 2018, some forty six percent of total expenditure on social protection benefits in the EU was for the old age and survivors function, followed by the sickness/health care function with almost thirty percent.During the period 2009-2018, the fastest expansion in expenditure on social protection benefits was recorded for the housing and social exclusion function, while the lowest rate of growth was for the unemployment function.

Social expenditure comprises cash benefits, direct in-kind provision of goods and services, and tax breaks with social purposes. Benefits may be targeted at low income households, the elderly, disabled, sick, unemployed, or young persons. To be considered "social", programmes have to involve either redistribution of resources across households or compulsory participation. Social benefits are classified as public when general government (that is central, state, and local governments, including social security funds) controls the relevant financial flows. All social benefits not provided by general government are considered private. Private transfers between households are not considered as "social" and not included here. Net total social expenditure includes both public and private expenditure. It also accounts for the effect of the tax system by direct and indirect taxation and by tax breaks for social purposes. This indicator is measured as a percentage of GDP or USD per capita.[69]

69 OECD (2021), Social spending (indicator). doi: 10.1787/7497563b-en.

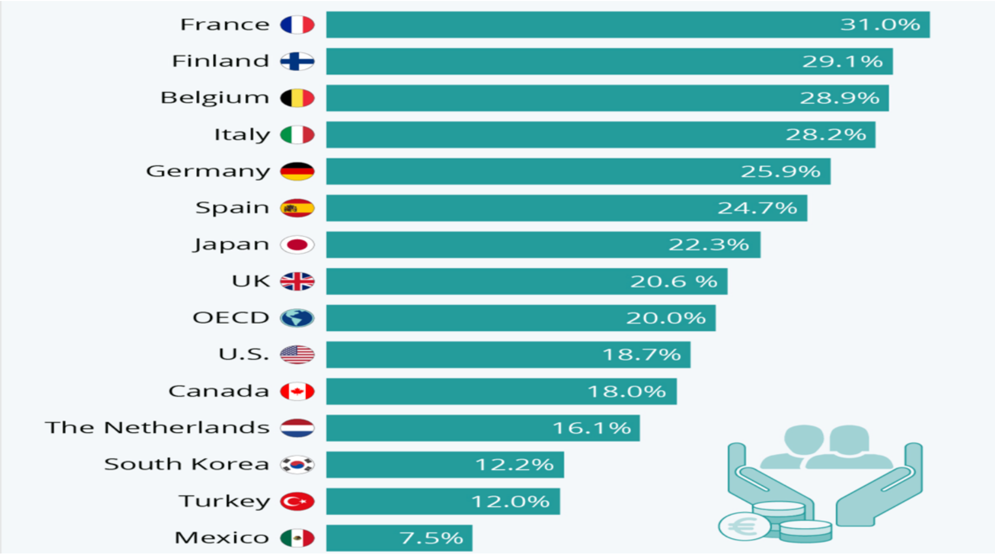
According to the aforesaid citation, the term “welfare” can be defined in a broader viewpoint including food assistance, unemployment assistance, payment of above market rate salaries, price concession on commodities, free health, free education, concessionary loan facilities and apparently a long list of other benefits as well which once granted withdrawal becomes a harrowing and cluttered political issue. The protagonist of welfare state, as cited above in this chapter, are inexplicably very silent on the subject of duration for which the state is to be engaged in the provision of welfare benefits; obviously a transfer payment without direct return on investment.

As regards the objectives of disbursing economic pogeys and other financial handouts to selected strata of population in a country, the literature is again murky and blurred if the state objective is to maintain the status quo of prejudiced clusters of people who are entitled for economic goodies as grants from the state or to transubstantiate underprivileged groups that are below the subsistence level into economically productive stratum of the society. The hypothesis of welfare state is intrinsically born out of the philosophical womb of the Keynes prescription of state intervention with Marxism providing midwifery service through its social classification as haves and have nots idiosyncrasy which, if accepted as logical proposition, makes it essential for the state on a perpetual basis to continue with the grant of welfare handovers as long as the state exists for the economic disparities among the people are very unlikely to be totally evaporated with the time.

As the Figure 2.6 illustrates, France reports the largest welfare expenditure of 31.0 percent of its GDP in 2019 while the second highest position of 29.1 percent is occupied by Finland. Mexico reports the minimum welfare expenditure of 7.5 percent in 2019 providing interesting assortment of data for cross country contrast in relation to welfare’s contribution to economic development of those countries. The pertinent question in relation to welfare states in Europe is whether the high welfare expenditure has stimulated a dynamic economic growth n those countries.

As shown in a different chapter of this paper, welfare and economic growth are two ends of a continuum unless welfare benefits are generated through economic development by prioritizing economic growth at the initial phase of development in a country for achieving distribution justice at a later stage.

Figure:2.6.
Social Spending as a Share of GDP In Selected Countries- 2019.



Source: STATISTA, 2021.

2.4. Literature on Sri Lanka' s Welfare Economic Policy:

2.4.1. Introduction:

This section of the paper outlines the literature review, based on contributions made by scholars as well as government bureaucrats responsible for policy formulation, on the government welfare policy in the post independent era with special emphasis on the period commencing from year 2000. Sources of literature ranges from the published academic or research papers, unpublished but openly accessible documents, journals, newspaper articles and internet references which are compiled by academically well recognized authors as well as contributed by nonproprietary and open-source origins.

2.4.2. Early Period of Welfare Policy:

The evolution of Sri Lanka's welfare state can be marked by three key milestones; the Education Act of 1945 (Kannangara Report 1943), the establishment of the Department of Social Services in 1948 (Jennings Report 1943) and the Health Act of 1953 (Cumpston Report 1950). Taking initiatives in implementing these three reports, laid a firm foundation for the collective provision of certain essential social services through state intervention. The proportion of public expenditure on welfare during the time period 1958-68 amounting to about forty percent of the total public expenditure or 10-12 percent of GDP gives further evidence to support this. This figure includes the social welfare expenditures on education, health, transport, food subsidy and public welfare assistance (Jayasuriya, 2000).
During the first two and half decades since independence, according to Wanninayake (Wanninayake,2012), successive governments firmly committed to pursuit the social development goals and to realize the equity objective and poverty eradication, in addition to the growth objective. During this phase, successive governments were committed to develop the country as a social welfare state. The policy framework was guided by the welfare first strategy. Public resources were allocated largely on social and human development. Social expenditure ranged between ten and eleven

percent of GDP in these years.[70]. Wnninayake who conducted his explorative study in the Hambantota district on sample survey research, concludes that the welfare programs achieved mixed results but the respondents included in the study were still had poor accessibility to the basic amenities such as houses, water and healthcare.

Another major publication under the title, "Welfarism and Politics in Sri Lanka: Experience of a Third World Welfare State" (Jayasuriya, 2000) professes that the welfarism in Sri Lanka was laid by the three pillars of the country's social policies: free education, free health and social services.[71] The strong competitive political culture in Sri Lanka has ensured the reincarnation of the social welfare state. Yet it has been more in response to emerging social and political pressures and as a means of mitigating difficulties rather than as a conceptual model linked to the development needs of the country. Jayasuriya argues for a new model of Market Socialism and Societal Corporatism. He articulates on the necessity of a theoretical or moral rationale for such a model. However, the question he does not address is whether market capitalism in a poor country has an adequate redistributive capacity to ensure the sustainability of such a model. Unless market capitalism is strikingly successful and the country's fiscal policies are effective in mobilising adequate resources, the social welfare state is likely to lack resources to be meaningful to the poor. The rhetoric of the social welfare state is ensured by the country's political culture, but the competitive electoral policies of the country might itself be the underlying reason for the weakening capacity of the state to meet the needs of those left behind by the capitalistic development process. As per the crust of Laksiri's arguments in his publication, apparently there is no major deviation of his theoretical articulations from the well-known models of welfare state referred to in the previous sections of this paper.

A CPRC working paper presented by Indra Tudawa (2004), summarizing the overall impacts of the post independent era welfare policy in Sri Lanka, states that the results achieved were not commensurate with the investment made by the state to ameliorate the standard of living of the underprivileged sections of the society. According to the author's assessment, the poor are examined within the 'livelihood' framework in terms of their command over human, physical, natural, financial, social and political capital. Examination of human capital in terms of education, health and nutrition shows that despite free services, the poor have not always been benefited, leading to low education, and poor health. In turn, these are associated with lower access to well paid employment as well as reduced labour productivity.[72]

The unabated increase in welfare expenditure during the second half of last three decades of 1900's has been propelled by the parochial action of political parties that positioned the entire economy into an unsavory situation by offering free economic gifts to the people in rivalry with one another for achieving political supremacy of the country which can be interpreted as pyrrhic achievement of political goals at the cost of the country. As Tudawe articulates "A large literature has developed analysing the degree to which Sri Lanka's equity-oriented policies contributed to slow rates of

70 Wanninayake M. S., (2012), Public Welfare Policy, Capability and Rural Poverty with special reference to Hambantota District in Sri Lanka. ResearchGate.
71 Laksiri J., (2000), Welfarism and Politics in Sri Lanka: Experience of a Third World Welfare State, University of Western Australia, Perth.
72 Indra, T, (2004), Institute of Policy Studies Sri Lanka.

economic growth after independence (Bhalla and Glewwe 1986; Bhalla 1988). While de Melo (1981) and Sahn (1987) argue that social expenditure was financed through taxing the agricultural export sector and that this discouraged investment and reduced growth, Jayasuriya (2000) contests this argument. Since the late 1980s, pressure from financial institutions as well as high public expenditure led to a number of the state owned institutions to be privatised and attempts were made to hold down public expenditure. However, such attempts have had limited success in significantly curtailing public expenditure."[73] The year 1977 marked a turning point in the political landscape of the country with a policy shift from indigenous development model to liberalized development model.

2.4.3. Post Liberalization Era:

Within this policy frame, the government implemented a trade liberalisation package by end 1977, which brought in a sequence of drastic changes to the economy. An important move was to reduce the restrictions on imports by licensing and quotas being replaced with tariffs. In addition, the government intended to convert expenditure on the food subsidy into expenditure on investment. This meant that the government had to come to a compromise by only targeting the subsidy to the bottom half of the population. Restrictions were relaxed for foreign travel and movement of capital and labour. Furthermore, the new government changed the two-tier fixed exchange rate system to a unified managed float (Indraratna, 1998; Jayawardena, 2004).[74]

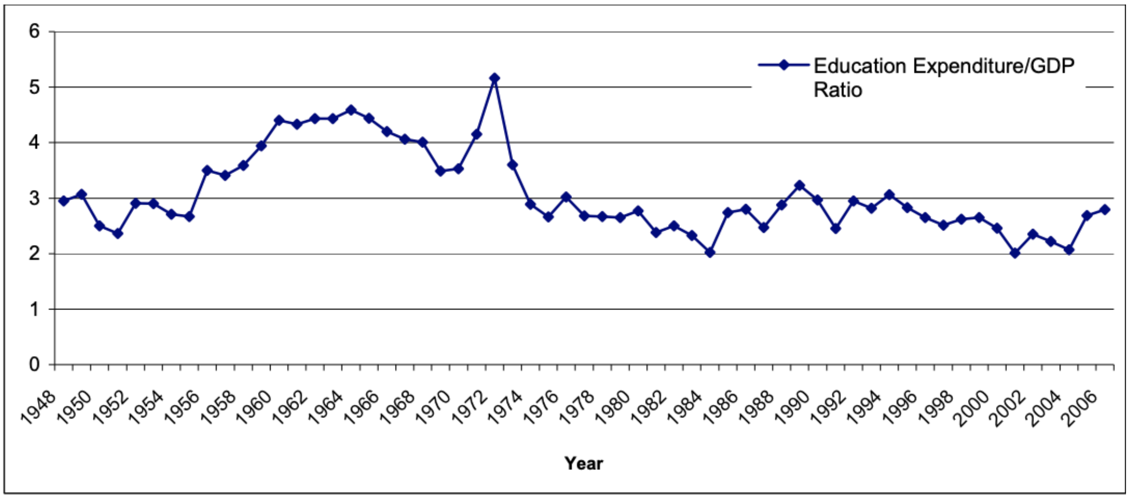
A review of literature on the welfare policy of sri Lanka highlights several salient features but still remains inconclusive and leaves a flaring gap as regards the affordability, sustainability and justification for long term continuity of welfare programs in the face of escalating expenditure without introducing suitable adjustments with the change of time, necessity and economic environment. All the avenues of literature available for the reference period signify in unison that the welfare expenditure has shown positive signs in income redistribution, alleviation of poverty, in improvement of living standards of underprivileged strata of the society but the agreement among different proponents abruptly end at that point since they disagree in varying levels with regard to the affordability , proportionality or commensurability of the benefits, the opportunity cost involved with the welfare program over the protracted period of time. The arguments brought forward in support of welfarism seem to be borrowed from age old political philosophy; in the same breadth John Locke(1632–1704) is thought to have set three restrictions on the accumulation of property in the state of nature: (1) one may only appropriate as much as one can use before it spoils (*Two Treatises* 2.31), (2) one must leave "enough and as good" for others (the sufficiency restriction) (2.27), and (3) one may (supposedly) only appropriate property through one's own labor.[75] It is in the same breadth that one can observe how John Locke contradicts himself when it comes to his advocacy on the treaties he has espoused.

Godamunne (2019) witting on the welfare state of Sr Lanka ventures to state that welfare policy is an apparatus of the government purposely implanted in the society to stablish its legitimacy through provision of free services to the eleemosynary groups of the country. Social welfare was used to strengthen the state's relationship with the people and by extension contributed to constructing legitimacy between the state and

73 Indra, T, (2004), Institute of Policy Studies Sri Lanka.
74 UNRISD, Development Strategies, Welfare Regime and Poverty Reduction in Sri Lanka, Geneva, 2007.
75 Stanford Encyclopedia of Philosophy, 2020.

social groups. Second, it illustrates that legitimacy is a process of transformation (Alagappa, 1995), based on norms which are historically and socially constructed.[76] The term 'legitimacy' used by Godamunne renders redundant since the Constitution of Sri Lanka enshrines clauses legitimizing the government to engage in welfare related activities. Sri Lanka's Constitution includes a chapter spelling out the directive principles of state policy, which call, amongst others, for the: 1) Pursuit of a social order with social, economic and political justice (art. 27 2 [b] and [f]) 2) Realisation "by all citizens of an adequate standard of living for themselves and their families, including adequate food, clothing and housing, the continuous improvement of living conditions and the full enjoyment of leisure and social and cultural opportunities" (art. 27 2 [c]) 3) "Equitabledistribution among all citizens of the material resources of the community and the social product, so as best to subserve the common good."[77]
Western democracies with the mammoth resource bases they amassed, both with the fortune of natural endowment and the exploitation of developing countries specially during the colonial era, are in an enviable position in the context of their ability to incur high welfare expenditure relative to the position of the downtrodden underdeveloped countries that are ensnared in a vicious trap of relative poverty and political quagmire. Notwithstanding the tunnel vision approach, the coverage of the literature available on the subject, as it is obvious from the historical summary recited above, is limited in the scope and has paid an inadequate attention to grasp the overall complex picture in respect of welfare state paradigm of Sri Lanka.
Public expenditure permeates almost all vital economic and social sub sectors of the economy including education, health, social security, farmer protection, consumer protection that requires a mammoth resource base inaccessible to a country like Sri Lanka. Figure 2.7 illustrates the long-term pattern of government expenditure for the period between 1948 and 2006 on free education as a percentage of GDP which seems to be beyond the means of financial resources available.

Figure:2.7.
Public Expenditure on Education Since 2006



Source: Central Bank of Sri Lanka.

76 Godamunne, N., (2019), How did social welfare provision (de-)legitimise the post-colonial state in Sri Lanka? Working Paper 83.
77 The State of Economic, Social and Cultural Rights in Sri Lanka: A Joint Civil Society Shadow Report to the United Nations Committee on Economic Social and Cultural Rights, 2017.

Chapter conclusion: Chapter 02 presents a comprehensive review of literature related to the welfare state with the comprehensive use of time series data and theoretical discourses that have been published by different scholars exploring diverse facets of welfare state. The theoretical review envelops the classical school, Marxist ideology, Keynesian postulate, welfarism and the modern monetarist approach with special emphasis given to the contributions made by those theories to the development of knowledge on welfare state. In addition to the descriptive narration, the sections on analytical review in the Chapter focus attention on the status of relationship between welfare state and social security expenditure with the support of cross-country information and theoretical scrutiny for the purpose of arriving at a conclusion if the welfarism is based on a sound theoretical justification. The discussion on the economic phenomenon of stagnation encompassing its scope, definitions, causes occupies a substantial in the Chapter 02. Furthermore, the practice of welfare state in Sri Lanka and the economic repercussions related to welfare policies reflected on escalating recurrent expenditure, deficit budgets, debt burden, oversized public sector vis a vis the long drawn economic stagnation in the country are critically reviewed.

The Chapter 02 after much elaboration on the theoretical perspectives and empirical data arrives at two focal conclusions; first, welfarism is a murky subject without strong theoretical support and; second, welfare and economic growth are at loggerheads and therefore cannot coexist.

CHAPTER 03 – RESEARCH DESIGN AND METHODOLOGY.

3.1. Conceptual Frame of the Research:

As research is a scientific investigation, the conceptual frame represents the bird's eye view of the researcher's synthesis of how he interrelates the independent and dependent variables in a given phenomenon. It maps out the spectrum of activities that are aimed at establishing or rejecting the assumed relationship among the identified variables in the perceives area of the study that are further specified by hypotheses and scope. To formulate the conceptual frame, the identified boundary and parameters of the proposed research, the investigator needs to be conversant with the dept and extensiveness of the previous knowledge unearthed by other researchers for the necessity of demarcating the area of investigation in new research. This requirement is very much facilitated by the literature review.

Stated in a different way, the conceptual frame assists the researcher to visualise the boundary of a given research which the researcher cannot trespass or overstep in the course of carrying out the research and to announce the consequent findings of the investigation. The conceptual frame is expected to perform the role of a road map which helps the researcher march on the right direction for reaching his research objective as well as it provides the connoisseur a criterion for evaluating the final product of the research.

As expounded by Kerlinger "Scientific research is systematic, controlled, empirical and critical investigation of the hypothetical propositions about the presumed relations among phenomena." (Kerlinger,1986). In the context of Kerlinger's proposition, the current research postulates to investigate the nature of relationship between the sluggish economic progress (stagnation) of Sri Lanka and the welfare driven economic policies implemented by different political regimes.

In the current research theme, the dependent variable or the recipient of impacts is the economy of the country which has not shown substantial economic growth over the last two decades in contrast to the progress achieved by other countries which demonstrate similar economic and social characteristics similar to those of Sri Lanka.

The independent variables in this particular conceptual frame include wide variety of factors which are generally classified or labelled as welfare oriented economic activities set in motion by the government for minimizing economic inequality. An intrinsic characteristic of welfare oriented economic approach is its inclusion of numerous grants, aids and concessionary facilities, in kind or money form, to the underprivileged social strata. This includes the disproportionately expanded public service, poverty alleviation programs, concessions provided on public goods, free health service, free educational service, different subsidies and charity based financial assistance programs which as a whole drain out a substantial percentage of national income which in many circumstances can be considered as transfer payments that do not contribute to the production of an economic output. The welfare driven economic policies are very often represented by proxy variables such as subsidies, assistance program etc. which are referred to previously as well.

Figure3. 1.
Conceptual Frame of the Research.

Independent Variables – Elements/Proxies of Welfare Policy:

1. Excessive public sector employment.
2. Subsidies granted for utilities.
3. Poverty alleviation programs.
4. Maintenance of loss making state institutions.
5.Government charity programs.
6. Price concessions and fixing.
7. Free health and education services.
8.Financial grants for distressed groups.

→

Dependent Variable:

Economic Stagnation.

Source: Developed by the Researcher.

The eight independent variables identified in the conceptual frame can further be anatomized for the purpose of understanding the span of spread and the complexity of each variable that result from the past and the present economic policies implemented by the respective governments.

Excessive public sector employment: this is measured through comparative statistics pertaining to population size, percentage of employed population, cross country comparison of relative size of the public sector, percentage of expenditure on public sector renumeration in the annual government budget and the annual production value attributed to the public sector performance.

Subsidies granted for utilities: this particular variable represents underpricing of fuel, electricity, water, fertilizer which incur a substantial portion of government revenue on an annual basis. Apart from underpricing, a subsidy can be granted by the government in the form of overpricing which results from a policy directive that regulates price level above market rate with the maintenance of a minimum price ceiling.

Poverty alleviation programs: in Sri Lankan context, the relevant examples are Samurdhi Program (program for prosperity), Janasaviya Program (people empowerment program) which siphon in a significant percentage of national income on an annual basis for a long stretch of time.

Maintenance of loss-making state institutions: Sri Lanka as a welfare driven state is in the practice of purposely maintaining loss making government institutions for a long time and the Ceylon Petroleum Corporation, The Ceylon Electricity Board, Ceylon Government Railway, Sri Lankan Airline and Sri Lanka Transport Board inter alia stand out as the major loss-making institutions that survive thanks to government grants.

Government charity programs: Numerous charity programs sponsored by government including financial assistance to the old aged, assistance to disabled people, grants for orphanages, financial assistance to religious organizations inter alia are included in this variable.

Price concessions and fixing: Fixing of minimum price for paddy, maize, and some other agricultural produce is a perpetual practice of government for a long period of time that aims at guaranteeing a floor price for the agricultural community of the country. On the other hand, price ceilings on passenger transport fee, bakery products and selected comestibles have been considered as another welfare measure adopted by the government to make an easy life for people through interference on the free marker behaviour.

Free health and education services: Health and education are supposed to be free services available in Sri Lanka and therefore they annually absorb a phenomenal quantity of national resources year in and year out which is further examined in details in the follow up sections of the study.

Financial grants for distressed groups: This category comprises the financial aids mobilized for the purpose of redressing the people affected by natural disasters like flood, drought, earth slips, damage to crops by pest which are also regular items appearing in government budgets in every year.

The variables referred to above as independent are in facts a cluster of proxies representing the "independent variable" in the conceptual frame that are instrumentalized for the purpose of monitoring, describing, anatomizing and evaluating mainly on the basis of their financial and physical dimensions.

The response of dependent variable, economic stagnation, is examined in the light of behavioural perspectives related to GDP, GNP, per capita income, export values, balance of payment, value of manufacturing, standard of living with the support of data related to temporal and sectoral dimensions.

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This conceptual frame illustrates a simple and straight relationship between the set of independent variables classified as welfare economic strategy and economic growth rate; however the influence of the other intervening variable cannot be vetoed since the net impact of welfare policies cannot be demarcated by drawing a line due to the fact that economic outcomes are the combined results of multifunctional and multifactorial variables working in unison in an inter connected and complex network.

To harp on the point, one can strongly argue that apart from warfare oriented economic policies there can exist multiplicity of other influential variable such as non-availability of economic resources, geopolitical factors, natural disadvantages, poor infrastructural facilities that are in a strong position to pullback an economy from a steady economic advancement. Nevertheless, the current research does not propose to extend its scope of exploration to the other intervening variables due to the unfathomable magnitude of such an exercise in the context of the objectives in the proposed study. The independent variables are represented by the proxies that include different welfare facilities granted in varying arrangements such as government grants, concessions and programs launched for providing free services.

Under the terms of reference of the current research design, although the impacts of intervening variables on the behaviour of dependent variable is recognized as a possible scenario, only passing reference is made to such extraneous perspectives in order to prevent the deviation of the study from its major objective.

In the same breadth, controversy on the definitions of economic stagnation and development can also be brought into the focus by referring to the economic nomenclature similar to stagflation, downturn, recession, slump and sluggishness which are tangent with the term; but the author is strictly guided by the definition of stagnation, given by authoritative sources in the main stream of economics, for all the academic purposes in conducting this study.

3.2. Problem Statement, Hypotheses and Research Questions:

The statement of problem and the conceptual frame are inseparably twined phenomena as regards the scientific investigations irrespective of the differences in research themes selected for various scientific investigation.

In the current investigation, the statement of problem is formulated as "the economic stagnation of Sri Lanka is mainly the outcome of welfare driven economic policies continuously adopted by successive political regimes." This statement set out the domain of the present study which ramifies, if not confined by terms of reference, into a vast area of related and peripheral subjects. The key terms in the problem statement are "welfare driven economic policies" and "economic stagnation". Articulation on the statement of problem raises a set of pertinent questions which lead to the formulation of the following hypotheses demarcating the area of spread of the investigation.

H1. Economic stagnation of sri Lanka is caused by the welfare driven economic policies.
H2. Economic stagnation of Sri Lanka is not caused by welfare driven economic policies.

In addition, an alternative hypothesis can also be formulated as:

Ha. Economic stagnation of Sri Lanka is caused by different factors other than welfare driven economic policies.

The same hypotheses can simultaneously be stated in the question form as illustrated below.

1) Is economic stagnation in Sri Lanka caused by the welfare economic policies of the country?
2) What are the repercussions of welfare driven economic policies?
3) What are the other contributing factors that are related to economic stagnation?
4) What are the harmful impacts inflicted by welfare driven economic policies on the Sri Lankan economy in the long run?

5) Are there visible positive consequences emanating from welfare driven economic policies?
6) Is stagnating economy positively corelated to generous welfare expenditure of government?

Despite of those distracting questions, this study pivots on the research objective of examining the nature of relationship between economic growth (G) and set of independent variables including welfare expenditure (W), capital expenditure(C), and other factors, ceteris paribus, like resource endowment of the country. The functional relationship, if there is any, is expressed in the following equation.

1) G=f (W, C, R).

Where R (Resource Endowment) is considered as a constant and the W and C are considered as mutually inversely related variables since increase in W essentially reduces the availability and possibility of investment in the production of capital goods given the restrictions on the availability of financial resources and endowment of physical (natural) resource in the country. G is measured using the standard values calculated as GDP, GNP and per capita income. However, the components included in W are of complex nature since there is the likelihood of raising refutations against the inclusion of free education and free health as welfare expenditure. Nonetheless the possibility of raising counterarguments cannot be ruled out stating since that transfer payment, similar to health and education for example, is generally construed as a part of welfares disbursement.

The above functional relationship can similarly be restructured in the form of GDP equation as indicated below.

2) GDP= C+I+G+(X-M)

Where:

- GDP stands for Gross Domestic Product.
- C stands for Consumption.
- I stands for Investment.
- G stands for Government Expenditure.
- X equals to Exports.
- M equals to Imports.

The conceptual frame is premeditated for testing the relationship, according to the formula 2), the nature of relationship between GDP and G subject to the assumption of ceteris paribus. G epitomizes all government expenditure, subdivided as recurrent and capital, behaviour of which totally depends on the government economic policy package and the outlook it has for the next few years demarcated as its planning horizon. Expenditure of the government is considered as a controllable factor due to the fact that all financial decisions are finally concluded by the political authority that is in power in line with the political hues of the party on saddle. It requires attention that G in the formula 2) encompasses two divergent components of expenditure, capital and recurrent, and if allocation for recurrent expenditure is higher than the funds available for capital expenditure essentially declines given that government's financial resources are subject to constraints. Since the current study employs descriptive methodology, testing of relationship between the two variables essentially fulcrums on the critical examination of temporal, secondary data by way of cross year and cross-country comparison assisted by academic judgements and interpretations made available in the subject literature.

The number of questions stemming from the statement of problem and the hypotheses referred to above can be countless in view of the complex social and economic variables intertwined with the behavior of the dependent variable, namely economic stagnation. Furthermore, related to the field of inquiry under reference, an inquisitive mind can also harp on the question if the countries that reject welfare policies or are not in the fold of welfare status are necessarily developed. It is also possible for an economist to state that the economic stagnation is part of the economic cycle which, irrespective of the development status of a given state, all the countries in the world are confronted with economic phenomenon of stagnation in different degrees in different periods. Since the subject can lead to numerous controversies and scholarly quagmires, the current investigation is confined in its scope to make an effort to assess the possible impacts, negative or positive, of welfare driven economic policies in the context of the current economic status of development in Sri Lanka in the light of theoretical justification and the local as well as global experience of the welfare state.

3.3. Methodology:

Research methodology is the navigation rout an investigator employs for the successful culmination of the scientific investigation. In this context as it was previously stated, the author intends to apply descriptive and qualitative research tools with the extensive usage of secondary data and the vast well of information available with institutional sources and repositories of the subject. As regards the economic data related to the core area of research, a heavy leaning on the published data by the Central Bank of Sri Lanka is unavoidable since it is the legally empowered body of government for providing a comprehensive data base due to the enormousness associated with the accomplishment of the task. To be specific, the Chapter on literature review, a systematic survey of knowledge, available in print and cyberspace relating to the research them, functioned like a searchlight in the formulation of the research design, determination of subject boundaries and deciding on special focus areas that require critical attention withing the study. As analytical sections are concerned, the paper heavily leans on statistical bulletins, annual reports, individual research papers and articles published in the cyberspace and the secondary data made available by the respective government agencies engaged in the reference functional fields.

Basic statistical tools are employed in the compilation of analytical chapters of the research with the intention of interpreting time series data made available by the Central Bank of Sri Lanka and the Department of Census and Statistics in their annual reports and statistical compendiums. The economic policies in practice are translated into action through a set of actionable programs, irrespective of the political hues of the regime in power and such actionable programs are expected to produce desirable results known as economic progress, which is generally identified as economic expansion or contraction in financial or physical production atmosphere. As such the researcher employed, on a selective basis, the Delphi technique, as circumstances permit, to interview key bureaucrats of the public sector organizations that have been tasked to formulate, implement and monitor economic development in institutional capacity. The analytical tools described above are used in the current research to corelate the two variables, namely welfare economic policies and economic stagnation, both in temporal and relative terms, with the intension of arriving at conclusions on the positivity, negativity or neutrality of the possible relationship pertaining to the reference period, at the culmination of the research.

In a nutshell, conceiving research theme, fathoming the scope of the subject area through literature survey, identification of concept related variable, review of theoretical supportasse, dissecting economic performance and testing the assumed relationship with the application of temporal and cross-country data are the major millstones that are being instrumentalized in carrying out the research undertaking.

CHAPTER 04 - ECONOMIC STAGNATION IN SRI LANKA

4.1. Economic Growth Rate:

The focal objective of Chapter 04 is to examine the degree of economic stagnation that Sri Lanka is enmeshed with the aid of subject specific economic data and standard behavioural pattern of stagnation as theorized by different schools of economists.

Economy of Sri Lanka continued with sharp and erratic fluctuations in the post 2000 period, according the Central Bank of Sri Lanka, due to the impacts of indigenous and exogeneous factors relating to economic, finical, natural and international atmosphere that has been in motion during the entire period. In this context, the performance of the economy during the reference period is detailed in the Central Bank Report of 2020 as the extract depicted in the table given below.

Table: 4.1
Summary of National Accounts 2014 – 2019

Item		2014	2015	2016	2017(b)	2018(b)(c)	2019(c)
Gross National Income (GNI), Rs. mn.							
GNI at Constant (2010) Prices		8,049,085	8,432,998	8,794,903	9,109,531	9,404,093	9,608,296
GNI at Current Market Prices		10,125,078	10,675,880	11,676,431	12,975,247	13,976,502	14,583,892
Gross Domestic Product (GDP), Rs. mn.							
GDP at Constant (2010) Prices		8,235,429	8,647,833	9,035,830	9,359,147	9,668,600	9,889,379
GDP at Current Market Prices		10,361,151	10,950,621	11,996,083	13,328,103	14,366,103	15,016,142
Real National Income at Constant (2010) Prices (RNI), Rs. mn.		**8,020,973**	**8,435,489**	**8,847,120**	**9,183,583**	**9,481,694**	**9,664,145**
Economic Growth Rates (In Real Terms), %							
Growth of GDP		5.0	5.0	4.5	3.6	3.3	2.3
Growth of GNI		5.1	4.8	4.3	3.6	3.2	2.2
Growth of RNI		5.7	5.2	4.9	3.8	3.2	1.9
Per Capita Income, (Current Market Prices)(d)							
GDP Per Capita,	Rs.	498,828	522,304	565,773	621,531	662,949	688,719
	US $	3,821	3,842	3,886	4,077	4,079	3,852
GNI Per Capita,	Rs.	487,462	509,200	550,697	605,076	644,970	668,894
	US $	3,734	3,746	3,782	3,969	3,968	3,741

Source: Department of Census and Statistics Central Bank of Sri Lank[78].

As the Table 4.1 indicates, the economic downfall of GDP, set in motion in 2015, continued till 2019 with recorded GDP growth rate of 2.3 percent from 5.0 percent in 2015. All the indicators in the table bear evidence to the fact that country has been tilting towards a deep economic slump with the GDP per capita reaching $3,852 from $4,079 recorded in the previous year. Although per capita GDP was marginally increased in 2019 in rupee term, in $ terms it declined to $ 3,741 from $3,968 registered in 2018.

[78] Department of Census and Statistics Central Bank of Sri Lank,2021.

As highlighted by the Moody's analysis, the country appears to be moving towards an economic crisis of serious magnitude with all the economic indicators showing unhealthy signs in respect of GDP, GNP, per capita income and the balance of payment. Sri Lanka appears to be upholding a sustainable economic growth strategy while maintaining macroeconomic stability under its IMF program that it began in 2016.

Table: 4.2
GDP, GDP Per Capita and GDP Growth Rate Sri Lanka Between 2000- 2020.

Year	GDP Nominal (Current USD)	GDP Real (Inflation adj.)	GDP change	GDP per capita	Pop. change	Population
2017	**$87,357,205,923**	**$82,547,720,664**	**3.31%**	**$3,907**	0.51 %	**21,128,032**
2016	**$81,787,420,023**	**$79,903,861,972**	**4.47%**	**$3,801**	0.54 %	**21,021,171**
2015	**$80,604,080,689**	**$76,485,840,044**	**5.01%**	**$3,658**	0.57 %	**20,908,027**
2014	**$79,356,449,841**	**$72,838,327,290**	**4.96%**	**$3,504**	0.61 %	**20,788,511**
2013	**$74,317,806,538**	**$69,395,808,983**	**3.40%**	**$3,358**	0.64 %	**20,663,046**
2012	**$68,434,409,315**	**$67,116,705,113**	**9.14%**	**$3,269**	0.66 %	**20,532,600**
2011	**$65,292,753,006**	**$61,493,396,999**	**8.40%**	**$3,015**	0.67 %	**20,398,497**
2010	**$56,725,749,222**	**$56,725,749,222**	**8.02%**	**$2,800**	0.69 %	**20,261,737**
2009	**$42,066,217,872**	**$52,516,077,579**	**3.54%**	**$2,610**	0.70 %	**20,123,508**
2008	**$40,713,812,310**	**$50,721,102,373**	**5.95%**	**$2,538**	0.72 %	**19,983,984**
2007	**$32,350,248,411**	**$47,872,638,203**	**6.80%**	**$2,413**	0.74 %	**19,842,044**
2006	**$28,279,814,925**	**$44,825,899,741**	**7.67%**	**$2,276**	0.77 %	**19,695,972**
2005	**$24,405,791,045**	**$41,633,334,151**	**6.24%**	**$2,130**	0.81 %	**19,544,988**
2004	**$20,662,525,941**	**$39,187,357,999**	**5.45%**	**$2,021**	0.85 %	**19,387,153**
2003	**$18,881,765,437**	**$37,163,768,055**	**5.94%**	**$1,933**	0.85 %	**19,224,037**
2002	**$16,536,535,647**	**$35,079,926,055**	**3.96%**	**$1,840**	0.80 %	**19,062,482**
2001	**$15,749,753,805**	**$33,742,158,886**	**-1.55%**	**$1,784**	0.71 %	**18,911,730**
2000	**$16,330,814,180**	**$34,271,798,041**	**6.00%**	**$1,825**	0.61 %	**18,777,601**

Source: www.worldometers.inf, 2021.

The government's high debt payments and bloated civil service cadre, which have contributed to historically high budget deficits and low tax revenues, remain a major concern. Government debt is about seventy five percent of GDP and remains among the highest of the emerging markets. Sri Lanka will need to balance its elevated debt repayment schedule with its requirement to maintain adequate foreign exchange reserve levels in the coming years. In Moody's comments, a clear reference has been made to the country's "*bloated civil service cadre*"[79] which means disproportionately

[79] Italics are the researcher's insertions.

large public service maintenance of which is redundant and it creates an unbearable drain of financial resources in crisis infected economy.

If the overall trend of the economic growth rate is reviewed from 1963 to 2020 as illustrated in the above Table 4.2 in conjunction with the GDP, the ballpark growth rate appears to be stagnant around an average annual growth rate of four percent if extreme fluctuations are roughed out. Review of economic progress and their indicators extended over fifty years point to the reality that there are no major take off points in the economy that are similar to the experience of Asian Tigers which have demonstrated clear turn around and dynamism in economic advancement during a short period of time.

The Word Bank Report (2021), referring to the economic flight of the country states that the external vulnerabilities have further aggravated in the first half of 2021. The trade deficit widened as the rising import bill (despite restrictions on non-essential goods) driven by intermediate and investment goods, offset the increase in earnings from exports. While foreign remittances showed a declining trend, weak tourism receipts widened the current account deficit. Official reserves declined to $3.6 billion in August (equivalent to 2.0 months of imports, estimated as of August), as the government continued to use reserves for debt service. Reserves include the proceeds from the SDR allocation equivalent to $787 million and excludes a currency swap of RMB 10 billion (equivalent to approximately $ 1.5 billion) with the People's Bank of China. The LKR depreciated by 7.4 percent against the US dollar in the first eight months according to the official exchange rate. However, the parallel market premia have been rising. Depleted net foreign assets in the banking system, at $3.5 billion by July, suggests increasing challenges in meeting foreign exchange demand.

The telescopic picture portraited by the Word Bank on the crisis ridden economy of Sri Lanka warrants the necessity of conducting inward looking, self-centered diagnosis to find out the root causes of aggravating economic pandemic which could lead to paralyzing of the entire economy if early remedial measures are not adopted[80].

The economic woes appeared on GDP and GNP have been further aggravated with leaps and bound in the period starting from 2015 spreading their influence in all the fabrics of the country's economic structure which has been highlighted by the World Bank in its review of Sri Lankan economy. Year-on-year inflation (measured by the Colombo Consumer Price Index) increased to 6.0 percent in August 2021 due to high food inflation (at 11.5 percent) and a fuel price hike in June (the first in 21 months). Food insecurity has been acute throughout the pandemic—a phone monitoring survey previously showed that 44 percent of households were concerned about running out of food, while weak safety nets heightened vulnerability. The government invoked emergency regulations to curb speculative practices of traders amid high food prices and shortages of some essential commodities. To curb rising inflationary pressures, the Central Bank increased policy rates by 50 basis points (Standing Deposit Facility to 5.0 percent and Standing Lending Facility to 6.0 percent) and the reserve ratio by 200 basis points. (World Bank, 2021).

[80] The Word Bank Report, 2021.

It is a moot factor for raising pertinent arguments whether similar trends have been experienced all over the world encompassing economically advanced countries in the West as well as developing countries in Asia alike in the face of global pandemic situation; however, a quick review of empirical date related to the Asian countries bears evidence to prove the fallacy of the argument. For instance, a review of India's economic recovery in the aftermath of the ravaging spread of the COVID pandemic and its unprecedented impacts on the economy points to the fact that the pandemic alone is not the decisive factor that attributed to the dismal economic performance of the country in the post epidemic period.

Table:4.3.
National Accounts: SAARC Countries.

Indicator	Ref. Year	Sri Lanka(a)	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan
Gross Domestic Product (GDP)(b), mn. US $	2015	80,555	20,607	194,446	2,060	2,146,759	4,109	20,801	267,035
	2016	82,391	20,231	220,837	2,220	2,286,229	4,414	20,982	277,521
	2017	87,420(c)	21,499	245,633	2,528	2,625,091	4,866	25,590	303,092
	2018	88,385(c)(d)	20,514	269,628	n.a.	2,779,692	n.a.	27,825	282,346
GDP Per Capita(b), US $	2015	3,841	760	1,224	2,721	1,673	9,043	744	1,393
	2016	3,886	732	1,373	2,888	1,760	9,343	741	1,420
	2017	4,077(c)	762	1,510	3,477	1,995	9,898	891	1,459
	2018	4,079(c)(d)	682	1,638	n.a.	2,087	n.a.	956	1,327
GDP Per Capita at PPP, US $	2018	13,450	2,546	4,278	10,803	7,864	15,422	2,981	5,528
Real GDP Growth, %	2016	4.5	3.5	7.1	8.0	8.2	7.3	0.6	4.6
	2017	3.6(c)	7.1	7.3	4.6	7.2	6.9	8.2	5.4
	2018	3.3(c)(d)	-0.2	7.9	n.a.	6.8	6.1	6.7	5.8

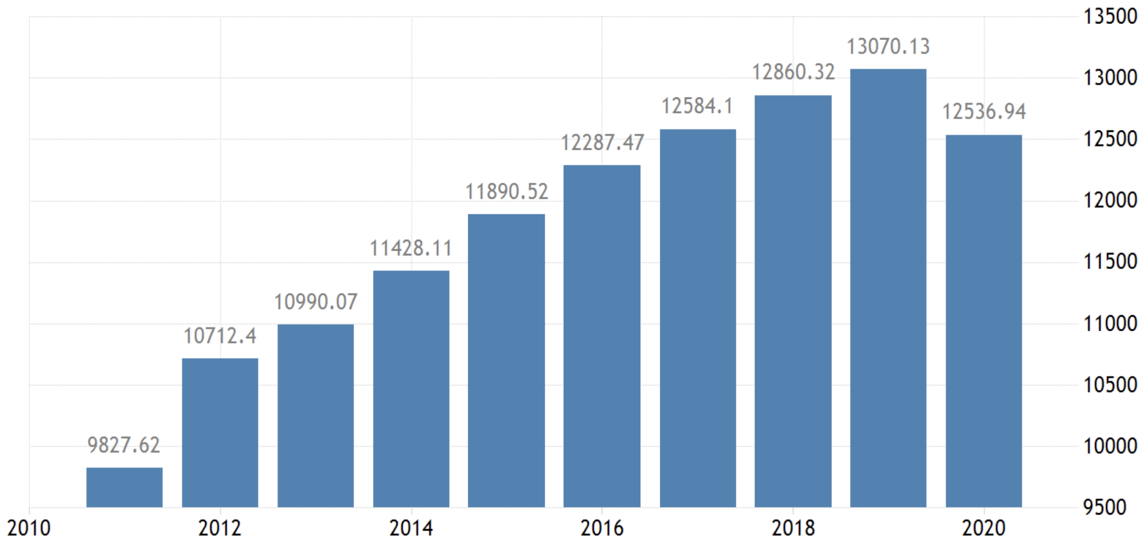
Source: Sri Lanka Socio Economic Data, 2020.

As data reveal, only Afghanistan was behind Sri Lanka in 2018 in terms of real GDP growth percentage and the dormant growth rates in GDP was a continuing trend, according to the Table 4.3, in 2016 and 2017 as well. Data on GDP per capita in US $ terms indicate that Malaysia, Korea, Philippine, Singapore and Thailand held far better positions compared to the $ value calculated for Sri Lanka.

A twenty-year review of GDP of Sri Lanka testifies that the country has never been able to achieve a GDP growth rate over 7.67 percent per annum since 1994 while other countries in South East Asia which are saddled with similar geopolitical conundrum have been able to achieve near two digit growth rates during the same period.

Economic signals emanating from the main performance indicators of Sri Lanka, particularly in the second decade of 2000, clearly and loudly demonstrate that the country is on the verge, if not already in, of a deep-rooted economic stagnation with a flaring gap between the two pillars of economic structure, expenditure and revenue, that is largely caused by flamboyant expansion of government expenditure without paying due attention to the grave repercussion of depleting revenue. The widening gap between expenditure and revenue attributes to the acceleration of negative ripple effects in the spheres of debt service payments, inflation, money supply, unemployment and depreciation of par value of local currency.

Figure: 4.1
GDP Per Capita of Sri Lanka- 2010 and 2020.



Source: tradingeconomics.com, 2021.

In view of the facts cited in this section, the logical conclusion that can be reached is that, in spite of intermittent upward movements, the overall tendency has been the stagnant economic existence of the country in comparison to the performance of similar countries in the same region and in the same time horizon.

4.2. Government Revenue:

Government revenue, according to the IMF, is an increase in net worth resulting from a transaction. For general government institutions, there are four main sources of revenue: taxes and other compulsory transfers imposed by government units, property income derived from the ownership of assets, sales of goods and services, and voluntary transfers received from other units[81]. In the context of Sri Lanka, the main sources of government revenue have been taxes of different category, excise duties, import and export levy, the structure of which has remained static, except average annual growth, in relation to the composition of revenue basket as well as the total financial value of revenue.

Non tax revenue according to the Table 4.4 recorded a value of Rs. 207.7 billion in 2018 which declined to Rs. 156.0 billion in 2020 showing continuous slide downwards in every year. Of the total government revenue Rs. 763.2 billion in 2020 the relative position of non-tax revenue remained at 12.15 percent which makes an interesting comparison with the revenue composition of the OECD countries prepared for the year 2019. According to the Table 4.4, the situation prevailed pre COVID period in 2018 and 2019 appears to be lackluster nature with only marginal increase of government revenue in2019 compared to that of 2018.

[81] International Monetary Fund, 2021.

Table:4.4.
Economic Classification of Government revenue.

Item	2018	2019 (a)	2019 Jan - Jul (a)	2020 Jan - Jul (a)
				Rs. billion
Tax Revenue	**1,712.3**	**1,734.9**	**944.4**	**670.4**
Income Taxes	310.4	427.7	184.9	126.0
VAT	461.7	443.9	265.6	119.3
Excise Taxes	484.3	399.5	225.8	184.9
Import Duties	97.0	98.4	55.2	60.4
PAL	113.9	112.2	64.5	62.4
NBT	71.4	70.7	42.2	1.8
SCL	75.8	70.4	42.2	46.5
CESS	53.4	50.7	28.3	28.1
Other Taxes	44.4	61.5	35.7	41.0
Non Tax Revenue	**207.7**	**156.0**	**87.5**	**92.8**
Total Revenue	**1,920.0**	**1,890.9**	**1,031.9**	**763.2**

Source: Ministry of Finance, Sri Lanka.

Resourcefulness of government revenue hinges upon several factors including the fiscal strategy of the state, abundance of natural resource stock, effectiveness of bureaucratic revenue collection mechanism all of which seems to be operating at sub optimal level as regards the Sri Lankan taxation system is concerned. Decline in revenue collection and earning by the Sri Lankan state in the past few years reflects the fact that the revenue structure of Sri Lanka is saddled with structural rigidities and the revenue collection mechanism operates at sub optimum level.

Review of the the period from January to July 2020, indicates that the government revenue as a percentage of estimated GDP declined to 4.9 per cent from 6.9 per cent of GDP in the corresponding period of 2019 due to a notable decline in the tax revenue collection. The decline in government revenue largely reflected the impact of the subdued economic activity following the COVID-19 outbreak amidst the tax concessions granted after the presidential election to stimulate economic activity. In nominal terms, government revenue declined by 26.0 per cent to Rs. 763.2 billion during the seven months ending July 2020 from Rs. 1,031.9 billion recorded in the corresponding period of 2019. This decline in revenue mobilisation was observed in major tax categories of income taxes, excise duties, VAT, Nation Building Tax (NBT), PAL and CESS.

However, non tax revenue increased by 6.1 per cent to Rs. 92.8 billion during the period under review, mainly due to the transfer of distributable profits of the Central Bank to the Government based on the financial statements of 2019, amounting to Rs. 24.0 billion[82].

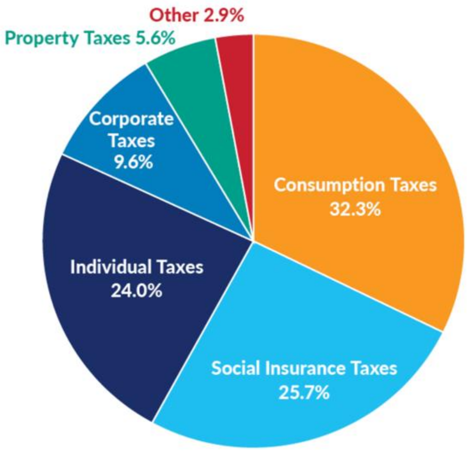
As research studies on taxation of Sri Lanka highlight, the country faces several issues such as low level tax ratio with declining trend, slow structural change of tax

[82] Recent Economic Developments, Central Bank of Sri Lanka, 2021.

composition, dismal outcome even after changing of tax system and low level of efficiency and productivity of Value Added Tax (VAT)[83].

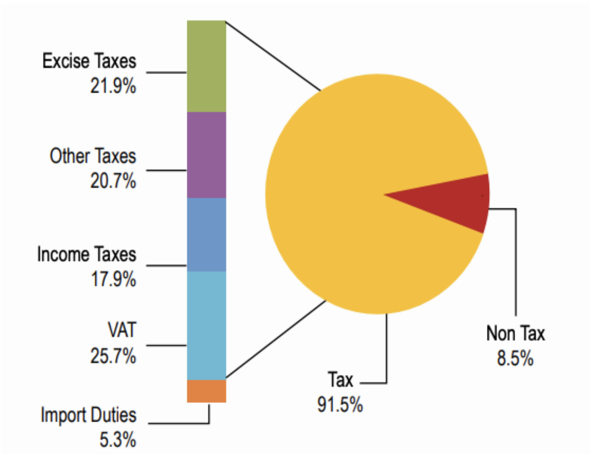
Figure:4.2

Panel A.
OCED Average Sources
of Tax Revenue -2019



Source: OECD, 2021.

Panel B.
Sri Lanka Average Sources
Tax Revenue- 2019



Source: Central Bank of Sri Lanka, 2021.

According to Kaldor [84](1963) for a country to become “developed” it needed to collect taxes at 25-30 per cent of GDP. It is obvious that Sri Lanka remains well short of Kaldor‟s target. International empirical evidence on tax ratio has been 36 per cent, 28.8 per cent and 16.5 per cent and 13.9 per cent as the tax ratios for high- income, upper middle income, lower middle income and low income countries respectively in 2004/2005/2006 (Pessimo & Fenochietto, 2010: IMF, 2011).

Though Sri Lanka’s tax ratio fluctuated during the period of 1980-2011, since 1997 it has always been below 16.5 per cent which is the average of lower middle income countries. The low tax revenue base of Sri Lanka propels from several factors including inefficiency of tax collection mechanism, narrow base of taxable revenue earners, tax evasion, and heavy dependence on indirect taxes.

The necessity to revamping the fiscal policy and develop the revenue base with an eye to diversifying the tax base is to be further examined in the context of mitigating the adverse impacts of fiscal policy on the long-term economic growth.

To reduce its dependency on money creation and debt, the country should take several measures including broadening the tax base, simplifying the tax rates, simplifying the tax laws, reducing the number of taxes, facilitating voluntary

[83] Joseph F, et al, (2020), Nexus between government revenue and economic growth in Sri Lanka during 1980-2018: A time Series Analysis, ResearchGate.
[84] Kaldor, Causes of the Slow Rate of Economic Growth of the United Kingdom, University of Cambridge Press, Cambridge, 1966.

compliance, avoiding politically motivated tax amnesties and tax concessions, and avoiding political interferences and influences on tax administration to enhance tax revenue.

Table:4.5.
Decomposition of Government Revenue in Sri Lanka.

Year	Tax Revenue (Million)	Non Tax Revenue[3]	Percentage of Total Revenue	
			Tax Revenue	Non Tax Revenue
1980	12158	864	93.4	6.6
1990	61206	6758	90.1	9.9
2000	182392	28890	86.3	13.7
2005	336829	42917	88.7	11.3
2010	724747	92532	88.6	11.3
2015	1,355,779	99,099	93.2	6.8
2017	1,670,179	161,353	91.2	8.8

Source: Compiled from the Central Bank Reports.

The logical conclusion that can be reached with the review of above data is, without doubt, revenue of government has been on the downturn which is definite indication of a weakening economy.

4.3. Level of Poverty:

Another useful indicator used by scholars in economics to assess the level of stagnation in a country is the continuing or deteriorating poverty level over prolonged period both in absolute and relative terms. In this context, the basic problem confronting all those who are involved in measuring and monitoring poverty is to define what is meant by poverty and whom to include in the category of the poor. As such before attempting to measure poverty in any country or a region it is necessary to understand what is meant by Poverty[85].

Poverty definitions are abundant since different countries and social groups have their own definitions; nevertheless, the generally acceptable definition developed by the Word Bank refers to the poverty line in demarcating the level of poverty. Poverty is a state or condition in which a person or community lacks the financial resources and essentials for maintaining a minimum standard of living which means that the income level from employment is so low that basic human needs are beyond the reach. Poverty-stricken people and families might go without proper housing, clean water, healthy food, and medical attention. There is an opinion that it is the 'Lack of access to basic needs. Some perceive that it is 'An inability to satisfy minimum needs'. Still

[85] Nanayakkara, A. G. W., (2006), Poverty in Sri Lanka - Issues and Options. Department of Census and Statistics.

others would point out that it is a 'Failure to meet Human Entitlement'. A relatively easy definition of poverty could be given as a condition in a society where some of the members of the society are unable to attain level of material wellbeing considered as an acceptable minimum by the standard of the society. Each nation may have its own threshold that determines how many of its people are living in poverty.

The international poverty line is a monetary threshold under which an individual is considered to be living in poverty. It is calculated by taking the poverty threshold from each country—given the value of the goods needed to sustain one adult—and converting it into dollars. The current international poverty line is $1.90 per day[86].

Between 2008 and 2015 the absolute international poverty line was set at $1.25/day in 2005 dollars. However, in 2015 the World Bank updated this from $1.25 to $1.90 per day, in 2011 dollars, to reflect the changes in the estimated purchasing power of the dollar in poor countries between 2011 and 2005. In both cases, the line was set based on the national poverty lines of fifteen very low-income countries, converted to US$ using purchasing power parity exchange rates. Sri Lanka has among the lowest extreme poverty rates among countries in the region, as 1.8 percent of the population were estimated to be extremely poor in 2013. However, living standards remain low, as nearly 45 percent of the population lived on less than $5 per day in 2013[87].

As detailed by the Asian Development Bank, the salient characteristics of Sri Lankan poverty are:

1) 4.1 percent of the population lives below the national poverty line in 2016.
2) the proportion of employed population below $1.90 purchasing power parity a day in 2019 is 0.4 percent.
3) For every 1,000 babies born in Sri Lanka in 2019, seven die before their fifth birthday[88].

There are two broad classes of methodology for estimating poverty: absolute poverty and relative poverty which are different poverty situations that can be used as instrumentals in gauging poverty under different circumstances depending on the purpose of assessment .

Poverty and macro level economic performance are interrelated. Macro level comparison of Sri Lanka's economic progress seems to be lackluster in relation to per capita income of Japan which stood at $ 90 in 1950 which reached phenomenal level of $ 32,000 whereas Sri Lanka's positing was $ 89 in 1950 which reached $ 840 in 2000. In case of Singapore its per capita income in year 1950 was $30 which went up to $ 28,000 in 2000. An analysis on the poor economic performance of Sri Lanka, Nawaratne expounds the reasons as 1). no Long-term Vision 2). too much freedom / No discipline 3). giving every thing, everyday, to everybody free of charge 4). working on wrong paradigms and conflicting policie[89]. It appears that Nawaratna mimics on the

[86] Investopedia. com, 2021.
[87] The Word Bank, (2017), Understanding Poverty in Sri Lanka.
[88] Asian Development Bank, (2021).
[89] Nawaratne, S. J, (2021), Poverty Alleviation in Sri Lanka: with special reference to Samurdhi (Prosperity) Movement, econ. fukuoka.

Japanese saying that "free is very expensive" which goes much deeper without saying in the context of Sri Lanka.

Table:4.6.
Official Poverty Lines and Poverty Headcount Index (%) by District - 1990/91,1995/96 and 2002.

Province	District	Poverty Line (Rs)			Poverty Head Count Index (%)		
		1990/91	1995/96	2002	1990/91	1995/96	2002
Western	Colombo	518	908	1537	16	12	6
	Gampaha	487	875	1508	15	14	11
	Kalutara	494	866	1523	32	29	20
Central	Kandy	485	850	1451	36	37	25
	Matale	466	816	1395	29	42	30
	Nuwara	494	841	1437	20	32	23
Southern	Galle	489	833	1466	30	32	36
	Matara	470	816	1395	29	35	27
	Hambantota	470	791	1338	32	31	32
North -West	Kurunegala	456	791	1352	27	26	25
	Puttalam	461	841	1423	22	31	31
North - Central	Anuradhapura	456	816	1380	24	27	20
	Pollonaruwa	475	783	1366	24	20	24
Uva	Badulla	485	850	1409	31	41	37
	Monaragala	480	791	1366	34	56	37
Sabaragamuwa	Ratnapura	494	833	1451	31	46	34
	Kegalle	466	858	1437	31	36	32
	National	475	833	1423	26.1	28.8	22.7

Source: Household Income and Expenditure Survey - 1990/91, 1995/96 and 2002.

Poverty is a complex problem with so many facets in Sri Lanka and it creates disparities among individuals as well as different social groups. Sri Lanka did not achieve the much anticipated structural transformation that could have provided greater employment opportunities for the poor in the nonfarm sector. Since 1985, the share of manufacturing in total GDP has hardly changed. Low rates of job creation in the formal sector, plus high wages there because of collective bargaining, and periodic statutory directives lead to the rationing of formal jobs on the basis of class and connections, which the majority of the poor lack. This problem is compounded by the lack of labor mobility as labor markets are highly segmented with spatial, skills-related, and institutional barriers to the movement of labor within and between regions. Many are pushed into informal employment by greater distance from commercial centers; lack of access to roads, electricity, schooling, and health facilities; and by poverty which limits their investment opportunities[90].

In concluding remarks, the empirical data relating to the poverty level in Sri Lanka do not demonstrate a total success since rural poverty, urban poverty, malnutrition, lack of sanitation facilities, inadequacy in housing and poor schooling habits of young

[90] Gunathilake R et al, (2009), Poverty and Human Development in Sri Lanka, Asian Development Bank.

children are still problems of substantial magnitude that are capable of producing negative cascading effect on the overall economic advancement.

4.4. Inflation in Sri Lanka:

Inflation is another salient characteristic of a stagnating economy since it pushes the price level upwards due to excess demand and restrictions in the expansion of supply side leading to the net result of continuous increase of price levels. A high and sustained economic growth in conjunction with low inflation is the central objective of macroeconomic policy formulation prescribed for both developed and developing countries.

An empirical research conducted using hundred countries for the period between 1960 and 1990 for assessing the effects of inflation on economic performance conclude that; If a number of country characteristics are held constant, then regression results indicate that the impact effects from an increase in average inflation by 10 percentage points per year are a reduction of the growth rate of real per capita GDP by 0.2-0.3 percentage points per year and a decrease in the ratio of investment to GDP by 0.4-0.6 percentage points. Since the statistical procedures use plausible instruments for inflation, there is some reason to believe that these relations reflect causal influences from inflation to growth and investment[91].

Three major measures used for monitoring inflation in Sri Lanka such as CCPI, Wholesale Price Index (WPI) and Gross Domestic Product Deflator (GDPD) concentrate on annual changes in the general price level.

A study carried out by Saduni (2015) reveals that both long run and short run factors influence inflation in Sri Lanka. The study further elaborates that exchange rate, money supply, GDP, government expenditure, oil prices and interest rate are the major contributory factors behind inflation in Sri Lanka[92]. This study further reports that increase in the money supply causes increase in domestic price level in the country. Resulting from higher money supply, investments will increase and more employment opportunities will be generated. As a result, the aggregate demand will increase and ultimately there will be an increase in domestic price level due to higher demand. Accordingly, money supply affects inflation through demand side. Further, there is a strong positive link between inflation and the exchange rate. The exchange rate is one of the main macroeconomic fundamentals that affect inflation in a small open economy like that of Sri Lanka.

Government expenditure also affects inflation through stimulated demand. Higher expenditure increases the aggregate demand of goods and services. This would result in higher domestic price levels. In the same manner, GDP has a positive impact on inflation. Furthermore, it has shown that there is a positive relationship between international oil prices and inflation. Thus empirical findings indicate that the decreasing interest rates have a positive effect on inflation in Sri Lanka. Therefore, it has proved that in the long run, both supply side and demand side factors namely, money supply, exchange rate, government expenditure, oil price GDP and interest

[91] Robert J B, (199), NBER, 5.
[92] Sanduni K, (2015), Inflation Dynamics in Sri Lanka: An Empirical Analysis.

rates play important roles in the determination of inflation level in Sri Lanka during the investigated period.

According to the monetarist school of thinking, inflation is fundamentally a monetary phenomenon that occurs due to imbalances in the monetary sector which in economic nomenclature referred to as demand pull inflation. The other scenario is the cost push inflation which according to theoretical expounding is mainly the result of increasing cost of production spearheaded by cost of labour. The Figure 4.3 given below illustrates the rate of inflation from 2013 to 2020 which shows extreme fluctuations in 2013, 2017, 2018 and 2020.

A study conducted on cause-and-effect relationship between money supply and inflation in Sri Lanka concludes that there is a positive relationship between the two. The findings indicate that increased money supply, depreciation of the rupee and higher public wages are the major causes of inflation in both the short and long-run. Thus, it can be stated that inflation in Sri Lanka is affected by both demand and supply side factors, which highlights the importance of a prudent and effective implementation of monetary and fiscal policies so as to ensure a stable macroeconomic environment in Sri Lanka[93].

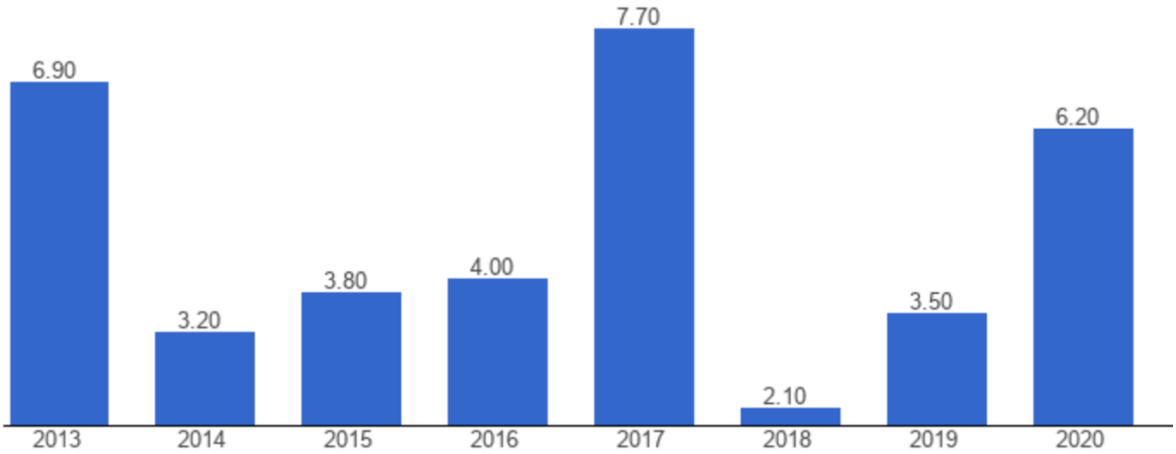
As is discussed in the subsequent chapters, government adhered to the practice of expansionary monetary policy in the face of mounting pressure of continuous increase in recurrent expenditure and stagnant revenue position by printing more currency notes.

In this context, the literature review on the subject indicates diverse views and inconclusiveness; however disproportionate increase of money supply, depreciation of par value of rupees as against $ and wage increase due to arm twisting practice of the trade unions are considered as the main contributory factors of inflation in Sri Lanka. This cause-and-effect relationship has been highlighted by a statistical study using Unit Root tests that affirms the existence of a strong relationship between inflation and monetary policy in Sri Lanka[94].

As Figure 4.3 depicts, the rate of inflation reached 6.3 percent in 1920 which must be viewed in conjunction the prime rate of interest rates of commercial banks. When rate of inflation increases steadily, its impacts are felt immediately on the cost of capital since real rate of interest tends to decline with the increase of rate of inflation. This affects, through direct and indirect ways, investment, national saving and profitability of business in adverse direction which in turn generate, as a combine result, downward slide in overall performance of the economy.

[93] Danusha. J., et. al, (2016), An Inquiry into the Causes of Inflation in Sri Lanka: An Eclectic Approach, NSBM Journal of Management.
[94] Colombage, S. S., (2006), Journal of Humanities, Social Sciences & Education - Vol. 3.

Figure:4.3
Sri Lanka Rate of Inflation 12013-2020



Source: The GlobalEconomy.com, 2021

In the short run, money supply is the main determinant of inflation. Exchange rate also plays a key role In the short run. In the long run too, in addition to money supply, the exchange rate Is instrumental as a dynamic force that adds momentum to Inflationary process. However, the high magnitude of elasticity of inflation with respect to money supply growth points to the fact that inflation In Sri Lanka is mainly caused by monetary factors rather than by real factors in the long run.

The point in focus is that Sr Lanka papers to be most certainly in the threshold of galloping inflation commencing from year 2019 with a main contributory role played by the excessive supply of money as a strategy for bridging the widening gap between the revenue and expenditure of government. The situation is amply illustrated in the Table 4.7 and 4.8 showing the steady increase of money supply, both in narrow and broad money, 0ver the period between 2014 and 2019. The relationship between monetary policy and economic outcome is well articulated in the Keynesian and Monetarist approaches and in particular reference is relevant to be made to the quantity theory of money which states; M.V = P.T In the formula M and V stand for money supply and velocity respectively while P and T represent price level and volume of transaction (GDP) in an economy. Apparently, Sri Lanka has forgotten the time tested and theoretically well-articulated fundamentals of monetary economics in the process of formulating its fiscal and monetary policies.

Table 4.7 contains data representing the monetary aggregates of Sri Lanka for the period between 2014 and 2019 and seems to be providing sufficient evidence to support the argument that over expanded money supply has significantly contributed to the inflation in the country. The broad money supply, M1 and M2, which stood at Rs. 3,875,853 million in 2014 reached an accelerated growth of Rs. 7,624,121 million posting a percentage growth of 96.7 in a period of six years

Table: 4.7.
Monetary aggregates.

Rs. million

Item	2014	2015	2016	2017	2018	2019[(a)]
Reserve Money	**577,912**	**673,432**	**856,147**	**939,793**	**961,096**	**932,604**
Narrow Money (M_1)	**612,155**	**714,988**	**776,624**	**793,299**	**830,793**	**865,467**
Currency	329,426	388,057	429,502	439,396	473,066	494,208
Demand Deposits	282,729	326,931	347,123	353,903	357,727	371,259
Time and Savings Deposits[(b)]	**3,263,698**	**3,850,929**	**4,628,972**	**5,514,762**	**6,297,503**	**6,758,654**
Domestic Banking Units	3,121,032	3,674,360	4,439,938	5,298,564	6,071,118	6,517,917
Foreign Currency Banking Units	142,666	176,569	189,034	216,198	226,386	240,737
Broad Money (M_2)	**3,460,558**	**4,057,212**	**4,823,559**	**5,665,313**	**6,427,330**	**6,912,710**
Time and Savings deposits (TSD)[(b)]	2,848,402	3,342,224	4,046,935	4,872,014	5,596,536	6,047,243
Broad Money M_{2b} (M_1 + TSD)	**3,875,853**	**4,565,917**	**5,405,596**	**6,308,062**	**7,128,297**	**7,624,121**
Underlying Factors in M_{2b}						
Domestic Credit	4,640,146	5,732,034	6,671,677	7,504,715	8,833,442[(c)]	9,383,185
Claims on Government (Net)	1,435,900	1,759,492	1,972,133	2,168,517	2,516,711[(c)]	2,767,103
Credit to Public Corporations	450,924	530,669	513,768	536,982	755,380	817,953
Credit to Private Sector	2,753,322	3,441,874	4,185,777	4,799,215	5,561,351	5,798,128
Net Foreign Assets	15,126	-298,163	-231,238	121,538	-67,007	128,256
Monetary Authorities	688,007	576,187	558,589	846,139	750,541	895,997
Commercial Banks	-672,881	-874,350	-789,827	-724,601	-817,548	-767,742
Net Other Items	-779,418	-867,954	-1,034,843	-1,318,191	-1,638,139[(c)]	-1,887,320
Currency / M_{2b} , %	**8.5**	**8.5**	**7.9**	**7.0**	**6.6**	**6.5**
Income Velocity of Money	2.85	2.62	2.43	2.26[(c)]	2.12[(c)]	2.04
Money Multiplier (M_{2b} / Reserve Money)	6.71	6.78	6.31	6.71	7.42	8.18

Source: Central Bank of Sri Lanka, 2020.

The situation was further aggravated in 2020 with the increase of M2 registering an increase of 23.4 percent while the M1 posting an increase of 36.6 percent in the same year, according to the Central Bank annual Report[95].

In a nutshell, the behavior of monetary aggregates during 2015 and 2019, as illustrated in the Table 4.7, has been on expansionary path. It is more meaningful if money supply aggregate is viewed in conjunction with the GDP growth rates pertaining to the corresponding years for understanding what contributed to the expansion of GDP and the inflation rate that accompanied by each year during the same period. Narrow money supply M1 increase recorded 16.6, 8.6, 2.1, 4.7 and 4.2 respectively from 1915 onwards, and the GDP in constant prices recorded -3.6 (minus) percent in 2020. All major components of GDP namely agriculture, industry and services recorded -2.4, -6.9 and -1.9 all minus growth rates respectively for each sector.

It is evident from the authentic data made available by the Central Bank of Sri Lanka (CBSL) that all economic barometers of the country at the beginning of 1920s indicated, clear and aloud, that the country was virtually ridden with crises of grave magnitude spared all over body economics.

The above monetary data presented in a summarized form in Table 4.8 further consolidate the fact that government resorted to printing money in order to meet with the expanding recurrent expediter which can be compared to the act of infusing inflammable fuel to an already overheated economy resulting the economy moving into the verge of economic abyss.

[95] Annual Report of the Central Bank of Sri Lanka, 2020,

Table: 4.8
Percentage Growth of Monetary aggregates. 2015 and 2019.

	2015	2016	2017	2018	2019[(a)]
Narrow Money (M_1)	16.8	8.6	2.1	4.7	4.2
Broad Money (M_2)	17.2	18.9	17.5	13.5	7.6
Broad Money (M_{2b})	17.8	18.4	16.7	13.0	7.0

Source: Central Bank of Sri lanka,2020.

In concluding remarks, the description given in the section with amply supported by time series data leads to the conjecture that the country's economy has shown all the signs of economic stagnation due to the influence of several attributing factors such as money supply, high inflation rate and lackluster GDP growth rates which as a combine force helps gathering momentum simultaneously in the march towards deep stagnation.

4.5. Capital Investment:

The main and the immediate causality of the welfare state is the capital investment of government since the two variables, welfare policy and capital investment, are cogitated to be mutually exclusive which means that if more resources are mobilized towards the welfare benefits of the masses, then less will be available for capital expenditure, an investment for the future. In technical terms, the capital expenditure refers to the money spent by the government on the development or acquisition of machinery, equipment, building, health facilities, education, etc. It also includes the expenditure incurred on acquiring fixed assets like land and investment by the government that gives profits or dividend in future. Capital expenditure is associated with investment or development spending, where expenditure is expected to produce multiple benefits extending over the years into the future. To be very precise, the caapital expenditure includes funds disbursed on the following:

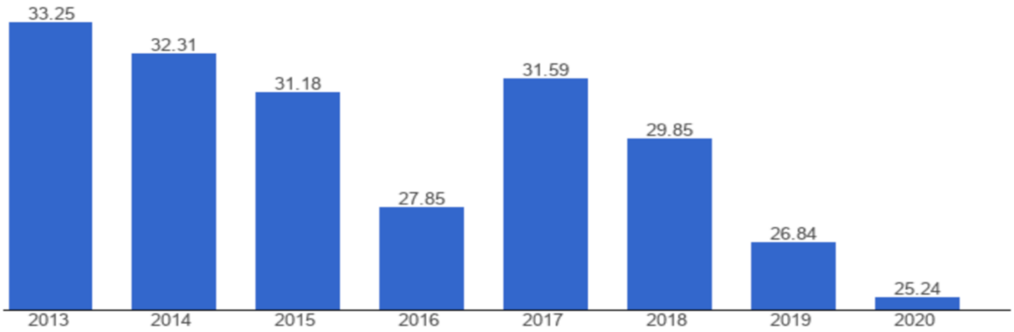
1) Acquiring fixed and intangible assets
2) Upgrading an existing asset
3) Repairing an existing asset
4) Repayment of loan.

Capital expenditure, which leads to the creation of assets are long-term in nature and allow the economy to generate revenue for many years by adding or improving production facilities and boosting operational efficiency. It also increases labour employment, takes stock of the economy and raises its capacity to produce more in future.

Capital investment in sri Lanka particularly after the year 2000 is characterized with mammoth infrastructure development projects launched with financial assistance of foreign lending countries or foreign aids made available under different conditions negotiated between the beneficiary and the provider or donor.

Sri Lanka’s capital investment as a percent of GDP during 1960 – 2020 period indicates that the average value for Sri Lanka during that period was 23.57 percent with a minimum of 12.53 percent in 1965 and a maximum of 39.06 percent in 2012. The latest value from 2020 is 25.24 percent. For comparison, the world average in 2020 based on 129 countries is 23.04 percent.

Figure: 4.4
Capital Expenditure as a Percentage of GDP- Sri Lanka 2013- 2020.



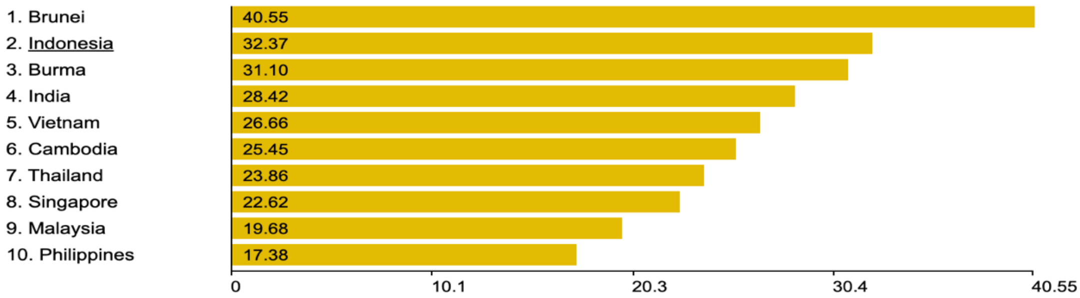
Source: The GlobalEconomy.com, 2021.

The relative position of Sri Lanka’s capital expenditure shown in Figure 4.4, in contrast with the same in selected ten counties in South East Asia, seems to be in dire situation as the long-term trend inclined to be tilting downward. The average capital investment for 2020 based on 10 countries was 26.81 percent in which the highest value was recorded from Brunei: 40.55 percent and the lowest value was in the Philippines: 17.38 percent. Long term repercussions of meager capital investment reflect on contraction of manufacturing, lowering capacity of job creation, depleted export income which as a whole undermines the capacity of economy by weakening the economic fundamentals needed for vibrant growth.

Furthermore, on the same breadth, low capital formation is a precursor showing a declining trend in future production, employment and standard of living since inadequate investment in an economic system produces ripple effect in all the spectrums of production activities due to contraction of manufacturing and service sectors.

The effect of shrinking capital expenditure has reflected on the economy particularly in 2020 and 2021 by way of increased unemployment, high rate of inflation caused by scarcity of goods and services. In addition, poor capital investment leads to higher imports and discouragement of investors through the impacts of high inflation and shaky economic stability of the country.

Figure: 4.5.
Capital investment, percent of GDP in South East Asia



Source: GlobalEconomy.com, 2020.

Being a welfare state, the government is under political obligation to prioritize the public welfare over economic growth objectives which results in allocation of overwhelmingly large proportion of scarcely available financial resources for providing public welfare and amenities. Although in academic and policy discussions, Sri Lanka was quoted as an exceptional and a success case of achieving redistributive justice in human development among developing countries, the critical issue of its sustainability has rarely drawn the attention in these discussions. According to Lakshman (1975: 65) '...the viability of any redistributive strategy is likely, in the long-run, to be seriously undermined by economic stagnation'. In the absence of a growth momentum, the sustainability of the welfare state gradually comes under increasing threat in two front. First, the maintenance of the welfare system itself required a continuous flow of resources to finance it. Second, the financial resources should be generated out of the expansion of the economy. This fundamental requirement required for long term sustenance of a welfare state appears to have been ignored in Sri Lanka.

As it was pointed out earlier, the expansion of the welfare system was based on not the realities but the contemporary economic prosperity prevalent at the time of independence. · Secondly, the state had to face the massive social demand that emanated from an extensive welfare system. People who were brought up within the welfare system had improved capabilities and higher social expectations. The capabilities needed to be utilized and the expectations to be satisfied in the development process by a corresponding expansion of the economy. The above requirements point to an important contradiction in the post independence development history of Sri Lanka. The expansion of the social welfare system was based not on a sustained growth momentum of the economy but on the historically accumulated resources, which formed its initial economic foundation.

Efforts to achieve redistributive justice in a stagnant economy is bound to boomerang sooner or later as it forces people to share resulting poverty rather than wealth and to live through the sense of exclusion and frustration. The Sri Lankan experience suggests that there is no possible choice between the provision of basic needs and the achievement of economic growth as alternatives of promoting human development, as it raises serious problems of sustainability of the development process, economically as well as politically[96].

As concluding remarks of the Chapter, the facts brought under reference and the analysis conducted as a whole bears evidence that Sri Lankan economy is under a long spell of economic stagnation with its towering recurrent expenditure, unemployment, increasing money supply on the one hand and depleting revenue moving into the opposite direction on the other hand; amidst the polarization of divergent economic forces, Sri Lanka is wedged in the vortex of stagnation. As it is focused in Chapter 02, all the symptoms of economic stagnation deliberated in theoretical models appear to be penetrated into the body structure of Sri Lankan economy by the beginning of 2020's.

[96] Sirimal, A., (2002), Economic Roots of Political Conflict: The Case of Sri Lanka.

CHAPTER 05 - WELFARE BASED ECONOMIC POLICY OF SRI LANKA

5.1. Review of Economic Policies After Year 2000:

A basic characteristic of welfare based economic strategy is the state intervention in economic affairs of a country leaving narrow leeway for the market forces to operate on their own. Development strategies that shaped the Sri Lankan economy over the last five decades may be distinguished under two eras: the first era covering the period between 1948-76, and the second era during the post-1977 period.

According to the policy declaration made by the Ministry of Finance for the period 2021 and 2025, the medium-term fiscal strategies of Sri Lanka contain[97]:

1) Achieving economic growth at 6.0 percent or higher.
2) Maintaining unemployment at less than four percent.
3) Retaining inflation not exceeding five percent.
4) Increasing revenue to GDP ratio over fourteen percent in 2025
5) Allowing the Budget on a sustainable foot by rationalizing unproductive expenditure
6) Containing budget deficit at less than four percent of GDP
7) Achieving primary surplus by 2025 and beyond
8) Reducing the Government debt to GDP ratio at 75.5 percent in 2025
9) Ensure a single-digit rate of interest
10) Maintain the stable exchange value of the rupee.

Economic policies of any country are formulated in tangency with the long-term goals and strategies that are adopted for archiving the goals, mainly decided in political flavor, to improve the overall economic performance of a state nation during a foreseeable time boundary. Such economic policies are developed with reference to the specific sub sectors of the economy encompassing financial, fiscal, infrastructure, educational agricultural and so forth which are construed as main pillars that carry the burden of an economic structure.

The most recent policy document in respect of economic policy in Sri Lanka is the Mahinda Chinthana: Vision for a New Sri Lanka. It envisions a development framework for the country within a ten year time horizon, 2006-2016. As it mentions, its aim is to raise the GDP growth rate in excess of eight percent. In addition, it further envisages to integrate the positive attributes of the market oriented economic policies while safeguarding the domestic aspirations by providing necessary support to domestic enterprises and encouraging foreign investment. The policy strives to establishing an economy that is predominantly private sector driven, more dynamic and regionally integrated. It is important to note that the current development strategy emphasises the importance of regional development, which is a priority issue from policy perspectives. The social development plan covers many areas such as education, health, livelihood development, social protection, disaster management, water supply and development of the lagging regions.

[97] Ministry of Finance, Sri Lanka, 2020.

The post 2005 welfare regime strengthened targeted welfare expenditure in Samurdhi, nutritional meal supply programme, free school uniforms, text books and season tickets, bursaries and scholarships, fertilizer subsidy.[98] In keeping with welfare economic fundamentals and Keynesian prescription, all political regimes that came to power in Sri Lanka have been engaged in deficit budgetary policy with the intention of stimulating the aggregate demand through easy money strategy. The effectiveness of demand stimulation strategy largely depends on the supply side dynamics and how supply reacts to the stimulated demand supported by relaxed monetary policy. Sri Lanka where a large quantity of comestibles is imported annually on an increasing basis, any increase in the quantity demanded will exert an additional pressure on the balance of payment as well as the par value of the rupee.

Another dimension of economic policy in Sri Lanka is the multiple layers withing which the fiscal policy framework is implemented and the services rendered by the second and the third layer institutions warrants a critical evaluation to justify the financial expenditure incurred every year for their maintenance. The first layer is the central government, which has national jurisdiction. The second stratum comprises provincial councils(PC), which govern over distinct provinces. The third layer consists of the local authorities such as municipal councils (MC), urban councils (UC) and Pradeshiya Sabhas (Local Councils), which govern even smaller geographical areas[99].

Table:5.1.
Government Fiscal Operations - Sri Lanka

ITEM	2016	2017	2018	2019 (a)	2019 Jan-July (a)	2020 Jan-July (a)
Rs. million						
Total Revenue and Grants	**1,693,558**	**1,839,562**	**1,932,459**	**1,898,808**	**1,033,008**	**765,393**
Total Revenue	1,686,062	1,831,531	1,919,973	1,890,899	1,031,944	763,246
Tax Revenue	1,463,689	1,670,178	1,712,318	1,734,925	944,435	670,410
Non Tax Revenue	222,374	161,353	207,656	155,974	87,509	92,836
Grants	7,496	8,031	12,486	7,909	1,064	2,147
Expenditure and Net Lending	**2,333,883**	**2,573,056**	**2,693,228**	**2,915,291**	**1,717,088**	**1,637,947**
Recurrent	1,757,782	1,927,693	2,089,713	2,301,155	1,343,728	1,457,727
Capital and Net Lending	576,101	645,363	603,515	614,136	373,360	180,220
o/w Public Investment	594,013	657,386	624,970	631,235	379,171	192,328
Current Account Balance	**-71,719**	**-96,162**	**-169,740**	**-410,256**	**-311,784**	**-694,481**
Primary Balance	**-29,430**	**2,071**	**91,421**	**-115,130**	**-122,529**	**-288,937**
Overall Fiscal Balance	**-640,325**	**-733,494**	**-760,769**	**-1,016,483**	**-684,080**	**-872,554**

Source: Central Bank of Sri Lanka,2020.

As the Table 5.1 illustrates the government revenue from 2016 onwards vis a vis the total expenditure for the same years and the gap between the total revenue and the total expenditure balloons up reaching Rs 872,554 million in 2020. The largest imbalance is shown by the current account which amounted to Rs. 694,491 million in 2020. This is not a recent phenomenon since throughout the post independent era of Sri Lanka, the successive governments that held the political reign of the country gradually racked up the unsustainable fiscal deficit with myopic ambitions.

With the accelerated Mahaweli Development Project carried out during 1978 and 1983, in tangent with the first wave of economic reforms, the fiscal deficit started ballooning into unsustainable double-digit proportion, recording a peak deficit of 19.2

[98] United Nations Research Institute for Social Development, (2007), Development Strategies, Welfare Regime and Poverty Reduction in Sri Lanka, Geneva.
[99] UNICEF, (2019), Budget Brief Cycle.

percent of GDP in 1980. The wave of deficit continues to destabilize the fiscal balance with the second major economic reforms introduced in1988, with a recorded deficit of 12.7 percent in the same year. Although some fluctuations are visible in the annual budget deficits, the long-term trend of budget deficit remained around 7.5 percent of the GDP propelling changes in the rate of inflation and cost of living in the subsequent years. The rising imbalance pushed the government into hyper action of borrowing both locally and abroad which created a greater problem of indebtedness that became a problem of monster proportion in time to come.

The pressing need for managing the fiscal deficit within a reasonable limit compelled the government to introduce Fiscal Management Responsibility Act in 2003 which aimed at reducing both public debt and fiscal deficit; nevertheless the tsunami disaster that devastated the coastal area of Sri Lanka in the following year, 2004, necessitated the relaxation of fiscal controls in the face of sharp increase in reconstruction and rehabilitation expenditure leaving the necessity of fiscal control to the back burner. However, Sri Lanka seems to have made some headway in mitigating the worsening fiscal deficit in 2013 with the fiscal deficit declining to 5.4 percent of the GDP together with the downturn of the debt to GDP ratio reaching at seventy percent of GDP.

Outstanding foreign central government debt declined to 40.4 per cent of GDP at end 2020, from 41.3 per cent of GDP at end 2019, reflecting mainly the impact of net repayments of foreign debt amidst limited access to foreign financing in 2020. In nominal terms, the outstanding foreign central government debt declined to Rs. 6,052.2 billion at end 2020, compared to Rs. 6,201.3 billion at end 2019. The outstanding non concessional debt, including commercial foreign borrowings, decreased by 10.8 per cent to Rs. 3,064.1 billion at end 2020 from Rs. 3,433.8 billion at end 2019. The share of non concessional debt in total foreign debt declined to 50.6 per cent at end 2020 from 55.4 per cent at end 2019. Nexus between budget deficit and economic stagnation is amply demonstrated by the impacts the deficits made on inflationary pressure, ballooning money supply while depleting investment expenditure that finally resulted in the widening fiscal deficit.

The increase in recurrent expenditure in 2020 was mainly due to the rise in expenditure on subsidies and transfers, salaries and wages and interest payments. Expenditure on current transfers and subsidies increased during the year, both in nominal terms and as a percentage of GDP, mainly due to the increase in current transfers to the household sector. Transfers and subsidies to the household sector increased on account of the rise in expenditure on pension payments, social security and welfare schemes for needy segments of the society, as well as the additional expenditure incurred due to the cash grant for vulnerable groups and unexpected and unprecedented increase in expenditure incurred on healthcare and other related activities to deal with the spread of COVID-19 pandemic[100]. The de facto fiscal status of the economy as reported by the Central Bank of Sri Lanka bears evidence to prove that the gloomy economic atmosphere loomed on the horizon unabated with the dawning of the century and rolling that into the whole of the first quarter of the century. In fact, the government has been compelled under the given circumstances over the entire time period to contend with two centrifugal forces, revenue and expenditure, seemingly moving into inverse directions, which resulted in heavy borrowing both from

[100] Annual Report of the Central Bank of Sri Lanka, 2020.

the local and foreign sources to bridge the ever-broadening gap between the two pillars of government finance. In a nutshell the expansionary monetary and fiscal policy that was in practice has not been the free choice of the policy makers, but the comeuppance for popularist economic policies adopted by different governments under the influence of myopic political objectives of successive political regimes that governed the country. The successive governments that occupied the saddle of state inclined to swim with the current granting subsidies and grants that are not sustainable in the long run rather than playing the role of rudder that changes the direction of the ship of state for the better and larger benefits of the hoi polloi in time to come.

The Table 5.2 shows the disaster level reached in relation to debt- GDP ratio, 101.0, which is the gradual culmination of the crisis ridden economy in 2020, resulting from government's lavish expenditure beyond its sustainable capacity.

Table: 5.2

Central Government Debt Indicators.

Indicator	2017	2018 (a)	2019(a)	2020 (b)
Central Government Debt/GDP	77.9	84.2	86.8	101.0
Domestic Debt/GDP (c)	42.5	42.5	45.5	60.6
Foreign Debt/GDP	35.4	41.7	41.3	40.4
Domestic Debt/Central Government Debt	54.6	50.5	52.4	60.0
Foreign Debt/Central Government Debt	45.4	49.5	47.6	40.0
Foreign Debt/Exports (d)	162.2	181.0	178.6	250.2
Debt Service/GDP	12.0	14.6	13.5	13.0
Debt Service/Government Revenue	87.5	108.8	107.0	141.9
o/w Domestic Debt Service/ Government Revenue	66.3	81.3	64.2	85.5
Debt Service/Government Expenditure (e)	46.6	53.1	45.4	48.5
o/w Domestic Debt Service/ Government Expenditure (e)	35.3	39.7	27.2	29.2
Foreign Debt Service/Exports (d)	13.4	16.0	23.3	31.9
Interest payments/GDP	5.5	6.0	6.0	6.5
Interest payments/Government Expenditure	21.4	21.7	20.2	24.5
Domestic Interest payments/GDP	4.3	4.5	4.4	4.8
Foreign Interest payments/GDP	1.2	1.5	1.6	1.8
Interest payments/Government Recurrent Expenditure	38.2	40.8	37.2	38.5
Foreign Interest payments/Exports (d)	5.7	6.5	6.7	11.0

Source: Central Bank report, 2020.

The crisis of fiscal deficit produces cascading effects by breading secondary crises of different magnitude in the other vital sectors of the economy such as servicing the debts, swollen money supply, stagflation and over heated economy which, with the combined repercussions, are capable of converting the economy into an over heated lava mountain that could explode at any time causing unprecedented damage unless the fiscal precautionary action is initiated in advance.

The vicious circle in which the country is entrapped appears to be further tightening its grip with the government's annual obligations in debt service payment, both in $ and SDR terms, which makes it essential further borrowing to honour the international obligation related to the foreign borrowing already made.

The parity impact on outstanding foreign currency denominated central government debt, resulting from the variation of the Sri Lankan rupee against the debt denominated foreign currencies, increased the rupee value of the outstanding central government debt by Rs. 355.7 billion by end 2020. This consisted of Rs. 329.9 billion due to the parity change on the outstanding foreign debt and Rs. 25.8 billion due to parity change on the outstanding foreign currency denominated domestic debt. The depreciation of the Sri Lankan rupee against the US dollar by 2.6 per cent mainly contributed to the parity impact by end 2020. In general, the impact of the depreciation of the rupee on the outstanding foreign currency debt would be of nominal importance, as the debt denominated in foreign currency is usually serviced using foreign currency inflows to the Government[101].

Table:5.3.

Debt Service Payments of Sri Lanka.

Rs. million

Item	2017	2018	2019 (a)	2020 (b)
Debt Service Payments	**1,603,049**	**2,088,551**	**2,022,507**	**1,941,373**
Domestic	1,213,498	1,561,363	1,213,698	1,169,522
Foreign	389,551	527,188	808,809	771,851
Amortisation Payments	**867,484**	**1,236,361**	**1,121,155**	**961,071**
Domestic	642,875	921,881	546,315	455,899
Foreign	224,609	314,480	574,839	505,172
Interest Payments	**735,566**	**852,190**	**901,353**	**980,302**
Domestic	570,623	639,482	667,383	713,623
Short Term	81,275	74,525	81,029	77,965
Medium and Long Term	489,348	564,957	586,354	635,658
Foreign	164,942	212,708	233,970	266,679

Source; Central Bank of Sri Lanka, 2020.

In this section, the impacts of fiscal policy of the government were thoroughly examined with due reference to budget deficits, recurrent expenditure, government indebtedness, money supply and their direct and indirect repercussions on macroeconomic variables using time series data and information extracted from scholarly researches conducted by authentic sources. As the subject is concerned, many studies have been conducted for the purpose of examining the relationship between government expenditure and economic growth. As a whole, the conclusions of these studies are quite contradictory as well as self-contradictory. Alam and Mohammad (2010) and, Jiranyakul & Brahmasrene (2007) have found a positive relationship between government expenditure and economic growth. Baum & Lin (1993) and Sjoberg (2003) have found a negative relationship between government expenditure and economic growth. Apart from that, what has been indicated by the study on Sri Lanka by Abhayaratne and Kalansooriya (2008) is that additional growth gained by the investment of welfare resources is not quite proportional for achieving

[101] Annual Report of the Central Bank of Sri Lanka, 2020.

higher economic growth. It has been further explained that without the higher welfare expenditure, the social indicators would never be able to achieve their present status; also, a considerable level of economic growth can never be achieved[102].

5.2. Public Sector Expansion:

The main predicament about the expansion of the welfare state is that it created a state of perpetual dependency of the recipient on the federal government.[103] Wittingly or unwittingly the welfare state has given birth to the global phenomenon of dependent mentality which later on interpreted by underprivileged social groups as an inalienable right on their behalf and inseparable obligation on the side of the government.

In the context of Sri Lanka, a salient characteristic of the welfare state is the proliferation of state in the form of specialized functional entities that play the role of regulator or provider on behalf of the government. Those state agencies, from their very inception, have been instrumental in providing services to the public at a subsidized cost or below market prices and very often functioning as catalyst that transformed government welfare goals into actionable programs and deliverable benefits. Accordingly, the administrative system of welfare state has given birth to two dependent layers; first the hoi polloi that banked on the government for their survival and the second a parasitical layer of institutions that expects the government to provide necessary funds out of tax payers' income for their maintenance infinitely. For instance, the Ceylon Petroleum Corporation, Sri Lanka Government Railways, Sri Lanka Postal Department, Ceylon Electricity Board have been prominent, inter alia, as the largest public sector institutions that heavily depend on exchequer for their existence since all those organizations make huge operational losses continuously over a long period of time. The justification behind the maintenance of loss-making government institution at the cost of taxpayers' money hinges upon primarily on political ideology of welfarism since the loss-making institutions are largely engaged in the provision of public utilities like water and electricity and they are not given a freehand to operate at least on a cost recovery basis by the government. The government agencies under question are engaged in the delivery of essential services to the public at subsidized prices, very often below the cost of production, to the public at the dictate of the government. It appears that the government of sri Lanka treading on a track of no return as well since the withdrawal of already granted welfare facilities creates a hornet nest of protests in the socio-economic system due to the objections of highly powerful, well organized and politically affiliated trade union network in the country. Observations indicate that the majority of both private and public sector organizations in Sri Lanka have trade unions and a higher percentage of the workforce has some form oftrade union membership. Majority of the trade unions in these

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[102] Wickramasiri R S, et al, Government Welfare Expenditure and Economic Growth in Sri Lanka: A Comparative Analysis of Different Policy Regimes, 2012.

[103] Germinal C V, The Cost of Maintaining the Welfare State, The George Washington University, Washington, D.C. 20052,2021.

organizations are branches of main trade unions affiliated to leading political parties[104].

Table:5.4

Number of Strikes and Man days lost In Sri Lanka.

Item	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total												
Strikes[1]	51	8	15	21	34	40	38	51	41	33	51	25
Workers involved	37,931	5,320	5,108	6,455	9,804	11,119	6,451	14,915	20,925	10,912	12,155	7,611
Man-days lost	65,655	7,665	25,071	25,420	36,817	80,417	37,323	82,294	104,327	60,079	43,527	56,052
Plantation												
Strikes[1]	34	2	9	14	14	21	31	31	26	21	29	9
Workers involved	34,014	300	3,185	2,713	4,278	5,031	4,833	10,427	10,758	9,027	6,545	1,981
Man-days lost	41,525	300	23,037	9,877	25,043	41,663	29,165	70,697	85,637	54,436	33,121	28,363
Others												
Strikes[1]	17	6	6	7	20	19	7	20	15	12	22	16
Workers involved	3,917	5,020	1,923	3,742	5,626	6,088	1,618	4,488	10,167	1,885	5,610	5,630
Man-days lost	24,130	7,365	2,034	15,543	10,774	38,754	8,158	11,597	18,690	5,643	10,406	27,689

Source: Department of Census and Statistics.

Number of man days lost due to labour strikes between 2008 and 2019 shown in Table 5.4 provides a searchlight for assessing the gravity of current state of affairs of the economy which is being sandwiched between the mounting budget deficits on one hand and the pressure exerted by the trade union demanding higher perks on the other with wildcat strikes that make it virtually impossible for the government to exercise fiscal management.

As it was referred to previously in this study, a large number of public sector organizations totally depends on the grants and concessions provided by the government for their survival perpetually year after year, according to the data made public by the Central Bank of Sri Lanka. State Owned Enterprises (SOEs) play a significant role in the country's economy and are present in key sectors including Ports, Energy, Banking, Insurance and Water. SOEs are vulnerable to mismanagement and corruption because of potential conflicts between the ownership and policy-making functions of the government, and undue political influence on their policies, appointments, and business practices[105]. Some of the SOEs are in fact engaged in business transactions as their main function but, according to their annual performance reports, huge losses are incurred by them due to inefficiency, restrictions imposed on them by the line ministry and corruption which have become the norm of general behaviour as far as SOEs are concerned. Underperformance appears common; according to the Department of Public Enterprises the fifty five largest SOEs delivered a net Return on Assets (ROA) of only 0.64% in 2017. The combined losses among the loss-making entities reached Rs.87bn in 2017 compared to Rs.42bn in 2016. Some are in a bottomless economic abyss. The Petroleum Corporation carries a negative equity. Sheer incompetence and corruption have pushed Sri Lankan

[104] Prabhashini W., et al, (2011), Reasons for Unionization and Politicization of Trade Unions in Sri Lanka: Evidence from State Owned Organization, ResearchGate.
[105] The Advocate, (2019), The State of State Enterprises in Sri Lanka.

Airlines close to financial collapse. Central budget support to SOEs amounted to Rs.41bn in 2017[106].

Research conducted by different scholars reveals that the accumulated losses of the fifty five state enterprises amounting to Rs 87 billion is equal to twenty five percent of the education budget allocation in 2019 and 37.5 percent of the Health budget allocation in that same year. The central budget support for SOEs in 2017 amounting to Rs 41 Billion is 11.9 and 17.6 percent respectively of the Education and Health budgets. The financial resources wasted in the gurgler for the maintenance of white elephants could have been deployed for improving health and educational opportunities and standards of living of the people in the country.

It is reported that Sri Lanka's national carrier Sri Lankan Airlines, the epitome of mismanagement amongst SOE's, is expected to lose 130 million US dollars (about 26 billion rupees) in the year to March 2020, taking total losses under full state ownership and management to 232 billion rupees. This loss is sixty seven percent of the education budget allocation for 2019 and hundred percent of the allocation for health in 2019.

Aggravating the situation further, Sri Lankan Airline states that it would also need a 300 million US dollars (approximately Rs 60 billion) capital injection to reduce a spiral of debt. It defies logic as to why the people of the country have allowed and are continuing to allow this large scale misappropriation of their money to go waste unabated. In the aftermath of the COVID pandemic, no profitable airline will be able to get back to their "normal" in the foreseeable future, and loss making airlines are bound to crash down the precipices they are already at the edge of. In this scenario, the Sri Lankan government will have to give very serious thought to innovative solutions that can save Sri Lankan Airlines.[107] The negative performance of the SOEs continues in 2020 and 2021 without showing any significant turnaround from deterioration to amelioration since the institutions are infected with chronic internal and external problems that are permeated to all the strata of the SOEs. As per the 'Fiscal Management Report 2020–21' issued by the Ministry of Finance, thirty one out of fifty two state owned enterprises have incurred a loss during the first eight months of 2020.

According to the same report, there has been an overall loss of Rs. 10,447 million from all 52 state owned enterprises.Ceylon Electricity Board, Ceylon Petroleum Corporation , Sri Lankan Airlines, SLTB, Lanka Sathosa, State Engineering Corporation, HDFC bank and the state owned TV channels Rupavahini and ITN were among the list of institutions which incurred heavy losses[108]. As Lalithasiri (2016) concludes in his research paper, "It is clear that the internal management dynamics of SoEs, be they Departments, Authorities, Boards or Corporations, do not have the required natural or structural incentives to be productively steered towards realising their strategic objectives. Inadequate management autonomy with regard to Department-type organisations and the lack of managerial accountability in the case of bodies corporate

[106] Ibid.

[107] Gonsalkorale, R., (2020), Reform of State Enterprises In Sri Lanka – Revival Through A Singapore Model To Stop The Haemorrhaging?

[108] Newswire. lk, 2020.

and companies were diagnosed as the main gaps which caused the failure of Sri Lanka's SoEs."[109]

In summarizing the section, the problems infected with the welfare policy in Sri Lanka, in relation to its contents, intents and fallacies, are examined under the topic 'Review of Economic Policies After Year 2000' and the writer's attention is focused in a nutshell on fiscal deficits, trade unionism and government own enterprises. It is evident that the welfare economic policy based on distributive justice has totally neglected rule that redistribution should be preceded by production. As a result, welfare orientation gave birth, unwittingly as it appears, to an unbearable welfare administrative structure, a Frankenstein monster, which has gone berserk, contrary to the original policy objectives espoused by the forefathers of welfare economic utopia.

5.3. Government Employment Policy:

Public Sector, according to Encyclopedia Britannica is the portion of the economy composed of all levels of government and government controlled enterprises and exculdes private companies, voluntary organizations and households. The public sector varies among countries depending on the legislation that governs the state-owned organizations, generally it focuses on providing services that can benefit the entire society rather than just those who are using the service. Public sector and public goods are supposed to be twines in economic sense.

Public sector therefore includes public good providers and government services such as public education, health care, police, military, physical infrastructure and those who work for the goverment. Rather than its mere functions as a service provider, public sector represents goverment ownership and control on matters such as exercising public authority and the implementation of public policy. Public enterprises on the other hand are, per se, self-financing commercial enterprises which are owned by the government and operate on a commercial basis and provide private goods and services for sale.

A built-in characteristic of welfare state is the oversized labour force employed in the SOEs, in which case the public sector institutions become virtual employment agencies that absorb a large number of unwanted employees at the whim of the government adding another dimension to the welfare conundrum. Employment in the public sector consists of four sub sectors manly; 1) employees in the central government, 2) employees in the Provincial Councils, 3) employees in local government institutions and 4) employees in GOEs and other statutory bodies which altogether stands over 1.5 million employees in 2020.

[109] Lalithasiri, G., (2016), Unsatisfactory Performance of Sri Lanka's State-Owned Enterprises: Causality Diagnostics in Management Autonomy and Accountability.

Table:5.5
Public and Semi Government Sector Employees in Census Years 1968-2016.

Year	Public sector	Semi government sector	Total employees
1968	303,674	115,355	419,029
1972	323,718	145,810	469,528
1980	368,849	228,531	597,380
1985	406,359	322,617	728,976
1990	421,009	279,583	700,592
1994	512,494	227,023	739,517
1998	561,163	213,789	774,952
2002	587,805	247,845	835,650
2006	626,992	226,306	853,298
2016	865,669	243,806	1,109,475

Source: Department of Census and Statistics Ministry of National Policies and Economic Affairs, 2016.

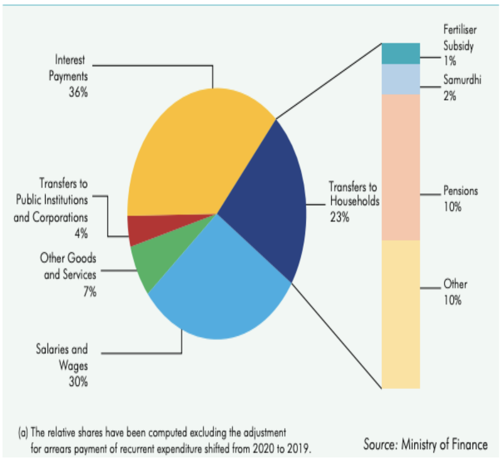
The bulging public sector reached 1.1 million employees in 2016 from 0.419 million in 1968, registering a growth of 164.77 percent over time span of forty-eight years averaging to 3.43 flat percentage growth rate annually which provides an interesting contrast as against the GDP growth rate during the corresponding period. With the phenomenal expansion of the public sector, government is necessarily committed to disburse a large percentage of recurrent expenditure for public sector emoluments as is shown in the Central Bank Annual report. Of the total government expenditure of Rs. 1,637.9 billion in 2020, salaries and wages comprised Rs 451.4 billion which in percentage term equals to 27.55 or more than one fourth of the total expenditure which could have been diverted into capital investment if a proportionately adequate public sector carder is maintained. In the same year the total recurrent expenditure of government sands at Rs 1,457.7 billion of which the share of public sector emolument recorded as Rs 451.4 billion or 30.9 percent or approximately one third of the annual recurrent expenditure of 2020.

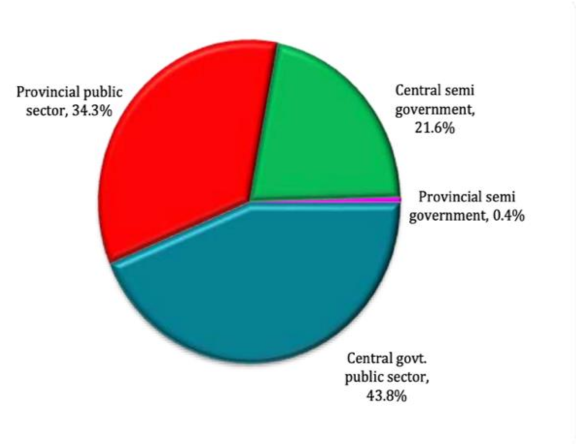
The classification given in the Labour Force Survey conducted by the Department of Census and Statistics of sri Lanka shown in Panel B of Figure 5.1 includes three typologies such as the Provincial Public Sector, the Central Semi Government Sector, the Central Government Public Sector of which the largest share is occupied by the central government public sector reported at 43.8 percent in 2016. The public sector employment to population ratio stands at 21.1 million to 1.5 (21.1: 1.5) million or one public sector employee to serve 14.06 hoi polloi which requires, from academic point of view, further rationalization in terms of benefit cost analysis.

Cost involved with the maintenance of the public sector does not end at paying of salaries and wages alone but ramifies into payment of over time, transport allowances, concessionary loans at low interest rates, maternity leave, travelling allowances, medical leave encashment, festival advance, welfare expenses, subsidized transport facilities and so forth which taken together forms a formidable challenge to the government since the means available for meeting the demand does not grow in the same velocity and magnitude as employees' requirements or privileges expand.

Figure:5.1 Panel A.
Composition of Government Recurrent Expenditure, 2020

Panel B.
Percentage Distribution of Public Sector Classified by Sector.





Source: Central Bank of Sri Lanka,2020.

Source: Labour Force Survey, 2016.

As the Finance Ministry statistics reveals, the expenditure on salaries and wages of public servants including Provincial Councils increased by 8 percent to Rs. 274 billion in the first four months of 2021, compared to Rs. 253.8 billion in the same period of 2020, The pension payment increased by 9.3 percent to Rs. 87.3 billion in the first four months of 2021, compared to Rs. 79.9 billion in the same period of 2020, the data revealed. The amount consumed by the public sector employment out of the total recurrent expenditure in 2020 equals to thirty percent according to Panel A of Figure 5.1. This increase was mainly attributable to the higher basic salaries of new pensioners together with the payment of overdue gratuity in the first four months of 2021, a senior Treasury official stated.
The situation reflects on the way that how government revenue is utilized for maintaining excessive and unbearable public sector work force that does not contribute proportionately to the cost incurred on an annual basis on a prolonged period.

The bulging state sector employment, apart from siphoning a substantial part of government revenue, creates a layer of employment with questionable level of contribution and productivity, proliferation of institutes that muddle the entire development administration structure, acts as an octopus tightening its grip through a well-orchestrated trade union mechanism that finally renders extraneous burden not only to the government but also to the entire economic system which irrevocably paralyzes the whole system similar to what has been experienced by Sri Lanka.

This section provides a lucid description of employment policy of government that has been conceived, nurtured and carried out with the intention of achieving self-contradictory dual objectives of economic growth and equity in the same time through unsustainable welfare-oriented employment policy which finally created a juggernaut that produces little but eats into flesh and blood of the body economy.

5.4. Paradoxical Growth of Social Benefit Programs:

The state of Sri Lanka and its citizens have developed an expensive inclination for everything free; education, health, food and so forth and whenever free services and goods are not available, they clamor for the second alternative that is concessions, government jobs, subsidies, tax reliefs the list runs very long indeed, fulfilment of which is beyond the imagination of a developing country like Sri Lanka. In economic nomenclature, social benefits are essentially current transfers, one way flow, received by households intended to provide for the needs that arise from certain events or circumstances, for example, sickness, unemployment, retirement, housing, poverty, education or family circumstances. In the context of Sri Lanka, the different programs launched by the government with the objective of providing welfare benefits are identified under different labels[110].

1) Social Assistance: a cash or in-kind benefit usually financed by the state, provided on the basis of a means or income test (Moser, 2001)
2) Social Insurance: financed by workers' and employers' contributions and based on the insurance principle, aiming to provide protection against life contingencies, such as sickness and old age (Moser, 2001)
3) Social Security: protection established by legislation that ensures the access of individuals and households to health care and guaranteed income security, particularly in old age, sickness and unemployment (ILO, 2001)
4) Social Safety Nets: targeted social assistance conceived as short term, compensatory measures to reduce poverty and protect against income shocks to ensure a minimum level of wellbeing or help households manage risk (Moser, 2001).

Unlike the social security system operated in Japan, the welfare mechanism in Sri Lanka sems to be welfare oriented rather than 'poverty elimination oriented' which results in the increasing of inequity at multiplying progression due to increasing number of welfare beneficiaries and enlargement of welfare scope (facility basket) in each year.

As records indicate, Sri Lanka has a long history of providing a wide range of social welfare programmes with the aim of uplifting and improving its citizens' well-being. At the centre of its social welfare programme are the health and education programmes, ensuring universal health and educational opportunities. Sri Lanka is ranked relatively high in the Human Development Index, particularly in respect to health and educational indicators, which are the highest in South Asia. This can be attributed to the country's history of early and high levels of coverage on health and education and for poverty transfers. Poverty transfers began as early as the 1930s, driven by early experiences of democratic politics and the global recession in the mid-1930s, with

[110] Nayana G, (2015), The role of social protection in state legitimacy in the former conflict areas of Sri Lanka, Secure Livelihoods Research Consortium Overseas Development Institute (ODI) 203 Blackfriars Road, London SE1 8NJ, United Kingdom.

social assistance for the poor, in the form of cash transfers, was first introduced in 1939, under the Poor Law Relief.

Table: 5.6.
Financial Performance of the Samurdhi Program- 2018.

Year	Public sector	Semi government sector	Total employees
1968	303,674	115,355	419,029
1972	323,718	145,810	469,528
1980	368,849	228,531	597,380
1985	406,359	322,617	728,976
1990	421,009	279,583	700,592
1994	512,494	227,023	739,517
1998	561,163	213,789	774,952
2002	587,805	247,845	835,650
2006	626,992	226,306	853,298
2016	865,669	243,806	1,109,475

Source: MARA, 2020[111]

In 1940, a food ration system was adopted by the Government of Sri Lanka to ensure a minimum quantity of food to households (ILO 2008). Since independence in 1948, Sri Lanka has pursued policies and programmes to ensure equity over the longer term. According to Gunetilleke (2005), the social welfare programmes pursued by successive governments were the axis of the development process. Thus, universal access to healthcare and free education from primary school through university is available to all Sri Lankans. Despite changes in government, the state commitment to social welfare became an implicit contract between the state and its citizens. This commitment to equity and social welfare continued during two violent insurrections in the south in 1971 and 1987/1988. During the war in the north and east, the government continued to finance and maintain social infrastructure, such as the provision of health and education, as well as food security in the areas under rebel control.[112] In other words, almost all the essential goods and services used by the people are expected to deliver with some concessionary wrapping as expected by the masses and promoted by subterfuge political parties which are hell bent on achieving their whims and fancies at the cost of the country. The size of the financial burden born by the country on behalf of maintaining generous welfare programs has reached beyond the capable tolerance level due to the fact that the expansion of revenue flows has been reduced to trickles under economic contraction caused by the pandemic.

111 Sanchez R, et al, (2020), Social protection in Sri Lanka: An analysis of the social, economic and political effectiveness of the Samurdhi program, MPRA.
112 Gunetilleke, G., (2005), Negotiating Development in an Evolving Democracy – Lessons from Sri Lanka. Harvard Asia Pacific Review.

The available data indicate that the Government has incurred a sum of Rs. 172.1billion on household subsidies including Samurdhi payments, elders' allowance, assistance to differently-abled soldiers, food package for pregnant mothers, and fertiliser subsidy and school uniforms and text books in the first four months of 2021.

Expenditure on Samurdhi cash grant provided to low-income families remained intact at Rs. 17,271 million in the first four months of 2021.

In the same time, financial support provided for kidney patients with a payment of Rs. 5,000 per month increased by forty percent to Rs. 776 million from Rs. 554 million due to the increase in beneficiaries effective from September 2020 with the inclusion of all low income kidney patients in the country as per the Cabinet decision dated 10.06.2020, the Ministry data showed.

The Government expenditure on medical supplies for state hospitals rose by forty six percent to Rs. 20,143 million in the first four months of the year 2021 compared to Rs. 13,763 million in the same period of 2020 due to additional expenditure on prevention of the COVID-19 pandemic.

A sum of around Rs. 2,000 million was spent on the nutritional food package programme for expectant mothers. Since the welfare system permeates all spectrums of social fabrics, the necessity of a highly complex bureaucratic and organizational network is a sine qua non which in turn paves the way for corruption in one hand and siphons a substantial portion of tax payers' money for its maintenance on the other hand.

The cost of welfare programmes on education such as free textbooks, uniforms and shoes for students in difficult school for the concerned period was Rs. 2,888 million.[113] As the Table 5.7 illustrates the social protection expenditure stood at Rs.112,798 million in 2018 at 2010 constant prices which amounts to 26.12 percent based on the total cost of social protection expenditure in 2014. It deems to be noteworthy to be aware that the figure quoted above is exclusive of education expenditure of Rs.111,608 million and health expenditure of Rs.109,250 million which if added to the cost of social protection expenditure the total reaches Rs. 233,656 million that equals to 35.48 percent of the total consumption expenditure of government in 2019 in constant prices. In contrast, the GDP at constant prices in 2019 registered a marginal increase of 2.3 percent while GNI recorded only 2.2 percent increase during the same period.

[113] The Sunday Times, 2021.

Table: 5.7

The Government Final Consumption Expenditure by Purpose at Constant(2010) Prices, 2014 – 2019.(Rupees Millions).

Purpose	2014	2015	2016	2017*	2018*	2019(1)
1.General public services	51,616	67,168	62,789	75,056	130,848	97,792
2.Defence	176,121	178,692	161,939	145,105	115,170	134,218
3. Public order and safety	44,098	45,885	50,232	47,256	40,137	43,192
4. Economic affairs	50,626	47,130	57,152	54,483	43,508	42,270
5. Environmental protection	661	2,633	2,554	2,474	1,922	1,951
6.Housing and Community Amenities	475	583	504	783	386	2,376
7.Health	85,049	96,180	100,065	90,740	81,150	109,250
8.Recreation, culture and Religion	5,620	2,613	2,479	3,910	3,119	2,963
9.Education	93,557	116,977	117,898	106,560	88,308	111,608
10.Social protection	89,436	100,531	117,788	107,659	96,312	112,798
Government Final Consumption Expenditure	**597,258**	**658,392**	**673,400**	**634,026**	**600,860**	**658,418**

Source: Source - Department of Census and Statistics,2020.

The logical conclusion that can be derived on the basis of above time series data is that social protection expenditure and economic growth rate are not positively corelated. Nevertheless, this argument can be belittled sometimes on the basis of high welfare cost incurred by developed countries in their annual budgets; however, such polemics is to be scrutinized in the light of sustainability and affordability conditions faced by a developing country like Sri Lanka and the countries that have surpassed the developing status decades ago.

Another pertinent question that needs attention in this context is whether or not the countries that are considered as developed today, provided the same generous social protection facilities to the citizens of their countries when they were grappling as underdeveloped counties confronted with similar economic situation as faced by Sri Lanka today.

5.5. Dependency Syndrome:

Sustainable development is the cliché of the development economists who have spent much labour to develop sustainable economic models and explain their virtues and prowess in creating balance development which, they assure, fulfill the aspirations of the current generation without making the future generation to pay for the past. Accordingly, sustainable development harmoniously combines three perspectives on social evolution, i.e., ecological, social, and economic. Furthermore, sustainable development refers to “development that meets the needs of the present without compromising the ability of future generations to meet their own needs"[114]. Arrow et al. define sustainable development as the "economic path along which intergenerational well-being does not decline"[115]. Sustainable development may also be regarded as "any economic activity that raises social welfare with the maximum amount of environmental degradation allowable within given economic, social, and technical constraints" [116] However the crust of the issue, the 'sustainable individual' has been side stepped in polemic discourses; therefore any discussion on the subject is doomed to be ended up in inconclusion at best or befogging the whole concept of sustainability at worst if 'sustainable individual' is not explained.

Since questions such as "what should be sustained" and "what kind of development do we prefer" are intertwined with questions such as "what can be sustained" and "what kind of system we can get" , which are ultimately focused on the feasibility of actions undertaken, a debate on sustainable development implies both a normative and a positive approach. These preoccupations belong to a type of social welfare, which implies "an evaluation of trade-offs among the different system goals"[117]The preoccupation with ensuring sustainable development requires the achievement of a balance between the use of scarce resources, economic growth, and social justice without transferring the today's warfare burden to the unborn future generation. In this context, the researcher's analysis does not reject the need of the welfare facilities to fight against poverty and inequality, but the paper offends the proliferation of the welfare mentality and welfare behaving like an octopus that strangles the economy threatening the very foundation of sustainable development based on freedom, capacity and individual responsibility. This means that the individuals should not wait with open arms till all needs are provided by the state for having a better life; instead they ought to take responsibility for their life, knowing that they can rely on the state support in case that their survival is affected by the factors that are beyond their control. .

The situation in Sri Lanka can best be referred to as an economic disintegration with regard to welfare mentality and economic development because the two variables, welfare and economic growth, cannot coexist side by side since they are mutually exclusive in the sense that the growth of welfare state hinders the growth of capital investment. In addition, the dependence syndrome exhibits a causative relationship with negative attitudes, dismal self-degradation, lethargy and inactivity, poor innovation, halfhearted effort, lack of perseverance and so on which in the final outcome generate an unentrepreneurial nation consisting of individuals without dignity, self-reliance and self-respect.

Since, economic policies to address sustainable development while maintaining social equity goals is not only self-contradictory but also internecine to both the beneficiary and the benefactor; therefore minimum welfare and the maximum self-reliance must be the right formula for balanced and sustainable development. An unblemished distortion of the welfare state in Sri Lanka is the creation of leviathan state sector with unproportionate sized workforce in the public sector, which has not only been

[114] The World Commission on Environment and Development (WCED), (1987), Our Common Future.
[115] Arrow, K.J. et al., (2010), Sustainability and the Measurement of Wealth. NBER Work.
[116] Barbier, E., (1987), The Concept of Sustainable Economic Development. *Env. Conserv.*
[117] Hediger, W., (2000), Sustainable development and social welfare. *Ecol. Econ.*

mollycoddled by the government but also self-proclaimed the right to commanding authority in all the matters that concern governing the country.

The Ministry of Finance confirming the facts stated above states that the expenditure on welfare programs amounted to Rs. 199.4 billion during January and August, 2020, compared to Rs. 141.5 billion for the same period of 2019. The health expenditure amounting to Rs. 44.01 billion were mainly consist the expenditure on 'Free Medicine for All', Triposha' program and 'Poshana Malla' nutritional program. The 'Free Medicine for All' program contributed to the largest expenditure while expenditure on education sector also increased during the period. (Ministry of Finance, 2020).

As concluding remarks of the Chapter 05, the researcher has defended the conceptual frame that Sri Lanka is a welfare state influence of which has been percolated into all the layers of the policy formulation process encompassing government expenditure, employment policy, public sector enterprises and the attitude of citizens which finally results in the creation of a welfare juggernaut whose maintenance as well as control, is beyond the manageable capacity of the Sri Lankan economy.

In a nutshell, all the above economic variables and their behavioural pattern are, as explained in the Chapter 05, the unmistakable signs of and caused by the welfare coated economic policies adopted in Sri Lanka.

CHAPTER 06
WELFARE STATE- INTERNATIONAL EXPERIENCE

6.1. Preview:

Chapter 06 discusses the international experience with regard to the present position of welfare state on the basis of some selected countries in the light of the analytical review presented in the Chapters two, three and four which dealt with theoretical underpinnings of welfare state and practical experience of Sri Lanka in the implementation of welfare policies.

The developed counties, as it appears according to officially sanctioned statistics, annually spend a substantial percentage of their national income for social security programs. Scandinavian countries, Germany, France and many European countries head the list of generous providers of social protection and therefore a critical inquiry into the costs and benefits of their welfare policies can be used as the benchmark of contrast to determine whether the same practices are able to produce equal momentum and benefits if they are duplicated in different countries whose economic and social fabrics are diametrically different from those of developed countries.

Therefore, the selected counties for the purpose of contrast in the Chapter 06 include the United State of America (USA), Communist Bloc Countries, Japan and European countries, as a cross section, representing economic models that are poles apart in terms of texture, design and their ideological bases, which, as a whole, is expected to facilitate the researcher to unearth both positive and negative facets of welfarism that can be used as a measuring scale to gauge the degree of success achieved by different nation states.

6.2. Welfare System in the United State of America:

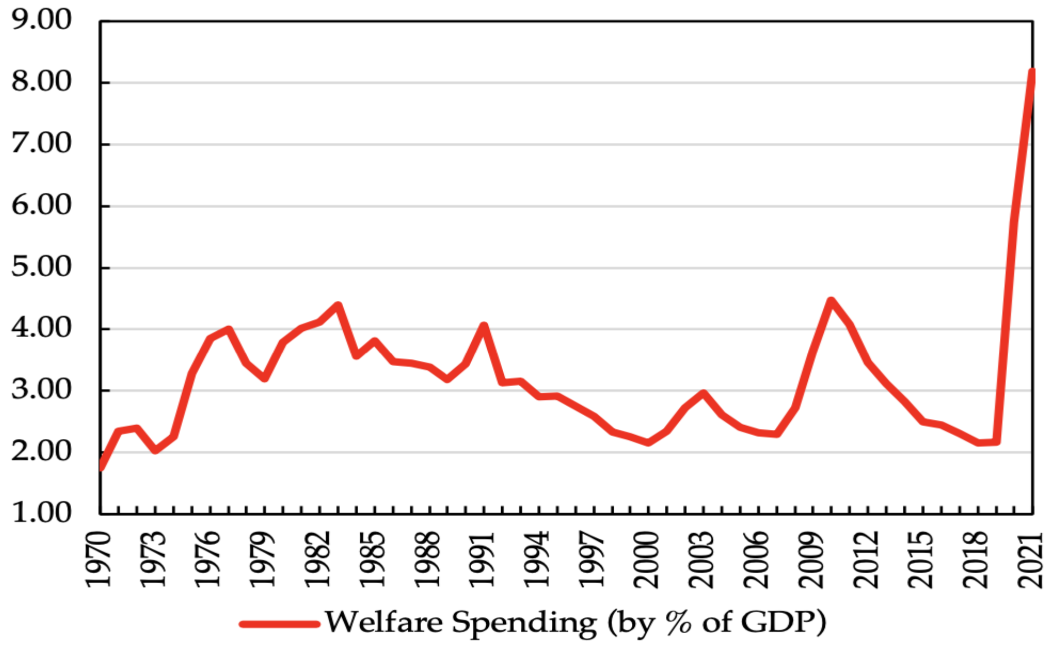
The welfare state has been in existence in the United States since the 1930s and before the 1930s, there was no system of social assistance. It was implemented as a system through the creation of various assistance programs to attenuate the impact of the Great Depression in the 1930s at the federal level. This system was principally developed under the presidency of Franklin Delano Roosevelt. It is undeniable that the welfare state was instigated with the best of intentions. In 1935, President Roosevelt declared: “The time has come for action by the national government to provide security against the major hazards and vicissitudes of life.” Following this declaration, President Roosevelt went on to implementing the first assistance and insurance programs such as Social Security, The National Industrial Recovery Act, the Federal Housing Administration, the Aid to Families with Dependent Children. In this context, blacks alone were estimated to have lost some 500,000 jobs during the period of great depression of 1030s.

The major result that the welfare state has delivered since its inception is the amplification of the powers of the federal government as well as the enlargement of its scope. Indeed, in the 1960s, the welfare state considerably expanded under the presidency of Lyndon Baines Johnson through the Great Society (Lyndon Johnson’s economic policy). Under the Great Society, the federal government created many new social programs such as Medicare and Medicaid, empowering the federal government to have a permanent foothold in the healthcare industry, the Primary and Secondary

Education Act, which warranted the federal government to subsidize schools and to administer a national curriculum, and Affirmative Action policies. This enhanced the capacity of the federal government to dictate schools the quotas that have to be reached to receive federal funds.

Figure: 6.1.

Welfare Spending of USA as a Percentage of GDP. 1970 - 2021



Source: US Census Bureau, 2021.

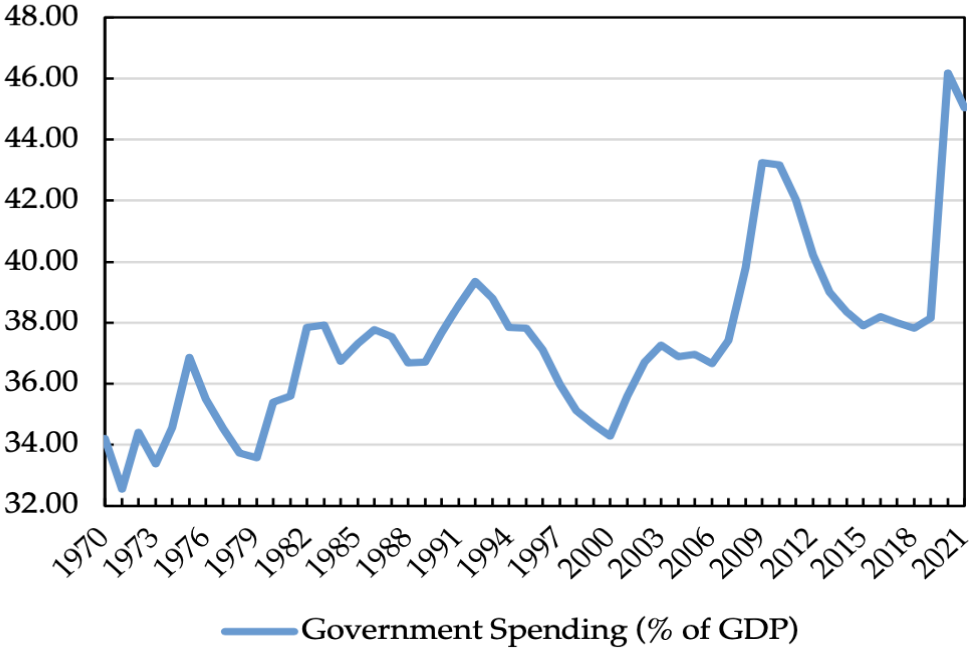
Since the expansion of the welfare state, government spending and welfare expenditure have considerably increased continuously as depicted in the Figure 6.1. A research paper presented by Germinal (2021) explicates, with the support of statistical evidence, the fallacies of arguments raised by the protagonist of welfarism to the effect that higher welfare expenditure and higher economic growth are positively corelated in the USA. [118] The research paper further elucidates on the positive relationship between the increase of recurrent expenditure with the ballooning of recurrent expenditure of the federal government budget.

According to Figure 6.1, welfare expenditure as a percentage of GDP reached its peak in 2021recording more than eight percent. USA being the largest economy in the globe with recorded GDP value of $ 20936.60 billion and the population of 333,622,477 million in 2020, its welfare expenditure of eight percent of GDP is a gargantuan amount in comparative terms.

[118] Germinal, G. , (2021), The Cost of Maintaining the Welfare State, George Washington University.

Figure:6.2

Government Spending in USA as a Percentage of GDP 1970 - 2021



Source: OECD, 2021.

The main predicament about the expansion of the welfare state is that it created a state of perpetual dependency of the recipient on the federal government. As a matter of fact, the number of participants in welfare programs has substantially been increased, especially in programs such as Medicaid, which has the highest participation rate (84.1 percent) among families receiving government means-tested assistance. Among one-parent families, 81.7 percent received government means-tested assistance, and 86.1 percent of two-parent families do so.[119] The US experience bears clear evidence to the fact that the welfare programs such as food stamps and medical support have been a contributory factor for increasing both the number of recipients and the amount disbursed proving the argument that welfare begets more welfare.

A regression analysis conducted for studying the relationship between the size of poverty and magnitude of welfare programs in the USA indicates that the regression there is also a positive correlation of moderate magnitude between government spending and the number of people in poverty. This is the aspect of the welfare state that has been the casus belli for many to advocates of limited government—the welfare state maintains people in poverty[120]. Government spending increases poverty to some extent because the maintenance of government programs, whether it is welfare programs or other government programs, prevents low-income individuals from savings since a greater portion of their income that they could reinvest in other ventures. A major welfare program implemented in the Aid to Families with Dependent

[119] Germinal G. T., (2021), The Cost of Maintaining the Welfare State, George Washington University.
[120] Ibid.

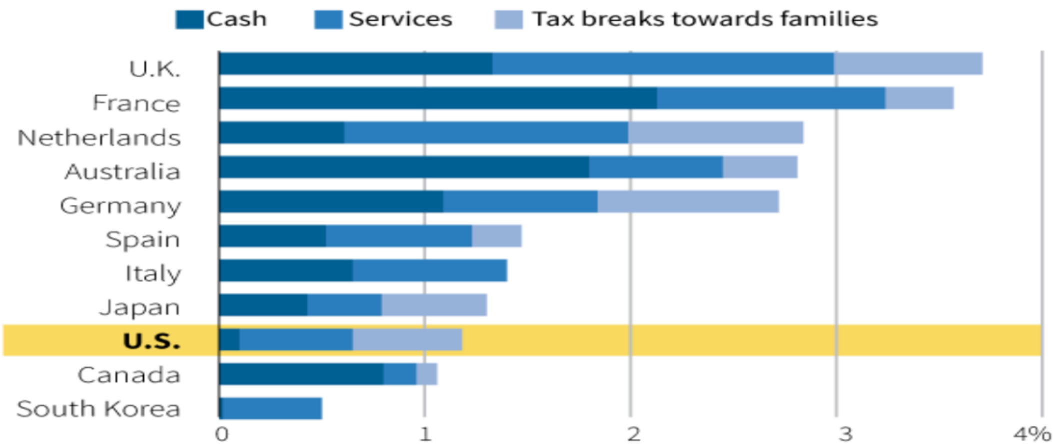
Children (AFDC) is criticized on the basis of the following deficiencies of the program.[121]

1) It caused poor adults who could work to not work.
2) It caused dependency; rather than using it as a temporary safety net, some people embraced it as a way of life.
3) It encouraged having children out of wedlock and discouraged marriage.

According to authentic surveys conducted in the USA on the trend of poverty level, the reduction in poverty is not commensurable with the large amount of fund allocations from the federal budget for poverty attenuation projects. The number of Americans below the federal poverty level - $22,350 a year for a family of four - hit 48 million in 2011, 17 million more than in 1989. Indiana has seen the second-largest increase in poverty of any state in that time, according to a Reuters analysis of Census data. Sixteen percent of the Hoosier State (*Indiana*) was poor in 2011, up from 11 percent.[122] The American welfare state has grown, but so have the ranks of the poor.

Figure:6.3.

Public Sending on Benefits Aimed at Families As a Percentage of GDP-2007.



Source: Organization of Economic Cooperation and development,

Figure 6.3 portraits the relative position of the USA on the subject of welfare expenditure in contrast to some selected counties which are either spending more or less than what US spends on underprivileged families in 2007. The economic power crunch was so strong in 2020 in the US economy which reached crisis dimension with the transfer payment spiraling due to vast increase of government expenditure in a short spell of time. Gross domestic product, the official scorecard of the economy, shrank by an inflation-adjusted 32.9 percent annualized pace from April through June, 2020, according to the government sources. That's three times larger than the previous record decline in 1958.[123] To finance the large welfare expenditure, a large increase in government revenue is essential but the question is how and from where

[121] Dylan., M., (2016), "If the goal was to get rid of poverty, we failed": the legacy of the 1996 welfare reform, Vox.
[122] Cristina, C., et. al, (2012), The Undeserving Poor, Reuters.
[123] Jeffry, B., A., (2020), 'massive welfare economy' - huge federal aid prevents an even steeper GDP collapse, MarketWatch.

the additional revenues can be found in an economy that is already under severe fiscal pressure. Under the circumstances the tax revenue is to be increased creating cascading effects of higher magnitude on almost all spectrums of the economy.

Deterioration in the US economy continues unabated in 2020 with the number of Americans applying for jobless benefits rose for the second straight week, a sign economic growth could be stalling in later in the year. Claims had been on a steady decline afterreaching a peak in late March.Initial jobless claims rose by 12,000 to 1.434 million in the week ended July 25, 2020 according to the Labor Department. Estimates predicted that 1.51 million new claims would be anticipated. The number of people already collecting economic benefits, known as continuing claims rose by 867,000 to 17.06 million.[124]

Poverty in USA has different dimensions and most of the families categorized as poor possesses household equipment and amenities the middle-class families enjoy. The government's own data show that the actual living conditions of the more than 45 million people who are deemed "poor" by the Census Bureau differ greatly from popular conceptions of poverty. Consider these facts taken from various government reports:[125]

1) Eighty percent of poor households have air conditioning. By contrast, at the beginning of the War on Poverty, only about 12 percent of the entire U.S. population enjoyed air conditioning.
2) Nearly three-quarters have a car or truck; 31 percent have two or more cars or trucks.
3) Nearly two-thirds have cable or satellite television.
4) Half have a personal computer; one in seven has two or more computers.
5) More than half of poor families with children have a video game system such as an Xbox or PlayStation.
6) Forty-three percent have Internet access.
7) Forty percent have a wide-screen plasma or LCD TV.
8) A quarter have a digital video recorder system such as a TIVO.

One may be intrigued to question whether even the tax payers enjoy such amenities at their homes while the 'so called poor', who obtain welfare benefits out of taxpayers' money, enjoy what tax payers do not enjoy. Another moot point is why taxpayers' money should be spent for providing non-essential semi luxury paraphernalia to the social groups that can manage their own daily life without being assisted by the government.

Conclusion: Ironically, the welfare state produces a higher cost to the taxpayer as well as government to maintain the poverty stricken individuals instead of providing benefit of making more people financially independent. The welfare state in the United States has created a high level of dependency between low-income people and the government. What it has perpetuated is the idea that nothing could be done without government. This dependency and reliance on needing the government for everything

[124] Greg, R., (2020), Jobless claims rise for second straight week as U.S. economic activity slows down, MarketWatch.
[125] Robert, R., (2015), Poverty and the Social Welfare State in the United States and Other Nations, Heritage foundation.

have drastically expanded the powers of the federal government far beyond its constitutional scope. The welfare state was created with the only intent to help people financially until they regain their financial autonomy; however, the opposite is what has happened as more welfare programs are created following the increasing number of recipients from those programs.

Dismantling the welfare state gradually seems to be a realistic solution to alleviate the tax burden on the taxpayer in the USA. This dismantlement approach will be an eye-opener for both the people and their regional governments. Lastly and more importantly, dismantling of the welfare state paves the way for less government, less taxes, less bureaucracy, less corruption and by extension less poverty in the long run.

6.3. Welfare Concept and Structure of Marxist Countries:

Social security system in the communist bloc countries appears to be structurally different, although some resemblance can be seen with those of social democratic countries, from the welfarism practiced in free market economies since in the socialist countries, as a fundamental principle, the state accepts social equality and is in control of market, factors of production, basic infrastructure and labour market. State socialist systems did have many common features with the social-democratic version, and in (Central and Eastern European Countries) CEECs also had some elements of the corporatist model. Levels of income inequality were not large by comparative standards, and state provision of a range of universal services and cash transfers further reduced inequalities in consumption levels. However, an intertwining of the economic and welfare systems under state socialism led to important differences. The aim was not simply protection against the effects of economic forces, but also to contribute to the economic aims of higher productivity, of maintaining labour discipline and at times of population, and hence future labour force, growth.[126]

However, four further features marked the socialist welfare models as clearly distinct from Esping-Andersen's ideal types[127]:

1) The price system under central control was used to protect those on low incomes, by subsidisation of basic foods, children's clothes, public transport and housing. Price liberalisation, fundamental to transformation into market economies, therefore immediately threatened a reduction in living standards for a significant part of the population.
2) Many services, including some housing, were provided by employing enterprises. In Russia this reached the equivalent of 3–5% of GDP, while enterprises in CEECs, where there was more use of cash transfers, spent about half that amount. Transformation into market economies, with enterprises free to concentrate on strictly commercial activities, therefore threatened the population with substantial welfare losses unless replacement services weredeveloped.
3) There was no protection for the unemployed through redundancy and unemployment benefits or through social assistance. Full employment was

[126] Martin M., et al, (2015), Welfare and Redistribution in Post-communist Countries, ResearchGate.

[127] Esping-Andersen's (1990) three ideal types, built from experience of advanced countries – liberal, corporatist and social demo-cratic – which describe systems with limited and conditional benefits – those with state involvement in provision but still with stratification of social-insurance-based benefits and an assumption of traditional family forms – and systems with universal benefits.

formally guaranteed, and employing enterprises typically had a responsibility for finding alternative employment for workers no longer needed, a factor also encouraging retention of labour.

4) A set of policies aimed at increasing birth rates including, at various times and in various countries, forms of subsidised child care and extended maternity leave (Heitlinger, 1979). In CEECs, family benefits provided substantial supplements to wages (Milanovic, 1998, p. 21).

Similar policies developed in some Western European systems, but the context here was the aim of addressing general labour shortages that disappeared with transformation to market economies, thereby provoking the purpose of the policies into question.

Table: 6.1
Public social protection expenditure as a percentage of GDP -2011.

Countries	Total	Old-age pensions	Healthcare	All	Income maintenance (%)
Bulgaria	17.7	6.7	3.9*	0.6	71
Czech Republic	20.4	7.4	6.0***	0.6	51
Hungary	23.0	7.2	5.0	1.0	64
Poland	19.2	7.1	4.5	0.7	28
Romania	16.3	7.4	4.3	0.4	68
Slovakia	18.2	5.8	5.6	0.8	31
Slovenia	25.0	6.3	6.2	1.2	71
Estonia	16.1	5.1	4.6	0.7	68
Latvia	15.1	7.4	3.7**	0.7	46
Lithuania	17.0	6	4.6	0.6	53
Austria	29.5	10.4	7.9	2.0	55
Germany	29.4	8.7	8.4	1.8	53
France	33.6	12.1	8.6	2.3	60
Sweden	29.6	8.8	7.3	1.8	35
United Kingdom	27.3	10.1		0.7***	43
EU28	29.1	9.4		1.9	60

Source: Eurostat.

The Commonwealth of Independent States (CIS) countries headed towards more limited welfare provision thanks to very substantial declines in inherited universalist provision alongside a general failure to develop new services. They passed through initial periods of state failure, during which either services were consciously cut or funding simply failed. They tended towards formalisation of their systems around, by comparative standards, very low levels of delivery. This, then, was a slightly more chaotic route to minimalist and marketised systems, outcomes that reflected the nature of political power and the limited scope for development and expression of alternative positions. Even then, some concessions to a social-democratic conception have continued, largely thanks to pensions. Ukraine moved towards significantly higher levels of provision following the development of open political competition.

Any treatise on the welfare expenditure and system of socialist bloc countries is basically lacks credibility unless the conceptual fundamentals based on which socialist states are founded, as cited below, are referred to in the discourse.

1) Elimination of the class inequity is the founding principle of the state.
2) Production system and the factors of production are owned and controlled by the state.
3) The labour market is mostly controlled by the state thus the problem of unemployment does not arise.

4) The precept of Marxism is that contribution of everybody to the GDP is essential therefore free transfers are not in the flavour of communism.
5) Since the public utilities are controlled and distributed by the state, the need for free transfers seems to be minimum.

Even there the evidence, more limited than that available for EU members, suggests that welfare systems are relatively ineffective in reducing income inequality or preventing poverty[128].

6.4. Welfare State in Japan and Europe:

Welfare system in Japan includes some characteristics of European welfare models in relation to the type of social securities provided under different programs; however according to studies conducted by scholars, the amount of funds diverted to social security programs is relatively low as a percentage of GDP.

Japanese welfare system in contrast to the Social Europe (SE) is different since the SE model, as Ferrera (1996) emphasizes, inherent with the (Italy, Spain, Portugal and Greece) following characteristics.

1) Cash transfer scheme (especially pension) plays a more significant role rather than services in welfare provision, and the income maintenance system (i.e., social insurance system) is organized according to occupations. Although this is common to some extent among conservative regimes, the feature that is conspicuous in the SE model is such generous protection of the core workers within the “institutionalized” labor market, with a great contrast to insufficient protection given to the contingent workers, whether it may be part timers or casual workers, in the “un–institutionalized” labor market.
2) The health care services, which used to be arranged and provided on the basis of an insurance system, were converted into the national health service system 3 financed by general tax revenue in the past twenty years (Italy in 1978, Spain in 1986, Portugal in 1976 and Greece in 1983).
3) However, the tax-financed system does not cover all spheres: Medical treatment based on the insurance schemes remains to a large extent and even private medical treatment coexists with it, therefore the peculiar public/private mix is formed.
4) Some benefits (especially the disability pension) and services have been introduced to get voters’ support for a governing party. Although such a thing may appear in many countries as the general “political business cycle”, the unique feature in the case of SE model is that the “individual” relationship between them, which is referred to as a “patron–client market”, can be observed[129].

With the start of the 1990s, the bubble economy collapsed and the Japanese economy entered a long recession requiring to practice constrains in fiscal management. During the period from 1990 to 2016, while Japan’s GDP grew 18.2 percent, rising from ¥451.6 trillion in 1990 to ¥539.2 trillion in 2016, social security expenditures rose 246 percent, leaping from ¥47.4 trillion to ¥116.9 trillion. As a result, from the latter half of

[128] Martin M, et. al, (2015), Welfare and Redistribution in Post-communist Countries, ResearchGate.
[129] Ferrera, M., (1996), ‘The” Southern Model” of Welfare in Social Europe’, in Journal of European Social Policy, vol. 6, no.1.

the 1990s through the current year, Japan has been making efforts to ensure the sustainability of the social security system.

Table:6.2
Social Security Benefits by Sector and Ratio of Social Security- Japan.
Benefits to National Income (F.Y.2000 to 2013) In One hundred million of yen.

Item		F.Y.2000	F.Y.2005 1)	F.Y.2010	F.Y.2011	F.Y.2012	F.Y.2013
Social security benefits		783,421	887,970	1,052,276	1,081,233	1,090,010	1,106,566
Medical care	2)	259,975	281,608	329,206	340,633	346,240	353,548
Pension	3)	412,012	468,386	529,831	530,747	539,861	546,085
Welfare and others	4)	111,434	137,976	193,240	209,853	203,909	206,933
Per capita social security benefits (1,000 *yen*)		617.2	695.0	821.7	846.0	854.8	869.3
National income		3,751,863	3,741,251	3,527,028	3,495,971	3,519,578	3,620,550
Ratio of social security benefits to national income	(%)	20.88	23.73	29.83	30.93	30.97	30.56
Medical care		6.93	7.53	9.33	9.74	9.84	9.77
Pension		10.98	12.52	15.02	15.18	15.34	15.08
Welfare and others		2.97	3.69	5.48	6.00	5.79	5.72

Source: Statistical Yearbook, Japan.

Although it is alleged that Japanese welfare expenditure is meager compared to that of European welfare states, the data shown in Table 6.2 prove the other way around as Japan maintained welfare expenditure at 30.93, 30.97 and 30.56 as a percentage of its national income respectively in 2011,2012 and 2013.

According to Mari Miura's book *Welfare Through Work,* an effort to develop a new theoretical framework to categorize the welfare state, Mura finds that Japanese welfare system bears different structural, design and ideological foundation[130]. Conventionally many scholars confine their analysis of welfare sate to the conceptual frame based on income maintenance programs that provide supplementary income to individuals living in poverty, unemployment, disability, or illness. By this definition, Japan certainly is a small welfare state as it has low public spending on social welfare as a percentage of GDP under fifteen percent which reflects on a low level of social transfers.

Miura argues that a better analysis of Japan's social protections can be reached if adequate attention is drawn to the additional dimensions of welfare policy related to both income maintenance and employment maintenance. The difference between the two policy framework is that income maintenance attempts to alleviate problems caused by poverty and inequality ex-post where as employment maintenance is an ex-ante measure to prevent those conditions from arising. This results in four welfare state categories. According to the new stratification of welfare sates, OECD countries can be grouped based on their rate of male employment (age 55-64) and their social expenditure as a percentage of GDP. Amongst the four categories Maria proposes,

[130] Mari M., (2021), Welfare Through Work, Amazon.

Japan is classified as a “welfare through work” state with high employment maintenance and low-income maintenance. Of the OECD countries, Switzerland joins Japan in this classification. “Welfare with work” countries are characterized by both high income and employment maintenance and include Norway, Denmark, and Sweden. Welfare states with high income maintenance and low employment maintenance are typified as “welfare without work” states, such as Germany, France, and other parts of continental Europe.

Finally, the “workfare” category is generally applicable to Anglo-American nations such as the United States, the United Kingdom, and Australia. This category of welfare states is seen as remarkably distinctive from the rest with a combination of low income maintenance and low employment maintenance, demonstrating the characteristics of classical small welfare state[131]. Accordingly, Japan’s high employment maintenance, Maria postulates, allows it to experience much lower rates of unemployment than other small welfare states whereby the necessity of making transfer payment as unemployment relief is preempted.

The Japanese welfare system theorizes upon the elimination and preempting of the necessity of making transfer payment that minimizes the peril of depleting the resource base available for economic growth but it merges its welfare system as a supportive apparatus that promotes the economic growth rather than being an obstructing fetter attached to the national economy.

Figure 6.4 makes an interesting contrast between rate of employment and the percentage of welfare expenditure in relation to the GDP and categorizes Japan and Switzerland together as countries of high male employment and low welfare expenditure countries.

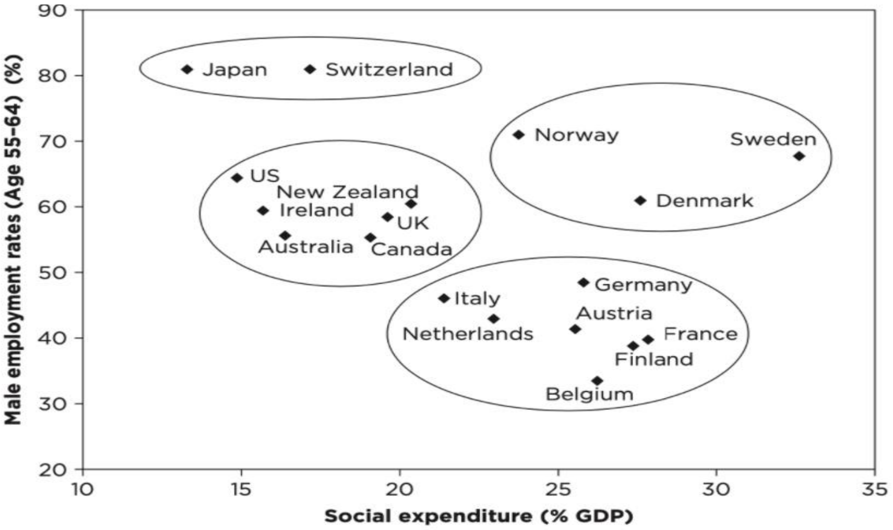
Similarly, Figure 6.4 clusters together Norway, Sweden and Denmark since their welfare systems is characterized with high employment rate of over seventy percent that accompanies by high rate of social expenditure as a percentage of GDP around thirteen percent.

Contrary to the high employment model, the ‘high social expenditure with low employment model’ includes, inter alia Germany, Belgium, France, Austria which have pursued a dichotomized economic policy between development orientation and welfare policy approach.

[131] Deborah, J., (2021), Japanese Welfare State: Critical Review of Competing Theories, linkedin.com.

Figure:6.4.

Matching Counties based on Typology of Work and Welfare



Source: OECD Statistics, 1990.

Thus far the discussion unfolded in this sub section points to the fact that the Japanese welfare system is totally embedded with the corporate business sector which allows the state to maintain a cautious distance from the welfare practice of Scandinavian countries where welfare is treated as a separate breed from the development needs which may be construed as conceptual deception similar to welfare for the sake of welfare.

Furthermore, in Japan, due to cultural, social and economic reasons, welfare is built in as a supportive arm of development which in the final outcome should contribute to the economic growth and long term wellbeing of the nation. Japan's welfare system is characterized by an integrated typology of welfare and production regimes as the CCWR, which is a combination of male-breadwinner-based social insurance with status-dependent programmes and generous occupational welfare, and whose driving force is the leading company cross-class alliance.[132] In concluding the section , the researcher is of the opinion, supported by facts, that the Japanese welfare system does not operate as an appendix on the system creating extra burden on the economy but has become a production supporting system that ensures the continuity of smooth production system through stability of work life of employees

6.5. Global Experience on Welfare State:

The overall review of welfare state reveals inconclusive results that encompass partial success stories in minority and total failures in majority. The first failure of government welfare programs is to favor help with current consumption while placing almost no emphasis on job training or anything else that might allow today's poor people to become self-sufficient in the future. Many states in the USA have been securing

[132] Masato, S., et. al., (2021), A corporate-centred conservative welfare regime: three-layered protection in Japan, Journal of Asian Public Policy, Volume 14.

waivers from the Obama administration so that people on various welfare programs (such as SNAP, what used to be called food stamps), are not required to either work or go to job training classes in order to continue to receive benefits. This is short-sighted because it keeps people dependent on government benefits.

It is the classic story of giving a man a fish or teaching him how to fish. Government welfare programs hand out lots of fish, but never seem to teach people how to fish for themselves. The problem is not the lack of job training programs, but rather the fact that the job training programs fail to help people. In a study for ProPublica, Amy Goldstein[133] documents that people who lost their jobs and participated in a federal job training program were less likely to be employed afterward than those who lost their jobs and did not receive any job training. That is, the job training made people worse off instead of better. If the necessity is to wean people off of welfare, then they should be equipped with better job skills, employability, and earning potentials.

The second failure of government welfare programs is the common requirement to have minimal assets to be eligible for aid. While many states have eliminated their asset tests, they still remain in a number of states and are as low as $1500. While it seems reasonable to deny welfare benefits to, for instance, a retired couple with low income but two million dollars in assets, it does not make sense to force people to go through virtually all their assets before giving them benefits. By making welfare recipients so financially fragile, we ensure that any little unforeseen financial setback will be very damaging. By diminishing their ability to surmount events such as a car repair or the need to buy a new home appliance, government makes it more likely that people end up homeless, hungry, or unable to pay their regular bills on time.[134]

The third flaw in the government welfare system is the way that benefits phase outs as a recipient's income increases. As a household's income approaches the poverty line and rises above it, families on various welfare programs can actually face effective marginal tax rates of fifty or sixty percent. That means due to the imposition of taxes on new income because of the rising income causes the family to lose fifty to sixty percent of its initial income gain as tax to the federal government.

In simple terms, a poor family trying to escape poverty pays an effective marginal tax rate that is considerably higher than a middle class family and higher than or roughly equal to the marginal tax rate of a family in the top one percent. Given that US federal income tax system is supposed to progressive, meaning higher income families pay a higher percentage of that income in taxes; it questionable rationality to impose such high tax rates on families in poverty.

Clearly, welfare benefits must phase out as incomes rise, but they do not have to phase out this rapidly. An effective marginal tax rate that high can (and by numerous accounts from the real world does) cause families in and near poverty to turn down opportunities for promotions, raises, or more hours of work because the higher earned income is hardly worth in the face of losses they fexperience from taxes and lost benefits.

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[133] Jeffrey D., (2016), Welfare Offers Short-Term Help and Long-Term Poverty, Thanks To Asset Tests, fobes.com
[134] Ibid.

Thus, the way that welfare benefits phase out can serve to trap people in poverty. To obtain a job that provides a middle class living a person typically works its way up through several entry-level and intermediate jobs with increasing incomes. Yet, if a person never accepts one of those intermediate jobs, because it pays more than the poverty line but less than the combination of a lower income plus welfare benefits, they will likely never get a job high-paying enough to be self-supporting. This is not laziness or gaming the system, but optimal behavior in face of a poorly designed welfare system. Unless a person is willing suffer in the short-run in order to be better off at some uncertain time several years in the future, they can be trapped in poverty.[135] It appears, according to above explanation, that welfare system needs a very complex and exorbitant bureaucratic mechanism for its successful implementation and it runs itself into inconsistencies and oxymora while welfare programs being carried out among the people who are in the need.

In the Chapter 06, the intricacies of welfare system implemented in the USA, the Socialist Bloc States, Japan and selected European countries have been discussed in details with cross refence to those of other countries across the globe. The intention of the researcher in this context is to explore the contributions made by welfare state to the economic growth, the problems associated with the warfare expenditure and to find conclusive evidence surfaced, through previous academic surveys, on the effectiveness of welfarism. Bulk of the evidence supports that:

1) All the countries selected in this section are engaged in provision of social security in different magnitudes and deferent types.
2) Social security systems in all the counties contribute to create big governments.
3) Net contribution of social security to the economic growth is not only inconclusive but also murky and obscured.
4) Welfare system in Japan is intrinsically merged with business requirements and the corporate culture.
5) Welfare begets more welfare and thereby dependency syndrome.
6) Social security system in the socialist countries is structurally different in terms of political philosophy on which they are founded and the self proclaimed role of government.

[135] Jeffery, D., (2016), Welfare Offers Short-Term Help and Long-Term Poverty, Asset Tests.

CHAPTER 07 - RELATIONSHIP BETWEEN STAGNATION AND WELFARE BASED ECONOMIC POLICY IN SRI LANKA

7.1. Relationship at a Glance:

In addition to the theoretical review presented in Chapter 02 and the analysis of empirical data related to the welfare programs carried out in Sri Lanka, the two variables identified in the conceptual frame of this thesis, namely stagnating economy and welfare policies are discussed side by side in the Chapter 07, with the intention of arriving at logical conclusions.

In this context Wickramasiri[136] who conducted a quantitative analysis using secondary data for the period between 1959 and 2009 concludes that the education and health have a positive relationship with economic growth, but when it comes to the overall social welfare expenditure, it has a negative relationship with the economic growth.

In the analysis of Wickramasiri (2012) referred to above, the Augmented Dickey-Fuller test was employed to test whether government welfare expenditure and economic growth are stationary. By regression analysis, the relationship between different types of government welfare expenditure and economic growth was studied in relation to different policy regimes. The following regression model was estimated by him for his analysis;

$EG = \beta_0+\beta_1EX +\beta_2HX\ \beta_3SWX+\beta_4IX+\beta_5PG+\beta_6D_1+\beta_7D_2+\beta_8D_3+U_t$ .... (1)

Where, EG – Economic Growth (percentage change in annual GDP), EX- Education Expenditure, HX- Health Expenditure, SWX- Overall Social Welfare Expenditure, IX-Investment, PG- Population Growth, D_1-Inward Looking Economic Policy, D_2 - Outward Looking Economic Policy, D_3 - *Mahinda Chinthana* Policy and U_t is the random error term. Apart from that, to study the causality, the Granger Causality Test was conducted. According to unit root tests, all variables were non-stationary at the levels, but in the first difference those variables were stationary.

According to the above study, the dummy variable D1, which represents the 'inward-looking policy regime', was dropped, and it is treated as the benchmark category. As it is evident from the regression results, the model is statistically significant;

21 R = 26.28%, which is relatively low in a time series regression analysis.

The study further indicates that the "*Mahinda Chinthana*" policy regime is statistically significant at five percent but not the other regimes. The independent variables, education expenditure, health expenditure, and aggregate social welfare expenditure which represent the government welfare expenditure were not statistically significant. Investment and population growth are statistically significant at five percent. As researcher asserts, according to the regression model, it is clear that there is no significant relationship between the government welfare expenditure and the economic growth, as all the three variables which represent the government welfare expenditure are not statistically significant. Among dummy variables, only the

[136] Wickramasiri, R. S., et al, (2012), Government Welfare Expenditure and Economic Growth in Sri Lanka: A Comparative Analysis of Different Policy Regimes.

"*Mahinda Chinthana*" policy regime seems to have a favorable impact on economic growth[137].

According to the results of the Granger causality test, economic growth seems to have a reverse causality with investment and education expenditure. But the other variables which represent welfare expenditure, do not have a Granger causal relationship with the economic growth[138]. The conclusions of the statistical analysis referred to above are further corroborated by the current study that envisaged into conducting a comprehensive analysis of secondary time series date pertaining to the welfare expenditure and economic slowdown of the country.

Table 7.1.

Cross Sector Indicators of the Economy.

Description	2014	2015	2016	2017	2018	2019	2020
1.GDP growth rate, percentage.	5.0	5.0	4.5	3.6	3.3	2.3	-.3.6
2.Per capita GDP at current market price. US$	3,819	3,842	3,886	4,077	4,057	3,852	3,682
3. Share of consumption of GDP, percentage	75.8	76.4	79.4	75.6	77.7	79.3	81.1
4. Recurrent expenditure as a percentage of GDP	13.4	16.2	15.4	15.2	15.3	16.9	17.3
5. Public sector employment numbers in million.			1.38	1.39	1.42	1.46	1.53
6. Inflation	3.3	3.8	4.0	7.7	2.1	3.5	
7.Money supply growth M2b		17.8	18.4	16.7	13.0	7.0	17.5
8.Current account balance - percentage of GDP.	-2.5	-2.3	-2.1	-2.6	-3.2	-2.2	-1.3
9.Overall fiscal balance-Percentage of GDP.	-5.7	-7.6	-5.3	-5.5	-5.3	-9.6	-11.1
10. Government debt- percentage of GDP.	72.3	78.5	79.0	77.9	84.2	86.8	101.0
11.Exchange rate Rupee against US$	131.5	144.6	149.8	152.8	182.7	181.6	186.4
12. Unemployment rate.		4.7	4.4	4.2	4.4	4.9	5.3

Source: Various Central Bank Reports.

An observation on the vital statistics pertaining to the economic performance of Sri Lanka Provides sufficient evidence to affirm the existence of a negative relationship, beyond doubt, between economic growth and welfare favored economic policy.

The Table 7.1 that includes cross sector economic indicators from 2014 to 2020 bears undisputable evidence on the inverse relationship between economic growth and unsustainable welfare expenditure of Sri Lanka. The foreign exchange rate which stood at Rs.131.5 per $ in 2014 reached the phenomenal rate of Rs.186.4 in 2020 indicating weak position of rupees which reflects on the entire structure of economic activities including, inter alia, export, import and the balance of payment. Government

[137] Wickramasiri R S, et al, (2012), Government Welfare Expenditure and Economic Growth in Sri Lanka: A Comparative Analysis of Different Policy Regimes.
[138] Ibid.

debt percentage over GDP has reached 101.0 from the reported percentage of 72.3 in 2014.

The welfare expenditure in the Sri Lankan context has been a man-made economic monster which eats into the economy by attracting a large quantity of scarce resources for making transfer payment on one hand and on the other hand and it simultaneously renders the economy crippled due to the fact that the necessary funds are made available meagerly for capital investment after allocation of resources for welfare.

Since the achievement of independence from the British rule in 1948, the country has been governed by different political regimes molded in welfare dogma vying with one another for political supremacy, but the country remained stagnated or as some point out has been deteriorated in contrast to the rapidity of development achieved by Singapore and Thailand which were behind Sri Lanka in terms of GDP and per capita income in the 1950s.The welfare policy objectives of Sri Lanka have been mis contrived and the long term objective of welfare is to strategically use welfare facilities as an instrumental in transforming a welfare state into a state where welfare is no more needed. Stated in different terminology, the objective of the welfare state is to create a state in which welfare is deemed to be redundant since the relative position of social poverty has been minimized due to the past welfare expenditure.

Welfarism in Sri Lanka can be compared to the well-known folklore of riding the tiger, where mounting is easy but dismounting exposes the rider to fatal casualty ; similarly the welfare facilities can easily be granted at will if resources are available in adequate quantities but withdrawing an already operating welfare facility is virtually impossible due to the political sensitivity of such a decision and the arm twisting tactics employed by well-organized trade union network against the withdrawal of an ongoing facility.

7.2. Collateral Damage Caused by Welfare Policy:

Welfare and politics are like conjoined twins and politicians need poverty so that they pledge to the poor that in the event that they are elected to power, poverty will be alleviated. However, the irony of the welfare political caricature is such that welfare should perpetuate over the years for politicians to thrive on; if not the survival of political parties is in jeopardy. Another unexpected outcome created by welfarism sometimes referred to as populism is it widens the social divide and develops hatred towards the “haves” and the ‘have-nots’ always believe that it is the responsibility of haves to look after the have-nots, the concept of which finally gets established as rights of the have-nots.

This belief, in turn, rests on the premise that many of those at the lower end of the economic spectrum are victims of bad luck, while many of those at the upper end owe their prosperity to a more fortunate toss of life’s dice. This premise is firmly rooted in Sri Lankan culture. Thus today’s debate centres not on whether the govern- ment should provide for the needy, but rather on exactly how much (and of which needs) it should supply.[139] Apart from the misconceptions established in the minds of welfare beneficiaries, the state intervention not only disturbs the natural process of market forces but also distorts the quality of services provided under welfare programs. For instance, as more public money is spent on socialised medicine, the quality and

[139] John, p., (1998), the welfare state as a failed experiment, world economic affairs.

quantity of care falls. It seems that whenever the state steps into alleviate a problem, the effect is to make the problem worse[140]. In line with this polemic, it is argued that in Sri Lanka, quality of the services provided as free services by the government including inter alia, education, health, transport, has been at substandard level in contrast to the similar services supplied by the business sector organizations.

Furthermore, since transfer payments are mobilized to the needy through bureaucratic implementation system, it is alleged that corruption is rampant at different stages of implementation and naturally promotes irregularities and injustices in the selection of recipients of welfare benefits and in the disbursement of benefits both in money and kinds to the underprivileged groups of the society. For instance, the welfare program known as Samurdhi, (prosperity) has been afloat several decades in the country but its long-term impacts both in terms of economic development and poverty alleviation are a subject of controversy among researchers who conducted empirical studies on the program. It is an ironical situation to observe that Samurdhi program with the employment of more than 25,000 officers of different hierarchies has also become a political apparatus in the hand of ruling party for achieving their political goals such as providing employment to the jobless and transferring public funds to politically favoured individuals in the society.

In 1875, Karl Marx stated the principle underlying the welfare state quite succinctly: “From each according to his abilities, to each according to his needs.” The welfare state is founded on the proposition that it is necessary to take the property of those who have it to meet the needs of those who do not[141]. However, it appears that Karl Marx has been misconstrued and misquoted in the afore quoted statement when Marx is stamped as one of the forefathers of welfarism since he never advocated the disbursement of transfer payment to idle, lethargic and lazy individuals who prefer to thrive a parasitical life based on the toiling of other working people. Nevertheless, left leaned political parties, with the support of vociferous trade union support, maintain that the present consumption, distribution and equity are the utmost priority objectives of government while development needs of the country are optional needs which can be placed in the back burner for leisurely action.

7.3. The Long-Term Outcome:

Based on the literature review and the analysis conducted with the help of empirical data, the following negative outcomes appear to be associated with the welfare driven economic policies.

1) Welfare begets more welfare as empirical experience of many developing countries reveal. When money transfers are made to a particular underprivileged groups numerous other social elements that possess some similar characteristics take cudgel against government accusing that they are being discriminated against.
2) Welfare siphons in a large quantity of national resources while depriving development needs of the funds.
3) Welfare programs further widen the social divide and internalize hatred among different social strata.

[140] Ibid.
[141] John., P., (1998), The welfare state as a failed experiment, world economic affairs.

4) Welfare promotes idle behaviour, dependent mentality and non-entrepreneurism.
5) Welfare policy is a political tool rather than a means for achieving social justice.
6) Welfarism has not offered a solution to the problem it intends to redress.
7) Welfare state, if devices of control are not in place, will lead to economic mayhem and political wilderness.
8) Welfare facilities increases the tax burden.
9) Welfarism is a rich country's tool in the hand of a poor country.
10) Welfare state creates proliferation of state agencies and enlarge the size of the state.
11) Welfare programs create welfare depended bureaucratic layer which thrives on poverty.
12) Welfarism conditions the mind of the poor that poverty is a desirable disposition or asset and therefore the struggle against poverty is mollycoddled.
13) There is no assurance that funds allocated for welfare objectives *de jure* are totally mobilized *de facto* to the hands of eleemosynary groups without being subverted in the process.

7.4. The Hidden Snare:

Welfarism is a rich country's tool in the hand of a poor country. Social security in developed countries typically combines three different elements—social assistance designed to relieve poverty, social insurance concerned with the provision of security and the spreading of income over the life cycle, and categorical transfers directed at redistribution between specific groups[142]. The developed countries, having got over their stage of underdevelopment, are endowed with all the economic wherewithal required for maintaining an expensive social security system using their economic power base made up of technology, resource endowment, institutional infrastructure and other factors of production; however in the case of developing countries, the effort to emulate the welfare model of developed countries is destined to be ended up in failure since they possess neither the same launching pad used by developed countries nor the preconditions required for implementing a social welfare program with a substantial coverage of under privileged social groups.

Another relevant dimension of the welfare state is its size that can be measured using different criteria. The size of the welfare state is usually measured by the ratio of social spending to GDP. Size is a very important dimension because it is strongly linked to a country's tax burden and—to some extent—fiscal fragility and the frequency of fiscal crises, all of which matter for long-term economic growth.[143]However, the Sri Lanka compared to economic dimensions of developed countries, occupies relatively weaker position in the context of the economic characteristics demonstrated by the developed countries.

Furthermore, welfare states differ not only in their size but also in their design or structure. To be certain, structure is related to size: countries with large PAYGO pension systems and publicly funded health services tend to have large welfare states. However, they can be designed or structured in various ways that have

[142] Ehtishan, A, et. al, (2011), Social Security in developing Countries, Oxford Scholarship Online.
[143] Balcerowicz, L., et. al., (2015), Puzzles of Economic Growth. Washington: World Bank.

important implications for their future growth[144]. Sri Lanka as a welfare state of third world category seems to be engrossed with the idea of mimicking the welfare programs implemented by developed countries, guided by misnomer and its own idiosyncrasies.

A noteworthy difference in the design is the inclusion of less fiscally important components of the welfare state, which matter for the strength of the perverse incentives and the resulting social traps they produce. A perverse incentive is an incentive that is created by a certain event or change that is unintended, and generally negative and hinders the provider's objective. Such incentives are something that function against the anticipated plans of the provider, and commonly, it's something that works against their intentions.These microstructures increase the relative utility of nonworking income and include the ease of access to, the duration of, and the replacement ratios of various social benefits. All those weak characteristics included in poorly designed welfare programs are apparently infiltrated into the very structure of some of the major welfare programs in Sri Lanka such as, inter alia, Samurdhi, Janasaviya, educational assistance.

A case of interest in this respect is the assistance programe for young school children in which school uniforms, free lunch, text books are all provided free of charge, indiscriminately to almost every pupil, thus inculcating the habit of dependency for everything in life once they become adults.

The structural issues of the welfare state include the distinction between the welfare state, which consists of many social programs, and the *universal* welfare state that would include the guaranteed income proposal (a negative income tax) originally proposed by Milton Friedman[145] and developed by Charles Murray.[146] The main argument for the latter option is that it would abolish the extended social bureaucracy and the pressures related to the possibility of lobbying for special social benefits. The conservative critics would object that social benefits should be "deserved" (i.e., at least means tested), and not evenly distributed. There are also some serious practical problems, especially regarding the transition to the system of guaranteed income in countries with large PAYGO pension systems. Finally, even if such a transformation succeeded there would still remain the issue of how to prevent politicians from reintroducing the special programs and politicizing the level of guaranteed income.

Furthermore, due consideration must be focused on the structure of taxes necessary to finance the welfare state. All taxes harm economic growth but direct taxes are worse in this respect than indirect ones.[147] In assessing the impact of the welfare state on economic growth it should, therefore, be considered the differences in the tax structure.

In looking at this issue from the point of view of political economy, one would perhaps prefer to have a worse tax structure on the assumption that increasing direct taxes

[144] Feldstein, M. , (2005), "Rethinking Social Insurance." American Economic Review.
[145] Friedman, M., (1962), *Capitalism and Freedom* . Chicago: University of Chicago Press.
[146] Murray, C. A., (1984), *Losing Ground: American Social Policy, 1950–1980* . New York: Basic Books.
[147] Acosta-Ormaechea S. at el., (2012), and Yoo, J. "Tax Composition and Growth: A Broad Cross-Country Perspective." IMF Working Paper No. WP/12/257 (October). International Monetary Fund. Washington.

generates more taxpayer resistance than relying on indirect taxes. Besides, even if it were politically more difficult to increase direct taxes than indirect ones, the pressure for increased spending could overwhelm taxpayers' resistance. In other words, the strategy to "starve the beast" may not be effective.[148] It appears again that there is no good substitute for civic efforts aimed at the source of the problem—namely, the pressure to increase social spending.Paterson (2021) commenting on the American welfare system states that the one of the factors that affected the increasing number of family breakdowns is the availability of generous welfare assistance extended to single mother families. Some programs (welfare) actively discouraged marriage. Welfare assistance went to mothers so long as no male was boarding in the household. Access to food stamps and Medicaid was automatic only if the welfare assistance met government approval. Once a family income crossed a specific threshold, access to these resources disappeared. Marriage to an employed male, even one earning the minimum wage, placed at risk a mother's economic well-being[149].The meaning of which is welfare encourages single mother families and discourages the reunion of spouses living separately.

Welfare, contrary to the objectives of its godfathers, is overwhelmingly of negative entropy resulting in dependency syndrome, tax burden, laziness, family breakdowns in addition to the economic crises it creates.

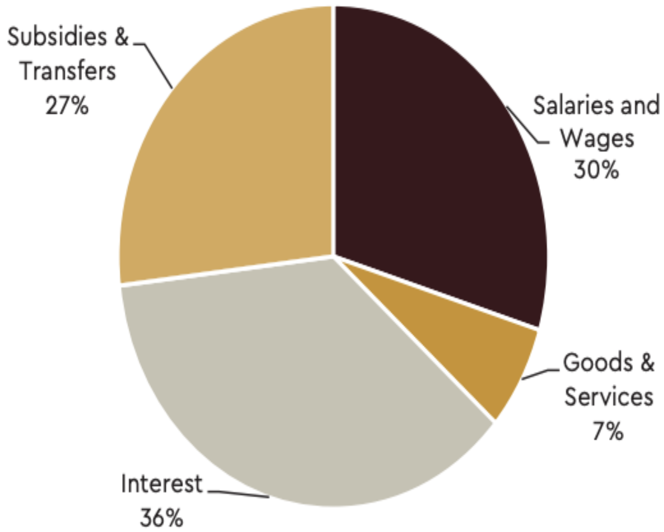
1.8. Welfare- A Pandora's Box:

Welfare resembles the mythical Pandora's box with is mysterious contents, magical powers and irrevocability of the existing facilities since it wields significant influence in toppling the existing government or saddling a new political regime in the welfare state. In an egocentric society like that of Sri Lanka, welfarism not only illusive but also entropic since everyone, the rich and the poor, in the society expects the government to emulate the role of Christian benevolent benefactor, Santa.

To fulfil the expectations of an egocentric society, the state needs to possess a bounty base of natural resources since welfare very often is a one-way movement that does not produce visible return on investment in the short run. In a welfare addicted society, government revenue becomes nobody's concern but expenditure has become the cynosure of everybody since it produces free goods, services and concessions by way of benefits to everybody. It appears that welfare journey once commences has no return unless governments are prepared to introduce austerity fiscal policies which may cause many hearts to burn in the short run but produce more benefits in the long run for everyone; however, this resembles to the task of belling the cat that no one want to pioneer or volunteer. As Athukorala (2021), points out, the economic strategies adopted by Sri Lanka is an emulation of Ostrich Strategy under which, ostrich hides its head under sand in the face of impending danger while exposing its entire body to the danger.[150]

[148] Niskanen, W. A., (1996), "Welfare and Culture of Poverty." *Cato Journal* 16 (1): 1–15.
[149] Paterson., P. E., (2021), Government Should Subsidize, Not Tax, Marriage, educationnext.org
[150] Atukorala, P., (2021), Seminar Papers, NSBM, Colombo.

Figure 7.1
Central Government Recurrent Expenditure in 2020



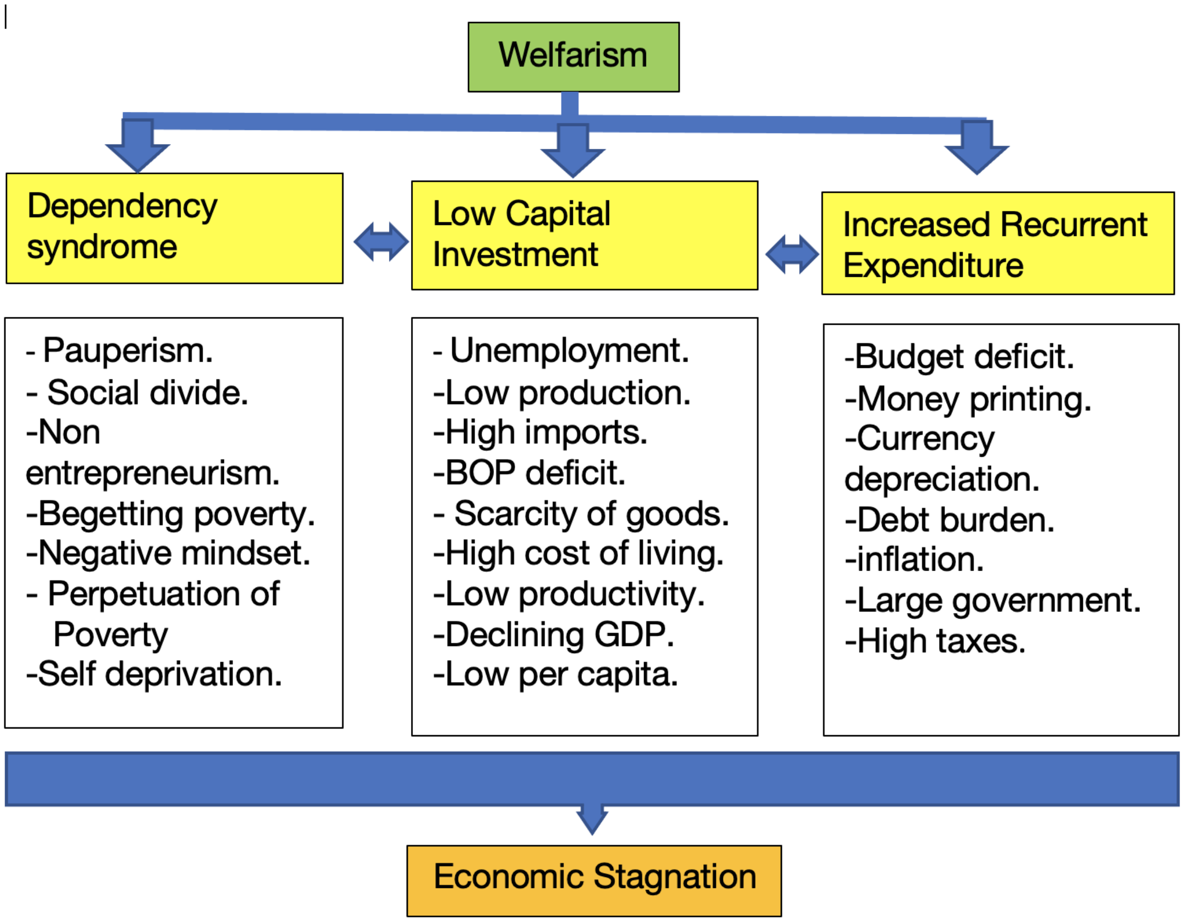
Source: Department of National Budget and Department of Fiscal Policy.

Government entanglement in expansionary monetary and fiscal policy and its reverberation has surfaced with spinning adverse effects in all the sectors of the economy particularly in the balance of payment, depleting foreign exchange reserves, downward spiraling of local currency and other related sectors with no solution in the close vicinity unless drastic austerity measure are adopted. Figure 7.1 shows that in 2020, of total recurrent expenditure of government, thirty six percent spent for interest payment, thirty percent for salaries and wages and twenty seven percent for transfer payment while in the same time government revenue is in a steep decline. Nevertheless, no political regime dares enough to touch the Pandora's box, the unbridled growth of welfare expansion, since making an effort to reign the spiraling welfare expenditure means self-political extermination.

The resultant economic crunch has already started making inroads into the economy by way of import restrictions, foreign exchange controls, unbearable loan and interest payments, scarcity of consumption goods and plummeting credit ratings while the government appears to be coy of revealing the stark truth and behaves like an Ostrich hiding its head in the sand of time. The IMF in its annual observation reports makes similar reflections and comments that are in agreement with the findings of the current research..

Figure 7.2 illustrates in a nutshell the relationship between welfarism and economic stagnation that is aptly demonstrated by time series data and the qualitative analysis conducted in the previous chapters.

Figure 7.2.
Relationship Between Welfarism and Economic Stagnation.



Source: Researcher Compilation.

In conclusion the analysis given in this chapter bears unchallengeable evidence to corroborate that the economy of Sri Lanka is in a midst of a severe and prolong economic stagnation that has been attributed mainly by lavish and perpetual welfare expenditure that is beyond the capacity of economic wherewithal available in the country. In addition, evidence available on the operation of welfare state proves that welfarism causes to establish a handicapped mindset and consolation of pauperism as the basis of survival among lower income social segments. Although the noble objective of godfathers of welfarism seems to aim at making everybody rich, in practice what happens is vice versa, that makes entire society relatively poor in the final outcome.

CHAPTER 08 - SUMMARY CONCLUSION AND RECOMMENDATION

8.1. Summary:

In this descriptive research study, presented in eight chapters, on the topic 'Conundrum of Stagnating Economy and Welfare Oriented Economic Policy -The Case of Sri Lanka', the relationship between dormant economic growth and its causative link with welfare driven economic policies has been examined with special emphasis on the period of 2000 and 2021. The main objective of the study as elaborated on in the Chapter 01, is to find out whether there is a causative effect between the inconsistent economic behavior of the country and the ever-increasing welfare expenditure as recorded in national accounts of Sri Lanka in all consecutive years after year 2000. Sri Lanka appears to be a strong follower of welfare policy from the very inception with the provision of indiscriminative handouts, aids and comestibles on the free for all basis ignoring the opportunity cost of welfare.

An extensive literature review included in the Chapter 02 looks into the theoretical progression of welfare economic theory commencing from the classical economic school to modern school of monetary theory included with the objective of examining whether there exists any theoretical foundation to justify the welfare state in the way that the concept is currently implemented in Sri Lanka and other counties. The scope of theoretical examination encompasses classical school, neoclassical doctrine of welfarism, Keynesian model, Marxist model and contemporary models of economic development.

The research design including conceptual frame, research questions, hypotheses and research methodology, provides the road map that shows the destination target and the path intended to be followed in the course of carrying out the research. The study has been designed to be carried out as qualitative research using secondary data available in published as well as unpublished documents in addition to consultation of subject experts in the spectrum of welfare economics. With the use of secondary data an extensive and comparative evaluation is conducted on the presumed relationship between independent and dependent variables, identified in the conceptual frame, which are proxied by GDP, per capita income, welfare expenditure, economic growth rates, inflation, employment and unemployment.

As evident surfaced in the analysis of the Chapter 06, in which historical data and views of different ideological underpinnings are brought to the focus; the welfare state concept of Japan proves to be different from that of the USA, Scandinavian Countries and the socialist countries which were formerly recognized as the communist bloc. In the next chapter attention is drawn again to the conundrum of welfare state in Sri Lanka and the obstructive role it played, both as flawed policy concept and misnomer in making budgetary decisions, in slowing down the economic growth rate continuously over a period of forty years. Extensive and thorough analysis of secondary data together with the scrutiny of the subject specific literature leads the research study to reach its culmination with appropriate and logical occlusions.

8.2. Conclusion:

The country's extensive welfare system coupled with a high degree of political liberalism created a welfare-depended society at the expense of creating a conducive setting for economic growth. By the 1960s there were clear signs that Sri Lanka has been living far beyond its means. Although in academic and policy discussions, Sri Lanka was quoted as an exceptional and a success case of achieving redistributive justice, human development among developing countries;however, the critical issue of its sustainability has scarcely drawn the attention in those discussions.

The viability of any redistributive strategy is likely, in the long-run, to be seriously undermined by economic stagnation which weakens the resource base required for the maintenance of welfare system. In the absence of a growth momentum, the sustainability of the welfare state gradually encounters an increasing threat in two fronts: first, the maintenance of the welfare system itself required a continuous flow of resources to finance it. The financial resources should be generated out of the expansion of the economy. This fundamental requirement appears to have been ignored in Sri Lanka. The expansion of the welfare system has been founded not on the realities but on the bygone economic prosperity built in at the time of independence. Secondly, the state had to face the burgeoning social demand that is reinforced by the extensive welfare system. The capabilities created by the ongoing welfare system through minimizing social inequalities required to be utilized and the the development expectations are to be satisfied by providing suitable avenues in a corresponding expansion of the economy which has not been materialized in Sri Lankan phenomenon.

Non fulfilment of the above requirements steered the country towards detrimental economic contradictions in the post independence development history of Sri Lanka, which finally resulted in an economic chaos of unprecedented magnitude in the last two decades. The expansion of the social welfare system was based not on a sustained growth momentum of the economy but on policies based on popularism which resulted from first, oxymoron economic priories of the country and second, the inability on the part of political hierarchy to envision the country's future in the right perspectives.

In a nutshell, the findings of the research are narrowed down precisely in the following conclusions.

1) In economic literature, no economic model has defended the welfare state in the present articulation of welfarism.
2) Welfarism has not provided a definite solution in all the countries studies to the problem of pauperism; instead, it has complicated the problem by addition of new dimensions to poverty.
3) Sri Lanka during the last two decades in particular has been moving deep into economic conundrum and downturn due to fallacious fiscal management policies and practices.
4) The welfare expenditure in Sri Lanka is beyond the sustainable capacity of the country.
5) The excessive welfare expenditure in Sri Lanka mainly contributed by subsidies, salaries of public sector employees, loss making government institutions, economic concessions and eleemosynary payments.

6) Welfare expenditure increases the tax burden that results in high inflation coupled with low standard of living. Welfare increases today's consumption at the expense of future growth.
7) One of the main causes of the perpetually widening budget deficit is the unrestrained recurrent expenditure of the government.
8) Budget deficit caused by unbearable government expenditure created a large debt burden, depreciation of local currency, unhealthy expansion of money printing, extremely unfavourable balance of payment, high rate of unemployment and inflationary trend.
9) The welfare state created a big government which characterized with proliferation of state institutions and flooding of the state institutions with redundant employees.
10) Welfare facilities in Sri Lanka are indiscriminately granted even to ineligible social groups or families and individuals.
11) The objective of welfare state in any country is to be elimination of welfare dependency which has been conveniently forgotten by the policy makers.
12) Welfare begets welfare and political parties instrumentalize the grants given to the needy for winning popularity.
13) Welfare state is the harbinger of poverty, social polarization and dependency syndrome.
14) Statistical evidence relating to welfare states particularly to Sri Lanka reveals that over bulging welfare expenditure has retarded the economic growth and destabilized the economy.
15) Excessive welfare expenditure in different forms in Sri Lanka is significant factor that attributed to the stagnation.
16) Welfare and development are self-exclusive and therefore unlikely to coexist together.
17) Sustainable welfare state must result from spillover effects generated through productivity and economic prosperity.

8.3. Recommendations for Further Research:

With the exposure accessed to in the course of current study, further investigations deem to be essential for establishing a comprehensive body of knowledge in welfare economic mechanism, that is immensely advantageous to policy makers, if studies are encouraged in the areas of welfare administration system and productivity of vast welfare expenditure incurred by the government of Sri Lanka for different welfare programs under its annual budgeting.

It is also convinced during the current study that the welfare programs implemented in sri Lanka are not driven by specific policy objectives; to be more precise the welfare programs are to be carried out within a demarcated time dimension making it mandatory that the recipients of welfare benefits should move out from 'underprivileged position' to 'self-sustainable' position with the assistance received under the welfare system. Further investigation in the suggested area can lead to the discovery of more effective designing of welfare systems which in the long run leads to the reduction of the welfare cost as well as gradual weaning off of the need for welfare intervention by government.

Possibility of delinking the relationship between welfare payments and the political interference seems to be another important area of further studies since political infringement with the selection of prospective beneficiaries creates an administrative mayhem and mockery of welfare system as a whole since it steals away steam of the whole rationale of introducing a welfare system.

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